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GLOSS ON THE RESOLUTION OF THE SUPREME COURT OF 4 APRIL 2023, III CZP 11/22*

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Abstract
This commentary on Supreme Court resolution III CZP 11/22 aims to address the question of whether a mortgage on a third party's property should be extinguished upon cancellation of the bankrupt's debts. It deals with the accessoriness of a mortgage and its role, as well as the admissibility of making a mortgage serve other purposes sanctioned by the legislature in the Bankruptcy Act. The commentary analyses the nature of the debt cancellation mechanism and the extent to which the solution proposed by the Supreme Court is compatible with the normative aim of the regulation, which is to seek creditor satisfaction. It also discusses the potential consequences of applying the judgment in practice, including the weakening of the function of a mortgage and of the position of the creditor, and the risk of abuse by debtors. Reference is also made to the impact the judgment may have in the context of conditional debt cancellation in bankruptcy proceedings.

Keywords: mortgage, debt cancellation, extinguishment of a mortgage

THESIS

Debt cancellation pursuant to Article 369 of the Bankruptcy Act (BA) of 28 February 2003, in the wording applicable before 1 January 2016, results in the extinguishment of a mortgage on a third party's property where the mortgage was created to secure the borrower's debt.

* Resolution of the Supreme Court of 4 April 2023, III CZP 11/22, OSN 2024, No. 5, item 47.

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INTRODUCTION

The following commentary is an attempt to address the question of the continued existence of a mortgage charge on a third party's property where the principal debtor's debt has been cancelled by a court in bankruptcy proceedings. It includes an analysis of the arguments presented in the court proceedings and of selected legal regulations, taking into account the consequences of applying the solution proposed by the Supreme Court.

FACTS

The facts giving rise to the resolution were as follows: the defendant's legal predecessor granted a loan to a person who was later declared bankrupt. The loan was secured by two mortgages created on real property belonging to the plaintiff, who was not the principal debtor. Upon completion of the bankruptcy proceedings, the District Court cancelled the whole of the unpaid debt owed by the debtor. Thereafter, the plaintiff sought the removal from the land register of the mortgage charges concerning the mortgage created on the plaintiff's property as security for the bankrupt's debt. The arguments set out in the plaintiff's claim asserted that debt cancellation in bankruptcy proceedings should lead to the mortgages being extinguished, as stipulated by Article 94 of the Act on Mortgage Registers and on Mortgages (AMRM).[1]

In considering the cassation appeal, the Supreme Court, sitting in an expanded composition, dealt with the following point of law:

> 'Does cancellation of debt, pursuant to Article 369(2) of the Bankruptcy Act of 28 February 2003, in the wording applicable before 1 January 2016, owed by the debtor to the creditor and secured on a property belonging to a third party, lead, with respect to the mortgage debtor who is also a party to the banking transaction establishing the mortgage, to the extinguishment of the claim secured by that mortgage, thereby entailing the extinguishment of the mortgage within the meaning of Article 94 Act of 6 July 1982 on Mortgage Registers and Mortgages?'

RESOLUTION

Pursuant to Article 369 BA, in the wording applicable before 1 January 2016, the admissibility of debt cancellation was contingent on the occurrence of special circumstances set out in that provision. The purpose of the provision was to release the debtor from personal liability so that he could restore his economic equilibrium. The legislature emphasised that this solution was not designed to shift the risk to creditors and should be used only in exceptional circumstances. Article 369 BA did not provide that debt cancellation did not affect the obligations of a loan guarantor or

[1] Act of 6 July 1982 on Mortgage Registers and Mortgages (Journal of Laws of 2023, item 1984).

a co-debtor. In contrast to Article 291 BA then in force, there was no regulation that would provide for the continued existence of a mortgage after the bankrupt's debt had been cancelled. The accessory nature of a mortgage was a further reason why the continued existence of the mortgage was deemed unjustified after the debt it had been created to secure had ceased to exist. The rule enshrined in Article 94 AMRM is that, if the debt is extinguished, the security is extinguished, even if that entails failure to repay the debt. Any exceptions to this rule should follow from special provisions.

ASSESSMENT OF THE RESOLUTION

The resolution in the case discussed must be viewed critically. According to the position taken by the Supreme Court, debt cancellation in bankruptcy proceedings leads to the extinguishment of a mortgage on a third party's property. This position has some basis. However, due to the nature of bankruptcy proceedings and the consequences of applying the resolution, the question arises whether the Supreme Court should in fact have taken a different view.

The resolution was adopted under the legal regime in force before 1 January 2016. At that time, Article 369 BA provided that, in a judgment concluding bankruptcy proceedings involving liquidation of the bankrupt's assets, where the bankrupt is a natural person, the court may, on application by the bankrupt, cancel all or part of the bankrupt's debt that remains outstanding following the bankruptcy proceedings if the bankruptcy was the result of exceptional circumstances beyond the bankrupt's control, the evidence in the case suggests that there are no grounds for depriving the bankrupt of the right to carry on business activity in his own name or the right to act as a representative of, or an attorney for, a commercial company, state enterprise, cooperative, foundation or association, or where the bankrupt duly performed the obligations imposed upon him in the bankruptcy proceedings. The cancellation applied to the debts listed in the schedule of debts and to any debt claims yet to be presented if their existence was documented by the bankrupt. The cancellation did not apply to the bankrupt's child maintenance payments, pensions by way of compensation for causing illness, incapacity for work, disability, or death, wages for employment, or national insurance contributions to employees' pension, disability and sickness funds.

It is tempting to assume that, as a consequence of the cancellation of debt secured on property, the mortgage securing the debt is extinguished. This view is justified by the accessory nature of a mortgage, which stems from Article 94 AMRM. Established case law states that, 'Under this provision, a mortgage interest in property is extinguished whenever the debt is extinguished, regardless of the reasons for its extinguishment, whether the creditor has been satisfied or not.'[2] One must consider, however, any exceptions whereby a mortgage can continue to exist even though the debt which it has been used to secure ceases to exist.[3] Although the

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[2] Order of the Supreme Court of 4 July 2014, II CSK 574/13, LEX No. 1493236.

[3] T. Czech, *Księgi wieczyste i hipoteka. Komentarz. Tom II. Hipoteka*, 2nd ed., Warszawa, 2024, Article 94, thesis 20.

exceptions should follow from the Act *expressis verbis*, case law shows that accessory liability may be limited by the application of principles of justice and fairness. An example of this is the view concerning the continued existence of a mortgage on a third party's property where the legal person who is the principal debtor ceases to exist.[4] Ensuring the continued existence of the security interest in such cases is dictated by the protection afforded to the creditor against any instances of abuse. It would appear that ensuring the continued existence of a mortgage interest after the debt has been cancelled in bankruptcy proceedings should serve a similar purpose.

The view that the accessoriness of a mortgage is of decisive importance is not uniformly upheld in case law. A contrary view holds that

> 'As a rule, the accessory nature of a mortgage is intended to protect the limited debtor in that its purpose is to provide broader protection for the limited debtor than for the principal debtor, that is, in cases where the principal debtor is no longer liable to the creditor. It also ensures that the creditor is not satisfied twice in respect of the same claim. Specifically, the purpose of the accessory nature of a mortgage transaction is not to release the limited debtor from his liability as a limited debtor in situations where the creditor of the principal debtor removed from the court register, retains the right to have his claims satisfied.'[5]

An unconditional subordination of personal liability relationships to the accessory nature of a mortgage may lead to a violation of the principles of justice and fairness and undermine trust in legal transactions. The position taken in the resolution seems to equate the existence of a mortgage with the existence of the underlying debt. It is contrary to the purpose of the accessory nature of a mortgage, the main aim of which is to protect the limited debtor against any liability over and above the liability he has accepted and the existing status of the debt. It justifies the extinguishment of the mortgage especially where the debt claim has been satisfied or modified, to the extent that its application would be contrary to justice and fairness. By contrast, the main purpose of a mortgage should be understood as securing a debt.

Similar doubts arise with regard to the legal effect under Article 369 BA as compared with that under Article 291 BA. It would appear that, if the legislature had intended Article 369 BA to be read as producing such an effect, it would have made this clear in the wording of the Article. On the other hand, such an interpretation, in its effects, is contrary to the purpose of this regulation, just as it is contrary to the *ratio legis* of bankruptcy proceedings. Article 2(1) BA requires that proceedings be conducted in such a way as to ensure that creditors' claims are satisfied to the fullest extent and, if reasonably justified, that the debtor's business enterprise is preserved. The principle of optimisation should be the lens through which the law is interpreted, so that creditors are protected and have priority over other parties.[6] It is assumed that the protection and satisfaction of creditors are the ultimate aim

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[4] Order of the Supreme Court of 10 May 2012, IV CSK 369/11, LEX No. 1238133.

[5] Judgment of the Supreme Court of 10 September 2015, II CSK 745/14, OSNC 2016, No. 7–8, item 90.

[6] R. Adamus, in: Witosz A.J., Witosz A. (eds), *Prawo upadłościowe i naprawcze. Komentarz*, 5th ed., Warszawa, 2014, Article 2, thesis 6.

of the proceedings and 'must not be diminished by other considerations, e.g. saving the debtor'.[7]

Under the law applicable before 1 January 2016, Article 2(2) BA required that proceedings falling under the law on natural persons not carrying on business activity be conducted in such a way as to ensure the cancellation of those of the bankrupt's debts that had not been settled in the bankruptcy proceedings and, if possible, the satisfaction of creditors' claims to the fullest extent. Consumer proceedings are first and foremost intended to help a bankrupt in financial difficulties make a fresh start by releasing him from debt liabilities he is unable to settle.[8] Their main aim is the cancellation of the insolvent debtor's liabilities, thereby allowing him to bring his financial affairs under control.[9] Insofar as the disputes concern consumers, the Supreme Court's position is justifiable to some extent; however, in proceedings concerning entrepreneurs, it raises doubts, not least because of the higher standard of duty of care required of entrepreneurs. Moreover, after the debtor has been made bankrupt and his debts have been cancelled, there are no grounds for shifting the risk of default to creditors. In securing their claims, creditors are primarily concerned with protecting themselves from precisely such circumstances arising. Since consumer proceedings serve a different purpose, neither the rationale of the debt cancellation mechanism *per se* nor the effect of extinguishing the security provided by the bankrupt is subject to dispute. A different state of affairs exists where debt is secured on property belonging to a third party. Extending the extraordinary advantages of debt cancellation to such a party has all the appearance of an abusive practice.

Article 369 BA set out exceptional conditions for the cancellation of a bankrupt's debts. It is worth noting that, currently, the only criterion for debt cancellation is the bankrupt's continued inability to settle any future claims. The introduction of special requirements to prove that the bankrupt acted in good faith and bore no fault is a positive development. Debt cancellation modifies the *pacta sunt servanda* rule and adversely affects the bankrupt's creditors. Extending any such far-reaching effects, potentially interfering with liability relationships, to a third party who is a limited debtor is a distortion of this mechanism. Since debt cancellation applies only to natural persons, such an interpretation is particularly ill-advised where the mortgage is used to secure the debt of a legal person.[10]

Due to the direct link between the debt cancellation criteria in Article 369 BA and the bankrupt's conduct, the mortgage debtor has no influence on the application of its provisions. Thus, the extent to which a third party should be protected is an open question, given that its release from material liability is fully predicated on the bankrupt's conduct. The Supreme Court argues that there is no provision that would state *expressis verbis* that debt cancellation in respect of a bankrupt under Article 369 BA does not diminish the rights of mortgage-secured creditors. Moreover, the only basis for an interpretation supporting the cessation of the mortgage interest is Article 94 AMRM. Although this line of reasoning is not entirely unreasonable, it would appear

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7 P. Janda, *Prawo upadłościowe. Komentarz*, 3rd ed., Warszawa, 2023, Article 2, theses 1–2.
8 Order of the Supreme Court of 25 May 2021, I CSKP 100/21, LEX No. 3220045.
9 Ibidem.
10 Order of the Supreme Court of 24 January 2020, III CZP 53/19, LEX No. 2769780.

that, in view of the purposive interpretation and the wording of Article 369 BA, it does not offer sufficient grounds for extending the scope of its application. As R. Adamus correctly points out, the extinguishment of the bankrupt's obligations is dictated by exceptional, personal circumstances. The interpretative method applied, however, favours other parties beyond the scope permitted under the Act.[11]

Article 291 BA does not expressly extend its application to the cancellation of the bankrupt's debts. Even though Article 291 does not extend its effect to Article 369 BA *de iure*, it would appear that this was the legislature's intention.[12] The literal interpretation, although first in order of priority, should not give rise to conclusions that are contrary to the normative purpose of the regulation. *A minori ad maius*, since a consensual modification of the debt through a debt arrangement scheme does not affect the security created on a third party's property, no such effect should, in particular, arise upon cancellation of the debt by the court, which is completely outside the creditor's control. Quite the opposite, in fact: it would seem that the extinguishment of the mortgage on a third party's property would lead to conclusions contrary to the law. It would mean an unjustified variation in the continued existence of the mortgage depending on whether the debt was cancelled by the court or restructured under a debt arrangement scheme.[13] Article 291 BA is most closely reflected in Articles 370a and 491(15) BA, both of which should be applied by analogy not only to the repayment plan but also to the cancellation of the bankrupt's debt.[14] The debt, despite the release of the bankrupt from liability, continues to exist and may justifiably be enforced against a third person who is liable to the creditor.[15] This view is consistent both with the personal nature of the debt cancellation criteria and with the purpose of bankruptcy proceedings, which seek to reduce the debt burden while at the same time satisfying creditors to the extent possible.

It bears pointing out that the mortgage mechanism has been weakened as a result of the position taken in the resolution. The primary purpose of a mortgage is to secure creditors' claims, with changes in the owner of the mortgaged property being of no consequence. Making a third party a limited debtor with a view to eliminating the risk of insolvency of the principal debtor appears to offer stronger protection. The view expressed in the resolution makes the fulfilment of this purpose illusory. If the main purpose of bankruptcy proceedings is to rescue the bankrupt, the principle of optimisation is compromised, as is the position of creditors. Changing the hierarchy of these values means extending the effects of debt cancellation to other parties at the expense of creditors. It should be noted that, as a model, proceedings should seek to achieve the fullest possible performance of the debtor's

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[11] R. Adamus, 'Czy oddłużenie upadłego powinno skutkować wygaśnięciem hipoteki na mieniu osoby trzeciej?', *Monitor Prawa Bankowego*, 2023, No. 9, p. 61.

[12] Judgment of the Supreme Court of 10 September 2015, II CSK 745/14, *OSNC*, 2016, No. 7–8, item 90; judgment of the Supreme Court of 10 May 2012, IV CSK 369/11, LEX No. 1238133.

[13] R. Adamus, 'Czy oddłużenie…', op. cit., p. 67.

[14] A.J. Witosz, in: Witosz A.J. (ed.), *Prawo upadłościowe. Komentarz*, 2nd ed., Warszawa, 2021, Article 491(15), thesis 11; P. Janda, *Prawo upadłościowe*…, op. cit., Article 370a, thesis 11.

[15] P. Janda, *Prawo upadłościowe*…, op. cit., Article 491(15), thesis 12.

obligations. It is true that creditor satisfaction should not be pursued at any cost, especially if the inability to settle the debt results from the bankrupt debtor's exceptional circumstances. However, the consequences of debt cancellation should not be extended to parties to whom such circumstances are of no relevance.

Based on the view taken in the resolution, it would follow that each time a bankrupt's debt is cancelled, including conditionally, the mortgage securing it must be extinguished. The problem with this reasoning becomes apparent when a decision on conditional debt cancellation is set aside. In such cases, pursuant to Article 369(2g) BA, the debt is not eligible for cancellation. It would seem unreasonable to argue that the mortgage should be restored solely by virtue of the setting aside of the decision on conditional debt cancellation. If this were the case, however, it would be problematic first to remove the mortgage charge from the land register and then to reinstate it. If, on the other hand, the mortgage charge did cease to exist upon conditional debt cancellation, then, after the decision on debt cancellation had been set aside, creditors could continue to enforce their claims, as shown in the debt management plan, but they would have to do so at additional expense in terms of time and money.

Undoubtedly, the continuation of the mortgage after the bankrupt's debt has been cancelled raises questions concerning the relationship between the principal debtor and the limited debtor if the latter has satisfied the debt. In fact, the limited debtor is now the liable party in place of the bankrupt, against whom he has no recourse. It is common to regard the principal debtor and the limited debtor as being liable *in solidum*. The grounds for liability are dissimilar and, to some extent, mutually independent, as they establish individual liability for the debt. Obligations *in solidum* should be regarded in the same way as joint and several obligations *sensu stricto*, which means that the creditor may claim repayment of the whole debt from each debtor.[16] The creditor's rights are grounded in the fact that both debtors stand in a liability relationship with the creditor, and thus both owe him performance. Both parties are liable until the claim is satisfied in full.[17] In this way, the primary purpose of security against the risk of default is fulfilled at the level of the mortgagor and follows directly from the reduction of risk at the level of the creditor once a mortgage has been created. After the creditor has been satisfied from the secured property, the risk attaching to the declaration of bankruptcy passes to the limited debtor, who has no recourse against the principal debtor. From the perspective of bankruptcy proceedings, this order of things is fairer than placing the burden of risk on creditors. Such an interpretation is further sanctioned by the nature of the remedy of recourse under liability *in solidium*, the scope of which depends on the relationship between the debtors.[18] Since the bankruptcy court's decision has an impact on this relationship, modification of the recourse claim is likewise justifiable.

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[16] Judgment of the Supreme Court of 10 September 2015, II CSK 745/14, OSNC 2016, No. 7–8, item 90.

[17] Judgment of the Court of Appeal in Gdańsk of 20 January 2015, I ACa 656/14, LEX No. 1770657.

[18] Judgment of the Supreme Court of 19 May 2016, III CSK 263/15, LEX No. 2108505.

It is sometimes argued that, after the creditor has been satisfied from the mortgage on a third party's property in the course of bankruptcy proceedings, any potential recourse claims should be included in the debt management plan.[19] It is likely, however, that the limited debtor may have difficulty recovering the full amount of the payment. On the other hand, 'once the debt management plan has been put in place and the creditor has been satisfied, the co-debtor is not entitled to claim repayment from the bankrupt',[20] which also means that the co-debtor bears the risk of assuming responsibility for another's debts. It would appear that a similar effect is justified where the principal debtor's debt is cancelled.[21] This does not contradict the rules and aims of bankruptcy proceedings, since the legislature has provided for this kind of mechanism *ipso iure*.

The judgment recognises the limited debtor's right to invoke Article 73 AMRM dealing with debt cancellation. That Article grants limited debtors the right to raise legal challenges on a par with principal debtors. There is reason to believe, however, that, due to the exceptional nature of the conditions for cancellation of the bankrupt's debt, the application of this right would violate the principles of justice and fairness. It would mean the third party invoking the defence of insolvency, which does not concern that party as such. Debt cancellation is justified by a desire to allow the debtor to make a fresh start.[22] The legislature makes debt cancellation subject to certain exceptional circumstances, since it is closely connected with the inability to discharge the obligation.[23] After all, the main thrust of bankruptcy proceedings should be to draw up a debt management plan with a view to at least partial debt repayment. It is rather unlikely that the legislature intended for a third party, which is not affected by such circumstances, to benefit vicariously from the cancellation of the debt. The rescue plan should serve to help the bankrupt in the first place, and only then to ensure creditor satisfaction. This line of reasoning supports the assumption that Article 291 BA, as it then was, implied an exception to Article 73 AMRM.[24]

Some doubts arise in comparing the bankrupt's debt cancellation to release from debt granted by the court. Pursuant to Article 508 of the Civil Code (CC), release from debt is an agreement between the debtor and the creditor,[25] where the creditor consents to the debt obligation being extinguished. It is unreasonable, however, to equate a voluntary debt modification by the parties with the debt obligation being extinguished by a court judgment, dictated by the occurrence of exceptional circumstances. Release from debt is rather similar to an arrangement with creditors where the arrangement leads to the creditors waiving the debt owed to them. The purpose of debt cancellation is to take into account the bankrupt's

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[19] A.J. Witosz, in: Witosz A.J. (ed.), *Prawo upadłościowe*…, op. cit., Article 491(15), thesis 13.

[20] P. Janda, *Prawo upadłościowe*…, op. cit. Article 491(15), thesis 12.

[21] A.J. Witosz, in: Witosz A.J. (ed.), *Prawo upadłościowe*…, op. cit., Article 491(15), thesis 11.

[22] F. Zedler, in: Jakubecki A., Zedler F. (eds), *Prawo upadłościowe i naprawcze. Komentarz*, 3rd ed., Warszawa, 2011, Article 369, thesis 1.

[23] A. Machowska, A. Ludwiczyńska, P. Skibiński, *Upadłość przedsiębiorców z uwzględnieniem praktyki notarialnej*, Warszawa, 2023, p. 410.

[24] Order of the Supreme Court of 24 January 2020, III CZP 53/19, LEX No. 2769780.

[25] Judgment of the Court of Appeal in Warsaw of 15 April 2019, V ACa 40/18, LEX No. 3039875.

financial difficulties and rescue him by reference to justice and fairness, whereas the reasons for release from debt may be entirely different. Thus, equating the two mechanisms by virtue of similar consequences alone appears to be a misconstrual. Due to the circumstances of debt cancellation and its being sanctioned by a court judgment, debt cancellation is more similar to the *rebus sic stantibus* provision in Article 357[1] CC. In contrast to release from debt, modification of the debt relationship is in the hands of the court, not the parties. The grounds for modification overlap, however: the parties to an agreement tend not to create obligations if they expect that the obligations will not be performed. Regardless of the above, due to liability *in solidum*, the applicable provision should be Article 373 CC, according to which release from debt or a waiver of joint and several liability with respect to one of the joint and several debtors has no effect on the co-debtors.

CONCLUSION

The Supreme Court's position, whereby cancellation of a bankrupt's debt triggers the extinguishment of a mortgage on a third party's property, may give rise to a misapplication of the law. In view of the traditional role of bankruptcy proceedings, this position contradicts their fundamental aims and principles. The relief granted by the Court to the limited debtor leads to a weakening of creditors' powers. Also weakened is the reassurance traditionally provided by a mortgage as an instrument designed to secure creditors' claims, even if the personal debtor is unable to satisfy them. Nevertheless, even though ensuring the continued existence of a mortgage on a third party's property despite debt cancellation, as proposed in this commentary, appears to be justified, it undoubtedly remains open to question under both the previous and current legal regimes in light of the literal wording of the provisions of the Bankruptcy Act. For this reason, it would seem desirable *de lege ferenda* to provide clarity in this matter so that a balance is struck between rescuing the debtor and protecting the creditor. One solution that presents itself is a clearly worded provision stating that debt cancellation does not affect the creditor's rights with regard to a mortgage created on the limited debtor's property. It would be advisable, however, to exclude the limited debtor's liability in situations where the preservation of justice and fairness so requires, such as, for example, where he becomes insolvent as a result.

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