

Chapter 21

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 and security interests on movable assets.

2. Main Regulations

- The New Romanian Civil Code, entered into force as of 1 October 2011 (the “**New Civil Code**”)¹;
- Law No. 71/2011 for the enforcement of the New Civil Code;
- The Romanian Civil Code, entered into force on 4 December, 1864, as further amended, supplemented and republished (“**Civil Code 1864**”)²;
- 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 amended³;
- Law No. 190/1999 on loan secured by mortgage granted for real estate investments (“**Law No. 190/1999**”).

3. Real estate security interests (immovable mortgages)

3.1 Types of Immovable Mortgages

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

² Although a New Civil Code entered into force, as a general rule, legal relationships born before its enforcement shall continue to be governed by the provisions of the old civil code.

³ Although the New Civil Code repeals the provisions of Law No. 99/1999, contracts concluded before its enforcement are governed by Law No. 99/1999.

Similar to the Civil Code 1864, the New Civil Code regulates two categories of immovable mortgages: (i) legal mortgages and (ii) conventional mortgages.

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

Immovable mortgages are interests created by their owner over immovable assets.

As a rule, future assets cannot be mortgaged. As an exception, the New Civil Code provides that mortgage on future constructions may be created, being, however, only temporarily registered with the relevant land book. Assets declared by law non-transferable or non-enforceable cannot be mortgaged. However, the mortgage over assets conventionally declared non-transferable or non-enforceable shall be considered valid as mortgage on a future asset.

The immovable mortgage contract must be concluded in authentic form, must contain the amount of the debt secured by the respective mortgage and must identify the mortgagor and the creditor, subject to the rendering of the contract null and void. In addition, subject to the same sanction, the immovable mortgage contract must indicate the purpose of the secured obligation and provide a precise and detailed description of the mortgaged asset. Nevertheless, a clause stating that the mortgage is created over all the mortgagors' assets or over all its present or future assets is not considered a detailed enough description of the mortgaged asset.

Although mortgage agreements usually contain an interdiction for the mortgagor to sell the mortgaged assets, according to the New Civil Code, the acts of disposal over the mortgaged asset are valid, even if the acquirer was aware of the contractual interdiction to dispose of the mortgaged 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 mortgaged asset, the creditor is secured even if the mortgagor alienates such assets, as he can trace it in the hands of whoever possesses it. Nevertheless, nothing prevents the creditor from introducing in the mortgage 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 mortgaged asset.

3.2 Immovable Mortgages registration formalities

In order for the mortgage to become effective and to acquire a preferential rank, the mortgage must be registered with the Land Book⁴. As per the New Civil Code, the registration with the Land Book ensures the effectiveness of the mortgage. Notwithstanding this, until finalization of the cadastral works for each territorial unit, registrations shall be performed for third parties acknowledgement purposes only, as until the entering into force of the New Civil Code.

⁴ 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.

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.

Under the provisions of the Civil Code 1864, 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 renewed⁵. 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. However, the New Civil Code does not set forth such term, as registrations performed thereunder ensure the actual effectiveness of the mortgage.

As a separate matter, according to the provisions of the New Civil Code, the creditor may assign to an unsecured creditor its mortgage interest. Moreover, creditors may agree to change the rank of their mortgages provided that registration with the relevant land book is performed.

4. Security interests on movable assets

Security interests on movable assets are currently regulated by the New Civil Code, having previously been regulated by the Commercial Code, the Civil Code and Law No. 99/1999⁶. Nevertheless, the security interests created prior to the entering into force of the New Civil Code are to be regulated by the enactments in force at the date when they were created, in accordance with the non-retroactivity legal principle.

The New Civil Code unified the formerly applicable enactments in the security interests' field and, thus, at present, all security interests are regulated by one law only (i.e. the New Civil Code). The New Civil Code also brings certain changes in the legal regime of security interests and restructures to a certain extent the legal concept of "security interest". Accordingly, under the New Civil Code, security interests are divided into: movable mortgages (previously known as "real guarantees"), pledge (formerly regulated by the Civil Code 1864) and the retention right (newly regulated; until the New Civil Code, it was the creation of practice and doctrine only).

4.1. Development in the law

4.1.1 General

The main amendments brought to the legal regime of security interests by the New Civil Code are as follows:

- (i) it has brought terminology changes by introducing new concepts such as "*movable mortgage*", "*perfect mortgage*", "*privileged mortgage*";

⁵ 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.

⁶ Law No. 99/1999 had instituted a unitary legal framework for security interests on movable assets, meant to provide, *inter alia*, enforcement regulations, especially in case of commercial obligations.

- (ii) it has provided new formalities related to the means of ensuring the security interests' ostensibility towards third parties by registration with the Electronic Archive of Movable Security Interests (the "Archive");
- (iii) it has introduced supplementary procedures for enforcement of security, by providing the possibility of the creditor to take possession of the asset for administration purposes, but only in case of the movable mortgage created over an asset pertaining to a business entity.

4.1.2. Movable mortgages

4.1.2.1. Movable mortgages contract

According to Romanian law, movable mortgages can be constituted only based on a mortgage contract, concluded either in authenticated form or under private signature. The breach of such formality renders the contract null and void. In addition, similar to the case of immovable mortgages, the movable mortgage contract must contain the amount of the debt secured by the respective mortgage and must identify the mortgagor and the creditor, subject to the rendering of the contract null and void. In addition, subject to the same sanction, the immovable mortgage contract must indicate the purpose of the secured obligation and provide a precise and detailed description of the mortgaged asset. Nevertheless, a clause stating that the mortgage is created over all the mortgagors' assets or over all its present or future assets is not considered a detailed enough description of the mortgaged asset.

The mortgage contract may have as object securing one or more debts and even a debt portfolio. The mortgage covers the secured asset, as well as its products. Moreover, the mortgage also covers all assets received from the mortgagor, resulting from an administration or conveyance deed concluded in relation to the mortgaged asset, as well as future assets and even universalities of assets.

Only perfect movable mortgages are opposable to third parties. The mortgage is considered perfect when (i) the secured obligation is born, and/or the mortgagor has acquired rights over the secured asset and (ii) the necessary publicity formalities have been accomplished.

The mortgage contract may provide that the mortgaged asset secures a future obligation.

The mortgage contract is an enforceable title.

During the performance of the movable mortgage contract, the mortgagor 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 mortgaged asset are valid, even if the acquirer was aware of the contractual interdiction to dispose of the mortgaged asset or contractual provision declaring such disposal an event of default.

The abovementioned legal provision is meant to ensure free circulation of assets. Having the right of pursuit over the mortgaged asset, the creditor is secured even if the mortgagor alienates such assets, as he can trace it in the hands of whoever possesses it. Nevertheless, nothing prevents the creditor from introducing in the movable mortgage 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 mortgaged asset.

On another note, clauses compelling the mortgagor to perform advance and immediate payments of the secured obligation upon the creditor's request or to perform the payment of any other obligation due to the creation of another security over the same asset, shall be considered unwritten.

4.1.2.2 Publicity of movable mortgages

The priority of a movable mortgage begins on the moment when a "security notice" is registered with the Electronic Archive for Secured Transactions (hereinafter referred to as 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. Each creditor is bound to send a copy of the security registration notice to the mortgagor, within maximum 24 hours as of the registration of the notice.

On the other hand, within 10 days as of the moment when the secured obligation has been performed, the creditor must submit with the Archive a request for the deregistration of the mortgage..

Moreover, similar to the case of immovable mortgages, creditors are entitled to assign their mortgage to unsecured creditors or to agree to change the rank of their mortgages, provided that the registration with the Archive is performed.

4.1.2.3. Enforcement of the movable mortgages

In case of failure to fulfill the secured obligation, the creditor is entitled (i) to sell the mortgaged asset, (ii) to appropriate the mortgaged asset in exchange of the secured liability, or (iii) to take possession of the asset for administration purposes (only in case of mortgages over the assets of a business entity). For the above purposes, the creditor is entitled to first take possession by its own means of the mortgaged asset together with all documentation attesting the ownership right of the mortgagor. Such possession take over occurs only after a prior notification to the mortgagor made through a court bailiff and only if the mortgage agreement expressly provides such possibility. If it is not possible to take possession of the mortgaged asset, the creditor may ask for the support of the court bailiff to this extent.

If the mortgagor disposes of the mortgaged 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 mortgaged asset over the proceeds resulting from the disposal of such asset, or over both asset and proceeds, irrespective in whose possession the asset is.

- (i) Sale of the mortgaged assets;

The sale of the mortgaged assets begins with the registration of an "enforcement notice" with the Archive. Subsequently, the creditor shall notify its intention to proceed to the enforcement to (i) the debtor of the obligation secured by mortgage (assuming that this is different from the mortgagor himself), his fidejussors

and the co-debtors (as the case may be), (ii) the mortgagor or, as the case may be, his rightful successors, (iii) all creditors whose mortgages have become opposable by registration with the Archive, (iv) all persons claiming a right over the mortgaged asset, (v) all mortgagees and privileged creditors whose guarantee has become opposable by other means, if the creditor is aware of their identity and address. The sale operations must be performed in a “commercially reasonable manner”, the procedure of selling the mortgaged assets being subject to court authorization.

(ii) Appropriation of the mortgaged asset.

As a secondary option, the creditor is allowed to appropriate the mortgaged asset, provided that the mortgagor agreed to such appropriation and the persons to be notified do not file an opposition to such enforcement method. Thus, in case the creditor chooses to appropriate the mortgaged asset in satisfaction of the secured liability, such operation shall be made (a) upon a prior notice rendered to the same categories of persons listed under point (i) above, and (b) upon registration of a “takeover notice” with the Archive.

(iii) Taking possession of the assets for administration purposes.

A whole new option regulated by the New Civil Code is the creditor’s right to take possession of the asset for administration purposes. This option only applies in case of creditors holding a movable mortgage over assets of a business entity and only for a limited period of time, namely until full satisfaction of the secured liability. The creditor is compelled as well to register an “enforcement notice” with the Archive.

4.1.3. The retention right

The New Civil Code regulates for the first time the retention right, which is 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 retain that asset until the respective owner pays the expenses incurred by the holder with the maintenance, preservation and, if case, improvement of the asset. The said right operates only as long as the asset is in the holder’s possession.

4.1.4. The pledge

As opposed to the movable mortgage, the pledge, as a security interest, involves the dispossession of the secured asset. Thus, 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. As concerns the enforcement of the pledge, the provisions related to the enforcement of the movable mortgages apply accordingly.

5. Security interests over vessels and aircrafts

Although prior to the entry into force of the New Civil Code, vessels and aircrafts could have been subject to mortgages (more precisely, to what is currently called “immovable mortgage”), at present, security interests over vessels and aircrafts are to be regulated by special laws (and not by the New Civil Code). Thus, such

types of assets do no longer follow the same regime as immovable assets. However, for the time being, special regulations have not been issued.

6. Other guarantees

Although these are personal guarantees (and not security interests), it is of relevance for the purpose of this presentation, to mention that the New Civil Code is the first Romanian enactment to regulate the bank letter of guarantee and the comfort letter, especially since their use is widely spread in practice.

6.1. The bank letter of guarantee

The bank letter of guarantee represents a legal document issued under a form of a letter expressing the commitment of its issuer (usually, a banking institution) to pay an amount of money to a third party, the beneficiary, upon request of the authorizing officer. Such commitment is entered into in consideration of an already existing legal relationship between the authorizing officer and the beneficiary, but has an independent existence.

6.2. The comfort letter

The comfort letter represents the irrevocable and autonomous commitment of its issuer to do or to refrain from doing something, with the view to support a third party (*the debtor*) with respect to the latter's obligations towards one of its creditors. The comfort letter is issued in consideration of the relationship between the debtor and the issuer of the comfort letter (for example, a banking institution issues a comfort letter whereby undertaking to provide financing to the beneficiary of an European funded project, in order for the beneficiary of the funds to prove to the authority managing the European funding that it will benefit from the necessary financing of illegible costs).