The Genesis of Russian Secured Transaction Law before 1917

Konstantin Osipov

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THE GENESIS OF RUSSIAN SECURED TRANSACTION LAW BEFORE 1917

KONSTANTIN OSIPOV

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I. INTRODUCTION

A central aspect of Russian and European legal systems concerns civil law relationships, such as obligational legal relationships. At present, there is an urgent need for the development of obligational law in Russia. The demand for regulating civil law relationships is being caused by significant changes that have happened in the Russian economy. The use of contracts is increasing with the changing economy of Russia.

A key aspect of civil law relationships is stability. Stability must be understood not only in a broad context, such as stability in legislation (one

1Mr. Osipov is currently a student at St. Petersburg State University Law School. Mr. Osipov was a visiting student at Cleveland-Marshall College of Law during the 1994-95 academic year. The author specially thanks Eric Spade for his help with editing this article, and Dimitri Tetyushev and Julia Sinitskaya who helped me in translating the article from Russian.

2In American legal terminology, "contractual relationships" or "contracts law" are synonymous with what is called "obligational law" in Russian system. Obligational law, however, is not limited to obligations arising out of contracts only, so it must be viewed somewhat broader than pure contacts law.
which Russia unfortunately cannot boast of) and guarantees from state interference with business affairs. In a narrower context, parties to a contract also seek stability. The stability created by a contract is a guarantee from unlawful acts of one party which might negatively affect the underlying transaction.

The question becomes: How can a party protect himself from possibility of a breach of contract? This problem can be solved to some extent by applying civil law remedies. But civil law remedies are available only as sanctions imposed on a wrongdoer, so they do not come into effect until after the damage is done. Also, the preventive role of civil law remedies is limited. If the threat of criminal punishment fails in preventing people from committing crimes, then what can we expect from the civil law remedies that are not as harsh in terms of their punitive nature. Thus, we must look for other means of protecting stability in civil law relationships—especially in commercial relationships. One means can be found in what Russian law terms methods of securing performance of obligations.

This article will begin by briefly explaining the characteristics of methods of securing performance of obligations in Russia. Then the article will focus on one method of securing the performance of obligations, namely the mortgage/pledge being used in Russian law under one common term—zalog. The article will trace the development of the mortgage/pledge from Roman law, and then will examine the role of the zalog in Russian law prior to 1917. A historical examination of the methods of securing the performance of obligations is especially relevant today since the developing Russian law is utilizing concepts as they existed prior to 1917.

II. CHARACTERISTICS OF METHODS OF SECURING THE PERFORMANCE OF OBLIGATION UNDER RUSSIAN LAW

What are the characteristics of the methods of securing the performance of obligation under Russian law? First, they have a securing character in that they stimulate the debtor to properly perform the obligation incurred while guaranteeing the satisfaction of the creditor’s interests. These methods can be provided for through both Russian statutes and through the contract itself. Except for this security, preventive function of the methods, it is possible to distinguish the methods, especially by their punitive function.

Professor Nikolas D. Yegorov classifies both forfeiture and down payment as not merely security methods, but also as measures of civil law liability that

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3 Basically the term “zalog” is analogous to the UCC term "security interest." In a while it will be obvious that there’s much in common between those two. One can substitute the words “zalog” or mortgage or pledge used to describe legal relationships under Russian law with the term "security interest" in American law.

4 The term "forfeiture" in Russian legal system is used to describe the following legal concept: The seller agrees to sell 10 cartons of wigs to the buyer at the price of $X per carton. The parties to the contract stipulate that in case of default the wrongdoer will pay to the aggrieved party either a specified amount of money or a certain percentage of the value of the carton. Now it is clear that the closest term in American contract law
are linked to additional encumbrances a debtor might incur. It should be noted that damages are actually the civil law remedy. Forfeiture and down payment, however, are classified as remedies only to the extent that they cover the creditors losses resulting from the debtor's default while damages are a real measure of civil law liability.

All methods of securing performance of obligations are in addition to the main obligation. Because of this, these methods can secure only real, actual, valid obligations, that is, actually existing ones. Indeed, it is hard to imagine that an obligation discharged upon performance can be secured by any means. Difficulties also arise with obligations where the time provided by the statute of limitations has expired. But what happens if someone attempts to secure an obligation that may or must arise in the future? Is it really possible to secure future obligations? It seems that still securing deals only with such obligation that has already begun to exist, to wit security switches on simultaneously with secured obligation and will draw legal consequences during the whole term the main obligation exists, though, for example, agreement as to how the main obligation will be secured might be achieved before the actual rise of the latter.

Mortgage, pledge, forfeiture, security interest, guaranty and down payment have been defined as accessory methods of securing obligations as opposed to the principal one—civil damages. Another trait of the methods of securing obligations is their property character since different types of property underlie the obligations. Russian legislation provided for a system with four methods of securing obligations: (1) forfeiture, (2) zalog (security interest or pledge/mortgage), (3) suretyship (guaranty), and (4) down payment or deposit. In the event of default, the mortgage/pledge allows a certain part of the debtor's property to satisfy the creditor-mortgagor's interests; suretyship (guaranty) allows third persons to participate in obligatory relationships and allows the creditor to satisfy from the guarantor's property; downpayment and forfeiture state adversary consequences for the debtor.

In commercial practice parties frequently resort to other measures, such as: refusal to pay for goods that proved to be of bad or different quality from what was agreed upon; retention of the result of the work until the full payment

that will describe the situation will be liquidated "damages." There are various forms of forfeiture which depend on the manner of recovering damages stipulated by the parties to the contract. The creditor has no obligation to prove his damages when he claims the sum of the forfeiture. THE CIVIL CODE OF THE RUSSIAN FEDERATION, pt. 1, tit. 23, § 330(1). That means that it will be enough for recovery that the event of default took place.


6It should be mentioned that Russian law provides for securing the performance of obligations, while American law provides for securing the transactions themselves. This distinction, however, is basically in terms rather than in substance.


8 See The Civil Code art. 186; Fundamentals of Civil Legislation art. 68.
being made analogous to possessory lien or right to retention, so called preliminary or advanced payment used with different types of contracts. These security measures are of the property character as well and are linked with adversary consequences to the debtors. Some scholars deem them as operational influence measures.9

The recently adopted new Russian Civil Code states in § 329(1) that performance of the obligations can be secured with forfeit, pledge/mortgage, retention of the debtor’s property by the creditor (possessory lien or right to retain), suretyship (guaranty), bank guarantee, down payment and other methods provided for in the legislation or in contract.10 Thus, the new legislation has increased the number of methods for securing performance of obligations.

The methods of security are well established in foreign law and include methods in addition to those inherent in Russian law. For example, the law of some countries classify the methods of securing of obligations into proprietary and obligatorial ones.11 Moreover, in Western countries the non-possessory methods of securing obligations have become widespread: Chattel mortgage, conditional sale, privileged right, transfer and reservation of title for the purposes of securing.12 Other original methods of securing obligations are: guaranty-like transfer of title, satisfaction of the creditor's claims out of a certain part of the debtor’s property, stoppage of the shipment, and right to retain (possessory lien).13

It is not only possible but simply necessary to develop the system of security methods based upon the demands of commercial practice. Furthermore, both theoretical development and scrutiny of the problems related to new or at least relatively new methods of security are needed so the Russian legislature can eventually adopt laws better covering secured transactions. Great potential exists for widening the system by utilizing operational influence measures, i.e., letters of credit, possessory liens, unilateral rejection to perform the obligation under the contract in case of rough defaults on the counterparts side.14

Besides, it is possible to return to the system which Russia had before 1917 and which still exist in some foreign countries. These systems differentiate between civil and commercial law, which may be justified by the special needs of commercial practice. Hence it is reasonable to presume that securing

9SYHANOv ET AL., supra note 5, at 28.


12KULAGIN, supra note 11, at 86.

13MOZOLIN & KULAGIN, supra note 11, at 196.

14SYHANOv ET AL., supra note 5, at 28.
methods in commercial practice may incur a number of special traits and be more variable than those in civil law itself.

In short, commercial law in Russia before 1917 recognized only four classical (common civil) methods of securing of obligations: (1) down payment, (2) forfeit, (3) guarantee (surety), and (4) pledge/mortgage. Usage of trade and judicial practice used another method—possessor lien (jus retentionis)—which was directly borrowed by Russian law from German law.\(^{15}\) It should be noted that the possessor lien was well developed in Russia both on the theoretical level (for instance, Professor Shershenevich mentioned in his "Course of Trade Law" seven conditions for jus retentionis to be valid) and in practice. In commercial practice the possessor lien was construed somewhat differently from the narrow point of view of the European legal systems.

III. THE SECURITY INTERESTS UNDER ROMAN LAW

One method of securing obligations is through the use of a pledge/mortgage. The roots of many contemporary legal institutions are found in classical Roman law, and these institutions were derived from Roman law throughout Europe because of the activities of glossators and postglossators. The pledge/mortgage [security interest] method of securing obligations is not an exception.

It is notable, however, that the Romans did not originally develop the pledge/mortgage. For example, bankers in Babylon in the 6th century B.C. gave loans secured with pledges.\(^{16}\) Also, various forms of pledge were familiar to Slavs, Germans, and the French.

A. Rights In Personam and Rights In Rem

Critical to the pledge/mortgage [security interest] institution analysis is the distinction between rights in personam and rights in rem. There was no such direct distinction in Roman law, but Romans did draw a distinction between two types of property actions: actions in personam [actiones in personam] and actions in rem [actiones in rem]. Later, rights were classified based on the Roman distinction of property actions. One can draw a distinction between rights in personam and rights in rem subject to their object. Tangibles are objects of rights in rem; rights in rem provide for their bearer an immediate opportunity to influence the objects and to determine their legal future. On the contrary, acts (or forbearances from acts) are objects of rights in personam. In rights in personam the bearer of the right has no opportunity to directly influence the tangibles, but only retains the incorporeal rights.\(^{17}\) The basis of the distinction in actions

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\(^{15}\)G. F. Shershenevich, Kurs Torgovogo Prava [The Course of Trade Law] 122 (St. Petersburg, 1908). Possessor lien actually existed in many European countries, including Germany, France, and Italy.

\(^{16}\)V. M. Budilov, Zalogovoie Pravo Rossii i FRG [Laws of Security Interests in Russia and FRG] 7 (St. Petersburg, 1993).

\(^{17}\)I. B. Novitski, Rimskoe Pravo [Roman Law] 73-74 (Moscow, 1993).

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was that Roman law protected the interests of the bearers of legal rights. Right in rem [real right] enjoyed an absolute defense against any offender [actio in rem], as opposed to right in personam whose defense was relative, that is, it was aimed against a certain circle of persons [actio in personam]. As explained by I. A. Pokrovskii, "Any real right represents some direct legal link between a person and a tangible—jus in rem. The tangible belongs to the person and all the other members of the society must admit and recognize that link of belonging and must not violate it with their acts."18

A contract for the sale of goods under Roman law can serve as a practical illustration of both rights. The contract did not give rise to the real right of ownership (property right), but it did give rise to the right to claim transfer of the goods—right in personam (incorporeal right). To establish the real link one had to follow the specific rules of the transfer act—traditio.

Roman law classified the following as rights in rem:

1) ownership rights; and
2) rights to other people's property [jura in re aliena].

The second category was further divided according to the specific traits intrinsic in the institutions of jura in re aliena.

1) easements;
2) superficies;
3) emphyteusis; and
4) pledge/mortgage (security interest).

Two St. Petersburg legal scholars, Professors Olympiad S. Ioffe and Valerii A. Musin, classify pledge and hypothec as independent elements, not bringing them together in the united institution of pledge/mortgage [security interest].19 Such a classification is logical and there are no grounds to doubt its correctness.

I. A. Pokrovskii drew another major distinction, besides the analogous classification of real rights, in jura in re aliena:

1) real rights to use another person's property (i.e., easements); and
2) real rights to dispose of another person's property (i.e., pledge/mortgage rights).

He explained, "The creditor (pledgee/mortgagee) has a right in case of default to sell the property to satisfy his interest, that is to dispose of the property . . . ."20

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19O. S. IOFFE & V. P. MUSIN, OSNOVY RIMSKOGO GRAZHDANSKOGO PRAVA [THE FUNDAMENTALS OF ROMAN CIVIL LAW] 83 (Leningrad, 1974).

20POKROVSKII, supra note 18, at 234.
B. The Historical Evolution of the Security Interest in Roman Law

Credit relations arose in the early stages of Roman history. Initially they were not wide spread, and they represented more the exception than the rule. The first to appear was personal credit, which was credit based on the confidence of the debtor.21 Later the personal credit relationships were replaced with relationships of real credit—credit based on property which secured the due performance of the obligations by the debtor. It is from the framework of the real credit relations that all types of real [in rem] securing measures evolved, including the pledge/mortgage.

Except for civil law easements, the civil law did not know any rights to another person's property. Thus, the civil law did not know pledge/mortgage rights in the way that they have been understood since the times of the Corpus Juris Civilis. But real credit was embodied in the form of the sale of collateral with a right of the seller to repurchase the collateral "sold". Real security of this kind was named fiducia in Roman law.22

Fiducia retained a number of specific traits. It was impossible to accomplish the transfer of the collateral by means of simple traditio because either mantipatio or in jure cessio were required. The collateral was delivered to the creditor being subject to his ownership rights, but under the condition [fiduciae causa] that upon repayment of the debt it would be returned to the debtor [fiducia cum creditore]. As explained by Professor Budilov,

In other words, to obtain credit in the form of money the purported debtor himself extended a credit in the form of collateral to his future creditor. Obtaining the ownership right to the collateral by the creditor meant obtaining a broader right by the latter than is understood by the subject matter of securing performance of obligations.23

In the event of default the creditor definitively obtained the ownership rights, thereby eliminating the conditional proviso. The creditor could retain the collateral or sell it to satisfy his interest. Any surplus the creditor received through the sale was not necessarily returned to the debtor.

Initially debtors were in a very difficult position because the pledged collateral was given to the creditors subject to their ownership rights. To make matters worse, even upon repayment of the debt the creditor could retain the collateral because the debtor had no means of protecting his interests (aside from the creditor being subjected to infamy [infamia]). Only later did a pretor's edict enable debtors to file an action against the creditor [actio fiduciae]. In its essence actio fiduciae was a personal action infamizing in character.24

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21 "Personal credit" was basically credit secured with the debtor's personality.

22 Id. at 344; NOVITSKII, supra note 17, at 112.


24 POKROVSKII, supra note 18, at 345.
But even then, the debtor’s position remained unfavorable. As long as the collateral was transferred subject to the ownership of the creditor, the creditor could dispose of it to third persons while the debtor had no cause of action against the third persons. The debtor could claim damages against the creditor, but without any opportunity to repossess the collateral.

Thus, none of the traits of the pledge/mortgage [security interest] concerning another person’s collateral can be found in fiducia. The creditor became a lawful quwirit owner and the debtor lost any real relation with the pledged collateral, retaining only the personal claim. Fiducia was not the establishment of the pledge [security interest], but was the transfer of ownership of the collateral. As N. D. Kolotinskii explained, "An undeveloped notion is devoid of abstraction, thus rejecting the existence of pledge as a specific real right. Likewise the ancient Roman law knew securing of performance of obligations with collateral only by means of transfer of the quwirit ownership itself to the creditor."25

Institutions similar to fiducia existed both in ancient German law [Kauf fua Weiderkauf] and in ancient French law [ventre à remere]. All of them were unilateral in essence since they protected only the creditors interest against debtors.

Another pledge-like institution in the civil law was pignoris capio, which meant "taking the debtor’s property in the action legos actio per pignoris capionem."26 This institution was more an exception than a rule and, according to I. A. Pokrovskii, the legal condition of the property taken was not as clear as the real existence of pledge.27

Economic development spurned the creation of analogs to fiducia which considered to a larger extent the debtor’s interests and which were more flexible. Thus, what was unknown in the rules of the strict law was reflected in the pretor’s law. One important innovation was the creation of the pledge/mortgage [security interest] as the right to another’s property. As Pokrovskii stated, "It may well be that the most important amongst the pretors’ innovations was the creation of the pledge."

Personal defense—the already mentioned actio fiduciae—obviously was not enough to effectively protect the debtor’s interests. The creditor could sell the collateral obtained under fiducia; if the creditor subsequently became insolvent, then the debtor was completely deprived of any means of regaining either his collateral or civil damages for its value. Thus sprang forth another pledge-like institution called pignus. Essentially, pignus was an informal pledge by the debtor, without resorting to mancipatio or in iure cesso, transferring collateral to the creditor; the collateral, however, was transferred to the possession of the

26 POKROVSKII, supra note 18, at 346.
27 Id.
28 Id. at 368.
creditor but not to his ownership. In other words, the collateral was transferred to the creditor, who had the right to hold it (bailment), and the creditor was granted possessorial defense (as if he had been a possessor, not a bailee). This is significant because Roman law did not recognize the holding of property as possession. Roman law distinguished between possession in the full sense—possessio/possessio civilis—and simple holding or detention of the property—detentio/possessio naturalis.

Two elements were necessary to speak of possessio: Corpus possessionis (literally meaning the "body" of possession or actual possession) and animus possessionis (meaning the "will" or intent to possess). The latter was recognized only in animus domini or the will to possess the thing as if it had been your own. That kind of will to possess could be found in three categories of persons:

1) owners;
2) bona fide possessors, which were persons who erred in good faith in deeming themselves as owners; and
3) usurpers who conceded the unlawfulness of their pretensions, but who presented animus domini to the outside world.

There was no kind of will—to treat the collateral as one's own—in persons in possession of the collateral under any kind of agreement with the owner, i.e., tenants. This explains why the latter had the status of detentors or holders in the owner's name under Roman law [detentor alieno nomine].

Thus, possession [possessio] may be defined as actual possession of the property by the person coupled with the intention to treat it as his own (to possess despite of the will of other persons, independently); detention [detentio] may be defined as actual (possession of the property without the said intention) possession based on the contract with another person, which includes non-independent possession and unintentional or unconscious possession.

This classification was of practical significance since only possessors [possessores] were independently protected from encroachments upon their property, while detentors or holders could receive protection only via the owners of the property. This clarifies what bailment meant with regards to pignus as protected by a possessorial defense.

The only securing power of pignus was its characteristic to grant the creditor the right to retain the collateral until the debt was paid. I. A. Pokrovskii compared this to the arrest of the property. The creditor's interests were protected with the pretor's interdictorial defense against all third persons and against the pledgor himself. But, as Pokrovskii believed, that defense was weak and hence pignus was another extreme opposite to fiducia—the feeble defense of the creditor's interests.

Nonetheless, even pignus was inconvenient for the debtor since he still had to transfer the collateral to the creditor's possession. Frequently, paradoxical

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29Novitstki, supra note 17, at 112.
30Id. at 76.
31Pokrovskii, supra note 18, at 369.
situations occurred. For example, the creditor, irrespective of maturity of the debt, could demand the transfer of the pledged collateral. This could put the debtor in a very difficult position because the debtor had to request the creditor to place the collateral in precarium, which meant the debtor retained possession of the collateral until it was demanded by the creditor. When the creditor demanded the collateral it could lead to difficulties for the debtor, such as obstructing the debtor’s economic venture, condemning the latter to the loss of the collateral, or even forcing the debtor into insolvency.

In addition to fiducia and pignus, another institution in Roman law bore all the traits of the pledge/mortgage (security interest), but was used only in state municipality relationships with "capitalists companies." This was the so called praeidibus praeidiisque. The debtor company named sureties [praedas] and lands [praedia] subject to sale in case of default. The named lands were inventoried [praedia subsignata] as security. If the debtor defaulted, regardless of who was in possession of the lands, they were subject to sale [venditio ex lege praedatoria] to cover the losses.32

A similar institution—the hypothec [hypotheca]—existed in Greek law. The hypothec, however, was used in private relations. The roots of this institution can be traced to ancient Egyptian law. This Greek-Egyptian institution was reborn in Roman law. The term hypothec was introduced to the Roman legal language by Justinian who incorporated it in Corpus Juris Civilis. Classical Roman law spoke of rem pignori obligare.

Hypothec in its most ancient form existed as the pledge of the movables of the tenant. All property brought to the rented parcel or living place was pledged to secure rent payments. The goal was achieved by including a special covenant in the contract dealing with inducta, inventa, illata. That covenant prohibited the lessee from removing anything taken, brought, or carried into the parcel (living or dwelling place) before the outstanding rental balance was paid. Thus the lessee possessed personal property which was pignori obligata to the creditor. Pokrovskii argued that custom could arise from the contracts of pignus and precarium.33

The right of the creditor to retain the collateral was the securing trait of that institution. But pretors in the cities gave debtor-lessees interdictum de migrando to curb attempts by creditor-lessors to limit the right of the debtors to change their dwellings. Yet in the country-side the creditors were granted interdictum Salvianum, which allowed them to demand the pledged collateral from the debtor-pledgor [colonus].

Later another cause of action—actio Serviana—was developed to benefit the creditors by allowing them to demand the pledged collateral that had been transferred to third persons. The rights of the creditor under that action were in reality [rights in rem]. Novitskii explained, "In result with regards to the land tenancy it created a mortgage form that did not immediately deprive the debtor

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32 Id. at 370.
33 Id. at 371.
of possession and use of the collateral, and yet the creditor had an absolute cause of action to claim the collateral for the purpose of its sale.\textsuperscript{34} Later the application of the hypothec was expanded to the other economic spheres (other obligations) via analogy.\textit{Actio quasi-Serviana} or \textit{actio hypothecaria in rem} in fact were general actions dealing with situations where under the terms of the contract the security interest in the collateral was granted in the form of hypothec. Subsequently the \textit{right in rem} was recognized in the cases involving \textit{pignus} too. In these incidents \textit{actio quasi-Serviana} was used under the name \textit{actio pigneraticia}.

Thus, pledge/mortgage (security interest) eventually became \textit{rights in rem} and two forms of the security interest emerged: \textit{Pignus} (with transfer of the pledged collateral) and \textit{hypothec} (without transfer of the collateral). Hypothec as a security interest form did not need any specific real act because the real right arose at the moment of the agreement.

Neither \textit{pignus} or \textit{hypothec} provided for the creditor’s right to sell the collateral and hence a special agreement was needed allowing the creditor to dispose of the collateral \textit{[pactum de vendendo]}. A separate agreement had to be entered into to enable the creditor to retain the pledged collateral and to expand his ownership to it \textit{[lex commissoria]}. But lawyers began to construe every security interest agreement as including the right to sell the collateral \textit{[ius vendendi]}, thus inducing the practice where a special agreement was needed to exclude the right to sell, not to include it \textit{[pactum de non vendendo]}.

Later Emperor Konstantin forbade \textit{lex commissoria}. Justinian, in his turn, determined that under \textit{pactum de non vendendo} it was still possible to sell the pledged collateral. Thus, ultimately the security interest was defined as the real right to sell the collateral belonging to another person.\textsuperscript{35}

The security interest was deemed by the Roman law as an accessorial right sharing the fate of the debt claim. It was not allowed to bring profits but could only cover the losses from the debt; surplus \textit{[hyperocha]} left over from the sale of the collateral had to be returned to the debtor. If the proceeds of the sale were not enough to satisfy the creditor’s claim, the latter had a personal claim against the debtor.

There was no distinction in Roman law with respect to transactions involving real or personal property as collateral. \textit{Pignus} and \textit{hypothecca} were applicable both to the real and personal collateral.

Possession of the collateral did not give the creditor the right to use it; if such a use took place it was deemed as a form of theft—\textit{furtum usus}. The only way to circumvent the prohibition was through an agreement—\textit{antichresis}.

Roman law permitted subsequent security interests. The maxim that the first in time had priority over others was to be applied to subsequent security interests; only the first secured party had the right to demand the sale of the collateral and all others had to satisfy their interests from the remainder. But

\textsuperscript{34}Novitistki, \textit{supra} note 17, at 114.

\textsuperscript{35}Pokrovskii, \textit{supra} note 18, at 374.
subsequent secured creditors could satisfy a precedent creditor's claim with their own assets, thereby subrogating the outgoing secured creditor in his place and positioning themselves closer to the collateral. Such a transfer of seniority to the person satisfying the first secured party was called a hypothec succession. If the proceeds of the sale were insufficient to satisfy all the subsequent creditors, then the deficiency was resolved in the same manner as if there had been only one creditor. Each secured creditor was granted a cause of action from the obligation on equal grounds.

Considerable changes took place in Roman law toward broadening of the type of property that could serve as collateral after the sale of collateral had become the common method of realizing a security interest. That broadening occurred first by including obligations in the scope of the security interest objects, and then by including within that scope everything that could be an object of sale.36

The form of security interest agreements changed after fiducia had become less significant with the rise of pignus and hypotheca; neither pignus or hypotheca demanded an obligatory form. This gave birth to a double inconvenience. First, creditors could not determine whether collateral had previously been encumbered once or even several times. Second, in a number of cases Roman law provided for a security interest that arose from a statute rather than the security interest provided by the agreement of the parties—the so-called general hypothecs.37 Statutory pledges were preferred in terms of the priority to be satisfied. Thus, the expectations of the creditor could be ruined if a statutory encumbrance existed.

During the absolute monarchy period a rescript was issued which gave priority to a hypothec evidenced with a writing and witnessed by three people. This step toward formalizing the security interest agreement appears to have been a progressive trend in the ancient Roman economy.

The termination of the security interest could occur:

a) upon destruction of the collateral;
b) upon the secured creditor obtaining the rights of the owner; or
c) upon termination of the underlying obligation.

Early security interest forms in Germany also were important to the evolution of the security interest. As with fiducia, collateral was initially transferred to the ownership of the creditor, but was to be returned upon repayment of the debt. Later the property was transferred to the possession of the creditor [altere Satrung], and to the creditor's use with the profits being applied to repay the principal and interest. Additionally, the real right to another person's property arose where the debtor retained the right to possess

36Novitstki, supra note 17, at 115.

and use the collateral, and the creditor only had the right to satisfy from the value of the pledged property [heure Satrung].

IV. THE SECURITY INTEREST ("ZALOG") UNDER RUSSIAN LAW

A. Development of Pledge/Mortgage in Russia

In ancient times, the debtor himself—his personality—secured payment of debts. This gave rise to an institution of Russian law known as zakupnichestvo. The root of the term was the word kuplia [purchase]—meaning the debtor usually "sold" himself to the creditor by undertaking to repay the debt in the course of his work for the creditor.

As the economy and trade developed in Russia there arose the zalog institution, which was widely used in the trade cities of Russia. For example, Pskovskaia Sudnaia Gramota [The Pskov Judging Deed] provided for securing with zalog all deals worth more than one ruble. The earliest security interest in Russia assumed the transfer of the collateral by the debtor to the possession of the creditor.

The earliest form was similar to the Roman fiducia in that it alienated the property rights to the creditor with retention of the right to redemption upon performance of the obligation by the debtor. But Professor Shershenevich states that examination of the pledge/mortgage deeds of that epoch show that acquisition of the property rights (ownership) in the collateral was tied to the time of default and did not arise at the time of transfer of the collateral. Like with the fiducia, the creditor's ownership of the collateral was limited only to the extent that he had to return the collateral when the debt was repaid. A number of scholars, including Professor Shershenevich, state that initially the creditor did not acquire the right to use the collateral. Professor Shershenevich presumes the creditor could use the collateral (which was usually land) only by submitting his right to the interest accruing to the principal.

On the contrary, Professor Paneliak found that the same Russian securing institutions appearing in the 1430s "to serve for the interest, to plough for the interest, and to mow for the interest." These institutions were an obligation of the debtor to render some kind of performance to the benefit of the creditor as a substitute to the payment of the interest. According to Professor Paneliak, the first form of the security interest could be described as giving the creditor

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38G. F. SHERSHENEVICH, UCHEBNIK RUSSKOGO GRAZHDANSKOGO PRAVA [THE TEXTBOOK OF RUSSIAN CIVIL LAW] 385 (Moscow, 1912).

39The ruble is the name of the Russian currency.

40SHERSHENEVICH, supra note 38, at 385.

41Id. at 387.

the right to use the collateral land in return for the amount loaned to the debtor. Moreover, it was not the creditor who had the right to claim the debt to be paid, but rather the debtor had the right to claim the return of the collateral land when the debt was paid off; there was a right to redeem the collateral upon payment of the debt.

Later, the rights to possess and use the collateral were united, and the creditor obtained the ownership of the collateral upon default. Another type of security interest transaction encumbered the collateral by allowing the debtor to retain possession and use of the collateral, with ownership shifting to the creditor only at the time of default. Such types of transactions were widespread in the trade cities of Russia.43

Article 55 (captioned "About Loans") of the Sudebnik [The Judging Book] by Ivan IV (Ivan the Terrible), dated 1497, contained a clause providing for a specific remedy—"prodazha [sale]"—for when the debtor negligently destroyed goods taken from the creditor.44 A prominent historian, A. Cherepnin, stated that "prodazha" was actually the equivalent of turning the debtor into a slave, thus the debtor's personal freedom secured the debt.45 Essentially the same provision was contained in an earlier legal Act, Russkaia Pravda, Prostrannaia Redaktsia [The Russian Justice, The Lengthy Version], though it was in a less detailed form.46 It might be possible to make another example of securing the debt with the personality of the debtor rather than with his property, although we must consent that this evidence is rather collateral. Thus, Article 6 of the 1497 Sudebnik began with words that seem to have allowed legal court challenges as a means to resolve conflicts arising from loan transactions. Like provisions also can be found in the second Sudebnik dated 1550, i.e., Article 11.47

Nonetheless, provisions encouraging the abandonment of personal securing (to be read literally) began to appear. For example, Article 82 of the 1550 Sudebnik provided that the debtor to the loan had no obligation to serve the creditor, and the debtor could live on his own while the creditor only had a right to receive his accrued interest. If the creditor had the debtor stay and work for him and the debtor eventually escaped and took the creditor's property items with him, then the creditor was deemed to have lost his personal property and was prohibited from seeking the debt sum.48

The 1550 Sudebnik also formulated a progressive conception of the obligation as a creditor's right to performance by the debtor, but not to the personality of

43SHERSHENEVICH, supra note 38, at 387.

442 ROSSIJSKOIE ZAKONODATEL'STVO 10-20 VEKOV, supra note 42, at 61.


46See Russkaia Pravda, Prostrannaia Redaktsia [The Russian Justice, The Lengthy Version], art. 54.

47ROSSIJSKOIE ZAKONODATEL'STVO 10-20 VEKOV, supra note 42, at 99.

48Id. at 117.
the debtor. This explains why Article 82 considered the obligation of the debtor to be only repayment of the principal and of the interest accrued, while prohibiting the creditor from seeking damages caused by the escape of the debtor. If the creditor sought damages, it was made clear that such misconduct by the creditor was understood as a breach of the loan agreement.49

The 1550 Sudebnik, except those provisions indirectly dealing with pledging the property, also embraces a number of obvious security interest provisions. For example, Article 88 of the 1550 Sudebnik dealt with pledging fees.50

In the 16th century an attempt was made to reform the traditional concept of the creditor's ownership of the collateral of the debtor upon default. The cause for the reform was the same as in Roman law: The extremely hard position which the debtor usually found himself in. As Professor Shershenevich explains,

The notion of granting a security interest in collateral as including in potentia the right to own it by the creditor in case of the debtor's default, met in the 16th century the first attempt of substitution by the notion of the security interest as a right to the others' property, a right to obtain satisfaction from the value of the collateral.51

Thus, according to the 1557 Decree, the creditor had to alert the debtor of the possibility of being deprived of his property in the event the debtor delayed in repaying the debt. The creditor could sell the collateral with witnesses present and satisfy his interest from the proceeds if the debt was not repaid; any surplus from the sale had to be returned to the debtor. The debtor was liable to the creditor to the extent of the outstanding balance if the proceeds were insufficient to cover the principal and the interest. Professor Shershenevich suggests that the 1557 Decree bore a temporary character because soon after its adoption there was a widespread trend in the Russian economy to deem the collateral as the creditor's property if the debtor defaulted.

In the 16th century another type of security interest became popular, especially between monasteries and fee holders. Fee holders would grant the wealthy monasteries security interests in their fees in return for cash advances. Thus the mortgage became a part of economic reality. Frequently, however, such transactions were merely disguised sales of land since the encumbered fees were bequeathed to monasteries instead of being redeemed.52 But that practice was terminated by order of the 1580 Council, which prohibited acquisition of lands by monasteries and provided for withdrawal of those lands that had been already acquired.

49 Id. at 168.

50 Id. at 117.

51 Shershenevich, supra note 38, at 387.

52 S. V. Rozhdestvenskil, Sluzhiloie Zemlevladenie v Moskovskom Gosudarstve 16 Veika [Landowning for Service in Moscow State in the 16th Century] 84 (St. Petersburg, 1897).
In the 17th century Sobornoie Ulozheniiie (the statute-book adopted by the 1649 Council) became the most significant statement of Russian law. Provisions of the Sobornoie Ulozheniiie developed the concepts of the pledge and mortgage. Article 196 of Title 10 stated the already mentioned rule that the creditor became the owner of the collateral upon default and could freely dispose of it. The Article did not consider the difference between the debt and the value of the collateral. But Article 196 provided for the result to be determined by a covenant in the loan agreement. Literally the Article provided for the debtor’s writing, and it is difficult to say what the result would have been if there was no such provision in the loan agreement.

Article 197 provided for cases where live-stock was the collateral. If, for example, a horse in possession of the creditor died, then the creditor only had the right to one-half of the principal amount of the debt. In other words, the creditor lost half the value of the principal if the collateral live-stock in his possession died with no fault on the creditor’s part.53

In the 18th century the security interest temporarily obtained incidental traits as jura in re aliena. The statute, effective August 1, 1737, declared a new procedure for recovering debts under security agreements by providing for public sales. The surplus of the sale, if any, had to be returned to the debtor-owner of the collateral. The creditor had an option to retain the collateral when the price proffered at the sale was lower than the amount of the debt. If the creditor elected to retain the collateral, he deprived himself of his right to claim the balance of the value to be paid out of the debtor’s other property. Section 7 of the statute stated that the creditor had to bear all the adverse consequences of the creditor’s reckless conduct since the creditor had willfully loaned the money to the debtor. Section 8, however, removed the debtor’s privilege if he ruined the value of his estate encumbered by a mortgage, thereby allowing the creditor to go after all the debtor’s property.54

In 1744 the unsafe motives of creditors prompted a return to the rules stated in the 1649 Ulozheniiie because creditors received neither money nor encumbered fees in return. It was not until 1800 that a definitive and final abolition of the old procedure of claiming satisfaction of the collateral occurred when new Bankrotskii Ustav [Bankruptcy Rules] for real estate where promulgated. The new Rules eliminated the need for giving possession of the estate to the creditor, but the estate was deemed under a prohibition that basically deprived the owner of his right to sell or obtain a second mortgage. The prohibition on obtaining a second mortgage was very straining to the debtor, and moreover, without any benefit to the creditor.55 As a rule with respect to personal property, the collateral could be retained by the creditor if the debtor did not demand that it be sold. If the debtor did demand the

54 Shershenevich, supra note 38, at 388.
55 Id.
collateral be sold and the proceeds were insufficient, the creditor had a claim in the unpaid amount against debtor’s other property.

The development of the security interests law in Russia was incomplete by the end of the 19th century. There existed a number of contradictions in the security interest legislation which interfered with both the practical application of the legislative provisions and the theoretical development of the law. In this regard, Professor Shershenevich noted: "Historical development of security interest law in Russia is not complete. Russian zalog bears an undeveloped, non-complete character, and suffers from significant contradictions as remainders of different accretions."56

Still, security interest law eventually formed. The pledge and mortgage along with other methods of securing the performance of obligations were contained in the Russian Empire Statute Book.57 Additionally, some methods of security interests arising from loans made by credit organizations were set forth in the Credit Rules and in the Charters of private and public credit organizations.58

The Russian Empire Statute Book contains provisions regarding the legislative regulation of the following types of security interests:

1) security interest in personal property—pledge;59
2) security interest in real estate;60
3) security interest in rights in action;61 and
4) security interest in securities.62

B. Security Interest Law in Russia Before 1917

The legislative provisions in the Russian Empire Statute Book deemed that security interest was to be real credit as opposed to a personal one. Rights arising out of a security interest were defined as the rights to another person’s property [jura in re aliena] belonging to the creditor, and which ensured the creditor’s right in action to satisfy his interest from the collateral value.63

Security interest was understood as a right in rem included within the jura in re aliena group of rights. The in rem character of the right had two elements:

56Id. at 389.
57X RUSSIAN EMPIRE STATUTE BOOK pt. 2, bk. 4. The RUSSIAN EMPIRE STATUTE BOOK is analogous to the United States Code; it is a compilation of statutes regarding different legal matters.
59X RUSSIAN EMPIRE STATUTE BOOK pt. 2, bk. 4, art. 1663.
60Id. art. 2163.
61Id.
62Id.
63SHERSHENEVICH, supra note 38, at 383.
1) property is the object of security interest; and
2) security interest follows the collateral regardless of the
ownership to it that can pass from one person to another.

A minority of those who studied the security interest problem in Russia at that
time argued that a security interest could be a personal right. These legal
scholars argued that under Russian law the encumbered fee could not be
passed in transactions to other persons. This was the major reason for
qualifying the right as a personal one.64 But the majority view adhered to the
jura in rem point of view. This viewpoint is advanced by authorities such as
Professor Shershenevich and Professor Vas’kovskiy in their textbooks for law
students.

Russian legal scholars have noted a number of peculiarities with the security
interest. For example, it is said that the security interest did not bear
independent significance as opposed to other rights in rem, rather it depended
upon the right in action. This means that the accessory character of the security
interest right was emphasized. Professor Budilov, however, argued that
security interest in Russia could exist as an independent legal relationship too,
being independent of the obligation.65

The subject matter of the other rights in rem was the use of the property,
whereas security interest, as a rule, gave neither possession nor the right to use
the collateral. Instead security interest had another advantage: It could entail
deprivation of the owner of his property.

Also, under Russian law "security interest was nothing but alienation of the
right to dispose of the collateral, that is an indispensable accessory of
ownership."66 In this respect, Russian law went too far since the law made it
appear that the security interest contemplated the ownership transfer. In reality
the security interest does not assume such a transfer. As noted by Professor
Shershenevich, "The owner granting a security interest in his fee did not
deprive himself of the right to dispose, i.e., to enter tenancy agreements. If
according to our law the security interest bars the sale, that is absolutely not a
specific feature of security interest."67 In other words, granting security interest
in collateral was nothing more than imposing limits on the owner, but it did
not bar the owner from his right to dispose.

The security interest was understood as a right in re aliena because the value
of the other person’s property could be used to insure the right in action.
Following from that, the creditor’s own property could not serve as collateral;

64 K. Annenkov, Opit Kommentariia k Ustavu Grazdanskogo Sudoproizvodstva [The
Commentary Attempt to the Civil Procedure Charter], 11 Sudenbnyi Zhurnal [THE COURT
JOURNAL] 4 (1875); I. Orshanskii, Rol’ Kazennogo Interesa v Russkom Prave [The Role of State
Interest in Russian Law], 1 Sudenbnyi Zhurnal [THE COURT JOURNAL] 22 (1875).


67 Shershenevich, supra note 38, at 384.
thus, if the ownership of the collateral shifted to the secured party, the security interest was terminated.

German law tremendously influenced Russian lawyers' views on security interest. The empirical conclusions of German civil law scholars were widely discussed in Russia legal circles. For example, while discussing the question of understanding security interest as *jura in re aliena*, certain provisions of the German hypothec system were discussed in Russian civil law literature (among other things, the German system allowed establishing a security interest in a real estate item where the owner himself was a beneficiary, but was barred from realizing his right by foreclosing on the collateral).68

Another example of the influence of German law on theoretical developments in Russia concerns the accessory character of the security interest. The majority of Russian scholars believed insurance of the right in action to be the objective of security interest, while legal relationships springing from the security interest were deemed to be additional to those relationships arising from the obligation. In German law, Grund Schuld argued that the security interest in real estate was assumed to be independent from the obligation—that is, an abstract right to the known portion of value. Professor Shershenevich, however, does not consider that case to be an example of security interest itself.69

Since security interest was one of the methods of securing the performance of obligations in Russia and bore accessory character it could not arise before *the right in personam* or continue longer than *the right in personam* existed. This is why if the parties entered the agreement granting security interest with respect to an obligation that had not yet arisen, the security interest itself arose only upon the obligation becoming effective.

A number of prominent Russian legal scholars have commented on security interest law in Russia at the end of the 19th century. L. A. Kasso explained,

Security interest as a right creating to the benefit of the secured party an exceptional position with respect to the known fraction of the other person's property, can be attributed to the category of *rights in rem*, occupying amongst them an isolated room because it, as opposed to all others, does not have use or possession of the collateral as its aim, rather it seeks to obtain the known portion of the value of the collateral, moreover its termination is linked with realization of the aforesaid secured party's authority. It will be enough for all types of real credit in modern life to define security interest as an absolute right to payment of the certain sum, directed against the owner of the certain piece of property and being realized in the form of an exceptional right to recovery.70

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68 *Id.*

69 *Id.*

V. L. Utin stated, "The core of security interest is that the owner of the collateral gives to the secured party the right in rem to that collateral, opening to him a source of repayment of the debt and what is more, preferential as to all other creditors." 71

C. Russian Legislation Devoted to Security Interest

It is interesting from both a theoretical and practical point of view to examine certain provisions of Russian legislation devoted to security interest. Russian legislation gave a right to pledge property only to persons with the right to dispose of the property by means of sale because security interest assumed the possibility of the collateral being sold. 72 Thus, as a general rule, only owners could be pledgors/mortgagors. 73 There was an exception to the general rule for life-long users, who were permitted to pledge the property. 74 This exception applied only to validly obtained fees and only for granting rights in a specific act; realization of the right granted by the life-long user meant the transfer to the secured party of more rights than the pledgor/mortgagor had himself.

The existing security interest could be used by the owner of the fee to prove his right to the property and to interrupt the flow of the term prescribing acquisition. Those acts, providing for the mortgage of the fee in question, could serve as proof of the owner's ability to dispose of his property and thus could bar the possibility for ownership of the parcel through long term possession. This was true because, subject to Article 1627, 75 only those who could dispose of the real estate by means of sale had a right to give mortgages. Further, Article 1629 76 provided that only collateral which was the property of the debtor could be encumbered with a mortgage. 77

Only those with civil law capacity could encumber property, which is why minors, the mentally disabled, and spend-thrifts could not be pledgors. The "disorder of property" as a result of wastefulness or insolvency was another reason that could lead to the limitation of the person's capacity. Other reasons for capacity limitation, such as for alcohol dependency, were not recognized unless they led to wastefulness. 78

71 V. L. UTIN, 10 PROTSESSUAL'NYIE NARUSHENIIA PRAV ZALOGODERZHATELEI [PROCEDURAL VIOLATIONS OF THE SECURED PARTIES' RIGHTS] 178 (1906).

72 X RUSSIAN EMPIRE STATUTE BOOK pt. 1, arts. 1627 & 1663.

73 Id. art. 1632.

74 Id. art. 1629.

75 Id. art. 1627.

76 Id. art. 1629.

77 UTIN, supra note 71, at 178.

78 SHERSHENEVICH, supra note 38, at 113.
Russian law provided that secured parties could only be those persons who were not barred from being owners of the collateral.79 Professor Shershenevich, commenting on that provision of the legislation, states:

This provision of our law is brought by the old order of recovery under mortgages and does not respond to the essence of security interest law. The ability to be a secured party does not depend on the ability to be an ownership right subject. Security interest is a right to a privilege as against other creditors' satisfaction out of the proceeds from the sale of the collateral. The person who is barred as a matter of law from becoming an owner cannot be a purchaser of the collateral being sold at the public sale. But this circumstance cannot influence the ability to be a security interest subject.80

Nonetheless, as a matter of law, Jews, those of Polish origin, and foreigners in a number of Russian regions were prohibited from accepting mortgages encumbering real estate.

Russian legislation specifically regulated the ability of the Church to be a participant in security interest relationships. Although the Church was not limited in its ability to obtain ownership over different kinds of property, a special legislative decree deprived it of the right to lend its capital in return for a security interests in collateral.81

Another interesting question is what types of things could be collateral, that is, security interest subjects. Some legal scholars analyzing Roman sources concluded that it was possible not only for tangible objects to be used as collateral, but also all property benefits having monetary value could serve as a security interest subject. For example, an easement qualified as an object because it was a right belonging to the debtor against third persons. Others legal scholars asserted that only tangible property could be objects of a security interest as a right in rem.82 Russian law also recognized as collateral "those securities in which the right under the instrument was indissolubly connected with the right to the instrument."83

An obligation could not be collateral since it did not give birth to a real right. If the debtor gave a promissory note to the creditor to secure his debt, the creditor did not acquire a right. Another trait of security interest was the possibility to sell the collateral and satisfy the debt from its value. Professor Shershenevich stated that even had the law recognized the creditor's right to

79X RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 1628.
80SHERSHENEVICH, supra note 38, at 113.
81X RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 1665; IX RUSSIAN EMPIRE STATUTE BOOK art. 444.
83X RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 1674.
request a court for recovery under the pledged instrument, that still would have been a compulsory transfer of rights rather than a sale.  

Russian law did not recognize property under prohibition as being collateral. A number of legal scholars, however, believed that the notarial system of perfecting rights prevented collisions of real rights subjects. Russian law deemed invalid a second security interest with regard to some collateral, although some have argued that the sequence of rights created only the sequence of their realization. Professor Shershenevich explained,

In former times, in the absence of a source according to which the perfection of rights in rem to real estate would have taken place where those rights were, there were not enough guarantees that the debtor would not mortgage the same collateral to "different hands" so creditors would unexpectedly face each other while trying to realize their rights. But now such unexpectedness is unbelievable because mortgaging to "different hands" is not possible, and only subsequent mortgaging to different persons can take place.

Although the Ulozheniie Q Nakazaniiah [The Punishments Code] provided a criminal sanction for the second mortgage, in practice ways were found to avoid the prohibitions. Thus Article 1646, which initially covered only nobles but was then extended to cover all security interest relationships, contained a number of provisions from which one could infer the legitimacy of the second mortgage. For example, neither debts with a state credit organization secured by a first mortgage or analogous debts and security with private persons were obstacles for the fee owner to mortgage it a second time with a credit organization. The same conclusion can be reached through Article 1215 of the Civil Charter for Court; Article 1215 established the order of satisfaction of the collateral according to the security interests seniority.

A. M. Guliaev explained,

The law does not contain the general permission to grant security interests in the same collateral to several persons, but a confluence of several security agreements and hence attachment of several security interests is provided for in the law: Article 1215 of Ustav Grazkdanskii Sudebnii [The Civil Charter for Court] provides that when the proceeds from the sale of the debtor's property are not enough to satisfy several creditors, subject to the court's order the recovery expenses and the secured claim are to be promptly paid due to the security interests

84 SHERSHENEVICH, supra note 38, at 391.
85X RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 1630.
86Id. art. 160, § 2.
87SHERSHENEVICH, supra note 38, at 391.
88ULOZHENIIE Q NAKAZANIIAH [THE PUNISHMENTS CODE] art. 1705.
89X RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 1646.
seniority. Thus without abolishing the law prohibiting attachment of several security interests to the same collateral, confluence of a number of security interests seemed to be possible, and there is no doubts about the court practice with respect to allowance of consequent security interests.90

The law also stated the rule that indivisible property (property that could not be divided into pieces without substantial harm to its economic value and functional usefulness) could not be encumbered in parts; that is, a security interest could not be granted in only part of indivisible property.91 The same rule applied to collateral accessories mentioned in Articles 386 and 387. A bridge, a ferry, a lake, and like accessories were indissoluble and inseparable parts of the main object—real property—with respect to which they had only easement significance. So under the law, those accessories were not subject to separate security interests.92

Additionally, the law invalidated security interest granted in property, clothes, dishes, farm products, and so forth if it took place "on a premises run as a drinking house and for drinking."93

An obligation was usually the reason for granting a security interest. The obligation in turn could arise out of a contract or will. Russian legislation provided for loans, governmental contracts and deliveries to the state as reasons for granting a security interest. But some legal scholars thought that a variety of transactions could be secured by granting security interests. They supported their opinion by citing Article 155494 according to which contracts and obligations generally could be secured by pledging or mortgaging the collateral.95 Senate practice adhered to that point of view.

The Russian legislature sought to prevent the granting of security interests during gambling. Creditors, who aware that a security interest was granted to secure a debt from gambling or for gambling, were subject to having the collateral confiscated and divided between the person reporting the transaction and the state treasury.96

Only creditors could be pledgees or mortgagees, but there was no such easy solution with regard to pledgors and mortgagors. Article 69 of the Polozhenie o Kazennyyh Podriadah i Postavkah [Governmental Contracts and Deliveries to the

91X RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 1633.
93X RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 1665.
94Id. art. 1554.
95SHERSHENEVICH, supra note 38, at 392.
96X RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 1666.
State Act] provided that with respect to securing contracts with the State Treasury, third persons could grant security interests in collateral. Professor Zmirlov argues that it was invalid as a matter of law for a private persons to grant a security interest in another person's collateral. But Professor Shershenevich contended that both civil statutes and Article 1705 of the Punishment Code prohibited the granting of a security interest in non-owned collateral, unless the pledgor had proper authorization of the owner.

Professor Demburg, in his Pandects, explained his point of view on this problem. He stated that transactions, secured with security interests granted in collateral in which the debtor hoped to acquire ownership, were later effective only if the debtor's wish was actually fulfilled. The security interest granted in another person's property was valid if the debtor-grantor later became the owner of the collateral, and the creditor believed at the time of the transaction that the grantor had the right to grant the security interest in the collateral. The same result was achieved if the security interest was granted by a non-owner, but the owner of the collateral was the heir of the grantor-non-owner. If the grantor-non-owner inherited the collateral only in part, the security interest was valid only to the extent of the successive part.

The question of statutory security interests was very complex and disputed area of Russian law. Some legal authorities took the position that Russian legislation did not provide for "legal hypothec," and hence neither a statute or a court's decision could give rise to a security interest. Others, such as Professor Goldstein, believed that Russian legislation recognized statutory security interests. Professor Goldstein supported his position with the following examples:

1) the right of the railroad carrier to the goods carried as security for the payments due for its services;
2) the right of the warehouse to the goods stored as security for the payments due under storage agreement;
3) the right of the commission agent to the goods of the principal as a security for the payments due under the agency contract.

Professor Shershenevich contended that the above cases provided a right to retain goods (ius retentionis), but did not give rise to a security interest. The commission agent's position under Russian law, however, was equivalent to that of a secured party. Professor Shershenevich suggested that a statutory security interest could be found only where the debtor, who had purchased goods on credit, was prohibited from granting security interests, selling, or

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97 See id. art. 1629.
99The Railroad Charter, XII RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 85.
100The Trade Charter, XI RUSSIAN EMPIRE STATUTE BOOK pt. 2, art. 784.
101Id. art. 542.
disposing of the goods in any other manner until the purchase price was paid in full. This was security for the vendor's claims arising from the credit sales contract.102

D. Security Interest Procedures in Russian Law

Security interests law in Russia at the end of the 19th century was generally based on two types of collateral: real estate and personal property. A feudal procedure was used for real estate. Under this procedure an agreement was entered into at a notary public's office, which was then to be submitted by the notary to a chief notary public. The chief notary public entered the transaction on the Record of Feudal Affairs. Upon entry of the mortgage the chief notary established a prohibition over the fee mortgaged, and issued an order for publication by the Senate Printing House. The use of any other procedure purporting to give rise to a security interest in real estate invalidated the transaction. The security interest attached at the time of entry by the chief notary public.

For personal property, the common procedure had two components:

1) a written security agreement; and
2) taking possession of the collateral.

The written security agreement could protect the creditor's interest against embezzlement, impairment of value, and substitution of the collateral by the debtor. Taking possession, in turn, protected the interests of third persons, who might consider the collateral to be free of encumbrances and make advances to the debtor based on the collateral.

Foreign legislation of the time also demanded the transfer of possession of the collateral to the creditor.103 But in some circumstances a security interest could exist without the transfer of possession. This happened when third persons had an opportunity to discover the existence of a security interest:

1) hypothec of sea vessels (because a special registration procedure was to be followed);
2) security interest in trade enterprises in France (because the law provided for recording of the transaction in the Commercial Court Register);
3) security interest in cattle in Switzerland (because entry in a special register was contemplated).104

In Russia, a security agreement granting a security interest in personal property could be executed by a notary public or by "home" order (not before a notary public). In both cases at least two witnesses had to be present at the

102 SHERSHENEVICH, supra note 38, at 394; see X RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 1509.
103 Compare FRENCH CIVIL CODE art. 2074 with GERMAN CIVIL CODE art. 1205 and SWISS CIVIL CODE art. 884.
104 See SWISS CIVIL CODE art. 888.
execution of the agreement. The collateral was enumerated in an inventory, one copy of which was given to the creditor and another, with the creditor's signature—was given to the debtor.

A security agreement not reduced to writing did not lose its validity, but rather could not be witnessed in the court by other persons. To prove such a security interest against third persons, Professor Shershenevich stated:

But to the extent we talk about the power of such security interest against third persons the security interest as a right in rem is void against purchasers and other creditors. Of course, not all details of form must be considered material—i.e., inventory, witnesses—but the written document must exist. It can be deemed only as a mere fact and not a right in rem that the collateral was in the creditor's possession when there was no written document, and hence other judgment creditors could go after such collateral. The Senate even believes that the debtor or his successor in the right to collateral can demand at any time that it be returned for being in unlawful possession, but at the same time, it does not recognize the form to be material unless there is a dispute with respect to identity of the collateral.

One a major difficulty in Russia was the grant of a security interest in a vessel because there was no hypothec system for security interests in vessels. As a practical matter, this was resolved by means of fictitious sale, reminiscent of fiducia. The debtor sold the vessel but stipulated a right to repurchase the vessel upon completing performance of his obligation. Additionally, the debtor could retain the vessel under a special lease agreement. Such an antiquated manner of granting security interests was much criticized.

The actual effect of a security interest was consistent with the purpose of granting it: The creditor, to the extent of his right to action, had a right to the value of the collateral regardless of whose hands it was in and for what reason. This right covered the whole collateral. The security interest was believed to be indivisible, so partial satisfaction of the creditor did not deprive him of the security interest to the whole collateral.

E. The Essence of the Security Interest—The Rights and Duties of the Parties

Russian law defined the rights of the debtor-grantor as those of the owner; security interest did not impede those rights, especially if the collateral stayed in his possession. Thus, the owner could use the collateral, such as gathering in the harvest and disposing of it. He had a right to determine the fate of the collateral by means of transactions (i.e., gift or sale) because the security interest

105X Russian Empire Statute Book pt. 1, arts. 1670 & 167.
106Id. art. 1671.
107Ustav Grazhdanskii Sudebnii [The Civil Charter for Court], X Russian Empire Statute Book, art. 409.
108Shershenevich, supra note 38, at 396.
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theoretically followed the collateral everywhere. Nonetheless, the law prohibited the sale of mortgaged real property unless the debt was repaid and the security interest was terminated. Only when the land was mortgaged to a credit organization was the owner allowed to sell the collateral and transfer the debt to the buyer.

The obligor also had a right to demand that the creditor keep the collateral without impairment to its value when the collateral was in possession of the secured party (it is hard to say whether a reasonable depreciation in value was contemplated, but it would be reasonable to assume it was). The obligor had a right to demand the return of the collateral upon completing performance of the principal obligation. If the creditor lost the collateral, he was liable "without any justification." This provision of the law, however, did not prohibit the creditor from making counter-arguments. Professor Shershenevich stated,

It is hardly permissible to understand the Article in the sense that the liability would exclude any kind of contests. More likely that it should be understood in the sense that the creditor has to do the best he can due to the conditions of his life or occupation. The pawn shop must not be excused for the damage to a fur coat that it kept in a damp room (Cassation Decision N87, 1905), but the same deterioration caused by the humidity of the apartment the creditor lived in may well be excused. But the burden of proof is on the creditor. It is not the debtor who has to prove the creditor's guilt but rather the creditor has to prove absence of any guilt or negligence on his part. Only casualty of the destruction proved by the creditor excuses his liability to the debtor. The same analysis should be applied to the mere damage of the collateral.

The law provided the creditor a right to demand through a court that the collateral be sold in case of default. In theory, the creditor also had a right to prevent the debtor from the actions that might impair the value of the collateral. But that right existed in Russia only as an essentially and vitally necessary one rather than an available. Russian law, as distinguished from German law, did not make this right available. As explained by Professor Shershenevich,

It is a pity that our legislation guarantees the creditor's interests only to a limited extent. Although it is true that the creditor, if he has not received full satisfaction out of the proceeds of the sale of the collateral, can state that he has been injured by the acts of the debtor that impaired the collateral in its value and sue for damages on that ground. But the creditor who does not trust the debtor's performance and solvency,

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109X RUSSIAN EMPIRE STATUTE BOOK, pt. 1, art. 188.

110Id. art. 1676.

111SHERSHENEVICH, supra note 38, at 398.

112See X RUSSIAN EMPIRE STATUTE BOOK pt. 1, art. 684.
gets little from such an opportunity. He is interested in stopping those acts that can impair the value of the collateral, he exclusively trusted to. Our law does not give that assurance to the creditor. The latter has no right to contest damaging and dissolving actions of the debtor with respect to the collateral.\textsuperscript{113}

Russian legislation permitted contracts, with regard to the fees entered by the mortgagor after receiving a court order granting foreclosure to the mortgagee, to be invalidated by the court upon the mortgagee's request. In the case of a public sale, the contract could be invalidated upon the buyer's request. But several problems existed. First, the contract could be invalidated by a court only upon the request of an interested persons. Second, the timing of invalidation was deemed by many scholars to occur too late. Third, a court, considering the interests of third persons who assumed a significant risk by entering the contract, was reluctant to invalidate the contract.

Security interest, as all other property rights, had a feature of passing from one person to another. Logically, since that right was expressed in a document,\textsuperscript{114} the easiest way to dispose of the security interest must be transfer of the right under the document. But the law prohibited transfers of security agreements by endorsement regardless of whether the security interests were granted in real or personal property.\textsuperscript{115} This is why a change of pledgee or mortgagee could be accomplished only by eliminating one security agreement and creating another one, provided the consent of pledgor-mortgagor was obtained.

For a long period of time, practice supported a view that it was forbidden to transfer mortgage deeds. But later, the Senate decided that there were no obstacles to such transfers in the legislation. After the Senate decision, mortgage deeds were transferred both through "home" and notary procedures, and the chief notary public made an entry of the transaction in the Register.\textsuperscript{116} As Professor Shershenevich explained,

The Senate came to that conclusion relying on the prohibition in Article 1653 against the transfer of security agreements by endorsements, that is, previously, in constructing the Article as stating that security agreements cannot be transferred by endorsement the Senate logically stressed the word 'transferred', now it moves it on the word 'by endorsement'.\textsuperscript{117}

\textsuperscript{113}SHERSHENEVICH, supra note 38, at 398-99.

\textsuperscript{114}See discussion concerning the procedure for security agreements in Part IV.D.

\textsuperscript{115}X RUSSIAN EMPIRE STATUTE BOOK pt. 1, arts. 1653 & 1678.

\textsuperscript{116}Cassation decisions N 20, 1898; N 82, 1908. A cassation decision was an appellate review of a case and the Russian Senate was the highest judicial authority with the power to review cases and make such decisions.

\textsuperscript{117}SHERSHENEVICH, supra note 38, at 400; see X RUSSIAN EMPIRE STATUTE BOOK pt. 2, art. 1653.
The Senate found that it was the debtor’s interest that was the ground for the prohibition contained in Article 1653, and hence there was no obstacle to let the debtor himself waive non-transferability. According to the Senate, a new security interest did not attach when a security agreement was transferred, but rather the security agreement that had been entered earlier was transferred to a new person.

The transfer meant that the successor under the agreement succeeded all the rights of the predecessor, and in the case of plural security interest he had the same seniority as a previous holder. In its construction of Article 1653 the Senate did not limit its decision to the possibility of transfer of the security agreement upon the debtor’s consent. Going further, the Senate concluded that the right to transfer the security agreement given by the debtor to the creditor needed no further debtor’s approval when subsequent security agreement holders tried to transfer it. Russian civil law literature noted in this respect that the preliminary consent of the debtor to transfer of security agreement "was not a material condition of security agreements transferability."

As already mentioned, when the debtor failed to perform the principal obligation the creditor was given the right to demand through a court order that the collateral be sold. But with regard to real property mortgaged, the law gave the debtor an additional chance to satisfy the creditor’s claim secured with the mortgage and thus to redeem the collateral. Upon default the creditor initially obtained only a right to temporarily use the real estate mortgaged.

The legal nature of this right can be found in legal scholarship and in legislation. Initially this right was provided in legislation as a right to possession. Later the lawmaker defined it as a right to manage. But neither wording reflected that under the right the creditor obtained rights to all profits from the land (i.e., rent) while simultaneously the interest on the capital stopped accruing. Proceeding from the premise that—the right to possess contemplates person’s right to retain certain property in the sphere of his economic supremacy and the right to manage has as its essence only management itself—it is natural to suppose that the creditor’s right to temporarily use the mortgaged collateral was a separate right, distinctive from the other two rights. Thus, the right was properly defined as a right to temporarily use the mortgaged collateral. The definition should be clarified, however, by adding the words—"and get profits of using it". This clarification is needed since situations could have arisen where the creditor used the realty mortgaged but obtained advantages from the use without appropriating the profits from the use, or where the creditor simply covered his expenses to maintain the collateral.

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118 Cassation Decision No. 74, 1909.

119 Zaksn Sudebnii Grazhdanskii [Civil Court Act], XVI Russian Empire Statute Book pt. 2, art. 615.

120 Ustav Grazhdanskii Sudebnii [Civil Charter for Court], X Russian Empire Statute Book art. 1129.
The law initially restricted the temporary use to one year, but later it cut the time period down to three months. The time restriction did not obligate the creditor to resort to the use of the parcel for those three months, but rather, it gave him the right to do so. Often the creditors refused the right to use the collateral land because it was more profitable and favorable for them to allow the interest to accrue.  

Since the essence of security interest is embodied by the requirement of selling the encumbered collateral to satisfy the secured creditor out of the proceeds of the sale, the collateral must be sold and cannot be appreciated by the creditor. Moreover, the sale must be administered by a court in compliance with established procedure and not by the creditor himself. Russian law allowed the creditor to take part in the sale; he could bid on the security agreement. If the proceeds from the sale were greater than the debt, the surplus was either used to satisfy other creditors or was returned to the debtor.

A Senate rule provided that if the proceeds were less than the principal amount of the debt, as a matter of practice the creditor had no opportunity to extend his claim to other property owned by the debtor. The substantive civil law norms did not unambiguously solve this question. But in those regions where new Court Procedure Charters were not adopted, there were procedural provisions to the effect that if the proceeds of the sale were less than the principal debt, the proceeds were deemed to be a definitive satisfaction of the creditor’s claims.

Some scholars have stated that the rule was effective even after adoption of the Charters. They reasoned that the rule bore the substantive material law character which could not have been abolished by promulgation of the Charters. The rules of substantive material civil law, as stated in civil procedure statutes that had not been substituted by the rules of the Civil Procedure Code, were to be used in all the regions where civil law statutes were applicable.

But the legislation of that time suffered from contradictions between branch provisions, and one can find a number of statutory provisions undermining the above viewpoint. For example, Ustav Sudebnii Torgovyi [The Trade Charter for Court] stated that insolvency could happen where there was not enough collateral with the claim aimed at the debtor’s property which happened to be

121 Zakan Sudebnii Grazhdanskii [Civil Court Act], XVI Russian Empire Statute Book pt. 2, art. 622.

122 Cassation Decision No. 34, 1908.

123 Zakan Sudebnii Grazhdanskii [Civil Court Act], XVI Russian Empire Statute Book pt. 2, art. 626; Polozheniye o Vziskaniiah Grazhdanskii [The Civil Remedies Code], XVI Russian Empire Statute Book art. 315.

124 Shershenevich, supra note 38, at 401.

125 XII Russian Empire Statute Book pt. 2, art. 3.

insufficient. Thus, Article 407 contemplated the possibility of turning the creditor's claim to the debtor's property that was not the collateral.

The provisions discussed above were related to regulation of real estate mortgaging. The law was different in respect to personal property. The treatment of personal property was very controversial and much discussed in civil law literature of the time. Some legal scholars concluded that the essence of security interest was that the creditor could satisfy his claims only from the value of the collateral. Under their construction, they extended application of those provisions of the law related to real estate collateral to personal property collateral. Support for this construction was found in Article 1674,127 which allowed the creditor to go after the debtor's property only upon the debtor's agreement. Moreover, Ustav o Bankrotah [The Bankruptcy Code] of 1800 stated that if the value of the collateral pledged was less than the amount of the debt, the collateral had to be left to the creditor because the creditor had deemed it sufficient to secure the debt. Article 634,128 however, provided that the remaining balance could be exacted from the pledgor if the proceeds from the sale of the collateral were less than the principal amount of the debt. This issue was not resolved for a long time. Eventually, practice and Senate decisions established that when personal property was pledged the creditor had a right to turn his recovery, to the extent not covered with the proceeds from the sale, to the other debtor's property.129

Professor Shershenevich believed Russian legislation was illogical and imprecise regarding the issue of whether a creditor could recover on the rest of the debtor's property when realty served as collateral. He thought the essence of security interest to be in the strengthening of the security power of a claim that already had as its object all the debtor's property. This explains why a security interest, along with a common right for all creditors to turn recovery to all the debtor's property, gave the creditor a right to preferentially satisfy from the value of certain property. It was this feature that was understood to be the real security.

Thus, since the principal obligation did not lose its power the creditor could not be deprived of his right to deny at any time a privilege given him and seek satisfaction on common grounds, that is in all the debtor's property and not in a designated, selected out of all the property part. More precisely, there were no obstacles to prevent the secured creditor, who had not received full satisfaction out of the proceeds from the sale of the collateral, from turning the unsatisfied part of his claim to the rest of the debtor's property with other creditors. Yet by analyzing Russian legislation, it can be inferred that the destruction of the collateral or invalidity of the secured transaction not only led

127X Russian Empire Statute Book pt. 1, art. 1674. Article 1674 dealt with the securities pledge and hence the rest of the debtor's property except designated securities was not a part of the collateral.

128XVI Russian Empire Statute Book pt. 2, art. 634.

129Cassation Decision No. 2, 1889; Cassation Decision No. 98, 1909.
to termination of the additional legal relationship, but also terminated the principal one depriving the secured creditor of his rights under the obligation.

Court practice used the same interpretation as the Senate decision,130 which explains why the secured creditor could find himself in less secured position than a general creditor, despite the aim and essence of the security interest. But the logical result of the court practice clashed with the direct prescription of the law; according to the provision in law, in case the security interest was granted by the grantor/non-owner, only the security agreement was deemed to be invalid and the main (underlying) obligation continued to exist with the creditor retaining his principal claim.131

Thus, the question governed by the legislation was very controversial. As a result, as it has already been mentioned, the real credit in a number of cases was in a worse position than the personal one. For example, the secured creditor could cut down the interest on the debt if compared with the unsecured creditor’s interest. The creditor usually took a higher interest rate because of the risk he assumed, but the secured creditor’s risk could still be higher than that of the unsecured creditor.

But this problem was solved, at least to some extent, as a practical matter by private agreement of the parties. The parties to the loan agreement would include a covenant providing for an obligation of the debtor to give full satisfaction from all his property, including property not listed as the collateral. The Senate recognized the legal validity of agreements of this kind.132

There was a special rule in Russian law regarding collateral in the event of the debtor’s insolvency. The collateral was not a part of the property subject to the creditor’s claims, but was to be sold separately. Only the surplus left after satisfaction of the secured creditor’s claim was included in the property subject to general creditors’ claims.133 If the trustee in bankruptcy thought he could sell the collateral at a higher price, he could redeem the claim from the secured creditor since the secured creditor would obtain full satisfaction of his claim.134

There were a few instances where Russian legislation contemplated specific rules for certain types of security interests. One of them was the mortgage with credit organizations. The debtor had to surrender a number of documents, including a security interest certificate from the chief notary public or court

130See Cassation Decision No. 143, 1880.

131X Russian Empire Statute Book pt. 1, art. 1629, § 1; X Russian Empire Statute Book pt. 1, art. 1164, § 1. One could infer that the invalidity of a security interest leads to the invalidity of the underlying obligation; this inference was controversial because there was a provision in law providing that security interests granted by non-owners were deemed invalid while the underlying obligations were still enforceable.

132Cassation Decision No. 5, 1884.

133Ustav Sudebnii Torgovyi [The Trade Charter for Court], Russian Empire Statute Book art. 505, § 1 and art. 506, § 3.

134Ustav Sudebnii Torgovyi [The Charter for Court], Russian Empire Statute Book arts. 480 & 481.
stating that the fee was the debtor’s property and was free of prohibitions. When buildings were mortgaged they had to be insured. Usually mortgage agreements were long term—often for thirty-six or forty-nine years. The bank appraised the collateral and the amount of credit was forty-five to fifty percent of the appraisal value. The sum of the credit was given to the borrower either in cash or in "mortgage sheets" (obligations of the bank itself) secured by the collateral mortgaged to it. Either the borrower or the bank could realize those obligations.

The owner’s rights were significantly limited:

1) he could not rebuild a building unless the bank consented by acknowledging that such rebuilding would not result in decreased value of the collateral;
2) the bank was entitled to demand that the mortgagor refrain from adverse acts which decreased the value of the collateral; and
3) the owner-mortgagor could dispose of the collateral by means of sale or gift, but only upon the creditor bank’s consent and subject to the condition that the debt was transferred without termination of the first mortgage.

The main peculiarity of this type of security interest was that the credit organization could sell the collateral mortgaged without any court intermediation. This provision was true with respect to both state and private banks.

A second activity subject to specific regulation by Russian legislation were Ssudnyie Kassy [Loan Funds], which were similar to pawnshops. Each kassa had to obtain a special book from the city magistrate where the following data had to be recorded:

— the name of the client;
— the description of the collateral;
— the amount of the loan with the time and date it was to be returned; and
— the amount due for the custody.

The borrower was given a ticket reciting the entry in the book and a tag was attached to the collateral as evidence of the transaction.

The interest accrued and the custody payment were usually paid by the borrower upon the repayment of the principal amount of the debt. The kassa was obliged to give the borrower a written acknowledgement upon repayment of the debt and redemption of the collateral. Collateral left in the pawn shop was subject to sale through auction upon default of the borrowers. But the law provided for a two month period after the payment had become due during which the collateral could not be sold and the debtor retained the right to redeem it. When an auction was held, the price the collateral was to be sold at

135 Ustav Creditnyi [The Credit Charter], XI RUSSIAN EMPIRE STATUTE BOOK pt. 2, tit. VI, art. 55, tit. XI, art. 140.
136 Id. tit. XI, art. 149.
included all the payments due by the borrower. The pawnshop obtained ownership over the collateral if the collateral was not sold at that price.

A third type of security interest subject to specific regulation concerned security interest granted in goods stored in a warehouse. According to the rules provided for in the 1898 statute, warehouses could issue "double" warehouse receipts evidencing the storage of goods. Double receipts consisted of two parts: (1) evidencing the title to the goods, and (2) the security interest granted in the same goods. Thus, the owner could encumber his property by endorsing the security interest certificate and transferring it separately from the part evidencing the title. A person in possession of the security interest certificate, who had not received full satisfaction from the owner of the goods, had the right to apply to warehouse officials. The warehouse officials could then sell the collateral to extinguish the debt without resorting to the court procedure. The surplus remaining after the sale was to be returned to the owner-debtor.

Two elements were unique to security interest certificates. First, the collateral could be sold without using the courts. Second, the security interest certificate could be transferred by endorsement. The ultimate possessor of the certificate had a claim against each endorser in the chain. This type of security interest then, undermined the general rule which allowed the security interest to be transferred from one person to another without debtor's consent by means of endorsement. Also, endorsements gave rise to joint and several liability of all the endorsers in the chain. If the proceeds from the sale were less than the amount of the debt, the ultimate possessor of the certificate had a claim to the extent not covered by the proceeds against both the principal debtor and all the endorsers.

V. CONCLUSION

In conclusion, it should be mentioned that legal issues connected with security interests were not widely discussed or litigated until after the promulgation of the Russian statute dealing with those matters in 1993. Since that time, a number of significant changes have affected security interest regulation in Russia. The recently adopted Civil Code of Russia, in its General Part, also devotes a number of articles to these questions.

The security interest is beginning to occupy a significant place in commercial lending by banks and in the real estate market. There still exists, however, a lack of certainty in security interest law in Russia, and the case law sheds little light in terms of how security interest problems are to be resolved.