Guidelines on Credit Risk Mitigation

Legal Framework in Slovenia

These guidelines were prepared by the Oesterreichische Nationalbank (OeNB) in cooperation with the Financial Market Authority (FMA)

We would like to point out that the nature of these Guidelines is intended as merely descriptive and informative. These Guidelines do not – and cannot – make any statements on the requirements imposed by supervisory authorities on credit institutions as regards their treatment of credit risk mitigating methods. Decisions by the competent authorities may diverge from the presentation given in these Guidelines. Furthermore, the Editors would like to point out that these Guidelines have been drafted with consultation by Slovenian jurists and were translated from German into English. Despite the great care taken, the editors do not assume any warranty or liability for the contents, for the selection of the collaborators or for the translation. These Guidelines are intended to serve as an initial source of information and by no means replace a consultation with experts in Slovenian law. The Guidelines refer to the legal situation as at 1 April 2004.

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Editor in chief:

Günther Thonabauer, Secretariat of the Governing Board and Public Relations (OeNB)
Barbara Nösslinger, Executive Board Affairs and Public Relations (FMA)

Editorial processing:

Andreas Höger, Wolfgang Spacil, Florian Weidenholzer (all OeNB)
Ursula Hauser-Rethaller, Christine Siegl (all FMA)

Design:

Peter Buchegger, Secretariat of the Governing Board and Public Relations (OeNB)

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Inquiries:

Oesterreichische Nationalbank
Secretariat of the Governing Board and Public Relations
Vienna 1090, Otto-Wagner-Platz 3
Postal address: Post Office Box 61, Vienna 1011
Phone: (+43-1) 40420-6666
Telefax (+43-1) 40420-6696
Austrian Financial Market Authority (FMA)
Executive Board Affairs and Public Relations Division
Phone (+43-1) 24959 /5100

Orders:

Oesterreichische Nationalbank
Documentation Management and Communication Systems
Vienna 1090, Otto-Wagner-Platz 3
Postal address: Post Office Box 61, Vienna 1011
Phone: (+43-1) 40420-2345
Telefax (+43-1) 40420-2398

Internet:

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Preface

The spreading use of innovative financial products such as securitized assets and credit derivatives and the growing volume of investments in Central and East European countries by Austrian companies is changing the face of the Austrian banking sector.

The Guidelines on Credit Risk Management have been drafted to help banks accomplish the changes to their systems and processes needed for the implementation of Basel II and as a source of information on the general market conditions in Central and Eastern Europe. A number of Guidelines were published in the course of the year 2004 on the topics of securitization, rating models and validation, the credit approval process and credit risk management as well as credit risk mitigation methods.

The aim of these Guidelines is to achieve a common understanding between supervisory authorities and banks regarding the upcoming changes in the banking industry. In this context, Oesterreichische Nationalbank (OeNB) and the Financial Market Authority (FMA) view their role as that of partners for the domestic banking community.

This series of Guidelines entitled Credit Risk Mitigation, Legal Framework in Central and Eastern Europe has been drafted with the collaboration of many renowned experts from the respective countries and is designed as an introduction to security law in each country for banks operating in those countries – or planning to launch operations there – as well as for their customers. The Guidelines describe the requirements of the most frequent types of credit security and the problems that may arise in this context.

We hope that the Guidelines on Credit Risk Management will be of interest to readers and will foster a more efficient discussion of developments in the Austrian banking sector.

Vienna, February 2006

Univ. Doz. Mag. Dr. Josef Christl
Member of the Governing Board
of Oesterreichische Nationalbank

Dr. Kurt Pribil,
Dr. Heinrich Traumüller
Management Board of FMA

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I. Introduction

These Guidelines look at the **most important instruments used for securing credit risk** that are available under Slovenian law. This Chapter provides a brief outline of the Slovenian legal system followed by a detailed examination of the methods available for the realization of security interest. The individual chapters look at the specific details of the realization for each type of security.

II. General

The issue of credit security has recently received much attention in Slovenia. A number of cases of abuse that occurred in connection with security instruments (mortgage loans) have highlighted the need for stricter rules. Amendments to current legislation providing for stricter rules for certain types of security rights and legal transactions (e.g. law on consumer credit) are already being drafted. In addition, greater accountability is to be imposed on all parties involved, specifically notaries, and more stringent formal requirements will be introduced.

III. Legal Sources

A. General

The Slovenian legal system is part of the legal system of continental Europe, in which laws govern all important areas. The highest-ranking source of law is the constitution from the year 1991, which, among other things, protects the right to private property. The majority of laws that are in force today was passed in the time after the year 1991, in which Slovenia declared its independence and fundamentally restructured its legal system along with its political and economic systems. In addition to laws, a large number of implementing decrees have been passed since then. It is required that both sources of law be published in the Official Gazette (*Uradni list Republike Slovenije*). In addition, they are accessible to the public at the website of Slovenia's national assembly (*državni zBor*).[1]

Under the constitution, it is illegal to pass laws or regulations with retroactive effect. In exceptional cases, a single legal provision may be passed retroactively if this is in the public interest and does not interfere with previously acquired rights. In practice, such cases do not arise, however. The responsibility for reviewing laws as to their constitutionality and evaluating implementing decrees as to their conformity with the law lies with the constitutional court (*Ustavno sodišce Republike Slovenije*).

On 1 May 2004, Slovenia joined the EU. By that date, almost all EU directives had been passed into Slovenian law. Under Section 3a of the Slovene Constitution, exercise of a part of the sovereign rights may be transferred to international organizations by a special procedure. Like in Austria, applicable legislation must comply with EC and EU treaties, directives, regulations, and other EC and EU legal acts as well as other international treaties.

[1] See www.dz-rs.si.

B. Legislation Relating to Credit Risk Mitigation

Credit risk mitigation instruments are regulated by a number of laws, most of which were enacted after Slovenia's declaration of independence in 1991. Due to the need to harmonize legislation with the EU's acquis communautaire, some of these legal provisions have already been modified several times and adapted to EU standards. Beside the regulations defining the various credit risk mitigation instruments, laws laying down the procedures for the realization of security rights (e.g. execution, entry in the land register or any other record) as well as laws laying down certain formal requirements (e.g. notarial act) play an important role. Beside the regulations defining the various credit risk mitigation instruments, laws setting out the procedure for realizing security rights (e.g. execution, entry in the land register as well as laws laying down certain formal requirements (e.g. notarial act) play an important role.

Among the most important laws[2] regulating or at least touching on credit security rights are

- The Banking Act (Zakon o bancništvu, zban),
- The Obligations Code (*Obligacijski zakonik*, OZ),
- The Code of Property Law (*Stvarnopravni zakonik*, SPZ),
- The Act on Execution and Security Rights (*Zakon o izvršbi in zavarovanju*, ZIZ),
- The Act on Bankruptcy, (Forced) Composition and Liquidation (Zakon o stecaju, prisilni poravnavi in likvidaciji, ZPPSL),
- The Act on Companies' Financial Conduct (Zakon o financnem poslovanju podjetij, ZFPP),
- The Consumer Protection Act (*Zakon o potrošnikih*, ZVPot),
- The Act on Consumer Credit (*Zakon o potrošniških kreditih*, ZPotK),
- The Act on the Securities Market (Zakon o trgu vrednostnih papirjev, ZTVP-1),
- The Act on De-materialized Securities (*Zakon o nematerializiranih vrednostnih papirjih*, ZNVP),
- The Land Register Act (*Zakon o zemljiški knjigi*, ZZK-1),
- The Act on Business Companies (*Zakon o gospodarskih družbah*, ZGD),
- The Notaries Act (*Zakon o notariatu*, ZN) and
- The Act on the Protection of Buyers of Apartments and Single-family Homes *(Zakon o varstvu kupcev stanovanj in enostanovanjskih stavb,* ZVKSES)

IV. Key Institutions in the Field of Security Interest

A. General

Among the key institutions whose work has a bearing on security interest are the National Bank of Slovenia (Banka Slovenije), the Securities Agency (*Agencija za trg vrednostnih papirjev*), and the Consumer Protection Office (*Urad za varstvo potrošnikov*), which will be briefly discussed in more detail below.

B. Banka Slovenije

The most important body is the National Bank of Slovenia (Banka Slovenije). This legal entity is governed by an act passed in 2002 (*Zakon o Banki Slovenije*)

[2] The issues of the Official Gazettes are given in the Annex, which contains a full list of legal sources.

and is wholly owned by the state, and enjoys autonomy in financial and administrative matters. It is responsible for the following tasks in relation to monetary policy:

- Determination and implementation of monetary policy
- Defining and controlling the money supply;
- Responsibility for providing liquidity to the banking system
- Participation in transactions on the foreign exchange and financial markets
- Deposit facilities for banks and savings institutions;
- Opening accounts for banks and savings institutions and;
- Regulation of payment systems

In addition, it exercises oversight over banks and savings institutions.

C. Securities Agency

The Securities Agency (*Agencija za trg vrednostnih papirjev*) has important responsibilities with regard to securities and takeovers as well as matters relating to funds and asset management companies. This legal entity is regulated by the Securities Market Act and has the status of a public agency.

D. Consumer Protection Office

The Consumer Protection Office (*Urad za varstvo potrošnikov*) is subject to oversight by the Ministry for Economic Affairs and was established under the Consumer Protection Act (*Zakon o varstvu potrošnikov*, ZVPot). Its responsibilities include the preparation of an annual program that is adopted by the government of the Republic of Slovenia based on a national consumer protection program. The Consumer Protection Office includes an advisory board that participates in the drafting of the annual program, deals with other matters falling within the competence of the Office, and submits comments and proposals to the Office Director.

E. Jurisprudence

The judicial system in Slovenia comprises four different types of courts organized in three levels. At the first level, there are two different types of courts: district courts (Okrajno sodišce) and regional courts (Okrožno sodišce).

District courts have jurisdiction in civil matters if the amount in dispute does not exceed 2,000,000 tolar. Regardless of the amount in dispute, the district courts have jurisdiction over the following matters:

- Disputes about statutory alimony (if not settled in the course of divorce proceedings)
- Disputes about property, and disputes about easements and encumbrances on property
- Tenancy disputes

District courts also have jurisdiction over execution proceedings and alternative dispute resolution proceedings

Regional courts have jurisdiction when the amount in dispute exceeds 2,000.000 tolar and when, regardless of the amount in dispute, the following matters are involved:

- Family law;
- Copyright law and industrial property rights;

- Disputes in trade matters;
- Disputes in connection with bankruptcy.

Regional courts are also responsible for national and international legal aid, for aid in relation with the costs of court proceedings, and for decisions relating to the recognition and enforceability of judicial decisions and arbitration awards originating in other countries.

The second level of the judicial system is the **court of appeal** (Višje sodišce), which hears appeals against decisions passed by courts of the first instance.

The highest level (instance) of the Slovenian judicial system is the Supreme Court (Vrhovno sodišce Slovenije). This court hears appeals against decisions passed by the court of appeal, petitions to resume proceedings and nullity appeals filed in protection of the law.

In addition, labor and administrative courts have been set up as special courts.

V. Real and Personal Security Rights[3]

The theory distinguishes between **personal** security, which involves a personal obligation (*osebna zavarovanja*) and **real** security or collateral (*stvarna zavarovanja*). These two types of security differ in several regards. While personal security can only be granted between two parties (*inter partes*) but not vis-á-vis third parties, collateral is effective vis-á-vis everyone (*erga omnes*).

A collateral right gives creditors **priority in the satisfaction of their claims** from the asset constituting the object of the respective right. Such priority involves the right to satisfy one's claim from the asset concerned before a debtor's other creditors and may normally[4] be enforced in the event of the debtor's bankruptcy.

Personal security likewise offers creditors satisfaction, but does **not** provide them with a **preferred status** vis-á-vis any other creditors.

Under Slovenian law, the principal types of personal security are:

- Suretyship (*poroštvo*)
- Bank guarantee (*bančna garancija*)
- Additional assumption of debt (*pristop k dolgu*)

Under Slovenian law, the principal types of real security are:

- Mortgage (*hipoteka*)
- Land charge (*zemljiški dolg*)
- Possessory and non-possessory lien on movable property (*ročna in neposestna zastavna pravica na premičninah*)
- Lien on property rights (*zastavna pravica na premoženjskih pravicah*)
- Lien on securities (*zastavna pravica na vrednostnih papirjih*)
- Assignment of movable property as collateral (*fiduciarni prenos premicnin v zavarovanje*)
- Assignment of claims as security (*fiduciarna cesija v zavarovanje*)

[3] For more details on Slovenian theory see Tratnik/Rijavec/Keresteš/Vrenčur: Stvarnopravna zavarovanja, IARS Maribor (2002); Galič/Jan/Jenull: Zakon o izvršbi in zavarovanju, komentar, GV Založba, Ljubljana (2002); Cigoj: Teorija obligacij, CZ Uradni list RS, Ljubljana, (1988); Trstenjak: Pomen stavbne pravice za pravo nepremičnin, Podjetje in delo, 5-6/1995, 580-587.

[4] An exception is stipulated for claims to seperate satisfaction that were created within two months before adjudication of bankruptcy proceedings. These claims expire with the adjudication of bankruptcy proceedings.

The parties' decision on what type of security is influenced by several factors. Among these factors are who is in possession of the asset involved, the need to observe formal requirements, procedural requirements, type of realization, as well as the role and the involvement of the court and other governmental agencies.

A more detailed discussion of all of the security instruments mentioned is given below. This discussion is preceded by a brief overview of how security rights may be realized.

VI. Realization of Security Rights

A. General

Real security differs from personal security in that an individual who provides a creditor with real security is liable only with the security furnished and not, without limitation, with all of his or her assets (liability in rem). By contrast, the personally liable debtor is liable to the creditor with all of his or her assets.

A debtor may also be liable personally and in rem at the same time. This is the case when a borrower pledges to the bank a specific object to secure a debt for which he or she is already liable with his or her entire assets.

B. Realization of Collateral

1. General

Collateral may be realized in several ways depending on the type of security involved. Generally, an executory title is needed before a security can be realized. Such an executory title may be obtained in various ways.

2. Realization of Mortgage and Land Charge

In the case of a **conventional mortgage**, the executory title is obtained by instituting **foreclosure action**. In addition, a mortgage may be created in the form of a **notarial act**, which is directly enforceable. In this case, it is not necessary to file for foreclosure, as the enforceable notarial act is in itself an executory title permitting the direct realization of the security.

In both cases, however, a court has to be involved in the realization of the security. Currently, there are deliberations about introducing the option of permitting mortgages in the form of a notarial act that may be realized by a notary public, but this is not (yet) possible due to the lacking a legal basis.

The **land charge certificate**, by virtue of being a security, is in itself an executory title. It is realized in accordance with the rules governing the realization of real property and requires the involvement of the court.

3. Realization of Movable Property

a. Possessory Lien

The asset pledged may be realized either in court proceedings or in out-of-court proceedings. Out-of-court realization of an asset under possessory lien is possible when a written agreement to this effect was concluded. In the absence of such an agreement, the pledged asset has to be realized in judicial proceedings.

In commercial transactions, such an agreement covering the realization of pledged assets is presumed to exist. A commercial transaction is an agreement entered into between two entrepreneurs (legal entities or sole proprietors). If a bank does business with a private customer (an individual not being an entrepreneur), such business is not deemed to be a commercial transaction.

b. Non-possessory Lien

The execution of liens entered in a register, one possible type of the non-possessory liens, differs from the realization of movable pledges. Such a registered lien is created by a notarial act, which is directly enforceable. This is important for the bank in the role of lienor in order to be able to take possession of the pledged object. As soon as the bank is in possession of the asset, the rules governing possessory liens apply along with the assumption applicable to commercial transactions that an agreement exists permitting out-of-court realization.

c. Rights

A **lien on rights** can likewise be realized in different ways. In the case of receivables, the bank has the right to collect them from the third-party debtor. In the case of other rights, judicial proceedings are required. With securities, the situation is similar. De-materialized securities may be realized through execution proceedings at the organization managing these securities. In Slovenia, this is the clearing and safecustody organization (*Klirinsko Depotna Druzba*, KDD). In order to be able to execute a claim, an executory title is required, which may be a court order or an executable notarial act.

4. Advantages of collateral

The essential advantage of real security over personal security is the fact that real security grants the creditor bank holding the security a **priority position** regarding the **satisfaction** of claims in execution and bankruptcy proceedings. Therefore, the bank's claims will be redeemed prior to all subordinate or unsecured creditors, whose claims will be satisfied only after the creditor holding real security has been fully satisfied.

C. Realization of Personal Security

Realization of personal security may extend to all assets of the person being personally liable. However, liability is limited by the amount of the claim. Personal security does not grant any privilege to the preferred satisfaction of a claim. In execution and bankruptcy proceedings, a bank holding personal security has the same status as all other creditors and is subordinate to creditors holding real security. Only in execution proceedings instituted by a creditor holding personal security may such a creditor obtain preferred status by having a mortgage with an execution note entered in the land register.

An **executory title** may be **obtained** in two ways: first, by a **directly enforceable notarial act**, in which the debtors agreed to immediate execution; second, by taking action against the debtor in **civil proceedings** in order to obtain an executory title in the form of a judgment. Following this, execution proceedings may be instituted against the debtor.

Generally, the bank may petition for execution proceedings against any type of asset (movables, real property, accounts receivable), but, given the restrictions on execution, only certain items can actually be seized. The following objects are **exempt from execution**:

- Personal items such as clothing, furniture and other vital matters such as heating material and fuel for six months;
- In the case of farmers, animals and equipment required for farming as well as seed and feed for four months;
- In the case of scientists or artists, the objects required for exercising their profession;
- Cash in the amount of the subsistence minimum;
- Medals and distinctions;
- Personal letters and photographs;
- Special appliances for handicapped persons.

Objects belonging to legal entities and sole proprietors are in general not subject to any restrictions. However, **production resources** required for regular production cannot be seized. Other assets of an enterprise are exempt from execution if they are required for keeping production going for one week.

Up to two-thirds of a **debtor's salary** is subject to execution if the debtor retains a certain minimum amount (about SIT 111,484 gross).

Execution against the assets of a **farmer** is subject to the rule that land and buildings are exempt from execution of they are required for the **family's subsistence**.

The above restrictions do not apply, however, if the items concerned were pledged under a contract.

Court proceedings in Slovenia may take a very long time. However, unlike certain types of pledges, personal security cannot be realized by out-of-court proceedings.

D. Scope of a Claim

When realizing assets, the general rule is that the **costs of the proceedings** have to be covered **first**. Any remaining proceeds are then applied against **accrued interest** and only then against the **claim itself**. In the event of **default**, the debtor also has to pay interest on arrears. The applicable **rate of interest** is laid down by law and is currently **15,5%**. The interest rate may also be agreed by contract provided the rate is not usurious.

E. Realization in the Event of Bankruptcy

The bank's position in the event of bankruptcy differs greatly depending on whether it holds personal or real security. Real security provides the creditor with a special right to separate satisfaction in bankruptcy proceedings. Even when a creditor having received a fiduciary transfer of title (assignment as collateral) is actually the owner of the asset, said creditor is only entitled to preferential treatment and does not have a claim to segregate assets of the bankrupt's estate, as this would enable the bank to segregate its assets from the bankrupt's estate and not being part of the realisation proceedings. All other creditors are

treated as **ordinary creditors in bankruptcy** and are therefore entitled only to a pro-rated settlement of their claims from the bankrupt's estate. This means that their claims are only partly satisfied. The same applies to creditors holding personal security.

Chapter 2: General Remarks on Liens

I. Introduction

Under Slovenian law, liens can be created on movables, real property, or rights. This chapter discusses the principles of the law governing liens, which apply to all types of liens equally. The subsequent chapter covers liens on movables. Separate chapters examine mortgages and land charges, which are special forms of liens on real property. Finally, liens on rights are explained in detail.

II. General

A. Nature

Under Slovenian law, a lien (*zastavna pravica*) is a property right giving the lienor – in the event a borrower defaults on a secured claim when it falls due – the right to satisfaction of his or her claim including interest and costs by taking recourse on the **value** of the **pledged item** prior to other creditors of the lienee who hold only personal security or subordinated real security.

For the bank, this type of security provides an advantage as it allows the bank to act in a dual capacity: on the one hand, it holds a personal claim against the borrower under the loan and, on the other hand, it is a creditor in rem under the lien. Regardless of the personal debtor's solvency, in the event the debtor defaults on its claim, the bank may satisfy its claim at any time from the pledged asset. The personal debtor and the real debtor need not necessarily be one and the same person. Rather, a lien may be placed on an asset to secure one's own or a third party's claim. Likewise, a lien may be created as security for **existing, future or conditional claims.** As an **accessory right**, the existence of a lien depends largely on the existence of the secured claim.

A change in the owner's status generally[5] has no impact on the lien and on the bank's ability to satisfy its claim. Even if the object of the lien is sold, the lien on the item continues to exist. In the case of multiple liens, the principle of priority has to be observed. Real rights created earlier enjoy priority over rights established at a later date.[6] This precedence, which also has to be taken into account in execution proceedings, allows the claims of the creditor ranking first to be fully satisfied from the proceeds of the sale of the pledged object before other claims are considered.[7]

The person granting the lien may be the personal debtor, i.e., the borrower, or a third party who is merely the real debtor.

B. Scope of the Security Right

A lien secures a claim up to the value of the object on which the lien is placed. This security, however, is often not sufficient to satisfy the claim. Whether or not the security is adequate depends primarily on the value of the object pledged. If the value is lower than the claim secured, the claim will not be fully satisfied. The

[5] Exeptions exists for bona fidae acquisitions stipulated by law and the sale of movabel property in execution proceedings and for real estate in execution and bankruptcy proceedings. (cf Sect. 64 SPZ, Sect. 96/V, Sect 173/1, Sect 89,96, ZZK-1)

[6] The principle of priority is set out in Sect. 6 SPZ. Special provisions for liens are laid down in Sect. 128(1) SPZ.

[7] Cf. Sect. 198 ZIZ for immovable property, Sect. 98 ZIZ for movable property. Also cf. Sect. 136 SPZ.

lower ranking of the lien may also prevent full satisfaction of a claim. When several liens have been placed on an object, the order in which claims are satisfied depends on the time the lien was created.[8] A lienor whose lien was created later has to expect that the proceeds from the sale of the asset may have been exhausted by the satisfaction of prior secured claims to such an extent that full settlement of the own claim is no longer possible. This fact has to be taken into account even before creating a lien at the time the object to be accepted by the bank as security is being appraised.

III. Assets that may be subject to Liens

The object of a lien may be a physical object, a right or a security.[9] It is essential that the object of the lien be an asset over which the lienee is free to dispose. Depending on the asset, a lien can be created on immovable objects, also called a mortgage (*zastavna pravica na nepremicninah, hipoteka*), on movables (*zastavna pravica na premicninah*) and on rights (*zastavna pravica na pravicah, pignus nominis*). Liens on movables may be either possessory liens (*ročna zastavna pravica, pignus*) or non-possessory liens (*neposestna zastavna pravica*).

Special rules apply to liens on vessels and aircraft as well as on the lien on securities. Liens on bearer securities are subject to the rules governing liens on movables. Whereas payment order instruments are pledged by endorsement and delivery, and non-negotiable instruments are pledged in accordance with the rules governing liens on rights.[10]

In this connection, reference is made to the Slovenian law governing execution proceedings, which contains special provisions for certain types of assets. Some items (clothes, shoes, linen, simple household appliances, food, heating materials, etc.) are exempt from execution, while others are subject to certain restrictions (e.g. the equipment of a business or legal entity required for practicing a trade). Exempt from execution is also agricultural land and agricultural buildings that are indispensable for the subsistence of the farmer, the immediate family and any individuals dependent on the farmer's support. It should be noted that the exemptions and restrictions on execution apply only with regard to statutory or judicial liens (see Chapter 1). They have no effect on liens agreed by contract.[11]

IV. Creation of Liens

A. Types of Creation

For the establishment of a lien, Slovenian law applies the principle of title and mode of acquisition (delivery) from the General Civil Code. A lien can be created by a legal transaction (*pogodbena zastavna pravica*, **contractual lien**), law (*zakonita zastavna pravica*, **statutory lien**) or court order (*prisilna zastavna pravica*, **judicial lien**). While a statutory lien is created at the time the condi-

[8] Tratnik, Stvarnopravni zakonik, 112.
[9] § 128(3) SPZ.
[10] Tratnik, Stvarnopravni zakonik, 57.
[11] Pursuant to Sect. 177(2), Sect. 80(2), and Sect. 79(3) ZIZ.

tions laid down by the law are met, a judicial lien is created when a judgment acquires legal force, unless otherwise provided for by the law.[12]

B. Agreement Creating an Obligation (Title)

The creation of a lien based on an agreement presupposes a valid legal transaction[13] laying down the obligation to create a lien and to perform the other conditions specified by law. The valid legal transaction (agreement creating an obligation or title) is executed by entering into a lien agreement governed by the law on obligations.

C. Disposition and Mode of Acquisition

The creation of a contractual lien presupposes the owner's willingness to have a lien placed on the object being pledged. The declaration of the owner's intent constitutes the disposition.

When **movable property** is pledged, the **disposition** is a bilateral informal transaction, which is **associated with a mode of acquisition** and therefore not visible externally. The mode of acquisition consists in the **delivery of the movable asset** into the direct possession of the lienor or the possession of a third party in a way that allows only the lienor to demand surrender of the pledged item from said third party.[14] It follows that constructive bailment of assets based on an agreement or a mere symbolic delivery does not suffice as a mode of acquisition to create a possessory lien.

In the case of **real estate**, the **mode of acquisition** consists of the **entry** of the lien into the **land register.**[15] Unlike in the case of liens on movables, **disposition transactions** relating to immovable property are subject to strict formal requirements. With real property, the disposition transaction is evidenced by a document that has to show, apart from other data, an unconditional unilateral **declaration of intent** by the lienee to create a mortgage on the immovable property. In addition, the document has to show the notarized signature of the person making the declaration. It is only based on such a document, i.e., a so-called "*clausula intabulandi*" that an entry in the land register may be made. For the disposition to be effective, it is assumed that the lienee has the right of disposition (*razpolagalna moc*) over the item being pledged.[16]

[12] An example of a judicial lien that is not created by a court order attaining legal force is the mortgage. Under Sect. 143 SPZ, a judicial mortgage is created only upon entry of the court order in the land register.

[13] From this provision it may be derived that there is causal relationship between title and mode.

[14] Cf. Sect. 155 SPZ.

[15] Cf. Sect. 143 SPZ.

[16] Cf. Sect. 133 SPZ.

Chapter 3: Lien on Movable Property

I. General

A lien on movable property may be designed as a possessory lien or a non-possessory lien. The former is also called a pawn. The only condition that must be met to create a lien is the delivery of the asset concerned into the possession of the lienor or a third party. There are no special formal requirements that have to be met. For the creation of a non-possessory lien on a movable asset by contrast, a notarial act is required. Only items to which suitable identification can be affixed can be entered into the register. In practice, this applies specifically to motor vehicles and pets. Aircraft and vessels, and de-materialized securities are likewise subject to a registration system that is similar to the land register.

II. The Possessory Lien

A. General

The Slovenian Property Code (SPZ; Sect. 155 - 169) governs the possessory lien (rocna zastavna pravica, pignus). Its creation requires a title and mode of acquisition. While the lien agreement represents the title – an informal consensual contract – the mode of procedure is the delivery of the movable asset into the immediate possession of the lienor. The mode of acquisition may also take the form of delivery of an asset to a third party, who, however, may surrender the item only if so instructed by the lien creditor.[17]

Any asset that is not real property or part of real property is deemed to be movable property.[18] The lien also extends to the components and accessories of the movable item.[19]

The significance of possessory liens as security for securing credit is minor in practice. Much more common is the non-possessory lien on movables and the fiduciary transfer of title.

B. Problems with Liens on Movable Property

1. Possession

The key characteristic of a possessory lien is the actual possession of the item pledged. The object encumbered by a lien has to be physically delivered to the lien creditor or a third party. Thus, the creation of a possessory lien through **constructive bailment[20] is not possible**, as is also explicitly laid down by law.[21] When the pledged item is returned by the lienor voluntarily to the possession of the lienee, the lien extinguishes.[22] This illustrates that direct possession of the pledged item by the lien creditor or a third party is an essential element of a possessory lien.

[17] Cf. Sect. 155 SPZ.
[18] Cf. Sect. 18 SPZ.
[19] Pursuant to Sect. 16 SPZ, all components are deemed to be material and/or accessory.
[20] With constructive bailment, the asset remains in the lienee's possession. Real delivery does not take place.
[21] Also see Keresteš in Tratnik/Rijavec/Keresteš/Vrenčur, Stvarnopravna zavarovanja, 192 and Tratnik, Stvarnopravni zakonik, Uradni list RS, Ljubljana (2002), 123.
[22] Cf. Sect. 168 SPZ.

A lien creditor acting it good faith acquires the pledged asset rightfully even if the lienee is not entitled to dispose of it, but the asset is in the possession of the lienee in accordance with the intent of its actual owner. Likewise, the lien creditor acting in good faith acquires a first-ranking lien if he or she did not know of the existence of other liens and the movable item was in the lienee's possession.[23]

The pledge extinguishes when the claim secured by it has been satisfied in full. As of that moment, the lien creditor looses the right to its direct possession and has to return the pledged item to the lienee or enable him or her to recover it from a third party's direction possession. During the entire life of the lien, the lienee may ask the court to instruct the bank to return the pledged item if the lienee urgently requires it to meet his or her needs and procures other suitable security for the lien creditor. Whether such other security is suitable is subject to the decision of the court.

2. Rights and Obligations of the Bank

The **bank** or the third party must hold the pledged **movable asset** in safekeeping in accordance with the practices of a **prudent businessperson**. Any costs incurred in safekeeping the item are added to the claim being secured. The bank does not have the right to use the pledged item or to deliver it to a third party for its use or for further pledging, unless expressly authorized by the lienee. In the latter case, the bank is liable for any accidental perishing of or damage to the asset.[24]

If the pledged item is not properly preserved by the bank or the third party, used without permission or made available for use by someone else, is not used or treated as agreed, the lienee may bring action for surrender of the movable item by the lienor and for its delivery to a third party who will hold it at the bank's expense.

By contrast, the lienee is liable for any material or legal defect of the pledged item that the bank is unaware of at the time the lien agreement was executed. The same applies if the bank was aware of an existing defect but the defect was not corrected despite a promise to do so before delivering the item into the bank's possession and the pledged item therefore does not provide adequate security. In either case, the bank may ask the lienee to provide other suitable collateral.

The lienee acquires ownership in the fruits of a pledged movable asset, which during the life of the lien are separated from the principal pledged asset. The parties to the agreement, however, may agree that ownership in the separated fruits may rest with the lien creditor; in such case, the secured claim is reduced by the value of the fruits.[25]

If the asset deteriorates, loses its value or if there is a risk that it will not provide the bank with sufficient security, the lien creditor may ask the court to sell the item early by public auction or private sale at the price quoted at the stock exchange or the market price. The proceeds from the sale are distributed to the bank taking into account any discount adjusting the amount to the value at the time of the maturity of the claim. The pledger may prevent an early sale by offer-

[23] Cf. Sect. 156 SPZ.

[24] Tratnik, Stvarnopravni zakonik, 125.

[25] Here the special offsetting rule applies according to which the value of the fruits is applied first against the safekeeping costs incurred by the lienholder, then against interest, and finally against the principal.

ing adequate substitute security to the bank.[26] Moreover, the lienee may ask for an early sale if a favorable opportunity for selling the item at a certain price to a certain party comes to his or her attention. In this case, the court likewise decides on the sale and transfers the proceeds of the sale - less a discount – to the bank.[27]

During the life of the lien, the bank enjoys the same legal protection as the owner.

3. Multiple Liens

A movable item (*večkratna zastava premičnine*) may be subject to several liens. The subordinate lienor's lien is acquired the moment the lienee notifies the bank having the item in its direct possession or the third party having direct possession of the item. On full settlement of its claims, the bank having possession of the item has to deliver it to the next-ranking lien creditor of whose existence the bank had been advised.

C. Realization of Liens on Movable Property

An asset subject to a possessory lien may be realized in two ways: The lien creditor may realize the pledged asset through court or out-of-court procedures.

In **judicial proceedings**, the lien is enforced through execution requiring the existence of an executory title. Such a title may be a judgment obtained by legal action (*actio pigneraticia*), a settlement reached in court, or a notarial act that is directly executable. Execution proceedings are subject to the same rules as execution through the out-of-court sale of a movable asset.

The second way of realizing a pledged item is its out-of-court sale. While out-of-court realization was possible only in commercial transactions before the Property Code came into force, the Property Code widened the scope to include all kinds of possessory pledges. To be legal, an out-of-court sale must be based on a written agreement. In the case of commercial transactions, such a written agreement is presumed to exist (see Chapter 1).

Out-of-court sales are executed by public auction or by a private sale at prices quoted at an exchange or at the market price, as applicable. Prior to the sale and after the due date of the secured claim, the bank has to notify the debtor and the lienee – unless identical with the debtor – of the intended sale, announcing the time and place of the sale. The sale may be carried out at the earliest eight days after such notification. The proceeds of the sale are used to satisfy the bank, with any surplus to be handed over to the lienee. This type of out-of-court realization is mandatory, with any other arrangement in the lien agreement being null and void.[28]

Accelerating clauses[29] are not admissible with possessory liens prior to the due date of the secured claim. However, after the maturity of the claim, the lie-

[26] Tratnik, Stvarnopravni zakonik, 126.

[27] Juhart, Stvarnopravni zakonik, GV, Ljubljana (2002), 61.

[28] Tratnik, Stvarnopravni zakonik, 128. It is therefore not possible for the lien creditor and the lien debtor to agree the price at which the asset is to be sold, even if such an agreement can be executed after the secured claim matures. Cf. Sect. 132 SPZ.

[29] Under the accelerating clause, ownership in a pledged asset passes to the lienholder on maturity of the secured claim.

nee and the bank may agree that the pledged asset shall pass into the lien creditor's ownership.

III. Non-possessory Lien

A. General

Even before the entry into force of the Property Code, Slovenian legislation provided for the **non-possessory lien** (*neposestna zastavna pravica*), which was regulated by the law on execution. The current rule, which was apparently modeled after the law of the Netherlands, is laid down in Sect. 170 to 177 of the Property Code. Even though the non-possessory lien is firmly rooted in Slovenian law, the question will arise in the future of whether it will be competing with the assignment as collateral.

The non-possessory lien is the counterpart of the possessory lien, with the lienee keeping the pledged item in his or her direct possession. This is to permit the beneficial use of the pledged item by the lienee while facilitating the satisfaction of the secured claim.

B. Creation

1. Notarial act

A **non-possessory lien** on a movable item is created by a legal transaction. Such a legal transaction **must** have the form of a **directly enforceable notarial act**. Such a notarial act must contain the following provisions:

- The name of the **lien creditor** and the **debtor** of the secured **claim** as well as the name of any real debtor;
- The **title** (lien agreement);
- The **description** of the movable **asset** being pledged or its unique identifier;
- The amount and **due date** of the claim or at least details enabling its calculation; and
- The **lienee's consent** to the creation of a lien and the satisfaction of the secured claim from the pledged item after the due date.[30]

The formal requirement of the notarial act, which serves the purpose of ensuring the certainty of legal relations, prevents any predating of a non-possessory lien and thus any circumvention of the rules governing bankruptcy.[31]

2. Special Features at the Creation

Even though criticized in theory[32], the provisions of the Property Code do **not specify any special mode of acquisition** for the creation of a non-possessory lien. Some scholars posit that in this case constructive bailment or long-handed delivery (instruction to hold on behalf of transferee) may constitute an admissible mode of acquisition.[33]

[30] Cf. Sect. 171 SPZ.

[31] Keresteš, Neposestna zastavna pravica, Gospodarski subjekti na trgu na pragu Evropske unije, IGP, Portorož (2003), 199 ff (203).

[32] Keresteš, Neposestna zastavna pravica, 204.

[33] Tratnik, Neposestna zastava premičnin v stvarnopravnem zakoniku, attachment to Pravna Praksa 10-11/2003, III.

A movable object may even be pledged several times if the preceding lienor consents. When placing additional liens on an object, the preceding lienors have to be notified in any case. A problem may arise in the case of a conflict of a non-possessory lien with a subsequent possessory lien. Since a holder of a possessory lien acting in good faith always acquires a first-ranking lien, there is a risk of the lienee putting existing lien creditors at a disadvantage.[34] This may be prevented by agreeing that the lienee does not remain in possession of the object, but transfers it to a third party. As a result, however, the advantages of the non-possessory lien over a possessory lien are lost.

Certain assets that carry a unique **identification mark** due to their nature (e.g. cars, livestock) have to be entered into a **registry of non-possessory liens**. Such a register has already been set up in Slovenia. Entry of a lien in respect of such movable items constitutes the mode of acquisition for creating a non-possessory lien.[35]

C. Special Rules for Liens on Inventories

One of the special advantages of the non-possessory lien is that it makes it possible to place a lien on inventories. Non possessory liens are created by entry in the relevant register.[36] Inventories kept at a specified place may thus be placed under lien without transferring possession. The lienee is required to replenish the inventories in the usual manner, to allow the bank to check such replenishment and to provide the bank with extracts from its books. The lienee and the bank may also agree on a minimum level of inventories to be held at a specified place at any time.

Viewed in isolation, liens on inventories do not provide very strong security, but may be combined with an anticipatory assignment of receivables[37] or the pledging of the corresponding share of those receivables that will be generated by selling the pledged inventories.[38] In this mode of acquisition, it is essential to enter into an agreement on the anticipated assignment of receivables in the form of a notarial act, as this is the only way any defenses may be raised against enforcement in execution proceedings or to demand separate satisfaction from the bankrupt's estate in the case of bankruptcy.[39]

D. Realization of a Non-possessory Lien

In principle, a non-possessory lien allows the lienee to use the movable asset on which the lien has been placed for business purposes. This is in conformity with its economic purpose and the agreement reached with the lienor. If the value of the item decreases or the item deteriorates, the bank may ask the lienee to deliver the item to the bank or a third party. Thus, the non-possessory lien is

[34] Keresteš, Neposestna zastavna pravica, 205.

[35] Cf. Sect. 171(4) SPZ. The register was established under the Regulation on the Register of Nonpossessory Liens and Pledged Movable Property (Uredba o registru neposestnih zastavnih pravic in zarubljenih premičnin), Official Journal RS, No. 23/2004.

[36] Art. 8 of the Regulation on the Register of Nonpossessory Liens and Pledged Movable Property

[37] Under an anticipatory assignment of receivables it is agreed on in advance that instead of the good sold from the warehouse, the associated claim against the buyer will be pledged. The lien on the movable asset is terminated and replaced by the lien on the receivable.

[38] Keresteš, Neposestna zastavna pravica, 209. This procedure is highly reminiscent of an extended reservation of title.

[39] Cf. Sect. 209 SPZ.

converted into a possessory lien, in respect of which it is assumed that an agreement exists on an out-of-court sale.

Non-possessory liens are generally realized through **out-of-court proceedings**. Under a **directly enforceable notarial act**, the lien creditor may **demand delivery of the movable item** to his or her direct possession when the claim falls due. This again converts the non-possessory lien into a **possessory lien** – with the assumption being in the case of commercial transactions that an out-of-court sale has been agreed.[40] The sale is then carried out in the same way as with a possessory lien.

If the lienee is not willing to deliver the pledged movable object to the bank, the bank may file a **petition for execution** under the directly enforceable notarial act to enforce the surrender of the **object**, which again converts the lien into a possessory lien in respect of which an agreement is presumed to exist, permitting out-of-court realization. The second possibility is a petition for execution leading to the direct judicial sale of the pledged movable item.[41]

Special conditions apply in the case of **multiple liens**. When one of the secured claims falls due, the lienors have to authorize a person to make the sale on their behalf.[42] It is to this person that the lienee has to surrender the pledged item for sale, which has to be conducted in accordance with the rules applicable to possessory liens. The proceeds from the sale are distributed among the lienors in accordance with the ranking of their liens. Claims not yet due also have to be distributed, but must be discounted accordingly.[43]

E. Register of Non-possessory Liens

The **register** of **non-possessory liens** (*register neposestnih zastavnih pravic*) is a **public register.** In principle, any person inspecting said register may trust that the entries are correct. Anyone applying due diligence in legal dealings cannot be held liable for any harmful effects. The **principle of good faith** applies in the same manner as with the land register.

The provisions governing mortgages apply to the register kept by the Agency for Public Registers and Services (*Agencija Republike Slovenije za javnopravne evidence in storitve*, AJPES) mutatis mutandis.[44] Details on the following types of assets can to be entered into the register:

- Inventories;
- Plant and equipment;
- Motor vehicles and rolling stock, motorcycles and trailers as well as semi-trailers;
- Animals; and
- Movable assets that have been entered into the reference registers.

In the register, each movable item is assigned a unique identification code as well as other information that may be useful for the purpose of identification. Inventories and equipment are identified based on data on the real property on which they are located.

[40] Commercial transactions: see Chapter 1.
[41] Keresteš, Neposestna zastavna pravica, 210.
[42] If the parties do not reach an agreement, the person has to be named by the court in non-contentious proceedings.
[43] Cf. Sect. 176(3) SPZ.
[44] Cf. Sect. 177 SPZ.

IV. Special Features of Financial Security Rights

The Act on Financial Collateral (*Zakon o finančnih zavarovanjih*, ZFZ) implementing the corresponding Directive 2002/47/EC of the European Parliament and the Council of 6 June 2002[45] introduced various types of financial security rights to Slovenian law. The act lays down special rules for financial security rights entered into by specific financial market participants.

The financial market participants named in the Directive – apart from certain financial institutions under supervision – include the following:

- EU Member States' public law entities responsible for public debt management as well as EU Member States' public law entities having the right to manage accounts for customers;
- The Member States' central banks, the European Central Bank, the International Monetary Fund, the European Investment Bank, the Bank for International Settlements, multilateral development banks as defined in Sect. 1 No. 19 of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and the pursuit of the business of credit institutions.[46]

In Slovenia, the Act on Financial Collateral is applicable to the following financial market participants:

1. The government;
2. The Slovenian central bank;
3. Banks;
4. Insurance companies;
5. Investment funds;
6. Fund management companies;
7. Clearing agent and custodian;
8. Slovenia's social insurance institution (*Zavod za zdvravstveno zavarovanje Slovenije*), the pension and disability insurance institution (*Zavod za pokojninsko in invalidsko zavarovanje*), the Slovenian Reimbursement Fund (*Slovenska odškodninska družba*), the Investment Management Company (*Kapitalska družba*), the Slovenian Export Company (*Slovenska izvozna družba*) and the institution authorized under the Act on the Collateralization and Financing of International Commercial Transactions (*Zakon o zavarovanju in financiranju mednarodnih gospodarskih poslov*), Official Journal RS, No. 2/04, and other management companies and funds set up by the Republic of Slovenia.
9. Other financial institutions supervised by the competent supervisory body in accordance with the regulations governing banking and financial services;
10. Other legal entities meeting the criteria set out in the Management Companies Act (*Zakon o gospodarkih družbah*, ZGD) and classified as large enterprises if they enter into transactions involving financial collateral with entities covered by the Act on Financial Collateral.

Financial collateral is defined as the transfer of a **financial instrument** or a **cash asset** as collateral or the placement of a lien on a financial instrument or cash. Financial instruments include shares of stock and other securities, bonds

[45] OJ L 168 of 27 June 2002.
[46] OJ L 126 of 26 May 2000.

and other debt securities intended for trading on the securities market as well as other serial securities issued by an issuer of stocks or bonds and granting the holder the option to buy, sell or swap these securities against other securities of the issuer, with the exercise of this option resulting in a buy, sell or swap agreement between the holder and the issuer (payment instruments being excepted), including the transferable coupons of the solidarity funds, money market instruments, debt securities issued by the Bank of Slovenia, and all other rights and options relating to the financial instruments named above. The transfer of the financial instrument for securing a claim represents financial collateral under which the right from the financial instrument or cash passes from the provider of the collateral to the receiver of the collateral for the period for which collateral is provided.

Financial collateral may be provided as security for claims involving cash or the transfer of a financial instrument. To be effective, a financial security agreement does not have to meet any specific formal requirements, but there has to be written documentory evidence of the commitment to provide financial collateral and of the conclusion of a financial security agreement. Such evidence may take the form of a note, a data storage device or any other object proving that a commitment to provide financial collateral was made and/or proving that an agreement was entered into. It is the obligation of the security provider to make available financial collateral by transferring the title to cash or the financial instrument or to deliver it into the possession of the security receiver or his or her representative in such a way that the title of the receiver of the security can be entered in the register of financial instruments.

Unless the financial security agreement provides otherwise, the receiver of the collateral may dispose of the financial instruments pledged in out-of-court proceedings immediately in a reasonable manner if the conditions for the enforcement of the security right are met. For this purpose, the receiver neither has to notify the collateral provider about the sale nor wait a certain time before making the sale nor carry out a public auction or obtain consent to the sale. If the financial security agreement so provides and the agreement includes elements for determining the value of the financial instrument, the receiver of the collateral may acquire the right under the pledged item as early as the time when the conditions for enforcing the financial security right have been met. In such a case, the right of the receiver of the security is deemed to have been acquired at the value set out in the agreement.

The **receiver of the collateral** has the right to dispose of the pledged financial instruments or cash during the **life of the financial security right** if he or she was expressly authorized by the collateral provider in the financial security agreement or at any time after the agreement was entered into. If the receiver of the collateral disposes of the pledged financial instruments or cash, he or she has to provide a substitute of equal value no later than on the due date of the secured claim agreed by contract, which will take the place of the pledged financial instrument or cash. The substitute has the same legal status as the pledged financial instrument and has to be treated in the same manner. If so provided in the financial collateral agreement, the receiver of the collateral, instead of providing a substitute asset, may offset his or her claim against the secured claim due up to the time of restitution of the substitute asset.

In bankruptcy proceedings the financial security agreement or the commitment to provide financial collateral will not be ineffective, void or contestable if it was entered into before a petition is filed for the institution of (forced) composition proceedings or before the decision to institute bankruptcy proceedings or proceedings leading to deletion from the commercial register.

Chapter 4: Mortgages

I. Introduction

This chapter discusses the different types of mortgage based on their creation and the object of the mortgage. A separate section is dedicated to the law governing the land register. This is followed by a section dealing with the realization of a mortgage. The land charge, a special form of using land as collateral, is examined in a separate chapter.

II. General

A. Nature

Mortgage (*hipoteka*) is the term used for liens on immovable property. A creditor whose claim is secured by a mortgage has the right, in the event the borrower defaults on his or her secured claim at maturity, to the satisfaction of his or her claims, including interest and costs, from the value of the mortgaged immovable property before all other creditors of the mortgagor not holding a mortgage or land charge or having acquired such an interest only at a later date. The mortgaged immovable property may be owned by the person owing the secured claim or owned by a third party.

B. Creation

Depending on how a mortgage is created, it is classified as a **statutory mortgage** (*zakonita hipoteka*), a **judgment mortgage** (*prisilna hipoteka*) or a mortgage based on a **legal transaction** (*pogodbena hipoteka*). Under Slovenian law, statutory mortgages occur only in exceptional cases.[47] In these rare cases, a mortgage is created at the time compliance with certain conditions laid down by law is established. It therefore exists as a hidden or silent mortgage (*prikrita hipoteka*, *hypotheca tacita*), which may lead to a conflict with mortgagees holding a contractual mortgage or a mortgage based on a court judgment. A mortgagee who acquires a contractual mortgage in good faith, assuming that the immovable property is unencumbered, is protected by the bona fide principle of the law governing the land register.[48] Finally, a mortgage may arise from a court judgment. Such mortgages are commonly created as a result of execution proceedings and gain legal force by their constitutive entry in the land register.[49]

The creation of a **contractual mortgage** based on a legal transaction requires **a title** and **mode of acquisition**. As a rule, the title is the mortgage agreement or a testamentary disposition in the event of death. A mortgage agree-

[47] Some examples: the statutory lien on parts of a deceased's estate taken over by tose heirs who lived with the deceased and worked in his business, for the benefit of co-heirs not paid out (Sect. 147 ZD) or the lien of co-owners when a co-owner property is divided and taken over by one of the co-owners (Sect. 124 ZNP). A special form of the statutory mortgage is the state's priority right to satisfaction from the immovable property in the event of its sale for taxes accrued in the past year that represent an encumbrance on the sold immovable property (Sect. 197 ZIZ).

[48] Berden/Tratnik/Vrečnur/Rijavec/Frantar/Keresteš/Juhart, Novo stvarno pravo, Codex iuris, Maribor (2002), 157.

[49] Cf. Sect. 143 SPZ.

ment may take the form of a simple written document or a directly enforceable notarial act.[50] Mode of acquisition is generally the entry of the mortgage into the land register. For a mortgage agreement drawn up in simple written form to be eligible for entry into the land register, a notarized notice of consent to its registration is required. Such a notice may already be part of the mortgage agreement. If this is not the case, it must be executed separately. A mortgage agreement drawn up in the form of a directly enforceable notarial act already includes a notice of consent to registration in the land register. In this case, it is the duty of the notary to arrange for the subsequent entry of the mortgage and the enforceability note in the land register.

A **special case** in this context is an **apartment, which has not yet been entered into the land register**.[51] On such apartments, a mortgage can be created only in the form of a directly enforceable notarial act specifying the situation, boundaries and area of the immovable property and other identifying features of the apartment. In addition, the document that would represent the basis for the acquisition of ownership had the apartment been entered into the land register (as a rule, the sales agreement on the apartment including the notice of consent to registration of the transaction in the land register) has to be attached to the notarial act. The **creation of the mortgage** has to be noted on this **document**. In addition, the **execution** of the **notarial act** has to be **announced** in the **official journal** of the Republic of Slovenia and the documented handed over to the notary for safekeeping. These acts are intended as substitutes for the disclosure stipulated by the mode of acquisition otherwise achieved by entry of the deal into the land register.

C. Object of the Mortgage

The object of a mortgage may be an **immovable property** representing a geographically defined part of the earth's surface including all **fixtures**. Therefore, mortgages are created primarily on real property. In accordance with the principle of *superficies solo cedit*, a building erected on land is an **integral part** of the **real property** and is therefore covered by the mortgage. **Exceptions** to this rule exist under Slovenian law with regard to the ownership of an entire floor and to the **building lease**. Apartments owned under the ownership rules for entire floors, and buildings constructed within a building lease are recognized as separate objects on which a separate mortgage can be taken out.

Every co-owner may agree to place a lien on his or her **ideational part** of an immovable property. The consent of the other co-owners is not required for this. By contrast, the other co-owner's consent is required, if the entire co-owned immovable property is mortgaged. When an immovable property is owned jointly, a mortgage can be created only on the entire immovable property.

[50] In the case of a directly enforceable notarial act, Sect. 153(2) Property Code provides that the sale of the immovable property shall be carried out through a notary if the claim is not satisfied. In practice, this rule cannot be applied as the required implementing provisions have not been issued yet.

[51] The fact that in 1991 a large number of apartments were not recorded in the land register in Slovenia may be attributed to the previous socialist system. Frequently, not even an existing residential building was entered in the land register, with the land register just showing a field or grassland. By establishing a building cadastre and new regulations for condominium ownership efforts are now being undertaken to record such apartments in the land register.

Mortgages can only secure pecuniary claims. Law allows one exception to this rule, however. A non-monetary claim that becomes a pecuniary claim at maturity may also be secured by a mortgage.[52] When such a mortgage is incorporated, the secured amount has to be entered into the land register along with the value date, the interest rate and the maturity of the future monetary claim. For a maximum-amount mortgage, the maximum amount of a potential loan has to be entered instead of the secured amount.[53]

III. Special Forms of Mortgages

A. Maximum-amount Mortgage

The legal provisions contained in the Property Code and the Land Register Act recently regulated the maximum-amount mortgage (maksimalna hipoteka). Previously, it was governed by the rules of the 1930 Land Register Act. It represents a softening of the principle of specialty and the requirement that the exact amount of a claim has to be entered in the land register. With this kind of **mortgage**, a **maximum amount** is entered for an underlying transaction, up to which the claim is secured by the immovable property. This allows securing a number of claims or even several claims arising under a specified legal relationship, the amounts of which are unknown at the time the mortgage is created.[54] The maximum amount entered secures the amount of the claim including interest and costs.

Even though the maximum-amount mortgage does weaken to a certain extent the principle of accessoriness, it is still associated with the secured claim. When the maximum-amount mortgage secures a single claim, the rules regarding accessoriness are the same as for the simple mortgage or lien. When a mortgage serves as security for several claims arising from an underlying contract, the existence of the mortgage is dependent on the existence of the underlying contract. As long as the underlying contract exists, the maximum-amount mortgage cannot be cancelled in the land register, even if no claims are outstanding at a given time.[55] The rule that a maximum-amount mortgage securing claims cannot be assigned along with the claims it secures must also been seen in this context.

The maximum-amount mortgage represents a departure from the general rule requiring the specification of the amount of the claim when the mortgage is recorded. With a maximum-amount mortgage, the details entered include a description of the mortgage and the maximum amount up to which the immovable property is liable as a security.[56] The amount of the maximum-amount must be shown in the notice of consent in order to have the deal recorded in the land register.

[52] Keresteš in Tratnik/Rijavec/Keresteš/Vrenčur, Stvarnopravna zavarovanja, IARS, Maribor (2001), 80.
[53] See Sect. 16 and 18 ZZK-1.
[54] Cf. Sect. 146 SPZ.
[55] Keresteš in Tratnik/Rijavec/Keresteš/Vrenčur, Stvarnopravna zavarovanja, 108.
[56] Cf. Sect. 18 ZZK-1.

B. Simultaneous Mortgage

A simultaneous mortgage (*skupna hipoteka*) is a mortgage under which **one single claim** is secured by **several immovable properties**. Until the claim is fully settled, it is secured jointly by all liens on the immovable properties. In the event of non-payment of the claim, the mortgagee may ask for **satisfaction** of his or her claim **from any of the immovable properties** in any order.[57] The mortgagee is free to choose from which one of several immovable properties he or she wishes to obtain satisfaction. When several real properties are mortgaged that are entered into different register sheets, special rules apply. In such a case, the mortgage is not entered with all of the real properties mortgaged, but only with the principal property, while the entries for all other properties contain a reference to the simultaneous mortgage.[58]

The **entry for the simultaneous mortgage** has to show the description "simultaneous mortgage" and the name of the principal real property. For this principal real property, all details have to be given that are required for recording the mortgage as well as data on the other units of real property being the object of the simultaneous mortgage.

With the other units of real property covered by the simultaneous mortgage, a note is entered referring to the simultaneous mortgage, with only the description of the simultaneous mortgage and the identification of the principal real property being given.[59]

The new Land Register Act[60] and the electronically maintained land register provide for each immovable property (unit of real property) to be recorded on a separate sheet. In the future, so-called false simultaneous mortgages meaning a single lien on all parcels of real property entered into one register sheet will no longer exist.[61]

C. Owner's Mortgage without an Underlying Claim

An owner's mortgage without an underlying claim (*lastniška hipoteka*) does not exist under Slovenian law. The rules governing the extinguishment of a mortgage may, however, create a situation giving rise to a "false owner's mortgage". Since the mortgage ends only upon its cancellation in the land register[62], a situation may occur in which the secured claim has already been settled (or has been otherwise redeemed) while the mortgage continues to exist. Such a case may be described by the term "false owner's mortgage". However, this does not correspond to an owner's mortgage divested of its underlying claim under Austrian law, as Slovenian law does not provide for a limited transferability of a mortgage after the expiry of the claim it originally secured.

D. Sub-mortgage

A sub-mortgage (*nadhipoteka*) is a **lien on a claim that is secured by a mortgage**. It is thus a lien on a claim. For this reason, sub-mortgages are subject to

[57] Keresteš in Berden/Tratnik/Vrenčur/Rijavec/Frantar/Keresteš/Juhart, Novo stvarno pravo, 164.
[58] Cf. Sect. 17 ZZK-1.
[59] Cf. Sect. 17 ZZK-1.
[60] Official Journal RS, No. 58/2003.
[61] Plavšak, Zakon o zemljiški knjigi, 107.
[62] Cf. Sect. 154(1) SPZ.

the same regulations that apply to liens on claims. The debtor of the secured claim has to be notified of the creation of the sub-mortgage. If the debtor and the lienee are not the same person, the lienee has to be notified as well. The consent of the mortgagor is not required, however, for the establishment of the sub-mortgage. In contrast to the situation prior to the entry into force of the Property Code, sub-mortgages no longer have to be incorporated into the land register, as the creation of a lien does not constitute a transfer of the claim secured by the mortgage. To provide information to the public and for the protection of the holder of the sub-mortgage, a note on the existence of the sub-mortgage may be recorded in the land register, however. Such a note is added to the mortgage underlying the sub-mortgage.[63]

Due to the nature of the sub-mortgage, the bank as the holder of the sub-mortgage cannot immediately institute proceedings upon the borrower's default for the satisfaction of its claim. The object ensuring redemption first of all is the claim secured by the mortgage and placed under lien.[64] It is only in the second phase, after non-satisfaction of the claim secured by the mortgage that the bank may obtain satisfaction of its claim from the lien placed on the real property. The sub-mortgage creditor thus needs two titles for execution and has to conduct two execution proceedings.[65]

IV. Potential Problems

A. Scope of the Lien

The mortgage covers the real property in its entirety, including fixtures (*sestavine*) and fruits (*plodovi*) of the land up until their separation from the principal asset as well as appurtenances (*pritikline*) owned by the mortgagor.

Fixtures are defined by the Property Code as all items, which according to generally accepted standards are part of another asset. This definition is a departure from the previous classification in material and immaterial fixtures (or non-accessory and accessory fixtures). The new concept of fixture is applied uniformly.[66] Whereas fixtures of a parcel of real property are considered to include primarily buildings and all parts of such buildings, trees, etc.[67], **appurtenances** are movable assets, which according to generally accepted standards are used for business purposes or as an improvement of the main asset. For the appurtanances to be included in the mortgage they have to be owned by the mortgagor. Examples of accessories may be tools in a workshop, domestic animals, agricultural implements and equipment on farms, machinery in plants and factories (not being fixtures).

Special provisions regarding fixtures apply in the case of **ownership of an entire floor** (*etažna lastnina*). A share in the common areas of the building (e.g. corridor) belongs to each part of a building held in ownership of an entire floor and co-ownership of separate jointly owned parts (e.g. separate outside boiler rooms in the case of larger buildings). Such co-ownership is inseparably

[63] Plavšak, Zakon o zemljiški knjigi, GV, Ljubljana (2003), 91.
[64] Tratnik, Stvarnopravni zakonik, 120.
[65] Keresteš in Tratnik/Rijavec/Keresteš/Vrencur, Stvarnopravna zavarovanja, 120.
[66] Modelled on the Netherlands.
[67] Tratnik, Stvarnopravni zakonik, 37.

associated with ownership of an entire floor and cannot be transferred separately. Nor is it possible to waive ownership or ask for a partition. When part of a building being subject to ownership of an entire floor is mortgaged, the mortgage also extends to the common areas of the building, which are deemed to be part of the ownership of an entire floor..

Slovenian law does not have any provisions for **buildings erected on third-party land** and not intended to stay there permanently **(superaedificium)**. Nor does it have special provisions governing **machinery.** Depending on generally accepted standards and the connection between the real property and a piece of machinery, machinery may be classified as a fixture or appurtenance.

The mortgage provides security for the secured claim until it is paid in full. Payment of part of the claim or expiry of the secured claim does not reduce the mortgage. When the real property that is encumbered by the mortgage is divided, each part of the real estate remains encumbered by the mortgage; the result is the creation of a simultaneous mortgage.

B. Building Lease

1. Nature

The building lease (*stavbna pravica*) is the **right to ownership** in a building that is erected above or below a **third party's real property**. This separation of ownership in the building and in the real property runs counter to the principle of *superficies solo cedit*. Under a fictitious assumption, the building lease is regarded as the equivalent of real property, with a building erected on the real property being viewed as a component of the building lease. The holder of the building lease is to be treated as the owner of the building.[68]

The building lease is a real right, the duration of which is limited to a maximum of 99 years. After this period, the right expires, causing the building to become again a fixture of the real property. The building lease is a transferable right and is transferred in accordance with the same rules applicable to ownership in real property. The acquisition is therefore contingent on the entry into the land register.

The establishment of the building lease presupposes the existence of a title, which is represented by an agreement creating an obligation. The agreement granting the building lease has to include details on the owner of the real property, the piece of real property, a description of the building lease, and its duration. The agreement may not include any condition subsequent. The owner of the real estate and the holder of the building lease may agree on compensation for said building lease. Apart from the title, the notice of consent to have the transaction recorded in the land register and the entry in the land register are required.

Ownership of an entire floor may be established in a building erected under the building lease if the individual parts of the building form functional units that are suitable for separate use. The law expressly provides for the option of creating a separate mortgage on a building that can be erected on land encumbered by a building lease. The building lease is de facto mortgaged, which is treated like an

[68] Juhart in Berden/Tratnik/Vrenčur/Rijavec/Frantar/Keresteš/Juhart, Novo stvarno pravo, 212.

immovable piece of property and thus like a plot of land.[69] The same applies to individual units of a building being held in ownership of an entire floor. The creation of a lien on the building or a unit within the building (e.g. a dwelling) is subject to the rules governing the creation of a mortgage.

2. Termination

Because of the limited life of the building lease, special rules have been defined for the termination of the building lease that is encumbered by a mortgage securing a claim that is still unpaid. After the termination of the building lease, the building becomes a fixture of the land on which it was erected. The owner of the land has to pay to the holder of the building lease, the agreed-on compensation for the building structure, which may not be less than half of the land's increase in market value (on account of the structure erected). These legal provisions relating to valuation have to be applied even in the absence of an agreement between the owner of the real property and the holder of the building lease. When the building lease expires, the mortgage creditor acquires a lien on the claim that the holder of the building lease has to compensate for the land's increase in value. The same applies if the building lease is terminated early due to a violation of the agreement (e.g. for non-payment of compensation). The termination of a building lease encumbered by a mortgage requires the consent of the mortgagee.[70]

V. The Land Register

A. General

The land register (*zemljiška knjiga*) is a **public book**, which is used to enter and disclose details on titles relating to immovable property and facts of legal relevance associated with immovable property. All **entries** in the land register are public and **take effect** as of the date on which the **petition for entry** or the deed on the basis of which the competent authority takes its decision on the entry is received by the **court keeping the land register**.

When the entry of a title in the land register is permitted, the title or fact entered is deemed to be known to the public on the working day following the day on which the court has received the petition for entry, as of the beginning of the office hours of the court keeping the land register. Any person acting in good faith in legal dealings and trusting the information on titles entered into the land register enjoys protection against any harmful consequences.[71]

A lien on immovable property takes effect as of the effective date of the entry into the land register, i.e., as of the time of receipt of the petition for entry of the mortgage.[72]

B. Types of Entries

The land register contains **principal entries** (*glavni vpisi*) and ancillary entries (*pomožni vpisi*). While the **principal entries** – incorporations (*vknjižbe*), prior-

[69] Tratnik, Stvarnopravni zakonik, 158.
[70] Juhart, Stvarnopravni zakonik, 86.
[71] Plavšak, Zakon o zemljiški knjigi, 37.
[72] Cf. Sect. 5 and 7 ZZK-1.

ity notice (*predznambe)* and annotations (*zaznambe)* – relate to titles and facts of legal relevance – the **ancillary entries** provide information that has to be entered in the land register due to a statutory requirement – disclosure by sealing docket number in pencil (*plombe*) und disclosure *(poočitve*).[73]

As a matter of principle, rights are entered by incorporation or priority notice. An exception exists for sub-mortgages, for which an annotation is entered. Apart from this, annotations are intended only for recording facts of legal relevance.

A mortgage is **registered** by recording details on the claim secured by the mortgage (amount, value date, stable value cause, interest, interest accrual and maturity of the claim). If the mortgage is created only on an ideal part, additional details are required on this ideal part.

A mortgage may also be created on the basis of a **priority notice**. This is the case when the mortgagee requests the registration of the mortgage even before he or she gains possession of a deed documenting such registration. As soon as the priority notice is backed by the submission of the registrable deed, the right concerned is acquired. The time allowed for submission is one month from the date on which the decision approving the priority notice was taken.

Annotations concerning mortgages can relate to the following facts of legal significance: bankruptcy, ranking, calling the mortgage-secured claim, foreclosure action, litigation, execution, restraint on disposal and encumbrance.

C. Extinguishment of the Mortgage

The mortgage is extinguished when it is **cancelled** from the **land register**. It may be extinguished following a petition by the parties or ex officio (e.g. when the decision that the property has to be surrendered to the buyer in a public auction attains legal force[74]). A petition for extinguishment may be filed when:

- The debtor has **paid off the secured claim;**
- The secured **claim has ceased to exist**;
- The **mortgagee waives** the secured **claim**;
- The mortgage is extinguished by **lapse of time**;
- The **owner** of a property and the **holder** of the **mortgage** are the same **person**.

The mortgage is deleted on presentation of a document authorizing the cancellation of the mortgage in the land register. The mortgagor is entitled to receive such authorization even if he or she sells the mortgaged property under an agreement with the mortgagee to enable satisfaction of the secured claim.

The **extinguishment** of a mortgage due to **lapse of time** is subject to special rules, according to which the mortgage is extinguished after 10 years following the date of maturity of the secured claim. But here again, the mortgagor has to petition for cancellation of the mortgage.[75] This can be done in two ways. First, the petition may be based on a notice of consent to the cancellation of the mortgage issued by the mortgagee. In the absence of such a notice, the mortgagor may petition for institution of a special procedure for extinguishing the mortgage. For this, the following conditions have to be met:

[73] Plavšak, Zakon o zemljiški knjigi, 46.
[74] Cf. Sect. 192 ZIZ.
[75] Juhart, Stvarnopravni zakonik, 60.

- 10 years have passed since the maturity of the secured claim;
- The mortgagee is unknown or cannot be reached;
- The claim was not judicially enforced in the period between maturity and the filing of the petition; and
- The mortgagee or sub-mortgagee does not raise any objection against the cancellation within 3 months after the publishing in the decree of old mortgages.

In the petition, the owner of the property encumbered by the mortgage has to satisfy the court that the said conditions are met. Then the court can institute proceedings to extinguish the old mortgage. The extinguishment has to be announced through a including a decree, containing a call on the mortgagees to file an appeal against the extinguishment within a period of three months. If an appeal is filed, the proceedings have to be stopped. Thus, the petitioner filing a petition for extinguishment is referred to the legal proceedings being appealed. If no appeal is made or it is done in a late, unlawful or incomplete manner, the court has to allow extinguishment of the old mortgage.

VI. Realization of the Mortgage

A. General

If the claim secured by the mortgage is not paid by the due date, the bank may obtain satisfaction of its claim from the lien placed on the real property. If the mortgagor diminishes the value of the property by his or her conduct or otherwise impairs the status of the property, such satisfaction may be obtained, by way of exception, even before the maturity of the secured claim. In such a case the bank, as the mortgagee, may petition the court to order the debtor to desist from harmful conduct or to approve realization of the mortgage by execution before the maturity date.

Under the Property Code, **mortgages** have to be **realized** with the assistance of the **court** (*oficielnost*; proceedings may only be instituted by the court). An exception from this rule is provided only for mortgages in the form of **directly enforceable notarial acts**. Under Sect. 153 of the Property Code, the credit institution may ask the **notary** to determine the maturity of the claim and execute the **sale** of the property used as security and satisfy the creditors' claims or the petition for execution. However, until the revision of **current** provisions governing notarial duties, a sale **cannot be conducted by a notary**. The sole exception is when all parties consent to this type of realization.[76] Therefore, execution proceedings are the only accepted way of realization currently available.

The mortgage agreement is not allowed to include any accelerating clause (*lex commissoria*). A clause agreed prior to maturity providing that the mortgaged property passes into the mortgagee's ownership if the borrower fails to make payment by the due date is therefore void. The same legal consequence applies to an agreement entered into prior to maturity, which provides for the sale of the mortgaged property at a predetermined price. Such agreements can be closed with legal effect only after the maturity of the secured claim.

[76] Tratnik, Stvarnopravni zakonik, 120.

Under an agreement between the mortgagee and the mortgagor, a mortgage may be realized even without the intervention of the court.[77]

B. Judicial Realization of the Real Property

1. General

Receivership is unknown in Slovenian execution law. The only way of **enforcing** a claim is through the sale of the real property (*prodaja nepremicnine*), with the proceeds being distributed among the creditors. For the institution of execution proceedings, an executory title (*izvršilni naslov*) is required. In practice, the majority of mortgages are created in the form of **directly enforceable notarial acts**, which directly provide the mortgagee with an executory title. Thus, the mortgagee may petition for execution against the mortgaged real property directly on the basis of the immediately enforceable notarial act or ask the notary to petition for execution. If the bank does not have any executory title, it has to obtain such a title by taking legal action. If the mortgagor is at the same time also a personal debtor, the creditor may obtain an executory title by taking legal action for payment of the secured claim. If the mortgagor is only a real debtor, the creditor bank has to take foreclosure action (seeking a judgment ordering the sale of the mortgaged real property).

The **executory title** for realization of the mortgage may be a directly enforceable notarial act (*neposredno izvršljiv notarski zapis*), a settlement in court (*sodna poravnava*), or a court judgment (*sodna odločba*). For execution proceedings to be conducted, the executory title must be suitable for execution and enforceable. Court judgments are executable if they are final and the period allowed for a voluntary discharge of the obligation by the debtor has expired. The court certifies enforceability by issuing a clause on the legal force (*klavzula o pravnomocnosti*).[78] **Settlements in court**, in contrast, are enforceable as of the maturity of the claims to which they relate. The records of the court proceedings provide evidence of maturity, but - analogously to the court judgments - the court also issues a **certificate** on the enforceability of the settlements. Directly enforceable notarial acts are executable if the **debtor has consented to direct enforceability in the notarial act a**nd the **claim is due**. The maturity of the claim has to be proven by the notarial act, a public deed or a duly certified deed. If the maturity of a claim cannot be proven in this way, it has to be established by a declaratory judgment.[79]

Mortgages on real property created by contract are **not subject to any bans or restrictions on execution**.

2. Sale by Forced Auction

When real property is sold by court order (*prisilna dražba*), the bank is satisfied from the proceeds of the sale of the mortgaged property. A sale by court order roughly comprises the following four phases:

a) Petition for execution
b) Appraisal

[77] Cf. Sect. 132 SPZ.
[78] Sect. 19 ZIZ.
[79] Sect. 20 ZIZ.

c) Auction
d) Distribution of proceeds from highest bid

a. Petition for Execution

The first phase of the proceedings is the petition for execution against the real property (*predlog za izvršbo*). With the petition, the mortgagee has to enclose evidence proving that the debtor is the owner of the real property. If the petition is complete, the court issues an execution order, which is delivered to the debtor and entered into the land register in the form of a annotation.

b. Appraisal

The court may determine the value of the real property even before the execution order attains legal force, but the appraisal (*Ugotovitev vrednosti nepremičnine*) is to be performed by the court only after the order has gained legal force.

The appraisal is to be performed by an expert who determines the value of the property on the basis of its market value on the day of the appraisal. Any decrease in the value of the property attributable to certain rights that remain attached to it even after the sale have to be taken into account. These rights are primarily easements, but may also include personal servitudes, real encumbrances and building leases that were entered prior to the rights of the mortgagee, the creditors of a land charge, and the creditor filing the petition.[80]

Eight days before the date set for the auction, the court may appraise the value of the property once again. For this, a petition is required and the submission of an expert opinion providing evidence that the value of the property has changed substantially since it was last determined. [81] The value of the property is fixed by court decision.

c. Auction

After the court's decision on the value of the property has been made, an order for the sale of the property is issued laying down the manner, the conditions of sale, the time and the place of the sale. Once the decision regarding execution and determination of the value has gained legal force, the sale can be carried out. Notice of the sale has to be given on the court's notice board or made public in some other manner that is locally common. In addition, the sale may also be announced in public news media at the creditors' expense. A minimum of 30 days has to pass between the publication of the notice and the sale.[82]

The sale is basically carried out in the form of a public auction (*javna dražba*). The creditors and the debtor may, however, also agree on a direct sale (*neposredna prodaja*) within a certain period. Such an agreement must be set out in writing.[83]

In order to be eligible to bid in a public auction, a potential bidder has to make a deposit (*varščina*). Even if a direct agreement is entered into, the buyer

[80] Cf. Sect. 174 ZIZ.
[81] Cf. Sect. 178 ZIZ.
[82] Cf. Sect. 181 ZIZ.
[83] Cf. Sect. 183 ZIZ.

has to meet this obligation. The deposit amounts to one tenth of the appraised value of the real property.[84] When buying a property, priority has to be granted to holders of preemptive rights if they declare, after the auction, that they wish to buy the property at the conditions offered by the best bidder. When real property is sold directly under an agreement (private sale), the court asks the holders of preemptive rights to state whether they wish to exercise their rights. If a holder of a preemptive right wishes to exercise it, the best bidder may bid a higher price again.[85] Neither the debtor nor persons performing an official function at the sale may act as buyers.[86]

The auction is carried out even if only a single bidder is present, unless the parties or the mortgagee suggest postponing it. On the first auction day, the property must not be sold beneath its appraised value. If a second auction has to be scheduled, a minimum of 30 days has to pass between the first auction day and the second. At the second auction, the property must not be sold for less than half of the appraised value. However, if an agreement is reached between the parties, the mortgagees and the other creditors, with such agreement being recorded in the minutes, the property may be sold even below that price.[87] If the buyer assumes the portion of the debtor's debt that the creditor would have received from the forced sale, the buyer and the mortgagee may agree for the mortgage to remain attached to the property even after the sale.[88] If the real property cannot be sold in the second auction either, the court has to approve another sale only upon a petition by the creditor.

After a sale by public auction or under a direct agreement, the court issues an order on the acceptance of the bid and subsequently, after the payment of the purchase price, an order for surrender of the real property to the buyer.[89]

d. Distribution of the Proceeds from the Highest Bid

Once the decision ordering the surrender of the real property to the buyer has attained legal force, the court has to satisfy the creditors. For this purpose, claims are ranked in the following order:

- Costs of the execution proceedings;
- Taxes on the property's revenues and other taxes that fell due in the past year and encumber the property;
- Claims arising from the title of statutory alimony, compensation for loss of ability to work or missed support payments, as well as social insurance contributions that fell due in the past year.

After satisfaction of these privileged claims, payments are made to the mortgagees, creditors of land charges and creditors entitled to compensation for personal servitude, building leases and real encumbrances. The claims have to be satisfied in the order in which the rights were acquired.[90] Items to be paid are the principal claim, costs, and interest accrued during the three years preceding

[84] The lien creditor and the land charge creditor are exempt from the obligation to make a deposit if their claims reach the amount of the required deposit. Cf. Sect. 185 ZIZ.
[85] Rijavec, Civilno izvršilno pravo, GV, Ljubljana (2003), 308.
[86] Cf. Sect. 187 ZIZ.
[87] Rijavec, Civilno izvršilno pravo, 309.
[88] Cf. Sect. 173 ZIZ.
[89] Galič/Jan/Jenull, Zakon o izvršbi in zavarovanju, GV, Ljubljana (2002), 379.
[90] Cf. Sect. 198 ZIZ.

the petition for execution proceedings.[91] After satisfaction of these creditors, the claims of all other creditors are settled. If the amount does not suffice to settle all claims of equal rank, claims have to be satisfied on a pro-rata basis.[92] In the case of liens that have not fallen due yet, interest has to be discounted at the bank rate applicable at the place of performance of the secured claim, for the period running from the day the decision on satisfaction was taken up to the day of the maturity of the claim.[93]

C. Treatment of Mortgages in the Event of Bankruptcy

Mortgagees have the right to separate satisfaction from a bankrupt's estate (*ločitvene pravice*) for claims secured by mortgages. This means that they are entitled to separate satisfaction prior to all other creditors in the bankruptcy proceedings. The same applies to (forced) settlement proceedings. As a special feature of the Slovenian (forced) settlement proceedings, the mortgagee may waive the right to separate satisfaction from the bankrupt's estate and thus attain a better voting right.[94]

As a matter of principle, the institution of bankruptcy proceedings has no impact on the right to separate satisfaction from the lien. The sole exception to this rule is liens acquired during the last two months prior to the opening of the bankruptcy proceedings.[95] In addition, the creditors and the bankruptcy trustee may contest all mortgages created in the last year prior to the beginning of the bankruptcy proceedings if the beneficiary (mortgagee) was aware or had to be aware of the debtor's poor economic and financial situation. If the mortgage was created in the last three months prior to the filing of the petition for institution of bankruptcy proceedings or the (forced) settlement proceedings, the assumption is that the beneficiary creditor was aware or would have had to have been of the debtor's poor economic and financial situation.[96]

[91] The limitation period for claims maturing annually or at shorter intervals is three years. Cf. Sect. 347 OZ.
[92] Rijavec, Civilno izvršilno pravo, 314.
[93] Cf. Sect. 203 ZIZ.
[94] Keresteš in Tratnik/Rijavec/Keresteš/Vrencur, Stvarnopravna zavarovanja, 121.
[95] Cf. Sect. 131 ZPPSL.
[96] Cf. Sect. 125 ZPPSL.

Chapter 5: The Land Charge

I. Concept

The land charge is an instrument newly introduced to Slovenian law on security interest by the Property Code in 2002. It is a **non-accessory** form of a **lien on land**, which was modeled on German and Swiss practices. The land charge is governed by Sect. 192 to 200 of the Property Code as well as Sect. 20 and Sect. 44 of Land Register Act as well as, mutatis mutandis, by the provisions governing mortgages unless explicitly otherwise provided. The Land Register Act also mentions the land charge but does not go into any detail.

According to the definition of the Property Code, a **land charge** is the **right** to **demand payment** of a **certain sum of money** from the **value** of the **real property** prior to all other lower-ranking **creditors**. The right to obtain satisfaction from the value of the real property is not linked to any other right in an accessory relationship, as is e.g. the case with a claim that is secured by a mortgage. The Property Code expressly stipulates that satisfaction of the land charge must not be subject to any condition (e.g. non-satisfaction of the secured claim).[97]

Slovenia law mentions exclusively the certificated land charge. This means that the land charge is entered in the land register and a certificate is issued. Thus, the land charge under Slovenian legislation may be used as a security interest and for insulating purposes. A land charge is used not only as security for claims but also for other purposes. A land charge may be created as an owner's land charge or a non-owner's land charge. Its status may change during the existence of the land charge. Usually, a land charge is created for the benefit of the owner of an encumbered real property and thus, initially, as an owner's land charge.[98]

II. Creation

The land charge is created by a unilateral disposition in the form of a **notarial act**, which represents the basis for its entry in the land register. When the land charge is registered, the court issues a land charge certificate for the creator. Basically, a land charge can only be created by the owner of the real property who establishes a land charge "for future use". Only in exceptional cases - if the mortgagee converts the mortgage into one or several land charges of equal rank - does a non-owner land charge arise.[99]

The unilateral legal transaction creating the charge on land has to include the name of the creator, the description of the encumbered real property and the amount and maturity of the claim.[100] If the charge on land arises from conversion, the consent of the owner of the encumbered real property[101] and of the sub-mortgagee[102] must exist.

[97] Keresteš in Berden/Tratnik/Vrenčur/Rijavec/Frantar/Keresteš/Juhart, Novo stvarno pravo, Codex iuris, Maribor (2002), 170, cf. Sect. 192 SPZ.

[98] Keresteš, Grundschuld in der neuen sachenrechtlichen Regelung der Republik Slowenien, Das Budapester Symposium, GTZ, Bremen (2003), 148 ff (151).

[99] Keresteš, Grundschuld in der neuen sachenrechtlichen Reglung der Republik Slowenien, 155.

[100] The maturity of an amount may be defined by a date, an acceleration clause, etc. or a land charge certificate is issued that has already matured.

[101] Cf. Sect. 194(3) SPZ.

[102] Cf. Sect. 44(4.2) ZZK-1..

Based on this transaction, the court has to enter the land charge in the land register, applying the provisions relating to the registration of the maximum sum mortgage. The land charge is registered for the benefit of each holder of a land charge certificate.[103] This entry is the basis for the land charge certificate. Upon registration, the land charge is deemed to have been created.

The land charge certificate is an order paper. Therefore, in any legal dealings outside the land register, it is subject to the rules governing the transfer of order papers.

III. Use

The land charge may be used by the holder or by a third party for a variety of purposes. It is mainly employed for securing claims. Attention is once again drawn to the fact that - in contrast to the mortgage - there is no accessory link between the land charge and the claim secured by it. For this reason, the land change may be used as security for several different claims. This is of particular importance in light of the fact that Slovenian law does not provide for transfers of regular mortgages (*renosljiva prometna hipoteka*).

When using a land change to secure a claim, the title employed is the assignment agreement by which the owner of the encumbered real property and the creditor agree to secure the claim by the land charge. Under this agreement, the owner of the real property and holder of the land charge assigns the land charge to the creditor, who holds it until the maturity of the secured claim. While, upon payment of the secured claim, the land charge has to be returned to the owner of the real property in conformity with the agreement, in the event of default the creditor may satisfy his or her claim from the land charge. Unless otherwise agreed, the creditor may also pledge or assign the land charge but - because of the non-accessory nature of the land charge - without assigning the claim.[104]

IV. Transfer

Being an order paper, the land charge certificate is transferred in accordance with the rules applying to order papers, i.e. by endorsement and delivery of the paper.[105]

Under the contract, the owner of the real property endorses the order instrument in favor of the creditor and delivers it to the creditor. Even though this in principle suggests a high negotiability of the land charge, such negotiability cannot only be accelerated but may also be delayed. The land charge certificate may also be transferred by blank endorsement, which turns the land charge certificate into a de facto bearer paper, which increases its negotiability while also raising the risk of its being abused. A restrictive endorsement by contrast would slow negotiability or may even suspend it.[106] A restrictive endorsement converts the land charge certificate into a non-negotiable instrument, which can be transferred only by assignment. In the event of assignment, however, the debtor has the right to raise all those defenses against the new creditor, which the debtor could have raised against the old creditor.

[103] Cf. Sect. 20 ZZK-1.

[104] Mehr Keresteš, Grundschuld in der neuen sachenrechtlichen Reglung der Republik Slowenien, 158.

[105] Therefore exclusively by transfer of the certificate, in accordance with Sect. 197 SPZ.

[106] Keresteš in Berden/Tratnik/Vrencur/Rijavec/Frantar/Keresteš/Juhart, Novo stvarno pravo, 180.

Unlike the mortgage, the **abstract land charge** may also be **pledged on its own.**[107] This is done by a pledging endorsement[108] and the delivery of the land charge certificate.[109]

V. Realization

In the event of non-repayment of a secured claim, the claim may be satisfied from the land charge. The first prerequisite for this is the **maturity** of the **land charge**. In addition, no obstacles may arise under the security transaction or the provision of personal security, which might be used in protest against enforcement. Provided no such obstacles exist, a petition for **execution proceedings** may be filed on the basis of the land charge certificate. The land charge certificate thus qualifies as an executory title. Any authorized holder of a land charge certificate, who shows that he or she is in possession of the land charge certificate and an uninterrupted chain of endorsements, may file a petition for execution.[110] An exception applies only to the owner of the encumbered property, as the owner cannot petition for an enforcement against him or herself.[111] Registration of the holder of the land charge in the land register prior to realization of the land charge is not required. The holder of the land charge only has to present the land charge certificate.

Execution is conducted in accordance with the rules on execution against immovable property, with the rules applying to mortgages being analogously applied as well.

VI. Extinguishment

The land charge can be used for multiple purposes. Under Slovenian law, this is the main advantage of the land charge over the mortgage. The land charge may, however, also be extinguished by cancellation in the land register. In addition to filing a petition for cancellation, the petitioner has to present the land charge certificate to prove that he or she is the (current) lawful owner-holder of the land charge certificate.[112] The Property Code does not answer the question of whether a petition for cancellation may be filed only by the owner of the encumbered real property or by any authorized holder of the land charge certificate. Based on the provisions relating to the petitioner it may be assumed, however, that anyone who is able to prove a lawful interest has the right to petition for cancellation of the land charge.[113]

[107] Cf. Sect. 198 SPZ.
[108] Legal act by which the holder of the land charge transfers the land charge in writing.
[109] Keresteš in Berden/Tratnik/Vrencur/Rijavec/Frantar/Keresteš/Juhart, Novo stvarno pravo, 181.
[110] Keresteš, Grundschuld in der neuen sachenrechtlichen Reglung der Republik Slowenien, 160.
[111] Specifically Sect. 199(3) SPZ.. Nor would the owner have any legal interest in such a petition for execution.
[112] See Sect. 200 SPZ and Sect. 44(5) ZZK-1.
[113] Cf. Sect. 128 ZZK-1.

Chapter 6: Lien on Rights

I. General

Sect. 178 to 191 of the Property Code governs the lien on rights. This section of the Property Code contains the provisions on liens on receivables and securities as well as other property rights. Liens on receivables are of lesser practical significance in Slovenia, as the preferred instrument is the assignment of receivables.

II. Lien on Receivables

Receivables may be pledged if they **involve a performance**. Establishment of a lien is subject to the principle of **title and mode of acquisition**, which requires a title to exist in the form of a **consensual informal lien agreement**. The mode of acquisition requirement is fulfilled by the **lienor notifying the debtor** that the receivable has been pledged.[114] To create the lien on the receivable, notification (to third-party debtor) is required. In addition, the **lienee has to deliver to the lienor all deeds** and evidence relating to the pledged receivables.

Beside the constitutive effect, notification (of the third-party debtor) serves yet another purpose: After receipt of **notification** that the receivable has been pledged, the debtor can **discharge the debt** only by **making payment to the lienor**. If the debtor nonetheless makes payment to the lienee, such payment does not discharge the debtor; for this reason, the debtor would have to render performance once again to the lienor.[115] The debtor **may**, however, **raise against the lienor the same defenses** that he or she would be entitled to raise against the lienee. In the event the lienor's lien is extinguished, the lienee has to advise the debtor that, once he or she has received this notification, only payments made to the lienee will discharge the debt.[116]

The lienor has to do all that is necessary to keep the pledged receivable. The lienor has to collect interest, if applicable, and claims that may arise from time to time from the pledged receivable. From these amounts, the costs of collection, interest and the secured claim (in this order) are deducted. When the pledged receivable falls due and payable, the lienor has to collect it.

If the claim involves to the surrender of an asset, the lienee acquires a lien on this asset. If, however, the receivable is a sum of money, the lienor may keep the owed amount after the maturity of the secured claim but has to surrender any remaining balance to the lienee. If the pledged pecuniary claim is collected before the maturity of the secured claim, the lienor may keep the money in safekeeping, but, if requested by the lienee, has to deposit the collected amount with the court.[117] From this amount, the lienor may receive payment of his or her claim even before the maturity of the secured claim by applying the appropriate discount.[118]

[114] Cf. Sect. 179 SPZ
[115] Vrenčur in Tratnik/Rijavec/Keresteš/Vrenčur, Stvarnopravna zavarovanja, 214.
[116] Cf. Sect. 183 SPZ.
[117] He has in any case a lien on this money. Tratnik, Stvarnopravni zakonik, 137.
[118] Cf. Sect. 185 SPZ.

III. Lien on Securities

A. Materialized securities

Physically materialized securities (*materializirani vrednostni papirji*) are **reified** by a certificate.[119] The creation of a lien on **materialized securities** is subject to the principle of title and mode of acquisition, with mode being expressly regulated by the Property Code.

- **Bearer papers** are pledged by **delivery** to the lienor;
- **Order papers** are pledged by a pledging **endorsement** and **delivery** of the instrument;
- **Registered papers** that are negotiated by **endorsement** are pledged by a **pledging endorsement** and **delivery** of the instrument;[120]
- Other **registered papers** are pledged by **notifying the debtor** under the security that the **claim** represented by the registered paper has been **pledged**.[121]

With regard to all other rights, the lienors enjoy the same status as lienors holding a lien on a claim.[122]

B. De-materialized securities

De-materialized securities (*nematerializirani vrednostni papirji*) do not exist in physical form but, sometimes, only in electronic form on a securities account. They consist of notices by the issuer that have been recorded in the central register of de-materialized securities.[123] In practice, such securities are exclusively shares of stock. The placement of liens on such shares is governed by the act on de-materialized securities (*Zakon o nematerializiranih vrednostnih papirjih*, ZNVP).[124] The procedure is modeled on the procedure for registrations in the land register.

Mode of acquisition consists of the **entry of the lien in the central register.**[125] This also applies in the case of multiple liens or sub-liens placed on a security. The lien is entered on the basis of an order that has to be signed by the owner of the security. Unless otherwise agreed, the lienor is deemed to be entitled to receive dividends and other income from the security. Such rights have to be recorded in the register beside the lien.[126]

When the debtor does not redeem a claim, the lienor has to remind the debtor of the need to make payment. If the debtor and the lienee are not the same person, the lienee has to be notified as well. The reminder has to be sent by registered mail. After expiry of the time granted in the reminder, the lienor may sell the pledged security on the organized market. On completion of the sale, the lien has to be cancelled in the register.[127]

[119] Vrenčur in Tratnik/Rijavec/Keresteš/Vrenčur, Stvarnopravna zavarovanja, 210.
[120] Such a case is regulated for the transfer of registered shares by Sect.. 233 of the Business Companies Act (Zakon o gospodarskih družbah, ZGD).
[121] Cf. Sect. 188 SPZ.
[122] Expressly laid down in Sect. 189 SPZ.
[123] Plavšak, Zakon o nematerializiranih vrenostnih papirjih s komentarjem, GV, Ljubljana (1999), 24.
[124] Also regulated under Sect. 188(4) SPZ.
[125] Cf. Sect. 43 ZNVP.
[126] Plavšak, Zakon o nematerializiranih vrednostnih papirjih s komentarjem, 200.
[127] Cf. Sect. 47 ZNVP.

IV. Lien on Other Property Rights

Sect. 22 of the Property Code defines a **property right** as a right that is **transferable** and **whose value can be expressed in monetary terms**. This shows that liens may potentially be created on all types of property rights. Unless otherwise provided by the law, liens on such property rights have to be created with due regard to the provisions governing the transfer of such rights. Property rights include, for example, industrial property rights (e.g. **patent rights**) (*industrijska lastnina*), **copyrights** (*avtorske pravice*), and certain design rights (*oblikovalna upravičenja*).

Liens on other property rights are subject to the rules governing liens on movable property unless otherwise provided. Thus, for example, provisions relating to defects of title - but not provisions relating to material defects - may be applied analogously.

The rules governing fruits apply only to civil fruits (interest, etc.).[128] An exception exists only with regard to liens on building leases, for which the rules for liens on real property are applied mutatis mutandis.[129]

[128] Cigoj, Komentar obligacijskih razmerij, IV. knjiga, Uradni list SRS, Ljubljana (1986), 2633.
[129] Tratnik, Stvarnopravni zakonik, 138.

Chapter 7: Assignment by Security – Fiduciary Transfer of Receivables

I. General Remarks on the Assignment of Claims

A. Nature

Claims may also be **assigned** as security. Under Slovenian law, an assignment is a disposition by which the **assignor** (borrower) transfers a claim to the assignee (bank). There are **no special formal requirements** that have to be met. Even an assignment agreement that is entered into only orally is deemed valid. The assignor has to deliver to the assignee all evidence documenting the assigned claim, including a certificate of indebtedness, if applicable. While in the case of a legal transaction carried out for valuable consideration, the assignor is legally liable for the continued existence of the claim, the assignor is responsible for the collectibility of the claim only if expressly agreed, but even in that case only up to the amount of the consideration received.

In principle, **any kind of claim may be assigned**; excepted are only claims the assignment of which law prohibits or which are closely associated with the person of the creditor. With regard to the effects of an agreed **prohibition of assignment** (*pactum de non cedendo*), a distinction must be made between legal transactions subject to **civil law** and trade transactions. While in the former case the prohibition **applies absolutely** if the assignor was aware or would have had to be aware of the prohibition of assignment (negligent ignorance), assignment is effective in **trade transactions**[130] **despite** an agreed **prohibition of assignment**. Nonetheless, in the latter case, the third-party debtor (cessus) may discharge the debt by rendering performance to the assignor.[131]

B. Ancillary Rights

Along with the **assigned claim**, any associated **ancillary rights** are also transferred to the assignee, including the r**ight to separate satisfaction from the bankrupt's estate, mortgages, liens,** rights under **guarantees, interest,** contractual penalty, etc. Special provisions apply to liens. The assignor may deliver the pledged asset to the assignee only if the lienee agrees. If consent is refused, the assignor has to keep the asset for the assignor in custody. Mortgages are likewise subject to special provisions. Transfer of a mortgage is not possible by mere assignment of the claim but, to be effective, has to be entered in the land register.[132]

C. Notification of Third-party Debtor

Slovenian law does not require the **third-party debtor** to be **notified** about an **assignment**. The assignment is effective even if the debtor did not receive notification from the assignor nor from the assignee. Nonetheless, notification of the debtor entails an important legal consequence. As long as the debtor has **not received notification** of the assignment of the claim, he or she may continue

[130] see Chapter 1.
[131] Cf. Sect. 417(4) OZ.
[132] Sect. 148(2) SPZ.

rendering performance to the **assignor** in **full satisfaction of the debt**.[133] The importance of notifying the debtor is also evident in cases of multiple assignments. In such case, the assignee first named to the debtor acquires the claim.[134]

The **third-party debtor** may **raise all defenses vis-á-vis the bank** that he or she could have raised vis-á-vis the **assignor** at the time he or she gained knowledge of the assignment. The debtor thus assumes the position of assignor towards the assignee.[135]

II. Special Forms of Assignment

A. Assignment of Securities

Assignment as a general rule[136] is also used to transfer securities that are recorded in the name of the owner (*imenski vrednostni papirji*, registered securities).[137] The same applies to instruments made out to order, which were negotiated by restrictive endorsement.[138] This type of assignment is subject to specific formal requirements according to which the name of the new holder of the security (bank) has to be noted on the security along with the signature of the transferor. If the security has been recorded in a register, a transfer of the right attached to the security requires, in addition, an entry into the register. However, the right to the security is transferred at the time of delivery.

B. Assignment in Lieu of Performance

Instead of performing his or her obligation, the borrower may assign a claim or part of a claim towards a third party to the bank. When the assignment agreement is executed, the borrower's debt extinguishes. If the bank, when collecting the claim assigned by the borrower, receives more than the amount of the assignor's obligation, it has to surrender any excess amount to the borrower.

C. Assignment for Collection

If the assignor assigns the claim to his or her creditor only for collection, the obligation towards the bank having received the security is extinguished only when the bank (assignee) has actually collected the assigned claim (in contrast to the assignment in lieu of performance). If the amount collected is higher than the claim, the bank is again obliged to surrender the excess balance.

D. Assignment by Security

Assignment by security is a special form of security in rem. The assignor provides security for the amount owed by assigning a claim due to the assignee.

As a matter of principle, such an assignment is deemed as accorded on the condition subsequent of repayment of the secured loan obligation, unless otherwise agreed. **Assignment by security** is thus generally **accessory** in nature but also permits other arrangements.

[133] Cf. Sect. 419 OZ.
[134] Cf. Sect. 420 OZ.
[135] Sect. 421 OZ.
[136] An exception exists for materialized registered shares, which are negotiated by endorsement
[137] Sect. 218 OZ.
[138] Sect. 226 OZ.

Assignment does not require any specific formalities. Nonetheless, is must be borne in mind that in the event of the assignor's default, the bank is entitled to **separate satisfaction from the bankrupt's estate** and, in the event of execution proceedings against the assignor, to the defense of inadmissibility only if the assignment was created by way of a **notarial act**.[139]

In the case of multiple assignments, the law provides for an exception to the general rule[140], stipulating that the party to which it was assigned first acquires the claim. Notification and all other matters relating to assignment by security are subject to the general provisions governing the assignment of claims.

The implications of assignment by security become evident when the secured claim is not paid off at maturity. In such case, the assignee may obtain satisfaction from the assigned claim, but only up to the amount of the claim due. Any excess amount has to be surrendered to the assignor.[141]

[139] Sect. 209 SPZ.
[140] That the claim is acquired by the party of whom the debtor is notified first.
[141] Sect. 208 SPZ and Sect. 426 OZ.

Chapter 8: Assignment as Collateral – Fiduciary Transfer of Assets

I. General

One way of using assets as security is the assignment as collateral. Under Slovenian law, assignment as collateral **is allowed for movable property**. The **movable property remains** in the **immediate possession** of the **transferor** or of the third party that holds the property for the transferor.

Assignment as collateral is usually agreed on the **condition subsequent of satisfaction** of the **claim** (accessory fiduciary transfer of title). An alternative arrangement, i.e., a non-accessory assignment as collateral, may also be agreed. Transfer is completed in the form of a **directly enforceable notarial act**, in which the bank, the transferor and - if identical with the transferor - the debtor of the secured claim must be named. The agreement also has to name the legal ground, the description of the movable property and the amount and due date of the claim.

In principle, the **status** of the secured party is **similar** to that of a lienor in the case of a **non-possessory lien**. He or she may keep the movable property at a reasonable price or sell it in the manner laid down in the notarial act. On the basis of the **directly enforceable notarial act,** the transferee may demand **delivery of the asset** to his or her direct possession and dispose of it by an **extra-judicial sale.** If the transferor is not willing to surrender the asset, the transferee may demand delivery of the asset or its direct judicial sale.

II. Insolvency of Transferee and Transferor

When the transferor becomes insolvent, the transferee is entitled to the defense that he or she is holding the asset concerned as collateral. In bankruptcy or (forced) composition proceedings, the transferee is entitled to separate satisfaction from the bankrupt's estate.

Chapter 9: Suretyship

I. General

The suretyship (*poroštvo*) is an **agreement** between a **creditor** and a **surety** to secure a debt owed by the debtor to the creditor. The participation of the debtor is not a precondition. The surety undertakes to settle a due and payable obligation of the debtor if the debtor does not discharge the obligation.

Thus, two persons are liable to the bank, the debtor and the surety. The surety's obligation does not exist by itself, but is dependent on the secured liability (**accessory**). Without a principal debt, a suretyship can neither arise nor exist. Likewise, the surety's liability cannot exceed that of the principal debtor.

Any natural person of full legal capacity as well as any legal entity may act as surety. Several sureties may also secure an obligation simultaneously. A legally effective suretyship has to be created **in writing**, but this applies only to the **surety's declaration of suretyship**, not to the entire suretyship agreement. But also with regard to an oral declaration of suretyship, the theory of realization applies, preventing the surety from demanding refund of the amount paid on the basis of an oral agreement.[142]

II. Types of Suretyship

Under Slovenian law, two types of suretyship exist, subsidiary and joint and several suretyship. With subsidiary suretyship, the creditor may ask for satisfaction of his or her claim by the surety only after the principal debtor's default on the obligation, except for cases in which the principal debtor is obviously unable to satisfy the obligation or bankruptcy proceedings have been opened on the assets. Under a joint and several suretyship, the debtor and the surety are jointly and severally liable, permitting the creditor to demand satisfaction from either of them in any order and amount. A jointly and severally liable surety is also called surety and payer. Whether a suretyship is a subsidiary suretyship or a suretyship of a surety and payer depends on the arrangements entered into by the creditor and the surety, which are laid down in the suretyship agreement. In the absence of such an agreement, the existence of a subsidiary suretyship is assumed in relationships subject to civil law, and joint and several suretyship is assumed in relationships subject to commercial law.[143]

III. Typical Features of a Suretyship

A. Enforcement of the Claim

Satisfaction of the obligation by the surety may be demanded by the creditor either upon maturity of the claim (surety and payer, joint and several suretyship) or upon default on the claim by the principal debtor. In this process, the creditor has certain due diligence duties towards the surety. This applies specifically in the event of the principal debtor's bankruptcy, in which he or she has to assert a claim and notify the surety. **Regardless** of the outcome of the **bankruptcy proceedings**, the **surety has to discharge the obligation in full**. The creditor

[142] Juhart in Juhart/Grilc/Ilešič/Strnad, Zavarovanje in utrditev obveznosti, Gospodarski vestnik, Ljubljana (1995), 55.

[143] See Chapter 1.

should not delay claiming settlement of the obligation from the principal debtor. If settlement of the claim is not demanded of the principal debtor within a month from the due date, the surety is deemed to have been released from all obligations.[144]

Under a subsidiary suretyship, the creditor has to demand settlement of the claim from the principal debtor by means of a written document. It is only upon non-satisfaction of the claim that the surety's obligation falls due. The surety's obligation comprises the entire obligation of the surety, collection costs, interest, and damages for the delay as well as contractual interest.

B. Defenses of the Surety

The surety may raise **defenses** against the creditor. The first of these is the defense of rank; in addition, his or her own defenses (e.g. invalidity of the suretyship agreement), all defenses that the principal debtor may raise against the creditor (e.g. defense of the statute of limitation, defense of non-performance of the contract, etc.). Raising defenses is not only a right, but also even a duty in the case of the surety. If the surety does not challenge the creditor by presenting all defenses available, the surety loses the right of recourse to the principal debtor.

C. Termination of the Suretyship

Slovenian law does not include any provisions explicitly governing the surety's options in terminating a suretyship. However, if the suretyship represents a contract for the performance of a continuing obligation, the suretyship agreement may be terminated in accordance with the general provisions for the termination of continuing obligations. Under Sect. 333 Bond Code, any of the parties may terminate a contract entered into for an indefinite period of time. Notice of such termination has to be given in writing and delivered to the other party to the contract. The contract may be terminated at any time, except at an inopportune time, i.e., when this would be to the detriment of the other party to the contract. While the law does not specify any notice periods, such periods may be agreed by contract.

D. Provisions for the Surety's Protection

Slovenian law does not include any particular provisions corresponding to the provisions of the Austrian Consumer Protection Act or the provisions governing suretyships by close relatives. Therefore, the bank does not have any particular obligation to provide information to the surety.

E. Costs

In Slovenia, a suretyship agreement is not associated with any particular cost, nor is it subject to the payment of fees or charges.

[144] Sect. 1026 OZ.

Chapter 10: The Guarantee

I. General

The guarantee is a vehicle for securing a claim under which the guarantor assumes the obligation towards the recipient of the guarantee (the beneficiary) to perform a third party's obligation if the conditions named in the guarantee agreement are met and if the obligation is not discharged by the third party at maturity. Guarantees are subject to the provisions of the Act on Obligations (*Zakon o obligacijskih razmerjih,* ZOR), which cover only the bank guarantee. The bank guarantee may be used as security for credit only if another bank is named as beneficiary or if a guarantee is pledged to the bank.

II. Types of Guarantees

A. The Bank Guarantee

1. General

Sect. 1083 - 1087 Act on Financial Securities regulates the bank guarantee. A bank guarantee is an obligation of a bank to render performance to the beneficiary if the principal debtor does not satisfy its claim at maturity. As a matter of principle, the bank guarantee is not accessory and thus, unlike a suretyship, not dependent on the continued existence of a claim. The parties may, however, agree on an accessory guarantee. In addition, bank guarantees may be conditional or unconditional, abstract or causal, standardized or individual, transferable or non-transferable. Even though ZOR includes a number of provisions on the bank guarantee, bank guarantees are governed in practice by the harmonized guidelines and practices for legal guarantees (*Enotna pravila za pogodbene garancije*), publication No. 325 of the International Chamber of Commerce No. 325, mutatis mutandis.

2. Features of Bank Guarantees

a. Abstract and Accessory Guarantees

Abstract guarantees are not contingent on the underlying legal transaction (the credit agreement) to be secured by the guarantee. By contrast, an accessory guarantee is valid only as long as a valid claim that has to be secured (continues to) exist(s). In practice, most bank guarantees are abstract. The main difference between abstract and accessory guarantees lies in the defenses that may be raised: with an abstract guarantee, the guarantor cannot raise any objections on grounds based on the underlying transaction with the principal debtor vis-á-vis the beneficiary bank; the beneficiary bank may call the abstract guarantee even if there is no valid claim to be secured.

b. Conditional and Unconditional Guarantees

With conditional guarantees, the guarantor has to render performance only if specific conditions, as, for example, the presentation of certain documents, have been met. In the case of an unconditional guarantee, the bank providing the guarantee has to make payment even if the beneficiary bank does not satisfy such con-

ditions. In addition, guarantees may be limited with regard to the duration of their validity, their value, etc.

c. Revocable and Irrevocable Guarantees

Only irrevocable guarantees provide certainty to the beneficiary bank that the guarantor will actually make payment. With a revocable guarantee the risk always exists that the debtor in the underlying transaction may ask the guarantor to cease making payments.

d. Transferable and Non-transferable Guarantees

Unless explicitly **agreed otherwise**, a **guarantee cannot be transferred**. For a guarantee to be transferable, it has to contain an express **transferability clause**. Such transferable guarantees are assigned by endorsement. Slovenian law, however, does not permit the transfer of a guarantee without the simultaneous transfer of the claim secured by the guarantee.

3. Liens on Guarantees

Under Sect.1086 ZOR, it is not possible to assign a guarantee without at the same time assigning the claim secured by it as well. This rule applies to both accessory and abstract guarantees. Based on this rule one may conclude that a guarantee cannot be placed under lien - what may be pledged is only the claim secured by a guarantee. However, there are no court rulings on the placement of liens on guarantees.

4. Defenses of the Guarantor

If the guarantee contains a clause saying "no defenses" or "at first call", the guarantor does not have to right to raise the defenses that the borrower under the secured credit agreement may raise against the calling bank. This is due to the nature of the abstract guarantee. With an accessory guarantee, the guarantor may raise all defenses that the borrower may raise under the credit agreement. In the case of a conditional guarantee, the guarantor may refuse to make payment if the beneficiary fails to fulfill the specific conditions, e.g. fails to present a certain document. The defense of abuse of law[145] is conceivable under Slovenia law, but it is neither covered by relevant literature nor by relevant court rulings in connection with the guarantee.

IV. Letters of Comfort

Letters of comfort, which are commonly used in relations within group companies, are usually issued by the parent company to the bank extending credit to a subsidiary, stating that the parent is informed about the subsidiary's situation and that the parent will ensure that the subsidiary will be able to repay the credit. One of the common features of all letters of comfort is that they are used predominantly by groups and are issued to a bank.

[145] The use of a guarantee might constitute an abuse of the law, for example, if a claim to a payment does not exist as the secured claim has already been satisfied. In such a case the guarantee is used with fraudulent intention.

Since the content of a letter of comfort may vary, it has to be considered in each specific case whether such a statement is sufficient to provide to the creditor adequate security for the credit extended.[146]

A distinction has to be made between hard, committal, and soft, non-committal letters of comfort.

One of the common features of all letters of comfort is that they are used predominantly by groups and are issued to a bank. Mostly, only hard letters of comfort are deemed to be legal transactions with consequential obligations such as the obligation to pass on information, to render performance or refrain from certain acts, and other duties. Nonetheless, it has to be pointed out in this context that in most cases even such obligations do not give rise to any liability on the part of the parent company to actually meet the obligations of the subsidiary towards the bank. The issuer of the letter of comfort is liable only for what the issuer undertook in the letter of comfort. Hard letters of comfort represent security, which, unlike soft letter of comfort, come close to suretyships and guarantees.

[146] Repas, Patronatska izjava kot novejša oblika zavarovanja obveznosti, Podjetje in delo 1/2001, 77.

Chapter 11: Additional Assumption of Debt

I. General

Under an additional assumption of debt (*pogodba o pristopu k dolgu*), a third party undertakes towards a creditor to meet a debtor's obligation. Thus, a third party is liable for the obligation in addition to the debtor. An agreement is entered into by the creditor (bank) and the third party that does not require the debtor's consent.[147]

II. Formal Requirements

Slovenian law does not prescribe any specific format for the additional assumption of debt. An oral promise is therefore sufficient, even though for the purpose of furnishing evidence it is advisable to make such a promise is writing.

III. Defenses

The person assuming the debt discharges **his or her own liability**. Therefore, said person has the right to raise any own defenses against the creditor. The original debtor has no defense against the creditor to the effect that the creditor has to demand payment first from the party who agreed to the additional assumption of debt. The two obligations are independent of each other and similar to joint and several liability - apart from the option of taking recourse, which in the latter case is usually possible. There is no legal relationship between the original debtor and the new debtor unless such a relationship is established by contract.

IV. Additional Assumption of Debt versus Suretyship

Under Slovenian law, the additional assumption of debt is very similar to suretyship. But there are a number of important differences. Specifically, the new debtor is not entitled automatically to recourse against the original debtor once he or she has made payment; nor does the new debtor, after making payment, automatically assume the rights that the secured bank has against the original debtor; any claim that the new debtor may have against the original debtor can arise solely from a contractual agreement between these two parties. In this respect a suretyship is different, with the surety's right to recourse being governed by Sect. 1028 OZ. In contrast to a suretyship, the additional assumption of debt is not accessory, which means that the obligation of the new debtor does not terminate automatically when the obligation of the principal debtor (original debtor) ends.

[147] Cf. Sect. 432 OZ.

Chapter 12: Insurance

I. General

An insurance contract is an agreement under which the buyer of insurance agrees to pay to the insurer a premium or an amount of money, and the insurer in turn agrees to pay to the insured person or a third party the amount insured or compensation for damage or to render performance on occurrence of an event (insured event).[148] This chapter explains only how insurance may be used as collateral for credit.

II. Life Insurance

A. Nature

Under a life insurance policy, the insurer agrees to pay out a lump sum or an annuity specified by contract on the occurrence of the insured event. In the case of life insurance, the insured event is death or survival until a specified time.

The **insurance policy may be pledged**, meaning specifically that the right to the proceeds from the insurance may be pledged. To become effective, a lien on insurance proceeds has to be notified to the insurer in writing. A lien on an insurance policy is treated like a restriction on its transferability. After having been notified of the lien, the insurer is obligated to pay out the insured amount to the insured person or the beneficiary only with the lienor's consent.

The **proceeds** of a life insurance policy may be agreed as **payable to a third party** enjoying the status of beneficiary. The beneficiary may be specified in the insurance policy or determined by other acts of legal significance (gift, will).

Compared with a property insurance policy, a life insurance policy is of an entirely different nature. Even though the policy also serves as evidence of insurance, the life insurance policy also has to show general data (name of insurer, name of insured person, duration and type of insurance) as well as information on the beneficiary (insured person). Name and birth of date have to be shown. In addition, it is essential to specify the event or period on which the right to payment of the insured amount is contingent.

Under a life insurance policy, the insurer is not entitled to take legal action in the event of non-payment of a premium. This is explained by the fact that life insurance is understood as a kind of investment, non-payment of which does not lead to the termination of the insurance policy but to an adjustment, in the insured event, of the performance to be rendered by the insurer to the amount of premiums paid. Nonetheless, the insurer has to inform the insured person of non-receipt of payment, setting a grace period not exceeding one month. If no payment is made during that period, and if a minimum of three premium payments have been made, the insurer may notify the insured person that the insured amount will be reduced to the cash surrender value of the insurance. If fewer than three premiums have been paid, the insurer's only option is to declare withdrawal from the contract. The procedure for calculating the cash surrender value is laid down in the insurance policy.

[148] Cf. Sect. 921 OZ.

B. Exceptions from Life Insurance

Life insurance does not cover events that depend on the will of the policyholder or might be brought about only to obtain payment of the insured amount. In addition, risks such as war are not covered by insurance. In the case of suicide certain distinctions are made: if suicide is committed within the first year of the insurance, the insurer is exempt from all obligations. If suicide is committed within three years of closing the insurance contract, the insurer is not obligated to pay out the insured amount but only the calculated contractual provisions. In all other cases of suicide committed at a later date, the insurer has to pay out the insured amount in full.[149]

In the case of a whole-life insurance policy, the insured person may sell the policy at its cash value once at least three premiums have been paid. Said person, however, may also ask for disbursement of an advance, which will be classified as a loan and may be redeemed later. In order to keep the contract alive, the insured person has to pay interest for the life of the loan; if he or she fails to do so, it will be assumed that he or she is asking for the policy to be bought back.

III. Limitation of Transfer in Insurance Policies

Slovenian law permits the use of loss payable clauses in insurance policies. This is done by entering on the policy words to the effect: "Limitation of transfer in favor of . . ." (naming a specific person). When the insured event occurs, the insurer has to make payment first to the person named and only any remaining balance to the policyholder. In no case may the insurer pay out the insured amount to the policyholder without the favored person's consent.

Limitation of transfer clauses are commonly used in loan and leasing contracts. Specifically, proceeds from comprehensive motor insurance are often made payable to the bank. The lessor and the lessee agree that the latter buys insurance for the leased asset from an insurance company named by the lessor, with the loss payments being made payable to the lessor. A certificate providing evidence of such arrangements has to be delivered to the lessor.

IV. Special Considerations when Insuring Credit Transactions

Especially consumer loans and low-value loans are frequently insured with an insurance company. The costs of such insurance are part of the loan costs and are fully charged to the borrower. In such a case, the insured party is the lender (the bank), to which the insurer has to pay the outstanding amount in full or in part upon occurrence of the insured event. Under the applicable law, the portion of the claim covered by the insurer passes to the insurer; the insurer may seek to recover the insured amount paid out from the debtor.

[149] Sect. 973 OZ, cf. Ivanjko, Zavarovalno pravo, Pravna fakulteta, Maribor (1999), 167.

Chapter 13: Concluding Remarks

Compared with the Austrian law on security interest, the following significant differences can be summarized in brief:

An **executory title** may also be obtained **extra-judicially** in the form of a directly enforceable notarial act (see Chapter 1).

Certain **movable assets** may be registered in a **lien register** permitting the creation of a lien on assets **without delivering** the asset itself (see Chapter 3).

Movable property may also be **realized extra-judicially** if such realization was agreed. In the case of commercial transactions (transactions between two entrepreneurs) the existence of such an agreement is presumed to exist. Slovenian law does not provide for **superaedificium, but** for a similar right in the form of a building lease (see Chapter 4).

In Slovenia, a **land charge** may be created following the model of German law. This is a special form of mortgage that is abstract and not accessory by nature. A land charge may be transferred even without the underlying secured claim (see Chapter 5.).

An **assignment by security** has to be agreed by **notarial act** to provide the bank with a right to separate satisfaction from the bankrupt's estate in the event of bankruptcy (see Chapter 7).

In contrast to Austrian practice, in the case of **fiduciary transfer of assets**, the **asset remains in the possession of the borrower** (lienee), who may continue to use it for business purposes; actual delivery of the asset is not required. Fiduciary transfer of assets requires a notarial act (see Chapter 8).

Pledging or assignment of claims under guarantees is not possible without transferring the secured claim as well (see Chapter 10).

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List of Abbreviations

OZ	Bond Code (Obligacijski zakonik, OZ).
SPZ	Property Code (Stvarnopravni zakonik, SPZ)
VerfGE	Rulings of the Constitutional Court
Zban	Banking Act (Zakon o bancništvu, zban)
ZFPP	Act on Companies' Financial Conduct (Zakon o financnem poslovanju podjetij, ZFPP)
ZFZ	Act on Financial Securities (Zakon o finančnih zavarovanjih)
ZGD	Act on Business Companies (Zakon o gospodarskih družbah, ZGD),
ZIZ	Act on Execution and Security Rights (Zakon o izvršbi in zavarovanju)
ZN	Notaries Act (Zakon o notariatu)
ZNVP	Act on Nonmaterialised Securities (Zakon o nematerializiranih vrednostnih papirjih)
ZOR	Act on Obligations (Zakon o financnih zavarovanjih)
ZpotK	Act on Consumer Credit (Zakon o potrošniških kreditih, ZPotK)
ZPPSL	Act on Bankruptcy, (Forced) Composition and Liquidation (Zakon o stecaju, prisilni poravnavi in likvidaciji)
ZTVP-1	Act on the Securities Market (Zakon o trgu vrednostnih papirjev)
ZVKSES	Act on the Protection of Buyers of Apartments and Single-family Homes (Zakon o varstvu kupcev stanovanj in enostanovanjskih stavb)
ZVPot	Consumer Act (Zakon o potrošnikih)
ZZK-1	Land Register Act (Zakon o zemljiški knjigi)