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# Guide for taking charges in the Slovak Republic



**European Bank**  
for Reconstruction and Development

# **Guide for Taking Charges in the Slovak Republic**

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## INTRODUCTION

Following the amendment to the Civil Code in September 2002 Slovakia will have one of the most advanced frameworks for secured credit of any country in Europe. This allows for a flexible, simple and reliable regime, which should bring significant benefits to the Slovak economy, and to the business environment.

Such a novel regime in a country where secured credit has been little used in the past requires explanation to facilitate understanding and to encourage full use to be made of it. This guide aims at giving the practitioner, be it businessman, banker or adviser, a brief overview of the law governing secured transactions in Slovakia with effect from 1 January 2003 and to provide answers to the practical questions that are likely to arise for a practitioner who is involved with the giving or taking of a charge to secure credit.

A charge is a right that a person (a ‘chargor’) gives a creditor (a ‘chargeholder’) in his assets to secure payment of a claim due to the creditor. The claim may be for repayment of a loan or trade debts arising in a business or any other claim for money. If the claim is not paid the assets given as security may be realised to satisfy it. The effect of a charge is to give the chargeholder a right in the charged assets in addition to his personal claim against the debtor.

An effective legal framework for the granting of secured credit is generally regarded as an essential aspect of a modern market economy. It facilitates the granting of credit thus stimulating economic activity and at the same time permitting a more efficient use of assets. The purpose of security is to reduce the risk attached to giving credit, by increasing the chances of the lender recovering the amounts owed by the debtor. As a result, the availability of credit is increased, its cost is reduced and the other conditions applicable to credit (for example the duration) are improved.

### **An explanation of terms used**

As far as possible this guide avoids the use of technical language but it may help the reader to explain, at the outset, certain terms used in this guide:

#### *Asset-Based Register*

A register in which certain types of assets are recorded, for example land registered at cadastral offices, aircraft register (same as *specific register*).

#### *Charge*

A right in assets to secure payment of a claim for money or a non-monetary claim (same as *pledge*).

#### *Charge Agreement*

An agreement which establishes a charge.

#### *Charged Assets*

Assets over which a charge is given (same as *charged property* or *collateral*).

#### *Charged Property*

Property over which a charge is given (same as *charged assets* or *collateral*).

*Chargeholder*

A person to whom a charge is given to secure payment of his claim (same as *secured creditor*).

*Charges Register*

The register of charges operated by the Slovak Chamber of Notaries.

*Chargor*

A person who gives a charge over his assets to secure payment of his debt or the debt of another debtor.

*Collateral*

Assets or property over which a charge is given (same as *charged assets* or *charged property*).

*Enforcement*

The process by which the rights of a chargeholder are exercised.

*Non-Possessory Charge*

A charge where the chargor retains the right to possession of the charged assets.

*Pledge*

A right in assets to secure payment of a claim for money or a non-monetary claim (same as *charge*).

*Possessory Charge*

A charge where the chargeholder (or a designated third party) takes possession of the charged assets.

*Realisation*

The sale of the charged assets on enforcement.

*Secured Claim*

The claim of the chargeholder that is secured by the charge (same as *secured debt*).

*Secured Creditor*

The creditor whose claim is secured by a charge (same as *chargeholder*).

*Secured Debt*

The debt due to the chargeholder that is secured by the charge (same as *secured claim*).

*Security*

An umbrella expression used to cover rights given to a creditor to reinforce or 'secure' his right to payment.

*Specific Register*

A register in which certain types of assets are recorded, for example land registered at cadastral offices, aircraft register (same as *asset-based register*).

## **Key features**

The new regime introduced for secured credit in Slovakia represents a fundamental change from the previous law. The principles underlying it include:

- Any legal or physical person can give a charge over its assets in favour of any creditor.
- The charge can be taken over any single or collective thing, right or asset that is capable of being transferred, including movable assets, land and buildings, rights and receivables, or even a group of assets which is constantly changing and assets that the chargor will acquire in the future.
- All types of claim may be secured, and may be denominated in any currency, be of fixed or varying amount and include claims that will arise in the future.
- The debtor may retain possession and continue to use the assets taken as security.
- The new provisions allow considerable contractual flexibility, with broad scope for the debtor and creditor to determine the terms of the security in a way, which fits with what they agree between themselves.
- Creation of security should be simple and rapid. As far as the contractual security is concerned, all that is required is a written agreement followed by publicity of the security by registration in the new Charges Register (or, where appropriate, in an asset-based register).
- The Charges Register will permit immediate registration of charges. Any person may inspect information on the register via the Internet.
- The creditor gains a first right in the charged assets, subject to any prior charge given to another creditor. Priority between charges is determined by the order of their registration. Claims of the tax authorities are subject to the same rules and do not have privileged treatment. Unsecured creditors are not able to take execution procedures against charged assets.
- If the debtor fails to pay the secured debt when due the secured creditor has the right to take possession and to sell the assets given as security and to use the proceeds to repay the debt. The process for enforcement allows for sale by auction or private sale without the necessity of involving the courts.

## **Which Laws?**

Charges are primarily regulated in articles 151a to 151md of the Civil Code as amended by Act No.526/2002 Coll. The Charges Register is regulated by Act No. 323/1992 Coll. as amended by Acts Nos. 232/1995 Coll., 397/2000 Coll., 561/2001 Coll. and 526/2002 Coll. and by Decree No. 607/2002 Coll. Sale by public auction is regulated by Act No.527/2002 Coll. on Voluntary Public Auctions.

## **1. FIRST STEPS: IDENTIFYING THE ELEMENTS OF A CHARGE**

### **1.1 Who is involved?**

#### ***1.1.1 Who can grant a charge?***

Anyone can grant a charge over his assets, as long as he is entitled in law to transfer those assets.

#### ***1.1.2 Who can receive a charge?***

Anyone can receive a charge to secure debts due to him.

The chargeholder will often be a bank or a credit institution, but any person who gives credit to another may receive a charge. Companies frequently receive charges to secure claims against other companies arising in the course of their business.

A charge can be granted to local and foreign creditors alike.

Under the previous regime, public sector creditors (such as the tax authorities) benefited from preferential treatment. This is no longer the case. Priority between charges is determined according to the chronological order of their registration. The first chargeholder will have first priority (see further § 4.4).

The chargeholder may appoint another person to be registered as chargeholder and to act vis-à-vis third parties in all respects as if he were the chargeholder (see § 3.2.3).

### **1.2 Identifying the property involved: What assets can be charged?**

Security may be granted over a very wide range of assets. The charge may thus cover a thing, a right, an intangible asset, or residential or non-residential premises that are transferable.

Security may also be granted over future assets and a group of assets which is constantly changing, such as inventory, stocks of raw materials or an entire enterprise.

There are very few restrictions on the types of asset over which security may not be given. One such exception exists in respect of certain state-owned assets (see § 1.2.4).

Movable property, tangible or intangible, is often a significant component of a company's assets and it can represent substantial wealth of the business (for example, the stocks of raw materials, the work in progress, the inventory of finished products, the claims against customers for goods supplied, the equipment and machinery used in the business, the trademarks and patents, etc). The law provides a viable regime for taking security over such assets, which will often make a charge over them at least as attractive as the more traditional mortgage over real estate.

### **1.2.1 Things - Tangible movable assets**

Any type of tangible movable asset can be charged, whether it is a piece of machinery, a stock of goods, a diamond, a computer, etc.

Often tangible movable assets are described generally since such assets in many cases are difficult to identify individually, for instance raw materials. In such a case, security may be given in respect of all raw materials of a specified type or in a specified location, as long as it is possible at any given time to identify the collateral. Special rules apply to the charging of certain movable assets which are recorded in specific asset-based registers, e.g. ships and aircraft - see § 3.3.

### **1.2.2 Land - Immovable assets**

Immovable assets may also be given as security – including residential or non-residential premises. The process for creating the charge is similar but, as with other registered assets, the exact formalities are different - see § 3.3.

### **1.2.3 Intangible assets**

A charge may also be granted over intangible assets such as claims for money, intellectual property rights (e.g. patents, rights to software), and shares and bonds. Receivables as charged assets are attractive as they can represent a substantial part of a company's assets, which can be efficiently liquidated and which have limited risk of depreciation. In a business where there is a predictable flow of payments from customers who have been accorded time for payment, a charge over the pool of receivables from customers and over the bank account into which those receivables are paid may provide valuable security.

A building supplies company gives its regular customers 60-day payment terms. As security for its bank overdraft it gives a charge over (i) the receivables from its customers, and (ii) the bank account into which customers make payment.

In relation to charges over receivables and bank accounts, see further § 4.1.4 and 4.1.5.

### **1.2.4 What assets cannot be charged?**

There are very few restrictions on the types of asset over which security may not be given. However, under some circumstances certain state-owned assets may not be subject to a charge. Also assets which are deposited in a warehouse against issue of a warehouse receipt may not be charged.

Otherwise, the only test is that the asset has to be freely transferable. If by law an asset is not freely transferable or if the parties to a contractual claim agree that it shall not be assignable, then it cannot be charged. For example, under Act No. 566/2001 Coll. on Securities, it is prohibited to create a charge over the securities (e.g. shares) which have already been charged.

### 1.2.5 *Can future property be charged?*

It is possible to charge not only assets owned by the chargor at the time of the charge agreement, but also assets that he may acquire in the future. These may be assets that actually exist at the time of the charge agreement or assets that only come into existence subsequently (e.g. equipment to be acquired at a later date, raw materials or other goods to be purchased in the future, future claims against customers).

Although technically the charge is only created in law at the time when the chargor acquires the assets, all the formalities are completed in advance and the charge comes into existence automatically on acquisition. For a description of the creation of a charge over future assets, see § 2.1. For questions of priority, see § 4.4.

Often, future assets will be generally described, since a specific description at the time of the agreement may be difficult or even impossible, see § 1.2.7.

To secure a loan, a lending bank requests a charge over production line machinery together with any additions or extensions that may be added in the future.

In order to secure a loan to a building company, a lending institution takes a charge over all amounts due to builder under a given construction contract together with all further amounts that may become due from the customer to the builder relating to the construction project.

*Practice note: It is important that the contract includes an adequate definition of the future assets to be included. A charge over production line machinery may not cover additions or extensions unless this is clearly stated.*

### 1.2.6 *Can property already charged to someone else be charged again?*

It is possible to grant several charges over the same asset, and thus charge the same property to different persons as part of different transactions. The first chargeholder will have first priority and any charge granted subsequently will have only a second (or lower) priority right over the assets. Sometimes the agreement between the chargeholder and chargor prohibits the creation of further charges (that is referred to as a "negative pledge clause"). In such cases, the creation of subsequent charges is a breach of agreement that may have contractual consequences but the charge created subsequently will still be valid, see § 4.1.7. Also, the Securities Act disallows the creation of a second-ranking charge over securities that have already been charged (see § 1.2.4).

### **1.2.7 Can a pool of assets be charged?**

It is possible to charge assets described in general terms, for instance ‘all machines deposited in warehouse’, or ‘all books in a library.’ Security may thus be granted over a group of assets, which is constantly changing, such as inventory, trade receivables, stocks of raw materials or an entire enterprise. However, the assets subject to the charge must be described in the contract and in the register so that it is possible at any time to determine what the security is composed of in practice

### **1.2.8 Can an enterprise be charged?**

A charge may be granted over an enterprise or over any unit of an enterprise. In that case the chargeholder has the right, on enforcement, to sell the enterprise or the unit as a whole but only if the charge has been registered against all parts of the enterprise or unit. Where the charge is over an enterprise or unit of an enterprise this fact has to be specified in the Charges Registry (see § 3.2.3).

### **1.2.9 What elements are automatically included in the charged property (e.g., fruits, additions, and attachments)?**

The fruits of the assets subject to the charge are automatically included within the charge until they become separated. In accordance with the principle of contractual freedom underlying the legislation, this rule may be modified by contractual agreement between the parties.

A charge over a cow will include its calf up to the moment of birth, a charge over a share will include the right to dividends not yet paid.

### **1.2.10 If the chargor sells the charged assets, does the charge extend to the proceeds of sale?**

The charge extends to the proceeds of sale only if the parties expressly so agree. A charge over proceeds of sale can be of limited value because of difficulties of identifying and tracing proceeds.

*Practice note: Where the parties agree that the charge should extend to proceeds it may be advisable to create a charge over the claim for the price payable by the purchaser as a charge over a receivable, (see § 4.1.4) and/or a charge over the bank account into which the price is payable (see § 4.1.5).*

### **1.2.11 Does the charge extend to insurance rights and or proceeds?**

When the charged assets are insured, any payment under the insurance will be included within the charge (see § 4.5.1).

**Practice note:** *If the chargeholder wants to obtain a charge over all rights under an insurance policy, then this must be expressly included in the charge. The law does not put the chargor under any obligation to insure the charged assets, but this will often be required contractually.*

### **1.3 The claim that needs securing**

#### **1.3.1 What claims can be secured by a charge?**

Any monetary claim or debt, and any non-monetary claim the value of which is determined or determinable, can be secured by a charge. The secured debt may be denominated in any currency, may be of fixed or varying amount (subject to a maximum) and may include claims that are conditional or will arise in the future. The law is not restricted to bank lending but covers credit given by any person. The secured debt may be from a customer to his supplier, from one group company to another, from one member of a family to another, etc.

#### **1.3.2 Can a charge secure a future claim?**

A claim which is not yet in existence or which is subject to a condition may be secured, provided that its value or the maximum principal amount up to which it is secured is specified in the charge agreement. The claim may be for example future advances up to €100,000 that may be made under a loan facility, or the price of SKK1 million payable for a machine, subject to delivery of the machine.

In practice the creation of the charge is often a condition precedent to the disbursement of a loan, in which case the charge secures a future claim.

On 1 February a bank enters into a loan agreement with a manufacturing company agreeing to lend SKK 5 million subject to receiving (a) a charge over its raw materials, work in progress, inventory and receivables from customers and (b) specified financial information and a certificate from the company's auditors. The charge is created on 5 February, the financial information and auditors' certificate is delivered on 20 February and the loan is advanced on 25 February. Between 5 and 25 February the charge has secured a future claim.

#### **1.3.3 Can a charge secure a fluctuating claim (e.g. a bank overdraft or a trading account)?**

In many cases, the secured debt will fluctuate (increase and decrease) in its amount during the life of the charge as new debts are incurred and as payments are made. At any particular time, the secured debt will be the amount then outstanding from the customer or on the overdraft.

It is possible to give a charge to secure such a debt, provided again that the agreement specifies the maximum principal amount up to which the claim is secured.

A charge may be created to secure, for example:

- all amounts advanced from time to time under a loan facility up to maximum outstanding at any one time of SKK 2 million, or
- all amounts which may be due from a customer to his bankers (whether for loans, overdraft, foreign exchange or any other transactions) up to maximum at any one time of SKK 5 million, or
- all amounts which may be due at any time from a customer to a supplier up to a maximum of SKK 2 million.

#### ***1.3.4 Can a charge secure a claim expressed in a foreign currency?***

It is possible to express the claim in a foreign currency.

#### ***1.3.5 What is included in the secured claim? Interest? Costs? Damages?***

Security is automatically extended to cover interest on the claim, as well as all default interest and the costs of the enforcement.

## **2. CREATION OF A CHARGE**

### **2.1 How to create a charge?**

To create a charge there needs to be an agreement and some form of publicity (see section 3). Failure to comply with any of the formalities can result in the charge being invalid.

A charge may also be created by an approved hereditary agreement between heirs, a decision of a court or administrative body or by operation of law. These charges are also subject to the requirements of publicity (see section 3).

#### ***2.1.1 What form should the charge agreement take? Written agreement?***

The charge agreement should be in writing, other than in the case of possessory charges where there is no need for a written agreement.

#### ***2.1.2 What must the agreement contain?***

The charge agreement should identify the parties and specify the secured claim (including its amount or maximum principal amount) and the charged assets.

The charged assets may be identified (i) individually (e.g. a specific motor vehicle), or (ii) generically (e.g. all delivery vehicles owned by the chargor), or (iii) by means other than in (i) and (ii) provided that at any time during the term of the charge it is possible to ascertain what the charged assets are (e.g. all the raw materials, work in progress and inventory of finished products of the chargor).

The agreement should also contain the contractual terms agreed between the chargor and chargeholder regarding the charge. The new law places emphasis on the notion of contractual flexibility, and this is illustrated in areas such as the definition of charged assets and the secured claim, and the structure of the enforcement mechanisms. The importance of the drafting of the contract is correspondingly heightened.

*Practice note: The efficacy of the charge will depend to a great extent upon the drafting of the agreement between the parties.*

## **2.2 What are the costs of creating a charge? How long does it take?**

Creating a charge is essentially a simple process. In most cases the preparation of the charge agreement should be quick but inevitably additional time may be incurred by reason of the complexity of the transaction or the difficulty of negotiations. Registration in the notarial Charges Register should take a matter of minutes. In the past delays have been experienced in specific registers (in particular the land register), and it may take time for this to improve.

The registration fees for the Charges Register are set out in § 3.2.5.

Additional costs may be incurred by the parties, for example for professional advisers.

## **2.3 Is there a risk of the charge being declared invalid if the chargor becomes insolvent soon after?**

If the charge was created less than two months immediately preceding the filing of the petition for the bankruptcy declaration, then the rights of the chargeholder to separate satisfaction from the charged assets cease to exist, and the creditor will rank along with other unsecured creditors.

*Practice note: Pending reform of the Bankruptcy Code it is unclear whether the relevant date for future assets is the date of registration or the date of acquisition of the assets by the chargor.*

## **3. PUBLICITY - INFORMING OTHER PERSONS OF THE EXISTENCE OF THE CHARGE**

Once the parties have entered into a charge agreement, they are contractually committed to each other. However, the charge is not created until other necessary formalities, principally designed to “publicise” the existence of the charge, have been fulfilled.

Registration is the means most often used for publicising the charge and alerting third parties that a debtor has given a creditor prior rights over some of his assets. Where the assets are already registered (e.g. land, ships or shares), then registration takes place in the existing register. For possessory charges, the assets have to be handed over to the chargeholder or a third party, and dispossession is treated as adequate publicity, although registration may still be preferable (see § 4.4.1). In all other cases registration is made against the name of the debtor in the new Charges Register operated by the Slovak Chamber of Notaries.

A novelty of the new regime is that a charge created by an approved hereditary agreement between heirs, a decision of a court or administrative body or by operation of law must also be registered in the Charges Register or relevant asset-based register.

### 3.1 Which charges have to be registered and where?

Publicity through registration is a condition of creation for all charges except possessory charges. Registration is at the new Charges Register operated by the Slovak Chamber of Notaries except for the following registered assets where registration is at the specified asset-based register:

- Charges over immovable assets: land registries of cadastral offices;
- Charges over trademarks, patents, utility designs and semiconductor topography: the Intellectual Property Office;
- Charges over book entry securities: Securities Centre and the Central Depository (after it replaces the Securities Centre);
- Charges over participation interests: Commercial Registry of the relevant district court;
- Charges over ships or aircraft: at the respective Ships or Aircraft Registries.

### 3.2 The Charges Register: How does registration work?

#### 3.2.1 *Where is the charge registered?*

The Notarial Central Register of Charges is maintained in electronic form by the Slovak Chamber of Notaries. The Register consists of a single centralised database, which can be inspected by any member of the public via the Internet or at any notary's office.

#### 3.2.2 *What is the procedure to obtain registration?*

An application for registration of a charge may be made at any notary's office regardless of the residence or registered office of the chargor. Registration is made by means of a computerised registration application, completed by the notary. Once the registration application form is completed with the requisite information (see § 3.2.3), the applicant signs a printed version of this form. Application for registration is made by the debtor or his authorised representative (or by the creditor where the charge is not created by contract).

The registration application is then transmitted electronically to the central registry. Once the registration is completed (it should normally take not more than a few minutes), the applicant will then receive a printed version of the confirmation of the registration, along with an ID number for the transaction.

The notary need only check the identity of the person filing the application for registration (and, where appropriate, his authority to act) and that the required information for registration has been provided. Due diligence on the charged assets, the secured debt and any other matters must be performed by the parties.

***Practice note:*** *The creditor must check carefully that the information to be registered is correct. Any defect in the validity of the charge cannot be made good by registration (see also § 3.2.10).*

If the secured debt is shown in the register as €10,000 but in the charge agreement as €5,000, the charge will only secure €5,000.  
If the charged assets are described in the registry as all the machinery at X and Y location but the charge agreement only refers to X location, the machinery at Y location will not be charged.  
If the chargor does not own the charged assets as described in the register, the charge will not be valid.

### 3.2.3 *What information has to be registered?*

#### *Identity of the parties*

Personal details of the chargor and the chargeholder:

- in the case of natural persons: name and surname, date of birth.
- in the case of legal entity: business name, registered office, identification number of the organisation.

Where the chargor is a different person from the debtor, details of the debtor also have to be registered. If another person is authorised to act on behalf of the chargeholder his details may be registered in the place of the chargeholder's, but this must be stated.

A loan of €10 million is granted by a syndicate of ten banks and the borrower gives a charge to all of them. The banks may agree that one of them, or another person, will act as chargeholder. In that case the identity of the bank or other person appointed will be entered into the register instead of the identity of the ten banks.

#### *Charged assets* (see § 2.1.2 for the form of the charge agreement)

A description of the charged assets must be included in such a way that it is possible to identify things, rights or assets encumbered by the charge at any time throughout its duration. If the charge is created over all or part of an enterprise this must be specifically indicated. Because of the limited space available in the register, the description may have to be shorter than in the charge agreement or can possibly cross-refer to the relevant provision of the charge agreement for a fuller description.

#### *Secured debt* (see § 2.1.2 for the form of the charge agreement)

A description of the claim, including its due date, if determined, and its value or, if not determined on creation, its maximum principal value. Because of the limited space available in the register, the description may have to be shorter than in the charge agreement.

*Additional information*

Subsequent to the initial registration any change concerning the initial information registered (e.g. identity of the chargor if the assets are transferred) must be registered, as must the commencement of enforcement of the charge and its deletion.

Any agreed change in the order of priority between chargeholders, and the period for which the charge has been created, may also be registered.

In order to facilitate advance preparation for registration, the templates of the application forms can be downloaded from the website of the Chamber of Notaries ([www.notar.sk/registre.aspx](http://www.notar.sk/registre.aspx)).

**3.2.4 How long does it take?**

Registration should take a matter of minutes.

**3.2.5 How much does it cost?**

Registration fee: a fixed fee of SKK 500 plus a degressive fee on the amount secured calculated as follows:		
On the first SKK 100,000		0.70%
On the next SKK 400,000		0.50%
On the next SKK 500,000		0.20%
On the next SKK 2,000,000		0.10%
On the next SKK 17,000,000		0.05%
Amendment & deletion fee		SKK 700

Illustrative table of registration fees			
Amount secured SKK	Amount secured €	Fee SKK	Fee €
100,000	2,381	1,200	29
500,000	11,905	3,200	76
1,000,000	23,810	4,200	100
3,000,000	71,429	6,200	148
20,000,000	476,190	14,700	350
50,000,000	1,190,476	14,700	350
100,000,000	2,380,952	14,700	350
500,000,000	11,904,762	14,700	350
1,000,000,000	23,809,524	14,700	350
<i>NB Fees are payable in SKK. € amounts are for illustration only and are based on €1=SKK 42</i>			

### **3.2.6 Can registration be refused? If yes, on what grounds?**

Registration can only be refused if the information for registration is incomplete or the fee is not paid.

### **3.2.7 What information in the register can be searched? And by who?**

The information in the registry is public and can be consulted by anybody.

### **3.2.8 How can searches be made?**

Searches can be made free of charge over the Internet ([www.notar.sk/registre.aspx](http://www.notar.sk/registre.aspx)) by reference to the name of the chargor. Searches can also be made at any notary's office, and the notary may issue, if requested, a certificate of an entry in the register.

### **3.2.9 How long does the search take and how much does it cost?**

Internet searches should take very little time and are free. Once the search criteria are entered into the terminal at a notary's office, the result is almost immediate. The basic search fee levied by the notary is SKK 200.

### **3.2.10 To what extent can a third party rely on the registered information?**

The Notarial Central Registry of Charges does not 'authenticate' the information registered. The notary only makes limited checks. A third party, even when acting in good faith, may not rely on the reality of the facts registered but should verify it for himself. However a third party can rely on the absence of information in the register. A registered charge cannot be created without registration. Therefore, if no charge is shown in the register a third party can assume that no charge exists. A special case

arises on a charge of a receivable where an extract from the registry is adequate proof of creation of the charge for the purpose of notifying the sub-debtor.

### **3.3 Charges over registered assets: How does registration work?**

Some assets are by nature registered in specific asset-based registries, and a charge over them will need to be registered in the respective registry, and not in the Charges Register (see § 3.1).

- Intellectual Property Office: charges over trademarks, patents, utility designs and semiconductor topography;
- Land registries of cadastral offices: charges over immovable assets;
- Securities Centre and the Central Depository (after it replaces Securities Centre): charges over book entry securities;
- Commercial Register of relevant district court: charges over participation interests in limited liability companies (SROs);
- Ships or Aircraft Registries: charges over ships or aircraft.

For existing immovable property, the charge must always be registered in the local land registry. The land registries are organised by region and the registrations are made by the district land registries in the area in which the relevant immovable property is located. Historically, this process may have taken up to several months. However, recently the position has improved and charge registration may now be made within 2-3 weeks (depending on the location of the property to be charged – delays are mainly in the urban areas). Also, as from 1 January 2002, accelerated registration can be obtained against payment of a higher fee.

In the case of book entry securities which are represented by data entries in the Slovak Securities Centre (the central securities registrar) the charge is over specific existing securities rather than an account. The parties need always to comply with the system charge rules - usually involving instruction given to the Slovak Securities Centre to register the charge in respect of the specific securities standing to the credit of the chargor's account with the Slovak Securities Centre. Nevertheless, under the recently passed Securities Act, a new system for the registration of security interests over securities is expected to be introduced in mid 2003, when the first Central Depository (that will replace the current Slovak Securities Centre) is expected to be granted a licence. Following that, all the security interests over any securities, irrespective of their form (i.e. physical or book-entry alike), would need to be registered with the Central Depository's register in order to be created.

Although the law permits the charging of future registered assets, the practical manner of registration of such charges in each of the relevant registers remains to be settled by practice.

### **3.4 Possessory charges on movable tangible assets: How does possession work?**

Transfer of possession is a condition of validity of the charge. It can be made to the chargeholder or to a third person for deposit. If the charge is not registered it automatically terminates if the charged asset is returned to the chargor. The chargeholder is obliged to return the charged asset to the chargor if the charge terminates for any other reason.

## **4. THE LIFE OF A CHARGE**

The right created by a charge is only exercised in the exceptional circumstance of the debtor failing to pay. Unless and until that happens the charge remains dormant. This section examines transactions and events that may take place meanwhile which may nonetheless be affected by the existence of the charge.

### **4.1 The charged assets**

#### ***4.1.1 Can the chargor use/consume the charged assets?***

When the chargor remains in possession of the charged assets he is entitled to make normal use of them in a usual manner, but must refrain from doing anything capable of being detrimental to the value of the collateral, except for ordinary wear and tear.

This right of use probably extends to consumption of the assets where that would be normal use. The parties may make their own agreement as to the use of the assets.

*Practice note: Where consumption of the charged assets is envisaged, it may be preferable for the charge agreement to provide for this expressly.*

For right to sell the charged assets, see § 4.1.8.

#### ***4.1.2 What are the duties to maintain the charged assets?***

The chargor is responsible for maintaining the charged assets in good condition. He must refrain from doing anything capable of being detrimental to the value of the collateral, except for ordinary wear and tear.

Where the chargeholder is in possession of the charged assets, he may use them only with the consent of the chargor. The chargeholder must take due care of the assets.

#### ***4.1.3 Does the chargor have to insure the charged assets?***

The law does not put the chargor under any obligation to insure the charged assets, but this will often be required contractually.

#### ***4.1.4 Specific requirements in the case of a charge over claims or receivables***

A charge over a claim or receivable is created in the same way as any other charge. However it is of no effect against the debtor of the charged claim (the 'sub-debtor') until he is informed of the charge. Notice to the sub-debtor is not a requirement for the existence of the charge, but until it is given the sub-debtor may discharge his debt by paying the chargor. Notice to the sub-debtor may be given by the chargor in writing or

by the chargeholder proving the creation of the charge to the sub-debtor (for this purpose a printout from the Charges Register is sufficient).

A company may give a charge to its bank over receivables payable by its customers. The charge is established upon registration. The bank may be prepared to allow customers to continue paying directly to the company, knowing that it can give notice to the customers at any time it feels appropriate, requiring payment direct to the bank.

Once the sub-debtor has been notified of the existence of the charge, he must perform solely to the chargeholder or to the person specified by the chargeholder. Unless the parties agree otherwise, the chargeholder is entitled to keep payments as a deposit and, if the secured claim is not duly and timely paid, to satisfy himself from the deposit.

#### **4.1.5 How does a charge over a bank account work?**

A charge over a bank account works the same way as any other charge over a receivable. Once the bank is notified of the charge it can only make payment from the account to the chargeholder unless otherwise agreed.

*Practice note: There will often be an agreement between the bank, its customer (the chargor) and the chargeholder allowing other payments from the account subject to specified limitations.*

The law allows for a bank to receive a charge over an account that the chargor holds with it. It often arises that a company borrows from a bank and also has an account with the same bank into which payments from customers or other payments are made. The bank may take a valid charge over the credit balance in the account as security for the loan.

#### **4.1.6 Can subsequent charges be granted over the previously charged property?**

An asset may indeed be charged several times to different chargeholders to secure different debts.

A computer company gives credit to a customer secured by a charge over a new computer system it has supplied. The customer later grants a second charge to its bank over all its computer and office equipment to secure a working capital loan.

There is an exception for charges over securities (see § 1.2.4).

#### **4.1.7 What if there is a negative pledge clause?**

Parties may include in the charge agreement an obligation on the chargor not to create further charges over the same (or other) charged property. This is valid as between the parties but will not be effective against third parties.

In the agreement with the computer company (see § 4.1.6) the customer undertakes not to create any further charges over the computer system. The later charge to the bank is valid, but the customer will be liable to the computer company for breach of its agreement.

#### **4.1.8 Can the chargor sell the charged assets?**

The ability of the chargor to sell the charged assets should be determined by the agreement between the parties. If the charge agreement is silent on this issue, then the sale is permitted but the separate question arises of whether the purchaser acquires subject to the charge. This is examined in § 4.1.9.

#### **4.1.9 What happens if the charged asset is sold to a third party?**

The charge creates a right over the asset and, subject to exceptions discussed below, this continues notwithstanding any change of ownership of the assets. Thus, if the owner of the charged assets sells those assets to a third party, then the normal rule is that the acquirer of the charged assets acquires them subject to the charge. A person acquiring the asset can find out about the charge from the registry and has to accept that the chargeholder has the right to enforce against the asset, should the secured debt not be paid. The acquirer's right to recover from the original chargor will depend on the terms on which he acquired the asset. However, all rights and obligations concerning enforcement of the charge become effective against the acquirer.

The customer sells the computer system to another company (see § 4.1.6). Later it fails to repay the credit to the computer company when due. The computer company has the same rights to enforce the charge against the purchasing company as it would have had against the customer.

Upon a change of ownership, the entry for the charge in the Charges Register must be amended. The chargor and the acquirer are jointly responsible for registering the change in the person of the chargor. Failure to undertake this obligation may result in a damages claim.

**Practice note:** *When acquiring assets it is important for the purchaser to check for any charges in the respective registers unless the purchaser is certain that he falls within the exceptions below.*

## ***Exceptions***

However, in the following cases, the acquirer will receive the charged assets free from the charge:-

- where the charge agreement provides for transfer of the charged assets free from the charge;
- where the chargor sells the assets (i) in the normal course of business, and (ii) within the scope of his business activities (this does not apply where the charge is registered in a specific register);
- where a bona fide purchaser acting with due care acquires the assets (if the charge is registered there is a presumption against good faith, subject to proof to the contrary). Also, this exemption shall not apply where the charge is registered in a specific register.

A dealer in agricultural equipment gives a charge over all its stock to its bank. A farmer who purchases a tractor from the dealer will acquire it free of charge. In order to finance the purchase the farmer takes a loan from his bank secured by a charge. The farmer then sells the tractor to his neighbour. The neighbour will acquire the tractor subject to the charge in favour of the farmer's bank, as, unlike the agricultural equipment dealer, the farmer is not in the business of selling tractors.

## **4.2 Can the secured debt be transferred?**

The secured debt can be transferred in the same way as any other debt. Unless the parties otherwise agree, the charge will follow the debt and the transferee will become a secured creditor of the debtor in the place of the transferor. The entry in the Charges Register must be amended to reflect the transfer, unless the name of a person authorised to act on behalf of the chargeholder is shown in the register and the same person is authorised by the transferee. If the chargeholder transfers the secured debt without the charge the debt becomes unsecured and the charge terminates since it cannot exist independently from the debt.

*Practice note: The person to whom a secured debt is transferred should ensure that he is registered as the new chargeholder. In order to avoid any difficulty in obtaining registration he should require the transferring chargeholder to make the change in the registry at the time of the transfer.*

## **4.3 The Register**

### **4.3.1 Do the parties need to renew the registration?**

Registration is valid until the charge terminates and there is no need to renew. However if the charge has been registered for a particular period of time, it will terminate at the end of that period.

### 4.3.2 *Does additional information need to be included in the register?*

Subsequent to the initial registration, any amendments and some new information must be registered (see § 3.2.3). In particular, identification of the new chargor (see § 4.1.9) and new chargeholder (see § 4.2), termination of a charge (see § 3.2.3), commencement of judicial or non-judicial enforcement (see § 5.2.3) must all be registered and change of priority between chargeholders (see § 4.4.2) may be registered.

Failure to undertake the obligation to register amendments and new information may result in a damages claim against the offending person.

A distinction must be made between amendments that in effect result in a new charge (for instance, modification of the charged assets increasing the scope of assets) and amendments to the initial registration that do not result in a new charge (e.g. change of identity of the parties).

A person gives a charge over ten paintings. Six months later he changes address and registers his new address in the Charges Register. He then extends the charge to cover five further paintings he has acquired. This cannot be registered as an amendment to the charge, since in reality it is a new charge over the five paintings and must be registered as such.

***Practice note:** If the charged assets in the original charge had been described as the ten paintings plus any further paintings that the chargor may acquire, the five paintings would have been included in the original description of the charged assets and so no new registration would have been required.*

## 4.4 **How is the priority of a chargeholder determined?**

### 4.4.1 *Vis-à-vis other chargeholders*

Priority between charges is determined according to the chronological order of their registration. This rule applies equally to registered and possessory charges. So a possessory charge which is not registered will lose priority to a subsequent registered charge.

In the case of charges over after-acquired assets, the charge is not created until the chargor acquires ownership, however the priority vis-à-vis other charges is from the time of registration.

Special temporary provisions apply to old charges created prior to 1 January 2003 (see section 6).

#### **4.4.2 *Where there is agreement for change of priority or subordination***

In the case of registered charges, chargeholders can agree amongst themselves to a different order of priority and have the changed order registered. The agreement is only effective upon registration, and has no effect as against a chargeholder who is not party to the agreement if it has a negative impact on the enforcement of his claim.

#### **4.4.3 *Vis-à-vis other enforcing creditors***

An *unsecured* creditor whose claim against the debtor is supported by either an enforceable judicial decision or by an enforceable notarial deed may resort to a forced enforcement procedure against the debtor's assets in order to recover his debt. However he may only obtain execution against the charged assets if the chargeholder consents. Thus, unlike under the previous law, a chargeholder cannot find that he has involuntarily lost his prior right in the charged assets to an unsecured creditor.

#### **4.4.4 *Vis-à-vis creditors benefiting of a retention right***

Creditors in possession with a legal retention right have a preferential right to the extent of their claim which relates to the asset. This may be relevant, for example, to warehouse keepers, carriers, forwarders and repairers vis-à-vis the assets in their possession.

#### **4.4.5 *Charges over the charged assets created by previous owners***

If the charged asset was acquired by the debtor already subject to a charge, the charge created by the previous owner will have priority over any charge created by the debtor. The debtor can only create a charge on the title he acquires - if he acquires the asset subject to a charge then he can only give it as security subject to that charge.

In October a farmer gives his bank a charge over all his present and future farm equipment and machinery. The following January, he acquires a tractor from his neighbour; the tractor is already subject to a charge given by the neighbour to a finance company in November. The charge in favour of the neighbour's finance company (although created after the farmer's charge to the bank) will have priority over the bank's charge.

#### **4.4.6 *Insolvency***

Where the chargor is declared bankrupt, the right of sale is exclusively vested in the bankruptcy administrator but the chargeholder is entitled to receive the proceeds of realisation of the charged assets subject to the administrator's right to retain up to 30% of the proceeds to cover the costs of the bankruptcy.

Where a bankrupt company's business is sold as a going concern, there is a risk that the chargeholder may receive less than the real value of the charged asset because of the rules applicable to pro-rating the price between the assets of the business. This applies in particular to more readily realisable assets such as accounts receivable.

**4.4.7 Are there any specific preferential rights granted to third parties that the chargeholder should be aware of?**

No. The “first in time, first in right” principle applies not only to private sector creditors, but also to the tax authorities and other public sector creditors. The preferential treatment that was previously enjoyed by the tax authorities has been abolished.

A trading company gives a charge over its bank accounts on 1 June to secure a loan. The tax authorities register a tax pledge over the same bank account for overdue taxes on 1 July. The tax pledge will rank behind the charge securing the loan.

**4.5 Could a charge be terminated without the express consent of the parties?**

**4.5.1 When the charged property ceases to exist? Loses value?**

If all things, rights and assets encumbered with the charge cease to exist, the charge will automatically terminate. However, if the charged assets are destroyed the charge will still cover any claim for insurance.

*Practice note: The charge agreement may provide what will happen when the charged assets are damaged or destroyed, for example immediate acceleration of the secured claim or replacement with additional security.*

**4.5.2 When the charged property ceases to be identifiable or separable or becomes incorporated with other property, which is not charged?**

Charged assets may be merged or incorporated into other assets and thus cease to be identifiable or separate. This is the case when raw materials are used in a manufacturing process and become merged or incorporated to new goods, steel becomes part of a car, yarn becomes part of clothing, etc. In such a case, the charge over the assets will cease.

**4.5.3 For a possessory charge, when the chargeholder ceases to have possession?**

The charge ceases upon return of the charged asset to the chargor.

**4.5.4 When the secured debt ceases to exist or is transferred without the charge?**

The charge shall cease to exist if the debt ceases to exist. If the debt is transferred without the charge, the charge will also cease unless another person (e.g. a guarantor) has satisfied the secured debt, in which case it seems it may continue to secure the recourse claim of the person who has made payment.

**4.6 Can the chargor and chargeholder agree to terminate the charge? Can the chargeholder waive his right to the charge?**

Yes.

## **5. ENFORCING THE SECURITY**

Enforcement is the ultimate stage of the security right. Although the majority of charges will never reach this stage, particular attention has to be paid to what happens on enforcement as the entire value of the charge depends upon it. In normal commercial practice, both parties should want enforcement to be fair, quick and efficient.

### **5.1 When can the chargeholder enforce the charge?**

#### **5.1.1 *When the secured debt is due and unpaid?***

If the claim secured by the charge is not duly and timely paid, the chargeholder may initiate enforcement of the charge.

*Practice note: The trigger for the chargeholder's right to enforce is the debtor's failure to pay. It is therefore preferable for the time for payment to be defined without ambiguity.*

#### **5.1.2 *When the chargor becomes insolvent/bankrupt?***

On bankruptcy the enforcement is carried out by the bankruptcy administrator - see § 5.5.1.

#### **5.1.3 *When the chargor breaches other obligations to the chargeholder?***

The trigger for enforcement is failure to pay, and other failures by the debtor or chargor, for example failure to maintain the charged assets, will not automatically give a right to enforce. However it is usual to provide contractually for the creditor to be able claim immediate payment if certain 'events of default' occur. In that way the chargeholder can choose to 'accelerate' the debt if the chargor is in breach, and can then commence enforcement if there is a failure to pay the debt that has become due.

*Practice note: The charge agreement or the credit agreement should define the procedures on default and the rights of acceleration.*

### **5.2 What are the basic procedures for enforcement?**

#### **5.2.1 *How is enforcement commenced?***

The chargeholder has to notify the chargor (and the debtor, if different) in writing about the commencement of the enforcement of the charge, specifying the method of realisation.

#### **5.2.2 *Is it necessary to involve the court?***

If realisation is by public auction or private sale it is not necessary to involve the court.

### **5.2.3 *Is enforcement publicised?***

Where a charge is registered in the Charges Register the commencement of enforcement of the charge must be registered in that register.

### **5.2.4 *What are the methods of realisation?***

A charge can be realised by:

- Public auction under the law on Voluntary Public Auctions which was introduced at the same time as the new provisions on charges; or by
- Private sale as specified in the charge agreement; or by
- Court procedure.

Public auction and court procedures are always available to the chargeholder. Private sale (or other method as agreed in the charge agreement) depends on the provisions of the charge agreement.

For details of the procedures see § 5.4.

### **5.2.5 *When can realisation commence?***

Realisation by public auction or private sale cannot begin until 30 days after:

- notice of commencement of enforcement is given to the chargor (and debtor, if different), or
- if later, the date of registration of the commencement of enforcement of the charge in the Charges Register (where relevant),

unless the chargor agrees, after notice of commencement has been given, to a shorter period.

### **5.2.6 *How are the realisation proceeds distributed?***

In the case of private sale and public auction the chargeholder must prepare a written account of the sale for the chargor, giving all details of costs and distribution of proceeds. The chargeholder must account for expenses incurred relating to enforcement of the charge.

If proceeds of sale of the collateral exceed the secured claim, the chargeholder shall hand over the surplus to the chargor without undue delay after deduction of reasonably spent expenses in relation to the enforcement. Where other chargeholders have a claim in the proceeds of sale the surplus is deposited with a notary. On a court sale distribution is made by the court.

### **5.2.7 *How long should it take and what should it cost?***

Historically, court procedure may take several years. It is anticipated that public auction and private sale should dramatically shorten the time needed for enforcement since the process will be within the control of the chargeholder.

As regards the costs, in addition to the parties' own costs (such as the fees of professional advisers) and any taxes payable on transfer of the charged assets, the court enforcement involves the court fees, the fees of the executing court officer under the Civil Procedure Code (2 per cent of the enforced claim, with a maximum of SKK 100,000) or the fees of the executor under the Execution Act (20 per cent of the enforced claim, with a maximum of SKK 1 million).

In addition to the parties' own costs, the public auction will always involve the fees and costs of the public auctioneer.

### **5.3 Are the charged assets protected during enforcement?**

#### ***5.3.1 Can the chargeholder take possession of the assets?***

The chargor is obliged to hand over to the chargeholder the charged assets and any documents necessary for taking over, transfer and enjoyment of the charged assets, and further to co-operate as provided in the charge agreement. The same duty is imposed on a third party in possession of the charged assets or of any such documents. The chargor is liable for any damages arising from his breach of these obligations. However, it should be noted that in order to enforce the right to possession, the chargeholder would have to go to court or have an executory title, such as a notarial deed, to obtain execution.

#### ***5.3.2 How can the chargeholder prevent loss, damage or deterioration of the charged assets during this period?***

The person in possession of the secured assets during enforcement must refrain from doing anything which might be detrimental to the value of the charged assets, except for normal wear and tear. The chargor is not allowed to transfer the collateral without consent of the chargeholder. However a person who acquires the charged assets from the chargor in the normal course of business within the scope of the business activities of the chargor will acquire free from the charge unless he knew, or ought to have known, of the commencement of enforcement.

### **5.4 What are the methods of realisation of the charged property?**

#### ***5.4.1 Public auction - how does it work?***

The new law on Voluntary Public Auctions, which came into force in January 2003, provides a framework for a rapid and efficient sale of the charged assets at auction. The chargeholder acts in the name of the chargor for purposes of the sale and is under a duty to inform the chargor about the process of enforcement, and in particular about facts that may have a negative impact on the price of the sale.

#### ***5.4.2 Private sale - how does it work?***

The parties may provide in the charge agreement for the method of sale on enforcement. The chargeholder acts in the name of the chargor for purposes of the sale and is under a duty to inform the chargor about the process of enforcement, and in particular about facts that may have a negative impact on the price of the sale. The chargeholder must act with due care so that the charged asset is sold for a price for which it or a similar asset is normally traded under comparable circumstances at the

time and place of sale. Subject to that the method of sale can be as agreed between the parties in the charge agreement.

*Practice note: It is important to ensure that the rights and obligations are clearly laid down in the agreement.*

#### **5.4.3 Court enforcement - how does it work?**

The secured creditor may apply for court enforcement once judgement has been obtained on the secured debt or on the basis of an enforceable notarial deed. The submission is made either to the executing court officer under the Civil Procedure Code or to the executor under the Execution Act (though the former is rarely used). The executing court officer or the executor organises the sale of the charged assets by auction and the proceeds are paid to the enforcing chargeholder after deduction of costs. The procedure tends to take a long time, even where an enforceable notarial deed is used.

#### **5.4.4 Can the chargeholder acquire the assets himself?**

Any agreement made before the secured claim becomes due which allows the chargeholder to acquire the charged assets, as satisfaction for his claim, is null and void. After the secured claim has become due such agreement is permitted.

#### **5.4.5 How does realisation take place over claims for money (receivables)?**

In principle the method of realisation for claims of the chargor against a sub-debtor is the same as for any other asset, and the claims can be sold by auction or private sale. In practice this may often be unsatisfactory, particularly where the claims are close to maturity. Alternatively the chargeholder may wait for the claims to be paid by the sub-debtor without taking any enforcement procedures. If the sub-debtor has been notified of the charge he is obliged to pay to the chargeholder and the chargeholder is entitled to satisfy his claim out of the money so received (see § 4.1.4).

#### **5.4.6 How does realisation take place over an enterprise?**

Although enforcement of the charge against an enterprise is envisaged when the charge was created over all parts of the enterprise, the law does not include any special provisions concerning realisation of a charge over an enterprise.

*Practice note: Much will therefore depend on the contract between chargor and chargeholder.*

### **5.5 What else is relevant to enforcement?**

#### **5.5.1 What happens if the chargor is insolvent?**

From the moment of the bankruptcy declaration, the chargeholder will cease to have the right to enforce. The charged assets are sold by the bankruptcy administrator, but the chargeholder is entitled to receive the proceeds of the sale (see § 4.4.6). Moreover, any enforcement proceedings underway when a bankruptcy declaration is made would automatically be discontinued.

### ***5.5.2 Where there are several chargeholders what are their respective rights?***

Where there is more than one charge over the same charged asset, special rules on enforcement apply:

- a prior ranking chargeholder whose claim is due may take over the enforcement;
- if the first ranking chargeholder enforces, the collateral is sold free from charges and any surplus proceeds of sale are deposited with a notary for the benefit of the other chargeholders and of the chargor;
- if another chargeholder enforces, the collateral is sold subject to the charges of all prior chargeholders and the enforcing chargeholder and the purchaser are jointly responsible for registering the continuing charges against the name of the purchaser;
- once enforcement has begun, a chargeholder is entitled to pay off the claim of the enforcing chargeholder, in which case he acquires the latter's rights and priority.

### ***5.5.3 Will the purchaser on enforcement be protected?***

The chargeholder acts in the name of the chargor for purposes of the sale of the collateral. A purchaser of the assets on enforcement does not have to concern himself with the validity of enforcement procedures. It is adequate for him to check that commencement of enforcement is registered (where relevant).

## **6. WHAT HAPPENS TO OLD CHARGES CREATED PRIOR TO 1 JANUARY 2003?**

Under transition arrangements, charges created before 1 January 2003 will need to be registered in the Charges Register no later than **30 June 2003**, otherwise they will automatically terminate. They will be registered as of the date of their creation and this will be the relevant date for determining priority. No further registration is required for pre-existing charges over assets registered in specific asset-based registries (such as a charge over immovable property) which will remain valid.

Pre-existing "possessory" charges (i.e. charges over a chargor's movable assets permanently in the possession of a chargeholder) may be (but do not have to be) registered in the Charges Register as of 1 January 2003, provided that the application for registration is submitted not later than **31 March 2003**. An incentive to proceed with the registration could be the possibility to transfer the possession of the asset back to the chargor, after the registration is completed.

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