

Swedish Credit Security Law – A Case for Law Reform?

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1 The General Background

Swedish law in the area of credit security is a combination of very old legislation and legal principles, dating back several hundred of years, and a case by case development through the courts, as well as more recent legislation regarding specific issues and types of property. Although Sweden is viewed as a civil law country in its fundamental legal structure, it also has a quasi-common law development through the case law due to the fact that Sweden never codified its general body of private and commercial law as did Germany and France in the 19th century. Sweden does not have a Civil Code or Commercial Code of the continental type. The codification of 1734 is not a codification comparable with continental models, but rather an amalgamation of medieval, local laws influenced by Roman law. This has meant that the law in force in the area of credit security is piecemeal and sketchy, and oftentimes difficult to discern. With this in mind, an overview of the structure and content of the Swedish credit security law is given below.

There is no traditional area of law categorised as “Credit Security Law,” and it is only recently that it has been accepted as a discipline in Swedish legal academic writing.¹ However, in later years an understanding has emerged in different quarters concerning the need for a more organised and constructive approach towards the material issues belonging to the area of credit security. The need for stability and predictability has dictated development in this field, although when it comes to legislative reform, it has just started.

2 What is Governed by Credit Security Law?

A summary of the legal techniques and institutions recognised in Swedish law with a security function is presented first, followed by a few comments as to their material content.

1 Security with Legal Effect towards Third Parties (in rem)

1.1 Security based on a property interest in specified property

Stoppage in transit

Retention of title clause

Property right to a sum of money held in trust by an intermediary

Commission agency goods

Consignment of goods

Security transfer with or without a change in possession

1 The first major book on the legal aspects of the subject is Helander, Bo, *Kreditsäkerhet i lös egendom*, AB P A Norstedt & Söners Förlag, Stockholm 1984. Observations on Swedish law in this area can be found in Lurger, Birgitta, Faber, Wolfgang *Principles of European Law, Acquisition and loss of Ownership of Goods*, Sellier, Munich 2011.

- Leasing
- Factoring
- Securitization
- Repurchase agreement
- Marking of timber without change of possession
- Boat construction advance payment
- 1.2 Security based on pledge and pledge-like techniques
 - Real property mortgage and shipping mortgage
 - Business (floating) charge
 - Aircraft mortgage
 - Pledge regarding patents and trade marks
 - Possessory pledge regarding personal property (chattels)
- 1.3 Lien
- 1.4 Set-off, clearing, netting

- 2 Security with Legal Effect only towards a Contracting Party (in personam)²**
 - 2.1 Security based on surety
 - Primary and secondary surety according to Chap. 10 of the Commercial Code 1734
 - Letter of intent, letter of comfort
 - Guarantee, warranty, covenants
 - Credit insurance
 - 2.2 Contract based securities, which are not a surety
 - Negative pledge
 - Subordination clauses
 - Contractual priority scheme among creditors

3 Some Comments Concerning the Content

Presented in this manner, a list of this kind may seem rather comprehensive and adapted to the demands of the modern market. However, there is much to be desired concerning the standards of the rules in terms of predictability and adaptation to modern demands. It is not possible here to give a thorough

² These forms of security interests will not be addressed in this paper.

account as to the intricacies of all these different security methods. It must suffice to highlight a few problematic questions.

First, Sweden does not have a general registration system for security interests as provided for in the United States by UCC Art. 9, in Canada through the Personal Property Security Acts or in New Zealand through the New Zealand Personal Property Act 1999. Each type of Swedish security interest has developed more or less on its own, without much co-ordination with related types. Secondly, there are no clear distinctions made between commercial and consumer relations, although a consumer as a debtor is treated by the courts with the consumer protection laws in mind, and therefore has a better position than a commercial debtor with respect to creditors. The only general legislative restriction is that a business (floating) charge is reserved for business activities and the assets of the business entity.

3.1 *Stoppage in Transit*

Stoppage in transit has been viewed as a security device by the Swedish Supreme Court³ under the rationale that there are no other practical means of security available for many sellers. However, stoppage is a device regulated in the Sale of Goods Act 1990⁴ sec. 61, and it cannot be extended by contract or unilaterally by the seller to situations other than those covered by this section. This means that stoppage is limited to cases in which the seller, during the course of transportation of goods to the buyer, learns that the buyer has difficulties in performing the obligation of paying the purchase price.⁵

3.2 *Retention of Title*

Retention of title is recognised by the courts as a security device for sellers of chattels, both in commercial and consumer relations. The contractual side of credit sales, including the use of retention of title clauses, has been regulated through mandatory legislation in the Instalment Sales Between Merchants Act 1978⁶, sec. 7-10, and the Consumer Credit Act 2010⁷, sec. 38-42. However, the seller's protection against claims from third parties (purchasers in good faith and the buyer's creditors) is not covered by this legislation. Retention of title clauses have been recognised in the case law as a right *in rem* under certain conditions. First, the chattel must be a physical, identifiable object with a second-hand value possible to realise. Secondly, only the seller's interest in the

3 *Nordisk Tekstil Væveri Aktieselskab v. Tedder Kläder Aktiebolag*, NJA 1985 p. 879.

4 Köplag (1990:931).

5 See for references to Swedish law, Johansson, Svante O., *Stoppningsrätt under godstransport*, Norstedts Juridik, Stockholm 2001.

6 Lag (1978:599) om avbetalningsköp mellan näringsidkare m. fl.

7 Konsumentkreditlag (2010:1846).

purchase price can be validly secured by a retention of title clause. Finally, retention can only be effectuated as long as there is a claim remaining on the debt and the chattel is still in the hands of the buyer (it has not been resold, processed or consumed). This means that the retention of title clause is not a very effective credit security measure for sellers in general, and particularly not for commercial sellers.⁸

3.3 *Property Right to a Sum of Money held in Trust by an Intermediary*

According to the Money Held in Trust Act 1944⁹, it is possible to have a property right to a sum of money held by another person on behalf of the owner. This claim must be labelled as a property right because the creditor/owner has the right to separate the entire sum from the debtor's estate, ultimately in bankruptcy. It is not necessary that the identity be maintained in the sum paid to the intermediary, but it has to be deposited by the intermediary in a separate account without undue delay after receiving it, in order to protect the principal's right to the amount. However, an ordinary debt cannot be transformed into money held in trust by the parties through contract. There has to be an independent ground for this conclusion, such as an instruction by a third party (the payer) to the intermediary to transfer the sum to the principal, or a contractual relation between the principal and the intermediary which encompasses the handling of external money by the intermediary. The 1944 Act has been addressed several times by the courts with respect to the interpretation of when a sum of money is held in trust and when undue delay exists, but there still is uncertainty concerning its application.¹⁰

3.4 *Commission Agency Goods and Consignment of Goods*

Commission agency is regulated in the Commission Agency Act 2009.¹¹ Section 23 of the Act stipulates that goods sold or bought by the agent on behalf of the principal are the property of the principal until the property directly moves to or from the third party (buyer or seller). The agent is never the owner of the goods unless he makes a purchase or sale expressly for his

8 The law in this area has been extensively researched and discussed by Persson, Annina H., *Förbehållsklausuler*, Rättsvetenskapliga Biblioteket no. 7, and part II *Förbehållsklausuler i vissa främmande rättssystem*, Stiftelsen Skrifter Utgivna av Juridiska Fakulteten vid Stockholms Universitet, Stockholm 1998.

9 Lag (1944:181) om redovisningsmedel.

10 See the Supreme Court Cases *Josam Lastbilsteknik AB v. Obligentia Finans AB, bankrupt*, NJA 1995 p. 367 II; *Zambagar Direkt Persontransport & Service i GBG AB, bankrupt, v. BSP Scandinavia ekonomisk förening*, NJA 1999 p. 812; *Gulliver's Resebureau AB, bankrupt, v. BSP Scandinavia ekonomisk förening*, NJA 2007 p. 599.

11 Kommissionslag (2009:865).

own account. This legislation is also applicable to trade in securities and financial instruments through intermediaries, sec. 1 paragraph 3 of the Act.

Consignment of goods is not regulated through legislation but is a method used in order to take advantage of the commission agency model without having to create the contractual relationship of a commission agency. It is doubtful if this method is recognised as binding towards third parties, e.g. the bankruptcy creditors of the consignee. This issue has not yet been tried in the courts.

3.5 *Security Transfer with or without a Change of Possession*

It has long been recognised that a sale of chattels can work as a security device. The purchase price is then a credit extended by the buyer to the seller, and normally, the sale is combined with some form of resale agreement between the parties. The common understanding in the legal literature is that in general, the rules concerning pledges are applicable to this kind of security transfer. One example of this is that sec. 37 of the Contracts Act 1915¹², invalidating contract clauses with automatic property transfers in the case of non-payment of a secured debt (*lex commissoria*), is applicable to both pledge-contracts and security transfer-contracts. However, for approximately the last one hundred years, the perfection of a sale of personal property, both a real sale and a security transfer, requires delivery of the property and a change of possession, or at least a passing of the legal control over the property.¹³ This possessory requirement can be substituted by a rather burdensome and formal method of publication and registration, which is regulated in the "Trade in Chattels, which the Buyer Leaves in the Seller's Care Act" 1845¹⁴. This means that the sale and lease-back of personal property, with legal effect towards third parties, can be used as a credit device under Swedish law, but it is rather difficult to meet the demands of the rules and to be certain that a secured position really has been achieved. It can be mentioned that there are two Supreme Court cases from the late 1990's, in which the buyer/creditor had not perfected the purchase in a correct manner, and consequently did not have a right of separation in the seller's bankruptcy.¹⁵

12 Lag (1915:218) om avtal och andra rättshandlingar på förmögenhetsrättens område.

13 See the discussion by the Supreme Court in *Britt Automobil AB, bankrupt, v. Förvaltningsbolaget ZXSAQAS I Stockholm AB*, NJA 2007 p. 413, and *Elcon Finans AS v. Sannäs Råkor AB, bankrupt*, NJA 2008 p. 684.

14 Lag (1845:50 s. 1) om handel med lösören, som köparen låter i säljarens vård kvarbliva.

15 *Förvaltningsaktiebolaget Traven v. Finnboda AB, bankrupt*, NJA 1997 p. 660, and *Masters Möbel AB, bankrupt, v. Nils N., bankrupt*, NJA 1998 p. 379.

3.6 *Leasing, Factoring and Securitization*

Finance leasing, factoring of receivables and securitization are all imports from the United States, and Great Britain to some extent, and have the same characteristics as in those jurisdictions. Initially, there was some uncertainty over the viability of these methods within Swedish law, but it has turned out that the Swedish legal system has had enough flexibility to harbour them. There is no specific legislation governing these methods as to date.

3.7 *The Repurchase Agreement*

Repurchase agreements or "Repos" are used in the financial markets in the same way as in other countries. There is no specific legislation regulating these contractual obligations and the precise extent of their validity in relation to third parties. It can be questioned whether a resale obligation is binding as to the obligated party's creditors. On the other hand, there is nothing in Swedish law that prevents a conclusion that they are valid and binding. When the EC Collateral Directive¹⁶ was implemented in Sweden it was stated that "repos" were valid and binding according to Swedish law.¹⁷

3.8 *The Marking of Timber without Change of Possession*

According to local custom in the forestry and timber industry in Sweden, it is common to leave timber in the woods for longer or shorter periods of time before transportation to a processing plant. This could mean an unforeseen risk to the buyer if the seller becomes insolvent before the buyer has taken possession of the purchased timber. However, according to specific legislation, the Marking of Timber Act 1944¹⁸, the marking of sold timber according to the custom of the place, for the account of the buyer will act as a substitute for the transfer of possession and protect the buyer's right as against the seller's creditors. The buyer can therefore pay the purchase price independently of the possession of the timber and, depending on the situation, the legislation can work as a credit device for the seller.

3.9 *Boat Construction Advance Payment*

If a contract for the construction of a boat stipulates advance payment or advance delivery of building materials by the buyer to the builder, and the

16 Directive 2002/47/EC of the European Parliament and of the Council of 6 June, 2002, on financial collateral arrangements.

17 Proposition (to implement Directive 2002/47/EC) 2004/05:30 p. 31.

18 Lag (1944:302) om köparens rätt till märkt virke.

contract is in writing, it can be registered with the District Court of Stockholm, and thereby create a security interest in the unfinished boat and delivered building materials for the buyer.

3.10 *Real Property Mortgage, Shipping Mortgage and Business (Floating) Charge*

Real property mortgages, shipping mortgages and business (floating) charges here can be discussed together because of their common legislative background. In 1970, a new Real Property Code¹⁹ was enacted, with new rules concerning real property mortgages. These rules have later been used as a model for the corresponding rules in the Maritime Act 1994²⁰ and the Business (floating) Charge Act 2008.²¹ For all three, the technique for establishing a perfected security is based on an entry in a register (the Land-, Ship- or Business charge-register respectively). This is followed by the issuance of a letter of mortgage (or charge) by the registrar, which is viewed as representing a certain value as stated in the letter regarding the registered piece of property, be it a certain real estate, a specified ship or a certain business entity. The letter of mortgage (or charge) can then be pledged as a piece of personal property and the perfection of the security is achieved by handing over the letter to the secured creditor. The physical letter of mortgage of real property and business charge, but not concerning ships, may be replaced by an electronic registration and in that case the perfection of a security is also done by registration. The creditor then has a valid security as long as he has direct or indirect possession of the letter or is registered holder.

There are, of course, differences between the three forms of mortgages or charges but this is not the place to go into more detail. However, it should be emphasised that the system of real estate mortgage and business (floating) charge, but not shipping mortgage, has been completely computerized and thereby dematerialised. The physical paper is replaced by an electronic “letter of mortgage”.

The shipping mortgage also covers ships under construction and fixtures to ships, but not cargo. The business charge is a floating charge in the sense that the property covered by the charge may change over time. It is the business as such that is charged and all personal property belonging to the business at any specific moment is covered, except for cash and means equivalent to cash.²² The charge crystallizes upon distraint on the business property or its bankruptcy. The secured creditor will have priority to a sum, with interest, equivalent to his demand or the letter of charge, whichever is the lowest.

19 Jordabalk (1970:1209).

20 Sjölag (1994:1009).

21 Lag (2008:990) om företagshypotek.

22 Other less significant exceptions are not dealt with here.

3.11 *Aircraft Mortgages*

Aircrafts, separate air plane machines and other flying equipment (spare parts), can be mortgaged through a registration in the Register of Swedish Aircrafts, according to the Registration of Rights in Aircrafts Act 1955²³. In this case, perfection is achieved at the moment of registration and there is no separate letter of mortgage issued, sec. 14 of the Act.

3.12 *Pledge over Patents and Trade Marks*

In later years, new legislation has been introduced in order to facilitate the pledge of certain intellectual rights (patents and trade marks). In the Patent Act 1967²⁴, a new chapter 12 was introduced in 1987²⁵ making it possible to register pledges over patents and at the same time made perfection of such a pledge dependent on registration. This model was followed a couple of years later by new legislation for pledges over trade marks, in the Trade Marks Act 1960²⁶, when sec. 34 a-j²⁷ were introduced. In these two cases, there are no letters of pledge or the like that have to be transferred into the hands of the pledgee. They are purely registered pledges. This construction was deemed appropriate by the Swedish legislator due to the fact that neither for patents nor for trade marks are there any material rights linked to any physical object. There is no “thing” to be transferred and it seemed enough to have only the public record of the Patent and Trade Mark Authority as the device for perfection of the security right.²⁸

3.13 *Possessory Pledges over Personal Property*

The traditional form of pledge over personal property is the possessory pledge, which is regulated in Chapter 10 sec. 1-7 of the Commercial Code 1734. These rules are rather ancient in character. The courts have had several opportunities to interpret and develop the rules; e.g. today possession does not necessarily mean actual, physical possession but rather control over the property, meaning that the owner/pledgor is separated from the control. This legislation today is limited to chattels pledged as separate objects, which is not very common in a

23 Lag (1955:227) om inskrivning av rätt till luftfartyg.

24 Patentlag (1967:837).

25 SFS (Swedish Acts in Force) 1987:1330.

26 Varumärkeslag (1960:644).

27 SFS 1995:1277.

28 The *travaux préparatoires* can be found in Proposition (to amend the Patent Act) 1987/88:4 pp. 9-11, 27-28, 38-39 and 42, and in SOU 1985:10 pp. 81-84 and 159-69; and Proposition (to amend the Trade Marks Act) 1995/96:26 p. 31 et seq.

modern economy²⁹, and is complemented by legislation concerning pledges over negotiable instruments and common receivables in the Negotiable Instruments Act 1936³⁰, and dematerialised or immobilised financial instruments in the Registration of Financial Instruments Act 1998³¹.

A personal property pledge is perfected through possession of the thing pledged (chattels, physical negotiable instruments and shares, paper bonds etc.), or through notice to the debtor (receivables and other claims that are not negotiable), or through registration (dematerialised or immobilised financial instruments). However, the contractual rules concerning the relationship between the pledgor and the pledgee, as far as can be established, are the same for all kinds of personal property. There has to be an agreement to pledge certain property and also an identifiable debt that the pledge is to secure. Further, the contractual liabilities of the parties and the realisation of the pledge are governed by the same non-mandatory rules. As to the exception for pawn brokering, this is true for both consumer and commercial relations.

3.14 *Liens*

A lien in Swedish legal practice is a security interest of limited use. Its primary function is to be a security for a creditor in situations in which work of some form has been performed on the debtor's property and not paid for, and this same property is still in the creditor's possession. The creditor then can retain the property until payment is rendered, on the condition that the claim is for payment for the work done.³² This right of retention is a protected right as against third parties and has priority in the debtor's distraint proceedings and bankruptcy, according to sec. 4 (2) of the Preferential Rights Act 1970³³. There is nothing in Swedish law that prevents the creation of a contractual lien, but it is very unusual in practice. For some reason, this is not a method of security that has been utilised within the Swedish credit market.

3.15 *Set-off, Clearing and Netting*

The general rules regarding set-off to some extent are legislated in the Negotiable Instrument Act 1936, sec. 18 and 28 (concerning the right of set-off in spite of a transfer of a negotiable instrument or claim to a new creditor), but to a large extent are regulated through the case law. This means that set-off can be utilised as a means of security to a certain extent. Set-off is also recognised

29 Except perhaps the system of Pawnbrokers, regulated by the Pawnbroker Act 1995 (Pantbankslag (1995:1000)), with mandatory consumer protection rules.

30 Lag (1936:81) om skuldebrev, sec. 10, 22 and 31.

31 Lag (1998:1479) om kontoföring av finansiella instrument, Chap. 6.

32 *Kockums Jernverks AB, bankrupt, v. Ronneby Rostfria AB*, NJA 1985 p. 205.

33 Förmånsrättslag (1970:979).

as a protected right in bankruptcy, unless the set-off is arranged to circumvent the ordinary rules of creditor equality in bankruptcy, the Bankruptcy Act 1987, Chap. 5 sec. 15 and 16.

Clearing and netting in the Swedish legal language are limited to the clearing and netting systems of the financial markets. The basic principles and boundaries for clearing and netting are found in the Securities Market Act 2007³⁴, Chap. 19-21. Although in both cases they have security functions, they will not be dealt with here.

4 A Final Remark

As demonstrated by this very short overview of Swedish credit security law, there is a lack of organisation within the field. The rules and principles have developed at different times and in many cases independently of each other. There has never been any serious attempt to codify this field of law. Instead, the legal development has often taken place in the courts. In some instances, this has meant an effective and flexible approach to unsolved problems, but in others, it has hindered the necessary adaptation and development of the law. It would seem that the credit security law would be an exceptionally good area for a major legislative initiative, maybe along the lines demonstrated by the developments in the Common Law area.

One example of how the courts have developed the law is the spread by analogy of the rule concerning the perfection of a sale or pledge of receivables. In sec. 10 and 31 of the Negotiable Instruments Act 1936, it is stated that perfection is accomplished by notice to the debtor concerning the sale or pledge of the debt. This rule is based on the rationale that a debtor who is made aware of the transaction concerning his debt cannot meet his obligation by paying a party other than the new creditor. Therefore, the material right to the demand can be linked to the notice given to the debtor, and if he is informed of the transaction, the seller or pledgor does not after that have any right to dispose over. This system of rules has been used by the courts in several situations that do not involve receivables, but have the same characteristics, with a third party (the debtor) obligated to deliver or perform something to a creditor. If the creditor chooses to dispose over his right through a sale or pledge, instead of demanding performance directly from the debtor, the rule from the Negotiable Instruments Act 1936 will apply by analogy. One example of this is a Supreme Court case concerning the validity of a refinancing scheme adopted by a leasing company.³⁵ The scheme involved the security transfer of leasing equipment by the leasing company to a financier. The equipment stayed with the lessee who was notified as to the transfer and that the leasing company for the remainder of the leasing period would be the representative of the financier and that nothing would change for the lessee. The Supreme Court

34 Lag (2007:528) om värdepappersmarknaden.

35 *AEC Investment AB v. Obligentia Finans AB, bankrupt*, NJA 1995 p. 367 I.

found that this was a perfected sale and that the financier thereby had priority to the equipment in the leasing company's bankruptcy proceeding. This finding is an example in which the Supreme Court has shown flexibility and a readiness to adapt the rules to modern demands. There was no indication of any deception with respect to the bankruptcy creditors – secured or unsecured – and it did not create any false wealth-problems. However, this attitude does carry the risk of creating a number of new questions and uncertainties, which may or may not be solved through new case law. Sweden is not a common law country and has a weaker system of precedent, with fewer cases tried in the courts than for instance, Great Britain or the United States. The Swedish attitude has traditionally been to address new demands with specific legislation, not to leave it to the courts, and therefore this area of the law is in great need for a legislative initiative.