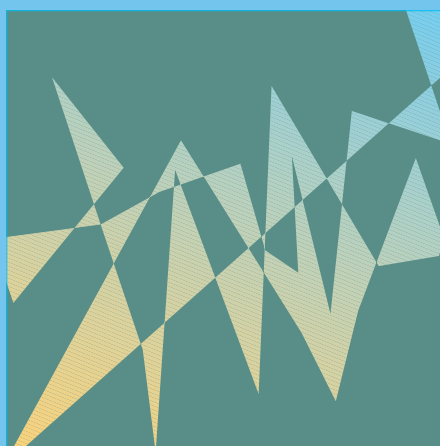


GUIDELINES ON CREDIT RISK MITIGATION

Legal Framework in Croatia



*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 Croatian 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 Croatian law. The Guidelines refer to the legal situation as at 1 April 2004.

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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 will be 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* have been drafted with the collaboration of many renowned experts from the respective countries and are 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, December 2005



Univ. Doz. Mag. Dr. Josef Christl
Member of the Governing Board
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Chapter 1: General Remarks on the Legal System in the Republic of Croatia

I. Introduction

The Guidelines set out below deal with the most important **credit risk mitigation instruments** available under Croatian law. This Chapter contains a brief description of the Croatian legal framework as well as a detailed analysis of the possible methods of collateral realization. The chapters dedicated to specific topics go into more detail on the special features of how each of the credit risk mitigation instruments can be realized.

II. Political and legal framework in the Republic of Croatia

The Republic of Croatia has been a sovereign, autonomous and independent state since 1991, and is now organized as a **multi-party parliamentary republic**. The powers of the state are separated into legislative, executive and judicial powers in accordance with the principle of separation of powers and these powers are limited by the rights granted to the local and regional autonomous governments laid down in the Constitution.¹ The Republic of Croatia is divided into 20 **counties (kotari)** and the **City of Zagreb** (capital of the Republic of Croatia) with a total of 121 cities and 416 communes.

The **legislative power** and representative body of the citizens is the Croatian **Parliament (Sabor)**. The parliament has at least 100 and at the most 160 representatives elected by general, equal and direct anonymous vote. The representatives are elected for a period of four years to the Croatian Parliament and enjoy immunity.² The **president of the Republic of Croatia** represents the Republic of Croatia within the country and abroad. The president is elected by a general and equal direct anonymous vote for a period of five years and for at the most two periods.³

The **government of the Republic of Croatia (Vlada Republike Hrvatske)**, which is made up of the Prime Minister, one or more Vice-Presidents and the Council of Ministers exercises **the executive powers**. At the local and regional level, all tasks that directly affect the interests of citizens are the responsibility of the bodies of the autonomous local and regional governments, namely, of the **counties, communes and cities**.⁴

The **judicial powers** are vested in the courts that operate autonomously and independently. The highest court is the **Supreme Court of the Republic of Croatia** whose responsibility it is to ensure the uniform application of the law and the equal treatment before the law of all citizens. Jurisprudence is exercised also by municipal courts, county courts, commercial courts, the High Commercial Court, the Administrative Court, the Misdemeanor courts and the High Misdemeanor Court. The Constitutional Court rules on the constitutionality of laws, regulations and acts (*Ustavni sud Republike Hrvatske*) and rules on

¹ Art. 4/1 of the Constitution of the Republic of Croatia (Official Gazette of the Republic of Croatia No. 41/01-new, amended text).

² Art. 80 of the Constitution.

³ Art. 93, 94 of the Constitution.

⁴ Art. 132 to 137 of the Constitution.

complaints against government bodies filed on the grounds of nonconformity with the constitution.⁵

When the Republic of Croatia declared its independence on 8 October 1991,⁶ it also began developing its legal system based on market economy principles. The parliament passed laws on the privatization of state property as well as many new regulations for commerce, real property, criminal law, family and inheritance law. Another reform of Croatian legislation is currently being prepared in the context of the adaptations being made to bring it into line with the *acquis communautaire* (body of common rights and obligations of the countries of the European Union) and in accordance with the Stabilization and Association Agreements, which were signed on 20 October 2001 between the Republic of Croatia and the European Communities and its member states.⁷

III. General Remarks on the Banking System of the Republic of Croatia

The function of central bank is assumed by the **Croatian National Bank** (*Hrvatska narodna banka – HNB*), which acts independently in fulfilling its duties, but reports to the Croatian parliament.⁸ A special law on the Croatian National Bank regulates the powers and the organizational structure of the Croatian National Bank.⁹ It is a legal entity with its registered office in Zagreb. The Croatian National Bank is represented by the Governor of the Croatian National Bank and is wholly owned by the Republic of Croatia, which is liable for the receivables of the Croatian National Bank.¹⁰ Apart from many other areas of responsibility such as monetary and foreign exchange policy, the Croatian National bank also acts as the banking supervisory authority.¹¹

⁵ Art. 128 of the Constitution.

⁶ Resolution passed by the parliament on 8 October 1991 No. 53/91); Resolution amending the Constitution on the Sovereign Status and Independence of the Republic of Croatia of 25 June 1991 (Narodne novine, 31/91); Declaration on the Establishment of an Independent and Sovereign Republic of Croatia of 25 June 1991 (Narodne novine, 31/91).

⁷ Stabilization and Association Agreement of 20 October 2001 between the Republic of Croatia and the European Communities and its Member States (Narodne novine – International Agreements 14/01).

⁸ Art. 53 of the Constitution of the Republic of Croatia.

⁹ Narodne novine No 36/01.

¹⁰ Art. 2 of the Croatian National Bank Act.

¹¹ Art. 4 of the Croatian National Bank Act.

Chapter 2: General Remarks on Security Interest in Croatian Law

I. General

Since its independence, work has been very intense to bring the economic and legal system up to the standards of a market economy. The introduction of market economy and the greater number of business transactions guided by these principles also gave rise to demands for greater efficiency in the protection of creditors in the event of default on debts.

Within the scope of the reform of the economic and legal system, efforts have concentrated on the protection of creditors (including banks) against credit risks. Laws on credit risk mitigation and the improved protection of creditors as well as numerous new laws regulating the areas of real property, execution and land registry were passed. Moreover, a number of laws (e.g. the provisions contract law) were adapted to the economic changes.

Despite the far-reaching reform and new laws, serious problems still crop up in banking practice as regards both the satisfaction of claims and the provision of security. For this reason, banks have developed cumulative security methods to protect themselves against default on their outstanding debts by demanding various types of security for loans. Therefore, in practice, banks frequently demand both collateral and personal securities to cover outstanding debts and as a means to lower the risk of default.

II. Legal Sources of Collateral and Personal Securities

A. Legal Sources of Collateral

The **Act on Real Property and Other Real Property Rights** (*Zakon o vlasništvu i drugim stvarnim pravima*) governs substantive real property law such as lien rights to movables (chattel), lien rights to real estate (mortgage), lien rights to titles, retention of title to secure an outstanding debt, and the assignment as collateral.

The **Land Register Act** (*Zakon o zemljišnim knjigama*)¹² is an extension of the provisions of the Act on Real Property and Other Real Property Rights, and together these two acts form an integral unity. The Land Register Act regulates, among other things, the type of entry for individual registered property rights, the types and requirements of the entry, the property registration procedure and the writing-off of old mortgage claims.

The **Execution Act** (*Ovršni zakon* - Act on the Levy of Execution)¹³ regulates the procedures for the forced collection of debts based on executable and trustworthy deeds¹⁴ (execution proceedings) and on the securing of debts (credit securing proceedings). The provisions relating to the securing of debts of the Execution Act also regulate the proceedings to secure claims through real security (liens, assignments as collateral), the requirements for establishing these rights and how to file petitions to satisfy debts. The establishment of real security under the provisions of the Execution Act is the most frequent form in

¹² Narodne novine 91/96, 137/99, 114/01.

¹³ Narodne novine 57/96, 29/99, 42/173.

¹⁴ Invoices, Checks, Bills of Exchange, Excerpts from Business Records, 28 Act on the Levy of Execution.

practice, because this type of security makes it possible for banks to recover their receivables easily and swiftly.

B. Legal Sources of Personal Securities

The **Act on Obligations** (*Zakon o obveznim odnosima* – Obligations Act, OblG)¹⁵ regulates the fundamental principles of contract law, how contractual and non-contractual debts arise, law on compensation for damages, and the individual types of contracts. The provisions of the Act on Obligations that deal with the rights of creditors to contest any legal acts of a debtor (action to invalidate a contract, *Actio Pauliana*) are of special relevance for the instruments used for credit risk mitigation; the rights of creditors in the event of non-fulfillment and delays in payment; rules on interest, advance payments, stipulated penalties, suretyships, assumption of debt and the assumption of performance obligations as well as the assignment of receivables.

The **Act on Interest on Arrears** (*Zakon o zateznim kamatama*)¹⁶ governs the calculation and payment of interest on arrears in the event a debtor defaults on pecuniary obligations (Art 1 par1).

The **Act on the Securities Market** (*Zakon o tržištu vrijednosnih papira*)¹⁷ governs the issuance of securities and securities transactions and in this context also liens on dematerialized securities.

The **Act on Bills of Exchange** (*Zakon o mjenici*)¹⁸ contains provisions on the types of bills of exchange, the endorsement, the accepted bill of exchange, the discharged bill of exchange, and the assignment of exchange rights. These provisions define how liens on bills of exchange are established.

The **Act on Checks** (*Zakon o čeku*) defines the issuance of checks and the form they must comply with, their endorsement and the right of recourse due to failure to cash as well as liens on checks.

C. Other legal sources

In addition to the provisions mentioned above, there are a number of other provisions of great significance for certain types of credit risk mitigation instruments such as the relevant sections of the **Bankruptcy Act**,¹⁹ the Act on **Litigation under Civil Law**,²⁰ the **Act on Notaries**,²¹ the **Banking Act**,²² the Act on **Foreign Exchange Transactions**²³.

¹⁵ Narodne novine 53/91, 73/91, 111/93, 3/94, 107/95, 7/96, 91/96, 112/99, 88/01.

¹⁶ Narodne novine 28/96.

¹⁷ Narodne novine 84/02.

¹⁸ Narodne novine 74/94.

¹⁹ Narodne novine 44/96, 161/98, 29/99, 129/00, 123/03, 197/03.

²⁰ Narodne novine 53/91, 91/92, 112/99, 88/01, 117/03.

²¹ Narodne novine 78/93, 29/94, 162/98.

²² Narodne novine 84/02.

²³ Narodne novine 96/03.

III. Collateral and Personal Security

A. General

The same as in Austria, the legal instruments for securing loans are divided into two groups: collateral and personal security. These Guidelines explain only those types of security that are suitable for securing bank loans (credit).

Legal transactions with **banks** are **always commercial transactions** and are subject to more favorable regulations as regards the realization of security. Thus, for example, an agreement on an out-of-court realization is presumed to exist unless explicitly agreed otherwise.

B. Collateral

Collateral (*stvarnopravna osiguranja*) is an asset pledged as security that is real property and has absolute effectiveness towards all (*erga omnes*). The owner of a pledged piece of real property is liable only with this property and not, for example, with his or her entire assets.²⁴ Collateral covers **liens on movables, liens on real estate** (mortgage), **liens on rights, retention of title, assignment as collateral, judicial security and notary-certified assignment** and the **right of retention**. The retention of title is not dealt with in these Guidelines, because it only serves as security for claims on a purchase price, but not for securing loans.

In practice, collateral has a much greater significance for securing credit risks than personal security. Its greatest value is that it can be claimed against any person, including the respective owner of the pledged property, regardless of whether the person was the owner at the time the property was pledged or not. This means that banks are covered even in the case of a change in ownership. However, the principle of *erga omnes* of collateral requires this fact to be made clear to third parties adequately. Banks are therefore only protected if they have made clear to all concerned parties that certain pieces of property have been pledged as collateral and indicate the content and priority ranking of said security.

There are problems in Croatia that occur in practice especially regarding the disclosure of liens on movables and real estate. The **difficulties** arise in the case of **real estate**, because the land register does not always indicate the **actual legal status** of the property and does **not always offer protection of legitimate expectation**. **Problems** can also arise in the case of movables, especially when liens are **not registered in the land register** and therefore in those cases in which a **non-possessory lien** with the bank as beneficiary has been established.²⁵

C. Personal Security

A feature of **personal security** (*osobnopravna osiguranja*) is the fact that the guarantor is liable for the debt owed with his or her entire assets. The most common forms of personal security are the **contract of suretyship**, the **additional assumption of debt**, the **bank guarantee**, the **stipulated penalty**, **promissory note** and **blank promissory notes**, and the **bill of exchange**.

²⁴ If the owner of the pledged property is also the person guaranteeing the debt (personal debt = real debt), this person shall be liable for the debt with his or her entire assets as well.

²⁵ See Chapter 4.

These Guidelines will not go into detail on the stipulated penalty, promissory note, blank promissory or bill of exchange due to their minor significance for credit risk mitigation.

Personal security provides banks with protection against the risk of default by making it possible for banks to satisfy claims from a wider source of total assets, namely, those of the person liable. However, in the case of personal security banks carry the risk of default of the person providing the security.

IV. The Realization of Security

A. The Realization of Collateral

The option of swift realization of collateral depends largely on the type of assets pledged (movables or immovable property) to the creditor, and, on the features of this security. **Pledged movable assets** may be sold under certain circumstances **extra-judicially**, which makes it faster to realize their value. Mortgages in contrast can **only be realized in judicial proceedings**, which in some cases can take a very long time.

The type of **realization** refers to the issue of whether the judgment creditor's claims are satisfied through **execution proceedings** or through **bankruptcy proceedings**. Moreover, the legal status of the judgment creditor in the execution proceedings essentially depends on whether the debt is secured by collateral or a personal security.

If the creditor's claim is satisfied from the proceeds of the asset pledged as collateral for which the creditor is beneficiary, he or she shall have a preferred status over the other creditors with respect to the satisfaction of the claim. The claims of the other creditors are satisfied only after the creditors with pledged collateral are satisfied.

B. Realization of Personal Security

1. General

In the event a creditor's claim is secured by a **personal security**, the liability of the person who acts as a guarantor in addition to the debtor (e.g. surety) shall be exclusively a **personal liability**. The person granting a personal security is liable with his or her **entire assets**, but only up to the amount of the outstanding debt owed by the debtor to the creditor. In **execution proceedings** against persons having granted a personal security, the creditor shall have the same status as the debtor's other creditors, i.e., said creditor shall not have any preferred status as regards the satisfaction of claims. The creditor has the right to apply for execution against all properties and rights of persons granting a personal security who are actionable according to the provisions of the Act on the Levy of Execution. The **object** of the **execution** may include **movables, real estate or property rights**.

2. The Compulsory Judicial Lien

In the course of execution proceedings, **claims** secured by **personal security** may be **secured** in the form of liens. This type of lien is referred to as a compulsory judicial lien.

This judicial lien is different from voluntary liens in that it is not granted before or at the time the credit is extended, but rather only in the course of court proceedings for execution to satisfy outstanding debts. Therefore, this type of lien serves primarily as **security in execution proceedings** for outstanding claims that may arise, for example, from **personal security**.

The **compulsory judicial lien on movables** (*sudsko prisilno založno pravo na pokretninama*) is acquired by a **ruling** on the execution on movables of the judgment debtor in order **to collect** a pecuniary claim²⁶ or on the basis of a **ruling** to issue a temporary injunction **to secure** a pecuniary claim.²⁷

The lien is established here as well by recording the movable property in the registry of liens.²⁸ The lienor, that is the party initiating the execution (security holder) does not have any ownership rights in the movable property on which the compulsory judicial lien is established. A compulsory judicial lien on movables cannot be acquired for those movables, which according to the Act on the Levy of Execution, are excluded from execution for reasons of protecting the subsistence of the debtor.

a. Restrictions on Execution

The compulsory judicial lien on movables is subject to special **execution restrictions**. As this type of lien is subject to the provisions of the Act on the Levy of Execution, it is not possible to establish it on movables that are excluded from execution under this law. Usually, this refers to movables that are necessary for satisfying the basic needs of the debtor and of those persons who have a claim to be supported by the debtor²⁹ or which are necessary for carrying on the activity of a legal entity³⁰. According to Sect. 128 of the Act on the Levy of Execution, the following **objects are excluded from execution**:

- a) Clothes, shoes, linen and other objects of personal use; dishware and cutlery, furniture and household appliances required for running a household if these are needed by the judgment debtor and the members of his or her household, and form part of the normal living conditions of their social environment;
- b) Food and fuels for six months commensurate with the needs of the judgment debtor and the members of his or her household;
- c) Live stock, seeds, farming machines and other tools needed for judgment debtor who is a farmer to maintain his or her farming enterprise to an extent necessary to cover his or her subsistence and that of the members of his or her household;
- d) Tools, raw materials, fuels, machines and other objects that judgment debtor who is a tradesperson or sole businessperson needs to carry on his or her business;

²⁶ Art. 311 Act on Real Property and Other Real Property Rights; Art. 127 Act on the Levy of Execution.

²⁷ A creditor may apply for a temporary injunction to secure a claim who already has a legally binding, but not yet executable court ruling for the claim and can argue plausibly that the enforcement of the claim would not be possible or much more difficult without such a measure to secure the claim (Art 284 Act on the Levy of Execution).

²⁸ Art. 135 Act on the Levy of Execution.

²⁹ Art. 70/1 Act on the Levy of Execution.

³⁰ Art. 71/1 Act on the Levy of Execution.

- e) Cash belonging to the judgment debtor based on claims that are excluded from the execution;
- f) Distinctions, medals, war medals and other medals of honor, personal letters, manuscripts and other personal files of the judgment debtor, family pictures, personal and family documents, family portraits;
- g) Support apparatus needed by handicapped persons or other persons with a physical disability to maintain life functions.

The **restrictions** listed above for compulsory liens **do not apply to voluntary and voluntary judicial or notary-certified liens** on movables (see Chapter 4) except for movables that are absolutely exempt from execution. According to the explicit provisions of Act on the Levy of Execution, a debtor who voluntarily (based on a legal transaction) has established a lien on an object for which execution is restricted according to the rules of the Act on the Levy of Execution or which are excluded from execution cannot reject the satisfaction of his or debt from the proceeds of the pledged objects.³¹

3. Execution of Real Estate Property

a. General

Just like the execution of movables, the execution of real estate can also be carried out by establishing the property as security in the form of a judicial lien. This type of **execution lien** (*sudska prisilna hipoteka*) is a mortgage on a property of the debtor based on a court ruling made in the course of proceedings for the compulsory securing of a debt.

The execution lien is established against the will of the debtor to secure the possibility of satisfying a debt owed to a creditor by placing a lien on piece of real estate property of the debtor that can be sold.

The requirements for establishing an **execution lien** depend on whether the mortgage is being created as a measure to secure a pecuniary claim established by way of an **executable deed** or if it is a **temporary assignment to secure a claim**.

The requirements for establishing an execution lien are:

A **ruling** issuing the **order** for the compulsory establishment of a mortgage lien on a piece of real estate property of the debtor (Sect. 258 Act on the Levy of Execution);

Incorporation of the **execution lien** in the **land register** (Sect. 259 par 1 Act on the Levy of Execution). The requirements for establishing a **execution lien as a temporary measure for securing a claim** are:

- a **ruling** stipulating the establishment of a **temporary order to secure a pecuniary claim** (Sect. 284 - 286 Act on the Levy of Execution);
- entry of a note on the **execution lien** in the land register (Sect. 287 par 1 fig 1 Act on the Levy of Execution).

b. Restrictions on Execution

The **object** of a **execution lien cannot be a real estate property** subject to execution restrictions.³² The following are excluded from execution liens:

³¹ Art. 72, 267 par 5 Act on the Levy of Execution.

³² Art. 70, Art 71, Art 86 par 1, Art 201 par 2 Act on the Levy of Execution.

Agricultural real estate property and farming buildings of a farmer to an extent required to ensure the subsistence of the farmer and the members of his or her immediate family and any other persons for whom he or she is obligated to support by law (Sect. 86 par 1 Act on the Levy of Execution); If the debtor is a natural person only those real estate properties that are needed to satisfy his or her basic living needs and those of persons for whom they are obligated by law to support, or such real estate property needed to carry on a self-employed business which is the principle source of income of the debtor (Sect. 70 par 1 Act on the Levy of Execution). However, real estate properties that serve as living quarters or are used for carrying on a business are not considered objects that are necessary to satisfy the basic living needs of a debtor (Sect. 70 par 3 Act on the Levy of Execution). Real estate property of a debtor who is a legal entity that has been constructed or adapted for the purpose of a strictly defined activity if by selling this property the activity of the debtor would cease (Sect. 201 par 2 Act on the Levy of Execution). In this case, property used as office space and property that has not been constructed or adapted for carrying on a strictly defined activity is not considered an object necessary for carrying on the activity of a legal entity (Sect. 201 par 1 Act on the Levy of Execution). The **restrictions** listed above for a execution lien **do not apply** to **voluntary liens and voluntary, judicial or notary-certified liens** (see Chapter 5). Therefore, it is possible for property (real estate) to be the object of these types of liens that are excluded from execution according to Act on the Levy of Execution or subject to restricted execution.

4. Execution by Pledging Rights

a. General

The compulsory judicial lien on rights is established by a court ruling in execution proceedings. The court ruling on the establishment of a compulsory judicial lien is done against the will of the debtor, specifically on property rights of a debtor that are suitable for the compulsory satisfaction of claims of a creditor.

The requirements for establishing this type of lien on property rights vary depending on whether it is done within the scope of execution proceedings to satisfy a creditor (Sect. 147-216 Act on the Levy of Execution) or within the scope of debt securing proceedings prior to execution as a measure to secure debts (Sect. 280-291 Act on the Levy of Execution).

The requirements for establishing compulsory liens in execution proceedings are:

Writ of execution issued by a court (Sect. 37 Act on the Levy of Execution);

The pledging of receivables of a debtor or of other property rights of the debtor (Sect. 150, 200 Act on the Levy of Execution). By pledging property rights, the creditor acquires a lien on the receivables of the debtor.³³ The lien on receivables refers to interest falling due after the lien has been established.³⁴

³³ Art. 152 3 Act on the Levy of Execution.

³⁴ Art. 155 - 268 Act on the Levy of Execution.

The **mode of acquisition** of the lien depends on the type of property right of the debtor for which the execution is being carried out:

- The pledging of a receivable is done by **serving the writ of execution to the third-party debtor**, thus prohibiting him or her from paying the judgment debtor. The judgment debtor (usually the borrower) is not permitted to draw on these receivables or otherwise dispose of these receivables or any lien having been established as security for said receivables. The lien is established when the writ of execution is served to the third-party debtor;³⁵
- The pledging of a receivable based on a **security transferable by endorsement** is done by **seizure of the security** by the **bailiff** and the handing over of said security to the court or to a notary public;³⁶
- The pledging of a **receivable based on a share of stock** for which no stock certificate is issued (dematerialized share) or a registered share issued in the name of the person for which the document has been issued is done when the **writ of execution is served to the stock corporation**;³⁷
- The pledging of a **receivable on the payout of savings deposits** on a bank account is usually done by **handing over the savings passbook**;³⁸
- The pledging of a pecuniary claim on a current account, a foreign exchange account or another account of the debtor is done by **serving the writ of execution to the legal entity with whom the account is maintained** by which this legal entity is at the same time ordered to **pay out** the pecuniary amount to the creditor (execution creditor, bank).³⁹
- The pledging of a **receivable** that is secured by a lien registered in a public registry (e.g. mortgage claim) is done by entering the lien in said **public registry**.⁴⁰
- The pledging of a **share in a business partnership** is done by serving the **writ of execution** to the **business partnership**;⁴¹
- The pledging of other property rights of the debtor (patents, technical innovations, right of usufruct, etc.) is done by serving the **writ of execution**, in which case the **debtor is prohibited from disposing over the pledged rights**.⁴²

The requirements for establishing the compulsory judicial lien on rights in **debt securing proceedings** are:

- A court **decision** on a **preceding measure to secure a debt** by which the court rules to secure the pecuniary claims based on the decision of another court or of an administrative authority (decision on taxes);⁴³

³⁵ Art. 152/2 Act on the Levy of Execution.

³⁶ Art. 153/1 Act on the Levy of Execution.

³⁷ Art. 153/3, 196/1 Act on the Levy of Execution.

³⁸ If the creditor (execution creditor) does not have the required information on the savings deposit of the debtor, upon request of the creditor the court may decide to place a temporary lien on all savings deposits of the execution debtor held on accounts of a specific legal entity. The seizure is executed on the day the decision of the court on the temporary lien is delivered to the legal entity holding the savings deposits (Art. 154/7 Act on the Levy of Execution).

³⁹ Art. 180/1 Act on the Levy of Execution.

⁴⁰ Art. 159/1 Act on the Levy of Execution.

⁴¹ Art. 198 Act on the Levy of Execution.

⁴² Art. 200 Act on the Levy of Execution.

⁴³ Art. 284 Act on the Levy of Execution.

- A **mode of acquisition** for the pledging of receivables or of other property rights;⁴⁴ this mode of acquisition follows the rules on liens for establishing a voluntary, judicial lien on rights (see Chapter 6);⁴⁵ or
- A **priority notice** entered on a lien if the object being secured has been entered into the land register by a temporary injunction (e.g. usus fructus, mortgage loan).⁴⁶

b. Execution Restrictions of Liens on Rights

The object of the execution and thus of the lien **cannot** be receivables from **taxes** or other **charges**.⁴⁷

The object of a compulsory lien on rights cannot be rights that are excluded completely from execution or subject to execution restrictions. When establishing a compulsory lien on rights, the following shall be exempt:

- Rights that are necessary for satisfying the basic living needs of a debtor and of those persons for whom the debtor has a statutory obligation to support;⁴⁸
- Rights needed by the debtor to carry on a self-employed business which is the principle source of income for the subsistence of the judgment debtor;⁴⁹
- Rights of legal entities if these rights are needed to carry on their activity, e.g., leasehold rights, building lease;⁵⁰

Receipts based on statutory alimony payments; compensation for damages received on the grounds of health impairment, loss or reduced ability to work and on the grounds of compensation for damages due to the loss of alimony payments on account of the death of the person under obligation to pay alimony; Compensation for damages due to physical injuries (except for the recovery of certain receivables based on statutory alimony payments); Benefits such as welfare payments, temporary unemployment pay, childcare allowances; Stipends and remunerations paid to soldiers and students of military academies; Remuneration for work performed by prisoners;●

Awards and recognition prizes;⁵¹

- Rights of legal entities that do not conduct activities for the purpose of making profits (e.g. foundations) that are necessary for carrying on their activity such as leasehold rights and building leases;⁵²
- Money on accounts held by the state, local government units required for these legal entities to perform their basic duties.⁵³

Restrictions on the establishment of compulsory liens are usually laid down in the rules on execution restrictions. An execution and the conclusion of a compulsory lien can only be done as follows:

⁴⁴ Art. 287 par 1 item 2 Act on the Levy of Execution.

⁴⁵ Art. 287 par 1 item 2, 262/1 item 4-11 Act on the Levy of Execution; see Chapter Lien on Rights, voluntary judicial lien.

⁴⁶ Art. 287 par 1 item 1 Act on the Levy of Execution.

⁴⁷ Art. 4/5 Act on the Levy of Execution.

⁴⁸ Art. 70/1 Act on the Levy of Execution.

⁴⁹ Art. 70/1 Act on the Levy of Execution.

⁵⁰ Art. 71/1 Act on the Levy of Execution.

⁵¹ Art. 148 Act on the Levy of Execution.

⁵² Art. 203/1 Act on the Levy of Execution.

⁵³ Art. 204/2 Act on the Levy of Execution.

- Up to half of the income or pension in the case of receivables based on statutory alimony obligations, compensation for damages received on the grounds of health impairment, loss or reduced ability to work, or compensation for damages due to the loss of alimony payments;⁵⁴
- Up to one-third of the income or pension in the case of other receivables;⁵⁵
- Up to one half of the income received for physical injuries, specifically for receivables grounded in a statutory alimony obligation, compensation damages paid for health impairment, loss or reduced ability to work and on the grounds of compensation for damages due to the loss of alimony payments on account of the death of the person under obligation to pay alimony;⁵⁶
- One part of the receipts under a contract for life-long support payments or life-long pensions, and one part of receipts based on an insurance contract, specifically, that part which exceeds the highest permanently paid welfare benefits at the domicile of the debtor.⁵⁷

The rules listed above on the restrictions and exceptions shall only apply to compulsory liens on rights. The rules shall not apply to voluntary liens on rights. When a **voluntary lien** on rights is established, the lien debtor may not raise objections by referring to the exceptions from compulsory execution or to the restrictions on compulsory execution (Art 72/1 Act on the Levy of Execution). The object of the voluntary lien on rights and of the **voluntary judicial/notary-certified lien** on rights may also be those rights that are exempt from compulsory execution or rights in their entirety regardless of whether execution is restricted or not.

C. Object of the Claim

Regardless of the type of security, the costs of the proceedings must be covered first from the proceeds of the sale in the **execution proceedings**. Subsequently, **interest** must be satisfied and **finally the principal must be paid**. A debtor who is in default on pecuniary liabilities also owes interest on arrears. Interest on arrears is defined in a Decree issued by the government of the Republic of Croatia and currently stands at 15% p.a.

D. Realization of Collateral in the Case of Bankruptcy

In the case of bankruptcy proceedings, the question of whether a bank has security for a loan in the form of collateral or a personal guarantee plays a material role. The creditor whose claim is secured by collateral shall have the status of a **creditor with preferential status** to segregated or separated assets. The other creditors who do not have the status of preferred creditors are satisfied out of the proceeds from the realization of the **bankrupt's estate**. These creditors only have the right to receive a proportional share of the debtor's assets after the creditors have realized the debtor's assets and drawn up a list of the assets to be divided.

⁵⁴ Art. 149/1 Act on the Levy of Execution. If a debtor receives only a guaranteed income, the execution of the receivables is limited to one-third of the guaranteed income (Art.149/2 Act on the Levy of Execution).

⁵⁵ Art. 149/1 Act on the Levy of Execution. If a debtor receives only a guaranteed income, the execution of the receivables is limited to one-third of the guaranteed income (Art.149/2 Act on the Levy of Execution).

⁵⁶ Art. 149/4 Act on the Levy of Execution.

⁵⁷ Art. 149/5 Act on the Levy of Execution.

Thus, for example, if the bank only has a personal guarantee as security, the bank must register its claim in the bankruptcy proceedings and in this manner secure its legal status as a bankruptcy creditor. The bankruptcy creditors are ranked by order of entitlement to payment.⁵⁸ The bankruptcy creditor ranked for payment at a later time will be paid only after the creditors of the preceding rank have been completely satisfied.⁵⁹ The order of discharge in bankruptcy is defined as follows:

1. **Costs of the bankruptcy proceedings and other claims against bankrupt's estate** (Art85-87 Bankruptcy Act);
2. Claims of the higher-ranking creditors in the order of discharge (Sect. 71 Bankruptcy Act):
First, the claims of dependent employees (a) are satisfied and then the other claims (general creditor ranking) (b):
 - a. The claims of the dependent employees of the bankruptcy debtor and of former dependent employees
 - The wages for the preceding three months before the petition for bankruptcy was filed or the employment contract was terminated (two-thirds of the average monthly wage in the Republic of Croatia per month);
 - Vacation remuneration for the annual vacation entitlement for the calendar year in which the petition for bankruptcy was filed or the employment contract was terminated as well as that of the previous year (two-thirds of the average monthly wages for the respective month);
 - Severance payment for every year of service with the employer (one-third of average monthly wage);
 - Compensation for accident injuries suffered at work or work-related illnesses and claims on the contributions to the pension, health insurance and public unemployment and deducted automatically from the wages, with the exception of those claims which must be satisfied as costs of bankruptcy proceedings or other claims against the bankrupt's assets according to the law;
 - b. Other claims against the debtor such as claims under a **loan agreement** with the exception of those claims assigned a low ranking (general creditor ranking).
3. **Claims of creditors with a low ranking** (Sect. 72 Bankruptcy Act) are satisfied in the following order:
 - **Interest** accrued on the amounts claimed by the bankruptcy creditors since the start of the bankruptcy proceedings;
 - Costs that the individual creditors incur by taking part in the proceedings;
 - Fines for punishable offences or misdemeanors and their incidental consequences that entail an obligation to pay a fine;
 - Claims for the performance of a service free of charge by the debtor;
 - Claims on the return of an equity substituting loan extended by a partner to a company or correspondent claims.

⁵⁸ Art. 70 par 2 Bankruptcy and Composition Act.

⁵⁹ Art. 70 par 2 Bankruptcy and Composition Act.

Chapter 3: General Remarks on Liens

I. Introduction

This chapter discusses the fundamental principles that apply to liens on all types of pledged objects (movables, real estate, rights). The following chapters explain the special features related to the pledged objects.

II. General

A lien (*založno pravo*) is a **restricted right in property** to a certain object (pledged object) regardless of whom it belongs to entitling the holder (lienor, bank) to the satisfaction of a certain claim – unless fulfilled by the due date – from the proceeds of the realization of the object. The respective owner of the pledged object (lienee) is obligated to accept this.⁶⁰

The principle content of the lien is the right to the satisfaction of a claim from the proceeds of the realization of the pledged object. As liens – the same as all other rights in property – have **absolute effectiveness towards all**, the satisfaction of a claim from the proceeds of the realization of a pledged object must be accepted by **any person** being the owner of the pledged object at the time of satisfaction.

Claims secured by liens shall have preferential status before all other subordinate lien rights when satisfying said claims from the proceeds of the realization of the pledged object, and before any claims not secured by liens on this pledged object.⁶¹

III. Creation of Liens

There are three basic requirements that must be met before a lien can be established:

- The lienee must be the **property owner** of the pledged object;
- **Legal grounds** (title) for the acquisition; and
- Appropriate **mode of acquisition** (modus).

Depending on the legal grounds and the form of acquisition, a differentiation is made between **voluntary liens**, the **voluntary judicial** or **notary-certified lien**, the **compulsory judicial lien** and the **statutory lien**.

The following chart shows the different types of liens.

⁶⁰ Art. 297 par 1 Act on Real Property and Other Real Property Rights.

⁶¹ Art. 302 Act on Real Property and Other Real Property Rights.

	Voluntary lien	Voluntary judicial or notary-certified lien	Compulsory judicial lien	Statutory lien
Movables	Voluntary lien on movables	Voluntary judicial or notary-certified lien on movables	Compulsory judicial lien on movables	Statutory lien on movables
Real estate	Voluntary lien on real estate	Voluntary judicial or notary-certified lien on real estate	Judicial lien on real estate	Statutory lien on real estate
Rights	Voluntary lien on rights	Voluntary judicial or notary-certified lien on rights	Judicial lien on rights	Statutory lien on rights

IV. Object of a Lien

Objects of a lien may generally be **all property** that can function as the object of legal relations. **Common property**, which cannot be the object of property rights on account of its nature or due to statutory provisions, cannot be pledged.⁶²

The object of a lien may therefore be any type of individually specified **movable**⁶³ or **immovable**⁶⁴ property or an idealistic part⁶⁵ of such a property⁶⁶ as well as an individually specified property⁶⁷, which may be suitable for satisfying the claim of a creditor. Liens may be created to include several real estate properties at the same time (simultaneous mortgage). A basic rule states that a lien charges a property and all of **its attachments** at the same time.⁶⁸ The object of a lien may be the right to any fruits that a property may bear based on a legal relationship (rents, lease).

⁶² Examples of common property (Art 3 par 1 and 2 Act on Real Property and Other Real Property Rights) are, for example, the water in lakes, rivers and oceans, the seaside, public roads. There are special provisions that apply to certain types of real estate stipulating that these may not be sold from the ownership of the state. As no execution can be carried out for this type of property to realize a secured claim, this type of property cannot be the object of a lien (e.g. forests and forest plots owned by the state pursuant to forestry law).

⁶³ Movables are pieces of property that may be moved from one place to another without violating their essential nature (substance) (Art. 2 par 4 Act on Real Property and Other Real Property Rights).

⁶⁴ Real estate properties are plots of land on the earth's surface together with anything permanently joined to the property above or below the surface (Art. 2 par 3 Act on Real Property and Other Real Property Rights).

⁶⁵ This is the share in ownership in percentage or fractions of a whole.

⁶⁶ Art. 298 par 1 Act on Real Property and Other Real Property Rights.

⁶⁷ Art. 298 par 2 Act on Real Property and Other Real Property Rights.

⁶⁸ Art. 298 par 4 Act on Real Property and Other Real Property Rights, appurtenances of a real property are all components and everything that is permanently connected to it as well as all fruits as long these are not separated from the principal property (growing plants and trees). Appurtenances of a real property are also all attachments which are needed to use the real property (pertinent) (Art 5 par. 3 Act on Real Property and Other Real Property Rights).

Every type of lien object gives the creditor certain rights, but at the same time also imposes obligations that may vary depending on the type of object of a lien.

V. Fundamental Principles of Liens

A. The Principle of Accessoriness

According to the principle of accessoriness, the **existence of a lien** is dependent of the existence and **validity of the secured claim**. The secured claim is the principal claim and the lien is the subsidiary right,⁶⁹ the accessory right.⁷⁰ The lien agreement cannot be established independently. The legal destiny of a lien depends on the destiny of the secured claim. Generally, when a secured claim expires, the lien also expires, as it cannot exist without the secured claim. The lien shall expire in actual fact when the entire claim secured by lien as well as all ancillary claims, interest and costs have been discharged and formally (only in the case of real property) deleted from the land register.⁷¹

Should a secured claim be assigned to another person for any statutory reason (assignment, inheritance), the lien shall at the same time also be assigned or transferred to said person without requiring any special legal act, unless the law defines otherwise.⁷²

When the secured claim does not exist (e.g. if the transactions out of which the claim arises is invalid), then neither shall the lien exist although all requirements for establishing a lien would be given (property of the lien debtor, valid pledge agreement as title of rights, valid acquisition type as mode of acquisition).

The nature of accessoriness of a lien means that it is not possible to dispose of a lien separately from the attached claim being secured. Certain assumptions regarding the nature of accessoriness shall be given only for liens on real property, specifically regarding the rules governing the ranking of mortgages not yet deleted from the books in accordance with the model of Austrian law (mortgage without claim for benefit of the owner).

B. Principle of specification

When a lien is created the **claim** that is being **secured** and the **object of the lien** (pledge) must be **individually specified** and precisely **defined**.⁷³

1. Definition of the Claim

A **claim is defined** when the creditor and the debtor, the legal grounds and the amount (fixed-amount lien) or at least a maximum amount (maximum amount mortgage) are defined.⁷⁴ Under these conditions, a lien may also be used to secure future claims that will arise only after a certain period or under certain

⁶⁹ Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property, 733.

⁷⁰ Gavella/Josipović/Gliha/Belaj/Stipković, Property Rights, 1998; Vedriš/Klarić, Civil Code, 2003.

⁷¹ Art. 346, Art 347 par 1 Act on Real Property and Other Real Property Rights.

⁷² Art.319 Act on Real Property and Other Real Property Rights.

⁷³ Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property, 733; Vedriš/Klarić, Civil Code, 328.

⁷⁴ Art. 301 par 1 Act on Real Property and Other Real Property Rights; This law refers exclusively to the principal claim and not to any ancillary claims (interest, collection costs, etc.). The ancillary claims do not need to be precisely defined in order to be secured by one and the same lien. It suffices if they can be precisely defined at the least. Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property, 733.

conditions, such as a claim arising from a loan granted; a management position assumed; a guarantee or under the title of compensation for damages.⁷⁵

The amount of the claim shall be defined either in absolute amounts in local currency or must be defined according to the rules of the currency or indexation clauses. Payment in foreign exchange or gold is only permissible in those cases stipulated by law.⁷⁶ It is also possible to reach a contractual agreement in which the value of the obligations is calculated based on the value of gold or of a currency exchange rate in relation to a foreign currency (currency clause Sect. 395 par 1 Obligations Act).⁷⁷ Unless the parties reach another agreement, the claim must be satisfied by payment in Croatian currency (Croatian kuna⁷⁸) according to the selling price of the authorized bank at the place of performance.⁷⁹ If the pecuniary debt is expressed contrary to the law in gold or in a foreign currency, it may only be settled in Croatian currency in accordance with the selling price of the authorized bank at the place of performance.⁸⁰ The amount of the pecuniary debt may be linked to changes in the prices of goods and services, which is tracked by a price index (index clause, Sect. 396 Obligations Act).

2. Individual Specification of the Object of a Lien

The **object of a lien** must be **individually specified**.⁸¹ The object of the lien can only be an individually specified object (*species*). According to Croatian law, the object of a lien may therefore neither be the assets in total nor fungible goods⁸² that cannot be specified individually. Fungible goods can only be pledged as collateral if these have been segregated from the assets and identified as pledged. Therefore, when pledging goods in stock and inventories, which is very frequent in practice, caution is advised. The definition of the object pledged in the lien agreement as “goods in stock”, “inventory” of the dental office” or “quantity XY sugar in stock” could result in the invalidity of the agreement on account of the lack of a specific definition.

C. Principle of Inseparability

The **lien cannot be separated from the object of the lien**. The inseparability of the lien from the object of the lien has two legal consequences. The lien is first, a right in property, which is attached to the object of the lien, and thus, ownership in such property may only be acquired with the lien. Secondly, as a rule a lien cannot be assigned from one object to another (Sect. 299 Act on Real Property and Other Real Property Rights).⁸³

⁷⁵ Art. 301 par 2 Act on Real Property and Other Real Property Rights.

⁷⁶ Art. 15 Foreign Exchange Dealings Act.

⁷⁷ In this case, the lien contract shall contain, for example, the following definition: “The lien secures a claim with a value in kuna of EUR 100,000 on the day of payment at the mean exchange rate of the Croatian National Bank”.

⁷⁸ The Croatian kuna was quoted on 17 August 2004 at 7.34 Croatian kuna/ EUR.

⁷⁹ Art. 395 par 2 Obligations Act.

⁸⁰ Art. 395 par 3 Obligations Act.

⁸¹ Art. 298 par 1, 2 Act on Real Property and Other Real Property Rights.

⁸² This is an object that is defined only with respect to type and quality, such as 15 kg sugar.

⁸³ The exceptions to the rule of non-assignability of a lien are regulated by law; e.g. if a lien ceases to exist and another right replaces it (claim to a replacement, to an insurance benefit, or similar), the lien on this right continues to exist (Art. 301 par 4 Act on Real Property and Other Real Property Rights).

D. Principle of Inseparable Liability of a Lien

The principle of inseparability states that a **lien** is inseparable with respect to the **secured claim and the pledged object**.⁸⁴ The lien secures a claim in its entirety, including all ancillary claims.⁸⁵ Any encumbrance by a lien is not diminished by reducing the claim. The inseparability of the lien as regards the object of the lien is stipulated in Sect. 301 par 4 Act on Real Property and Other Real Property Rights. In this Act, a pledged object secures the satisfaction of a claim in its entirety, including its attachments (parts of the object, inseparable usufruct, attachments, Sect. 5 Act on Real Property and Other Real Property Rights). A reduction in the value or division of the pledged object does not mean that the lien has ceased to exist. The lien shall continue to exist on those parts of the object that have been separated from the object.⁸⁶ The lien shall cease to exist when the lien on the object becomes fully extinguished and no other object or right replaces it.⁸⁷

According to this rule, it is possible to satisfy a claim from the rights that have replaced the object of the lien. Thus, for example, Sect. 296 par 2 Act on Real Property and Other Real Property Rights explicitly states that after the expiration of a building lease, which has been pledged, the right to claim compensation from the owner is considered as pledged. Similarly, in the event a pledged object is extinguished, the lien may be transferred to a claim on an insurance policy. A bank may make the granting of a loan contingent on the prior insurance of the pledged object (e.g. automobile, building) against the risk of extinguishment.⁸⁸

E. Principle of Officiality

According to the principle of officiality, the creditor has a general obligation to enforce his or her rights to the satisfaction of a claim from the value of a pledged object by **filing a complaint with the court**.⁸⁹ An **extrajudicial settlement** is only possible if the object of the lien is **movable property**.⁹⁰

As a lien may usually only be satisfied through court proceedings, it may substantially prolong the satisfaction of the claim. Accordingly, the **realization** is preceded by **execution proceedings** in which a decision is reached regarding the execution by way of a sale of the pledged property. Because of the excessive

⁸⁴ For details, see Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property, 735.

⁸⁵ Art. 301 par 5 Act on Real Property and Other Real Property Rights.

⁸⁶ Art. 301 par 4 Act on Real Property and Other Real Property Rights.

⁸⁷ Art. 343 Act on Real Property and Other Real Property Rights.

⁸⁸ Thus, some banks require property insurance in the case of mortgage loans and vehicle insurance in the case of automobile purchases; cf. the conditions for mortgage loans, loans for automobile purchases. Zagrebačka banka - www.zaba.hr (mortgage loan, automobile purchase loan). Privredna banka - www.pbz.hr (residential construction loan, loan for automobile purchase).

⁸⁹ Art. 336 par 2 Act on Real Property and Other Real Property Rights.

⁹⁰ Art. 337 Act on Real Property and Other Real Property Rights.

workload of the Croatian courts, time-consuming execution proceedings may lead to a delay in the satisfaction of a claim.

In the year 2003, the Act on the Levy of Execution was amended as regards liens. These changes have made sales proceedings in the course of an execution simpler and faster. Pursuant to Sect. 143 a Act on the Levy of Execution, **movable property** being the object of an execution may be sold upon request of a creditor through the **Financing Agency (FINA)**⁹¹ or a public **auction house** (Sect. 143 a Act on the Levy of Execution).⁹² As of 1 October 2004, **public notaries** are authorized to conduct the **execution of real property** based on the **execution decisions of courts**.⁹³ In the case of execution proceedings, public notaries will be conferred all of the rights and obligations of judges of the first instance of civil courts.⁹⁴

VI. Realization of the Lien

A. The Legal Position of the Bank in Execution Proceedings

In execution proceedings, lienors who have not filed a petition for execution proceedings are also satisfied.⁹⁵ In the case of claims satisfied from the proceeds of the sale of the pledged objects, a lienor shall have priority over the other creditors of the debtor as well as over those lienors who have a subordinate lien right vis-à-vis such lienors.

The creditors shall satisfy their claims from the proceeds of the lien object in the order in which the lien rights have been acquired or in the order in which the right to the satisfaction of a claim has been acquired⁹⁶, after all **claims having priority** have been satisfied. Such claims are:

The costs of the execution proceedings; Taxes; Claims based on statutory alimony obligations; and Other claims according to Sect. 106 Act on the Levy of Execution (compensation claims for health damages and impairments or the loss of the ability to work; compensation claims due to the loss of alimony payments on account of the death of the person under obligation to pay; claims of employees, and any amounts due to the health and pension insurance scheme for the past year). Several claims having the same ranking for the satisfaction of claims shall be settled pro rata in accordance with their amounts unless the proceeds of the sale are not sufficient for the complete satisfaction of the claims.⁹⁷

⁹¹ The Financing Agency (FINA) is a legal entity founded by the Republic of Croatia (Act on the Financing Agency, Narodne novine 117/01). FINA provides information technology support for the system operations of the state treasury and for the system for collecting public revenues; it keeps the statistics on financial flows; surveys, processes and publishes data on the subjects of the transactions and keeps the relevant records. FINA also engages in commercial activities such as services in the name of and for the account of commercial banks, and the distribution and processing of cash in the name of the Croatian National Bank. Furthermore, it also manages the inter-bank netting system, among other things, FINA is licensed to provide competent state bodies upon their request IT support for the surveillance and monitoring of legal subjects.

⁹² To date, no regulatory implementing acts have been passed based on which FINA and auction houses would be authorized to sell chattel in execution proceedings.

⁹³ Art. 307 a - 307 s Act on the Levy of Execution.

⁹⁴ Art. 307 m Act on the Levy of Execution.

⁹⁵ Art. 81/1 Act on the Levy of Execution, Art 105 Act on the Levy of Execution.

⁹⁶ A creditor who has applied for execution of a certain real property acquires the right to satisfaction of a claim (pravo na namirenje). This right is acquired by an annotation of the execution entered into the land register. This annotation gives the creditor the right to have his or her claims on the real property satisfied even if the property passes into the ownership of a third party at a later time.

⁹⁷ Art. 109 Act on the Levy of Execution.

The right to the satisfaction of a claim in execution proceedings shall also be granted to lienors whose claims have not yet fallen due (Sect. 112 Act on the Levy of Execution)⁹⁸ and shall also be granted to a lienor whose claims are contingent on a condition that has not yet occurred (Sect. 114 Act on the Levy of Execution)⁹⁹.

B. The Legal Position of the Bank in Bankruptcy Proceedings

In bankruptcy proceedings, the bank in the role of a **lienor** has the same status as a **creditor with preferential rights (right to separated satisfaction)**.

¹⁰⁰The bank shall have the preferential right to satisfaction of its claims from the separated assets of certain parts of the bankrupt's estate.

⁹⁸ This claim is satisfied after deducting the amount that equals the statutory interest running from the day of decision on the satisfaction of the claim until maturity (Art. 112 par 1 Act on the Levy of Execution).

⁹⁹ The amount of a contingent claim is separated and deposited with the court or with a notary; it is paid out when the conditions are met (Art. 114 par 1 Act on the Levy of Execution).

¹⁰⁰ Art. 81, 82 Bankruptcy Act.

Chapter 4: Liens on Movable Property

I. Establishment of Liens

Liens may be grouped by the legal grounds on which these are acquired. There are **voluntary liens** (liens established by contract), **voluntary judicial** or **notary-certified lien**, the **compulsory judicial lien** and the **statutory lien**.

The provisions governing the acquisition of a lien on movable property shall apply accordingly to cases of *pignus pignoris* (secondary lien).¹⁰¹ The secondary lien is a lien on a lien.

A. Liens on Movable Property

In the case of **voluntary liens on movable property** (*dobrovoljno založno pravo na pokretnini*), the **title** shall be a contract of lien agreed on by the owner of the pledged object (lienee, *založni dužnik*) and the lienor (*založni vjerovnik*). In the contract of lien, the lienee undertakes to pledge a specific movable piece of property to the lienor as a pawn. The creditor shall keep the pledged object in custody and shall return it to the lienee after the claim has been discharged.¹⁰² It is **not required** that the contract on the pledging of movable property have any **particular form**.

The **mode of acquisition** shall be the **handing over** of the pledged property into the possession of the lienor.¹⁰³ All types of derived possession of real property are possible, including *traditio brevi manu*¹⁰⁴, with the exception of the constructive bailment based on agreement.¹⁰⁵ Usually, this will involve the handing over of property directly into the possession of the creditor. The lienor shall generally have the right to directly take possession of the property in the pledging phase (period from the creation of the lien until claim matures).¹⁰⁶

B. Voluntary Judicial or Notary-certified Liens on Movable Property

In the case of the **voluntary judicial lien on movable property** (*dobrovoljno sudska založno pravo na pokretninama*), the title is established by a contract of lien in the form of a **court record**,¹⁰⁷ while in the case of **voluntary, notary-certified lien on movable property** (*dobrovoljno javnobilježničko založno pravo na pokretninama*) the title is established by a contract of lien in the form of a notarial deed.¹⁰⁸

In the two cases, **mode of acquisition** shall be the **pledging** (i.e. the identification as such) of the movable property and the **establishment** of a **register of lien**.¹⁰⁹ The **pledged property** remains in the **possession** of the **debtor** and the **disclosure** of the lien is assured by **publication** of an announcement

¹⁰¹ Art. 315 par 1, Art 316 par 1 Act on Real Property and Other Real Property Rights.

¹⁰² Art. 307 par 1 Act on Real Property and Other Real Property Rights.

¹⁰³ Art. 308 par 1 Act on Real Property and Other Real Property Rights.

¹⁰⁴ In this case, the lienor already has possession of the pledged object for some reason.

¹⁰⁵ In the case of constructive possession of chattel, the borrower would keep the object. This would not be in line with the disclosure requirement stipulated for liens. The non-possessory lien is possible only in connection with the publication in the Official Gazette. For details, see later section.

¹⁰⁶ Art. 321 par 1 Act on Real Property and Other Real Property Rights.

¹⁰⁷ Art. 312 par 1 Act on Real Property and Other Real Property Rights, Art 262 Act on the Levy of Execution.

¹⁰⁸ Art. 269 Act on the Levy of Execution.

¹⁰⁹ Art. 262, 264, 131 Act on the Levy of Execution.

in the **Official Gazette**.¹¹⁰ The lienor does not have the right of possession in the movable property. The **objects** of judicial or notary-certified liens on movable property may be **all objects that can be sold, including those movable objects** for which **no execution may** be carried out according to the provisions of the Act on the Levy of Execution.

C. Statutory Lien

Statutory liens on movable property (*zakonsko založno pravo na pokretnostima*) are acquired when certain criteria defined by law are met.¹¹¹ For example, when co-ownership is terminated by paying the value of the co-owned share to the co-owners, the lien on the co-owned property shall remain intact until the actual payment is done.¹¹² The statutory lien does not entitle the lienor to possession of the property and therefore the pledged object remains in the possession of the lienee after the establishment of the statutory lien.¹¹³

II. Acquisition of Liens by Non-owners

The risks carried by the lienor when acquiring a lien on movable property from non-owners has been ameliorated by the new legislation on real property in Croatia. When a creditor has a title of acquisition for a voluntary lien on an object that it does not own and which has been pledged without the consent of the owner, this title shall create a lien if the party not entitled meets the ownership requirements for the object.¹¹⁴

The requirements for the acquisition of ownership from a party not being the owner are regulated in Sect. 118 Act on Real Property and Other Real Property Rights:

According to these provisions, a person shall acquire **ownership in a property** who has concluded a legally binding transaction by **paying a sum of money in good faith**¹¹⁵ to obtain the **autonomous possession** (*samostalni posjed*)¹¹⁶ of a **movable property** from a person who is not legally entitled to dispose of said property. This provision shall not be applicable if the property was stolen from the owner or if the owner lost it or misplaced it, except in the case of cash, bearer securities or purchase at a public auction.

III. Realization of Liens on Movable Property

A. Judicial Realization

Pursuant to the principle of officiality, the realization of pledged movable property to satisfy a claim **before a court of law** must follow the rules for the execution of movable property.¹¹⁷

¹¹⁰ Art. 266 Act on the Levy of Execution.

¹¹¹ Art. 314. Act on Real Property and Other Real Property Rights.

¹¹² Art. 51/2 Act on Real Property and Other Real Property Rights.

¹¹³ Art. 321 par 4 Act on Real Property and Other Real Property Rights.

¹¹⁴ Art. 317 par 1 Act on Real Property and Other Real Property Rights.

¹¹⁵ The acquiring party acted in good faith if at the time the transaction was concluded as well as at the time he or she took immediate possession of the property did not know nor in consideration of the circumstances had any reason to doubt that the seller was the owner of the property (Art. 118 par 3 Act on Real Property and Other Real Property Rights).

¹¹⁶ Anyone in possession of a thing as if he or she were the owner is an autonomous possessor. Possession is deemed to be autonomous possession until proven otherwise.

¹¹⁷ Art. 126-146 Act on the Levy of Execution.

The object is sold at a **public auction by open outcry** or through an **open-market sale**.¹¹⁸ In the **first auction**, movable property **may not be sold at less than two-thirds** of its estimated market value. If this price is not attained at the first auction, the court shall order upon request of the party a new auction in which the movable property may not be sold for less than one-third of its estimated value. If it is not possible to sell the movable property at the second auction either, then the court shall discontinue the proceedings.¹¹⁹

According to the changes to the Act on the Levy of Execution,¹²⁰ movable property in execution proceedings may also be sold upon request of the party demanding execution (creditor) by the Financing Agency and through public auction houses (Sect. 143 a Act on the Levy of Execution).¹²¹ The petition to conduct such a sale shall be submitted by the party initiating the execution within a certain period.¹²² Should the movable property fail to be sold within two months even at two-thirds of the estimated value, the court shall lower the price by one-third. Should the movable property fail to be sold even after an additional month has expired, then the court shall discontinue the proceedings.¹²³

B. Extrajudicial Realization

It is also possible to satisfy claims on the value of the pledged movable property out of court if the lienee agrees (Sect. 337 par 1 Act on Real Property and Other Real Property Rights)¹²⁴ or if the secured claim arises under a **commercial transaction**¹²⁵, unless the lienee has explicitly excluded the extrajudicial realization.¹²⁶

The **extrajudicial realization** shall be generally through a **public auction**. It may also be conducted in another form if this is the only way of achieving the satisfaction of a claim under the given circumstances or has been explicitly agreed.¹²⁷ If an object has been pledged to satisfy the claims of a person extrajudicially that has an **exchange or market price**, then this person has the right to **sell** the pledged object at this price in the **open market**, specifically, through a person who is authorized by the state to sell such objects through an exchange or to the public.¹²⁸ The **extrajudicial sale** of pledged property may only be conducted if the **movable property is in the possession of the lienor**.

¹¹⁸ Art. 141 par 1 Act on the Levy of Execution.

¹¹⁹ Art. 142 Act on the Levy of Execution.

¹²⁰ Narodne novine 173/03 of 31 October 2003.

¹²¹ The sale on consignment is introduced by an authorization of competent minister for judicial affairs and on the basis of a public tender (Art. 143 a par 3 Act on the Levy of Execution).

¹²² Art. 143 b par 2 Act on the Levy of Execution.

¹²³ Art. 143 f Act on the Levy of Execution.

¹²⁴ The lien debtor may give his or her consent to out-of-court satisfaction of claims at the time the lien contract is concluded or afterwards; the consent must be given in writing.

¹²⁵ Commercial transactions are transactions in which one of the contractual parties is a businessperson, i.e., a legal entity or natural person who independently engages in a business on a permanent basis in the market for the purpose of making a profit through the production of goods, the trading of goods or by providing services. Legal transactions in which one of the contractual parties is a bank are always considered a commercial transaction.

¹²⁶ Art. 337 par 2 Act on Real Property and Other Real Property Rights.

¹²⁷ Art. 337 par 3 Act on Real Property and Other Real Property Rights. For example, the creditor may sell the pledged object in the open market if the object has an exchange or market price (Art. 337 par 4 EDRG). This may play a role in the case of perishable goods.

¹²⁸ Art. 337 par 4 Act on Real Property and Other Real Property Rights.

According to Croatian law, it is possible to pledge movable property without having to hand it over, meaning that the property remains in the possession of the debtor even after the debt falls due (voluntary judicial lien or notary-certified lien). Should the debtor fail to pay the claim after the due date, it will be difficult for the creditor to execute a public extrajudicial sale of the property, as the creditor does not have it in his or her possession. The only way of obtaining the amount owed in this case is through a public sale held by the court according to the rules of execution.¹²⁹ Thus, the creditor is exposed to all of the risks of a judicial sale of pledged objects in execution proceedings, including the risk of not being able to sell the property for the estimated value.

IV. Problems Relating to Liens on Movable Property

A. Restrictions Regarding the Object of the Lien

Not all movable property belonging to a debtor may become the object of a lien. There are restrictions in cases in which the sale is carried out by the **court**. In these cases, the regulations governing execution proceedings shall apply according to which certain types of movable property are excluded from execution. **The object of an execution may therefore not be any object** that is generally or specifically excluded by a special law (such as arms and defense objects) from the **capacity of being an object of legally binding transactions (absolute prohibition to pledge or execute)**.¹³⁰ Neither may a voluntary lien be created on such objects.

According to the explicit provisions of Act on the Levy of Execution, a debtor who voluntarily (based on a legally binding transaction) has established a **lien** on an object for which **execution is restricted** according to the rules of the Act on the Levy of Execution or which are excluded from execution **cannot reject** the satisfaction of the claim from the proceeds of the pledged objects.¹³¹

B. Problems Relating to Disclosure

In practice in Croatia, the most common form of lien on **movable property** is the **voluntary judicial or notary-certified lien**. The voluntary lien on movable property acquired when the property is handed over into the possession of the creditor is rare. Banks establish this lien only, for example, on jewellery, gold and similar assets that may simply be deposited and held in custody. Banks can easily organize the public sale of such objects. Since we are dealing with claims from commercial transactions being secured, it is possible to satisfy said claims through extrajudicial realization¹³², and therefore banks themselves organize public auctions (apart from advertisements in daily newspapers) for the sale of pledged objects.

Practice in pledging movable property has largely shown that the voluntary judicial lien or the notary-certified lien on movable property has a number of advantages for the lienee as well as the lienor. These advantages exist when securing the claim and during the process of satisfying the claim. During the

¹²⁹ Art. 276/1 Act on the Levy of Execution.

¹³⁰ Art. 4/4.6 Act on the Levy of Execution.

¹³¹ Art. 72, 267 par 5 Act on the Levy of Execution.

¹³² Art. 337 par 2 Act on Real Property and Other Real Property Rights.

securing stage (until the claim falls due), the pledged property remains in the possession of the lienee. The lien debtor can therefore use it, exploit it economically and earn the funds to repay the debt. The lienor does not have the right to possession of the movable property. The lienor does not have to take any measures to keep the pledged object in custody, to maintain its value, to secure a suitable location for its safekeeping, etc. The lienor therefore does not incur any costs for the pledged object, as all of the costs of maintaining it are borne by the lienee who is in possession of the object. In business practice, the establishment of a voluntary judicial lien or a notary-certified lien is one of the most frequent types of security for loans. This is how, for example, automobiles, trucks, machines and equipment of higher value are pledged.

Another very important advantage of the **voluntary judicial lien** or the **notary-certified lien** is that the **contract of lien** gains the status of an executable title after the claim falls due. In this manner, the bank may conduct an execution directly on the grounds of this title, i.e., petition the sale of the pledged object or execution to receive possession of the object so that the bank can conduct the realization itself out of court. It is, for example, possible for the debtor to agree already in the contract of lien that the bank has the right to demand that the object be transferred into its possession through execution proceedings. This requires that the contract have the form of a notarial instrument or a private document certified by a notary.¹³³ As the lienor therefore already has a title of execution, he or she is no longer obliged to file for action (*actio pignoratitia*) before execution. In this manner, the proceedings for the realization of the lien are shortened considerably, because no legal dispute needs to be conducted to obtain an executable title. However, the bank – as already mentioned – cannot realize the pledged object itself if it is in the possession of the lienee.

Despite the major advantages for the bank and the borrower of the voluntary judicial lien or notary-certified lien, in practice, it has become clear that **disclosure** with respect to this lien poses some **problems**. No special public **register of liens** is kept on pledged objects, but rather liens are disclosed by **publication** in a notice in the **Official Gazette**.

This type of disclosure entails many problems in connection with legal certainty. Checking the published notices in the Official Gazette is very time consuming and the review would have to go back to the year 1996 when the Act on the Levy of Execution entered into force that created the option of establishing non-possessory liens on chattel.

In contrast, the Act on the Levy of Execution does not contain any provisions indicating the legal effect of the publication of an announcement in the Official Gazette, such as whether the party rightfully acquiring the pledged object is protected by this disclosure, and if it is, under what conditions.

The Official Gazette is available to the public and all announcements made therein are deemed as known to everyone. This would mean that every acquisition of movable property always involves the risk of buying a property encumbered with a lien. This problem of legal uncertainty for the future buyer is aggravated by the fact that the property is pledged without being in the posses-

¹³³ This is a document whose authenticity is certified by a notary public who certifies the content in addition to the signatures of the contractual parties.

sion of any person, and is usually sold several times (autos, furniture, machinery, animals, etc).

The mere publication of a notice in the Official Gazette is therefore, the greatest risk for the lienors, namely the banks. As the object of the lien remains in the possession of the lienee after the lien has been created, the bank no longer has control over the object and how it is used by the debtor, or whether the debtor preserves its value or sells it to a third party. Therefore, the bank is exposed to the risk that at the time the claim falls due it does not know who actually possesses the object, where it is and against whom it has to initiate execution proceedings in order to sell the pledged property.

One method to guarantee a sufficient degree of legal certainty when creating non-possessory liens on movable property would be the establishment of a public register of liens on movable property, which are created without handing over the movable property into the possession of the creditor. This type of register does not (yet) exist in the Republic of Croatia although the possibility of setting up such a register is given in the Act on Real Property and Other Real Property Rights.

Chapter 5: Liens on Real Property

I. Introduction

This chapter analyzes the subject of mortgages and how they are created. It also describes how mortgages extinguish and the realization process for mortgages. At the end of the chapter, the principles and the problems of maintaining a land register are dealt with separately.

II. Term

A lien on real property (mortgage) is a **restricted right in rem** to a certain piece of **real property** that entitles the **mortgage creditor** to the **satisfaction** of a certain claim – unless fulfilled by the due date – by way of realization from the value of this property. The owner of the property (mortgage debtor) is obligated to accept this. A lien on a real property does not mean that the property is transferred into the possession of the creditor.

III. Object of the Mortgage

The object of a mortgage can be any **individually defined piece of real property that can be realized**.¹³⁴ An individual piece of real property is a plot of land including everything that it is relatively permanently connected to the land on the surface or under the surface, and everything that has been built on it, planted in the ground, any structures added or in any other form permanently connected to the plot.¹³⁵ An individual piece of property may also be several lots of land that are legally linked to form one entry in the land register and are registered in the same land register record.

The lien is on the real property including all **of its attachments** unless another definition has been agreed on.¹³⁶ This means that together with the real property, all of **its components** (Sect. 6 Act on Real Property and Other Real Property Rights), **fruits** (Sect. 7 Act on Real Property and Other Real Property Rights), and **uses** are charged including those fruits of the object arising from legal relationships (e.g. rents, leases; Sect. 8 Act on Real Property and Other Real Property Rights). Machinery and other equipment that would normally form part of a real property are not considered as such, but as independent objects if the owner of the real property consents to enter into the land register that said objects are owned by other persons (Sect. 9/5. Act on Real Property and Other Real Property Rights).¹³⁷

The **idealistic share**¹³⁸ of real property can also be pledged.¹³⁹ It is assumed in legal transactions that an idealistic share of an object is an independent object and thus everything that is defined as belonging to an object also applies to the idealistic parts unless special provisions apply.¹⁴⁰ Every co-owner has the right to dispose of his or her share in the object independently as long as the rights of

¹³⁴ Art. 298 par 1 Act on Real Property and Other Real Property Rights, par 35 par 1 Land Register Act.

¹³⁵ Art. 9 Act on Real Property and Other Real Property Rights

¹³⁶ Art 298 par. 4 Act on Real Property and Other Real Property Rights .

¹³⁷ This annotation shall remain effective until it is cancelled, with this effectiveness expiring after a period of five years of the entry in the land register even if it is not cancelled; the term is interrupted for the duration of bankruptcy and execution proceedings.

¹³⁸ This is the share in ownership in percentage or fractions of a whole.

¹³⁹ Art. 298 par 1 Act on Real Property and Other Real Property Rights, par 35 par 1 Land register Act.

¹⁴⁰ Art. 37 par 3 Act on Real Property and Other Real Property Rights.

third parties are not infringed upon.¹⁴¹ Therefore, a co-owner may also mortgage his or her share in the real property. This mortgage is entered into the land register as a charge on the idealistic part of this co-ownership.¹⁴² The consent of the other co-owners is not required for one co-owner to pledge a co-owned share.¹⁴³

If the idealistic part of a real property is inseparably connected to a special part of the real property (condominium ownership, Sect. 69 par 1 Act on Real Property and Other Real Property Rights), this share may be mortgaged. If ownership in a special part of a real property is inseparably connected with the co-ownership of a real property (Sect. 66 Act on Real Property and Other Real Property Rights), then the co-owned share in the real property to which ownership in a special part is inseparably connected shall be the object of the mortgage.¹⁴⁴ The mortgage shall also include any ancillary parts of the real property.¹⁴⁵

The object of a mortgage may also be **several pieces of real property** (so-called **simultaneous mortgage**).¹⁴⁶ The simultaneous mortgage is entered into the land register as an inseparable charge on two or more pieces of real property (one entry in the land register).

The creditor secured by a simultaneous mortgage may choose whether he or she desires to have the claim satisfied from all real properties, only from one, or from several of them.¹⁴⁷

The **fruits** of a property can also be pledged.¹⁴⁸ The right to fruits that a property may yield due to a legal relationship entered into (rent, lease), can also be the object of an independent pledge (*hypotheca ad fructus*). If a mortgage is established only on the fruits, this must be explicitly noted in the land register. The mortgage creditor has the right to draw on the fruits. The value of the fruits drawn is offset against the secured claim.¹⁴⁹

Furthermore, the **building lease**¹⁵⁰ on a piece of real estate may also be pledged.¹⁵¹ In such case, the object of the mortgage is the building lease including the building constructed under said building lease on the encumbered land.¹⁵²

IV. The Secured Claim

The mortgage secures a pecuniary claim or a claim whose value is expressed in money (Sect. 301 par 1 Act on Real Property and Other Real Property Rights – **fixed-amount mortgage**). A mortgage can also secure a future claim, i.e., a claim that will arise after a certain time or when certain conditions are met (Sect. 301 par 2 Act on Real Property and Other Real Property Rights – **maximum-amount mortgage**). When a mortgage is used to secure a future claim

¹⁴¹ Art. 37 par 5 Act on Real Property and Other Real Property Rights.

¹⁴² Art. 35 par 1 Land register Act.

¹⁴³ Art. 306 par 2 Act on Real Property and Other Real Property Rights.

¹⁴⁴ Art. 69 par 1 Act on Real Property and Other Real Property Rights.

¹⁴⁵ Art. 67 par 3, 5 Act on Real Property and Other Real Property Rights.

¹⁴⁶ Art. 298 par 3 Act on Real Property and Other Real Property Rights, par 37 par 1 Land register Act.

¹⁴⁷ Art. 37 par 2 Land register Act.

¹⁴⁸ Art. 298 par. 5 Act on Real Property and Other Real Property Rights .

¹⁴⁹ Art. 331 Act on Real Property and Other Real Property Rights .

¹⁵⁰ The building lease is the right to erect a building on a third party's land.

¹⁵¹ Art. 280 Act on Real Property and Other Real Property Rights.

¹⁵² Art. 280 Abs 3 285 Abs 2, 3 Act on Real Property and Other Real Property Rights.

that may arise under a loan granted, then we speak of a mortgage loan. This future claim is deemed as sufficiently **specified**, if, when the mortgage is being created, at least the **maximum amount** of the claim secured is defined or the maximum amount of the loan or the liability is defined.

The mortgage secures the principal claim as well as all accessory claims (statutory and contractual) interest, as well as the costs of legal disputes and execution proceedings required for the collection of the receivable from the proceeds of the pledged property.¹⁵³ When collecting the claims, the accessory claims have the same rank as the secured claim. Interest on arrears for a maximum period of three years due to the creditor under a contract or by law has the same ranking as the due principal.¹⁵⁴ Should a **claim secured by a mortgage become statute barred**, any **claims on interest being statute barred** from the encumbered property **can no longer be claimed**.¹⁵⁵ In this case, the proceeds from the value of the property can only be used to satisfy the principal due.

V. Creation of a Mortgage

A. The Voluntary (Contract) Mortgage

1. General

The **voluntary mortgage** (*dobrovoljna hipoteka*) is a mortgage established on the basis of a **legal transaction** (Sect. 306 par 1 Act on Real Property and Other Real Property Rights). The following conditions must be met:

The property must be **owned** by the **lienee**;

A valid **contract** on the mortgage must exist (title); and

The mortgage must be **registered** into the **land register** (mode of acquisition).

A person who is registered in the land register as the owner of a piece of property shall be considered the **owner**.¹⁵⁶ If the piece of property is a co-owned or jointly owned property, the co-owners and joint owners shall only be entitled to establish a mortgage on the entire property.¹⁵⁷

The **contract** on the mortgage is a contract¹⁵⁸ in which the debtor or a third party (lienee; owner of the property) is under the obligation to allow the creditor to record a mortgage into the land register. The creditor is under the obligation to take all steps necessary to extinguish the mortgage from the land register as soon as the claim secured by the mortgage is discharged.¹⁵⁹

The mortgage contract can be executed as an independent legal transaction. The provisions of this contract may also be part of the contract from which the claim to be secured by a mortgage arises such as the loan agreement. The mortgage contract is a formal legal transaction, which is required to be **in writing** in order for it to be valid.

¹⁵³ Art. 301 par 3 Act on Real Property and Other Real Property Rights, par 38 par 1 Land register Act.

¹⁵⁴ Art. 38 par 2 Land Register Act.

¹⁵⁵ Art. 368 par 2 Obligations Act.

¹⁵⁶ Art. 306 par 1 Act on Real Property and Other Real Property Rights.

¹⁵⁷ Art. 306 par 2, Art. 41 par 1, Art. 61 Act on Real Property and Other Real Property Rights.

¹⁵⁸ Art. (Art) 306 par 1, Art. 307 Act on Real Property and Other Real Property Rights.

¹⁵⁹ Art. 307 par 1 Act on Real Property and Other Real Property Rights.

The voluntary mortgage is deemed as acquired when it has been entered into the **land register**.¹⁶⁰ The mortgage is entered by incorporation or by priority notice on the encumbered property in the land register.¹⁶¹ The incorporation renders the mortgage unconditional, while the priority notice means that it is acquired on the condition of supplying a justification later on. The entry is constitutive.

The mortgage is entered into the land register with a precisely defined amount and may include clauses on currency and index adjustments in line with applicable regulations.¹⁶² In the case of maximum-amount mortgages, the maximum amount is also entered.¹⁶³ The interest rate is also recorded (Sect. 36 par 2 Land Register Act) in the case of claims for which interest payments have been agreed; in the case of claims for which annuity payments are agreed, the annuity payment instead of the interest rate is entered (Sect. 36 par 3 Land Register Act). When the mortgage is established with a condition or for a limited time, on such restrictions shall be annotated together with the entry of the mortgage.¹⁶⁴

If the **property is not recorded in the land register**¹⁶⁵, the voluntary lien is established by **depositing the deed** with the court, which has local jurisdiction over the property to be pledged.¹⁶⁶ The procedure of depositing the deed with the court has the same effect as entering the mortgage into the land register. Such deeds are also subject to the rules for the acquisition of mortgages by entry into the land register.

2. Acquisition of a Contractual Mortgage by Parties other than the Owners

In cases in which a person disposes over a piece of property and is registered as the owner, but is not the actual owner, the mortgage creditor acquires the mortgage anyway as long as the principle of protection of legitimate expectation is effective to his or her benefit (Art 318 Land Register Act). The **rules on the acquisition of real property** based on the good faith in **the correctness and completeness** of the land register apply to the acquisition of a mortgage from a person not being the owner.

The protection of legitimate expectation is effective only to the benefit of the **honest mortgage creditor**. The mortgage creditor is honest if he or she **neither knew nor had reasons to doubt** that the **real property belonged to the assignor** (lienee). This type of mortgage creditor acquires the mortgage even though the person entered into the land register before was not the owner.

Should the legal protection of the legitimate expectation of correctness of the land register be to the benefit of the honest mortgage creditor, then it will not be possible to object to the acquisition of the mortgage on the grounds that the entry of the prior owner in the land register was incorrect. This shall become legally effective only after the deadlines have expired until which

¹⁶⁰ Art. 309 Act on Real Property and Other Real Property Rights, Art. 35 - 38, Art. 52, Art. 56 Land Register Act.

¹⁶¹ Art. 309 par 1, 2 Act on Real Property and Other Real Property Rights.

¹⁶² Art. 36 par 1 Land Register Act.

¹⁶³ Art. 36 par 4 Land Register Act.

¹⁶⁴ Art. 31 par 2 Act on Real Property and Other Real Property Rights, par 35 par 4 Land Register Act.

¹⁶⁵ The property is not entered into the land register if the plot of land (the cadastral plot of land) is not in the Land Register (Art. 115 of the Employee Rules for the Keeping of Land Registers).

¹⁶⁶ Art. 309 par 3 Act on Real Property and Other Real Property Rights.

a petition for the cancellation of the invalid entry in the land register of the prior party may be lodged.¹⁶⁷

Should the legal protection of the legitimate expectation of completeness of the land register be to the benefit of the honest mortgage creditor, then it will not be possible to object to the acquisition of the mortgage on the grounds that the owner according to the books was not the actual owner of the real property. In this case, the mortgage creditor acquires the mortgage already at the time the mortgage is entered into the land register.

B. Voluntary, Judicial Mortgage

The **voluntary judicial mortgage** (*dobrovoljna sudska hipoteka*) is established during the legal proceedings to secure a pecuniary claim on the grounds of an **agreement between the parties** according to the provisions of the Act on the Levy of Execution.¹⁶⁸ The requirements for establishing a voluntary judicial mortgage are as follows:

The **owner** of the real property must be the lienee;

The mortgage **contract** must be concluded **before a court** in the form of a **judicial record**.¹⁶⁹ The signed record has the effect of a settlement reached in court;

The **incorporation** of the voluntary, judicial mortgage into the land register (Sect. 264 Act on the Levy of Execution); this is done by way of a ruling giving an order to secure a claim reached by the court on the basis of an agreement between the parties on the establishment of a voluntary, judicial mortgage. The incorporation has a **constitutive** effect for the acquisition of the mortgage.¹⁷⁰

The most significant difference between the voluntary, contractual mortgage and the voluntary, judicial mortgage is in the proceedings for the satisfaction of a claim. The proceedings for the satisfaction of claims are shorter in the case of the voluntary, judicial mortgage and the creditor will settle his or her claim faster. In the case of the voluntary, contract mortgage, a creditor desiring to satisfy his or her claims from the proceeds of the encumbered property must first file for hypothecary action to obtain a legally effective judgment by which the mortgage debtor is ordered to accept the satisfaction of the claims from the proceeds of the real property.¹⁷¹

In the case of the voluntary, judicial mortgage, the agreement reached in the form of a court record becomes a valid, executable title as of the time the claim falls due. Therefore, the creditor does not have to file for hypothecary action in order to obtain an executable title. The creditor can apply for execution to satisfy his or her claim based on this court record. For this reason, a voluntary, judicial mortgage is more advantageous for the mortgage creditor in comparison to the simple voluntary mortgage and used more frequently in practice.

¹⁶⁷ Art. 129 par 2 Land Register Act.

¹⁶⁸ Art. 261 - 268 Act on the Levy of Execution.

¹⁶⁹ Art. 313 par. 1 Act on Real Property and Other Real Property Rights, Art. 263 Act on the Levy of Execution.

¹⁷⁰ Constitutive means that for it to become legally effective, an entry into the land register is an absolute requirement.

¹⁷¹ Art. 338 par 1 Act on Real Property and Other Real Property Rights.

C. Voluntary, Notary-certified Mortgage

The **voluntary, notary-certified mortgage** (*dobrovoljna javnobilježnička hipoteka*) is very similar to the voluntary, judicial mortgage. It is different only as regards the reasoning. In the case of the voluntary, notary-certified mortgage, the contract is concluded in the **form of a notarial deed or of a private document certified by a notary** (Sect. 269 par 1 Act on the Levy of Execution).

The notarial deed or the private document certified by a notary becomes a title of execution on the day the claim falls due that has been secured by a mortgage, and based on this title, the execution can be applied for directly (without filing for hypothecary action). It is a very important instrument for securing claims in practice.

D. The Statutory Mortgage

The statutory mortgage is created only in cases in which this is explicitly prescribed by law. Upon request of the mortgage creditor, it is entered into the land register. This **entry** has **declarative** effect, because the mortgage already comes into existence at the time the conditions set out by law are met (Sect. 314 par 1 Act on Real Property and Other Real Property Rights).

VI. Sub-lien (sub-mortgage)

A **mortgage creditor** has the right – within the scope of the creditor's right to satisfaction of a claim from the property – to establish a **mortgage on the existing mortgage** without the consent of the mortgage debtor in **favor of a third party** (sub-mortgage, *nadhipoteka, podzaložno pravo*). The sub-mortgage follows the rules applicable to the voluntary mortgage or to the compulsory, judicial or statutory lien.¹⁷²

VII. Transfer of a Mortgage

When a **claim secured by a mortgage** (e.g. assignment, inheritance) is transferred to another person, the **mortgage that serves to secure such claim is transferred at the same time as well** (Sect. 319 Act on Real Property and Other Real Property Rights). The new creditor of the claim secured by the mortgage becomes the mortgage creditor with the same ranking as the predecessor by the transfer of the claim (even if it is not recorded in the land register). The **entry** therefore has only a **declarative** effect. However, an **entry into the land register** is required for the **realization**. The new mortgage creditor assumes the same priority ranking as the predecessor.

VIII. Realization of the Mortgage

A. General

The satisfaction of a claim secured by a mortgage can only be enforced by the creditor through **judiciary proceedings**, specifically, by the means applicable to the **execution of pecuniary claims** (Sect. 336 par 2 Act on Real Property and Other Real Property Rights, principle of **officiality**). The satisfaction of the claim is possible through a **court sale** of the real property,¹⁷³ the temporary

¹⁷² Art. 315/2 Act on Real Property and Other Real Property Rights.

¹⁷³ Art. 336 par 2 Act on Real Property and Other Real Property Rights.

receivership and realization of the fruits, or the other possible uses of the pledged object.¹⁷⁴

B. Satisfaction through the Court Sale of the Real Property

Satisfaction through a court sale is done according to the rules of the Act on the Levy of Execution relating to the execution of real property to collect pecuniary claims.¹⁷⁵ The execution through the sale of a real property requires an **executable title** giving the creditor the right to file for execution. The mortgage creditor therefore must **as a rule file for hypothecary action** against the mortgage debtor (*hipotekarna tužba*) in which he or she requests of the mortgage debtor (owner of the real property) to accept the satisfaction.¹⁷⁶ The mortgage creditor is not required to file for hypothecary action if he or she already holds an executable title based on which the creditor can apply for the realization of the pledged property. This applies to voluntary, judicial and voluntary, notary-certified liens on real property. At the time the claim falls due, the creditor has **an executable title**.

The execution is done by entering a note on the execution in the land register, the appraisal of the value of the real property, the sale of the real property and the satisfaction of the judgment creditor from the proceeds of the sale (Sect. 75 Act on the Levy of Execution). In the course of execution proceedings on real property, those mortgage creditors, who did not file for execution are also satisfied.¹⁷⁷ The value of the property is established by a ruling on the sale also based on an expert opinion on the day of appraisal.¹⁷⁸

The real property is sold at a **public, open-outcry auction** (Sect. 92 par 1 Act on the Levy of Execution). The proceeds of the sale are used to satisfy as **first priority the costs of the execution proceedings, taxes** and under certain conditions, personal easements **fees** as well as certain **other claims** (e.g. **alimony costs** and claims for damages).

Subsequently, claims secured by the mortgage, claims of the judgment creditor who filed for execution and the **claims relating to personal easements** and other rights that cease to exist with the sale are satisfied. The creditors are settled according to the priority of acquisition of the lien or right to satisfaction of a claim or according to the priority of the entry of the personal easement into the land register. Several claims having the same priority ranking will be satisfied in relation to their amounts (*pro rata*) if the proceeds of the sale are not enough to completely satisfy the claims (Art 109 Act on the Levy of Execution).

C. Temporary Receivership

A mortgage creditor who is capable of granting fruits or other uses from the proceeds of which the claim due can be satisfied has the right to demand execution from the court on the basis of a title of execution. Moreover, the mortgage creditor may demand that the court place the real property temporarily

¹⁷⁴ Art. 336 par 7 Act on Real Property and Other Real Property Rights.

¹⁷⁵ Art. 74-125 Levy of Execution.

¹⁷⁶ Art. 338 par 1 Act on Real Property and Other Real Property Rights.

¹⁷⁷ Art. 81 par 1 Act on the Levy of Execution.

¹⁷⁸ Art. 87 par 3, Art. 88 Act on the Levy of Execution.

under receivership and appoint a receiver. The receiver shall reap the fruits, use and realize them, and deposit the amounts procured with the court.¹⁷⁹

IX. Extinguishment of the Mortgage

The mortgage extinguishes when it is deleted from the land register, i.e., when the incorporation or note of cancellation has been entered.¹⁸⁰

Reasons for the deletion of a mortgage:

- The **destruction** of the pledged object, i.e., the **real property** (Sect. 343 Act on Real Property and Other Real Property Rights);¹⁸¹
- The **relinquishment** by the mortgage creditor (Sect. 344 Act on Real Property and Other Real Property Rights);
- **Expiry of the period** or **fulfillment** of a **cancellation clause** (Sect. 345 Act on Real Property and Other Real Property Rights);
- **Extinguishment of the secured claim** (Sect. 346 Act on Real Property and Other Real Property Rights); the mortgage extinguishes only when the entire claim including all ancillary claims, interest and costs are cancelled (Sect. 346 Act on Real Property and Other Real Property Rights);
- The dissolution of the **legal entity** who is the **lienor** and does not have a universal successor (Sect. 350 Act on Real Property and Other Real Property Rights);
- **Cancellation** in depreciation procedures (Sect. 351 Act on Real Property and Other Real Property Rights, Sect. 141–144 Land Register Act);
- **Discharge by operation of law** or by decision of the administrative authorities (Sect. 352 Act on Real Property and Other Real Property Rights);
- The **legal force of the decision is rescinded** by which the security provided was ordered and the compulsory lien was established (Sect. 353 par 1 Act on Real Property and Other Real Property Rights);
- The **circumstances** on account of which the **statutory lien** was established **cease to exist** (Sect. 353 par 2 Act on Real Property and Other Real Property Rights);
- The **acquisition in good faith of an unencumbered property** (Sect. 349 Act on Real Property and Other Real Property Rights); the mortgage, which has not been entered into the land register, extinguishes when a person acquiring the encumbered real property had no knowledge of this fact nor should have been able to know about such lien.

¹⁷⁹ Art. 336 par 7 Act on Real Property and Other Real Property Rights.

¹⁸⁰ Art. 344 par 5, Art. 345 par 1, Art. 347 par 1, Art. 350, Art. 351 par 2, Art. 352 par 2, Art. 353 Act on Real Property and Other Real Property Rights.

¹⁸¹ This reason is rather improbable, because real property as a plot of land including everything that is relatively permanently connected to it cannot become extinguished. However, it is possible for real property on which a mortgage has been established to be removed from the market and thus no longer be capable of serving as the object of a mortgage. The lien would then pass on to the fee to which the owner is entitled for removing the real property from the market (Art. 33 par 2, Art. 301 par 4 Act on Real Property and Other Real Property Rights).

X. Some Problems with Mortgages

A. Restrictions Regarding the Establishment of the Mortgage Claim

In practice, **mortgage claims are frequently agreed in a foreign currency** in order to protect the bank in the event of a change in value of the domestic currency. An agreement on the mortgage claim in a foreign currency is possible only in exceptional cases. Payment and satisfaction in foreign currency between residents and non-residents for tax purposes in the Republic of Croatia is only permitted in cases prescribed by law or by a decision of the Croatian National Bank.¹⁸²

For this reason, the protection of the mortgage creditor against the risk of fluctuation of the domestic currency can only be guaranteed by agreement on a **currency or index clause**. It is permitted to define in the agreement the value of the obligation in the currency of the Republic of Croatia based on the value of gold or calculated on the exchange rate of the Croatian Kuna in relation to a foreign currency (currency clause; Sect. 395 par 1 Obligations Act).

B. Restrictions Regarding the Object of the Mortgage

There are rules according to which certain types of real property cannot be objects of a mortgage. These restrictions result from the principle of officiality according to which the satisfaction of a mortgage claim can only be enforced by initiating execution proceedings. However, there are special restrictions for certain types of mortgages as regards the object of the mortgage in order to protect the judgment debtor.

The object of a mortgage can only be a specific real property that can be realized, i.e., a real property that can also be included in execution proceedings. The rules on the absolute exclusion of certain types of property as the object of a mortgage apply to all types of mortgages (voluntary, statutory and execution lien).

Thus, the following can never be the object of a mortgage:

- Properties that are **excluded from the object of legal transactions** (e.g. public property)
- Properties on which execution proceedings cannot be carried out according to the rules of the Civil Code, i.e., properties that are **excluded from execution** (e.g. objects whose purpose is national defense).

XI. The Land Register

A. General

The Land Register (*zemljišne knjige*) reveals the legal situation of real property of relevance for legal transactions (Sect. 1 Land Register Act).

The Land Register may contain:

- a. Fungible real property¹⁸³;

¹⁸² Art 15 of the Act on Foreign Exchange Transactions, Narodne novine 96/03.

¹⁸³ Real properties are incorporated as plots of land: parts of the earth's surface designated by a specific number in the cadastre of real estate together with everything that is on or under the earth's surface and permanently and organically connected to it.

- b. Rights *in rem* in real property¹⁸⁴;
- c. Certain obligatory rights to real properties¹⁸⁵; and
- d. Personal relationships and any legal facts of major relevance for legal transactions in the real property¹⁸⁶.

The basic **features of the land register** in Croatian law are:

- The land register is a **publicly** accessible book (Sect. 7/1 Land Register Act): Therefore, any person may inspect the contents.
- The land register is based on the general cadastral measurements of the plots of land (Sect. 9/1 Land Register Act).
- The keeping of a land register and the processing of land registry matters is the competence of the **courts**. The land registers are kept by the land registry departments of the **local courts** for those real properties located in the territory of jurisdiction (Sect. 5 Land Register Act).
- The land register is kept according to a system of **title sheets**.
- The land register is kept in handwritten form (**handwritten land register**) or by electronic data processing (**EDP land register**) (Sect. 6 par 1 Land Register Act). The EDP land register is modeled after the Austrian Land Register Conversion Act, with the deadline for the conversion being set at 1 January 2007.
- The land register consists of: a) the principal book; b) the collection of deeds; c) the collection of cadastral folder collection; and d) the indexes.
- There are three types of entries into the land register: a) **Incorporation** (intabulation, extabulation), b) priority notice and c) **annotation** (adnotation) (Sect. 30/1 Land Register Act).

The **incorporation** (*uknjižba*) is used to acquire, restrict, change or cancel rights entered into land registers without requiring any *ex post* justification.

The **priority notice** (*predbilježba*) makes these rights conditional, i.e., under the condition of a subsequent justification and applies to the extent to which these rights have been justified, acquired, restricted, changed or cancelled *ex post*.

The **annotation** (*zabilježba*) reveals any material legal facts that derive from the personal relations of the holder of the rights entered into the land register or may have specific legal effects.

¹⁸⁴ The Land Register may contain ownership rights, easements in appurtenances and easements in gross, rent charge, building lease and mortgages. All of the real rights in property mentioned above are entered into the land register even if they are restricted by a defined period of time or certain conditions.

¹⁸⁵ The contractual rights entered into the land register are the right to resell and the right of first purchase, the right of use (rent or lease) and licenses.

¹⁸⁶ The following is entered into the land register: The fact that the person registered is a minor, assignment of a legal representative, the prolongation of parental rights, legal coming of age and initiation of bankruptcy proceedings. The following legally relevant facts are entered: The securing of priority in the order of ranking, the cancellation of a mortgage claim, the filing of a hypothecary action, the note on a dispute, the petition for cancellation, the petition for a correction, any defenses raised, the appointment or removal of a receiver, the rejection of the execution, the awarding in execution proceedings, the existence of a simultaneous mortgage and numerous facts arising in the course of the land registration proceedings. The registration of various legal facts in the land register is regulated by many other positive law provisions such as those of the Act on Real Property and Other Real Property Rights, the Inheritance Act, Act on the Levy of Execution, Act on Expropriation of Property, etc.

B. Principles of Land Register Law

1. Principle of Disclosure

The fundamental legal effect of the disclosure of all rights in property entered into the land register is the creation of a contestable presumption that the person named in the land register as the holder of right in property is the actual holder of said right. However, in relation to the honest buyer it has the effect of an uncontestable presumption thus legally protecting the honest buyer who has relied on the correctness and completeness of the facts in the land register.

Based on the circumstances that the right to examine the land register is open to all persons, any party interested has the obligation to inform himself or herself on the status recorded in the land register. Therefore, not knowing the status in the land register does not excuse anyone, and it is presumed irrevocably that all persons have knowledge of the status in the land register.

2. Principle of Legitimate Expectation

The principle of legitimate expectation, which is the principle of disclosure in a material sense, protects honest third parties who trust the completeness and correctness of the status recorded in the land register and base their actions on this presumption. The principle of legitimate expectation has two effects: **positively** to protect the trust in the correctness and truth of the land register, and **negatively** to protect the trust in the completeness of the land register.

According to the **principle of trust in the correctness**, the honest third party who has trusted the correctness of the disclosed information on the legal status of the property acquires the right in this real property even if the legal status has not been correctly recorded in the land register.¹⁸⁷ Third parties acting in good faith acquire the right in property to the full scope, content and ranking with which this right was registered, even if the entry of the prior party is materially incorrect as regards scope, content and ranking of said right.

However, the legal effects of the trust in the correctness do not immediately take effect to the benefit of a third party acting in good faith at the time the entry into the land register has been done. An appeal with postponing effect is possible against the approval of the registration that can delay the entry into force of the registration or even prevent it.¹⁸⁸

The fundamental legal effect of the **protection of trust in the completeness** is revealed by the fact that rights, which have not been entered into the land register, cannot be enforced against third parties acting in good faith nor can their realization be executed. An exception is given in the case of rights and legally relevant facts that have an effect regardless of whether they have been entered into the land register or not (e.g. statutory liens, statutory first purchase right, encumbrances under public law).

The **requirements** for the applicability of the so-called **legal effects** of the principle of trust are the same regardless of whether it is the principle of trust in the correctness or the principle of trust in the completeness. These requirements are:

¹⁸⁷ Art. 122/1, 123 Act on Real Property and Other Real Property Rights, Art. 8/2,5 Land Register Act.

¹⁸⁸ Art. 123 to 128 Land Register Act.

- The discrepancy of the entry in the land register with the actual legal status;
- The honesty of the acquirer¹⁸⁹
- The acquisition based on a legal transaction; and
- The material validity of the acquisition.

3. Principle of Intabulation

The principle of entry into the land register means that land registry rights can only be established, transferred, restricted or cancelled by **entering these into the principal land register** (Sect. 15/2 Land Register Act).

In the case of an **acquisition of rights** in property through a legal transaction, the entry is **constitutive**.¹⁹⁰ In contrast, if property rights are acquired by **operation of law**, based on an **order of a government body** or by **inheritance**, then the entry into the land register is only of **declarative** nature. The entry into the land register of obligatory rights (rental rights, leases, right to resell, license) is also of declaratory nature. As the nature of these rights is relative, their entry into the land register establishes only their absolute effectiveness (i.e., the possibility of effectiveness vis-à-vis third parties) and makes their disclosure possible.

4. Priority Principle

a. General

The order of discharge is governed by the principle of chronological order (principle of *prior tempore potior iure* – the first to arrive has the stronger legal right), with rights acquired earlier having priority over rights acquired later.

The principle of priority states that the legal effects of the entry into the land register vis-à-vis other entries is determined by the sequence of the execution of the entry. As the entry is deemed as executed at the time the application for entry into the register is received by the land registry,¹⁹¹ the order is governed exclusively by this point in time.

When real property is encumbered by several mortgages, the satisfaction of those claims shall have priority that come before the other claims in the order of discharge (Sect. 302 par 2 Act on Real Property and Other Real Property Rights). If there are several applications for entry into the land register filed with the land registry for the same real property, all mortgages shall have the same rank and will be satisfied, if applicable, on a pro-rated basis.¹⁹²

The principle of priority is also of significance for the acquisition of rights that are mutually exclusive. In such cases, that right shall have priority as regards the entry into the land register, and thus also the acquisition, for which an application has been filed earlier, specifically, without taking the sequence of the

¹⁸⁹ The party acquiring the property acts in good faith when at the time the legal transaction is executed or at the time he or she applies for the registration did not know – taking the circumstances into account – nor had sufficient reason to harbor suspicions that the entries in the land registry were not complete or at variance with the actual status outside of the land register.

¹⁹⁰ Art. 119/1, 120/1, 121/1-4, 220/1,2, 263/1,2, 288/1,4, 309/1,2; Art. 119/2, 220/4, 263/4, 288/5, 309/4 Act on Real Property and Other Real Property Rights.

¹⁹¹ Art. 45/1, 107/1 Land Register Act.

¹⁹² Art. 45 par 2 Art. 114 Land Register Act.

execution of transactions into account that serve as a basis for the entry into the land register.

b. Disposal over the Rank

Whenever a right with a higher priority is cancelled, the rights entered subsequently will move up in rank (**principle of advancement**). An exception to this principle is contained in the Act on Real Property and Other Real Property Rights in the provisions on the disposal over the **sliding order of priorities** of the mortgage.¹⁹³ Advancement will not take place only if the owner of the property has **disposed** over the order of the mortgage.

Apart from the mortgage debtor (property owner), the mortgage creditor may dispose over the ranking of the mortgage as follows:

The mortgage creditor can exchange the ranking of his or her mortgage against the ranking of a mortgage entered later or another registered property right (**assignment of ranking**).

The owner of a real property can dispose over the ranking as follows:

- The owner can dispose over the encumbered property based on a receipt or another deed that proves the extinguishment of the claim secured by this mortgage by **assigning the mortgage to a new claim** that is not higher than the claim still in the land register. The right of the owner to dispose of the mortgage not yet cancelled is established when the claim secured by the mortgage is extinguished, and ends with the deletion of the mortgage from the land register.
- In the case of a deletion of a mortgage, an entry may be requested in the land register stating that for a new mortgage up to the amount of the cancelled mortgage the ranking is to be reserved for a period of three years after the approval of the annotation of the reservation of a ranking (**reservation of ranking**).
- The owner may request that a mortgage for a new claim be entered into the land register with the rank and up to the amount of the existing mortgage with the restriction that the new mortgage shall only have legal effect if within one year of the approval of the registration of the new mortgage, the deletion of the old mortgage is incorporated (**conditional lien**).

These acts by the property owner over the ranking are not possible if the owner has an obligation toward someone to obtain the deletion of a certain mortgage and this has been entered into the land register next to said mortgage (annotation on obligation to delete a mortgage).

5. Principle of the intabulated Predecessor in Title

According to this principle, an entry is only permitted against a person who at the time the application is received is already registered as the lawful owner of a real property in the land register or who has been incorporated as such at the same time said application for registration is received or for whom the land register contains a relevant priority notice (Sect. 40 Land Register Act). Should the predecessor in title of the person applying for entry into the land register

¹⁹³ Art. 347 f Act on Real Property and Other Real Property Rights.

not be registered, then the court shall reject such application, because its execution would not coincide with the status in the land register.¹⁹⁴

An exception to this rule is made in the cases in which several transfers of title are carried out that are not entered into the land register. In the event of the consecutive transfer of title, the court having jurisdiction over the land register may incorporate the ownership right immediately to the benefit of the last acquirer (without entering the acquirers in between) if the last acquirer can prove the uninterrupted consecutive transfer of title without registration in the land register by furnishing valid deeds on the acquisition of ownership from the registered predecessor in title up to the entry of his or her own person (Sect. 41/1 Land Register Act).

6. The Principle of Consensus

In line with the principle of consensus, the registration in the land register can only be done with the consent of the two parties involved. The person acquiring the title grants his or her consent informally and indirectly by submitting the application for entry in the land register. In this manner, said person determines the scope and content of the right he or she desires to be entered into the land register.

The person whose right is restricted or cancelled by this entry, gives his or her consent by way of the so-called *clausula intabulandi* (**consent to registration of a transaction**), i.e., by the explicit and strictly formal declaration that he or she agrees to the incorporation of the right for which the entry has been applied for.¹⁹⁵

7. The Principle of Legality

In accordance with the principle of legality, the court having jurisdiction over the land register has the obligation *ex officio* to check if all of the legal requirements are met for entering the registration into the land register (Sect. 108 Land Register Act). Should compliance with any one of the legal requirements be lacking, the court will reject the application. The land register court must ascertain whether:

- There are any hindrances to the entry into the land register with respect to the current status of the entry;
- The parties applying for the entry into the land register have the power of disposition over the object to which the entry refers and if the application for registration has been submitted by a person entitled to do so;
- The grounds given in the application are proven by the accompanying documents; and
- These documents have been drafted in the form required for the execution of the entry into the land register applied for.

¹⁹⁴ Art. 108 par 1 indent 1 Land Register Act.

¹⁹⁵ This declaration must be unambiguous, free of doubt and unconditional. It may be contained in the deed on the basis of which the entry in the land register is executed, in a special deed or in the application for registration.

C. Problems in Connection with the Land Register

1. Lacking Completeness and Correctness of the Land Register

In practice, problems relating to mortgages on real property arise repeatedly for banks because of possible errors or the lacking completeness of the Croatian land register system. The entry of a mortgage into the land register is usually preceded by a process to clarify the status of the land register for the purpose of registering the mortgage debtor as the owner of the real property or to correct the data on the surface area and the status of development of the pledged real property.

The frequent lack of agreement of the land registers with the actual state of affairs in fact and as regards the legal status of the real property results in a situation in which the disclosure function of the land register does not apply in full and the legal certainty cannot be fully guaranteed for legal transactions in real property.

Land registers have not been established in all cadastral communes or were destroyed in some cases during World War II. Even in those cases in which land registers have been created, some problems hinder the full implementation of its disclosure functions.

Often, the status of the real property in the land register and the status in the cadastral register do not coincide, because although changes due to the frequent subdivision of plots of land into lots, the formation of construction lots and the construction of buildings are recorded in the cadastre of properties, these are not entered into the land register. A large number of land registers have not been updated to agree with the new land surveys of the cadastral offices. Moreover, a great number of buildings and apartments have not been registered at all.

Thus, changes in rights in property are also recorded only with a delay.

The regulations on the conversion and privatization of collective property into private property had a special influence on the discrepancies in the land registers.

On account of the lacking agreement of the status in the land register with the actual, factual and legal status of the real properties, changes in property rights were often executed without entering these into the land register (even in cases in which the entry is constitutive for the legally valid acquisition, alternative modes of acquisition were selected, e.g. the transfer of possession, record of the properties). This has created an even greater discrepancy between the status in the land registers and the actual legal status of properties and for this reason the disclosure function of the land registers does not fully apply even though a new law has been passed on land registers.

2. Protection of Legitimate Expectation in the Transition Period

In those cases in which the disclosure function has been applied only to a limited extent, it is not possible to achieve a satisfactory protection of legitimate expectation in legal transactions. Thus, the protection of legitimate expectation as regards the land register has been diminished due to jurisprudence that frequently denies this principle.

The protection of being able to trust in the completeness and correctness has been postponed for a certain time in order to update the status in the land registers to match the actual legal situation of the real property.

The principle of **protection of legitimate expectation** regarding completeness and correctness does **not apply to entries** done until **1 January 2007** if it relates to the acquisition of a real property for which collective ownership was registered but was not deleted before the law took effect.¹⁹⁶ Until this period expires, the protection of legitimate expectation as regards correctness and completeness is postponed for real property that had been under collective ownership.

The Land Register Act contains special provisions for exemptions from the application of regulations on the protection of legitimate expectation for real property in private ownership. The holders of real rights not entered into the land register are obligated to initiate proceedings by 1 January 2007 for procedures to register real rights in property and all changes thereto in the land registers. The public prosecution office is also under the obligation to initiate the proceedings by this deadline to register real rights in property of which the holder is the Republic of Croatia and to register public and communal goods.¹⁹⁷

The land register courts are also under the obligation to set up land registers and to redesign these by means of electronic data processing by 2007, with this deadline not applying to those land registers that contain entries that reflect the actual and factual situation of the real property correctly and completely.¹⁹⁸

3. Acquisition of Real Rights by Entry in the Land Register

In the case of acquisition of real rights in a real property not incorporated into the land register, the registration has been replaced by the depositing of the deed with the competent court as a mode of acquisition.¹⁹⁹ The act on the depositing of deeds documenting the transfer of legal rights is therefore valid as a mode of acquisition for the acquisition of real rights in property.

Until the passage of the Act on Real Property and Other Real Property Rights there had been difficulties in putting the various modes of acquisition into practice for the acquisition of real rights in those cases in which the objects, buildings and apartments were not incorporated due to the temporary suspension of the principle of *superficies solo cedit*. Buildings and apartments were legally separated in legal transactions from the plots of land under collective ownership. In such cases, it was not possible to register those buildings and apartments, which were not incorporated, in the land register, even if the plots of land on which these buildings stood were registered in the land register. This type of acquisition became highly topical during the sale of apartments, which have been in collective ownership, to which residents had occupancy rights.

Ownership in an apartment in a building that is not incorporated in the land register is acquired by depositing the deed in the book of deposited deeds. A mortgage on an apartment is acquired in the same manner. Today, two parallel

¹⁹⁶ Art. 388 par 5 Act on Real Property and Other Real Property Rights.

¹⁹⁷ Art. 224 par 2,3 Act on Real Property and Other Real Property Rights.

¹⁹⁸ Art. 226 par 1 Act on Real Property and Other Real Property Rights.

¹⁹⁹ Art. 120/4, 121/5, 220/3, 263/3, 288/5, 309/3 Act on Real Property and Other Real Property Rights.

sets of files containing evidence are kept: the **land register**, which contains the plot of land but not the change due to the building on it, the **book of deposited contracts**, in which apartments are registered as separate parts of a building that are separate from the plot of land. In the light of the fact that the Act on Real Property and Other Real Property Rights has reinstated that a plot of land and the building on it are legally a unified whole²⁰⁰, a special provision was passed to create a connection between these two records.²⁰¹ Currently, the book of deposited contracts is deemed part of the land register.

Real rights in apartments that are registered in the book of deposited contracts are still being entered into this record and not in the land register. However, now it is expressly prescribed that all entries in the book of deposited contracts are deemed entries in the land register, and all the effects of a registration in the land register are thus given (Sect. 149 Land Register Provision).

The entry has been replaced also in other cases in which the property has not been incorporated by other modes of acquisition. For example, in the proceedings for the judicial or notary-certified creation of security for a claim by creating a line on the basis of an agreement of the parties as well as in the case of the creation of judicial or notary-certified security by transferring the ownership in property and rights.²⁰² In the event that security is to be provided by creating a lien on a real property not incorporated into the land register, this is done by pledging real properties in accordance with the rules on the execution to satisfy pecuniary claims from the value of the real properties not registered in the land register;²⁰³ An announcement will be published soon on the register of pledged objects in the Official Gazette (Sect. 125/5 Act on the Levy of Execution).

When security is provided for a real property not registered in the land register by transferring the ownership, the assignee becomes the owner by signing the record on the agreement to provide security by transfer of ownership and the transfer of ownership is announced in the Official Gazette.²⁰⁴ In the case mentioned above, the mode of acquisition is the transfer of ownership and recording this act. The publication of the act of registration of the property in the Official Gazette is only required for meeting disclosure requirements.

²⁰⁰ The legal unification has been achieved by declaring the owner of the building on land that was in collective ownership to be the owner of the plot of land in accordance with the law (Art. 367 - 369 Act on Real Property and Other Real Property Rights); the owner of a separated part becomes co-owner of the entire property, i.e., the plot of land on which the building was erected and the building as an appurtenance of the plot of land (Art. 370 - 373 Act on Real Property and Other Real Property Rights).

²⁰¹ Art. 149-157 Land Register Provision.

²⁰² Art., 261 - 272, 273 - 279 Act on the Levy of Execution.

²⁰³ Art. 262 fig. 2 in connection with Art. 125 Act on the Levy of Execution.

²⁰⁴ Art. 274/5,7, Act on the Levy of Execution.

Chapter 6: Liens on Rights, Assignment by Security

I. Introduction

In Croatian law, assignment primary is the mode of acquisition used for establishing a lien. Assignment by security without a lien does not have any effect of securing real property and is therefore a very weak form of security, because it does not establish any rights to separated assets in the event of bankruptcy of the borrower. For this reason, assignment by security is dealt with in the section on the much more important pledging of rights.

II. General

Liens are rights in property with restrictions on a subjective property right that entitles the party having such right (lienor; bank) to satisfy a certain claim from the value of this right while the party granting such right (lienee) is obligated to accept this.

III. Assignment

The object of a lien on rights can be any subjective right to a property that is suitable for satisfying a pecuniary claim (e.g. performance in the form of surrendering something or doing something, participation in commercial companies, rights derived from securities, usufruct, patents). The lien on a right can be established on any **individually defined, sellable right** or an idealistic share in such a right. In order for a subjective right to an asset to be capable of being the object of a lien, the following three conditions must be given:

- It must be a **property right**;
- The right **must be available for selling or buying**; and
- It must be **suitable for realization**.²⁰⁵

A pledged object shall be deemed to include – apart from the right itself – all of its appurtenances and fruits that such pledged right yields due to its legal status, for example, interest. Such fruits may also be pledged independently.²⁰⁶

As an object of a lien, rights are generally considered equivalent to property: movable property or real estate.²⁰⁷ The rules applicable to liens on movable property or on real property also apply accordingly to liens on rights unless special provisions have been defined for liens on rights or its legal nature indicates otherwise.

The lienor has all rights and obligations of a pledged right that he or she would have if a movable property would have been pledged to him or her.²⁰⁸

The object of the execution and thus also of the lien **cannot** be receivables from **taxes** or other **charges**.

²⁰⁵ Gavella/Josipović/Gliha/Belaj/Stipković, *Law of Real Property*, 854.

²⁰⁶ Art. 298/5 Act on Real Property and Other Real Property Rights .

²⁰⁷ A number of types of rights may be rendered equivalent to property rights by law. The right in such a case is usually considered as belonging to the movable property; however, the right is considered as belonging to real property if it is connected to the ownership of the immovable property or is an encumbrance on it, or if it is declared by law to be a real property (Art. 2/6 Act on Real Property and Other Real Property Rights).

²⁰⁸ Art. 333 Act on Real Property and Other Real Property Rights.

IV. Origin

A. Voluntary Lien on Rights

The voluntary lien on rights is acquired through a lien agreement entered into between the lienee and the lienor. Three conditions must be met for the **acquisition** of the voluntary lien on rights:

- The **right** must belong to the **lienee**;
- A **valid contract** must exist on the **pledging of rights**;²⁰⁹ and
- A **mode of acquisition** is required.

The mode of acquisition, i.e., the method by which the lien on rights is acquired depends on the type of lien pledged:²¹⁰

- A **lien on a claim** of the lienee is acquired by fiduciary transfer by **assignment** (cession) with the notification of the debtor of the assignment;
- A **lien on rights arising from registered securities** is acquired by fiduciary transfer by **assignment** (cession) with the notification of the debtor of the assignment;
- A lien on **rights arising from bearer securities** is acquired by **handing over** these securities to the lienor for the purpose of securing the claim;²¹¹
- A **lien on rights arising from instruments to order** is acquired by a **pledging endorsement**.²¹²
- A **lien on other property rights** that are equal to movable assets (patents, technical innovations, royalties) are transferred by the **appropriate method prescribed** for these types of rights.
- The **lien on rights** created by entry in **public registers** and for which no securities (e.g. immaterial or de-materialized securities)²¹³ are issued are acquired by entry in precisely this public register²¹⁴;

²⁰⁹ The contract on the pledging of rights is subject to the provisions of Section 307 Act on Real Property and Other Real Property Rights on the contract of lien, including the provisions on prohibited covenants in the contract of lien (Art. 307/3-5 Act on Real Property and Other Real Property Rights).

²¹⁰ The forms of acquisition of voluntary liens on rights are regulated in Art. 310 Act on Real Property and Other Real Property Rights.

²¹¹ The provisions on handing over pledged chattel into the possession of the lienor as laid down in the Act on Real Property and Other Real Property Rights apply to the handing over of securities to the holder of the lien.

²¹² The pledging endorsement is a statement of an entitled person in written form by which such person transfers the rights derived from securities (e.g. bill of exchange to order, check to order) to the lienor for the purpose of creating a pledge. The pledging endorsement is conducted in the following mode: a note is entered on the back side of the security reading "value of security", "value of lien" or another note indicating the lien. The endorsement and the pledging endorsement are governed by the Act on Bills of Exchange (Art. 10-19) respectively the Act on Checks (Art. 7 and 8). The provisions of the Act on Bills of Exchange are applied in the same way to checks (Art. 23 Act on Checks).

²¹³ Dematerialized securities are electronic notes on the securities account in the computerized securities register of the Central Securities Depository. The issuer of such a security is therefore under the obligation to fulfil the obligation contained in the dematerialized security toward the owner (Art. 124 of the Act on the Securities Market, NN 84/02). Provisions on dematerialized securities are applied in the same way to dematerialized equities (Art. 133 of the Act on the Securities Market, Art. 227/1 Commercial Companies Code). The Central Securities Depository is a legal entity that is authorized to conduct transactions such as the depositing of dematerialized securities and the netting and setting off of legal transactions in such securities. The Central Securities Depository is a stock company whose stockholders are, among others, the Republic of Croatia, authorized companies, stock exchanges, investment management companies, banks issuing dematerialized securities (Art. 134, 135 of the Act on the Securities Market).

²¹⁴ A lien on dematerialized securities is acquired based on a valid lien contract by means of the respective registration of this right on the account of dematerialized securities. (Art. 129 of the Act on the Securities). Only **one** lien may be acquired on one dematerialized security (Art. 129 of the Act on the Securities Market).

- Especially liens on rights to real property are acquired by registration in the land register, i.e., by incorporation or by the entry of a priority notice.²¹⁵

B. Special Features of the Assignment

1. General

As already mentioned, the mode of acquisition for pledging receivables is the assignment of the receivable (cession). Therefore, the special features of the assignment in this context are explained in the following. It should be noted that the assignment by security not executed within the scope of pledging a claim has different effects than a pledge. In particular, the bank does not have any rights to separate satisfaction from a bankrupt's estate due to the solely **personal effect** (*inter partes*) of the “**pure**” **assignment by security**.

An assignment is a contract specifying the transfer of a creditor's negotiable claim to another person.²¹⁶ The creditor can transfer any claim to another person with the exception of those claims which are prohibited by law to be transferred or which are of a strictly personal nature. The assignment is regulated in Croatian law by Art 436-445 Obligations Act. The existing debtor becomes the assignor, the new creditor becomes the assignee, and the third party debtor is referred to as the debtor.

The assignment means that the entire claim or portion of a claim including any ancillary rights (liens, rights arising from contracts with sureties, rights to interest, contractual penalties, etc) is transferred to the assignee. These rights are transferred *ex lege*, i.e., without any special legal act required for their acquisition. As of the time at which the recipient becomes a creditor of the assigned claim, said recipient also becomes the lienor.

2. Notification of Third-party Debtor

The consent of the initial debtor is not required for the assignment. However, it is possible for the debtor and the creditor to reach an agreement prohibiting the creditor from transferring the claim to any other person or doing so without the consent of the debtor to another person (prohibition of assignment). Should the creditor assign the claim to another person in such cases violating the prohibition or without the consent of the debtor, the assignment contract shall not be effective *vis-à-vis* the initial debtor.²¹⁷

It required to inform the third party debtor of the assignment executed. After this notification of the third-party debtor, he or she may effectively fulfill the obligation only toward the new creditor. Should the third party debtor have paid the existing creditor prior to the notification, the obligation shall expire only if the third party debtor did not know of the assignment.²¹⁸

²¹⁵ All applicable rules of the Land Register Act regarding the entry of property rights in the land registers apply accordingly to the registration of such a lien.

²¹⁶ *Vedriš/Klarić*, *Bürgerliches Recht*, 427.

²¹⁷ Art 436/2 Obligations Act.

²¹⁸ Art 438/2 Obligations Act.

3. Rights of the Third-party Debtor

The **legal status of the third-party debtor** does **not change** after the assignment of the claim to a new creditor. The third-party debtor has the same rights vis-à-vis the new creditor as he or she had vis-à-vis the existing creditor. Therefore, the third-party debtor may raise all defenses against the new creditor that he or she had against the existing creditor with the exception of strictly personal defenses. Furthermore, the third-party debtor may net any claims he or she had against the existing creditor against the claim of the new creditor.²¹⁹

4. Relationship between New and Existing Creditor

The relationship between the existing and the new creditor differs depending on **whether or not** the assignment was **free of charge**. If the assignment involved the payment of a fee, the existing creditor shall be liable for the **existence of the claim at the time the assignment was executed** (liability for legal effectiveness of the claim). The **existing creditor is liable** for the claim being **collectible** (liable for creditworthiness of debtor) if the assignment involved the **payment of a fee** and such liability has been explicitly agreed on.²²⁰ In the case of an assignment without the payment of a fee, the existing creditor is not liable for the legal effectiveness of the claim assigned and creditworthiness of the third-party debtor.

5. Assignment by Security

If the assignment by security is used as an instrument to secure credit, the bank usually has the role of the new creditor. The assignment by security for securing a debt is regulated in the Obligations Act in the sections relating to the so-called special cases of assignment.²²¹ The assignment by security is the assignment of a receivable for securing a claim of the new creditor against the existing creditor. The new creditor is obligated to collect the assigned claim with the due care of a prudent businessperson and to hand over to the existing creditor any excess amount after successfully collecting the debt.²²²

If a lien on claims is acquired by assignment by security (Art 310/1 Act on Real Property and Other Real Property Rights), until the claim matures the lienor (recipient of the claim) shall be under the obligation to take the measures required for enforcing the pledged claim (Art 334/1 Act on Real Property and Other Real Property Rights). If the claim assigned grants interest and other recurring benefits, the lienor has the right to collect these.²²³ When the assigned claim matures, the lienor is entitled and obligated to undertake all measures required for the performance of the obligation, and to accept fulfillment.²²⁴ The lienor is entitled to demand performance from the third party debtor.²²⁵ By fulfilling the pledged claim, the lien passes on to the asset through which

²¹⁹ Art 440, 340 Obligations Act.

²²⁰ Art 442, 443 Obligations Act.

²²¹ The special cases of assignment include the assignment instead of payment and assignment for collection (Art. 444 Obligations Act)

²²² Art 445 Obligations Act.

²²³ The value of this interest is offset against the costs the lienor incurred, and furthermore, against the interest that the debtor owes the creditor, and finally, against the principal (Art. 334/2 Act on Real Property and Other Real Property Rights).

²²⁴ Art 334/3 Act on Real Property and Other Real Property Rights .

²²⁵ Art 335/1 Act on Real Property and Other Real Property Rights .

the claim was satisfied. If the lienor has received money from the performance of the pledged claim, which is usually the case, and the claim of the creditor is not yet due, the lienor shall deposit the money received with the court.²²⁶

When a secured claim is satisfied by a pledged lien to rights, the lienor is under the obligation to return to the lienor the claim assigned for securing the debt (so-called re-assignment).²²⁷

C. The Voluntary Judicial or Notarial Lien on Rights

The voluntary judicial lien on rights is acquired based on a lien agreement entered in the form of a judicial record²²⁸, while the voluntary notarial lien on rights is established by a lien agreement in the form of a notarial act.²²⁹

The mode of acquisition of the voluntary judicial or notarial lien is the **pledging of a subjective property right**. The attachment proceedings are regulated by the **rules on execution** in certain of the subjective property rights mentioned for the purpose of satisfying a pecuniary claim.²³⁰ The **pledging of rights** is announced by a notice in the **Official Gazette** and if necessary in other **public media**.²³¹ This announcement ensures a certain degree of disclosure to the public.

A voluntary judicial or notarial lien can be acquired for the following claims:

- Pecuniary claim;
- Income received by a debtor under an employment contract;
- Pensions, disability pensions or the remuneration for earnings foregone;
- Receivable on an account with a bank savings passbook;
- Claim for the surrender or delivery of movable assets or the surrender of a real property;
- Other property rights such as stock certificates and other securities as well as their handing over for safekeeping;
- Stocks for which no certificates were issued; and
- Shares in commercial companies.

D. Pledging by a Letter of Consent of the Debtor

1. General

Croatian enforcement law grants the possibility of legally enforcing the execution of a pecuniary claim (establishment of a forced lien, attachment, collection of the debt owed) based on a letter of consent of the debtor.

The debtor may grant his or her consent to the **seizure** of a portion of his or her **income** or other recurring pecuniary revenues by signing a **public document certified by a notary**. The relevant pecuniary amount on the public document is paid directly to the creditor in the manner specified in said document (Art 178 Obligations Act). The public document is served to the

²²⁶ Art 334/4 Act on Real Property and Other Real Property Rights .

²²⁷ Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property, 864.

²²⁸ Art 313 par. 1 Act on Real Property and Other Real Property Rights , Art 263 Act on the Levy of Execution.

²²⁹ Art 269 Act on the Levy of Execution.

²³⁰ Art 262, 4 to 11 Act on the Levy of Execution, Art 264 Act on the Levy of Execution.

²³¹ Art 266 Act on the Levy of Execution.

employer by the creditor²³², and it has the same legally binding effect as the delivery of a writ of execution. The delivery gives the creditor a lien to a portion of the income of the debtor. This lien is equivalent to a compulsory lien with respect to its effects.

The **accounts** (giro accounts, foreign currency accounts, etc) of a borrower may be pledged in the same manner, i.e., the borrower gives his or her consent to establishing a **public document certified by a notary**. In this case, the document is delivered to the bank maintaining the account. This type of public document also has the same effect as a final writ of execution for pledging a receivable on an account and by which the receivable is transferred to the execution creditor by debiting it from the account. The creditor acquires the lien when the document is served to the bank that maintains the accounts of the debtor.

Apart from the debtor, the same declaration can be made in the certified document by a surety and payer.²³³ With the delivery of the declaration to the legal entity that maintains the account of the surety and payer, the creditor acquires a lien on the pecuniary receivable on an account of the surety and payer. The creditor can demand that the receivable be debited from the account of the debtor or from the account of the surety and payer or from both at the same time.²³⁴

The consent to the seizure of the account can be given by the debtor in the form of a promissory note in blank²³⁵ if the debtor is a merchant. The debtor may even grant his or her consent in the document bearing his or her authenticated signature to pledge all of his or her bank accounts to secure the claim not yet recordable and to pay from these accounts directly to the creditors named in the document or recorded in it afterwards.²³⁶ The creditor delivers to the bank, which maintains the accounts of the debtor, the declaration with the information on said creditor recorded *ex post* and the amount of the claim recorded *ex post*. The delivery has the same effect as the delivery of a final writ of execution, thus this delivery gives the creditor a compulsory lien on pecuniary claims on the accounts of the debtor.

The possibility of seizure by the consent of the debtor is of relevance in practice especially if no other assets are available for securing a debt (particularly pledged chattel, real property). It is enough for the borrower to have a recurring income (e.g. wages, pension) or other available funds on a giro account or a foreign currency account.²³⁷

²³² The document is delivered without the involvement of the court by registered mail with notice of receipt, or by a public notary.

²³³ A guarantor and a payer is a guarantor who is jointly and severally liable with the debtor for the claim (so-called joint and several liability, Art. 1004/4 Obligations Act). For more details, see Chapter on Suretyship.

²³⁴ Art 183/1-3,5 Act on the Levy of Execution.

²³⁵ The form and the content of blank promissory notes indicating the maximum amounts that can be entered are governed in the working instructions on the form and content of blank promissory notes (Narodne novine 107/99, 135/99, 18/00). According to these working instructions, the maximum amount up to which the creditor may collect a claim is to be indicated on the promissory note when it is issued. The following amounts may be entered: up to HRK 5,000.00; up to HRK 10,000.00; up to HRK 50,000; up to HRK 100,000.00; up to HRK 500,000.00 or up to HRK 1,000,000.00 (Art. 2). Interest on arrears is due as of the day defined afterwards by the creditor, but at the earliest as of the day the promissory note was issued (Art. 4 item 3).

²³⁶ Art 183a Act on the Levy of Execution.

²³⁷ Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property, 879.

2. Advantages of a Pledge with the Consent of the Debtor

The effects of the pledging with the consent of the debtor are very favorable for creditors. It gives the creditor a fast, effective and secure way of obtaining satisfaction of claims. The creditor does not have to enforce his or her claim by execution proceedings or wait for a writ of execution to obtain satisfaction of a claim. The creditor already has the execution document. The third-party debtor to whom the declaration is served is under the obligation to pay the portion of the income or the money on the account of the debtor to the lienor.

A special advantage of pledging an account with the consent of the execution debtor is furthermore, the fact that the creditor can obtain satisfaction in the same manner from surety and payer. The surety and payer can consent to the pledging even if the debtor has signed a blank promissory note. The public documents bearing the consent of the debtor and of the surety and payer to pledge the account are at the same time **enforceable public documents** based on which the direct execution of other eligible objects and liens can be demand (Art 183/7 Act on the Levy of Execution).

An advantage of this type of security for the creditor is moreover, the fact that the bank can transfer the rights in the **public document** according to which the debtor has consented to the pledging of the account. The transfer is done by a public document bearing the signature of the creditor authenticated by a public notary. The new creditor thus acquires the rights that the existing creditor had under this public document.²³⁸

3. Disadvantages of the Pledge with the Consent of the Debtor

A **disadvantage** of this type of security for the creditor consists in that the Act on the Levy of Execution explicitly stipulates that such a pledge does not have any influence on the execution income or the account to satisfy claims arising under **statutory alimony obligations** and certain **compensation payment claims**.²³⁹ These **claims** still have a **preferential status** with respect to their satisfaction.

V. Realization of Liens on Rights

After a secured claim falls due, the lienor has the right to the satisfaction of his or her claim from the value of the pledged property rights.²⁴⁰

Generally, the satisfaction of the lienor from the value of the pledged right is subject to the principle of officiality. The realization is thus carried out by **judicial execution proceedings** (Art 336/2 Act on Real Property and Other Real Property Rights). The type of realization depends on the nature of the property rights pledged:

- The execution of pecuniary claims is carried out by the **enforceable transfer** (enforceable assignment) of the claim to the **lienor**.²⁴¹ Upon the lienors request, the court may order the transfer of the claim for collection or in

²³⁸ Art 183/4 Act on the Levy of Execution.

²³⁹ Art 178/3, 183/8, 183a/3 Act on the Levy of Execution.

²⁴⁰ Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property, 865.

²⁴¹ Art 160-171 Act on the Levy of Execution.

place of payment.²⁴² The transfer itself is done by **delivery** of the **writ of execution** to the **third-party debtor**.

- The realization of a security transferable by endorsement is done by **registering the transfer declaration by the court and the handing over of the security to the creditor**.
- Claims to **wages or salaries** or other recurring pecuniary receivables are executed by **issuing an order to the employer to pay** the pecuniary amount to the lienor.²⁴³
- Satisfaction by way of execution of a pecuniary amount on an account is done by **issuing an order to the bank to pay** the pecuniary amount to the lienor.²⁴⁴
- Satisfaction by way of **execution from dematerialized securities** or shares in commercial companies is done by **selling** these.²⁴⁵
- Satisfaction by way of execution of a **claim not consisting of money** (e.g. claim to the surrender of objects) is done by transferring the claim to the lienor and by **selling** the objects after they have been surrendered.²⁴⁶
- Satisfaction from other property rights is done through their realization in accordance with the provisions on the **sale of movable assets**.²⁴⁷

In the case of a voluntary judicial or notarial lien on rights, an agreement certified by a notary having the form of a court record on the establishment of a lien shall have the effect of a judicial settlement. The creditor can demand the sale through execution proceedings based on a declaration that the agreement of the parties on the establishment of the lien has become enforceable.

The **out-of-court satisfaction** from the value of the pledged right is possible if the conditions applicable to movable assets are met. The out-of-court satisfaction from pledged movables is **permissible**, if the debtor consents to satisfaction in this manner by a **written declaration**. In the case of claims of a bank (**commercial transaction**), the out-of-court method of satisfaction is possible, if the debtor does not explicitly rule out this option at the time the lien is established (Art 337/1,2 Act on Real Property and Other Real Property Rights).

If the object of the pledge is a pecuniary claim, the lienor has the right to satisfaction in an out-of-court settlement by keeping the amount paid.

VI. Problems in Connection with the Acquisition of Liens by a Person not Entitled

Under Croatian law, the principle of **legitimate expectation** applies only in legal transactions in moveable assets and real property. This principle of legitimate expectation is based on the disclosure function of the possession of moveable assets or the registration in the land register. However, the nature of rights is that they are not material and for this reason, the principle of legitimate expectation does **not apply to legal transactions in pledged rights**. It is

²⁴² The transfer of the claim through settlement entitles the lienor to claim payment of the amount stated in the writ of execution from the debtor's debtor (Art. 165 Act on the Levy of Execution). The lienor acquires the debtor's claim through the transfer of the claim instead of payment (Art. 171 Act on the Levy of Execution).

²⁴³ Art 172-177 Act on the Levy of Execution.

²⁴⁴ Art 180-182 Act on the Levy of Execution.

²⁴⁵ Art 194-198 Act on the Levy of Execution.

²⁴⁶ Art 185-193 Act on the Levy of Execution.

²⁴⁷ Art 200.

therefore not possible to acquire a lien to a property right from a person who is not the bearer of this right.²⁴⁸

However, the rule stated above **does not apply** to the acquisition of liens on rights arising from bearer **securities**, because such claims are to be treated like objects in transactions. In this case, when acquiring a lien on a moveable asset the rules of the principle of legitimate expectation are applied by the person not being the owner (Art 317/1 Act on Real Property and Other Real Property Rights).²⁴⁹

An exception to the rule consists in relation to the rights that are recorded in public registers (e.g. land register). Public registers enjoy the trust of the public. Persons acquiring liens on rights recorded in public registers can acquire liens on registered rights also from persons who are not the owner of such rights although such persons are registered in the public records as the owners if they are honest.²⁵⁰

²⁴⁸ Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property, 860.

²⁴⁹ Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property, 860.

²⁵⁰ See Chapter on Liens on Real Property, the Land Register.

Chapter 7: Other Types of Real Security

I. Assignment as Collateral- Fiduciary transfer of assets

A. General

The assignment of a property is a form of security by which the debtor transfers to the creditor the ownership of an object for the purpose of securing a certain claim. Assignment as collateral is the transfer of ownership to the creditor with the restrictions of a **resolutory clause**.²⁵¹ Ownership is returned to the debtor as soon as the claim is satisfied. In this legal relationship, the acquirer (the creditor) is the **foregoing owner of the pledged property** and the assignor (debtor) is the **subsequent owner**.

Generally, the contract has only a **relative legal effect** for the owner and the creditor, because it is effective only for the relationship between the contractual parties. For a restriction to ownership to apply also to third parties **absolutely**, it must be **registered in a public register**. This public disclosure feature is given when the transfer of the ownership to real property is recorded in the land register. The assignment as collateral is recorded in the **land register** in such a manner that at the time the foregoing ownership of the acquirer is recorded in the register (the creditor) the subsequent ownership of the assigner (debtor) is recorded (Art32 Abs5 Land Register Act). The entry of the subsequent ownership rights is deemed a priority notice that can be enforced as soon as the secured claim is satisfied (Art34 par4 Land Register Act).

The transfer of ownership of a **moveable asset** for the purpose of securing a debt would likewise have to be recorded in a public register to which the rule applies that without an entry in the register it is not possible to acquire such object to which a restriction has been assigned.²⁵² However, no such registers for moveable assets exist at present and for this reason, the assignment as collateral of moveable assets can only have a relative effect.

Assignment as collateral is regulated in Art 34/5 Act on Real Property and Other Real Property Rights. The rules on liens apply accordingly to the assignment as collateral as well.²⁵³ The transfer of ownership for securing a debt is subject to all principles applicable to liens with the exception of the principle of officiality. The creditor as the preceding owner is therefore obligated to refrain from using the object and from disposing over the object except for the satisfaction of this claim.

If the claim is not satisfied upon maturity, the owner has the right to obtain satisfaction by selling the object in accordance with the rules on the satisfaction of claims secured by liens in **out-of-court** proceedings (Art34 par5 Act on Real Property and Other Real Property Rights). The satisfaction itself can be done rapidly and effectively without requiring execution proceedings.

Assignment as collateral can be established on moveable assets and real property that is transferable through legal transactions, i.e., that can be sold.

²⁵¹ Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property 608.

²⁵² Art 34/5 EDRG.

²⁵³ Art 297/2 EDRG.

B. Judicial and Notarial Assignment as Collateral

1. General

In banking practice in Croatia, the most frequent type of real security that uses the transfer of ownership to secure a debt is the judicial and notarial securing of debt by transfer of ownership to assets or to pecuniary claims in accordance with the rules of the Act on the Levy of Execution (Art 273–279).

The transfer of ownership referred to here refers to the one in which it is transferred to the creditor with the **resolutive clause** requiring the satisfaction of a certain claim of the creditor. Compared to the other types of real security, this form of security has many advantages giving the creditor a faster form of realization of security.

2. Origin

The **prerequisites** for the judicial or notarial transfer of ownership for securing a debt are:

- An **agreement** on the transfer of ownership to an asset or a claim to secure a pecuniary debt. The agreement is entered into by the owner of the asset (guarantor) and the creditor (transferee). This agreement is reached before a competent court in the form of a **judicial record**.²⁵⁴ The judicial record has is effective as a court settlement.²⁵⁵ The agreement may have the form of a **notarial deed** or of a **private document certified by a notary**.²⁵⁶ By entering into this agreement, the transferee (creditor) becomes the preceding owner and the guarantor becomes the subsequent owner in the meaning of Art 34/5 Act on Real Property and Other Real Property Rights.²⁵⁷
- The appropriate **mode of acquisition**, depending on whether it is movable property, real property or a pecuniary claim that is being transferred. The judicial transfer of ownership for the purpose of securing a debt is done as follows:
 - (1) In the case of **real property**, by entry of the preceding and of the subsequent owner into the **land register**; the entry is done in accordance with the provisions of Art 34/5 Act on Real Property and Other Real Property Rights just like in the case of the out-of-court transfer of ownership for the purpose of securing a debt;²⁵⁸
 - (2) In the case of **real property** that is **not** registered in the **land register**, by signing a court record on the transfer of ownership to secure a debt;²⁵⁹
 - (3) In the case of **moveable assets** by signing a court record on the transfer of ownership for securing a debt;²⁶⁰ The asset remains in the possession of the assignee, i.e. of the subsequent owner;

²⁵⁴ Art274 Abs1 Act on the Levy of Execution.

²⁵⁵ Art274 Abs3 Act on the Levy of Execution.

²⁵⁶ Art 279 Act on the Levy of Execution.

²⁵⁷ Art 274/2 Act on the Levy of Execution.

²⁵⁸ Art 274/4 Act on the Levy of Execution Art, Art 32/5 Land Register Act.

²⁵⁹ Art 274/5 Act on the Levy of Execution.

²⁶⁰ Art 274/5 Act on the Levy of Execution.

- (4) In the case of pecuniary claims, stocks, and shares in commercial companies by signing a court record on the transfer of ownership to secure a debt;²⁶¹ the transferor does not lose voting rights or right to receive a share in the profits.

The public disclosure function of the assignment as collateral for real property that is not recorded in the land register and for chattel and other pecuniary claims is done by posting an announcement in the Official Gazette.²⁶²

3. Realization

a. Judicial Realization

The advantage of this type of security is seen above all in the satisfaction of the creditor. The creditor (the transferee) does not have to take legal action in order to obtain an enforceable deed if the debtor defaults. If the agreement of the parties is in the form of a **court record**, the creditor has an enforceable deed already on the day the claim falls due based on which he or she can petition for satisfaction of the claim.

b. Out-of-Court (notarial) Realization

Another advantage is the possibility of an out-of-court realization of the asset or a pecuniary claim. The creditor does not need to petition for execution in order to obtain satisfaction of a claim from the asset. The sale is done by a public notary if the debtor requests this. If the debtor falls into default on the performance of the secured claim, the creditor may demand of the debtor to notify him or her within 15 days if the realization is to be done by a notary. Communication between the debtor and the creditor is done through a public notary.

The debtor must define the minimum price for which the asset may be sold and must name a public notary to conduct the sale. If the public notary fails to sell the asset within a period of three months, the creditor obtains the right to sell the asset in a public auction (conducted by a court or notary). The remainder of the proceeds of the sale shall be paid to the debtor by the creditor immediately after satisfying the claim.²⁶³ This shall also apply accordingly if a pecuniary claim has been assigned to secure a debt.

If the debtor pays the amount owed or the debt is cancelled for another reason (e.g. netting), the creditor has the obligation to immediately return the asset to the debtor. In the case of a real property, the creditor shall hand over a letter of consent to the cancellation, which effectively cancels the creditor's foregoing ownership. In the event of an execution or of **bankruptcy** proceedings against the **creditor**, the debtor has the **right to separate satisfaction from segregated assets** as the economic owner of the assets.²⁶⁴

²⁶¹ Art. 278/2, 278a Act on the Levy of Execution; The court shall immediately inform the commercial company about the transfer of the shares and interests for the purpose of entering the transfer into the respective books of the company, with the entry being marked with the annotation that the transfer was done to secure a debt.

²⁶² Art 274/7, 278/1, 278a Act on the Levy of Execution.

²⁶³ Art 277 Act on the Levy of Execution.

²⁶⁴ Art 276 Act on the Levy of Execution.

Vice versa, in the case of the assignment as collateral the creditor has the role of **creditor with the right to separate satisfaction from separated assets** in the event of **bankruptcy** of the **debtor**.²⁶⁵

The rules stated on the assignment as collateral were passed with the amendments and supplements to the Act on the Levy of Execution in 2003.²⁶⁶ Until then, the legal status of the creditor was completely different as regards the satisfaction of the secured claim.

Now, a public sale of the assets must always be conducted. The only advantage is that an out-of-court sale can also be conducted. However, problems can arise because the asset is not with the creditor, but rather with the debtor.²⁶⁷ For this reason, new amendments and supplements to the enforcement legislation have already been announced.

II. Right of Retention

The right of retention (*ius retentionis*) is the right of a creditor of a claim falling due who has the asset in his or her possession to keep the asset and not return it to the debtor as long as the debtor does not satisfy or secure the claim, and to obtain satisfaction from the value of the asset.²⁶⁸

The right of retention is governed in Art 286 to 289 Obligations Act. This section contains some general rules on the right of retention that can be applied to all creditors, unless otherwise regulated by other special provisions. The creditor has the right to retain an asset in his or her possession belonging to the debtor as long as the claim is not satisfied or as long as the debtor does not provide adequate security.

The object of the right of retention may be a moveable asset or a real property. The claim that is secured and the asset over which the right of retention is enforced do not have to originate from the same legal relationship.²⁶⁹

Under Croatian law, the right of retention entitles the creditor to obtain satisfaction from the value of the asset just as a lienor (Art 289 Obligations Act). The creditor must notify the debtor in time and in advance of his or her intention. The right of retention ends when the claim extinguishes or when the actual dominion over the asset is lost.

In bankruptcy proceedings against the owner of the asset to which a right of retention exists, the creditors that have a right of retention by law have the position of **creditors entitled to satisfaction from separated assets**.²⁷⁰

²⁶⁵ Art 81a Bankruptcy Act.

²⁶⁶ NN, 173/00.

²⁶⁷ The Act on the Levy of Execution explicitly prohibits agreements entitling the creditor to take the object into his or her possession after the debt matures (Art. 274/6 Act on the Levy of Execution).

²⁶⁸ Gavella/Josipović/Gliha/Belaj/Stipković, Law of Real Property 898.

²⁶⁹ Vedriš/Klarić, Civil Code 418.

²⁷⁰ Art 83 Z 2,3 Bankruptcy Act.

Chapter 8: Suretyship

I. General

A **suretyship** (*ugovor o jamstvu*)²⁷¹ places an **obligation** on the **surety** to satisfy a valid debt of the debtor that is due to the **creditor**, if the **debtor fails to do so** himself or herself.²⁷² The contract of suretyship must be concluded **in writing** (Art.998 Obligations Act). Any person without limited capacity to contract can play the role of surety. In addition to the debtor, a third party, namely the surety, is also liable for the repayment of the debt, personally with his or her entire assets. A suretyship can be established for every type of valid liability irrespective of the content.

II. Features of the Suretyship

The features of a suretyship under Croatian law are the principles of **accessoriness** and **subsidiarity**.

Accessoriness means that liability of the surety depends on the obligation of the debtor. If the obligation of the debtor is invalid or does not exist, then neither is there a liability of the surety. The surety can be liable at the maximum up to the amount of the liability of the debtor or for a certain portion. If it has been agreed that the liability of the surety is greater than that of the debtor, then it is reduced to the scope of the liability of the debtor. The surety is liable for every increase of the debt that occurs due to the default in payment of the debtor. The surety is also liable for the interest and the costs of collecting the debt.²⁷³

When the principal debt **expires**, the liability of the surety expires as well. An interruption of the expiration vis-à-vis the principal debtor is only effective for the surety if the cause of the interruption were court proceedings of the creditor against the principal debtor. However, the expiration is not interrupted for the surety if the debtor acknowledges the debt, even though the acknowledgement of debt causes an interruption of the expiration period vis-à-vis the principal debtor. The restriction of the expiry of the claim of the principal debtor does not have any effect on the surety.²⁷⁴

Subsidiarity of the suretyship means that the creditor can only demand satisfaction of the liability from the surety when the creditor has failed to obtain satisfaction from the debtor. A written request of the creditor sent to the debtor demanding repayment of the debt is sufficient. If the debtor fails to satisfy the claim within the period stated in the written request, the creditor may demand collection of the debt from the surety (**subsidiary suretyship**).

The **liability** of the **surety** shall not be subsidiary but rather a **joint and several liability with the principal debtor** if this it has been explicitly agreed on (**liability as surety and payer, joint suretyship**).²⁷⁵ In this case, the creditor has the right to demand satisfaction of the liability either from the principal debtor or from the surety or from both at the same time. The surety is liable

²⁷¹ Art997-1019 Obligations Act.

²⁷² Art997 Obligations Act.

²⁷³ Art 1002 Obligations Act.

²⁷⁴ Art 1019 Obligations Act.

²⁷⁵ When several guarantors are liable for one and the same debt, they are jointly liable for the debt of the principal debtor unless otherwise agreed.

jointly and severally with the principal debtor for debts under commercial agreements unless otherwise agreed.²⁷⁶

III. Bankruptcy of the Debtor

If the debtor declares bankruptcy, the creditor can demand payment directly from the surety without having to demand this of the debtor beforehand (Art 1004/2). The creditor is under the obligation to report his or her claim in the bankruptcy proceedings and to inform the surety of this (Art 1007/1 Obligations Act). If the creditor fails to do so, he or she must compensate the surety for any damages suffered because of this failure to report.

A reduction of the debt of the principal debtor in bankruptcy proceedings does not entail a reduction of the liability of the surety. The surety is still liable vis-à-vis the creditor for the entire amount of the liability.

IV. Death of the Debtor

The suretyship does not expire with the death of the debtor. Generally, the heirs are jointly and severally liable for the debts of the bequeather (debtor). They are liable with their entire assets (personally), but only up to the amount of the assets inherited. The surety in contrast is always liable for the entire debts of the debtor/bequeather regardless of the fact that only payment of a part of the claim can be demanded of the heirs, which corresponds to the value of the inherited assets (Art 1008 Obligations Act).

V. Release from Liability of the Surety

When the claim falls due, the surety may request the creditor to demand satisfaction from the principal debtor. If the creditor does not meet this request within one month, the surety is released from liability.²⁷⁷ The surety is released from liability also in cases in which the creditor relinquishes another security or loses the security due to the creditor's own negligence and thus makes the transfer of the security to the surety impossible. The surety is then released from liability for the amount that would have been obtainable by enforcing the claim and realizing the security.²⁷⁸

VI. Realization of the Suretyship as Security

In the case of a **subsidiary suretyship**, the creditor can only demand collection when he or she has requested the principal debtor to pay the debt and after the period has expired that the debtor was granted for payment. In the case of a **joint and several suretyship**, the creditor may demand collection from the surety already as of the time the liability of the debtor claim falls due.

The creditor can satisfy his or her claim against the surety in **execution proceedings**. The execution is enforced based on an executory title, i.e., on a final court ruling that orders the surety to pay the liability of the principal debtor. The execution is conducted on assets and rights of the surety that are

²⁷⁶ Art 1004 par. 3, 4 Obligations Act.

²⁷⁷ Art 1011 Obligations Act.

²⁷⁸ Art 1012 Obligations Act.

not exempt from execution or subject to restrictions in execution proceedings.²⁷⁹

The surety has the right to raise all defenses against the request for payment of the bank that the principal debtor would be entitled to including the defense of netting, but not the strictly personal defenses of the principal debtor. The surety has the right, for example, to net debts of the principal debtor against claims of the creditor.²⁸⁰ The surety can also raise his or her own personal defenses against the creditor (e.g. suretyship agreement being null and void, claim being statute barred, netting of mutual claims). The relinquishment of the debtor to raise defenses and the acknowledgement of the claim of the creditor does not have any effects vis-à-vis the surety.

VII. Right of Recourse of the Surety

If the surety pays the debts of the principal debtor, all rights of the creditor vis-à-vis the debtor are transferred by law - *ipso iure* - to the surety. The creditor does not need any special legal act to transfer these rights to the surety. The surety may demand of the debtor to reimburse everything he or she has paid the creditor. If one of several suretys has paid a debt, this surety may demand of the other suretys reimbursement of the shares that they are liable for.²⁸¹

The surety loses the rights to reimbursement against the principal debtor if the surety has paid the creditor without the knowledge of the debtor. The surety can then only demand reimbursement from the creditor.²⁸²

VIII. Problems with Suretyships

The greatest problem in practice is posed by the gradual and complex collection of a debt. If a bank is the creditor, then the suretyship is always joint and several, because agreements entered into with banks are considered commercial contracts. This means that the bank can immediately demand satisfaction of the claim by the surety after the debt falls due. However, in order to obtain satisfaction of its claim, the bank must first take legal action against the surety to obtain an enforceable title to be able to conduct the execution. The bank is exposed to all risks of collection.

However, it is possible to agree on an execution clause in the suretyship agreement. The surety has the right to agree in advance at the time the suretyship agreement is entered into that the creditor has the right to request execution based only on the suretyship agreement after the claim falls due. This type of agreement must be done in the form of a **notarial act** or a **private document certified by a notary**. Thus, the bank would not have to take legal action against the surety, but could immediately request execution against the surety upon maturity of the claim.

²⁷⁹ For details on restrictions and exceptions applicable to certain objects and liens in execution proceedings, please refer to the chapters General Remarks on Liens and The Compulsory Judicial Lien; these chapters list the objects and liens that are exempt from execution or subject to restrictions in execution proceedings.

²⁸⁰ Art 1009/1 Obligations Act; This is one of those examples in which mutual claims are not required for netting.

²⁸¹ Art 1018 Obligations Act.

²⁸² Art 1016 Obligations Act.

Chapter 9: The Bank Guarantee

I. General

A bank guarantee (*bankarska garancija*)²⁸³ obligates a bank vis-à-vis the beneficiary of the guarantee to satisfy the beneficiary in the event that a third party (client, borrower) fails to satisfy the claim upon maturity if the conditions set out in the guarantee are met.²⁸⁴ The guarantee must be executed in writing (Art 1083 par. 2 Obligations Act).²⁸⁵ Only banks are permitted to assume bank guarantees.²⁸⁶ The deed of guarantee must be signed by an authorized staff member of the bank.

II. Legal Relationship between the Parties

In connection with the bank guarantee, there are three parties each of which has a contract with the other parties: the mandator of the guarantee (borrower), the guaranteeing bank (guarantor) and as the beneficiary of the guarantee, the beneficiary bank granting credit.

A. The Relationship between the Beneficiary and the Client

The legal relationship between the beneficiary bank (creditor) and the client (debtor) from which the claim to be secured arises is called an **underlying debt relationship**. The contract that constitutes the legal basis for the claim (**loan agreement**) must contain an agreement between the creditor and the debtor that the debtor will obtain a bank guarantee from a certain bank (so-called **finance clause, guarantee clause**). If the debtor does not obtain a bank guarantee within the agreed on period for the benefit of the creditor, then the creditor has the right to reject the fulfillment of his or her contractual obligations by referring to the rule of the simultaneous fulfillment of obligations under bi-lateral contracts.²⁸⁷

B. Relationship between Client and Guaranteeing Bank

The legal relationship between the client (debtor under the underlying agreement) and the guaranteeing bank is created when the guarantor accepts the mandate to establish a contract (**contractual relationship, cover**). This legal relationship is subject to the rules applicable to mandate relationships.²⁸⁸

C. Relationship between the Beneficiary and the Guaranteeing Bank

The legal relationship between the bank and the beneficiary under the guarantee (creditor of the underlying contract, beneficiary bank) is established after the guaranteeing bank submits the guarantee to the beneficiary bank and the beneficiary accepts it (**deed of guarantee**). This creates a bi-lateral contract stating the obligation of the bank to make a payment to a beneficiary on the conditions

²⁸³ Art 1083 - 1087 Obligations Act.

²⁸⁴ Art 1083 par. 1 Obligations Act.

²⁸⁵ Über die Bankgarantie s Gorenc, Gesetz über die Schuldverhältnisse mit Kommentar, Zagreb, 1998, 1322-1328; Vukmir, B.: Recht der Bankgarantien, Recht und Steuern, 4/2002 (S 35-42), 5/2002 (S 16-24), 6/2002 (S 6-14); Milinović, A., Potkonjak, M.: Die Bankgarantie als Sicherungsmittel für die Erfüllung von Verpflichtungen, Freies Unternehmertum, 15-16/1997, S 16-30.

²⁸⁶ Art 6 Banking Act.

²⁸⁷ Art 122 Obligations Act.

²⁸⁸ Art 749-770 Obligations Act.

set out in the guarantee. This legal transaction is binding for one side, because it only stipulates that the bank must pay a certain amount to a beneficiary of the guarantee under the conditions specified.

III. Types

Croatian law defines the following types of bank guarantees:

- Accessory bank guarantee
- Non-accessory bank guarantee
- Super guarantee
- Counter guarantee

A. Accessory Bank Guarantee

The **accessory (dependent) bank guarantee** is one in which the obligation of the guarantor depends on whether an obligation is given in the underlying contract. This type of bank guarantee is similar to a suretyship (so-called **bank suretyship**).²⁸⁹ The guaranteeing bank undertakes to act as guarantor vis-à-vis the beneficiary of the guarantee. These guarantees are subject to the provisions of the Obligations Act on **suretyships**. The guaranteeing bank can raise all defenses against the beneficiary that the debtor is entitled to according to the underlying contract with the exception of strictly personal defenses.

Considering that the obligation under the guarantee is accessory in nature, the beneficiary of the guarantee can transfer the rights under the guarantee to a third party only by **assigning** (cession) the **claim** that is secured by a guarantee.²⁹⁰ This assignment is subject to the **provisions** of the Obligations Act on the **assignment** of claims.

B. Non-accessory Bank Guarantee

In the case of **non-accessory (independent) bank guarantees**, the guaranteeing bank undertakes independently vis-à-vis the guarantee beneficiary to pay a certain amount under the agreed on conditions. The obligation of the guaranteeing bank is **abstract** and not contingent on the existence of the obligation of the debtor under the underlying contract. The obligation of the guaranteeing bank from the independent guarantee is also given even if the contract is invalid in which the secured claim is defined.

The independent guarantee contains the unconditional obligation to pay a certain amount, if it contains the explicit clause “**no defenses**“, “**upon first request**“ or a similar formulation.²⁹¹ In this case, the guaranteeing bank may not raise any defenses that the principal debtor could raise against the beneficiary (creditor bank) based on the fundamental relationship (loan agreement). The bank cannot refuse to pay on the grounds that there is no obligation under the underlying contract, because the contract is ineffective, the claim has expired or satisfaction would be impossible. The guarantor can only raise the defenses against the beneficiary that are defined in the deed of guarantee.

After the guaranteeing bank has paid the beneficiary the amount guaranteed, the client (debtor) is under the obligation to refund the guaranteeing bank for

²⁸⁹ Art 1083 – 1086 Obligations Act.

²⁹⁰ Art 1086 Obligations Act.

²⁹¹ Art 1087/1 Obligations Act.

this amount.²⁹² Defenses claiming non-existence or invalidity of the obligation under the underlying agreement can only be raised by the debtor against the beneficiary bank. If the guaranteeing bank pays a beneficiary of a guarantee a pecuniary amount to which he or she is not entitled, because one of the defenses regarding the existence of the claim under the underlying contract is valid, the debtor can demand that the amount be refunded by the beneficiary of the guarantee on the grounds of unjustified enrichment.²⁹³

C. Super Guarantee

In the case of a **super guarantee**, another bank confirms the obligation established in an already existing bank guarantee.²⁹⁴ The beneficiary can then enforce the **claim** under the guarantee **against two banks**. The creditor requests a super guarantee when he or she does not have enough confidence in the first bank. The super guarantee is subject to all of the rules relating to guarantees. A guarantee can be **accessory** or **non-accessory** in nature. If the super guarantee is non-accessory, i.e., exists on its own, then it is independent of the obligation that the first bank has assumed under the guarantee established.

D. Counter Guarantee

The **counter guarantee** is a guarantee created by a bank under the condition that another bank grants a guarantee as security for the right of recourse. The bank that has established the counter guarantee does not have any legal relationship to the beneficiary of the guarantee (creditor) and therefore the beneficiary does not have any claims on this bank under the counter guarantee.

IV. Features of a Bank Guarantee

The purpose of the bank guarantee is that it gives the person who is the beneficiary of the bank guarantee (guarantee beneficiary) **security** against the **risk of default** of the debtor based on a special contract on the bank guarantee.

The scope of the protection of the creditor depends on the clauses in the guarantee. For example, the clause “upon **first request**” means that the beneficiary can demand payment of the bank **without** obtaining the previous **consent** of the debtor. The clause “**no defenses**” protects the creditor in such a manner that the guaranteeing bank cannot raise any defenses, in particular, none that demand the prior initiation of judicial proceedings for the collection of the debt. The only condition on which the payment depends based on the independent bank guarantee is the declaration that the debtor has not fulfilled his or her obligation under the underlying contract or has not done so properly. After receipt of the **written declaration** of the guarantee beneficiary (so-called “first request”), the bank is obligated to pay out the amount stated in the guarantee.

²⁹² Art 1087/2 Obligations Act.

²⁹³ Art 1087/3 Obligations Act.

²⁹⁴ Art 1085 Obligations Act.

The beneficiary must send a written request for payment to the guaranteeing bank in order to preserve his or her claim to payment under the guarantee before expiry of the deadline within which the guarantee is valid.²⁹⁵ The creditor is best protected if the bank guarantee contains the two clauses, i.e., the clause “upon first request” and the clause “no defenses”. This type of guarantee offers the creditor the greatest protection against the risk of default.

V. Significance of the Bank Guarantee as Security

The bank guarantee is a very inexpensive means of securing a claim. Considering the non-accessory nature of the obligation of the guaranteeing bank, the creditor can demand payment regardless of whether the obligation of the principal debtor exists or is effective, moreover, even without conducting any judicial or arbitration proceedings beforehand. Collection is simple and fast, and does not depend primarily on the creditworthiness of the principal debtor, but rather on the liquidity of the guaranteeing bank. Furthermore, the creditor enjoys special protection if a super guarantee is issued for a bank guarantee that also protects the creditor even if the first bank does not fulfill its obligation under the bank guarantee in accordance with the terms of the guarantee.

²⁹⁵ The maturity of the obligation from the independent guarantee does not depend on the maturity of the obligation of the underlying agreement. A guarantee clause according to which the validity of the guarantee ends on the day the obligation of the principal debtor matures is legally ineffective. In general, a term is agreed in the guarantee within which the beneficiary must demand payment of the bank after the debt falls due. This clause protects the guaranteeing bank against an unduly long extension of the validity of the guarantee beyond the adequate period needed by the beneficiary to determine whether the principal debtor has satisfied the claim. Cf. Milinović. A., Potkonjak, M.: *ibid*, p 21.

Chapter 10: Additional Assumption of Debt

The additional assumption of debt is a **contract between a creditor and a third party** in which the third party undertakes vis-à-vis the creditor to satisfy his or her claim against the debtor.²⁹⁶ By entering into a contract on the additional assumption of debt, a third party accepts an obligation in addition to the debtor. The creditor acquires the right to demand fulfillment from the debtor or the third party who has assumed liability for the debt.

A special case of **additional assumption of debt** is given in the case of acquisition of an entirety of assets by persons²⁹⁷ to which an entirety of assets (e.g. business) or parts thereof are transferred from an individual or legal entity under civil law based on a contract. In this case, the assets and liabilities of this entirety of assets are transferred to the party assuming the debt. The person assuming liability for this entirety of assets is also liable for any debts relating to the assets or parts thereof. The party assuming the debt is **jointly and severally liable** in addition to the **hitherto owner**, but only up to the amount of the entirety of assets actively assumed. A clause according to which such liability is restricted or excluded does not have any validity vis-à-vis the creditors.

²⁹⁶ Art 451 Obligations Act.

²⁹⁷ Art 452 Obligations Act.

Chapter 11: Concluding Remarks

In comparison to Austrian security interest law, the following significant differences exist:

Bank transactions are always deemed to be **commercial transactions** and are subject to special rules. Thus, for example, it is **presumed** that an **agreement** on the **out-of-court realization** exists unless explicitly agreed on otherwise.

In the case of the realization of a **lien** in **execution proceedings**, certain other claims have **priority** over the lien (claims for alimony payments, damage compensation) (see Chapter 2).

Liens are grouped into **voluntary liens**, **voluntary judicial** or **notary-certified liens** and the **compulsory judicial lien**. The voluntary lien corresponds to the contractual lien under Austrian law. The voluntary judicial and notary-certified lien is a special form of contractual pledge done before a court of law or a public notary. The compulsory judicial lien corresponds to the executory lien in Austria.

In Croatia, it is possible to create a **non-possessory lien** on **moveable assets**. This means that the pledged object can be used commercially by the borrower. Since there is no liens register for these types liens, the creation of the lien is announced in the Official Gazette. The law does not stipulate that the extinguishment of such liens must be announced to the public (see Chapter 4).

In the case of auctions of moveable assets, it is remarkable that after the **second failed attempt** to sell the asset in an **auction**, the proceedings are **discontinued** (see Chapter 4).

The **realization of real properties** can be **accelerated** by setting up voluntary judicial or notary-certified lien. The **lien documents** are executable titles (see Chapter Liens on Real Property).

Generally, a **land register modeled after the Austrian** land register exists. However, since the actual legal status deviates considerably from the status recorded in the land registers and the goal is to correct the land registers, the protection of legitimate expectations of relying on the correctness of the land register will not be given until **2007** (see Chapter 5).

In Croatian law, the concept of buildings on land owned by a third party (Superädifikat), does **not exist**, but a similar concept of **building rights** does (see Chapter 5).

The **mode of acquisition** for **pledging receivables** is different from the one applicable in Austria (third-party notification, entry into the register) and is done by assignment. An **assignment by security** without pledging the assets in contrast has only the **effect** of being **obligatory** (not a real security, no **right to separate satisfaction** in bankruptcy) (see Chapter 6).

The assignment as collateral can have an absolute (real) or relative (contractual) effect. An entry in the register is required in order for it to have an absolute effect, but this only possible for real property because there is no lien register for moveable assets. If a moveable asset is assigned as collateral in the form of a court record or notarial act, the assignment can be done without actually transferring the asset (see Chapter 7).

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