New possibilities in joint-venture financing in Polish law

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The role of the mortgage in Poland is on a constant increase. One can see that the difficult period in financing investments, especially in the real estate sector caused by the crisis, is slowly drawing to an end. The revival occurring after many months is manifested in the increasing number of commenced investments and entails, obviously, both investors as well as of financial institutions' interest in new forms of securing the financing of projects. Hence, the question on the role of the mortgage in commercial transactions returns.

Undoubtedly, the basic manner of securing a loan in Polish law is a mortgage although the possibility of securing a debt by the transfer of the title to secure a loan repayment, which can pertain both to a real estate as well as to movables or claims, is also admissible. The attractiveness of the latter manner of securing repayments has, however, decreased as of the moment of the entry into force of the amendment of the Act of 28 February 2003, the Law on Bankruptcy and Rehabilitation ("LBR")[1] by the Act of 6 March 2009 on the Amendment of the Law on Bankruptcy and Rehabilitation Act, the Bank Guarantee Fund Act, and the National Court Register Act[2].

The principle is that the asset components not belonging to the bankrupt's assets are excluded from the bankruptcy estate (Article 70 of the LBR) and the items the title to which had been transferred by a debtor onto a creditor were recognised to be precisely these types of components. The Amending Act introduced Article 70[1] of the LBR under which the provisions on the exclusion from the bankruptcy estate do not apply to objects, claims, and other property rights transferred by a bankrupt onto the creditor with the view to secure the debt. The provisions of the act pertaining to the pledge and pledge-secured debts apply respectively to these objects as well as to debts thus secured. However, in the literature, it is assumed that the said provision does not pertain to situations where a transferred object is held by the creditor while not by the bankrupt[3]. Hence, presently, in the event of the declaration of bankruptcy of a debtor, a creditor who concluded an agreement on the transfer of the title to secure the loan repayment with the debtor is unable to demand that the transferred object be excluded from the bankruptcy estate[4].

In the Polish law, the mortgage is regulated by the Act of 6 July 1982 on the Land and Mortgage Register and Mortgage (hereinafter: "LMRA")[5]. However, the said Act was written during the times when Poland was under a different political system, in the times of a planned economy, where the role of the mortgage was practically marginal. In the outcome of the social and economic transformations after 1989, the manner of regulating the mortgage has rendered it a manner for securing a loan increasingly less popular for investors and to an ever decreasing degree corresponding with the requirements of commercial transactions. The Polish legislator noticed this problem and with the Act of 26 June 2009 on the Amendment of the Act on the Land and Mortgage Register and Mortgage and several other acts[6], the LMRA was extensively amended.

The amendment shall enter into force in February 2011. Its objective is to introduce solutions which shall render the mortgage an effective, adjusted to practice, and flexible manner for securing cash claims[7]. Particular attention is due to the institution of the mortgage administrator, introduced by the amendment, which can find its application in the event of securing several claims used to finance the same venture and which different entities are entitled to, with the use of one mortgage[8]. This institution is rather complicated while to take advantage thereof the conclusion of a certain "complex" of agreements, to be presented below, is required.

Due to a rather inflexible regulation pertaining to the mortgage against the background of the LRMA, based on the "one claim – one mortgage" principle, until the amendment at issue has not been implemented, the possibility to secure consortium facilities, ie. loans where several entities are entitled to secured claims, with one mortgage has stirred multiple doubts. This issue has been of particular significance for banks in the event of big investments financing. However, a practice has been formed to secure these types of loans with a mortgage. This practice has been subject to diverse opinions of representatives of the doctrine. The issue of the admissibility of securing consortium facilities with a mortgage is undoubtedly of enormous significance since the recognition that hitherto Polish law has not allowed for such a solution may lead to the nullity of the agreement on the establishment of the mortgage which constitutes a danger to creditors. For this reason, the introduction of an unequivocal regulation of this issue in the LRMA was particularly desirable and it must be hailed with satisfaction.

The institution of a mortgage administrator shall apply, first and foremost, in the case of loans granted by bank consortium for financing a given venture. The assessment of the new regulation still remains an open issue – only practice can show whether it actually corresponds with the needs of the transactions and whether it duly secures creditors' interests.

As results from Article 68[2] item 1 of the LRMA, creditors shall appoint a mortgage administrator with the view of securing several claims which various entities are entitled to and which serve to finance the same venture with a mortgage. The administrator can be one of the creditors or a third party.

On the grounds of the said provision, it is not clear how the notion of "claims which serve to finance the same venture" is to be understood. As it seems, the joint "venture" is to credit the borrower's operations by the creditors. The notion of "a venture" used by the legislator, according to the definition to be found in the Dictionary of Contemporary Polish means[9] "that which has been planned, thought to be realised, that which has been decided to be carried out, a project, a realised intention". On the one hand, therefore, it is broad enough to facilitate the flexible application of the institution of a mortgage administrator, nevertheless, on the other hand, the legislator here introduces a certain restriction since, as follows from the dictionary definition of "a venture", it is an goal-oriented activity and, thus, accidental actions cannot be such, even if they form a set of interrelated activities. The administrator cannot be appointed in the event in which the premises of Article 68[2] item 1 of the LRMA are not fulfilled and, in particular, when there is no joint venture.

No doubts should arise that the institution of the administrator may apply already in the case of at least two claims and at least two creditors. A situation is also possible when the mortgage administrator is appointed in order to secure several claims which different (two at least) entities are entitled to in the situation in which each of these creditors is entitled to two or more claims[10]. It is inadmissible to appoint a mortgage administrator in order to establish a mortgage meant to secure one claim only.

To take advantage of the mortgage administrator institution, the entities intending to grant a loan are required to display huge precision of operation in getting involved in a number of activities. Since it is these entities that shall conclude the consortium facility agreement, the agreement on the appointment of the administrator, the loan agreement, and finally, the administrator shall conclude the agreement on the establishment of the mortgage. Without exaggerating too much, one can state that the mortgage administrator institution shall prove true in these cases where creditors (consortium participants) shall co-operate efficiently and act loyally towards one

another. The lack of understanding between creditors shall signify, as a rule, the need to "quit" the consortium, which is possible by the division of the mortgage.

Agreement with consortium of lenders

Firstly, to ensure the effective operation of the consortium, the shaping of the relations between its participants, and especially of the rules for the settlement of accounts, the scope of the collateral, the potential mutual liability, is of particular importance. All these contractual regulations shall form the internal relations between creditors. They can be contained in one or in several agreements with consortium of lenders.

The agreement on the appointment of the mortgage administrator

Secondly, it is necessary to conclude an agreement on the appointment of the mortgage administrator which in order to be valid requires to be drawn up in writing (*ad solemnitatem*). It is a bilateral agreement where the administrator appears on one side with all the creditors on the other. Such an agreement constitutes a type of an authorisation for the administrator to conclude an agreement on the establishment of the mortgage; it is also indicated that this agreement sets out the limits of the administrator's competence[11].

"The administrator shall exercise all the rights and obligations of a mortgage creditor – on his own behalf, but on account of the creditors whose claims are covered by the collateral"

Nonetheless, the administrator is not the creditors' proxy (therefore, no direct representation has been provided for here) but he acts on his own behalf to the benefit of the creditors (the indirect representation construction). The conclusion of an agreement on the appointment of the administrator is synonymous with awarding the person appointed the administrator the competence to shape the creditors' legal situation. Hence, the administrator takes over the role of the mortgage creditor while he is not entitled to the claim secured by the mortgage. Without the creditors' consent, the administrator may not renounce the mortgage and it is so due to the relation existing between the mortgage and the claims it secures. Simultaneously, since the administrator is an absolute direct representative, having established the administrator, the creditors cannot exercise any rights or obligations of a mortgage creditor other than those they are awarded in Article 68[2] of the LRMA and indirectly by granting their consent to certain activities of the administrator.

The agreement on the appointment of the mortgage administrator shall specify the obligations of the parties. First and foremost, it is going to be the administrator's obligation to conclude the agreement on the establishment of the mortgage and the creditors' obligation to disburse the remuneration for the administrator. The said agreement also ought to indicate the claims or legal relations from which the claims subject to being secured by the mortgage established by the administrator arise or shall arise from. In turn, it is not necessary to indicate "the joint venture" in the said agreement, however, it shall usually be done.

The creditors' relations with the mortgage administrator ought to be regulated in the agreement appointing the administrator to the post. In particular, it is possible to introduce a variety of restrictions as well as bar the administrator from engaging in certain actions without obtaining the creditors' consent expressed in a specified form first. All such restrictions of the scope of "authority" of the mortgage administrator shall be of solely internal importance, in the relations between the administrator and the creditors, and shall not bear on the validity and effectiveness of the activities performed by the administrator without such an internal consent or at transgressing the scope thereof. They may, however, substantiate damage claims of the consortium participants towards the mortgage administrator on the grounds of the improper performance of the agreement (Article 471 of the Civil Code)[12].

As it has been already indicated, the agreement on the appointment of the administrator shall be concluded in writing under the pain of invalidity, however, it is not clear whether this form is sufficient to disclose the administrator in the land and mortgage register since Article 31 item 1 of the LRMA provides that an entry in the land and mortgage register may be made on the grounds of a document with a signature certified by a notary if specific provisions do not provide for another form of the document. Therefore, a question arises whether Article 68[2] item 2 of the LRMA derogates the form requirement provided for in Article 31 item 1 of the LRMA.

It is a substantial issue since under Article 68[2] item 5 of the LRMA, it is the mortgage administrator that is entered in the land and mortgage register as the mortgage creditor. In consequence, also in the event of the change of the mortgage administrator, which is certainly possible, it is necessary for this change to be reflected by the disclosure of the new administrator in the land and mortgage register.

Admittedly, the literal interpretation of Article 31 item 1 of the LRMA could provide the basis to conclude that if the act provides for any form for a given action, then the form provided for in this regulation does not apply, however, a teleological interpretation advocates against adopting this latter stance. This is, first and foremost, advocated for by the function of the land and mortgage registers kept by courts with the view of establishment of the legal status of a real estate as well as the limited cognition of the land and mortgage register court in the course of the proceedings for the entry in the land and mortgage register.

The conclusion of an agreement for the appointment of the mortgage administrator in writing with signatures certified by the notary is, therefore, most purposeful, should one take into consideration the functions of land and mortgage registers and the fact that while examining the motion, the court examines exclusively the contents and the form of the motion, the documents attached thereto, and the contents of the land and mortgage register (Article 626[8].2 of the Code of Civil Procedure).

The agreement on the establishment of the mortgage

Another agreement in the process of the organisation of the consortium shall be the agreement on the establishment of the mortgage concluded between the mortgage administrator and the owner of the real estate to be encumbered with the mortgage. The agreement on the establishment of the mortgage ought to specify the scope of securing of individual claims and the venture the financing of which they are to be used for (Article 68[2] item 3 of the LRMA).

At the conclusion of the agreement on the establishment of the mortgage, the administrator shall have to be obligated to submit the agreement on his appointment as the mortgage administrator in order to demonstrate his authorisation to act, which shall enable a notary to verify the scope of the administrator's competence. The declaration of the owner of the real estate on the establishment of the mortgage shall have to have the form of a notary deed (Article 68[2] item 4 of the LRMA) even in the case when the mortgage administrator is a bank. It is so, for the legislator has unequivocally excluded the application of Article 95 of the Act of 29 August 1997 – The Banking Law[13] in this case (the said provision introduces an exception from the rule that a declaration of the owner of the real estate on the establishment of the mortgage must be submitted in the form of a notary deed).

The mortgage administrator is entered in the land and mortgage register as the mortgage creditor (Article 68[2] item 5 of the LRMA). To the motion of the creditors whose claims are covered by the collateral, the court changes the mortgage administrator entry.

The scope of mortgage administrator's operation

The administrator shall exercise all the rights and obligations of a mortgage creditor – on his own behalf, but on account of the creditors whose claims are covered by the collateral. The mortgage administrator cannot dispose of either the mortgage or the secured claims. Creditors cannot dispose of the mortgage, however, they can

dispose of the claims they are entitled to. In such a case, a transferee accedes the legal relationship connecting a transferor with the administrator.

A person appointed a mortgage administrator ceases to be the administrator at the moment of the expiry of the agreement under which they had been appointed the administrator. In the event of the expiry of the agreement on the appointment of the mortgage administrator and in the case a new administrator is not appointed, each of the creditors whose claims are covered by the collateral may come forth with a demand for the division of the mortgage (Article 68^2 item 6 of the LRMA). As a result of such a division, mortgages securing individual claims, so far covered by the collateral of one mortgage established to the benefit of the administrator, will be created and the total of these mortgages must not exceed the total of the mortgage established to the administrator's benefit.

A question arises, however, whether creditors can engage in any actions, the competence to engage in which had been granted to the administrator, until the moment of appointment of a new administrator or until the mortgage has been divided. In the literature it is assumed that, exceptionally, in such a situation the rights and obligations of the mortgage creditor shall be discharged jointly by the creditors whose claims had been secured by the mortgage established by the administrator. The literature also proposes that the provisions on co-ownership shall apply *per analogiam*[14]. The adoption of the opposite view would have this result that until the moment of appointment of the new administrator or until the moment of division of the mortgage, there would be no person able to exercise the rights and obligations of the mortgage creditor.

The administrator enjoys the right to satisfy the secured claims from the mortgage object, it takes place by means of the enforcement proceedings. Of course, there is no need to conduct the enforcement proceedings in the event in which the owner of the real estate encumbered with the mortgage delivers the performance to the administrator's hands. The administrator is not authorised to accept a performance from a personal debtor. The literature indicates that creditors are entitled to accept the performance directly from the owner of the encumbered real estate. However, this view may stir doubts.

As it has been indicated, the mortgage administrator is an absolute indirect representative which means that by virtue of the act itself, all the actions performed thereby bear effects in the creditors' legal sphere. In view of the above, it is proper to state that there are no grounds to construct the transgression of the scope of "the authorisation" specified in the agreement on the appointment of the administrator. The transgression by the administrator of his obligations towards the creditors may, certainly, result in his compensatory liability.

Specific problems may appear in the event the mortgage administrator's bankruptcy is declared. As if predicting these complications and in particular taking the regulation of Article 62 of the LBR under which the bankruptcy estate covers the assets held by the bankrupt on the date of declaration of their bankruptcy as well as the assets acquired thereby in the course of the bankruptcy proceedings into consideration, the legislator had amended Article 63 of the LBR. Under the amended Article 63 item 1 point 3 of the LBR, the bankruptcy estate does not cover the amounts obtained on the grounds of the realisation of the registered pledge or a mortgage if the bankrupt served as the mortgage or collateral administrator, in the part which under the agreement on the appointment of the administrator, falls to the remaining creditors.

Doubts arise whether the function of the administrator is automatically taken over by the receiver in bankruptcy or whether the bankrupt remains the administrator upon the declaration of bankruptcy of the mortgage administrator. In this respect, the literature is far from being unanimous, however, it is proper to point out that it is in the creditors' best interest to discharge the person holding the function of the administrator, if only to avoid unnecessary confusion and complications.

The amendment of the act on bonds

The Act of 26 June 2009 on the amendment of the Act on the Land and Mortgage Register and Mortgage and several other acts amended also the Act of 29 June 1995 on Bonds[15]. Under the amended Article 7 item 1a, prior to the commencement of the issue of bonds, the issuer is obligated to conclude an agreement with the mortgage administrator who exercises the rights and obligations of the mortgage creditor on their own behalf but on the bondholders' account, in writing, under pain of invalidity. The bank acting as the representative's bank may also act as the mortgage administrator. The provisions of Article 31 item 2-5 apply respectively to the mortgage administrator. However, Article 7 item 1b provides that the provisions of Article 68^2 of the LRMA do not apply to the mortgage administrator.

Recapitulation

The institution of the mortgage administrator undoubtedly constitutes a step forward in rendering the mortgage functioning in Polish law more modern. It opens new possibilities for financing of joint ventures which constitutes a particularly relevant issue in the case of investments of a high value. It seems that due to this institution a mortgage collateral shall become not only more accessible but shall also be used more often. Financial institutions, but not only, have obtained a new instrument to be used to secure their claims.■

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1. Uniform text, Journal of Laws of 2009, No. 175, item 1361 as amended.
2. Journal of Laws of 2009, No. 53, item 434.
3. R Adamus, Upadłość a przewłaszczenie na zabezpieczenie. Komentarz. (Bankruptcy and the Transfer of Title to Secure the Loan Repayment), Warszawa 2010, Legalis.
4. However, it is contentious whether said provision applies also to the transfer of the title to secure a real estate since it refers to the provisions on the pledge applied respectively while not to those on the mortgage, compare: S Gurgul, Prawo upadłościowe i naprawcze. Komentarz (The Bankruptcy and Rehabilitation Law. Commentary), Warszawa 2010, p. 243.
5. Uniform text, Journal of Laws of 2001, No. 124, item 1361 as amended.
6. Journal of Laws of 2009, No. 131, item 1075.
7. The concept of harmonisation of the regulations on the substantive law, including the pledge laws within the frames of the European Union law has its advocates as well as adversaries, compare: S Kalus, Perspektywy stworzenia europejskiego prawa rzeczowego (The Perspectives for the Establishment of the European Substantive Law) , (in:) Rozprawy prawnicze. Księga pamiątkowa Profesora Maksymiliana Pazdana (Legal Dissertations. Professor Maksymilian Pazdan Memorial Booklet), Kraków 2005, p. 625 et seq. and the literature quoted therein.
8. The collateral administrator institution is regulated by Article 16 of the Model Law on Secured Transactions constituting the model regulation of the European Bank for Reconstruction and Development.
9. Słownik współczesnego języka polskiego (Dictionary of Contemporary Polish), B Dunaj (editor), Warszawa 1996, p. 875.
10. M Kućka, (in:) Hipoteka po nowelizacji. Komentarz (The Mortgage after the Amendment. Commentary), Warszawa 2010, p. 211, p. 208.
11. M Kućka, op. cit., p. 211.
12. B Jelonek-Jarco, J Zawadzka, Praktyczne problemy nowelizacji ustawy o księgach wieczystych i hipotece cz. II (Practical Problems of the Amendment of the Act on the Land and Mortgage Register and Mortgage, part II), Rejent 2010, No. 10, p. 56.
13. Journal of Laws of 2002, No. 72, item 665, as amended.
14. M Kućka, op. cit., p. 220.
15. Journal of Laws of 2001, No. 120, item 1300, as amended.