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Collateral Law:

TEPPSA Case Study

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**CASE STUDY:
“TEPPSA HOLDING”**

❖ INTRODUCTION

Teppsa was a carpet company. In 1996 it received a loan in the amount of one million marks from USAID. The loan was administered by the Business Finance Project (BF) of USAID.

Though we were unable to secure copies of the loan documents from USAID, the Chief of Party of BF advised us that the loan was roughly broken down 46-47% for the purchase of equipment, 10-12% for working capital and the balance was for renovations. The Chief of Party told us that no payments were ever made on the loan.

The lead attorney for BF told us that the property foreclosed, real estate, had rent paying tenants and that the rents continued to pay to the debtor by the tenant throughout the litigation. The dilatory tactics used by the tenant were assumedly to protect this rental stream.

This case was conducted under the old Enforcement Law. The purpose of this analysis is to show how that law was used to abuse essential court resources, resulting in losses to the creditor and extensive profits to the defaulting debtor.

The following is a chronological listing of the various motions, orders and appeals taken in the case.

❖ CHRONOLOGICAL PHASES OF PROCEDURE

Procedure has been held pursuant to provisions of previous Law on Enforcement Procedure (therefore, terms creditor-debtor are used). Basic facts and dates related to deadline and duration of procedure are presented chronologically by items:

1. 28.11.1996. – Loan agreement No. 029 has been concluded at amount of 1.000.000 for procurement of equipment for production of carpets,
2. 28.11.1996. – proposal for lien on real estate of debtor – loan user,
3. 09.01.1997. – decision on registration of collateral debtor's real estate – loan beneficiary (Zk.ul.br. 4984 K.O. Hrasnica),
4. 01.09.1998. – formal notice to debtor about default with request of creditor for payment of entire loan amount,
5. 04.11.1998 – Motion for enforcement procedure sent to Municipal Court I in Sarajevo (Ip.3375/98),
6. 05.11.1998. – The Court issued decision on approval of enforcement procedure,
7. 16.11.1998. – Objection by debtor on decision on enforcement dated 05.11.1998,
8. 14.12.1998. – decision of Municipal Court I, Sarajevo on rejection of debtor's objection,
9. 02.02.1999. – Decision by Municipal Court I Sarajevo for appraisal of collateral value,
10. December 1999 – The appraisal filed with the Court,
11. 07.01.2000 – decision on value of collateral (1.482.989,20 KM),
12. 25.01.2000 – debtor's appealed decision on appraisal dated 07.01.2000,
13. 23.03.2000 – Decision by Cantonal Court upon debtor's appeal (appeal granted with explanation that it is not clear why financial expert's finding has been taken into account),
14. 18.08.2000 – decision on appraised value of collateral (2.165.482,00 KM),
15. 29.11.2000 – The minute of Municipal Court I, Sarajevo on first hearing for auction of real estate of debtor, which was scheduled for 29.01.2001,
16. 29.01.2001 – first auction for public sale – not successful (no bidders),
17. 14.03.2001 – second auction for public sale – not successful (no bidders),
18. 14.09.2001 – third auction for public sale – not successful (bidders did not pay in insufficient deposit),
19. 02.04.2001 – proposal of plaintiff to re-schedule hearing for public sale (third auction),
20. Court decision for scheduling second public auction for 12.06.2001,
21. 12.06.2001 – Auction for sale of collateral – successful (real estate sold to buyers for 1.443.700,00 KM),
22. 12.06.2001. – Decision of Municipality court on giving possession of real estate to buyers,
23. 27.06.2001. – Appeal of debtor against decision,

24. 27.03.2002 – Decision of Cantonal court by which appeal is granted and case is returned to first instance court for procedure,
25. 17.07.2002 – Decision on adjudication (real estate shall be given to buyers after they submit the amount of 1.443.700.00 KM to court),
26. 21.08.2002. – Debtor’s appeal against decision dated 17.07.2002,
27. 28.11.2002. – Decision by Cantonal court (disputed decision corrected) – collateral adjudicated as ownership, with right of usage for land,
28. 08.04.2003. – Decision by Cantonal court on conveyance of real estate to buyers,
29. 22.04.2003 – Debtor’s appeal against decision dated 08.04.2003,
30. 04.07.2003 Decision by Cantonal Court – case returned to procedure again (debtor’s appeal adopted because “there were no sufficiently clear reasons about price given by buyers”),
31. 18.08.2003 – Decision by Municipal court on submission of real estate purchased via public sale.
32. 25.08.2003. – Debtor’s appeal against decision dated 18.08.2003,
33. 03.09.2003. – USAI BF – submitted response to appeal,
34. 18.09.2003 – Decision by Cantonal Court in Sarajevo – appeal rejected and first-instance decision dated 18.09 confirmed,
35. 26.02.2004 – Finding and opinion of financial expert (amount of debt – claims),
36. 26.04.2004 – Decision on settlement,
37. 26.04.2004 – Creditor collected paid amount of 709.932,36 Euros from price of sold collateral,
38. 25.05.2004 – Decision of Municipal administration on payment of tax for transfer of real estate.

❖ BASIC INDICATORS IMPORTANT FOR ENFORCEMENT PROCEDURE

1. DURATION OF PROCEDURE AS KEY ISSUE FOR PROTECTION OF CREDITOR’S – INVESTOR’S INTERESTS

- a. In the concrete case, the procedure lasted from 04.11.1998. to 26.04.2004, i.e. 5 years and 6 months.
- b. During the procedure, the debtor used all possible legal means (objection/item 7 and appeals against five court decisions/items 12, 23, 26, 29, and 32). Most of the procedure’s duration was owed to waiting on decisions upon appeal by debtor, i.e. decision of Cantonal court upon appeals (items 13, 24, 27, 30 and 34). It can be concluded by analysis of activities (item 24) that almost a year has passed in wait for this decision. During that period the interest rate alone has risen up to 178.000 KM.
- c. Analysis of the duration of certain phases in the procedure indicates slowness in work process in both first- and second-instance courts. Namely, when monitoring information about flow of documents, when it

is forwarded to the Cantonal court upon appeal (items 12, 23, 26, 29 and 32), which shows that the procedure on appeal at the Cantonal court took 1-9 months. If we keep in mind that the creditor, owing to his immediate cooperation with presidents of all Cantonal courts, managed to obtain a right that procedures are truly treated as urgent, than the statement about slow work of courts is more than obvious. Compared to contents of decisions passed by Cantonal courts upon appeal of the debtor, it needs to be stressed that these decisions were on several occasions inadequate, in the sense of the Law's application, as well as statements stressed in the appeal (item 13: method for determining value of real estate, item 30: "there were insufficiently clear reasons as to why the buyers deposited a certain price", which was totally irrelevant for the appeal). Apart from the above special attention should be paid to the work of the first-instance courts on cases forwarded after the second-instance decisions have been issued, with attention to a long time period that passes from the moment of making a second-instance decision to the moment of action by the first-instance courts. The reason for this can also be inadequate administration of court cases (items 25 and 27).

SUMMARY

The time period the creditor required for realization of court protection in the enforcement procedure handled pursuant to provisions of the old Law on Enforcement, and initiated for purposes of forced settlement of claims, was unacceptably long. Total creditor's claim has been constantly increasing during this procedure (interest rate, expenses for procedure, decrease in pledged real estate's value, etc.), without realistic prospects that the protection of the creditor would increase because of this. Also, creditors as key initiators of economic activity in any society expect with reason a faster and more quality protection of their financial assets with which they start up their own activities as well as those of the society. Therefore they request undisturbed disposal of financial assets. Any obstruction in retrieving of such assets is directly targeted against creditors and social interests as a whole.

2. DIRECT EFFECTS OF PROCEDURE'S DURATION THROUGH CASH INDICATORS

a. PRINCIPAL:

1. Principal in total amount (debtor has never paid any amount on behalf of debt service) **1.000.000,00 KM**

b. INTEREST

1. Interest rate calculated by financial court expert on total amount of creditor's claims for period since initiation of procedure until settlement of interest rate: **923.209,10 KM**

c. EXPENSES OF PROCEDURE :

1. Upon court decision, expenses of procedure in total amount are **55.193,00 KM**, listed as follows:
 1. Court fee (for decision on enforcement)... **10.000,00 KM**
 2. Legal representation fees.... **44.893,00 KM**
 3. Other expenses **4.081,00 KM**

- d. **DEPOSITED FUNDS FROM SALE OF REAL ESTATE:** It needs to be stressed that, after successful public sale, money from purchase price of immovable property was paid to court deposit (12.06.2001.), and that the creditor was waiting for collection from purchase and sale price (26.04.2004.) for **over 2 years and 10 months** (funds on Court deposit are not subject to interest rate).

SUMMARY

It can be seen from the given data that there is a direct proportion between the final settlement of creditor from assets collected through enforcement procedure on one hand, and the duration of forced settlement and collection procedure, on the other hand. Namely, under assumption of successful public sale of pledged real estate (property), financial indicators on successful protection of creditor in enforcement procedure are presented in chart. The goal is to show that the main task of enforcement procedure is urgency, first of all (article 5 of LEP), as well as efficiency in providing protection:

| Date | STATUS | Basis for Claim | Amount |
|-------------|---|--|--|
| 02.09.1998. | Debtor default | Principal + interest rate | 1.093.234,38 KM |
| 04.11.1998. | Motion for to initiate enforcement procedure | Principal + interest rate | 1.138.460,20 KM |
| 18.08.2000. | Determined value of lien | Real estate | 2.165.482,00 KM |
| 26.02.2004. | Expert's finding and opinion on level of claim-debt | <ol style="list-style-type: none"> 1. principal 2. interest rate 3. expenses of procedure 4. Sales tax for real estate | - 1.000.000,00 KM - 923.209,10 KM - 81.018,80 KM - 86.580,00 KM |
| 12.06.2001. | Real estate sold for 2/3 of estimated value | | 1.443.700,00 KM |
| 26.04.2004. | Creditor collected total amount of claim during enforcement procedure | | 1.388.507,00 KM |
| 26.02.2004. | Creditor claimed | | 2.090.807,90 KM |

Table clearly shows that the ratio of collected amount compared to the total claim is extremely disproportional, i.e. out of total claims in the amount of 2.090.807,90 KM, the creditor successfully collected only 1.388.507,00 KM from the value of pledged assets appraised on 2.165.482,00 KM. When "time" factor is added to all this information (the procedure took 5 years and 6 months), and the fact that there is a very small number of successful public sales (unofficial information is that less than 10 % of all auctions were successfully bid). The conclusion is that realistic protection of investors-creditors during enforcement procedure is reduced to minimum, especially under the provisions of the new Law because now it is possible to sell collateral for any amount. For the said reason, it can be said that the existing legal framework – Law on Enforcement Procedure, is not an appropriate method of interest-protection for both creditors and debtors because it artificially increases debts and at the same time decreases possibility for collecting funds for creditor.

3. PRIORITIES AND FINAL EFFECTS OF PROCEDURE

Considering the realistic situation of courts in BH, it can be stated that, starting from problems in application of Law on Enforcement, there are two basic groups of courts:

- Category of courts that are overburdened with cases and have huge number of outstanding cases, e.g. Sarajevo, Banja Luka
- Category of courts that don't have a huge number of cases, but judges are not only in charge of enforcement, but other procedures as well; therefore their skills are a key factor for proper application of the Law.

It can be seen from the presented information about course of settlement procedure (chronological and chart review), as well as from information from the field, that application of the Law on Enforcement does not have as result the protection that the Law should provide for claimants. One especially needs to have in mind is that provisions of this Law do not permit any categorization of cases (small amount claims vs. enormously high amounts of claims of certain creditors, or categorization of cases of trusteeship). These issues and problems should be resolved through practice or in some other adequate way.

4. OTHER PROCEDURES INCLUDED IN ENFORCEMENT PROCEDURE

- a. Determining total amount of claims – debts.** It can be stated that almost as a rule, claim of the creditor is higher than the amount for which the pledged property is sold at the auction. Therefore, in all such cases considerable time could be saved if unnecessary procedure to determine claim-debt is escaped; court experts from different fields must be included in this.
- b. Conveyance of sold – pledged property** In enforcement cases where pledged real property of debtor is sold as means of protection for creditor's claim, the constituent part of enforcement procedure is conveyance of immovable property to buyers, which is not directly linked to creditor and the procedure of foreclosure. A lot of time could be saved if conveyance of property to buyers would be set as a separated procedure.
- c. Settlement of creditor from assets acquired from sale of pledged property.** This is a key moment for creditor and should represent finalization of creditor's legal protection. The goal is that the shortest time span should pass from the beginning of court procedure until moment of settlement and it should be predictable for the creditor.
- d. Payment of tax on real estate –** The new Law on Enforcement Procedure (article 85, paragraph 5), related to sale of real estate, prescribes how price is determined and who should pay taxes and fees in relation to sales. This provision can be applied so that it doesn't impact duration of procedure, or rights of creditors to settle their claims.

SUMMARY

It is apparent from the analysis of the case flow in the case of the Law on enforcement procedure via sale of Teppsa Holding-debtor's real estate, that an unacceptably long time period passed. Since the moment the pledged real estate is sold until the moment of collection 2 years and 10 months passed. During this period other procedures like determining total amount of claims-debts, conveyance of sold-pledged property, collecting from assets acquired via pledged property and payment of sales tax for real estate were included in this enforcement procedure. All these procedures are not directly related to the main goal of foreclosure, i.e. protection of creditor-claimant's interest, and as such, should be excluded from foreclosure and be conducted as a separated procedure.

5. COMPARISON OF PROVISIONS OF OLD AND NEW ZIP

a. DIFFERENCES IN PROVISIONS OF OLD AND NEW ZIP

1. Compared to regular legal remedies, provisions of the new Law are mainly identical, but compared to special legal remedies, there are differences;
2. Deadlines for activities are prescribed by Article 15 of the Law, they are new and their goal is to meet urgency principle, but there are no guarantees that application of these provisions is feasible in practice;
3. Cash fines and necessary measures on enforcement prescribed by Article 17 of this Law, regulated issues of client's and participant's discipline in a brand new way. With regular application, the end result of this should be efficiency and urgency of procedure;
4. Article 34 of this Law prescribes that the court cannot stop the enforcement procedure to wait for decision of another institution on previous issue. The said provisions, along with provisions of Article 52 of the new Law put enforcement judges in a completely new and much more responsible position, because their role with application of the said provisions includes decision-making in procedures that are not exclusively enforcement procedures. This means that a much wider scope of knowledge regarding material law should be included, than it was case before;

5. Provisions of Article 37 of the new Law resolve in a completely new way the issue of determining property of judgment debtor, which can significantly contribute to efficiency regarding settlement of judgment creditor;
6. Provisions of article 43 of the new Law prescribe a completely new role of judgment officers in procedure; with a quality education from them, this should contribute to efficiency of procedure;
7. The new Law (article 60) prescribes that only judgment creditor can propose delay of enforcement, which seriously jeopardizes “supreme position of debtor” under the previous law, while protection of judgment creditor is strengthened;
8. Provisions of Chapter X of the new law introduced many changes on enforcement on real estate of judgment debtor (e.g. compulsory determining value of real estate and movable assets after decision becomes enforceable), procedure of enforcement on real estate not registered in land books (Article 113)
9. Among the most important changes in the new Law are those related to change in regime for saleable property (real estate, article 85 and movable property – article 118) from which judgment creditor is settled. The most important change is related to price at which the offered real estate or movable property can be sold at hearing for public sale (price is not limited at last hearing and therefore the item can be sold for any price). Another important change is related to time when the next hearing for public sale can be scheduled after unsuccessful auction (expiration of six-month deadline is not necessary after second unsuccessful sale of real estate). The important change is also related to establishing a list of bidders, which provides that, in the situation when a bidder gives up from purchase, another bidder can purchase the offered collateral.

b. PRACTICE

1. Implementation of the Law on Enforcement procedure does not mean that the new provisions will make significant changes in practice . Namely, the old practice of enforcement judges is not changed by the fact that the new Law has been adopted. The most important issues that occurred so far in implementation of the both old and new Law are as follow:
 1. Large number of cases in certain courts (Sarajevo, Banjaluka);
 2. Insufficient number of judges, legal associates and enforcement officers, as well as inadequate material equipment for implementation of enforcement procedures;

3. Insufficient education of judges, expert associates, enforcement officers and other court staff in regards to implementation of the Law on Enforcement and other laws, especially when it comes to certain specific areas in application of the Law;
4. Insufficient public information about novelties in this area.

CONCLUSIONS

Using the basic information and data from the “TEPPSA HOLDING” successfully closed case, information acquired by comparing provisions of old and new Law, as well as information acquired from courts, these are the most important conclusions and comments:

- The most important factor in efficient protection envisaged by the Law on Enforcement **is the time** necessary to complete enforcement proceeding. It can't still be predicting in advance, nor can it be expressed in actual time. Also, net proceeds still cannot be predicted for certainty.
- Current conditions at the market are to a large extent unstable for marketing credit and other assets, which impacts the sale of collateral. This also impacts the efficiency of judgment creditor's collection which as a result increases price of the capital put to market.
- The quality of implementation of the Law, first of all depends on capability of the enforcement courts to implement enforcements. Objective difficulties in work of courts, judges and other court staff when it comes to implementation of this Law could be partially overcome by education of parties and participants in procedures. The education should include enforcement judges, legal associates, enforcement officers, appraisers, banks' attorneys (all potential creditors). Also, general education of public about basic goals of the new Law would contribute to a higher level of general protection and therefore, higher level of overall legal security.