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# The Pledge of Securities as a Way of Providing Satisfaction for Credit Obligation under Ukrainian Law

## I. Introduction

One of the most common ways of providing satisfaction for credit obligation in Ukraine is pledge. In the scientific literature it is referred to the most effective,[1] most efficient,[2] highly liquid,[3] and the most important way of providing satisfaction for credit and other agreements.[4]

In recent years, as a result of development of the securities market and collective investment, crediting under pledge of securities has gained wide acceptance. On the one hand, using securities as a pledge is less expensive to foreclose on them compared to other types of property, and on the other hand, leads to additional risk associated with their liquidity. That is why securities with fixed income most often become a subject of pledge.[5]

Characteristic features of pledge of securities as a way of providing satisfaction for credit obligation include: 1) the right of the pledgee in case of non-fulfilment of the pledger's obligation provided by pledge, to obtain satisfaction due to pledged securities primarily to other creditors; 2) pledge obligations is an additional transaction in relation to the credit agreement, and has accessory (derivative) character that appears as follows: invalidity of the principal obligation leads to invalidity obligation that it ensured, accordingly, the invalidity of the transaction to ensure the fulfilment of the obligation does not specify the invalidity of the principal obligation.

Thus, the recognition of future credit agreement as null and void, automatically generates invalidity of the pledge agreement, and a court decision for this case is unnecessary; 3) pledge provides requirement to the extent that exists at the time of satisfaction, including main debt, interests, necessary expenses of pledgee on the maintenance of the pledged property, damages for overdue (and in cases stipulated by the contract or by law – penalty) as well as the costs for fulfilment, secured by pledge, requirements unless otherwise provided by the contract of pledge; 4) ensure the existence and preservation of pledged securities at the time of calculation of the debtor with creditors; 5) real threat of deprivation of ownership securities is a good incentive for the pledger to fulfil his obligations properly.

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1 *О.А. Загорулько,* Заклад як речовий спосіб забезпечення виконання зобов'язань (*Zagorul'ko*, The pawning as in rem way of providing satisfaction for obligation), Автореф. дис. [...] канд. юрид. наук: 12.00.03, Харків 1997, с. 1.

2 *Д.М. Гриджук/В.О.Олійник*, Застава як спосіб забезпечення виконання зобов'язань (*Grydžuk/Oliinyk,* The pledge as a way of providing satisfaction for obligation), Київ 2002, с. 3.

3 *Г.В. Макаренк*о, Речово-правові засоби забезпечення за цивільним законодавством України (*Makarenko*, In rem-lawfuls tools of providing under Ukrainian civil law), Актуальні проблеми держави і права 2007, Вип. 33, с. 228 (Actual problems of state and law 33|2007).

4 *Е. Павлодский*, Каким быть закону об ипотеке (*Pavlodskii*, What should be the mortgage law), Закон 1993, № 3, с. 48 (Law 3|1993).

5 *Е.В. Варнавская*, Особенности кредитования под залог ценных бумаг (*Varnavskaja,* Features of lending against pledge of securities), Молодой ученый 2013, № 1, с. 90–93 (Young scientist 1|2013).

Considering the specific legal nature of the securities, the difference in their treatment, conditioned the form of their existence, their pledge comparing to other types of property has many special features in practical realization. Not the least complications are aroused by theoretical analysis of pledge.

## II. Legal regulation of pledge of securities

Legal regulation of pledge of securities as a way of providing satisfaction for credit obligation is differentiated by a large number of regulatory array. First of all it is caused by the features of subjective composition of relations related to ensuring the credit agreement and specificity of securities as an object of pledge legal relations. Legislation in the area of pledge of securities as a way of providing satisfaction for credit agreement can be divided into the following groups:

1) Codified acts: Civil Code of Ukraine[6] (CC) and the Commercial Code of Ukraine[7] (CommC), which set out the general principles of pledge of securities as a way of providing satisfaction for credit obligation. Thus, Chapter 49 of fifth book "Law of Obligations" CC is devoted to ways of providing satisfaction of obligations. Paragraph 1 of this chapter determines general provisions about the ways of providing satisfaction for obligations, and the following paragraphs 2–7 are devoted to regulating certain kinds of ways of providing satisfaction for obligations in particular, forfeit, guarantees, bailment, deposit, pledge and retention. In paragraph 6 "Pledge" from among the other type of property, which may be a subject of pledge, the legislator distinguishes securities, but he doesn't establish special regulation of the pledge in the CC. Without specific regulations about the ways of providing satisfaction for obligation, in art.199(1) CommC it is determined that the relevant provisions of the CC, which contains a blanket rule in relation to the provisions of CC, shall be applicable to the relationship about the way the of providing satisfaction for obligation between the participants of commercial relations.

2) Special regulations devoted to movable property pledged as a way to enforce obligations, these include: the Law of Ukraine "On Pledge"[8] (which determines general provisions regarding the pledge as a way of providing satisfaction for obligation, guarantees the rights of the parties in the pledge, and contains separate sections devoted to pledge goods for sale or processing establishment, property rights and securities), Law of Ukraine "On securing creditors' claims and registration of encumbrances"[9] (defines the legal regime regulating movable property encumbrance established to the providing of satisfaction for obligations, and legal regime of origin, publishing and other rights of businesses and individuals in relation to personal property).

3) Special regulatory legal acts devoted to the regulation of credit obligations, including: the Law of Ukraine "On banks and banking",[10] Law of Ukraine "On the Na-

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6 Цивільний кодекс України (Civil Code of Ukraine) від 16.01.2003 № 435-IV/Відомості Верховної Ради України (ВВР) (Supreme Council of Ukraine), 2003, № 40–44, ст. 356.

7 Господарський кодекс України (Commercial Code of Ukraine) від 16.01.2003 № 436-IV/Відомості Верховної Ради України (ВВР) (Supreme Council of Ukraine), 2003, № 18, 19–20, 21–22, ст. 144.

8 Про заставу. Закон України від 02.10.1992 № 2654-XII/Відомості Верховної Ради України (ВВР), 1992, № 47, ст. 642.

9 Про забезпечення вимог кредиторів та реєстрацію обтяжень. Закон України від 18.11.2003 № 1255-IV/Відомості Верховної Ради України (ВВР), 2004, № 11, ст. 140.

10 Про банки і банківську діяльність. Закон України від 07.12.2000 № 2121-III/Відомості Верховної Ради України (ВВР), 2001, № 5–6, ст. 30.

tional Bank of Ukraine",[11] the Law of Ukraine "On financial services and state regulation of financial services market",[12] Law of Ukraine "On liability for untimely monetary obligations discharge"[13] the Law of Ukraine "On the protection of consumers' rights"[14] (contains provisions devoted to consumer crediting), National Bank of Ukraine Board Resolution "On measures to ensure repayment of credits". [15]

4) Regulatory legal acts devoted to the regulation of the circulation of securities: the Law of Ukraine "On securities and stock market"[16], the Law of Ukraine "On the depository system of Ukraine",[17] (defines the legal principles of operation of the depository system of Ukraine, establishes the procedure for registration and confirmation of rights to equity securities and rights for them in the depository accounting of securities, and the procedure of payments for transactions on equity securities), the Law of Ukraine "On mortgage crediting, operations with consolidated mortgage debt and mortgage certificates"[18] (among other, establishes principles of circulation of one of the types of securities – mortgage certificates) the Law of Ukraine "On the circulation of promissory notes in Ukraine",[19] the Convention, which introduced a Uniform Law on transferring and ordinary promissory notes,[20] Convention on the Settlement of Certain Conflicts of Laws of on transferring and ordinary promissory notes,[21] National bank of Ukraine Board Resolution "On the order of banking operations with promissory notes in local currency in Ukraine",[22] the Law of Ukraine "On Pledge"[23] (among other things, regulates the circulation of one of the types of securities – pledge), Law of Ukraine "On financial and credit mechanisms and management of housing construction and real estate transac-

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11 Про Національний банк України. Закон України від 20.05.1999 № 679-XIV/Відомості Верховної Ради України (ВВР), 1999, № 29, ст. 238.

12 Про фінансові послуги та державне регулювання ринків фінансових послуг. Закон України від 12.07.2001 № 2664-III/Відомості Верховної Ради України (ВВР), 2002, № 1, ст. 1.

13 Про відповідальність за несвоєчасне виконання грошових зобов'язань. Закон України від 22.11.1996 № 543/96-ВР/Відомості Верховної Ради України (ВВР), 1997, № 5, ст. 28.

14 Про захист прав споживачів. Закон України від 12.05.1991 № 1023-XII/Відомості Верховної Ради УРСР (ВВР), 1991, № 30, ст. 379.

15 Про заходи щодо забезпечення погашення кредитів. Постанова правління Національного банку України від 06.08.2009 № 461/Урядовий кур'єр від 18.08.2009, № 149.

16 Про цінні папери та фондовий ринок. Закон України від 23.02.2006 № 3480-IV/Відомості Верховної Ради України (ВВР), 2006, № 31, ст. 268.

17 Про депозитарну систему України. Закон України від 06.07.2012 № 5178-VI/Відомості Верховної Ради (ВВР), 2013, № 39, ст. 517.

18 Про іпотечне кредитування, операції з консолідованим іпотечним боргом та іпотечні сертифікати. Закон України від 19.06.2003 № 979-IV/Відомості Верховної Ради України (ВВР), 2004, № 1, ст. 1.

19 Про обіг векселів в Україні. Закон України від 05.04.2001 № 2374-III/Відомості Верховної Ради України (ВВР), 2001, № 24, ст. 128.

20 Конвенція, якою запроваджено Уніфікований закон про переказні векселі та прості векселі від 07.06.1930/ Офіційний вісник України, 2013, № 31, с. 368.

21 Конвенція про врегулювання деяких колізій законів про переказні векселі та прості векселі від 07.06.1930 № ETS 051 available at: http://zakon4.rada.gov.ua/laws/show/995_007 (30 March 2015); Про приєднання України до Женевської конвенції 1930 року про врегулювання деяких колізій законів про переказні векселі та прості векселі. Закон України від 06.07.1999 № 827-XIV/Відомості Верховної Ради України (ВВР), 1999, № 34, ст. 291.

22 Про порядок здійснення банківських операцій з векселями в національній валюті на території України. Постанова правління Національного банку України від 16.12.2002 № 508/Офіційний вісник України, 2003, № 10, с. 58.

23 Про іпотеку. Закон України від 05.06.2003 № 898-IV/Відомості Верховної Ради України (ВВР), 2003, № 38, ст.313.

tions"[24] (sets legal principles and characteristics of production, placement and accounting one of the types of securities – certificates of real estate funds), the Law of Ukraine "On joint stock companies"[25] (among other, defines the principles of outstanding shares), the Law of Ukraine "On Collective Investment Institutions"[26] (among other things, sets emission features, circulation, accounting and redemption of collective investment institutions securities (investment certificates and corporate investment fund shares), The decision of the National Commission on Securities and Stock Market "On approval of Regulation of the procedure of issuance of corporate bonds, bonds of international financial organizations and their circulation",[27] Decision of the National Commission on Securities and Stock Market "On approval of Regulation of the procedure of issuance of local bonds and their circulation",[28] Resolution of the Cabinet of Ministers of Ukraine "On the issue of treasury promissory notes "Military"",[29] National Bank of Ukraine Board Resolution "On the approval of the Regulation of the procedure for banks of Ukraine deposit transactions with corporations and individuals",[30] (along with other things, regulates the procedure for circulation of one of the types of securities – savings (deposit) certificates), Resolution of the Cabinet of Ministers of Ukraine "Some issues of the bonds emission of international financial institutions",[31] the Law of Ukraine "On Mortgage Bonds",[32] the Law of Ukraine "On certified warehouses and simple and double warehouse certificates",[33] the Decision of the National Commission on Securities and Stock Market "On the approval of the procedure of registration of the issue option cer-

[24] Про фінансово-кредитні механізми і управління майном при будівництві житла та операціях з нерухомістю. Закон України від 19.06.2003 № 978-IV/Відомості Верховної Ради України (ВВР), 2003, № 52, ст. 377.

[25] Про акціонерні товариства. Закон України від 17.09.2008 № 514-VI/Відомості Верховної Ради України (ВВР), 2008, № 50-51, ст. 384.

[26] Про інститути спільного інвестування. Закон України від 05.07.2012 № 5080-VI/Відомості Верховної Ради (ВВР), 2013, № 29, ст. 337.

[27] Про затвердження Положення про порядок здійснення емісії облігацій підприємств, облігацій міжнародних фінансових організацій та їх обігу. Рішення Національної комісії з цінних паперів та фондового ринку від 27.12.2013 № 2998/ Офіційний вісник України, 2014, № 12, с. 56.

[28] Про затвердження Положення про порядок здійснення емісії облігацій внутрішніх місцевих позик та їх обігу. Рішення Національної комісії з цінних паперів та фондового ринку від 29.04.2014 № 578/Офіційний вісник України, 2014, № 46, с. 24.

[29] Про випуск казначейських зобов'язань. Постанова Кабінету Міністрів України від 05.09.2012 № 836/Офіційний вісник України, 2012, № 67, с. 5; Про випуск казначейських зобов'язань "Військові". Постанова Кабінету Міністрів України від 01.04.2014 № 100/Офіційний вісник України, 2014, № 32, с. 12.

[30] Про затвердження Положення про порядок здійснення банками України вкладних (депозитних) операцій з юридичними і фізичними особами. Постанова правління Національного банку України від 03.12.2003 № 516/Офіційний вісник України, 2004, № 1, с. 32.

[31] Деякі питання емісії облігацій міжнародних фінансових організацій. Постанова Кабінету Міністрів України від 13.08.2014 № 327/Офіційний вісник України, 2014, № 66, с. 27.

[32] Про іпотечні облігації. Закон України від 22.12.2005 № 3273-IV/Відомості Верховної Ради України (ВВР), 2006, № 16, ст. 134.

[33] Про сертифіковані товарні склади та прості і подвійні складські свідоцтва. Закон України від 23.12.2004 № 2286-IV/Відомості Верховної Ради (ВВР), 2005, № 6, ст. 136.

tificates and their emission prospectus",[34] the Law of Ukraine "On privatization securities".[35]

5) Regulatory legal acts, which do not belong to the special in the regulation of pledge of securities, however, contain provisions that may apply to the legal pledge relations, which ensure credit obligation, in particular: the Law of Ukraine "On insurance"[36] the Law of Ukraine "On enforcement proceedings"[37] (defines the conditions and procedure enforcement of court decisions and other organs (officials)), the Law of Ukraine "On restoring the solvency of the debtor or declaration of bankruptcy"[38], the Law of Ukraine "On notary"[39] (among other, establishes the procedure for committing notary's acceptance of a deposit securities), and others.

## III. The subject of the pledge securities contract

The foundation of the origin of pledge securities on credit obligations is a contract. According to the general rule a contract is concluded since the parties reach agreement on all its essential conditions. In accordance with the provisions of the CC, the essential conditions are conditions recognized as essential by law or necessary for contracts of this type, and the conditions which should be agreed upon request of either party. A pledge contract should provide the nature, size and term of satisfaction of the principal obligation secured by the pledge and a certain subject of pledge (art. 584 CC).

The derivative nature of the pledge from the secured obligation allows both: presentation of conditions of pledge contract directly in the text of the contract and by reference to the conditions of the credit agreement.

Considering the specificity of the legal nature of the securities as a special kind of civil rights, in the legal doctrine there is a scientific debate on the certainty of the subject securities pledge agreement. Some scholars argue that the subject of the pledge securities agreement is a security as an object of right in rem,[40] others understand that the subject of the pledge securities agreement is single set: security, certified property rights, and in some cases – property;[41] some consider that the subject is a property right, which is con-

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[34] Про затвердження Порядку реєстрації випуску опціонних сертифікатів та проспекту їх емісії. Рішення Національної комісії з цінних паперів та фондового ринку від 16.06.2009 № 572/Офіційний вісник України, 2009, № 80, с. 53.

[35] Про приватизаційні папери. Закон України від 06.03.1992 № 2173-XII/Відомості Верховної Ради України (ВВР), 1992, № 24, ст. 352.

[36] Про страхування. Закон України від 07.03.1996 № 85/96-ВР/Відомості Верховної Ради України (ВВР), 1996, № 18, ст. 78.

[37] Про виконавче провадження. Закон України від 21.04.1999 № 606-XIV/Відомості Верховної Ради України (ВВР), 1999, № 24, ст. 207.

[38] Про відновлення платоспроможності боржника або визнання його банкрутом. Закон України від 14.05.1992 № 2343-XII/Відомості Верховної Ради України (ВВР), 1992, № 31, ст. 440.

[39] Про нотаріат. Закон України від 02.09.1993 № 3425-XII/Відомості Верховної Ради України (ВВР), 1993, № 39, ст. 383.

[40] *О.І.Виговский*, Правове регулювання застави бездокументарних цінних паперів (*Vygovskyi,* Legal regulation of pledge of uncertificated securities), Актуальні проблеми міжнародних відносин 2003, Вип.39/1, с. 163 (Actual problems of international relations 39/1|2003); *О.С.Кізлова*, Вексель у заставних правовідносинах за законодавством України (*Kizlova*, The promissory note in pledge legal relations under Ukraine law), Науковий вісник Міжнародного гуманітарного університету (Серія: Юрисруденція), 2013, № 5, с. 100 (Scientific Bulletin of the International Humanitarian University (Series: Jurisprudence) 5|2013).

[41] *А.А. Маковская,* Залог денежных средств и ценных бумаг, Москва 1999, с. 33 (*Makovskaja*, Pledge of cash and securities).

tained in the security.[42] Determining the subject of the pledge securities – securities or certified property rights – is the first and perhaps the most difficult theoretical problem, the solution of which is closely related to the purely practical legal issues. After all, there are some differences in the regulation of pledge of things, and pledge of property rights. In the case of pledge of things, the pledger is its owner, whilst in the case of pledge of property rights the pledger is the person who owns the proper rights. The order of realization of things, i. e. the subject of the pledge in the case of penalty, is different from the order of property rights realization, because the realization of property rights is held by way of pledger concession in favour of the pledgee requirements concerning property rights.

In legal acts that regulate the relationship connected with pledge securities, the latter is viewed as direct subject of pledge. In practice, the contract of pledge of securities is also concluded as a contract the subject of which is the securities. Taking into account the fact that the securities belong to things and are the subject of civil rights, including property rights, what ensues from the definition of art.115 (2), 116, 177, 344, 389, 576 CC, we must understand that this approach to pledge securities is valid and legitimate.

The dualistic legal nature of the securities lies in the combination of proprietary-legal and obligation-legal characteristics, which are manifested in close connection with property law on securities and rights of securities. Therefore, pledge of rights certified by securities, apart from pledge of rights, is impossible. We consider securities, regardless of the form of their existence, to be a specific object of civil law, the legal nature of which has a thing-obligation nature, and referring them to things, spreading the legal regime of the object of ownership on them is a manifestation of the use of legal fiction. The attribution of securities in the CC to the category of movables certainly affected the possibility of pledge.

Thus, the subject of the pledge during pledge of securities as a way of providing satisfaction for credit obligation is a security and whole set of legal rights, which it contained.

Specifying the subject of pledge, the parties must fulfil mandatory rules laid down in art. 576 of CC and in art. 4 of the Law of Ukraine "On pledge" – "the subject of pledge can be a property, which, according to the legislation of Ukraine, is liable to alienation by the pledger, and in which the penalty may be incurred". The legal restrictions and prohibitions relating to pledge securities of a certain type should be taken into account. Thus, in order to prevent circumvention of mandatory rules about the procedure for redemption of shares by their issuer, art. 24 (3) of the Law of Ukraine "On joint stock companies" stipulates that the corporation has no right to take into pledge its securities. The decision of the Board of the National Bank of Ukraine "On the order of banking operations with promissory notes in local currency in Ukraine"[43] determined that promissory notes issued only for the funds debt or the actual delivery of goods, completed work, rendered services are accepted for the provision of credit obligations. Privatization certificates cannot be used as a pledge for providing credits (art. 5 (3) of the Law of Ukraine "On Privatization Securities").

Taking into account the specificity of the securities as a subject of a pledge contract, we should focus on the research questions associated with the issuance of the additional

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[42] *М. Дякович,* Особливості застави цінних паперів, Вісник Львівського університету ім. Івана Франка 2001, с. 327 (*Diakovych*, The features of securities pledge, Bulletin of Ivan Franko National University of Lviv 2001).

[43] Про порядок здійснення банківських операцій з векселями в національній валюті на території України. Постанова Правління Національного банку України від 16.12.2002 № 508/Офіційний вісник України, 2003, № 10, с. 58.

shares, firstly, results in an increase in the number of shares of the pledger, and secondly, reduces the cost of pledge securities in relation to the share capital of the stock company. It is worth mentioning the situation related to the issuance of additional shares of the issuer in the period of the pledge contract. In this case, due to the increased number of shares of the pledger, there is no automatic increase in the number of securities taken into pledge. After all, in accordance with the contract of pledge securities, a certain number of nominal value shares were transferred into a pledge and the contract did not provide their increase under certain circumstances, including in the additional issue. Shares of additional issue will perform an independent object of civil rights and will be in circulation regardless of the pledged shares. However, in the case of a long-term pledge contract, the pledgee cannot completely eliminate the risk of adoption shares transferred into a pledge and make a decision about additional issue of shares by the issuer. This may result the significant reduction of the number of shares, transferred into a pledge in relation to the total amount of the authorized capital of the company; in accordance with that the value of the securities, in the case of incurring a penalty, will be significantly reduced. In this situation during the conclusion of the pledge securities contract, the parties should use the provisions of the CC, according to which the object of the pledge agreement may be property which is in the pledger's ownership, and the property, which will be in the pledger's ownership after concluding the pledge contract. The pledge contract should provide that the additional shares, which the pledger will take, are the subject of the contract, and that the size of the pledge share of the authorized capital of the issuer cannot be reduced during the term of the pledge contract.

The subject of pledge of securities might not be limited to one type of securities. In this case, as noted in p. 4.3.4. of the Resolution of the Plenum of the Supreme Commercial Court of Ukraine "On certain issues of dispute resolution practice, which are arising from credit agreements", all subjects of pledge must be individualized, and these subjects are defined not only by their specific features, but also by individual characteristics.[44] The description of securities should include qualitative and quantitative indicators. Quality indicators include parameters identifying the issuer, the degree of risk, information about security. Quantitative indicators are expressed in the quantity of securities, which will be pledged. The agreement of pledge must provide the value of each subject of pledge specified by agreement of the parties, and the cost of the entire mass of the pledge in Ukrainian national currency (if necessary, in another currency). All possible changes in estimations of subject of pledge (for example in the case of reducing the cost of pledged securities) must be specified in the contract of pledge. According to the theory of the stock market, the types of securities value are divided into: a) the nominal value of securities –a certain value, which equals the share in the property of the issuer of the security; b) emission value of securities – the cost of purchase of securities by their first owners; c) the market value of securities – the main indicator of liquidity of securities, which is formed in the stock market under the influence of supply and demand for these types of securities; d) carrying value of securities –a value that reflects the issuer's share of net assets, which are measured in accordance with their carrying value.[45]

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[44] Про деякі питання практики вирішення спорів, що виникають з кредитних договорів. Постанова Пленуму Вищого господарського суду України від 24.11.2014 № 1, available at http://vgsu.arbitr.gov.ua/files/pages/ppVGSU_24112014_1.pdf (30 March 2015).

[45] See also: Т.*Б. Бердникова,* Рынок ценных бумаг и биржевое дело (*Berdnikova*, Securities market and exchange deal), Москва 2002; В.С. Загорський, Ринок цінних паперів (*Zagorskyi*, Securities market), Львів 1995; *М.А. Гольцберг*, Акционерные товарищества. Фондовая биржа. Операции с ценными бумагами (*Gol'tsberg*, Joint-stock company. Stock Exchange. Securities trading), Киев 1996; *А.В. Калина/В.В. Корнеев/А.А. Кощеев,* Рынок ценных бумаг *(Kalina/Korneev/Koščheev*, Securities market), Київ 1999; *О.М. Мозговий*, Фондовий ринок (*Mozgovij*, Stock market), Київ 1999; *Я. М.Миркин*, Ценные бумаги и фондовый рынок (*Mirkin*, Securities and stock market),

Considering the abovementioned points, it should be noted that in the contract of pledged securities, for the assessment of securities, the market value of the securities should be indicated. The value of credit issued against securities depends on the quality of the securities and their liquidity rate in the stock market. However, keeping under control the level of pledge securities rate, the pledgee may require additional providing of the credit or reducing the credit line limit.[46] Indeed, reducing the market value of securities does not mean the automatic duty of the pledger to provide additional property (additional securities) to the pledgee for providing the basic requirement, because the current legislation of Ukraine does not define the change in value of the pledged property as a ground of premature termination of legal pledge relations.

The amount of the credit that is given against securities is a fixed certain percentage of the pledge value. This percentage is determined by the degree of risk for the bank on each security, pledged to secure the credit. Therefore, before granting a credit against securities, the bank must take into account a number of factors that are common to all types of securities: the quality of pledged securities; the possibility of the sale of securities; solvency of the issuer's securities (reputation, stability of payments income for securities, which indicates a steady rate of securities); presence in the market value of securities, specified in the contract of storage space of securities.[47]

In accordance with legislation, public accountant verification of the authenticity and the plenitude of balance or financial state of the corresponding side of the pledge agreement and an estimation of the article of pledge can be carried out at the conclusion of pledge contract on the consent of parties or upon request of one of parties.

In practice, the necessary minimum for the credit application on securities pledge is the following list of documents: 1) for issuing securities: financial reporting of issuer, copies of its constituent documents, information about quotation in the organized security market, information as to whether the securities are contained in the stock register, certificate of registration of extract security, and an extract of securities account of the owner of the securities provided by the depository institution (for non-documentary form of issuing securities), or a certificate which is accepted on storage in a bank on the term of action of pledge agreement (for documentary securities issue), the auditor's report, disposal of pledge securities. 2) for non-equity securities: financial reporting of issuer, pledger, promisor, another person that is the payer of a security, constituent documents of the issuer (copy) the pledger, promisor, another person that is the payer of a security, the original of security (including the registry if is necessary), documents and information that are important to the rights arising from the pledge, promissory notes, auditor's report of pledger, promisor, another person that pays for the security.

Unless otherwise provided in the contract of pledge, the securities which are pledged may be the subject of another pledge (art. 588 CC and art. 18 of the Law of Ukraine "On pledge"). Another pledge does not terminate the right of pledge of the prior pledgee,

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Москва 1995; *В.М. Попович*/*А.И. Степаненко*, Управление кредитними рисками заемщика, кредитора, страховика (*Popovyč*/*Stepanenko*, Credit risk management of the borrower, creditor, insurer), Київ 1996; *М.В. Старинський*/*Ж.В.Завальна,* Правове регулювання відносин у сфері випуску та обігу цінних паперів в Україні (*Staryns'kyi*/*Zavalna*, Legal regulation of the issuance and circulation of securities in Ukraine), Суми 2007.

[46] *Попович*/*Степаненко* (*Popovych*/*Stepanenko*), fn. 45, c. 100; *Старинський*/*Завальна* (*Staryns'kyj*/*Zaval'na*), fn. 45, c. 326–327.

[47] Зобов'язальне право України: Підручник / За ред. *Є.О. Харитонова*/*Н.Ю.Голубєвої,* Київ 2011, с. 72–82 (Law of Obligations of Ukraine, *Kharitonov*/*Golubeva* (eds.)); *Д.М. Гриджук*/*В.О.Олійник*, Забезпечення кредитних зобов'язань у діяльності банків (*Grydžuk*/*Oliinyk,* Provision of credit obligations of banking), Київ 2001, с. 34.

which has a preferential right before the following pledgee in order to satisfy his requirements by pledged securities. Following requirements are satisfied in the order of priority of the right of pledge, after having completely provided the requirement of the prior pledge. The pledger is obliged to inform each of the pledgees about all previous pledges, as well as the nature and extent of obligations provided by these pledges.

A transfer of securities into a pledge does not generate the acquisition of the right by the pledgee. The owner of the set of rights under the securities is the pledger. Therefore, the pledgee will not obtain the right to vote at general meetings of the company, because he is not a shareholder of the company, and his interests may be quite different from the interests of the shareholders (for example, in order to satisfy his requirements it will be beneficial to carry out liquidation of the company).[48]

General rules of the CC that establish the rights of pledge disposal are used in pledged securities. The pledger has the right to dispose of the subject of pledge, transfer it to another person, or otherwise dispose of them only with the consent of the pledgee, unless otherwise provided by the contract (art. 586 (2)). Typically, in a pledge securities contract, the parties establish the prohibition on the pledgee's right of disposal of pledged securities in particular, and for the right of alienation without the consent of the pledger. However, this prohibition does not always have an absolute character. Despite this prohibition, in some cases, the pledger will be entitled to dispose of the pledged securities without the consent of the pledgee. Thus, in accordance with the rules of art. 68 of the Law of Ukraine "On joint stock companies", in certain cases the shareholder must request the mandatory redemption of its own stock company's voting shares. As this right is granted to the shareholder by law, he can then use it in the case of pledging his shares regardless of getting permission from the pledgee for alienation of shares.

## IV. The parties of pledge securities contract

The parties in the pledge contract are the pledger and pledgee, who can be an individual, legal entities or the state (art. 11 of the Law of Ukraine "On pledge"). The pledgee can be a bank or other financial institution that provides funds (credit) to the loan debtor in the amount and on terms set by the credit agreement. By virtue of direct prohibition established in art. 24 (3) of the Law of Ukraine "On pledge", the issuer of the pledge securities of a joint stock company cannot act as its pledgee.

The pledger can be both the debtor himself and a third party (property guarantor). The guarantor is liable to the creditor in the event of the debtor's failure regarding the principal obligation solely within the value of the securities that serve as subject of the pledge. All the creditor's rights under this obligation are transferred to the property guarantor, who performed the credit obligation provided by pledge, to the extent to which he met the requirements of the creditor. He is the pledger whose identity does not match with the person of the debtor in the obligation provided by pledge.[49]

Analysing the responsibility of the property guarantor as a pledger under the contract of pledge securities, it must be taken into account that the property guarantor serves as pledger under the contract of pledge and shall be liable to the pledgee for the failure of the debtor to perform the principal obligation. But since he is not the debtor established by the principal obligation, in case of breach of the principal obligation, the property

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[48] Здійснення та захист корпоративних прав в Україні (цивільно-правові аспекти), *В.В. Луць/ В.А. Васильєва/І.Р.Калаур* та ін., *В.В. Луць* (заг. ред.) (The making and protection of corporate rights in Ukraine (civil-law aspects), *Luts/Vasyl'eva/Kalaur, Luts* (eds.)), Тернопіль 2007, с. 198.

[49] Зобов'язальне право України: Підручник/За ред. *Є.О. Харитонова/Н.Ю. Голубєвої* (Law of Obligations of Ukraine, *Kharitonov/Golubeva* (eds.)), Київ 2011, с. 71.

guarantor is responsible for satisfying the requirements of the pledgee only to the property which is the subject of the pledge.

For some categories of subjects, the law may establish prohibitions of participation in relationship as pledge property guarantor. Thus, according to art. 14 (3) of the Law of Ukraine "On collective investment institutions", a corporate investment fund has no right to grant assets in a pledge in the interest of third parties.

The pledger under the contract of pledge securities can be the owner who has the right to alienate pledged securities, and the person to whom the owner in the prescribed manner has transferred these securities with the right of pledge. Thus, a state enterprise, the property of which is subject to the right of full economic management, independently performs pledge of the property, because according to art. 136 CommC of Ukraine the right to economic management as one of the proprietary rights of business entity establishes for it only limited powers of disposition for certain types of property with the consent of the owner. Securities that are in common ownership may be pledged only with the consent of all owners (art. 578 CC, art. 6(1) of the Law of Ukraine "On pledge"), presented in writing (for example by signing an agreement by all owners or their authorised persons). This rule also applies to securities owned by spouses on the right of common ownership. If one or more co-owners of this property will not give such consent, the pledger is not deprived of his right to appeal to court under art. 364 CC of Ukraine in order to demand the separation of his share of the common property for subsequent transfer of it to pledge. In case if securities located under common ownership that were pledged without the consent of all co-owners, the particular contract can be recognized as invalid by a court on the claim of any of the co-owners of the property, whose rights and legitimate interests were violated.

An interesting aspect from a practical viewpoint is the issue of pledge securities by a person who is bound by them, for example in the case of pledge of promissory notes and shares. According to the opinion of *Vygovskyi*, in the case of pledge of promissory notes, the promiser can act as pledger as well as the pledgee of this promissory note. There is a significant different in the case of the transmission of the pledged promissory notes by the pledger issued by him under the contract of pledge. In this case, during the period of the contract of pledge of promissory notes the pledger has no rights – neither rights to any promissory note nor any rights of a promissory note – and, therefore, the right of pledge on such a promissory note does not arise. The joint stock company, which becomes the owner of its own shares for subsequent resale, distribution among its employees or cancellation may also serve as pledger. These shares are owned by the joint stock company by right of ownership, and the company is entitled to dispose of those shares at its own discretion, in particular in order to provide pledge. However, thus the pledge relationship does not cease prior to the expiration of the term of alienation of these shares. As for the shares acquired by the joint stock company in order to reduce the share capital, the company is not entitled to perform any agreement with them, including their transfer into pledge. Shares which have not been paid by the shareholders in a timely manner cannot be transferred on pledge by the joint stock company, as such shares are not located in securities, and the issuer has no ownership rights to unallocated security or rights certified by these securities, and, therefore, such person shall not be entitled to carry out any authority of the owner in relation of these shares and, in particular, pass them on pledge.[50]

The law provides guarantee to preserve the object of pledge in the case of change of the owner (art. 27 (1) of the Law of Ukraine "On pledge"). The position of the Plenum of

[50] *О.І. Виговський*, Правове регулювання застави цінних паперів в Україні (*Vygovskyi,* Legal regulation of the pledge of securities): дис. […] канд. юрид. наук: 12.00.03, Київ 2005, с.10.

Higher Commercial Court of Ukraine is that the pledge remains valid also in the case of transfer of the object of the pledge to the full economic management of another person, and in cases of replacement of the pledger by the assignee on the grounds provided by law. At the same time, in the case of the forced sale of pledged securities, the pledge ceases. The pledge remains in force regardless of whether the person to whom the securities were moved knew that the latter were the subject of pledge, and/or knew about the existence of pledge rights of third parties to such property. If the person was not aware of the existence of collateral, this circumstance has implications on the relationship between the applicant and also the pledger.[51]

In particular, according to the requirements of art. 659 CC, if the pledger during the conclusion of the contract of sale fails to fulfil his obligation to notify the buyer about the existence of the pledge rights of third parties for sold goods, this fact gives the buyer the right to demand a price reduction or termination of contract.

The legal nature of the securities and the peculiarity of their circulation determine the necessity of participation in pledge relationships, which are the subject of uncertificated securities of depository institutions and of the Central Securities Depositary.

Thus, the parties of the pledge relationships arising from the enforcement of obligations under the credit agreement of pledge securities are represented by banks or other financial institutions (pledgee), physical entities, the state – the loan debtor under the credit agreement, or a third party (property guarantor) (pledger).

## V. The emergence of relations connected with the pledge of securities

The pledge securities contract should be concluded in written form and in the case of an agreement between the parties, or upon request of one of them it should be notarized. Besides the conclusion of the contract, the parties should register the pledge according with the Law of Ukraine "On providing creditors' claims and registration of pledges". This registration is based on entering encumbrances of movable property information about the origin, modification, suspension encumbrances, as well as the incurring of penalty on the subject of encumbrance, into the State register.

The legal importance of registration securities pledge lies in the fact that the pledgee of a registered pledge has a preferential right to satisfaction of requirements before the pledgee of unregistered pledge or pledgee, who registered his right later (art. 18 (5) of the Law of Ukraine "On pledge"). However, it should be noted that the registration of pledge is not related to the moment of appearing pledge right, and does not affect the validity of the pledge contract, and, therefore, cannot be a reason to declare its invalidity (art. 16 (2) of the Law of Ukraine "On pledge"). In this case, the pledgee of unregistered pledge is denied the right to demand the satisfaction of his requirements by the pledge property, including the pre-emptive right of incurring of penalty on registered property.

Art. 16 of the Law of Ukraine "On pledge" provides for the mandatory necessity of concluding a pledge contract, which means that the legislator does not provide any exceptions for uncertificated securities. The conclusion of the contract of pledge of securities predetermines the necessity of the pledger to appeal to the depository institution of securities, which provides services of these securities regarding a demand for blocking

[51] Про деякі питання практики вирішення спорів, що виникають з кредитних договорів. Постанова Пленуму Вищого господарського суду України від 24.11.2014 № 1, available at http://vgsu.arbitr.gov.ua/files/pages/ppVGSU_24112014_1.pdf (30 March 2015).

securities which is a sign of fixing of pledge of uncertificated securities. If the pledger does not initiate any action as to the fixing of the pledge, its fixation can be made by court decision. In this case, the contract of pledge of securities should be deemed not concluded, and the pledge not existent. Taking into account the abovementioned points, and in order to avoid a situation in which the fixation pledge agreement can be significantly delayed, if such a fix is generally denied to the parties in the contract of pledge uncertificated securities it is advisable to carry out the following steps: firstly, confirming and signing all necessary documents in order to fix the pledge of uncertificated securities documents at the same time of signing the pledge agreement; secondly, determining the pledger's duties on the fixing of pledge and a timetable; thirdly, providing special rules of responsibility for failure or improper performance of duties in a prescribed period; fourthly, in the contract that establishes the basic obligation, the performance of which is provided by a pledge of uncertificated securities: including conditions that such an agreement will enter into force only after it is fixed by pledge.[52]

We consider that pledge of uncertificated securities arises from OR is based on the following legal structure: conclusion of a certain agreement, notarization of the depositor signature on disposal of depository institution of securities in order to commit accounting operations to fix pledge by blocking pledger's securities as specified in the contract amount and direct performing of that operation by depository institution of securities.

Considering that the pledge of uncertificated securities requires the depository institutions to commit accounting operations on the securities account of the pledger, it seems necessary to require by law that pledge of uncertificated securities arises from the moment of conclusion of the contract of pledge and fixation of pledge by the depository institution, and thus it is advisable to introduce a necessary amendment to art. 16 of the Law of Ukraine "On Pledge".

If the subject of pledge of securities consists of certificated securities, the pledge can be done by transferring to the pledgee, or in deposit to the notary or private bank. In this case, the parties or their representatives approve the act of transferring the securities, which indicates the type of securities, their quantity, series number, year, place and conditions of storage, carrying costs, and other relevant information. The act shall be signed and sealed (if available). Pledge warrant securities (promissory notes, bill of sale) are carried out by conclusion of a contract of pledge, by performance of endorsement, and the transfer of endorsed security to the pledgee. A pledge endorsement of a promissory note is a form of endorsement for which prohibits the further transfer of the securities issued under the pledge. In order to protect the rights on promissory notes, which are pledged by the bank, the bank should monitor the compliance with all procedural terms, namely: period of presentation for acceptance, payment, protest, and so on. In accordance with the pledged endorsement, the following rights are transferred to the bank: the right to presentation of payment and receipt of payment on a promissory note; right to protest in the case of failure or partial payment of promissory notes; the right of legal action for the recovery of the amount for payment to the person obligated on the promissory note. If the bank receives a payment on a promissory note prior to an offence against the term of debt liquidation under the credit, the bank is entitled to regard this payment as being provided by agreement of the parties.[53]

In order to secure the credit, as a rule, the promissory notes are accepted (or promissory notes for which the bank is one of the responsible institutions) with maturity a few

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52 *Маковская* (*Makovskaja*), fn. 41, c. 57–58.

53 Про порядок здійснення банківських операцій з векселями в національній валюті на території України. Постанова правління Національного банку України від 16.12.2002 № 508/Офіційний вісник України, 2003, № 10, с. 58.

days later than the date of return of the principal amount of credit. For all promissory notes that are taken to secure the credit, the latest entry in the endorsement number should be on the name of the pledger.[54]

In theoretical works there is a point of view according to which a pledge endorsement constitutes the only legal grounds of pledge legal relations. However, most scholars rightly emphasize the practicability of the conclusion of a pledge contract and the registration of a pledge endorsement. [55] At the same time, *Belov* argues that a pledge endorsement is the only means of pledge securities in which the drafting of a separate contract of pledge does not make any sense. The presence of the pledge agreement, which contained its individually determined object, the act of acceptance and transfer of the pledge and other documents in the absence of a pledged endorsement do not establish a pledge right on a security.[56] *Višnevskij* indicates that the pledge of securities, made in the form of pledge endorsement, is not a pledge by its legal nature in the sense given to pledge by the civil legislation.[57] *Krašeninnikov* supports a contrary viewpoint. He believes that for the appearance of right on pledge securities, besides the compilation of a pledged endorsement, the pledge agreement shall be required.[58]

It should be noted that between the contract of pledge of securities and the pledge endorsement there are some differences. Firstly, a pledge endorsement and a pledge securities agreement are independent elements of the establishment of the right of pledge on securities. Each of them is a stage in legal pledge securities relations. On the basis of a pledge agreement, legal relations of pledge securities are established, while under the pledge endorsement legal registration of the transfer of pledge securities is made. Secondly, the pledge of securities, which arises under the pledge endorsement, has some differences from the general civil regulations that determine the specific mechanism of pledge. They are caused by means of legitimizing, a form of transaction, the rights of the pledgee, satisfaction in the case of default of the obligation secured by pledge, and so on.[59] Thirdly, the legal registration of pledge relations by pledge endorsement deprives the pledger of his opportunity to protect his rights in the event of a violation of the pledge obligations by the pledgee, because securities pledged the sealed endorsement which is transferred into the pledgee. The pledger does not receive any confirmation of registration of legal relations of pledge securities.[60]

In conclusion, it can be said that the pledge endorsement in itself is neither a contract of pledge of securities nor its form, and it cannot be regarded as the basis of appearance of legal pledge relations. *Agarkov* noted that pledge of security is different, depending on what is registered: a security paper, a bearer or an order security. The differences in the

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54 *Гриджук/Олійник* (*Grydžuk/Oliinyk*), fn. 2, c. 3.

55 *Е.А. Шикова*, Правовые проблемы залога ценных бумаг (*Shykova*, Legal problems of of pledge of securities), Актуальные проблемы гражданского права /под ред. проф. *М.И. Брагинского* (Actual problems of civil law, *Braginski* (eds.)), Москва 2002, Вып. 4, с.221–222; *Кізлова* (*Kizlova*), fn. 40, с. 102.

56 *В.А. Белов*, Вексельное законодательство России: научно-практический комментарий (*Belov,* The promissory note legislation of Russia: academic and practical commentary), Москва 1998, с. 148.

57 *А.А. Вишневский,* Вексельное право (*Višnevskii,* The promissory note law), Москва 1999, с. 104.

58 *Е.А. Крашенинников,* Залог векселя (*Krašeninnikov*, The pledge of promissory note), Хозяйство и право 1999, № 4, с. 38 (Economy and Law *4|1999).*

59 *А.В. Габов,* Вексель в системе российских ценных бумаг (*Grabov*, The promissory note in the system of Russian securities): автореф. дис. […] канд. юрид. наук: спец. 12.00.03, Москва 1999, с. 7.

60 *Д.О. Кулик*, Розрахунковий чек як предмет договору застави (*Kulyk*, The settlement check as an object of pledge contract), Право і суспільство 2013, № 6, с. 97.

realization of pledge registered, bearer and order securities are mainly caused by differences in the order of transfer of rights by such securities.[61]

The emergence of the relations connected with the pledge of order securities requires a legal structure, the elements of which are the conclusion of the contract of pledge securities, making an endorsement on securities, and the transfer of the securities to the pledgee. The Civil Code of Ukraine distinguishes two types of movable property, for which the property remains in the possession of the pledger, or is passed into the possession of the pledgee (pawning). Registering pledge securities in the form of pawning facilitates the realization of control of their availability by the creditor; and the cost of storage of securities certificates and maintenance of accounting are burdensome. Taking into account the features which are typical of uncertificated securities as a registration accounting entry of securities into the system of a depositary account of securities, it must be considered that the establishment, as a variety of pledge of securities, can be used only in relation to certificated securities.

## VI. Legal consequences of non-fulfilment of a credit obligation

In the case of non-fulfilment of credit obligation secured by the pledge, the pledgee shall be entitled to incur a penalty on the securities (the object of pledge), as well as to satisfaction of own requirements to the full extent. In the CC there is the following distinction of separate, independent stages: the first stage is related to incurring a penalty on the object of the pledge (art. 590); the second stage pertains to the realization of the object of the pledge (art. 591), which gives the pledger and pledgee the opportunities to apply to each of these stages the principle of freedom of contract.

The pledgee is entitled to premature performance of the pledged credit obligations in the following events: 1) the object of the pledge was transferred by the pledger to another person without the consent of the pledgee, if obtaining such consent was necessary; 2) a violation by the pledger of the rules of replacement of the object of the pledge; 3) the loss of the object of the pledge as a result of circumstances beyond the pledgee's control if the pledger has not replaced or restored the subject of pledge; 4) a violation of the rules for the following pledge on the part of the pledger; 5) a violation of the rules on disposal of the object of the pledge on the part of the pledger; 6) in other cases established by the contract; 7) initiation of proceedings against the pledger in order to restore the solvency of the debtor or declaring it bankrupt; 8) decision on the elimination of the legal entity of the pledger.

According to the legislation incurring the penalty of pledge is preformed: 1) by a court decision; 2) on the basis of an executive inscription of notary; 3) in the extra-judicial order. The possibility of incurring the penalty indisputably to the pledged property on the basis of an executive inscription of notary is established by Law of Ukraine "On notary". However, the executive inscription can be applied only when the given documents confirm the indisputability of the debt or another liability of the debtor to the plaintiff, and if it is provided that the date of the claim has passed no more than three years (between enterprises, institutions and organizations: a maximum of one year) (art. 88 Law of Ukraine "On notary").

Incurring the penalty of pledge is conducted exclusively by a court decision if the object of the pledge securities are public enterprises (enterprises, at least 50 percent of shares are state-owned) (art. 20 (6) of the Law of Ukraine "On pledge"). Contracts signed in violation of this requirement shall be recognized as invalid according to

[61] *М.М. Агарков*, Учение о ценных бумагах (*Agarkov*, The doctrine of securities), Москва 1993, с. 108.

art. 215 CC.[62] In accordance with p. 17 of the Resolution of the Plenum of the Higher Specialized Court of Ukraine based on the consideration of civil and criminal cases "About the practice of application of legislation courts at the decision of disputes) arising from credit relationships", the presence of a court decision on the satisfaction of requirements of the creditor, that is not executed by a debtor, does not terminate the legal relationships of the parties of the credit agreement, nor does such a decision exempt the latter from liability for failure of monetary obligation; the decision does not deprive the creditor of his right to receive the amounts under art. 625 (2) CC, as the obligation remains unfulfilled properly in accordance with art. 526, 599 CC.[63]

If the subject of the contract of pledge of securities consists of two or more types of securities, the pledgee gets full satisfaction of their secured claims. He determines the securities on which the penalty is drawn. According to the principle of legal indivisibility of the subject of pledge, a bank or another financial and credit institution, in the case of incurring a penalty on the part of securities, reserves the right to incur a penalty on other securities, which constitute the subject of pledge.

In the case of registering an encumbrance of the subject of the pledgee, the latter must register the information regarding the incurrence of the penalty in the State register of encumbrances over movable property. This registration is mandatory prior to the incurrence of the penalty. Prior to lodging a claim to a court, the pledgee is obliged to make a notice to all encumbrancers.

The realization of the pledge subject, on which the penalty is incurred, is carried out by a state executor on the basis of the executor's letter or decision of a Commercial court, by way of selling the subject in a public auction, unless otherwise provided by contract or law. The initial price of the subject of pledge for its sale by public auction is determined by the court. If the first auction (public tenders) is declared frustrated, another auction shall be held. The starting price of the second and subsequent auctions is a price reduced by 30 percent relative to the initial price of the previous auction. It is an interesting situation, when the auction is declared frustrated. The legal consequence of this fact is regulated in law, but with certain collisions. Thus, according to art. 591 CC, if the public auction is declared frustrated, the subject of the pledgee can be transferred into the pledgee's ownership at the initial price with the consent of the pledgee and the pledger, unless otherwise provided by contract or law. Art. 21 of the Law of Ukraine "On pledge" stipulates the right to keep a pledged property at the initial price which was proposed at the last auction (public tenders), if the second and subsequent auctions (public tenders) were declared frustrated. That is, in one legal act the legislator requires the consent of the pledgee and pledger for transferring the pledge into ownership, in another legal act for this action only the will of the pledgee is required. In my opinion, in this situation the Law of Ukraine "On pledge" should be applied, because, firstly, this is lex specialis in relation to the general regulation of CC, secondly, art. 591 CC is a blanket rule, containing provisions such as "... unless otherwise provided by law ..."; so in this case, namely the Law of Ukraine "On Pledge" is in fact another regulation; thirdly, concluding the pledge agreement, the pledger made the will, which relates to the possibility of transition of the pledge property into the ownership of the pledgee in the event of non-satisfaction of the obligation. If the pledgee refuses to keep the pledge property, it is to

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62 Про деякі питання практики вирішення спорів, що виникають з кредитних договорів. Постанова Пленуму Вищого господарського суду України від 24.11.2014 № 1, available at http://vgsu.arbitr.gov.ua/files/pages/ppVGSU_24112014_1.pdf (30 March 2015).

63 Про практику застосування судами законодавства при вирішенні спорів, що виникають із кредитних правовідносин. Постанова Пленуму Вищого спеціалізованого суду України з розгляду цивільних і кримінальних справ від 30.03.2012 № 5, available at http://zakon4.rada.gov.ua/laws/show/v0005740-12 (30 March 2015).

be sold in the prescribed manner, unless otherwise provided by the contract. The amount of money received from the sale of the pledge after satisfaction of the obligation is returned to the pledger. If the amount received from the sale of the pledge does not cover the requirements of the pledgee, the latter is entitled to receive an additional amount from other property of the debtor, in the order of satisfaction requirements of other creditors.

In accordance with established legal restrictions (art. 7 (8) of the Law of Ukraine "On Joint Stock Companies"), the realization of pledged shares of a private joint stock company is carried out in a special mode, taking into account the possibility of using shareholders pre-emptive rights to purchase the shares. A notification to shareholders regarding the sale of shares must be sent within two business days from the date of receipt of the information from the pledger prior to the public auction. Shares are offered to shareholders in proportion to the number of shares owned by each of them, at an initial price established by agreement or court decision. Pre-emptive rights are valid from 20 days to two months, and can be terminated prematurely, given that all shareholders received written statements on the use or discourage of the use of their pre-emptive right to purchase shares. If shareholders do not take advantage of their pre-emptive right to purchase all shares, the shares will be sold to third parties at a public auction. If only one shareholder uses his pre-emptive rights, this shareholder concludes a contract of sale of pledged shares without public auction. In the case of a violation of the pre-emptive right to buy shares, any shareholder of the company may require a court to transfer to the shareholder the rights and obligations of the buyer of the shares. Such transfer is only possible within three months from the date when he learnt about, or should have learnt about, such violation.

In the case of entering information on the pledge of securities into the State register of encumbrances over movable property, in accordance with art. 26 the Law of Ukraine "On securing creditors' claims and registration of encumbrances", the pledger shall be entitled to select one of the following extrajudicial remedies at its own discretion: 1) transfer of securities into pledger's ownership; 2) sale securities by purchase and sale contract with any purchaser or at a public auction; 3) encumbrancer transfer of securities, including direct debit; 4) realization of pledged securities on the basis of notary executive order. According to art. 27, a pledgee, who intends to extrajudicially foreclose on the securities that are the subject of security encumbrance, must send a written notice about the violation of an obligation secured by encumbrance to the pledger and other encumbrancers, in favour of which the registered encumbrances is set. The notification is sent simultaneously along with the registration of the information on incurring a penalty over secured encumbrances in the State register of encumbrances over movable property. If within 30 days of the registration the obligation is fulfilled, and the securities are not in the possession of the pledger, the pledger must transfer the securities in the possession of the pledgee immediately at the request of the latter. Then a bank or other financial lending institution has the right to satisfy its demand for credit commitments by the acquisition of ownership of securities and notification of the debtor, other encumbrancers of these securities about its intention to acquire ownership of the securities. They may express an objection in writing within thirty days, and send it to other encumbrancers. Under these conditions, the pledgee must satisfy the request, which is secured by encumbrance, by selling securities to any person at a public auction, and take notice of the debtor, other encumbrancer of the securities, indicating the chosen method, place and time of the sale procedure.

If the debtor expressed any objections, the encumbrancer, which initiates the incurrence of the incurring of penalty procedure may acquire the ownership based on the court decision. A contract of sale of securities is concluded by the pledgee on behalf of the

pledger, and it is the legal basis for the acquisition the ownership of the buyer over these securities. Within ten days from the date of sale of securities, the pledgee must give to the debtor and all encumbrancers, for whom registered encumbrance of securities was established, a written report on the results of the sale. According to art. 24 of the Law of Ukraine "On securing creditors' claims and registration of encumbrances" using extrajudicial methods of incurring of penalty on the subject of encumbrance of security does not deprive the debtor, encumbrancer or third parties of their right to claim to the court. The following procedure for sale of securities that is the subject of enforcement of credit obligations is not applied to debt securities, the time of payment on which are already due for payment, or which shall be paid on demand. In this case, the pledgee satisfies his requirements by presenting appropriate security for payment. If the amount received from debt securities payment exceeds the amount of secured by encumbrance claims, the pledgee must return the excess amount to the debtor. Equity and derivatives securities (which include shares, investment certificates, certificates of real estate funds, shares of corporate investment funds, corporate bonds, government bonds of Ukraine, municipal bonds, treasury promissory notes of Ukraine, savings (deposit) certificates, promissory notes, bonds of international financial institutions, bonds guarantee fund of individuals) are in possession of the pledge. Such equity can be sold on the stock exchange at a price not lower than their market value. If the subject of a pledge consists in securities as bill on sale, then, according to the literature, the pledger can choose one of three ways for satisfaction of his requirements: through the implementation of pledged bill on sale directly by the pledgee, and by addressing to him foreclose on the mortgage (in case of failure to satisfy the principal obligation secured by a mortgage) or satisfaction of its claims through the implementation received from the debtor mortgagee (in case of performance of such obligation), or by conventional procedures of incurring of satisfaction in court or out of court.[64]

In contrast to incurring satisfaction on pledged property on the grounds provided by law, there is no clear definition neither in theory nor in practice, for the foreclosure of the pledged property in cases stipulated by contract. In my view, using the civil law principle of dispositive, the parties may add other circumstances to the pledge agreement which are not required by law. Once these circumstances occur, the pledgee obtains the right to foreclose on pledged property. Such circumstances may include the deterioration of the borrower's financial position, a change of interest rate of the National bank of Ukraine on conditions that a borrower renounces a suggestion of his bank or other financial institution regarding this change, and so on. The "Legal Committee of the Professional Association of Registrars and Depositories of Ukraine" has developed recommendations[65] for foreclosure on securities that are the subject of a pledge agreement, carried out under contract by: 1) the conclusion of a separate agreement regarding foreclosure on the pledge with the participation of depository institutions which accounts pledged securities; or 2) the inclusion of a direct indication in the pledge agreement that the pledged securities are to be transferred in foreclosure in the event of certain conditions (for example, default by the debtor of the principal obligation which is confirmed by the documents specified in the contract, or expiration of the term set by the creditor to the debtor to perform the principal obligation, if such period has not been established immediately, etc.); or 3) the duty of the pledger to make an order for the cancellation of pledged secu-

64 *Виговський*, (*Vygovskyi*), fn. 50, c. 11.

65 Рекомендацій правового комітету професійної асоціації реєстраторів і депозитаріїв "Щодо порядку звернення стягнення на заставлені цінні папери" (The recommendations of the legal committee of Professional Association of Registrars and Depositories, On the order of foreclosure on pledged securities), available at www.pard.ua/uploads/documents/534ce24b29355.doc (30 March 2015).

rities to the pledgee in the event of failure regarding the principal obligation; such a duty shall be reflected in the contract of pledge. This method of realizing the right of incurring a penalty on the pledge is the most risky one from the viewpoint of the pledgee, because the latter is completely removed from the control of the fulfilment of the pledge obligation. In the event of foreclosure and sale of pledged uncertificated securities on the basis of a court decision or order of the commercial court or executive notary, the depository institution performs unconditional operation in the depository account to unblock securities in the account of the depositor and their transfer to the securities account of the new owner (the pledgee or a third party).

The pledger has the right to sell securities or to transfer the ownership to the pledgee at any time, in order to stop foreclosure on pledged property by performing the obligation which is secured by a pledge.

After the foreclosure on pledged property the pledge right is terminated (art. 593 CC), that is, a transaction terminates following requirements of the creditor against the debtor.

## VII. Conclusion

Currently the pledge of securities is the most common way of incurring the satisfaction of credit agreements. It is caused by efforts to ensure the proper execution of the contract, all the more during an economic crisis in the absence of stability and reliability in contractual legal relationships, creditors are interested in additional guarantees of the proper implementation of credit obligations by the debtor. The degree of development of market economy principles in the Ukraine has a direct impact on the law on pledge. The peculiarity of the legal nature of securities, the difference in the mechanism of circulation of certificated and uncertificated securities makes it necessary to improve Ukrainian legislation on pledge as a means of ensuring credit commitments. Such improvements would constitute one of the most important components of the general civil law reform in Ukraine.

The current legislation of Ukraine in fact stipulates the necessity of extending the legal regime of the pledge of things on the pledge of securities while, of course, taking into account the specific characteristics of securities. This viewpoint is also upheld in the civil law doctrine regarding the classification of securities to the category of things.