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# STATUTORY RIGHT OF LIEN PROVIDED BY SECTION 672 OF THE CIVIL CODE AND ITS APPLICATION IN THE INSOLVENCY PROCEEDINDS

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**Abstract in original language**
Příspěvek se zabývá zákonným zástavním právem dle § 672 občanského zákoníku. Pozornost je, kromě zamyšlení nad povahou a principy tohoto institutu jako takového, zaměřena zejména na problematiku vzniku zástavního práva, specifikaci zástavy a s tím souvisejících problémů spojených s pořízením soupisu movitých věcí tvořících zástavu soudním vykonavatelem. Obsaženo je rovněž pojednání o možnostech využití tohoto zajišťovacího institutu pro účely insolvenčního řízení.

**Key words in original language**
Zákonné zástavní právo, pronajímatel, nájemce, zajištění, insolvenční řízení.

**Abstract**
The contribution focuses on statutory right of lien which originates under the conditions provided by Section 672 of Civil Code. The main issues are origination and subject of the right of lien and problems connected to inventory of movable assets being the pledge as well as the principles and nature of this legal institute. The paper also disserts on the possibility of application of this statutory right of lien within the insolvency proceedings.

**Key words**
Statutory right of lien, lessor, lessee, security, insolvency proceedings.

This paper disserts on the right of lien provided by Section 672 of the Act No. 40/1064 Col., Civil Code, as amended (hereinafter the "Civil Code"). The aim of this contribution is to point out particular selected issues concerning this legal institute which might be or which seem to be unclear or disputable. Although the respective right of lien might create useful security for lessor, if known and applied, the acquaintance of the institute is very low, even among lawyers. Therefore, not only is this institute interesting but it is also important as it can be used as useful form of security.

To briefly summarize the main points of this contribution, it focuses mainly on the issues connected to pledge and its nature, the origination of the right of lien, the official inventory and the issues connected to the proceedings in

which the inventory of movable things being the pledge is ordered and finally on application of the respective right of lien in insolvency proceedings and its advantages.

As is provided in the above mentioned Section 672 of Civil Code, to secure the claim for rent the lessor has right of lien to the movable assets owned by the lessee or by the members of lessee's common household which are located in/on immovable subject of lease (with exception for the movable assets exempted from the court execution) (hereinafter the "statutory right of lien"). The statutory right of lien ceases to exist should the movable assets are removed before being invented by the court executor, unless they were removed on basis of official order and the lessor announces his rights to the court within the time limit of eight days. Should the lessee moves or should the movable assets are being removed although the rent is not duly paid or secured, the lessor is entitled to retain the respective movable things on his own risk and is obliged to file request to the court for official inventory of the respective assets within eight days after the retention. If the request for inventory is not filed to the court within the above mentioned time limit the lessor is obliged to release the retained assets.

From the contents of Section 672 of Civil Code summarized above in the previous paragraph of this contribution it is clear that only the person leasing an immovable is entitled to the statutory right of lien. Therefore, the statutory right of lien applies if the subject of lease consists of immovable buildings, plots of land, apartments or non-residential spaces. It is important to be aware of the fact that there are some "buildings" which does not have the nature of immovable - the constructions not inseparably connected to the land, e.g. some garages, sheds etc. In such cases the statutory right of lien does not originate. Although the lessees of apartments usually enjoy substantially higher protection than lessees of any other immovable or movable assets, the statutory right of lien applies in case of lease of residential spaces under the same conditions as in case of any other immovable.

In connection to any right of lien one of the most important aspects is to define the pledge. In compliance with the Section 672 of Civil Code, the subject of statutory right of lien, i.e. the pledge, can consist of movable things only, the immovable assets are excluded. This limitation of the pledge is not likely to cause problems very often. Nevertheless, it is possible to have house (i.e. immovable) built on leased plot of land. In such case, the lessor would have no statutory right of lien to the lessee's house located on the leased plot of land, the statutory right of lien would apply only to the movable assets of the lessee or his household members located in the respective house. On the other side, it is hardly possible to remove the house from the leased land and such house owner would be probably highly motivated to pay the rent in order to keep the lease of the plot. In conclusion, it theoretically may be problem that the pledge is limited to the movable assets only, however, it can be expected that the real problems in

practice would occur rarely. It would be useful to mention that there is no reason why the statutory right of lien shall not be applied to the securities placed in/on the subject of lease since in compliance with Section 1 par. 2 of the Act No. 591/1992 Col., Securities Act, as amended, the securities shall be treated as movable assets. The statutory right of lien also applies to money which occur in/on the leased immovable. In connection to the assets being the pledge, it does not matter whether the respective assets are placed in another movables thing not owned by the lessee or his household members which is situated in/on the leased immovable[1]. This may be for instance the case of car owned by some third person (e.g. lessee's employer or leasing company) which is parked on leased plot and in which the lessee has his or his household members' things. In such case, there would be no statutory right of lien to the car, but there certainly would be the statutory right of lien in respect to the movable things placed in it.

It is necessary to emphasize that only the movable assets owned by the lessee himself or by the members of his common household can be the pledge. In particular, the statutory right of lien does not apply to the movable things owned by sub-lessee as was also confirmed by the Supreme's Court decisions No. 28 Cdo 311/2006 issued on February 22, 2006. Moreover, should an immovable is leased by lessee and on his behalf for benefit of any third person (in compliance with Section 50 of Civil Code), no statutory right of lien is applicable to the movable things owned by such third person. Basically, the Supreme Court concluded in above mentioned decision that the institute of statutory right of lien interferes substantially to guaranteed rights and thus the provision of Section 672 of Civil Code should not be interpreted extensively. Such reasoning corresponds to one of the basic legal principles guaranteed by Czech constitution that only the laws may impose duties. Therefore, for the lessor, it may be precarious to have either sub-lessee or the third person in terms of Section 50 of Civil Code in his leased immovable.

As to the moment of origination of the statutory right of lien the Section 672 of Civil Code says nothing. Nevertheless, considering the general provisions of Civil Code concerning the right of lien in accordance to which the right of lien may be established also to secure future claims as well as with respect to the sense and purpose of the statutory right of lien it may be concluded that the statutory right of lien originates by bringing the movable things into/onto the leased immovable, yet not sooner than the lease contract becomes effective. So there are two cumulative prerequisites of origination of the statutory right of lien - existence of effective lease contract (once originated, the statutory right of lien may exist even after the termination of lease contract as described below) and location of some lessee's or his common household members' movable things in/on the leased immovable.

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[1] Švestka, J. - Spáčil, J. - Škárová, M. - Hulmák, M. et al: Občanský zákoník II. Komentář. Praha: C.H. Beck, 2008, s. 1749, ISBN 978-80-7400-004-1.

It is obvious that the lessor has unlimited possibility to change the scope of pledge (unless the official inventory is made as described below) by simple moving in or removing the movable assets. There are some opinions that the statutory right of lien originates with the maturity of claim for rent[2], i.e. if there is no collectible claim of rent there would be no statutory right of lien. With reference to already mentioned basic rules provided by law in respect of right of lien as well as considering the purpose and sense of statutory right of lien such opinion can be hardly acceptable. The statutory right of lien, once originated, is considered to secure any future claims for rent.

It is important that the statutory right of lien does not cease to exist with termination of lease. Although this is not expressly provided by the Section 672 of Civil Code, the purpose of the statutory right of lien, as provided by law, is to secure claim for rent. Therefore, if there is any claim for rent it does not matter whether the lease contract lasts or not, should there are still some movables things in the respective immovable or should the official inventory of respective movable things was drawn up. This opinion was supported by decision of Municipal Court of Prague No. 20 Co 62/98. Of course, the lessee usually removes his property when the lease is terminated, especially the things of higher value which would be the most satisfactory pledge for the lessor. Anyway, in such situations the lessor may apply the retention right under the conditions provided by Section 672 of Civil Code and thus ensure preservation of his rights to the pledge. Of course, the retention right may be applied both during and after termination of the lease if the conditions provided by law are fulfilled.

The same rules apply in respect to the request for official inventory of lessee's or his household members' movable assets located in the leased immovable. The request for the official inventory may be filed both during the lease and after its termination, i.e. the right to file such request is not conditioned by existence of lease but only by existence of claim for rent. From this point of view two types of inventory may be distinguished: (i) preventive inventory which is drawn up in situation when the rent is not paid and the lessee still uses the leased immovable without removing any movable things and (ii) the inventory ensuing application of retention right in case that the rent is not paid and the lessee either moves or removes the movable assets from the leased immovable. The two types of the inventory are i.a. distinguished also in the decision of Municipal Court of Prague No. 20 Co 62/98. As to the retention right under the Section 672 of Civil Code there is remarkable difference in comparison with "ordinary" retention right under the Section 175 et seq. of Civil Code. Whereas the general retention right can be applied only if the obligee has the respective movable thing in his direct disposal, under the Section § 672 such direct disposal is not

[2] Fiala, J. - Hurdík, J. - Korecká, V.: Občanský zákoník - komentář. Část VIII. Hlava VII. Oddíl druhý, Nájemné § 672. ASPI - původní texty pro ASPI, 1999.

necessary and even is not assumed since the movable things being subject of retention are in/on the immovable used by the lessor.

The other disputable question concerning the statutory right of lien is the nature of proceedings in which the inventory of movable assets under the Section 672 of Civil Code is ordered. There is no explicit answer to this question provided by law; it may be either precaution proceedings or some special type of civil proceedings sui generis. The Municipal Court of Prague tends to clasify the proceedings as precaution proceedings; it decided in this matter two times - in decision No. 20 Co 62/98 and recently in decision No. 30 Co 97/2010. In compliance with the above mentioned decisions the inventory has the nature of special precaution. Although there are some discrepancies between the character and purpose of precaution as provided by Section 74 et seq. of Act No. 99/1963 Col., Civil Procedure Act, as amended, and the purpose of the official inventory of movable assets under Section 672 of Civil Code, these are of minor relevance only. But if the inventory is considered as special type of precaution, the courts should comply with the time limits provided by law and order the inventory within these time limits. In this connection it must be emphasize that the time limit in which the precaution order must be delivered is seven days in maximum, but it often takes weeks to the courts to decide on inventory order under the Section 672 of Civil Code. Due to such negligent approach of the courts to the institute of official inventory of movable assets under the Section 672 of Civil Code the very purpose and sense of this institute is affected and the rights and just expectations of the lessor might be invaded, legal certainty may be weakened. Considering the purpose of the institute the procedure should be as fast as possible.

In connection to the proceedings in respect to the inventory of movable assets under the Section 672 of Civil Code there is another unclear issue - the territorial jurisdiction of the court. Although it seems logical to determine court jurisdiction on basis of location of respective leased immovable the court judicature so far took another stand. As was concluded by the Municipal Court of Prague in decision No. 30 Co 97/2010 the court appropriate for the decision on inventory under the Section 672 of Civil Code is the court of general trial jurisdiction, i.e. the petition in this matter shall be lodged to the court in territory of which the lessee has its residence or registered office. In reality, this approach might be inefficient, because the closer the court is to the leased immovable, the faster and more efficiently it is possible to draw up the inventory of movable assets located in the respective immovable. Of course, the inventory might be realized upon request addressed from the appropriate court (the court of general trial jurisdiction) to the court in territory of which the immovable is situated. But it would certainly be better to file the petition directly to the latter court which would be able to proceed in the matter of official inventory of movable assets more efficiently and without additional expenses. In addition to that, in the old and already cancelled Civil Procedure Code, i.e. Act. No. 142/50 Col., it was expressly provided that the territorial jurisdiction in this

matter shall be governed by the location of the immovable. It seems there is no logical reason to change the rule which was in operation in past and which is certainly more effective. As to the reasoning of above quoted decision the Municipal Court of Prague deduced that the proceedings relates to the movable things not to the immovable itself. Nevertheless, the court probably did not consider the fact that the inventory may be drawn up only if the respective movable things are still located in the leased immovable. Ttherefore the inventory itself is always realized in the respective immovable and thus is directly and inseparably connected to it.

The reason why this paper is focused on the statutory right of lien in connection with insolvency proceedings is the fact that although the statutory right of lien could provide significant advantage to the lessor within the proceedings it is not used very often. In almost every insolvency proceedings there is some lessor who lodges his claim for unpaid rent - it can be said that almost every bankrupt debtor usually used some leased spaces, either non-residential spaces, plots or apartment. Nevertheless, only few creditors who has the claim for rent lodge their claim as secured by the statutory right of lien. By not taking advantage of the possibility to lodge the claim as secured the creditor might deprive himself of settlement of his claim. In absolute majority of cases the creditor's claims lodged into the insolvency proceedings remains almost unsettled. Usually, the bankrupt debtor has not enough finances to cover all the lodged claims and in addition to that some of the claims has priority. Basically, the claims which are covered first are the claims arising from labour contracts and other claims provided by the Act No. 182/2006 Col., Insolvency Act, as amended (hereinafter the "Insolvency Act"). Then, the secured claims are settled and remaining "ordinary", i.e. unsecured claims are settled at the end by using the rest of financial means. Moreover, if the claim is secured by right of lien the creditor's claim will be covered with the proceeds of the sale of pledge. Thus, on supposition that the movable assets owned by the debtor or his common household's members placed in the respective immovable which is or was subject of lease are not priceless, lodging the claim for rent as secured by statutory right of lien could substantially increase probability of settlement of the claim as well as the amount in which it will be covered.

Nevertheless, only the security established or originated before the initiation of insolvency proceedings may be applied[3]. This provision is obviously based on the idea that someone who concludes lease contract with person against whom the insolvency proceeding was already initiated must be aware of the risk of default from part of such lessee and therefore shall be less protected than the creditors who had no idea about any thread of lessee's bankruptcy. Because of this legal rule provided by Section 109 par. 1 letter b) of the Insolvency Act it is important to determine the moment in which

[3] Kotoučová, J. et al: Zákon o úpadku a způsobech jeho řešení (insolvenční zákon). Komentář. Praha: C.H. Beck, 2008, s. 431, ISBN 978-80-7179-595-7.

the statutory right of lien originates as described above. The moment of origination is decisive not only regarding the right to apply the statutory right of lien within the insolvency proceedings but also in respect of the order of settlement of secured claims in case that there are more than one creditors having right of lien to the same movable assets (e.g. based on contract on pledge of either concrete movable things or the whole business establishment).

Therefore it is obviously not advisable to conclude lease contract with person against which the insolvency proceedings was already initiated. Anyway, only the fact that the contract was concluded prior the initiation of the insolvency proceedings does not give enough guarantee to the lessor for settlement of his claim for rent in the insolvency proceedings. Each lessor should monitor his lessee whether all the payable rent is duly paid and if it is not, whether the lessee removes the movable assets from the leased immovable. In case the lessee does remove the movable things being the pledge the lessor should apply the retention right and then file petition to the court to draw up the official inventory. In such situations, the inventory could strengthen the position of the lessor since the movable assets listed in the inventory are subject to the statutory right of lien even if they were removed from the respective immovable.

Nevertheless, although the official inventory of movable assets under the Section 672 of Civil Code is theoretically strong instrument in order to preserve the statutory right of lien, its real efficiency might be disputable. Once the inventory is drawn up the lessor has no longer any right to retain the movable assets and therefore the lessee is fully entitled to remove them form the respective immovable, whereas the statutory right of lien to the assets listed in the inventory remains. Nevertheless, in practice it may be very difficult to find the listed movable assets being the pledge in order to execute the statutory right of lien.

In conclusion it can be said that the legal institute of statutory right of lien provided by Section 672 of Civil Code may be efficient means for the lessor how to enforce his position and increase the probability of having his claim for rent paid. Of course, the lessor who wants to take advantage of this legal institute must adhere to the ancient legal principle vigilantibus iura since it is necessary to duly monitor the lessee if there is suspicion of any payment problems. Anyway, the low knowledge of rights provided in Section 672 of Civil Code still brings obstacles to effective use of this legal institute. Moreover, there is still lack of Supreme's Court judicature in respect of matters provided by Section 672 of Civil Code and therefore some questions are still subject of discussion.

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