



## **BALTIC JOURNAL OF LAW & POLITICS**

A Journal of Vytautas Magnus University

VOLUME 11, NUMBER 1 (2018)

ISSN 2029-0454



Cit.: *Baltic Journal of Law & Politics* 11:1 (2018): 85–107

<https://content.sciencedirect.com/view/journals/bjlp/bjlp-overview.xml>

DOI: 10.2478/bjlp-2018-0004

### **PECULIARITIES OF ENTERPRISE MORTGAGE AS A NEW FORM OF COMMERCIAL CHARGE**

**Renata Juzikienė**

**Adviser to the President of the Supreme Administrative Court (Lithuania)**

**Contact information**

Address: Žygimantų g. 2, LT-01102 Vilnius

Phone: +370 5 268 55 82

E-mail address: ren.juzikiene@gmail.com

Received: April 4, 2018; reviews: 2; accepted: August 16, 2018.

**ABSTRACT**

Enterprise mortgage is a new form of commercial charge applicable in the law of Lithuania since 1 July 2012. An enterprise mortgage as set out in the national law is distinct by its object, i.e. that an enterprise mortgage allows charging an enterprise as a whole, as an immovable property item; by the debtor's (grantor's) right to use the mortgaged assets in the ordinary course of business by transferring them to third persons free from encumbrance; also by the opportunity for the enterprise mortgagee to enforce his rights by special method of enforcement: the enterprise purchase and sale. As a result of its wide scope, embracing both the existing and future assets of the debtor, as well as due to the absolute priority granted to the mortgagee to get all proceeds from the sale of the charged property, enterprise mortgage affects not only the debtor but also other creditors of the debtor (grantor). The method of minimum regulation for enterprise mortgage chosen in the law leaves a number of open questions for practical and doctrinal development. The article presents an analysis of the content of object of enterprise mortgage, explores the impact of enterprise mortgage on the satisfaction of claims of other creditors of the debtor (grantor)

both in enforcement and insolvency proceedings, the rationale behind absolute priority of the enterprise mortgagee, effectiveness of the enterprise purchase, and sale as a method of enforcement of enterprise mortgagee's rights. The article also analyses the relevance and adequacy of the existing legal regulation.

**KEYWORDS**

Enterprise mortgage, fund of assets, charge, negative pledge, over-collateralization

## INTRODUCTION

On 1 July 2012, the Law Amending and Supplementing the Civil Code containing the provisions reforming the law on security rights came into force;<sup>1</sup> they have not only reinforced the institutional reform but also changed the substantive law regulating the legal relations of mortgage (charge). From the perspective of commercial charge, the most significant changes relate to the liberalisation of the legal regulation – a move has been made from an imperative regulation method to a dispositive one, and the requirement of specificity<sup>2</sup> has been withdrawn in the charge of assets of a commercial entity. That opened an opportunity for introducing two forms of universal charge: the charge of funds of assets<sup>3</sup> (in Lithuanian, *turtinių kompleksų įkeitimas*) and enterprise mortgage<sup>4</sup> (in Lithuanian, *įmonės hipoteka*). These forms of commercial charge make it possible for commercial entities to encumber not only specified existing assets held by the grantor but also the future assets or assets defined by class, which can be used in ordinary course of business. Enterprise mortgage is the widest form of commercial charge by its object.

Many scholars of the doctrine<sup>5</sup> agree that the introduction of the charge which allows the encumbering of all or substantially all of the property of commercial entity is an attribute of the modern law of secured transactions; not only has it extended the application of charge as such, but it has also expanded the scope of the collateral. Enterprise mortgage allows the charging the assets which otherwise could not be pledged by separate transactions of a specific asset charge and which, in principle, increase the value of collateral (most often, intangible corporate

---

<sup>1</sup> Law Amending and Supplementing Articles 4.127, 4.170, 4.171, 4.172, 4.173, 4.174, 4.175, 4.176, 4.177, 4.178, 4.179, 4.180, 4.181, 4.182, 4.183, 4.184, 4.185, 4.186, 4.187, 4.188, 4.189, 4.190, 4.191, 4.192, 4.193, 4.195, 4.196, 4.197, 4.198, 4.199, 4.200, 4.201, 4.202, 4.204, 4.206, 4.207, 4.209, 4.210, 4.211, 4.212, 4.213, 4.214, 4.216, 4.219, 4.220, 4.221, 4.223, 4.224, 4.225, 4.226, 4.256 of the Civil Code of the Republic of Lithuania and Supplementing the Code with Articles 4.192-1, 4.194-1, Official Gazette (2012, No. 6-178).

<sup>2</sup> The requirement of specificity for the assets under charge derives from the general doctrine of specificity of property rights. "All property rights can only exist on individual and specified objects. Property rights on a kind of certain object do not exist" (for more see Sjef Van Erp and Bram Akkermans, *Cases, Materials and Text on Property Law* (Oxford and Portland: Oregon, 2012), 76). "They require that the collateral is identified – the doctrine of specificity. This excludes assets where it is not possible in practice to specify them or their location in the required degree of detail, especially receivables, raw materials and inventory. Since it is not possible to specify the details of future assets, except generically by class, the effect is also to exclude future assets" (for more see Philip R. Wood, *Comparative Law of Security Interests and Title Finance* (London: Sweet & Maxwell, 2007), 94).

<sup>3</sup> Article 4.202 of the CC. This form of charge covers shifting fund of movables of the debtor (grantor), including stocks of goods, equipment, claims, etc., which is defined by indicating the group of collateral.

<sup>4</sup> Article 4.177 of the CC.

<sup>5</sup> Philip R. Wood, *supra* note 2, 97; Eva-Maria Kieninger, ed., *Security Rights in Movable Property in European Private Law* (Cambridge: University Press, 2004), 525; Jan H. Dalhuisen, *Dalhuisen on International Commercial, Financial and Trade Law* (Oxford and Portland: Oregon, 2004), 604.

assets).<sup>6</sup> Moreover, a charge of all corporate assets by one transaction and withdrawal of the requirement of specific identification for the assets which are subsequently acquired, reduce business costs.<sup>7</sup> It is also recognised that " <...> the facilitation of a general floating security interest – is likely to foster access to credit and assist in reducing default risk for borrowers".<sup>8</sup> There is a noticeable overall trend that the number of legal systems introducing enterprise mortgage is increasing.<sup>9</sup> It is also suggested that some forms of charge be set up with the effect of enterprise mortgage in international soft law sources. For example, the 1994 Model Law on Secured Transactions of the European Bank for Reconstruction and Development<sup>10</sup> recommends incorporating enterprise charge (of both movable and immovable property) into national law; Article 8 of the UNCITRAL Model Law on Secured Transactions<sup>11</sup> provides that a security right may encumber all of a grantor's movable assets, which allows a business to make maximum use of the value of its movable assets in order to obtain a credit.

The method of minimum regulation has been chosen for establishing enterprise mortgage in the national regulation of Lithuania: there are only two articles on enterprise mortgage in the Civil Code<sup>12</sup> (hereinafter – the CC) (Article 4.177 and Article 4.192<sup>1</sup>). These Articles are not in themselves enough to answer new questions arising in the studies and practice of the enterprise mortgage: regarding the content of enterprise mortgage object, regarding the measures to ensure the balance of interests of the enterprise mortgagee and the debtor (grantor), regarding the position of other secured and unsecured creditors of the grantor in relation to the collateral, regarding the specifics of enforcement from enterprise mortgage, etc. Due to its wide object and content, enterprise mortgage has implications for a very broad range of enterprise-related persons and inherent legal relations; therefore, the emerging questions are relevant not only from the practical but also from the doctrinal perspective.

The primary aim of this article is to unfold the main features of the enterprise mortgage as set out in the national law, and describe the specifics and potential shortcomings of legal regulation. For researching enterprise mortgage, interdisciplinary analysis is important because the application of this institute relates not

<sup>6</sup> Riz Mokal, "The Floating Charge – An Elegy": 482; in: Sarah Worthington, ed., *Commercial law and commercial practice* (Oxford: Hart Publishing, 2003).

<sup>7</sup> Philip R. Wood, *supra* note 2, 100.

<sup>8</sup> John Armour, "The Law and Economics Debate About Secured Lending: Lessons for European Law Making": 29; in: Horst Eidenmüller and Eva-Maria Kieninger, eds., *The Future of Secured Credit in Europe. European Company and Financial Law Review – Special Volume* (Berlin: De Gruyter Recht, 2012).

<sup>9</sup> Eva-Maria Kieninger, *supra* note 5, 650.

<sup>10</sup> European Bank for Reconstruction and Development, *Model Law on Secured Transactions* (1994) // <http://www.ebrd.com/news/publications/guides/model-law-on-secured-transactions.html>.

<sup>11</sup> *UNCITRAL Model Law on Secured Transactions* (2016) // [http://www.uncitral.org/pdf/english/texts/security/ML\\_ST\\_E\\_ebook.pdf](http://www.uncitral.org/pdf/english/texts/security/ML_ST_E_ebook.pdf).

<sup>12</sup> *Civil Code of the Republic of Lithuania*, Official Gazette (2000, no. 74-2262).

only to property law but also to contract law, company law, insolvency law, and enforcement law. The research in this article is based on the comparative analysis of legal regulation in different jurisdictions and doctrine. The systems of law of England, Quebec and Russia have been chosen as the underlying systems for comparative analysis.<sup>13</sup> All the functional equivalents of enterprise mortgage applicable in the above-referred systems of law can cover all assets of an enterprise (movable and immovable, present and future, tangible and intangible). Other jurisdictions, which recognize an enterprise mortgage, usually limit the range of collateral, which can be included into enterprise mortgage.<sup>14</sup>

There are no relevant national studies on the enterprise mortgage carried out to date. Comments on the legal rules of enterprise mortgage are available in the Commentary to Book IV of the Civil Code.<sup>15</sup> In 2002, Egidijus Baranauskas published an article about enterprise mortgage<sup>16</sup> with an analysis of the possibility of enterprise mortgage after the CC recognises that an enterprise, as the object of civil rights, is an immovable property item. The possibilities of applying enterprise mortgage have also been dealt with by Baranauskas in his doctoral dissertation.<sup>17</sup> The possibilities of introducing enterprise mortgage in the national regulation have been briefly discussed in the doctoral dissertation of Asta Jakutytė-Sungailienė;<sup>18</sup> this academic research also explored the marketability issues of an enterprise as a fund of assets. A comparative overview of functional equivalents of enterprise mortgage is, to the extent it relates to the comparative study of the universal security over movable property, available in the doctoral dissertation of Andrius Smaliukas "Reform and harmonization of law of security over movable property:

---

<sup>13</sup> The law of the province of Quebec served as a reference when drafting Book IV of the Civil Code of the Republic of Lithuania. The floating charge developed by the law of England is regarded as a predecessor of the modern universal charge; between the end of the 19<sup>th</sup> century and the beginning of the 20<sup>th</sup> century it was used as the broadest-scope instrument of commercial charge. In modern practise the effect of the charge, which covers all kinds of property of an enterprise, is reached by using mixture of floating and fixed charge. The regulation of enterprise mortgage, as the object of civil rights and an immovable property item, as established in Lithuanian law, is similar to the regulation set out in law of the Russian Federation.

<sup>14</sup> E.g. Enterprise mortgage in France (in French, *du nantissement du fonds de commerce*), in Belgium (in French, *en gage du fonds de commerce*), in Sweden (in Swedish, *företagshypotek*) can cover only a part of the property of an enterprise, which is prescribed by law. In Germany fiduciary transfer is used instead of non-possessory charge due to the legal requirements of specificity, what makes this jurisdiction different from Lithuanian one.

<sup>15</sup> Andrius Smaliukas, *et al.*, *LR civilinio kodekso komentaras. Ketvirtoji knyga. Daiktinė teisė. Hipoteka (Commentary to the Civil Code of the Republic of Lithuania. Book Four. Property Law. Mortgage)* (Vilnius: Justitia, 2013) [in Lithuanian].

<sup>16</sup> Egidijus Baranauskas, "Įmonės įkeitimas" (Enterprise Mortgage), *Jurisprudencija* 28 (2002) [in Lithuanian].

<sup>17</sup> Egidijus Baranauskas, *Įkeitimo teisinis reguliavimas: daktaro disertacija (Legal Regulation of Mortgage: Doctoral Dissertation)*, Social Sciences, Law (01S) (Vilnius: Law University of Lithuania, 2002) [in Lithuanian].

<sup>18</sup> Asta Jakutytė-Sungailienė, *Įmonė kaip civilinių teisių objektas: daktaro disertacija (Enterprise as an Object of Civil Rights: Doctoral Dissertation)*, Social Sciences, Law (01S) (Vilnius: Mykolas Romeris University, 2010) [in Lithuanian].

comparative study”.<sup>19</sup> All these studies, however, were carried out before the introduction of enterprise mortgage in the national regulation; therefore, relevant academic research on this topic does not exist in the national doctrine. There is also no national case law on the application and interpretation of the legislative provisions regulating the institute of enterprise mortgage.

## 1. THE OBJECT OF ENTERPRISE MORTGAGE

There is no uniform term for enterprise mortgage in the doctrine.<sup>20</sup> Likewise, a common definition of the object of enterprise mortgage does not exist because different legal systems provide for different-scope functional equivalents of enterprise mortgage. Generally, enterprise mortgage means a charge of the whole assets or a substantial part of the assets of a commercial entity.<sup>21</sup>

Article 4.177(1) of the CC states that enterprise mortgage means the charging of an enterprise as an immovable property item. The legal regulation does not specify what constitutes the content of an enterprise as the object of mortgage. A generic definition of an enterprise, as the object of civil rights, is set out in Article 1.110(1) of the CC, which states that “an enterprise, as a complex of assets, property and non-property rights belonging to the person who is engaged in business (seeking profit), as well as debts and other duties thereof, may be the object of civil rights. An enterprise is considered to be an immovable thing.” It can be concluded from the systematic analysis of Article 4.177 and Article 1.110 of the CC that the object of enterprise mortgage consists of assets, debts and other obligations as a whole. However, the acknowledgement that all the debts and obligations of a legal entity are charged along with its assets in case of enterprise mortgage leads to the question about the legal relationship between the mortgagee and other creditors of the debtor (grantor) both during the performance of the contract on enterprise mortgage and in the proceedings of enforcement from the encumbered assets.

Legal fiction – legal classification of enterprise as immovable item – is used for ensuring the marketability of an enterprise as the object of civil rights. The marketability of an enterprise as an object is regulated by special legislative norms ensuring the contract types applicable to enterprises. The effective legal regulation provides for the contracts of enterprise sale and purchase, the lease of an

<sup>19</sup> Andrius Smaliukas, *Kilnojamojo turto įkeitimo teisės reforma ir derinimas: lyginamoji analizė: daktaro disertacija (Reform and harmonization of law of security over movable property: comparative study: Doctoral Dissertation)*, Social Sciences, Law (01S) (Vilnius: Vilnius University, 2002) [in Lithuanian].

<sup>20</sup> There is no one single term defining this concept in comparative research of law – different sources use different names: enterprise mortgage, all asset charge, universal business security, global security, universal floating charge, etc.

<sup>21</sup> Eva-Maria Kieninger, *supra* note 5, 525.

enterprise and enterprise mortgage; therefore, the content of an enterprise as the object of such contracts should be determined with reference to the specifics and rules of a particular contract. The legislative provisions regulating enterprise lease contracts and contracts on enterprise purchase and sale detail the content of an enterprise as the object of these transactions.<sup>22</sup> An enterprise is specified by a fund of its assets, including not only property (assets) but also debts and other obligations (liabilities) – however, in case of lease debts may be transferred to the lessee with agreement of the creditors,<sup>23</sup> while in case of enterprise purchase and sale debts must be paid by the purchaser prior to the contract of enterprise purchase and sale.<sup>24</sup>

Article 4.177 of the CC does not detail the content of the object of enterprise mortgage. In accordance with general legislative provisions regulating mortgage and charge, the object of mortgage and charge can only consist of property: immovable property, movable property and property rights.<sup>25</sup> The specifics of enterprise mortgage compared to other transactions is that, after conclusion of the enterprise mortgage contract, commercial activities are further carried out by the same legal entity, i.e. the grantor (debtor) who also retains the obligation to perform all liabilities and pay the debts relating to ordinary course of business. In enforcement proceedings from the assets charged under enterprise mortgage, the enterprise mortgagee may resort to a special instrument of enforcement – the sale of the enterprise as a fund of assets or exercise the right to sell the mortgaged enterprise by separate objects.<sup>26</sup> The absolute priority of the mortgagee to the proceeds from the sale of the collateral allows the use of all funds for satisfying its claim irrespective of the claims by other creditors. Thus, the obligations and debts of the grantor (debtor) to other creditors have no implications for the rights of the enterprise mortgagee and, for this reason, may not be considered as constituting part of the object of enterprise mortgage.

For example, the law of the Russian Federation follows the same approach that an enterprise is immovable property as an object.<sup>27</sup> Article 70(2) of the Law of the Russian Federation on Mortgage (Charge of Immovables) of the Russian Federation<sup>28</sup> states that, where an enterprise is the object of mortgage and a contract does not specify otherwise, the composition of charged property includes the tangible and intangible assets held by the enterprise, as well as buildings,

<sup>22</sup> Article 6.536 and Article 6.402 of the CC.

<sup>23</sup> Article 6.537(2) of the CC.

<sup>24</sup> Paragraphs 3–5 of Article 6.405 of the CC.

<sup>25</sup> Paragraphs 1 and 2 of Article 4.171 and Article 4.200(1) of the CC.

<sup>26</sup> Article 4.192<sup>1</sup> of the CC.

<sup>27</sup> *Civil Code of the Russian Federation*, Official Gazette (No. 51-Φ3, 30.11.1994), art. 132, sec. 1.

<sup>28</sup> *Federal Law on Hypothec (Charge of Immovables) of Russian Federation*, Official Gazette (No. 102-Φ3, 16.07.1998).



structures, equipment, inventory, raw materials, finished goods, rights of claim, exclusive rights, i.e. the Law indicates explicitly that the object of enterprise mortgage consists of property only. Article 2684 of the Civil Code of Quebec<sup>29</sup> indicates that: "Only a person, partnership or trustee operating an enterprise may grant a hypothec on a universality<sup>30</sup> of property, movable or immovable, present or future, corporeal or incorporeal". The positive law of England does not define either charge or floating charge; therefore, the content of these concepts unfolds only in the case law and doctrine. "In case of a floating charge, the creditor's right is valid not for specified objects but for a shifting fund of assets, which the company is free to manage in the ordinary course of its business."<sup>31</sup>

Although there is no general consensus in the national doctrine whether an enterprise as an object should be considered as a fund of assets,<sup>32</sup> it should, however, be agreed with the available definition of the object of enterprise mortgage: "the mortgage of an enterprise as a fund of assets covers the whole present and future (that the enterprise will acquire in future) movable and immovable property, *inter alia*, intangible assets and the rights of claim deriving out of the debtor's activities."<sup>33</sup> It follows that an enterprise as the object of enterprise mortgage should be recognised as a *sui generis* fund of assets, i.e. a narrower object compared to an enterprise as defined in Article 1.110(1) of the CC and broader than the definition of a fund of assets set out in Article 1.110(2) of the CC because the object of enterprise mortgage consists not only of the tangible assets unified by common business designation but also of other kinds of property.

The legal characterization of enterprise mortgage by a fund of assets is relevant for the enterprise mortgage contract and allows pledging all assets of an enterprise without specifying them. The content of a fund of assets is always shifting – some assets are removed, some other are added but the substance of a fund of assets remains unchanged, similarly "the River Thames remains the River

<sup>29</sup> *Code civil du Québec (1991) (Civil Code of Quebec)* // <http://legisquebec.gouv.qc.ca/fr/showdoc/cs/CCQ-1991>.

<sup>30</sup> In French, *une universalité*.

<sup>31</sup> Roy M. Goode, Heather Keating, and Sally Cunningham, *Goode on legal problems of credit and security*, 5<sup>th</sup> edition (London: Sweet & Maxwell, 2014), 7.

<sup>32</sup> Some sources recognise that an enterprise should be regarded as a fund of assets (for more see Vytautas Mizaras, ed., *Civilinė teisė. Bendroji dalis (Civil Law. General Part)* (Vilnius: Justitia, 2009), 484 [in Lithuanian]; Julija Kiršienė and Kristupas Kerutis, "Verslo perleidimas akcijų ar įmonės pardavimo būdu: teisinio reglamentavimo ir praktikos lyginamoji analizė" (Methods of Business Transfer: the Sale of Shares or a Company: a Comparative Analysis of Legal Regulation and Practice), *Jurisprudencija* 3 (2006): 25 [in Lithuanian]; Asta Jakutyte-Sungailienė, *supra* note 17, 63). Other authors state that "an enterprise should be distinguished from the notion of a fund of assets" and that the term "a fund of assets of an enterprise" rather than "an enterprise as a fund of assets" should be used because "during the sale of an enterprise, the fund of assets held by that enterprise is always sold, however, it does not constitute the whole enterprise as the object under sale" (for more see Virginijus Bitė, *Uždarosios bendrovės akcijų pardavimas, kaip verslo perleidimo būdas: daktaro disertacija (Sale of Shares of Private Limited Liability Company as a Means of Business Transfer: Doctoral Dissertation)*, Social Sciences, Law (01S) (Vilnius, Mykolas Romeris University, 2009), 39 [in Lithuanian]).

<sup>33</sup> Andrius Smaliukas, *et al.*, *supra* note 14, 50.



Thames regardless that its water is not the same each minute.”<sup>34</sup> Since the object of enterprise mortgage is an enterprise as a fund of assets,<sup>35</sup> i.e. the assets as a whole rather than specific property objects, the enterprise mortgage object includes separate property objects of the debtor (grantor) either encumbered by previous charges (mortgages) or attached for securing the claims by other creditors. The presence of such objects in the composition of corporate assets does not limit the grantor's right to conclude a contract for the charge of assets as a whole. Where all these objects are combined into a fund of assets for the purpose of entering into an enterprise mortgage contract, they do not lose their individual legal status, restrictions and encumbrances. Thus, after an enterprise mortgage is registered, previous creditors do not lose their rights to direct enforcement towards specific assets.<sup>36</sup> Where the entire object of enterprise mortgage is classified as a fund of assets, it becomes legally irrelevant to classify the separate objects constituting the enterprise, as a fund of assets, by property items, i.e. by specifying which object is primary and which is secondary. The possibility to charge the existing and future assets of an enterprise as a whole releases the transaction parties from the obligation to revise and amend the contract when new assets are charged and the mortgage object is supplemented.

## **2. THE RELATIONSHIP BETWEEN THE ENTERPRISE MORTGAGEE, DEBTOR (GRANTOR) AND OTHER CREDITORS OF THE DEBTOR (GRANTOR)**

It is agreed, both in support of and critical response to enterprise mortgage, that the charge of all existing and future assets to one creditor has a monopolistic effect; that confers extensive powers to such creditor in relation to the debtor who most often is a small or medium-size enterprise without any possibilities of diversification of its financing sources and dependent on the financing from one bank. When introducing the legal regulation of enterprise mortgage, the Lithuanian legislator did not provide for any exceptions and special regulations applicable to other creditors of the grantor (debtor), i.e. it allowed the charge of all (existing and future) assets to one creditor and did not lay down any restrictions for the priority

<sup>34</sup> Roy M. Goode, Heather Keating, and Sally Cunningham, *supra* note 30, 127.

<sup>35</sup> The doctrine distinguishes the following attributes of a fund of assets: a fund of assets should consist of more than one element, the legal outcome of which can be different; it should be of property nature, i.e. it should consist of assets; there should be common objective or activity direction; marketability (see Viktor A. Belov, *Imushchestvennye komplekсы (Funds of Assets)* (Moskva: AO Centr Jurinfor, 2004), 28-52 [in Russian]).

<sup>36</sup> Article 37(1) of the UNCITRAL Model Law on Secured Transactions (2016) provides that the right of a creditor that has obtained a judgment or provisional order (“judgment creditor”) has priority over a security right if, before the security right is made effective against third parties, the judgment creditor has [taken the steps to be specified by the enacting State for a judgment creditor to acquire rights in the encumbered asset or the steps referred to in the relevant provisions of other law to be specified by the enacting State] (*UNCITRAL Model Law on Secured Transactions*, *supra* note 11).

held by the enterprise mortgagee either in coercive enforcement proceedings or in insolvency proceedings.<sup>37</sup> The enterprise mortgagee enjoys the same absolute priority as that held by mortgage (charge) creditors of separate property objects. The claims secured by charge (mortgage) both under the Code of Civil Procedure<sup>38</sup> (hereinafter – the CCP) and the Enterprise Bankruptcy Law<sup>39</sup> are excluded from the ranking of creditors and are satisfied first from the proceeds received from the sale of the charged enterprise assets or by transferring the assets pledged. The priority to get the proceeds from the sale of charged assets prior to the grantor is held only by the bailiff<sup>40</sup> and the bankruptcy administrator<sup>41</sup> to the extent necessary to cover enforcement or administration costs.

If all corporate assets are charged by enterprise mortgage, later it may become difficult for the grantor (debtor) to get financing from other sources both in the form of a credit or sale because other contracting parties of the debtor, who provide financing to its activities after the enterprise has been mortgaged and have no opportunities to secure the enforcement of their claims, are likely to lend under less favourable conditions or refuse to make contracts. The opportunity of the grantor (debtor) to offer the assets charged under enterprise mortgage as a security repeatedly is normally restricted by the clause of negative pledge,<sup>42</sup> which is set out in the contract of enterprise mortgage. Article 4.170(5) of the CC sets out a general rule that a subsequent mortgage of charged assets shall be allowed, unless the mortgage contract specifies otherwise. Legal acts, however, do not describe the legal implications of a breach of the prohibition of the charge of assets by subsequent mortgage (or charge).

The doctrine holds that such negative pledge clause does not create any right *in rem*. It is held that it means only a contractual obligation, and rather weak, if the debtor decides not to comply with it; moreover, it does not limit the possibility of contracts with the effect similar to charge, i.e. quasi-security interest or property

---

<sup>37</sup> This attribute makes the enterprise mortgage established in the Lithuanian law different from the priorities held by the creditor of the functional equivalents of enterprise mortgage in the law of England and Quebec. The creditor of floating charge in the law of England has a very weak priority both in enforcement and insolvency proceedings. Priority over the floating charge creditor is held both by fixed charge creditors and employees, as well as by unsecured creditors to the extent of fence-ringing. Mortgagees do not have absolute priority under the law of Quebec.

<sup>38</sup> *Code of Civil Procedure of the Republic of Lithuania*, Official Gazette (2002, no. 7436-1340), art. 754(1).

<sup>39</sup> *Law on Enterprise Bankruptcy of the Republic of Lithuania*, Official Gazette (2001, No. 31-1010), art. 34.

<sup>40</sup> Article 753(1), sub-paragraphs 1–3 of the CCP.

<sup>41</sup> *Law on Enterprise Bankruptcy of the Republic of Lithuania*, *supra* note 38, art. 33, sec. 6.

<sup>42</sup> Normally, the clauses of this type are used: (a) in case of unsecured lending, where the creditor is granted the status of a secured creditor (*pari passu* or higher ranking), if the debtor charges the assets to a third person; (b) in case of secured lending, where the creditor are willing to secure a higher ranking of their charge in order to secure their right against subsequent creditors (that is, in particular, relevant in the systems of law where a subsequent charge of separate property items has priority or is *pari passu* with the prior charge of the whole property) (see Paul A. U. Ali, *The Law of Secured Finance* (Oxford: Oxford University Press, 2002), 89).

acquisition financing contracts.<sup>43</sup> A breach of such clause is normally regarded as a breach of contract permitting the initiation of enforcement from the pledged assets before the term. However, it has no effect on the validity of the security interest held by third persons, unless the third person knew or ought to have known about the existence of such clause.<sup>44</sup> It follows that in the absence of provisions in the national regulation that would provide that a transaction made in breach of the prohibition of repeated charge invalid, as, for example, it is provided for in the law of the Russian Federation,<sup>45</sup> also in the absence of the requirement to make such clause public, as it is the case, for example, in the law of England,<sup>46</sup> it is doubtful whether there would be a basis to invalidate a subsequent mortgage (charge) contract, except in the cases when the new mortgagee (chargee) acted in bad faith. In any case, however, that would have implications for the legal relationship between the debtor and the mortgagee, in case the mortgagee decides to submit a claim for enforcement before the term or for the compensation of losses resulting from a breach of the contract.

The parties must indicate the total value of the mortgage object in the enterprise mortgage contract.<sup>47</sup> The debtor (grantor) undertakes that the enterprise value will not become lower than the value of the mortgage object specified in the mortgage contract,<sup>48</sup> unless the enterprise mortgage contract provides otherwise. Where the parties do not agree otherwise, this clause is likely to lead to the problem of over-collateralization,<sup>49</sup> which is not addressed separately by our legal regulation. The law also does not regulate the ratio between the secured obligation amount and the value of the collateral.<sup>50</sup> In *UNCITRAL Legislative Guide on Secured Transactions* we read that:

<sup>43</sup> *Ibid.*, 90; Philip R. Wood, *supra* note 2, 136; Louise Gullifer and Jeniffer Payne, *Corporate Finance Law. Principles and Policy*, 2<sup>nd</sup> edition (Oxford/Oregon: Hart Publishing, 2015), 324.

<sup>44</sup> Hugh Beale, Michael Bridge, et al., *The Law of Security and Title-based Financing*, 2<sup>nd</sup> edition (Oxford: Oxford University Press, 2012), 58.

<sup>45</sup> Article 43(3) of the Law of the Russian Federation on Mortgage (Charge of Immovables): "An overlying mortgage agreement concluded despite the prohibition stipulated by an underlying mortgage agreement, may be declared null and void by a court decision on a claim made by the underlying mortgagee irrespective of whether the overlying mortgagee knew of such prohibition" (see *Federal Law on Hypothec (Charge of Immovables) of Russian Federation*, *supra* note 27).

<sup>46</sup> From April 2013, negative pledge clauses have to be registered in the Companies House when registering the floating charge contract (*Companies Act 2006 (Amendment of Part 25) Regulations 2013*, art. 859, sec. 2, p. c // <https://www.legislation.gov.uk/ukSI/2013/600/>). schedule/1/made.

<sup>47</sup> Article 4.177(3) of the CC.

<sup>48</sup> Article 4.177(3) of the CC.

<sup>49</sup> The issue of over-collateralization or oversecuritisation (German *Übersicherung*) has been formulated by the Federal Court of Justice of Germany (German *Bundesgerichtshof*): the value of a security (collateral) is considerably higher than the amount of a secured obligation. Such disproportion can exist right after the contract has been made or come up in the course of performance of the secured obligation. A disproportion of security entitles the debtor to claim a release of the surplus assets from encumbrance (see Sjef Van Erp and Bram Akkermans, *supra* note 2, 440-443).

<sup>50</sup> For example, Article 71 of the Law of the Russian Federation on Mortgage (Charge of Immovables) states that "Mortgage of an enterprise may be used to secure a financial obligation amounting to not less than half the value of property of the enterprise, as well as financial obligation with a maturity term of not less than one year from the conclusion of the mortgage agreement. In the event that the term of

The problem of over-collateralization arises in situations where the value of the encumbered assets significantly exceeds the amount of the secured obligation. The grantor's assets may be encumbered to an extent that makes it difficult or even impossible (at least in the absence of a subordination agreement between creditors) for the grantor to obtain secured credit from another creditor granting a second-ranking security right in the same encumbered assets. In addition, because all the assets of a grantor are encumbered, enforcement by the grantor's unsecured creditors may be precluded or at least be made more difficult, unless there is clearly identifiable value remaining after the satisfaction of all the secured obligations.<sup>51</sup>

The problem of over-collateralization may, to a certain extent, be solved by imposing the maximum amount of obligations secured by mortgage;<sup>52</sup> however, for this purpose the parties should agree in the contract that the debtor's obligations concerning the enterprise value should be linked with the amount of a secured obligation, which varies depending on the degree of performance of the secured obligation rather than with the value of the mortgage object as specified in the mortgage contract.

If all existing and future assets of an enterprise are recognised as the object of enterprise mortgage, the question arises about the rights of other creditors to the assets held by the enterprise mortgage debtor (grantor), as the contractual party, in order to satisfy their claims both in coercive enforcement and in insolvency proceedings. The relationship between the ranking of claims of the enterprise mortgagee and other creditors should be determined according to generic rules. Therefore, the relationship between different secured creditors is governed by the general rule established in Article 4.193(3) of the CC that in the event of multiple mortgages of the thing, claims of mortgagees shall be satisfied according to the time of registration of their mortgages in the Mortgage Register (a similar provision with regard to charge can be found in Article 4.212 of the CC), i.e. prior charge (mortgage) of a separate object will have priority over the subsequent enterprise mortgagee in relation to that specific object; the prior enterprise mortgagee will have priority over the subsequent chargee of a separate object in relation to that specific object; and, the sequence of claims of several enterprise

---

performance of the secured obligation is shorter, the mortgagee's right of foreclosure under the unfulfilled obligation shall originate at the end of one year from the conclusion of the mortgage agreement" (see *Federal Law on Hypothec (Charge of Immovables) of Russian Federation*, *supra* note 27).

<sup>51</sup> UNCITRAL *Legislative Guide on Secured Transactions* (2007), 82 //

[http://www.uncitral.org/pdf/english/texts/security-ig/e/09-82670\\_Ebook-Guide\\_09-04-English](http://www.uncitral.org/pdf/english/texts/security-ig/e/09-82670_Ebook-Guide_09-04-English).

<sup>52</sup> Article 4.182 of the CC; Article 2689 of the Civil Code of Quebec.

mortgagees will be determined according to the chronological order of registration of the enterprise mortgage contracts.

As far as enforcement proceedings are concerned, the creditor who has attached or otherwise encumbered the disposal of a specific collateral in order to satisfy its claims before the registration of the enterprise mortgage, retains the priority right to dispose of the specific mortgage object after the registration of the enterprise mortgage. The claim of this creditor would be considered senior; therefore, the enforcement of this claim should be excluded from the scope of Article 747 of the CCP, according to which the bailiff, when enforcing from the mortgaged or charged assets of the debtor, must contact the mortgagee or the chargee in writing for the consent for the enforcement from the mortgaged or charged assets of the debtor.<sup>53</sup>

A different approach in enforcement proceedings would be applied to the claims of the creditor who has attached or otherwise encumbered the disposal of a specific collateral to secure its claims after the registration of the enterprise mortgage. In such a case, enforcement is directed towards the collateral; therefore, the consent of the mortgagee is required. Whether the particular claims of other creditors may be satisfied from the mortgaged assets of the enterprise will depend on the operations that the parties will consider in the contract as falling into the scope of ordinary course of business.<sup>54</sup>

Another important consideration is related to the position of creditors holding quasi-security interest. Lithuania has a semi-functional approach, similar to that established in the law of the province of Quebec, to these instruments – it is required to register them in order to be able to use them against third persons.<sup>55</sup> The CC of Lithuania requires registering the same contracts, i.e. contract of purchase and sale with the right of redemption,<sup>56</sup> contract of instalment sale,<sup>57</sup> leasing (financial lease) contract<sup>58</sup>. In all contracts which are based on the retention of ownership, the mere fact of registration of the contract is enough for the claim holders to enforce their rights against enterprise mortgagees – Lithuania, as other countries of continental law, relies on the concept of property law that the assets, for which the ownership has been retained and has not been transferred, are excluded from the mass of the debtor's assets and do not become an object of enterprise mortgage.

---

<sup>53</sup> Article 747(1) of the CCP.

<sup>54</sup> Article 4.177(5) of the CC.

<sup>55</sup> Articles 1745, 1765, 1852 of the Civil Code of Quebec.

<sup>56</sup> Article 6.417(2) of the CC.

<sup>57</sup> Article 6.411(2) of the CC.

<sup>58</sup> Article 6.572 of the CC.

Nevertheless, the enforcement of the rights of claim under contracts whereby ownership is assigned in order to secure obligations can be complicated if such contracts have been made after the conclusion of the enterprise mortgage contract. For example, along with the provisions regulating an instalment sale contract, Article 6.414(2) of the CC provides for the rule that where the right of ownership passes to the buyer from the moment of delivery of the item, it shall be considered from the moment of delivery of the item to the buyer until the payment of the full price that the items have been charged to the seller in order to secure performance of obligations by the buyer under the contract (legal charge (mortgage)), unless the contract provides otherwise. Under such contracts, the persons who provide the credit equal to the purchase price to the debtor are regarded as creditors with the right *in rem*, which they must publish. However, there are no exceptions provided in law for the ranking of their claims. As a result, the legal mortgage (charge) right they hold will be enforced under the general order of sequence according to the time of registration of the mortgage (charge), i.e. after the claims of the enterprise mortgagee have been satisfied. Such regulation should be improved because these creditors are financing the acquisition of new property which should not fall into the scope of enterprise mortgage. In order to secure the protection of rights of such creditors, their claims should get priority over the claims of enterprise mortgagees.

This matter is clearly regulated in the Civil Code of Quebec. Immovable hypothec ranks only from registration of the grantor's title but after the seller's hypothec<sup>59</sup> (in French, *l'hypothèque du vendeur*) created in the grantor's act of acquisition.<sup>60</sup> The same is the approach to the hypothec of movable property: a movable hypothec acquired on the movable of another or on a future movable ranks from the time of its publication but after the seller's hypothec, if any, created in the grantor's act of acquisition, provided that hypothec is published within 15 days after the sale.<sup>61</sup> As C. Walsh writes, "this rule provides for the rule of super priority that the hypothec of future movable becomes valid for the grantor only after the seller's hypothec."<sup>62</sup>

---

<sup>59</sup> Article 2954 of the Civil Code of Quebec states that a sale contract may provide for the seller's hypothec, which must be registered within 15 days.

<sup>60</sup> Article 2.948 of the Civil Code of Quebec.

<sup>61</sup> Article 2.945 of the Civil Code of Quebec.

<sup>62</sup> Catherine Walsh, "Super priority for Asset Acquisition Financing in Secured Transaction law: Formalism or Functionalism": 460; in: Sarah Worthington, ed., *Commercial Law & Commercial Practice*, Ch. 16 (Oxford: Hart, 2003).

### 3. ENFORCEMENT FROM THE ASSETS CHARGED BY ENTERPRISE MORTGAGE

The specifics of enforcement of enterprise mortgagee rights is specified in Article 4.192<sup>1</sup> of the CC. First of all, priority in enforcement from enterprise mortgage should be attributed to the administration of assets.<sup>63</sup> Although Article 4.192(7) of the CC provides for the possibility of the mortgagee to choose whether to sell the charged assets by public auction or transfer them for administration to the mortgagee, this provision is interpreted as obligating the enterprise mortgagee to consider the possibility of enforcement from the charged assets by way of property administration.<sup>64</sup> Article 4.192<sup>1</sup>(5) of the CC states that, in case it comes to light that the claim secured by mortgage cannot be satisfied from the proceeds derived from the mortgaged corporate assets under administration, the property administrator (mortgagee) may apply to the bailiff regarding the sale of the whole enterprise<sup>65</sup> under the procedure set out in Articles 6.402–6.410 of this Code. The property administrator acts as a seller in this case. If it turns out that the sale of the whole enterprise is impossible or economically unviable, the property administrator (mortgagee) may apply to the bailiff regarding the sale of the enterprise assets in parts, i.e. regarding the sale of separate objects.

Thus, the law grants priority to the sale of an enterprise as a fund of assets, while the sale of separate property objects of the enterprise is envisaged as a last resort of enforcement. In enforcement proceedings, the scope of the object of enterprise mortgage allows the sale of an enterprise as a whole. That can increase the sale price of the object and the distribution of the sale proceeds satisfies more claims of creditors compared to piecemeal sales, which often result in a loss of value. Besides, some assets derive their value only from being part of a business and are diminished or lose their value entirely if sold separately (especially intellectual property, customers, inventory and equipment).<sup>66</sup> Where an enterprise as a fund of assets can be sold more expensively than separate objects of the assets constituting that fund, such sale benefits not only the enterprise mortgagee but also other creditors of that legal entity because the proceeds remaining after the settlement with the enterprise mortgagee should be distributed to them. The enterprise mortgagee, however, is not always interested in the highest sale price of

<sup>63</sup> Article 4.192<sup>1</sup> (1) of the CC.

<sup>64</sup> Andrius Smaliukas, et al., *supra* note 14, 103.

<sup>65</sup> A similar measure of enforcement of enterprise mortgagee right's is provided in Article 73 (2) of the Law of the Russian Federation on Mortgage (Charge of Immovables) (see *Federal Law on Hypothec (Charge of Immovables) of Russian Federation*, *supra* note 27). Rules on the sale and purchase of enterprise should apply *mutatis mutandis* to the sale of an enterprise in enforcement proceedings (see *Civil Code of the Russian Federation*, *supra* note 26, art. 560-562).

<sup>66</sup> Philip R. Wood, *supra* note 2, 102.



the enterprise assets. J. Armour explains that “this might happen where the value of company’s asset are higher than the amount owing to the secured creditor. Under such circumstances, the creditor lacks an incentive to expand effort on realising the assets for more than the amount of the secured claim. This would refuse recoveries for unsecured creditors and potentially lead to inappropriate closure of good firms”.<sup>67</sup>

The existing legal regulation does not protect from the potentially passive approach of the enterprise mortgagee in relation to other creditors. Article 4.192<sup>1</sup>(4) of the CC states that the property administrator may exercise the rights granted to it by law only to the extent necessary to satisfy the claims secured by enterprise mortgage, which implies that the administrator acts only in the interests of the enterprise mortgagee, i.e. it has no obligation to seek the sale of the charged assets under the most favourable terms not only for itself but also to other creditors. Moreover, the administrator acts on the basis of simple administration. Considering the fact that the purpose of such property administration is only the preservation of such assets and the ensuring of their use according to their designation,<sup>68</sup> that does not confer the right to the administrator to increase the assets, manage them so that they generate proceeds and use them for such purpose which is the most favourable for the beneficiary<sup>69</sup> as it would be possible in the case of full administration.<sup>70</sup> Therefore, it may be presumed that the generic principle of simple administration as applicable to enterprise mortgage narrows the possibilities of administration and, in certain cases, makes it pointless.

The UNCITRAL Legislative Guide on Secured Transactions suggests, upon enforcement from the assets as a whole, the use of the institute of administrator, which would “assist in avoiding liquidation and in facilitating reorganization of the enterprise with beneficial effects for creditors, the workforce and the economy in general.”<sup>71</sup> To avoid the situations when administrators favour only the secured creditor, “this problem may be mitigated to some extent if the administrator is appointed and supervised by a court or other authority”.

It should also be admitted that the method provided for in law for the transfer of enterprises is disadvantageous in case of enforcement of enterprise mortgage; therefore, the only enforcement method of enterprise mortgage used in practice is

---

<sup>67</sup> John Armour, *supra* note 8: 21.

<sup>68</sup> Article 4.239(1) of the CC.

<sup>69</sup> Article 4.239 of the CC.

<sup>70</sup> Article 2773 of the Civil Code of Quebec provides that: “A creditor who holds a hypothec on the property of an enterprise may temporarily take possession of the hypothecated property and administer it or generally delegate its administration to a third person. The creditor or the person to whom he has delegated the administration acts in such a case as administrator of the property of others charged with full administration”.

<sup>71</sup> UNCITRAL *Legislative Guide on Secured Transactions*, *supra* note 50, 81.

the disposal of enterprise assets by separate objects.<sup>72</sup> First of all, the method of purchase and sale of enterprises is expensive and lengthy, which is utterly incompatible with the principle of prompt and fast enforcement in the security law. The national regulation on the transfer of enterprises has also been criticised in the doctrine as being difficult to be applied in business transfer practices where it is often replaced by the purchase and sale of shares – “a simple and fast process that does not lead to any employee redeployment problems.”<sup>73</sup>

The procedures of enterprise purchase and sale are criticized due to their complexity and high costs (mandatory notarised form, information to creditors, disclosure of information about the transfer of the enterprise (business) to the creditors, involvement of the purchaser into the business activities of the enterprise); such procedures should also be applied in case mortgaged enterprises are transferred as the law does not provide for any exceptions. Moreover, the mechanism of protection of creditors provided for in the law in case of the sale of an enterprise is “overly complex, turning the protection of creditor rights (proof that the buyer is capable of paying its debts) into payment of the debts of the enterprise.”<sup>74</sup> For example, similar provisions regulating the purchase and sale of enterprises in the CC of Quebec<sup>75</sup> were revoked in 2002 because the regulation, which was previously in place and aimed at protecting the creditors of enterprise sellers, aggravated the position of enterprise buyers disproportionately and made this institute unusable.<sup>76</sup>

Whereas the enterprise mortgagee holds mortgage over the whole assets of the enterprise and has absolute priority to the proceeds of sale of the encumbered assets, it is in its interests to sell the enterprise as a fund of assets, without any debts and liabilities. A major safeguard in the sale of mortgaged enterprises can be ensured by stipulating a statutory obligation for the administrator who sells the enterprise to seek maximum benefit not only for the mortgagee but also for other creditors, i.e. to sell the enterprise for the highest price possible in order to satisfy as many creditor claims as possible.

The creditor of floating charge in England can use the so-called pre-pack administration, as an enforcement measure, which is mostly initiated by the holders of security rights to all corporate assets.<sup>77</sup> The English pre-pack administration has been defined as an arrangement under which the sale of all or part of a company’s

<sup>72</sup> The data have been obtained from the survey of bailiffs that was carried out in October–November 2016.

<sup>73</sup> Virginijus Bitė, *supra* note 31, 36–43; Julija Kiršienė and Kristupas Kerutis, *supra* note 31: 24–31.

<sup>74</sup> *Ibid.*: 28.

<sup>75</sup> Articles 1767–1778 of the Civil Code of Quebec.

<sup>76</sup> *Loi n°50: Loi modifiant le Code civil d'autres dispositions législatives (Bill n°50: An Act to amend the Civil Code and other legislative provisions)* // <http://www.assnat.qc.ca/en/travaux-parlementaires/projets-loi/projet-loi-50-36-2.htm>.

<sup>77</sup> Louise Gullifer and Jeniffer Payne, *supra* note 42, 333.

business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the administrator effects the sale immediately on, or shortly after, his appointment.<sup>78</sup> The use of pre-pack administration is said to have increased after the reform undertaken by the Enterprise Act 2002<sup>79</sup> when the possibility of administrator appointment outside court was introduced.<sup>80</sup> Although the Act itself does not make any reference to pre-pack administration, the possibility of administrator appointment out of court with minimum formalities has opened the avenue for this form of administration to become widespread.<sup>81</sup> The proceeds obtained from the pre-pack sale of an enterprise are used to settle with creditors according to their ranking and later the legal entity is most often liquidated because, after the transfer of the enterprise as a business the enterprise becomes a “mere shell” with debts.

The proceedings of enforcement from the assets encumbered by enterprise mortgage are often accompanied by insolvency procedures. The law does not prohibit the sale of an enterprise or its part as a fund of assets during bankruptcy; however, it does not regulate the procedures or terms of such sale. The Seimas of the Republic of Lithuania has registered Draft No. XIIP-3944 of the Enterprise Bankruptcy Law No. IX-216 of Republic of Lithuania proposing to recast the Enterprise Bankruptcy Law and provide for the possibility of enterprise sale in bankruptcy proceedings in its Article 53. The Explanatory Letter to the Law states that:

The underlying specifics of such transfer of an enterprise is that the contract of the enterprise purchase and sale transfers into the ownership of the purchaser the whole enterprise or its substantial part as a fund of assets, except for the creditor claims approved by the court, which derive from the obligations not performed before the institution of the bankruptcy proceedings, as well as the rights and obligations that the seller is not entitled to transfer to other persons under other laws. The contract on the enterprise purchase and sale may also stipulate that the liabilities, which have been incurred before the enterprise sale and have been defaulted with resultant creditor claims approved in relation to them, shall not be transferred to the purchaser, unless the purchaser agrees to take over such liabilities and the creditors with claims taken over by the seller agree that the liabilities of that

---

<sup>78</sup> Mark N. Wellard and Peter Walton, “A Comparative analysis of Anglo-Australian pre-packs: can the means be made to justify the ends?” *International Insolvency Review* 12 (2012): 122 // DOI: 10.1002/iir.1201.

<sup>79</sup> *Enterprise Act 2002 (Legal act of the UK)* // <http://www.legislation.gov.uk/ukpga/2002/40/contents>.

<sup>80</sup> *Graham Review into Pre-pack Administration* (2014), 14 //

<https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>.

<sup>81</sup> Roy Goode and Royston M. Goode, *Principles of Corporate Insolvency Law* (London: Sweet & Maxwell, 2011), 413.

enterprise will be discharged or the claims resultant from their non-performance will be satisfied by the seller.<sup>82</sup>

The adoption of these legislative amendments would make such legal regulation more favourable to enterprise mortgagees in the cases of the debtor's insolvency rather than in the cases of enforcement from encumbered assets, which can make the mortgagee wait until the debtor's financial situation meets the criteria of insolvency.

## CONCLUSIONS

The legal regulation of enterprise mortgage does not provide an answer about the content constituents of an enterprise as the object of enterprise mortgage. Systematic analysis of the legal regulation leads to the conclusion that the object of enterprise mortgage is an enterprise as a fund of assets, which consists of the property (tangible and intangible, movable and immovable, existing and future) held by the legal entity. The legal characterisation of enterprise mortgage as a *sui generis* fund of assets makes it possible not only to identify the scope of this object but also to ascertain the content of the rights of other creditors to the collateral and the enforcement right held by the enterprise mortgagee. In enforcement proceedings the sale of a fund of assets used for a specific business as a whole can be more beneficial not only to the mortgagee but also to other creditors of the legal entity the assets of which have been charged by enterprise mortgage. However, the achievement of this goal can be difficult because the existing legal regulation is not favourable for the sale of mortgaged enterprise as a whole in enforcement proceedings due to its complexity, high costs and mechanism of protection of creditors. The enterprise mortgagee should be in the position to sell the assets charged by the legal entity as a fund of assets, excluding the debts and obligations to other creditors. In order to avoid any abuse by the enterprise mortgagee of its rights and seek the sale of fund of assets for the maximum market price, an active approach is required from the administrator, who would have obligations not only towards the enterprise mortgagee but also towards other creditors in case of a sale of the enterprise. The enterprise mortgagee should share the benefits of its absolute priority with other creditors in enforcement proceedings. A major flaw in the national regulation is related to the provisions granting the absolute priority to

---

<sup>82</sup> *Explanatory Letter to the Law Amending Enterprise Bankruptcy Law No. IX-216 of the Republic of Lithuania, the Law Amending Article 6.410 of Civil Code of the Republic of Lithuania, the Law Amending Articles 20 and 24 of the Law on Companies No. VIII-1835 of the Republic of Lithuania and Supplementing the Law with Article 23<sup>1</sup> and the Law Amending Article 120 of the Code of Administrative Offences of the Republic of Lithuania //* <https://e-seimas.lrs.lt/portal/legalAct/lt/TAK/946ef700af9b11e59010bea026bdb259?jfwid=-pozqu8iev>.

the enterprise mortgagee over all creditors of the debtor (grantor) without any exceptions, i.e. by the monopolistic effect of enterprise mortgage. This effect should be reduced in order to avoid over-collateralization and dependence of debtor (grantor) on one single creditor. Some problems can be solved only by amendments of legal regulation, some of them can be eliminated by the clauses of contract on enterprise mortgage. A revision is necessary of the provisions related to the protection of the rights of other creditors of the debtor (grantor) by providing super priority protection to the creditors who finance the acquisition of new assets after the publication of the enterprise mortgage contract and who are ensured by remedies *in rem* by law to secure the enforcement of obligations. Whereas the freedom of contract applies to the area of commercial charge, in order to reduce its dependency on one single creditor, the debtor could negotiate the terms which would reduce the negative implications of enterprise mortgage. The parties should agree in the enterprise mortgage contract on the ratio between the value of the encumbered assets and the amount of the secured obligation during the performance of the contract; on the grounds and conditions under which the mortgagee is entitled to claim enforcement of the claim secured by mortgage before the term in order to avoid coercive enforcement measures where a breach of the secured obligation is minor; and, by specifying the clause of negative pledge as the requirement to get the creditor's consent for any secondary charge (mortgage) rather than in the form of an absolute prohibition to encumber any assets that constitute the object of enterprise mortgage by a subsequent mortgage (charge). That would not only reduce potential over-collateralization but would also ensure an opportunity for the debtor to obtain, when necessary, financing from other sources.

#### BIBLIOGRAPHY

1. Ali, Paul A. U. *The Law of Secured Finance*. Oxford, 2002.
2. Armour, John. "The Law and Economics Debate About Secured Lending: Lessons for European Law Making": 3–30. In: Horst Eidenmüller and Eva-Maria Kieninger, eds. *The Future of Secured Credit in Europe. European Company And Financial Law Review – Special Volume*. Berlin: De Gruyter Recht, 2012.
3. Baranauskas, Egidijus. *Įkeitimo teisinis reguliavimas: daktaro disertacija (Legal Regulation of Mortgage: Doctoral Dissertation)*. Social Sciences, Law (01S). Vilnius: Law University of Lithuania, 2002 [in Lithuanian].
4. Baranauskas, Egidijus. "Įmonės įkeitimas" (Enterprise Mortgage). *Jurisprudencija* 28(20) (2002): 124–127 [in Lithuanian].

5. Beale, Hugh, Michael Bridge, et al. *The Law of Security and Title-based Financing*. 2<sup>nd</sup> edition. Oxford: Oxford University Press, 2012.
6. Belov, Viktor A. *Imushchestvennye komplekсы (Fund of Assets)*. Moskva: AO Centr Jurinfor, 2004 [in Russian].
7. Bitė, Virginijus. *Uždarosios bendrovės akcijų pardavimas, kaip verslo perleidimo būdas: daktaro disertacija (Sale of Shares of Private Limited Liability Company as a Means of Business Transfer: Doctoral Dissertation)*. Social Sciences, Law (01S). Vilnius: Mykolo Riomerio universitetas, 2009 [in Lithuanian].
8. Dalhuisen, Jan H. *Dalhuisen on International Commercial, Financial and Trade Law*. Oxford and Portland: Oregon, 2004.
9. Eidenmüller, Horst, and Eva-Maria Kieninger, eds. *The Future of Secured Credit in Europe. European Company And Financial Law Review – Special Volume*. Berlin: De Gruyter Recht, 2012.
10. Erp, Sjef V., and Bram Akkermans. *Cases, Materials and Text on Property Law*. Oxford and Portland: Oregon, 2012.
11. European Bank for Reconstruction and Development. *Model Law on Secured Transactions* (1994) // <http://www.ebrd.com/news/publications/guides/model-law-on-secured-transactions.html>.
12. Goode, M. Roy, Heather Keating, and Sally Cunningham. *Goode on legal problems of credit and security*. 5<sup>th</sup> edition. London: Sweet & Maxwell, 2014.
13. Goode, Roy, and Royston M. Goode. *Principles of Corporate Insolvency Law*. 4<sup>th</sup> edition. London: Sweet & Maxwell, 2011.
14. *Graham Review into Pre-pack Administration* (2014) // <https://www.gov.uk/government/publications/graham-review-into-pre-pack-administration>.
15. Gullifer, Louise, and Jenifer Payne. *Corporate Finance Law. Principles and Policy*. 2<sup>nd</sup> edition. Oxford/Oregon: Hart Publishing, 2015.
16. Jakutytė-Sungailienė, Asta. *Įmonė kaip civilinių teisių objektas: daktaro disertacija (Enterprise as an Object of Civil Rights: Doctoral Dissertation)*. Social Sciences, Law (01S). Vilnius: Mykolas Romeris University, 2010 [in Lithuanian].
17. Kieninger, Eva-Maria, ed. *Security Rights in Movable Property in European Private Law*. Cambridge: University Press, 2004.
18. Kiršienė, Julija, and Kristupas Kerutis. "Verslo perleidimas akcijų ar įmonės pardavimo būdu: teisinio reglamentavimo ir praktikos lyginamoji analizė" (Methods of Business Transfer: the Sale of Shares or a Company: a

- Comparative Analysis of Legal Regulation and Practice). *Jurisprudencija* 3 (81) (2006): 24–31 [in Lithuanian].
19. Mizaras, Vytautas, ed. *Civilinė teisė. Bendroji dalis (Civil Law. General Part)*. Vilnius: Justitia, 2009 [in Lithuanian].
  20. Mokal, Riz. "The Floating Charge – An Elegy": 479–513. In: Sarah Worthington, ed. *Commercial law and commercial practice*. Oxford: Hart Publishing, 2003.
  21. Smaliukas, Andrius. *Kilnojamojo turto įkeitimo teisės reforma ir derinimas: lyginamoji analizė: daktaro disertacija (Reform and harmonization of law of security over movable property: comparative study: Doctoral Dissertation)*. Social Sciences, Law (01S). Vilnius: Vilnius University, 2002 [in Lithuanian].
  22. Smaliukas, Andrius, et al. *LR civilinio kodekso komentaras. Ketvirtoji knyga. Daiktinė teisė. Hipoteka (Commentary to the Civil Code of the Republic of Lithuania. Book Four. Property Law. Mortgage)*. Vilnius: Justitia, 2013 [in Lithuanian].
  23. *UNCITRAL Legislative Guide on Secured Transactions* (2007) // [http://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670\\_Ebook-Guide\\_09-04-0English.pdf](http://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-0English.pdf).
  24. *UNCITRAL Model Law on Secured Transactions* (2016) // [http://www.uncitral.org/pdf/english/texts/security/ML\\_ST\\_E\\_ebook.pdf](http://www.uncitral.org/pdf/english/texts/security/ML_ST_E_ebook.pdf).
  25. Walsh, Catherine. "Super priority for Asset Acquisition Financing in Secured Transaction law: Formalism or Functionalism": 457–477. In: Sarah Worthington, ed. *Commercial Law & Commercial Practice*. Ch. 16. Oxford: Hart, 2003.
  26. Wellard, Mark N., and Peter Walton. "A Comparative analysis of Anglo-Australian pre-packs: can the means be made to justify the ends?" *International Insolvency Review* 12 (2012): 143–181 // DOI: 10.1002/iir.1201.
  27. Wood, Philip. R. *Comparative Law of Security Interests and Title Finance*. London: Sweet and Maxwell, 2007.

## LEGAL REFERENCES

1. *Civil Code of the Republic of Lithuania*. Official Gazette, 2000, no. 74-2262.
2. *Civil Code of the Russian Federation*. Official Gazette, No. 51-Φ3, 30.11.1994.
3. *Code civil du Québec (Civil Code of Quebec)* // <http://legisquebec.gouv.qc.ca/fr/showdoc/cs/CCQ-1991>.
4. *Code of Civil Procedure of the Republic of Lithuania*. Official Gazette, 2002, no. 7436-1340.



5. *Companies Act 2006 (Amendment of Part 25) Regulations 2013* // <https://www.legislation.gov.uk/ukdsi/2013/9780111533208/contents>.
6. *Enterprise Act 2002 (United Kingdom)* // <http://www.legislation.gov.uk/ukpga/2002/40/contents>.
7. *Explanatory Letter to the Law Amending Enterprise Bankruptcy Law No. IX-216 of the Republic of Lithuania, the Law Amending Article 6.410 of Civil Code of the Republic of Lithuania, the Law Amending Articles 20 and 24 of the Law on Companies No. VIII-1835 of the Republic of Lithuania and Supplementing the Law with Article 23<sup>1</sup> and the Law Amending Article 120 of the Code of Administrative Offences of the Republic of Lithuania* // <https://e-seimas.lrs.lt/portal/legalAct/lt/TAP/3ef92a20af9611e59010bea026bdb259?positionInSearchResults=59&searchModelUUID=1649f0c7-2d6b-4040-bc7b-29ce43408f13>.
8. *Federal Law on Hypothec (Charge of Immovables) of Russian Federation*. Official Gazette, No. 102-Φ3, 16.07.1998.
9. *Law on Amending and Supplementing Articles 4.127, 4.170, 4.171, 4.172, 4.173, 4.174, 4.175, 4.176, 4.177, 4.178, 4.179, 4.180, 4.181, 4.182, 4.183, 4.184, 4.185, 4.186, 4.187, 4.188, 4.189, 4.190, 4.191, 4.192, 4.193, 4.195, 4.196, 4.197, 4.198, 4.199, 4.200, 4.201, 4.202, 4.204, 4.206, 4.207, 4.209, 4.210, 4.211, 4.212, 4.213, 4.214, 4.216, 4.219, 4.220, 4.221, 4.223, 4.224, 4.225, 4.226, 4.256 of the Civil Code of the Republic of Lithuania and Supplementing the Code with Articles 4.192-1, 4.194-1 of Code*. Official Gazette, 2012, no. 6-178.
10. *Law on Enterprise Bankruptcy of the Republic of Lithuania*. Official Gazette, 2001, no. 31-1010.
11. *Loi n 50: Loi modifiant le Code civil et d'autres dispositions legislatives (Bill n°50: An Act to amend the Civil Code and other legislative provisions)* // <http://www.assnat.qc.ca/en/travaux-parlementaires/projets-loi/projet-loi-50-36-2.html>.