Introduction

- The law security devices is one of the **sets of laws, rules and principle**, formulated to regulate and faster the **smooth running of business transactions**, it governs **the relation b/n creditors and debtors**, regarding the performance of various obligations, with a special focus on the **credit system.**
- According to an old song **‘’love makes the world ground’**’ while this may be true love does not provide much help in the business environment.

Intro Cont. ....

- I deed from a business perspective credit may be what makes the business world go round'' (Source:- Davidson Knowles, business law principle and cases in the legal environment)
- -The grand objective of law of security device is to **facilitate the smooth running of commercial transactions w/c are indispensable for the creation of one economic community**.
- In the strict sense of the term **''security'' refers to either personal security(surety) or property securities - pledge and mortgage.**

Intro Cont. ....

- In the broad sense of the term ‘’**Antichresis** – special type of mortgage, **lien rights**, **rights of redemption** also possess the nature of securities.
- As to law of security devices is based on **special contracts** and the **general principles and guidelines from the provisions of contract in general** are applicable.

CHAPTER ONE

General Introductory issues

1. 1 Definition of securities.

- Blacks law dictionary provides that security is

1) Collateral given or pledged to guarantee the fulfillment of an obligation, esp, the assurance that a creditor will be repaid (USu –with interest) any money credit extended to a debtor.

2) A person who is bound by some type of guaranty – surety (A person who is primarily liable for the payment of an others obligation).

General Intro. Cont. ....

- In his treatise an civil law – the M. Pilaniol-also provides definition of ‘**’security contracts**” as “those contracts intended to protect creditor against the insolvency of the debtor.
- Insolvency is the state of debtor whose liabilities are greater than his assets”.
- **<u>Points from the above definitions.</u>**

  1) Security is an undertaking to assure / guarantee the creditor that the debt will be paid or the obligation will be performed to the satisfaction of the creditor.

General Intro. Cont. ....

2) It is also providing the creditor with alternative remedy in case the debtor fails to pay the debt to fulfill his obligation.

3. Security created principally for the benefit of the creditor, however, the debtor also many be considered to have at least indirect benefit (e.g getting loan easily

4) Security arise, most of the time, from contract b/n the creditor and the debtor or 3rd party.

5) Security can exist only if there is a debt to be paid or obligation to be performed.

1.2 Importance of Securities.

- From the very purpose for the creation of security, they are designed to **facilitate the relations b/n creditor and debtor.**
- Securities play a great role in smoothening the relation b/n creditor and debtor – how?
- It is by assuring the creditor that the debtor will pay or discharge his obligation, then the security rights of the creditor will be enforced to satisfy the claim of the creditor.
- This substantially reduces, if not avoid, the possible damage and inconveniences w/c may ensure from the non-performance by the debtor.

Importance Cont. ….

- The importance of securities is not only for the creditor but also for the debtor and even the society in generally.
- From the debtor’s angle, the debtor who offers security will have better access to loan than a debtor who requests creditor a credit with-out offering any security.
- From the societies angle, Business activities specially in developing countries are financed through loan system. It assists business activities.

1.3 Nature of Securities

- The most important distinguishing character of securities is that securities by their nature are accessory or secondary rights.
- Accessory rights are those rights the existence of which is conditioned up on valid existence of another rights referred to as primary rights.
- Rights in general are referred to as accessory if they don’t have independent existence or if they are not created for their own sake.

Nature Cont. ..

- The division of certain rights as principal (primary) and the others as secondary (accessory) indicates that the former groups of rights is enforceable by themselves independently while the enforceability of the later groups depends on the failure to enforce the principal rights.
- Therefore, primary rights are available for the owner of the right and enforceable for their own sake while accessary rights are made available merely in substitution for the primary rights the existence of w/c has failed for various reasons.

Nature Cont. ....

- There would be no reason for securities to exist unless there is primary obligation the performance of w/c is ensured by creating security right.
- Accordingly, securities are accessory as they cannot exist or cannot enforce in the absence of principal rights/ obligations.
- Generally, securities are created as an alternative remedy for the creditor in case the debtor fails to perform the principal obligation

Nature Cont. ....

- This accessory nature of securities can be seen from various angles.

1st – without valid obligation no securities can exist

2nd – the enforcement of securities is conditioned up on the failure of the debtor to discharge his obligation.

- Securities can be enforced only after ascertaining the failure of the debtor.
- To ascertain the failure of the debtor we need to wait for the due date of the principal obligation.
- Hence, securities stay inactive until **the due date of the secured obligation.**

3rdly if the **primary obligation is extinguished** for what so ever reason, **it automatically results in the extinction of securities**.

Nature Cont. ....

- **<u>In conclusion</u>**,

  -the **creation of securities**, whatever its type may be, **presumes the existence of a valid obligation** w/c the creditor expects to be performed,

  -the **execution of securities** presumes the failure of the debtor to discharge his obligation

  -**a reason** w/c **brings about extinction of primary obligation** at the same time result in **the extinction of securities**.

1.4 Types of Securities

- Depending on their nature, content and effects securities are classified in different forms in different legal systems.
- The classification adopted our legal system; there are two types of securities. These are:-
- 1) Personal security
- 2) Real (property)
- 1) **Personal security**:- is also referred to a surety.
- This is the type of security in which case the security right of the creditor is against human person called **guarantor**.

Types of securities Cont. ...

- The guarantor undertakes, in terms of money, towards the creditor, to perform the primary obligation in case the debtor fails to perform it.
- Another important point here is that personal security (surety) is **a part of contracts** in generally since the relevant provisions of surety(1920-1952) are found in the part of civil code dealing with general contracts. (Please refer the course Law of contract)
- Here, Do not forget that surety is one of **the actively working type of security** in day to day business transaction.
- What is more, some of the provisions of surety ship are highly relevant in the **functioning of other securities** (real securities) – read art 1920-1952 ECC.

Types of securities Cont. ...

- **2. Real(Property) Security-** is the case where the security right of the creditor is against property or a thing.
- Under this type of security the right of the creditor will be enforced against the thing on which he claims to have security right.
- Real security, in turn are classified in to two
- These are - 1) Pledge 2) Mortgage

Types of securities Cont. ...

1) **Pledge:** - is security against movable which is referred to as pledge in many legal system including ours

- But also called as **pawn**, **bailment** etc. in other legal systems.

2) **Mortgage**:- is the case where the security is created against immovable principally.

- It is called Mortgage in most of legal systems.

- Mortgage may sometimes, change to another form of security i.e. **Antichresis**, if there is a special arrangement b/n the creditor and the debtor.

Types of securities Cont. ...

- Antichresis, is therefore, a **special type of mortgage**
- An important point that the above classification does not automatically exclude other types of rights which may, in certain circumstances, be considered as securities.
- The principal examples of such rights may be- **Lien rights**, **Sale with ownership reserved**, **Rights of redemption and others.**

CHAPTER TWO
Pledge (Security on movables)

•2.1 Definition of pledge

- The definition of pledge has gone through a long process of development which has contributed to the refinement of the definition of pledge and its elements.
- However, **common understanding and uniform definition** of pledge seems to be still lacking.
- This is true because for one legal system **pledge is simply a specially type of bailment**, while it is **a lien right** for the other legal system

Definition cont. ....

- Read the following definition of pledge taken from books and identify the basic elements and points from,
- **Black's law Dictionary 8th ed 2004**
- Pledge is ''**a security interest in personal property** represented by **an indispensable instrument**, the interest being created by a **bailment or other deposit of personal property** for the purpose of **securing the payment of debt or the performance of some other duty''**
- **Merchantile law, 5th ed, by Me Kuchhal (1999**)
- ''The bailment of goods as security for payment of a debt or performance of a promise is called **'pledge**': the **bailor** in this case is called the **pawn** or'' the **bailee** is called ''the **pawnee**''

Definition cont. ....

- **From Treatise on civil law, Vol II, Part II, by M. Planiol (1939)**
- "Pledge is a contract by which the **debtor himself or a third person** remits to the creditor a movable object to serve him as security. Pledge is a contract at the same time production of obligations and creator of a real right''
- **From the elements of jurisprudence, 13th ed, by sir Thomas Erskine Holland, k, (2006)**
- Pledge may be defined as ''**a right in rem realizable by sale, given to a creditor** by way of accessory security to right in personam.
- The above definitions, in general, address various aspects of pledge like **the purpose of the contract of pledge, the nature of the relation under contract of pledge, the indication about rights and duties of the parties.**

Definition cont. ....

- **Please answer the following questions.**

- Who are parties to the contract of pledge?
- What kind of objects can be pledged and who can offer the object for pledge?
- What is the principal purpose of pledge?
- What is the basic nature of contract of pledge?
- What basic rights and obligations do you expect to arise from contract of pledge?

- Now let us look in to the definition of pledge and its various elements under the Ethiopia law of pledge.

Art 2825-Definition

"A contract of pledge is a contract where by a debtor undertakes to deliver a thing called pledge to his creditor as security for performance of an obligation".

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Definition cont. ....

- After reading the provision, please answer the following questions?
- What is the source of pledge, can it arise from provision of law or can it be created by decision of the courts?
- Who can give an object as a pledge?
- What is the basic obligation that the pledger has to assume for the contract of pledge to be created validity?
- What kind of pledge can be delivered as a security under contract of pledge?
- What is the principal purpose of Concluding contract of pledge?

Definition cont. ....

- Consider the following components of the definition

Contract of pledge is:- a**) a contract, b) the debtor c) undertakes to deliver d) a thing e) to his creditor f) as security for performance of an obligation**.

- **A) Pledge is a contract**:- (What is the source of pledge?)
- Contract of pledge is a contract. This is an important point as it shows that in our legal system, **the only source of pledge is contract.**
- In other words, unless there is a clear agreement between the parties with the purpose of creating pledge, there is no way for pledge to exist.
- It arises only from **express contract**, which has to fulfill certain requirements of law for its validity.
- (Illustration- Case 1 and 2)

Definition cont. ....

- The simple fact that certain property belonging to the debtor falls under the possession of the creditor by chance or for a different purpose does not entitle him to claim security right on the property even if he has lawful claim from the debtor. Because, pledge as a security, may arise only from contract pursuant to art 2825 of the civil code.
- The mere fact that there is preceding contract of pledge to secure the payment of specified loan does not automatically entitle the creditor to claim security right on the same property for the payment of another loan extended to the same debtor.

Definition cont. ....

- The creditor may be entitled to continue in the possession of the object as security for the second loan only **if they vary the existing contract of pledge before the due date of the 1st loan** or **if they conclude a new contract of pledge to secure** the payment of the second loan.
- In the absence of such arrangements the creditor is duty bound to return the property to the owner up on the discharge of secured obligation and cannot claim security/priority right for the payment of another debt in accordance with art 2845(1) and 2858(2) of the civil code which provide as follows:

Definition cont. ....

- Art 2845 Return of pledge

(1) The creditor shall return the pledge to the pledger to the person designated by him if the contract of pledge is extinguished by payment of the debt or for any other reason

- Art 2858(2)

(2) The pledge may not enforce his priority right arising out of the contract of pledge beyond the maximum amount specified therein.

Definition cont. ....

- The pledgee may not enforce his priority right to obtain security for another debt, even if incurred subsequently to the contract of pledge, owned to him by the debtor or pledger.
- In conclusion, a creditor enjoy a security right as a pledge only if there is a clear contract of pledge which entitles him to this right.
- Hence, the only source of pledge is contract unlike the case provisions of the law or judgment of courts or arbitral tribunals

Definition cont. ....

- b)…..**the debtor…..**(Who may deliver the object as a pledge? Who can be a pledger?)
- As per art 2825 of the civil code, it seems that the appropriate person to deliver the object is the debtor.
- However, from the fact of the real world as well as the provisions of the law, it is clear that the pledged property may be delivered by **either the debtor himself or a non-debtor 3rd party on behalf of the debtor**. (Case 3)
- Art 2826 – a contract of pledge may be made between the creditor and a third party to secure the debt of another person.
- In general, the point here is that it is not only the definitional article says, but also a third party may deliver the object and be considered as a pledger.

Definition cont. ....

c**) .....undertakes to deliver** ....

- From the reading of the above phrase in the definitional article, it is understandable that the basic obligation to be assumed by the pledger in the creation of the a contract of pledge is **undertaking to deliver rather than actual delivery**, that is for the contract of pledge to come in to existence.
- Undertaking by the pledger is sufficient.
- In other words, actual delivery of the object is not precondition to say that a valid contract of pledge has been concluded.

Definition cont. ....

- Actual delivery and immediate transfer of possession is not a requirement under the law. (Case 4)
- Art 2842- Action for possession

(1)The pledgee may bring actions for possession in respect of the pledge.

- **d) ....a thing .....(**What kind of object can be pledged?)
- Everything, that has an economic and financial value can be pledge because; the definitional article says that – a debtor undertakes to deliver a thing.

Definition cont. ....

- A thing refers to everything whether corporeal or incorporeal, movable or immovable, which can be appropriate and put into economic use.
- Hence, the word “thing” refers to at least movables and immovable.
- However, it is not much difficult to understand from other provisions in the law of pledge that it is only movable that can be given as pledge in our legal system.
- Here , it is also important to note that movables, is understood in its broad sense. That is it refers not to only movable objects but also to various forms of rights and claims on movables.

Definition cont. ....

- Please read Art 2829
- 1) The pledge may consist of a chattel, a totality of effects, a claim or on other right relating to movable property.
- 2) It must be capable of being sold separately by public auction.
- From the reading of the above article one may understand that pledge relates to either movable things themselves or claim and rights on movables.
- Another important point here is that the pledge of movable should be capable of being sold transferred by public auction.
- **For example** - objects/properties forming part of a public domain cannot be sold in any way.
-

Definition cont. ….

- In conclusion, it is not everything, which can be pledged, but only movable or rights and claims relating to movables w/c are capable of being sold separately.

e) …….to his creditor……. (Who may be the possessor of pledged property?

- In principle, the pledged property will be delivered to the pledgee - creditor and he is considered as a lawful possessor who can bring even possessory action to protect his possession (see Art 2842(1).
- However, in some exceptional situations the pledged property may be delivered to a 3rd party custodian who will keep the thing under his custody on behalf of the pledger and pledge- creditor.

Definition cont. ....

- Article 2931 – possession by an agreed 3rd party

1) The parties may agree that the pledge be delivered to a third party acceptable to them both.
2) The rights and duties of such 3rd party shall be prescribed by the provisions relating to the bailment of goods and warehousing.

- f) .....as a security for the performance of an obligation(the accessary nature of contract of pledge)
- The contract of pledge may be concluded and the property may be delivered to the creditor as a security for the performance of an obligation.

Definition cont. ….

- This phrase clearly shows that contract of pledge is accessory to some principal obligation which a creditor expects to be performed at a certain date in the future.
- In other words, the only purpose of pledge is to secure the performance of an obligation.
- Without the existence of any principal obligation, pledge may not be created for it does not have any other purpose except securing the performance of an obligation.
- **Note:-** When we say that primary obligation should exist it is not a requirement that the obligation should actually exist on the date of conclusion of the contract of pledge. It may be an obligation, which we are certain to exist in the future.

Definition cont. ....

- Art- 2827 debt guaranteed

  “A contract of pledge may be made in order to guarantee a future or conditional debt”.

- Moreover, pledge is accessary right not only because it presumes the existence of a primary obligation it secures but also it extinguishes if the primary obligation it secures is extinguished by any reason including performance (see art 2845(1) and 2849.
- In addition, the enforcement/execution of pledge is conditioned on the non- performance of the obligation it secures.

Definition cont. ….

- In our legal system, the definitional article (Art 2825) seems not to be comprehensive enough to give us a more general and sufficiently elaborative definition of pledge. Therefore, it is possible to get a better definition of pledge by reading provision like art 2825, 2826, 2031.

- **Consider the following definition/statement after reading the above articles.**

- ‘’Contract of pledge is a contract where by a debtor or a non- debtor third party undertakes to deliver a movable thing called pledge to his creditor or 3rd party custodians as the case may be in order to secure the performance of an obligation”.

2.2 Requirements for a valid creation of contract of pledge

- **1) Formality Requirements**- specification of maximum claim and written form
- Specification of maximum claims and written form are the requirements, which the law prescribes to be fulfilled in order for valid contract of pledge to exist.
- These are mandatory requirements to be fulfilled in order for valid contract of pledge.
- Clear specification of the obligation itself and maximum amount of the part of obligation is the 1st important and mandatory requirement ment here.

Requirements Cont. ...

- Close reading of Art 2828(1) shows whatever the value of the secured obligation may be whether the contract of pledge is made in the written form or not, as the case may be, the maximum amount of the debt guaranteed should be specified in the contract of pledge itself.
- What do you understand by the phrase *the maximum amount of the debt guaranteed?* Consider the following Case.

Requirements Cont. …

- Ato Bulcha approached Ato. Kolcha for the loan of birr 10,000. Ato Kolcha agreed to extend the loan but only if Ato. Bulcha can provide security for the payment of the loan after a year. Ato. Bulcha could not find any other property to offer as security except a golden ring worth birr 7000. Ato Kolcha then said any way give me the gold ring for the time being, I will give you the money, but you have to look for another additional security. Accordingly, they agreed and the loan was granted, the gold ring was delivered to the creditor.
- ***What amount of the debt do you think is guaranteed?***

Requirements Cont. ...

- Hence the question is what does the law want to be specified? Is it the max- value of obligation (10,000) or it is the amount of the debt guaranteed (birr 7000) what is important here is the max- of the amount guaranteed.
- Regarding the specification of the principal obligation itself, what is important is that the nature and the content of the obligation has to be clearly provided in order to meet the requirement that the object of a contract has to be clearly defined (Art 1714 of ECC)
- Therefore, in the contract of pledge what we expect to be specified for the contract to be valid is the nature, content and identity of the secured primary obligation and the maximum part of such primary obligation, which is secured by concluding the contract of pledge.

Requirements Cont. ...

- The second formality requirement is with written form
- Art 2828(2) provides/requires that the contract of pledge to be made in writing upon the max –amount guaranteed, exceeds 500 birr.
- Note that the amount referred here also is not the max mount of the claim of the creditor, but it is the maximum part of such claim which is guaranteed by pledge contract.
- This is important to ascertain whether the creditor is secured for his total claim or only some part of it.

Requirements Cont. ...

- Therefore, the contract of pledge has to be supported by a written document- Otherwise, the contract shall not be valid in the eyes of the law without fulfilling a form prescribed by law.
- Non- compliance with such requirement renders the contract a mere draft than full pledged contract in the words of 1720 of ECC.
- Moreover, remember that in cases where certain contract is required to be made in the form prescribed by law there are additional requirements and that the contract should be that there should be at least two witnesses (Art 1727 of the civil code)

Requirements Cont. ...

2) Transfer of possession

- Is other important requirement which has to be fulfilled in order for the security right (pledge) itself to be an enforceable right.
- The requirement for transfer of possession demands that the pledger has to be dispossessed of the pledge property.
- The debtor should relinquish the possession of the pledged property in to the hands of appropriate person, either the creditor or third party.
- Transfer of possession is made a requirement principally because of the nature of the thing subject to pledge i-e movable.

Requirements Cont. ...

- This is why whosoever is in possession of movable thing is presumed to be an owner and can transfer the thing as owner to a third party in good faith (a purchaser, a creditor etc…) (Refer property law)
- Therefore, once the contract of pledge is concluded the possession of the thing should not remain in the hands of the debtor. The thing has to be transferred to be creditor or custodian.
- Q-When should the debtor be dispossessed of the pledged property for the contract of pledge to be valid?
- Is it exactly on the date of the conclusion of the contract of pledge or can they post phone the transfer of possession for a certain day in the future? (Read art 2832, art 2852)

Requirements Cont. ...

- Under Art 2832, the law principally requiring the parties not to exclude the transfer of possession totally by stipulating that the pledge remain with the debtor.
- The possibility of the contract to be effective with no transfer of possession at all may be provided only by law.
- Consider art 2830 as an example of such law which provides exceptional circumstances where a contract of pledge may be effective even if there is no transfer of possession of the pledge.
- This is when the thing subject to pledge cannot be disposed without a document of title and such document of title has been delivered to the creditor.

Requirements Cont. ...

- The examples of such goods are goods on board ship, which will be evidenced by issuance of bill of lading, goods warehoused, which will be evidenced by issuance of voucher.
- In conclusion, the basic requirement of the law here is that the parties should not by their agreement, **exclude the transfer of possession.**
- However, the law does not prohibit the transfer of possession to be on certain day in the future after conclusion of the contract of pledge.
- As per art 2852(1) – the security right of the creditor will be effective, both against the pledger and the 3rd parties in generally only if it is under the possession of the creditor at the time he claims the enforcement of the contract of pledge.
- A creditor who does not have possession of the pledge cannot claim the enforcement of contract of pledge.

Requirements Cont. ...

- Hence, an important requirement for the creditor is to have possession of the pledge on the day he invokes the contract of pledge which is, in principle, either on or before due date of the secured obligation.
- Therefore, it is sufficient for the creditor if he can take possession at any time before due date.
- Actual delivery and transfer of possession on the date of conclusion of the contract of pledge is not a requirement (Remember definitional section)
- The law seems to advise the creditor to take possession as soon as possible for the effective protection of his security right.
- However, it is not mandatory requirement to take possession on the date of conclusion of the pledge contract.

Requirements Cont. ...

- What is the demerit of pledge Compered to other securities?
- Transfer of possession is that though it effectively protects the right of the creditor, this requirement seriously affects the right of the debtor as he cannot make use of the thing or exploit it in any manner as long as the thing is under possession of the creditor.
- Moreover, the creditor also cannot make use of pledge in any way w/c shows that this requirement takes the pledge property out of commercial transaction there by affecting its economic utility.

Requirements Cont. ...

- However, in our legal system in order to mitigate this undesired effect of transfer of possession, the creditors are advised to focus on movables which can be represented by documents.
- Secondly, the law has adopted mechanisms where by the debtor is entitled to exercise certain rights even if the thing is under possession of the pledgee.
- Such rights include re-pledging, disposing, releasing the pledge by paying even a premature debt etc... which will be discussed later on.

2.3 Rights and Duties of the Parties to the Contract of Pledge

- In as much as pledge is a contract, it gives rise to the right and duties for the parties.
- Inherent to the nature of contracts in generally the rights of one party is the duty for the other party of one and vice versa.
- The principal rights and duties of the parties emanating from the contract of pledge are the following.

Rights and Duties Cont. ….

- **1) Rights and duties of the pledger**

I- Right of the pledge**r**

a) Right to retain ownership(Art 2834)

b) Right to take back the thing by discharging the secured obligation at any time(Art 2837)

II- Duties of the pledger

a) Duty to deliver the thing

b) Duty to cover cost of preservation 2835

Rights and Duties Cont. ....

I- Right of the pledger

A) Right to Retain Ownership

- The right of the pledger under contract of pledge pertains to full right of ownership on the pledge.
- However, the security right of the creditor is an accessary right, which will be enforced only after the due date of secured obligation in case the debtor fails to perform it in the manner agreed.
- Hence, the law does not want to seriously restrict the right of ownership on the basis of necessary right.

Rights and Duties Cont. ….

- Accordingly the law clearly provides that the pledger retains right of ownership on the pledged property and can exercise this right of ownership in a way it does not affect the security right of the creditor.
- Art 2834 - Ownership of pledge.
- As per the above provision, the pledger retains full right of ownership on the pledge and can exercise certain rights in inherent to the right of ownership.
- The exercise of these rights may appear as practically difficult since the thing is under the possession of the creditor and subject to security right.

Rights and Duties Cont. ….

- Moreover, the debtor in the exercise of ownership can enter into another contract of pledge with respect to the same property to provide another creditor with security right. In other words, he can create several pledges in the same property.
- If any dispute arises between the creditors regarding, for example, the possession of the pledge the thing can be delivered to a 3rd party custodian in accordance with -Art-2831
- If the thing is sold to pay the debts of the creditors and the proceed is not sufficient of cover the claim of all the creditors, he who enters in to contract of pledge in the 1st place shall be paid 1st in accordance with art 2860 of ECC.

Rights and Duties Cont. ….

- **B Right to take back the thing by discharging the secured obligation at any time**
- Here, the debtor has an absolute right to claim the return of property by discharging the guaranteed debt.
- This right is absolute, as it cannot be restricted even by agreement.
- Article- 2837 premature payment of the debt.
- The above-discussed rights are principal rights. But still there are other rights & these are:-
- 1st The right to get back his property up on the discharge of the secured obligation- (Arts- 2845(1) and 2849)

Rights and Duties Cont. ....

- 2nd If the pledge is to be sold the debtor fails to perform the obligations, he (the pledger) has **the right to apply to the court for the restriction of sale to the part of the property** which can satisfy the claim of the creditor when the thing is divisible by its nature (e.g TV- 4000.00, Video Camera -5000.00, Cd player =8000.00) (Art 2855)
- 3rd Once the pledge is sold, **the pledger has a right to get any balance of the proceeds** after the secured creditor is paid **sufficiently**. Accordingly, the balance of the proceeds, should be handed over to the owner of the thing (Art 2859(2))

Rights and Duties Cont. ….

II. Duties of the pledger

- **A) Duty to deliver the thing**
- As discussed earlier, the possession of the thing has to be transferred **either to the creditor or to a 3rd party custodian** one way or the other it is the duty of the pledger to deliver the thing and transfer of possession of the thing to the appropriate person.
- This dispossession of the pledger is necessary for the effective protection of security right of the creditor.

Rights and Duties Cont. ….

- **B) Duty to cover cost of preservation**
- When considered in general terms, both the pledger and pledger have interest in the preservation of the thing.
- On the part of the pledger he is the owner of the thing and it the thing sustains any damage the harm is to the owner.
- On the part of the pledgee, the strength of his security right depends on the value of the thing. Whenever the thing deteriorates and loses value as such it reduces, the security right of the creditor.
- Therefore, **both parties are interested in the preservation of the thing and they have to take part in the preservation of the thing.**

Rights and Duties Cont. ....

- The creditor is expected to preserve the thing even by **incurring expenses** if necessary.
- However, the pledger **shall reimburse** the pledgee for the cost of preservation since the duty to preserve a thing actually **the duty of the owner of the thing**. (Read Art 2835)
- Q- What if the creditor fails to preserve the thing in the way he is expected to preserve it?
- Obviously the pledger can demand the pledge to be delivered to a 3rd party who may preserve the thing in a better way.
- Again is the right of the debtor to demand the thing to be delivered to 3rd party in case the pledger abuses his right. i.e. fails to preserve the thing although he is legally entitled to the possession of the thing. (See Art 2836 of ECC)

Rights and Duties Cont. ....

2) Rights and Duties of the Pledgee

- The contract of pledge is principally for the benefit of the pledgee.
- Hence, the pledge drives, from the contract of pledge, various rights together with certain duties.
- **I. Rights of the pledgee**
- **A) Rights to possess the pledged property**
- It is the right of the creditor to take possession and retain the pledge under his control until the debt is paid.
- The creditor is considered as the lawful possessor of the pledge and can bring even possessory action to protect his possession.
- (Refer Art 1148 and 1149 on law of property or even in law of pledge Art 2842 of the civil code).

Rights and Duties Cont. ....

- The pledgee is entitled to a possession even if the right does not belong to the pledger.
- As long as the pledgee concluded the contracts of pledge with the pledger in good faith or innocently and take possession of the thing even if the thing has a real owner different from the pledgee.
- He can enjoy his security right as if the pledger is the owner of the thing.
- (Read Article 2843, 2844 and Art 1193)

- Case 9 – Nega vs Teka
- <u>Solution to the owner</u>:- bad faith, subrogation, proceeding against the debtor

Rights and Duties Cont. ....

- **B) The Right to Collect Fruit**
- If the pledged property by its nature produces fruit, the law entitles, the creditor to the right of ownership of on the fruit. (e.g. think of a cow given as pledge and its milk to be collected daily) – Read Art 2841(1)
- However, the pledgee is entitled to the ownership of the fruit not free.
- The values of the fruits he collected will be used to settle the claims of the creditor w/c includes,

- the cost of custody and preservation of the pledge,
- the interest if the debt is interest bearing (contractual or legal),
- and lastly the capital of the principal debt itself.

- Case 10 Hashim vs Kasim.

Rights and Duties Cont. ....

- C) Right to be Paid first (priority right)
- This is the principal right which is a real expression of security right.
- This right of priority exempts the secured creditor from competition with other creditors who claim payment from the same debtor.
- What is the right of priority then?
- It is the right to be paid first from the proceeds of sale of a pledge. (Read Case 11 – Read Art 2857 Art 2858)
- Regarding payment of unsecured claims, the creditor will have right with other creditor pursuant to art 2839 (1) of ECC.

Rights and Duties Cont. ....

- **<u>II. Duties of the Pledgee</u>**

A)The duty to preserve the thing

- Because of his right to possess the thing, the pledge will be under physical control of the pledgee unless the thing is put under the custody of a third party in an exceptional situation the pledgee is in a better condition (position) to check the state of the pledge property.

- That is why the law provides that the duty to preserve the pledged property is the duty of the pledgee although he is entitled to the reimbursement for the cost of preservation by the pledger.

- Art -2835 – cost of maintaining and preserving the pledge
- Art 2845- return of pledge
- Art 2847- loss or deterioration of the pledge

Rights and Duties Cont. ….

- In conclusion, the pledgee is assimilated to **a bailer** in discharging the duty to preserve the pledge.
- Art 2720- Loss or deterioration of the chattel
- Art 2721- Limits of liability.
- Q – What if the pledgee fails to preserve the thing in the way he is required by law?
- If the thing sustained actual damage (deterioration or loss of Value) because of the failure by the pledgee to make a reasonable preservation, it amounts to breach of legal duty which may be considered as commission of fault.

Rights and Duties Cont. ....

- Moreover, if the pledgee fails to preserve the thing while the thing is under his possession, it may be considered as abuse of right to possess and the pledger may demand the pledge to be given to trustee (Art 2836 of ECC)

B. The duty not to use the thing

- Although the pledgee is entitled to the possession of thing as well as collection of the fruit, he is not as of right entitled to use the thing.
- Its possession doesn’t give rise to the right to use the thing.
- He may be entitled to use the thing only under two exceptional circumstances.

Rights and Duties Cont. ....

- Art 2840 use of the thing
- In principle, the pledgee is not entitled to make use of the thing. (The protect abuse of right)

•However, the pledgee may use the thing under two circumstances.

1. With full consent of the pledger
2. If making of the thing is necessary for its preservation.

•An important example may be things with special quality, the quality which may be lost unless practiced regularly –specific examples- Animals like Horses, Oxen.

Rights and Duties Cont. ….

C. The duty to return the thing up in the extinction of the secured obligation

- The right of the creditor up on the pledged property is the right to possess the thing until the secured obligation is discharged.
- Once the secured obligation is discharged, there is no reason why the creditor may retain the possession of the thing.
- The discharging of the secured obligation results in the extinction of pledge and the pledger can exercise his full ownership without any restriction.
- This duty of the pledgee to return the pledge to return the pledge can be understood from Arts- 2845 (1) and 2849 of ECC.

2.4 Execution of Pledge- Sale of Pledge

- Sale of pledge is the means **to the execution of the security right of the pledgee**.
- Hence, the execution of a pledge takes place through **the sale of the pledged prope**rty after **ascertaining that the debtor has failed to discharge the secured obligation.**
- Like the preservation of the thing, both the **pledger and pledgee have interest** to be protected during the **process of sale of pledge.**

Execution of Pledge Cont. …

- Regarding the interest of the pledgee, the extent to which he is given priority depends on the **amount of proceeds collected from the sale of the pledge**.
- If the proceeds from the sale the pledge are not sufficient to cover the payment of his claims, he **will be ordinary creditor**.
- On the other hand, the pledger is also interested in the process of sale since he is entitled, **as an owner**, to **the balance remaining** after setting the claims of the security of the creditor
- Therefore, the process of sale of pledge should be as **reasonable and fair possible** to strike the balance of the two interests.

Execution of Pledge Cont. …

Rules and procedures to make sale of pledge

- **1. In cases of ordinary creditors- General**
- The principal provisions of law intended to serve the above stated purpose of balancing interests of parties are- Art 2851, 2852, 2853/54/55/56 ECC (The concept of Judicial foreclosure enumerated here)
- An overall consideration of these provisions shows that **the law principally aims at protecting the pledger**.
- The reason is that from the very beginning the debtor or pledger is in a disadvantaged position.

Execution of Pledge Cont. …

- At the time of sale of pledge, the thing is under the possession of the pledgee and the pledger may not be such interested in looking the maximum possible price of the thing.
- The pledgee may simple focus on satisfying his claim turning blind eyes to the interest of the pledger in getting that not possible price of the thing.
- The strong interest of the pledger deserving protection by law is plain, specially where the value of the thing is greater than the secured obligation

Execution of Pledge Cont. …

- Accordingly, in the above-enumerated provisions, the law fixes certain rule and procedures, which the pledgee has to comply with while processing the sale of pledged property.
- 1st The pledgee is not entitled to undertake a private sale of the thing; he cannot even under contract of pledge, demand the debtor to give him the power to immediately sell the thing on private sale when the debtor fails to discharge his obligation. Such agreement b/n the pledger and pledge is possible only after the due date of the obligation.
- 2nd The pledgee can apply to the court for the sale of only if it is under his possession of at the time he applies for the sale of the thing.

Execution of Pledge Cont. …

- 3rd- he has to ascertain, by giving default notice that the debtor has failed to discharged his obligation.
- 4th He can cause the sale of pledge only by court order or through a neutral 3rd part in case the thing has price quoted on market (በእለት ገበያ የተወሰነ ዋጋ)
- 5th -He may be required to restrict the sale of the pledge only to the part of the pledge which can sufficiently satisfy his claim.
- 6th-He has to hand over to the pledger any amount of proceeds in excess of his secured claim.

Execution of Pledge Cont. …

- If the pledgee breaches any of these rules and procedures, the enforcement of security right may not be valid and the pledger can being action against the pledgee for any damage he sustained
- The pledgee is required to observe that above rules and procedures because of the fact that our civil code adopted, under the above-enumerated articles, the concept of judicial Foreclosure.
- Judicial foreclosure – is the type of foreclosure where by the pledger is entitled to enforce his security right only by court order and under the supervision of the court. This type of foreclosure tries to balance the interest both the pledgee and the pledger

Execution of Pledge Cont. …

- **2) In cases where the creditor is a bank** – special protection
- There is a special law which regulates the execution of security rights. This special law is proclamation No 97/1998, a proclamation which is issued to provide for properties mortgage or pledged with banks.
- An important points introduced in to the Ethiopia law of securities by this proclamation the concept of the power of sale foreclosure.
- The power of sale foreclosure is the concept where by the creditor and the debtor are legally entitled to conclude an agreement which entitles the creditor to acquire ownership of the property or sale the property privately without a need to apply to the court to secure an order for sale foreclosure.

Execution of Pledge Cont. …

- Hence, creditor banks are entitled to a special protection whereby they are relieved from court procedure.
- Creditor banks are given this special protection because of the practical problems they are facing in the enforcement of securities
- The special protection of banks is further justified by the practical situation in our courts where enforcement of securities may be delayed for a number of years for various reasons.
- Therefore, banks are legally free from the rules and procedures, which require creditors to apply to courts for the enforcement of securities.

Execution of Pledge Cont. …

- However, with regards to the right of debtor, the creditor bank is responsible for any damage caused to the debtor if the debtor can show that the creditor bank sold the property for unreasonable lower price which affects the interest of the debtor.
- Note - Globally there are various foreclosure procedures

1) Strict foreclosure
2) Power of sale foreclosure
3) Judicial foreclosure

<u>Assignment:</u> Discuss about various foreclosure procedures under the foreign and Ethiopian context. Identify their differences and similarities.

CHAPTER THREE (3)
Mortgage (Security on immovable)

- **3.1 Definition, Subject matter and Essential Features of Mortgage**
- **<u>Definition</u>**
- The definition of mortgage, its nature and purpose as well as the essential preconditions, for its formation are all affected by the understanding of the society at different level of development of legal systems.

Definition cont. ....

- For example:- in the early Roman law hypothec security (in old times equivalent to security over property, and through passage of time used as substitute term for mortgage) is known in generally terms without making any difference between **security on movables and security on immovable.**
- However later on in the major legal systems of the world i.e. **civil law and common law**, fundamental distinction b/n securities on movables and immovable regarding their importance and effects are developed.

Definition cont. ....

- Even the understanding of scholars varies at different stage of the development of jurisprudence.
- In Black's law dictionary- it is provided that mortgage is a **conveyance of title to property** that is given as **security for the payment of debt** or the **performance of a duty** that will become void up on payment or performance according to the stipulated terms.

Definition cont. ....

- 1st – mortgage is principally the **conveyance(delivery) of title to property given as a security**. (Temporary delivery of title to the creditor)
- 2nd – Mortgage extinguishes **up on payment or performance of the obligation** (shows one of the accessory features of mortgage)

Definition cont. ....

- To consider one more definition Marcel Planiol in his comment on the French civil code provides that:-

  "Mortgage is **real security** which **without presently dispossessing the owner of the property** hypothecated, permits the creditor at the due date to take it over and have sold, in whosoever it is found and to get paid from the proceeds by reference to the other creditors".

Definition cont. ....

- **<u>Points from the above definition</u>**
- 1. Mortgage is **real property** i.e. the right that creates relations b/n a person's(creditor) and a thing (the property given as security) and the right that can be enforced against everybody in the world.
- 2. the phrase ------ without presently dispossessing the owner of the property – means that the creation of mortgage does not result in dispossessing the debtor thereby allowing him to use, enjoy, administer or do anything he wants to do with his property.

Definition cont. ....

- 3. The phrase --- **permits the creditor at the date to take it over and have it sold**------ indicates that mortgage by its nature entitles the creditor to exercise his security right only if the debtor fails to perform his obligation at the due date. Hence, before due date mortgage is not enforceable.
- 4. The definition provides the principal rights of the mortgage creditor.
- These are – the right to follow the property and satisfy his claim in whosever hand the property may be found (the right of pursuit), the right to be paid (to satisfy his claim) from the proceeds of the sale of the property in priority to other creditors (the right of preference).
- Regarding the definition of mortgage in our legal system, <u>there is no any provision dedicated to the definition of mortgage</u>.

Subject matter of mortgage

- What can be subjected to mortgage?
- History shows that at the early stage of development of the concept itself, **mortgage could be created for any form of property whether immovable or movable**.
- However, through an in reasoning development of the essential difference b/n pledge and mortgage as real securities and the distinction b/n movables and immovable, **mortgage is created principally against immovable in the present days.**
- Our law also provides that mortgage **principally charges immovable together with its intrinsic elements and accessories.**

Subject Matter Cont. ....

- However, our law also provides some **exceptional situations** where **special type of movables may be mortgaged**
- Read **Art 3047(2)** of the ECC together with **Art 171 & ffg** of Ethiopian commercial code.
- the law provides that **business**, w/c is **special type of movable and subject to registrations** can be mortgaged.

The Essential Characteristics of mortgage

- The essential features to be discussed in this section are those w/c may help in making distinction b/n mortgage and other real right or right in rem(those rights w/c create relations b/n person and a thing.
- The principal characteristics of mortgage are:-
- **A) It is a real right**
- It entitles the mortgagee creditor to exercise his security right against the property wherever the property may be.
- The following quotation from an article written by Montego- may explain this nature of mortgage in a better manner.

The Essential Characteristics Cont. ..

- “[Mortgage] is called **‘real**’ become it consist of **direct and immediate power over property or real estate.** Unless the property belongs to a 3rd party, the right holder can make its power effective regardless of the person-holding it. It is real because it falls upon real property; which as any real right of guarantee, secures the fulfillment of an obligation through the concession of direct and immediate power over some one’s property”.
- Hence, while enforcing his right as a mortgagee **the creditor proceeds against the property encumbered with the right of mortgage not against anybody.**

The Essential Characteristics Cont. ..

- **2) It is created against immovable.** (Refer the subject matter of mortgage.)
- In fact, in our law also it is provided that mortgage principal charges immovable together with its intrinsic elements.
- However, some exceptional situations where special type of movable may be mortgaged are not excluded in our legal system.
- Read Art 3047 of ECC and Art 171 of E. commercial code.

The Essential Characteristics Cont. ..

- **3) It is accessory to the principal obligation.**
- Mortgage is one of the accessory right as it can not exist or can’t be enforced in the absence of the principal right/obligation the performance of w/c it secures.
- Generally, mortgage is created as an alternative remedy for the creditor in case the debtor fails to perform the principal obligation.
- As provided by M Planiol- the Mortgage being the simple guarantee of a creditor, follows the fate of the latter and cannot subsist without it.

The Essential Characteristics Cont. ..

- The existence of mortgage implies **the existence of a creditor, whom it secures.**
- The existence of mortgage or any accessary right presupposes **another principal right** without which an accessory right **cannot exist or could not be necessary**.
- The most important point is that the creation of **accessary rights**, especially **mortgage doesn't result in dispossession of the debtor or prevention of the debtor from using, enjoying and managing his mortgaged property.**

The Essential Characteristics Cont. ..

- Under the Ethiopian law of mortgage that deals with the extinction of mortgage, it is possible to see that **the existence of mortgage depends on the existence of the principal claim.**
- The cumulative reading of Art 3109(1) and 3110(a) of the civil code shows that registration of mortgage and protection of the creditor as such exists only as far as the claim exists.

Article 3109- principle-

a mortgage is extinguished if the registration of the mortgage is cancelled in the registers of immovable property.

The Essential Characteristics Cont. ..

- Article 3110 grounds for cancellation.
- Any interested party may require the registration to be cancelled where:-

a) the claim secured by the mortgage is extinguished;

- In other words, if the claim for the security of which the mortgage is created extinguished for any reason.

(a) Then the extinction of the principal obligation guaranteed by mortgage is a sufficient cause for cancellation for mortgage w/c in turn, results in extinction of mortgage

- Read Article 3084 and 3088 of ECC

The Essential Characteristics Cont. ..

- The accessary nature of mortgage is recognized in other legal systems.
- In French law, a similar idea and in English law an understanding w/c is not very much d/t from the idea discussed above prevails
- ‘’The accessary character of the hypothec (a Spanish word equivalent to mortgage) is also society maintained in French law’’ as provided by M, Planiol.
- In English law also equivalent understanding exists where **lien and charges** (substitute terms for mortgage) are considered as a mere shadow. So to speak, Cast by the debt upon the property of the debtor.

The Essential Characteristics Cont. ..

- **4- . Indivisibility of mortgage**
- Almost all securities by their nature, are indivisible.
- Indivisibility is reflected in two principal ways.
- 1st – Even if the debtor pays a portion of the claim. He is not entitled, as of right, to claim proportional reduction of the value of mortgage.
- The unpaid part of the claim shall be secured by the total value of the original mortgage.
- Therefore, even if the claim may be discharged in divided form, mortgage continues as undivided until the claim is paid in full.

The Essential Characteristics Cont. ..

- The 2nd reflection of indivisibility is that for various reasons in immovable subject to mortgage may be divided, for examples, among heirs.
- However, the mortgage over the divided immovable continues as un divided.
- That is the mortgage continues to apply in its undivided form to each part of the divided immovable - each part will be encumbered with the total value of mortgage for the payment of the total claim.
- The provisions of the Ethiopian civil code under Art 3055 and Art 3087 are relevant in this case.

The Essential Characteristics Cont. ..

- Art- 3055(1) where the debtor has discharged ¼ of the debt, he may apply for the entry in the register to be corrected accordingly

2. The creditor shall give his consent to the correction.

3. The fact that part of the debt has been discharged does not enable the debtor to require that part of the immovable mortgaged to be released.

- Art 3087 – (1) A mortgage is indivisible

(1) Where part of the immovable mortgage is alienated or such immovable is divided, each part shall secure the full payment of the debt.

The Essential Characteristics Cont. ..

- The former article (3055) provides that if the debtor discharge ¼ of the secured claim, he can claim the correction of the registration regarding the reduction of the amount of the principal claim secured.
- i.e he doesn’t have the right to claim the release of the immovable in proportion to the reduced amount of principal claim.
- The later provision clearly states that if the mortgaged property is divided for what so ever reason, the mortgage shall continue to apply on each part as divided.
- Therefore, the indivisibility of mortgage is irrespective of the payment of the claim party or division of the property.

3.2 Importance of the mortgage

- What makes mortgage preferable to other forms of securities?
- Mortgage has been recognized as **the most effective and economic type of security** for various reason.
- As affirmed by Planiol: Of all the securities w/c have been invented in favor of creditors, **perfect is certainly the mortgage.**

Importance Cont. ...

- In the 1st place, like **all other real rights**, it entitles the creditor **to proceed against property** in case the debtor fails to pay the claim.
- Mortgage provides **perfect protection** not only because his right is **against property**, **but also he can proceed against the property in whosoever hand it may be.**
- The 2nd importance of mortgage is that it does not, in any way, **result in dispossession of the debtor**. In other words, it does not affect the power of the debtor to possess, use, collect fruit, improve, manage, create rights for others or even dispose the property.

Importance Cont. …

- Therefore, it is possible to conclude that mortgage **not only secures the creditor in a better and effective manner but also allows economic utilization of the property** as the debtor is entitled to continue in the **possession, use, enjoyment or generally reasonable exploitation of the thing in** the manner he thinks fit.
- The above stated importance of mortgage has been recognized in our law as it can be understood from the cumulative readings of **Art 3059, 3081 ,3084 and 3088 of the ECC.**

3.3 The Essential requirements for the creation and enforcement of mortgage

- **1) Written form**- One of the most important manner or order to be observed **in constructing legal documents** is obviously, **making the document in writing.**
- This is the **principal form** to be fulfilled by various legal documents as prescribed by law.

Written form cont. ....

- **The reasons are:-**

1) The written form clearly shows the **intention of the parties to be arises** b/n the parties during the course of their relation.
2) In case **any dispute arises between the parties** during their relation, **it will be easily to prove the terms and contents of their relations** only if they have a written document which can serve as evidence.

Written form cont. ....

- 3) T**he huge capital or money which it guarantees and the nature of property** (immovable w/c has multifaceted economic value) it affects.
- Therefore, because of the above stated and other importance various laws prescribe certain relations to be governed by written form documents.

Written form cont. ....

- In our laws Art 3045(1) of the civil code provides that **mortgage shall have a legal effect on if its creation makes the relation legally ineffective as the failure to observe a form prescribed by law results in the in effectiveness of the relation.**
- (Remember the discussion on contracts in general, regarding the effect of failure to observe two form prescribed by law).

2) Registration

- In most legal systems, **starting even from the Roman time**, registration is considered as one of the pre-conditions for **the existence of the right itself**.
- All the same whatever, its status may be, **registration guarantees two principal rights** in the security of the creditor.
- **1st The right in priority in payment.**
- **2nd The right to follow the mortgage immovable in the hands of 3rd parties who acquire the thing subsequent to registration of mortgage.**

Registration Cont. ...

- The above two rights secured by registration are often referred to as **the right of preference and the right of pursuit** respectively.
- Registration also serves **the purpose of publicity.**
- By registration, 3rd parties will be able to know **what kind of effective rights they can have on the thing** and **who can create these rights lawfully on the concerned property**.
- Coming to our laws, **registration is one of the essential preconditions for the valid existence and effectiveness of mortgage**.

Registration Cont. ...

- As per Art 3052, mortgage starts to be **effective only as of the date of registration.**
- Moreover, the elements of the security right of creditors as discussed above(Right of preference and right of pursuit) are also clearly recognized in our law.
- The cumulative reading of **Art 3057, 3059(1) and (2) 3081 and 3085, 3089,** of the civil code shows that **the creditor who registers his right of mortgage dully will be given priority.** Such a creditor is also **entitled to attach the thing in the hands of every 3rd party** while enforcing his security right.
- In other words, **his priority right applies against other creditors as well as all 3rd parties whose right is registered after the registration of mortgage.**

3) Ownership

- The debtor (mortgager) is required to be, **the full owner of the immovable against w/c is creating mortgage**. It demands to be an owner of the immovable in order to **create mortgage lawfully.**
- The basic reason for this requirement is that eventually **the enforcement of mortgage entitles the transfer of ownership to 3rd party** in order for the creditors to satisfy his claim from the proceeds of the sale.
- ***The creditor must be careful in checking whether the person who after him a mortgage guaranty is really the owner**.

Ownership cont. ….

- Close reading of **Arts. 3049 and 3050** of the civil code clearly indicate that **unless the person is the owner who is entitled to dispose the thing at the time of creation of mortgage the mortgage cannot be valid and enforced as such.**
- Here one may raise a question what if the debtors has the right of ownership but it is common ownership like b/n spouses or what if the debtor is given the power of attorney to dispose the thing but not to mortgage it?
- This issue is solved by various special laws.

Ownership cont. ....

- *Consider Arts 68 and 69 of revised family code w/c requires consent of both spouses for the creation of valid mortgage even if the property is registered in the name of one of the spouses.
- Also consider Art 2205(2) of the civil code in the law of agency w/c requires a special agency for an agent to create valid mortgage on the property of the principal.
- Anyway, our law is so strict regarding ownership that even is the debtor (mortgager) acquires full right of ownership on the thing mortgaged after creating the mortgage, it does validate the mortgage
- (Do exercise 14 and 15 on page 209 on a teaching material)

4) **Specification of maximum claim secured by the mortgage**

- The maximum claim secured by mortgage has to be clearly specified in the document (**contract creating mortgage**) – This has two purposes.

  1. **It informs 3rd party to know the maximum value of encumbrances on the thing**.

  2. **It enables the debtor to create another mortgage on the same immovable** in order to **take additional loan from other creditors also**.

Specification cont. …

- To make it clearer in the words of **Montego** in his article referred above.

----- When the mortgage is issued the value of the property must be established in a definite way. Thus, any interested person will know, easily, safely, and at any time, the maximum value of the obligation. Besides, it will be guaranteed that the owner is entitled to transfer the property or acquire new resource through the imposition of other minor mortgages".

- As provided under Art 3045(1), the requirement of specification has been recognized under our law as **one of mandatory pre- conditions the non- fulfillment of which makes the mortgage invalid.**

3.4 Types of mortgage

- Based on its source, mortgage may be divided in to **three principal types**. These are:-
- 1) **Legal mortgage** - where the source of mortgage is **provisions of law**.
- 2) **Judicial mortgage**- arises from the **decisions of the courts**; and
- 3) **Contractual mortgage**- where mortgage is created by **lawful agreement between the mortgager the mortgagee**.

Types of mortgage cont. ...

- **1) Legal Mortgage**:- is the case mortgage rights for certain creditors arise from the provision of the law itself without any agreement between the creditor and debtor.
- In cases of legal mortgage, the purpose of the law is **to provide special protection to certain creditors**.
- **For example** an owner who sales immovable is entitled to **legal mortgage** on the immovable he has sold as for as he is **not paid the full price of property.** This is because, he is transferring to the buyer full right of ownership once and for all. Art 3042 and 3043
- Co-heirs also have the same protection since they are entitled to legal mortgage against immovable put in the share of another co-partitioner.

Types of mortgage cont. ...

- **2) Judicial mortgage:-** is the case where the right of mortgage for the creditor is provided by decision making organ, principal court or administrative tribunal.
- In the case of Judicial mortgage, the purpose of the law seems to be ensuring the better **enforcement of decisions** rendered by courts or various arbitrative tribunals.
- The law clearly states that courts or administration tribunals may ensure the execution of the decision or awards by creating judicial mortgage against one or more of the immovable belonging to the judgment - debtor (Art 3044 of ECC)

Types of mortgage cont. ...

- **3) Contractual mortgage**
- Contractual mortgage arises from clear or express agreement between the mortgager and mortgagee by fulfilling all the requirements as discussed under section 3.3.
- *Lastly, an important point which worth mentioning is that whatever its type may be, mortgage can have a **legal effect only it is duly registered**.(Art 3052)
- Therefore, the requirements of registration apply to all types of mortgages.

3.5 Effects of Mortgage

- Like any **contractual** relations, the creation of mortgage **results in rights and duties for the parties** to the contract of mortgage.
- It will have a **legally binding effect on the parties** if it is created by **fulfilling the requirements of the law.**
- It may even affect the interest of 3rd parties in certain circumstances, (3rd parties in the operation of mortgage system.

Effects of Mortgage cont. ….

- **1) The relation between the parties to mortgage**
- Our discussions in this sections focuses on contractual mortgage as it is the most prevalent type of mortgage, even the provisions of the civil code on mortgage principal deal with the case of contractual mortgage.
- **I) The rights of the creditor (mortgagee)**
- The creditor derives two principal rights
- 1st **The right to be paid from the proceeds of the sale of property**, **in priority to any other creditor-** This right is referred as the right of **preference or priority in payment**.

Effects of Mortgage cont….

- 2nd the right to follow the property in the hands of 3rd parties whose right is registration of the mortgage. This right is referred to as the **right of pursuit**.

•The above stated principal rights of the creditors are provided under Art 3059 of ECC.

A)<u>The right to be paid first (priority right)</u>

•The priority right of the creditor is reflected in two principal ways. These are:-

- The extent of priority-(what are the claims covered by the priority?

Effects of Mortgage cont….

- The property to which the priority right applies (the **principal immovable**, it is **intrinsic elements** and **accessories**, **improvements**, and **various compensations** which may be paid in the event of loss of immovable etc …).
- Obviously, The 1st claim which the creditor can demand to be paid in priority to other creditors is the **principal claim** (Art 3076), 2nd **contractual interest** to be calculated on the principal claim (Art 3077(1), However, since interest is accessory claim to principal claim, the right of other creditors should not be prejudiced by the priority of secured creditor.

Effects of Mortgage cont….

- Hence, the law **limits preferential payment of interest to the amount of interest calculated for the time not exceeding two years** (Art 3077)(2) and (3)
- As a result, if there is an interest that has been calculated in excess of 2 years' time, **then as regards the payment of such interests the creditor will assume the position of ordinary creditor**.
- 3rd - **Necessary expenses** incurred for the preservation of the immovable and **insurance premiums** due by the debtor (Art 3078).
- If the immovable is insured, then creditor's security right extends to the **compensation paid in case the immovable lost because of the materialization of insured risk** (Art 3069 of ECC and Art 684 of E Commercial code)

Effects of Mortgage cont….

- Another aspect of priority right is the property to which the priority right applies/extends.
- 1st – The priority right of the creditor applies to the **immovable itself**. The immovable obviously includes **the intrinsic elements** from w/c the immovable is made some objects, which may be fixed to the immovable **as accessories**. However, the mortgage may transfer some of the intrinsic elements or accessories to 3rd parties separately from the immovable itself (Art 3065).
- In accordance with above legal provision, the creditor **cannot follow the intrinsic elements or the accessories in the hands of 3rd party**.

Effects of Mortgage cont….

- This is because the intrinsic elements and the accessories, when independently considered, **are principal movable** and anybody **who acquires movables in good faith** is entitled to legal protection as such.
- However, the transfer of intrinsic elements or accessories separately from the immovable obviously **reduces the value of the immovable** and this in turn affects the security right of the mortgagee.
- Hence, the law provides **alternative remedy**, the remedy is that the creditor demands **the debtor to provide another property** which can replace the intrinsic elements or accessories transferred 3rd parties.

Effects of Mortgage cont….

- If the debtor cannot provide such property, the creditor has the right to demand **immediate performance of the parts of the principal claim** which turn out to be unsecured because of the reduction in the value of the mortgaged immovable which resulted from the transfer of intrinsic elements or accessories (Read Art 3065 and 3073-3075.
- On top of the immovable, its intrinsic elements and accessories, the law considers the priority right as **extending to improvements** that may be made to the mortgage e.g building additional rooms on mortgaged property (Art 3066).
- Another property to which the security right extends is **the rent which may be collected from the mortgaged immovable**(Art 3068).

Effects of Mortgage cont….

- This is applicable, **once the due date of the secured obligation arrives**, **the debtor fails to pay it to the creditor**, **any rent collected after the attachment of the immovable** forms a part of the property to which the property extends and, hence the creditor will have priority right on such rents too.
- The last important point regarding the priority right of the creditor applies even **against other creditors** who claim security right on the same immovable.
- But, in case all the competing creditors are secured creditors, **the priority right shall be enforced on the basis of the date of registration**. (Art 3081-3083 provide applicable rules).

Effects of Mortgage cont….

- **B) The right to follow the property**
- This right is sometimes referred to as **the right of pursuit** (Art 3089).
- Mortgage is **a real right** in the sense that the security right of the creditor is **against the mortgaged immovable** and he can apply for the enforcement of his security even if the immovable is in the hands of 3rd party who acquired it after the registration of mortgage.

Effects of Mortgage cont….

- **<u>II- The right of the debtor (Mortgager) on the property after the creation of mortgage</u>**

- 1) The debtor continues **to possess and exercise his right of ownership on the thing** (since mortgage is accessory and no transfer of possession). This allows the debtor **to exploit his property in a manner he thinks fit** even after giving it as a mortgage.
- 2) It enables the debtor to create another **additional mortgage** or other **real right** on the property as far as its value can be sustained.
- 3) Among others, the debtor is **entitled to create or enjoy all possible rights on the mortgaged immovable**. (As provided under Art 3084-3088)

Effects of Mortgage cont…..

- **III- The place of 3rd parties in the mortgage relation**

- Here, the question is that what is the fate of the 3rd party who acquires rights in rem(ownership, servitude, usufruct etc.) subsequent to the registration of mortgage or the 3rd party who mortgages his property for the debt of another person?
- 1st – with regards to the **buyer of mortgaged immovable**, it is the duty of this 3rd party before entering in to contract of sale, **to check what rights have been already created and registered on the immovable.**
- The legal remedies for such 3rd party stipulated under Art 3090, 3091, 3093, 3094, 3085 and 3097.

Effects of Mortgage cont….

- **Remedy 1** :- As per Art 3090- The 3rd party assumes the position of the **guarantor and then makes use of any rights or defenses available for a guarantor.**
- Art 3090 refers Art 1920 and the ffg of the C. code i.e defenses for the guarantor
- Defenses that can be raised by the buyer
- 1. If the primary obligation is invalid owing to the incapacity or mistake on the part of the debtor (Art 1923) and where
- 2. Primary obligation has been extinguished for what so ever reason- Art 1926(1)

Effects of Mortgage cont….

- 3. Primary obligation has been extinguished through substituted performance (Art 1927)
- 4. The primary obligation has been varied or date of its payment has been extended (Art 1928).
- Moreover, the 3rd party buyer can demand the mortgagee **to proceed against other assets of the debtor** if he fulfills the following pre-conditions cumulatively,
- a) He has to raise this defense prior to the debtors declaration of banking other assets of the debtors w/c are free from any litigation and possible to be attached (Art 1936(2))

Effects of Mortgage cont….

- b) He has to advance sufficient money to proceed against the assets or properties of the debtor (Art 1936(1).
- c) The 3rd party demand also the mortgagee to proceed against the debtor within 6 weeks where the primary obligation has fallen due (Art 1938)
- Then, if the creditor fails to proceed against the indicated assets or against the debtor himself as indicated above, its seems possible that the 3rd party can invoke- Art 1937 and 1938(2) to relive himself of an obligation to surrender the immovable to the secured creditor mortgagee.

Effects of Mortgage cont….

- Generally, the law consider the buyer of immovable as a guarantor who can raise all possible defenses and defend himself action brought by the creditor who claims to have security right on the immovable.
- A very serious challenge against this protection of the 3rd party buyer is that it changes the real right of the creditor to the personal right as the creditor is going to face all the defenses.

Effects of Mortgage cont….

- **2nd Remedy Art 3093**
- Here the idea is that if the 3rd part cannot avail himself of Art 3090 then the creditor (mortgagee) has the right to follow the property in the hands of 3rd party.
- -Assuming that the immovable has been attached and sold in the hands of 3rd party buyer, the 3rd party has the right to claim compensation from the proceeds of the sale, for the improvements that he has made on the immovable.
- He also a right to become the owner of fruits that he has collected of the immovable in his hands (Art 3093).

Effects of Mortgage cont….

- Moreover, the 3rd party is not liable for any loss or deterioration of the immovable unless the loss is because of his own fault or negligence and unless the loss occurs after he has been informed that a proceeding has been instated for the attachment of the immovable.
- The other possible remedy of the 3rd party is the right to bring action for warranty against the debtor. Hence, this is a right to demand security from the debtor that the 3rd party will not be dispossessed of the immovable.
- If the 3rd party is dispossessed, he has the right to be subrogate to the right of creditor (Art 395 and 3097)

Effects of Mortgage cont….

- The 3rd party may pay the debt on behalf of the debtor before attachment of the immovable with the consent of creditor.
- Read Art 3095, 3097, and 1971 of E.C.C
- If he pays the debt, the 3rd party cannot be said to assume the position of the debtor. Hence, merger cannot be invoked against him.
- The next point at issue is the position of 3rd party mortgager. The law refers to such 3rd party as guarantor under art 3105-3108.
- Basically this 3rd party is not liable for the payment of primary debt. Hence, the liability of such one party should be limited.

Effects of Mortgage cont….

- Accordingly, the law provides that the maximum liability of the guarantor (3rd party mortgager) is limited to immovable that he has given as security. Other property of the guarantor is not liable under Art 3105.
- Moreover, the 3rd party mortgager can avail himself of all the defenses/remedies that we have stated above for any 3rd party who acquires the immovable mortgaged from the debtor (Art 3107).
- Hence, pursuant to Art 3106 he can avail himself of the provisions of Art 3090 & ffg. This right is however, without prejudice to Art 3107 and 3108.

Effects of Mortgage cont….

- As stated above, in case of the remedies for the buyer of mortgaged immovable, these remedies for the 3rd parts tend to affect the nature and importance of real securities, specially mortgage since the buyer of mortgaged immovable or 3rd party mortgager can rises against the mortgagee all the defenses available for a guarantor.
- The mortgagee creditor may face all the challenges as though his security is not guarantee (personal security) while the creditor might have purposely chosen real security by calculating the importance and easily enforceable nature of securities on properties.
- security by calculating the importance and easily enforceable nature of securities on properties.
- Consider the following real case decided by one of the courts in (Diredawa)

Effects of Mortgage cont….

- * In that case husband and wife borrowed some amount of money from a bank. They were requested to provide security and they approached their neighbor to offer her house as security. The neighbor agreed to mortgage her house for the security of the debt of the couples and contract of mortgage has concluded b/n the bank and the owner of the house -the neighbor.
- On the due date, the debtor(the couples) failed to pay the money and the bank started the process of executing its mortgage right on the house. However, the 3rd party mortgager the neighbor, applied to the court for the injunction of the sale process arguing that debtors (the couples) have another property w/c can be sold to cover the debt.
- The court accepted the argument and ordered the bank to stop the process of sale of the house and to proceed against the property of the debtors situate in Addis.

Effects of Mortgage cont….

- Of course, the court enforced what the law says under Art 3106 of ECC. In the above case, the mortgagee had to argue with the 3rd party mortgager and could not directly enforce the mortgage right b/se of the remedies the law provides for the 3rd party mortgager.
- Therefore, if the creditor has to face challenges from the buyer of mortgaged immovable or 3rd party mortgager, it is difficult to see the benefit of real securities.
- Note also that the debtor is legally entitled to transfer the mortgaged immovable (Art 3084) or to make use of mortgage offered by 3rd party(Art 3105) while the 3rd party buyer and the 3rd party mortgager are also entitled to challenge the mortgagee by raising the above stated defenses.

3.6 Extinction of Mortgage

- In principle, as its existence and effectiveness should be evidenced by registration, the extinction of mortgage also should be evidenced by cancellation of registration. Hence, cancellation of registration is the main proof of extinction of mortgage – Art 3109.
- Cancellation may be sought from the court
- a) If the principal claim is extinguished or settled for one or the other reason (Art. 3110)
- b) Where the creditor renounces his right of the mortgage as provided under Art 3110(b) and 3112(1).

Extinction of Mortgage cont. ….

- But, note that the renunciation of the mortgage does not amount to renunciation of the principal claim since the mortgage is simply to secure the payment of the principal claim (see Art 3112(2).
- c) When the creditor makes the subrogation impossible. Where the mortgager is not the debtor himself but 3rd party, such 3rd party mortgager has the right to be subrogated to the right of the creditor as can be understood from Art 3106 cumulative Arts 3095 and 3097.
- Hence, if the creditor makes this subrogation impossible, the 3rd party mortgager has a right to demand cancellation of the mortgage.
- Read also Art 3113, 3114 and 3115 and 3116.

Extinction of Mortgage cont. ….

- d) Sale of mortgage (See Art 3010(c)
- Similar to the case of pledge, sale of mortgage is he 1st and the most important step towards the enforcement of security right of the mortgage.
- However, the sale and enforcement of mortgage is not different from that of pledge as discussed in the previous chapter.
- This is true it you consider the provision s of the civil code, dealing with mortgage where no detailed rules have been provided regarding sale of mortgage except some general principles under Art 3060-63
- (Please refer back to the discussion on the sale of pledge in chapter 3)

Chapter 4 (Four)
Other security Devices

- **Introduction**
- The law does not clearly consider the contractual or legal relation as constituting security and address them as such.
- Hence, an important question w/c the students should keep in mind through the discussion in this chapter is
- "Are these relations created to secure the performance of an obligation, stated otherwise, do these relations really constitute security devices? – This question is left open for the students to make further investigation and develop their own opinion by making use of their knowledge of the principal securities discussed earlier.

Other security Devices Cont. …

- The main relations to be addressed in this chapter are:-
- Antichresis (as provided under Art 3117 ffg
- Assignment of rights as provided under Art 1962 ffg
- Sale with ownership reserved as provided under Art 2387 ffg
- Sale with the right of redemption as provided under Art 2390 ffg
- Lien rights in various circumstances- (Laws)

- Definition (Art 3117)

- Antichresis has been defined under our laws as- a contract where by the debtor undertakes to deliver an immovable to his creditor as a security for the performance of an obligations.
- **Essential elements of the definition**

(1)Antichresis is a contractual relation b/n the debtor and the creditor – This signifies that it arises only from contract.

(2)Antchresis can be created only against immovable.

Antchresis Cont. ....

(1)The principal purpose of antichresis is to secure the performance of an obligation.

(2)The immovable will be delivered to the creditor (the most important element)

- The above stated definition and the essential feature of antichresis indicate that it is simply a special type of mortgage.

- The subject matter, the requirements for creation, the main purpose is not different from that of mortgage except for some differences.

Antchresis Cont. ....

- Creation – The requirements for creation of antichresis are almost similar to those w/c we have discussed in the case of mortgage (Read Art 3118, 3129)
- Registration
  - Specification of Maximum claim
  - Ownership
- Written form is also requirements for creation of antichresis.

Antchresis Cont. ....

- **Distinction b/n Antcresis and Mortgage**
- *The most important difference is that in case of ordinary mortgage there is not transfer of possession of the immovable. But, in case of Antichresis the possession of the mortgaged immovable will be transfer to the creditor (see Art 3117)
- To this extent there is similarity b/n pledge and Antchresis. However, unlike the case of pledge, in case of antichresis, the transfer of possession to the creditor will entitle him the right to make use of mortgaged property.

Antchresis Cont. ....

- It is this transfer of possession w/c changes the relation b/n the debtor and the creditor from ordinary mortgage to special type of mortgage (Antchresis)
- Before the transfer of possession of the immovable or once the immovable returns to the possession of the debtor, then the contract of antchresis remains to have the effect as mortgage(Read Art 3121)
- The use that the creditor derives from the immovable replaces the interest to be calculated on the principal claim Art 3124.
- No other additional interest can be calculated on the principal claim on top of the use the creditor derives from the immovable.

Antchresis Cont. ....

- 2) The creation of antchresis has to be necessary supported by contract. Antichresis cannot be inferred from the conduct or any prior relation b/n the debtor and creditor or from the provisions of the law. There should be clear agreement for the creation of antichresis in accordance with Art 3119.
- Like all other securities, antichresis also has accessory character from the reading of Art 3128.
- The principal reason to conclude contract of mortgage in the form of antichresis is to stop the calculation of interest on the principal claim by entitling the creditor to have possession of the immovable and make use of it in place of interest.

4.2 Affiliated cases

- There are certain relation w/c at least indirectly have the purpose of securing the performance of an obligation. Consider the following statements.
- 1. A creditor who, for consideration, assigns his right to another person shall guarantee the existence of such right at the time of assignment Art 1964 – Assignment of rights 1962 ffg.
- 2. Any person (seller) who sale a thing and delivers to a buyer may reserve the right of ownership on the thing himself until the payment of full price of the thing – Art 2387. (sale with ownership reserved).

Affiliated cases cont. ….

- 3. Any person (seller) who sells a thing and delivers it to a buyer may reserve to himself the right to buy back the thing with in certain period of time – Art 2390. (Sale with the right of redemption).
- 4. Any person who has been serving as an agent of another person (the principal) is entitled to keep possession of all the object of the principal w/c has come under the possession of the agent to carry out his agency.
- *The question is that can we consider all the above cases as security devices?