

Polish Commercial Law

Security Interest

1. Economic purpose of security interest

- significance of security interest for availability of credit

Possibility of using assets towards obtaining credit. A well-defined system of security interest allows a debtor to obtain credit (=obtain monetary value of his/her assets) without relinquishing total control over his/her assets and without falling into excessive dependency on a particular creditor. For a creditor, the system needs to provide a guarantee of satisfaction as long as the value of collateral covers the value of the claim.

- security interest and stability of credit institutions

A well-functioning system of security interest is able to protect credit institutions (at least to a certain extent) from adverse effects of the debtors' default on their debts. Possibility to limit the risk of default greatly reduces the risk factor already at the moment of the credit being granted and throughout the life cycle of the credit claim. → less risk leads to lower cost of credit

2. General classification of security interest under Polish law

- guarantees and other ways of securing claims by liability of third parties

Effectiveness only between the parties (*inter partes*). It is the possibility of resorting to the estate of the third party (the guarantor) that serves as additional security for the creditor → those ways of securing claims are dependent on **solvency of guarantors**. In case of the guarantor's insolvency a guarantee is worthless.

- collateral arrangements (mortgages, pledges and title transfer)

Rights *in rem* referring to particular assets, effective against all third parties (*erga omnes*). The creditor is given a right to be satisfied from a particular asset (collateral) with priority against all other creditors of the debtor/collateral giver. Collateral arrangements are dependent on the value of collateral. Even in case of insolvency of the debtor/collateral giver, the creditor can preserve the value of his/her claim and is entitled to be satisfied from the collateral, provided it covers the amount of the claim. → those ways of securing claims are dependent on the **value of assets provided as collateral**.

3. General principles applying to security interest

- priority

Several security rights may be usually established on the same collateral. In such case the principle of priority applies – rights established earlier prevail over those established later. In order for such principle to be effective, security rights established on the collateral need to be made public towards all potential future creditors.

- publicity

The principle of publicity is closely related to the priority principle. It has two purposes. First one is to disclose the legal situation of the collateral in question to all parties who would consider acquiring it and all creditors who would consider establishing a new security right on it, as any new right would be subordinated to the right established earlier. Second purpose is to disclose the debtor's situation to all possible business partners and possible future creditors, by indicating the extent to which his/her estate is already encumbered by existing security rights. As security rights entitle secured creditors to be

satisfied with priority to general, unsecured creditors, a high degree of encumbrance of the debtor's estate by security rights indicates a low degree of his/her solvency.

- accessory (connection of security interest to the underlying claim)

Accessory means that the creditor's security right on collateral (or his/her claim against the guarantor) exists only to the extent of the underlying claim secured by it. Expiry of the underlying claim by any reason (e.g. satisfaction by the debtor) causes automatic expiry of the security right on collateral (or of the claim against the guarantor).

Main purpose of accessory – protection of the debtors from falling into excessive dependence on creditors having security rights on their estate.

Main drawback – impracticality, in particular in longer and more complex business relations between the debtor and the creditor → need to establish a new security right for any new claim

Solution – some forms of security rights are based on weakened accessory or are not accessory at all.

4. Guarantees & liability of third parties

Effectiveness only between the parties (*inter partes*)

- **guarantee** (Polish: *poręczenie*, DE *Bürgschaft*, FR *cautionnement*)

Regulation: Articles 876 – 887 of the Civil Code (*Kodeks cywilny*)

Definition – a liability of the guarantor towards the creditor to fulfill the obligation of the debtor in case of non-fulfillment by the debtor.

Accessory – the extent of the guarantor's liability depends on the extent of the debtor's liability (Article 879 of the Civil Code).

The guarantor and the debtor are jointly and severally (Polish: *solidarnie*) liable for the guaranteed claim, but the guarantee contract may provide otherwise (Article 881 of the Civil Code), in particular that the guarantor assumes secondary liability only following non-fulfillment by the debtor.

- **banking guarantee** (Polish: *gwarancja bankowa*)

Regulation – Articles 81-84 and 87 of the Banking Law (*Prawo bankowe*)

Unilateral obligation of a bank to pay an amount of money to the beneficiary on fulfillment of specified conditions (e.g. presentation of specified documents).

Used to secure claims – “specified conditions” refer to non-fulfillment of the underlying claim by the debtor.

Practicalities: bank issues guarantees usually on request of a debtor, subject to payment of a fee.

Lack of accessory. However, according to prevailing opinion, a valid cause is required for the banking guarantee to be effective. Lack or invalidity of the underlying (secured) claim amounts to a lack of valid cause for the banking guarantee → invalidity of the banking guarantee.

- **documentary credit** (Polish: *akredytywa dokumentowa*)

Regulation: Article 85 of the Banking Law

Unilateral obligation of a bank to pay an amount of money to the beneficiary on fulfillment of conditions specified in a document, on presentation of specified documents.

Wider use – not only to secure claims but also to settle transactions, often in international business relations (wide degree of international harmonization).

- other forms of securing claims – e.g. freeze of a bank account, assumption of joint liability

Based on the principle of contractual liberty, without a comprehensive regulation.

5. Collateral arrangements (*zabezpieczenia rzeczowe*)

Rights *in rem* referring to particular assets, effectiveness against all third parties (*erga omnes*).

a) mortgage (*hipoteka*)

Regulation: Articles 65-112 of Law of 6 July 1982 on Real Estate Register and Mortgage (*ustawa o księгах wieczystych i hipotece*)

Definition – a right to be satisfied from real estate, regardless to the person of its owner, with priority to the owner’s personal creditors. Its purpose is to secure a specified claim/claims resulting from a specified legal relationship.

A right *in rem* – referring to an asset (real estate), not to the person of the debtor.

Mortgage may also be established on some other rights related to real estate or on a claim already secured by mortgage.

Initially strict accessory – mortgages secured specified claims (including future claims) and satisfaction was possible only to the extent of the secured claim. Expiry of the claim caused the expiry of the mortgage (Article 94 of the Law).

Relaxation of accessory – from February 2011 the reference to particular claim was replaced by reference to a particular legal relationship from which several claims may arise, also in the future (wording of Article 94 of the Law, as entered into force in Feb 2011). If future claims may arise from the same legal relationship, the mortgage does not expire upon the expiry of the (currently) secured claim.

Other relaxations: possibility of establishment of a joint mortgage for several claims (Articles 68¹ – 68⁴ of the Law, entered into force in Feb 2011).

A joint mortgage may also be established for several claims of different creditors, provided the claims are related to the financing of the same undertaking (Art. 68² of the Law), e.g. a loan consortium when several lenders grant loans to finance an investment. In such case the creditors have to agree for an administrator of the mortgage who will exercise their rights.

Publicity – mortgage is entered into the real estate register (Polish: *księga wieczysta*, literally meaning ‘perpetual book’), being added to the register entry of the real estate used as collateral. The real estate register is publicly available and the confidence of third parties in data entered into the register is legally protected.

Formal requirement – entry of a mortgage into the real estate register is a court decision (subject to the necessary procedure and involving the delays resulting thereof).

Priority – was relaxed in Feb 2011 by new Articles 101¹ – 101¹¹ of the Law, providing for a possibility to reserve priority left by an earlier expired mortgage.

Creditor satisfaction – by way of enforcement proceedings

b) pledge (*zastaw*)

Regulation: Articles 306-335 of the Civil Code

Definition – a right to be satisfied from a moveable asset or a claim, regardless to the person of its owner, with priority to the owner’s personal creditors. Its purpose is to secure a specified claim.

Strict accessory – no relaxations of the relation between the pledge and the underlying secured claim.

Publicity – the asset encumbered by pledge needs to be transferred to the possession of the pledgee (creditor) → impracticality, in particular for banks, who would need to store assets subject to pledge.

Creditor satisfaction – by way of enforcement proceedings

c) registered pledge (*zastaw rejestrowy*)

Regulation: Law of 6 December 1996 on Registered Pledge and Pledge Registry (*ustawa o zastawie rejestrowym i rejestrze zastawów*)

Main purpose – to replace the unpractical possession requirement by an entry into the pledge registry. The pledged collateral remains in possession of the pledgor (debtor).

Originally its applicability was limited to commercial claims (of entrepreneurs). Currently this restriction no longer applies and registered pledge is universally available. Eligible assets include movable assets and proprietary rights which may be disposed of (Article 7 of the Law).

Publicity is intended to be guaranteed by an entry into a registry. Drawbacks: it is unsorted and unsearchable → such publicity is inefficient, basically limited to protection against fraudulent backdating.

In case of cars, establishment of a registered pledge is entered into the car's registration certificate (purely for information purposes).

Formal requirement – entry of the registered pledge into the registry is a court decision (subject to the necessary procedure). Possibility of delays.

Creditor satisfaction – through enforcement proceedings. In some cases the parties may provide for takeover of the collateral by the creditor (Articles 21-22 of the Law) or auction by a notary or a debt collector (Art. 24).

d) title transfer (*przewłaszczenie na zabezpieczenie*)

Developed in practice - lack of regulation, except some isolated and fragmented provisions of banking and bankruptcy law. Intended by the parties as a remedy for practical inefficiencies of pledge and registered pledge.

Construction – transfer of full ownership of an asset (collateral) to the creditor, with an agreement to transfer the ownership back on payment of the secured claim.

The asset in question (collateral) may be left in possession of the original owner.

Advantage – lack of formal requirements to transfer ownership means that title transfer is quick and cheap to perform.

Creditor satisfaction – unregulated. In practice the creditor may keep the collateral or sell it and keep the proceeds (surplus is to be paid back to the debtor as unjust enrichment).

Problems result from:

- lack of accessory – transfer of the ownership back to the original owner is only an obligation. No instruments protecting against abuse by creditor (e.g. demanding transfers of assets of excessive value).
- lack of publicity – if collateral is left in possession of the original owner/debtor, title transfer arrangement is unrecognizable for third parties → legal uncertainty

5. Special focus – registered pledge vs. title transfer

Better efficiency vs. better balance between the parties' interest – an alternative to be avoided?

6. Main drawbacks of Polish collateral law and efforts at reforming it

- excessive rigidity, in particular overreliance on court procedures in establishing security interest (registered pledge, mortgage) → significant streamlining of the procedures, reducing the accessory of the mortgage

- resulting attractiveness of title transfer in comparison to pledge and registered pledge → somewhat reduced by streamlining the provisions on registered pledge and regulating some aspects of the title transfer (esp. in bankruptcy)

- general inefficiency of enforcement proceedings