

COMPARATIVE ANALYSIS OF THE SECURED PARTY'S OPTIONS AFTER THE DEBTOR'S DEFAULT (SOUTHEAST EUROPE)

I INTRODUCTION

This analysis is focused on the legal remedies available to the secured creditor in the case when the debtor fails to perform his contractual obligations, with an emphasis on the legal systems of Southeast Europe.¹ Here, the *subject-matter of the conducted research* does not include the *actions* of a *mortgagee* in a similar situation, but rather in the forefront are those creditors who secured their claims by movable property. In addition to the security rights that are created by establishing limited real rights: *pignus*, registered pledge and the right of retention, the 'regional legal systems' also recognise security devices by which ownership is used for the purpose of security: *pactum reservati dominii* and financial leasing, while some of them even regulate a fiduciary transfer of ownership. Needless to say that in terms of each of the *above mentioned security* devices, a lot of issues arise, particularly on secured creditors' rights against the collateral in the event of debtor's default.

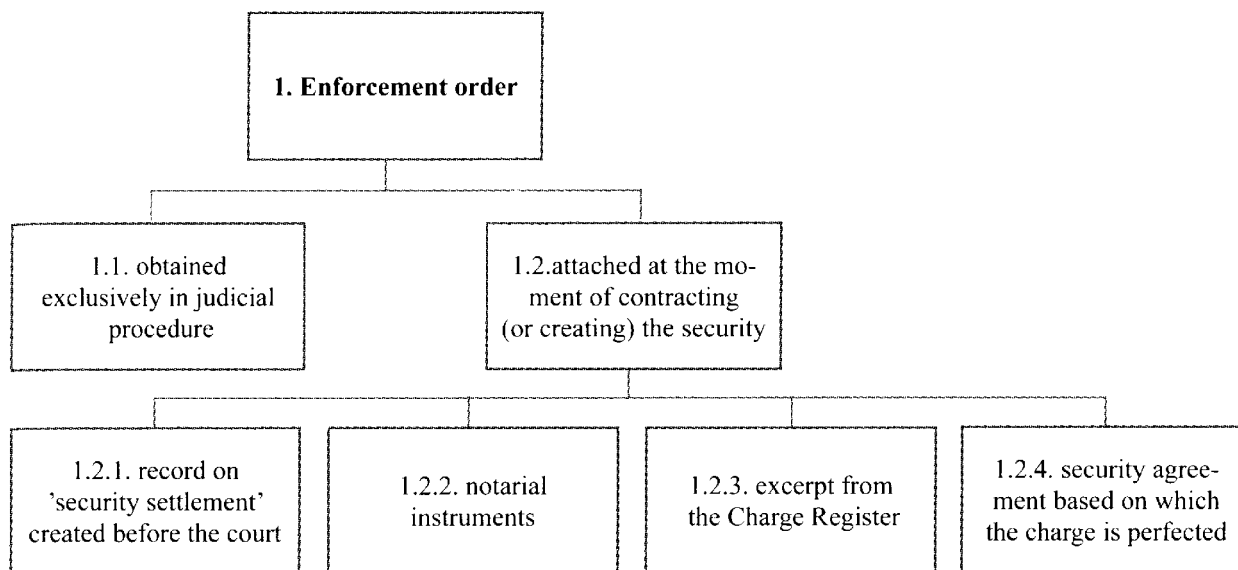
II CORE ISSUES

It seems that overall complexity of the secured party's remedies in the situation when a debtor fails to meet his obligations may be understood through a number of key issues both practical and doctrinal that are uncommon for legal systems in the region. It is primarily the manner in which the creditor reaches the enforcement order, which allows him to satisfy his claim from the value of encumbered property, then the way in which the creditor reposes the collateral, and in the end, the method of foreclosure enabling the secured creditor an efficient reimbursement of their claim prior to unsecured creditors, and those creditors whose security was created later. It appears that these three major issues that plague any creditor from the moment when they realize that the debtor is not able or willing to pay its debts create more options for their solution, each of which deserves appropriate attention of legislators. For better clarity and understanding, we will illustrate these main dilemmas in a few related charts.

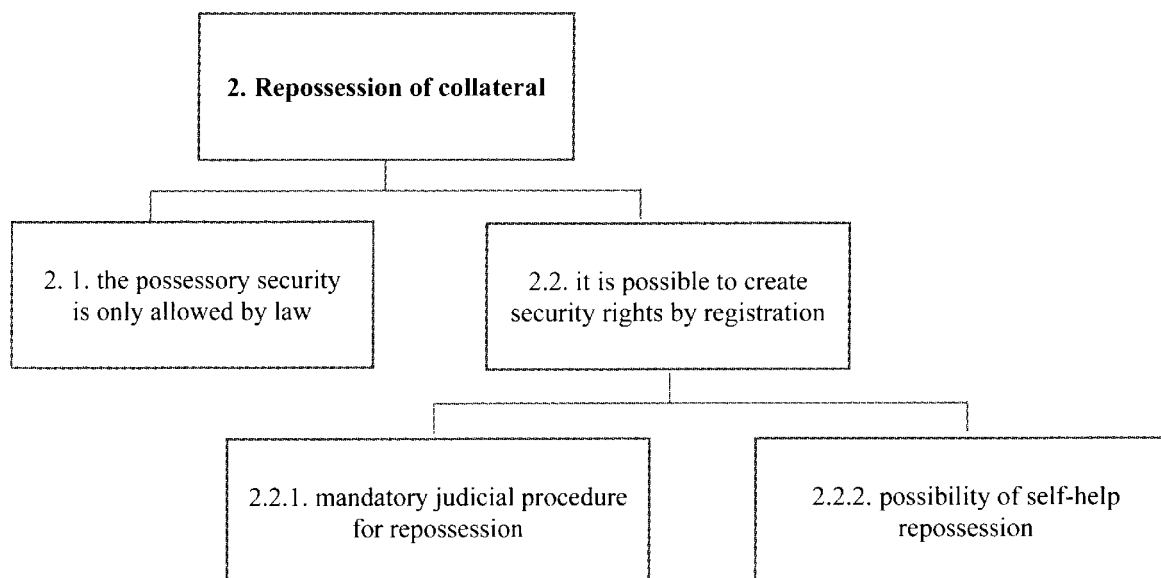
* Original text is in local language

¹ The expression 'legal systems of Southeast Europe' refers in this paper to the legal systems of: Serbia, Croatia, Federation of Bosnia and Herzegovina, Montenegro, Macedonia, and Albania (hereinafter also: 'regional legal systems').

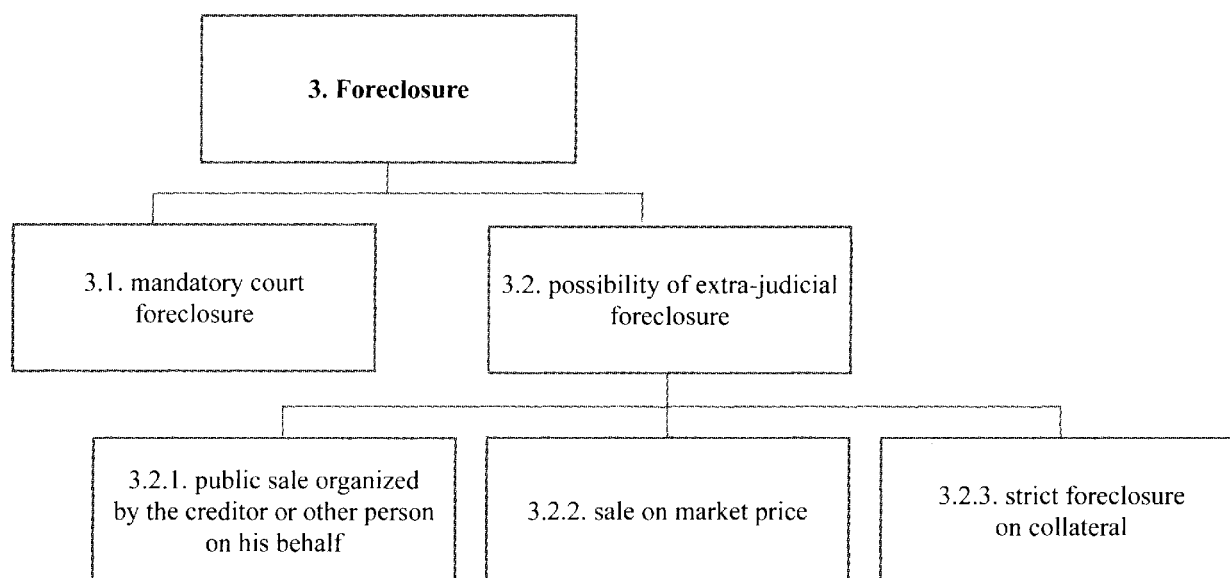
1. Enforcement order



2. Repossession of collateral



3. Foreclosure



It can be said that the listed issues and accompanying dilemmas are particularly vibrant in the Southeast Europe therefore here we will reveal the solutions offered by the regional legislators in this respect.

III OVERVIEW OF REGIONAL LEGAL SYSTEMS

1. Enforcement order

Serbia: a certified *excerpt* from the Register of Pledges is equated with the enforcement order.² However, the courts in Serbia were faced with the question of whether an *authenticated* extract from the Register is enforceable only in special proceedings for repossession of collateral, or whether it is an enforcement order (in general) with which one may foreclose on debtors property as well. 'Based on the certified excerpt from the Register of Pledges, and the certificate on initiation of foreclosure, secured creditor may request the court order on repossession of pledged assets (...) Although, it is not enough for him to require a judicial sale of pledged assets and satisfaction of his claim from the value generated by that sale'.³ It seems that in debtor's default, the certified excerpt from the Register only proves that a charge holder acquires by rule of law (*ex lege*) the right of possession over the pledged assets.⁴ Based on this excerpt, the court, in a special repossession procedure, may order to the debtor to deliver

² Art. 41, para. 3 of the *Law on Registered Pledges* 'Official Gazette of the RS' no. 57/03, 61/05 (hereinafter also: LRP).

³ Decision of the Higher Commercial Court, I. 689/2009 (18. 03. 2009) – *Commercial Courts Case Law – Bulletin* no. 2/2009.

⁴ 'If the debtor fails to fulfil his obligation upon maturity, the pledgee shall acquire the right to possession *ex lege*'. (Art. 35, para. 1 LRP).

the collateral to the creditor, harmonizing in that way the legislative proclamation in terms of possession with 'situation in the field'. In other words, certified excerpt from the Pledge Register enables the creditor only to establish an actual possession (control) over the pledged assets, in order to satisfy his debt out-of-court. Certified excerpt from the Register, however is not an enforcement order based on which creditor may require the judicial foreclosure on debtor's property,⁵ even when the motion for execution is related to the pledged assets stated in the certified excerpt.⁶ In Serbian law, the court may also create the record of charged movables based on the mutual proposal of debtor and creditor ('security settlement'). The claim approved in this settlement becomes enforceable at the time of its maturity.⁷

Croatia: If the security right is created before the court, signed record of security agreement between the parties has the effect of a court settlement.⁸ If the 'security settlement' is made before a notary public, the same force has an enforceable notary instrument.⁹

BH: Certificate of registration is considered enforceable, i.e. it is equal to an enforcement title.¹⁰ Since the registration is done by the creditor himself, to initiate foreclosure the creditor has to provide not only the certificate of registration but also the valid pledge agreement, thus proving that his claim exists and that the prerequisites for enforcement have been met.

MN: 'The security agreement on the basis of which the pledge has been perfected possesses the force of an enforcement order in relation to the collateral and its proceeds (...)'.¹¹

Macedonia: The public (notary) form of security agreement is not a prerequisite for the validity of the contract and its registration, but for acquisition of the enforcement title it does. If the parties want to create an enforcement title, then it is necessary that the debtor agrees to foreclosure when signing the agreement, or later when the agreement is entered into the Register.¹² When the fiduciary transfer of ownership is created, the record that contains the agreement on security shall have the status of an enforcement order, upon the maturity of the receivable.

⁵ On enforcement actions on movables see Art. 71, para. 1 *Law on Enforcement Procedure* 'Official Gazette of the RS', no. 125/04, of 15 November 2004. (hereinafter: the LEP)

⁶ Pursuant to the *Law on Enforcement Procedure*, executive documents are: 1) executive order of the court and the executive judicial settlement, 2) an executive decision in the administrative and misdemeanour proceedings and settlement of administrative proceedings, if they are reached for the purpose of fulfillment of financial obligations and if the special law does not provide otherwise, 3) other documents that have been legally designated as the executive documents, (Art. 30 LEP). Executive document is therefore eligible for execution if it designates the executive creditor and executive debtor, and the subject, type, scope and the time to fulfil obligations (Art. 34, para. 1 LEP).

⁷ Art. 33, para. LEP, at which it remains unclear whether the confirmation of enforceability is placed on judicial settlement as well.

⁸ Art. 263, para. 2 *Enforcement Law*, 'Official Gazette' no. 57/96, 29/99, 42/00, 173/03, 194/03, 151/04, 88/05, 121/05, 67/08.

⁹ Art. 54 and Art. 59, para. 1 of the *Law on Public Notaries*, 'Official Gazette' no. 78/93, 29/94, 162/98, 16/07, 75/09.

¹⁰ See: Art. 26, para. 1 of the Framework *Law on Pledges* ('Official Gazette of the BH', no. 28/04, 54/04).

¹¹ See: Art. 20, para. 3 *Law on Pledge as Means of Securing Claims* ('Official Gazette of the Republic of Montenegro' no. 38/02) (hereinafter: 'Pledge Law of Montenegro').

¹² However, if the parties do not perform registration of the security agreement in the public registry, the agreement shall lose its force of an enforcement order. Art 22 of the *Law on Contractual Pledge of Macedonia* ('Official Gazette of the Republic of Macedonia' no. 5/2003).

2. Repossession of collateral

Serbia: after notification of debtor and the pledgor, when they are not the same party, and to a third person with whom the collateral is kept, the pledgee is entitled to repossess the collateral.¹³ If the debtor refuses to transfer the subject-matter of the pledge, the creditor may file an appropriate motion for repossession.¹⁴ If the creditor with this motion appends the security agreement and the authenticated excerpt from the register, the court shall issue an order according to which the collateral should be handed over to the pledgee.¹⁵ Contrary to this solution, which does not allow a self-help repossession of pledged assets, Draft Law on Ownership and other Rights in Rem¹⁶ provides a possibility for creditor to establish actual possession of encumbered assets if the common conditions for self-protection of right are fulfilled.

Croatia: If a voluntary security is created before court or public notary the creditor is neither in possession nor has the right to establish the control over the collateral through self-help repossession. However, these kind of voluntary security rights are equalized to the court settlement,¹⁷ and consequently they have the force of an enforcement order.

BH: If the *debtor breaches the agreement*, the secured creditor may repossess the collateral personally even without the help of a court bailiff, but only after the debtor has provided written consent to this. Validity of this consent does not require any authentication by public notary or by court ...¹⁸. Provided that this clause (consent) is void if contracted prior to the debtor's default.¹⁹

MN: If the *debtor breaches the agreement* the pledgee has the right to enter into possession of the pledged asset.²⁰ If the pledgee decides to initiate proceedings before the court, he is entitled to submit a motion for the decision on foreclosure on pledged item, based on which the collateral will be seized and handed over to the pledgee.²¹

Macedonia: To satisfy his claim by selling the subject-matter of security through a notary public or a bailiff, or by other persons who are authorized to so, the creditor is entitled to request repossession of the pledged assets.

¹³ Art. 40 LRP: The pledgee may file the motion for repossession of collateral only after obtaining a certified excerpt which indicates that there is an entry made in the Register on the commencement of the foreclosure.

¹⁴ 'If the pledgor does not voluntarily fulfill his obligation to hand over the charged asset, the pledgee may submit a request to the court to issue a decision to take the collateral from the pledgor or other person holding the object and to hand it over to the possession of the pledgee. (Art 41, para. 1 LRP)

¹⁵ In order to appeal against the decision on repossession of collateral from the pledgor or other person holding the object, the pledgor may, within three days of receipt of the decision, file a complaint (which does not suspend enforcement of the decision) that the creditor's claim, or pledge, does not exist, or that the debt has been paid, of which he must submit written evidence. See: Art. 41, para. 7 LRP.

¹⁶ Art. 521, para.2 of the Draft.

¹⁷ Art. 263, para. 2. *Enforcement Law*.

¹⁸ Art. 26, para. 3 *Framework Law on Pledges*.

¹⁹ Art. 5 *Framework Law on Pledges*.

²⁰ Art. 20, para. 2 *Pledge Law of Montenegro*.

²¹ Art. 20, para. 3 *Pledge Law of Montenegro*.

3. Foreclosure

If the debtor failed to pay his debt derived from commercial contract (In Serb. 'ugovor u privredi'), the pledge holder is not obligated to address the court but rather may sell the pledged assets in a public sale upon expiration of 8 days from the day when the notice on auction was sent to the debtor and the security provider (if they are not the same person).²² From the amount generated by sale of pledged assets, prior to other security provider's creditors, pledge holder shall be entitled to pay off his principal claim, related interest, expenses related to the maintenance of encumbered property and expenses related to the realization of claim.²³ Similarly, extrajudicial recovery of debt is allowed under the Law on Registered Pledges. In other words, if the pledgor is an entrepreneur or a company, the Serbian law allows the parties in the security agreement to agree on extra-judicial foreclosure. If the charged asset has a market or stock exchange price, the security agreement may provide that the pledgee has the right to sell it at that price, or to keep it at that price for himself.²⁴ If the charged asset does not have a market or stock exchange price, the pledgee can sell it in a way that a reasonable and careful person would have, preserving the interests of a debtor and security provider (if they are not the same person).²⁵ A creditor is not obliged to leave the debtor an additional period before repossessing the object of pledge, however the creditor can organize extra-judicial sale of the pledged assets only after 30 days from the day when the initiation of foreclosure is noted in the Register of Pledges.²⁶ Before the sale, the creditor shall provide to the debtor adequate notice of the place and time of sale.

Croatia: when it comes to *pignus*, extra-judicial foreclosure is an exception and can be achieved when the debtor explicitly consent to it in writing.²⁷ In terms of the commercial contract it is the rule unless this right has been explicitly prohibited when establishing the pledge.²⁸ Extra-judicial foreclosure, is usually done through public auction, but it can be arranged differently, or if in the given circumstances that is 'the only possible way for the recovery of claim'.²⁹ When a property or a right have a market or a stock exchange price, the creditor is authorized to sell the charged asset at that price through a person who is publicly authorized to sell in the stock market (brokers) or for public auction of such items or rights.³⁰ If the charged asset is money, or a claim that has been collected, the creditor is entitled to keep for him the appropriate amount.³¹

BH: In his motion for enforcement, the pledge creditor must propose: to have the court bailiff seize the collateral for the purpose of its sale by the pledge creditor, or to have the court bailiff seize and sell the collateral.³²

²² Art. 981, para. 1 *Law of Obligations*.

²³ Decision of the Higher Commercial Court, Pž. 6946/2004 (14. 06. 2004).

²⁴ Art. 27, para. 2. LRP.

²⁵ Art. 27, para. 5 LRP.

²⁶ Art. 44, para. 1 LRP.

²⁷ Art. 337, para. 1, 2 *Law on Ownership and Other Proprietary Rights*, 'Official Gazette' no. 91/96, 68/98, 137/99, 22/00, 73/00, 129/00, 114/01, 79/06, 141/06, 146/08, 38/09, 153/09.

²⁸ Art. 337, para. 2 *Law on Ownership and Other Proprietary Rights*

²⁹ Art. 337, para. 3 *Law on Ownership and Other Proprietary Rights*.

³⁰ Art. 337, para. 4 *Law on Ownership and Other Proprietary Rights*.

³¹ Art. 337, para. 5 *Law on Ownership and Other Proprietary Rights*.

³² Art. 26, para. 2 *Framework Law on Pledges*.

IV CONCLUDING REMARKS

1. Enforcement order

The regional legal systems have generally abandoned the concept (1.1.) by which the secured creditor can reach an enforcement order to satisfy his claim only if he successfully accomplished both civil and enforcement procedure. The first step towards the broader acceptance of an option (1.2.), that the enforcement order may be obtained in another way was the introduction of voluntary security before the court, which record upon maturity of the claim becomes an enforcement order (e.g. Serbia, Croatia) (option 1.2.1.). The record signed by the parties practically contains their agreement on the amount of claim and the time of its maturity, and the consent that the security right is created by performing an inventory. The very agreement before court is abstract by its nature and it could be called a 'security settlement'. The next phase of this liberalisation process was the opening for the possibility that other instruments, upon maturity of the claim, gain a status of enforcement orders: notary instruments (Croatia, Macedonia) (option 1.2.2.). Even 'lower' formal requirements for obtaining the enforcement titles are placed in the second group of regional legal systems where the relevant excerpt from the register is also declared executive order *ex lege* (1.2.3.). In Serbia, for example, an authenticated excerpt from the Register of Pledges is an enforcement order, but with a limited scope, only for purpose of repossession of the charged asset and further extrajudicial foreclosure. This option is favoured in Bosnia too, where a certificate of registration is an enforcement order for the forced sale of charged property if the enforcement court is served with the pledge agreement, which proves that the creditor's claim exists and that the prerequisites for enforcement have been met.

It seems that in terms of acquiring enforcement orders the most liberal approach is taken in the Montenegro accepting the rule that in debtor's default plain security agreement *underlying the perfection* of security interest represents an enforcement order (option 1.2.4.).

2. Repossession of collateral

Regional legal systems definitely left behind the concept (2.1.) and its permissibility of only possessory security. Exactly the opposite, all of the *legal systems evaluated* are bending toward option (2.2.) that the publicity of security rights can be achieved by registration. Such non-possessory security opens up a new dilemma about the way in which a creditor may, in case of debtor's default, establish actual control over secured property. In resolving this issue, regional legislations almost unanimously go for alternative (2.2.1.), which does not allow self-help repossession of collateral. This is probably out of fear that a solution in which the creditor may take away the object of security right from the debtor without his consent could undermine legal certainty. One may notice that the Montenegro is a relative exception in this respect. Its current Pledge Law provides that if the debtor breaches the agreement, the creditor has the right to take over the subject-matter of security, but the law remains silent on the ways in which the secured creditor can exercise his right of repossession without recourse to court.

3. Foreclosure

Regional legal systems have also definitely abandoned the concept (3.1.) according to which, the satisfaction of secured claim could be done only in court procedure ('principle of officiality'). Although the judicial settlement is still the rule, the parties in security agreement

may stipulate the possibility of extra-judicial foreclosure (option 3.2.). In Serbia extra-judicial foreclosure is allowed only if the secured debt arises from commercial activity of the debtor. If the debtor is a consumer, extra-judicial settlement can not be provided by agreement, unless the claim became mature.³³ In Croatia, the creditor may foreclose out-of-court even if the claim does not arise from a commercial agreement, but in this case such a possibility is not presumed, and it must be expressly stipulated in the agreement.

In order *to exercise his 'power-of-sale'* through foreclosure, the secured creditor has several options available. These remedies with minor variations are evenly represented in the region. The creditor can organize a public sale or authorise another person to arrange the sale on his behalf: the private bailiff (in Macedonia only), notaries, brokers or commissioners. (3.2.1.). Furthermore, a creditor has the choice either to sell the collateral at its market price (3.2.2.), or to keep the charged asset for himself at a designated price instead of the repayment of debt ('strict foreclosure') (3.2.3.)³⁴

³³ Art. 28, para. 4 LRP.

³⁴ Serbia: Art. 28, para. 4. LRP and Art. 90 LEP. Croatia: Art. 277, para. 7 *Enforcement Law* and art. 5, para. 4, *Financial Collateral Law* (2007); BH: art. 33, para 1. *Framework Law on Pledges*.