Security Interest and Insolvency:  
A Comparative Analysis between Swedish, Estonian, Latvian and Lithuanian Law

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The purpose of this study is twofold, first to describe and analyze from a comparative point of view the present status of the law relating to security interest and insolvency in Sweden and the three Baltic states of Estonia, Latvia and Lithuania, and, second, to elucidate the direction that legal development has taken in the four countries.

General survey of the legislation

There is no cohesive legislation regulating security interests in Sweden. The legislation is mainly gathered in the Civil Code\(^1\), but the provisions are scattered and in some cases of great antiquity. Swedish insolvency rules are governed by the following legislation: (1) on bankruptcy, the Bankruptcy Act\(^2\), (2) on company reorganization, the Company Reorganization Act\(^3\), on debt remission for natural persons, the Debt Remission Act\(^4\). Closely linked to insolvency are the rules on priority rights, the Right of Priority Act\(^5\) and the Enforcement Code\(^6\).

The law regarding security interests and insolvency in Estonia is contained in a number of different enactments. Interesting provisions can be found in the Law of Property Act\(^7\). This Act regulates real rights, e.g., ownership and right of security. It regulates content, formation and termination of such rights. Other interesting pieces of legislation for this topic are the

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1. Handelsbalken (1736:0123 2).
2. SFS 1987:672.
5. SFS 1970:979.
Bonds Act, the Property Law Implementation Act, the Commercial Pledges Act, the Commercial Code, the Bankruptcy Act and the Enforcement Code.

The law regarding security interests and insolvency in Latvia is also contained in a number of different enactments. Of special interest is the Latvian Civil Code, especially Part 3 Property Law (Chapter 3, Sections 927-1129 regarding ownership and Chapter 6, Sections 1278-1380 regarding pledge rights). Other relevant acts are the Latvian Bankruptcy Act for Companies – Law on Insolvency, the Commercial Law and the Law on Commercial Pledge.

The Lithuanian Civil Code, which came into effect in July 2000, is of special interest to security interests. Book 4, Rights in Rem, includes provisions about the transfer of ownership. It also includes provisions on protection of good-faith possessors of things acquired under a contract. It deals also with the form and the content of some real rights, such as mortgage and pledge. Other interesting pieces of legislation are Lithuanian Bank-

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19 See Sec. 4.170 of the Civil Code and the following sections.
20 See Sec. 4.198 of the Civil Code and the following Sections.
ruptcy law – Enterprise Bankruptcy Law\textsuperscript{21} and the Law on Restructuring of Enterprises.\textsuperscript{22}

Different types of security interest

A security interest can generally be defined as a creditor’s right to use property for a profit in one or more respects and privileged ways. Traditional security interests include pledges on immovable and movable property, floating charges, liens, chattel mortgage (assignments of goods without leaving possession of them), retention of title clauses and guarantees. The form and content of these security interests,\textsuperscript{23} with the exception of suretyship\textsuperscript{24} and liens\textsuperscript{25} will now be analyzed in the light of insolvency law. What kind of assets may be subject to a security interest?\textsuperscript{26} How is the security interest perfected? Is it possible for the creditor or another third party to check the title to assets in the debtor’s possession? What remedies are available for the secured creditor in case of the debtor’s default? What impact does the debtors’ insolvency have on the possibility of the creditor to enforce his security interest?

Security interests in movable property

\textbf{Pledge on movable property – Swedish Law}

The fundamental legal provisions on the legal relations between a pledgee and pledger in Swedish law are set out in Chapter 10, Sections 1-7 of the Commercial Code. These rules are mainly focused on a particular group of movables called ‘lösören’ (chattels like cars, animals, furniture, etc.) but can also be applied to other types of movable property if that property is not regulated by other legislation. In principle, all kinds of movable property can

\textsuperscript{21} Law on Enterprise Bankruptcy, March 20, 2001, Law no IX-216.
\textsuperscript{22} Law on Restructuring of Enterprise, March 20, 2001 no IX-218.
\textsuperscript{23} Because of different terminology in the four countries, chattel mortgage and floating charge will be discussed under the subheading Pledge on movable property.
\textsuperscript{24} See, regarding suretyship in the Swedish Commercial Code (1736:0123 2), Chapter 10, Sec. 8-12, the Estonian Law of Obligations Act, effective July 1, 2002, RT I 2002, 53, 336. Amended May 1, 2004, RT I 2004, 37, 255. Chapter 8, Division 1, Sec. 142-155, the Latvian Civil Code, Part 4, Chapter 5, Subchapter 1, Sec. 1692-1715, the Lithuanian Civil Code, Sec. 6.76 and the following sections.
\textsuperscript{26} These criteria for analyzing the security interest are based on Wood (1995).
be used as collateral. In addition to these general and well-established rules, there are provisions on pledges in Chapter 3 of the Maritime Act concerning ships, Sections 10, 22, 31 and 32 of the Commercial Papers Act on Pledging of Negotiable and Non-Negotiable Instruments and Debts, the Accounting of Financial Instruments Regarding Pledging VPC-Registered Shares and Other Non-Paper-Based Financial Instruments. In general, freedom of contract prevails between the pledgee and the pledger, with very few exceptions. One exception is found in Sec. 37 of the Contract Act (lex commissoria). The provision states that an agreement whereby the pledgee acquires the pledged object for satisfaction of the claim is void. Another exception is if conditions of a contract would be unfair to one of the parties, they could be subject to Sec. 36 of the Contract Act and altered in favor of the discriminated party.

Under Swedish Law, the prerequisites for a valid pledge on movable property are as follows:

1. A pledge agreement – which can be oral or in writing,
2. An identifiable debt for which the pledge constitutes security (pledge debt),
3. The collateral is or will become individualized to such a degree that it can be identified as the property stipulated in the pledge agreement (speciality principle),
4. A certain measure is taken (perfection) – e.g., transfer of the object from the pledger to the possession of the pledgee (possessory pledge), or by informing a third party that is responsible for the security of the collateral (notice) or by entering the pledge in a pledge register (registration). The nature of the property will determine when the pledge is perfected. Sometimes the pledge agreement can be enough.

In this context, it becomes pertinent to mention the Right of Priority Act, which regulates creditors’ right to payment in the event of the debtor’s insolvency. Priority (i.e. which creditor receives payment first) can be either special or preferential. Subject to certain exceptions, special priority rights take priority over preferential rights. The Right of Priority Act provides that pledges on movables carry special priority rights, Sec. 4 p 2.

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27 See Chapter 19, Sec.3 of the Swedish Companies Act (SFS 2005:551).
29 SFS Lag (1936:81) om skuldebrev.
31 See Lag (1915:218) om avtal och andra rättshandlingar på förmögenhetsrättens område. See also other mandatory legislation that could have an impact on pledge, e.g., Sec. 21 of the Consumer Credit Act (SFS 1992:830) and Pantbankslagen (SFS 1995:1000).
Another security interest – similar to the pledge – is the floating charge.\textsuperscript{33} This provides companies with the practical possibility of pledging chattels without having to comply with the rules on possessory pledge. These rules are set out in the Floating Charges Act.\textsuperscript{34} A person who wishes to give a floating charge may, under Chapter 1, Sec. 1 of the Floating Charges Act, issue a charge on his property for a specific sum of money. This is evidenced by a deed of floating charge. It should be noted that several such deeds could be issued over the same assets of a person. The charge that is created first has first priority. A floating charge can attach to all kinds of property belonging to the person creating the charge. However, in order for the creditor to have a secured position, a businessperson must hand over the deed of floating charge as security for a debt. It is the creditor’s responsibility to check that the person handing over the deed is a businessperson. Section 11 of the Right of Priority Act provides that floating charges retain a preferential right, but certain claims with special priority rights are to be satisfied prior to a claim under the floating charge. In the event of the business being insolvent, the creditor will have priority only to 55% of the net value of the bankruptcy estate after creditors with better priority have received payment.

A third pledge is the chattel mortgage. Under the Bills of Sales Act,\textsuperscript{35} a purchaser can acquire creditor’s protection despite the fact that the property remains in the possession of the seller (chattel mortgage). An assignment of goods by the seller without the goods leaving possession of the seller is usually not valid against the seller’s creditors because of lack of perfection. However, perfection can be accomplished by registration in accordance with the above-mentioned Act. The purchase itself and the physical movable must be documented in writing, the purchase published in daily newspapers and the contract to purchase and evidence of publication registered with the Enforcement Administration. Once the purchaser has fulfilled these requirements, there is an annulment period of 30 days before the purchaser acquires creditor’s protection. A correctly executed security transfer gives the purchaser a right of repossession of the property in the event that the seller is declared bankrupt.

**Pledge in movable property – Estonian Law**

Part 8 of the Law of Property Act\textsuperscript{36} contains provisions on pledge. The legislation provides for types of pledges of movables: (1) possessory pledge, Sec. 281 and the following sections, (2) registered pledge, Sec. 297 and the following sections and (3) pledges of rights, Sec. 314 and the following sec-

\begin{itemize}
\item \textsuperscript{33} Concerning commercial pledges, see under subheading 3.2.2.
\item \textsuperscript{34} SFS 2003:528.
\item \textsuperscript{35} SFS 1845:50 p 1.
\item \textsuperscript{36} See Law of Property Act, passed June 9, 1993, effective December 1, 1993, amended May 1, 2004, RT I 2004, 37, 255.
\end{itemize}
The Commercial Pledges Act contains provisions on commercial pledge, a certain type of registered pledge.

A claim secured by a pledge is preferred to all other claims with respect to the pledged property, unless otherwise provided by law, Sec. 280 of the Property Act. The Bankruptcy Act provides that pledges on movable property carry special priority rights, Sec. 153.37.

Physical transfer of possession of the pledged thing38 (the collateral) from the pledger to the pledgee creates a possessory pledge, if they have agreed on the establishment of the pledge, Sec. 282(1) c.f. Sec. 281.39 If the thing is already in the possession of the pledgee, the pledge is created by entering the pledge agreement. A pledge can also be created on a thing that is transferred to a third person, whereby the pledgee obtains indirect possession of the collateral. A possessory pledge can only be created in movables that are not subject to registration in a public registry.40 The pledge agreement must be in writing if the value of the pledged thing exceeds 500 Estonian kroons. Any claim that can be valuated in money may be secured by a pledge, including a conditional or a future claim, Sec. 279.

Not more than one possessory pledge can be established on the same object. However, a possessory pledge can be taken on several objects. In this case, the entire claim is secured by each thing, Sec. 283(1). The possessory pledge is extinguished, e.g., by (1) termination of the claim or (2) by destruction of the movable, (3) the pledgee becoming the owner of the pledged thing, (4) the pledged object no longer being in the possession of the pledgee and the pledgee being unable to reclaim the thing, (5) the pledgee returning the pledged thing to the pledger or notifying the pledger of discharge of the pledge, (6) a third person holding the pledged object returning it to the pledger, Sec. 284-286 and (7) failure to submit a claim in the bankruptcy of the pledger (Bankruptcy Act Sec. 95 cf. 34. If the claim secured by the pledge is not satisfied, the pledgee has the right to sell the pledged thing, Sec. 292(1) and (2). The pledged object must be sold at a public auction unless the pledger and the pledgee agree to sell it in a different manner, Sec. 294(1) and (4). A pledgee is required to notify the pledger of the sale of the pledged thing 1 month in advance. If notification is impossible, it may be waived. In that case, the pledged thing may not be sold before 1 month has passed since creation of the right of sale, Sec. 293(1). An agreement

37 It should be observed that a Commercial pledge ranks lower than a pledge in general. See further under subheading 4.2.2.
38 See discussion about the concept thing in Pärnu (2001).
39 Sec. 281(1) states, “A movable may be encumbered with a pledge such that the pledged thing is transferred into the possession of the pledgee and the establishment of a possessory pledge is agreed upon. A thing may also be encumbered by a pledge so that the thing is transferred to a third person and the pledgee obtains indirect possession of the pledged thing”.
40 See Paron and Tomachyeva (2003, p 97).
whereby the pledgee acquires the pledged object for satisfaction of the claim is void, Sec. 292(3).

Intellectual property, motor vehicles and aircraft, which are subject to registration in a public registry, may be encumbered with a registered security, Sec. 297. Creation of a registered pledge over movables requires a written agreement between the involved parties and registration, Sec. 299. The pledged object can remain in the possession of the pledger, but registration is needed. Several registered pledges can be established in the same object and the ranking of a registered security over movables is determined by the time of entry in the register, Sec. 300(1). The priority can be changed on request but only with the consent of the parties involved, Sec. 300(6). If the claim secured by the pledge is not satisfied, the pledgee has the right to demand compulsory execution by auction, Sec. 302(1). The pledged object must be sold at a public auction unless otherwise provided by law, Sec. 302(3). An agreement whereby the pledgee acquires the pledged object for satisfaction of the claim is void, Sec. 302 (2).

Rights such as securities and claims can be pledged under Sec. 314 and the following sections. A written agreement between the pledger and the pledgee is needed, unless otherwise provided by law, Sec. 315. If the right, e.g., is a claim, the pledger shall notify the debtor of the pledged claim, Sec. 317.

An undertaking registered in the commercial register may establish a commercial pledge in the commercial pledge register, Sec. 1 of the Commercial Pledges Act. The pledge will serve as security for a claim (commercial pledge) without the need of transferring possession of the pledged property, Sec. 3. A commercial pledge does not presuppose the existence of a securable claim and is not extinguished by termination of a claim. The provisions of the Property Act concerning registered pledge apply, unless otherwise stated in the Commercial Pledges Act. Thus, several pledges may be established on the same object of pledge for the benefit of one or several creditors, unless otherwise provided by law or the pledge contract, Sec. 277(3) of the Property Act.

Under Sec. 2(1) and (2), a commercial pledge extends to all movable property of a company or movable property relating to the economic activity of a sole proprietor. All property that belongs to the company at the time of the pledge entry being made and property that the undertaking acquires after the pledge entry is made are part of the commercial pledge. However, the pledge does not extend, e.g., (1) shares, stocks, promissory notes or other loan documents, or (2) property on which another registered security has

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41 Even though ships are not mentioned in the paragraph, it is possible to pledge a ship in the respective registry (see Paron and Tomachyeva 2003, p 98). Furthermore, defects in the law do not permit pledging of motor vehicles by registered pledge.
been established over movable or immovable property under the Property Act, or 3) property that, pursuant to law, cannot be subject to a claim for payment. A commercial pledge may be established on movable property of the Estonian branch of a foreign company.

**Pledge in movable property – Latvian Law**

General provisions applicable to all pledges both on movable and immovable property are found in Sec. 1278-1380 of the Civil Code. Under Sec. 1278 a pledge right is a right to property owned by another so that this property provides security for a creditor’s claim in such a way that he/she is able to receive payment of such claim from the collateral. All pledges must be based on a claim, which the collateral is to secure, Sec. 1280. As already mentioned, in case of non-performance on the part of the debtor, the creditor is entitled to seek satisfaction of his claim by selling the pledged property.

A pledge right may be created by contract, by testamentary disposition or by judicial process, Sec. 1304. It can also be created by law. Under Sec. 1294 all things, where sale is not prohibited, may be a subject of pledge rights, not only existing things but also future things and tangible (movable or immovable) as well as intangible property. However, the pledging of immovable property without transfer of possession is called a mortgage. Likewise, the pledging of a ship without transfer of possession called a ship mortgage, Sec. 1279 and note 1.

The creditor has no right to keep the collateral as his property. An agreement whereby the pledgee acquires the pledged property in place of the claim is invalid, Sec. 1334. On the other hand, the creditor has the right to sell the collateral if the debtor fails to pay the underlying debt within the agreed term, Sec. 1319. The creditor may only sell the collateral on the open market if the debtor has granted him to do so. If such a right has not been granted, the creditor may only sell the collateral at an auction through a court, Sec. 1321.

A possessory pledge is established when the pledger transfers the movable property into the possession of the pledgee, with the intent that it shall be security for the claim, Sec. 1340.

Under Sec. 1358, the general provisions regarding termination of the pledge right (Sec. 1309 and subsequent sections) are also applicable to possessory pledge. The pledge right may also be terminated by renunciation, Sec. 1359.

A commercial pledge can be established by a person, which may pledge property in order to secure liabilities. The Law of Commercial Pledge governs the security interest, but the general provisions of Sec. 1278-1380 in the Civil Code are also applicable, see Sec. 2 (3) of the Law of Commercial Pledge. The object of the commercial pledge may be: (1) a movable tangible

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42 Compare the Commercial Pledge Law and sec. 1279 note 2 in the Civil Code.
or intangible object that belongs to a legal person engaged in business, (2) a pool of such assets and (3) the complete assets of an enterprise, sec. 3 (1). Private persons may pledge movable items subject to registration (e.g., vehicles) as well as an enterprise or a pool of things; shares and bonds may be object of the pledge irrespective of the ownership of the above things, Sec. 3 (2). The commercial pledge where the object is a pool of things shall include the existing as well as future parts of the pool if it is not explicitly clear that the pledger intended to pledge only the part of the pool as it was at the moment of creating the pledge right, Sec. 3 (3).

Under Sec. 4 of The Law of Commercial Pledge, a vessel or a claim arising from a check or a bill of exchange cannot be the object of a commercial pledge. If the complete assets of an enterprise or a pool of things has been pledged, the claims just stated as well as real estate, vessels and publicly traded financial instruments should be considered excluded from the pledge property.

Failing express agreement to the contrary, the commercial pledge will secure not only the principal claim but also auxiliary claims, Sec. 7(1). The parties shall determine the maximum amount of the claim to be secured by the collateral. The part of the claim that exceeds this amount shall be deemed an unsecured claim, Sec. 7(2). A commercial pledge takes effect – in addition to the basis of the agreement between the pledger and the pledgee – when it has been registered in the Commercial Pledge Register, Sec. 9 (1). The application for registration shall be in a special form and have a certain content, Sec. 10-11. It should be signed by the parties and the signature on the application should be verified by a notary, Sec. 12. It should be noted that the registry is public and any person can have access to general data on registered pledges, Sec. 21, (note that it does not permit access to the documents). This makes it fairly easy for a third party to determine whether property is charged or not. It is possible to grant more than one commercial pledge on the same object, unless otherwise agreed between the original pledger and pledgee. The priority between several pledges will be determined in accordance with the registration sequence in the register. However, one can change the priority right, Sec. 27. The collateral can be in the possession of either the pledger or the pledgee, Sec. 24-25. Another alternative is to appoint a third person to act on behalf of the pledgee over the pledged property, Sec. 29-32. If the pledger cannot pay the secured claim, the pledgee may take possession of the collateral and sell it. Furthermore, Sec. 41 grants the creditor the right to exercise his enforcements rights before maturity of the obligation if the court issues an order to start bankruptcy proceedings against the pledger. If the pledger is declared insolvent, the possibility for the pledgee to exercise the pledge right is restricted by the insolvency law, Sec. 36. The collateral may be sold without a public auction if the

pledger has granted such a right to the pledgee and it has been registered in the pledge registry, Sec. 37-38. Otherwise, the object will be sold at a public auction, and the proceeds distributed to the pledgee, Sec. 46.

Pledge in movable property – Lithuanian Law

Pledge regarding movable property is regulated in Chapter XII, Sec. 4.198 - 4.228 of the Civil Code. Sec. 4.198(1) defines a pledge as pledging of a movable thing or property rights securing an existing or future debt when the collateral is transferred to the creditor, a third person or remains with the pledger. If the collateral remains with the pledger, it may be locked, sealed or marked, indicating that it has been pledged. Thus, available security interests are possessory pledge and non-possessory (registered) pledge. A pledge is created by contract or by law, Sec. 4.199(1). If it is a legal pledge, provisions in the Civil Code about legal mortgage also apply to the legal pledge. Sec. 4.199(2). When a pledge is created by law, the law shall specify exactly the thing subject to the pledge. A pledge may secure a performance of any monetary obligation, Sec. 4.200(1). Movable things and property rights (e.g., lease rights) may be the object of a pledge, Sec. 4.201(1) and Sec. 4.204. The pledge covers also accessories of the thing and non-separated fruits, unless otherwise provided in the contract and by law. Things in respect of which enforcement may not be levied under the existing laws, as well as movable things that have been pledged together with an immovable thing may not be the object of a pledge, Sec. 4.201 (2). As property rights are concerned, the property rights that the pledger will acquire in the future may also be the object of the pledge, Sec. 4.204(2). When a property right subject to a pledge is evidenced by securities or special documents, they should be transferred to the pledgee unless otherwise provided by laws or by an agreement of the parties, Sec. 4.204 (3).

Creation of something similar to the commercial pledge in Estonia and Latvia and the floating charge in Sweden can be achieved by applying Sec. 4.202 of the Civil Code. This stipulates that a pledger, having pledged goods in stock that are in circulation (goods, raw material, semi-finished goods and finished goods), has the right to change the composition and form of pledged goods in stock provided their total value is not reduced. When pledged goods are sold while the pledger is engaged in business, the pledge of goods is released and new goods in stock acquired by the pledger become the object of the pledge from the time of acquisition of the goods. The debtor himself or a third person may be the pledger, Sec. 4.206. The pledger must be the owner of the collateral or the owner of the property rights where the rights are the

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44 See further about the legal pledge under subheading 3.3.4.
45 Sec. 4:204 (1) “Rights pertaining to land, forest, other things, i.e. the right to use, the right of lease and other property rights, except for rights related to the personality of the owner of the thing pledged as well as rights that are not transferable by laws or by the contract may be the object of the pledge”.

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object of the pledge (except when the law stipulates that the pledger may acquire the object in the future). A property right that belongs to several persons may be pledged by written consent from all of them. The law or the contract may stipulate the duty to insure the pledged thing, Sec. 4.205(1). A contract may also provide for the duty of the pledger (a legal person) to insure the object of the pledge in the event of liquidation or insolvency, Sec. 4.205(2).

If it is a possessory pledge, a written pledge contract must be concluded between the parties, Sec. 4.209 cf. Sec. 4.213. A pledge contract may be concluded as an individual contract or as a pledge contract that could be included into the agreement from which the principal obligation arises. If the pledged object is transferred to a third person or remains with the pledger, a pledge contract and a unilateral declaration by the owner of the pledged property is drawn up by perfecting a pledge bond (contract) certified by a notary and registered in the register of mortgages. Non-compliance with the rules makes the contract null and void, Sec. 4.209(3).

A pledge bond should be signed by the debtor, the creditor and the person to whom the collateral is transferred. In certain cases, it is enough if only the pledger signs the pledge bond.46 In accordance with Sec. 4.210, a pledge contract must also fulfill certain formal requirements and may include other additional data.

Under Sec. 4.211, a subsequent pledge is possible if the collateral has not been transferred to the pledgee and the pledge bond does not provide otherwise. In such a case, the prior pledge remains valid. If a subsequent pledge is created, the pledger must notify each creditor of all prior and subsequent pledges and obligations secured by the pledge and their amount and make good any losses to the creditors because of failure to discharge his duties. If the same object is the subject of several registered pledges, the priority is determined in accordance with the registration sequence, Sec. 4.212.

The creditor has the right to satisfy his claim from the value of the collateral prior to other creditors, if the debtor fails to discharge his obligation secured by the pledged property, Sec. 4.198(2). A pledgee acquires the right of enforcement towards the collateral on the pledger failing to perform, but not less than 20 days after the expiry of the period for the performance of the obligation. A beneficial term that is not shorter than 10 days may be set up by a mutual agreement of the parties, Sec. 4.216 (1). A creditor is entitled to demand performance of the obligation secured by the pledge before the expiration of the maturity date if a liquidation procedure commences for the pledger (legal person) or if the value of the pledged property decreases with more than 30%, or in certain other cases, as provided in Sec. 4.216 (2).

When the debtor fails to perform the obligation secured by the pledge, the creditor’s claim is met from the value of the collateral, unless the law of con-

46 See Sec. 4.209 (4) of the Civil Code.
tract provides otherwise, Sec. 4.219(1). A creditor must notify the debtor and the pledger (when the pledger is not the same person as the debtor) in writing that if the secured obligation is not performed within the grace period, the enforcement will commence. If it is a registered pledge, a written warning notice should be delivered to the debtor through the Office of Mortgages, which is bound to inform all persons listed in the Register who are entitled to the thing. A creditor can sell the collateral in the manner agreed upon by the creditor, the debtor and the pledger, Sec. 4.219 (5). If the collateral is pledged several times, all parties may mutually agree to transfer the collateral into the ownership of the creditor. If such an agreement cannot be met, the collateral is sold by auction, Sec. 4.219(5).48

Security interest in immovable property

Mortgage in immovable property – Swedish law
Well-established rules regarding mortgage in immovable property are found in Chapter 6 of the Real Property Code. Under Chapter 6, Sec. 1, a property owner is entitled to obtain, according to the rules in Chapter 22 of the same Act, registration of a certain amount of money as a charge on the property. As evidence of the registration, a mortgage deed is issued by the Land Registration Authority. The deed can be in electronic form. In order for the creditor to obtain a secured position, the mortgage deed must then be transferred to the creditor as a pledge for the creditor’s claim, Chapter 6, Sec. 2. If the deed is electronic, registration of the creditor in the mortgage-deed registry will have the same effect. If the debtor should become insolvent, the creditor is then entitled to payment when the proceeds of an executive sale of the property are distributed. The Right of Priority Act, Sec. 6 (1) provides that there may be special priority rights in real property. There can be several mortgages on the property and the ranking of them is determined by the chronology/time of entry in the register.

Mortgage in immovable property – Estonian law
Immovable property may be encumbered with a mortgage. The security interest extends to the entire immovable property that has been registered in the Land Registry. Thus, the mortgage extends to the parts, accessories and

47 See Sec. 4.220 of the Lithuanian Civil Code concerning realization of pledged property rights.
48 Special rules apply to securities, see Sec. 4.219 (5) of the Lithuanian Civil Code.
50 It is possible to divide and merge a mortgage (partial mortgage, Sec. 355 of the Property Act, combined mortgage, Sec. 359 of the Property Act, judicial mortgage, Sec. 363 of the Property Act.
fruits of an immovable, Sec. 343 of the Property Act. In the event of the debtor becoming insolvent, the creditor is entitled to satisfaction of his claim secured by the mortgage out of the pledged immovable, Sec. 325. The agreement to establish a mortgage requires notarization, Sec. 326. The mortgage is created by a land registry entry based on the agreement and a notarized application.\textsuperscript{52} Only the owner of the property can establish a mortgage, Sec. 326. The mortgage does not presuppose the existence of a claim to be secured, Sec. 325(4).

**Mortgage in immovable property – Latvian law**

Mortgage in immovable property is established by registration in the Land Register, Sec. 1367 of the Civil Code. In order to have the mortgage registered certain requirements must be fulfilled, Sec. 1368. The registration must take place at the relevant institution, i.e. the Land Register Office where the immovable property is located, Sec. 1368 (1) and Sec. 1369. The form prescribed by law must also be observed in the course of registration and it must be done in due time, Sec. 1370. The claim must have certain characteristics, Sec. 1371 and Sec. 1372. A mortgage can only be registered for a specific amount of money and registration can only be for a specific immovable property, Sec. 1373. The form for registration must also be observed. When the debtor is paying off the mortgage, he must make certain that the appropriate record is entered in the Land Register, Sec. 1374. Otherwise, the payoff is not binding in respect of third persons, only between the parties. If several creditors have rights in the same object, their right to receive satisfaction is determined by the order of priority as the mortgage has been recorded in the Land Register, Sec. 1379 cf. Sec. 1309 and subsequent sections.

**Mortgage in immovable property – Lithuanian law**

Mortgage in immovable property is governed by Chapter XI, Sections 4.170 - 4.197 of the Civil Code.\textsuperscript{53} The object of a mortgage may be individual immovable things, registered in a public register, which are not withdrawn from the civil turnover and can be presented for sale at a public auction. The mortgaged property (with the exception of land) must be insured, Sec. 4.171(4). Present and future fixtures are objects of the mortgage, unless otherwise provided in the mortgage contract, Sec. 4.171(2). Lithuanian law distinguishes between contractual and legal mortgage. A legal mortgage arises on the basis of law or through a court decision: (1) in order to secure state claims arising from taxes and state social insurance legal relations, (2) in order to secure claims related to the construction of buildings or reconstruc-

\textsuperscript{52} See Paron and Tomachyeva (2003, p 97).

tion, 3) in order to secure property claims in accordance with a court judgment and (4) in other cases provided for by the Civil Code, Sec 4.175(2). A mortgage can be of different types. First, it can be an ordinary mortgage, which is a mortgage of one definite immovable property in order to secure one definite obligation, Sec. 4.179. Second, it can be a joint mortgage, which is a simultaneous mortgage of several immovable properties in order to secure one definite obligation. Third, it can be a mortgage of a thing belonging to another person, which is a mortgage of an immovable property in order to secure the discharge of the debt obligation of the other person, Sec. 4.181. Fourth, it can be a maximal mortgage, which is a mortgage on an immovable property when an agreement is made only to secure the maximum sum of obligations on the basis of a mortgaged property and on the area in which the loan will be used, Sec. 4.182. Fifth, it can be a joint (common) mortgage, which is a mortgage on several immovable properties belonging to different owners in order to secure one debt obligation, Sec. 4.183. Sixth, it can be a conditional mortgage, which is a mortgage of property in order to secure the obligation if it has been agreed that the mortgage becomes effective from the moment of the fulfillment of the condition stipulated in the contract or during the time when the condition, stipulated in the contract, is being fulfilled, Sec. 4.184.

A contractual mortgage is created by contract between the creditor, the debtor and the owner of the mortgaged property (if the debtor is not the owner) or by unilateral application of the owner of the property. Under Sec. 4.185, the mortgage contract, a unilateral application by the owner of the mortgaged property as well as the application to register the legal mortgage, shall be executed as a mortgage bond. The contents of the mortgage bond are quite specific, Sec. 4.186. When the mortgage is contractual, a notary shall in addition to these specific requirements certify the mortgage bond. A mortgage bond must be signed by the creditor, the debtor and the owner of the mortgaged property (when the debtor is not the owner of the property). When the object is mortgaged following unilateral application by the owner of the property, it is sufficient for the contract to be signed by that person. If the mortgage is legal, the mortgage bond is signed by the creditor. The mortgage must then be registered in the Register of Mortgages to be valid. If the debtor fails to discharge his obligation, the mortgagee has the right to sell the mortgaged property at a public auction and satisfy his claim prior to other creditors from the proceeds from sale, Sec. 4.192. In the event of several mortgages on the property, claims of mortgagees are satisfied according to the time of their application for registration of the mortgage, Sec. 4.193(2).
Retention of title clauses

Terminology and classification
From an international point of view, there exist several different types of retention of title clauses (called ROT clauses), which are often used in combination. In most countries, one finds a simple ROT clause that usually stipulates that the property in the goods delivered to the buyer shall not pass to him until he has paid the purchase price in full. This type of ROT clause has a limited value as it gives the creditor security for the price of the goods only. Its lesser value is also because the clause is limited to a particular object. Especially when stock is involved, the buyer may often want to resell the goods. In these cases, the creditor would much rather use a retention of title extended to proceeds. The ROT clause usually stipulates that the seller shall retain his title to the goods until payment has been made in full, but that the buyer may resell the goods in the ordinary course of business if he assigns to the seller all debts or claims arising from such a resale. When raw materials are sold, it happens quite frequently that the buyer would like to mix the goods with his own goods or with those supplied by a third party. In this case, the creditor would like to use a retention of title clause extended to products. The ROT clause can stipulate that when the goods become mixed with other materials, the seller shall be the owner of the resultant product until the price of the goods has been paid in full.

As mentioned before, a simple ROT clause has a limited value, as it only gives the creditor security for the price of the goods. A retention of title clause expanded to other indebtedness is therefore often preferred. It secures not only the price of the particular goods sold, but also other kinds of both existing and future debts of the buyer, arising from the dealings between the parties and sometimes their affiliate companies.

Retention of title – Swedish law
Swedish law does not possess a coherent body of legal rules concerning ROT clauses. Apart from a few scattered sections, such as Sec. 54 p 4 of the 1990 Sales Act 54 or Sec. 7 of the 1978 Installment Act 55, the main rules concerning the validity of the security interest are found in case law. In some cases neither statutory provisions nor case law can be found, which means that a solution to a given question may sometimes be quite uncertain.

It is common for a seller to grant the buyer the right of possession of the object of sale before payment has been made (credit sale). However, such a transaction involves a high degree of risk for the seller. In the Swedish legal system, if the buyer is not willing or able to pay the agreed purchase price,
the seller usually cannot reclaim the goods once they have come into the buyer’s possession. However, if the contract contains a valid ROT clause, the seller can reclaim the goods, even if the buyer is insolvent, Sec. 54 p 4 of the Sale of Goods Act.

Both the Swedish Installment Act and the 1992 Consumer Credit Act\(^5\) contain several sections that influence the possibilities of stipulating a ROT clause in these types of contract. Under Swedish law, a creditor who has delivered goods to the debtor and secured his demand of payment with a ROT clause may seek a judgment through the courts entitling him to have the goods redelivered to him or to reclaim possession of the goods. Under the rules on simple procedure (see, e.g., Sec. 11–18 of the Swedish 1978 Installment Act.)

It is possible to stipulate a ROT clause in a contract of sale regarding real estate. However, the application of such a clause to equipment can sometimes be affected by the Land Code.\(^5\) Under the Code, real property refers to land and what pertains thereto, such as buildings, trees and. To a building pertains, in general, anything necessary for use of the building (Chapter 2, Sec. 2). Machinery and other equipment installed in a factory or other industrial property and for use in the business also belong to the property (Chapter 2, Sec. 3). However, it is possible to stipulate a valid ROT clause to apply to a machine that falls into the last category of real property. It is also possible to uphold the validity of such a clause if the ground and the building have different owners. Because of these exceptions, it is of the utmost importance to determine when a certain object falls under Chapter 2, Sec. 3 or Chapter 2, Sec. 2, as in the latter situation the ROT clause has no validity at all against the owner of the building or other creditors (mortgagees on real estate). This is sometimes difficult to determine and has, on occasion, led to many legal disputes and comments.\(^5\)

From a Swedish point of view, it is of the utmost importance that the seller makes sure that the ROT clause has been incorporated in the contract, and he should establish whether any formal requirements must be satisfied. Since a ROT clause in a sale contract is most frequently part of the general conditions of sale, he must make sure that these conditions have been included as terms of the contract. If one examines the formal requirements for a ROT clause, there are no formal requirements connected with such transactions, except regarding consumer sales. Only in such transactions must the ROT clause be in writing. A third condition that has to be fulfilled for the ROT clause to be valid is that the parties should have agreed on the clause before the conclusion of the contract, or at the latest, before the goods have come into the buyer’s possession. If this important requirement is not ful-

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\(^5\) SFS 1992:830.
\(^5\) SFS 1970:994.
filled, the seller does not have priority before the buyer’s creditors. A fourth condition that has to be fulfilled is the requirement that a ROT clause is only valid if the goods have been specified and that it should be possible to distinguish them from among the other goods in the buyer’s possession as collateral. If the secured object cannot be identified, the ROT clause may lose its effect. A fifth condition that must be fulfilled is that the ROT clause should be related to the purchase price. As a consequence of this rule, it is impossible to use goods as collateral for unrelated or future debts. It can happen that a seller co-operates with a financier who grants the buyer a loan for the purchase of goods. If the seller receives the purchase price directly from the financier, the parties can agree that in return for the money the financier will get the right to the security interest when the goods have been transferred to the buyer. However, under Swedish law, such a transaction can make the ROT clause invalid, as it is of the utmost importance that the seller gives the credit. On the other hand, the seller can later discount the contract to the financier in exchange for the security interest.

An important limitation of a ROT clause is that it becomes invalid if the secured object has been incorporated into other goods or real estate. The same holds true if the secured object loses its identity because of processing. The rule is very strict. The ROT clause is declared void if the contracting parties intend to incorporate the object into other goods even though no incorporation has taken place before the debtor’s default or insolvency. The same rule applies if the debtor has the right to sell the goods prior to payment. The ROT clause is invalid if such a right of disposal is given the debtor. One may conclude that all the above-mentioned conditions mean that only simple ROT clauses are valid in Sweden. Any extended clause that secures the proceeds from a resale or a new product that results from the processing of the goods sold would be considered, in principle, invalid against the buyer and his creditors.

Retention of title – Estonian law

Under Estonian law\textsuperscript{59}, it is possible in a sales contract for a seller to use a ROT clause in order to secure payment from the buyer for delivered goods, see\textsuperscript{60} Sec. 233 of the Law of Obligations. In comparison to Swedish law, ROT clauses for movable objects are not restricted to a specific form. It is possible to stipulate a simple ROT clause that will give the seller the right to separate the sold goods from the buyer’s bankruptcy estate. It is also possible to stipulate a retention of title clause extended to proceeds. The buyer may resell the goods in the ordinary course of business if he assigns to the seller all debts or claims arising from such a resale. On the other hand, it is not

\textsuperscript{59} Pihkva (2005, p 13.)

clear if it is possible to make a valid ROT clause extended to products. However, it is possible to stipulate in a sales contract a retention of title expanded to other indebtedness. It secures not only the price of the particular goods sold, but also other kinds of both existing and future debts of the buyer arising from the dealings between the parties and sometimes their affiliate companies. Concerning the legal point of retention of title, Estonian law seems to be influenced by German law.

Retention of title – Latvian Law
It is possible to use a simple ROT clause as a security interest in Latvia. This view is founded on Sec. 2033, 2037, 2047, 2069 of the Civil Code. Under Sec. 980, it should be possible to use a retention of title clause extended to products, allowing the buyer to process the goods before he has paid for them. It is not clear if it is possible to use a retention of title clause extended to proceeds or expanded to other indebtedness.

Retention of title – Lithuanian law
It seems that the Lithuanian law regarding ROT clauses is regulated in the same way as in Estonian Law. This view is founded on Sec. 4.37 and the following sections, particularly section 4.49(3) of the Civil Code. Sec. 4.49(3) says that a contract may stipulate that the ownership to an object shall pass to the acquirer only after the latter has carried out a condition established in the contract. This shows that it is possible to draw up a simple retention of title clause. Furthermore, it is clear that a retention of title clause extended to products would be valid, Sec. 4.54. Thus, the ROT clause can stipulate that when the goods become mixed with other materials, the seller shall be the partial owner of part of the resulting product (in proportion to what the seller has delivered) until the price of the goods has been paid in full. It is not clear if it is possible to use a ROT clause extended to proceeds or expanded to other indebtedness.

Analysis of the security interests
The rules described above give the impression that in all four countries all kinds of assets may be subject to a security interest. In Sweden, the security interest is perfected by transfer of the secured object, by registration, by the contract itself or by noticing the debtor. It is difficult to say which method is the prevailing one. In Estonia, Latvia and Lithuania, one finds all four mentioned methods of perfecting the security interest, but it seems that registration is the main method to perfect. In contrast to Swedish law, the security interest must sometimes be notarized according to the law of the three Baltic

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61 Compare sec. 2007 and 2009 of the Civil Code.
Lithuanian law demands notarization in more cases than in the other two Baltic legal systems. Under Swedish law, notarization is never demanded. The formal requirements regarding the agreement of the security interest are also stricter according to the legal rules in the three Baltic States than according to the Swedish rules. Under Estonian, Latvian and Lithuanian law, it is more common to demand that the security agreement is made in writing and the content of the security document is described in detail in the law. A valid oral agreement, which in many cases is sufficient according to the Swedish rules, is generally not accepted.

A different rule from a Swedish point of view is found in Lithuanian Civil Code sec. 4.200 (2), which says that a pledge is a derivative obligation from a principal obligation. Rights of the pledgee are derived from his rights as a creditor and the exercise of these depends on the fate of the obligation secured by a pledge. In Sweden, the pledge agreement is separate from the principal obligation. The pledge right can exist without an obligation against the debtor personally. If a minor person pledges an object, it can happen that the pledge agreement is valid. The creditor/pledgee cannot demand payment directly from the minor, but he can obtain payment by selling the pledged object. If the principal obligation ceases to exist, it is still possible for the creditor to receive payment by selling the pledged object.63 Another different rule from a Swedish point of view is found in sec. 4.203, which provides that, subject to the pledgee’s consent, the pledger may substitute for the pledged object, defined by individual characteristics, another thing that has not been pledged previously. In the case specified, the pledge of the prior thing is revoked following the execution of the pledge of a new thing. From a Swedish point of view, a change of the pledged object can violate the principle of speciality and also lead to recovery in case of insolvency of the pledger64.

In none of the four countries, can one find any limitations on the secured debt such as exclusions for future debts. Nor can specific rules be found regarding the secured amount, with the exception of the rules for Lithuanian legal mortgage on immovable property and the Latvian legal rules regarding the commercial pledge and mortgages. It is possible to establish a subsequent pledge on the same asset, with the exception of the rules in Estonia regarding possessory pledge. All security interests in the above four countries are available to all kinds of creditors. Nationals and foreign creditors are treated equally. On the other hand, it is possible that the commercial pledge in the Baltic States, like the floating charge in Sweden, is used mainly when the creditor is a bank. It is clear that Estonia, Latvia and Lithuania have more liberal rules than Sweden regarding retention of title clauses. The legal posi-

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63 See Bergström and Lennander (2001, p 78).
64 Compare Chapter 4, Sec. 12 of the Swedish Bankruptcy Act.
tion on retention of title clauses in Estonia, Latvia and Lithuania is more like the legal position in the United Kingdom and Germany.65

Concerning remedies of the secured creditor, Sweden is the most creditor-friendly country of the four states analyzed. There are no compulsory grace periods and the object secured can be sold privately. If an insolvency procedure has started against the debtor, the trustee will sell the collateral by auction or in another way that is profitable for the bankruptcy estate. The collateral can only be sold by auction, unless the pledgee consents to an alternative sale or it is likely that the trustee will get a higher price and the supervisory authority (which ensures that bankruptcy procedures are carried out appropriately in accordance with the Bankruptcy Act, etc.) consents.66 In none of the investigated countries, are there requirements that the sale must be in local currency or that the collateral must be sold to the country’s own nationals.

However, Lithuanian, Latvian and Estonian laws are more debtor-friendly than Swedish law in certain regards. One example is that the legislation in the Baltic countries stipulates certain grace periods to enable the creditor to sell the collateral. Under Latvian, Estonian and Lithuanian law, the main method for selling the secured object is by public auction,67 although the Latvian legal system, e.g., allows the collateral to be sold by private auction. In contrast to Swedish law, with fewer registration systems, it is fairly easy in the Baltic countries for the secured creditor or another third party to check the debtor’s title to certain assets, whether the debtor owns the assets and whether there are any encumbrances on the assets. The registration systems mean good predictability for the creditor.

Insolvency law

Swedish law

**General observations**

Bankruptcy is a procedure whereby all of a debtor’s (bankrupt’s) property is claimed in the interests of all the creditors. The bankrupt’s property is placed under special administration and sold off and the proceeds are then in principle divided equally between the creditors. The principle of equality is somewhat modified, however, by the rules on priority rights. Bankruptcy is usually known as general execution, as opposed to execution by various meas-

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65 See regarding German and English law, Persson (1998).
66 See Chapter 8, Sec. 7 of the Swedish Bankruptcy Act. Compare also Chapter 8, Sec. 6 of the Swedish Bankruptcy Act regarding immovable property.
67 This goes for immovables and for movable property pledged, as well as commercial pledges.
ures pursuant to different Enforcement Codes,\(^68\) which are known as forms of special execution.

Swedish insolvency rules are defined by the Bankruptcy Act\(^69\), the Company Reconstruction Act\(^70\) and the Debt Remission Act.\(^71\) Closely linked to these laws are the rules on priority rights.\(^72\) Swedish law provides for the following insolvency procedures: Bankruptcy, Company reorganization, Debt remission,\(^73\) Composition in bankruptcy,\(^74\) Suspension of payments\(^75\) and Private composition\(^76\). Here only the position of different security interest in bankruptcy and reorganization will be discussed.

Swedish bankruptcy law is applicable to both legal and natural persons. The same is true of the Reorganization Act, which can be used by all business operators, both natural and legal persons pursuing some sort of economic activity. Certain activities, however, are exempted from the scope of application of the Act; Chapter 1, Sec. 3 provides that certain financial institutions (such as banks and securities companies) cannot avail themselves of the Act. Furthermore, the Act cannot be used by debtors over whose business activities the state or local authority, etc., exerts considerable influence.\(^77\)

\(^{68}\) See, e.g., the Swedish Enforcement Code, SFS 1981:774 and the Estonian Enforcement Code, Bailiffs Act, RT I 2001, 16, 69, passed on January 17, 2000, amended June 28, 2004, effective 1\(^{st}\) March 2005, RT I 2004, 56, 403. Lithuania does not have a separate enforcement law. The enforcement procedure is defined in the Code of Civil Procedure as well as in the Enforcement Instructions confirmed by the Ministry of Justice and used by bailiffs here in Lithuania. The creditor, having obtained a court decision, may request enforcement against the debtor’s property. The bailiff may attach the debtor’s, but only up to 25% of it. Latvia has a similar system to Lithuania’s.

\(^{69}\) SFS 1987:672.

\(^{70}\) SFS 1996:764.

\(^{71}\) SFS 1994:334.

\(^{72}\) SFS 1970:979.

\(^{73}\) Under this act, it is possible under certain circumstances for a natural person not carrying on a business to obtain a discharge, wholly or in part, from liability for payments of debts. See SOU 1990:74 p 335.

\(^{74}\) Compositions in bankruptcy are regulated by Chapter 12, Bankruptcy Act, but they rarely arise after a company is declared bankrupt. The composition becomes binding on each creditor, whether identified or not, who has the right to lodge the proof of his claim as regards unsecured distribution in the bankruptcy.

\(^{75}\) A suspension of payments is a way for the company to win some time for negotiation with creditors. Either payments can be suspended without notice, i.e. the company simply stops paying old debts, or expressly, i.e. the company specifically informs all of its creditors. Suspension of payments is not regulated by legislation. An express suspension of payments can have certain legal consequences (e.g., there will be a presumption of insolvency should a dispute on this point arise when a bankruptcy petition is being heard).

\(^{76}\) A company that has difficulties making payments can try to draw up a private composition with its creditors. Private compositions are not regulated by law but require the agreement of all creditors affected. Another alternative is to petition for company reorganization, the procedure that is regulated by the Company Reorganization Act, SFS 1996:764.

\(^{77}\) Reorganization and liquidation of credit institutions and insurance companies are regulated in a separate law, SFS 2005:1057. See Directive 2001/24/EC of the European Parliament and the Council of April 4 on reorganization and winding up of credit institutions, and directive
The purpose of the Company Reorganization Act is to allow measures to be taken, without resorting to bankruptcy, in order to reconstruct companies in crisis that are still considered to have good prospects of continued profitable activity. A process of reconstruction can be commenced once a court has given its consent.

Reorganization

A reconstruction petition can be presented at the request of the debtor himself, or at the request of a creditor on the condition that the debtor allows the petition, Chapter 2, Sec. 1 and 3 of the Company Reconstruction Act. The prerequisite for presenting a petition for a company reconstruction is that it can be assumed that the debtor cannot pay its debts as they have fallen due for payment or it is clear that the company will very soon be unable to meet its payments, Chapter 2, Sec. 6. A debtor must therefore be insolvent or there must be a risk that it will soon become insolvent. If a particular debtor is involved in company reconstruction proceedings and a creditor presents a bankruptcy petition in respect to that debtor, such a petition shall, at the debtor’s request, be stayed until company reconstruction procedure is concluded, Chapter 2, Sec. 19 of the Company Reconstruction Act, c.f. Chapter 2, Sec. 10a of the Bankruptcy Act.

If the debtor is insolvent or there is a risk that it will very soon be unable to meet its payments, and if the conditions are met as regards the ability for the aim of the company reconstruction to be met, the courts must grant the petition, Chapter 2, Sec. 6 of the Company Reconstruction Act. The district courts must therefore determine whether the conditions for the procedure are met, i.e. that the debtor’s business can become profitable again by virtue of a reconstruction in either business or financial terms. The court then decides whether the petition will be granted, rejected or dismissed. If the petition is granted, the district court shall appoint an administrator and call all parties to a creditors’ meeting, where the creditors will discuss whether the reconstruction should go ahead, Chapter 2, Sec. 10. As the creditors’ interests and claims are at stake, it is important that they be given the opportunity to understand the procedure and thereby influence how it will be implemented. The court can appoint a creditors’ committee at the request of any creditor, Chapter 2, Sec. 16. A creditors’ committee may comprise up to three people. If the debtor has employed at least 25 persons during the last financial year, an employee representative must sit on the creditors’ committee.

Chapter 2, Sec. 17 of the Company Reconstruction Act provides that there are to be no seizures or executions against the debtor under the duration of the company reconstruction, and neither must decisions on sequestration or

2001/17/EC of the European Parliament and the Council of March 19 on reorganization and winding up of insurance companies.
attachments be taken. This prohibition applies in principle to all creditors, including those retaining title (creditors with a retention of title clause). This is clear from Chapter 2, Sec. 17 p 1(3), which provides that assistance pursuant to the 1978 Installment Act may not be given. The prohibition in Chapter 2, Sec. 17 does not apply to certain creditors (e.g., those with claims secured by a pledge or lien and those regarding maintenance allowances), however.

Chapter 2, Sec. 18 constitutes a safeguard securing creditors’ rights. This section provides that a court may, at the request of a creditor, order suitable measures to be taken in order to secure a creditor’s position by taking or permitting a certain measure if there are specific reasons to believe that the debtor will jeopardize the creditor’s rights. The provision of Chapter 2, Sec. 17 does not prevent the effectiveness of such a decision. The safeguard measures that the court can determine are of a civil law nature, namely a penalty under Chapter 15, Sec. 3 of the Code of Judicial Procedure78, or ordering that the property be placed under special administration. If the debtor does not co-operate in good faith throughout the procedure and follow the administrator’s directions, it may be necessary in certain cases to consider whether the procedure should continue. If the debtor takes or permits a measure to be taken that jeopardizes the creditor’s rights, the question of whether the procedure should be halted and the possibility of instituting bankruptcy proceedings should be considered. The debtor should also be warned that immediate bankruptcy proceedings could be decided should the administrator’s directions continue to be ignored.

Compulsory compositions may arise within the framework of a company reconstruction procedure, Chapter 3, Sec. 1 of the Company Reconstruction Act. The prerequisite for a compulsory composition is that the debtor offers the creditors payment of at least 25% of the amount of their claims, Chapter 3, Sec. 2. Only those creditors whose claims have arisen before a petition for company reconstruction can participate in a compulsory composition. However, those creditors whose claims are secured with a priority right or repossession condition or that can obtain a contribution towards their claims through set-off cannot participate. Only where such a creditor either wholly or partially waives his priority right or right to set-off may he participate in a compulsory composition.

Bankruptcy
If the reorganization fails, bankruptcy proceedings will very often begin. The procedure begins with either the debtor himself or his creditors petitioning the court for the debtor to be declared bankrupt.79 If it is the debtor that is seeking a bankruptcy declaration, the petition is usually granted accorded to Swedish law. This is because there is a presumption for insolvency under

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78 SFS 1942:740.
79 See Chapter 2, Sec. 1 of the Swedish Bankruptcy Act.
Chapter 2, Sec. 7 of the Bankruptcy Act. The provision states that information presented by a debtor evidencing that he is bankrupt shall be accepted if there are no special reasons indicating the contrary.\textsuperscript{80} A petitioning creditor must establish his competence, i.e. he must show that he really does have a claim against the debtor. However, this alone is not enough. In addition, the creditor must (if the debtor does not concede as much) show that the debtor is insolvent. Because it can often be difficult for the creditor to prove insolvency, the Swedish Bankruptcy Act includes certain rules of presumption for insolvency. It is stipulated, e.g., that a debtor that has been called upon to pay an overdue debt but has failed to do so within one week, shall be deemed to be insolvent if the creditor demanding payment presents a bankruptcy petition within 3 weeks thereafter and then the debt is still not paid. This rule of presumption applies only to debtors under a duty to keep accounts.\textsuperscript{81}

Under Swedish law, the district court appoints a trustee and decides how many there should be. Prior to appointing the trustee, the supervisory authority (which ensures that bankruptcy procedures are carried out appropriately in accordance with the Bankruptcy Act, etc.) provides its opinion on the matter. During the course of the procedure, the trustee must wind up the estate and sell its assets. The trustee shall decide early on whether the business will be continued without selling off the assets or whether it shall be continued in order to sell its property. Furthermore, decisions will be taken as to whether there are transactions that can be recovered.

A bankruptcy procedure ends when the receiver presents a working report and a statement of account, which is known as final account. The report shall detail the measures taken by the receiver and the assets and liabilities must be listed to allow a final assessment to be made of what is left to be shared among the creditors. The receiver must then draw up a distribution proposal in which the costs of the bankruptcy (e.g., the receiver’s fee) are settled first, to be followed by the claims against the bankruptcy estate itself (costs incurred by the estate during the course of the procedure). Super-priority creditors, such as creditors with retention of title are not part of this list, as their property is not part of the bankruptcy estate, which means that they are able to separate the collateral from the estate. Once these two groups of creditors have received their distributions creditors with special priority rights (pledge in movable or immovable property) and those with ordinary priority rights (creditors with a floating charge and claims of employees) are next on the list. Anything left after that goes to the unsecured creditors. The distribution proposal is passed to the supervisory authority for its review. The court then reaches a decision and ratifies the proposal. If no applications are lodged against the proposal, the distribution proposal becomes binding, the distributions are made and the procedure ends. Of course, a bankruptcy procedure

\textsuperscript{80} Chapter 2, Sec. 7 of the Swedish Bankruptcy Act.
\textsuperscript{81} Chapter 2, Sec. 9 of the Swedish Bankruptcy Act.
can end in ways other than by distribution, i.e. by dismissal, which arises if the bankruptcy estate’s assets are not sufficient to cover the costs of the bankruptcy procedure. Bankruptcy procedures can also be withdrawn and a composition in bankruptcy may also arise.

Estonian Law

General observations
Estonian bankruptcy law is mainly governed by the Bankruptcy Act\(^{82}\), which came into force on January 1, 2004. Similar to the Swedish Bankruptcy Law, the Estonian Bankruptcy Act is applicable both to legal and natural persons.\(^{83}\) Contrary to the Swedish legal system, however, reorganization and debt remission are not regulated separately. These procedures are part of the general bankruptcy act. Debt remission is possible as a natural person may be released from his obligations that were not liquidated during the bankruptcy proceedings, Chapter 11 (Sec. 169 and the following sections). Reorganization (compromise) is possible on the proposal of the debtor or the trustee after the declaration of bankruptcy. The reorganization decision is made at a general meeting of creditors (see Chapter 12, Sec. 178 and the following sections).

Bankruptcy
Bankruptcy proceedings begin in a similar way as in Sweden, i.e. with either the debtor himself or his creditors petitioning the court for the debtor to be declared bankrupt, Sec. 4 and Sec. 9 of the Estonian Bankruptcy Act. In Estonian law, the debtor must substantiate the insolvency. If the debtor submits a bankruptcy petition, the debtor is presumed – as in Swedish law – to be insolvent.\(^{84}\) A petitioning creditor must support his competence and show that the debtor is insolvent. Therefore, the Estonian Bankruptcy Act, like the Swedish Act, includes certain rules of presumption for insolvency.\(^{85}\)

Upon commencement of bankruptcy, the court will appoint an interim trustee who will, among many other duties, assess the solvency of the debtor and determine and preserve the debtor’s assets, Sec. 22. If bankruptcy is declared, the court shall decide on the time and place of the first general meeting of creditors, appointment of a trustee/trustees and application for securing actions, Sec. 31 (5). The requirements for a trustee are stated in Sec. 56. It should be (1) a natural person whom the examination board for trustee in bankruptcy formed by the Minister of Justice has granted the right to act as

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\(^{83}\) See Sec. 8(1) and (2) of the Estonian Bankruptcy Act.

\(^{84}\) See Sec. 13(1) and Sec. 31(4) of the Estonian Bankruptcy Act.

\(^{85}\) See Sec. 10 of the Estonian Bankruptcy Act.
trustees in bankruptcy and (2) sworn advocates and senior clerks of sworn advocates. The trustee must have the confidence of the creditors and the court and be independent of the debtor. The trustee shall not be an employee of the court or connected with the judge hearing the matter. The right to act as a trustee is granted, among other things, to a person who has passed the examination for trustees in bankruptcy, is proficient in oral and written Estonian and is honest and of good repute, Sec. 57. The appointment of the trustee is subject to approval by the first general meeting of creditors, Sec. 61(1). If a trustee is not approved, the creditors shall elect a new trustee whose approval shall be decided by the court. If the court does not approve this new trustee, it shall appoint a new one. The role of the Estonian bankruptcy court is similar to that of its Swedish counterpart. Its duties are under Sec. 84 to exercise supervision over the lawfulness of the bankruptcy proceedings and perform other duties provided by law. In this regard, Estonia, like Sweden, has bankruptcy legislation that is more creditor-friendly, leaving several issues to be decided by the creditors. It can be mentioned that at the first general meeting of the creditors, a bankruptcy committee should be elected that will safeguard the interest of the creditors, monitor the activities of the trustee and have other duties, Sec. 73 and Sec. 77. The general meeting of the creditors will also decide among other things on the continuation or termination of the activities of the undertaking of the debtor (reorganization/comprise) or a release (debt remission) for natural persons.

Under Estonian law 86, creditors’ claims are paid in the following order: (1) Super-priority creditors like creditors with retention of title. Objects belong to third parties shall not be included in the bankruptcy estate, which means that creditors with a reservation of title are able to separate the secured object from the estate, Sec. 123 of the Bankruptcy Act. (2) Payments relating to bankruptcy proceedings, Sec. 146 of the Bankruptcy Act. (3) After these specified payments, the claims of the creditors should be paid in the following order, Sec. 153 of the Bankruptcy Act

- claims secured by pledge
- claims that are not filed on time but are accepted.

Claims secured by pledge are preferred claims in respect of the money received from the sale of the collateral. Claims that have lower ranking are satisfied only after claims of higher ranking have been paid. Claims secured by pledge are satisfied according to the ranks of the relevant pledges. Certain payments are made even before the claims secured by pledges. Those include claims arising from the exclusion of property from the estate and recovery of property, support to the debtor and his dependants and payments

86 Paron and Tomachyeva (2003, p 103).
relating to the bankruptcy proceedings. Employee claims are typically paid out of governmental funds, which explain non-priority of salary claims.

**Reorganization (compromise)**

Under Sec. 178 of the Estonian Bankruptcy Act, a compromise means an agreement between a debtor and the creditors concerning payment of debts and involves reduction of the debts or extension of their terms of payment. A compromise is made on the proposal of the debtor or the trustee after the declaration of bankruptcy. A general meeting of creditors or the bankruptcy committee may assign the trustee with the duty to draft a compromise proposal.

A general meeting of creditors should make the decision and the court shall approve it.

A compromise proposal shall set out to which extent and by which date the debtor is to pay the debts. The compromise proposal shall contain proof that the debtor is able to pay the debts to the extent and by the date indicated. If the debtor is a business person, the rehabilitation plan shall be annexed to the proposal, Sec. 179. A compromise is deemed to be made if a certain percentage of creditors whose claims constitute a certain amount vote in favor of the proposal. Compromise can have a major impact on the secured creditors’ position under Sec. 182. If a debtor engages in business or professional activity and according to the compromise the collateral is necessary for continuing the activities of the enterprise of the debtor, the claim secured by the pledge shall not be invoked during the term determined by the compromise. If a pledgee votes against a compromise, the term just specified shall not exceed 1 year. If that happens, the pledgee can in certain cases demand interest, Sec. 182 (3).

**Latvian law**

**General observations**

The Latvian Bankruptcy Act governs the Latvian bankruptcy procedure for companies.

Law on insolvency. The law applies only to undertakings and companies registered in the Enterprise Register, Sec. 2(1). The law is not applicable to insolvency proceedings of credit institutions, insurance companies and insurance broker companies. There is no particular law that regulates insolvency of natural persons. Similar to the Estonian legal system, composition (settlement) and reorganization (restoration) are regulated in the bankruptcy law, Chapter IX and X (Sec. 77 and the following sections).

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88 See Law on Credit institutions, passed on October 5, 1995, amended in June 2005.
Reorganization

Under Chapter I, Sec. 1(13), a settlement means a resolution of a state of insolvency manifested as an agreement between the creditors and the debtor regarding the fulfillment of the debtor’s obligations in cases provided for and in accordance with the procedures by the above-mentioned law. A settlement is allowed at all stages of the insolvency process until the beginning of the auction of the debtor’s property, Sec. 77(1). The possibility of a settlement shall, without exception, be examined at the first meeting of creditors if the debtor or the creditors propose entering into it, Sec. 77(2). At the subsequent meetings of creditors, the issue of a settlement shall be re-examined, if it is included in the agenda for the meeting. The administrator is obligated to include the issue of settlement in the agenda of the meeting of creditors, if the draft settlement proposed by the debtor or the creditors has been submitted to the administrator no later than 3 weeks before the meeting of creditors, Sec. 77(3). A settlement may be manifested as: (1) a reduction in the amount of claims, (2) renunciation of contractual penalties or interest and (3) postponement of the term of fulfillment of obligations, Sec. 80. The settlement provisions just mentioned shall not be allowed with respect to claims of priority creditors without their written consent, Sec. 80(2) and Sec. 107. In case of settlement, the rights and interests of secured creditors may not be violated without their direct and unmistakable written consent, Sec. 80(3).

Under Sec. 81, the administrator shall work out the draft settlement, which shall be determined at the meeting of creditors. The settlement must indicate what amount the claims of each group of creditors are to be satisfied with. A settlement is concluded if a certain percentage of the creditors according to the amount of debts vote for it, Sec. 82 (2). If the creditors approve it, the court must also approve it, Sec. 83.

If a settlement is not approved, the creditors’ meeting must decide on restoration or on initiating bankruptcy procedure. Restoration means resolution of a state of insolvency manifested as the carrying out of planned measures with the purpose of preventing a possible bankruptcy of an institution, restoring its solvency and satisfying the claims of creditors, Chapter 1, Sec. 1(18), and Sec. 87.

Restoration is considered at the meeting of creditors if: (1) a settlement has not been proposed at the first meeting of creditors, (2) a settlement has been rejected, (3) a settlement has not been entered into or (4) the settlement has been cancelled, Sec. 89. The administrator shall manage the restoration according to the restoration plan adopted by the meeting of creditors, Sec. 88 (1).

The creditors must vote for application of restoration, which will be adopted if it is voted for by a certain percentage of the creditors according to the amount of claims, Sec. 90. If a decision is taken regarding restoration, the secured creditors may not exercise their rights with respect to the secured
property until the restoration plan is rejected. If the restoration plan is adopted, they must wait until the end of the restoration or until its discontinuation. However, after the restoration plan has been approved, the secured creditors may exercise their rights with respect to the pledged property if it is not indicated in the restoration plan under Sec. 92(5).

**Bankruptcy**

Chapter 1, Sec. 1(2) of the Bankruptcy Act defines bankruptcy as a resolution of an insolvency situation manifested as liquidation of the debtor and satisfaction of the creditors’ claims from resources obtained during the liquidation process, by selling the debtor’s property in accordance with the procedure of the above-mentioned law.

A debtor is insolvent under Sec. 3(1) if a court determines at least one of following elements: (1) the debtor is unable or, because of circumstances that can be proven, will be unable to adequately settle its debt obligation, (2) the debtor has ceased to settle its debts which have come due and the creditor has given the debtor certain notices as stated in section 39 (1) or (3) the debt obligations of the debtor exceeds its assets.

A decision on initiating bankruptcy proceedings shall be taken by a majority vote at a meeting of creditors, Sec. 100(1). A decision on initiating bankruptcy proceedings is deemed to have been taken: (1) if neither settlement nor restoration have been proposed at the meeting of creditors or (2) if a proposed settlement or restoration has been rejected at the meeting of creditors or (3) if a restoration has been interrupted without another resolution being adopted regarding the debtor’s insolvency, Sec. 100(2).

Under Sec. 104 and 105, the assets of the debtor should be sold according to the rules of the Civil Code and the Civil Procedure Law, which means that the assets will be sold by the administrator through a public auction unless otherwise specified in these laws. All property of the debtor shall be included in the auction, except monetary funds and property, which are subject to pledges. It should be noted that full or partial discharge of obligations regarding a debtor by set-off is not allowed, Sec. 106.

Under the Latvian Bankruptcy Act, claims of non-secured creditors are paid in the following order:

1. The administrative expenses of the insolvency proceedings should be covered by monetary funds of the debtor or money received by selling the debtors property, Sec. 107 (2) and Sec. 109.

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90 Nevertheless, one should take into account the EU Regulation nr 1346/2000 on May 29, 2000 on insolvency proceedings that allows set-off provided that this is permitted by the law applicable to the transaction (i.e. non-Latvian Law).
(2) The remaining funds shall then be distributed firstly in the following order (first level):

- claims of employees,
- payments to farms, individual producers, co-operatives and incorporated companies for agricultural products supplied to processing undertakings,
- claims regarding social security tax up to 1 year prior to the initiation of insolvency,
- state claims for repayment of state-guaranteed credits,
- claims regarding other taxes and fees.

(3) After satisfying completely the first group, the remaining funds should be distributed to the remaining creditors in the following group (second level):

- claims of other creditors such as deferred tax payments, salary debts remaining after payments to the first group have been made and other payments resulting from lawful employment relationships,
- claims for interest of creditors with and without priority
- claims of creditors that have not submitted their claims in due time.

The funds that remain after all other creditors have been satisfied are distributed to the debtor’s shareholders (Sec. 107(6)).

Lithuanian law

General observations
The Enterprise Bankruptcy Law governs the Lithuanian bankruptcy law. The law applies to all enterprises, public institutions and commercial banks. The insolvency of natural persons is not regulated in Lithuania. The specific aspects of instituting bankruptcy proceedings against banks, other credit institutions, insurance agencies and agricultural enterprises are regulated in the laws regulating such entities.

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Reorganization

Under the Law on Restructuring of Enterprises,\(^{92}\) it is possible for a company\(^{93}\) to preserve its activities and restore its solvency. This procedure is only open if bankruptcy proceedings have not been started yet under the Enterprise Bankruptcy law.\(^{94}\) However, it is possible to commence reorganization within the procedure of the Law on Restructuring of Enterprises. It is also possible for the creditor and the debtor to refrain from applying for bankruptcy proceedings, if the debtor is unable to satisfy his obligations and makes a public announcement to this effect or notifies every creditor to this effect in writing. If all creditors approve the reorganization procedure, the creditors may appoint the administrator, who takes over the management of the enterprise and performs the bankruptcy proceedings.\(^{95}\)

In accordance with Sec. 2(2), the reorganization of an enterprise shall be the transformation of the structure of the enterprise by dividing or transferring its assets to other economic entities and the alteration of the character of the enterprise’s activities in order to satisfy the claims of the creditors. At the instance of the meeting of creditors or the enterprise, the court may adopt a decision of reorganization if one of the following objectives can be attained: (1) restitution of the enterprise’s solvency and (2) realization of a part of the enterprise’s assets with the aim of fully satisfying its debts to creditors without suspending economic activities.

Bankruptcy

Under Sec. 28 of the Enterprise Bankruptcy law, a creditor or a group of creditors may conclude a settlement agreement with the company during the bankruptcy proceedings. The settlement is concluded when it has been approved at the meeting of creditors by all of the creditors whose claims are not secured by mortgage and by the court, Sec. 28 and 29. A settlement may not be concluded if the court has found a fraudulent bankruptcy.

The enterprises is liquidated if a settlement is not concluded, if a concluded settlement declared invalid or if the enterprise is not reorganized. The decision on liquidation is taken by the court, Sec. 30.

Under article 35 of the Enterprise Bankruptcy law, claims of creditors are paid in the following order:

- The creditors’ claims are satisfied in two stages. During the first stage, the creditors’ claims are satisfied in the sequence provided

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\(^{93}\) Sec. 1(4) of the Law on Restructuring of Enterprises provides that the law is not applicable to banks, credit institutions, insurance companies and other financial institutions. See Doing Business in Lithuania, www. Infolex.lt, 2005-12-13.

\(^{94}\) Sec. 3 of the Law on Restructuring of Enterprise.

\(^{95}\) Sec. 4 of the Law on Restructuring of Enterprises; See www.lda.lt/invest.law_tax.company. html. 2005-12-13.
below, not including the computed interest and default interest, while in the second stage the remaining part of the creditors’ claims (interest, default interest) is paid in the same sequence.

- First in line for satisfaction shall stand workers’ claims arising from employment relationships; claims for compensation for damage caused by grievous bodily harm or some other injury, an occupational disease or death because of an accident at work; claims of natural or legal persons for payment for agricultural produce purchased for processing.
- Second in line for satisfaction shall stand claims for payment of taxes and other payments into the state budget, claims for compulsory state social insurance contributions and compulsory health insurance contributions and claims relating to loans obtained on behalf of the state or guaranteed by the state;
- Third in line for satisfaction shall be all claims other than those specified above.

Claims of the creditors of each successive sequence shall be met after full payment of the claims of the creditors of the preceding sequence. If assets are insufficient to satisfy all of the claims of one sequence in full, the said claims shall be paid in proportion to the amount due to each creditor.

Claims connected with employment relationships that have been put forward by workers of an enterprise in bankruptcy or a bankrupt enterprise, referred to in paragraph 2 of this Section, may be met from the resources of the Fund for the Satisfaction of Claims of Workers of Enterprises in Bankruptcy or Bankrupt Enterprises arising out of their Employment Relationships and from the resources of the Guarantee Fund. Claims of natural and legal persons for payment for agricultural produce purchased for processing by enterprises in bankruptcy or bankrupt enterprises may be paid from the resources of the Fund for Payment of Claims of Natural and Legal Persons for Agricultural Produce Purchased for Processing by Enterprises in Bankruptcy and Bankrupt Enterprises. The allowed claims of a worker or a natural or legal person shall be reduced by the amount of the sum paid from the above Funds.

The administrator organizes the sale of the assets of the enterprise and procedure of satisfying the creditors claim, Sec. 33. Creditors’ claims secured by a pledge or a mortgage are first of all satisfied from the proceeds of sale of such pledged assets of the enterprise, Sec. 34. 96

Analysis of the insolvency law

The validity of a security interest will usually be questioned in the case of the buyer’s insolvency (bankruptcy and reorganization). However, the above-mentioned rules in all four countries give the impression that insolvency does not have a great impact on a secured creditor’s position. On the other hand, it is not possible for a secured creditor to file an application for bankruptcy proceedings against the debtor, except when the claim can no longer be presumed to be fully secured by the asset. Usually, the secured creditor can recover payment out of the proceeds of the sale of the secured asset. However, if the secured claim exceeds the value of the secured asset, the creditor is considered to have only an unsecured claim for the excess amount. Usually, the bankruptcy rules do not pose a threat to a creditor with a security interest. On the other hand, the rules concerning the estate’s right to duly recover property disposed of by the bankrupt debtor within certain periods prior to the bankruptcy to the detriment of other creditors may be dangerous.\(^97\) If this situation does not occur, the position of the security interest is safe. In general, one can say that a creditor with a pledge is paid first, with the exception for creditors with a security interest such as retention of title and administrative expenses of the bankruptcy estate.

Bankruptcy does not have a significant impact on the possibility of the creditor enforcing his security interest. However, the rules concerning reorganization of companies can be a threat to the secured creditors’ position. Under these rules, a seller has to defer the reclamation of the goods for a specific period. The seller’s demands can also be limited to the value of the goods. Interest that has accrued owing to the delay is consequently handled without priority in the reconstruction procedures. In comparison with the rules concerning bankruptcy proceedings, the rules concerning reorganization can therefore adversely affect the position of the security interest. Another threat to the creditor could be super-priority loans. In order for a reorganization to be successful, it is sometimes necessary for creditors to lend money or make other investments at the commencement of the reorganization. In order to do so, they may wish to secure their loan for the contingency of the reorganization failing. Under the Swedish rules, a creditor who has given such a loan will, in the event of bankruptcy, take priority over creditors with a floating charge, Sec. 10 p 2 of the Right of Priority Act. In Estonia, a creditor who has made such a loan may even have priority before claims secured by a pledge, Sec. 186 (1) (2) of the Estonian Bankruptcy Act. On the other hand, Latvian law does not have such a provision.\(^98\)

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\(^97\) See Chapter 4 of the Swedish Bankruptcy Act, Section 65-72 of the Latvian Bankruptcy Act, Sections 114-119 of the Estonian Bankruptcy Act and Section 5 and 7(3) of the Lithuanian Bankruptcy Law.

Conclusion

The survey shows that the legal rules concerning security interest in the insolvency system of the four countries are quite similar. A more debtor-friendly approach can be seen in Latvia and Estonia than in Sweden, as it is possible for the insolvency administrator in the first mentioned countries to use the secured assets or substitute security in the event of insolvency rescue proceedings. In all four countries, the creditor has a number of different security interests to choose between in order to secure his claim. The legal rules in the three Baltic States are modern in comparison with the Swedish rules. The establishment of registered security interest as the main method to create a security interest is also a step in the right direction, as the legal trend in a more harmonized European system is in favor of registration.99

References
