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MORTGAGE INSTITUTION AND POSSIBILITIES OF IMPROVEMENT THEREOF IN THE LATVIAN LAW

Summary of the Doctoral Thesis
for obtaining the degree of a Doctor of Law

Subsection – Civil Law

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Defence of the Doctoral Thesis will take place at the public session of the Doctoral Council of Legal Sciences on 27 June 2017 at 14.00 in Hippocrates Lecture Theatre, 16 Dzirciema Street, Rīga Stradiņš University.

Doctoral Thesis is available in the RSU library of and at RSU webpage: www.rsu.lv.

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INTRODUCTION

The latest financial crisis (2008–2013) highlighted the utmost importance of financial stability in ensuring stability of the fiscal system and national economy, where financial stability of credit institutions specifically play the key role. The core basis of transactions conducted by the credit institutions is acceptance of deposits at lower interest rates and lending at higher interest rates, thus ensuring their revenues from the difference. These two financial services in particular – deposits and loans – are the most important transactions of credit institutions, whereupon the very existence of credit institutions depends, not only their revenues. Furthermore, security of deposits made by depositors is directly linked to security of loans, i.e. how the loans will be repaid – whether they will be repaid in due time, and whether they will be promptly monitored if overdue, as well as whether they will be recovered, if borrowers fail to repay the loans.

A loan security serves as an instrument for securing the loan in a form of pledge or guarantee. A mortgage over a real property is the most widely used type of security interest, and the mortgage therefore plays a crucial role in lending and development of the entire national economy, as well as financial stability.

Topicality of the topic is based on the following aspects:

1. Mortgage is the key type of pledges in the national economy. If a stable mortgage institution exists, a stable and sustainable lending is possible.

2. Even though, in general, the mortgage institution is stable in the Latvian law and serves its purpose, there are many deficiencies in the legal framework concerning the mortgage institution, which can be eliminated by amendments to the laws and regulations.

3. Strengthening of the mortgage institution would be a significant contribution not only to development and sustainability of lending, but also

improvement of the investment environment. As noted by economists of the Bank of Latvia, in order to prevent persistence of weak lending, more extensive measures of the economic policy are required that would form a foundation for sustainable development of lending and improve confidence. Among other, it is important to develop an environment attractive for investments, improve operations of the courts and protection of the rights of investors.[1]

Scientific novelty of the research stems from complex research of underlying issues of the mortgage institution and enforcement of mortgage both in terms of procedures of execution in respect to real properties (under civil procedure) and in respect to satisfaction of creditors' claims in insolvency proceedings.

The doctoral thesis is a complete scientific research. During the research process the author consecutively reviews historical background for development of the mortgage institution and reception (*receptio*) thereof, contents of the mortgage institution, and its impact on enforcement of a mortgage, as well as the issues existing in practice. An added value of the research is the practical experience of the author in law after 12 years in the banking sector, as well as experience of several years as an in-house counsel in business companies, which use banking services.

In his doctoral thesis the author researches, analyses, and lodges his own proposals for amendments to the law in order to resolve such issues that have not been resolved yet, namely: 1) solution of the problem caused by fictitious employment agreements aimed at circumventing mortgagees (hereinafter also interchangeably referred to as a "mortgage lenders"); 2) solution of the problem with limitation period of creditors' claims; 3) solution of the problem with

[1] Finanšu Stabilitātes Pārskats 2016. Latvijas Banka (*Report on Financial Stability 2016. Bank of Latvia*). Available on: https://www.makroekonomika.lv/sites/default/files/fsp_2016_1.pdf [Accessed 07.11.2016.].

archaic nature of real burdens; 4) solution of the problem with the mandatory requirement to offer non-recourse loans to potential borrowers (consumers); 5) solution of the problem with accessority of a third-party mortgage; 6) solution of the problem with enforcement of a claim of a lender (hereinafter interchangeably also referred to as a "creditor") secured by third-party obligations in insolvency proceedings; 7) solution of the problem with absence of right of the pledgor to review information about the debtor's debts.

The research is crucial for development of the civil law in legal science. The author suggests an innovative solution for the majority of issues listed above. Moreover, the thesis is not only one of the latest researches in the legal science, but also the only scientific research currently, which focuses on the mortgage institution and related issues in an in-depth and complex manner.

Scientific and practical value of the present doctoral thesis is a possibility to use it as a source of reference about the mortgage institution and its issues by legal practitioners – judges, attorneys-at-law, bailiffs, insolvency administrators, and in-house counsels of credit institutions, business entities etc. The research paper can be also used for theoretical training of the students of law, especially study courses in the Property Law, Insolvency Law, and Civil Procedure. The key practical significance of the research lies in the legislative sector – the research can be used as a foundation for amendments to the laws and regulations for the purpose to consolidate the mortgage institution.

Objective of the research is to prepare a scientific justification for strengthening of the mortgage institution and prevention of issues in a form of amendments to the laws and regulations.

The following **tasks** were set to accomplish the objective of the doctoral thesis:

1. Perform study and description of the historical development of the mortgage institution – from the classical Roman law period (1st through 3rd centuries) until nowadays.

2. Perform study of the mortgage institution in terms of its contents.
3. Perform comparative study of the mortgage institution in the USA, where legal framework of non-recourse mortgages exists in individual states.
4. Analyse legal doctrine in the light of mortgage institution.
5. Analyse case law in matters related to mortgages.
6. Establish issues and raise proposals for the elimination of them.

Object of the research is the system of relations among legal subjects existent in the civil legal system, where the mortgage institution is incorporated. **The subject of the research** is the legal framework governing the mortgage institution.

Questions of the research are raised for the purpose to accomplish the objective of the research:

1. How has the mortgage institution developed historically, and how is it transposed in the Latvian law?
2. What is the content of the mortgage institution: purpose, principles, process of implementation, and whether any improvements are necessary in these elements of contents of the mortgage institution?
3. What is the legal framework governing non-recourse mortgage loans in USA, and whether the legal framework introduced in Latvia should be deemed to be the legal framework of non-recourse mortgages?
4. What are possible courses of action and possibilities for improvement of the mortgage institution in the Latvian law?

Methods of the research. In order to accomplish the tasks set in the doctoral thesis and achieve the objective of the doctoral thesis, the author uses general methods of scientific research in his research: historical method, analysis, abstraction, comparative method, inductive and deductive method, as

well as methods for interpretation of the legal provisions: theological, systemic, historical and grammatical method of interpretation.

Approbation and publication of findings of the doctoral thesis. Findings of the research have been approbated at various conferences and in different publications, by presenting individual issues and possible solutions of them:

Table 1

Approbation of Findings of the Doctoral Thesis

Oral presentations at scientific conferences on local scale, in Latvia	
1.	12.02.2014: Presenting at the 72nd Conference of the University of Latvia paper "**Enforcement of a Mortgage for Third-Party Obligations in Insolvency Proceedings" (*Hipotēkas par svešu saistību īstenošana maksātnespējas procesā*)**.
2.	11.04.2014: Presenting at the 13th scientific conference of the Riga Stradiņš University paper "**Protection of a Good-Faith Mortgagee**" (***Labticīga hipotēkas ņēmēja aizsardzība*)**.
3.	27.03.2015: Presenting at the scientific conference of the Riga Stradiņš University of 2015 paper "**Conformity of Article 147(6) of the Insolvency Act to the Principle of Equality**" (***Maksātnespējas likuma 147. panta sestās daļas atbilstība vienlīdzības principam***).
Oral presentations at international scientific conferences	
1.	11.04.2014: Presenting at the 56th international conference of the University of Daugavpils paper "**Legal Planning Documents concerning the Mortgage Institution**" (***Tiesiskās plānošanas dokumenti saistībā ar hipotēkas institūtu***).
2.	23.04.2014: Participation at the international practical conference of the Riga Stradiņš University "**Legal Policy for Development of General Public" (*Tiesiskā politika sabiedrības attīstībai*) with presentation "Certain Possibilities for Improvement of Guarantee**" (***Atsevišķas galvojuma pilnveidošanas iespējas***).
3.	15.05.2014: Presenting at IV international scientific and practical conference of young researchers and students "**Challenges and Time of Opportunities: Problems, Solutions, Prospects" (*Izaicinājumi un iespēju laiks: problēmas, risinājumi, perspektīvas*)** organized by the Baltic International Academy, paper **"Non-Recourse Mortgage Loans in USA**" (***Bez regresa hipotekārie kredīti ASV***).

Table 1 continued

4.	27.11.2014: Presenting at the international interdisciplinary conference "Society Health Welfare" by the Riga Stradiņš University paper "**Housing Support Program – Hopes and Reality**" (***Mājokļa atbalsta programma – cerības un realitāte***).
5.	12.12.2014: Presenting at the international scientific and practical conference "Transformation Process in the Law, Regional Economy and Economic Policy: Current Issues of Economic and Political, and Legal Relations" organized by the Baltic International Academy, paper "**Conformity of Amendments to Article 147 of the Insolvency Act to Article 105 of the Constitution (*Satversme*) of the Republic of Latvia**" (***Maksātnespējas likuma 147.panta grozījumu atbilstība LR Satversmes 105.pantam***).
6.	17.04.2015: Presenting at the 57th international conference of the University of Daugavpils paper "**Formation of Mortgage in the Roman Law**" (***Hipotēkas izveidošanās romiešu tiesībās***).
7.	23.04.2015: Presenting at the international scientific conference "Current Issues of Consolidation of Security: Political, Social, and Legal Aspects" by the Riga Stradiņš University, paper "**Importance of Financial Education of Residents in guaranteeing Financial Security**" (***Iedzīvotāju finanšu izglītošanas nozīmīgums finanšu drošības garantēšanā***).
8.	03.07.2015: Presenting at "Second European Academic Research Conference on Global Business, Economics, Finance and Banking" Zurich, Switzerland, paper "**Banking Loan Recovery Issues in Latvia**".
9.	11.12.2015: Presenting at IV international scientific and applied conference "Transformation Process in the Law, Regional Economy and Economic Policy: Current Issues of Economic and Political, and Legal Relations" organized by the Baltic International Academy, paper "**Exceptions to the Principle of Accessority of the Guarantee**" (***Galvojuma akcesoritātes principa izņēmumi***).
10.	20.04.2016: Presenting at the international scientific and applied conference "New challenges of the Modern Society in Consolidation of Security: Actual Status and Prospects" by the Riga Stradiņš University, paper "**Issues of Fictitious Lease Agreements**" (***Fiktīvu īres līgumu problemātika***).
11.	23.08.2016: Presenting at "3rd International Multidisciplinary Scientific Conference on Social Sciences & Arts SGEM 2016" in Albena, Bulgaria, paper "**Real Encumbrance Institution in Civil Law of the Republic of Latvia**".
12.	23.08.2016: Presenting at „3rd International Multidisciplinary Scientific Conference on Social Sciences & Arts SGEM 2016" in Albena, Bulgaria, paper "**Fictitious Lease Agreements Issue in Loan Recovery Processes in Latvia**".
13.	24.11.2017: Presenting at conference "6th International interdisciplinary scientific conference 'Society. Health. Welfare 2016'" organized by the Riga Stradiņš University paper "**Fictitious Employment Contracts Issue in Loan Recovery Processes in Latvia**".

Table 1 continued

Publications (theses) in articles of conferences of local scale
1. "**Protection of a Good-Faith Mortgagee**" (***Labticīga hipotēkas ņēmēja aizsardzība***) – theses of the 13th scientific conference of the Riga Stradiņš University of 10.-11.04.2014. Available: http://www.rsu.lv/images/stories/zk2014/Labticiga_hipotekas_nemeja_aizsardziba.pdf (ISBN 978-9984-793-52-8)
2. "**Certain Possibilities for Improvement of a Guarantee**" (***Atsevišķas galvojuma pilnveidošanas iespējas***) – theses of the scientific conference of the Riga Stradiņš University of 23.04.2014 "*Legal policy for development of the general public*". Available: http://www.rsu.lv/eng/images/Documents/Publications/legal_policy_conference_abstracts.pdf (ISBN 978-9984-793-55-9; p. 65.-67.).
3. "**Conformity of Article 147(6) of the Insolvency Act to the Principle of Equality**" (***Maksātnespējas likuma 147. panta sestās daļas atbilstība vienlīdzības principam***) – theses of the scientific conference of 2015 of the Riga Stradiņš University dated 27.03.2015. Available: http://www.rsu.lv/images/stories/zk2015/maksatnespejas_likums_147_pants_vienlidzibas_princips.pdf.
4. "**Formation of Mortgage in the Roman law**" (***Hipotēkas izveidošanās romiešu tiesībās***) – theses of the 57th international scientific conference of the University of Daugavpils of 17.04.2015. Available: http://dukonference.lv/files/proceedings_of_conf/2015_978-9984-14-716-1_DU_57_starpt%20zinatn_konf_tezes.pdf (ISBN 978-9984-14-716-1; p. 71).
5. **"Importance of Financial Education of Residents in guaranteeing Financial Security**" (***Iedzīvotāju finanšu izglītošanas nozīmīgums finanšu drošības garantēšanā***) – theses of the RSU international scientific conference of the Riga Stradiņš University dated 23.04.2015. Available: www.rsu.lv/images/stories/dokumenti/bukleti/drosibas_nostiprinasana_konf_tezes_apr2015.pdf (ISBN 978-9984-793-72- 6; p. 79.-80.).
Publication (article) in a collected articles of an international conference outside Latvia
1. Presentation "**Banking Loan Recovery Issues in Latvia**" is published in the collection of scientific articles of conference "Second European Academic Research Conference on Global Business, Economics, Finance and Banking". Available: http://globalbizresearch.org/Swiss_Conference/Conference_Papers.php (ISBN: 978-1-63415-477-2).
Publications (articles) in peer review editions in Latvia and abroad
1. Publication of article "**Non-Recourse Mortgage Loans in USA**" (***Bez regresa hipotekārie kredīti ASV***) in the collected articles of IV international scientific and applied conference of young researchers and students "Challenges and Time of Opportunities: Issues, Solutions, and Prospects" organized by the Baltic International Academy (ISBN code 978-9984-47-091-7).

2.	Article "**Legal Planning Documents concerning the Mortgage Institution**" (***Tiesiskās plānošanas dokumenti saistībā ar hipotēkas institūtu***) published in the collected articles of the 56th international scientific conference of the University of Daugavpils. Available: http://www.dukonference.lv/files/proceedings_of_conf/978-9984-14-702-4_56%20konf%20kraj_B_Soc%20zin.pdf (ISBN 978-9984-14-702-4; p. 174.-180.). **Included in the database of EBSCO Host**.
3.	Article "**Conformity of Amendments to Article 147 of the Insolvency Act to Article 105 of the Constitution (*Satversme*) of the Republic of Latvia**" (***Maksātnespējas likuma 147.panta grozījumu atbilstība LR Satversmes 105.pantam***) published in the collected articles of III International Scientific and Practical Conference "Transformation Process in the Law, Regional Economy and Economic Policy: Current Issues of Economic and Political, and Legal Relations" organized by the Baltic International Academy (ISBN 978-9984-47-099-3).
4.	Article "**Exceptions to the Principle of Accessority of the Guarantee**" (***Hipotēkas akcesoritātes principa izņēmumi***) published in the collected articles of the international scientific forum, XVI International Scientific Conference at the Business Graduate School "Turība" – "Wise, sustainable and engaging Europe: challenge for development". Available: http://www.turiba.lv/f/XVI_konf.raksti_FINAL.pdf (ISSN 1691-6069; p. 238.-245.). **Included in the database of EBSCO Host**.
5.	Article "**Exceptions to the Principle of Accessority of the Guarantee**" (***Galvojuma akcesoritātes principa izņēmumi***) published in the collected articles of IV international and applied conference "Transformation process in the law, regional economy and economic policy: current issues of economic and political, and legal relations". Available: http://bsa.edu.lv/docs/konf11122015.pdf (ISBN 978-9984-47-108-2, p. 305.-310.).
6.	Article "**Fictitious Lease Agreements Issue in Loan Recovery Processes in Latvia**" published in the collected articles of the 3rd International Multidisciplinary Scientific Conference on Social Sciences & Arts SGEM 2016 (ISBN 978-619-7105-73-5, ISSN 2367-5659; p. 631.-638.), to be **posted in Thomson Reuters, ISI Web of Knowledge, ISI Web of Science, CrossRef, ProQuest, EBSCOHost and Google Scholar databases**.
7.	Article "**Real Encumbrance Institution in Civil Law of the Republic of Latvia**" published in the collected articles of the 3rd International Multidisciplinary Scientific Conference on Social Sciences & Arts SGEM 2016" (ISBN 978-619-7105-73-5, ISSN 2367-5659; p. 761.-768) to be **posted in Thomson Reuters, ISI Web of Knowledge, ISI Web of Science, CrossRef, ProQuest, EBSCOHost and Google Scholar databases**.
8.	Article "**Fictitious Employment Contracts Issue in Loan Recovery Processes in Latvia**" is accepted for publication in the collected articles of the 6th International interdisciplinary scientific conference "Society. Health. Welfare 2016" organized by the Riga Stradiņš University, which will be posted in the **database of Thomson Reuters**.

Findings of the doctoral thesis are not only approbated in scientific conferences and collected articles, but also tried in practice. The author is actively involved in the Latvian Association of Commercial Banks representing interests of members (banks) of the association in various legislative workgroups, including the workgroup established by the Ministry of Justice for amending the Insolvency Act. One initiative of the author in respect to the status of a secured creditor in insolvency proceedings[2] is incorporated and adopted in paragraph one of Article 7 of the Insolvency Act[3] by the amendments to the Insolvency Act of 25 September 2014.[4]

The proposals for amendments to the laws and regulations promoted in the doctoral thesis have been submitted by the author to the Latvian Association of Commercial Banks, which will forward them to the workgroups formed by competent ministries (Ministry of Justice, Ministry of Economics, and Ministry of Finance) and to the responsible commissions of Saeima (Parliament) (Legal Commission and Commission of National Economy, Agricultural, Environmental and Regional Policy). The author himself will take part at the meetings of these workgroups in order to achieve incorporation of relevant amendments to the laws and regulations by way of legislation.

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[2] Establish that the status of the secured creditor shall be applicable not only to obligations of the insolvent debtor, but also to third-party obligations, as well as stipulate that a public pledge over the debtor's property specifically (irrespective of how the obligations are secured – debtor's or those of the third party) forms grounds for bestowing the status of the secured creditor on the lender.

[3] Maksātnespējas likums: Latvijas Republikas likums (*Insolvency Act: Act of the Republic of Latvia*). *Latvijas Vēstnesis,* 124 (4316), 06.08.2010.

[4] Grozījumi Maksātnespējas likumā: Latvijas Republikas likums (*Amendments to the Insolvency Act: Act of the Republic of Latvia*). *Latvijas Vēstnesis,* 204 (5264), 15.10.2014.

1. HISTORICAL DEVELOPMENT OF THE MORTGAGE INSTITUTION AND CONTENTS OF THE MORTGAGE INSTITUTION

1.1. History of the Mortgage Institution

The classical Roman law (1st through 3rd centuries)[5] saw formation of a right of pledge institution – *hypotheca*[6] or mortgage. The idea of a mortgage as an actual security interest irrespective of possession by a lender was, probably, borrowed from Greece. Romans new about the Greek mortgage, saw it in practice in the provinces, and unambiguously adopted the Greek word *hypothec*.[7] In the beginning it meant white[8] pillars erected along boundaries of a land plot to publicly demarcate that the respective piece of land is pledged. No corroboration in its present sense existed in the Ancient Greece and Ancient Rome. To ensure the principle of publicity and prevent invasion on the interests of third parties, who had no way of knowing about mortgaging in each individual case the said stone pillars were erected, thus forming the so-called "actual corroboration".[9] The stone pillars had the amount of debt inscribed on them, and they were erected by the lenders.[10]

A mortgage could be established on the basis of a simple agreement between the debtor and the creditor about imposing a lien on an item without

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[5] Kalniņš V. *Romiešu civiltiesību pamati*. 1977. gadā publicētās grāmatas faksimilizdevums. Rīga: Apgāds Zvaigzne ABC, 2010, 26., 124. lpp.

[6] Kalniņš V. *Romiešu ķīlu tiesību attīstība*. Jurists, 01.03.1939., Nr. 3/4 (97/98), 49. sleja.

[7] Jackson T.C. *Justian's Digest (Book 20) with an English Translation and an Essay on the Law of Mortgage in the Roman Law*. London: Sweet and Maxwell, Limited, 1908. Reproduction: Lavergne: Gale, 2014, p. xxviii.

[8] Čakste K. *Civiltiesības. Lekcijas. Raksti*. Rīga: Zvaigzne ABC, 2011, 123. lpp.

[9] Sinaiskis V. *Latvijas civiltiesību apskats. Lietu tiesības*. Rīga: L.U. Studentu padomes grāmatnīcas izdevums, 1940, 58. lpp.

[10] Grīns A. (red.). *Pasaules vēsture*. I daļa. Senie laiki. Rīga: Grāmatu draugs, 1929, 175. lpp.

handing over the item itself. During the period of lien the item remained in the hands of the debtor – in freehold and possession, which allowed him to still use it in economic operations.[11]

Several mortgages could be created over one and the same item, such as property, building – in favour of one lender, another one, and a third one, etc. Without prejudice to such repeated mortgage, which was often necessary in various economic transactions, the Roman law introduced a principle of priority – chronologically the first mortgage was satisfied, then the second one, etc.[12]

Having assessed the mortgage institution in the light of the right of pledge, it can be acknowledged to be the right of pledge in the fullest sense of this notion. It clearly shows it being inherent to the property law (right in rem to another person's property), as well as its accessory nature (dependence on existence of a debt obligation).[13] The main difference between modern mortgage and a mortgage incorporated in the Roman law is the subject-matter of the mortgage: in the Roman law the subject-matter of mortgage could be both movable and immovable property, whereas nowadays only immovable property (real estate) can be a subject-matter of the mortgage.

Transposition and practical application of the Roman law in the continental Europe (at the dawn of formation of the Romano-Germanic legal system) unfolded in three stages: 1) until the 13th century elements of the legal culture of Romans remained in the southern Europe; simplified sources of the Roman law were used (such as the Breviary of Alaric adopted by the Visigoth King Alaric II); 2) in 13th–17th century (university stage) – Roman law was studied and presented at the universities of Northern Italy based on the Code of

[11] Kalniņš V. *Romiešu civiltiesību pamati*. 1977. gadā publicētās grāmatas faksimilizdevums. Rīga: Apgāds Zvaigzne ABC, 2010, 124. lpp.
[12] Покровский И.А. *История римского права*. Available on: http://civil.consultant.ru/elib/books/25/page_42.html [Accessed 17.03.2016.].
[13] Kalniņš V. *Romiešu ķīlu tiesību attīstība*. Jurists, 01.03.1939., Nr. 3/4 (97/98), 53. sleja.

Justinian (*Corpus Juris Civilis*); Roman schools of law emerged; in the 14th through 15th centuries the Roman law was recognized as valid in the Western Europe, where it was either adapted (postglossators/commentators) or fully transposed (as in Germany); 3) after the revolutions in Europe of the 17th and 18th centuries institutes of the Roman law were adopted the law of European countries (such as the Napoleon's civil code in the early 19th century).[14]

On 12 November 1864, Russian tsar Alexander II approved Part Three of the Collection of Law in the Baltic Provinces drafted by Friedrich Georg von Bunge, professor at the University of Tartu (*Universität Dorpat*) – Private/Civil Law of Livonia, Estonia and Courland (in German – Liv-Est-und Curlaendisches Privatrecht, in Russian – Сводъ гражданскихъ узаконеній губерній Остзейскихъ).[15] According to orders of the Emperor, Part Three of the Collection of Law of the Baltic Provinces, or the Collection of Local Civil Law, came into effect on 1 July 1865.[16]

The key source of the Collection of Local Civil Law was the Roman law and Pandectae.[17] The Collection of Local Civil Law compiled by Bunge consisted of 4,600 articles, of which 2,882 articles contained provisions of the Roman law.[18]

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[14] Lazdiņš J., Osipova S. *Latvijas un Eiropas viduslaiku tiesību vēsturē sastopamie jēdzieni un to skaidrojumi*. Rīga: LU tipogrāfija, 1996, 14. lpp.
[15] Gailīte D. *Frīdrihs Georgs fon Bunge*. Jurista Vārds, 11.11.2014., Nr. 44/45 (846/847), 10. lpp.
[16] Пахман С. В. *Исторія кодификаціи гражданскаго права въ двухъ томахъ*. Томъ II. С.-Петербургъ, 1876, 346. стр.
[17] Lazdiņš J. *Baltijas Civillikums laikmetu griežos: likuma pieņemšanas 150 gadu jubilejas atcerei*. Jurista Vārds, 11.11.2014., Nr. 44/45 (846/847), 20. lpp.
[18] Sal.: Švābe A. *Jaunais Civīllikums latvju tiesību vēstures gaismā. Prezidenta Ulmaņa Civīllikums*. Rakstu krājums. Rīga: Pagalms, 1938, 109. lpp.; Kalniņš V. *Romiešu tiesību nozīme mūsu laikos*. Novilkums. Jurists, 1939., Nr. 7/8(101/102), Rīga: b.i., 1940, 18. lpp.

The Civil Act of the Republic of Latvia adopted on 28 January 1937[19] (hereinafter referred to as the Civil Act) was developed on the basis of the Collection of Local Civil Law,[20] and after restoration of the independence of Latvia was restored in 1992 and 1993 by three individual acts accordingly.[21] Thus, the currently effective Civil Act, for the most part, is comprised of the Roman law institutions, including the mortgage institution.

1.2. Role of a Mortgage in the System of Pledges and Consequences of the Mortgage

The mortgage is subject to not only special legal provisions and special principles of mortgage but also those norms and principles of law, which are common for all right of pledges.[22]

Article 1278 of the Civil Act stipulates that a right of pledge is such right in regard to property of another as on the basis of which the property secures the claim of a lender (creditor) so that the lender is able to receive

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[19] Latvijas Republikas likums Civillikums (*Act of the Republic of Latvia: Civil Act)*. *Valdības Vēstnesis*, 41, 20.02.1937.

[20] Kalniņš E. *Ievads grāmatai: Vīnzarājs N. Civiltiesību problēmas. Raksti (1932.-1939.)*. Rīga: Erlena Kalniņa un Viktora Tihonova izdevums, 2000, 10.lpp.

[21] Likums „Par atjaunotā Latvijas Republikas 1937. gada Civillikuma ievada, mantojuma tiesību un lietu tiesību daļas spēkā stāšanās laiku un kārtību": Latvijas Republikas likums (*Act "On Date and Procedure for Introduction, Inheritance Law and Property Law Sections of the Restored Civil Act of 1937 of the Republic of Latvia coming into Effect": Act of the Republic of Latvia*). *Ziņotājs*. 29/31, 30.07.1992.; likums „Par atjaunotā Latvijas Republikas 1937. gada Civillikuma saistību tiesību daļas spēkā stāšanās laiku un kārtību": Latvijas Republikas likums (*Act "On Date and Procedure for Obligation Law Section of the Restored Civil Act of 1937 of the Republic of Latvia coming into Effect": Act of the Republic of Latvia*). *Ziņotājs*. 1/2, 14.01.1993.; likums „Par atjaunotā Latvijas Republikas 1937. gada Civillikuma ģimenes tiesību daļas spēkā stāšanās laiku un kārtību": Latvijas Republikas likums (*Act "On Date and Procedure for Family Law Section of the Restored Civil Act of 1937 of the Republic of Latvia coming into Effect": Act of the Republic of Latvia*). *Latvijas Vēstnesis,* 35, 08.06.1993., *Ziņotājs*, 22/23, 10.06.1993.

[22] Besides the mortgage, also a commercial pledge, *antichresis*, possessory lien, financial collateral, and ship mortgage.

a payment for such claim from the property. It is clear from the above definition that **the purpose of the right of pledge is to secure a claim in such a way that the lender (creditor) may receive a payment based on such claim.** It creates an actual security interest, unlike the personal securities.[23]

The mortgage is most common type of pledge. It is due to the fact that the mortgage is used as one of the safest pledges in bank lending transactions. From early 1993 until 16 January 2017, 630,899 corroboration requests have been submitted to the Land Register for corroboration (perfection) of mortgages.[24] Conversely, the second most commonly used type of pledges is a commercial pledge – 177,175 commercial pledges have been registered since 1998.[25] In comparison, 624,769 corroboration requests have been submitted for corroboration of mortgages since 1998,[26] i.e., 3.5 times more than commercial pledges were created.

As one of the types of right of pledge, the mortgage has both its own legal principles and common legal principles of the right of pledge, which stipulate both contents and procedure for enforcement of the mortgage as a pledge.

A. Principle of accessority of the pledge. Right of pledge differs from other rights in rem due to the fact that they are of merely accessory (ancillary) nature, i.e., they cannot exist on their own. They cannot be imagined apart from the claim, because their objective is to secure the claim, and therefore the right

[23] Čakste K. Civiltiesības. Lekcijas. Raksti. Rīga: Zvaigzne ABC, 2011, 123. lpp.
[24] Statistika par darījumiem zemesgrāmatu nodaļās. Valsts vienotā datorizētā zemesgrāmata (*Statistics about transaction in land registry departments. State Uniform Computerized Land Register*). Available on: https://www.zemesgramata.lv/lv/Home/Statistics [Accessed 16.01.2017.].
[25] Komercķīlu reģistrācijas dinamika. Lursoft statistika. (*Dynamics of registration of commercial pledges. Lursoft statistics*). Available on: https://www.lursoft.lv/lursoft_statistika/?&id=63 [Accessed 16.01.2017.].
[26] Statistika par darījumiem zemesgrāmatu nodaļās. Valsts vienotā datorizētā zemesgrāmata (*Statistics about transaction in land registry departments. State Uniform Computerized Land Register*). Available on: https://www.zemesgramata.lv/lv/Home/Statistics [Accessed 16.01.2017.].

of pledge exists insofar the claim itself exists – if the claim ceases to exist, the right of pledge ceases either.[27]

B. Principle of indivisibility of the pledge. The right of pledge remains effective until full satisfaction of the lender, for whom, after a partial payment is made, the pledge therefore still secures the outstanding part of the debt. If a claim is secured by security interest (right of pledge) in several items, and it is secured only partially, the lender retains the security interest to all pledged items due to the fact that each of them in the entire body secures his claim (Articles 1286 and 1287 of the Civil Act).[28]

C. Principle of absolutism of the pledge. Arising on the structure of the right of pledge in the Roman law, the right of pledge in respect to the pledged object is *ius in re aliena* (right in rem to the other's property – from the Latin language). That means that the lender holds the right in rem to enforce his claim through sale of the pledged item. The right of pledge for the lender is a legal possibility to enforce the security, irrespective of who has the security in possession. This legal possibility of the lender is absolute. Due to this reason the right of pledge (security interest) over the real property has to be registered with public land registers.[29]

D. Autonomous nature of the obligation. The obligation between parties is always independent – its validity is not affected by existence or nonexistence of securities. The securities, irrespective of their type (real (tangible) – pledges, including mortgages; relative (personal) – surety, earnest money, contractual penalty) are always ancillary rights, i.e., accessory rights. If the obligation is performed, the securities cease to exist as well.

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[27] Lēbers A. *Civiltiesības un civilprocess: kara juridiskos kursos lasīto lekciju konspekts*. Rīga: 1921, p. 56.
[28] Sinaiskis *V. Latvijas civiltiesību apskats. Lietu tiesības. Saistību tiesības*. Rīga: Latvijas juristu biedrība, 1995, p. 77.
[29] *Ibid*., p. 76.

E. Scope of liability under the pledge. Pursuant to Article 1290 of the Civil Act, unless specifically agreed otherwise, a right of pledge shall not only secure the principal claim but also its associated ancillary claims. A crucial principle of the right of pledge stems from the said – the right of pledge secures both the principal claim and the ancillary claims related thereto: interest, inherent expenses,[30] contractual penalty, and losses.

F. Priority right of the mortgage. Several lenders may rely on a single object of pledge. A priority right of lenders (creditors) needs to be discerned in respect to the mortgage ranking them the first, second, third etc.; the lender who has corroborated its right with the Land Register earlier has the priority.[31]

No misunderstandings for the previous lenders can result from corroboration of new, later mortgages with the Land Register, because, upon sale of the property at a public auction, the claims secured by mortgages are satisfied based on the priority right, which is established according to the time the mortgage has been corroborated with records of the Land Register.[32] That means that earlier mortgages are satisfied before later ones.

G. Principle of public credibility of the Land Register. In accordance with Article 1 of the Land Registry Act,[33] real properties are entered into the Land Register and rights related thereto are corroborated there. The Land Register is available to everyone, and its entries enjoy public credibility.

H. Principle of specification of the mortgage. The principle of specification of the mortgage is consolidated in Article 1373 of the Civil Act, stipulating that the mortgage shall be registered with the Land Register in respect to a specific real property, the owner of which is the pledger, as

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[30] Sinaiskis *V. Latvijas civiltiesību apskats. Lietu tiesības. Saistību tiesības*. Rīga: Latvijas juristu biedrība, 1995, p. 77.
[31] *Ibid.*
[32] Bukovskis V. *Civīlprocesa mācības grāmata*. Rīga: Autora izdevums, 1933, 633. lpp.
[33] Zemesgrāmatu likums: Latvijas Republikas likums (*Land Registry Act*: *Act of the Republic of Latvia*). *Ziņotājs*. 16, 29.04.1993., *Likumu un noteikumu krātuve*. 38, 30.12.1937.

recorded in the register. Stemming from the foregoing, a subject of the mortgage can be only an asset that can be individually identified, thus a general mortgage over the entire property is not allowed.[34]

Article 1278 of the Civil Act provides that the right of pledge (lien) is such right to another person's asset, on the basis of which such asset secures a claim for the lender so that he can receive payment under such claim therefrom. On the other hand, pursuant to Article 1319 of the Civil Act, a pledgee, who has not been satisfied by a debtor within the set period of time, may resort to the pledged property for satisfaction and, for this purpose, take all the necessary steps for its sale. Essence of the pledge stems from these fundamental provisions of the right of pledge – a security of the creditor's claim, which can be enforced by the creditor only in case the debtor fails to perform the obligation. Either these provisions or other general legal provisions governing the pledges, as well as special legal provisions governing the mortgage result in certain consequences inherent for the mortgage.

Legal consequences of the mortgage differ from the legal consequences of the right of pledge by a simplified possibility of proof, related expedient manner of collection and privileges in the insolvency proceedings. In light of the substantive law, the same disclaimers and legal remedies are allowed in these proceedings as well, just as in any proceedings concerning a security interest.[35]

The effect of corroboration of the mortgage with the Land Register is as follows: 1) occurrence of the rights in rem; 2) indisputable nature of the corroborated rights; 3) binding nature for everyone; 4) occurrence of the

[34] Краснокутский В. А. *Мѣстное гражданское право губерній прибалтійскихъ и привислянскихъ. Пособіе къ лекціямъ*. Москва: Типографія Императорскаго Московскаго Университета, 1910, 124. стр.
[35] Rozenfelds J. *Lietu tiesības.* 4. labotais, papildinātais izdevumus. Rīga: Zvaigzne ABC, 2011, 186. lpp.

priority right;[36] 6) right of the lender to initiate non-contentious compulsory enforcement of an obligation in case of default; 7) right of the creditor to sell the asset at a voluntary auction for a free price, if such a right is contracted in the mortgage agreement; 8) protection of the creditor, if other claims are aimed at the pledged property; 9) status of a secured creditor in insolvency proceedings of the debtor (pledgor), legal protection proceedings, or out-of-court legal protection proceedings.[37]

[36] Краснокутский В. А. *Мѣстное гражданское право губерній прибалтійскихъ и привислянскихъ. Пособіе къ лекціямъ*. Москва: Типографія Императорскаго Московскаго Университета, 1910, 88. стр.

[37] Only legal entities may be subject to legal protection proceedings or out-of-court legal protection proceedings; consequently, the debtor (pledgor) will always be a legal entity in this case.

2. GENERAL ISSUES OF THE MORTGAGE AND SOLUTIONS THEREOF

2.1. Fictitious Lease Agreements and Purpose Thereof

For the purpose to delay recovery process, play for time in transferring possession of the property to a new owner who has won it in the auction, cause damage to the mortgagee, as well as ensure a possibility for oneself and one's relatives to live in the mortgaged apartment or residential house as long as possible without paying any loan payment or actual rent, dishonest debtors often enter into fictitious lease agreements with their family members, in-laws, friends, or acquaintances. Such fictitious lease agreements are binding on the new owner, who has bought such apartment or residential house at the auction organized by a bailiff.

If the winning bidder of the real property has asked the court to approve his possession of the real property (transfer the possession), the court resolves on transferring the real property into possession of the acquirer by ratifying the auction statement (paragraph seven of Article 613 of the Civil Procedure Act). Transferring into possession is procured by a sworn bailiff under the procedure set out in Article 74^2 of the Civil Procedure Act. Upon transferring possession of the real property to the acquirer, the bailiff invites the debtor to vacate the real property from the belongings owned by the latter and leave the real property along with family members and other persons, who live together with his family (paragraph two of Article 620^6 of the Civil Procedure Act). If it is established, upon transferring the possession, that other persons reside in the apartment or the residential house based on a lease agreement, the bailiff is not authorized to evict them.

The only possibility to legitimately evict the fictitious tenants from the real property and recognize the fictitious lease agreement null and void is to

bring an action in court for recognition of the lease agreement null and void and eviction of the fictitious tenant from the real property along with the persons who cohabit with the tenant.

Arising from both practical experience of the author and the case law, the fictitious nature of a lease agreement can be usually inferred from several characteristics in various combinations: 1) fictitious lease agreements are entered in respect to the residential houses or apartments, which are subject to recovery – a bailiff has started the recovery and served a notice of recovery, or already announced a forced auction of the real property, or the auction has already been held, when the fictitious lease agreement is submitted to the bailiff; 2) the fictitious lease agreements are entered into with retroactive effect; 3) the fictitious lease agreements are concluded with relatives, in-laws, friends and acquaintances of the debtor; 4) the fictitious lease agreements are concluded for long periods; 5) the rent is established incommensurately low in such agreements; 6) the agreements contain a provision that the tenant has paid the rent in cash for a long time in advance; 7) the agreements stipulate that utility and management fees for the private house or apartment are paid by the landlord; 8) agreements stipulate a high contractual penalty, if the landlord unilaterally withdraws from the lease agreement.

The possibility to use fictitious lease agreements in full would be precluded, if the new owner had only the lease agreements corroborated with the Land Register binding on him. Right now a draft Act on Lease of Residential Premises[38] has been developed by a workgroup under auspices of the Ministry of Economics, where Article 27 stipulates this principle. In addition to that, it should be prescribed that in case the property is encumbered by a mortgage consent of the mortgagee is required for corroboration of the lease agreement with the Land Register.

[38] Not published.

2.2. Fictitious Employment Agreements

Besides fictitious lease agreements, there is another possibility how legal interests of the mortgagee are infringed – and it is entering into fictitious employment agreements on management of the mortgaged real property and obtaining a court ruling for recovery of the salary. In accordance with sub-paragraph 1 of paragraph one of Article 628 of the Civil Procedure Act, the money received for the sold real property encumbered by the mortgage shall first cover expenses of execution of the judgment related to sale of the real property, then claims of employees for payment of a salary related to management of the real property and social security contributions associated with such salaries are to be satisfied. The claims secured by mortgages rank only fourth (after the salaries for management of the mortgaged property, property related taxes, and real burdens, which have become due and payable).

The above provision of the Civil Procedure Act is being abused in practice in bad faith. A debtor (mortgagor), aware that recovery will be aimed at the mortgaged property owned by him, because the debtor has failed to perform his obligations towards the creditor, enters into a fictitious employment agreement with some friend or an acquaintance on management for the mortgaged real property. During the judicial proceedings the fictitious employer acknowledges the claim brought against him resulting in the court passing a judgment fully satisfying the claim for salary owed to the fictitious employee. Later on, based on the court judgment, a writ of execution is issued which vests the right in the fictitious employee to rank before the mortgagee and receive the funds which, in fact, belong to the mortgagee. If one manages to implement such dishonest scheme, the mortgagor and the fictitious employee split the money thus obtained among themselves.

Historically, the purpose of such priority of salaries over mortgages has been to ensure management of the mortgaged property, when its owner ceases to take care of the property; therefore, this very purpose should be reinstated, precluding the possibility to abuse this priority in bad faith.

Arresting and managing a real property is aimed at preservation of the property in the condition as it was at the time of arrest. Consequently, salaries associated with management/maintenance of the real property should be tied to management of the real property after its arrest specifically, and it should be stipulated that settlement of accounts (accounts for the work performed and expenses incurred in maintenance of the property) with a real property manager approved by the sworn bailiff shall form grounds for disbursement of a salary to such manager.

2.3. Issues with Limitation Period of the Mortgage

One of the most topical issues in the civil law lately is the issue of the limitation period of a mortgage – whether the mortgage, as a right in rem, is not subject to a limitation period, or quite to the contrary – the mortgage can lapse.

As regards the limitation period in the law of obligations, Article 1893 of the Civil Act expressly states – obligations expire, if the eligible person does not exercise them properly within the statutory limitation period.

The issue about existence or nonexistence of limitation for the mortgage in modern civil law can be resolved through systemic interpretation. The Civil Act does not limit a period for existence of a pledge (including mortgage) as an ancillary right – according to the general rule, the right of pledge is effective as long as the obligations secured by such pledge are not performed. It arises from Article 1286 of the Civil Act, which stipulates that the right of pledge remains effective until full satisfaction of the creditor, for whom, after a partial payment

is made, the pledge therefore still secures the outstanding part of the debt. On the other hand, Article 1314 of the Civil Act provides that sale of the pledged asset lawfully performed by the pledgee shall terminate not only his own right of pledge to this asset but that of all his successive creditors; nevertheless, he himself, as well as other creditors, until they are satisfied, retain the security interest in the amount received from the sale of the asset to the extent necessary for their satisfaction.

This principle is also consolidated in paragraph 2^1 of Article 628 of the Civil Procedure Act: "If the mortgagee has not joined the recovery (paragraph five of Article 621), funds in the amount of the mortgage amount specified in the Land Register or in the amount specified in the notice of the mortgagee, if such is received (paragraph four of Article 600), taking into account priority right of the mortgage claim, shall be transferred to the deposit account of the bailiff, who organized the auction, and shall be deposited until receipt of enforcement documents." Consequently, it can be inferred that there is no limitation period in respect to the mortgage in the civil law, notwithstanding the fact that it is not expressly stated in the Civil Act. Conversely, a limitation period for creditors' claims and subsequently the pledges, including mortgages, has been introduced in the special branch of law – insolvency law.

Arising out of paragraph 1 of Article 73 and paragraphs 1 and 1^1 of Article 141 of the Insolvency Act, creditors' claims against the debtor are to be submitted to the administrator within one month as of the day when an entry is made with the insolvency register about opening of the insolvency proceedings of the debtor. If the lender has missed this deadline, he can submit his claim against the debtor within a period, which is not longer than six months as of the day when the entry is made with the insolvency register about opening of the insolvency proceedings of the debtor, while no later than by the day when a plan for satisfaction of the creditor's claims is drafted (for private individuals – the final list of bankruptcy procedure costs is drafted) under the procedure set

out in the Insolvency Act. The limitation period lapses after this deadline; and the creditor subsequently forfeits the status of the lender and his claim right against the debtor.

Arising out of the foregoing, the limitation period applies to all creditors' claims, which are not submitted to the administrator within the timeline established in the Insolvency Act – both secured and unsecured claims. Thus, the special provisions contained in the Insolvency Act regarding the limitation period are also applicable to the pledges recorded with public registers – mortgages and commercial pledges.

Such procedure cannot be recognized as the one facilitating stability in the civil law, because the lender needs to continuously monitor entries with the insolvency register to check if any of its debtors has not become insolvent. In practice there are often situations where the lenders do not submit their creditor's claims in insolvency proceedings of debtors because they simply were not aware of the opening of the debtors' insolvency proceedings, the most exposed being small business of housing management and maintenance among them.

The only instance when the insolvency administrator has to inform the creditors (lenders) are the secured creditors in case insolvency proceedings are opened against a private individual; moreover, there are conditions too: firstly, they have to notify electronically, and not bay mail; secondly, only if the email address of the creditor is publicly known. It is not commensurate with the consequences suffered by the secured creditor – lapse of the limitation period and forfeiting of the claim either within insolvency proceedings of a private individual or after completion of the procedure of extinguishing obligations and discharge of the non-performed obligations of the debtor.

In order to ensure balance between consequences unfavourable for the creditor resulting from failure to submit the creditor's claim (forfeiting of the claim) and duties of the debtor and the administrator, it should be stipulated

that in all cases the administrator has to notify known creditors about opening of the insolvency proceedings of the debtor. Conversely, the limitation period for creditors' claims could lapse only if the lender has been informed and has failed, however, to submit his claim as a creditor to the insolvency administrator within the timelines set by the Insolvency Act.

2.4. Archaic Nature of Real Burden

In accordance with Article 1260 of the Civil Act a real burden is a permanent obligation attached to a real property to repeatedly provide certain performance in cash, in kind, or in corvée (unpaid, unfree labour). Notwithstanding the fact that there is no corvée nowadays, this legal framework is preserved in the Civil Act.

In accordance with sub-paragraph 3 of paragraph 1 of Article 628 of the Civil Procedure Act, the real burdens recorded with the Land Register, which have become due and payable, are to be covered before the mortgages, which are corroborated over the real property. That means that existence of the real burdens aggravates the status of the mortgagees (mortgage lenders) and their possibilities to satisfy their claims from the money received from the sale of the mortgaged real property.

Real burdens were created in the Medieval law.[39] In the late 6th century, the Christian Church charged the tithe as a church tax in the Carolingian Empire (*Regnum francorum*) based on the passages in the Old Testament where such was imposed on the Jews. In the second half of the 8th century the state supported this claim of the Church in order to compensate the Church for

[39] *Civīltiesības. Sastādīts pēc Latv. Ūniv. jur. fakult. valsts eksāmenu programmas*. Rīga: A. Vilka izdevniecība, 1934, 129. lpp.

secularization of the land owned by the Church.[40] Charlemagne introduced the tithe tax in the entire Carolingian Empire, including Italy, in 779. This tax was collected by parish priests, whereas the resources thus obtained were managed by bishops to be allocated for the needs of the Church according to the Canon law.[41]

The tithe was introduced in the territory of modern Latvia concurrently with the Catholic faith. Newly baptized converts were subject to the tithe concurrently with formal introduction of the Christendom. Every baptized person had a duty subsequently imposed to pay the tithe to the Catholic Church. In early 13th century residents of the territory of Latvia – farmers – were subjected to the tithe in full, as a 10% tax on the gross harvest, on growth of cattle, on apiary, and on income from fishery.[42]

This tax imposed instead of the tithe was called the master's share or "goba". It was not established at the rate of 10% of the harvest, but in a permanent certain amount. The tithe was established by the Divine law, whereas the master's share was where some servant of God took pity of the newly baptized Christians and allowed them to pay a lower tax instead of the God's share.[43]

Besides the tithe and the master's share, the new landlords imposed other burdens on inhabitants of Livonia as well, which are mostly of military nature in the 13th century. Under the treaty of 1230 baptized Couronians (Cours) had to take part in warfare against heathens not only in defence but also attack, thus spreading the Christian faith. Semigallians, Estonians, and other tribes had the same duties under the treaties. Furthermore, non-German people

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[40] Secularization (lat. *saecularis* – mundane, temporal) – transformation of the property of the Church into secular (for example, state) property. See secularization. Available on: http://vesture.eu/index.php/Sekulariz%C4%81cija [Accessed 09.06.2016.].
[41] *Latvijas tiesību vēsture*. [B.V.]: 1944, pp. 188-189.
[42] *Ibid.*, p. 189.
[43] *Ibid*., p. 190.

were subject to military corvée by erecting castles and churches, building roads and bridges.[44] The real burdens remained in circulation right until adoption of the Collection of Local Civil Law in 1864, and their legal framework was subsequently incorporated in the text of the Collection of Local Civil Law.

After the Republic of Latvia was proclaimed, an agricultural reform was introduced, where associated laws and regulations provided for revocation of the real burdens. In reality it was not accomplished, and the real burden was transposed from the Collection of Local Civil Law to the Civil Act adopted in 1937.

Real burdens nowadays. According to the statistical data of the State Uniform Computerized Land Register, 329 corroboration requests were submitted to the Land Register in Latvia during the period of time between 1998 and 16 January 2017 for corroboration of real burdens. During the period of time between 1993 and 1997 not a single such corroboration request was submitted. The majority of the corroboration requests – 267 – were submitted to the Riga Regional Land Registry Office.[45]

During development of the thesis, the author has personally reviewed the information of the Riga Regional Land Registry Office regarding the corroboration requests and documents enclosed thereto concerning the period until 19 April 2016, i.e., regarding 256 corroboration requests for a real burden.[46] Out of the satisfied corroboration requests, 87% were submitted by a one developer of a private housing village located in the Riga Region, whereas 16 corroboration requests, or 10%, were submitted by another developer of a private housing village located in the Riga Region. Only 3% of the

[44] *Latvijas tiesību vēsture*. [B.V.]: 1944, p. 54.
[45] Statistics about transaction in land registry departments. State Uniform Computerized Land Register. Available on: https://www.zemesgramata.lv/lv/Home/Statistics [Accessed 16.01.2017.].
[46] This information is information of restricted access and is not publicly available.

corroboration requests are not corroboration requests from developers of private housing villages.

Corroboration requests from both developers of private housing villages have been substantiated by similar reasoning. The developers sell individual land plots or land plots with private houses, and concurrently with entering into a purchase contract they enter into contracts for management of common roads and infrastructure corroborating these management contracts with the Land Register as the real burdens. The management fee established in a form of real burden is convenient for developers of the villages, because, when a land plot changes owners, the real burden recorded with the Land Register remain binding on the new owner.

Notwithstanding the fact that real burdens are a type of property rights used extremely seldom (329 requests for corroboration of real burdens have been submitted to the Land Registry Offices since 1993 in comparison with 630,899 requests for corroboration of mortgages submitted in the same period, that is, 1918 times more[47]), the real burdens have a priority over mortgages, if a collection is aimed at the real property.

The real burdens have been created during feudal era, and they managed to survive in the civil law of Latvia until now, irrespective of the fact that their original purpose is absolutely incongruent with the modern era. Since today real burdens are used extremely rarely (moreover mainly for the purpose to secure income from management fees of 2 private housing developments for maintenance of common roads and infrastructure), the real burden institution should be modified – firstly, the corvée as a real burden type should be excluded from the law, secondly, the real burden priority over mortgages

[47] Statistics about transaction in land registry departments. State Uniform Computerized Land Register. Available on: https://www.zemesgramata.lv/lv/Home/Statistics [Accessed 16.01.2017.].

should be repealed because nowadays such a priority is not objectively justified.

2.5. Issues with Legal Framework of Non-Recourse Loans

A discussion heats up from time to time in Latvia about non-recourse loans or the so-called "returned-key principle" insisting that the law should provide that a mortgage borrower (consumer) is liable for his/her obligations before the mortgage lender (usually, the bank) only in the amount of the real property's value. According to statements of politicians, such legal framework allegedly exists in USA and is to be regarded positively.

On 19 February 2015, amendments to the Consumer Rights Protection Act were adopted supplementing Article 8^1 of the Act with paragraph five, which stipulates that the lender shall offer at least two different sets of terms for a loan agreement to the consumer at the latter's choice after receipt of a loan request, where one set of terms stipulates that the real estate, for acquisition of which the loan is being taken, serves as a sufficient security for the obligations before the lender would be discharged in full.[48] Respectively, mortgage lenders (for the most part they are banks) had a duty imposed to offer a choice to consumers between a recourse and non-recourse loan, upon granting mortgage loan to the consumers.

It is stated in the explanatory notes of the draft law that the draft law is necessary to comprehensively implement the "returned-key principle" without tying it to the insolvency proceedings.[49] Such reasoning of necessity for the

[48] Grozījums Patērētāju tiesību aizsardzības likumā: Latvijas Republikas likums *(Amendment to the Consumer Rights Protection Act: Act of the Republic of Latvia*). *Latvijas Vēstnesis,* 42 (5360), 01.03.2015.

[49] Likumprojekta „Grozījums Patērētāju tiesību aizsardzības likumā" sākotnējās ietekmes novērtējuma ziņojums (anotācija) (*Report on initial impact of bill "Amendment to the Consumer Rights Protection Act" (explanatory notes*)). Available on:

legislative bill is quite ambitious. Arising therefrom, as of adoption of the amendments, the non-recourse loans or so-called "returned-key principle" is introduced in Latvia.

A non-recourse loan is a loan, which does not include personal liability of the borrower. The lender has agreed that the security is sufficient and, if the sale of property in case of recovery gains a lower amount than the loan amount, the lender will bear the losses and will not be able to recover them from the borrower.[50]

There is a substantiated opinion that the non-recourse loan system exists in 11 US states. The states, which can be classified as non-recourse are: Alaska, Arizona, California, Iowa, Minnesota, Montana, North Carolina, North Dakota, Oregon, Washington, and Wisconsin.[51]

In the majority of the above states the anti-recovery laws fall into one of the following categories: 1) law that prohibits any recovery of balance after sale of the property through court; 2) law prohibiting recovery of balance on loans, which are secured by the housing real property; 3) law prohibiting recovery of the balance, if the mortgage secured funds necessary for purchase of property; 4) law limiting recovery of the balance conforming to the difference between the balance of the loan and highest of the following values: sale price or fair market value of the property.[52]

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http://titania.saeima.lv/LIVS12/SaeimaLIVS12.nsf/0/F091C6D7EEFDE0E1C2257DE3003E0D86?OpenDocument [Accessed 17.10.2016.].

[50] Nonrecourse loan. The Free Dictionary by Farlex. Available on: http://financial-dictionary.thefreedictionary.com/nonrecourse+loan [Accessed 17.10.2016.].

[51] Ghent A. C., Kudlyaky M. *Recourse and Residential Mortgage Default: Evidence from U.S. States*. Federal Reserve Bank of Richmond Working Paper No. 09-10R February 25, 2011. Available on: http://ssrn.com/abstract=1432437 [Accessed 23.03.2014.].

[52] Minnes O., Solomon D. *Non-recourse, No Down Payment and the Mortgage Meltdown: Lessons From Undercapitalization*. Available on: http://www.law.syr.edu/media/paper/2011/3/Article_SolomonMinnes_March_2011.pdf [Accessed 23.03.2014.].

In Latvia, such non-recourse loan system as it exists in 11 US states is not introduced by promulgation of the amendments of 19 February 2015 to the Consumer Rights Protection Act. The amendments introduce a procedure that the prospective mortgage lender has an obligation to offer two types of loans to the consumer – a recourse loan and a non-recourse loan. The consumer (prospective borrower) is entitled to choose, which of the loans he will use. If the borrower opts for the non-recourse loan, then subsequent relationship between the lender and the borrower in respect to the non-recourse status of the loan is subject to contractual relationship between these parties, because no law or regulation in Latvia establishes legal framework governing the non-recourse loan along with the liability of the borrower to be limited to just the mortgaged real property.

Consequently, we can merely talk about contractual non-recourse loans in Latvia; furthermore, not because such would be introduced by the amendments to the Consumer Rights Protection Act of 19 February 2015, but because a duty is introduced for the lender to offer choice between recourse and non-recourse loans.

For lenders resources are squandered on offering the choice between recourse and non-recourse loan to the potential borrower (consumers) – time of employees, presentation materials, etc. Considering the low popularity of the non-course loans (2.3% in 2015) it is not feasible to retain such duty of the lender, and it should be excluded from the Latvian law.

3. ISSUES WITH THIRD-PARTY MORTGAGES AND SOLUTIONS THEREOF

3.1. Issues with Accessority of Mortgage

One of the principles of the mortgage (as a pledge) is the principle of accessority of the mortgage – the mortgage, as a security of an obligation, is of ancillary nature. That is, the mortgage may exist only if the obligation secured by the mortgage exists. If there is no obligation, the mortgage cannot exist either, because the objective of the mortgage is to secure performance of the obligation. In absence of the obligation there is no duty, performance of which would have to be secured.

There would be no questions about the accessority principle of the mortgage, if only provisions of the Civil Act arising out of the Collection of Local Civil Law existed nowadays. However, today there is also the Insolvency Act, which prescribes liquidation of a legal entity after completion of the insolvency proceedings in respect of the legal entity, whereas private individuals enjoy discharge of obligations after completion of the procedure of extinguishing obligations.

Issues arise in those situations, where obligations of the insolvent debtor are secured by a mortgage over a real property owned by a third party. During insolvency proceedings of the debtor the obligation will be discharged, most probably, without covering the entire creditor's claim. Here a question arises – what happens to the mortgage over the third party's real property? Does the mortgage over the third party's property ceases to exist, upon discharging the obligation during the insolvency proceedings without full performance thereof, or else it continues existing as an independent right?

The mortgage in respect of third party's obligations has certain similarities with a guarantee (surety), because the security of obligations is

provided by other persons (not the debtor). In case of the guarantee, the guarantor guarantees obligations of the principal debtor. If the obligations are not performed, the creditor may claim performance of the obligations from both the debtor and the guarantor. In case of the mortgage for obligations of a third party, the creditor may claim performance of the obligation from the debtor, as well as aim recovery at the mortgaged property. Consequently, both scenarios have provision of a security for third-party obligations in common; however, the main difference is the type of security interest. In case of the guarantee, the security interest is personal – the guarantor is personally liable with all his property for the debtor's obligations. In case of the mortgage securing third party's obligations the security interest is material – it is the mortgaged real property. The creditor can aim the recovery only at the property, and not at its owner; moreover, not more than in the amount of the mortgage amount. If after the recovery a positive balance is left, this balance is to be returned to the owner (Article 1329 of the Civil Act).

In 1914 professor Vladimirs Bukovskis has pointed out that establishing of a lien for an obligation undertaken by another person is of a nature of in rem guarantee, that is, such guarantee, which is limited only to the scope of the pledged property and is not tied to personal liability of the pledgor for a debt of another person.[53]

Both the guarantee and the mortgage have the principle of accessority in common – these securities cannot exist without an obligation. Furthermore, the guarantee and the mortgage have another key aspect in common, why these institutions exist at all – and that is the purpose. The purpose of the guarantee

[53] Буковскій В. *Сводъ гражданскихъ узаконеній губерній Прибалтійскихъ съ продолженіемъ 1912-1914 г. г. и съ разъясненіями въ 2 томахъ. Томъ I, содержащій Введеніе, Право семейственное, Право вещное и Право наслѣдованія*. Рига: Типографія Г. Гемпель и Ко, 1914, p. 563.

and the mortgage is to secure against default on an obligation, and against debtor's insolvency risk among other.

Consequently, an answer how to resolve the conflict between the accessority principle of the mortgage and right of the mortgage lender to the property can be sought in the judgment of the Department of Civil Cases of the Senate of the Supreme Court of 27 April 2011 in case No SKC–86/2011 and the judgment of the Department of Civil Cases of the Supreme Court of 16 June 2016 in case No SKC–178/2016.

In its judgment in case No SKC–86/2011, the Senate pointed out to the purpose of the guarantee as the key condition for validity of the guarantee: "The accessority principle of the guarantee is not absolute, and in the cases where the nature of the guarantee as an ancillary obligation becomes contradictory to the purpose of the guarantee, exemptions therefrom are permissible.

Upon guaranteeing debtor's obligations, the guarantor assumes the risk of being held liable by the creditor for the debtor's obligations even if the latter faced financial difficulties. Consequently, the duty of guarantor's liability before the creditor for obligations of the debtor, who has become insolvent, accurately conforms to the purpose of the guarantee. On the other hand, release of the guarantor from the duty to be liable before the creditor for the obligations of the principal debtor due to the mere reason that the poor financial status of the debtor has led to insolvency is contradictory to the purpose of the guarantee.

The above forms grounds for granting priority to the guarantee's purpose over accessority of the guarantee, as a result of which in case the principal debtor – business company – is winded up (deleted from the commercial register upon terminating the insolvency proceedings), the guarantee is transformed from the ancillary obligation into an autonomous obligation, and concurrently the creditor's claim towards the guarantor

becomes an autonomous one from the obligation inherent to the principal claim."[54]

Conversely, in the judgment of 16 June 2016 in case No SKC–178/2016, the Department of Civil Cases of the Supreme Court resolved a discussion that persisted among legal practitioners, members of the parliament, and in the legal literature for several years[55] concerning liability of the guarantor, if insolvency proceedings are opened in respect to the principal debtor – private individual. The Department of Civil Cases acknowledged that conclusions contained in the judgment of 27 April 2011 in case No SKC–86/2011 are applicable both to the cases when the principal debtor is a legal entity and to the cases when the principal debtor is a private individual.[56]

Taking into account that key features of the guarantee and third-party mortgages are identical (accessority and purpose), the said conclusions of the Department of Civil Cases can be also attributed to the third-party mortgages. Namely, in cases when the debtor is a legal entity and the insolvency proceedings result in liquidation thereof (deletion from the respective register), the mortgage from an ancillary right becomes an autonomous right. The same can be applied in a situation where the debtor is a private individual and his/her obligations have been discharged upon completion of the procedure of extinguishing obligations. Also in this case the mortgage created for the

[54] Judgment of the Department of Civil Cases of the Senate of the Supreme Court of the Republic of Latvia of 27 April 2011 in case No SKC-86/2011. Available on: http://at.gov.lv/files/uploads/files/archive/department1/2011/skc-0086.doc [Accessed 31.05.2016.].

[55] For more detail see Neilands R. *Galvojuma patstāvība pēc galvenā parādnieka saistību dzēšanas procedūras pabeigšanas*. Jurista Vārds, 16.02.2016., Nr. 7 (910). Available on: http://www.juristavards.lv/doc/268089-galvojuma-patstaviba-pec-galvena-paradnieka-saistibu-dzesanas-proceduras-pabeigsanas/ [Accessed 20.07.2016.].

[56] Judgment of the Department of Civil Cases of the Supreme Court of the Republic of Latvia of 16 June 2016 in case No SKC–178/2016. Available on: at.gov.lv/files/uploads/files/archive/department1/2016/SKC-178-2016.doc [Accessed 20.07.2016.].

purpose to secure the debtor's obligations, becomes an autonomous right, and the mortgage lender has the right to aim the recovery at the mortgaged real property.

Several examples can be found in the case law where the conclusions of the judgment of the Department of Civil Cases of the Supreme Court in case No SKC–86/2011 have been applied in mortgage cases. For example, in its judgment of 30 April 2014 in case No C27182513 the Civil Court Panel of the Riga Regional Court has referred to the judgment in case No SKC-86/2011 among other, and also noted the following: "In fact, providing a pledge for a third party's obligations, in its legal nature, shall be equalled to a guarantee. In both cases the person secures a creditor's claim towards the principal debtor by the former's property. In case of the security interest (right of pledge) such security is limited to merely the pledged property, whereas in case of the guarantee it applies to the entire property of the guarantor, if not limited to a certain amount. [..]

Therefore, release of the pledgor from the obligation to be held liable before the creditor for obligations of the principal debtor only due to the reason that the poor financial status of the debtor has led to limited solvency is contradictory to the purpose of the pledge – providing an opportunity for the lender to obtain satisfaction from the sale of the object of pledge in case of sale in the amount of the outstanding share of the obligation, when the creditor cannot gain satisfaction from the debtor himself/herself."[57]

To avoid the solution of the problem to be confined only to the doctrine and case law, it would be necessary to introduce amendments to the Civil Act, by supplementing it with Article 1306[1] in the following wording: *„1306.[1] A pledge for another person's obligation becomes autonomous, if:*

[57] Judgment of the Civil Court Panel of the Riga Regional Court of 30 April 2014 in case No C27182513. Available on: https://manas.tiesas.lv/eTiesasMvc/nolemumi/pdf/192860.pdf [Accessed 21.09.2016.].

1) Insolvency proceedings are completed in respect to insolvent debtor – legal entity – and the debtor is removed from the respective register;

2) After performance of the plan for discharge of obligations the remaining outstanding obligations specified in the said plan are discharged for the insolvent debtor – private individual."

3.1. Enforcement of the Creditor's Claim for Secured Third-Party Obligations

Until 1 March 2015 the Insolvency Act did not resolve the issue how to act in a situation when the pledgor has become insolvent, while the debtor performs his/her obligations. In this situation there is no reason to request sale of the pledged property, because the obligation is being performed. At the same time, the Insolvency Act stipulates sale of the entire property of the debtor, and without the sale thereof the insolvency proceedings cannot be finalized. Furthermore, it is not known, whether the debtor will perform its obligations in full – if it performs, it will not be necessary to sell the object of pledge in future, whereas, if it does not perform, the sale thereof will be necessary.

By amendments to the Insolvency Act that came into effect on 1 March 2015 a solution for the above situation is provided. The Insolvency Act is supplement with Article 118^1 – procedure for covering creditors' claims, if a claim of such secured creditor is lodged, whose claim rights is conditional. The essence of the article is that money from the sale of the pledged property is deposited by the administrator into an account specifically opened by the Insolvency Administration with the National Treasury until the moment when the secured creditor has submitted a notification to the Insolvency Administration about occurrence of the condition.

The amendments have just one crucial drawback – they stipulate that the money received from sale of the mortgaged property is to be kept in custody no longer than three years after the sale of the mortgaged property, or five years after opening date of the debtor's insolvency proceedings depending on which of these deadlines occurs earlier (paragraph two of Article 118^1). After this deadline the money shall be disbursed pursuant to Article 118 of the Insolvency Act, i.e., to cover costs of the insolvency proceedings, cover claims of the Insolvency Administration for salaries paid to the debtor's employees, and to satisfy the unsecured creditors in the amount of the principal debt. Such procedure cannot be considered fair in cases when the obligation secured by the pledge is longer than the above period of time and will continue afterwards. Often, there are cases when the obligation is long-term – for five and more years.

The Civil Act does not limit the timeline for existence of a pledge (including mortgage) as an ancillary right: according to the general rule, the right of pledge is valid until the obligations secured by the pledge are performed. This principle is also consolidated in paragraph 2^1 of Article 628 of the Civil Procedure Act, pursuant to which a bailiff, after sale of the mortgaged real property, if the mortgage lender has not joined the recovery, deposits money on a deposit account in the amount of the mortgage amount specified in the Land Register or in the amount specified in the notification of the mortgage lender, if such is received, and keeps it in custody until receipt of the execution documents.

Arising out of the foregoing, under the civil procedure the bailiff can sell the mortgaged property upon executing the recovery (in favour of other collectors, not the mortgage lender); however, the rights of the mortgage lender are not infringed, because he can submit an execution document to the bailiff at any time and thus receive the deposited money in the amount of the claim.

Consequently, the amendments to the Insolvency Act create such a procedure for enforcement of the mortgage for third-party obligations that does not conform to justice in case of long-term obligations infringing the creditor's right to property, as well as is contradictory to the procedure established in the Civil Procedure Act, thus violating the principle of equality among the creditors (lenders). Such procedure may result in emergence of new malicious insolvency schemes aimed at gaining financial benefit from sale of the mortgaged property circumventing rights of the mortgage lender. In order to prevent the foregoing, it would be necessary to introduce amendments to Article 118^1 of the Insolvency Act that would rescind the limited period for keeping the money in custody, which has nothing to do with the actual validity period of the obligation, and would tie keeping the money in custody for the period while the particular obligation exists. The only case when the current limited period of deposit should be retained would be in the event that the creditor is unaware of the term when the condition is to occur (upon which the obligation expires), or else, the creditor had not specified it in its application.

3.2. Rights of the Pledgor to review Information about the Amount of the Debt

Means for securing the obligations – mortgage and guarantee – are means of security governed by the civil law that can be used by contracting parties to secure any obligations. However, in practice these means for securing obligations are most commonly used by credit institutions (mainly banks) in their lending transactions, that is, upon granting loans, which are being secured by guarantees and mortgages.

In accordance with paragraph one of Article 61 of the Credit Institutions Act[58], the credit institutions are obliged to guarantee confidentiality of the identity, accounts, deposit and transactions of clients. Article 62 of this act establishes accurate range of entities whom the credit institutions are entitled to divulge information about the client's transactions. Naturally, the client himself or herself, including the borrower, may obtain data about his or her own transactions; however, pursuant to paragraph 4^1 of Article 62, data about the client's loan payment schedule, performance of loan obligations, including payments made, and outstanding amount of the debt obligations are to be provided to the guarantor of the client's loan upon its written request.

Such procedure was introduced by the amendments to the Credit Institutions Act of 24 April 2014, which came into effect on 28 May 2014,[59] in order to provide for the right of the guarantors to obtain information from the credit institution about the schedule of the guaranteed (borrower's) loan payments and performance of the repayment obligations.[60] The procedure introduced by the amendments should be regarded positively, because before the amendments the guarantor did not have grounds to request information from the credit institution about payment discipline of the debtor and amount of the debt. Furthermore, the credit institutions were not even authorized to disclose this information because this information was subject to protection of the client's confidentiality, including in respect to the guarantors. After

[58] Kredītiestāžu likums: Latvijas Republikas likums (*Credit Institutions Act: Act of the Republic of Latvia*). *Latvijas Vēstnesis,* 163 (446), 24.10.1995., *Ziņotājs*, 23, 07.12.1995.

[59] Grozījumi Kredītiestāžu likumā: Latvijas Republikas likums (*Amendments to the Credit Institutions Act*: *Act of the Republic of Latvia*). *Latvijas Vēstnesis,* 92 (5152), 14.05.2014.

[60] Likumprojekta „Grozījumi Kredītiestāžu likumā" sākotnējās ietekmes novērtējuma ziņojums (anotācija) (*Report on initial impact of bill "Amendments to the Credit Institutions Act" (explanatory notes*)). Available on: http://titania.saeima.lv/LIVS11/SaeimaLIVS11.nsf/0/4CB484EDC531C29EC2257C4F00417CE5?OpenDocument#b [Accessed 12.10.2016.].

adoption of the amendments the guarantors have no obstacles to receiving information from the credit institutions.

At the same time, obstacles to receipt of information have remained intact in respect to pledgors (third parties). Property (assets) owned by them serve as a security of a claim held by the credit institution, i.e., such property is pledged in favour of the credit institution in order to secure obligations of the debtor. Notwithstanding the foregoing, the pledgors are not eligible to request information from the credit institution about the outstanding debt and payment discipline. Such absence of rights is to be deemed a deficiency, because the pledgors need to have right to know information about outstanding balance of the obligation and payment discipline, because the real property or movable property owned by them is pledged in favour of the credit institution in order to secure performance of the debtor's obligations. Compliance with the payment discipline and outstanding balance of the debt concerns the pledgors, that is, their property right in respect to the pledged property. If the credit institution launches recovery due to debtor's default on obligations, then the recovery will, most probably, be aimed at the pledged property as well, including the real property. Thus, the fact whether the debtor performs obligations and what the outstanding balance of the debt is directly concerns the pledgors. Consequently, the Credit Institutions Act should stipulate that the pledgor also has the right to review information about performance of the loan obligations and outstanding balance of the loan.

CLOSING CHAPTER

The research fully answers to the research questions incorporating the answers in the explication of the doctoral thesis and the objective of the doctoral thesis is accomplished – the author has prepared a scientific substantiation for strengthening of the mortgage institution and prevention of issues in a form of amendments to the laws and regulations.

Arising out of findings of the doctoral thesis, the current legal framework governing the mortgage institution in the Republic of Latvia is deficient, and improvements of the legal framework are necessary in both the Civil Act as special law governing the mortgage institution, as well as other laws and regulations, which directly concern enforcement of the mortgage, the Insolvency Act in particular.

1. Conclusions

In the doctoral thesis the author has drawn the following conclusions in respect to the mortgage institution and possibilities for improvement thereof:

1. The Civil Act is based on the Collection of Local Civil Law, which for the most part was comprised of the norms of the Roman law. Since the mortgage institution in the Civil Act was transposed from the Collection of Local Civil Law with only minor editorial adjustments, the mortgage institution contained in the Civil Act is based on the mortgage institution created by the Roman law.
2. The purpose of the mortgage is identical to the purpose of all pledges – securing of a claim in such a way that the lender (creditor) may derive payment of the claim from such pledge.
3. The mortgage is the most widely used type of pledge. This stems from the use of mortgage as one of the safest pledges in lending transactions

conducted by the banks. Since early 1993 until 16 January 2017, 630,899 corroboration requests have been submitted to the Land Register for establishing of mortgages. On the other hand, the second most commonly used type of pledges is a commercial pledge – 177,175 commercial pledges have been registered since 1998. For the sake of comparison, 624,769 corroboration requests have been submitted for corroboration of the mortgages since 1998, that is, 3.5 times more than perfected commercial pledges.

4. Content of the mortgage institution is determined by the general principles of pledges: principle of accessority of the pledge; principle of indivisibility of the pledge; principle of absolutism of the pledge; principle of autonomous nature of the obligation; principle of the scope of liability for the pledge, as well as special mortgage principles – principle of priority of mortgage; principle of public credibility of the Land Register, and principle of specification of the mortgage.
5. Consequences of corroboration of the mortgage with the Land Register are: 1) creation of the right in rem; 2) indisputability of the corroborated right; 3) binding nature for everyone; 4) creation of the priority right; 6) right of the creditor (lender) to commence non-contestable compulsory enforcement in case of default on obligations; 7) rights of the creditor (lender) to sell the object of pledge in voluntary auction for a free price, if such right is contracted in the mortgage agreement; 8) lender's protection, if other claims are aimed at the mortgaged property; 9) status of the secured creditor in insolvency proceedings, legal protection proceedings, or out-of-court legal protection proceedings of the debtor (mortgagor).
6. Upon change of the owner of the leased housing property, the lease agreement remains valid and is binding on the new owner. For the purpose to interfere with the recovery proceedings, to play for time in transferring possession of the sold property to the new owner, causing

damage to the mortgage lender, as well as to ensure a possibility for oneself and one's own relatives to live in the mortgaged apartment or residential building as long as possible without paying either loan payments or actual rent, dishonest debtors often enter into fictitious lease agreements with their relatives, in-laws, friends, or acquaintances. Such fictitious lease agreements are binding on the new owner, who has bought the apartment or residential building at the auction organized by the bailiff.

7. Besides the fictitious lease agreements, another way to invade on the statutory rights of the mortgage lender is to enter into fictitious employment agreements on maintenance of the mortgaged real property and obtain a court judgment about recovery of salary. Pursuant to sub-paragraph 1 of paragraph one of Article 628 of the Civil Procedure Act, claims secured by mortgages are to be satisfied from the revenues gained through sale of the mortgaged real property only in the fourth tier (after salaries for maintenance of the mortgaged property, taxes associated with the property, and real burdens, which have become due and payable). Abusing this provision, the fictitious employees obtain execution documents for recovery of the salary and submit them to a bailiff for the purpose to gain income from the sold mortgaged real property before the mortgage lender, i.e., to receive the money that is due to the mortgage lender.
8. Upon systemically interpreting Article 1286 and Article 1314 of the Civil Act and paragraph one of Article 628 of the Civil Procedure Act, it can be inferred that no limitation period exists in the civil law in respect to the mortgage. Conversely, in the special branch of law – insolvency law – a limitation period for creditors' claims is introduced and subsequently for pledges either, including the mortgages.

9. The only case when the insolvency administrator has to notify creditors about opening of insolvency proceedings of a debtor is the secured creditors in case of insolvency of a private individual is declared; moreover, on condition that it shall be done, firstly, electronically and not in writing by mail and, secondly, only if the email address of the creditor is publicly known. That is not proportionate to the consequences suffered by the secured creditor – lapse of the limitation period and forfeiting of the claim both in insolvency proceedings of a private individual and after completion of the procedure of extinguishing obligations and discharge of outstanding obligations of the debtor.
10. Real burdens are an archaic institution of the feudal law, the historical purpose of which was to ensure revenues for feudal lords and the Church in a form of a tithe, master's share, and unpaid, unfree labour (corvée). Nowadays the real burdens are used extremely rarely; furthermore, they are used in a way not conformant to their purpose – by developers to collect a management fee from private housing villages for maintenance of common roads, territories and infrastructure of these villages.
11. In the USA only eleven states have non-recourse loans, contrary to the idea prevalent in Latvia that such loans exist in all US states. Majority of the laws governing non-recourse loans today exist as a historic trace of debt relief, as adopted in 1930s, to alleviate the Great Depression in the USA.
12. In Latvia, the non-recourse loans exist only in a contractual form – they are agreed on in a loan agreement concluded with a consumer. On 9 June 2016 amendments to Article 8^1 of the Consumer Rights Protection Act were adopted, which stipulate that that a lender, who has received a request for a loan lodged by a consumer, has an obligation to offer at least two different sets of contractual terms for consumer lending at the consumer's discretion, of which one prescribes that the real property, for

acquisition of which the loan is being taken, serves as a sufficient security for discharge of the obligations before the lender in full. By this legal provision, irrespective of the statements made by politicians, the non-recourse loans are not introduced in Latvia. It just creates an incommensurate administrative burden on the lenders, notwithstanding the fact that borrowers choose non-recourse loans very rare (they constituted only 2.3% of all loans granted to households in 2015).

13. Within the scope of the principle of accessory nature of the mortgage problems occur in those cases when obligations of the insolvent debtor are secured by a mortgage over real property owned by a third party. The obligation is discharged within the scope of insolvency proceedings of the debtor, most probably, without satisfying the entire claim of the creditor (lender). If due to this reason the mortgage ceased to exist based on the principle of accessority as well, it would be contradictory to the right of the mortgage lender to the property. Taking into account the case law and practice a conclusion can be drawn that the purpose of the mortgage prevails over the principle of accessority. Upon discharging the debtor's (private individual's) obligations after completion of the procedure of extinguishing obligations, or, upon liquidating a legal entity as a result of insolvency, the mortgage becomes autonomous (independent), and the mortgage lender has the right to aim his remaining claim at the mortgaged real property owned by the third party.
14. The case law that developed both before the amendments to the Insolvency Act adopted on 25 September 2014 and after these amendments implies Article 7 of the Insolvency Act prescribing that in case when property of the insolvent debtor is pledged for obligations of a third party, the status of the creditor in insolvency proceedings of this insolvent debtor (also in legal protection proceedings and out-of-court legal protection proceedings) is a secured creditor. On the other hand, in

cases when obligations of the insolvent debtor are secured by a pledge over property of another person, the status of the pledgee in insolvency proceedings of this insolvent debtor (also in legal protection proceedings and out-of-court legal protection proceedings) is an unsecured creditor, and in such case the insolvency administrator does not have the right to alienate the property owned by a third party and pledged for obligations of the debtor, including the real property.

15. Article 118^1 of the Insolvency Act establishes such a procedure for enforcement of a mortgage for obligations of a third party, which in cases of long-term obligations is not fair, violates right of the lender to property, and is contradictory to the procedure consolidated in the Civil Procedure Act, thus breaching the principle of equality among the creditors. Such procedure may lead to dishonest insolvency schemes for the purpose to gain financial benefit from sale of the mortgaged property circumventing rights of the mortgage lender.
16. In accordance with paragraph 4^1 of Article 62 of the Credit Institutions Act, data about a loan payment schedule, performance of loan obligations by the client, including payments made and amount of the outstanding debt obligations, are to be provided to a guarantor of the loan of the client, upon a written request. There are obstacles to receiving information by pledgors (third parties). The property (assets) owned by them serve as a security for a claim of the credit institution, i.e., it is pledged in favour of the credit institution in order to secure the debtor's obligations. Notwithstanding the foregoing, the pledgors do not have any right to request information from the credit institution regarding outstanding balance of the debt and payment discipline. Such vacuum of rights is to be deemed deficiency, because the pledgors need to have right to have access to information about outstanding balance of obligations and payment discipline, because in case of default on the obligations the recovery will

be aimed at the property owned by them and mortgaged in favour of the credit institution.

2. Proposals

In order to resolve the issues associated with the mortgage institution, the author makes the following proposals for amendments to the laws and regulations:

1. In order to solve the problem with fictitious lease agreements, it is necessary to establish that only lease agreements recorded with the Land Register are binding on the new owner. The Act on Lease of Residential Premises is currently under development, where this principle will be incorporated (in Article 27); however, it does not stipulate that a lease agreement can be registered with the Land Register only upon consent of the mortgagee, if the property is encumbered by a mortgage. Consequently, Article 27 of the draft Act on Lease of Residential Premises should be supplemented with a third paragraph in the following wording:

   "*(3) If the real property or residential space is encumbered by a mortgage, then the lease agreement can be registered with the Land Register only upon a written consent of the mortgage lender."*
2. In order to solve the problem with fictitious employment agreements, sub-paragraph 1 of paragraph one of Article 628 of the Civil Procedure Act should be restated in a new wording:

   "**Article 628. Allocation of the money received from sale of the real property encumbered by a pledge (mortgage)**

   (1) From the money received for the sold real property encumbered by a pledge, firstly, execution expenses of the judgment associated with sale of

the real property shall be covered, subsequently claims shall be satisfied in the following sequence:

1) A claim of a manager of the real property for payment of a salary, which is approved by the bailiff, including social insurance contributions related to the manager's salary. The claim referred to in the present article shall pertain to the period from the day of arrest of real property until the day of handing over of the real property to the new owner."

3. In order to prevent infringement of the lenders' rights upon lapse of the limitation period in insolvency proceedings of debtors, Articles 73 and 141 of the Insolvency Act should be supplemented with the following paragraphs:

"Article 73. Submission of the creditor claims

(1^1) The administrator shall promptly send a notification to all known creditors or the debtor about opening of the insolvency proceedings.

(2^1) If the administrator has not sent the notification to a creditor about opening of the insolvency proceedings, the consequences set out in paragraph two of this article shall not set in.

Article 141. Creditors' claims and meeting of creditors

(2^2) If the administrator has not sent the notification to a creditor about opening of the insolvency proceedings, the consequences set out in paragraph 1^1 of this article shall not set in."

4. For the purpose to consolidate the mortgage institution, as well as resolve the problem with archaic nature of the real burden, it would be necessary to exclude sub-paragraph 3 of paragraph one of Article 628 of the Civil Procedure Act (real burden priority over mortgages), as well as delete word "corvée" from Article 1260 of the Civil Act and delete words "or corvée" from Article 1276 of the Civil Act.

5. For the purpose to alleviate the administrative burden and unfeasible consumption of resources for lenders, paragraph eight should be deleted

from Article 8^1 of the Consumer Rights Protection Act, which stipulates lender's obligation to offer at least two different sets of terms for a consumer loan agreement to the potential borrower, of which one prescribes that the real property, for the acquisition of which the loan is taken, serves as a sufficient security to discharge the obligations before the lender in full. By deleting such provision from the Consumer Rights Protection Act, the lender and the borrower would have an opportunity to mutually agree in a loan agreement on terms of a non-recourse loan just like before adoption of such provision.

6. In order to prevent seeking solutions for the problem of accessority of the mortgage only in the legal doctrine and case law, it should be necessary to introduce amendments to the Civil Act by supplementing it with Article 1306^1 in the following wording:

   "1306.[1] A pledge for another person's obligation becomes autonomous, if:

   1) Insolvency proceedings are completed in respect to insolvent debtor – legal entity – and the debtor is removed from the respective register;

   2) After performance of the plan for discharge of obligations the remaining outstanding obligations specified in the said plan are discharged for the insolvent debtor – private individual."

7. In order to prevent incongruity of the procedure for enforcement of a mortgage for a third-party obligations contained in Article 118^1 of the Insolvency Act with the notion of justice, invasion on the creditors' rights to property, and infringement of the principle of equality of the creditors, amendments to Article 118^1 of the Insolvency Act would be necessary that would rescind the limited period for keeping money in custody, which has nothing to do with the actual period of obligation, and would tie deposition of money to the validity period of the obligation. The only situation, where the current limited period of deposition should be retained would be in case the creditor is unaware of the time when the

condition has to set in (when the obligation ceases), or else, the creditor had not specified it in its application. Taking into account the foregoing, paragraph two of Article 118[1] of the Insolvency Act should be stated in the following wording:

"**Article 118[1]. Procedure for satisfaction of creditors' claims, if such a claim of a secured creditor is lodged, where the claim rights depend on a condition setting in**

[..]

(2) The money referred to in paragraph one of this article shall be kept in custody no longer than by the date specified in an application of a secured creditor, by which date a condition has to set in.

If the date, by which the condition has to set in, is not known, the money referred to in paragraph one of this article shall be kept in custody no longer than for three years after the pledged property is sold for the benefit of the secured creditor, whose claim rights depend on the condition setting in, or for five years as of the opening date of the insolvency proceedings of a debtor, depending which of these deadlines sets in earlier."

8. Pledgors (mortgagors) are directly affected by such factors like whether the debtor performs obligations and what the outstanding balance of the debt is. The Credit Institutions Act should stipulate that not only a guarantor but also a pledgor (mortgagor) shall have a right to review information about performance of the debt obligations and outstanding balance of the loan. Taking into account the foregoing, paragraph 41 of Article 6[1] of the Credit Institutions Act should be stated in the following wording:

"**Article 62.**

(*4[1]) Data about a loan payment schedule, performance of the loan obligations by the client, including payments made and the outstanding*

amount of the debt obligations, shall be provided, upon a written request, to a guarantor of the client's loan and a pledgor, whose property is pledged as a security for the client's loan."

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