

Chapter 21

Legal Regime of Security Interests

1. General

The security interests created in favor of a creditor grant the latter the right to recover his debt, secured by mortgaged or pledged assets, prior to any unsecured creditor or any other creditors holding subsequent ranking security interests or other preference rights. Moreover, the secured creditor has the right to enforce its debt irrespective of the holder of the secured asset (the right of pursuit).

From the perspective of the secured asset type, security interests fall into two large categories: real estate security interests (mortgages) and security interests on movable assets.

2. Main Regulations

- The Civil Code;
- The Civil Procedure Code;
- Law No.7/1996 on cadastre and real estate publicity with subsequent amendments and supplements (“Law No.7/1996”);
- Title VI of Law No. 99/1999 regarding certain measures for speeding up the economical reform (“Law No. 99/1999”), as subsequently amended;
- Law No. 190/1999 on loan secured by mortgage granted for real estate investments (“Law No. 190/1999”).

3. Real estate security interests (mortgages)

3.1 Types of Mortgages

According to the Civil Code, a mortgage is a “real interest in a property affected to the performance of an undertaken obligation”.

The Civil Code regulates two categories of mortgages: legal mortgages and conventional mortgages.

While a legal mortgage arises out of a special legal provision, conventional mortgages are created by mutual agreement of the parties.

As a general rule, mortgages are interests created by their owner over immovable assets. Exceptionally, although not classified as immovable assets, vessels and aircrafts may be as well mortgaged.

Future assets cannot be mortgaged, however, an exception to this rule is regulated by Law No. 190/1999.

The mortgage contract must be concluded in authentic form and must contain both the description of the mortgaged real estate and the amount of the debt secured by the respective mortgage, subject to the rendering of the contract null and void.

3.2 Mortgages registration formalities

In order to ensure ostensibility towards third parties and a preferential ranking thereof, certain real estate publicity formalities must be observed when creating a mortgage, namely such mortgage must be registered with the Land Book¹. The registration with the Land Book becomes ostensible towards third parties only upon recording the application for registration of the mortgage. The moment of the application recording determines the rank of the registration, which is essential to make a difference between various ranking creditors. Accordingly, the first to register the mortgage interest will have priority over the other creditors in recovering his debt. In case several applications are submitted at the same time with the same Land Book, the mortgage rights will take the same rank.

The effects of a mortgage registration cease after 15 years as of the date of its registration with the Land Book, unless such registration is renewed². An exception to this rule was established by Law No. 190/1999, whereby mortgages constituted to secure mortgage loans last until full repayment thereof, thus no registration renewal after 15 years being necessary.

4. Security interests on movable assets

Security interests on movable assets are regulated by the Civil Code and were previously also regulated by the Commercial Code. Although having endured the test of time since their entering into force in the nineteenth century, the Civil Code and the Commercial Code have not kept the pace with the new economical realities. This is why Law No. 99/1999 has instituted an unitary legal framework for security interests on movable assets, meant to provide, *inter alia*, enforcement regulations, especially in case of commercial obligations.

4.1. Traditional frameworks

The Civil Code provides as security interests the retention right and the pledge.

4.1.1. The retention right

The retention right is considered an imperfect security right, based on which, the holder of a movable or immovable asset owned by another person and which must be ultimately returned to the latter is entitled to

¹ The application for the registration with the Real Estate Registry will be submitted with the Real Estate and Publicity Office where the mortgaged real estate is located.

² There is a separate opinion among scholars stating that the 15 year term does no longer apply to mortgage registrations, since it was meant to be applicable only to registrations performed before the entering into force of Law No. 7/1996.

retain that asset until the respective owner pays the expenses incurred by the holder with asset's maintenance, preservation and improvement. Said right operates only as long as the asset is in the holder's possession.

4.1.2. The pledge

Generally, under the traditional legislation, the pledge mechanism involved the debtor's dispossession of his asset. Law No. 99/1999 regulates however both the pledge with dispossession and the pledge without dispossession.

The pledge agreement is an ancillary contract whereby the debtor hands over to the creditor a movable asset with the purpose to secure the obligations of the former towards the latter. To validly conclude the agreement, the pledgor must be the owner of the pledged asset.

4.2. Development in the law

4.2.1. General

The main amendments brought to the legal regime of security interests by Law No. 99/1999 are as follows:

- (i) it has extended the asset categories over which actual security interests may be created, by including intangible movable assets and future assets;
- (ii) it has clarified the legal status of security interests without dispossession;
- (iii) it has provided for the means of ensuring the security interests' ostensibility towards third parties by registration with the Electronic Archive of Movable Security Interests (the "Archive");
- (iv) it has introduced supplementary procedures for enforcement of security, by providing for the possibility of the creditor to peacefully take possession of the asset and to sell it under a simple and cost-efficient procedure.

4.2.2. Security interest contract

According to Romanian law, security interests can be constituted only based on a security contract, concluded either in authenticated form or under private signature or by other specific means in case of certain commodities traded on regulated markets (i.e. securities).

The applicable law provides for the obligation to specify in the contract the maximum amount of the secured obligation and a detailed description of the pledged asset(s).

The security contract may have as object future assets and even universalities of assets.

Such security produces effects only as of the date when the debtor receives title over the assets described in the contract.

The security contract may provide that the pledged asset secures a future obligation.

The security contract is an executory title.

During the security contract duration, the debtor is allowed to manage or dispose in any legal way of the secured asset and or its proceeds, including leasing, encumbering or selling the respective asset. The acts of disposal over the pledged asset are valid, even if the acquirer was aware of the contractual interdiction to dispose of the pledged asset or contractual provision declaring such disposal an event of default.

The above-mentioned legal provision is meant to ensure free circulation of assets. Having the right of pursuit over the pledged asset, the creditor is secured even if the debtor alienates such assets, as he can trace it in the hands of whoever possesses it. Nevertheless, nothing prevents the creditor from introducing in the security contract a provision stating that the transfer constitutes an event of default under certain specific circumstances. Such a provision is legal and will produce effects, but it may not invalidate a potential transfer of the pledged asset.

4.2.3. Publicity of security interests

The priority of a security interest begins on the moment when a “security notice” is registered with the Archive.

The Archive is a record system regarding the priority and publicity of security interests, structured by persons and assets. The Archive is a public system and its access is free of charge. The security notice is valid for a period of 5 years as of the registration date.

The persons intending to conclude and register security contracts may at first register with the Archive the intention to create a security. The registration of such intention produces effects only for a period of 2 months as of registration. Once the security is actually constituted and registered within the 2 months, it will gain retroactive priority as of the date of the intention registration.

Each creditor is bound to send a copy of the security registration notice to the debtor, within maximum 24 hours as of the registration of the notice.

On the other hand, within 40 days as of the security contract termination, the creditor must submit a notice to such effect to the Archive.

4.2.4. Enforcement of the security interests

In case of failure to fulfill the secured obligation, the creditor is entitled to peacefully take possession over the pledged asset or the proceeds resulted from its sale, as well as of the documents and deeds attesting the debtor’s title to the asset, without any preliminary formalities being necessary (such as the obtaining of an authorization, the issuance of a notice or payment of any taxes or fees). The law provides however that, in order to peacefully take possession over an asset, the security contract must include the following formula, written in capital letters, of at least font 12 (0.5 cm): “IN CASE OF DEFAULT, THE CREDITOR MAY USE

ITS OWN MEANS IN ORDER TO TAKE POSSESSION OVER THE PLEDGED ASSET". Public clerk or police officers can not accompany the creditor during the peaceful taking possession over the asset.

If taking possession over the pledged asset is not possible in a peacefully manner, the secured creditor may ask for the support of a court bailiff, or, as the case may be, of a bank liquidator or any other competent body. Within 48 hours as of the receipt of such request, the bailiff will take possession of the pledged asset and will deliver it to the secured creditor.

If the debtor disposes of the pledged asset or grants other rights over the asset, in case of a potential forced enforcement, the secured creditor is entitled to exercise its security interest over the pledged asset over the proceeds resulting from the disposal of such asset, or over both asset and proceeds, irrespective in whose possession the asset is.

The parties may agree, based on the security contract, on the capitalization methods of the pledged assets, in case of failure to perform the secured obligation. In the absence of such an agreement, the creditor will be bound to sell the asset by reasonable commercial means.

The buyer will take possession of the pledged asset, free from any security interests or other encumbrances.

Before the sale, under the sanction of voidance and liability for the damages caused, the creditor should send a sale notification to the debtor, to the other creditors who have registered a security notice against the same debtor and over the same asset and to the owner of the pledged asset, if the debtor is no longer the asset owner.

The creditor cannot take possession over the pledged asset under a sale initiated by himself, without first offering to third parties the possibility to participate in the sale, except when otherwise agreed by the parties.

If the pledged asset is sold, the creditor shall distribute the sale proceeds as follows (art.78 of Law No. 99/1999):

- (i) payment of any expenses resulted from the maintenance, preservation, taking possession and sale of the asset;
- (ii) payment of interests and secured receivable having a superior priority ranking, even if such has not become due.

Any outstanding amounts remained, after the debt of the creditor ranking highest in terms of priority is covered, will be distributed to the other creditors according to their priority rank, even if their debts have not yet fallen due. Only after full payment of creditor(s) having one ranking, the payment of other ranking creditors may be initiated.