

## NULLITY OF LOAN AGREEMENTS CONCLUDED WITH FOREIGN LENDERS IN CROATIA

Following the initiative of several consumer organizations, and based on allegations that the constitutional order has been disrupted by the lending operations of unauthorized foreign lenders, the Croatian Parliament unanimously passed the Act on Nullity of Loan Agreements with International Elements Concluded in the Republic of Croatia with Unauthorized Lenders ("Act") which entered into force on 29 July 2017. The Act has already been labelled as controversial for its retroactive effect and Croatia seems to continue down the path started by the 2015 amendments to the Consumer Credit Act forcing a retroactive conversion of CHF denominated loans.

Under the law, all loan agreements concluded on the territory of the Republic of Croatia by unauthorized foreign lenders automatically become null and void as of the date of the agreement, unless they have already been fully performed by the parties. A lender is deemed unauthorized if it is a foreign entity which at the time the loan was granted (i) did not meet the special requirements for the granting of loans in Croatia (e.g. the EU passport), or (ii) did not hold the required banking licenses/approvals granted by Croatian authorities.

Controversially, the Act has a retroactive effect and applies to loan agreements concluded prior to the Act entering into force. The nullity covers also the related agreements, such as security agreements, and is determined in a special court proceeding.

Although the Act is not fully clear on this point, we believe it relates only to loans granted to Croatian counterparties (borrowers, guarantors or security providers), irrespective of whether they are an individual or an entity. It is also unclear how the Act would be applied in cases of several participants with different nationalities.

The only exemptions from application of the Act include loans granted to the following borrowers:

- the Republic of Croatia or its local authorities, including their subsidiaries and other budgetary beneficiaries; and
- large or medium-sized entities.

If the agreement is declared null and void by the court, each party will be obliged to return the benefits received under the loan agreement. If a return of the received benefits is not possible, an appropriate remuneration would be payable by one party to the other. In our view, the Act does not properly address the effects of nullity. It remains unclear how the debtors would repay the principal amounts received and on which terms, especially in cases where the funds have already been utilized (e.g. in real estate projects).

Alongside the sanction of nullity, the Act also introduces a number of other significant novelties, such as:

- effects on enforcement proceedings – all pending and future enforcement proceedings will be suspended during the litigation for determining the nullity of loans and dismissed if the underlying agreement is declared null and void;
- special inequitable rules on jurisdiction – lenders may initiate litigation proceedings in relation to these loans only before the courts of the borrower's residence, while the borrowers may initiate the litigation also before the courts of the lender's residence. It is unclear how these rules would apply in case of multiple borrowers with different nationalities;
- exclusive application of Croatian law – the disputes relating to loan agreements falling under the scope of the Act will be decided with the exclusive application of Croatian law even if the proceedings are initiated before the foreign courts and irrespective of the agreed governing law and rules governing conflict of laws.

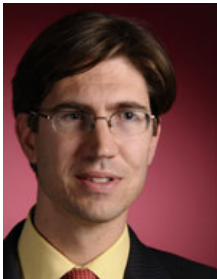
Apart from the ambiguities related to its retroactive effects, there are several other concerns related to the practical application of the Act, especially due to its imprecise wording which causes serious uncertainties in relation to the interpretation of the Act by courts on the scope of its application.

Consequently, according to the publicly available information, certain foreign credit unions have already announced that they will challenge the constitutionality of the Act before the Constitutional Court. The retroactive effect of the Act seems to be the most controversial, as it is allowed only exceptionally, and legal experts seem unconvinced that the legal requirements in this regard have been met. Therefore, further developments in this controversial legal matter are expected shortly.

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