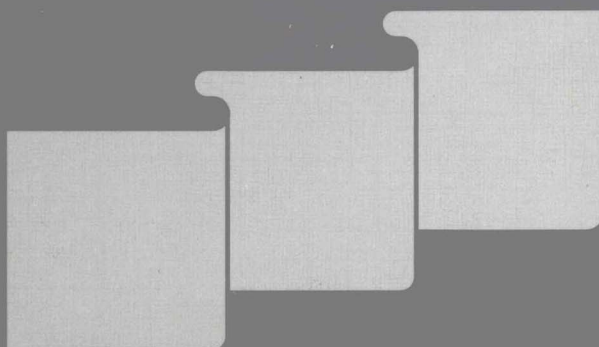


CENTER FOR INTERNATIONAL
LEGAL STUDIES

SECURITY
OVER IMMOVABLES
IN SELECTED
JURISDICTIONS



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Security over Immovables in Selected Jurisdictions

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Security over Immovables in Selected Jurisdictions

The Center for International Legal Studies

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Editor's Note

The 2005 Special Issue of the *Comparative Law Yearbook of International Business* addresses issues relating to security in immovables. Each chapter contains an overview of the security in immovables laws of a particular country. The laws vary widely among the countries; the word "immovable" (or "real property" in Common Law jurisdictions) even has different definitions in different countries.

Crossborder transactions involving immovables are integral to international business dealings. This publication provides a general overview of the methods by which immovables are secured in various countries, and each chapter contains details such as the priority granted creditors and openness of the land registers. Each chapter contains a country-specific explanation of the method by which one obtains a mortgage, lien, or similar security, and an exploration of the possible problems that might arise during such a process. In addition, special attention is given to the obstacles facing non-nationals interested in buying immovables. The book evidences the varied attitudes of governments towards the purchase of immovables by non-nationals. In some countries, such as The Philippines, non-nationals are prohibited from buying land. Other countries, such as the Slovak Republic, allow foreign acquisition of nearly any immovable, only forbidding purchase of items that no private citizen can own, such as the country's rivers.

This publication reflects recent developments in security in immovables, especially in Eastern Europe. The chapter on immovables in Ukraine is based on the country's new property laws, passed in 2004. The chapters on the Czech Republic, the Slovak Republic, and Hungary all reflect the changes brought by accession to the European Union.

The acquisition of property in a foreign country is an integral facet of international business, and practitioners will find this publication's in-depth instructions for the purchase of security in immovables useful as it pertains to individual countries. In addition to showing practitioners how transactions work in individual countries, readers will be able to compare diverse legal regimes to find the one most favorable for their particular business transactions.

Allen Brenner, Editor
Center for International Legal Studies
Salzburg, Austria

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Czech Republic

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Introduction

In General

This chapter aims to provide a brief summary of the Czech law governing security interests in immovables (real estate property) as traditional security instruments, and focuses on tangible and intangible immovables. However, due to its limited scope, it is intended as an overview rather than a comprehensive analysis of the topic. Its purpose is to assist people not familiar with the Czech legal environment to understand this area of law.

This chapter has been organized to follow the structure of the Draft Legislative Guide on Secured Transactions of 20–24 May 2002, as subsequently amended and compiled by the United Nations Commission on International Trade Law. This chapter is based on the law, available jurisprudence, and generally accepted interpretations of the law as of July 2004.

Czech private law is as yet very young, a mere sixteen years from what is called the "Velvet Revolution" in 1989. Czech private law is in a state of continuous development. As an example, the regulation of pledges and mortgages has undergone two fundamental changes in the last three years.

Therefore, a number of problematic practical issues that arise in this respect have not been finally resolved by the courts, as the standard length of judicial proceedings in the Czech Republic averages three to eight years. Moreover, a new code of Czech civil law currently under preparation will certainly bring new insights to the law. Additionally, with the entry of the Czech Republic into the European Union (EU), a number of other changes in the law may be anticipated.

Instruments Traditionally Designed for Security

Among the instruments traditionally designed for security interests in immovables, Czech law recognizes a mortgage as a non-possessory property security right. A mortgage is understood to be a limited property security right for the secured obligation established in favor of the creditor for the immovable asset owned by the grantor or the debtor. A mortgage includes the right of the secured creditor for satisfaction from the sale of the asset on the debtor's default.

Specific rules governing Czech law should be noted. Czech law does not distinguish between the terms "mortgage" and "pledge" as in other jurisdictions, and both terms are subsumed under one term: *zástavní právo*. Thus, in this chapter the term "mortgage" is used in respect to immovable property.

Furthermore, it should be emphasized that the rule *superficies solo cedit* does not apply in Czech law, so that buildings constructed or located on a land plot do not automatically belong to the owner of that land plot. Thus, it is not uncommon that a building constructed on a piece of land does not belong to the owner of the land.

The general legal regime of a mortgage applies to all kinds of immovable property, with certain exceptions and modifications for immovable property not registered in the Real Estate (Cadastral) Register (see text, below).

Use of Title for Security Purposes

Transfer of Title to the Creditor (Sale-Leaseback)

Czech law generally approves the transfer of title to the creditor as a non-possessory title-based security. The law explicitly provides that performance of an obligation may be secured by a transfer of a right that, by prevailing understanding, includes an ownership right to the immovables as well.

However, no special and detailed regime is provided for such security. Thus, a combination of the general regime for the standard transfers of title set forth by the law of property and the general regime for security rights must be used to interpret this security instrument, which certainly is not a desirable situation.

The most important limitation concerning the transfer of a title is that such a security right may be granted only by a debtor, and not by other third parties.

Security transfer of a title is recognized in two fundamental forms: a transfer, subject to a resolutive condition, of the debtor's performance (in which case the asset reverts back to the grantor automatically on such performance); or a transfer with an agreement of the secured creditor to return (re-transfer) the asset to the grantor following such performance. The resolutive condition has recently been confirmed as a rule by a judicial resolution.

The security transfer of title also may be described as a sale and leaseback of the immovable property, but in practice this term is more often used for certain kinds of real estate transactions rather than for this type of security transfer.

It should be noted that the legal regime of security transfers is short and unexplored, and the security transfer of immovables is associated with negative tax consequences, as it is subject to standard real estate transfer tax that does not support the low-cost credits. Thus, this security instrument is not widely used for immovable property in practice. This situation results in lack of judicial decisions on this matter, and contributes to the current legal uncertainty about security transfers.

Retention of Title by the Creditor (Lease-Purchase)

Generally, Czech law recognizes two forms of retention of title by the creditor.

The first form represents a contractual arrangement on reservation of ownership to the assets until the full payment of the purchase price. However, the law explicitly allows the reservation of ownership to be used only in respect of movables; its use for security in immovables is not allowed.

The second form of retention of title arrangement is a combination of a lease contract with an option for the lessee to purchase the leased immovable asset within a certain period (financial leasing of immovables). This concept is not legally considered as a form of security and, therefore, is not subject to the general rules on security such as requirements of form, publicity, or priority.

Uniform Comprehensive Security

Czech law does not recognize a unitary concept of a security right as set forth in the United States Uniform Commercial Code, Article 9.

The only concept in Czech law that may be compared to a uniform comprehensive security is a pledge over an enterprise (as a floating charge). A pledge over an enterprise is expressly allowed by Czech law, but the detailed description of the creation, publicity, and priority of security rights over the individual assets forming the enterprise and the consequences of debtor's default are lacking.

The interpretation reverts to the general regime valid for pledges and mortgages over individual movable property. Thus, at present, this security right cannot be recommended for practical use.

Limitations on Alien/Non-Resident Interests in Immovables

Although Czech law generally prohibits the acquiring of a title to immovable property by alien/non-residents, several exceptions are set forth by law. On the one hand, after EU accession, this prohibition currently relates more to physical persons (other than EU citizens), as legal entities are allowed to acquire real estate, provided they have a branch or enterprise established in the Czech Republic.

On the other hand, the security rights of alien/non-residents are not expressly restricted by Czech law at all. Thus, alien/non-residents are allowed to create a mortgage over immovables without any limitations.

An issue may arise in respect of a security transfer of title to an alien/non-resident creditor, where such a creditor acquires a title only for a limited period. Czech law does not explicitly deal with the transfer of title to a creditor for security purposes among the exceptions from the prohibition of aliens/non-residents acquiring titles to immovable property. It can therefore be concluded that, in this case, the security transfer of title (even of a temporary nature) would not be allowed.

Creation

In General

This chapter describes a contractual creation of mortgage as the traditional non-possessory security right over immovables, and does not deal with the creation of statutory and judicial security rights.

Contractual creation of a mortgage is based on a two-step process: (i) an agreement between the grantor and the creditor, which gives

rise to an enforceable personal obligation of the grantor to create the security; and (ii) the subsequent act required by law, which concludes creation of the security right.

The second step is decisive for the moment of creation of a security right and for the security right to become enforceable against third parties. This step also is decisive for the purpose of priority of satisfaction of other creditors having security rights on the same immovable property.

Basic Elements of a Security Right

Obligations to Be Secured

A mortgage may secure any monetary or non-monetary claim. As opposed to a monetary claim, which may be determined as an exact amount, a non-monetary claim is secured up to the amount of the common price of such a claim as on creation of the mortgage.

A mortgage also may secure a claim that could arise in the future, or is subject to a condition precedent. Explicitly, a mortgage also may secure future claims of the kind that will arise against the debtor at a certain time (typically, revolving loans).

The accessories to a claim (i.e., interest, default interest, and costs of enforcement) are secured together with the main claim by law, and thus need not be explicitly specified. The amount of a claim can be expressed in any existing currency.

An "all sums" claim to be secured would most likely be considered invalid due to his lack of specificity, which is strongly required in respect of all legal acts.

As described above, the security transfer of a title is not properly covered by prevailing legal regulations, and the regulation speaks of a "claim" only, without a similarly detailed description, as in case of a mortgage. Thus, in this case, specifying the secured claim along with accessories in the agreement on security transfer would be recommended. The possibility of this kind of security for future, conditional, or revolving claims is left to interpretation, as no judicial decision has been issued in this respect. Similarly, future, conditional, and revolving claims also should be allowed in case of the security transfer, provided that the specificity requirement is met.

Assets to Be Encumbered

Generally, all immovable assets capable of a legal disposition may be subject to a mortgage or a security transfer. The immovable assets include land plots, buildings, and unfinished buildings. They also include flats and non-residential premises in the ownership pursuant to special law when they represent "units" registered in the Real Estate Register, and such unfinished flats and non-residential premises.

It should be noted that immovable property may generally be classified as:

- (1) Immovables registered in the Real Estate Register; and
- (2) Immovables not registered in the Real Estate Register.

Generally, immovables subject to registration in the Real Estate Register are: (i) all land plots; (ii) all flats and non-residential premises in the ownership pursuant to special law (units); and (iii) most buildings.

The exceptions from the registration are defined by law as "tiny buildings" (i.e., accessories to main buildings) and underground constructions. As these exceptions are marginal and not of much importance for secured transactions, the rest of this chapter will not deal with this group in detail.

The assets to be encumbered must exist at the time the security is created and need to be specifically described in the agreement. Additionally, the immovables registered in the Real Estate Register also must be specified in the agreement in a manner set forth by law (e.g., the land plot number and cadastral district) to be considered specific.

An "all-assets" security cannot be created under Czech law, due to the aforesaid requirement of specificity of a legal act. Thus, a grantor cannot grant a security over all his assets or over after-acquired assets in general. The only exception to this rule would be the case when certain immovable assets are to be acquired by a grantor in the near future, or subject to a condition, and such assets can be properly specified. In such cases, a future agreement on creation of mortgage may be concluded between a creditor and a grantor, which would give the creditor a right to create a security over such assets.

In this regard, it should be noted that the created pre-emptive right to purchase immovable property to be encumbered does not represent the restriction that disables creation of mortgage over such assets. The no-transfer clauses in agreements between the grantor and third parties also do not represent an obstacle preventing creation of a

mortgage, as the consequences of eventual breach of the commitment applies only between the parties to the agreement. The foregoing also may be stated in respect to the security transfer of a title.

Proceeds

The natural proceeds of mortgaged immovable assets are subject to a mortgage until they are separated from the asset. On the other hand, the proceeds from a disposition of the mortgaged asset (e.g., rent, purchase price) are not subject to the mortgage and would have to be pledged individually. The main reason for this is that a mortgage remains attached to the asset even if it is sold or otherwise disposed of.

The law is silent in respect to the proceeds in the case of a security transfer of title to immovables. Logically, the natural proceeds and proceeds from disposition of the asset should belong to the creditor as the owner of the asset, but different views exist in legal theory. Therefore, the regime of proceeds should be provided for in the security transfer agreement to avoid potential disputes in interpretations of this matter.

Security Agreement

Definition

A security agreement is an agreement between the creditor and the grantor that constitutes (but does not yet create) a security right.

There is a distinction between the security agreement that constitutes a mortgage as a non-possessory security right (which is governed by legal regime on property security rights), and an agreement that constitutes a security transfer of an asset (and where the general regime of a transfer agreement applies).

Minimum Content

The minimum content of a security agreement as required by law is nearly identical in both cases (i.e., mortgage and security transfer). The legislation sets forth the minimum content of a security agreement as follows:

- (1) Identification of the creditor and the grantor;
- (2) Specification of the claims to be secured; and
- (3) Specification of the encumbered assets.

Due to the general requirement of specificity of legal acts, the specification of the minimum required contents should be as detailed as possible, in order to enable unexchangeable identification by any third party.

Failure to include the minimum content in the agreement, or lack of specificity in the agreement, results in the security agreement being invalid.

Formalities

A security agreement constituting a mortgage over the immovable assets registered in the Real Estate Register, and an agreement on security transfer of a title to such immovables, both require a written form and must be signed by the parties. The signatures of the parties on the agreement must be verified in one of the manners prescribed by law (e.g., by a notary or by an attorney-at-law).

This condition of signature verification is not required for an agreement to be valid; however, it is required for the subsequent registration in the Real Estate Register. The written form may be substituted by an electronic form and an electronic signature, provided that the requirements set out by special law are met. However, in practice, the electronic form is almost never used for security agreements.

An agreement for the creation of a mortgage over immovable assets not registered in the Real Estate Register must be in the form of a notarial deed. This is a document in prescribed form (having the same minimum content as the regular security agreement), which is executed by a notary for a fee.

Dating security agreements is a common practice and can generally be recommended. The law, however, does not require stating a date on a security agreement, and the date of the agreement is not of any importance for the creation of the security right, save for one exception described in the following section.

Effects

An additional act is always required for creation of a mortgage over immovables, regardless of whether they are registered in the Real Estate Register.

A security agreement itself only constitutes contractual rights and obligations between the creditor and the grantor; it does not create a security right of the creditor over the immovable assets to be encumbered.

The security transfer of a title to immovable assets not registered in the Real Estate Register is effected only by a valid security agreement between the creditor and debtor.

Additional Requirements

In General

As mentioned above, the mere security agreement generally (with the given exception) does not suffice to create the proprietary effects of a security agreement, which can come into existence only after the additional requirements have been met.

Right of Disposition of Grantor

As a general rule, a disposition of immovable assets may be performed only by a person who is either the owner or has the owner's consent to dispose of such assets.

Therefore, immovable assets may be mortgaged only by a grantor who is the owner of the asset or has the consent of the owner. Furthermore, for the creation of a mortgage law, it is necessary to have the consent of a person who has other property rights that are incompatible with the mortgage. Until now, however, no one in legal theory or in practice has been able to define "other property rights incompatible with a mortgage".

Most commentators allege in concordance that neither the pre-emptive right nor the easement can be considered an incompatible right as such. An acquisition, in good faith, of legal rights concerning immovables is (in the majority of cases) excluded, as property rights are registered in the publicly accessible Real Estate Register (see text, below).

Transfer of Possession, Publicity, and Control

As noted above, an additional act is required for the creation of a security right over immovable assets. Such an additional act is based on publicity and is represented by registering the security right in:

- (1) The Pledge Register, in case of immovables that are not subject to registration in the Real Estate Register; and
- (2) The Real Estate Register, in case of the immovables that are subject to registration in the Real Estate Register.