

## COURT EXAMINES VALIDITY OF A PLEDGE OF REVENUE IN BANKRUPTCY

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The Supreme Court recently held that the bank to which a company had pledged a business premises and associated rental revenue was entitled to rental revenues accumulated after the bankruptcy of the company.

### 1 Background

In June 1991 the company pledged to the bank shares that entitled possession of the business premises. According to the contract of pledge, the pledge also covered the revenue from the pledged object, which was defined as the rental revenue of the business premises.

The company leased the pledged premises to an investment bank in July 1991. The lessee was notified by the company and the pledgee that the premises and their rental revenue had been pledged to the pledgee and that the rent may be effectively paid only to the pledgee.

In June 1992 the company was declared bankrupt. After the lessor's bankruptcy the lessee continued to pay rents to the pledgee.

### 2 Claims and Proceedings

The company's bankruptcy estate demanded that the pledge of the rental revenues accumulated after the bankruptcy be invalidated. The bankruptcy estate believed that the rental payments to the pledgee endangered the capability of the bankruptcy estate to comply with its contractual obligations. It also claimed that the pledge of the shares and the pledge of the rental revenues were two separate pledges, and that their validity should be decided separately.

In response the bank claimed that there was no legal basis for such claims. According to the bank, a principle of the solidarity of a pledge and its revenue has been confirmed by the courts. Therefore, the issue of a pledge of rental revenues should be considered as ancillary to the pledge of the shares. Further, the bank claimed that it is common to pledge shares and their revenue jointly, and as the bankruptcy estate was bound by the contract of pledge, the rental revenues belonged to the bank.

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### 3 Decision

Both the district court and the court of appeal found that there was a valid agreement between the company and the bank on the pledge of the revenue, and that a valid notice of the assignment of the pledge was made to the lessee. Thus, both courts dismissed the case. The district court stated that rental revenue is often considered to be the revenue of pledged objects and that there were no special circumstances in the case to alter this conclusion.

The Supreme Court also held that the bank had the right to keep rental revenues accumulated after the bankruptcy of the company. The court stated that there is no legislation on the issue of whether the rental revenues of a pledged movable object accumulated after bankruptcy belong to the bankruptcy estate or the pledgee. Further, the decision could not be based on the provisions concerning pledges of real estate. The Supreme Court concluded that the issue must be decided according to the Promissory Notes Act and its provisions with regard to receivables.

Since the parties had effectively agreed on the pledge of the rental revenues and the lessee had been notified of the pledge in accordance with Article 10 and Article 31 of the Promissory Notes Act before the bankruptcy of the company, the Supreme Court found that the bank had the right to keep the rental revenues accumulated after the bankruptcy of the company.