



THE NEW CROATIAN LAW ON THE REGISTRY OF COURT
AND PUBLIC-NOTARY SECURITY INTERESTS ON
MOVABLES AND RIGHTS IN THE LIGHT OF THE UCC
ARTICLE 9 PERFECTION SYSTEM

by Ivana Sverak

LL.M. SHORT THESIS

COURSE: Comparative Secured Transactions

Professor: Tibor Tajti

Central European University
1051 Budapest, Nador utca 9.
Hungary

Abstract

The new Croatian Law on the Registry of Court and Public-Notary Security Interests on Movables and Rights, its main features, problems and advantages are discussed herein.

Chapter 1 of the thesis addresses: (i) the most important legal instruments available in Croatia for the purpose of taking security; (ii) taking security over movables with analysis in respect of creating a pledge and transferring of ownership for security purposes and the main differences between them; (iii) the analysis of the concepts introduced by the Law on Registry, (iv) enforcement of the security interest and (v) bankruptcy of the grantor of security.

Chapter 2 deals with (i) Uniform Commercial Code and general remarks connected therewith, (ii) perfection system and other related issues under original version of UCC Article 9 and (iii) perfection system and other related issues under revised version of UCC Article 9.

Chapter 3 pinpoints the most important differences between the two systems in relation to the creation, attachment and perfection of security interest, methods of perfection, purchase money security interest, floating lien, collaterals, transfer of ownership for security purposes and filing.

Table of Contents

Abstract.....	i
Abbreviations.....	iv
Introduction.....	1
CHAPTER 1: THE NEW CROATIAN SYSTEM OF SECURED TRANSACTIONS	4
1.1 Short Overview of Most Important Legal Instruments Available in Croatia for the Purpose of Taking Security.....	4
1.1.1 Pledge.....	4
1.1.2 Mortgage.....	6
1.1.3 Transfer of Ownership for Security Purposes (Fiduciary Ownership)	7
1.2 Taking Security over Movables	8
1.2.1 Creation of Pledge.....	8
1.2.2 Transfer of Ownership	10
1.2.3 The Main Differences between Two Ways of Creating Security Interests in Movables (Advantages, Disadvantages, Instruments Usually Used in Financing Practice)	11
1.3 The Law on Registry.....	14
1.3.1 General Remarks.....	14
1.3.2 Perfection of Security, Priority Rules - Possible Conflicts, Effect of Registration, Protection of the Secured Party	17
1.3.2.1 Perfection of Security	17
1.3.2.2 Priority Rules – Possible Conflicts	18
1.3.2.3 Effects of Registration	20
1.3.2.4 Protection of the Secured Party.....	21
1.3.3 Organization of the Registry - Particulars Recorded in the Registry.....	22
1.3.4 Procedure for Registration (Process, Documentation, Deregistration/Deleting, Fees).....	22
1.3.5 What does the Security Interest in Movables Cover and the Concept of Floating Lien.....	27
1.3.6 Selected Data on Application of the Law on Registry.....	30
1.4 Enforcement of the Security Interest	31
1.5 Bankruptcy of the Grantor of the Security.....	33
CHAPTER 2: UCC ARTICLE 9	36
2.1 On Uniform Commercial Code.....	36
2.1.1 Introduction.....	36
2.1.2 Original Version of UCC Article 9	38

2.1.3 Revised Version of UCC Article 9	39
2.2 Perfection System and Some Other Related Issues under Original Version of UCC Article 9	41
2.3 Perfection System and Some Other Related Issues under Revised Version of UCC Article 9	45
CHAPTER 3: MAIN DIFFERENCES BETWEEN THE CROATIAN AND THE AMERICAN SYSTEM	49
3.1 Creation of Security Interest, Attachment/Enforceability, Perfection	49
3.2 The Methods of Perfection.....	50
3.3 Purchase Money Security Interest	50
3.4. Floating lien	51
3.5 Collaterals	51
3.6 Transfer of Ownership for Security Purposes (Fiduciary Ownership)	52
3.7 Filing	52
Conclusion	54
Bibliography	57

Abbreviations

ALI	American Law Institute
<i>etc.</i>	<i>et cetera</i>
EU	European Union
IBAN	International Bank Account Number
<i>i.e.</i>	<i>id est</i>
<i>e.g.</i>	<i>exempli gratia</i>
NCCUSL	National Conference of Commissioners on Uniform State Laws
PMSI	Purchase Money Security Interest
UCC	Uniform Commercial Code
US	United States of America
SWIFT	Society for Worldwide Interbank Financial Telecommunication
VAT	Value Added Tax

Introduction

Having in mind modern business transactions, it is reasonable to conclude that financial obligations of the parties are almost always the usual consequence of their business relations. Only very rarely do agreements impose on the parties other kind of obligations which are not of financial nature. In most cases one of the parties has an obligation which is not of financial nature for which the other one has to pay a certain amount of money. In these cases the financial obligation is usually the one which is supposed to be fulfilled after the specific non-financial obligation is already fulfilled. Exactly this time gap causes problems to the creditors and is connected with the risk that the payment is not going to be made at the time when their claim becomes due. Moreover, globalization in general and particularly globalization of trade market in which things that were unimaginable hundred years ago now become possible, has as a consequence the fact that, on almost every day basis, businesspeople cooperate with clients all over the world and, hence, not having prior experience with new clients and especially not having an insight in their commercial situations, bear the risks of not being paid.

Even if we take into account not just business transactions and business relations primarily connected to international trade, but also transactions connected to business relations between lenders and borrowers, the situation remains the same. In these cases both of the parties have financial obligations whereby one of them again fulfils its obligation under the agreement at a later stage.

The new Croatian Law on the Registry of Court and Public-Notary Security Interests on Movables and Rights came into force on October 25, 2005 and started to be applicable on April 25, 2006. It established the Registry of Court and Public-Notary Security Interests

on Movables and Rights (hereinafter: "the Registry") and the procedure for the registration of such security interests, as well as the requirements and effects of the registration. It also introduced some new concepts and should enhance the system of Croatian secured transactions. Prior to the enactment of the mentioned law the method of creating security interests was time-consuming, complicated, connected with rather high costs and a problem of making the public aware of the creation of the respective security interests. A consequence of such a system was legal uncertainty and unwillingness of, for instance, lenders to support borrowers in their business transactions. Even if the parties involved in a particular business transaction managed to reach an agreement, the conditions under which the lenders accepted to support borrowers were less favorable than they are supposed to be now, after enactment of the new law.

Furthermore, the new system should be beneficial to the "young", "new" players who have just started to be involved in the current market scheme, players with excellent ideas and know-how, but without any kind of background and positive credit history, and should strengthen their status as a newly formed entity in the market.

Furthermore, in overall picture connected with modern business, one has to bear in mind that not just the role of the banks as usual lenders is at bar, but also the role of business entities that must have a possibility to secure their claims towards their business partners. The legal environment not having a developed system of secured transaction is, at the very start, faced with obstacles which collide with the modern business needs and therefore is not suitable enough to enable the necessary level of market conditions.

The object of this thesis is to identify problems connected with securing payments in Croatia having in mind the US system developed under the auspices of National Conference of Commissioners on Uniform State Laws and American Law Institute, *i.e.* the scheme offered by UCC Article 9. Namely, due to the fact that almost all business transactions (especially the ones which are mainly connected with the international business scene) are connected with certain risks (such as non-payment, late payment etc.), which might greatly influence the outcome of the whole initial scheme, the question to be answered is how to secure payments in order to reach the final goal and make the scheme works.

Although the Law on the Registry of Court and Public-Notary Security Interests on Movables and Rights came into force only recently and hence it is probably a bit too early to discuss the effects it has in practice, this thesis shall try to locate possible problems and (where possible) offer solutions.

CHAPTER 1: THE NEW CROATIAN SYSTEM OF SECURED TRANSACTIONS

1.1 Short Overview of Most Important Legal Instruments Available in Croatia for the Purpose of Taking Security

A short overview of most important legal instruments, usually used in business relations and available in Croatia for the purpose of taking security is given hereinafter.

In the spirit of Croatian law and legal practice, only the real rights acquired by a creditor against the assets of a debtor and/or any third person providing its assets, are still considered the strongest securities.

Hence, in general, security in Croatia may be granted by a pledge (or mortgage if the secured asset is real property) or by a fiduciary transfer of ownership.¹

1.1.1 Pledge

Pledge is a real right regulated by the provisions of Croatian Law on Ownership and Other Real Rights (Official Gazette 91/96, 68/98, 137/99, 22/00, 73/00, 129/00, 114/01, 79/06, 141/06; hereinafter: "the Law on Ownership").² According to Article 297 of the Law on Ownership, a pledge is a limited real right on a particular pledged property,

¹ Additionally, the author's practical experience shows that the security packages usually contain (depending on a particular project and transactions involved) security documents such as, for instance (i) monetary claims under project contracts (e.g. the Concession Agreement, the Operation and Maintenance Agreement and the related performance guarantees) - the Pledge of Contractual Claims; (ii) monetary claims under onshore and offshore insurances - Pledge of Insurance Claims; (iii) shares - Pledge of Shares, Fiduciary Transfer of Shares; (iv) movable assets - Pledge of Movables; (v) real estates - Mortgage agreement; (vi) accounts - Bank Accounts Pledge, Depository Accounts Pledge, Seizure of Account Consents and Control Accounts Pledge etc.

² Croatian legal system recognizes *numerus clausus* of *in rem* rights, i.e. (i) ownership right, (ii) pledge, (iii) servitude right, (iv) land charge - this institute gives to its holder *in rem* right on a piece of real estate, which entitles it to receive certain benefits on the basis of the value of this real estate and (v) construction right.

which gives a right to the pledgee to satisfy its claim from the value of the pledged property, in case its claim is not settled at the time it becomes mature.

The importance of a pledge lies, *inter alia*, in the fact that the pledged property does not necessarily have to be in the ownership of the debtor, whose payment towards the creditor is to be secured, but may also be in the ownership of a third person, which then has to agree on the creation of a pledge.

Another important thing, prescribed by the provision of Article 297 of the Law on Ownership, is that, notwithstanding the fact in whose ownership the pledged property is from time to time, the pledge does not stop to exist, *i.e.* the fact that the "original" pledgor has disposed of the pledged property does not influence the existence of the pledge.

The pledge may be created on the basis of (i) an agreement, (ii) a court decision or (iii) by virtue of law.³

Having in mind the movables as collateral and creation of pledge, pursuant to the provision of Article 308 of the Law on Ownership in order for the pledge to be created, the transfer of possession of the respective movables has to take place, *i.e.* the pledgor has to transfer possession of the movables to the pledgee or to the third person designated by the pledgee. Hence, under the Law on Ownership (save in the case of intangible property such as contractual claims) if the assets are not subject to a title registration system (*e.g.* assets other than ships, real estate, shares etc.), it was necessary to take physical possession thereof to effect the security. In other words, the Law on Ownership in respect of the movables recognizes a so-called possessory pledge.

³ See Article 305 Of the Law on Ownership.

Before the entry into force of the Law on the Registry of Court and Public-Notary Security Interests on Movables and Rights (Official Gazette 121/05; hereinafter: "the Law on Registry"), the pledge on a debtor's movables, if not created pursuant to the provisions of the Law on Ownership, was created pursuant to the provisions of the Enforcement Act as in force at that time, upon making the seizure list of the movables being pledged, while no taking over of the possession was required. The seizure list of the respective assets was created either by (i) a court or (ii) a public notary and it was announced in the Official Gazette or otherwise communicated to the public. The debtor and/or the owner of the pledged assets were allowed to continue to deal with those assets in the ordinary course of business, which is a logical consequence of this non-possessory pledge, since the transfer of possession of the respective assets was not necessary. The problem with this type of security was that there was no central register of such pledges which made it very difficult to establish if a particular asset had already been pledged in this way.

To conclude, before the entry into force of the Law on Registry, a security against a debtor's movable could have been taken and perfected under different terms and conditions depending whether it was governed by the Enforcement Act or by the Law on Ownership.

1.1.2 Mortgage

Unlike the pledge of movables, the pledge of real estates, *i.e.* mortgage is created upon entry thereof into the Land Registry Books⁴ and is a legal instrument usually used by the banks as a security for payment of their claims towards borrowers. The mortgage under

⁴ See Article 309 of the Law on Ownership.

Croatian law is a real right, usually over the real property, and its legal nature is the same as of the pledge of movables or rights.

It is important to emphasize that real rights provide priority of rank. For example, the mortgage entered as the first in the land registry shall exclude all other mortgagors coming thereafter. The same applies to other real rights.

By entry into force of the Law on Registry the perfection system of security interests changed and now, according to the new system, the pledge, *i.e.* security interest in movables and rights (if created by parties' agreement, *i.e.* through the exercise of public notary's authorization) has to be registered in the Registry of Court and Public-Notary Security Interests on Movables and Rights (hereinafter: "the Registry"). Hence, it could be concluded that the new system under the Law on Registry is in a way similar to the system recognized by the Law on Ownership ten years ago and therewith the system that governs pledge of movables and rights is getting closer to the system governing mortgage.

1.1.3 Transfer of Ownership for Security Purposes (Fiduciary Ownership)

This legal instrument is governed by the provisions of Enforcement Act (Official Gazette 57/96, 29/99, 42/00, 173/03, 194/03, 151/04, 88/05, 121/05) and the Law on Registry and shall be discussed in more details under 1.2.2 below.

For the reasons discussed in more details under 1.2.2 below, this legal instrument is in practice used not as often as, for example, the pledge, especially when movables are at stake.

1.2 Taking Security over Movables

For the purpose of taking security over movables the legal instruments available in Croatia are (i) pledge and (ii) transfer of ownership for security purposes (fiduciary ownership). Two Croatian laws govern both of these instruments, *i.e.* the Enforcement Act and the Law on Registry.

Another possibility of taking security over movables, as already mentioned under 1.1.1 above, is given pursuant to the provisions of the Law on Ownership according to which a creditor creates a pledge over the movable assets by transfer of possession of the movables in question on the basis of a valid security agreement (without a need of registration thereof).⁵ Due to the fact that this particular scenario requires transferring of the possession of the movables, having in mind that this kind of creation of security interest is not suitable for modern business needs (hence, nowadays loses the value it had in the past) and since the main subject matter of this thesis is the Law on Registry, this shall not be discussed hereinafter.⁶

1.2.1 Creation of Pledge

According to the Enforcement Act, the creation of the voluntary security interest, *i.e.* pledge, in, *inter alia*, the movables may be carried out through either (i) a court or (ii) a

⁵ See Article 308 of the Law on Ownership.

⁶ Possessory pledge is the oldest institute known to the mankind. In the past, in order to secure creditor's claim, debtor would usually hand him over a particular item of personal property, therewith transferring the possession thereof. Hence, creditor obtained the possession of the collateral and the debtor was unable to use it, dispose of it or do anything else with it. Exactly this was one of the biggest problems of possessory pledge due to the fact that the development of business activities and demands of modern commercial law showed that this institute cannot satisfy modern business needs any more. Debtors needed to keep the collateral in their possession and be able to either use it (e.g. equipment) or sell it (e.g. stock-in-trade).

public notary.⁷ The author's practical experience so far shows that the most suitable way of creation thereof is through the exercise of the public notary's authority. Thus, further elaboration on this issue shall be given having this in mind.

In the mentioned scenario, the agreement between the creditor and the debtor determines the existence and maturity of the creditor's claims to be secured and contains a debtor's statement allowing a creation of a pledge over the movable assets by entering thereof into the Registry of Court and Public-Notary Security Interests on Movables and Rights (hereinafter: "the Registry"). The claims have to be identified or identifiable and the agreement has to be concluded either as a public notary's act⁸ or as a solemnized private deed⁹. In case when the security agreement is made in the form of the solemnized private deed, containing a clause by which the debtor would agree to an immediate enforcement (a so-called enforcement clause) in the event of a default and after the notary public provides the agreement with the enforcement certificate, the creditor could start the enforcement proceedings on the basis of the agreement as if it has already obtained a final court judgment.¹⁰

Pursuant to the Law on Registry, the movables are considered as pledged after the decision on the entry becomes final.¹¹ However, once the decision on entry of the security interest becomes final it is deemed that the security interest has been created at the time

⁷ This is governed by Part 3, Chapter 27 of the Croatian Enforcement Act.

⁸ See Article 279 (2) of the Enforcement Act.

⁹ *Id.*

¹⁰ See Article 54 of the Croatian Public Notary Act (Official Gazette 78/93, 29/94, 162/98, 16/07).

¹¹ See Article 32 in connection with Article 17 (1) of the Law on Registry.

when the application form for the entry thereof has been submitted to the Registry Office.¹²

The creation of a pledge in a manner described above allows the debtor to continue to deal with the movables in the ordinary course of business, which is exactly the main idea of the modern secured transactions laws, at least as far as the movables are concerned.

1.2.2 Transfer of Ownership

The Enforcement Act also recognizes another legal instrument to be used for creation of a security interest in movables, *i.e.* the transfer of ownership for security purposes (a so-called fiduciary ownership).¹³ The transfer of ownership may be again carried out through either (i) a court or (ii) a public notary.¹⁴ Since the author's practical experience so far shows that the most suitable way of carrying out the transfer of ownership is through the exercise of the public notary's authority, further elaborations shall be given having that in mind.

In the mentioned scenario, by entering into an agreement the creditor and the debtor agree on the transfer of ownership on movables to the creditor with the aim of securing the creditor's claims. These claims have to be identified or identifiable, their maturity has to be established (or the agreement has to contain a provision granting the secured party, *i.e.* the creditor, the authority to determine the exact due amount of the secured claim from time to time, and the due date thereof) and the agreement has to be concluded either as a public notary's act or as a solemnized private deed. The agreement may also contain

¹² See Article 17 (2) of the Law on Registry.

¹³ This is governed by Part 3, Chapter 28 of the Croatian Enforcement Act.

¹⁴ *Id.*

debtor's statement allowing creditor to initiate enforcement proceedings upon maturity of the claims and acquire the possession of the movables.

Pursuant to the Law on Registry the transfer of ownership is considered as perfected after the decision on the entry becomes final.¹⁵ However, once the decision on entry of the security interest becomes final, it is deemed that the transfer of ownership has been performed at the time when the application form for the entry thereof has been submitted to the Registry Office.¹⁶

The transfer of ownership (as well as the already mentioned creation of a pledge) in a manner described above allows the debtor to continue to deal with the movables in the ordinary course of business.

1.2.3 The Main Differences between Two Ways of Creating Security Interests in Movables (Advantages, Disadvantages, Instruments Usually Used in Financing Practice)

By creating a pledge the creditor obtains a real right over the pledged movables and is entitled to settle its due claims from the value thereof.

Provided the relevant pledge agreement contains a so-called enforcement clause and is certified by a so-called enforcement certificate given by the notary public, the secured party is entitled to start directly the enforcement proceedings over the movables at bar, in order for them to be sold by way of direct sale or public auction (run by the court officer or the notary public).¹⁷

¹⁵ See Article 32 in connection with Article 18 (1) of the Law on Registry.

¹⁶ *Id.*

¹⁷ See Article 141 of the Enforcement Act.

On the other hand, the transfer of ownership enables the creditor to become a fiduciary owner of the movables and under certain conditions it may also become the "full" owner¹⁸. There are two ways in which the movables subject to the fiduciary ownership may be sold, although the general rule is that the creditor has the right to dispose of the movables after the claims become mature.¹⁹

According to the provision of Article 274.f of the Enforcement Act, in case the creditor disposes of the movables before the maturity of the claims, this kind of disposal shall be valid, but the creditor may be liable for the damage caused to the debtor. The fact that this transaction is valid does not exclude the possibility of criminal responsibility of the persons who participated therein.

As mentioned previously, the sale of the fiduciary transferred movables may be conducted (i) in the same way as in case of sale of the pledged assets but here by the notary public only, and (ii) in the procedure prescribed in details by the Enforcement Act, which procedure is conducted by the notary public exclusively and which may be particularly interesting to the secured party as, under the conditions prescribed by the Enforcement Act, the secured party may even become the true owner of the movables at bar.

Namely, pursuant to Article 277 of the Enforcement Act, the creditor is, through the public notary, authorized to demand the debtor to inform him within the time period of 30 days whether it requests the sale to be carried out through involvement of the public notary. In its notice the debtor is obliged (i) to determine the lowest price for the

¹⁸ See Article 277 (7) of the Enforcement Act.

¹⁹ See Articles 274.f and 277 of the Enforcement Act.

movables (this price cannot be lower than the amount of the secured claims including interests, creditor's costs and prospective taxes), (ii) to name the public notary who is going to conduct the sale and (iii) to enclose public notary's statement by which it consents to the performance of the sale and agrees that the amount for which the movables are to be sold shall be used to settle debtor's claims including interests, costs and transfer tax (if any). After receipt of the debtor's notice the creditor is obliged within the time period of 15 days to authorize the named public notary to conduct the sale. In case the debtor does not proceed according to the above-mentioned, as well as in case the public notary does not succeed to sell the movable goods within the time period of 3 months, it is deemed that the creditor has become the "full" owner of the movables (the price is deemed to be the amount of the secured claims including interests, costs and taxes). The problem with this kind of enforcement is that if the creditor becomes the "full" owner of the movables, it is deemed that the secured claim is fully settled regardless of whether this is actually the case, and thus, this type of enforcement is not appropriate if the value of the claim is higher than the actual value of the movables being subject to enforcement.

On the other hand, if the debtor fulfills its obligations and settles the creditor's claims within the given period of time, the creditor is obliged to return the ownership to the debtor without delay.²⁰

Having in mind the above and assuming it is likely that the amount of the secured claims are usually higher than the value of the specific movables being subject to enforcement,²¹

²⁰ See Article 277.a of the Enforcement Act

²¹ However, it has to be noted that at least as far as bigger projects are concerned, especially the ones involving national and international banks acting as lenders, the security packages include not just security

the author's opinion and practical experience show that it is more opportune and advisable to create the pledge over the movables than to fiduciary transfer them. Namely, provided the above assumption is correct, the enforcement procedures would after all be very similar both in case of the pledge and the fiduciary transfer. On the other hand, having in mind that the concept of the fiduciary transfer has been changed several times in the last few years, which has brought a kind of legal uncertainty in relation to this concept, it is questionable what would actually be arguments in favor of granting the fiduciary transfer.

1.3 The Law on Registry

1.3.1 General Remarks

The Law on Registry²² established the Registry of Court and Public-Notary Security Interests on Movables and Rights (hereinafter: "the Registry") and the procedure for the registration of such security interests, as well as the requirements and effects of the registration.²³

The fundamental feature of the court and public notary security interests is that collaterals remain in the possession of the debtors and therewith this scheme has advantages in comparison with the creation of pledge in accordance with the provision of the Law on Ownership. On one side, the court and public notary security interests enable the debtor to continue commercially exploiting the collateral and on the other side, the creditor does not have to bare the burden of maintaining and preserving the collateral. However, the

interests in movables, but also and usually primarily, security interests in contractual claims, insurance claims, real estates, bank accounts, business shares etc.

²² The Law on Registry came into force on October 25, 2005, but started to be applicable on April 25, 2006.

²³ See Article 1 of the Law on Registry.

main problem with this kind of security interests was connected with the fact that there was no publicity in respect of their creation, which had as a consequence the weaker position of the creditors who have acquired such security interests. Thus, the main reasons for enactment of the Law on Registry were (i) to generate economic growth, (ii) to make created security interests public, (iii) to therewith protect the rights of the creditors towards third parties and (iv) to protect the interests of third persons – potential creditors, who may, by undertaking a search through the Registry, get information on the credit rating of the debtor.

The Registry is established within the Financial Agency (legal entity founded by the Republic of Croatia which principal task is, *inter alia*, the information technology support in relation to the public treasury, public incomes, statistics, etc., as well as commercial activities - internal payments)²⁴. Since the Registry is a public registry everyone is entitled to search through it and obtain excerpts.²⁵ The searches can be made by the following criteria: (i) by collateral; (ii) by collateral and debtor and (iii) by collateral and creditor.²⁶

The provision of Article 2 of the Law on Registry prescribes that the Registry Office which administers the Registry shall be established. Paragraph 6 of the same provision prescribes the obligation of the Minister competent for legal affairs²⁷ to enact the regulation which is supposed to govern the issues such as the form and the content of the

²⁴ See Articles 1 and 3 of the Croatian Financial Agency Act.

²⁵ See Article 3 of the Law on Registry.

²⁶ See Article 3 (6) of the Law on Registry.

²⁷ At the moment this is the Minister of the Ministry of Justice.

Registry and the organization of the Registry Office, everything in accordance with the Law on Registry.²⁸

An interesting provision of Article 5 of the Law on Registry prescribes that the Financial Agency and the Republic of Croatia are jointly and severally liable for damage arising out of irregularities, errors or delays, as well as loss of data from the Registry.²⁹

Pursuant to the provision of Article 6 of the Law on Registry, the Registry contains information on the rights and orders (like temporary measures issued under the Enforcement Act), which are not registered in other public registries (such as land registry for real estates or special registries for ships and aircraft).

The same Article contains a list of rights to be recorded in the Registry, as follows:

- (i) pledges on movables, rights, or shares created within the enforcement proceedings;
- (ii) floating lien³⁰ on debtor's property or on the mass of assets located in a specified place;
- (iii) transfer of ownership on movables or other rights for security purposes;
- (iv) transfer of stocks and shares for security purposes;
- (v) court injunctions prohibiting transfer or encumbrance of specific assets;
- (vi) transfers of ownership on movables or other rights and shares which have already been pledged in accordance with (i) above;

²⁸ In accordance with the mentioned, the following regulations have been enacted: (i) Regulation on the Form and Content of the Registry and the Internal Organization of the Registry Office (Official Gazette 77/06), (ii) Regulation on the Fees for the Entries into the Registry (Official Gazette 77/06) and (iii) Regulation on the Fees for Use of Data through Electronic Sources (Official Gazette 77/06).

²⁹ Until now, there are no cases related to this provision, at least according to the author's knowledge.

³⁰ Although the exact Croatian word used in this respect does not exactly correspond to the "floating lien", the author is of the opinion that the meaning and scope of this new institute is most similar to the concept of floating lien known in common law countries (the USA in particular).

- (vii) retention of title on movables made pursuant to an agreement, if its duration is over one year.

1.3.2 Perfection of Security, Priority Rules - Possible Conflicts, Effect of Registration, Protection of the Secured Party

1.3.2.1 Perfection of Security

According to the Law on Registry, the perfection³¹ of both the pledge of movables and the transfer of ownership takes place after the decision on the entry of the security interest into the Registry becomes final.³² However, once such decision becomes final, it is deemed that the security interest has been created at the time when the application form for the entry thereof has been submitted to the Registry Office.³³ Due to the fact that the Law on Registry adopted the electronic real-time entry system³⁴ the exact day, hour and minute of the filing is known. According to the Article 17 (2) of the Law on Registry, a certificate on the time of the filing may also be issued to the creditor upon its request.

Since after the decision on the entry becomes final it is deemed that the security interest has been created at the time when the application form for the entry thereof has been submitted to the Registry Office, the entry into the Registry is of constitutive nature.

It has to be mentioned that there is no need for renewal of the registration. However, in case the secured claim would be assigned to a new creditor, the transfer of security to such new creditor should be registered with the Registry.

³¹ The word “perfection” used hereinafter also means creation, *i.e.* attachment. This issue and the differences in terminology between Croatian and American system shall be addressed in more details in Chapter 3 below.

³² See Article 32 in connection with Articles 17 and 18 of the Law on Registry.

³³ *Id.*

³⁴ See Article 2, paragraphs 3, 4 and 5 of the Law on Registry.

1.3.2.2 Priority Rules – Possible Conflicts

The Law on Registry introduced computer-based real-time entry and the "first-in-time, first-in-right" rule. Hence, the priority rules system is related to the real-time entry rule, so if one collateral can be the object of several security interests, they will be sorted by the "first-in-time, first-in-right" rule.³⁵ This novelty allows limited possibility for priority conflicts. Hence, if the security interests are mutually exclusive, only the first one to be registered will produce legal effects, and the Registry will refuse registration of all subsequent ones.³⁶

The problems that might arise are connected with the fact that not all entries into the Registry are constitutive. Namely, there are some entries that have a declaratory effect. Pursuant to the provision of Article 16 (1) of the Law on Registry, these entries are connected with the creation of the pledge in the enforcement proceedings³⁷ or with the creation of the security interest without the consent of the debtor³⁸. This kind of security

³⁵ See Article 13 of the Law on Registry.

³⁶ *Id.*

³⁷ This could happen if a certain creditor initiates enforcement proceedings against a certain debtor in order to settle its mature, but unpaid claims and in the course of these proceedings seizes debtor's movables creating a real right, *i.e.* a pledge over these movables.

³⁸ Provisions of the Enforcement Act allow the creditor to request from the competent court, under certain conditions, the issuance of the decision on preliminary injunction (Part 3, Chapter 30 of the Enforcement Act). According to these provisions, a preliminary injunction may be issued in order to secure creditor's monetary claim on the basis of: (i) a decision of the court or administrative body which has not yet become final and binding, (ii) a settlement entered into before the court or the administrative body, if the claim determined therein has still not become mature, (iii) a public notary's decision or public notary's deed, if the claim determined therein has still not become mature. In these cases (on the basis of the mentioned documents), the court shall issue a decision on preliminary injunction, if the creditor proves that there is a likelihood of a danger that without the issuance thereof, its claim shall not be satisfied or the satisfaction thereof shall be imperiled. However, there are certain situations in which the creditor is under no obligation to prove that there is a likelihood of a danger. Namely, pursuant to the provision of Article 285 of the Enforcement Act it is deemed that the likelihood of a danger exists, if the issuance of the preliminary injunction is proposed, *inter alia*, on the basis of a decision on enforcement issued on the basis of public or publicly certified deed, bill of exchange or check against which a timely objection has been filed, a decision which has to be enforced abroad, etc. The preliminary injunctions, which the court may order, include, *inter alia*, a seizure of debtor's movables, by which a creditor obtains a security interest (pledge). Hence, the security interest is, in this case, created without the debtor's consent. As mentioned, this kind of security

interests are deemed to be perfected by way and at the time determined by the provisions of the Enforcement Act.³⁹ They are entered into the Registry only on the request of the creditor or if the court orders such entry *ex officio*.⁴⁰ In practice, this could lead to a situation in which one creditor might enter into a valid security agreement but could still be prevented from obtaining its rights there under due to the fact that another creditor has already, prior to the entry into the Registry of security interest on the basis of a valid security agreement, obtained a security interest on, for example, the same movables. The fact that this prior security interest obtained during, *e.g.* enforcement proceedings was not registered would have no effect since it was perfected in accordance with the provisions of the Enforcement Act.⁴¹ Moreover, according to the provision of Article 17 (3) of the Law on Registry, if the Registry Office receives at the same time the application forms for the entry of (i) the pledge of movables on the basis of a valid security agreement and (ii) the decision prohibiting the disposal or encumbrance of the same movables, it shall be deemed that the decision prohibiting the disposal or encumbrance of the movables arrived earlier, and this shall be registered into the Registry. Furthermore, according to the provision of Article 18 (3) of the Law on Registry, if the Registry Office receives at the same time the application forms for the entry of (i) transfer of ownership and (ii) pledge, it shall be deemed that the documents on the basis of which the pledge should be

interest is deemed to be perfected by way and at the time determined by the provisions of the Enforcement Act and is entered into the Registry only on the request of the creditor or if the court orders such entry *ex officio*. Accordingly, the entry into the Registry has a declaratory effect.

³⁹ See Article 16 (1) of the Law on Registry.

⁴⁰ See Article 16 (4) of the Law on Registry.

⁴¹ See Article 16 (1) of the Law on Registry.

registered arrived earlier. Hence, the priority is given to the pledge and to measures prohibiting the disposal or encumbrance of the assets.⁴²

Since the Law on Registry entered into force at the end of April 2006 and the Registry started to operate only in August 2006, it is still rather difficult to have an overall overview whether or not the courts usually initiate proceedings for the entry of security interests created either during enforcement proceedings or without the consent of the debtors into the Registry.

In addition, what seems to be important to mention from the practical point of view and having in mind the priority rules and possible conflicts, is the fact that in case of a sale of collaterals in the course of enforcement proceedings, costs of the enforcement proceedings (such as court fees) and taxes and other duties related to the secured assets that became due in the past year, have priority over secured claims.⁴³

1.3.2.3 Effects of Registration

As far as the effects of the entry *inter partes* are concerned, according to the provision of Article 20 (1) of the Law on Registry, in case the security interest is entered on the basis of the parties' agreement the debtor is not allowed to question the right, which the creditor has acquired claiming that the at the time of the creation he was not the owner thereof. However, paragraph 2 of the same provision stipulates that this is of no influence to the possibility of the debtor to challenge the agreement on the basis of which the entry

⁴² See also Mihajlo Dika, *Upisivanje sudskih i javnobilježničkih dobrovoljnih založnopравnih i fiducijarnih osiguranja u upisnik sudskih i javnobilježničkih osiguranja tražbina vjerovnika na pokretnim stvarima i pravima*, SAVJETOVANJE – REGISTAR SUDSKIH I JAVNOBILJEŽNIČKIH OSIGURANJA - ISKUSTVA I PROBLEMI 41 (Narodne novine d.d., 2007).[hereinafter Dika]

⁴³ See Article 144 in connection with Article 106 of the Enforcement Act.

was made for the reasons such as the deficiency in will while entering into the agreement or for some other reason.

Furthermore, the provision of Article 21 of the Law on Registry prescribes that, *inter alia*, the entry of the pledge or transfer of ownership into the Registry is of no influence to the right of the third party to claim, within the enforcement proceedings or security proceedings, that the enforcement or creation of security in relation to which the entry was performed, is not allowed. The third party also has the right to claim in a separate litigation proceedings that the security is to be proclaimed as illegal.

1.3.2.4 Protection of the Secured Party

The provision of the Article 21 (4) of the Law on Registry specifically prescribes that from the day of the entry of the security interest into the Registry the third parties cannot claim that they were not aware of the existence of such entry. That basically means that the institute of the *bona fide* purchases as such does not exist at least not as far as the creation of security interest according to the Law on Registry is concerned.

However, according to the provision of Article 21 (2) the entry of a pledge or transfer of ownership into the Registry is of no influence to the right of the third party to claim, within the enforcement proceedings or security proceedings that the enforcement or creation of security in relation to which the entry was performed, is not allowed. The third party has also the right to claim in a separate litigation proceedings that the security is to be proclaimed as illegal.

1.3.3 Organization of the Registry - Particulars Recorded in the Registry

The Registry is composed of the Main Book and the Documents Collection.⁴⁴ The Main Book is composed of individual folders, which are debtor-based.⁴⁵ Every folder comprises of three parts⁴⁶: part A, which contains information on the debtor (company name; name and surname of the debtor being a physical person; the address of the registered seat or residence; tax number of the legal entity or unique citizen's number for physical persons and, if necessary, other data needed in order to determine the debtor's identity)⁴⁷, part B, which contains information on the collateral⁴⁸ and part C, which contains information on the creditor⁴⁹.

On the other hand, the Documents Collection, which also comprises of individual folders, contains documents on the basis of which the entry is performed.⁵⁰

1.3.4 Procedure for Registration (Process, Documentation, Deregistration/Deleting, Fees)

The provision of Article 22 of the Law on Registry prescribes that the procedure for the registration may be initiated on the request of the secured party (creditor) or *ex officio*. In the entry proceedings the capacity of the parties is also given to (i) the debtor/counter-party and (ii) the third party upon whose assets the security by entering into an agreement

⁴⁴ See Article 11 (1) of the Law on Registry.

⁴⁵ See Article 11 (2) of the Law on Registry.

⁴⁶ See Article 12 (1) of the Law on Registry.

⁴⁷ See Article 12 (2) of the Law on Registry.

⁴⁸ See Article 12 (3) of the Law on Registry.

⁴⁹ See Article 12 (4) of the Law on Registry.

⁵⁰ See Article 14 of the Law on Registry.

is created, as well as to (iii) the third persons who have a legal interest to participate therein.⁵¹

The application for the entry has to contain:

- (i) the information on the parties;
- (ii) the information on the public notary's act (solemnized private deed) on the basis of which the entry is requested;
- (iii) the request for the entry of a specific right (such as pledge) in respect of described assets into the Registry; and
- (iv) it has to be signed by the applicant or another person having a valid power of attorney.⁵²

There are some additional documents which have to be submitted to the Registry together with the application form. These documents are, as follows:

- (i) the original of the public notary's act or solemnized private deed on the basis of which the entry is requested; and
- (ii) the original or certified copy of the documents proving the debtor's ownership title to the pledged movables.⁵³

The Regulation on the Form and Content of the Registry and the Internal Organization of the Registry Office prescribes the application forms⁵⁴, which are to be submitted to the

⁵¹ See Article 29 of the Regulation on the Form and Content of the Registry and Internal Organization of the Registry Office.

⁵² See Article 23 of the Law on Registry in connection with Article 34 of the Regulation on the Form and Content of the Registry and Internal Organization of the Registry Office.

⁵³ See Article 24 of the Law on Registry in connection with Article 35 of the Regulation on the Form and Content of the Registry and Internal Organization of the Registry Office.

⁵⁴ Pursuant to the provision of Article 23 (3) of the Law on Registry, the Regulation on the Form and Content of the Registry and Internal Organization of the Registry Office prescribed particular forms that are to be submitted to the Registry.

Registry. The applications may be delivered to the Registry Office of the Financial Agency by personal delivery, mail, or email (not yet applicable in practice).⁵⁵

On the same day when the application form is received the Registry Office creates a temporary folder, which corresponds to the decision on the entry.⁵⁶ This temporary folder remains in the Registry until the decision on the entry is delivered, in which case a new permanent one replaces the temporary folder.⁵⁷

In case the creditor's request for the entry is justified, the Registry Office shall deliver the decision on the entry in which case it does not have to contain reasons of such decision.⁵⁸

On the other hand, in case the Registry Office delivers a decision on rejection (on the basis of formal reasons) or refusal (on the basis of material reasons) of the entry, or a decision, which has as a consequence termination of the entry proceedings, this decision has to contain the respective reasons of such decision.⁵⁹ The Registry Office has an obligation to deliver a decision on the entry in the time period of 8 days as of the day of the receipt of the application.⁶⁰ However, the author's practical experience shows that in most cases the Registry Office does not deliver the decision on the entry in the said time period. Hence, it is reasonable to expect a procedure of delivering the decision on registration to take approximately one month (provided all relevant documents and data are presented).

⁵⁵ See Article 5 of the Regulation on the Form and Content of the Registry and Internal Organization of the Registry Office.

⁵⁶ See Article 27 (1) of the Law on Registry.

⁵⁷ See Article 27 (2) of the Law on Registry.

⁵⁸ See Article 26, paragraphs 2 and 8 of the Law on Registry.

⁵⁹ See Article 26 (8) of the Law on Registry.

⁶⁰ See Article 26 (10) of the Law on Registry.

A party, *i.e.* a participant in the proceedings (such as the third party upon whose assets the security is created or a third person having legal interest to participate in the respective proceedings) may object to the decision of the Registry Office in the time period of 8 days as of the day of the delivery thereof.⁶¹ In case the Registry Office does not accept the objection (which it may, according to the provision of Article 30 (6), accept in case the rights of other persons are therewith not infringed), the competent municipal court shall decide thereon.⁶² As mentioned, after the decision on the entry becomes final the security interest is perfected and it is deemed that it has been created at the time when the application form was submitted to the Registry Office.

With regards to deleting of the entries, the provision of Article 36 of the Law on Registry prescribes that the Registry Office shall, on party's proposal, delete the entry of the security interest on the basis of:

- (i) parties' mutual proposal or on the proposal of one of the parties to which the other party gave its consent;
- (ii) public or publicly certified deed containing the creditor's statement giving its consent to deleting of the respective entry;
- (iii) public or publicly certified deed proving that the conditions for deleting of the entry are fulfilled; and
- (iv) final and binding court decision ordering the deleting of the entry.

Regarding the registration fees the amounts thereof are presented in the table below.⁶³

⁶¹ See Article 30 of the Law on Registry.

⁶² See Article 30 (5) of the Law on Registry prescribes the competence of municipal courts, which territorial jurisdiction is determined pursuant to the seat of the respective Registry Office.

⁶³ Taken from the website <http://zaloznaprava.fina.hr/> visited on March 25, 2007.

Service Description	Basis for Calculation	Price in HRK ⁶⁴ /EURO ⁶⁵
Submission of the application for the entry		
Up to 20 collaterals	Proposal/Court Decision	305.00/42.00
More than 20 collaterals	Proposal/Court Decision	341.60/47.00
Submission of the proposal for entry of the note⁶⁶	Proposal/Court Decision	122.00/17.00
Submission of the proposal for deleting of the entry	Proposal/Court Decision	67.10/9.00
Submission of the objection against the decision on the entry	Objection	231.80/32.00
Submission of the request for change of the registered data	Registry Folder	30,50/4.00
Issuance of the excerpt from the Main Book		
Directly by the Registry Office	Excerpt	30,50/4.00
By facsimile message	Excerpt	36,60/5.00
By regular mail	Excerpt	42.70/6.00
Issuance of the copies of the documents from the Documents Collection		
Directly by the Registry Office	Copy	36,60/ 5.00
By facsimile message	Copy	42.70/6.00
By regular mail	Copy	48,80/7.00

Regarding the public notary's costs for the documents that need to be solemnized, the fee depends on the amount of the secured value.⁶⁷ Nevertheless, the maximum notary public fee for each document (including each annex thereto) to be solemnized as a private deed

⁶⁴ The prices expressed herein include VAT.

⁶⁵ Prices in EURO are expressed in approximate amounts.

⁶⁶ According to the provision of Article 7 (3) of the Law on Registry, a note is a type of entry showing, *inter alia*, that there is a pending dispute in connection with a particular entry, or that the objection was submitted in connection with a particular entry, or that the procedure for deleting of a particular entry was initiated etc.

⁶⁷ See Article 12 of the Public Notary Tariff (Official Gazette 97/01).

amounts to approx. HRK 20,000.00 (approx. EURO 2,740.00) plus VAT and maximum of HRK 1,000.00 (approx. EURO 137.00) for a stamp duty.⁶⁸ In case the same document is executed as a public notary act the maximum fee would be twice the fee prescribed for solemnization of a private deed.⁶⁹

1.3.5 What does the Security Interest in Movables Cover and the Concept of Floating Lien

The usual questions the author has encountered in practice are connected with the problem of what does the security interest actually cover (namely, movables, especially after the entry into force of the Law on Registry, *i.e.* after it became applicable, are more and more object of creation of security interests and are usually connected with the financing of certain parts of infrastructure). Recently, the author had experience with possible financing of railway infrastructure and the problems connected to the creation of security interest in rolling stock. Hence, the above question was posed in connection with the problem of what shall the potential security interest in rolling stock cover. The answer is rather simple; namely, the security interest covers the movables listed in the agreement and entered into the Registry, as well as all other movables such as spare parts in case they are subject to the created security interest or are considered as a component part of a specific movable.

In the above described situation and situations similar thereto there is a possibility of making use of a new concept (until enactment of the Law on Registry completely

⁶⁸ See Article 16 in connection with Article 12 of the Public Notary Tariff.

⁶⁹ See Article 12 of the Public Notary Tariff.

unknown to Croatian law)⁷⁰ introduced by the provision of Article 38 of the Law on Registry. This concept (floating lien) corresponds, in a way, to the similar common law concept, especially the US concept of floating lien).⁷¹ By recognizing this new institute Croatian system departed from the principle that the objects of pledge may only be individually determined movables.⁷²

One of the main differences in comparison with the US floating lien concept lies in the fact that the floating lien under the Law on Registry is a contractually created security interest in movables of all kind, or in all movables of a specific kind (goods, inventory, spare parts, furniture, tools and alike), which are located in a specified place (*e.g.* a warehouse, factory, business premises) of the debtor. In other words, Croatian law still does not recognize a floating lien that would cover all assets of the debtor. The individual movables are not registered separately and the entry of the created security interest into the Registry is of constitutive nature. The debtor is entitled to dispose of the movables encumbered by the floating lien and the person who obtains possession of such movables acquires them free of the lien. According to the provision of Article 38 (5) of the Law on Registry, the debtor has a duty to replace the movables he disposed of by acquiring new

⁷⁰ Before the entry into force of the Law on Registry, Croatian law did not recognize the concept of a floating lien as such at all. In other words, it did not allow a pledge to be taken over future moveable assets, as well as over monetary claims or receivables. Therefore, a usual scenario regarding agreements constituting a security package was to impose a contractual obligation on the debtor (*e.g.* borrower) to enter into the annexes to the pledge agreements whenever it acquired further assets (usually, the assets acquired after the execution of the pledge agreement, for which there was an obligation to enter into annexes to the original agreements, were described with a certain threshold, *e.g.* “all movables exceeding value of certain amount expressed in certain currency”). One can imagine how many problems this caused in practice and how time consuming it was, not to mention the additional costs that were imposed on the parties involved. Due to the fact that it was not possible to take security over future physical assets, every time the property was purchased by the debtor (*e.g.* borrower) a new security interest had to be created.

⁷¹ One of the most famous US “inventions” in respect of consensual liens is the floating lien. It attaches upon entering into the security agreement, can cover all assets of the debtor or a particular mass of assets and is perfected upon filing a financing statement (which is filed with the respective registry in a particular state). Unlike English floating charge, floating lien is usually deemed as more secure, since US concept does not recognize the institute of crystallization.

⁷² See Dika, *supra*, at 33.

ones; according to the nature of its business and provided that this obligation is not contractually excluded. The newly acquired movables replacing the ones disposed of become subject to the floating lien in the moment when they are placed into the specified area.⁷³ The author is of the opinion that one of the problems connected with the new Croatian concept of floating lien, as currently prescribed, lies in the mentioned obligation of the debtor to replace the movables disposed of. Namely, the debtor's obligation as prescribed in the respective provision is rather vague and causes a rather high level of legal uncertainty. Namely in case the floating lien covers, *e.g.* all automobiles located in a specified area (business premises, warehouse) and these automobiles are being subject to everyday sale, it is questionable in what manner and particularly when is the debtor going to replace the automobiles already disposed with. Moreover, the wording of the mentioned provision prescribing that the debtor shall replace the sold movables "*according to the nature of its business*" is again quite vague and ambiguous. Unlike the US concept of floating lien which might cover all assets of the debtor, the Croatian version thereof recognizes only specific mass of assets and therefore the creditor is in a somewhat weaker position. For these reasons the practical experience shows that the parties usually explicitly exclude the application of the provision at bar.⁷⁴

In case the creditor who has a security interest in movables created pursuant to the provision of Article 38 of the Law on Registry initiates enforcement proceedings the objects of the floating lien will be all movables, which are currently in the area specified

⁷³ See also Dika, *supra*, at 35.

⁷⁴ There, of course, is a possibility to include certain covenants into security agreements that would impose an obligation on the debtor to replace movables subject to the floating lien (*e.g.* the number of specific movables located in a specified area may not decrease below certain number), but the problem with these kind of covenants in legal systems similar to the Croatian lies in the fact that, in practice, they are usually not respected and end up in litigation proceedings. In order to reach certain level of legal certainty in this respect a „mind shift“ has to be reached and for this to happen, a certain time period is definitely needed.

in the security agreement. The creditor's priority will be determined according to the moment when the application for the entry of its security interest has been submitted to the Registry Office (subject to the condition that the decision on the entry has become final).⁷⁵

1.3.6 Selected Data on Application of the Law on Registry

In the period from July 27, 2006 until December 31, 2006 the following data were collected:⁷⁶

(i)	the number of pledged vehicles	8,936
(ii)	the number of pledged machinery	4,337
(iii)	the number of pledged cattle	2,531
(iv)	the number of other movables and rights	2,361
(v)	the number of pledged crops	415
(vi)	the number of pledged business shares	198
(vii)	the number of pledged computers	84
(viii)	the number of floating liens	15
(ix)	the number of pledged patents	2
(x)	the number of pledged stocks	9

Furthermore, the available data show that the number of registered transfers of ownership for security purposes amounts to 7,501 (88% of total entries), while the number of

⁷⁵ See Article 38 (6) of the Law on Registry.

⁷⁶ See Zlatko Mičetić, *Iskustvo i problemi u radu službe upisa u primjeni zakona o upisniku sudskih i javnobilježničkih osiguranja tražbina vjerovnika na pokretnim stvarima i pravima*, SAVJETOVANJE – REGISTAR SUDSKIH I JAVNOBILJEŽNIČKIH OSIGURANJA - ISKUSTVA I PROBLEMI 78 (Narodne novine d.d., 2007)

registered pledges amounts to 935 (11% of total entries), which to the author is rather surprising due to the reasons set out under 1.2.3 above.⁷⁷

1.4 Enforcement of the Security Interest

As mentioned under 1.2.1 above, in case the security agreement is made in the form of a solemnized private deed containing a clause by which the debtor would agree to an immediate enforcement (enforcement clause) in the event of default and after the public notary provides the agreement with the enforcement certificate, the creditor may start the enforcement proceedings on the basis of the agreement as if he has already obtained a final court judgment.

Pursuant to the provision of Article 129 (2) of the Enforcement Act, the creditor is obliged to specify in the proposal on enforcement whether the respective movables are to be delivered to him, to the court or to a third person (if the movables would be delivered/transferred to the creditor's possession, he would be liable for destruction or impairment of the movables, except in cases of *force majeure*).

Following the initiation of the enforcement procedure, the court would adopt the enforcement decision,⁷⁸ such decision being subject to a potential appeal⁷⁹ submitted by the debtor, creditor or a third party claiming the existence of such rights being appropriate to prevent the enforcement. Provided the enforcement procedure would be initiated on the basis of so-called enforceable deed (e.g. the pledge agreement, supplied

⁷⁷ See Zlatko Mičetić, *Iskustvo i problemi u radu službe upisa u primjeni zakona o upisniku sudskih i javnobilježničkih osiguranja tražbina vjerovnika na pokretnim stvarima i pravima*, SAVJETOVANJE – REGISTAR SUDSKIH I JAVNOBILJEŽNIČKIH OSIGURANJA - ISKUSTVA I PROBLEMI 79 (Narodne novine d.d., 2007)

⁷⁸ See Article 37 of the Enforcement Act.

⁷⁹ This is governed by Part 2, Chapter 5 of the Enforcement Act.

by the enforcement clause and enforcement certificate), an appeal of the debtor or a third party would normally not influence the continuation of the enforcement procedure and the related sale. In the course of the enforcement procedure, either a direct sale or the public auction would be conducted.⁸⁰ Following the sale of the collateral, the proceeds of such sale would be used for the satisfaction of the claims having priority under mandatory provisions and, following that, for the satisfaction of the claims of the creditor(s) according to the priority ranks of their claims.⁸¹

The enforcement proceedings and the settlement of the creditor's claims in connection with the transfer of ownership have already been discussed under 1.2.3 above.

The practice shows that the usual questions connected with the creation of the security interests and possible subsequent enforcement thereof, especially in the light of international transactions, are connected with the issue of the currency in which the enforcement is to be made. In this respect it has to be noted that the assets subject to the creditor's security interest are offered and sold in Croatian currency, but, provided the secured claim is expressed in foreign currency, the proceeds of enforcement to be transferred to the creditor having such foreign currency claim, are converted in the relevant foreign currency and transferred to the creditor's account. Furthermore, there should be no problems in connection with the transfer of the proceeds abroad, provided the main transaction, *i.e.* the facility agreement under which the secured claim arose in the first place, was properly filed with the Croatian National Bank (for statistical purposes) and all taxes (if any) arising there from were paid. The information needed for

⁸⁰ See Article 141 of the Enforcement Act.

⁸¹ See Article 145 in connection with Article 106 of the Enforcement Act.

this transfer to be performed is, as follows: (i) the basic data on the creditor (company name and the registered seat), (ii) the bank account number, (iii) SWIFT and (iv) IBAN.

The main problem connected with the enforcement of security interests is related to the question of the time period in which the creditor may expect his claims to be finally settled. The time needed for the enforcement of a security interest over movables is, of course, subject to the relevant circumstances of the case and hence it is rather difficult to envisage a scenario for which one could say that it is a usual one. However, as a general rule the enforcement proceedings in Croatia are often time-consuming and the enforcement debtors often tend to delay and obstruct the enforcement proceedings, especially when they include the sale of pledged movables, such as personal property of physical persons and machinery/inventory of legal entities. The author's practical experience in relation to the enforcement of the security interest in movables shows that the outcome of the enforcement proceedings mostly depends on whether there are any potential purchasers thereof.

1.5 Bankruptcy of the Grantor of the Security

Pursuant to the provision of Article 81 of the Bankruptcy Act, there are some creditors who have the right to a separate satisfaction from the proceeds of the sale of certain assets being a part of a bankruptcy estate. These creditors are primarily creditors having a security interest over the assets owned by the bankruptcy debtor, *i.e.* security grantor. Hence, both the creditors who have obtained a security interest in assets by way of a pledge and the ones who have obtain it by way of transfer of ownership fall into this category.

According to the mentioned provision of Article 81 of the Bankruptcy Act, these creditors have the right to initiate enforcement proceedings in order to sell the respective assets pursuant to the provision of Article 164.a of the same Act. They exclude other bankruptcy creditors from satisfaction from the proceeds of the sale of the assets subject to their security interest up to the amount of their claims.

Two scenarios are possible pursuant to the provisions of Articles 164 and 164.a of the Bankruptcy Act. In the first, the creditor initiates the enforcement proceedings in which the assets are sold, in the second the bankruptcy judge carries out the sale of the assets subject to creditor's security interest.

In case the creditor decides to initiate the enforcement proceedings, pursuant to the abovementioned Article 164.a of the Bankruptcy Act after the sale of the assets subject to the security interest has been carried out, the court dealing with enforcement shall settle the costs of the enforcement proceedings (such as court fees) and shall hand over the rest of the amount to the bankruptcy judge. From this amount the bankruptcy judge first extracts into the bankruptcy estate the costs in connection with the sale (in principle, up to 10 per cent of the proceeds) and taxes if these incur, and then settles the claims of the creditors having a security interest in the sold assets. The rest of the amount (if any) is given to the bankruptcy trustee.

In case the bankruptcy judge carries out the sale of the assets subject to security interest in bankruptcy proceedings, the order of payment is almost identical to the above described one, apart from the fact that in such case there are no enforcement proceedings costs to be settled first.

It seems important to mention that, pursuant to the provision of Article 173 (5) of the Bankruptcy Act, the creditors having a security interest over the assets owned by the bankruptcy debtor are under an obligation to notify the bankruptcy trustee on (i) their right to a separate satisfaction, (ii) legal basis thereof and (iii) a part of the bankruptcy estate subject to the security interest. Furthermore, the provision of Article 173 (6) of the Bankruptcy Act prescribes that the creditors who have not notified the bankruptcy trustee as mentioned shall not lose their right to a separate satisfaction. However, in exceptional cases, they shall lose this right and shall not have the right to seek damages or any other satisfaction from the bankruptcy trustee or other creditors if the assets subject to security interest are sold in the bankruptcy proceedings without their involvement, subject to the condition that the security interest was not registered in the public registry or the bankruptcy trustee did not know or did not need to know of such security interest.⁸²

⁸² The creditors having security interest over the assets owned by the bankruptcy debtor may also file their claims to the bankruptcy trustee as "regular" bankruptcy creditors. In this application they are obliged to specify a part of the bankruptcy estate subject to their security interest and the amount of their claims, which might not be satisfied through enforcement of their security interest (Article 173 (5) of the Bankruptcy Act).

CHAPTER 2: UCC ARTICLE 9

2.1 On Uniform Commercial Code

2.1.1 Introduction

Uniform Commercial Code (hereinafter: "UCC") is, as its name states, a uniform, model law, *i.e.* a so-called soft law. The main motive for drafting a code like this is connected with a rather simple and almost an exclusive reason. Namely, the conclusion that immediately comes into one's mind (especially if he/she comes from Europe) is that the main motivation for drafting a code like this corresponds to the motives of the Member States of the European Union (hereinafter: "EU") when they were (and they still are), indirectly of course, working on EU legislation through making of, *inter alia*, regulations and directives. The principal goal was (and still is) to make the respective laws of the Member States, if not uniform, then at least as similar as possible, thus increasing legal certainty. The answer to the question why has this been done and why is this going to be done in the future as well is rather simple. Namely, all these efforts in unifying the laws are connected with the trade, *i.e.* with one ultimate goal: to encourage business activity, to therewith secure economic growth and, finally, to make benefit to the consumers⁸³.

Hence, as soon as the people within the United States started to move from one state to another and the trade was not limited to the territory within the borders of one state only, the logical consequence was to start to think of a model law that would make transactions and all other related procedures easier and unified. *"Until the appearance of the Uniform*

⁸³ Regarding consumers, in a past decade there was a strong incentive towards benefits for consumers. This kind of policy is not typical just for the developed countries, but also for the countries with emerging markets, especially the ones trying to enter the EU.

Commercial Code (hereinafter: UCC) each state's law evolved independently of the law of the other states. The existing uniformity throughout the country today is due to the harmonizing force of the UCC, which was completed in 1950 and was later adopted in one form by all of the states."⁸⁴

For the reasons mentioned above and according to the data available on the website of the National Conference of Commissioners on Uniform State Laws (hereinafter: "NCCUSL") *"the National Conference of Commissioners on Uniform State Laws has worked for the uniformity of state laws since 1892."*⁸⁵

Hence, the NCCUSL, among other things, started to work on the Uniform Commercial Code in order to unify the laws related to commerce, which was obviously of great importance, due to the fact that unification of the laws in a particular field, without a doubt, simplifies procedures, makes them more transparent and is, in the end, more favorable to participants in business transactions, especially if these transaction include places outside the territory of a participant's domestic state. Therefore, in 1940 the National Conference of Commissioners on Uniform State Laws decided *"to attack major commercial problems with comprehensive legal solutions - a decision that set in motion the project to produce the Uniform Commercial Code in partnership with the American Law Institute. The Code took ten years to complete and another 14 years before it was enacted across the country."*⁸⁶ This is how the original version of the UCC was born.

⁸⁴ TIBOR TAJTI, COMPARATIVE SECURED TRANSACTIONS LAW, 118 (Akadémiai Kiadó, 2002) [hereinafter Tajti]

⁸⁵ <http://www.nccusl.org/nccusl/aboutus.asp#history>, visited on March 29, 2007.

⁸⁶ *Id.*

2.1.2 Original Version of UCC Article 9

The original version of the Uniform Commercial Code⁸⁷ (hereinafter: "Original UCC") is divided in five parts. The first part deals with the following: a short title of the Article⁸⁸, applicability of the code⁸⁹ and with certain definitions⁹⁰ such as, for example, "collateral", "debtor", "document", "encumbrance" etc. The second part deals with the validity of the security agreement⁹¹, attachment and enforceability⁹² and rights of the parties to the security agreement⁹³. The third part contains provisions relating to the rights of third parties⁹⁴, perfected and unperfected security interests⁹⁵, proceeds⁹⁶, protection of third parties⁹⁷ and priority rules⁹⁸. The fourth part contains provisions dealing with filing, such as place of filing⁹⁹, formal requisites of financing statement¹⁰⁰, duration and effect of filing, fees¹⁰¹ and the fifth part deals with the situation where a debtor is in default¹⁰², *i.e.* with rights and obligations of the creditor and the debtor¹⁰³.

⁸⁷ The original version of Uniform Commercial Code was taken from the website <http://www.law.cornell.edu/ucc/9/overview.html>, visited on March 23, 2007.

⁸⁸ See Section 9-101 of the Original UCC Article 9.

⁸⁹ See Sections 9-102, 9-104 of the Original UCC Article 9.

⁹⁰ *E.g.* sections 9-105, 9-106, 9-107 of the Original UCC Article 9.

⁹¹ See Section 9-201 of the Original UCC Article 9.

⁹² See Section 9-203 of the Original UCC.

⁹³ *E.g.* sections 9-206, 9-207 of the Original UCC Article 9.

⁹⁴ See Section 9-301 of the Original UCC Article 9.

⁹⁵ See Sections 9-301, 9-302 of the Original UCC Article 9.

⁹⁶ See Section 9-305 of the Original UCC Article 9.

⁹⁷ *E.g.* sections 9-307, 9-308, 9-309 of the Original UCC Article 9.

⁹⁸ *E.g.* sections 9-310, 9-312, 9-313, 9-315 of the Original UCC Article 9.

⁹⁹ See Section 9-401 of the Original UCC Article 9.

¹⁰⁰ See Section 9-402 of the Original UCC Article 9.

¹⁰¹ See Section 9-403 of the Original UCC Article 9.

¹⁰² See Section 9-501 of the Original UCC Article 9.

¹⁰³ *E.g.* sections 9-502, 9-504, 9-506 of the Original UCC Article 9.

2.1.3 Revised Version of UCC Article 9

In 1998, the NCCUSL together with the American Law Institute (hereinafter: "ALI") started to work on a revised version of UCC Article 9 - the most important Article as far as secured transactions are concerned.

The main reasons for this revision were, *inter alia*, (i) changes in business practice, (ii) faster methods of communication and (iii) globalization, *i.e.* the need to put the US laws in line with international commercial law.¹⁰⁴ The other reasons, not less important, were connected with the intention to bring certainty to financing transactions and therewith to reduce the transaction costs and the costs of credit.¹⁰⁵

The most important changes introduced by the revised version of UCC Article 9¹⁰⁶ (hereinafter: "Revised UCC Article 9" or "Revised Article 9") may be divided into four parts.

Firstly, the Revised Article 9 introduced some new types of collateral. Namely, the Original Article 9 did not recognize security interests in deposit accounts as original collaterals; it only recognized security interests in deposit accounts as proceeds of the original collateral.¹⁰⁷ It has also introduced new types of transactions, such as the sale of payment intangibles and promissory notes.¹⁰⁸ This broadening of categories of collaterals has as a consequence more opportunities for the debtor and therewith increases his access

¹⁰⁴ See Tajti, *supra*, at 140.

¹⁰⁵ See Steven O. Weise, *An Introduction to the Revised UCC Article 9*, 2000, found on the website <http://library.findlaw.com/2000/Apr/1/130705.pdf>, visited March 30, 2007. [hereinafter Weise]

¹⁰⁶ The revised version of UCC Article 9 was taken from the website <http://www.law.cornell.edu/ucc/9/>, visited on March 23, 2007.

¹⁰⁷ Section 9-104 (l) of the Original UCC Article 9.

¹⁰⁸ Section 9-102 (a) (12) of the Revised UCC Article 9.

to credit. On the other hand, this also benefits the creditors because they have more options for securing their claims.

Secondly, the Revised Article 9 managed to simplify the choice of law governing the place to perfect the security interest. A general rule is that the debtor's location within a jurisdiction governs perfection, the effect of perfection and the priority of a security interest in collateral.¹⁰⁹ It also defines the debtor's location, so, for example, if a debtor is a registered organization, the secured creditor has to determine its place of incorporation to be able to determine the respective jurisdiction.¹¹⁰

Thirdly, since the revised version introduced some new types of collateral, it respectively also introduced perfection rules for these new types of collaterals. For example, as far as deposit accounts are concerned, the revised version prescribes that the security interest in deposit accounts is perfected by control.¹¹¹ According to the section 9-104 of the Revised UCC Article 9, a secured party has control over deposit account, if (i) the secured party is the bank with which the deposit account is maintained; (ii) the debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or (iii) the secured party becomes the bank's customer with respect to the deposit account.

Fourthly, the revised version of Article 9 improved the position of consumers. Namely, there are several notification requirements that have to be fulfilled, such as requirements

¹⁰⁹ See Section 9-301 of the Revised UCC Article 9.

¹¹⁰ See Section 9-307 (e) of the Revised UCC Article 9.

¹¹¹ See Section 9-314 (a) of the Revised UCC Article 9.

prescribed by section 9-614 of the Revised UCC Article 9 dealing with the contents and form of notification before disposition of collateral in consumer-goods transactions.¹¹²

2.2 Perfection System and Some Other Related Issues under Original Version of UCC Article 9

Before discussing perfection of security interests few other notions have to be explained. These notions are attachment and enforceability. Namely, without making a clear distinction between these three moments connected with the creation and effects of the security interest, the whole concept of security interest under UCC Article 9 can become blurred and incomprehensible.

For the security interest to be created, it, firstly, has to "attach" to the collateral and therewith to become "enforceable" against the debtor.¹¹³ According to the provisions of section 9-203 of the Original UCC Article 9 a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless: (i) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral; (ii) value has been given; and (iii) the debtor has rights in the collateral.¹¹⁴ The attachment and enforceability of the security interest affects the rights between the respective contracting parties, *i.e.* has an *inter partes* effect, not influencing third parties because of the fact that

¹¹² According to the section 9-102 (a) (24) consumer-goods transaction means a consumer transaction in which (i) an individual incurs an obligation primarily for personal, family, or household purposes; and (ii) a security interest in consumer goods secures the obligation.

¹¹³ See Bart A. Basi and Roman Basi, *Secured Transactions and Article 9: The Rubix Cube of the UCC*, found on the website <http://www.amtda.org/education/secured%20transactions.pdf>, visited March 28, 2007.

¹¹⁴ These three requirements for the security interest to attach and become enforceable have to be met cumulatively, which means that, as long as one of them is not met, the security interest will not attach and will not be enforceable.

at the time of creation, *i.e.* attachment of the security interest they are still not notified of the creation and existence of the security agreement.¹¹⁵ Simply put, there are two particular moments in establishing of security interest. First one is the creation of the security agreement itself and the second one is the attachment. Hence, before all three conditions from section 9-203 of the Original UCC Article 9 are fulfilled, the security interest does not attach to the collateral and is not enforceable even *inter partes*, *i.e.* against the debtor.

After the attachment of the security interest to the collateral, the notion of “perfection” comes into picture. Namely, in order for the third parties to be notified of the existence of a particular security agreement¹¹⁶ and creation of the security interest, the act of “perfection” has to be undertaken. Therewith the security interest becomes enforceable *erga omnes*.¹¹⁷

The perfection itself has as a consequence not just the *erga omnes* effect, but is also connected with the priority rules. When it comes to satisfaction of creditors’ claims, the one having the “strongest” security interest (and this will usually be the security interest first perfected) shall have the priority over other secured creditors (which have perfected their security interest later) and, of course, over unsecured creditors. In practice, the perfection itself becomes very important, which is not surprising due to the fact that exactly perfection and priority rules in the end influence the satisfaction of the creditor’s claim towards the debtor. According to the provision of section 9-302 of the Original

¹¹⁵ See Tajti, *supra*, at 38.

¹¹⁶ According to the provision of section 9-203 of the Original UCC Article 9, the security agreement has to be signed by the debtor, meaning that it has to physically exist and has to contain the description of the collateral. Usually, security agreements contain additional provisions describing the secured obligation, the events of default and other rights and obligations of the parties to the agreement, as well as provisions relating to the transaction at hand.

¹¹⁷ See Tajti, *supra*, at 38.

UCC Article 9 the perfection takes place through filing of a financing statement. The same provision also contains exceptions to this rule prescribing that some security interests need not be filed in order to be perfected.¹¹⁸

An interesting provision of section 9-303 (1) of the Original UCC Article 9 prescribes that a security interest shall be perfected when it attaches and when all of the applicable steps required for perfection are taken. Hence, the first sentence of this provision anticipates a situation in which the security interest attaches before it is perfected, which is probably, in most cases, a usual scenario. However, one could imagine a situation in which, for example, a financing statement has been filed, but the security interest itself has still not attached to the collateral. This kind of scenario is the object of the second sentence of the provision at bar, which prescribes that if the required steps for perfection of the security interest are taken before it attaches, the security interest shall be perfected at the time when it attaches.

The act of perfection is basically not undertaken in order to inform the third parties (although it seems, at first glance, that this is the only reason), but primarily in order to protect the secured party and enable it to acquire the best possible position in case of the debtor's default. For the secured party the effect of perfection is primarily gaining priority over other creditors.

The priority rules prescribed by the Original UCC Article 9 may be summarized in one principle: first-in-time, first-in-right rule.¹¹⁹ This general principle derives from the

¹¹⁸ Pursuant to the section 9-302 of the Original UCC Article 9, these security interests are, for example: (i) security interests in collateral in possession of the secured party under section 9-305 (security interests in letters of credit, money, goods, instruments etc perfected by the secured party's taking possession of the collateral), (ii) purchase money security interests in consumer goods, with an exception for motor vehicles required to be registered, (iii) security interests created by an assignment of a beneficial interest in a trust or a decedent's estate etc.

provision of section 9-312 (5) prescribing that in cases where there are conflicting security interests in the same collateral, the priority between these conflicting security interests is determined according to the following rules: (i) conflicting security interests rank according to priority in time of filing or perfection and (ii) in cases where the conflicting security interests are unperfected, the first to attach has priority.

However, this is not the only rule set out by the Original UCC Article 9, since it *“incorporates a unique set of priority rules”*¹²⁰. The priority rules system of the Original UCC Article 9 is rather complex, especially from the point of view of a lawyer coming from a civil law country. The reasons for this complexity stem, *inter alia*, from the fact that UCC Article 9 introduced *“a wide variety of personal property used for security purposes”*¹²¹.

Probably the most interesting exception from the first-in-time, first-in-right rule connected with purchase money security interest (hereinafter: "PMSI")¹²². Namely, PMSI has a so-called super-priority, *i.e.* a priority over non-purchase money security interests and over security interests in after-acquired property (*e.g.* floating lien). Depending on the type of collateral involved, some additional conditions have to be fulfilled in order to perfect the PMSI. For example, if collateral cannot be considered as consumer goods, no automatic perfection rules apply, so in order to perfect PMSI, a financing statement

¹¹⁹ See Tajti, *supra*, at 164.

¹²⁰ Tajti, *supra*, at 164.

¹²¹ Tajti, *supra*, at 165.

¹²² The provisions of section 9-107 (a) (b) of the Original UCC Article 9 define PMSI as a security interest that is *“taken or retained by the seller of the collateral to secure all or part of its price”* or *“taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used”*.

should be filed (having in mind the grace period, place of filing and other related issues).¹²³

Under the provision of section 9-403 (2) of the Original UCC Article 9 a filed financing statement is effective for a period of five years from the date of filing. Unless a continuation statement is filed the effectiveness of a filed financing statement shall cease to exist after the mentioned time period of five years expires.¹²⁴ In case the continuation statement is not filed, pursuant to the provision of section 9-403 (3) of the Original UCC Article 9, a filing officer may remove a lapsed statement from the files. However, in some cases a termination statement shall be necessary in order to remove a filed financing statement.¹²⁵

2.3 Perfection System and Some Other Related Issues under Revised Version of UCC Article 9

The provision of section 9-203 of the Revised UCC Article 9 roughly corresponds to the Original UCC Article 9. However, there are some changes in respect of the security agreement. Namely, in the original version of UCC Article 9 the security agreement has to be signed by the debtor, it has to physically exist and has to contain the description of the collateral. The provision of section 9-203 (b) (3) (A) of the Revised UCC Article 9 allows the possibility for the security agreement to be authenticated by the debtor. This basically means that even in cases where there is no security agreement, there still is a possibility for the parties to prove that the agreement exists and this may be done either

¹²³ For priority rules system regarding PMSI see also section 9-312 (3) (4) (5) of the Original UCC Article 9.

¹²⁴ The continuation statement has to be filed prior to the expiry of the five years time period.

¹²⁵ See for example section 9-403 (6) of the Original UCC Article 9.

on the basis of documents or in case the respective transaction falls under provisions of UCC Article 9. Furthermore, the *“Revised Article 9 confirms that the exception to the requirement of a signature where the secured party has possession pursuant to “agreement” means that the “agreement” for possession has to be an agreement that the person will have possession for purposes of security”*.¹²⁶

The Revised UCC Article 9 introduces some new types of collateral and respectively it also introduces some new perfection rules applicable for these new types of collaterals. As far as deposit accounts are concerned, section 9-314 (a) of the Revised UCC Article 9 prescribes that the security interest in deposit accounts is perfected by control of the collateral.¹²⁷ The same provision prescribes the applicability of this method of perfection to electronic chattel paper and letter-of-credit rights. As far as the control of electronic chattel paper is concerned, according to the provision of section 9-105 of the Revised UCC Article 9, a secured party has control thereof, if the record or records comprising the chattel paper are created, stored, and assigned in such a manner that: (i) a single authoritative copy of the record or records exists and has to be unique, identifiable and, except as otherwise provided under (iv), (v) and (vi), unalterable; (ii) the authoritative copy identifies the secured party as the assignee of the record or records; (iii) the authoritative copy is communicated to and maintained by the secured party or its designated custodian; (iv) copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the participation of the secured party; (v) each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and (iv) any revision of the authoritative copy is

¹²⁶ Weise, *supra*.

¹²⁷ For conditions under which the secured party has control of deposit account see under 2.1.3 above.

readily identifiable as an authorized or unauthorized revision. In respect of the control of a letter-of-credit right, the provision of section 9-107 of the Revised UCC Article 9 prescribes that a secured party has such control to the extent of any right to payment or performance by the issuer or any nominated person if the issuer or nominated person has consented to an assignment of proceeds of the letter of credit or otherwise applicable law or practice.

Furthermore, the provisions of section 9-309 (3) (4) show that the Revised UCC Article 9 introduced automatic perfection upon attachment for, for instance, sale of payment intangibles and promissory notes.

Regarding priority rules the Revised UCC Article 9 still is line with a general first-in-time, first-in-right rule. However, since the revised version introduced some new types of collateral, it respectively also introduced perfection rules for these new types of collaterals and this has as a consequence some changes and novelties in respect of priority rules. Hence, one of the examples is connected with the fact that, as previously stated, the sale of promissory notes is automatically perfected upon attachment. According to the provision of section 9-330 (d) in case where a purchaser of, for instance, a promissory note has priority over a security interest in the promissory note automatically perfected if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that this purchase violates the rights of the secured party.

As far as filing and financing statements are concerned, according to the provision of section 9-504 of the Revised UCC Article 9, a financing statement sufficiently indicates the collateral it covers if it provides (i) a description of the collateral pursuant to section

9-108 or (ii) an indication that the financing statement covers all assets or all personal property. Hence, a so-called "supergeneric" description of collateral is allowed in a financing statement, but is still considered as inadequate in respect of the description of the collateral in the security agreement.¹²⁸

The provision of section 9-301 of the Revised Article 9 simplifies the choice of law governing the place to perfect the security interest, *i.e.* the place to file a financing statement. A general rule is that the debtor's location is the place where a financing statement should be filed. According to section 9-307 (e) of the Revised UCC Article 9, contains, *inter alia*, a definition of a debtor's location, so, for example, if a debtor is a registered organization, the secured creditor has to determine its place of incorporation to be able to determine the respective jurisdiction and file a financing statement. Furthermore, according to section 9-307 (b) if a debtor is an individual, the place to file a financing statement shall be this person's principal residence.

¹²⁸ See section 9-108 (c) of the Revised UCC Article 9.

CHAPTER 3: MAIN DIFFERENCES BETWEEN THE CROATIAN AND THE AMERICAN SYSTEM

3.1 Creation of Security Interest, Attachment/Enforceability, Perfection

As discussed under 2.2 above according to the US system there are two relevant moments connected with the effects of the security interest; namely attachment and perfection. The provisions of section 9-203 of the UCC Article 9 prescribe three conditions that have to be met in order for the security interest to attach and therewith become enforceable against the debtor, *i.e.* the other party. Thus, the attachment and enforceability of the security interest affect the rights between the contracting parties, *i.e.* have an *inter partes* effect.

After the attachment of the security interest to the collateral, in order for the third parties to be notified of the existence of a particular security agreement and creation of the security interest, the act of "perfection" has to be undertaken. Therewith the security interest becomes enforceable *erga omnes*.¹²⁹

The Croatian system does not make any distinctions between attachment and perfection. Moreover, the court and public notary voluntary pledge is considered as created after the decision on the entry becomes final¹³⁰, *i.e.* once the decision on entry of this security interest becomes final it is deemed that the security interest has been created at the time when the application form for the entry thereof has been submitted to the Registry

¹²⁹ See Tajti, *supra*, at 38.

¹³⁰ See Article 32 in connection with Article 17 (1) of the Law on Registry.

Office.¹³¹ In other words the creditor's *in rem* right does not exist prior to registration in the Registry.

3.2 The Methods of Perfection

The American system recognizes the following methods of perfection: (i) taking of possession, (ii) filing (or registration), (iii) control.¹³²

The Croatian system, at least as far as the voluntary security interests in movables and rights are concerned, recognizes filing as the only method of perfection, *i.e.* as previously explained as a method of creation of security interests.

3.3 Purchase Money Security Interest

According to the provisions of section 9-107 (a) (b) of the Original UCC Article 9 the purchase money security interest is defined as a security interest (i) taken or retained by the seller of the collateral to secure all or part of its price or (ii) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used. The purchase money security interest has a so-called super-priority, *i.e.* a priority over non-purchase money security interests and over security interests in after-acquired property (*e.g.* floating lien).

The PMSI is not recognized in Croatian system.

¹³¹ See Article 17 (2) of the Law on Registry.

¹³² See Tajti, *supra*, at 400.

3.4. Floating lien

The American system recognizes the concept of floating lien by which the whole or substantial part of the debtor's property may be encumbered and is usually connected with long-term financing.¹³³

Unlike the American concept, the concept of floating lien introduced by Article 38 of the Law on Registry is much more narrow and covers only contractually created security interests in movables of all kind, or in all movables of a specific kind (goods, inventory, spare parts, furniture, tools and alike), which are located in a specified place (*e.g.* a warehouse, factory, business premises) of the debtor. In other words, Croatian law still does not recognize a floating lien that would cover all assets of the debtor, *i.e.* which would cover the whole or substantial part thereof irrespective of their location.

3.5 Collaterals

Under American system almost everything can be and is used as collateral (namely, even transactions that *prima facie* do not appear to be undertaken for security purposes may fall within the scope of UCC Article 9 if their purpose was to create security and if the intention of parties was such), unlike under Croatian system where the types of collaterals are much more restricted.

¹³³ See Tajti, *supra*, at 178.

3.6 Transfer of Ownership for Security Purposes (Fiduciary Ownership)

The American system is not aware of the legal instrument such as fiduciary transfer of ownership. The main features thereof in Croatian system are discussed under 1.1.3 and 1.2.2 above.

3.7 Filing

Under the provision of section 9-403 (2) of the Original UCC Article 9 a filed financing statement is effective for a period of five years from the date of filing. Unless a continuation statement is filed the effectiveness of a filed financing statement shall cease to exist after the mentioned time period of five years expires.¹³⁴ In case a continuation statement is not filed, pursuant to the provision of section 9-403 (3) of the Original UCC Article 9, a filing officer may remove a lapsed statement from the files. However, in some cases a termination statement shall be necessary in order to remove a filed financing statement.¹³⁵

Unlike under the American system, the Croatian one does not recognize the institute of continuation statements and there is no need for renewal of the entries already registered in the Registry. Furthermore, according to the provision of Article 36 of the Law on Registry the Registry Office shall, on party's proposal, delete the entry of the security interest, on the basis of (i) parties' mutual proposal or on the proposal of one of the parties to which the other party gave its consent, or (ii) public or publicly certified deed containing the creditor's statement giving its consent to deleting of the respective entry,

¹³⁴ The continuation statement has to be filed prior to the expiry of the five years time period.

¹³⁵ See for example section 9-403 (6) of the Original UCC Article 9.

or (iii) public or publicly certified deed proving that the conditions for deleting of the entry are fulfilled, or (iv) final and binding court decision ordering the deleting of the entry.

Another difference between the two systems is that the Croatian Registry Office does not order deleting of the entries *ex officio*, but only on a proposal of the parties or on proposal of the body which was competent to order the entry into a Registry *ex officio*.¹³⁶

Finally, the American system has no central filing authority (at least not on a federal level), which is criticized by practitioners as well as scholars. On the other hand, the Law on Registry obviously managed to deal with this problem.

¹³⁶ See Article 36 (2) of the Law on Registry.

Conclusion

The future will show whether or not the efforts of Croatian legislator to, on one side, enable the debtors to continue commercially exploiting the collaterals and, on the other side, to free the creditors of the burden of maintaining and preserving the collaterals, achieved the anticipated goal. However, one thing is certain; the publicity in respect of the creation of security interests is achieved, at least to some extent. What has to be resolved, either by amendments to the Law on Registry or by case law, is the problem of declaratory entries of the security interests created within enforcement proceedings and without the debtor's consent and the conflict of priority rules in this respect. At the moment this seems to be one of the greatest problems of the new law.

Furthermore, the completely new concept of the floating lien is still to be evaluated and until there are at least few cases in which the creditors will try to enforce their rights created under the provisions of Article 38 of the Law on Registry, it will be impossible to assess whether this concept is suitable for securing creditors claims and whether it offers the necessary level of legal certainty to the creditors.

Another valuable achievement of the new Law on Registry is the possibility of undertaking a search through the Registry in order to get information on the credit rating of the debtors and the possibility (although this is still not available in practice) to deliver the applications for the entries to the Registry Office by email. It could be concluded that the organization of the Registry, especially having in mind the electronic real time entry system, is in line with the modern needs.

The American system of secured transactions introduced by UCC Article 9 is an example of a well developed, economy oriented system. Its primary advantages are the flexibility

of concepts it introduced (e.g. floating lien), a wide range of security devices (the majority of which are still not recognized in Croatia), and awareness of modern business needs. Shortly, the American system provides incentive for credit economy at a level which should present an objective for emerging markets.

Due to the fact that the Croatian Law on Registry is in its infancy and the effects thereof are yet to be evaluated, it seems too early to consider possible changes thereto and introduction of concepts typical for developed markets (although this fact should not hinder the critical approach towards some of the concepts and problems they pose already at this stage). In spite of the fact that it is difficult to objectively assess the impact of the new Croatian law, some of the advantages mentioned above and provided by UCC Article 9 should be taken into account in the future. However, the mere transposition of these advantages into Croatian legal system would not be as beneficial as it might seem. What needs to be done in the future, after the feedbacks of the newly enacted law are evaluated, is to identify the weaknesses of the system and to see to what extent some of the concepts already standard in the developed markets could be used in a system like the Croatian one.

Finally, instead of making a conclusion, one of the central problems this thesis tries to address could best be described by citing Dr. Jan-Hendrik Röver, *i.e.* a sentence said to him by an American banker who managed to “*summarize the difference between developed and emerging markets in a very handy manner*”¹³⁷:

“If you are a banker and you drive around the city of Moscow, what is the difference between Moscow and driving through the center of London, Tokyo or New York? The big

¹³⁷ Translation provided by the author.

difference is everything you look at in London or New York is debt, in other words, everything you look at has been mortgaged to the hilt, and most of it is security for the banks who have provided the financing. If you drive around Moscow all I see is equity, unencumbered assets: unencumbered assets to me mean borrowing power."¹³⁸

¹³⁸ JAN-HENDRIK RÖVER, VERGLEICHENDE PRINZIPIEN DINGLICHER SICHERHEITEN (Verlag Beck 1999), taken from COMPARATIVE SECURED TRANSACTIONS 1 (Central European University, Budapest 2006/2007).

Bibliography

Books

RÖVER, JAN-HENDRIK, *VERGLEICHENDE PRINZIPIEN DINGLICHER SICHERHEITEN* (Verlag Beck 1999), taken from *COMPARATIVE SECURED TRANSACTIONS* (Central European University, Budapest 2006/2007).

TAJTI, TIBOR, *COMPARATIVE SECURED TRANSACTIONS LAW*, 118 (Akadémiai Kiadó, 2002)

Articles

Basi, Bart A. and Basi, Roman, *Secured Transactions and Article 9: The Rubix Cube of the UCC*, found on the website <http://www.amtda.org/education/secured%20transactions.pdf>, visited March 28, 2007.

Dika, Mihajlo, *Upisivanje sudskih i javnobilježničkih dobrovoljnih založnopravnih i fiducijarnih osiguranja u upisnik sudskih i javnobilježničkih osiguranja tražbina vjerovnika na pokretnim stvarima i pravima*, SAVJETOVANJE – REGISTAR SUDSKIH I JAVNOBILJEŽNIČKIH OSIGURANJA - ISKUSTVA I PROBLEMI (Narodne novine d.d., 2007)

Mičetić, Zlatko, *Iskustvo i problemi u radu službe upisa u primjeni zakona o upisniku sudskih i javnobilježničkih osiguranja tražbina vjerovnika na pokretnim stvarima i pravima*, SAVJETOVANJE – REGISTAR SUDSKIH I JAVNOBILJEŽNIČKIH OSIGURANJA - ISKUSTVA I PROBLEMI (Narodne novine d.d., 2007)

Weise, Steven O., *An Introduction to the Revised UCC Article 9*, 2000, found on the website <http://library.findlaw.com/2000/Apr/1/130705.pdf>, visited March 30, 2007

Statutes - Croatia

Bankruptcy Act (Official Gazette 44/96, 161/98, 29/99, 129/00, 123/03, 197/03, 187/04, 82/06)

Enforcement Act (Official Gazette 57/96, 29/99, 42/00, 173/03, 194/03, 151/04, 88/05, 121/05)

Financial Agency Act (Official Gazette 117/01, 60/04, 42/05)

Law on Ownership and Other Real Rights (Official Gazette 91/96, 68/98, 137/99, 22/00, 73/00, 129/00, 114/01, 79/06, 141/06)

Law on the Registry of Court and Public-Notary Security Interests on Movable and Rights (Official Gazette 121/05)

Public Notary Act (Official Gazette 78/93, 29/94, 162/98, 16/07)

Public Notary Tariff (Official Gazette 97/01)

Regulation on the Fees for the Entries into the Registry (Official Gazette 77/06)

Regulation on the Fees for Use of Data through Electronic Sources (Official Gazette 77/06)

Regulation on the Form and Content of the Registry and Organization of the Registry Office (Official Gazette 77/06)

Statutes - United States of America

UCC, Uniform Commercial Code, original version, found at the website <http://www.law.cornell.edu/ucc/9/overview.html>

UCC, Uniform Commercial Code, revised version, found at the website <http://www.law.cornell.edu/ucc/9/>

Other sources

Benc, Rankica, *Javnobilježnički aspekt primjene zakona o upisniku sudskih i javnobilježničkih osiguranja tražbina vjerovnika na pokretnim stvarima i pravima*, SAVJETOVANJE – REGISTAR SUDSKIH I JAVNOBILJEŽNIČKIH OSIGURANJA - ISKUSTVA I PROBLEMI (Narodne novine d.d., 2007)

Goodman, Gary A., *Revised UCC Article 9: Its Broad and Varied Impact on Real Estate Finance*, found at the website <http://www.akingump.com/docs/publication/359.pdf>

Jelčić, Olga, *Upisnik sudskih i javnobilježničkih osiguranja te podzakonski akti za njegovu provedbu*, SAVJETOVANJE – REGISTAR SUDSKIH I JAVNOBILJEŽNIČKIH OSIGURANJA - ISKUSTVA I PROBLEMI (Narodne novine d.d., 2007)

Nekić Plevko, Nada, *Prava i mjere koje se upisuju u upisnike u povodu ovrhe i prisilnog osiguranja*, SAVJETOVANJE – REGISTAR SUDSKIH I JAVNOBILJEŽNIČKIH OSIGURANJA - ISKUSTVA I PROBLEMI (Narodne novine d.d., 2007)

Pogarčić, Zdenka, *Upisnik sudskih i javnobilježničkih osiguranja (Upisnik mobilijarne hipoteke)*, 12 PRAVO I POREZI, 1, 16 (2005)

Schwartz, Steven L., *Automatic Perfection of Sales of Payment Intangibles: A Trap for the Unwary*, found at the website [http://eprints.law.duke.edu/archive/00001589/01/Ohio_St._L.J._\(2007\).pdf](http://eprints.law.duke.edu/archive/00001589/01/Ohio_St._L.J._(2007).pdf)

Tepšić, Igor, *Upisničko osiguranje i kreditna politika banaka*, SAVJETOVANJE – REGISTAR SUDSKIH I JAVNOBILJEŽNIČKIH OSIGURANJA - ISKUSTVA I PROBLEMI (Narodne novine d.d., 2007)