PROBLEMS OF LESSORS WITH ENFORCEMENT ON MOTOR VEHICLES - A COMPARATIVE ANALYSIS OF US AND GERMAN LAW AS COMPARED TO CROATIAN LAW AND PRACTICES

by Martina Gornik

LL.M. SHORT THESIS

COURSE: Comparative Secured Transactions Law

PROFESSOR: prof. Tibor Tajti

Central European University

1051 Budapest, Nador utca 9.

Hungary

Abstract

This paper addresses the issues encountered by lessors when recovering their claims through enforcement proceedings on motor vehicles in Croatia, comparing Croatian legislative solutions with those existing in the United States and Germany.

The lack of legal tools for fast repossession of objects of leasing have proved to be one of the key problems in further development of local leasing industry in Croatia. Inadequate legal regulation of enforcement measures or lack thereof, the fact that the courts do not efficiently use available measures at their disposal to force debtors to cooperate, have led lessors to an absurd situation where they cannot protect their retained ownership through quick repossession, because often they cannot locate their own property.

It is legitimate to devote this thesis to this problem because after the adoption of the first Croatian Leasing Act in 2006, albeit many scientific papers were published on leasing in Croatia, none of them focused on problems lessors face when trying to enforce their retained ownership on motor vehicles. Additionally, there are only a few papers that take critical approach towards modern enforcement regulations in Croatia which are the primary reason for problems of lessors. However, even the latter do not establish a comparative model, naming those jurisdictions whose efficient solutions Croatian legislator should follow in the future.

In this research, it is suggested that the solutions employed in the United States and Germany may be exploited by Croatia to increase the efficiency of the enforcement system.

Through this comparative analysis, the author aims to single out the key advantages and disadvantages of the analyzed systems, as well as to exemplify with case law the practical side of leasing and crucial problems of lessors with enforcement on vehicles in Croatia.

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Introduction

This paper addresses the issues encountered by lessors when conducting enforcement proceedings on motor vehicles in Croatia, with special focus on Germany and the United States as model jurisdictions whose solutions to the problems should be followed in future changes to relevant legislation.

Problems that lessors face while conducting enforcement proceedings on motor vehicles are mainly due to current legal framework and it has become clear that changes in legislation are needed to tackle the deficiencies. These problems result in more and more lessors refraining from starting enforcement proceedings on vehicles. In addition, they withdraw from further enforcement actions if they already started enforcement proceedings on vehicles to prevent the emergence of new costs.

Before forming a specific research question, an initial broad assumption can be established, which is that the current state of enforcement proceedings on vehicles in Croatia is described as time consuming and lingering. Large number of enforcement proceedings on vehicles as objects of enforcement ends with impossibility of performance of enforcement actions[1]. It is precisely for this reason that we have to ask how this problem can be addressed in terms of solving the problems of lessors even in cases where vehicle is also the object of leasing. Furthermore, if we take into consideration the broader socio-economic implications of the research question, it seems right to claim that development and modernization of enforcement

[1] I. Bošković, 'Ovrha na motornim vozilima' (2014) 3 Zagreb L. Rev. 329., Accesible at: https://hrcak.srce.hr/file/209353, Accessed on: 25th March 2019.

proceedings on vehicles in Croatia should have priority in future amendments of the Croatian Enforcement Act[2].

Finding the solution to our research question is important not just for further development of leasing industry in Croatia, but also for easing the connected social problems of Croatian population. Namely, the citizenry of Croatia is over indebted[3] and there is a growing number of creditors that are not able to recover their claims. The reason for this is, *inter alia*, that the creditors usually do not have a large pool of assets of over-indebted debtors on their disposal as objects of enforcement. If we consider the previous hypothesis that it is very difficult to conduct enforcement proceedings on vehicles, this shrinks the pool of assets even more and deepens the problem. However, by making the enforcement on vehicles more efficient and thus more appealing to the creditors, the legislator would decrease a growing number of real estate enforcements for smaller claims and disburden the courts[4].

Previously stated broader socio-economic implications of the research question can be furthermore specifically formulated and branched as lack of legal tools for fast repossession of

[2] Enforcement Act (Official Gazette No. 141/2012, 25/2013, 93/2014, 55/2016, 73/2017).

[3] According to data accessible at: www.fina.hr, in March 2018, the number of citizens whose accounts were frozen by FINA due to an ongoing enforcement proceedings on their accounts, was 325.254 with an accrued debt in the amount of 43,37 billion HRK. Approximately 85% of these citizens has their accounts frozen for more than 360 days, whereas their debt amounts to 97% of the total amount of debt. These negative trends were tried to be minimized by amendments to Law on enforcement of debtor's monetary funds

[4] Similar effect was tried to achieve through introducing in 2011, the enforcement proceeding on accounts of the debtor through Croatian financial agency (hereinafter: FINA), as an out-of-court enforcement that would accelerate the recovering of claims and unburden the courts, as well as decrease the number of enforcement proceedings on other assets of the debtor, primarily real estates, For more information see: https://www.hnb.hr/en/about-us/consumer-protection/information-for-consumers/key-information/enforcement-actions and https://www.fina.hr/gradani/ovrha-na-novcanim-sredstvima.

objects of leasing, inadequate legal regulation of enforcement measures or lack thereof, as well as the fact that the courts do not efficiently use available measures at their disposal to force debtors to cooperate. All stated problems have led the lessor to a situation where (if object of enforcement is also the object of leasing) they cannot protect their ownership through quick repossession, first and foremost because they cannot locate their own property, the leased vehicle. As it is presented in the thesis, in practice (when recovering their claims) it is much more probable that the lessor will initiate enforcement proceedings on any other object of enforcement than on motor vehicles. Thus, a new set of problems emerge, such as depreciation of vehicle with time, resale of the vehicle by non-owners, or the risk of demolition of the vehicle by the lessee and the subsequent sale in parts.

The abovementioned research question will be inspected through comparative analysis of the legal framework developed in Croatia juxtaposed to two other jurisdictions. This paper will therefore cover Croatia, Germany and The United States of America (hereinafter: the US).

The central problem inspected in this paper arises from Croatian Leasing Act[5].

Germany is selected as model jurisdiction, as the Croatian legislator typically adapts its legislative solutions from this jurisdiction. The provisions of German law concerning enforcement proceedings on motor vehicles can be found in German Code of Civil Procedure[6]. This paper will focus on key similarities and differences between the two systems to show what solutions Germany had implemented that might help in solving research question.

[5] Enforcement Act (n 2).

[6] Code of Civil Procedure as promulgated on 5th December, 2005 (Bundesgesetzblatt (BGBI., Federal Law Gazette)) I page 3202; 2006 I page 431; 2007 I page 1781), last amended by Article 1 of the Act dated 10th October, 2013 (Federal Law Gazette I page 3786), (hereinafter: BGBI)Accessible at: https://www.gesetze-im-internet.de/englisch_zpo/englisch_zpo.html, Accessed on: 18th October 2018).

The US is a jurisdiction where leasing was born that shows us some fast-track solutions to repossession of objects of leasing, where self-help repossession is common practice. This paper provides for key advantages of the US system, such as preventing lessee to hide, damage or dispose of object of leasing. In addition, this paper inspects the ability of the lessor in the US to switch to the court enforcement in case the self-help option does not provide success and vice versa.

In addition to analyzing primary and secondary written sources, special attention will be given to case law of Croatian courts. For an in-depth analysis of the socio-economic background of enforcement proceedings on vehicles in Croatia, this paper will also draw from articles or daily newspapers, as well as practical findings resulting from author's past experience in the field of leasing.

Through this comparative analysis, the author aims to single out the key advantages and disadvantages of analyzed systems, as well as to exemplify with case law the practical side of leasing and crucial problems of lessors in Croatia.

CHAPTER 1: Leasing in Croatia

This chapter analyses development of leasing industry in Croatia, as well as the need to regulate and whether this regulation hinders or promotes this development.

Furthermore, this chapter analyzes the treatment of vehicles as objects of enforcement in Croatia. Special attention will be given to method of enforcement foreseen specifically for vehicles and whether such treatment is justifiable. Enforcement on vehicles will be portrayed as a hidden potential of the Croatian Enforcement Act[7] which was not given enough attention, neither in regulations nor in practice. Thus, this regulation creates one of the biggest problems of lessor when recovering their claims through enforcement on vehicles.

1.1. Theoretical background

When we talk about leasing in Croatia, we are referring to the same group of instruments to which conditional-sales, hire-purchase or consignments belong in common law systems. These are all title-finance or acquisition finance instruments[8], terms that will be used interchangeably throughout thesis. Leasing, as well as the other mentioned transactions, all rely on retained ownership[9] as the main security. This is something that is not usually recognized by legal practitioners in Croatia, although these instruments are globally widely used.

[7] Enforcement Act (n 2)

[8] C. von Bar, E. Clive (eds), *Principles, Definitions and Model Rules of European Private Law — Draft Common Frame of Reference (DCFR)* (Full Edition, Oxford 2010), (hereinafter referred to as 'DCFR Comments

[9] Or retained title — in civil law systems the concept of 'title' is not used, replaced with 'ownership'. As a consequence, retained title is known as retained ownership. The two will be used interchangeably throughout the thesis.

The main economic purpose of leasing in Croatia is acquisition finance as its "utility is exactly acquisition of various assets from motor vehicles to equipment"[10]. Title-finance and acquisition finance overlap but are not identical types of financing. "While title-finance contracts are supplier instruments, acquisition finance includes also banking finance in case of which the bank gives a loan to the borrower to purchase a specific asset upon which then a security interest (charge, registered pledge) is created".[11]

What made such title-financing instruments so popular globally, as well as in Croatia, and what is considered to be their enormous economic advantage over possessory security transactions like (possessory) pledge is that acquirer gets possession of the object of leasing immediately and can use the object even to generate income and pay the leasing installments.

The notion of leasing arrived to Croatia and other Central and East European countries (hereinafter: CEE countries) as a "variable business pattern rather than a precisely formulated model law ready for easy transplantation".[12] It was brought to Croatia mostly by the "West European banks and other financial organizations, suppliers of equipment…".[13] The CEE countries have significant differences in the way they look at leasing which could be contributed to the fact that each of them looked at different Western European country as their model jurisdiction. Typically, Croatia uses either German or French law as models and adapts their solutions into its national legislature, sometimes even without paying attention to its own socio-economic particularities. To support these differences between regulations of leasing in

[10] T. Tajti, 'Leasing in the Western Balkans and the Fall of the Austrian Hypo-Alpe-Adria Bank' (2018) 8 Pravni Zapisi 158,

[11] Ibid

[12] Ibid 159

[13] Ibid 160

different CEE countries due to previously explained reasons, "while Serbia and Hungary regulate specifically only financial leasing[14], in Croatia both operating and financial leasing are covered by the same *lex specialis"*. [15] These differences are also the result of widely accepted principle of freedom of contract that is present in civil law countries. Namely, the parties usually tailor the contract to their own needs and thus, leasing contract in Croatia can often be closer to a common law conditional sales or hire-purchase contract than to what is usually known as "leasing" in common law. Croatian leasing is thus "a kind of universal substitute for many title finance devices known to common laws."[16]

Contrary to abovementioned differences between leasing in CEE countries, there are also some similarities, but the important ones are unfortunately more significantly diverging. *First*, there is a structural deficiency in the economies of CEE countries. Namely, they are mostly oriented on motor vehicles as objects of leasing which makes life particularly difficult for small and mid-scale enterprises, especially start-ups (hereinafter: SMEs) given that equipment leasing is virtually unknown in practice. Due to the underdeveloped equipment leasing industry SMEs cannot enter into equipment leasing contracts as they are not offered on the market. Moreover,

[14] Under Article 5 para. 2 of the Leasing Act (Official Gazette No. 141/2013), financial leasing is a "legal relationship in which a lessee pays the lease installments to the lessor, which include the entire value of the leasing object, bears the costs of amortization of the leasing object and by exercising the purchase option acquires the ownership of the leasing object". Under Article 5 para. 3, operational leasing is a "legal relationship in which the lessee pays to the lessor certain fee that does not have to take into account the overall value of the leasing object, the lessor is responsible for bearing the costs of amortization of the leasing object, the lessee cannot exercise the purchase option and the risks and benefits associated with the ownership of the leasing object remain with the lessor".

[15] Tajti (n 10) 160

[16] Ibid

they are highly unlikely to be receivers of bank loans, because they have no collateral they could offer to the potential creditor. This data can be supported by looking into "2016 Findings of the European Investment Bank (hereinafter: EIB) that reports about shrinking leasing sectors, large portfolios of problematic leases, dominance of vehicle leasing, underdeveloped branch systems and lack of familiarity with leasing products".[17] Another proof of this hypothesis is that the European Bank for Reconstruction and Development (hereinafter: EBRD) provides loans that promote equipment leasing for SMEs in some CEE countries.

Second, these leasing markets are usually dominated by banks or are bank's affiliates. It is rare to see an independent leasing company in this part of the world which of course affects competition on the market as banks are usually very conservative market players that don't take risks and don't like big economic climate changes.

Third, even though that written laws and court practice may vary in CEE countries, the problems of enforcement of leases that hinder the growth of industry, seem to be similar for this part of Europe. Some authors claimed that it is justified to hypothesize that misunderstanding of the phenomenon of leasing led to the fall of once fifth largest Austrian bank, Hypo-Alpe-Adria Bank. "As critical analyses of the Bank's fall are lacking to a great extent due to that a fiasco remains politically sensitive issue and empirical evidences are non-accessible publicly, a thorough analyses of this specific contributing factor has hereinbefore been neglected".[18]

[17] EIB Assessment of financing needs of SMEs in the Western Balkan Countries, Synthesis report (August 2016), Available at: http://vienna-initiative.com/full-forum-2018/ , Accessed on: 2nd February 2019). Quoted from Tajti (n 10) 165.

[18] Tajti (n 10) 165.

1.2. Leasing Act

By adopting the first *Leasing Act*[19] in 2006, Croatia ended the period in which leasing contract was treated as an innominate contract. Before adoption of the Act, the content of contract, including the mutual rights and obligations of the parties, was almost exclusively governed by the general business terms and conditions of the contract adopted by the leasing companies, and a certain consistency of their content appeared in practice. Having this in mind, the question arises whether the new legal framework on leasing is adequate? Especially whether it might hinder the development of leasing, an institute that has otherwise successfully emerged and developed in business practice.

In the period following the adoption of the Leasing Act, several scientific papers were published, focusing on this newcomer contract in Croatian law. These papers, however, did not deal with the analysis of concrete contractual provisions of the leasing contract, neither is the analysis of these provisions included in the earlier Croatian legal literature[20].

As mentioned above, for this newcomer contract, there was a wide misunderstanding in Croatia of what leasing really represents. For this reason, there are still no explicit provisions on leasing in the Croatian Obligations Act, which is, with some other specific acts, the most important substitute of a civil code in the country. One possible explanation for the vacuum can be found in practice, because there have always been a multitude of different forms of contracts called 'leasing' employed on the Croatian market. The variety then made it difficult to find a general legal solution that would encompass all of the forms under a simple definition to fit them all.

[19] Leasing Act (Official Gazette No. 135/2006).

[20] I. TOT, 'Rizik unovčenja objekta leasinga u ugovoru o operativnom leasing motornog vozila' (1991) 38 Zbornik PFSR 303.

However, the adoption of the Leasing Act in 2006 supports the fact that a significant development of leasing created a need to regulate this area by a *lex specialis*.

Some of the reasons for adoption of the Act were mentioned in the Proposal of the Leasing Act. By referring to the data on total assets under leasing in the Croatian financial sector and distinguishing banks from the so-called non-banking sector, which includes leasing companies, the legislator suggested that the assets in the non-banking sector are dominated by leasing companies, whereby leasing market has become the second largest market immediately behind the banking sector[21].

In the said Proposal the legislator states as follows:

> "As is well known, leasing is traditionally divided into operating and financial leasing, and the characteristic of both types of leasing is that the user is not the owner of the object. However, in Croatia the so-called 'third type of leasing' appeared, loan financing of the user by which he becomes the owner of the object[22]. Such type of 'leasing' developed predominantly after the Croatian National Bank imposed different restrictions with various monetary instruments on foreign sources of funds. In the impossibility of further expansion of business and increase of placements in Croatia by foreign banks, foreign banks started to place funds as 'loans' through leasing

[21] J. Brežanski, 'Ugovor o leasingu – novo zakonsko uređenje' (2008) 29 (1) Zbornik PFSR 1.

[22] Equivalent for this in the US would be "chattel mortgage" – acquisition finance device where the lender extends a loan to the debtor for acquisition of specific tangible asset, which then serves as collateral and security. For further detail see Gilmore, G. *Security interests in personal property* (Union, N.J. : Lawbook Exchange 1999) 24-62.

companies. Thus, the total assets of all companies in 2005 increased by about HRK 3.4 billion or EUR 460 million."[23]

The legislator explains further:

> "Out of twenty active leasing companies, the portfolio or the outstanding value of principal of 15 largest companies amounts to about EUR 2.2 billion, with the operating and financial leasing being almost equally represented in the portfolio structure, each by 35% and the 'loans' are represented by almost 30% or around EUR 650 million."[24]

In conclusion:

> "While there is lex specialis on banks, insurance, investment funds, there has so far been no special law that would regulate leasing, despite making almost six percent of the financial market. Therefore, having in mind the size of the leasing market, the need for a lex specialis to regulate business rules has emerged."[25]

Apart from these reasons there is another important reason for adopting the *lex specialis*. Considering the specifics of the leasing market, the legislator tried to influence the practice bearing in mind the most common objections concerning the imbalance in the position of the parties of the contract and the transfer of business risk to only one party (the lesee).

Prior to adoption of the Leasing Act, the Law on Croatian Supervisory Agency for Financial Services (Official Gazette, No. 140/05) [hereinafter: Law on HANFA], HANFA was passed, which stipulates, *inter alia*, that "HANFA supervises business activities of legal persons

[23] Translation from J. Brežanski n (21) 2-3

[24] Ibid

[25] Ibid

engaged in leasing"[26]. In addition, Leasing Act also contains special provisions on supervision of leasing companies and numerous provisions on the authority of HANFA.

According to the official website of HANFA, there are 16 leasing companies registered in Croatia and another 7 leasing companies undergoing the process of liquidation in February 2019.[27] What is interesting is the variation in number of leasing companies from the adoption of first Lasing Act until today. Namely, according to periodical HANFA reports[28], the number of active leasing companies was steadily declining from 2005 until today, whereby there was 66 registered leasing companies in 2005, comparing to only 16 in 2019. Thus, we could conclude that the Leasing Act had a negative effect on the number of leasing companies and maybe even development of the leasing industry itself. However, it is hard to make such assumption just from observing steady decline of the number of leasing companies, because this data might also indicate the need for regulating the leasing market itself to prevent the placement of foreign bank "loans" through Croatian leasing companies, as was explained above. This might also be perceived as regulating the leasing market influenced the competition, as it made those unable to adapt to the new regulation leave the leasing market.

Yet another trend may also be observed: the number of active financial leasing contracts that shows a different trend. We face a steady increase in number of active financial leasing contracts from only 21.663 in 2005 to 60.458 active contracts in 2018. Being aware of the fact that this is the type of leasing where lessee receives the title after the end of financing term, this data proves that there is a real demand of acquisition finance in Croatia that was not

[26] Translation Article 15 of the Law on Croatian Supervisory Agency for Financial Services (Official Gazette, No. 140/05).

[27] Accessible at: https://www.hanfa.hr/leasing-i-faktoring/registri/leasing-drustva/, Accessed on: 29th March 2019.

[28] Accessible at: https://www.hanfa.hr/publikacije/statistika/#section5, Accessed on: 25th March 2019.

hindered even by the adoption of the new Leasing Act (Official Gazette, 141/2013) (hereinafter: Leasing Act).

1.3. Leasing in Croatian business practice

Leasing can be carried out either as financial or operational leasing. In practice, it is usually conducted as an indirect leasing. Under Article 5 para. 6, indirect leasing is defined as a "tripartite legal relationship between lessor, lessee and a supplier of the object of leasing"[29].

Leasing is a legal relationship that is created when abovementioned parties enter into two contracts. One of them being a contract between lessor and supplier of the vehicle and the other one being a leasing contract between the lessor and the lessee. Series of negotiation activities precede the conclusion of these contracts. These negotiation activities are largely carried out between the supplier and the lessee. These two parties negotiate technical and commercial details of the supply of the vehicle and they only include the lessor once the details have been agreed between the supplier and the lessee. In the usual course of business in Croatian leasing practice, the lessee is in contact with the supplier he has independently chosen. Then the supplier for the purpose of financing the vehicle refers the lessee to a leasing company with which he has a regular business relationship[30].

Approximately at the same time with the conclusion of a leasing contract with the lessee, the lessor concludes another contract with the supplier, on the basis of which the lessor becomes

[29] Article 5 para. 6 of the Leasing Act (Official Gazette No. 141/2013)

[30] In rare cases where a supplier of a leasing company is not in a business relationship with any leasing company, the potential lessee will refer to a leasing company that he has chosen independently or in an agreement with the supplier.

the owner of the vehicle. Lessee is only given the right to use the vehicle on the basis of leasing contract.

This model of simultaneous conclusion of two contracts is taken from the German law. German legal scholars call this model *gleichzeitiger Abschluss des Leasingvertrages und des Lefervertrages.*[31]

In German business practice, indirect leasing is sometimes also found in a model that is also called "stepping into"[32] model.

[31] For Austrian law: Schopper, A.; Skarics, F., Das Leasinggeschäft, u: Apathy, P.; Iro, G.; Koziol, H. (ed.), Österreichisches Bankvertragsrecht – Band VII: Leasing, Factoring und Forfaitierung, Verlag Österreich, Wien, 2015., p 88. For German law: Kaiser, D. (ed), J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen – Buch 2 – Recht der Schuldverhältnisse – Leasing (Leasingrecht) – Neubearbeitung 2014 von Markus Stoffels, Sellier – de Gruyter, Berlin, 2014. (hereinafter: Stoffels u: Staudinger), p. 61. This model is also called "negotiation" model (de. Vorverhandlungsmodell: Beckmann, H.; Scharff, U., Leasingrecht – Rechtsprobleme beim Finanzierungsleasing, Verlag C. H. Beck, München, 2015., p. 18; Beckmann u: Martinek, M.; Stoffels, M.; Wimmer-Leonhardt, S. (ed.), Handbuch des Leasingrechts, Verlag C. H. Beck, München, 2008., p. 61; Wimmer-Leonhardt u: Martinek et al., op. cit., p. 128), "basic" model (de. Grundmodell: Beckmann i Scharff, loc. cit.), "unique" model (de. Einheitsmodell: Engel, J., Handbuch Kraftfahrzeugleasing, Verlag C. H. Beck, München, 2015., p 78) and model "on demand" (de. Bestellmodell: Reinking, K., Leasing, u: Dauner-Lieb, B.; Langen, W. (ur.), BGB – Schuldrecht – Band 2, Nomos, Baden-Baden, 2016., Suppl. with §§ 535 – 580.a, para. 148.) as quoted in Markovinovic, Tot: *Predugovorni odnosi u poslu neizravnog leasinga,* (2017), Zbornik PFZG, vol. 6, no. 6.

[32] For example see: Beckmann and Scharff, op. cit. in note 3, p. 20 – 21; Beckmann in: Martinek et al., op. cit. in note 3, p. 64; Engel, op. cit. in note 3, str. 79; Koch, J., Finanzierungsleasing, in: Krüger, W.; Westermann, H. P. (ed), Münchener Kommentar zum Bürgerlichen Gesetzbuch – Band 3 – Schuldrecht – Besonderer Teil - §§ 433 – 610, Verlag C. H. Beck, München, 2012. para. 41.; Stoffels in: Staudinger, loc. cit. in note 3; Wimmer-Leonhardt in: Martinek et al., op. cit. in note 3, p. 128 – 129. Einsteigemodell): Assies u: Graf von Westphalen, F. (ed.), Der

> "The specificity of indirect leasing in the model of simultaneous conclusion of contracts is that details agreed upon by the lessee and the supplier become part of the two contracts that they do not conclude, while the pre-contractual relationship that they had is also not transformed in a special contractual relationship".[33]

Answers to these questions cannot even be found within the provisions of Chapter VI. of the Leasing Act[34], which regulates certain aspects of legal relationships among the participants in the leasing business. Croatian Obligations Act[35] is applied subordinately to these legal relationships. Chapter VI of the Leasing Act[36] has been substantially copied from the UNIDROIT International Convention on Financial Leasing[37]. UNIDROIT's understanding of

Leasingvertrag, Verlag Dr. Otto Schmidt, Köln, 2015., p. 328; Engel, op. cit. in note 3, p. 79. In the model of stepping into contract the first contract is concluded between the supplier and the lessee, and in the leasing contract the lessor assumes the obligation to enter into legal position of the lessee. See more in Assies in: Graf von Westphalen, op. cit., p. 318 - 324; Beckmann and Scharff, op. cit. 3, p. 20 - 25; Beckmann in Martinek et al., Op. cit. 3, p. 64 - 66; Engel, op. cit. 3, p. 79 - 80; Stoffels in: Staudinger, op. cit. 3, p. 64 - 65. as quoted in Markovinovic, Tot: *Predugovorni odnosi u poslu neizravnog leasinga,* (2017), Zbornik PFZG, vol. 6, no. 6.

[33] Translated from Markovinovic, Tot: *Predugovorni odnosi u poslu neizravnog leasinga,* (2017), Zbornik PFZG, vol. 6, no. 6.

[34] Leasing Act n (29).

[35] Obligations Act (Official Gazette No. 35/05, 41/08, 125/11, 78/15, 29/18).

[36] Leasing Act n (29).

[37] UNIDROIT Convention on International Financial Leasing / Convention d'UNIDROIT sur le crédit-bail international, Ottawa, 28 May 1988. (hereinafter: CIFL), Accessible at: http://www.unidroit.org/leasing-ol/leasing-english, Accessed on: 25th March 2019. For official comment on CIFL see: UNIDROIT, Draft Convention on International Financial Leasing as adopted by a Unidroit committee of governmental experts on 30 April 1987 with Explanatory Report prepared by the Unidroit Secretariat, UNIDROIT 1987 – Study LIX –

cross-border financial leasing is based on the simultaneous conclusion of two contracts, but it does not contain any specific provisions that would regulate the rights and obligations of the parties in the pre-contractual stage.

There are many questions that arise out of pre-contractual relationship between the three parties. However, the answer to these questions cannot be found in Croatian court practice or scholarly papers[38].

1.4. Enforcement Act

Another act that is indispensable in case of leasing and relevant for this discussion is the Croatian *Enforcement Act.* [39] This is the Act that regulates the enforcement proceeding in both of the following cases:

1. when lessor recovers his claims through enforcement proceedings on vehicle
2. when lessor conducts enforcement proceedings to recover possession of leased vehicle.

However, the difference between them is that in the latter case, the lessor is also the owner of the vehicle that is object of enforcement (leased vehicle), whereas in the former example this is not the case. Furthermore, the claim of the debtor in the former case is monetary, whereas in

Doc. 48, Rim, 1987. (hereinafter: Comment on CIFL), Accessible at: http://www.unidroit.org/english/documents/1987/study59/s-59-48-e.pdf, Accessed on: 25th March 2019.

[38] For example see: Josipović, T., Financial leasing in Croatia, Uniform Law Review, vol. 16, no. 1-2, 2011., p. 271 – 289; Keglević, A., Ugovor o leasingu – novi imenovani ugovor hrvatskog prava, u: Gliha, I.; Josipović, T.; Belaj, V.; Baretić, M.; Nikšić, S.; Ernst, H.; Keglević, A.; Matanovac, R. (ed.), Liber amicorum Nikola Gavella - Građansko pravo u razvoju, Pravni fakultet Sveučilišta u Zagrebu, Zagreb, 2007., p. 607 – 657; Parać, Z., Zakon o leasingu (ili što je to pjesnik stvarno htio reći), Pravo u gospodarstvu, vol. 46, pa. 4, 2007., p. 147 – 184; Pešutić, A. Ugovor o leasingu, u: Slakoper, Z. (ed.).

[39] Enforcement Act (Official Gazette No. 141/2012, 25/2013, 93/2014, 55/2016, 73/2017).

the latter it is a claim to transfer the possession of the vehicle if the defaulted debtor does not transfer it willingly. Referring to the title of thesis, most of the problems of lessors, in both of these cases, derive precisely from implementation of the Enforcement Act. However, most of the problems of lessor mentioned under this chapter will refer only to the former case, whereas it will be specifically mentioned if they also refer to the latter.

Enforcement proceedings on vehicles in Croatia are regulated by special provisions within general provisions on enforcement of movables of the Croatian Enforcement Act. Special feature of motor vehicles as object of enforcement lies within special administrative procedure of registration that needs to be conducted before their participation in traffic. Because of registration features the legislator envisaged different treatment of vehicles within otherwise general rules for enforcement on movables.

Croatian Enforcement Act was amended several times with many of the amendments taking place within no more than a year time apart from each other. Thus, we have the following amendments of the Enforcement Act: 57/1996, 29/1999, 42/2000, 173/2003, 194/2003, 151/2004, 88/2005, 121/2005, 67/2008, 139/2010, 154/2011, 70/2012, 80/2012, 112/2012, 93/2014, 55/2016, 73/2017.[40] The 139/2010 and 112/2012 represent a completely new piece of legislation, not just an amendment of the old one.

Often changes of a crucial piece of legislation, such as the Enforcement Act, create legal uncertainty. This sub-chapter delivers short overview of some of the most important amendments of the Enforcement Act that support the thesis question.

[40] The first number represents the number of the Official Gazette and the second number represents the year of publication.

With the 2005 amendments to the Enforcement Act, motor vehicles became a separate institute within the general provisions on the enforcement of movables. The changes concern enforcement actions. Enforcement is thereby conducted by means of confiscation, evaluation, transportation, entrusting to the custody of the court, court bailiff or a third party of a vehicle, its sale and settling the claim from the amount received.

The provisions on acquisition of a lien (i.e., in rem right) by registering the enforcement order in the Registry of Croatian Ministry of Internal Affairs (hereinafter: MUP[41]), introduced by this amendment, are in force to this day. However, there is another register to which the enforcement order needs to be filed, but the filing itself is not the prerequisite for acquisition of a lien. This other register is the Registry of security interests in movable property and rights, which may be created by courts or notaries (hereinafter: FINA's[42] Registry)[43]. According to available data, in 2015 there was 168.531[44] vehicles registered in FINA's Registry. Anyone familiar with a specific matriculation number of the vehicle, can check whether the vehicle is encumbered[45]. Otherwise the data is not publicly accessible.

The special illogicality of the 2005 amendments was Art. 143 k), para. 2, which provided for obligation of the court bailiff to remove license plates at the moment of confiscating the vehicle. This provision created an unnecessary additional cost for creditor of engaging tow services,

[41] At some places in the text also: police administration

[42] Croatian financial agency

[43] Article 162 para. 4 Enforcement Act n (39)

[44] HINA, *Pod ovrhom ili teretom u Hrvatskoj 168 tisuća vozila, 97 tisuća računala, 49 tisuća strojeva*, (2015) Accessible at: http://www.novilist.hr/Vijesti/Hrvatska/Pod-ovrhom-ili-teretom-u-Hrvatskoj-168-tisuca-vozila-97-tisuca-racunala-49-tisuca-strojeva, Accessed on: 25th March 2019

[45] Accessible at: https://www.fina.hr/informacije-o-zaloznim-pravima

instead of just transporting the confiscated vehicle to the place of storage. Further illogicality of these amendments was prescribing that the buyer of the vehicle under enforcement acquires ownership only by registering in the Registry of MUP. The reason for this is a general misunderstanding of the purpose of the Registry. Namely, it does not represent a record of ownership of vehicles, but the record of registered vehicles which is not the same thing.

Both illogicalities were changed by adopting the new Enforcement Act in 2012[46]. However, since 2006 when the first Leasing Act was adopted, until 2012, there was more than enough time for the lessors and other creditors that engaged in enforcement proceedings on vehicles to experience problems due to the mentioned illogicalities.

More significant changes were introduced by Art. 162 of the 2012 amendments, which changes the mode of enforcement. These amendments have slowed down the enforcement proceeding even more, making it in turn completely lagging and inefficient, but these provisions are in force to this day.

Legislator rejected the general regime envisaged for other movables, aside from vehicles, in terms of handing over the enforcement order to the debtor immediately before confiscation of the vehicle. At the moment of confiscation, the court bailiff is already at the location of the vehicle, making it impossible for the debtor to hide the vehicle.

However, according to these amendments, the court delivers the enforcement order immediately after it has been passed directly to the debtor. In simple terms, the court delivers the enforcement order to the debtor before any of the enforcement actions even started. This is

[46] Enforcement Act (Official Gazette No. 141/2012).

one of the crucial problems of lessors today, as this informs the debtor of the enforcement proceeding in advance, making it possible for the debtor to hide or demolish the vehicle[47].

Relative to vehicles as objects of enforcement are also the 2014 amendments of Enforcement Act.[48] Namely, the legislator decided to change the title of relevant provisions from "enforcement on motor vehicles" to "enforcement on vehicles". The rationale behind this change was that not all vehicles that could be objects of enforcement are motor vehicles. For example, in case of enforcement on truck with a sidecar, one might think that different rules should apply to truck as opposed to the sidecar. However, this is not the case. Sidecars also need to be registered and are under same legal regime as are motor vehicles. Contrary to what was just said, some lighter versions of sidecars do not need to be registered, thus, one cannot apply the regime of motor vehicles to those kinds of vehicles.

Therefore, it should be concluded that, regardless of numerous amendments of the Enforcement Act, Croatian legislator still hadn't managed to harmonize all legal terms with specific provisions of the Road traffic safety Act[49], as well as enable quick and successful enforcement proceedings.

[47] For more details see sub-chapter: Locating the vehicle.

[48] Enforcement Act (Official Gazette No. 141/2012, 25/2013, 93/2014).

[49] Road traffic safety Act (Official Gazette No. 67/2008, 48/2010 – OUSRH, 74/2011, 80/2013, 158/2013 – USRH, 89/2014, 92/2014, 64/2015, 108/2017).

CHAPTER 2: Problems of lessors in Croatia

This chapter deals with specific problems of lessors in Croatia dealing with enforcement on vehicles. Special attention will be given to certain provisions of the Croatian Enforcement Act, since most of the problems are due to ineffective regulatory solutions.

The chapter will be introduced by quantitative data and trends concerning vehicles as objects or enforcement and /or objects of leasing.

When it comes to motor vehicles in Croatia, on 31st December 2017, there was a total number of 2.056.127 registered motor vehicles[50]. Since 2008, when the economic crisis began, this figure was in continuous decline. However, in 2017 this number rose to its previous level again. During economic crisis, some owners were deregistering their motor vehicles because of lack of funds. However, deregistration does not mean that the title of vehicle is transferred, it only means that it cannot participate in road traffic. Thus, the vehicle can still theoretically be an object of enforcement, although not registered. However, in practice, there is no other way that the creditor can check whether there even is a vehicle if it is not registered. In case of lessor, this fact is known for the object of leasing, because it has been given to lessee for his use on the basis of the leasing contract.

As explained before, the dominant object of leasing in Croatia are vehicles, due to underdeveloped nature of the Croatian equipment leasing industry. According to periodical report from HANFA[51], with regard to total number of active financial leasing contracts of 90.857 in 2018, only 7.312 concerned machinery and equipment, whereas 60.458 concerned

[50] 'Bilten on security of road traffic' Croatian Ministry of Internal Affairs (2018) 15 Accessible at: http://stari.mup.hr/UserDocsImages/statistika/2018/bilten_promet_2017.pdf, Accessed on: 25th March 2019.

[51] Data accessible at: https://www.hanfa.hr/publikacije/statistika/#section5

motor vehicles (only passenger cars). As the data confirms, motor vehicles are the most popular objects of leasing.

When debtor defaults on payments, there usually isn't such a rich pool of potential objects of enforcement. However, motor vehicle is still not very popular as an object of enforcement. The question is why is that so? The answer should be found in lengthiness and ineffectiveness of enforcement proceedings. Therefore, another hypothesis in relation to the thesis title is although motor vehicles are popular as objects of leasing, they are unpopular as objects of enforcement.

Furthermore, we are faced with an illogicality whereas lessors are faced with an obvious choice of object of enforcement, leased motor vehicle. However, lessors are aware that if debtor doesn't willingly hand in the vehicle, they will satisfy their claims faster on any other asset of debtor. There are many reasons for this problem, out of which we can name a few. *First*, the average age of personal motor vehicles in Croatia varies between 9,83-12,64[52] years. Thus, in most of the cases the value of the vehicle will not be high enough to cover the costs of enforcement on vehicles or the debt in significant amount. This mostly has to do with the fact that enforcement proceedings on vehicles are complicated, require engagement of towing service and witnesses every time that the debtor was uncooperative during enforcement actions.[53] This raises costs of enforcement considerably. *Second*, taken into consideration that,

[52]Croatian center for vehicles, Official statistics, Accessible at: https://www.cvh.hr/media/3026/s11__prosjecna_starost_po_vrstivozila_2007do2018.pdf, Accessed on: 25th March 2019.

[53] According to Article 136 Enforcement Act (57/1996, 29/1999, 42/2000, 173/2003, 194/2003, 151/2004, 88/2005, 121/2005, 67/2008, 139/2010, 154/2011, 70/2012), the creditor can submit a new proposal for confiscation of the vehicle every time that the debtor is not at home, does not want to cooperate or for any other

on public auction, the vehicle can be sold for a minimum of half of its established value[54], its value, as well as popularity as object of enforcement, decreases even further.

These negative trends could be avoided by introducing a more efficient legal framework. Some of the solutions already exist in other jurisdictions, such as fast and effective enforcement, as well as making vehicles an obligatory alternative to unsuccessful enforcement on funds of debtor. The latter would promote beneficial social effects, as it might also decrease the unnecessary number of real estate enforcements. Fast and effective enforcement on vehicles might also decrease the pressure on courts.

2.1. Provisions of Enforcement Act Delaying Enforcement

Strict formalism present in Croatian Enforcement Act, as well as inability of the Croatian legislator to harmonize the relevant laws, has the effect of slowing down enforcement proceedings considerably, ultimately rendering it unsuccessful.

As explained before, enforcement on vehicles in Croatia is conducted by following very strict and formal court enforcement actions of confiscation, evaluation, transporting, entrusting to the custody of the court, court bailiff or a third party of a vehicle, its sale and settling the claim of the creditor from the amount obtained by selling the vehicle. The form of each of these enforcement actions is strictly prescribed by the relevant provision of the Enforcement Act. For example, it is crucial that the creditor indicates the exact enforcement action that needs to

reason the confiscation could not be conducted. The creditor can submit a new proposal for confiscation only once if the debtor was cooperative at the moment of tried confiscation of the vehicle, but the vehicle was not found. This is no longer so, according to Article 144 Enforcement Act (112/2012, 25/2013, 93/2014, 55/2016, 73/2017). Now the creditor can propose the new date for confiscation only once, immediately after the first confiscation was unsuccessful.

[54] Article 150 Enforcement Act n (39)

be taken already in the enforcement order. If the creditor does not do that, the court will dismiss the motion for enforcement. As the District court in Varaždin decided in its decision No. Gž Ovr-596/15-2;

> "In the writ of execution, the creditor did not request from court the enforcement actions exactly following the letter of the law, prescribed by the relevant Enforcement Act (Official Gazette No. 112/12, 25/13, 93/14). The said regulation, in Art. 136, para. 1 stipulates that enforcement of movables is carried out by following strictly formal court enforcement actions, i.e. confiscation, evaluation, transporting, entrusting to the custody of the court, court bailiff or a third party of a movable, its sale and settling the claim of the creditor from the amount obtained by selling the vehicle. It also stipulates that the creditor is obliged to indicate in the writ of execution whether the transported vehicle is kept in custody of the court, court bailiff or a third party (Art. 140, para. 4) and 5).). Since the creditor failed to propose the confiscation of movables as one of the prescribed enforcement actions and did not specify whether or not the confiscated movables are to be entrusted to the custody of the court, court bailiff or a third party, it must be concluded that the conditions for the dismissal of the motion are fulfilled in the sense of Art. 136. para. 4 of the Enforcement Act."[55]

This can lead to prolonged time necessary for even starting the enforcement proceeding, let alone successfully finishing it. Therefore, the legislator needs to consider the question, how to mitigate the strict formalism to make the enforcement correspond to one of its main principles – urgency of the proceeding?[56]

[55] Translated from the decision of District court in Varaždin No. Gž Ovr-596/15-2, 20th August 2015.

[56] Article 13 Enforcement Act (n 39).

This issue was a matter of wide debate in Croatian legal circles and it went so far as starting the proceedings before the Constitutional court of the Republic of Croatia (hereinafter: Constitutional court) to determine whether this strict formalism of Enforcement Act, especially formalism prescribed by Article 39 para 3[57], is unconstitutional. This Article states as follows:

> "A motion for enforcement that does not contain all the information referred to in paragraphs 1 and 2 of this Article shall be rejected by the court, without inviting the parties to supplement or correct it."

It should be emphasized that the Constitutional Court of the Republic of Croatia in its decision No. U-I-2881/2014, from 1st June 2016 abolished[58] the provision of Article 39 para. 3 of the Enforcement Act stating that the provision is not in accordance with the Constitution and with Article 109 of the Civil procedure Act[59] that states as follows:

[57] Enforcement Act (Official Gazette No. 112/2012, 25/2013, 93/2014), former Article 35 para. 3 of the Enforcement Act (Official Gazette No. 57/1996, 29/1999, 42/2000, 173/2003, 194/2003, 151/2004, 88/2005, 121/2005, 67/2008, 139/2010, 154/2011, 70/2012).

[58] Peček, 'Nema više odbačaja nepotpunih ovršnih prijedloga - povodom odluke Ustavnog suda RH broj: U-I-2881/2014 i dr. od 1. lipnja 2016.' (2016), Accessible at: http://www.iusinfo.hr/Article/Content.aspx?SOPI=CLN20V01D2016B941&Doc=CLANCI_HR, Accessed on: 25th March 2019.

[59] Civil procedure Act (Official Gazette No. 53/1991, 91/1992, 112/1999, 129/2000, 88/2001, 117/2003, 88/2005, 2/2007, 96/2008, 84/2008, 123/2008, 57/2011, 25/2013, 89/2014). This Law should be applied subsidiarily according to Article 21 Enforcement Act (Official Gazette No. 112/2012, 25/2013, 93/2014, 55/2016, 73/2017).

> "If the application is incomprehensible or does not contain all that is necessary, the court will order the plaintiff to amend it in accordance with the court's instruction and return the application to the plaintiff for purpose of correction or amendment."[60]

The Article was later on amended[61] to be in accordance with the Constitution and Article 109. of the Civil procedure Act.

2.2. Illusory role of public notaries

Aside from courts, public notaries can also participate in enforcement proceeding and decide on creditor's motion for enforcement[62]. The participation of public notaries in enforcement proceedings is certainly a positive innovation in relation to the old system of exclusive court jurisdiction, because it was meant to accelerate the proceeding and enable fast adoption of the enforcement order by the public notary based on credible document, not an enforceable[63] one. However, according to the current state of regulation these potential benefits of the notarial enforcement do not come to the fore.

Enforcement Act recognizes two grounds for enforcement order, enforceable and credible document[64].

[60] Enforcement Act (n 39).

[61] Enforcement Act (n 39).

[62] Articles 278-289 Enforcement Act (n 39).

[63] According to Article 23 Enforcement Act, Enforcement documents are: "enforceable court decision and enforceable court settlement, enforceable court settlement based on Article 186a of the Civil Procedure Act, enforceable decision of the arbitral tribunal, enforceable decision of Administrative court and enforceable settlement of Administrative court, enforceable notarial decision…".

[64] Article 22 Enforcement Act (n 39)

Credible documents that can be grounds for enforcement are:

1. Receipt,
2. Bills of exchange and check,
3. Public document,
4. Excerpt from financial records,
5. Certified private document and
6. Document that is considered public document by special regulations.[65]

According to Article 281 para. 1 and 2 of the Enforcement Act:

> "If a public notary considers that a motion for enforcement is justified, he will issue an enforcement order on the basis of a credible document and deliver it to the parties.
>
> If a public notary declares that a motion for enforcement on the basis of a credible document is not admissible, he will forward the case to the competent court for the purpose of deciding."

Public notary will also forward the enforcement order to the competent court if there is a legal remedy against the enforcement order that was delivered to the parties.

From relevant provisions it is clear that the main reason for the illusory role of public notaries in enforcement on vehicles is that they cannot execute any enforcement actions. Once the public notary receives creditor's motion for enforcement, he will either allow it, if he finds it justified, or he will forward the motion to the relevant court, if he finds it inadmissible. The latter applies also in case the parties appealed the notary's enforcement order. If the parties do

[65] Article 31 para 1 Enforcement Act (n 39).

not appeal the enforcement order, it must again be forwarded to the competent court for the actual enforcement[66], as the notary is not competent for taking any enforcement actions.[67]

This legislative solution has serious consequences for successfulness of enforcement on vehicles. Namely, since public notaries have only been given a role to examine justification of the motion for enforcement and have no real power when it comes to actually undertaking enforcement actions, there are no real benefits of having public notaries as part of enforcement on vehicle. It only adds another step to already complicated, costly and burdensome enforcement on vehicles.

2.3. Ownership of the vehicle as a prerequisite for enforcement

Article 161 para. 1 reads as follows:

> "The court orders enforcement on vehicles on the basis of enforceable or credible documents and excerpts from the MUP's register."[68]

By also adding an excerpt from MUP's register as a prerequisite for starting the enforcement, the legislator evidently wanted to prevent enforcement on vehicle that is not in debtor's ownership. However, the hypothesis is that this attempt was unsuccessful for several reasons. *First*, the register is not the proof of ownership, but of having the car properly registered. Therefore, it does not prevent the possibility of enforcement on vehicle that belongs to a third

[66] This is not applicable on every object of enforcement. Namely, if enforcement order of public notary was on funds of the debtor, different rules apply. If the parties do not appeal the enforcement order, the creditor will send the order to FINA for an out-of-court enforcement.

[67] G. Mihelčić, 'Novine u ovrsi na pokretninama nakon stupanja na snagu Novele Ovršnog zakona iz 2008.', (2008) Aktualnosti hrvatskog zakonodavstva i pravne prakse 774.

[68] Article 161 para. 1 Enforcement Act (n 39).

party, and not to the debtor. *Second*, as the filing with MUP's register is not *modus* of acquiring the title of vehicle, "by using it as a supporting document in motion for enforcement, the creditor is wrongfully limited in his ability to prove legally relevant facts."[69] *Third*, the excerpt from the register is in its nature a public document for which it is presumed that its content is true. According to Article 230 of the Civil procedure Act[70], this presumption is rebuttable. Therefore, it is unclear why would the legislator give this excerpt such irrefutable power, even more so as civil procedure rules are to be applied subsidiarily in enforcement proceedings[71]. Furthermore, due to this illogicality, creditor could not use any other public document as a supporting document to start the enforcement proceeding, not even debtor's solemnized statement confirming the title of the vehicle. *Fourth*, this arrangement is very unfair from the perspective of creditor as it limits his procedural rights[72] in case the debtor omitted to register his vehicle to his name in MUP's register (willingfully or negligently).

As this particular prerequisite of the Enforcement Act is adopted from the regime that exists for real estates and other filing systems, furthermore about this particular problem can be found under the next sub-chapter.

[69] Bošković (n 1) 335.

[70] Civil procedure Act (Official Gazette No. 53/1991, 91/1992, 112/1999, 129/2000, 88/2001, 117/2003, 88/2005, 2/2007, 96/2008, 84/2008, 123/2008, 57/2011, 25/2013, 89/2014).

[71] Article 161 para. 6.Enforcement Act (n 39),

[72] Article 29 Constitution of the Republic of Croatia (Official Gazette No. 56/1990, 135/1997, 113/2000, 28/2001, 76/2010, 5/2014).

2.4. Erroneous comparison with real estate's filing system

Another solution that is better after amendments of Enforcement Act but is still not satisfying and ultimately also renders enforcement proceedings too slow, is Art. 161. para 6. of the Enforcement Act. This provision states as follows:

> "After enforcement order has been filed, it is no longer allowed to register the change of ownership on the vehicle or register any encumbrances on the vehicle based on debtor's disposition, regardless of when the disposition took place. Dispositions made in violation of this provision have no legal effect whatsoever."[73]

This means that after the filing of enforcement order, the debtor can no longer voluntarily transfer the title or encumber the vehicle, or such transactions would have no legal effect[74]. As vehicles under enforcement cannot further be sold to third parties nor can they be encumbered, it is only logical that in relation to such vehicles the MUP register's entries also cannot be changed. If we tried to interpret this literally, we would conclude that the provision of Article 161 para 6 prohibits the registration of the vehicle on behalf of the buyer, but not the acquisition of ownership by the buyer. In other words, the buyer would become the owner of the vehicle but could not register it. Of course, such a ban would have no purpose at all. It would be even more absurd to interpret this provision in a way that the debtor can sell the vehicle, but it cannot encumber it, because such encumbrances are acquired by filing, an action that is forbidden after the enforcement order has been registered. Therefore, the only logical interpretation of this provision is adequate application of regime applicable to immovable property.

[73] Art 161 para. 6 Enforcement Act (n 39).

[74] Z. Stuhne, *Ovršni zakon s komentarom* (Zagreb, Zgombić & Partneri 2006) 298.

This provision is poorly formulated and should be interpreted as the legislator tried to compare the filing system that exists for vehicles with the regime of immovable property and other filing regimes[75]. By adding this provision, the legislator envisioned that filing with the MUP's register has the same legal effect as filing with the Land Registry. However, these two filing systems have a completely different purpose. Filing with the Land Registry is the *modus* for acquiring ownership of immovable property, whereas filing with the MUP's register does not guarantee ownership of the vehicle. *Modus* for acquiring ownership of the vehicle is taking its possession[76].

Debtors will often try to prolong or sabotage enforcement proceeding, and subsequently conclude sales contracts on the basis of which they can claim that the vehicle is no longer in their ownership and possession. The fact that an informal agreement would be sufficient for transfer of title only goes to their advantage. However, as title of vehicle under enforcement cannot be registered, it is logical that no change of registration can be made with respect to such vehicles. Therefore, the *rationale* behind the provision of Article 161 para. 6 of the Enforcement Act is to ensure effective enforcement and stop the debtor's abuse of their extensive rights within the enforcement proceedings. This is confirmed in a decision of the Supreme court of Croatia, Rev-1947/1999-2, from 8th January 2003. That states as follows:

> "In case at hand, the plaintiff alleges that the vehicle under enforcement became his property based on purchase agreement concluded between plaintiff and the defendant. In the proceedings before lower courts, it was established that: - in the contract dated 2nd February 1998., called the "motor vehicle sales contract", the plaintiff and the defendant

[75] Bošković (n 1) 340.

[76] Law on Ownership and Other Property Rights (Official Gazette No. 91/1996, 68/1998, 137/1999, 22/2000, 73/2000, 114/2001, 79/2006, 141/2006, 146/2008, 38/2009, 153/2009, 90/2010, 143/2012, 152/2014).

did not express the will to transfer the title of the personal vehicle to the plaintiff, but only wanted to create an illusion that they did. Accordingly, the contract does not have any legal effect and the plaintiff did not acquire any right that would, in the sense of Art. 55 and Art. 56., prevent the enforcement on vehicle. For this reason, the lower courts have correctly applied the law when they refused the motion to declare enforcement on vehicles inadmissible."[77]

In addition, the provisions of Article 161. para. 2 and 4, state the following:

"A copy of enforcement order is sent to MUP where the records of registered vehicles are kept for the purpose of filing the enforcement order to an appropriate register.

By filing the enforcement order, the acquirer acquires the lien on the vehicle."

Therefore, by stipulating that the lien is acquired by filing the enforcement order with MUP's register, the legislator wanted to prevent subsequent changes in filing with the register. This is again comparing the vehicles with the regime envisaged for real estates.

Additionally, in case of real estates, the court will only issue the enforcement order if the creditor provides a proof with the motion for enforcement that the property is owned by the debtor. This, of course, makes sense in case of real estates as the Land Registry for the following reason:

"It is considered that the Land Registry fully reflects the factual and legal status of the land.

[77] Translated from decision of the Supreme court of Croatia, No. Rev-1947/1999-2, 8th January 2003

An acquirer who is in good faith acting with trust in land register is legally protected."[78]

This is to say that the Land Registry is a public register, with a rebuttable presumption that it mirrors the legal and factual status of the land and thus, the *bona fide* purchaser who thought that the seller was the owner of the land enjoys the legal protection. However, unlike the Land Registry, MUP's records are not public, thus making this legislative maneuver completely useless to the *bona fide* buyer of the vehicle.

Namely, the creditor needs to check the data of the MUP's register before starting enforcement proceeding to make sure that the debtor is the owner of the vehicle. The creditor will have to refer the request to MUP, i.e. the competent police authority, to receive an extract from the records of registered and marked vehicles. As a supporting document for his request, the creditor will have to use enforceable or credible document that he will later use to start the enforcement proceeding[79]. This document proves the creditor's legitimate interest in bringing the proceeding. Again, this is just another formal requirement that prolongs the enforcement proceedings and is in its nature entirely unnecessary, as was demonstrated above.

In conclusion to this subchapter, the enforcement on vehicle should not be conditioned by an excerpt from MUP's register as an exclusive proof of the ownership of the vehicle. The legislator should have followed the regime of presumed ownership of movables that are in debtor's possession. Of course, the possession of vehicle should not be an irrefutable presumption of ownership, but a rebuttable one, whereas the legal remedies offered by the Enforcement Act and a right to Objection of a third party (claiming to be the owner of the

[78] Article 8 para. 2 and 3 Land Registry Act (Official Gazette 91/1996, 68/1998, 137/1999, 114/2001, 100/2004, 107/2007, 152/2008, 126/2010, 55/2013, 60/2013, 108/2017).

[79] Article 18 para. 7 Enforcement Act (n 39).

vehicle)[80] are sufficient safeguards to prevent the enforcement be carried out in case the vehicle is in ownership of a third party and not the debtor.

2.5. Locating the vehicle

Another obstacle of efficient enforcement relates to Article 162 para. 1 of the Enforcement Act states as follows:

> "After obtaining a lien on a vehicle in accordance with the provision of Article 161 para. 4, the court shall deliver the enforcement order to the debtor with an order to deliver the vehicle within eight days with all the documents relevant to the vehicle to the person to whose custody the vehicle was entrusted."[81]

If the debtor fails to comply with the order within 8 days, the vehicle will be seized wherever it is found. The creditor must propose within 60 days the time, place and manner of seizure and ensure all necessary means and work force. If the creditor fails to comply with this provision the court will suspend the enforcement.[82] Additionally, the police administration shall, upon receipt of an enforcement order, invite the debtor to register the enforcement order in its registration card[83].

These provisions are just another example of relatively unsatisfying solutions of Croatian legislator. Namely, so far, one of the biggest problems of enforcement on vehicles was finding their location. Vehicles are movables that are very easily transported, and the practice has shown that the debtors are not cooperative in most of the cases. Moreover, by delivering the

[80] Article 59 - 61 (n 39).

[81] Article 162 para. 1 (n 39).

[82] Article 162 para. 2 (n 39).

[83] Article 20 para. 6 (n 39).

enforcement order to the debtor in advance, or by inviting the debtor to register the enforcement order in their registration card, the court is actually notifying the debtor of the proceeding and gives him an opportunity to cleverly displace the vehicle to a secluded location, thereby avoiding the enforcement measures. It should be added that the enforcement is suspended if no vehicles were found during the first seizure of the vehicle.[84]

All of the mentioned provisions, as well as knowing the reality of life, brings us to conclusion that the chances for the creditor to locate the vehicle, as well as complete the enforcement procedure successfully are very slim.

It would be much more logical if the legislator applied to vehicles the same solution that was envisaged for movables in general, and to deliver the enforcement order to the debtor immediately before the seizure of a movable[85]. As for the registration of enforcement order in the registration card, the *rationale* behind this is to give notice to potential buyers that the vehicle is object of enforcement. If the lien on vehicle was acquired by filing with a public register, this provision would also have been avoided.

In conclusion to this sub-chapter, it is important to emphasize that this state of regulation where the creditor needs to locate the vehicle himself and then propose the confiscation of the vehicle at the location, whereas the court at the same time informs the debtor of an ongoing enforcement proceeding, is placing the burden of successful enforcement completely on creditor. A better regulatory solution should be found in the future, whereas German enforcement model might be followed.

[84] Article 144 para. 4 (n 39).

[85] Article 137 (n 39).

2.6. Impossibility of enforcement

As already mentioned above, high number of enforcement proceedings on vehicles ends with impossibility of enforcement.

There is a general provision that supports this that states:

> "Enforcement will be suspended if it has become impossible or cannot be executed for other reasons."

This impossibility of enforcement can be factual (e.g. if a vehicle that is object of enforcement does not even exist) or legal (e.g. if the court passed an enforcement order for an object that is legally exempt from enforcement).

This institute is very widely used to suspend the enforcement proceeding in practice. However, its use should be inspected through the old and the new Enforcement Act, as the old one is still applicable to those proceedings that have commenced before the new one entered into force[86].

According to Article 136 para 1 of the Enforcement Act[87]:

> "If no movables are found that could be object of enforcement, the court will inform the creditor who was not present at the confiscation.
>
> The creditor may, within thirty days from the date of notification or from the date of the attempted confiscation to which he was present, propose that the confiscation be repeated."

According to Article 144. Para 4 of the Enforcement Act[88]:

[86] Article 369 para 1 (n 39).

[87] Enforcement Act (n 39).

[88] Enforcement Act (n 39).

> "If the confiscation cannot be conducted because the debtor, his legal representative, authorized representative, the adult member of the debtor's household or the representative of the legal person as debtor is not present or will not open the doors or the doors are locked, the creditor is obliged to immediately announce if he wants the confiscation to be repeated with presence of two witnesses or notaries and other persons required to force entry into the space where the confiscation needs to be conducted.
>
> If the creditor does not comply with this provision and the confiscation cannot be carried out, the enforcement shall be suspended.
>
> If there are no movables that may be objects of enforcement, enforcement will be suspended."[89]

Therefore, it can be seen that the ability of court to suspend the enforcement proceeding depends on applicable version of the Enforcement Act, whereas 2012 Enforcement Act promotes faster suspension. However, promoting faster suspension is not a positive trend. Enforcement proceeding should not be an end in itself, the purpose of the proceeding should be successful enforcement.

The provisions that were in force before 2012 promoted slower suspension of enforcement proceeding and the creditor could propose new confiscation as many times as he needed, until the court bailiff determined that there are no vehicles at the place of confiscation and that enforcement is impossible. It seems like these provisions were created for the creditor to lead endless enforcement proceedings that were almost impossible to suspend. However, although the proceedings lasted forever and it was really difficult to suspend the enforcement, it was

[89] Enforcement act (n 39).

rarely successful. Creditor could lead unsuccessful enforcement proceedings for years before it being suspended. This also increased the cost of proceeding.

One such example can be found in the court decision of District court in Bjelovar No. Gž-3042/11-2 from 16th February 2012 that states:

> "It is not an unsuccessful attempt of confiscation if the court bailiff found no one at the debtor's address and therefore, could not examine the living space and could not determine that there were no movables that could be object of confiscation. In this case the conditions to suspend enforcement are not fulfilled."[90]

However, provisions of 2012 Enforcement Act show faster suspension of enforcement. This is also one of the reasons why enforcement proceeding in Croatia is unsuccessful. As shown above, the creditor is on his own in locating assets and proposing enforcement actions and the legislator threatens with suspension of proceedings at every turn. On the other hand, the court warns the debtor in advance of an ongoing enforcement, which allows the debtor to hide, demolish or sell the vehicle into parts.

[90] Županijski sud u Bjelovaru No. Gž-3042/11-2, 16th February 2012

CHAPTER 3: Leasing in Germany

This chapter analyses leasing regulations, as well as enforcement measures. The author introduces this chapter with some of the basic notions of German secured transactions law. It continues with explaining the enforcement measures present in German law, as well as similarities and differences with the Croatian law. The chapter concludes by analyzing lessons for Croatian legislator based on the efficiency of the German enforcement model.

3.1. Basic concepts

Commercial lawyers in all European countries today are interested in modernization of their domestic systems of secured transactions. In the recent past most countries developed set of rules that deal with appearance of non-possessory security interests.

> "The growing demand for supply of credit to entrepreneurs and enterprises made it obvious that the traditional possessory pledge, which had until then served as the main form of security interest, was no longer sufficient to satisfy the need for adequate security."[91]

Most European countries adhere to the principle of *numerus clausus*[92] of proprietary rights, legislation is strictly speaking the most important source of proprietary security rights.[93]

[91] J. De Lacy, *The reform of UK personal property security law: comparative perspectives* (New York, NY: Routledge 2009).

[92] The Latin phrase numerus clausus, quite often used by civil law scholars, means a closed or laundry list. Thus, the numerus clausus of proprietary rights expresses that a legal system recognizes only a limited number of proprietary rights and besides the ones listed in the civil code (or in other source of law of equal importance) new ones cannot be invented.

[93] The American term "security interest" as used in Article 9 of the Uniform Commercial Code (hereinafter: UCC) is not used by continental legislators, nor by legal writers. An "interest" is not regarded as equivalent to a fully -

Although in Germany, *numerus clausus* principle is recognized, non-possessory security was developed mostly through case law. The courts in Germany were not as strained by the regulatory frame so they also developed something called "quasi-security".[94]

The Global Law Map[95] introduced by Philip Wood, characterizes the attitude of a specific country towards security and it places Germany in the category of "quite friendly to security". Aside from Germany, this particular category is occupied by Scandinavian countries and the Netherlands.[96]

3.2. Specific aspects of security regulation

To understand the specific aspects of secured transactions in Germany, it is important to get beyond some general qualifications and approach certain aspects of it in a bit more detail.

German system, unlike many other European systems or the US system, deals in a different way with the debtor who tries to conceal the existing security interests in collateral to obtain additional funding. This system lacks any form of public filing system which also raises the

fledged right, quoted from J. De Lacy, *The reform of UK personal property security law: comparative perspectives* (New York, NY: Routledge 2009).

[94] i.e. a contractual relationship whereby the creditor manipulates title so as to give himself recourse to an asset in the event of his debtor's default, but that arrangement does not operate as areal security i.e. a mortgage, charge, pledge or lien, as quoted from J. De Lacy, *The reform of UK personal property security law: comparative perspectives* (New York, NY: Routledge 2009).

[95] P. Wood, *Global Law Maps, World Financial Law* (London: Sweet & Maxwell 2003) 30.

[96] Different in J. De Lacy, *The reform of UK personal property security law: comparative perspectives* (New York, NY: Routledge 2009) 447; "Germany is roughly in the same category as the United Kingdom in that it clearly favors security, in some respects even more so than English Law." (In the Global Law Maps, England was put above Germany)

problem of ostensible ownership[97] and "uncertainty among creditors regarding priority"[98] of their rights in bankruptcy. However, this lack of filing is completely supported by the legislator and the judiciary. Furthermore, the German law on secured transactions "completely supports the debtor's interest in the continued use of collateral in the secrecy of the secured transaction."[99] Therefore, there are not any indications of future reform in the German system that would lead to some kind of filing. Even a very respective professor Ulrich Drobnig, who generally incites any UCC Article 9[100] resembling reform ("Unitary Model"), has actually emphasized that the publicity principle is not so important in Germany when he asked as follows:

> "Is the complicated technical system really necessary if all the information it offers is a notice that there may exist a security interest, so that intending creditors are put on notice but have to turn to the debtor in order to verify the true state of affairs. Is not nearly the same effect achieved in countries without a registration system where the

[97] The notion of ostensible ownership was explained by Mr. Justice Brandeis in Benedict v Ratner case, 268 U.S. at 362-363, 45 S.Ct. at 569, 69 L. Ed. At 999., as: "seeming ownership because of possession retained". Namely, this is applicable to German model, as there is no registration of security interest, therefore, it may seem that someone who holds the possession also has a right in the object, but it is not exactly so. This seeming ownership because of the possession of the object is called ostensible ownership.

[98] J. Hausman, *The value of public notice filing under Uniform Commercial Code Article 9: A comparison with the German legal system of securities in personal property,* Vol. 25, No. 3 (Georgia Journal of International and comparative law 1996) 432.

[99] Ibid.

[100] 'Uniform Commercial Code.' (1978) 1978 (4) Utah L Rev 809, (hereinafter: UCC); Under Article 9 of UCC, all security interests require publicizing with a proper register (publicizing).

> courts proceed from a general presumption that business people must know that any major piece of equipment is bought on credit."[101]

However, one may argue that a specific reason for success of this registrationless system is the fact that Germany has a "relatively closed credit market where there are a number of powerful players with a quasi-monopolistic control on credit."[102] Why is this so? Presumably the reason for this is that the big banks that control the market have detailed information on the business and credit needs of other players on the market. However, any other financial institution that tries to enter the market is excluded by the fact that it doesn't have the experience or knowledge to compete with the big players in the industry.

Furthermore, due to the non-registration principles, security interests created are latent (secret).

> "German law is the prime example of a legal system that permits creation of latent (secret) security interests in tangible moveable property (chattels) or intangible property (choses-in-action)."[103]

An entrepreneur needing further financing can get the credit from a supplier or the credit institution. Depending on the creditor, the entrepreneur can secure the creditor's position by delaying the passage of title from creditor to the debtor until the price has been payed in full (entrepreneur)[104] or by transferring as security his own assets or claims against third parties

[101] U. Drobnig, *Present and Future of real and personal security*, Vol. 11, No. 5 (European Review of private Law 2003).

[102] G. McCormack, R. Bork, T. Tajti, *Security rights and the European insolvency regulation* (Cambridge: Intersentia 2017) 114.

103 S.A. Riesenfeld, W. Pakter, *Comparative law casebook* (Ardsley, N.Y. : Transnational Publishers c2001).

[104] Meaning retained title (de. Eigentumsvorbehalt) as explained in (n 102) 97.

(supplier)[105], all "without registration, change of possession or notice to the third parties."[106] Except security transfers and retained title security devices on movables include expanded and extended versions of these instruments. If these security devices include also future advances, then we are talking about the expanded version and if they include only after-acquired property, then it is called extended version. German courts have legitimized these extensions.

Whereas retained ownership is recognized by statute, other latent securities exist outside statutes, because the courts are wiling to recognize these security instruments that are created usually by contracts. Many scholarly works refer to these instruments as contract-based security devices (de. "*kautelarische Sicherheiten*").

Generally, it can be stated that Germany recognizes quasi securities. "The best-known examples of these are leasing, factoring and sales with retention of title/ownership clause."[107]

Since leasing in Germany is point of interest in this discussion, next chapter will deal with description of some common features of leasing market in Germany.

[105] Meaning security transfer or transfer of title by way of security/assignment by way of security, as explained in (n 102) 97.

[106] Riesenfeld (n 103).

[107] McCormack, (n 102) 101.

3.3. Description of leasing market

In German civil law all leasing contracts are initially treated as rental agreements, as there is no definition of leasing contract.[108] Similar treatment leasing receives in other branches of law, like commercial or fiscal law.

In Germany, there are no restrictions on conducting leasing activities by the leasing companies and leasing companies usually operate as limited liability companies (GmBH). No restrictions apply to types of assets that can become objects of leasing.

> "Approximately 1300 companies make up the leasing industry in Germany, with 120 of these having a significant share of the market. The *Bundesverband Deutscher Leasinggesellschaften* (hereinafter: BDL)[109] currently includes 64 movable-asset lessors and 12 real-estate lessors. In 1990, the BDL represented 70 percent of the total leasing industry in Germany and almost 100 percent of all real-estate leasing business."[110]

Leasing companies in Germany are mostly independent which makes a big difference from those in Croatia that are mostly owned by foreign banks. Although the number of leasing companies in Germany that are bank-owned is very small, these companies still account for a large part of the market.

[108] Section 535 of German Civil Code (hereinafter: *Bürgerlichen Gesetzbuchen*, BGB), Civil Code in the version promulgated on 2 January 2002 (Federal Law Gazette [*Bundesgesetzblatt*] I page 42, 2909; 2003 I page 738), last amended by Article 4 para. 5 of the Act of 1 October 2013 (Federal Law Gazette I page 3719)

[109] Federal Association of German Leasing companies

[110] *Leasing in Europe* (London, England: McGraw-Hill c1992) 28, Available at: https://ceuedu.sharepoint.com/sites/itservices/SitePages/vpn.aspx, Accessed on: 26th March 2019.

Independent leasing companies are not subject to supervision as they are not considered to be credit institutions, whereas this may be different for bank-owned leasing companies that may be under supervision of credit institution.

The main function of leasing in Germany is to provide financing for the lessee. Normally, just like in Croatia, financial leasing entails involvement of three parties; supplier, lessor and lessee. The supplier is the one who supplies the vehicle to the lessor and then the lessor and the lessee enter into a leasing contract to which the supplier is not a party.

> "Since the leasing contract is mainly aimed at the leave for use it is regarded by the German Federal Supreme Court as an atypical rental agreement, applying the legal provisions governing rental agreements[111] analogously, although its function as a financial accommodation is obvious. Nevertheless, despite this being obvious, German case law regards the ownership of the lessor as full ownership and not merely as a security ownership."[112]

3.4. Enforcement proceeding

It is a general principle that security interests in civilian systems are enforced through courts and not in an out-of-court proceedings.

As explained in the book *Security rights and the European insolvency regulation*[113], in most of civil law jurisdictions, the "following steps need to be taken:

1. The secured creditor needs to obtain an enforceable judgement or equivalent (other enforceable document),

[111] Article 535 BGB (n 108).

[112] McCormack (n 102) 101.

[113] Ibid.

2. He has to apply to local court for enforcement and
3. The court is to issue an enforcement order stipulating also the method by which the security right is to be enforced (normally a public auction)."

In general, the difference between civil and common law countries when it comes to enforcement is that there is no self-help repossession. Repossession in civil law countries entails voluntary surrender of possession from debtor to the creditor, but the creditor has no right to retake the possession without creditor's consent. In Germany, if there is no cooperation on the side of the debtor, the creditor will have to resort to protection from court.

The provisions on enforcement on vehicles in German law are contained in the *Zivilprozessordnung*[114]. However, there are no specific rules on vehicles, but the general rules of enforcement on movables apply. The enforcement proceeding is normally initiated at the proposal of creditor and on the basis of the prescribed documents, which must contain an enforceable clause. In German enforcement proceeding the court bailiff (de. *Gerrichtvollzieher*) has a very important role in gathering data on assets of debtor. Based on the data he has collected, *Gerrichtvollzieher* compiles a list of debtor's assets, which he submits to the court and the creditor. These lists, however, do not only have effect in a specific proceeding, but they create a comprehensive database on the debtor's assets, which the interested parties may undergo under the prescribed conditions.[115]

Gerrichtvollzieher is authorized to offer to the debtor a debt repayment plan, about which the creditor must immediately be notified so that he can veto the plan in case of disagreement.

[114] BGBI (n 6).

[115] Translated from (n 1) 3.

If the debtor does not cooperate with the court bailiff, upon the proposal of creditor, the debtor can be served with a sentence of maximum six months jail time.

Here we find an important difference in relation to the Croatian system, where the burden of searching for the debtor's assets is shifted to the creditor. In Germany, the solution to this problem existed through the institute of debtor's statement containing the list of assets. This statement is to be submitted by the debtor on the proposal of the creditor. If the debtor did not comply with the court's order to make this statement, he may have been fined by the court until he complies with the court order. Although this solution of debtor's statement containing the list of assets and the court's ability to fine the debtor exists in Croatia, Croatian courts were generally not using this possibility. With 2014 Amendments of the Enforcement Act[116], this solution of debtor's statement containing the list of assets has been removed for unknown reasons by the legislator.

Enforcement actions in Germany are very similar to those in Croatia. We can even say that, if there are any differences, they are more of technical than substantive nature.

Therefore, enforcement on vehicle in Germany is also conducted by confiscation of the vehicle. Unlike in Croatia, it is with confiscation of the vehicle by the *Gerrichtvollzieher* that the creditor acquires lien on the vehicle in Germany. As the Croatian legislator gave practical importance to the MUP's register, it tied the acquisition of lien to the receipt of the enforcement order by the register.

ZPO prescribes as a general rule that a vehicle is to be confiscated and transported from the debtor's possession, because leaving it with the debtor can jeopardize the creditor's position.[117]

[116] Enforcement Act (Official Gazette No. 93/2014).

[117] Article 157. ZPO.

The only circumstances when the vehicle is to be left in the possession of the debtor is when the creditor agrees with this, as well as when it is justified for other reasons. If *Gerrichtvollzieher* cannot take the possession of the car for any reason, he is obliged to undertake any measure to prevent its unauthorized use, from taking the registration card to disabling the engine.

It is also *Gerrichtvollzieher's* duty to sell the vehicle on public auction that can be conducted through internet. This possibility exists also in Croatia, after the 2014 Amendments to the Enforcement Act. Although it is not an actual internet auction but an electronical bid collecting, it is certainly a positive change.

3.5. eCall in-vehicle system

It was already mentioned above, that one of the biggest problems of enforcement is locating the vehicle. Enforcement will mostly be carried out at the place of residence or in the headquarters of the debtor because the creditor will most often have no other data on where the vehicles may be located. The situation is also aggravated by the fact that according to the current regulations, debtors know about enforcement proceedings and can easily move the vehicle to another location and hide it. The solution to this problem needs to be sought in technology, i.e. enforcement proceeding needs to be regulated in accordance with the automotive industry's developments to maximize technological potential.

In that sense, the European Parliament and Council adopted a Decision No. 585/2014/EU of 15 May 2014 on the deployment of the interoperable EU-wide eCall service[118]. It is an initiative at EU level which foresees that from 2015, an eCall system must be built-in when new M1

[118] Decision No 585/2014/EU of the European Parliament and of the Council of 15 May 2014 on the deployment of the interoperable EU-wide eCall service Text with EEA relevance, OJ L 164, 3.6.2014, p. 6–9.

motor vehicles (motor vehicles for the carriage of persons that are equipped with up to 8 seats) and N1 vehicles (the maximum permissible cargo weight ≤ 3,500 kg) are produced. This system would automatically call 112 in the event of an accident and provide the competent authorities with exact location of the vehicle. To do that, the eCall system would have to be in accordance with existing satellite navigation systems. If the implementation of this regulation goes as scheduled, we can conclude that in next 20 years the majority of motor vehicles will have an eCall system installed.

This system certainly could find its use in enforcement proceedings as well. The implementation of this system in enforcement proceedings is certainly a task on which technological and legislative work should be based in the coming years. Even though the European Commission has already put the emphasis on the protection of privacy and the disabling of permanent vehicle tracking through an e-call system, it is certainly expected that the eCall system will be applied in cases where public interest is above individual privacy. For example, in case of hidden vehicles under enforcement, they could be located immediately through this system.

On the technical side, these modifications are feasible, although it remains to be seen in which direction will the European and national law be developed. To conclude, application of the eCall system in enforcement proceeding might solve the problem of locating the vehicle under enforcement, which is one of the main problems of lessors when recovering their claim through enforcement on vehicles.

3.6. Lessons for Croatia

As can be concluded, enforcement measures envisaged under German regulatory system, are very similar to those in existence in Croatia. This is due to the fact that the Croatian legislator usually follows the German regulatory solutions as a model jurisdiction.

However, the German enforcement model, in comparison to Croatian, is much more efficient. It promotes fast and effective enforcement. There are several possible reasons for the difference in effectiveness. *First* and the most important difference is that the burden of locating the assets in German model is not solely on the creditor. The creditor has an interest to locate the assets, but if the debtor was cooperative and made it easy for the creditor to locate the assets, the creditor would not even need the court enforcement measures to take place. *Second*, Croatian Enforcement Act achieves this level of pressure on the creditor by threatening the creditor at every step possible that the enforcement will be suspended if the creditor does not comply with the provisions of the Enforcement Act. Third, and the most astonishing reason is, the Croatian system enables the debtor to undermine the enforcement by allowing courts to inform the debtor of enforcement in advance and giving him enough time to hide, demolish or sell the vehicle into parts. *Fourth*, all of the above would not be so grave if there was a strong judicial hand behind these obligations of the creditor that would demotivate the debtor from delaying and preventing enforcement.

Therefore, not only did the Croatian legislator deviate in these important principles from the German model, but it abolishes some important institutes such as statement on the debtor's assets, it threatens creditor of suspension of enforcement and the courts never use the sanctions at their disposal against non-cooperative debtor.

Even though the difference in German and Croatian enforcement models is more technical than substantive, it is these small technical details that make a difference in effectiveness of enforcement proceeding.

CHAPTER 4: Leasing in the US

This chapter introduces the US as another model jurisdiction that makes enforcement fast and efficient. The author will first deal with some of the basic concepts that explain the position of the leasing industry in the US. The chapter will continue with explaining what the most important measures for enforcement at disposal of the US creditor are. The conclusion of this chapter delivers some lessons, based on the US approach, for the future amendments of the Croatian Enforcement Act.

4.1. Basic concepts

There is a common understanding that the US is a birth place of leasing, although some more detailed historical developments are missing. However, a modern concept of leasing undoubtedly started to spread through Europe from the US in 1950's: "The US Leasing Corporation established in San Francisco in 1952 as the first modern leasing company."[119]

Professor Grant Gilmore, a US scholar little known in Europe, observes:

> "Until early in the nineteenth century the only security devices which were known in our legal system were the mortgage of real property and the pledge of chattels. Security interest in personal property without delivery of possession was looked on as being in essence fraudulent conveyance, invalid against creditors and purchasers."[120]

Leasing is considered to be a title-finance instrument and goes in the same group of instruments as the conditional sales, hire-purchase and consignments. The reason why they are put into this category is that each of them relies on retained-title as a main security for the lessor (or a

[119] Tajti, (n 10).

[120] G. Gilmore, *Security interests in personal property* (Union, N.J.: Lawbook Exchange 1999).

consignor, conditional seller or hirer). In addition, some states of the US know sub-variants of leasing, such as "bailment lease in some States, led by Pennsylvania as the 'leading bailment-lease state"[121]

Title retention devices have through the US history been always looked at as stronger in contrast to "weaker lien devices of mortgage, pledge and factor's lien."[122]

UCC Article 9 deals with leasing contracts in its Article 2A.[123] A lease is defined as "a transfer of right to the possession and use of goods for a term in return for consideration, but a sale…or retention or creation of a security interest is not a lease." Chapters 1-8 all deal with sales of goods, but analogous provisions that apply to leases can also be found. To determine whether the agreement is a lease or a sales agreement the court would apply the so-called "residual value test".

> "This approach requires a factual determination by the courts whether the transaction results in a leasehold of value to be returned by the lessee. If the object of the lease is returned with value remaining, it is a lease under article 2A. If not, it was a conditional sale under the purview of Article 9."[124]

Good understanding of UCC Article 9 is a prerequisite for resolution of scope problems. This is to say how hard it is to determine the scope of Article 9. The importance of scope is a

[121] Tajti (n 10) 159.

[122] Gilmore (n 120) 67.

[123] UCC Article 2A-103(1)(j) and Comment (j), 1-201(37), 2-106(1), 9-102(2) (hereinafter: UCC Article 2, 2A).

[124] D. B. King, C. A. Kuenzel, B. Stone, *Commercial transactions under the uniform commercial code and other laws* (Casebook series, New York, NY : M. Bender 1997).

practical and historical one. Namely, in history, creditors managed to avoid filing requirements by structuring a lending transaction as a lease.

Under UCC Article 2 there is a distinction between "true lease" and a lease that creates a security interest.

> "By structuring the transaction as a lease, the creditor/lessor retained ownership of the property; if the lessee defaulted, the lessor could simply reclaim its property. Provisions for public notice and proper repossession upon default simply did not apply."[125]

> "A fecund source of disputes that the 1999 revision did not resolve is the question whether a particular document labeled a 'lease' is a true lease – and so outside of Article 9 and under Article 2A – or whether it is a security agreement that creates a security interest under the terms of section 1-203."[126]

> „All this does not mean that leasing is nothing more than a historical fraud which created this need of subjecting these kinds of transactions to filing. Ultimately, however, ... leases were transformed into secured transactions and subjected to the same legal regime by the arrival of the UCC in the early 1950's; including registration in the same registers as chattel mortgages and other secured transactions."[127]

Therefore, if the arrangement creates a security interest, the transaction is governed by Article 9 which means that filing and default requirements apply. This is why some creditors would choose to structure the transaction as a lease, to avoid application of these provisions. In practice, it means that if a lessee has an option to keep the object of leasing, the transaction is

[125] Ibid.

[126] J.J. White, R.S. Summers, *Uniform commercial code* (Hornbook series, St. Paul, MN : Thomson/West c2010).

[127] Tajti (n 10) 191.

meant as a security („if it is also compliant with the terms of the lease“[128]). In contrast, a true lease[129] entails that there is something to be returned to the lessor after the leasing term.

> „Under common law theory, the lessor, since he hasn't parted with the title, is entitled to full protection against the lessee's creditors and trustee in bankruptcy; so far he is in the same position as the common law consignor, but the lessor's protection goes a step further: since, unlike a consignor, he has not given the lessee power to sell the goods, the lessor's title should prevail even against good faith purchases from the lessee.“[130]

It is up to US court to decide on case-by-case basis whether something is a true or a security lease. This is, of course, not the most practical solution.

As the purpose of this analyses is to compare the Croatian and the US leasing model, something that makes the comparative analyses difficult is „the trend to subject title finance contracts ... to secured transactions law.“[131] This because of the „functional approach“ of the UCC Article 9 where all transactions whose aim is to secure the creditor by using personal property as collateral should be subject to the same set of rules. In Europe in general, the „systemic approach“ is present, whereas the goal is to form a definition and create a very neat legal system.

For this reason, the difference in true and security lease is important as it is hard to compare these with possible equivalents in the Croatian leasing regulation. Namely, all civil codes

[128] King (n 124).

[129] Rent-a-car is a form of true lease as the parties never try to obtain title; as described in Tajti (n 10) 157.

[130] Gilmore (n 120).

[131] Tajti (n 10).

recognize „the nominated contract of rent."[132] Whether this one would be similar or distinct from true lease is hard to answer. Today, mostly, they are considered as two distinct categories of law.

As far as the leasing market goes, the predominant players in the US leasing industry are independent leasing companies[133]. This is not so in case of Croatia. In Croatia, as already explained above, banks influence leasing market, which makes it hard for the industry to develop, as banks are usually not prone to changing the market.

4.2. Self-hel repossession

Perhaps the most pressing problem of leasing industry in Croatia is locating and taking possession of object of leasing. The reason for this is that the lessor should be in the position to protect his retained ownership, particularly by taking possession quickly. As we stated above, in civil law countries the lessor needs to apply the principle to follow what the law mandates.

One important difference between the US and the Croatian system with this regard is that the US lessor can follow the principles of self-help (out-of-court) repossession. In civil law countries, however, out-of-court repossession of the collateral is legally not possible or some functional equivalents are present that do not show the same efficiency.

As professore Grant Gilmore said it:

> „The enforcement part of UCC Article 9, proceeds on the theory that the normal procedure after default is for the secured party to take possession of the collateral (if he

[132] Tajti (n 10) 195.

[133] Tajti (n 10) 163.

doesn't hold it in pledge) and to dispose of it at a public or private sale, thereby creating a surplus (which must be returned to the debtor) or establishing a deficiency.“[134]

Therefore, a normal procedure for a US lessor after the debtor's default would be taking possession of the collateral without judicial proceedings which enhances his strategic position. This is why in the US, the lessee cannot hide, demolish or dispose of leasin object, which is one of the biggest problems of enforcement on vehicles in Croatia. Furthermore, after repossession, the burden of proof that the repossession was justified is not on the secured creditor, but on lessee.

The position of professor Grant Gilmore is that every modern security statute should recognize the right of the secured party to take possession of the vehicle on default. UCC Article 9-503 provides as follows:

„Unless otherwise provided a seecured party has on default the right to take possession of the collateral. In taking possession a secured party may proceed without judicial process if this can be done without breach of the piece or may proceed by action.“[135]

There is a difference in how repossession works in practice in the financing of business or consumer finance. While there is usually no problems with the repossession in businss financing, the consumer financing repossession is a difficult thing There the rules of fair play are often disregarded by both sides and it does not seems to be illegal. If there is resistance by the debtor to transfer possession, the secured creditor will invoke judicial help and have the

[134] Gilmore (n 120) 1183.

[135] Gilmore (n 120) 1212.

repossession done by an officer of the court. In addition, secured party does not have to give any notice of repossession to the debtor.[136]

Once the collateral is repossessed, its disposal can also be done extra judicially which is not the case in Croatia. The system tries to support the secured creditor, leaving him enough avenues to achieve effective enforcement. In the words of Grant Gilmore:

> „UCC opted for a loosely orginized, informal, everything-goes type of forececlosure pattern, subject to ultimate judicial supervision and control which is explicitly provided for.“[137]

Therefore, the lessor who wants to resort to self-help repossession can turn to court enforcement at any given moment and vice-versa.[138]

In practice, all these measures at disposal of secured creditors must, at least, sometimes lead to their abuse. Therefore, there are also efficient measures put in place to protect the debtor from possible abuses.

> „It is little known yet in fact the US system possesses more layers of protections of the debtor (lessee) starting from the federal and State (mini) Fair Debt Collection Practices Act, through the 'without the breach of the peace'[139] and the 'commercial reasonability'

[136] Ibid.

[137] Gilmore (n 120) 1239.

[138] UCC Section 9-601(c) (Revised Version 1999).

[139] The standard was intentionally left open ended. Accordingly, old cases are still of relevance. The gist of the standard is, as put by White and Summers, is that in general the creditor may not enter the debtor’s home or garage without permission. The debtor’s consent, freely given, legitimates any entry, conversely, the debtor’s physical objection bars repossession even from a public street. This crude two-factor formula of creditor entry and debtor response must, of course, be refined by a consideration of third-party response, the type of premises entered, and

standards, availability of punitive damages and other explicit rules sanctioning non-compliance[140], the limitations inherent to the 60% rule[141], the tort of conversion[142], and the protections afforded to debtors through a string of constitutional cases testing the compatibility of self-help and ex parte measures through the lenses of the due process clause[143] in the 14th Amendment."[144]

As this analyses is important for comparing with the situation in Croatia, it is important to emphasize that, absence of similar measures in Croatia might be a reason for ineffective enforcement.

When discussing the difference of the US and German model and which one would be more acceptable for Croatia to follow, Stummel's collection of model contracts offers the following approach:

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possible creditor deceit in procuring consent.' White & Summers, UCC (2010), ∫ 26-7, p 1335-36 as quoted from Tajti (n 10) 201.

[140] UCC Section 9-626, titled 'Remedies for Secured Party's Failure to Comply with Article.'

[141] As per the 60% rule, if the buyer (including a lessee) has paid 60% of the leasing installments or 60% of the loan, then the secured party (lessor) cannot keep the collateral (object of leasing) but must sell (dispose of) it. This is essentially a consumer-protection device. UCC 9-620 (3) as quoted from Tajti (n 10) 201.

[142] The wrongful possession or disposition of another's property as if it were one's own; an act or series of acts of willful interference, without lawful justification, with any chattel in a manner inconsistent with another's right, whereby that other person is deprived of the use and possession of the chattel, Black, H. C., Nolan-Haley, J. M. and Nolan, J. R., *Black's law dictionary* (St. Paul, Minn.: West Publishing Co. 1996).

[143] The US Supreme Court Cases dealing with the topic started with Fuentes v. Shevin (407 U.S. 67, 92 S. Ct. 1983, 32 L, Ed. 2d 406) that was decided in 1972 and with Mitchell v Grant (416 U.S. 600, 94 S. Ct. 1895, 40 L. Ed. 2d 406) from 1974 as quoted from Tajti (n 10) 201.

[144] Tajti (n 10) 201.

„First the lessor gets the right to terminate the contract with immediate effect if the lessee is late with more than two consecutive lease payments (installments) or with a significant portion thereof, or if the object was used contrary to contractual terms and despite written warning (s. 7(1)). Second, after default however, the lessor may only ?pursue the sale of the asset' – without the right to repossess it first. (s.7(2)). If the sales has proven to be unsuccessful, third, the lessor gets the entitlement to charge damages based on an expert opinion (s. 7(4)). A far cry from the right to repossess extra-judicially but, fourth, the lessor may charge default interest on overdue amounts at a higher rate (s. 3(2)).“[145]

The German type of enforcement offers more peaceful enforcement method, whereas in the US, the repossession professional (the „repoman“) will retry the self-help repossession as many times as necessary. It seems a little unrealistic that the German model presumes the debtor will cooperate with the secured creditor and allow the sale of object of enforcement from his premises or even return it voluntarily. Still it is difficult to say, which of the two models, German or the US, would be more easily applicable in Croatia, because of possible socio-economic differences.

4.3. Ex parte measures

Lessor that is worried that the debtor (lessee) might dispose of assets during a case, may seek a prejudgement remedy. The rationale behind this is to secure a judgement and make sure that the creditor will have enough or will have specific assets in debtor's possession to enforce the judgement. These measures are only efficient if the creditor actually wins the case.

[145] Stummel, D., 2003, *Standardvertragsmuster – zum Handels – und Gesellschaftsrecht (Deutsch-English) (*Munchen, Beck, contract No. 11) 387-395.

There were series of Supreme Court cases[146] decided from 1969 to 1975 that imposed significant due process limits on prejudgement remedies, as they are considered disfavoured for the debtor and thus, hard to invoke.

It is also worth inspecting whether the ex parte measures[147] could be an efficient substitute for self-help repossession.

Namely, if the courts could issue a provisional or interim measure and if it could function efficiently, the hypothesis is that it could efficiently take place of self-help repossession.

However, in Croatia, the courts only issue some non ex parte provisional measures[148] and they are usually left a dead letter on paper as it is very hard to achieve the standard of proof necessary for these to be awarded. Even if someone successfully obtains such a measure in court, it is very difficult to enforce.

4.4. Lessons for Croatia

It is difficult to say how different is the socio-economic environment of the US and the Croatian debtor and to what extent does this affect the applicability of certain measures. The risk of

[146] North Georgia Finishing v Di Chem, 419 U.S. 601 (1975) (commercial garnishment held unconstitutional, Mitchell v W.T. Grant, 416 U.S. 600 (1974) (sequestration statute upheld), Fuentes v. Shevin, 407 U.S. 67 (1972), Sniadach v. Family finance Corp. 395 U.S. 337 (1969) (wage garnishment law held unconstitutional), Connecticut v. Doehr, 501 U.S. 1 (1991) (real estate attachment held unconstitutional); as quoted from Tabb, C. J. and Brubaker, R. (no date) *Bankruptcy law : principles, policies, and practice*. Cincinnati, Ohio : Anderson Publishing Co., c2003., 41

[147] Done or made at the instance and for the benefit of one party only, and without notice to, or arhument by, any person adversely interested, as defined in Black, H. C., Nolan-Haley, J. M. and Nolan, J. R., *Black's law dictionary* (St. Paul, Minn. : West Publishing Co. 1996).

[148] Article 331-355 Enforcement Act (n 39).

debtor hiding, demolishing or disposing of vehicle is present in the US the same as it is in Croatia. However, it seems that by keeping all the avenues open for the secured creditor, UCC Article 9 effectively combats these risks.

The sign of how big the need for a change of leasing industry and enforcement measures in Croatia is, is also the fact that creditors (lessors) often resort to measures that resemble of US self-help repossession but are on the verge of illegality. In these cases lessors take the role of the US "repoman" and reach for self-help measures.

There are also other instruments that can be adopted into civil law legislation that might further promote a leasing-supportive legal environment. One such example is also "Hell or High-water clauses"[149]. This is an instrument that has proved to be very effective in US financial lease transactions.

> "The main economic benefit of properly working hell and high-water clauses is that banks and other financial organizations that are interested in profiting from lending money but do not want to be entangled in warranty disputes – may appear on the equipment leasing market. More participants competing on the same market reasonably would result then in more favorable interest rates and better terms and conditions for leases as well. Eventually the pricey leasing that could not be afforded by small and mid-scale start-ups might very shortly be replaced by affordable ones upon the entry of such new financiers on the leasing market." [150]

[149] As defined by Black's Law Dictionary „a clause in a personal property laws requiring the lessee to continue to makle full rent payments to the lessor even if the thing leased is unsutable, defective or destroyed.

[150] Tajti (n 10) 209.

The main question still remains - what is Croatian legislator ready to do to boost the local industry and market? Even if the legislator adopts a more efficient enforcement measures, it would all be in vain without a strong, effective and independent judicial power.

It would also be useful to mention that leasing should be primarily looked at as a "secured transaction" and not a contract. This can be achieved by adopting a "Unitary model" such as European soft law instrument – the Draft Common Frame of Reference[151]. What this would achieve is that all secured transactions would be subject to same set of rules which make the whole system more predictable and it is harder to avoid any of the rules.

As shown above, it is clear that the leasing industry in Croatia needs change. There are sufficiently developed model industries that seem to have grasped the real problems of lessors with enforcement on vehicles and have put in place adequate solutions to tackle these problems. It is up to Croatian legislator and the courts to notice the need for a change and to make use of the available models.

[151] Christian von Bar (n 8).

Conclusion

The focus of the paper was to emphasize the problems of lessors when conducting enforcement proceedings on vehicles in Croatia, with special focus on Germany and the US as model jurisdictions whose solutions should be followed in future changes to relevant legislation.

Through this comparative analysis, the author singled out some of the key advantages and disadvantages of analyzed systems, as well as exemplified with case law the practical side of leasing and crucial problems of lessors in Croatia.

It is clear from the paper that the main problems of lessor result from inadequate legislative solutions mainly related with enforcement proceeding on vehicles. The legislation is often subject to change, making the system unpredictable and ineffective. Difficulties faced in locating vehicles, placing the burden of locating only on creditor, threatening the creditor on every corner to suspend the enforcement if he does not comply with the strict rules, courts not using available measures to punish the uncooperative debtor and enabling the debtor to hide, demolish or dispose of object of leasing, are only some of the difficulties faced by lessors in Croatia. The solution to the legislative problems might be found in German or the US enforcement model.

The analysis has shown that the solutions of the German model are not as revolutionary as the US ones, whereas the difference between what we already have in Croatia and Germany are mostly of technical nature, not the substantive one. This can especially be seen in the willingness of German courts to support the creditor's aim of reaching a successful enforcement on vehicles before the debtor gets in a position to hide, demolish or dispose of object of enforcement. However, it is precisely the small technical details that make a difference between an effective enforcement and an ineffective one.

However, both Germany and Croatia seem to have put in place a more peaceful enforcement measures, expecting a cooperative debtor that will give up the vehicle voluntarily or let the creditor peacefully approach debtor's premises, confiscate and sell the vehicle. It is in the US secured creditor's ability to resort to a wide panel of enforcement measures, where benefits of the UCC Article 9 "Unitary model" come to the fore. Namely, the US enforcement model supports the secured creditor with a great number of enforcement measures that allow him to change from one to the other to secure their full effectiveness. Self-help repossession, ex parte measures, hell and high-water clauses, switching to court enforcement just to name a few.

However, to be able to track the effectiveness of any of these measures, more serious mechanisms need to be put in place to be able to keep track of data and trends. Without empirical data, it is only a hypothesis to say whether possible socio-economic differences in each of the jurisdictions would strongly influence the effectiveness of the measures. Therefore, something that is acceptable in one country does not have to be acceptable in another. That being said, we can see some positive changes in adopting a "Unitary model" through a European soft law instrument – the Draft Common Frame of Reference[152]. What this would achieve is that all secured transactions would be subject to the same set of rules which makes the whole system more predictable and it makes it harder to avoid the rules with already makes one step closer to the UCC Article 9 model.

It is up to the Croatian legislator to choose which of the analyzed measures or models would be appropriate in Croatia, considering the socio-economic context. However, one thing remains true, to reap the benefits of, once one of the fastest developing industries, the leasing industry in Croatia needs change and more space for self-development. To achieve this, Croatian

[152] Ibid.

enforcement regulations once again need change. However, this time the change needs to be effective and correspond to one of the more successful models and not the political aspirations of a few.

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