

EFFICIENCY OF SECURITY RIGHTS VERSUS OWNERS' PROTECTION

Estonian Perspective

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BACKGROUND

General features of Estonian mortgage system (1)

- Detailed mortgage regulation in the Property Law Act from 1992)
- Estonian mortgage (*hüpoteeik*): a mixture of German *Grundschild* and *Hypothek*, non-accessory upon creation and extinguishment but strictly accessory upon enforcement
- Apparent similarities to the *Eurohypothec* project

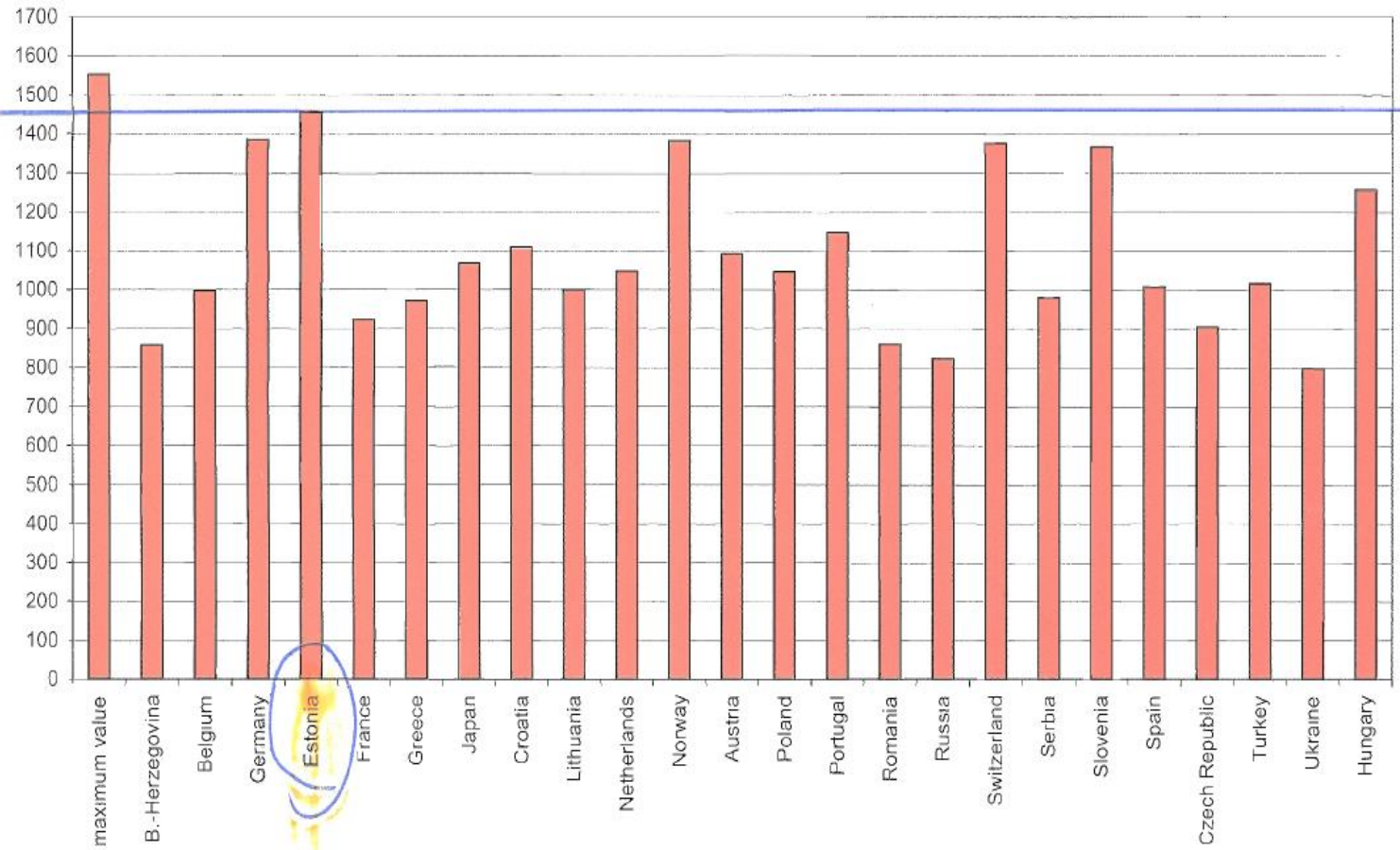
BACKGROUND

General features of Estonian mortgage system (2)

- Fair amount of court practice and theoretical literature
- Comparative solutions concepts and arguments from similar legal systems taken into account by courts where national law solution or concept is lacking or unclear. Concepts often borrowed from German property law
- The regulation is generally viewed as modern, flexible and mortgagee friendly: 2010 VDP study “Flexibility, Security and Efficiency of Security Rights over Real Property in Europe” (1st in “usability” ranking, 2nd behind Germany in overall ranking s. next slides)

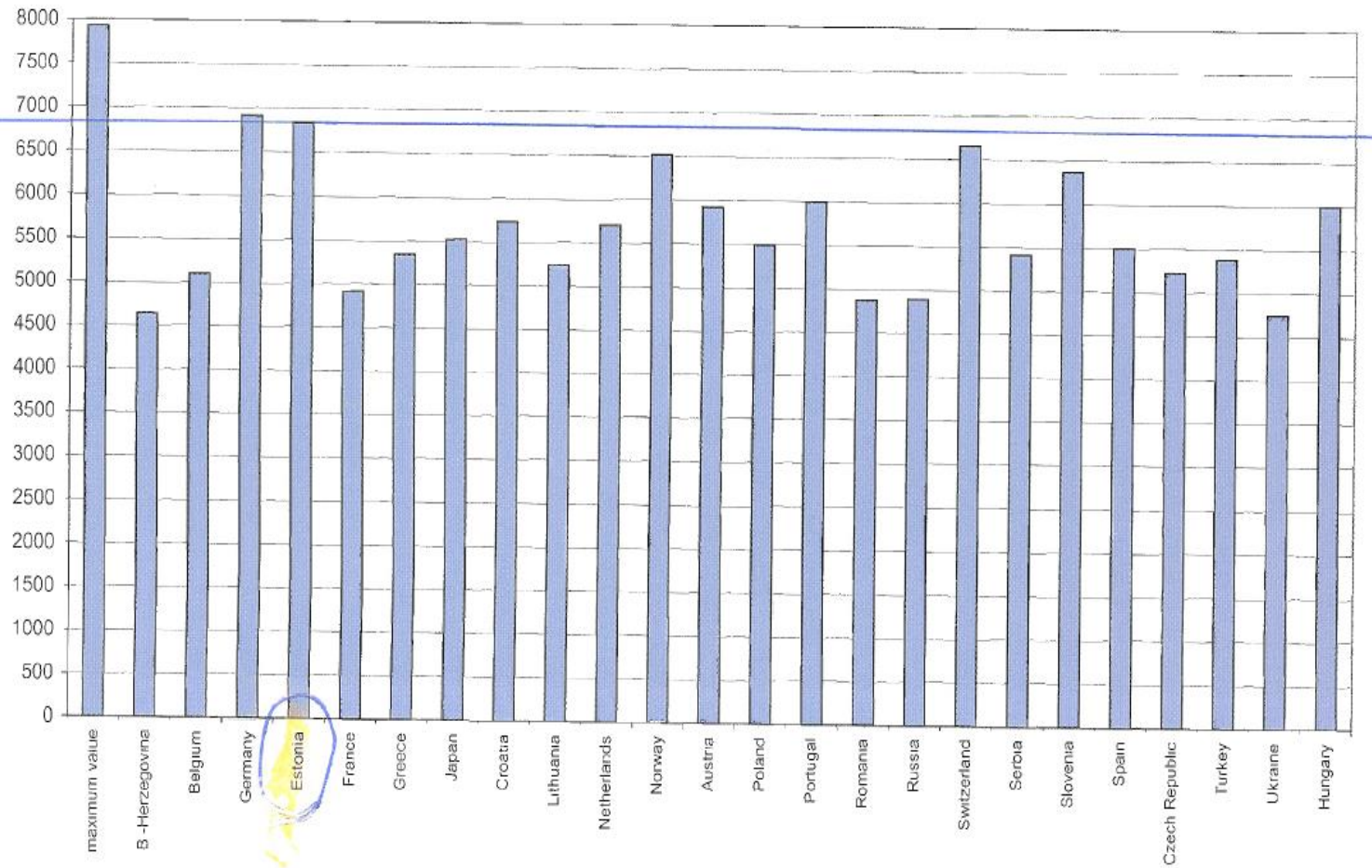
Round Table "Flexibility, Security and Efficiency of Security Rights over Real Property"

Complete findings - perspective of usability



Round Table "Flexibility, Security and Efficiency of Security Rights over Real Property"

Complete findings - total addition of all scores



SHIFT TO OWNERS' PROTECTION

Reasons and methods (legislation)

- Financial and housing crisis in 2007 and aftermath has resulted in no significant legislative developments
- Proposal to limit lender's personal liability under mortgage loans to the value of the mortgage was dropped (such new legislation to take effect in Latvia from 2015)
- The new debt restructuring legislation introduced after 2007 both for enterprises and individuals excludes mortgage loans from restructuring plans or enables restructuring of the unsecured part of the loan only

SHIFT TO OWNERS' PROTECTION

Reasons and methods (court practice)

- The aftermath of the financial and housing crisis brought about a considerable number of legal disputes on loans, loan restructurings, security and its enforcement
- Shift to more owners' protection is case law driven and attributable to general trend in court practice to more individual case justice
- This trend is largely driven by application of general private law concepts such as principle of “good faith and fair dealings” in the property law disputes

EXAMPLES

Over-Collateralisation Cases

- Over-collateralisation cases marked first instance where mortgage law provisions and mortgagees rights were limited for owner's protection purposes under good faith principle
- Structure of Estonian mortgage (non-accessoriness upon creation, strict accessoriness upon enforcement) requires the existence of the (legally) separate security agreement (*Sicherungsabrede*)
- In practice majority of security agreements for mortgages are entered to provide global security
- Keeping of security prohibited under good faith principle if no or insignificant secured claims and emergence improbable in future or claims otherwise sufficiently secured

EXAMPLES

Restrictions to provision of global security

- Over-collateralisation cases provided basis for new case law on restrictions to global security
- In relation to **consumers** global security agreement for future claims is permitted only where such future claims are sufficiently specified, foreseeable to the owner and are reasonably connected to transaction or relationship for which security was initially given. Unspecified claims against third party cannot be secured
- Restrictions are less stringent for non-consumers i.e global security agreement is allowed in principle and may encompass any and all claims. Conditions for providing security for claims against third party (incl. intra group) remain unclear

EXAMPLES

Pre-contractual information duties (1)

- Creditor's pre-contractual duty to establish creditworthiness and provide information to consumers introduced due to new consumer credit directive
- Unclear if this amounted to change of law as Estonian law general pre-contractual information duties derived from the good faith principle
- Breach by the creditor entitles the lender to demand reinstatement of the situation which had existed, had the pre-contractual duties not been breached (claim for damages)
- This has effectively amounted to claims to release the lender from its obligations under credit agreement (negative creditworthiness check is deemed to result in prohibition to provide new credits)

EXAMPLES

Pre-contractual information duties (2)

- Pre-contractual duty to establish creditworthiness and provide information is not limited to consumer credits
- Due to existence of general pre-contractual duties same obligations exist vis a vis to non-consumer lenders
- In a recent case it was found that upon refinancing of a credit provided to the lender that was in financial difficulties, the professional creditor did not act in good faith where it offered an expensive refinancing package under unfavourable conditions which the lender was unable to fulfil

EXAMPLES

Pre-contractual duties upon acquisition of security

- It took the courts one step further to recognise that the same general pre-contractual duties also existed upon creation of security i.e recognition of the pre-contractual duties of the secured party towards the owner
- In addition to the pre-contractual duties towards the lender the duties towards the owner are relevant where security is not provided by principal debtor
- In general it is recognised that the secured party acts in bad faith if it fails to disclose to the owner the specific risks related to the lender or the credit that is secured or refinances the credit under unfavourable conditions which leads to additional costs, covered by security

THANK YOU!



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