

This is a PREPRINT of a piece that appeared as: “Modern Application of the Roman Institution of *Fiducia Cum Creditore Contracta*”, in Letitia Vacca *La Garanzia nella prospettiva storico-comparatista* (G. Giappichelli Editore, Torino, 2003), pp. 327–44. Date of this Preprint: 29 September 2004.

MODERN APPLICATION OF THE ROMAN INSTITUTION OF FIDUCIA CUM CREDITORE CONTRACTA

C.G. van der Merwe, Professor of Civil Law, University of Aberdeen, formerly Professor of Private Law, University of Stellenbosch

Introduction

In intend to illustrate the modern application of the Roman *fiducia cum creditore* (*Sicherungsübereignung*) by reference to a recent South African case in which the doctrine of fiduciary transfer of ownership of movables was rejected.¹ South Africa has a mixed legal system that combines civilian and common law principles. Since English law influence is strongest in the commercial fields, South Africa has taken over most of the English pseudo security institutions such as reservation of ownership, hire purchase and sale and leaseback transactions and endeavoured to adapt them to civil law principles.

The recent South African case, *Nedcor Bank Ltd v Absa Bank Ltd*² deals with a dispute between two financing institutions (financiers) concerning the financing of the purchase of motor vehicles by a motor dealer from a supplier. Retailers, traders and motorcar dealers often need to buy their stock (in this case the fleet of motor cars in the showroom) on credit. The provider of this credit typically desires real security. Since the supplier (the car factory) is not usually geared for the business of providing such credit, numerous financial institutions have mushroomed to cater for this financial need. The motor dealer is not averse to providing the security in the form of his movable stock (fleet of motor cars) as long as it does not interfere unduly with the profitable carrying on of his business. This was exactly what the motor dealer purported to do in the South African case. The purpose of this presentation is to explain the business context and the legal position in South Africa after this decision and to see what lessons can be learned from it generally.

Business and legal context

In the South African case a financier, Nedcor Bank provided finance to a motor-dealer through a so-called ‘floor plan’ or master agreement that regulates the provision of security for a supply of motorcars via retention of ownership.³ In this particular case, the master agreement distinguished between two scenarios. In the first scenario the supplier sells batches of new cars to the financier who in turn sells them to the motor dealer. In such a case where the financier is also the seller of the motorcars, a long-standing security device is readily available in South African and English law for the

¹ For a more detailed examination of South African cases on this topic, see VAN DER MERWE, SMITH, *Financing the Purchase of Stock by the Transfer of Ownership as Security: A Simulated Transaction?* *Stellenbosch Law Review*, 1999, 303ss.

² 1998 2 SA 830 (W).

³ See GOODE, *Commercial law*, 2^o ed., London 1995, 795-796 and 798-800.

provision of security, namely retention of ownership of the cars. Possession of the property is transferred to the motor dealer, but ownership is retained by the seller/financier until full payment of the purchase price. The transfer of the motor vehicles on credit with reservation of ownership is usually effected through a sale transaction. In many cases the parties will use a lease transaction, or a hire-purchase transaction (a lease with an option to purchase at the end of the term) instead. For most movables, these transactions are basically interchangeable in economic terms as long as the term of the lease or hire approximates the useful life of the movable in question. The choice is usually dictated by a combination of commercial practice, differences in applicable legislation, and tax considerations.

In most cases the financier will be some kind of financial institution that is not actually in the business of selling stock to traders. The transaction must therefore be structured in a certain way. The seller of the stock (supplier) sells for cash to the financier at the same wholesale price, which would have been offered to the trader. The financier is then in a position to sell on credit to the trader, retaining ownership as security. The sale to the trader is at a price that allows the financier to recover its outlay plus a margin of profit for the provision of the finance. The price will be payable by the trader upon resale to a sub-buyer, possibly within a time limit built in to protect the financier if goods cannot be sold. The expectation of the parties is that the price of the sub-sale would be such as to allow the trader to pay the debt to the financier and still retain some margin of profit for his own business.

Since the motor dealer holds the goods in question (motor vehicles) as stock for resale, the whole point of the excise and the practical business expectation of the parties are that the trader will sell the goods on to some sub-purchaser. In legal terms, it makes no difference whether the goods in question (motor vehicles) are held by the trader (motor dealer) as stock for resale or are to be kept indefinitely by the trader. In practical business terms, it does make a difference, because if the goods are held as stock for resale, then the whole point of the exercise and the expectation of both parties is that the trader will sell the goods on to some sub-purchaser. Only by making such a sub-sale would the trader be in a position to pay the debt he has incurred in acquiring the goods. This makes the financier's position precarious. If the trader sells the stock in the course of his business, as he is expected to do, the ultimate buyer will normally acquire ownership and so the financier's real security will be lost. This is so if the trader in terms of the agreement had the financier's authority to dispose of the goods. Even if such authority is not present and the trader acted in breach of the agreement, principles of estoppel or ostensible authority might allow the trader to transfer ownership or at least to estop the financier from claiming the return of the goods. There is no mechanism in South African law that would allow the financier's interest to be transferred to the proceeds of the sub-sale held by the trader. The practical implication is that the financier of stock needs to monitor the conduct of the trader's business to ensure that as stock is sold, the corresponding debt is paid out of the proceeds. If this system is not followed, the financier can rapidly become undersecured.

However, this transactional structure will not fit all the cases in which stock needs to be acquired by the trader (motor-dealer). This is illustrated by the *Nedcor Bank* case where the floor plan attempted to cover not only the situation in which the trader acquired new cars from car manufacturers (suppliers), but also a second scenario

where the trader acquired a single used car from some other source. In the *Nedcor Bank* case the motor dealer had acquired the car from another car dealer thus a single unit and not a batch of new cars and obviously not so well planned in advance. The floor plan also covered the case where the motor dealer acquires a used car from a customer as part exchange for a new car. Business proficiency requires that the trader acts quickly when these opportunities arise, and it is not practicable to structure the transaction as a sale to the motor dealer's financier followed by a sale to the trader with the retention of ownership.

The floor plan in question therefore contemplated another transactional structure to cater for this second scenario. This was that the motor-dealer already having become the owner of the car, should sell them to the financier, at the same price, which the dealer had paid. In this case the transfer of ownership to the financier occurs without physical delivery and therefore has to rely on the institution of *constitutum possessorium*, leaving the car with the dealer for further sale. Following that the system works as above. The financier resold to the motor-dealer on retention of ownership terms, thus giving the financier real security for the debt. The dispute arose because the motor-dealer had then sold the car to a retail buyer, (the ultimate buyer); more precisely it had purported to transfer ownership to the ultimate buyer's financier, the plaintiff Bank (Absa Bank) that then sold the car to the ultimate buyer with retention of ownership. On the default of payment by the ultimate buyer, the plaintiff (Absa Bank) sought to assert ownership of the car. Presumably the motor-dealer failed to pay the first financier (Nedcor Bank) the debt owing for this car, because the first financier also claimed to own the car.

The court decided, however, that the transaction between the motor dealer and the first financier (Nedcor Bank) was a 'simulated transaction': the parties had attempted to create a loan secured by a pledge, but possession of the goods had not been transferred to the creditor. The attempt to transfer the motorcar to the first financier (*Nedcor Bank*) was therefore without legal effect and as a result the second financier (Absa Bank) prevailed.

Simulated transactions and structured transactions

The judge acknowledged that the commercial practice of extending credit under floor plans was practised in South Africa since the 1960's.⁴ Still he found that the transaction was simulated in that it amounted to an attempt to create a non-possessory pledge, which is not recognised in South African law. He accepted that some reform might be desirable, but he regarded it as improper for a judge of first instance to recognise in effect a new form of security.

I shall consider first the notion of a simulated transaction and especially the question when a structured transaction becomes a simulated transaction, and so crosses the line from the permitted to the prohibited. Then I shall turn to the particular context of financing the acquisition of stock and consider whether the line between permitted and prohibited makes sense in policy terms or whether it is dictated by purely doctrinal considerations that should perhaps yield to matters of policy.

⁴ At 838G.

Simulated transactions

What is a simulated transaction? As a general rule parties to a contract express themselves in a language calculated without concealment or subterfuge to embody the agreement at which they have arrived. They intend the contract to be exactly what it purports. Not infrequently, however, the parties to a transaction endeavour to conceal its real character either to secure some advantage the law would otherwise not give, or to escape some disability that otherwise the law would impose. They call it a name or give it a shape, intended not to express but to disguise its true nature. A court can only give effect to what the transaction really is not what in form it purports to be according to the maxim: *plus valet quod agitur quam quod simulate concipitur*. Thus a transaction that in form purports to be a sale while the parties actually intends a pledge is a simulated transaction.⁵ But the court must be satisfied that there is a real intention definitely ascertainable, which differs from the simulated intention. If the parties intend the contract to have its purported effect, the fact that the same object might have been attained in another way will not necessarily make the arrangement other than it purports to be. The inquiry in each case is thus one of fact. According to the old Roman-Dutch authority, Perezius⁶ simulations can be detected by considering the facts leading up to the contract and by taking account of any unusual provisions embodied in it.⁷

This view of the Highest Court in South Africa expressed in 1910 corresponds with the position of the English Court of Appeal in *Welsh Development Agency v Export Finance Co Ltd*,⁸ decided in 1992. The English court also accepted that the court looks to the agreement that the parties have reached and not directly to the economic effects of that agreement.⁹ The parties are in principle free to use some transaction even though another transaction, which might be more suitable, would have had the same economic effect. Thus there are many ways of raising cash besides borrowing. If in form it is not a loan, it is not to the point to say that its object was to raise money or that the parties could have produced the same result more conveniently by borrowing and lending money.¹⁰ According to the Lord Justice the (simulated) transaction can be approached¹¹ in two ways namely by the external and the internal route.¹² In the external route one attempts to show that the parties' formal agreement (written

⁵ See Staughton LJ at 185: 'disguise, cloak, mask, colourable device, label, form, artificial, sham, strategem and pretence.'

⁶ PEREZIUS, *Praelectiones in Codicem Justiniani*, Amstelodami 1645, ad Codex 4 22 2.

⁷ This is a paraphrase of a remark by Innes JA (as he then was) in *Zandberg v Van Zyl* 1910 AD 302 at 309.

⁸ 1992 BCLC 148, 1992 BCC 270.

⁹ See the *Crowther Committee's Report on Consumer Credit* (Cmnd 4596 (1971) para 1.3.6 quoted by Staughton LJ at 186

¹⁰ Staughton LJ quoted Lord Devlin in the Privy Council case of *Chow Yoong Hong v Choong Fah Rubber Manufactory Ltd* 1962 AC 209,216; 1961 3 All ER 1163, 1167: 'There are many ways of raising cash besides borrowing... If in form it is a loan, it is not to the point to say that its object was to raise money for one of them or that the parties could have produced the same result more conveniently by borrowing and lending money.'

¹¹ GOODE, *Commercial Law* 2^o ed., London (1995) 646-651 calls this the process of 'characterisation of the transaction'.

¹² At 186.

document) does not actually reflect the agreement of the parties. In an attempt to generate or avoid some legal consequence, they execute a contract and they conduct their affairs in a manner, which does not correspond with that contract. Their common intention is to be bound by different terms. In such a case the parties should not be surprised to find that the court calls it a sham, a cloak or device and does not give effect to the terms of the contract. By contrast, if one follows the internal route, one looks solely at the written agreement in order to ascertain from its terms whether it amounts to a transaction of the legal nature, which the parties ascribe to it. In the internal route, the parties intend to be bound by the agreement they have made, but the question is whether that agreement has the legal effects, which the parties intend it to have. In this sense the term 'simulated transaction' does not refer to a 'sham, a cloak or a device', but to the situation (as in *Nedcor Bank*) where the parties intend to be bound by their agreement, but nonetheless find that it does not have the legal effects they desired.

Once the matter is so confined, it becomes clear that the idea of a simulated transaction is little more than a conclusion as to what is permitted. The decision in *Nedcor Bank* was that a transfer of ownership to secure a loan was a simulated transaction. But transfers of ownership to secure debts are not always considered to be so. The English common law mortgage of an immovable was a transfer of the mortgagor's estate in land to the mortgagee, as security for a debt. In South African law, cession *in securitatem debiti* (*Sicherungszession*) is a similar transaction: an incorporeal movable (debt or claim) is ceded (assigned) to the creditor to secure a debt.¹³ Viewed in an abstract way, both of these examples are just as artificial as the transfer of ownership of corporeal movables for security: the parties do not really intend an outright transfer of the asset, but only the transfer of a security interest. But in the case of the English mortgage and the South African cession *in securitatem debiti* (*Sicherungszession*), the transfer is not considered simulated; this simply means there is no objection to it on policy reasons, and so it was judicially allowed. There was no objection to the English law mortgage of an immovable because the mortgagee would acquire the title documents and so, even though the mortgagor remained in occupation, there was no fear that third parties could be deceived through a subsequent attempt to encumber or transfer the asset. So too in the case of cession *in securitatem debiti*: the encumbered asset being incorporeal, it is not the case that the debtor remains in possession of it with the possibility of working deceit on subsequent parties.

Once we take the transfer of ownership as security for a loan as evidenced in the *Nedcor Bank* case outside the domain of the sham, cloak or deceit, then an inquiry into the real intention of the parties or whether there was any subterfuge seems meaningless. What the parties intend in such a case is the following: the financier wants the strongest security interest that the law will allow him to take. The motor dealer is willing to give any security interest that the law will allow him to give, as long as this does not prevent him from carrying on his business and from taking the economic benefit of the sub-sale that he hopes to effect. This is their intention and

¹³ The other view is that cession *in securitatem debiti* is an outright transfer of an incorporeal and not a kind of pledge. See generally, VAN DER MERWE, *Sakereg* 2^o ed., Durban 1989, 673-688; KLEYN, BORAINÉ, *Silberberg and Schoeman's The Law of Property* 3^o ed., Durban 1992, 458-461.

reasoning based on the parties' intention cannot go beyond that. The concept of 'simulated transaction' thus means little more than 'prohibited or non-permissible transaction'. With the advice of their lawyers the parties then attempt to find a means to give legal effect to those intentions. They may try to do it by the transfer of ownership as security. If the law allows this as is the case in under German law, then that is how the parties want to 'structure their transaction'. If it does not, the term 'prohibited transaction' (in stead of 'simulated transaction') is preferable and presumably the parties will try something else in future. Nor is it fruitful to frame the enquiry in terms of 'unusual provisions'. If the transaction is allowed, however unusual it may seem initially, other parties will adopt it and it will become common form. One of the marks of a good transaction lawyer is to be able to innovate new transactional structures for new commercial needs.

In substance one might as well go directly to what is permitted. The first part of the floor plan in *Nedcor Bank* that applied to the acquisition of a batch of new cars, envisaged the transfer of ownership from the manufacturer (supplier) to the financier, which then sells to the trader on retention of ownership terms. Looked at by the light of reason, the whole transaction is a simulation; it is artificially structured so as to get ownership in the hands of the financier. Next consider the second part of the floor plan namely where a single car was acquired from another motor-dealer. Here the motor dealer acquires ownership, albeit briefly, and then transfers it to the financier. The first scenario is generally accepted as effective; the second scenario is now said to be ineffective as a simulation. But the intention of the parties is the same in each case: that the financier shall have a real security in the car while the trader shall have possession of it to permit him to sell it. This lies outside the 'external route': there is no pretence or disguise by the parties and so there is no real enquiry except as to what the law permits. This must be informed by doctrine, and, within the limits of flexibility allowed to the judicial development of the law, by policy.

Policy considerations

Similar to judicial authority in other legal systems, the South African courts have never expressed any policy objection to real security in movables as such.¹⁴ Thus every legal system allows some forms of real security in movables. The real issue is why some forms are permissible and others are not.

The most serious concern centres on publicity.¹⁵ The existence of real security must be discoverable by other parties; it should to a certain extent be manifest to the outside world. A real security that is not easy to detect can work unjustifiable hardship on a number of parties. These include a buyer of the asset subject to the security interest, who assumes that he will become the outright owner of the asset; a subsequent secured creditor who takes a real security right in the thing, on the assumption that the entire value of the thing is at his disposal for satisfaction of his claim; and a subsequent unsecured creditor of the debtor who may rely on the debtor's apparent

¹⁴ See e.g. BEBCHUK, FRIED, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, *Yale Law Journal*, 1996, 857ss. who illustrated that real security by way of movables is notoriously difficult to justify theoretically.

¹⁵ South African Law Commission *Report on the Giving of Security by Means of Movable Property* Project 46 par 2 1 14.

prosperity as sufficient security, while the debtor's assets are invisibly encumbered in favour of another creditor.

Real security rights in immovables are publicised by registration in the land register. Note that the South African Deeds Registries Act prohibits the registration of the transfer of immovables as security.¹⁶ For publicity of real security rights in movables, South African law essentially requires actual possession by the holder of the security right. Although *constitutum possessorium* is recognised for the transfer of ownership, it is frowned upon when utilised for the creation of a pledge. In a pledge transaction, the debtor transfers possession of the thing to the creditor.¹⁷ Where a lien arises by operation of law, this depends upon possession by the creditor.¹⁸ Either way, the debtor is out of possession and so not in a position to mislead subsequent third parties. But the debtor rather than the creditor might want to be in possession of the thing. When consumers buy things on credit, it is usually so that they can have the use of them immediately. Likewise the motor dealer must be in possession of his stock (fleet of motor cars) in order to run his business successfully. His whole business depends on a quick sale of these assets. The economic benefit of being able to use these assets, as security for more financing is obvious: he can purchase even more stock.

From a policy perspective the law had been inconsistent in allowing the use of retention of ownership as a form of real security. This transaction, which allows the debtor to possess the thing while giving the creditor a security right in the object, clearly violates the principle of publicity. The doctrinal explanation for the difference is that while ownership can be used as a kind of security right, it is not really a security right but the most extensive real right that there is. The seller begins the transaction as owner, and the parties simply stipulate for the postponement in the transfer of ownership.¹⁹ But of course the terms of the contract are such that all of the

¹⁶ Deeds Registries Act 47 of 1937 s 91: 'No transfer of land and no cession of any registered lease or sub-lease or other real right in land except a mortgage made as security for a debt or other obligation shall be attested by any registrar or registered in any deeds registry.'

¹⁷ See VAN DER MERWE, *Sakereg* 2^o ed., Durban, 655-660.

¹⁸ See the authorities cited by VAN DER MERWE, *Sakereg* 2^o ed., Durban, 721 n 903.

¹⁹ In *Armour v Thyssen Edelstahlwerke AG* 1991 AC 339, 1990 3 WLR 810; 1990 3 All ER 481, the House of Lords held in an appeal from Scotland the retained ownership was not a security interest. At 353-354: 'Here the appellants by the terms of the contract of sale, have in effect reserved the right of disposal of the steel strips until fulfilment of the condition that all debts due to them by Carron (manufacturers of metal, plastic and general engineering products: respondents joint receivers on Carron's assets) have been paid. By virtue of this enactment that has the effect that the property in the goods did not pass to Carron until that condition had been fulfilled. Counsel for Carron argued that the words 'conditions' in s 19(1) must be read as excluding any condition which has the effect of creating a right of security over the goods. I am, however, unable to regard a provision reserving title to the seller until payment of all debts due by him by the buyer as amounting to the creation by the buyer of a right of security in favour of the seller. Such a provision does in a sense give the seller security for the unpaid debts of the buyer. But it does so by way of legitimate retention of title, not by virtue of any right over his property conferred by the buyer.' And again at 355: 'The contract of sale did not attempt to create a right of security in favour of the appellants, rather did it operate to transfer possession and

economic benefits of the thing are transferred to the buyer, and the seller's retained ownership is stripped down to what, in economic terms, is a security right. Does this mean that since the publicity principle is violated, retention of ownership is a 'simulated transaction', an attempt to create a pledge without possession, and so impermissible?²⁰ Only the Scottish Court of Session has taken this position but was overruled in the House of Lords. In some jurisdictions, the lack of publicity has led to statutory intervention, in Canada as early as 1882²¹ requiring either registration in a public register or the marking of goods in the owner's (seller's) name.

But once the facts depart too far from the straightforward retention of ownership, policy considerations will assert itself. If the financier buys stock from the manufacturer and then sells it to the trader with retention of ownership this seems acceptable even though the acquisition of ownership by the financier is purely for security reasons. If this transaction were branded as simulated, no financier who was not the original seller of the thing could finance the purchase of it by retaining a real security right in the thing, while still leaving the buyer (motor dealer) in possession. This transactional structure is used very often in South Africa and in England both at the consumer and at the wholesale level.²² In *Nedcor Bank* case, these were the terms on which the trader acquired new car stock and these were the terms on which the ultimate purchaser's financier attempted to acquire the car in dispute.²³

However, the line appears to be drawn if the debtor (trader, dealer) once acquires ownership as is the case in the second scenario where the motor dealer first buys from another dealer or acquires the car as (part) exchange for another sale. This is also the position in English law as illustrated by the 1990 English case *Re Curtain Dream plc*.²⁴ In this case a carpet trader wanted to borrow money from the financier on the security of stock (carpets) already owned by the trader. There was a transfer of ownership to the financier under a cash sale at the price, which the trader had paid for the stock. Then there was a sale back to the trader with reservation of ownership, the price payable in instalments. The trader became insolvent and the administrator in insolvency (receivers) argued that these transactions taken together amounted to the creation of an equitable security charge over the goods (a non-possessory pledge in South African terms)²⁵ requiring registration in English law, which was extant in this

dominium in two stages. Until the conditions of clause I.3(1) were satisfied (full payment) dominium remained in the appellants.'

²⁰ The Second Division of the Scottish court of Session in *Amour v Thyssen Edelstahlwerke AG* took the view that clause I.3(1) amounted to an ineffective attempt to create a right of security over moveables without the transfer of possession thereof.' See 1991 AC 339 at 354G.

²¹ See GOODE, ZIEGEL *Hire-Purchase and Conditional Sale: A Comparative Survey of Commonwealth and American Law*, London 1965, 13.

²² DIEMONT, MARAIS, ARONSTAM *The Law of Credit Agreements and Hire-Purchase in South Africa*, 4^o ed., Cape Town 1982, 222-224. See also GOODE *Commercial Law*, 2^o ed., London 1995, 758-759, 768-773 and 783ss.

²³ See *Nedcor Bank Ltd v Absa Bank Ltd* 1998 2 SA 830 (W) 832H-833A where counsel admitted that the dealer sold the car to the second financier that sold the car to the ultimate purchaser in terms of an instalment sale agreement that contained a reservation of ownership clause in favour of the plaintiff.

²⁴ 1990 BCLC 925, 1990 BCC 341.

²⁵ See *Goldinger's Trustee v Whitelaw & Sons* 1917 AD 66.

case.²⁶ Influenced by the references in the documentation to ‘credit line’ and to the payment by the carpet trader of ‘interest’, the judge agreed with the administrator in insolvency (receiver) that this was an unsuccessful attempt to create to a equitable charge over the carpets. The judge found it most significant that the sale by the trader to the financier was offset by an obligation on the part of the financier to sell the goods back to the trader.²⁷

Of course, the economic effect of the transfer of ownership in such a case is not much different from the effect in a simple sale with reservation of ownership; and the publicity problem is just the same. But one could say that while we are stuck with the publicity problem of reservation of ownership in sales, we are not bound to expand them by allowing a *fiducia cum creditore* of movables namely a two-step transaction with a transfer of ownership and a sale back with retention of ownership. If this transaction were allowed generally it would overwhelm the pledge, and the policy of publicity, which the requirements for a pledge protects. The best solution of all might be a comprehensive legislative reform that would treat alike all transactions which are functionally indistinguishable, and which would ensure publicity in all cases. This was done in the United States, under art 9 of the Uniform Commercial Code. This development has been adopted in the most of Canada. It has been recommended, but not adopted in the United Kingdom²⁸ and has been proposed by the Model Law on Secured Transactions promulgated by the European Bank for Reconstruction and Development.²⁹

From a policy perspective an important difference between *Nedcor Bank* and *Re Curtain Dream* was that in *Re Curtain Dream* the trader had unfettered ownership of the carpets without the intervention of the financier. The finance advanced was for general operating purposes. In *Nedcor Bank*, however, it appears that the finance provided by the financier was to allow the purchase of the car in question.³⁰ In other words, the Bank’s real security right (had the floor plan been held effective) would have been a security right over the motor cars to secure a debt incurred in purchasing the cars. In the North American terminology of Article 9 of the US Uniform Commercial Code, this is a ‘purchase-money security interest’. Article 9 effected a

²⁶ Failure to register means that the charge is void as against a liquidator or another secured creditor: Companies Act 1985 s 395.

²⁷ This he thought was the most important of the indicia set out by Romer LJ in *Re George Inglefield Ltd* 1933Ch 1 27-28. This case was approved in *Lawson and Kirk v South African Discount and Acceptance Corp (Proprietary) Ltd* 1938 CPD 273.

²⁸ DIAMOND, *A Review of Security Interests in Property*, London 1989.

²⁹ This model law is discussed in MCCORMACK, DAHAN, *Comparisons and Convergence, Company Financial and Insolvency Law Review*, 1999, 365

³⁰ This is to some extent a matter of inference. We are told (at 834G) that the trader bought the car from Car Deals, invoiced the financier and purported to transfer ownership of the car to it, and received payment on the same day. The terms of the floor plan agreement provided (clause 1.3.833H) that the price paid by the financier would be the same as that which the trader had paid Car Deals. One may infer that the funds provided by the financier were used, in some sense at least to pay for the car. There are precedents for tracing funds, not to allow some proprietary claim to the proceeds (which is not possible in South African law), but to show that they were used to purchase an asset so as to establish a purchase money security interest: see *Agricultural Credit Corporation of Saskatchewan v Pettyjohn* 1991 79 DLR 4th 22 Sask CA.

root-and-branch statutory reform of all security interests in movables modelled on functional policy considerations with minimum regard to pre-existing legal doctrine. The drafters gave a special ‘super-priority’ to purchase-money security interests. The rationale is that if a trader only holds a particular asset because a financier advanced credit to permit the acquisition of that asset, then it is reasonable to accord a high priority to that financier’s real security right in that asset.³¹ This does not harm other creditors, because if the financier had not provided the credit in question, the trader would not have this asset anyway.

Although the article 9 system requires registration of purchase money security interests, it adopts the usual functional approach as to what counts as a security money interest. Reservation of ownership by the seller or the lessor under a finance lease or hire purchase agreement, are the core examples of purchase-money security interests. However the status of a purchase money security interest applies also to the security interest which a financier holds in a thing, where that financier was not the seller but provided the funds which the motor dealer or trader used to acquire the thing.³² In other words that case is seen as attracting the same policy considerations as a sale with a reservation of ownership.

The crucial question is whether the common law can employ the same functional approach to deciding when a transfer of title as security is permissible? Goode notes that a common transactional structure of a finance lease (which economically at least approximates a sale with the reservation of ownership) is that the lessee who will use the goods (e.g. cars) selects and purchases them from the supplier. He then sells them to the financier and leases them back under the finance lease. This comes perilously close to the *Re Curtain* scenario and a disguised chattel mortgage, which would be void for lack of registration against the lessee’s liquidator and creditors. Nevertheless Goode accepts the financial lease as a well-established and legitimate practice. He concludes that so long as the parties intend an outright transfer of title to the financier (lessor) so that the documents truly record the nature of their agreement, it will not be treated as a security.³³

Very little is therefore gained by asking whether the transaction was ‘genuine’ or ‘simulated’. The parties intended a certain economic consequence (secured lending) and they tried to use transfer of ownership to bring that about. The only real question is whether the law allows this or not. The example of sale and leaseback of immovables is not directly applicable because the requirement of publicity is handled differently in that

³¹ The rationale for giving super-priority to improvement liens in South African law is the same since the improvement of the market value of the improved article, is solely attributable to the efforts of the lien holder.

³² See the Saskatchewan Personal Property Security Act 1993 SS 1993 c P-6.2 s 2(1)(jj)(ii)

³³ GOODE *Commercial Law*, 2^o ed., London 1995, 790 and describing the same structure at 653-653: “There is nothing wrong with a genuine sale and leaseback, which is very common in (immovable) property transactions and is also encountered in equipment leasing in those cases where the intended lessee buys the equipment from the supplier himself. But where goods are involved, the courts are likely to scrutinise the transaction with particular care to ensure that the transfer of ownership was genuinely intended as a sale and was not a mortgage in disguise.”

case. But in the functionally similar case of financial leasing, Goode is clearly of the view that the *Re Curtain Dream* reasoning would not apply to a sale and leaseback of equipment that had been purchased earlier with that sale and leaseback in mind. He describes this as a 'well-established and legitimate practice'. In a financial lease, the financier, who buys the equipment and leases it back, is arguably providing the purchase money finance and taking a purchase money security interest. Commercial dynamics (dynamism) requires this structure rather than the more normal structure in which the financier buys the equipment himself and then leases it to the user.³⁴

Let us reconsider the controversial transactional structure litigated and held ineffective in the *Nedcor Bank* case in the light of the above reasoning. This concerns the structure where the dealer instead of the financier acquires ownership of the car from another dealer (or from a trade-in customer) and then engages in a sale (at the same price) and sale back transaction with the financier. Business dynamics (namely the need for prompt action by the first dealer) lies at the heart of this mechanism. In substance the economic picture is the same as in the uncontroversial scenario where the financier acquires a new batch of cars from the supplier and then sells them to the dealer. In both cases the financier is supplying the purchase money for the acquisition of the cars, which would not have happened, but for his financial assistance. Functionally he is therefore entitled to a super-priority in the same way as that recognised in the uncontroversial case.

If the law permitted the transfer of ownership as security only where the financier had provided the purchase money for the asset in question, there would be no question of subverting the whole field of operation of the pledge. Rather the law would simply be treating functionally similar cases alike. Although the lack of publicity can to some extent be rationalised by the fact that a similar insufficiency of publicity does not invalidate reservation of ownership sales, this provides a reason for restricting validity to those cases where business efficiency excludes utilisation of the uncontroversial transactional structure. Thus the controversial structure litigated on in the *Nedbank* case can be validated if it is put into the context of relevant policy considerations. The reason why the courts should allow a security device in both cases is that the financier is providing purchase money financing. By his provision of credit, he enables the trader to acquire a new asset, which he otherwise would not hold. Other creditors could therefore have no sound objection if the financier is given a priority claim to that asset.

The argument can be summarised as follows. A transaction in terms of a used vehicle floor plan agreement should not be treated as a simulated transaction. The intention is that the bank (financier) should acquire ownership in the vehicle as security for the finance extended to the motor dealer. Although it is not the intention of the bank to use the vehicle, its intention is indeed, if needed, to repossess the car on default of the dealer and to dispose of it at as good a price as possible. This is not to say that the parties contemplated a non-possessory pledge, which is not countenanced in South African law.³⁵ What the parties intend is the transfer of ownership as security, a

³⁴ GOODE *Commercial Law*, 2^o ed., London 1995, 782 mentions that financiers under finance leases sometimes desire a level of anonymity.

³⁵ Subject to the provisions of the Security by Means of Moveable Property Act 57 of 1993.

transaction that harks back to the Roman *fiducia cum creditore* by which ownership in land could be transferred as security for a loan. By accepting this, one recognises as in modern German law that transfer of ownership by way of security can be a *causa* for *constitutum possessorium*. As a result I do not regard the transfer of ownership by way of *constitutum possessorium* in terms of a floor plan agreement as an unworkable anachronism unsuitable in modern day commerce but as a valuable commercial instrument. If the floor plan agreement is meticulously drafted and carefully (painstakingly) implemented, then the doctrinal requirements for *constitutum possessorium* can be satisfied. In policy terms, if the loan being secured is for the price of the goods in question, then there are sound reasons why the creditor should be allowed to have a real right in that asset, without the need to take possession of it. As a result there is no policy reason to invalidate the transfer of ownership as security in such cases.

The above reasoning implies that one should draw a distinction between purchase money finance and other loans. In the few South African cases dealing with purchase money finance, the transactions (except in the *Nedcor Bank* case) were permitted. In the cases where the finance was needed for ordinary operating costs, the transactions were branded as simulated and not allowed. Still such a distinction was not made in the ancient *fiducia cum creditore* where other policy considerations might have been applicable. And it was not made in the most recent decision of the *Hoge Raad* in the Netherlands, which concerned a sale and leaseback of printing presses to finance the operational costs of a printing enterprise. The *Hoge Raad* decided that as long as there was an intention to transfer outright ownership to the financier (*Sogelease*), the transaction did not contravene the prohibition on security transfer of ownership contained in art 3:84(3) of the new Dutch Civil Code.³⁶

The transfer of ownership as security is still problematic in the sense that since possession remains with the dealer there is no publication of the transfer of rights and the change of status of the dealer from owner to mere holder on behalf of the Financier. The same problem of hidden real rights is, however, encountered under the 'new car' part of a floor plan agreement as well as in every case of simple sale with reservation of ownership. A wholesale legislative reform might require publicity in all these cases. One non-legislative solution might be to require that notices must be displayed on individual vehicles in the showroom, to the effect that a financing institution owns that particular vehicle. It is difficult to know in what way this would affect customer confidence and thus inhibit future sales. We have seen that even in the absence of notices, customers will to a certain degree be protected by the doctrines of estoppel and ostensible authority and in Continental law by bona fide acquisition of the movable. It is the motor-dealer's other creditors who might seem to need the publicity provided by such notices, although they are likely to be aware of commercial financing practices. Still, courts might take the view that in order to validate transactions like the one in *Nedcor Bank*, this extra level of protection is a helpful requirement.

³⁶ *Hoge Raad* 19 May 1995, *RvdW* 1995, 116C (*Keereweer q.q./Sogelease B.V.*). On this decision, see inter alia VRIESENDORP *Sogelease*, *Ars Aequi*, 1995, 872ss; SIGMAN *Keereweer v. Sogelease BV seen from an American Perspective*, *Weekblad voor Privaatrecht Noterisampt en Registratie* no.6214, 1996, 167ss

Conclusion

There is a pressing need for real security to finance the acquisition of stock for sale, not only in the motor industry but also in other industries. It is not always practicable for the financier to acquire ownership before selling to the trader with reservation of ownership. The above arguments endeavoured to show that there are sound reasons, in policy and precedent, for validating a limited use of the transfer of ownership as security device: namely, where the financier has provided the finance which allowed the purchase of the asset in question.

However, *Nedcor Bank* has shown that the law may choose to draw a line between the reservation of ownership as security and transfer of ownership as security, rather than between purchase money loans and other loans. That first line is easier to see, but it is less sensitive to commercial needs and to the underlying policies. If the line is drawn there, the consequences are difficult to foresee. Certainly this would increase the pressure for a comprehensive legislative reform, such as has occurred in North America. The reforms there have been a success in improving the rationality of the law and its sensitivity to commercial needs. But the lessons of other jurisdictions may show that just because a need for reform is perceived, it does not follow that it will occur. In the United Kingdom a full review of the situation called for just such reform but ten years later, nothing has occurred.

In the absence of statutory reform business will continue but it may be forced into inefficient transactional structures. Clearly, South African law recognises the validity of the pledge. This might seem useless for stock, since the trader needs to be in possession of the goods in question. In this regard the United States experience before the introduction of the Uniform Commercial Code instructive where the non-recognition of non-possessory pledge of movables gave rise to the phenomenon of 'field warehousing', whereby goods were held on the site of the trader, but in a physically cordoned-off area. This validated the use of the pledge transaction since in this way the goods were possessed not by the trader, but by the warehouseman who held them for the financier. This is hardly a model of modern commercial efficiency.

In South Africa, limited legislative reform by the Security by Means of Moveable Property Act³⁷ extended the scope of the pledge device by contemplating a non-possessory pledge. Movables furnished as security can be 'specified and described' in a special notarial bond and this bond may be registered. If this is done, the particular movable is deemed to have been pledged to the mortgage-creditor (financier) as effectually as if it had expressly been pledged and delivered to the mortgagee. This system is not, however, suitable for the automobile industry, nor indeed for the financing of stock generally.³⁸ Two of the basic characteristics of an ideal system for the secured financing of stock³⁹ are that the parties must be freed from the need to

³⁷ Act 57 of 1993 s 1.

³⁸ Cf SONNEKUS *Vloerplanooreenkomste en 'n Sober Klank van die Regbank daarteen? Tydskrif vir die Suid-Afrikaanse Reg*, 1998, 776

³⁹ See GOODE, ZIEGEL *Hire-Purchase and Conditional Sale: A Comparative Survey of Commonwealth and American Law*, London 1965, 191-192. The others were (iii) cross-over security, rendering it possible for the security interest to 'float' so that it does not attach to particular assets but rather to a pool; (iv) an interest in proceeds, so that on the sale of the stock by the trader, the financier still has a real right, now in the

have a separate agreement and a separate registration in respect of each advance or each security right. The fundamental flaw inherent in the South African notarial bond system is that unlike the Article 9 system and the floating charge of English law, it does not allow the registration of a security interest over stock in general terms for example in the form of ‘automobiles held as stock’. In such cases the financier’s security rights will attach automatically as the trader acquires new stock. But the South African Security by Means of Moveable Property Act requires the goods to be *specified* as well as described, ‘in the manner that renders it readily recognisable’ This precludes a registration with a general description, such as ‘automobiles held as stock’.

The Security by Means of Moveable Property Act is a welcome innovation but it will not serve commercial needs of parties who wish to lend and borrow money against the security of stock. Still less would such parties wish to be driven to field warehousing, which if taken seriously, involves the generation of documentation for each movement of goods into and out of the field warehouse.⁴⁰

The law should be developed consistently with precedent and the demands of legal principle, so as to facilitate legitimate commercial enterprise rather than to obstruct it. While comprehensive legislative reform might be the best way to tackle the problem, I have tried to argue that in the particular context of the purchase money financing of stock, the case law of South Africa is flexible enough to meet the needs of commerce. Archaic principles and traditional ideas about fictitious delivery should not be allowed to impede commercial development. Roman-Dutch law is still a ‘virile system of law, ever seeking, as every system must, to adapt itself consistently with its inherent basic principles to deal effectively with the increasing complexities of modern organised society.’⁴¹

Floor plans in one form or another have been used in South Africa since the 1960’s. The motor industry relies heavily on the validity of these arrangements for its efficient operation. Hopefully, the South African courts would, as was the case in the Netherlands, be bold enough to decide that precedent, policy and the needs of commerce all point to the validity of this kind of transaction. Unlike the Dutch system, it should not be necessary for the South African courts to employ the same

proceeds of the sale held by the trader; and (v) a recognition that the regulations which apply to lending money to consumers are not necessarily apposite (appropriate) in commercial loans.

⁴⁰ Other structures may present themselves. Perhaps the trader buying a used car will do so as an agent for his undisclosed principal, the financier; ownership would pass to the financier, not by *consitutum possessorium* but by actual delivery to the agent. The difficulty with this is that the financier will not want to bear the risk that the car cannot be sold within a reasonable time, but contractual provisions which transfer this risk to the trader may be impermissible as inconsistent with the nature of agency. Then there could be a sale to the agent/trader with reservation of ownership; or the agent/trader could simply sell the car on behalf of the principal/financier. The complexity and artificiality of the transaction in *Welsh Development Agency v Export Finance Co Ltd* 1992 BCLC 148, 1992 BCC 270 reflects well on the ingenuity of the solicitors who dreamed it up, but not so on the legal system which generated the incentive for its creation.

⁴¹ Lord Tomlin in *Pearl Assurance Co v Union Government* 1934 AD 560 (PC) 563.

device as the Modern Dutch Hoge Raad and to validate a leaseback transaction only where it was the intention of the trader to transfer outright ownership to the financier. As an uncodified system, South African law could hark back to decisions of the *Hoge Raad* in the Netherlands in the 18th century which recognised the validity of the ancient *fiducia cum creditore* in financing the acquisition of stock even though famous Roman-Dutch writers like Voet and van der Linden criticised the institution on doctrinal grounds.⁴²

⁴² Such a transaction with regard to movables was recognised by the High Council (Hoge Raad), the highest court in Holland at the time, in decisions handed down on 13 November 1737 and on 23 September 1746. See VAN BIJNKERSHOEK *Observationes Tumultuariae*, Haarlem 1962 IV no. 3051 and PAUW *Observationes Tumultuariae Novae* Haarlem 1964, I no. 187. The case concerned a shopkeeper who had transferred her stock in trade to a creditor by way of constructive delivery obviously to avoid the rules applying to hypothecs. The court felt obliged to determine the true nature of the transaction by considering the actual words used by the parties. It found that the parties actually intended to create a security interest by way of constructive delivery. What had actually happened was that, despite VOET's contrary opinion in *Commentarius ad Pandectas*, Lugduni Batavorum, Hagae 1698-1704, 20 1 12 supported by VAN DER LINDEN *Koopmans Handboek* Amsterdam 1806 1 12 3 (that all non-possessory security interests, be it hypothec or a non-possessory pledge, were subject to the maxim *mobilia non habent sequelam* and that security interests in movables could only be validly created by transfer of possession to the creditor), a valid security interest on the stock had been created by constructive delivery. But because judicial decisions were given without any reasoning and the reports of van Bijnkershoeck and Willem Pauw were not published until the 20th century, Voet remained influential despite his rejection on this point by High Council.

SUPPLIER (VOLKSWAGEN FACTORY)

FIRST FINANCIER (Nedcor Bank)

ANOTHER DEALER (OR TRADE IN)

MOTOR DEALER

SECOND FINANCIER (Absa Bank)

ULTIMATE PURCHASER

