

U n i d r o i t

INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

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M e m o r a n d u m

concerning the introduction of some principles
of trust into the "Civil Law Legislations"

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Trust Receipts.

The trust receipt is used in the U.S.A. (and, to a lesser extent, in England)⁽¹⁾ to enable banks and other finance corporations to advance money to traders on the security of goods in such a way that the goods remain in the possession of the dealer for the purposes of trade.

The device was first used in the import trade, in the following way. An American importer would conclude a contract for the purchase of goods with a foreign seller, at the same time making an agreement with a bank or finance corporation whereby the seller would be allowed to draw on the bank for the price in return for the bill of lading. In order to permit the importer to obtain possession of the goods, the bill of lading would be handed over to him, he giving a trust receipt for it to the banker. The trust receipt would acknowledge that the importer as to hold the bill of lading, and the goods referred to therein, as trustee for the bank and that the proceeds of the sale of the goods (or a stated sum of money) would be remitted to the bank before a certain date. Thus, until the trust was extinguished by the repayment by the importer of the sum advanced, no title to the goods would pass to him. It was on this ground that the trust receipt device was distinguished, from a legal viewpoint, from a mortgage of chattels by the importer. He could not mortgage the goods because he did not own them; but since he had possession of the goods for the purposes of trade, a buyer from him in the ordinary course of trade would obtain a good title.

(1) See Law of Banker's Commercial Credits, by H.C. GUTTERIDGE and M. MEGRAH, London 1955, at 135.

The success of the trust receipt in the field of import trade has led to its adoption in all those branches of commerce which involve financing operations. Wherever anyone other than a consumer needs the possession of goods which are the security for a credit operation the trust receipt is used.

The machinery foreseen by the Uniform Trust Receipts Act (drafted to unify the legislation of the different States on this topic) is as follows:

1. Goods must be delivered to the trustee (the dealer), by the entruster (bank or finance corporation) or by a third party.
2. The entruster must have a security interest in those goods, and a trust receipt be given by the trustee in respect of them.
3. The goods must be delivered to the trustee in order to be sold by him, or to be processed, transshipped or stored by him with the purpose of ultimate sale.

In other words, the whole transaction must envisage temporary possession by the trustee, with a power to pass title in the ordinary course of his business.

4. The effect of the trust receipt, as regards a third party buying the goods to which the trust receipt relates from the trustee, is that the buyer gets a good title, provided he buys in the ordinary course of trade.

As regards other third parties claiming rights over the goods, e.i. the general creditors of the trustee, the entruster's security is valid for a period of 30 days with and without notice, and is valid thereafter provided that a notice of the fact that the trustee and entruster are engaged in financing under trust receipt transactions is filed in a state register kept especially

for this purpose. Such notice gives no details of individual transactions (thus precluding help to competitors), but merely gives a general warning that goods in the possession of the trustee may not, in fact, be his own property, so that a person receiving them other than in the ordinary course of trade does so at his peril.

Voting Trusts.

The voting trust is a device used in many joint-stock companies which allows a group of shareholders to pool the voting rights attaching to their shares in order to increase their influence on the policies of the company. It is well recognised that shareholders who are compelled to act individually can have but little hope of exercising any control over the administration of a large company. But the difficulties to be overcome in organising joint act are usually found to be insuperable, at any rate until times of crisis. And the formation of a shareholders' committee is rarely possible except on a temporary basis.

The utility of the voting trust is, therefore, that it allows a group of shareholders who have a common interest to exercise their votes collectively on a permanent, or at least semi-permanent, basis. The shareholders pool their share by transferring them to trustees, each retaining the right to receive from the trust the beneficial interest (dividends, bonuses, options, etc.) in respect of the shares contributed by him.

The trust deed or contract will provide for the establishment of the arrangements for deciding the manner in which the trustees are to exercise the voting rights. This may be left

in all circumstances to the discretion of the trustees or the latter may be instructed to obtain some indication of the wishes of the shareholders before voting on important questions. In any case, some discretion must be given to the trustees to be exercised in emergencies when there is no time to consult the shareholders; but in such event, the trustees must afterwards justify the manner in which that discretion has been exercised.

The trust deed should also specify the duration of the trust, it being remembered that during such period the trust is irrevocable. As a result, a shareholder cannot withdraw his shares from the trust during its existence, but he can, however, dispose of his interest in the trust, i.e. his right to the dividends etc. due in respect of the number of shares he contributed.

As for the trustees, they know that for the period of the duration of the trust they will be able to exercise the voting rights in respect of the shares rested in the trust. This puts them in a stronger position vis-à-vis the board of directors, since they will be known to control a "monolithic" block of shares.

And the trustees may be able to exercise their influence not only directly, when question of policy are voted upon at the general meetings of the company, but also indirectly, through understandings and agreements with other important shareholders on such questions as the nomination of directors.

Through the device of the voting trust, therefore shareholders, who individually could not hope to exert any influence on the administration of the company, are enabled to pool their resources in order to ensure respect for their rights.

Trusts for debenture holders.

Where a company issued a series of debentures charged on the security of its assets it is often desirable, in order to give a more complete protection to the debenture holders to charge specific property of the company as security for the loan. Normally this is difficult, because of the number of persons involved the charge is in favour of a large number of individuals, who may find it impossible to establish machinery for the adequate protection of their interests.

With the use of the trust, however, this practical difficulties are circumvented. The debenture are issued on the understanding that the charge constituting their security shall be vested in trustees, whose duty it is to provide for the proper protection of the debenture holders' interests. Any subsequent sale of the debenture, takes place subject to the same condition, so that the trustees may serve a changing body of beneficiaries.

The trust deed, by which the appointment of the trustees is effected, also regulates their duties and powers. They must, of course, have power to realise the security given as regards the debenture by the company, by compelling the company to sell the asset charged. The trust deed may also impose on the company a duty to disclose information over and above that which company law requires to be made public. In such a case, the trustees should be empowered to convene meetings of the debenture holders in order to pass this information to them and to obtain their advice and instructions. The trustees may be given a discretion in these matters by the trust deed.

Another clause of the same document should specify the various events on the happening of which the security is to become enforceable by the sale of the asset. Default by the company in the payment of principal or interest or the breach of any other fundamental condition of the debenture agreement are, naturally, the chief of such events, but others may be included should the parties so desire.

The advantages of debenture trust deeds are, therefore, as follows:

- 1) The practical difficulties of organisation involved in any form of "self-protection" by the debenture-holders are eliminated.
- 2) The trustees appointed by the trust deed will be persons with business experiences, which the debenture holders themselves may not have.
- 3) The trust deed may compel the company to disclose, as to the state of its affairs, information not required to be published by the company law.
- 4) If the interests of the debenture holders are in peril at any time, machinery already exists for the prompt assertion of their rights.

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