Center for the Study of Democracy
Commercial Law Center

American Bar Association
Central and East European Law Initiative

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Bulgarian Collateral Law Conference

Materials

Sofia, Bulgaria
30-31 January 1995

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BULGARIAN COLLATERAL LAW CONFERENCE

Sofia, January 30-31, 1995
Center for the Study of Democracy

Central and East European Law Initiative of the American Bar Association (ABA/CEELI)
Hanns Seidel Foundation, Germany
The Government of Canada

January 30, Monday
Collateral Law and Secured Lending in Bulgaria: Legal Framework and Practice

14:00 Opening
Dr. Ognian Shentov, President of the Center for the Study of Democracy
Mr. Mark Beesley, Commercial Law Specialist and ABA/CEELI Liaison

14:10 Introduction
Mr. Stephan Kyutchukov, Coordinator of the Law Reform Program of the Center for the Study of Democracy

14:20 Substantive Collateral Law Provisions:
1. Pledges and Mortgages: General Framework
2. Chattel Mortgage
3. Irregular Pledges: Pledges to Banks; Pledges to Foreign Persons; Pledges of Ships
4. Fees

Introductory comments by **Mr. Angel** Kalaidjiev, Chief Assistant Professor, Sofia University School of Law, LL.M.

Discussion

15:30 Break

15:40 Foreclosure on Collateral:
1. In- and Out-of-Court Methods
2. Obtaining a Writ of Execution
3. Debtor's Defences
4. Public Auction
5. Fees

Introductory comments by: **Mr. Silvy Chernev,** attorney-at-law, LL.M.
Mr. Borislav Belazelkov, Judge, Sofia City Court

Discussion

16:50 Summary
Mr. Stephan Kyutchukov

January 31, Tuesday

Modern Collateral Law Framework

09:00 Principles of Modern Collateral Law:

1. Types of Charged Property
2. Foreclosure
3. Collateral in Bankruptcy Proceedings
4. Pledges Registry

Mr. Ronald Dwight, Director of the IRIS-Poland Project

Discussion

10:50 Break

11:10 Drafting a Modern Collateral Law: Experience from East European Countries

Laws, Models and Drafts:

1. The Polish Draft *Law on Registered Pledges and the Pledge Registry*
2. EBRD *Model Law on Secured Transactions*
3. Other Laws and Drafts

Mr. Ronald Dwight, Director of the IRIS-Poland Project

Discussion

12:50 Concluding Remarks

Mr. Mark Beesley

Additional materials, including the Polish Draft Law on Registered Pledges and the Pledge Registry *and the EBRD* Model Law on Secured Transactions, *will be distributed at the Conference.*

Apendix A

The Need to Update Bulgaria's Collateral Law

The purpose of this paper is to report on the status of Bulgaria's collateral law and identify the minimum requirements of a new law. Collateral law lets borrowers use property to secure loans. Bulgaria's current law - technically called a pledge law -- is inadequate for a market economy and needs to be replaced with a local version of an internationally accepted collateral law.

Modern market economies are largely based on financing projects with credit. The proper legal framework must exist, however, to provide security for lenders.[1] Good collateral law promotes commercial and private lending and enhances trade by allowing financiers, producers, distributors and retailers to increase operations by financing businesses and purchases on short term bases.

1. Status of the Law[2]

Two methods are available to lenders in Bulgaria to acquire security interests in physical property. The first, the real estate mortgage, applies to using real estate as collateral and is similar to mortgages elsewhere in the world.[3]

The second applies to the use of moveable (chattel) property as security. No adequate laws exist in Bulgaria that allow for the use of chattel as security. To use chattel as security, a debtor must execute a "pledge agreement" that requires the debtor to transfer possession of the collateral to the creditor. The creditor, or a third party authorized by the debtor and creditor, must take actual physical possession of the property.[4]

This "transfer of possession" rule for chattel represents an insurmountable obstacle *to* securing commercial lending where the borrower often wants to use the property it is purchasing as collateral to obtain a loan. Because the new property would have to be turned over to the creditor, it could not be used to generate revenue to repay the money borrowed.

For a "pledge agreement" to be enforceable, all essential elements of the agreement - including identification of the specific property — must be certified on a specific date.

"Security encourages investment. A creditor who knows that he has legally recognised rights to turn to his debtor's assets in case of non-payment is more willing to invest than the one who cannot make such recourse. It must, therefore, be said that security is indeed a necessary element of the institutional framework of a modem market economy." J.M. Rover "Security in central and eastern Europe and the EBRD's Model Law on Secured Transactions".

2 The major body of Bulgaria's pledge law is contained in Bulgaria's Obligations and Contracts Act of 1950 (OCA).

3 Mortgages are entered in real estate registers; a security interest is not created and is not binding on third parties without proper registration of the mortgage deed in the register. Thereafter, every person who acquires any interest in the mortgaged property takes subject to the rights of the secured creditor. This portion of Bulgaria's collateral law is adequate.

The Law on Banks and Credit Activity of 1992 and the Law on Economic Activity of Foreign Persons and on Protection of Foreign Investment of 1992 provide banks and foreign persons with some favorable exceptions to the otherwise cumbersome mechanism of acquiring security interest in chattel. With respect to banks and foreign persons, the law waives the "transfer of possession" rule. A written agreement with a certified date that identifies the collateral is sufficient to create a collateral agreement that would be binding on third parties.

This rule makes it practically impossible to use inventory[5] as collateral because it would be very difficult to identify and certify every item of inventory every time the inventory changes.

No registry exists in Bulgaria to register the use of chattel as collateral. Because no registry exists, it is impossible to determine whether collateral secured by one creditor has been previously secured by another. Even in cases where the lender is not required to take possession of the collateral,[6] the lack of a system to register collateral effectively eliminates its use in all cases.

Bulgaria's collateral law is undoubtedly costing it hundreds of millions of dollars of investment that it could otherwise secure.

2. Recommendation

Organize a working group to draft and lobby for passage of a Bulgarian version of an internationally accepted model collateral law. Create and maintain a central registry to register when chattel is used as collateral.

Bulgaria should create a collateral law that meets the following requirements:

(a) Written Agreements Should Create Security Interests

The current law requires transfer of possession of the collateral. The law should be changed to allow a written agreement without possession to create a security interest in the collateral.

(b) A Central Registry Should Be Developed

If the law were to be changed as suggested above, there would be no guarantee that a debtor would not pledge the same collateral to different creditors.[7] The creation of a central registry to record the use of chattel as collateral would guard against this problem. Several countries have developed or are developing registries that are self-sustaining or show a profit (through user fees). Such a system could be easily adopted in Bulgaria.

(c) More Types of Property Should Be Allowed to Serve as Collateral

Practically speaking, under current law it is possible only to use as collateral specific, individual pieces of movable property. Collateral law reform should make it possible to use other types of collateral, including:

- fungible goods (e.g. coal, corn or wheat);

As it is used here, the term "inventory" means goods or materials stored for the purpose of sale.

[6] See note 4.

Even under current law, this problem still exists. Becausebanks and foreign persons are not required to take possession of collateral, there is no way for them to ensure that the collateral securing their agreement has not been previously pledged to other creditors.

- goods in process (e.g., the security interest in the grapes should pass on to the wine produced from the grapes);

- inventory (e.g., it should be possible to create a security interest in rotating inventory that would apply to goods when they enter a merchant's warehouse and end when they leave the warehouse; this would allow a creditor the right to claim a specific portion of goods present in a warehouse at any time).

(d) Proceeds from Sale of Collateral Should Serve as Security

Under current Bulgarian law, if the debtor sells the collateral, the creditor's rights to the collateral are terminated. Likewise, the creditor has no rights to collateral sale proceeds. The law should be changed so that the creditor may claim the money or other value received by the debtor.

(e) The Possibility of Out-of-Court Sale of Collateral Should Exist

Under current law, a creditor may sell the collateral only in a court appointed and supervised auction. This requirement makes the process of selling collateral long and expensive. This process should be simplified and court involvement should be minimized or excluded. The creditor should be given the right to seize and sell collateral privately, according to specified rules, at the prevailing market rate, at an established exchange market, or at a privately held auction.

(f) Collateral Law Should Apply Uniformly to All Creditors

Under current law, the law is not uniform with respect to all creditors. The general rule is that the debtor should transfer possession of the collateral to the creditor and the creditor must sell the collateral in a court appointed auction. Banks and foreign creditors, however, may leave possession with the debtor. Additionally, banks may sell the collateral in a privately held auction.

The collateral law adopted for Bulgaria should give equal protection to all creditors and make competition fair.

January 1995
Sofia

Apendix B

SURVEY

Questions on Collateral Law
(Secured Transactions or Asset-based Loans)

This questionnaire was devised by the IRIS-Poland Project and the European Bank for Reconstruction and Development. We would be grateful if you could reply to the questions in a comprehensive fashion. It would be particularly helpful if your answers would reflect the practice in your country and if you could support them by making reference to relevant articles of the law, regulations or even ground breaking cases. Feel free to answer the questions by writing on this document.

The purpose of this questionnaire is to obtain an overview of the laws of your country relating to the creation and enforcement of non-possessory security interests over movable property. The questions are designed to find out:

a. whether it is possible to have non-possessory pledges (or other kinds of non-possessory security interests) over movable property;

b. the types of movable property that may be subject to such security interests;

c. the method and costs of creation of such security interests;

d. who may create and who may receive such security interests;

e. the methods and costs of enforcement of such security interests;

The information will be used to compile a region-wide survey on secured transaction laws in Central and Eastern Europe. We also plan to sponsor a seminar featuring the results of the survey. Your cooperation will greatly assist us in our work. We will be happy to make reference to your contribution in a possible publication which will also be made available to you in return for your participation.

Please do not hesitate to contact Pawel Kunachowicz, Legal Advisor, or William Rich, Project Coordinator, at IRIS (tel: 48 22 45 25 12) or Rechtsanwalt Jan-Hendrik Rover, LL.M., Legal Advisor, at the European Bank (tel: 44-71-338 6050) if you have any questions or comments concerning the questionnaire. We would be grateful if you could return the questionnaire to Mr. Kunachowicz at IRIS Poland Project, c/o American Studies Center, Warsaw University, Ksawerow 13, PL 02-656, Warsaw, Poland. Our fax number is (48)(22) 45-25-12.

The following response regarding Bulgaria's collateral law was prepared by Mark Beesley, a liaison with the American Bar Association's Central and East European Law Initiative, and Stephan Kyutchukov, Secretary of the law program at the Center for the Study of Democracy in Sofia, Bulgaria. For additional information, please telephone: (359 2) 70 20 25 or facsimile: (359 2) 72 05 09 or e-mail: mark@sf.cit.bg.

The general rule is that security interests in chattel do not attach until the creditor, or a third parry authorized by the debtor and creditor, takes physical

possession of the collateral. The laws on Pledge on Chattels and Pledge on Claims are found in the Obligations and Contracts Act of 1950 (OCA), Art. 156 - 165.

The Law on Banks and Credit Activity of 1992 (Law on Banks) and the Law on Economic Activity of Foreign Persons and on Protection of Foreign Investment of 1992 (Foreign Investment Law) provide banks and foreign persons with exceptions to the general OCA rule. Article 36 (2) of the Law on Banks allows that ". . . pledges may remain under the responsible custody of the pledgor in terms specifically contracted with the bank." The Foreign Investment Law, Art. 12, allows foreign persons to secure claims with pledges which "shall be valid even if the item under pledge is left with the debtor and is used by the latter, so long as the pledge has been executed in writing and has a certified date."

In the case of a bank or a foreign person, a security interest will attach at the moment there is a valid agreement (that is, a written agreement for banks and a written agreement with a certified date for foreigners). Perfection occures for foreigners at the moment of attachment and for banks when it obtains a certified date.

The certified date is obtained by notarizing the pledge agreement and it proves that the agreement existed on the certified date. The purpose of the certified date is to prove the sequential order of security interests in the same chattel. Because there exists no registry system, the certified date helps resolve priority problems in cases of conflicting security interests in the same chattel.

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1. What kinds of property can be used as collateral in a non-possessory pledge (or secured transaction) in your country?

movables

Movables may be pledged. OCA Art. 156 - 161. Possession must be transferred, however, except when the creditor is a bank or foreign person.

receivables

Transferable claims may be pledged. OCA Art. 162 - 165. The debtor must be informed of the pledge and the pledgor must hand over to the pledgee the documents which prove the pledged claim.

inventory

In most cases, a pledge of inventory cannot be perfected. A pledge agreement cannot be enforced against third parties unless there exists a document that describes the pledged property as of a certified date. OCA Art. 156, para. 2 (amended State Gazette No. 12/1993). Thus, it would be difficult to acquire a security interest in inventory and still maintain a normal course of business because the document describing the property would not be perfected if the inventory changed. The transfer of possession rule would also apply requiring the creditor to hold the inventory.

intellectual property rights

The OCA does not contemplate pledging intellectual property (or other intangible) rights.

crops and livestock

Livestock and harvested crops could be pledged subject to applicable transfer of possession rules. Crops in the ground would be considered part of real property and probably could not be pledged as chattel. It would be possible, however, to contract to pledge the final crop and such contract could be enforced through judicial means.

2. Must the pledged property be described individually, piece by piece, or can it be described as a fungible pan of a floating pool of assets?

A *pledge contract could be worded so that a security interest could attach on generally described assets. The requirement that a document exist describing the pledged property as of a certified date makes it impossible to perfect a pledge of a floating pool of assets where property is entering and exiting the pool*

3. Can the pledged property be described so as to include after-acquired property?

One could contract for after-acquired property, but the certified date requirement would prevent perfection (or attachment with respect to foreign persons).

4. What are the most commonly used non-possessory pledge (or other security interest device) used in your country concerning each type of property in question 1?

The two available methods are pledge agreements and sales with retention of title. The latter is seldom used. The usual collateral used would be movables, accounts receivable and livestock (depending, of course, on the ability to avoid the transfer of possession rule).

4A. What costs (such as legal fees, stamp duties taxes and registration fees) are incurred in their creation and registration?

Certification of date costs 1% of the secured amount. This fee is paid to the notary.

5. Who may be a pledgor? Individuals? Business organizations?

Individuals and businesses may both be pledgors.

6. Can a person pledge property to secure the debt of a third person?

Yes. See OCA Art. 149.2

7. Can foreigners (either individuals or business organizations) be pledgers?

Yes. There is no prohibition.

8. Who may be a pledgee? Individuals? Business organizations?

Individuals and businesses may both be pledgees.

9. Can foreigners be pledgees?

Yes. Foreign Investment Law, Art. 12

10. Can the secured debt be expressed in a foreign currency?

The claims of foreigners can be expressed in foreign currency. Foreign Investment Law, Art. 12

11. Is retention of a title by a seller in a contract of sale effective against buyer under your law?

a) with respect to movables?

Yes. See OCA Art. 205.

b) with respect to land?

No provision exists under current law; OCA Art. 205 implies a prohibition.

c) with respect to crops?

Yes. See OCA Art. 205.

12. Is it necessary to register a non-possessory pledge (or secured transaction) in order for it to be effective:

a) against the debtor (pledgor)?
b) against other creditors of the debtor?
c) against insolvency or liquidation officials?
d) against purchasers of the collateral?

There are no registries for pledges on chattels, but for (b), (c) and (d) the seller must have a written document with certified date to perfect its claim. See OCA Art. 156.2.

13. Is it necessary to register a retention of title by a seller in a contract sale in order for it to be effective:

a) against creditors of the buyer?
b) against insolvency or liquidation officials?
c) against sub-purchasers from the buyer?

Registration is not possible, but the seller must have a written document with certified date. See OCA Art. 205.2.

14. Can the debt secured by the collateral be revolving or include future advances?

Yes.

15. If registration is required, must the amount of the debt be stated? Must the debt be described in any way?

Registration of chattel is not possible. Mortgages must be registered and the amount of the debt, parties to the debt, debt maturity and interest rate must be stated.

16. What methods are available to a pledgee to enforce his security?

A creditor may pennon the court for a writ of execution based on the pledge agreement without having to sue the debtor. In limited cases, the debtor under the pledge agreement may bring a counterclaim disputing the debt and force the creditor into litigation regarding the validity of the creditor's claim. In such cases, the secured creditor must obtain a final judgement and then request a writ of execution.

Every creditor who procures a writ of execution, regardless of whether it is a secured creditor, must go through a lengthy judicial foreclosure process. Sale of the secured property must be effected at a court appointed auction. The initial auction price must be determined by a court appointed expert. If a creditor must foreclose on a combination of real estate and chattel, this must happen in two different procedures which do not necessarily run parallel in time. Debtors are not allowed to bid and creditor's rights to bid are limited. Foreclosure on bank accounts is practically unworkable.

At any point up to the time of auction, a debtor may stop the foreclosure process by paying 20 percent of the creditor's claim and agreeing to pay ten percent of the claim every quarter.

Under Law on Banks Art. 37, if the pledge agreement negotiated between the bank and the debtor provides, the bank may sell the collateral in an out of court auction. Most banks require this provision.

Writs of execution are satisfied out of the pledged collateral preferentially for the benefit of secured creditors.

The foreclosure process favors debtors. They have numerous opportunities to prolong the procedure. Fines for violation of procedural rules are outdated and low and do not deter procedural violations. Written to service a 1952 command economy, the law is unsuited to 1994 market realities.

16A. What are the costs of enforcement (e.g. stamp duty, notarial fees, court fees) ?

Fees are as follows:

> *2% of the claim when the writ of execution is obtained on the basis of a pledge document;*
>
> *0.2% of the claim if the writ is obtained on the basis of an arbitration award;*
>
> *400 leva (currently, the leva:dollar exchange rate is 65:1) if the writ is obtained on the basis of a final judgement;*

the fee for a trial is 4% of the claimed amount; the appealing party must pay an additional 2% for the appeal;

0.5% of the higher of either the claim or the value of the property as determined by an expert. This fee is to be paid upon the sale of the collateral

16B. How long does enforcement take?

In a best-case scenario, the process could take weeks. Conceivably, however, it could take years.

17. Is there any work in progress concerning the creation of a new collateral law? What is its status? (If there are any written reports of draft legislation we would greatly appreciate it if you could send us a version in the original language and in English.)

There is no draft collateral law in progress. The Center for the Study of Democracy (CSD) and the Central and East European Law Initiative (CEELI) have contacted potential collateral law working group members, but so far, no funds exist for the project. The Center for the Study of Democracy has been working with the World Bank in its studies of the current law and the World Bank and EBRD to secure funds to change the law.

Apendix C

Security in central and eastern Europe and the EBRD's Model Law on Secured Transactions[1]

Jan-Hendrik M Rover, EBRD

Purposes Of security in commercial transactions

Modern market economies are, to a large extent, based on the financing of projects by way of credit. Such credit is even more needed in those countries of central and eastern Europe that have entered into the transition process towards market-oriented economies with poor capital structures. Financing by way of credit does, however, presuppose a proper legal framework for security. Everybody who has sought credit will have had the experience that one of the creditor's most important considerations was what security the debtor could make available. It is perhaps helpful to remind ourselves of the reasons why creditors inevitably seek security. One can summarise that security performs three main functions in commercial transactions:

Security encourages investment. A creditor who knows that he has legally recognised rights to turn to his debtor's assets in case of non-payment is more willing to invest than the one who cannot make such recourse.[2] It must, therefore, be said that security is indeed a necessary element of the institutional framework of a modern market economy.

The first function of security is closely linked to the second: the existence of a legal framework of secured transactions determines the terms on which an investor is prepared to invest. Security is an important factor which allows for long-term planning: whereas an investor who cannot rely on security will only be prepared to lend for a short period, the protected creditor is able to lend for a long period. Also, the existence of a proper security system will influence the interest rate for which a creditor is prepared to give credit. Security keeps interest rates (i.e. prices for credit) low as the creditor is prepared to accept a lower reward when the risk is reduced,

The third function of granting security is to give a creditor protection in the case of insolvency proceedings. Insolvency is the moment when security is most needed because it normally causes loss of creditor's assets. Security is intended to give the creditor a position from which he can expect preferred treatment in relation to the distribution of the debtor's assets in case of insolvency,

Security, therefore, is very much in the interest of the debtor, it is only against security that the creditor will provide the kind of credit the debtor is looking for.

Acid tests for secured transactions laws

Although it should be clear that security is needed in a market economy, as the legal systems of most countries recognise, security systems can be more or less adequate. In other words, it does not suffice to have a security system, it must be the right one. What is right and what is wrong is certainly difficult to decide in relation to legal questions. Any comparative study reminds us that legal systems have many ways of achieving similar results, and it is sometimes difficult to tell which way is preferable provided a legal system achieves a certain degree of predictability. Comparative studies and the experience gained by them do, however, enable us to establish certain criteria which a workable[3] system of secured

i Presentation given at a seminar of the United Nations Economic Commission for Europe (UNECE) on the problems surrounding real property transactions involving foreign and domestic investors in central and eastern Europe, on 5 September 1994 in Geneva.

' Simpson and Rover, in: EBRD Model Law on Secured Transactions, London, 1994, p v.

3 The meaning of 'workable' is to be determined with a view to the purposes of secured transactions, see above.

transactions should meet,[4] particularly if it is to suit commercial transactions. There are six general criteria to measure the adequacy of a security system.[5]

1. The method of creation of security must be simple. This means that formalities should be kept to a minimum. The parties of commercial transactions will normally be informed about the working of security and should, therefore, not go through cumbersome procedures. This means that a security contract between the parties should be in writing and the formalities should be kept relatively simple. The law should make it simple to describe the debt secured and the collateral. Any procedure for registration of the security should be easy, and particularly be quick and cheap. A simple method of creation of security will help to make security available to the parties at little cost.

2. The person giving security must have the right to use the collateral.[6] Security in commercial transactions is often only feasible if the collateral can be used by the debtor even if it serves as security. It was, therefore, a legislative error of many legal systems to require the taking of possession of movable assets, which can only be explained by the lesser role of the credit and security at the time the provisions were drafted. Many Western legal systems found their way around the limitations caused by the possessory security right on movable assets, but some east European laws still contain provisions to this effect,

3. The person giving security must have to some extent[7] the right to sell assets in the ordinary course of his or her business.[8] It is important that security does not freeze the debtor's assets which he would normally want to sell as the debtor is dependent on receiving income which he cannot generate without sales. The creditor will, on the other hand, have an interest in keeping an adequate amount of security. This interest can be accomplished by many ways other than by freezing the collateral,

4. Another important criterion for an adequate security system is the enforcement mechanism provided. Three aspects are of particular importance: first, the means of enforcement must be quick, flexible[9] and simple. It is, therefore, necessary to keep any court involvement to a minimum as it makes enforcement more complex. Second, the enforcement mechanism must give rise to little cost, as otherwise this would reduce the proceeds that go to the creditor and to the debtor. Costs are for example minimised if court involvement is reduced. The third aspect of the enforcement procedure is that the creditor must get value for his security,

5. Potential creditors must be able to determine whether the debtor's assets are already subject to a charge. An easy way to meet this

* "Study on security interests" and "Legal principles governing security interests" (study prepared by Professor Ulrich Orobnig of Germany), UNCITRAL Yearbook, vol. VIII, 1977. part two. II, A; Philip Wood, Law and Practice of International Finance, Comparative Law of Banking and Insolvency, London, 2nd ed. 1995, Chapters 19 (Principles of security) and 20 (Title finance) (to be published shortly).

5 Rolf Serick, Eigentumsvorbehalt und SicherungsObertragung, Neue Rechtsentwicklungen, Heidelberg. 2nd ed. 1993, pp 135-136; similar ideas have been developed by Professor John A, Spanogle, The George Washington University (Washington DC) who has been advising the Polish civil law reform commission on the development of a secured transactions law for banks.

6 Serick, supra note 5, p 135.

7 See limitations under Article 19.2 -19.4 of the European Bank's Model Law on Secured Transactions.

8 Serick. supra note 5, p 135.

9 Serick, supra note 5, p 135.

requirement is to ask for registration of security in a separate registry. Many central and eastern European countries have already adopted this view, although the registries have in many cases not yet been established.[10]

6. The role of security as protection in insolvency proceedings was mentioned above. The ultimate test of a security system is how security is dealt with in the insolvency of the debtor. Secured creditors expect to be paid in full or up to the amount of their asset.[11]

Obstacles to secured transactions in central and eastern Europe

Few, if any, of the central and eastern European laws on secured transactions can be said to be truly operational. Although by now most of the countries have enacted new statutes[12] it is still extremely difficult for local and foreign investors alike to get security, and this is a serious impediment for any financing in the region. Although the EBRD is taking security for all its private sector loans, it very often finds it difficult to create security for a reasonable price and duration, and which gives an assurance of real protection.

A main obstacle in many countries in the region is the lack of a framework in which secured transactions can work properly. Civil and commercial codes are often lacking, as are related areas of law such as enforcement provisions and insolvency laws. Where such laws exist they are often not put into practice as secondary legislation has not been promulgated, registries have not been established and court systems are working slowly. Most of the countries have, however, identified these problems and are taking action, although legal reform does not always take priority as one would wish.

It may also be said that secured transactions are not yet a familiar feature of financings in central and eastern Europe and are, therefore, regarded with suspicion. Many people have still to become acquainted with the idea that on the event of default of a debtor the creditor can enforce against the collateral.

There are particular substantive problems which investors face in most of the central and eastern European countries. In line with civil law doctrine most of the countries require that security can only be created over specific assets (doctrine of specificity) and that any description of collateral must be sufficiently certain (doctrine of certainty). In an economy that does not rely to a large extent on credit these requirements are perfectly sensible because security will not occur very often. Where security is, however, a normal ingredient of commercial transactions and where the debtor may still use and sell the collateral, these requirements become serious limitations to investments. Many Western civil law countries have detected these problems and, therefore, relaxed their doctrines of specificity and certainty. For example in Germany it is quite possible to take security over a whole

10 That is why many see registration as an unnecessary complication of the process of taking security. Sometimes the example of Germany and the Netherlands is quoted where the most practical forms of security over movable assets including rights do not require any publicity. These views are, however, often based on the presumption that registration involves delays and is an expensive and cumbersome process.

11 This may lead to the 'insolvency of the insolvency' (Kilger, KTS 1975, 142) as all other creditors may not receive any proceeds.
It is, however, important to understand that only the preferential status of secured creditors increases the possibility that creditors are willing to finance businesses even during a crisis.

12 See Wim Timmermans, Survey of Legislation on Secured Transactions in Central and Eastern Europe, International Bar Association Eastern European Forum Newsletter Summer 1994, pp 10-11.

warehouse without identifying each single asset held there.[13] The doctrines are still of importance in central and eastern European countries but should be carefully considered there.

It should also be mentioned that registration of security, which is provided for in many of the new enacted statutes, is almost impossible, and the fees envisaged in some of the statutes are prohibitive. For the most important questions regarding security, namely how the enforcement mechanism works and what the position of security rights is in insolvency proceedings, one is often left to speculate.

All this adds up to a heavily debtor-protective investment environment, which is the direct opposite of an investor-friendly climate facilitating the flow of capital.

Why a model law?

The EBRD has developed a Model Law on Secured Transactions.[14] It may be unclear what a model law can do for central and eastern European countries in the present situation. A model is after all not a law applicable in a country but only a proposal by an international organisation of how a national law might look. The EBRD felt that it had to offer some help in an area it is naturally very close to. "It would have been possible to give only general advice to central and eastern European governments. But advice has to be applied and it is often only from the practical drafting of a law that the nature and extent of the legal issues are properly understood. The Bank, therefore, decided that it would be more efficient and of more help to those seeking to develop their own laws if it drew up a guide in the form of a model law. The model is not intended as detailed legislation for direct incorporation into local legal systems but rather is intended to form the basis for national legislation."[15] It is also intended to give those who want to learn about the basic issues of secured transactions a point of reference.

The work of the EBRD has been supported by an international Advisory Board, comprising 20 practitioners and academics both from central and eastern Europe and from Western countries, The members of the Advisory Board have provided the comparative background for the work of the Bank and have greatly contributed to the final product. Although the model law has been completed the members of the Advisory Board are still very closely related to the project and often help with specific advice,

Main features of the EBRD's Model Law on Secured Transactions

The criteria formulated above for an adequate security system provides an idea about the content of the model law which the EBRD has developed. Naturally the method of creating security under the model is simple, particularly as the secured debt and the charged property can be described in specific or general terms. The model law even encompasses the idea of a business charge where the collateral consists of all the assets of a debtor. It contains provisions on the registration of security which enable third parties to learn that an asset has been given as security. It will be easy to understand that the model sketches an enforcement mechanism which allows for a simple realisation of the collateral.

13 It is certainly significant that this possibility has been devised praeter legem as a transaction called fiduciary transfer of title **(SicherungsGberaignung).**

14 See Jonathan Bates, EBRD's model law on secured transactions. Project Finance International August 4 1994, pp. 36-38.

15 See Simpson and Rover, in: supra note 2, p v.

warehouse without identifying each single asset held there.[13] The doctrines are still of importance in central and eastern European countries but should be carefully considered there.

It should also be mentioned that registration of security, which is provided for in many of the new enacted statutes, is almost impossible, and the fees envisaged in some of the statutes are prohibitive. For the most important questions regarding security, namely how the enforcement mechanism works and what the position of security rights is in insolvency proceedings, one is often left to speculate.

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The general idea was to achieve a balance between the interests of creditors and debtors. It is certainly necessary to create a security system which gives the creditor sufficient assurance that he will receive his money even in the undesirable case of an enforcement or insolvency. It is, on the other hand, important that the debtor is protected against improper actions and that he too can count on a reliable system in which he finds adequate protection.

The role Of the Model Law in the transition process

What is the role the model law can play in the transition process towards workable secured transactions laws in central and eastern Europe? As mentioned above, the role can be twofold.

The model law can be used as a basis from which to build legislation. Any country that would like to use the model in this way would, however, have to adapt it carefully to its legal system. After all, the legislative process is a matter which every country has to go through itself and which no Western aid can substitute. The role of an international organisation is to give help when asked but not to substitute national decision making. There are now excellent examples of how the model has been applied usefully in the preparation of legislation, particularly the case of Hungary. Professor Attila Harmathy, one of the members of the EBRD's Advisory Board, was appointed head of the Hungarian civil law reform commission and drafted provisions on secured transactions to be included in the Hungarian civil code. Contacts the Bank has in the region demonstrate that the model may also be useful in other countries.

The second role for the model law is as a point of reference or template for those working in the area who want an informed view about the working of security. The model presents an up-to-date picture of secured transactions on a comparative basis[16] which should be of interest to lawyers and investors alike. It helps in understanding foreign laws as well as in developing one's own law.

The Bank hopes that its countries of operations will establish secured transactions laws which allow for adequate protection of investors. This will be an important achievement on the road to market economies,

16 see for the comparative approach of the model law Ulrich Drobnig, The Comparative Approach of the EBRD's Model Law, Speeches given at the Presentation of the Model Law during the Third Annual Meeting of the EBRD on Saturday 16 April 1994 in St Petersburg, London, 1994, pp 1-2.

Apendix D

THE IRIS-POLAND PROJECT

Funded by USAID

LAW ON REGISTERED PLEDGES AND THE PLEDGE REGISTRY

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Substantiation of Draft Law on Perfected Security Interests and Registry of Security Interests

I. One of the basic universal principles of credit and finance is the ability to grant creditor adequate collateral. Polish law provides for security interest in real estate or other rights in real property (e.g. in perpetual usufruct) or security in chattels or in other forms of property (e.g. in debts).

Doctrine and jurisdiction provide additionally for so called "establishment and transfer of secured interests".

The main objective of the new law is to adjust the institution of security interests to the requirements of market economy and to make it:

1. simple and efficient for creditors,
2. to allow debtors (the party offering the property as security) to maintain physical possession of and use of property offered as security,
3. to facilitate access by third parties to clear and reliable information on secured interests.

Regulations on security interests included in *the* Civil Code (art. 306 - 326) do not presently meet these requirements. For example: in order to create an ordinary security interests in chattels, apart from a security agreement signed by the owner of the chattel and a creditor, it is necessary to give physical possession of the collateral to the creditor or to a third party on which both contracting parties agreed (art. 307 of CC). This makes the party offering property as security (usually the debtor) unable to use the collateral notwithstanding the fact that using the collateral may be necessary to meet the debtor's obligations to the creditor (e.g. when collateral is a means of production). In order to prevent such situation, the Civil Code provides for banks to secure their credits by secure interests in debtor's chattels, and leave the collateral for debtor or third party use. The security agreement shall be perfected in the registry of security interests managed by a bank (art. 308). However, neither the Civil Code nor the Banking Law provide clear rules for banks on how the registry of security interests should be maintained. The registry is not public, no access to third parties that may be interested is permitted (e.g. for other potential creditors). No actual or constructive notice is related to the registration in the registry. In case when the same property is offered as a security in another security agreement, second security interest - according to art. 310 of the CC - has priority over the first one, unless the second creditor acted in ill faith. However, due to the high diffusion and secrecy of registries, ill faith is unlikely to be proven.

As a result of the above, and particularly due to the regulations of art. 1025

point 5 of the Code of Civil Proceedings, instruments of perfected security interest, as it is defined by the Civil Code, seems to be a rather fictitious security instrument for banks.

However, taking into account that it may be, and should be, an instrument efficiently protecting the creditor, it is necessary to change the law entirely, the first step of which is the new draft law on perfected security interests and the registry of security interests.

n. The new Law shall be divided into ten chapters with descriptions to assist in locating relevant provisions. Chapter 10 consists of interim and closing regulations.

Chapter 1 consists of regulations on implementation of the Law and activities necessary to create a perfected security interest.

Compared with perfected security interest currently limited by the Civil Code to credits granted by Polish banks, the new draft law substantially expands the range of credits and the number of creditors entitled to use this kind of security.

According to art. 1.1 of the draft law, security interests in property may be created in order to secure credits granted by:

bank located in Poland,
foreign banks with branch or representative offices within the territory of the Republic of Poland,
international financial institutions of which the Republic of Poland is a member (e.g. World Bank, EBRD).

However, item 2 art. 1 provides for the Minister of Justice with the consent and approval of the Minister of Finance and the President of NBP, to define, by regulations, other domestic and foreign persons entitled to secure their credits by registered security interest.

This way, the number of creditors entitled to secure credits through use of registered security interests, may be increased without amending the Law. In order to create a perfected security interest, a written security agreement between a debtor and a creditor must be signed and registered in the registry of security interests. Personal property collateral, as well as all securities and other documents related to rights offered as security, may remain in the possession of the debtor or third party designated by both parties in the security agreement.

Art. 4 of the draft law provides for possibility of establishing perfected security interests in order to secure credits of so called bank consortia, even if some of consortia members are not entitled to such security.

According to art. 5 creditors enjoy the right to priority satisfaction from the property offered as security prior to any other creditors of the debtor, as well as debts to government (e.g. taxes), unless they had been registered prior the security interest registration or they are directly related to the property offered as security (e.g. duty on import of such a property).

Chapter 2 consists of regulations on credits secured by perfected security interest, and **Chapter 3** includes provisions on properties that may be offered as security. According to these regulations, the security interests may be granted in all kinds of personal property, except for ships registered in the Register of Ships (in this case, regulations on so called maritime mortgage of the Maritime Code apply), as well as transferable asset rights.

Regulations of **Chapter** 4 define rights and obligations of debtors and creditor, but these regulations are of residual character, which means that they are applied, only if security agreement does not provide otherwise. Contrary to current regulations of the Civil Code, the draft law permits a creditor to get a debtor's additional affidavit that he will not sell or offer the same property as security to other creditors before maturity of the perfected security agreement. This provision, if it is registered in the registry of security interests, shall be executed against parties to which the debtor, in spite of the fact that he accepted the objection, sold the property offered as security or offered the same property as security in another security agreement, unless this person acted in good faith. If the party purchased the property offered as security in ill faith, that party becomes responsible for the debt secured by the perfected security interest to the amount of the value of the property purchased unless the party submits the object of security to the creditor. However, if the sale of the property offered as security results from the regular business of the debtor, the sale is free from any restrictions and does not carry any responsibility of a purchaser against the creditor.

Basic provision for terminating security interests is set forth in **Chapter 5.** Secondary secured interests in real property (including second security interests) shall not be executed in a manner which would undermine the prior security interest (art. 16).

However, for credits described in art. 49 of the Tax Law (Law of December 19, 1980, published as uniform text in 1993 in the Official Journal NR 108, item 486 with later amendments), the draft law creates the obligation to include these credits in the Register of Security Interests (art. 17). This results in art. 18 par 2 of the draft law stating that these credits, as they coincide with other credits registered, shall be subject to the order of priorities set forth in art. 18 par. 1 from the moment of their registration.

The issue of transfer and expiration of perfected security interests is covered by **Chapter 6. Chapter 7** provides for creation and administration of one or more

registries by local courts, in courts named by the Minister of Justice to cover one or more provinces of Poland. The registry and documents submitted shall be of public record, and copies and statements from the registry shall be issued upon any request after paying the required fee.

Chapter 8 of the draft law embraces regulations on judicial and extra-judicial procedures.

The basic premise of the law is to include legal solutions that would enable creditor to achieve satisfaction in the most direct way omitting, wherever possible, judicial procedures, which tend to be long, drawn out, and expensive. At the same time, debtors' rights shall be protected.

In developing the system for satisfying debtors' rights, the legislator drew on the standards in that respect established by the Polish Commercial Code in the pre-war period; extensively applied and formally in force until 1965. Those were included in art. 509 - 517 of the Commercial Code.

However, the draft law does not just duplicate regulations of the Commercial Code. Copying these would not serve a purpose as differences between economic conditions before the war and today, as well as changes in the legal culture - or rather lack of this culture - in today's economy, would not be taken into account.

A basic rule, expressed in art. 29 of the draft law, is satisfaction by execution of rights. Extra-judicial foreclosures are permitted, but only in these cases provided by the law (see below). Range of extra-judicial proceedings for foreclosure are covered by art. 29 - 36 of the draft law.

According to these regulations, extra-judicial foreclosure is permitted:

a/ by public sale of the object pledged as security,
b/ from publicly traded securities,
c/ from commonly traded goods (commodities),
d/ from profits from debtor's business or rent proceeds from lease of the debtor's entire company.

The intend of this provision is that extra-judicial foreclosure would be allowed only against properties the value of which may be easily and objectively determined.

In case of publicly traded securities, value is reflected by market price; in case of goods commonly traded, the average market price. It is also easy to estimate profits from business or rent proceeds from lease of the debtor's entire company. The solution adopted does not result in any infringement of creditor or debtor rights. Security interest perfected in the registry of security interests is meant for professional

businessmen: in cases when contracting parties agree on extra-judicial proceedings, they shall be able to agree on property that may be offered as security and from which they can expect recourse, taking into account risk of price fluctuations for the property offered as security.

Extra-judicial proceedings embraced by the draft law cover situations when property offered as security is in a creditor's possession, or when the debtor voluntary surrenders it to the creditor.

In a case of refusal to surrender the property offered as security, the secured party (creditor) shall be forced to demand the property offered as security by way of a civil lawsuit.

Extra-judicial proceedings are accepted only in those cases when a debtor or third party in possession, do not assume the defense against actions set forth in art. 33 of the draft law.

Extra-judicial proceedings in the draft law provide the creditor (secured party) with the right to take possession of property offered as security or to get profits or proceeds from leases of the debtor's business. Art. 31 of the draft law provides for public sale of property offered as security as a form of extra-judicial recourse.

Art. 32 covers secured party satisfaction realized by taking possession of property offered as security. Transfer of title shall be automatic, in accordance with art. 34 of the draft law. In such case, the secured party shall notify the debtor seven days before maturity date that in case of nonpayment, the title to property offered as security shall pass to creditor.

In the draft law, in case of agreed extra-judicial foreclosure of party secured, defense of debtor rights, as well as rights of third parties, may be enforced by filing of a complaint (art.33). The basic form of complaint is one to determine the existence of debt. Moreover, the draft law provides for protection of debtor's and possessor's rights by complaints filed, by filing vindication or anti-foreclosure complaint.

There is a rule that if a debtor had filed a complaint, creditor shall be satisfied through judicial proceedings conducted based on judicial title issued as a result of legal proceedings taken by the debtor (art. 29 of the draft law). In order to avoid abuse of this kind of defense by the debtor (party offering property as security), art. 35 of the draft law provides for possibility of securing creditor's claims by security proceedings.

Art. 37 of the draft law permits free transfer of foreign currency abroad, if the creditor is a foreign bank. This regulation is aimed at protection of rights of foreign banks with branches in Poland. Formula for determination of foreign exchange rate is defined in art. 37 items 2 and 3. The value date is the day of bank's satisfaction, i.e. the day on which the possession of property offered as security had been taken,

or the day on which bank should be satisfied if foreclosure mechanisms worked properly.
Chapter 9 proposes, inter alia, changes in regulations on judicial proceedings.

The three basic amendments to the Code of Civil Proceedings (art. 41 of the draft law) are as follows:

a/ change in art. 777 of the CCP is aimed at implementation of a possibility to undergo judicial proceedings in cases when due amount is not readily determinable but only an upper limit up to which the debtor agrees to undergo foreclosure, and data necessary to determine the value of debt have been given; this solution shall enable extensive use of this kind of foreclosure proceedings which shall substantially facilitate execution of claims. Current regulations of art. 777 par. 4 on undergoing foreclosure by a notarial deed is not useful due to the requirement to determine the exact amount of the sum being executed;

b/ Polish law on judicial proceedings does not cover the judicial proceedings against a company. Art. 1062 of the CCP law fills this gap; the included reference to foreclosure on real property is intentional and arises from legal regulation of this kind of execution and legal status of the company;

c/ deleting item 5 of art. 1025 par. 1 of the CCP shall eliminate banks' rights to privileged satisfaction prior to debts secured by mortgage or lien. There are no economic reasons for such a preference in a free economy.

Proposals of amendments to the Banking Law are embraced by art. 43 of the draft law.

The aim of these changes is to eliminate from Polish law so called "bank's title to execute its rights of security interest" which is unreasonably advantageous for banks. Given the right to issue such titles, which are a basis for foreclosure without judicial assistance, banks became judges in their own cases. Such a solution was partially reasonable in a controlled economy when banks had administrative functions. There are no reasons for such titles in the current market economy.

In order to facilitate satisfaction for banks, the draft law provides for implementation of titles of execution to the Banking Law. Banks would issue such titles based on debtor's written consent to foreclosure. After a court's grant of judgment on foreclosure, the title would serve as the basis for foreclosure. On one side it would make easier for banks to claim their rights, and on the other side this would be in compliance with Polish law.

At the same time, the issue of titles shall be limited only for specified purposes.

It will guarantee that this instrument shall not be used in a way detrimental to debtor or other parties. Additional protection of debtor's rights shall be in the form of new regulations on pre-foreclosure complaint proceedings (art. 53^4 of the Banking Law). Summons in such cases shall be free from any court fees, which should facilitate the defense.

Other regulations of **Chapter 9** introduce amendments to the Commercial Code, Law on Real-Estate Registers and Mortgages, Law on Public Trading of Securities and Insolvency Law, that results from implementation of perfected security interest instrument in the form planned.

Chapter 10 of the draft law includes, among the other items, temporary regulations that cover mainly security proceedings.

Changes proposed are aimed at substantial acceleration of security proceedings allowing satisfaction of creditor claims as soon as possible. Moreover, the draft law provides for transfer of legal protection granted by transforming temporary injunctions into permanent ones. It is provided that temporary injunctions shall be granted by courts according to standard rules. However, banks will be entitled to have issued so called "bank titles by right of security interest". This right is limited to activities which permit the bank to execute its security interest. It is envisaged that this title would permit execution on the security interest without judicial assistance or intervention. The idea is to simplify, as much as possible, the opportunity for the bank to protect its interests.

The draft law (art. 48) provides a requirement to consider the request for security within three days from the day of its submission, otherwise it may be claimed. The aim of this regulation is to introduce an obligation to adjudicate security interests. Practice shows that courts do not consider requests for security at all, or they consider them after a long delay which, in practice, minimizes use of this form of legal protection.

Security should be made in compliance with the CCP's regulations. Art. 50 modifies execution of security interest by taking control of a company according to provisions of a security agreement. The intent is to increase efficiency of this kind of security interest and that the security agreement complies better with the character of the company taken over.

The regulation of art. 52 item 2 of the draft law is intended to facilitate handling of disputes when the debtor (the party offering property as security) does not deny the claim, i.e. to reduce needless proceedings.

Regulations of art. 52 correspond with regulations of **Chapter** 7 on protection of debtor's rights. Since the basic form of protection is to file a complaint to determine

the debt, courts considering the complaint shall adjudicate the security interest, as well as possible judgments on remedy of injustice committed against creditor.

HI. It is envisioned that registries of security interests shall be held by relevant courts currently holding Commercial Registers, i.e. 49 provincial register courts shall oversee the local registries.

Phase I will be a pilot implementation of program in 5 selected registry courts with simultaneous establishment of a central data-base of security interests and secured parties. After the program has been tested for one year, it will be implemented in other provincial courts.

Basic features of the computer system of registry of security interests shall be as follows:

1. each court maintaining the registry of security interests will have access to a local data-base including not only all security interests registered, but also the list of parties applying for security interests;
2. all data shall be conveyed through the computer system to the central data base held by an independent institution with legal and organizational personality, e.g. a budgetary entity institution or a joint-stock company (wholly-owned by the State Treasury) - under full control of the Ministry of Justice; the main task of the central data-base would be to gather, store and provide access - on commercial basis - to information sent by courts, with no rights to implement any changes to the information received; it is foreseen that the center shall also have access to data-bases of other courts' registries, e.g. economic registers - likewise on commercial basis.

Information sent to the center shall include not only data on transactions already registered but also on parties applying for registration of security interest. A property offered as security shall be identified mainly by identification of a debtor.

Implementation of such a form of registry of security interests shall require:

1/ establishment, within the court, of an independent post ("podsedek" or the German "rechtspleger") serving as the administrator of specified activities in the place of a judge,
2/ creation uniform identification codes for natural and legal persons as well as glossaries of terms and definitions in use,
3/ implementation uniform application forms for registration.

IV. Costs of implementation of the automated registry of security interests system is estimated as follows:

1. phase I - initial implementation of system in five registry courts and establishment of the center - approximately PZL 45 bn including costs of equipment for 5 local networks (20 workstations in each court), network system and user software,
2. phase II - full computerization of all 49 registry courts and connecting them to the center - approximately PZL 200 bn.

Total costs of implementation of computer system for registry courts and establishment of an information center are estimated at PZL 250 bn.

It is worth noting that it will be possible to use such an automated computer system not only for the needs of the registry of security interests, but also for other courts registries including the Register of Business Entities.

LAW

of ..[insert date of enactment]...

on Registered Pledges and the Pledge Registry

Chapter 1

General Provisions

Art. 1.

1. A registered pledge[1] may be established in accordance with this Act to secure the claims of:

1) a bank organized and existing under the laws of Poland
2) a foreign bank with a licensed branch or representative office in Poland
3) an international financial organization[2] of which Poland is a member.

2. The Minister of Justice, with the approval of the Minister of Finance and the President of the National Bank of Poland, may authorize, by a decree, other Polish and foreign entities to secure their claims by a registered pledge.

3. In matters not regulated herein, the provisions of the Civil Code on pledges shall

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[1] The concept of "pledge" in Polish law is similar to the "lien" or "security interest" in US law, the "gage" in French law, the "charge" in English law, or the "floating hypothec" and "movable hypothec" in the recently revised Civii Code of Quebec.

[2] Examples are the World Bank, the European Bank for Reconstruction and Development (EBRD), and the International Finance Corporation (IFC).

control.[3]

Art. 2.

1. To establish a registered pledge, there must be a "pledge agreement" [See Art. 3.1 *infra]* between the person empowered to dispose of the object of the pledge [hereinafter the "pledgor[debtor]"} and the creditor [hereinafter the "pledgee[creditor]"] and an entry in the pledge registry.[4]

2. Movable things and securities encumbered by a registered pledge, as well as other documents concerning rights encumbered by such a pledge, may [but need not] be left in possession of the pledgor[debtor] or a third party specified in the pledge agreement.

Art. 3.

1. The pledge agreement shall, upon pain of absolute nullity, be made in writing and shall specify at least the following [four items]:

1) the date of the pledge agreement,

2) the names, surnames and addresses [or seat of] of the pledgor[debtor], the pledgee [creditor] and of the debtor in a case where the latter is not the pledgor,

3) a description of the subject of the pledge with sufficient specificity, so that it may be identified,

4) the claim secured by the pledge, its amount and the legal relationship

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[3] This Act will not displace Art. 306 governing the classical or possessory pledge (where the property pledged must be delivered to the pledgee), but will replace Art. 308 on old-style bank pledges. See Art. 47 of this draft. In this translation, the expression "pledged property" refers only property pledged under this new registered pledge. The Polish version makes this clearer by using the expression "przedmiotow obciazonych zastawen rejestrowym" [an object subject to a registered pledge],

[4] For clarity, we are using the terms "pledgor[debtor]" and "pledgee[creditor], although there are situations where the pledgor and the debtor are not the same nor are the "creditor" and the pledgee always the same. See Art. 24.1.2.

giving rise to such claim, or

5) the limit of the liability [denominated in a currency], if the secured claim is a future or conditional one of an amount not yet determined at the time the pledge agreement is made.

2. A motion for the entry into the pledge registry shall be rejected if not made within one month after the signing of the pledge agreement.

Art. 4.

In the event of a syndicated loan where there are two or more lenders,[5] where at least one of them is eligible to secure its claim by a registered pledge pursuant to this Act, [if one lender is a Polish bank], it may, pursuant to a separate agreement with the other lenders, be empowered to secure with a registered pledge the claims due the other lenders under the syndicated loan, and may exercise, in its own name but for their benefit, all the rights and responsibilities of the pledgee[creditor] resulting from the pledge agreement and from applicable law. Such bank shall be known as the "administrator of the pledge."

Art. 5.

1. The pledgee [creditor] shall have priority in satisfaction of its claim from the pledged property over the personal creditors of the pledgor[debtor] as well as the collection of claims arising under public law,[6] not evidenced in the register before the establishment of the registered pledge.

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[5] Under Polish law, a "kredyt" is given only by banks; loans may be given by other persons, legal and natural. Therefore, this provision applies only to loans given by syndicates involving at least one Polish bank.

[6] Such as statutory claims, tax claims, customs taxes, sociai insurance, etc. Henceforth, such general claims against the debtor must be filed in the pledge registry prior to other creditors to enjoy priority over them.

2. Sec. 1 of this Article shall not apply to statutory liens which attach directly to a specific object which is subject to a registered pledge.[7]

Chapter 2

Claims Secured by a Registered Pledge

Art. 6.

1. A registered pledge may secure a claim expressed in Polish zlotys or a foreign currency.

2. The actual amount of the claim paid in Polish zlotys or a foreign currency may be determined according to an agreed upon standard of value.[8]

3. The provisions of Sec. 1 and 2 shall not be inconsistent with the laws or regulations governing foreign exchange.

Art. 7,

Future or conditional indebtedness may be secured by a registered pledge only up to the maximum amount provided for in the pledge agreement,

Chapter 3

Subject of a Registered Pledge

Art. 8.

The subject of a registered pledge may be any movable or property right which is

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[7] Examples are a specific car on which neither customs duties, stamp duty, or VAT has been paid. But such taxes would not have priority over other assets of the debtor.

[8] This could be bushels of corn, dollars, or ounces of gold.

transferable with the exception of sea-going ships registered in the maritime registry.

Art. 9.

1. A registered pledge may encumber in particular:

1) one or more things which may be specifically identified,

2) things identified as to type, if in the pledge agreement their quantity or means for differentiating them from other things of the same type is specified,

3) a collection of movable things and rights constituting an economic entity, even though the individual may be replaceable or a part of such entity [i.e. equivalent to a floating pledge],

4) claims,

5) intellectual property rights,

6)rights arising from securities.[9]

2. A registered pledge may also encumber objects, which the pledgor[debtor] is to acquire in the future. In such case the encumbrance of these objects shall be effective at the moment of their acquisition by the pledgor[debtor].

Art. 10.

1. The encumbrance of a thing by a registered pledge shall remain in force without regard to changes which the thing may undergo in the manufacturing process, and in the event of joining or mixing an encumbered thing with other movable things in such a manner as to make the restoration to their original state costly or impracticable, the registered pledge shall encumber the whole of the things joined or mixed.

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[9] This includes dematerialized certificates. See the separate law on securities of March 22, 1991.

2. If things joined or mixed as specified in the preceding Section were encumbered by registered pledges in favor of different pledgee [creditors], the pledges shall remain in force and shall encumber the whole of the things joined or mixed, and the priority of the pledges shall be determined according to the provisions of Art. 16.

3. If a movable thing encumbered by a registered pledge becomes a component part of immovable property [10] [often called a "fixture"], the pledgee [creditor] may demand that the real estate be encumbered by a [real estate] mortgage established by filing a certified copy of the entry from the pledge registry, the value of that encumbrance not to exceed the value of the movable which has become a fixture.[11]

4. If the value of the fixture is not specified in the pledge agreement, this value shall be determined by the court having jurisdiction over the real property on evidence supplied by a licensed [court] expert in valuation.[12]

5. The excerpt from the register of pledges shall be attached to the motion to file a mortgage entry.

Art. 11.

Unless otherwise specified in the pledge agreement, the subject of a registered pledge shall be construed to include:

1) any compensation obtained by the pledgor[debtor], or any claim due to it for compensation for the loss, destruction, damage, or devaluation of the

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10 As defined in An. 169 of the Poiish Civil Code. A purchaser of real estate thus need only check in the appropriate "perpetual book," unless there is some reason for him to check the pledge registry. If he were buying farm equipment with a farm, for example, he would be required to check the pledge registry.

11 It is unclear how much is secured when a depreciating asset becomes a fixture. Is the new purchaser liable for the amount of the asset when affixed or its value when he purchased the real estate?

12 This should be revised to conform with Article 3, Sec. 1, Subsection 4 or 5 which require the denomination of the underlying obligation.

subject of the pledge,

2) payments received or due to the pledgor[debtor] in consideration of the sale or exchange of pledged property,

3) natural or civil profits [such as rents] from the pledged property owed to the pledgor[debtor].

Chapter 4

Rights and Obligations of the Pledgor[debtor] and Pledgeefcreditor]

Art. 12.

1. Unless otherwise specified in the pledge agreement, the pledgor[debtor]:

1) may use objects encumbered by a registered pledge in accordance with their socio-economic purposes [normal intended use],

2) shall maintain the pledged property in a condition not worse than that resulting from its proper use [normal wear and tear excepted],

3)shall be obliged to allow the pledgee [creditor] to inspect the condition of the pledged property at a suitable time established by the pledgee[creditor].

2. If the provisions of the pledge agreement permit the pledged property to be in the possession of a third party, then the provisions of the preceding Section shall apply to that party as well.

Art. 13.

The pledge agreement may provide that the pledgor shall maintain a book of pledges in which the pledgor specifies property subject to a registered pledge, modifications to the

subject property and other covenants of the pledge agreement pertaining to the property.[13]

Art. 14.

If, as specified in the pledge agreement, the pledged property is to be marked in a specific manner, the pledgor[debtor] shall be obliged to mark it without delay at its own cost in the prescribed manner and ensure that the marking remains in the proper condition until the pledge expires.

Art. 15.

1. The pledgor[debtorj may obligate himself not to sell or to encumber the pledged property before *the* registered pledge expires. Such an undertaking shall be made in the pledge agreement and is effective against third parties from the date of entry in the registry.

2. Any sale or encumbrance of the pledged property shall be invalid if made contrary to the undertaking specified in section 1 unless the pledgee has consented in writing to such a sale or encumbrance.

3. A sale or encumbrance of pledged property in violation of the clause specified in Art. 15.1 shall entitle the pledgee [creditor] to seek immediate satisfaction of its claim.[14]

4. If a purported purchaser acts in bad faith and the pledge property is in its possession, he is liable to the pledgee [creditor] up to the value of the pledged property, unless he returns the pledged property to the pledgor[debtor].

5. The provisions of Art. 15. 1-4 shall not apply to objects sold in the ordinary course of business of the pledgor[debtor]. The purchaser shall acquire such property free of

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13 Such as **maintenance,** insurance, permission to take abroad.

14 Compare to Art 13.2 where the language is "due and payable." Is there a difference?

registered pledge.[15]

Chapter 5

Conflict of Encumbrances

Art. 16.

Any encumbrance established subsequent to the entry of a registered pledge is subordinate to any earlier registered pledge.[16]

Art. 17.

Indebtedness, which is referred to in art. 49 of the Act of December 19, 1980 on tax obligations (Journal of Laws, No. 108, item 486) is to be entered into the pledge registry.

Art. 18.

1. If the same property is encumbered by more than one registered pledge, the date[17] of the filing of the motion for entry in the pledge registry shall determine the priority of such pledges. Motions filed on the same day have equal priority.

2. The principle stated in Sec. 1 is also applicable to indebtedness, as described in art. 17.

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15 For example, someone buying a refrigerator at an appliance store need not check the pledge registry. Someone buying a iarge industrial refrigerator from a restaurant would be required to check the pledge registry to be certain he was acquiring the refrigerator free of encumbrances.

16 Under Polish law, are certain encumbrances called "limited property rights." (See Act 214 to 335 of the Civil Code),
such as mortgages, pledges, easements will have this priority. Not included would be "rights of first refusal," option to buy, and it is unclear whether they can registered.

17 Whether the time [hour and minute] will also be recorded is still under discussion.

Chapter 6

Transfer and Expiration of a Registered Pledge

Art. 19

1. A registered pledge may only be transferred to a person together with the underlying claim to a person entitled to have its claims secured by a registered pledge pursuant to the provisions of this Act.[18] With respect to the transferee, the transfer assignment of a registered pledge shall be effective from the date of an entry into the pledge registry noticing the transfer.[19]

2. In the event of a transfer of the claim secured by a registered pledge to a person other than the one described in Sec. 1, the registered pledge shall expire. In such case the pledgee[creditor] is obliged to file without delay a motion to strike the expired pledge from the pledge registry and shall be liable for damages caused to the pledgor[debtor] resulting from its failure to fulfill that obligation.

Art. 20.

1. Expiration of a claim secured by a registered pledge shall result in the expiration of the pledge, unless the pledge agreement provides otherwise.

2. Apart from the cases provided in this Act, a registered pledge may also expire pursuant to other statutory provisions, particularly provisions of the Civil Code ensuring the protection of the buyer in good faith, or provisions of the Code of Civil Procedure

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[1S] See Art. 1

[19] With respect to the priority date, the assignee can use the assignor's priority date. The Commission for Reform of the Civil Code decided that no explicit explanation of this was necessary, since other sections of the Civil Code make it clear that an assignee stands in the place of the assignor with respect to the priority date.

concerning the sale of property in judicial enforcement proceedings.

Art. 21.

A registered pledge shall be stricken from the pledge registry when it expires. A pledge may be stricken from the registry on motion of:

1) the pledgee [creditor],

2) the pledgor[debtor], who shall append to the motion a written declaration of the pledgee [creditor] that the claim secured by the registered pledge has expired or that the pledgee [creditor] has waived the pledge, or a final judgement of a court that the pledge has expired,

3) a person who has purchased the pledged property in a manner resulting in the expiration of the pledge. Such a person shall append to the motion the following:

    a) the written permission of the pledgee [creditor] to strike the pledge from the pledge registry, or

    b) the certification of the court bailiff that the pledged property has been purchased in judicial enforcement proceedings, or

    c) a final judgement of a court declaring that the registered pledge has expired.

Chapter 7

Pledge Registry

Art. 22.

1. The pledge registry shall be maintained by the regional courts indicated by the Minister of Justice. The Minister of Justice may by decree issue specific regulations designating one regional court to maintain the pledge registry for one or more specified voivodships.

2. In the event pledge registry is maintained by two or more courts, the Minister of Justice shall establish a central data bank on registered pledges which will collect data from the pledge registries maintained by the regional courts.

Art. 23.

3. The Minister of Justice shall issue by decree specific provisions concerning the maintenance and operation of the pledge registry, issuing certified excerpts and certificates from such registry, and the amounts of the fees to be paid for registration, as well as detailed regulations to govern the central data bank.

Art. 24.

1. The pledge registry, together with documents filed in the registry, shall be a matter of public record.

2. Certified excerpts from the pledge registry shall serve as evidence of an entry in the registry and shall serve as evidence of the lack of an entry and both shall be issued to any person upon application and payment of the appropriate administrative fee.

3. Beginning from the date of entry in the pledge registry, no one may plead ignorance of the facts evidenced in the register, unless he can prove its inability to have learned about those facts.

4. The pledgor [debtor] and the pledgee [creditor] may not assert as to any third party

acting in good faith that the data evidenced in the registry is not true.

5. If the data entered into the pledge registry is inconsistent with that in the motion, the applicant who neglected to file a further motion to introduce necessary corrections or to strike the entry from the register, may not assert as to any third party in good faith that the data are inadequate.]

Art. 25.

1. Entries into the pledge registry may only be made after the filing of a motion in writing, to which the pledge agreement must be attached.

2. An entry in the pledge registry shall include:

1) the date of the filing of the motion,

2) the name and registered address [or the seat of] of the pledgor[debtor], the pledgee[creditor], and the debtor, if the debtor is a person other than the pledgor,

3) a description of the pledged property, and the method of marking, if marking is provided for in the pledge agreement,

4) the amount of the secured and in the event the property is intended to secure future or conditional claims, the maximum limit of pledgor's(debtor's) liability,

5) the procedure of satisfaction provided for in the pledge agreement, if it is in accordance with the provisions of this Act.

6) negative covenants specified in Article 15.

Art. 26.

The registry court shall determine whether the motion and the appended pledge agreement conform in form and content with this Act.

Art. 27.

The registration procedure shall be regulated by the provisions of the Code of Civil Procedure concerning non-adversary proceedings[20], as well as the provisions of this Act.

Art. 28.

1. A correction or deletion shall also be an entry, unless the provisions of the law provide otherwise.

2. An entry shall be effective retroactively from the date of the filing of the motion for an entry.[21]

Chapter 8

Satisfaction of the Pledgee[Creditor]

Art. 29

Satisfaction of the pledgee[creditor] from the pledged property shall be carried out in judicial enforcement proceedings unless provided otherwise herein below.[22]

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20 See the Polish Code of Civil Procedure, Articles 506 to 694.

21 In other words, the entry when approved by the judge shall have priority date determined by the date the motion was
filed, not when approved.

22 Execution in Poland is based on the very complicated German model which encompasses three types of actions:

(1) the creditor may apply to the court for a **writ of attachment** *(tytul zabezpieczenia);*
(2) the creditor may obtain an **executory title (tytul** *egzekucyjny)* by applying to either a judicial court, a court of

Art. 30.

1. The pledge agreement may permit the pledgee [creditor] to satisfy its claims by a statement that it assumes title to the pledged property[23] on the day when the underlying claim becomes due, if:

1) there is a pledge on publicly traded securities or on objects which are commonly circulated goods, or

2) the pledged properties are movables the value of which have been defined precisely in the pledge agreement.

2. The transfer of title to pledged publicly traded securities and to movable pledged property to the pledgee [creditor] shall be effective when the claim secured by the pledge becomes due.

3. If the pledgor[debtor] files a motion or complaint referred to in Art. 33, the pledgee [creditor's claims specified in the motion or complaint shall be satisfied solely by execution under the executory title based on the court judgment.

Art. 31

arbitration, or a public body (e.g., the Treasury) which is empowered to issue such titles. In addition, the creditor may obtain an executory title in cases where the debtor submits voluntarily to execution and that fact is certified by a notary (see the Polish Code of Civil Procedure, Art. 777);

(3) having an executory title, the creditor may apply to the court for a **enforcement title** *(tytul wykonawczy),* sometimes translated as "a perfected executory title," which bears an official court stamp on it.

The court bailiff *(komornik)* may execute against the debtor's property only if the creditor has obtained an enforcement title. A primary innovation of this draft law is under this section creditors will be entitled to execute directly against debtor's property without a komornik if the pledge agreement so provides (See Art. 28 to 36). Of course, if there is opposition by the debtor, the creditor bank will be required to obtain an enforcement title by having a court approve the executory title which the bank can issue itself and then enlisting the assistance of a komornik.

[23] See Art. 32 where 7 days notice required. But in the case where there is no possibility of dispute over the value of the pledged property, i.e. where it is publicly traded, the pledgee[creditor] is allowed to take title immediately and to sell the collateral.

1. If the pledge agreement permits the pledgee to satisfy its claims by the public sale of the pledged property, the sale shall be conducted by a notary public or by a court bailiff [komornik] within fourteen days from the day when the claim became due.

2. The Minister of Justice may by decree issue regulations governing such sales.

Art. 32.

1. If the pledge agreement provides for the satisfaction of the pledgee[creditor] through the seizure of title to pledged property which is a publicly traded security or commodity, then the value of the seized security or commodity shall be the closing price on the day of seizure. If on the day of seizure, trading on the stock or commodity exchange was not conducted, the value of the seized security or commodity shall be the price at the close of trading on the next following trading session during which the seized security or commodity was actually traded.

2. If the pledge agreement provides for the satisfaction of the pledgee[creditor] through the seizure of title to the pledged property which is a commonly circulated good[24], the value of these goods shall be determined on the basis of average price of the object on the day of the seizure.

3. In cases specified in section 1 of this Article, the pledgee[creditor] shall settle its claims with the pledgor[debtor] within 14 days from the date of the seizure.

Art. 33.

The preceding provisions shall not limit the rights of the pledgor[debtor], nor those of any third party after enforcement proceedings, to file a motion or a complaint concerning

[24] Such as a late model car.

enforcement proceedings seeking a court judgment that the value of the seized pledged property was determined in a manner inconsistent with the provisions of this Act, or to claim redress for damages caused by the seizure of the pledged property inconsistent with provisions of this Act.

Art. 34.

Before undertaking any action to satisfy its claim with respect to pledged property, the pledgee [creditor] shall notify the pledgor[debtor], in writing, of its intent to do so. The pledgor[debtor] may within 7 days of receiving such notice either satisfy the claims of the pledgee[creditor], or apply to the court for a determination that the claim does not exist or that it is not due in whole or in part. In the latter case, the court shall also define the scope of the obligations of the pledgor[debtor].

Art. 35.

In the event the fulfillment of the claims of the pledgee [creditor] to the pledged property is endangered, the rights of the pledgor[debtor] as specified in Art. 33 shall not bar the pledgee[creditor] from obtaining a judicial attachment [to protect the pledged property] even before the [underlying] claim is due and payable.

Art. 34.

1. If the pledge agreement provides for the satisfaction of the claim of the pledgee[creditor] from the profits of an enterprise containing the property pledged by the registered pledge, an appointed administrator may be imposed over the enterprise. The identity of such administrator shall be specified in the pledge agreement.

2. An enterprise containing pledged property may be leased in order to satisfy claims of the pledgee [creditor] from rent receipts.

Art. 37.

1. In the event that the pledgee[creditor] is a foreign bank, its claim may be satisfied in foreign currency if provided for by the pledge agreement. In such a case, the transfer of the foreign currency abroad shall not require an individual foreign exchange license.[25]

2. The exchange rate for calculating the foreign currency equivalent of the amount resulting from enforcement of the rights of the pledgee [creditor] shall be the "sale exchange rate" announced by the National Bank of Poland for the currency in which the pledgee [creditor] is to be satisfied either on the day the pledgor[debtor]'s property was seized or, if satisfaction is to occur through an appointed administrator or the lease of the pledgor[debtor]'s property, on the day the appointed administrator or lessee is obliged to transfer the profits to the pledgee[creditor].

3. If execution is performed by court executory authorities [bailiff or "komornik"], the basis for calculating the foreign currency equivalent shall be the "sale exchange rate" on the day after the day on which the distribution plan for the proceeds of the sale becomes final or, if a distribution plan is not prepared, the sales exchange rate on the day after the debtor's property is sold.

Art. 38.

1. The expiration of a claim secured by a registered pledge reason of expiring the

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[15] See Art.6.3. Such transfers of foreign currency abroad are permissible only if the foreign exchange law permits the denomination of the credit agreement in a foreign currency. For example, licenses from the National Bank of Poland may be necessary for large loans denominated in foreign currencies.

limitation period, shall not deprive the pledgee [creditor] of the opportunity to pursue satisfaction of its claim from the pledged property.[26]

2. The above Section shall not apply to claims for interest or other ancillary performance.

Chapter 9

Changes in the Required Provisions

(Articles 39 to 44)

— omitted —

Chapter 10

Transitional and Final Provisions

(Articles 45 to 54)

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Center for the Study of Democracy
Commercial Law Center

American Bar Association's Central and East European Law Initiative
Hanns Seidel Foundation
Government of Canada

Bulgarian Collateral Law Conference

30 and 31 January 1995

Report

This is a report on the Bulgarian Collateral Law Conference that was held at the Center for the Study of Democracy (CSD) on 30 and 31 January 1995.

Background

Modern market economies are largely based on financing projects with credit. The proper legal framework must exist, however, to provide security for lenders so they will have incentive to lend funds. No adequate law exists in Bulgaria that allows the use of moveable property as security. Thus, a Bulgarian company that owns valuable manufacturing equipment may find it difficult or impossible to use that equipment as security for a loan.

Goals

The purposes of the Conference were to (1) gather Bulgarian government officials, members of parliament, bank representatives, lawyers, academics and businesspersons to determine whether there is support to change the current collateral law, (2) identify problems with the current system and (3) examine modern collateral law requirements.

Sponsors

The Conference was made possible by grants from the Hans Seidel Foundation in Munich, Germany and the Government of Canada. Technical support and assistance was provided by the American Bar Association's Central and East European Law Initiative (CEELI). Additional support was provided by the United States Agency for International Development (USAID); the IRIS-Poland Project, Warsaw, Poland; the European Bank for Reconstruction and Development (EBRD); the World Bank; the Sofia City Court; Sofia University Law School; and Chernev, Komitova & Partners, a Sofia law firm.

Acknowledgments appear on page one of the materials.

Presenters

Mr. Angel Kalaidjiev, Chief Assistant Professor at Sofia University Law School, reviewed the status of Bulgarian collateral law. Messrs. Silvy Chernev, attorney, and Sofia City Court Judge Borislav Belazelkov reviewed Bulgarian foreclosure requirements. Mr. Ronald Dwight, Director of the IRIS-Poland collateral law project, reviewed the requirements of a modern collateral law, discussed his experience in assisting with the Polish draft law and answered participant questions about collateral law.

Participants

A list of participants is attached. The Conference attracted senior representatives from the academic, government, legal, business and banking communities. Notably, Mr. Kristian Krastev, Deputy Chairman of Parliament, attended along with the First Secretary of the Ministry of Foreign Affairs, Supreme Court judges and legal counsel from most major banks.

Materials

Materials were prepared in both English and Bulgarian. The materials included two articles reviewing Bulgarian law, a commentary regarding collateral law in Central and Eastern Europe, the Polish draft Law on Registered Pledges and the Pledge Registry and the EBRD Model Law on Secured Transactions. Mr. Dwight supplemented these materials with the Spanogle Draft of the Polish Charges Act.

An example of the great interest toward the conference was the receipt of over 30 additional requests from MPs for conference materials.

Presentation

The presentations were well accepted. Several problems were identified with the current law in Bulgaria, particularly with the possessory pledge (which requires lenders to take physical control of property used as collateral in many cases). Mr. Kaladjiev noted that Bulgarian law is inconsistent, providing numerous rules for different categories of lenders and distinct requirements for different types of moveable property.

Mr. Belazelkov discussed the high costs associated with using moveable property as collateral and Messrs. Chernev and Belazelkov outlined the foreclosure process. The major fault identified with foreclosure was its unpredictable length. A typical foreclosure can take up to two or three years.

Mr. Dwight emphasized that a new collateral law for Bulgaria should be "cost effective." It should cost little to create a security interest; it should cost little to enforce a security interest; the lender must obtain value if it attempts to enforce the collateral agreement; before the lender loans funds, it should be able to determine whether someone has a better claim to the property; and the lender must be protected from claims of third parties.

Many participants voiced the opinion that it is time to change Bulgaria's collateral law and expressed interest in helping to draft a new law.

Media Coverage

Several print, television and radio reporters covered the Conference. Radio Vitosha interviewed Mr. Dwight and ran the interview on 1 February. Bulgarian National Television ran a lengthy report on the Conference opening and interview with Mr. Stephan Kyutchukov, Secretary of the CSD Law Reform Program. Several news articles appeared about the Conference. Translations of articles of which we are aware and the CSD Conference press release is attached.

Additional Meetings

The Conference was used to gain access to a number of individuals to discuss with them the status of Bulgarian collateral law. On 31 January and 1 February, Mr. Mark Beesley, CEELI's Commercial Law Liaison, Mr. Kyutchukov and Mr. Dwight met with Minister of Justice Mladen Chervenyakov, Mr. Borislav Stratev, Member of the Governing Board and Legal Department Head of the Bulgarian National Bank and Deputy Chairperson of the National Assembly Kristian Krastev. All of these individuals expressed support for reforming collateral law.

Minister Chervenyakov specifically asked for technical assistance and funds to help Bulgarian experts to draft a new law. Mr. Stratev promised bank support for a drafting project. Mr. Krastev urged that work on collateral law reform should begin soon and should not be postponed. He stated that he is willing to spearhead the effort to pass a new law in the National Assembly.

Summary

The Bulgarian Collateral Law Conference was a success. All goals were accomplished and the support of several key individuals was rallied to help change the current law.

Sofia, Bulgaria
February 1995