Collateral in Public Register as a Security of Private Debt

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This article deals with approaches to establishment of the collateral. Registration in public registers is a precondition to establish a mortgage and a commercial pledge, where the first one is recorded in the Land Register, while the second – in the Register of Commercial Pledges. Unlike the mortgages, execution of rights to a commercial pledge depends not only on registration, but also on whether a pledgee has taken actual possession of property. Taking of possession has not been expressly set forth by Latvian laws. It is necessary to specify the moment in legal acts when the pledged property was actually taken into possession.

The subject of a mortgage is immovable property. The subject of a commercial pledge is movable property. Immovable property cannot be the subject of a commercial pledge. Distinction between movable and immovable property may lead to a situation when a holder of the commercial pledge loses the collateral due to the fact that the subject of pledge, once movable, has turned into immovable property.

The collateral is also endangered by the fact that public reliability is not necessarily always attributed to all public registers in all situations. Legal regulation of the register of commercial pledges more corresponds with the principle of public reliability. This principle, however, is not clearly defined for land registers and is variously interpreted by courts, thus leaving negative influence upon the stability of pledge rights.

It is highlighted in Latvian law that existence of the collateral depends on whether there is a claim secured by a pledge (accessoriness). Current practise differs from that in the interwar period in Latvia. The difference lies within such secured claims that cannot be executed by force due to the limitation period or other reasons. Such changes in practise have led to the situation when secured claims may not be executed in case of insolvency of a debtor if the creditor has been in default to apply his claim within the term set by the insolvency administrator.

**Keywords:** accessoriness, collateral, mortgage, commercial pledge, possession, secured creditor, insolvency, movable, immovable, registration.

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Introduction

Establishing of the collateral is regulated by the Latvian Civil Law (CL), by the Law on Commercial Pledge and by the Financial Collateral Law.

Section 1279 of the CL provides two different ways to establish the collateral: possession and registration. The result would be a possessory pledge and a mortgage respectively.

The Law on Commercial Pledge provides for more complex way to establish the pledge which is a combination of registration and taking of actual possession. The result would be a commercial pledge.

Possession is regarded as a specific way to establish an unregistered possessory pledge. A possessory pledge can be established over a movable property by establishing (if the movable property is delivered in order to establish possessory pledge) or by maintaining physical control (if the movable property is already under physical control of the pledgee, i.e. a landlord) over the property (sections 878–908 of CL).

Immovable property or a ship can be mortgaged by registration in the Land Register or in the Ship Register respectively. In both cases registration alone constitutes mortgage with immediate effect for the pledger as well as for third parties.

Registration in the Land Register is regulated by the Land Register Law and by the law On Recording of Immovable Property in the Land Registers. Registration in the Ship Register is regulated by the Maritime Code and by Regulations Regarding Registration of Ships in the Latvian Ship Register.

Terms of the delivery and loss of the possession prescribed by the CL are extremely complicated and sometimes contradictory due to which they were widely criticised. These terms are also very formal.

As composed under the domineering influence of Savigny’s concept of two key elements of possession – corpus possessionis and animus possidendi – the above rules heavily rely on the possession’s subjective element as well. An inevitable consequence of taking over as well as losing of possession under the CL is not only by acquiring or losing the actual physical control over property but also by changing one’s subjective attitude towards his or her actual possession as such.

If property is already under the control of a person, then he or she shall acquire possession simply by his or her intention to possess it as his or her own (section 886 of CL).

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A person who possesses property in his or her own name may also commence to possess it according to his or her own discretion as the substitute for another person, albeit the latter has not taken it under his or her control (section 890 CL).

As the same rules for acquiring possession apply to establishing of a pledge, the only precondition for establishment of a pledge is that possession of the pledged property is transferred to the creditor (the pledgee).

This was one of the main reasons why the possessory pledge, which can be established by possession alone (i.e., without any registration), caused problems in practice. The unregistered pledge has been withdrawn from circulation and nowadays is not used except for some pawn shops.

Unfortunately, the aforementioned principles for taking over possession apply to the commercial pledge, as well. This brings about undesired consequences into the procedures carried out by the Register of Commercial Pledges.

The subject of the commercial pledge can be anything except immovable property, ships or financial assets (because the first one can only be mortgaged by registration in the Land Register and Ship Register respectively, but the latter – exclusively as a financial pledge).

Establishing of the financial pledge is regulated by the Financial Collateral Law in the result of implementation of Directive 2002/47/EC.

As it is a common practice to establish a commercial pledge over the whole assets of the commercial entity (sometimes called a floating charge), it is important to establish the exact time for taking over the aforementioned assets in case the pledgee is obliged to seize the same assets in order to regain debt from the auctioned price. Such takeover can happen immediately after or even before registration of the commercial pledge. However, in the majority of cases such takeover is only a remote probability which should take place in case the debtor, whose debt is secured by pledge, is in default. Such time gap between registration of a commercial pledge and taking over of the pledged items exists because the pledger is usually interested in retaining his or her control over the pledged assets during the life time of the collateral.

The status of a pledger of the commercial pledge is of some significance as well. There are two different types of pledgers.

Only a legal entity can pledge all assets as an aggregation of property as a commercial pledge (section 1, paragraph 3; section 3; section 3 part (3); section 10, part (3) of the Law on Commercial Pledge, section 1303 of the CL).

Individuals can only pledge movable property that is subject to registration: land transport vehicles, aircraft and animals and herds as well as patents, trademarks and registered designs to be registered with relevant national registers.

1. Establishing of Collateral Through Taking Possession of Property

The main feature which distinguishes a commercial pledge from a possessory pledge or a pawn is that the first one needs to be registered with the Register of Commercial Pledges run by the Company Register (section 2 of the Law of Commercial Pledge), but the latter is established by simply taking possession of property (section 1279 CL).

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Since those categories of property that cannot be registered anyway exceed those which can be, one would expect that only the latter are regarded as a subject of the commercial pledge. This is not true. There is indeed a clause in the Law on Commercial Pledge, which deals with so-called recordable property in a specific way (section 1 part 3 of Law on Commercial Pledge). However, this law does not preclude parties from pledging a variety of property, both tangible and intangible, that cannot be registered in any way.

This is achieved by a simple trick – any legal entity is able to register any property – tangible as well as intangible or even the whole assets as an aggregation of property (section 3, part (3) of the Law on Commercial Pledge). In this case, registration means filling in certain paper form and filing it with the register. The register shall not follow up whether the particular property was ever materialized. This means that the key in establishing the pledge right lies not with registration, as it is ‘registration’ by name only, but in actual taking of the pledged property in actual possession by the pledgee.

Actual possession of property can take place at the moment when the collateral is established (which would be a rare occasion though) or only at the moment when the debtor is in default, and this entitles the creditor to sell the pledged property. Since the pledged movable property remains under physical control of the pledger until the pledgee decides to take over assets of the pledgee, he or she is free to alienate this particular property or all his or her belongings at any time unless the property is taken over by the pledgee. If the pledge agreement is concluded and performed in such a way, the risk of losing his or her rights in the pledged property is completely with the pledgee.

Technically, however, the pledged property remains in the possession of the pledger. Even if the latter never touched anything, the rules for taking over possession are flexible enough to allow possession continue as long as the pledgee keeps an intention to possess. These rules are not specified by the Law on Commercial Pledge. Thus, the general principles for taking over and maintaining possession as provided by the CL are at work here. In practice it means that the pledged property remains in full control of the pledger. He or she is considered as a ‘substitute’ of the possessor, i.e. the pledgee.

In order to acquire possession through a substitute, it is necessary that the person being substituted for actually has such intention [to keep the property for another person – J. R.] (section 888 of CL).

Formally the pledger cannot alienate the pledged property without written permission by the pledgee (section 34 of the Law on Commercial Pledge).

It is a criminal offence if a person commits alienation of property pledged by way of commercial pledge without the authorisation of the pledge (section 216 of the Criminal Law).

However, a person may be brought to such liability only under certain additional qualifications, i.e., if substantial harm has been caused thereby to the property interests of the pledgee or other persons and if indeed the sale has taken place without permission. It is still doubtful though whether absence of such permission would be proven if the pledger was engaged in trade with the property subject to the collateral. If accused in illegal sale of the property, the pledger can always claim that he or she considered that the permission for sale was implied in the agreement.

Apparently, such system works only thanks to reliability of the pledger and the mutual confidence with the pledgee.
In order to improve this fairly unreliable system, it would be advisable to introduce provisions that would restrain the pledger from alienation of the pledged movables property without consent of the pledgee, e.g. by putting certain time frame during which the pledgee could claim restitution of the alienated pledge. Such provisions would make any third person as a buyer vigilant enough to obtain permission of the pledger. It would also be helpful either to introduce some restrictions over acquisition of possession and in this way give up the notorious *constitutum possessorium* as a way for acquisition of possession (or abandoning it) by changing one’s mind alone. If this would seem too drastic means (proposed already more than 80 years ago but still left without notice even during the new codification back in 1937), then at least it would help to put some restrictions for using this very discreet method for acquiring possession in order to establish the possessorly pledge.

2. Establishing of Collateral Through Registration

Registration is a precondition for establishing of a mortgage as well as a commercial pledge. Mortgaged objects can be immovable property, as well as ships. Recently, it has however turned out that regulations are not clear enough to distinguish between the construction permanently attached to the land (i.e., immovable property) and a ship.\(^4\)

There are three different registers that may be used to establish a registered pledge: Land Register, Ship Register and Register of Commercial Pledges.

The most common form of registered collateral is a mortgage. The object of registration or corroboration can be immovable property (sections 992, 994 of CL), land (sections 1004, 1042, 1070, 1073, 1075, 1082, 1087, 1088–1096, 1099–1101, 1108–1110, 1117, 1124, 1127, 1143, 1163, 1166, 1170, 1181, 1186, 1200, 1210 of CL), a ‘parcel of land’ (sections 1121, 1127, 1130, 1159, 1161, 1164, 1182, 1183, 1197, 1216, 1222, 1223, 1224 of CL) or a ‘mortgageable parcel’ (section 993 of CL). As regards establishment of the mortgage, the CL distinguishes between a parcel of land and a building (section 1299 of CL).

Only the first term (immovable property) may be regarded as scientifically adequate.\(^5\)

The registration of a mortgage in the Land Register may only be made at the Land Register office in whose administrative area the immovable property is located (section 1369 of CL).

Registration of pledge rights in the Land Register shall only be allowed with the consent of the pledger, which he or she has expressed either in establishing the pledge right or subsequently. This provision does not apply to those cases where the pledge right is registered on the basis of the judgment or decision of a court (section 1372 of CL).

A mortgage shall only be registered in the Land Register for a specific amount of money and in regard to a specific immovable property, the owner of which designated in such Register is the pledger (section 1373 of CL).

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\(^4\) Čepāne, I. Kuģis vai māja – tāds ir jautājums [A ship or a building – that is the question]. *Jurista Vārds*, No. 15(1021), 2018, pp. 14–21.

\(^5\) Būmanis, A. Piezīmes pie B. Disterlo k-ga raksta par terminoloģiju likumdošanā [Notes to B. Disterlo’s article on terminology in legislation]. *Tieslietu Ministrijas Vēstnesis*, No. 4, 1936.
Registration in the Land Register is the necessary precondition to establish mortgage rights. However, there is also another kind of registration which is carried out in the Cadastre Information System in accordance with the National Real Estate Cadastre Law. Registration in this system predates the Land Register and may be traced back to the registration system which existed during the Soviet occupation.

During the land and property reform when the Land Register either did not exist (it was re-established in 1993) or did not succeed in registering all existing rights, it was a common practice to rely on the data provided by the Cadastre Information System. This practice was widespread in dealing with residential property or apartments (section 7 of the National Real Estate Cadastre Law).

The role of the Cadastre Information System was crucial in establishing whether there was a statement from the local government that the particular construction was not registered with the local government in the name of another person until 5 April 1993 in accordance with the Law On Renewal and Procedures for Coming into Effect of the Land Register Law of 22 December 1937 (section 44 of the National Real Estate Cadastre Law).

Before registration of a mortgage, it is important to examine whether there is not any person’s interest in the land which has existed before registration of the mortgage. If this is the case, the litigation over implementation of the mortgage cannot be excluded.

However, at least in theory the Cadastre Information System provides information for taxation, while the Land Register consists of rights in rem.

Requests for corroboration shall be in writing (section 56 of the Land Register Law). A request for corroboration, which has been signed in accordance with the procedures laid down in the laws and regulations regarding electronic documents, shall be submitted by a sworn notary, if the corroboration is based on a notarial deed prepared by such sworn notary (section 56\(^1\) of the Land Register Law).

Registration of a commercial pledge takes place in the Register of Commercial Pledges. Application may be submitted as an electronic document. It may also be delivered in person. In such case, the identity of the deliverer is certified by the staff of the register. The notary can certify a power of attorney issued by the pledger to a third person (section 14 of the Law on Commercial Pledge).

Similar rules apply to registration of a mortgage to the ship (section 16 of the Cabinet Regulations No.467 Regarding Registration of Ships in the Latvian Ship Register adopted on 6 June 2006).

The so-called recordable movable property (except ships) include all kinds of property from vehicles to pets. There are about a dozen of registries dealing with registration of such movable property.

Special kind of intangible recordable property is intellectual property (IP).

The right to an invention based on a patent or the application thereof shall, according to the legal treatment, be regarded as equal to the right to the movable property. The property rights associated with the patents and patent applications may be inter alia the subject of a pledge (section 50 of the Patent Law). Similar clauses are included in the special laws on trademarks (section 25\(^1\) of the Law on Trade Marks and Indications of Geographical Origin) and designs (section 41 of the Law on Designs). Until 2016, the Patent Board of Latvia also dealt with registration of pledges. Due to amendments in the Law on Commercial Pledge, the intellectual property is now treated as a variety of movable property and as such may be registered as a commercial pledge in the Register of Commercial Pledges. The Patent
Board does not register these items as pledges but is being noticed about such registration. Only national registration and registration with EPO, if the registered patent applies to Latvia as a member state of EPO, can become the subject of the commercial pledge. IP can be regarded as the subject of the commercial pledge only under condition that it is expressly mentioned in the application for registration of the commercial pledge. It will not be accepted as the subject of a commercial pledge to be a part of the aggregation of property (section 10, part (3) of the Law on Commercial Pledge).

3. The Subject of a Pledge

Since only immovable property can be mortgaged and only movable property (except ships) – pledged as a commercial pledge, it is important to distinguish the former from the latter.

It is not always possible to draw a fine line between two kinds of property which are subject to two different systems of registration. The problem with this regulation as provided by the CL is that it does not meet strict scientific criteria for classification of movable and immovable property.

There are properties which, albeit movable by their appearance, could be regarded as an inalienable element or a part of immovable property by their location and specific role towards the immovable property – the so-called auxiliary property or appurtenances.

The CL puts forward three different criteria for “auxiliary property”. Auxiliary property “acquires the character of an appurtenance, if its function is to serve the principal property, it is permanently connected with it and pursuant to its natural characteristics it corresponds to this function” (section 857 of CL).

Then there are properties which, albeit immovable by their appearance, can be regarded as movable due to special exceptions provided by law. These are small buildings, surface and underground utilities, temporary engineering structures, which shall not be recorded in the Land Register in accordance with section 19 of the law On Recording of Immovable Property in the Land Register.

Still there is more complex problem with items which although inseparably connected to the land nevertheless could be regarded either as immovable property belonging to another person (section 14 of the Law on Time and Procedures for Coming into Force of Introduction, Inheritance Law and Property Law Part of the Renewed Civil Law of the Republic of Latvia of 1937) or as the so called “dual property,”6 and registered as an independent immovable property.7

As the subject of a commercial pledge can only be movable property (immovable property is excluded by section 3 of the Law on Commercial Pledge), the blurring distinction line between movable and immovable property has provided opportunity to get rid of the burden of the registered commercial pledge by the pledger who has transformed assets of the wind power station initially pledged as movable property and registered as a commercial pledge, and afterwards turned into immovable property with disastrous consequences for the unsuspecting pledgee.8

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8 Case No. C33382113. Available: https://www.google.lv/search?q=C33382113&ie=utf-8&oe=utf-8&client=firefox-b-ab&gws_rd=cr&dcr=0&ei=Kx6xWVTlKazagAac_In4Bg [last viewed 20.03.2018].
One of the difficulties for classification of property as provided by the CL is that distinction of movable and immovable property is incompatible with that of tangible and intangible property.

As only tangible property is regarded by the CL as movable or immovable (section 842 of CL), it seems at the first glance that so-called intangible property like claims, IP objects etc. cannot be pledged altogether. However, the CL somehow circumvents this obstacle and provides that claims as well as other intangible property may be pledged eventually.

Law on Commercial Pledge treats this issue in a specific way. It provides that each claim by a legal entity can be pledged as a separate commercial pledge or all claims can be pledged as a part of aggregation of property. In the latter case the commercial pledge would not only apply to the already existing claims but also to future ones.

The exact number and amount of pledged claims in such case would be fixed only if and when the pledgee finds it necessary to exercise his or her pledge rights.

A person, who accepts as a pledge a claim on debt against a third person, must inform such third person in order that he or she not repays the debt to his or her direct creditor (section 1335 of CL).

If, in such a case the debtor does not make payment within the set period of time, the pledgee has the right to claim for recovery from the third person who is in debt to the debtor of the pledgee, or to cede his or her claim by selling it to another (section 1336 of CL).

The problem with the regulation as provided by the Law on Commercial Pledge may arise when it comes to weather and when the pledgee of the commercial pledge has taken over pledged assets. As provided by the Law on Commercial Pledge, such take-over can happen at the moment of registration of the commercial pledge with immediate effect or, if this is not the intension of the parties, then taking over of the pledged assets can happen at the moment when the pledgee has to sell the pledged assets due to the pledger’s default on his or her obligations (section 36 part (2) of the Law on Commercial Pledge).

Commercial pledge of all assets of the pledger is even more complex.

Pledge of all assets (floating charge) as provided by the CL was already put under scientific examination. According to the view by Mr. E. Kalniņš, there are two significant flaws in this regulation.

First of all, the very term for an aggregation of property is unclear.

An aggregation of property is such collection of several items of property, self-contained, of one or more classes, tangible or intangible, for a known purpose, in a unitary composition and with one joint designation as shall be acknowledged in a legal sense as a whole, or a unitary property. The concept of an aggregation of property, and its essence, shall not be destroyed or altered either by the reduction or augmentation of the separate items of property incorporated in its composition, or any other change in them (section 849 of CL).

In view of Mr. E. Kalniņš, such a broad definition of an aggregation of property brings at least two uncertainties.

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Firstly, such definition contradicts with the so-called principle of speciality which provides that only certain tangible things can be regarded as property.\textsuperscript{10}

Secondly, section 849 of the CL does not make any distinction between tangible and intangible things as is the case in Roman law where there are two kinds of aggregation of property – one which consists only of tangible items (\textit{universitas rerum}) and another which consists only of intangible items (\textit{universitas iuris}).\textsuperscript{11}

Thirdly, the wording of the CL runs into irresolvable controversy by stating that an item as a property cannot be at the same time intangible and movable or immovable as it declares that “when intangible property is treated as a constituent part or appurtenance of tangible property, then it assumes the characteristics of the latter and in accordance therewith, shall be considered either moveable or immovable” (section 846 of CL). In the result of what is stated under section 846 of the CL, the latter becomes incompatible with section 842 of the CL stating that “tangible property is either moveable or immovable”.

As stated by the CL, “a pledge right, the subject of which is an aggregation of property, applies not only to the already existing but also to future, and not only to tangible but also to intangible parts of such aggregation, provided that it is not clearly evident that the intention of the pledger was only to pledge such aggregation of property as was constituted when the pledge was given” (section 1303 of CL).

Still, the proposal by Mr. E. Kalniņš to change the wording of section 846 of the CL\textsuperscript{12} was not approved.

The same flaws apply to the pledge rights, if an aggregation of property is at issue.\textsuperscript{13}

Combined with another controversial clause which allows symbolic takeover (the so called \textit{constitutum possessorium}), this regulation, if applied to an aggregation of property of the legal entity, turns the real take-over of the pledged assets into mere paper work the result of which is hardly noticeable by third persons as ‘registered’ in the Company Register.

The above mentioned flaws in regulation of the commercial pledge have led Mr. Kalniņš, who earlier was criticising this mechanism, to conclude that the commercial pledge of the whole assets by the legal entity is translating itself only in a form of a transaction that has never reached the stage of handing over (transition) the pledge to the pledgee.\textsuperscript{14}

Given that the criteria for distinction between movable and immovable property are uncertain, it would be necessary to fill in the gaps thus taking away from unscrupulous pledgers the opportunity to get away from the undertaken liability by turning movable property into immovable and vice versa. In order to avoid this uncertainty, it would be necessary to introduce a provision that after any particular property – movable or immovable – is pledged as a commercial pledge or mortgage respectively, the status of such property cannot be changed until the end of duration of the respective pledge right.


\textsuperscript{11} Ibid.

\textsuperscript{12} Ibid., p. 9.

\textsuperscript{13} Ibid., p. 10.

\textsuperscript{14} Kalniņš, E. Laulāto manta laulāto likumiskajās mantiskajās attiecībās [Property of spouses in lawful property relations of spouses]. Rīga, 2010, p. 34.
4. Reliability of Public Registers

Since reinstatement of the Civil Law back in 1992, the case law is struggling to find the right balance between protection of the *bona fide* acquirer of the immovable property and the ancient principle of causation meaning that no one can transfer more rights (to another) than they are having themselves.

The observation made just a couple of years ago that “courts have departed from the strictly observed provision in the pre-war literature and judicial practice that the sole criterion to dispute the good faith of an acquirer of the immovable property may be the defects that could be learned from the record in the land register”\(^{15}\), can be also attributed to the cases of later origin, although quite a few court decisions may be found where a court has considered acquisition in good faith as sufficient grounds for the defendant even if the underlying transaction for acquisition of ownership rights should be declared invalid.

So, the main problem in reliability of public registers is unpredictability of the outcome when the above-mentioned reliability should pass the test at court.

Reliability of the Land Register of Latvia was also examined by the European Court of Human Rights, who found that Latvia has not fulfilled the obligation “that the authorities have to put in place an effective exchange of information in order to ensure the reliability of public data”.\(^{16}\)

This, however, did not preclude the Constitutional Court of Latvia from not only deciding that “grounds for concluding that in Latvia’s situation a regulation that differs from the approach to protection of a bona fide acquirer existing in other countries is admissible”,\(^{17}\) but it also actively defended rightfulness of the same decision.

It does not improve faith in reliability of the Land Register. It comes without saying that if reliability on the Land Register data regarding ownership rights is shattered, the reliability on the data regarding mortgages registered in the same Land Register, albeit in different section, is not better either.

It also does not help that the principle of protection of the acquirer in good faith is not expressly stated in any Latvian law. Consequently, legal scientists have usually deduced this principle from section 1 of the Land Register Law and section 994 of the CL.\(^{18}\)

The Land Register alone is a poor protection for the acquirer if something turns out to be incorrect. In such a case not only multiple exceptions provided by other laws (in the case No. 2016-07-01, there was a very specific exception provided by sections 356(2) and 360(1) of the Criminal Procedure Law), but also provisions on transfer of property provided by the CL turn out to be contradictory and in part

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\(^{16}\) Case of Dzirnis v. Latvia. Available: https://hudoc.echr.coe.int/eng#{%22itemid%22:[%22001-170461%22]} [last viewed 05.04.2018].


unclear.\textsuperscript{19} We cannot find anything remotely similar to the presumption that “If a right has been entered in the Land Register for a person, it is presumed that the person is entitled to this right” (found in BGB § 891\textsuperscript{20}) in any law of Latvia.

Situation with a commercial pledge seems to be better. The Register of Commercial Pledges is run by the Company Register. The latter is also responsible for maintaining the Company Register which, in turn, is dealt with by the Commercial Law. Both include regulations which significantly differ from those of the CL with respect to consequences if publicly available information provided by the Company register turns out to be incorrect.

Section 12 part (1) of the Commercial Law provides that entries in the Commercial Register shall be in effect as to third parties from the date of their publication. This provision shall not apply to legal activities, which are performed within 15 days following the promulgation of the entry, insofar as the third party can prove that he or she did not know or could not have known the relevant information.

Section 33(2) of the Law on Commercial Pledge provides that the data of the Register of Commercial Pledges towards third persons shall be regarded correct and the third persons shall not be under duty to examine lawfulness of the said data.

These two above mentioned regulations make clear distinction between reliability of public data and vulnerability of the underlying right which depends on lawfulness of the relevant private transactions to certain extent.

Nevertheless there is at least one particular case where referring to reliability of public data of the Company register did not spare the acquirer of the company’s immovable property from defeat in the court by the rightful heir of the same property (that was alienated by the director of the company by forging signature of the deceased CEO of the same company).\textsuperscript{21}

However, as a rule the pledgee can successfully defend him/herself against claims based on invalidity of ownership rights of the pledger.\textsuperscript{22}

As there is no distinction between registered ownership right and registered pledge right, the consequences arising out of the mistake in the public register are equally applicable to the registered mortgage.

The Supreme Court has confirmed that the principle of reliability of the Land Register (section 1 of the Land Register Law and section 994 of CL) is applicable to the pledgee.\textsuperscript{23} Due to the fact that fraudulent transactions leading to unfair loss of property keep reappearing rather frequently, protection of the pledgee’s interests, that is usually a bank, sometimes causes public outcry when such decision is regarded as unfair. In one of the recent cases\textsuperscript{24} the public condemnation against the


\textsuperscript{20} BGB. Available: http://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html\#p3671 [last viewed 05.04.2018].


\textsuperscript{22} Ibid.

\textsuperscript{23} Ibid., last viewed 09.04.2018.

court’s decision was so intense that one of the largest credit institutions in Latvia felt compelled to waive its right of mortgage.\textsuperscript{25}

A multitude of registrations, which due to different types of fraudulent activities, were declared invalid on regular basis have not led to satisfactory solution of the problem which in the view of the author of this article can be only found by strengthening reliability of public registers. Unfortunately, faced with this problem, the common sense has kind of moved into the opposite direction by subjecting the principle of reliability of public registers to the multiple ‘exceptions’ that may only lead to deeper erosion of this substantial principle.

What should and could be recorder in the Land Register under Latvian law itself has been a subject for discussion in recent literature, as well as in case law. Generally, though it is acknowledged that rights \textit{in rem} are recordable, while claims (right in personam) are not.

However, as distinction is not clear-cut, some of the claims have been put under fierce discussion regarding their ability to be registered in the Land Register and to be the subject of mortgage rights. Some of the decisions made by judges of the Land Registry Office have been criticised\textsuperscript{26} and returned by the Supreme Court.\textsuperscript{27}

The lingering case law\textsuperscript{28} has not done any good to the common understanding as to which rights are eligible for registration and which are not.

Uncertainty about the right as the subject of registration in a public register has definitely laid negative impact upon reliability of the registered collateral right.

5. Accessoriness Between the Loan and the Pledge

The main difference between the various forms of mortgages to be found in Europe lies in the principle of accessoriness, i.e. the linkage of a mortgage to the existence of the secured debt, which applies in the English and French, but not in the German legal family.\textsuperscript{29}

The interdependence of the underlying relationship between the debtor and the original creditor was based on the idea of public faith (\textit{öffentlicher Glaube}) in the public land register, comparable with the law on negotiable instruments. The secured claim and the right of mortgage were laid down in an instrument that, like a bill of exchange, could be transferred easily. This demanded an abstraction from the underlying legal relationship. The secured claim and the right of mortgage had to be valid, despite possible defects in the legal relationship on which the claim and the

\textsuperscript{25} Pēc “Nekā personīga” sižeta “Swedbank” atsakās no hipotēkas mājai, ko īpašniekam izkrāpa organizēta grupa [After a TV broadcast “Nothing personal”, “Swedbank” refuses from a mortgage put on the house which was defrauded from its owner by an organised criminal group]. Available: https://skaties.lv/zinas/latvija/neka-personīga/pec-neka-personīga-sizeta-swedbank-atsakas-no-hipotekas-majai-ko-ipasniekam-izkrapa-organizeta-g [last viewed 11.04.2018].


mortgage were based, and it had to be impossible for the claim and mortgage to be thwarted by defences of which the assignee could not readily know.\textsuperscript{30}

Accessoryness between the loan and the pledge was always regarded as undisputed feature of any collateral in Latvian legal doctrine.\textsuperscript{31}

However, there is significant difference between the ‘ancient’ (i.e. the inter-war doctrine and practice) and ‘contemporary’ (i.e. the mainstream doctrine and practice established after reinstatement of the CL in 1992) understanding as to how far-reaching the above-mentioned interdependence between the collateral and secured claim could be and should be.

Most of all the enormity of this shift exposes itself in whether a registered collateral (a mortgage as registered in the Land or Ship Register, as well as a commercial pledge as registered in the Commercial Register) should survive insolvency (as it was during the inter-war period) of the pledger or, on the contrary, insolvency should extinguish rights to the collateral (as it was typical after 1992).

This important turning point in understanding of the interdependence between the collateral and the secured claim has transcended through different understanding of those CL sections which establish accessoriness of the mortgage (sections 1280, 1283 of CL).

Section 1283 of the Civil Law of 1937 has originated from section 1339 of the Civil laws of 1864 (Part III of the Codification of Local Laws or the CLL).\textsuperscript{32}

The CLL, in turn, is based on sources of Roman law which were applied in the territory of Latvia by local courts long before it was codified back in 1864. The author of the above-mentioned codification of 1864 – F. Bunge, supplemented almost each of 4600 articles or sections of the CLL with citations from different sources, preferentially from the Digest of Justinian. The first citation under section 1339 is L. 5,12 et 13 D.de pignor.et hypoth. (XX,1) which by using the modern method of citation would lead to D., 20, 1, 5, 12, 13 respectively.

D. 20, 1, 5 states: “Property can be mortgaged for any obligation [...] [not excluding] natural obligation”.\textsuperscript{33}

The same approach may be found in literature dealing with the so called modern Roman law.\textsuperscript{34}

Sources of law (the CLL and since 1937 – the CL) have regarded the collateral securing a natural obligation as relevant, sufficient right. This was also manifested


in the court practice during the inter-war period in Latvia as it follows from commentaries to the court practice published back in 1935.\textsuperscript{35} This interpretation means that the creditor’s ability to implement the right which is based on the collateral does not necessarily expire in case the underlying debt becomes unenforceable for some reason, i.e. due to the statute of limitation.

Unfortunately, contemporary interpretation of the same section 1283 of the CL is much narrower. It is established by the court practice as well as corroborated in the modern Insolvency law of Latvia of 2009 that with expiry of the statute of limitation not only the creditor’s ability to implement his or her right of pledge ceases to exist but also the right to pledge ceases to exist notwithstanding what form was used for establishing such right. This mean that even the mortgage which is duly corroborated in the Land Register (or a commercial pledge which is registered in the Commercial Register) by expiration of the statute of limitation becomes unenforceable but the debtor (or, most commonly, insolvency administrator) is entitled to claim in the court that the above mentioned registration of mortgage is deleted from the Land Register or from the Commercial Pledge Register, respectively.

One may wonder whether such poorly informed creditor could ever exist given that on the one hand, his or her pledge rights are duly registered in the publicly available register, and, on the other hand, the institution who is responsible for the insolvency procedure (the administrator, court) may easily find out whether such publicly registered security existed.

The administrator is under the duty to send a notification regarding the proclamation of insolvency proceedings electronically to all known creditors of the debtor whose right to claim is secured by a commercial pledge, or a mortgage registered in the Land Register or Ship Register (section 141 of the Insolvency Law). The case law, however, provides evidence that there are creditors who have not been duly noticed of the insolvency proceedings.

“\textit{If a creditor has missed the deadline for submitting a claim referred to in paragraph 1 of this section, he may submit his or her claim against the debtor within a deadline not exceeding six months from the day when the entry has been made in the Insolvency Register regarding proclamation of the insolvency proceedings of the debtor, but not later than until the day when the plan for settling the creditors’ claims has been drawn up in accordance with the procedures laid down in this Law. After this deadline a limitation period sets in, thereby the creditor shall lose his or her creditor status and his or her rights to claim against the debtor}” (section 73 of the Insolvency Law).

It means that insolvency can disrupt the mortgage (registered in the Land register for much longer period) or the pledge (registered in the Commercial Pledge Register), as well as the underlying obligation prior to the original expiry term as stipulated by the debtor/creditor agreement and by the Land or Commercial Pledge Register. This provision makes any secured creditor be alert of the debtor’s solvency round the clock in order not to lose the security. The creditor who has missed the aforementioned deadline is regarded as ‘negligent’.\textsuperscript{36}


\textsuperscript{36} Bērziņš, G. Ātziņas par aktuālo tiesu praksi maksātnespējas jomā [Conclusions about current court practise in insolvency proceedings]. Jurista Vārds, No. 14(917), 2016, pp. 10–16.
It is difficult to measure effectiveness of the collateral as a security. According to the recovery rate for claims secured by the collateral there are 0.23 euro cents and 0.31 euro cents due from each euro owed by a bankrupt company to secured creditors in 2016 and 2017 respectively. However, recovery rate for secured claims is significantly higher than 0.04 euro per each owed euro rate for creditors who do not have such security. Low recovery rate may be rather explained by ineffectiveness of the Latvian insolvency procedure (overall cost of recovery of one euro was 2, 17 euro in 2017) than by accessoriness of the collateral.

Nevertheless, the failure of the registered security right to withstand insolvency of the debtor diminishes the role of the collateral in general and contradicts with the theory and practice of the inter-war period.

Exceptions provided by the Insolvency law also diminish the general principle that the rights registered in the Land Register shall not be subject to prescription. This principle applies not only to registered rights in rem but to a certain degree – also to claims (rights in personam), if they are registered in the Land Register (section 1907 of CL).

Summary

In order to improve establishment of the collateral through taking possession of property, it would be advisable to introduce provisions that would restrain the pledger from alienation of pledged movable property without consent of the pledgee, for instance, by setting certain time frame within which the pledgee could claim restitution of the alienated pledge. Such provisions would make any third person as a buyer vigilant enough to obtain permission of the pledger.

It is recommended to clarify provisions for acquisition of possession by disposing of the subjective criteria of the possession that have been abandoned by other systems of law long ago.

Rules for registration of IP as the collateral were changed recently (2016), still, they might turn out to be too complicated.

Pledging of all assets of a legal entity as an aggregation of property (floating charge) could cause misunderstandings as to what was the exact intent of the parties – the pledger and the pledgee.

In order to avoid this uncertainty, it would be necessary to introduce a provision that after any particular property – movable or immovable – is pledged as a commercial pledge or mortgage respectively, the status of such property cannot be changed until the end of duration of the respective pledge right.

Reliability of public registers must be significantly improved.

The principle of accessoriness between the loan and the pledge has led to premature termination of registered mortgage rights in some cases. This practice has diminished reliability of the collateral as a security of obligations.

38 Ibid., p. 25.
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