

# *Collateral Conversion in Cross-Border Infrastructure Financing Projects* \_\_\_\_\_

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**D**ue to its geographical position, and also because of the potential integration of the Western Balkans economies into the European single market in the near future, in recent years, important and legally challenging cross-border infrastructure projects have taken and will continue to take place in Albania. These complex projects, such as the construction of railways, gas and oil pipelines and others, are challenging to finance, not to mention the legal challenges they face including the occupation of construction sites and easement. Above all, providing collateral is a crucial factor in increasing the chances of successfully financing, implementing, and completing these projects; particularly where in such projects the assets themselves used as collateral are purchased, created, and built during the implementation phase.

In this article I will address some Albanian legal issues to be considered in the process of legal assessment of the quality and provision of collateral in financing of cross-border infrastructure projects. Specifically, I will address some specific legal issues associated with the conversion of collateral. The need for this analysis arises from the challenges involved in implementing such projects in Albania and also from the need to recognize the compatibility of the legal provisions and their applicability in different jurisdictions. Especially when the same pool of lenders are available for the companies building and developing the relevant infrastructure networks in multiple cross-border states. Below, I have itemized the key issues to consider when seeking to secure such financing.

1. In the various jurisdictions where the cross-border construction projects are being conducted, the treatment of collateral conversion from movable property to immovable property depends on the legal definition of ‘movable property’ and ‘immovable property’ in the relevant jurisdiction. Under Albanian law (according to Article 142 of the Civil Code) land, water springs and springs, trees, buildings,

other land-based floating constructions and everything that is embodied in the land and/or building are defined as ‘immovable property’. All other items, including any other natural energy, are considered ‘movable(s)’.

2. Depending on the relevant definitions, in order to properly address the issues of collateral and its conversion, we should assess whether during the construction of the relevant infrastructure network there will be a transformation of the tangible movable property into immovable property. We must ask whether it is possible for a tangible movable property to be transformed into an immovable property in a specific project. Movable assets, which due to installation, assembly and/or construction work create a permanent connection to the land, may be defined as immovable property at the instant when they acquire the quality of being immovable in relation to the land, i.e. become connected to the land. Thus, for example pipe pieces, which during installation are mounted and/or installed and extend as pipelines above ground and/or underground by their nature are movable items when purchased. However, these movables acquire the quality as immovable property because of the qualities they gain after assembly/installation and inclusion in construction works, these works that permanently connect them to land (Article 142 of the Albanian Civil Code).

3. The legal challenge in the said projects remains with the different types of collateral for different types of properties (i.e. movable property or immovable property). In this respect, the next question to address during the legal due diligence should be: What is the type of available security offered for the concerned movables and for the immovable property?

Under the Albanian legislation, the means to use a movable item as security for relevant financing is achieved through a possessory or non-possessory lien. According to Article 546 of the Civil Code, *“the lien shall be placed on a movable property... A lien is created by placing the property or title in the possession of the creditor or a third party upon agreement between the parties”*. In practice, in Albania, possession is almost never used in project financing, and much less in the case of large investments. It simply isn’t pragmatic in such instances to render the movable property blocked and not put in use. Further, as of 1999, Albanian Law no. 8537/1999 “On Securing Charge” (as amended) provides a comprehensive, efficient and effective means for a non-possessory lien (otherwise referred to as a securing charge). Under a non-possessory lien/securing charge movable property is permitted to be used during the respective construction projects and is perfected upon registration in the Securing Charge Registry (Article 8 of the Securing Charge Law). It is important to note that the Securing Charge Registry is intended to provide lenders/creditors with the means to register a securing charge on the movable tangible and intangible property of the borrowers (Article 1 of the Securing Charge Act). The perfection/registration of collateral is also the means

through which one prioritizes claims over the enforcement of the same movable property used as collateral for several creditors, as well as between complete and incomplete securing charges (Article 11 of the Securing Charge Law).

Movable property serving as collateral for the relevant financing until it is transformed into immovable property, i.e. after it is assembled/installed and merged through construction works in permanent connection with the land and, thus, qualifies as immovable. At which point (under Articles 560 and 562 of the Albanian Civil Code) a contractual mortgage becomes the means of securing the enforcement of the obligation which represents a creditor's real right over the borrower's or a third party's immovable property for the benefit of the creditor, to ensure the fulfillment of a borrower's obligation.

4. For the purposes of these infrastructure projects the ability to obtain security on future immoveable property is imperative. While a mortgage can be created by contract (Article 562 of the Civil Code), a mortgage can then only be registered thus enforceable once the immovable property comes into existence (Article 567). In this regard, it is important to determine the instant in which the asset is legally considered to be immovable property, namely that the 'immovable asset exists'. Further detail, which I shall not enter into in this article, can be found in the Albanian legislation related to real estate development and construction for guidance on the interpretation of when that instance is.

5. Given that we have a transformation of the movable property into immovable property in these infrastructure projects and given that our legislation offers different types of security for both movable property and immovable property, the legal challenge lies in the conversion of that collateral. This conversion should seek not to affect the interest of the lenders, their priorities, but also to achieve continuity of effective collateral without any interruption. So, what is collateral conversion? Above all, it should be made clear that 'conversion' is not the 'renewal' of the collateral. In relation to collateral, the term 'conversion' is used as an analogy because of the possibility of transformation of the asset subject to collateral, but, the effect of conversion of the collateral itself is achieved by 'substituting' the type of collateral. According to Albanian legislation, we are dealing with the substitution of the 'securing charge' with a 'mortgage'. Can this substitution be done safely for the lenders? Collateral conversion through substitution without diligent attention to corresponding legal framework could potentially leave the creditor/lender with no effective collateral at the time of this conversion; the relevant legal risks will not be covered by this article. Only through proper legal due diligence can the security of lenders be maximized in these complex projects. As a relevant and proportionate legal solution, it is important to mention here that the mortgage should not follow the transformation of the movables into immovable property. Creating a contractual mortgage on the immovable property that will exist in the future seems

likely to create legal comfort. The procedure of establishing a contractual mortgage on the future asset, its registration hence perfection on the prospective immovable property must be coordinated and overlapped with the release of the securing charge created and registered/perfected when the borrower becomes the owner of the movable property. For the purpose of the secure substitution of the collateral, it should also be considered that while the registration of the securing charge is done in a single central register which is the Securing Charge Register ('RBS'), the mortgage is registered in the real estate registry offices of the place where the actual immovable property is located. Likewise, the issue of extinguishment of a securing charge and mortgage should be given special attention, as should the moment of the creation of the borrower's title to the immovable property, the validity and effectiveness of securing charge and mortgage, the extension of the mortgage on the relevant servitude (Article 564 of the Civil Code), the order of the mortgage and the application of the principle *pari passu* during the enforcement of the mortgage under Articles 574, 575 and 576 of the Civil Code.

6. The legislation of all countries where the relevant project will be implemented should be considered simultaneously to ensure compatibility and, to the extent possible, uniformity in multi-jurisdictional legal solutions to the success of the project and, in particular, the security of lenders. In such multi-jurisdictional infrastructure projects, the legislations from the relevant jurisdictions must be comparatively examined with respect to the specific legal definitions, types of collateral applicable to movable and immovable property, the legal solutions that these legislations have regarding the creation, validity, registration, and effectiveness of the mortgage on future immovable property, and with respect to all of the items covered above herein. For example, in cross-border projects with Italy and Greece, it has been comparatively assessed that there are many legal issues treated similarly in the Albanian legislation and in their respective legislation, but there are also differences which, for the purposes of securing financing lead to different legal solutions to those provided under Albanian legislation.

Having considered all the above, in conclusion, I would comfortably summarize that the Albanian legislation does indeed provide effective legal opportunities to maximize the security of lenders in the financing of the construction of cross-border infrastructure networks. Of course, the legal challenges to the practical implementation of the above legal remedies are numerous given the complexity and can be open to interpretation given such projects are relatively new in Albania and as such relevant jurisprudence and court practice is virtually non-existent.

*Disclaimer: This article does not represent and should not be considered as legal advice that can only be provided if circumstances and particularities of a specific project are known.*