



Asian Development Bank

Promoting Regional Cooperation in the
Development of Insolvency Reform

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Draft Country Report for Singapore Conference
Intersection of Secured Transactions and
Insolvency Law Regimes – Indonesia, Korea,
Philippines and Thailand

Indonesia

Part One – Creation, Registration and Enforcement of Secured Transactions

Asia Business Corporation (“ABC”) is a company incorporated in your country and conducts its business from there.

First Scenario – the creation/registration of security by ABC over immovable property – land

B Bank is a bank/financier. It agrees to lend/provide a finance facility to ABC and ABC agrees to provide security for the loan/finance over land owned by ABC.



Issues:

1. **Question:** *In your country would the usual nature of the ownership or title of ABC to the land be freehold, leasehold or other (e.g. land use right)?*

Answer: The ownership of land in Indonesia is basically regulated by Law No.5 of 1960 regarding the Basic Agrarian Law ("BAL"). The BAL does not recognise the legal concept of freehold and long lease hold. Rights over land comprise of the following:

- the right of ownership (*hak milik*);
- the right to utilise (*hak guna usaha*);
- the right to build (*hak guna bangunan*);
- the right to use (*hak pakai*);
- the right to rent (*hak sewa*);
- the right to open the land (*hak membuka tanah*); and
- the right to collect of forest product (*hak untuk memungut hasil hutan*).

2. **Question:** *Is it the case the ownership/title of the land of ABC would be registered in a land registration system?*

Answer: Yes, in Indonesia such a right over the land is registered in the Land Registrar Office (*Kantor Pendaftaran Tanah*). See Government Regulation No.24/1997 dated 8 July 1997 regarding the Registration of Land.

3. **Question:** *Would it be easy/difficult for B Bank to determine that ABC was the owner/had title to the land in question? [Please expand by commenting on the reliability and certainty of the registration system and the nature and state of the land registration system – single or multiple registry; centralised/local registry; manual/computer based; reliability of registered information; difficulties of searching etc]*

Answer: It is not difficult to obtain such information, providing that the land has been registered, since the certificate of the land clearly incorporates the name of the owner, the right of the owner over the land and the history of the land. Problems will arise if the land has not been registered, and if the land does not have a certificate. It is also advisable to double check the status of the land with regard to the Land Registrar Office.

4. **Question:** *Does any land ownership/title registration system extend to the registration of the proposed security that ABC will create in favour of B Bank?*

Answer: Yes, for land with the right of ownership, the right to utilise, the right to build and the right to use, the registration of "hak tanggungan" (mortgage, security right or hypothec) shall be made at the Land Registrar Office. Land which has no certificate (including land with the right to rent, right to open land, and the right to collect forest product) can be subject to the "fiduciary register security", and the registration of these types of securities shall be with the Fiduciary Registrar Office.

5. **Question:** *What formal requirements does the law impose upon ABC and B Bank for the creation of a security over land?*

Answer: Articles 10 and 11 of Law No.4/1996 regarding the security right on Land and Land Related Object ("Law No.4/1996") regulate the procedure for the establishment, registration, transfer and waiving of a mortgage.

The establishment of a security right shall be preceded by a pledge to bestow a mortgage as security for the satisfaction of the relevant debt, which shall be expressed in, and form an inseparable part of a debit and credit agreement concerned with other agreements which shall give rise to the debt.

The mortgage shall be commenced by the drawing up of a mortgage deed by a Land Deed Officer in accordance with the prevailing laws.

If the object of a mortgage takes the form of a land title which is derived from the conversion of an old title, and the requirements for registration have not been fulfilled, the mortgage shall be established at the same time as the completion of an application for the registration of the land concerned.

The deed of the establishment of a mortgage should mention the following:

- the name and the identity of the holder (grantee) and the bestowal (grantor) of the mortgage;
- the domicile party. (note that if one of the parties is domiciled outside Indonesia, then a chosen domicile in Indonesia must also be mentioned in his favour, and the Land Deed Officer where the deed on the bestowal of a mortgage is drawn up shall be considered as the chosen domicile if the chosen domicile is not being mentioned in the deed;)

- the value of the security; and
- a description of the object of mortgage.

The deed of a mortgage may incorporate the following terms and conditions:

- unless there is prior written approval from the mortgagee, a pledge which restricts the authority of the mortgagor lease which is the object of the mortgage/"security right", and/or determines or changes the lease period and/or rent received in advance;
- a pledge which restricts the authority of a mortgagor to change the model or the arrangement of the object of a mortgage, unless there is a prior written approval from the mortgagee;
- a pledge covert authority to a mortgagee to manage the object of a mortgage on the basis of a ruling of the chairman of a court of law whose jurisdiction encompasses the site of the object of the mortgage if the debtor defaults with respect to his pledge;
- a pledge conferring authority to a mortgagee to save the object of a mortgage, required for the implementation of the execution or to prevent the waiver or the cancellation of the right which shall become the object of a mortgage because of non-fulfilment of, or a violation against, the law;
- a pledge that the first mortgagee shall receive the right to sell by virtue of his own power the object of a mortgage if the debtor defaults;
- a pledge given to the holder of the first mortgagee to the effect that the object of a mortgage shall not be cleared from the mortgage;
- a pledge that the mortgagor shall not relinquish his right over the object of a mortgage without prior written approval from the mortgagee;
- a pledge that the mortgagor shall receive all or part of the compensation received by the mortgagor for the satisfaction of the claim to his receivables if the mortgagor relinquishes his right over the object or a mortgagor if the said right is revoked in the interest of the public;
- a pledge that the mortgagee shall receive all or part of the insurance money received by the mortgagor for the satisfaction of the claims to his receivables if the object of a mortgage is insured; and
- a pledge that the mortgagor shall vacate the object of a mortgage at the time when the mortgage is executed.

6. Question: *What requirements does the law impose upon ABC and B Bank for the registration of a security over land? In particular, if registration is required, what is the effect of non-registration in relation to:*

(a) the parties, and

(b) third parties?

Answer: The security right over land can only be established with the right of ownership, the right to utilise, the right to build and the right to use. Land which has other rights accorded to it can only be subject to the fiduciary transfer security.

The registration of a security over land can only be established by the land owner or his proxy providing a special power of attorney made in notarial deed form.

The security right may be a first security right, second security right, third security right, etc. The fiduciary transfer security, however, can only be established once. Therefore there will be no second or third fiduciary security.

The establishment of a security right should be in a special form used by the Land Deed Officer ("Pejabat Pembuat Akta Tanah"), or, in the event that the certain plot of land is located in a region which has no Land Deed Officer, by the Head of Sub District ("Camat").

An official fee will be imposed in the establishment of this land security. An additional fee should be paid to the Land Deed Officer or the Head of Sub District, as the case may be, and also for the lawyer handling the case.

7. Question: *Is a building erected upon the land treated as part of the land (so that if ABC takes security over the land it also includes/covers the building) or, if not, what must ABC do to take security over the building?*

Answer: Yes, the building erected upon the land is treated as part of the land. Article 4, paragraph 4 of Law No.4/1996.

8. **Question:** *Is plant and equipment (e.g. heavy plant and equipment that is clearly fixed or attached in a permanent way to the land or buildings) treated as part of the land (so that if ABC takes security over the land it also includes/covers the plant and equipment) or, if not, what must ABC do to take security over the plant and equipment?*

Answer: Yes, any plant and equipment that is clearly fixed or attached in a permanent way to the land or to buildings is treated as part of the land: Article 4 paragraph 4 of the Law No.4/1996. However, if the plant and equipment are easily removed, then such plant and equipment will not be deemed to be part of the land. It will therefore not be subject to security right, but instead to fiduciary transfer security.

Second Scenario – creation/registration of multiple security interests by ABC over the same land

Next, assume that B Bank has taken security over the land of ABC. C Bank, another bank/financier, agrees to make a loan/finance facility available to ABC. ABC agrees to provide security to C Bank over the same land that B Bank has taken security.

Issues:

1. **Question:** *Does the law in any way prevent, prohibit (or does it simply not provide for) multiple secured interests over land?*

Answer: There are two possible ways of dealing with this situation. First, the new bank lender may establish another security right, e.g. a second security right, which will rank lower than the previous security right, i.e. the first security right. Otherwise, the sharing security arrangement is advisable. The problem is that this sharing security agreement can only be concluded with the consent of the holder of the previous security right.

2. **Question:** *Would it be easy/difficult for C Bank to discover that B Bank had an existing security over the land?*

Answer: C Bank could discover that B Bank had an existing security over the land by examining the original certificate of land, and doing a direct assessment of the Land Registrar Office or the Fiduciary Registrar Office, as the case may be.

3. **Question:** *Assuming that C Bank took security over the land, how will priority between B Bank and C Bank be determined?*

Answer: As the security holder, the bank cannot directly take title over land which is subject to any security right, if there is more than one security right. The rank among those security rights will be determined based on the date of the registration of each of the security rights. Those registered earlier will rank higher.

In any event, it is possible that the second rank which took over the land as security established its security earlier than the first rank having the first security right over the same plot of land. However, in practice the establishment and the registration of the second security right can be done only with the knowledge and consent of the first security holder. The fact that the original certificate will normally be in the hands of the first security holder, unless a fake land certificate has been provided to the new bank, means that the establishment of the second security cannot be done by the new bank alone.

4. **Question:** *Assuming that C Bank took security over the land, would the answer to Issue 3 be any different if the security that B Bank took over the land was not registered and C Bank had no knowledge of that security?*

Answer: See answer to Second Scenario, Issue 3.

Third Scenario – enforcement of security over land

Next, assume that ABC has defaulted in respect of the loans/finance facilities made available to it by B Bank and C Bank such that either or both of B Bank and C Bank were able to enforce their respective security over the land.

Issues:

1. **Question:** *What means or process of enforcement is available to either or both of B Bank and C Bank?*

Answer: The bank can sell the plots of land, subject to any security right, through public auction, or by private auction, if the possibility of private auction is clearly stated in the agreement.

2. **Question:** *Assuming that the default of ABC is quite clear, could ABC easily delay, obstruct or prevent any such process of enforcement?*

Answer: No, it cannot.

3. **Question:** In general, what period of time might it take for B Bank or C Bank to complete the process of enforcement?

Answer: The period of time for completion of the process of enforcement is not clearly regulated by Law No.4/1996. Article 20, paragraph 3 of Law No.4/1996 only provides for the protection of parties having interest in the same plots of land. The auction sale can be implemented only after the lapse of one month's written notification made by the security holder, or by the buyer to the parties concerned, and it must be announced in at least two newspapers circulating in the area concerned, and/or in the local mass media, without any parties stating their objection.

4. **Question:** Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law (other than an insolvency law) provide for the payment of 'priority claims' (for example employee, revenue claims owed by ABC) out of the proceeds of the sale of the land and in priority to the secured claims of B Bank and C Bank?

Answer: See answer to Third Scenario, Issue 1.

5. **Question:** Is it possible that a security arising by 'operation of law' might intervene upon the secured property entitlements of B Bank and C Bank to the proceeds of the sale of the land?

Answer: Pursuant to Article 1131 of the ICC, any and all movable and immovable property of a debtor, and present and future debt, shall account for his or her personal obligations. However, if a certain plot of land has been encumbered with a security right or fiduciary transfer security, as the case may be, then Article 1131 of the ICC shall intervene such that the security right or fiduciary transfer security is enforced.

Fourth Scenario – creation/ registration/enforcement of a possessory security by ABC over movable property

Next, assume that D Bank, another bank/financier has agreed to lend/provide a finance facility to ABC. ABC has agreed to give D Bank security for the loan/finance facility by a 'pledge' of certain movable property owned by ABC (e.g. shares). The result is that D Bank will have actual possession of the property.

Issues:

1. **Question:** Does a law govern the creation of the type of security proposed between ABC and D Bank?

Answer: Yes, according to Article 1150 of the ICC, a pledge is a right obtained by the creditor on movable properties.

2. **Question:** What formal requirements does any such law impose upon ABC and D Bank for the creation of this form of security?

Answer: The pledge arrangement must comply with the provisions of Indonesian Company Law, Law No.1/1995 (in particular Articles 53 and 54), Articles 1150-1160 of the ICC, and the Articles of Association of the relevant pledgor company.

3. **Question:** Does a law require that such a security must be registered?

Answer: This matter is regulated only by Article 1153 of the ICC, which states that a pledge will be effective only upon notification of that pledge arrangement to the main obligor. For evidentiary purposes, this pledge of arrangement will be registered at the share register and special share register of the company issuing the pledged shares.

The registration requirement of a pledge of shares was confirmed by the proposed Amendment to the Company Law, Law No.1/1995. In the proposed Article 55 of Law No.1/1995, it is stated that a pledge of shares must be registered at the share register and special share register, provided for in Article 45 of Law No.1/1995.

4. **Question:** If yes, what requirements does the law impose upon ABC and D Bank for the registration of such a security interest? [Please refer back to First Scenario, Issue 6 in advising on this issue].

Answer: See answer to Fourth Scenario, Issue 3.

5. **Question:** Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue].

Answer: The registration done by public companies is more safe and reliable in comparison with that done by private/close companies. The problem with private/close companies is not that not all private companies have produced/printed their share certificates, and not all private/close companies maintain a share register and special share register.

6. **Question:** Assuming that ABC has defaulted in respect of the repayment of the loan/finance facility made available to it from D Bank, what means or process of enforcement is available to D Bank?

Answer: In case of default by a pledgor, the pledgee shall be entitled to exercise his or her right to sell the pledged shares, but is not entitled to directly take over the pledged shares and own them: Article 1154 of the ICC. The pledgee bank may only own the pledged shares if the sale of the pledged shares is done through public auction or private auction (if it is agreeable by parties and clearly stated in the agreement), or authorised by a court decision. Where the shares being pledged are shares of a public company, the sale of such shares can be done through the stock exchange.

7. **Question:** Could ABC easily delay, obstruct or prevent that enforcement process?

Answer: Most likely not.

8. **Question:** In general, what period of time might it take for D Bank to complete the process of enforcement?

Answer: This matter is not regulated by either the ICC or the Company Law. In practice, the period of time that it might take for D Bank to complete the process of enforcement will depend on how this arrangement is reflected in the terms and conditions of the share pledge agreement, on good faith and co-operation from the pledgor's side.

9. **Question:** Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the proceeds of the pledged property and in priority to the secured claim of D Bank?

Answer: Yes. Article 1149 of the ICC which sets out general priorities as follows:

- legal fees exclusively arising from auction and the safeguarding of estates (these costs have priority over pledges, mortgages, security rights and fiduciary transfer security);
- reasonable claims for burial costs;
- claims for medical and hospital expenses in connection with a terminal illness;
- employee wage claims for the current and preceding year;

- claims for the supply of basic necessities to the debtor and his family for the preceding six months;
- claims of boarding schools; and
- claims relating to debts of minors and persons under guardianship, and claims relating to expenses incurred in the maintenance and education of minors.

10. **Question:** Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of D Bank to the pledged property?

Answer: In general, the debtor will be in a position to intervene upon the entitlement of the bank creditor to the pledged property, only if the pledge agreement of the pledged property is deemed as not yet being effective, e.g. the pledge of shares has not been registered at the share register or special share register of the company issuing the shares.

Fifth Scenario – creation/registration of a non-possessory security by ABC over movable property

Next, assume that E Bank, another bank/financier, agrees to lend/provide a finance facility to ABC. ABC agrees to provide E Bank with a non-possessory security over some equipment it owns. The result is that ABC would retain possession of the equipment.

Issues:

1. **Question:** Does the law provide/permit security to be taken over equipment?

Answer: Yes. The security will be in the form of a fiduciary transfer security, as referred to in Law No.42/1999 concerning the Registration of Fiduciary Transfer.

2. **Question:** How would E Bank determine that the equipment is owned by ABC and is not subject to an existing security interest?

Answer: E Bank would determine this by reviewing the underlying agreement of the equipment, e.g. sale of goods, hire purchase agreement, purchase by instalment and other types of agreement, with similar effect.

It is not easy to decide whether or not certain equipment has been subject to any fiduciary transfer security. As a guide, investigations should begin at the Registrar Office of Fiduciary Security at the debtor's domicile, or where the assets are located, and also directly at the site of the assets.

3. **Question:** *What formal requirements does the law impose on ABC and E Bank for the creation of this form of security?*

Answer: Under Article 5 of Law No.42/1999, the formal requirements include the following:

- the identity of the party granting and receiving fiduciary;
- data on the master agreement guaranteed by the fiduciary;
- specification of the property being the object of the fiduciary transfer;
- the value of security; and
- the value of the property that is the object of the fiduciary transfer.

4. **Question:** *What requirements does the law impose upon ABC and E Bank for the registration of this form of security? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: The requirements are clearly stated in Articles 11 to 18 of Law No.42/1999 regarding the Registration of Fiduciary Transfer.

The property with the fiduciary transfer must be registered at the Fiduciary Registrar Office. This provision also applies to the property which is located outside the territory of the Republic of Indonesia. The first Fiduciary Registrar Office was established in Jakarta and covered the entire territory of the Republic of Indonesia.

Pursuant to Article 13, paragraph 1 of Law No.42/1999, the application of Fiduciary Transfer shall be submitted by the parties who received the fiduciary. The application of the Fiduciary Transfer shall comprise of the following:

- the identity of the party granting and receiving fiduciary;
- the date, number of the deed of fiduciary transfer, and name and domicile of the notary drawing up the fiduciary transfer deed;
- data on the master agreement guaranteed by fiduciary;
- description of the property being the object of fiduciary transfer;
- value of security; and
- value of the property that is the object of the fiduciary transfer.

The Fiduciary Registrar Office shall issue and submit to the party receiving fiduciary a fiduciary transfer certificate, which includes records of matters as intended pursuant to Article 13, paragraph 1 of Law No.42/1999.

If a change arises in respect of the matters indicated in the fiduciary transfer certificate, then the party receiving fiduciary transfer shall apply for the registration of such changes in the Fiduciary Registrar Office, and the Fiduciary Registrar Office shall register such changes in the fiduciary registry, and shall issue an amendment statement which shall form an inseparable part of the proof of fiduciary transfer.

All information concerning the property which is the object of fiduciary transfer, and is at the Fiduciary Registrar Office shall be available to the public.

5. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: Yes, the registration is safe and reliable. The Fiduciary Certificate will be issued by the Fiduciary Registration Office: Article 14, paragraph 1 of Law No.42/1999.

6. **Question:** *Assume that the 'equipment' mentioned above comprised motor vehicles. Does that alter any of the advice given above? In particular, apart from any general requirement to register a security over motor vehicles, does such a security have to be also registered at, for example, a motor vehicle registration/licensing office?*

Answer: Fiduciary transfer security can be applied and established over motor vehicles. There are two scenarios to consider, namely where there are motor vehicles still at the warehouse, and where there are motor vehicles which have already been sold under a hire purchase or purchase by instalment arrangement. In the first scenario, the requirement for detailed information for each of the individual motor vehicles may be waived by providing a general description on the number of stock and types of motor vehicles, year of production, and stock of related spare parts. In the second scenario, details of individual motor vehicles must be provided.

Sixth Scenario – creation/registration of multiple non-possessory securities by ABC over the same movable property

Next, assume that E Bank has taken security over the equipment of ABC. F Bank, another bank/financier, agrees to make a loan/finance facility available to ABC. ABC agrees to provide F Bank with a non-possessory security over the same property that has been secured to E Bank.

Issues:

1. **Question:** Does the law prevent, prohibit (or does it simply not provide for) multiple non-possessory secured interests over the same property?

Answer: According to Article 8 of Law No.42/1999, the fiduciary transfer may only be granted to one fiduciary security holder. However, fiduciary security may be granted to more than one party jointly receiving fiduciary, or to the proxies or representatives of such parties receiving fiduciary. This means that granting fiduciary to more than one party jointly receiving fiduciary shall be in the context of the joint receiver being in a joint consortium credit.

2. **Question:** Would it be easy/difficult for F Bank to discover that E Bank had an existing non-possessory security over the equipment?

Answer: It is not easy. As a guide, the party which wants to know whether certain equipment has been subject to any fiduciary transfer security should begin investigations at the Registrar Office of Fiduciary security at the domicile of the debtor, at the domicile of the grantor of fiduciary security, or where the equipment is located.

3. **Question:** Assuming that F Bank took security over the equipment, how will priority between E Bank and F Bank be determined?

Answer: In the case of joint receivers under a certain joint consortium, the priority between E Bank and F Bank will depend upon the terms and conditions agreed on by parties to the joint consortium. Otherwise, they will be determined in accordance with the *pari passu* principle.

4. **Question:** Assuming that F Bank takes security over the equipment, would the answer to Issue 3 be any different if the security that E Bank took over the property was not registered and F Bank had no knowledge of that security?

Answer: See answer to Sixth Scenario, Issue 3.

Seventh Scenario – enforcement of non-possessory security over movable property

Next, assume that ABC has defaulted in respect of the loans/finance facilities made available to it by E Bank and F Bank such that either or both of E Bank and F Bank were able to enforce their respective securities over the equipment.

Issues:

1. **Question:** What means or process of enforcement is available to either or both of E Bank and F Bank?

Answer: Article 29 of Law No.42/1999 regulates the procedure for the execution of the fiduciary transfer, which is as follows:

- the enforcement execution is done only by the party receiving fiduciary;
- the sale of the property being the object of fiduciary transfer to be implemented through public auction, and the collection proceeds to be made available to the party receiving fiduciary security; and
- private sale can only be conducted if it is clearly stated in the terms of agreement concluded between the party granting and the party receiving fiduciary, if the highest possible price favourable for the parties can be reached.

2. **Question:** Could ABC easily delay, obstruct or prevent that process of enforcement?

Answer: In general, the company granting fiduciary security will have no right to intervene, obstruct or prevent the process of enforcement.

3. **Question:** In general, what period of time might it take either E Bank or F Bank to complete the process of enforcement?

Answer: See answer to Third Scenario, Issue 3. The sale of the property which is subject to a fiduciary security will be implemented only one month after written notice is given by the grantee of fiduciary security to the grantor: Article 29, paragraph 2 of Law No.42/1999.

4. **Question:** Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law (other than an insolvency law) provide for the payment of 'priority claims' (e.g. employee/revenue claims owed by ABC) out of the proceeds of the sale of the equipment and in priority to the secured claims of E Bank and F Bank?

Answer: Pursuant to Article 27 of Law No.42/1999, the ranks of priority are as follows:

- the party receiving fiduciary shall have the right of priority over the creditors;
- the priority right shall be the right of the party receiving fiduciary to collect payment of his other account receivable from the

proceeds of the execution of property being the object of the fiduciary transfer; and

- the priority right of the party receiving fiduciary shall not be revoked for reason of bankruptcy and or liquidation of the party granting fiduciary.
5. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlements of E Bank and F Bank to the proceeds of the sale of the equipment?*

Answer: See answer to Fourth Scenario, Issue 10.

Eighth Scenario – creation/registration of a non-possessory security by ABC over 'inventory', possibly including inventory acquired in the future

Next, assume that G Bank, another bank/financier, has agreed to lend/provide a finance facility to ABC. ABC has agreed to give G Bank a non-possessory security for the loan/finance facility over its inventory of raw materials and finished goods, an inventory that will change from time to time as finished goods are manufactured and sold and new raw materials are supplied.

Issues:

1. **Question:** *Does the law provide for/permit security to be taken over inventory?*

Answer: The fiduciary law, Law No.42/1999, provides that the object of the fiduciary security can be any property that is capable of being owned and disposed of. It can be tangible or intangible property, registered or unregistered property, and movable or immovable property, provided that such property does not qualify for encumbrance with a security right ("Hak Tanggungan"). This is regulated by Law No.4/1996, and by a hypothec as provided in Article 314 of the ICC, and Article 1162 of the ICC. Based on this definition, inventory is included within the meaning of property, as defined by Law No.4/1999.

2. **Question:** *What formal requirements does the law impose upon ABC and G Bank for the creation of this form of security?*

Answer: See answer to Fifth Scenario, Issue 3.

3. **Question:** *What requirements does the law impose upon ABC and G Bank for the registration of a security over inventory? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: See answer to Fifth Scenario, Issue 4.

4. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: Yes, it is safe and reliable.

5. **Question:** *Is it possible for ABC and G Bank to create the security in such a way that it will apply both to raw materials and finished goods?*

Answer: Yes, it is possible. See answer to Eighth Scenario, Issue 1.

6. **Question:** *Is it possible for ABC and G Bank to create the security in such a way that it will apply to a constantly changing inventory of raw materials and finished goods (i.e. a security over after acquired/future property)?*

Answer: Pursuant to Article 9, paragraph 1 of Law No.42/1999, in addition to property that is already owned at the date a fiduciary security is granted, the property that will be owned in the future can also be encumbered with a fiduciary security. In this regard, it is not necessary to conclude a new and separate fiduciary security agreement, since title to the said property has already been transferred in anticipation. The possibility of encumbering future property with fiduciary securities will facilitate the financing of stock purchase of raw materials and ancillary materials.

Ninth Scenario – enforcement of a non-possessory security over inventory

Next, assume that ABC has defaulted in respect of the loan/finance facility made available to it by G Bank, such that H Bank is entitled to enforce its security over the inventory.

1. **Question:** *What means or process of enforcement is available to G Bank?*

Answer: See below where the answers for Ninth Scenario, Issues 1 to 6 are combined.

2. **Question:** *Can such process of enforcement be easily delayed/obstructed/prevented by ABC?*

Answer: See below where the answers for Ninth Scenario, Issues 1 to 6 are combined.

3. **Question:** *In general, what period of time might it take G Bank to complete the process of enforcement?*

Answer: See below where the answers for Ninth Scenario, Issues 1 to 6 are combined.

4. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the proceeds of the sale of the inventory and in priority to the secured claim of G Bank?*

Answer: See below where the answers for Ninth Scenario, Issues 1 to 6 are combined.

5. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of G Bank to the proceeds of the sale of the inventory?*

Answer: See below where the answers for Ninth Scenario, Issues 1 to 6 are combined.

6. **Question:** *If JS, a supplier, supplied raw materials to ABC under a 'retention of title' contract (such that JS was entitled to claim ownership of or a security over the raw materials until ABC had paid for them in full), what would be the position between G Bank and JS regarding entitlement/priority to those raw materials? [Note: to avoid unnecessary complication, assume that the raw materials as supplied by JS to ABC continue to exist in their 'raw' state and that they have not been incorporated into finished goods]*

Answer: Ninth Scenario, Issues 1 to 6 combined – see the answers provided for the Eighth Scenario. They shall mutatis mutandis apply herein.

Tenth Scenario – creation/ registration/enforcement of a security by ABC over 'receivables' (book debts)

Next, assume that H Bank, another bank/financier, has agreed to lend/provide a finance facility to ABC. ABC has agreed to give H Bank security for the loan/finance facility over receivables (book debts) owed to ABC by its trade debtors.

Issues:

1. **Question:** *Is the creation of such a security possible? [Note: If such a commercial arrangement would not be regarded as a security but rather as a factoring/absolute assignment/transfer of ownership arrangement, please state so and take that into account in addressing the following issues]*

Answer: As described above, the coverage definition of property under the Fiduciary Law of 1999 is very wide. It can include tangible and intangible, registered and unregistered property, movable and immovable property, property that has already been obtained, and property that will be obtained in the future. As a result, receivables are included in the definition of property, and can therefore be subject to fiduciary security.

2. **Question:** *What formal requirements does the law impose on ABC and H Bank for the creation of a security over receivables?*

Answer: See answer to Eighth Scenario, Issue 2.

3. **Question:** *What requirements does the law impose on ABC and H Bank for the registration of a security over receivables? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: See answer to Eighth Scenario, Issue 3.

4. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: See answer to Eighth Scenario, Issue 4.

5. **Question:** *Is it possible for ABC and H Bank to create the security in such a way that it will apply to and be valid over a constantly changing 'stock' of receivables?*

Answer: It is regulated by Articles 29 to 34 of Law No. 42/1999.

6. **Question:** Assuming that ABC has defaulted in repayment of the loan/finance facility made available to it by H Bank, such that H Bank is entitled to enforce its security over the receivables, what means or process of enforcement is available to H Bank?

Answer: In the event of default by the debtor or the party granting fiduciary, the execution of property being the object of fiduciary transfer may be carried out in the following manner:

- enforcement of execution title by the party receiving fiduciary;
- sale of the property being the object of fiduciary transfer at the sole discretion of the party receiving fiduciary through public auction and collecting settlement of account receivables from the proceeds of sale; and
- private sale based on an agreement between the party granting and the party receiving fiduciary, if the highest possible price favourable in the party concerned can be reached.

The party granting fiduciary shall be obliged to submit the property that is the object of fiduciary transfer in the context of execution of the fiduciary transfer concerned.

In the event that the property being the object of fiduciary transfer consists of commodities or securities tradeable on the market or the stock exchange, the sale may be conducted at the aforementioned place in accordance with the prevailing laws and regulations.

Article 34 of Law No.42/1999 provides that in the event that execution exceeds the secured amount, the party receiving fiduciary shall be obligated to return the excessive amount to the party granting fiduciary. In the event that the execution proceeds are not sufficient to cover the settlement of the debt, the debtor shall remain liable for the outstanding debt.

7. **Question:** Can ABC easily delay, obstructed or prevent such enforcement process?

Answer: No, they do not have any legal right to do so.

8. **Question:** In general, what period of time might it take H Bank to complete the process of enforcement?

Answer: See answer to Seventh Scenario, Issue 3.

9. **Question:** Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the proceeds of the collection of the receivables ahead of the claim of H Bank?

Answer: See answer to Fourth Scenario, Issue 9, and Seventh Scenario, Issue 4.

10. **Question:** Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of H Bank to the proceeds of the collection of the receivables?

Answer: See answer to Third Scenario, Issue 5, Fourth Scenario, Issue 10 and Seventh Scenario, Issue 5.

Eleventh Scenario – supply of goods to ABC by a supplier on a 'retention of title' contract

Next, assume that JS, a supplier of goods, has agreed to supply goods to ABC on credit and on terms that, although possession of the goods is given to ABC, title in the goods remains with JS until payment for the goods has been made in full.

Issues:

1. **Question:** Would such a commercial arrangement be treated as a security?

Answer: Article 1, paragraph 2 of Law No.42/1999 states that a fiduciary security constitutes a collateral for the repayment of debt. The types of debt that can be secured by a fiduciary security is described in Article 1, paragraph 7 and Article 7 of Law No.42/1999. It is clear that the types of debt that can be secured by a fiduciary security are not limited to the types of debt referred to in those two articles. A debt can be the result of an obligation arising out of contract.

Article 1234 of the ICC consists of contractual obligations to give something, to do something, or an obligation to refrain from doing something. An obligation on the part of a supplier to deliver the goods sold to a purchaser therefore falls under the definition of debt, and can therefore be secured by a fiduciary security.

2. **Question:** If yes, what formal requirements does the law impose on ABC and JS for the creation of such a security?

Answer: See answer to Eighth Scenario, Issue 2 and Tenth Scenario, Issue 2.

3. **Question:** *What requirements does the law impose on ABC and JS for the registration of such a security? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: See answer to Eighth Scenario, Issue 3 and Tenth Scenario, Issue 3.

4. **Question:** *How does the law resolve a situation in which a supplier of goods claims retention of title in those goods (whether by way of security or otherwise) and another person claims a non-possessory security over inventory? [Note: Please refer back to Ninth Scenario, Issue 6]*

Answer: A fiduciary security can only be established once over certain property. If the fiduciary security has become effective due to its registration at the Registrar Office of Fiduciary Security, then the fiduciary holder is the party having privilege rights on the property being the subject of a fiduciary security.

5. **Question:** *Assuming that ABC defaults in payment of the price payable for the goods supplied by JS, what process of enforcement is available to JS?*

Answer: See answer to Tenth Scenario, Issue 6.

6. **Question:** *In general, what period of time might it take JS to complete the process of enforcement?*

Answer: See answer to Seventh Scenario, Issue 3.

7. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the value/proceeds of the goods ahead of the claim of JS?*

Answer: See answer to Third Scenario, Issue 4, Fourth Scenario, Issue 9 and Seventh Scenario, Issue 4.

8. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of JS to the goods?*

Answer: See answer to Third Scenario, Issue 5, Fourth Scenario, Issue 10, and Seventh Scenario, Issue 5.

Twelfth Scenario – creation/registration of a lease to ABC of movable property

Next, assume that ABC wants to acquire equipment for use in its business operations but does not want to purchase the equipment. KL, a lease/finance company, has agreed to purchase the equipment and then to lease the equipment to KL for a term of years. A provision of the agreement provides that ABC may become the owner of the equipment upon the payment of the full lease and other charges.

Issues:

1. **Question:** *Would such a commercial arrangement be treated as a security?*

Answer: The essence of a fiduciary security is that there is a transfer of right of ownership. Such transfer of the right of ownership, however, is done in a fiduciary transfer with the express agreement that the property of the title which has been transferred to the fiduciary security grantee will remain in the possession of the fiduciary security grantor, in the interest of, and on behalf of, the fiduciary security grantee. The commercial arrangement referred to in the twelfth scenario would not be covered and treated as a fiduciary security.

2. **Question:** *If yes, what formal requirements does the law impose on ABC and KL for the creation of such a security?*

Answer: Given that the commercial arrangement is not a fiduciary security, Issues 2 to 7 are no longer relevant.

3. **Question:** *What requirements does the law impose on ABC and KL for the registration of such a security? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: N/A

4. **Question:** *Assuming that ABC defaults in payment of the lease charges, what process of enforcement is available to KL?*

Answer: N/A

5. **Question:** *In general, what period of time might it take KL to complete the process of enforcement?*

Answer: N/A

6. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) ahead of the claim of KL to the equipment?*

Answer: N/A

7. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of KL to the equipment?*

Answer: N/A

Thirteenth Scenario – creation/registration of a security by ABC over 'foreign' property

Next, assume that ABC owns movable property situated in a foreign jurisdiction and agrees to give security over that property to L Bank, a bank/financier that carries on business in the place in which ABC is incorporated.

Issues:

1. **Question:** *Does a law of the place of incorporation of ABC in any way intervene upon or seek to regulate the creation of such security?*

Answer: The answer will depend on the kind of movable goods that are being referred to, the security that can be placed on the movable goods, the location of such goods, whether the goods are owned by a public or private company, how the law of the countries

governing such goods will regulate the matter, and whether there is any bilateral or multi lateral agreement which relates to the issues concluded upon by Indonesia.

2. **Question:** *Does a law of the place of incorporation of ABC impose any requirement for the registration of such a security in the place of incorporation of ABC?*

Answer: It will also depend on the type of movable property. A satellite owned by an Indonesian company in its business activities is not governed by the laws and regulations of Indonesia alone.

3. **Question:** *Does a law of the place of incorporation of ABC seek to regulate the process of enforcement that is available to L Bank?*

Answer: A sufficient response to this question requires the provision of more detailed information.

Part Two – Commencement/Opening of Insolvency Proceedings and the Effect on Secured Transactions

A. Issues relating to information about secured property and security holders

1. **Question:** *Would it be easy/difficult to determine, by reference to a public register, the security interests that had been created by ABC, the property that was the subject of those security interests and the identity of the holders of those security interests?*

Answer: A distinction must be made between security interests established prior to the issuance of the Security Right Law, Law No.4/1996, and the Fiduciary Transfer Security Law, Law No.42/1999; and security interests established after the enactment of those new laws on security.

Prior to the enactment of Law No.4/1996, land with the right of ownership, the right to utilise and the right to build were subject to hypothec. This hypothec was registered at the National Land Agency ("Badan Pertanahan Nasional" – "BPN"). Other types of land title, including land

with the right to use, the right to rent and the right to cultivate forest products, cannot be hypothecated. They may be subject to fiduciary transfer of ownership for security purposes. It is difficult to determine this type of fiduciary security, as it is not required to be registered, and is not available at the public registrar. After the issuance of Law No.4/1996, hypothec on land is to be replaced by a security right ("Hak Tanggungan"). This right can be established on land with the right of ownership, the right to utilise, the right to build and the right to use. Hak Tanggungan is registered at BPN, and is available to public security on land not covered by Hak Tanggungan that is not registered, and as such is difficult to determine.

After the issuance of Law No.42/1999, property which is owned by the debtor, including land not covered by Hak Tanggungan, can be subject to fiduciary security. Unlike the old fiduciary security, their fiduciary security is registered at the Fiduciary Registrar Office, and is available to the public. The old fiduciary security is not required to be registered and is not available at the public registrar, and is therefore difficult to determine.

Pledges are only required to be registered at the Share Registrar and Special Share Registrar of the company issuing such shares. Accordingly, the data and information are not available at the public registrar, and become difficult to determine.

2. Question: *Would it be easy/difficult to determine whether the security/property interests involving ABC were in the nature of security interests or non-security interests?*

Answer: We believe that it is not difficult to determine whether a certain property is covered by the terms of a security interest or non security interest.

3. Question: *In cases where ABC has created multiple security interests in respect of the same property, would it be easy/difficult to determine the priority between the competing security holders?*

Answer: Unless the transactions involve fake land certificates, it is not difficult to determine the ranks of a number of Hak Tanggungan that may be placed on the same plot of land. This is because all those other subsequent Hak Tanggungan must be consented to by the previous holder of Hak Tanggungan, and also registered at the BPN.

B. Issues relating to validity of secured property interests

1. Question: *Does the Insolvency Law provide for the possible invalidity or avoidance of any of the security interests created by ABC as a result of some imperfection in the creation of security interest (e.g. for failure to observe the formalities imposed by the law for the creation of a security interest or failure to observe the requirements of the law relating to registration)?*

Answer: The Bankruptcy Law does not regulate this matter.

2. Question: *Does the insolvency law provide for the possible invalidity or avoidance of any of the security interests created by ABC (despite that a security interest may have been created and perfected in accordance with other relevant law) by the application of provisions relating to creditor preferment, transactions at an undervalue or fraudulent transactions?*

Answer: It is clearly stated in Article 41 to Article 42 of Law No.4/1998, that:

In the interest of the bankruptcy estate, annulment may be requested of all legal acts of a debtor who has been declared bankrupt, which were performed one year before the declaration of bankruptcy was rendered; and

Annulment may only be effected if it can be proven that at the time of the performance of such acts the debtor and the party involved in the transaction knew, or should have known that the said legal act would result in damage to creditors.

C. Issues relating to interference with substantive secured property rights

1. Question: *In a case of insolvency, how is 'secured property' (or other 'proprietary' interests in property) treated in relation to the estate of the debtor (i.e. is the property included in the estate of the debtor or excluded from the estate) and how are the claims of the secured creditors treated?*

Answer: In general, creditors will rank *pari passu*. They therefore have equal rights to sale proceeds of the bankrupt estate in property. However, pursuant to Article 56 of Law No.4/1998, any creditor holding a hypothec, a pledge or other security right in rem may enforce their rights as if there were no bankruptcy.

It is further stated in Article 56 that the enforcement right of such creditors shall be stayed for a time period of at most 90 days. The enforcement of secured creditors and rights (referred to in Article 56 of Law No.4/1998) within the said 90 days can only be implemented with the approval of the receiver or supervisory judge.

2. **Question:** *If the actual or anticipated proceeds or value from the sale/foreclosure of the secured property is less than the amount of the debt claim of the secured creditor, can the secured creditor claim the balance in the insolvency proceedings as an unsecured claim?*

Answer: The distribution of the sale proceeds among the unsecured creditors will depend on the decision of the unsecured creditors. Secured creditors shall have no right to cast votes at that meeting, and as such, decisions taken by unsecured creditors in most cases will not have regard to the position of the secured creditor, and will therefore not favour the secured creditors.

3. **Question:** *Other than as mentioned in B1 & 2 above, does the insolvency law in any way provide for the invalidity/non-recognition of any of the secured property interests created by ABC despite that such interest has been validly created and perfected under the relevant secured transactions law?*

Answer: See answer, to B1 and B2.

D. Issues relating to stay/suspension of enforcement powers in relation to secured property interests

1. **Question:** *Does the insolvency law provide for any type of stay/suspension upon the enforcement rights of any of the secured creditors of ABC?*

Answer: Yes.

2. **Question:** *If so, at what point in time would such stay/suspension operate?*

Answer: Pursuant to Article 56A of Law No.4/1998, the stay/suspension would operate for 90 days, counted from the date the bankruptcy decision is rendered.

3. **Question:** *Does such stay/suspension operate 'automatically' (e.g. through force of a law in consequence of some triggering event such as the commencement/opening of insolvency proceedings) or may it be only imposed by a court order?*

Answer: The stay/ suspension operates automatically.

4. **Question:** *If such stay/suspension does not operate automatically or until a court order has been made, does the insolvency law provide for the possibility of an 'interim' or 'temporary' stay/suspension?*

Answer: Since the Bankruptcy Law applies an automatic stay/suspension of enforcement rights, no interim suspension of enforcement is regulated.

5. **Question:** *If some of the transactions referred to in Part One of the case study are not regarded as secured property interests (but rather as proprietary/ownership rights), does any stay/suspension of enforcement rights extend to and apply to those transactions?*

Answer: The suspension of enforcement rights applies only to the secured creditors, who shall have the right to enforce their rights as if there were no bankruptcy. See Article 56 of Law No.4/ 1998.

6. **Question:** *Does the stay/suspension apply even though a security holder has commenced/almost completed the enforcement process?*

Answer: Generally yes, but exemption is possible if it is approved by a Receiver or the Supervisory Judge.

E. Issues relating to liquidation

Assume that ABC is to be liquidated under the Insolvency Law:

1. **Question:** *Does any stay/suspension of the enforcement powers of a secured creditor apply or continue to apply?*

Answer: Pursuant to Article 57 of Law No.4/1998, a secured creditor must, at the latest, enforce its right within 2 months of the commencement of the state of insolvency referred to in Article 168 of Law No.4/1998.

2. **Question:** For what period of time would such stay/suspension operate?

Answer: See answer to E1. After the expiry of such a period, the receiver shall claim the assets which were subject to security rights to be sold in accordance with the normal proceedings without prejudice to the secured creditors right to receive proceeds from the sale of such assets.

3. **Question:** Does the law provide that an affected security holder may apply for such stay to be lifted?

Answer: The Bankruptcy Law is silent on this issue.

F. Issues relating to priority claims

1. **Question:** Does the insolvency law provide for 'priority claims' to be paid ahead of the claims of a security holder?

Answer: The Bankruptcy Law does not specifically regulate this matter. However, if we look at the provisions of Articles 1138 to Article 1139, and Article 1149 of the ICC, the rank of priority claims to be paid to the secured creditors is below the priority payment to the court and auction costs and expenses, and taxes.

2. **Question:** If so, what are these priority claims and is there any conflict between them and any priority claims as mentioned in Part One of the case study (for example in scenarios 3, 4, 7, 9 & 10)?

Answer: In summary, the assets of the bankrupt estate will be applied to creditors' claims in the following order of priority:

- court and auction costs and expenses;
- taxes;
- claims of secured creditors;
- privileged creditors; and
- unsecured creditors.

G. Issues relating to enforcement

1. **Question:** Does the insolvency law provide for the enforcement of secured property interests or does it leave this to be determined by other law?

Answer: The Indonesian Bankruptcy Law contains certain specific rules relating to the enforcement of secured property, e.g. Articles 56, 57 and 58 of the Law No.4/1998. For other related matters not specifically regulated in the Bankruptcy Law, the Indonesian Civil Code and the Indonesian Commercial Law shall apply.

2. **Question:** Does the insolvency law provide for the enforcement/realisation of secured property interests through the insolvency representative (office holder)?

Answer: The Indonesian Bankruptcy Law also regulates matters relating to the enforcement of secured property by insolvency representatives. Articles 63-66 are concerned with the Supervisory Judge, Articles 67-70B are concerned with the Receiver, and Articles 71-76, are concerned with the Creditors' Committee.

H. Issues relating to corporate rescue processes [rehabilitation; reorganisation; restructuring]

Assume that ABC is under the 'rescue' process of the insolvency law, but has not yet reached the point of approval of a plan of reorganisation

1. **Question:** Does any stay/suspension of the enforcement powers of secured creditor apply or continue to apply?

Answer: Any petition of suspension of payment of debt shall be submitted by the debtor to the competent Commercial Court. The petition shall be accompanied by a composition plan which includes an offer of payment of all or part of the debts to the unsecured creditors: Article 213, paragraph 1 of Law No.4/1998. Based on the submission of this by the debtor, the court shall immediately grant a provisional suspension of obligation for payment of debt.

2. **Question:** For what period of time would such stay/suspension operate?

Answer: The stay/suspension would operate for 45 days from the issuance of the suspension of payment of debt by the Commercial Court: Article 214, paragraph 2 of Law No.4/1998.

3. **Question:** Does the law provide for the length of the stay to be extended?

Answer: Immediately after the issuance of the provisional suspension of payment debt by the court, the court shall summon the debtor and the creditor to appear at the court session at the latest 45 days from the date on which provisional suspension of debt is granted: Article 214, paragraph 3 of Law No.4/1998.

If, after the hearing, a permanent suspension of payment is approved, the said suspension and the extension thereof may not exceed 270 days from the granting date of the provisional suspension of payment: Article 217, paragraph 4 of Law No.4/1998.

4. **Question:** Does the law provide that an affected security holder may apply for such stay to be lifted?

Answer: Prior to the granting of a provisional payment obligation of debt, there is no possible way for creditors to lift such a suspension of payment. The chance is available at the hearing at the court discussing possible permanent suspension to the petition.

5. **Question:** If so, what conditions must be established before such stay may be lifted?

Answer: There are no specific provisions regulating the conditions to enable the provisional suspension of payment obligations to be lifted. However, Article 217A of the Law No.4/1998 stipulates that if the period of time for suspension of payment expires because the unsecured creditors do not approve the granting of a permanent suspension of payment of debt, or the permanent suspension or the extension thereof has been granted, but no agreement can be reached on the composition plan up to the time limit stated in the Bankruptcy Law, i.e. 270 days from the granting of the provisional decision on the suspension of payment debt obligation, then the administrator shall, on the day of expiration, notify the court, and the court shall declare the debtor bankrupt by the next day at the latest.

6. **Question:** Does the law provide that secured property may be used during the period of stay?

Answer: Pursuant to Article 226(1) of Law No.4/1998, the debtor may not, without the administrator's approval, take actions for the management or the transfer of rights to any part of his other assets during the suspension of payment obligation of debt.

7. **Question:** Does this 'use' extend to the sale or other disposal of the secured property?

Answer: See answer to H6.

8. **Question:** What conditions must be fulfilled before secured property may be sold?

Answer: The obligations of the debtor arising from acts performed without obtaining authorisation from the administrator may only be imposed upon the estate of the debtor in so far as the act benefits the debtor: Article 226, paragraph 2 of Law No.4/1998.

9. **Question:** If a plan is proposed in respect of ABC, what voting rights and powers do the security holders mentioned in Part One of the case study have?

Answer: As stated in Article 217, paragraph 5 of Law No.4/1998, a permanent suspension of payment obligation shall be granted by the court if it is approved by more than half of the unsecured creditors whose rights are acknowledged in attendance, and representing at least two thirds of all claims which are acknowledged in attendance of the session. Any dispute arising between the unsecured creditors and the administrator regarding the voting rights of the said unsecured creditors shall be resolved by the supervisory judge.

10. **Question:** Does the law provide that any of the secured creditors mentioned in Part One of the case study form a separate class of creditors for voting and plan approval matters?

Answer: The secured creditors without the right to cast votes at the meeting form a separate class of creditors for voting and plan approval matters, unless the said secured creditors have waived their rights as secured creditors, and become unsecured creditors.

11. **Question:** If a majority vote in favour does this bind all security holders?

Answer: See answer to H9.

I. Issues relating to 'new money' financing of an insolvent corporation

1. **Question:** Does the law provide for the possibility of raising additional working capital to enable ABC to continue in business?

Answer: Pursuant to Article 226, paragraphs 1, 3 and 4 of Law No.4/1998, the debtor may obtain loans from third parties in the framework of increasing the value of the estate debtor upon authorisation being granted by the administrator.

2. **Question:** If so, does this permit the repayment of such 'new credit' to rank as a 'super priority', ahead of the security holders mentioned in Part One of the case study?

Answer: Super priority shall not rank ahead of the security holders rights as secured creditors.

3. **Question:** *Is the raising of such 'new credit' subject to the consent of secured creditors, approval of creditors generally or an order of the court?*

Answer: Approval from secured creditors shall mean approval from secured creditors generally.

Part Three

A. General issues relating to of security interests – rating, interest rate factor, barriers to secured lending, intersection problem areas.

1. **Question:** *In terms of quality and quantity, what rating would lenders apply between the forms of security interest examined in Part One (i.e. which are the most popular and why)?*

Answer: No general rating shall be applied in all types and circumstances of transactions. The rating which is applied will depend on the parties involved, good faith, the reputation of the parties, the nature of transactions, the nature of the businesses involved, prospect of business, and the role and functions expected from the collateral security.

2. **Question:** *If it is possible, please provide average term of loan and interest rates charged by lenders to corporate borrowers for loans secured by:*

- *Mortgage over land;*
- *Pledge over movable property;*
- *Security over inventory;*
- *Security over receivables;*
- *Security over equipment; and*
- *Security over motor vehicles.*

Answer: Though it is not easy to determine, the rank will generally be as follows:

- security right;
- hypothec/mortgage;
- fiduciary security;
- pledge; and
- other types of security.

3. **Question:** *Having regard to the issues raised in Parts One and Two, what would the banking/finance sector consider are the main barriers/drawbacks to secured lending?*

Answer: The banking/ finance sector would consider the main barriers/drawbacks to secured lending to be:

- Fake certificate, which cause the establishment of security rights without the knowledge of the previous securities rights holder;
- The bad faith of the debtor to establish more than one fiduciary security;
- The absence of a public registrar for pledge of shares;
- The lack of clear regulations on the possible establishment of fiduciary security by a foreign grantor;
- Corruption issues;
- Weaknesses in law enforcement which create legal uncertainty; and
- The absence of regulations on cross-border secured transactions.

4. **Question:** *What areas of the 'intersection' cause the most problems or are most problematic in the banking/finance sector?*

Answer: See A3.

5. **Question:** *What areas are considered to be the main areas of target for reform or improvement?*

Answer: The main areas for improvement are:

- The quantity and quality of human resources involved;
- Increasing socialisation of laws and regulations (especially new laws and regulations);
- Law enforcement and legal certainty;
- Co-ordination/co-operation between the technical department and/government agencies;

- The degree of wealthy civil servants; and
- Minimising corruption.

6. **Question:** *Do any of the issues mentioned in Parts One or Two cause problems in relation to informal workout processes?*

Answer: All of the issues mentioned in A5 are closely related to the problems faced by the informal workout process.

B. Issues relating to internal corporate record of creation of secured property interests

1. **Question:** *Regardless of the requirements of any law to register secured property interests in a public register, does any law require that ABC must maintain an internal register or book of every security interest created by ABC and, if so, is such register or book available for inspection by a prospective creditor?*

Answer: The Indonesian Company Law, Law No.1/1995; the Capital Market Law, Law No.8/1995; and their proposed amendments; and the Foundation Law, Law No.16/2001, indirectly require the company/foundation to maintain an internal register or book of security interest, by requesting the company to provide Financial Reports to be submitted, discussed and possibly approved at a shareholders meeting.

The internal registration of pledge shares has been imposed by the Indonesian Civil Law, the Company Law and the Capital Market Law.

C. Issues concerning law reform and development

1. **Question:** *In relation to the areas covered in the case study, are there any proposed reforms/developments to the laws in your country that might affect any of the issues raised in Parts One and Two of the case study?*

Answer: The proposed reforms/developments that might affect issues raised in Parts One and Two of the case study are:

- Amendment to Company Law, Law No.1/1995;
- Amendment to Capital Market Law, Law No.8/1998;
- Amendment to Law on Foundation, Law No. 16/2001;
- Amendment to the Bankruptcy Law, Law No.4/1998;

- New draft Law on Financial Services Authority.

D. Issues concerning domestic and international investment and finance

1. **Question:** *In relation to the remedy of 'foreclosure', are there any restrictions that intrude upon the power of a foreign lender to take possession, sell, become the 'owner' of or otherwise dispose of secured property?*

Answer: There are restrictions in the case of land. The eligibility of foreigners is limited to being the owner of land, with the right to use and the right to rent, and does not extend to land with the right of ownership, the right to utilise and the right to build.

2. **Question:** *Is it considered that domestic/foreign lending might be increased by reform/improvements to the secured lending and/or insolvency law processes?*

Answer: Most likely yes.

E. Issues concerning cross-border implications

1. **Question:** *Assume that ABC is either:*
 (a) *a foreign company operating in your jurisdiction; or*
 (b) *a wholly owned subsidiary (and incorporated and operating in your jurisdiction) of a foreign company; and*

assume further that insolvency proceedings are commenced/opened in respect of ABC or the parent of ABC in its place of incorporation (a foreign jurisdiction) and the foreign insolvency representative of ABC wishes to prevent any enforcement or recovery action by the secured creditors or property owners as mentioned in Part One of the case study.

In your jurisdiction, how might the foreign insolvency representative seek protection from such enforcement action?

Answer: Indonesian Bankruptcy Law contains no provisions regulating matters related to cross-border insolvency. However, we believe that a suspension of payment of debt obligation can be filed by a wholly owned company established in Indonesia, if such a company is the debtor company, and not by the parent company as a shareholder in the wholly owned company subsidiary.



Asian Development Bank

Promoting Regional Cooperation in the
Development of Insolvency Reform

RETA 5975

Draft Country Report for Singapore Conference
Intersection of Secured Transactions and
Insolvency Law Regimes

Korea

Part One

Creation, Registration and Enforcement of Secured Transactions

Asia Business Corporation ("ABC") is a company incorporated in your country and conducts its business from there.

First Scenario – the creation/registration of security by ABC over immovable property – land

B Bank is a bank/financier. It agrees to lend/provide a finance facility to ABC and ABC agrees to provide security for the loan/finance over land owned by ABC.



Issues:

1. **Question:** *In your country would the usual nature of the ownership or title of ABC to the land be freehold, leasehold or other (e.g. land use right)?*

Answer: The ownership of ABC to the land would be freehold, unless subject to any other restrictions.

2. **Question:** *Is it the case the ownership/title of the land of ABC would be registered in a land registration system?*

Answer: It is necessary, rather than required by law, to register the ownership of the land so that one can assert its ownership against a third party.

3. **Question:** *Would it be easy/difficult for B Bank to determine that ABC was the owner/had title to the land in question? [Please expand by commenting on the reliability and certainty of the registration system and the nature and state of the land registration system – single or multiple registry; centralised/local registry; manual/computer based; reliability of registered information; difficulties of searching etc]*

Answer: Korea has a computerised system of immovable property registration in place. Each article of immovable property may have single registry, rather than multiple registry, provided that in the event that a single article of property has multiple registry by mistake, the subsequent registration in time becomes invalid, unless the prior registration in time is void. To determine whether ABC is the owner of the land in question, one could access, with ease, the registry of the immovable property.

In general, the owner of immovable property stated in the relevant registry is presumed to be the true owner of such property. Likewise, in practice, secured transactions are made in reliance upon the registry. In a strict legal sense, however, there is no guarantee that entries in the registry are entirely true or reliable. For this reason, in the event that a person stated as the owner of land in the registry is not in fact the true owner, any person that purchased the land in reliance on entries in the registry will not be deemed to be the owner of the land. Accordingly, strictly speaking, a mere entry of ABC as the owner of the land in the relevant registry cannot necessarily be relied upon. Nonetheless, such a defect hardly undermines the general reliability of Korea's registration system.

4. **Question:** *Does any land ownership/title registration system extend to the registration of the proposed security that ABC will create in favour of B Bank?*

Answer: Yes. The proposed security that ABC will create over the ownership of ABC to the land in question should be registered as well.

5. **Question:** *What formal requirements does the law impose upon ABC and B Bank for the creation of a security over land?*

Answer: For the creation of a security over land, it is necessary that ABC and B Bank enter into a security agreement. In addition, such an agreement should be registered so that B Bank can assert the validity of the security right against a third party.

6. **Question:** *What requirements does the law impose upon ABC and B Bank for the registration of a security over land? In particular, if registration is required, what is the effect of non-registration in relation to:*

- (a) *the parties, and*
(b) *third parties?*

Answer: For the registration of a security over land, both parties should submit to the competent registry office documentary evidence of the security agreement mentioned above, and file an application for registration. Although the failure of registration does not affect the effect of the security right created between the parties, a third party's creation and registration of security over the land in question before the security right created between ABC and B Bank is registered prohibits B Bank from asserting the priority of its security right.

7. **Question:** *Is a building erected upon the land treated as part of the land (so that if ABC takes security over the land it also includes/covers the building) or, if not, what must ABC do to take security over the building?*

Answer: Such a building is treated as a completely separate article of immovable property from the land. Therefore, a security over the land does not cover the building. For the creation of security over the building, both parties should enter into and register a separate security agreement for the building.

8. **Question:** *Is plant and equipment (e.g. heavy plant and equipment that is clearly fixed or attached in a permanent way to the land or buildings) treated as*

part of the land (so that if ABC takes security over the land it also includes/covers the plant and equipment) or, if not, what must ABC do to take security over the plant and equipment?

registered its security before B Bank did, then the security interest taken by C Bank is prior to the security interest taken by B Bank.

Answer: For security purposes, any heavy plant or equipment that is clearly fixed or attached to land in a permanent way will be treated in accordance with the Factory Mortgage Act. In practice, a factory mortgage is where land, buildings and equipment in a factory site is incorporated into a factory estate, over which a security can be created. In such cases, it is common that equipment, as well as land and buildings in the factory site, are provided as security.

Second Scenario – creation/registration of multiple security interests by ABC over the same land

Next, assume that B Bank has taken security over the land of ABC. C Bank, another bank/financier, agrees to make a loan/finance facility available to ABC. ABC agrees to provide security to C Bank over the same land that B Bank has taken security.

Issues:

1. **Question:** *Does the law in any way prevent, prohibit (or does it simply not provide for) multiple secured interests over land?*

Answer: No. The law does not prevent or prohibit multiple secured interests over land.

2. **Question:** *Would it be easy/difficult for C Bank to discover that B Bank had an existing security over the land?*

Answer: The presence of an existing security over the land can be easily checked with the relevant registry.

3. **Question:** *Assuming that C Bank took security over the land, how will priority between B Bank and C Bank be determined?*

Answer: Priority will be determined in accordance with the order of registration of security.

4. **Question:** *Assuming that C Bank took security over the land, would the answer to Issue 3 be any different if the security that B Bank took over the land was not registered and C Bank had no knowledge of that security?*

Answer: Again, priority will be determined in accordance with the order registered. If C Bank

Third Scenario – [enforcement of security over land

Next, assume that ABC has defaulted in respect of the loans/finance facilities made available to it by B Bank and C Bank such that either or both of B Bank and C Bank were able to enforce their respective security over the land.

Issues:

1. **Question:** *What means or process of enforcement is available to either or both of B Bank and C Bank?*

Answer: Generally speaking, both B Bank and C Bank may file an application for participation in an auction of the land at issue, for the purpose of enforcement of security with the competent court. Such application must be accompanied with documents evidencing the presence of the security interest.

2. **Question:** *Assuming that the default of ABC is quite clear, could ABC easily delay, obstruct or prevent any such process of enforcement?*

Answer: If ABC is unable to repay debts, it is almost impossible for ABC to prevent or delay the process of enforcement.

3. **Question:** *In general, what period of time might it take for B Bank or C Bank to complete the process of enforcement?*

Answer: It would generally take 6 to 8 months. However, it may take much longer if the auction of the land continues to be unsuccessful.

4. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law (other than an insolvency law) provide for the payment of 'priority claims' (for example employee, revenue claims owed by ABC) out of the proceeds of the sale of the land and in priority to the secured claims of B Bank and C Bank?*

Answer: The Housing Lease Protection Act, the Framework Act on National Taxes, the Local Tax Act, the Labor Standard Act and other acts provide for the payment of priority claims, including claims to a small amount of key lease deposit (not more than 12 to 16 million Korean Won, as determined in each region), wages payable to employees for the service for the last three months, severance payment for the last three months, compensation for employment injury and taxes under certain conditions, shall be in priority to any secured claims.

5. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the secured property entitlements of B Bank and C Bank to the proceeds of the sale of the land?*

Answer: No.

Fourth Scenario – creation/ registration/enforcement of a possessory security by ABC over movable property

Next, assume that D Bank, another bank/financier has agreed to lend/provide a finance facility to ABC. ABC has agreed to give D Bank security for the loan/finance facility by a 'pledge' of certain movable property owned by ABC (e.g. shares). The result is that D Bank will have actual possession of the property.

Issues:

1. **Question:** *Does a law govern the creation of the type of security proposed between ABC and D Bank?*

Answer: Under the Korean Civil Code (the "KCC"), a security right by which D Bank has actual possession of any movable property provided as security is either pledge or keun pledge.

2. **Question:** *What formal requirements does any such law impose upon ABC and D Bank for the creation of this form of security?*

Answer: ABC and D Bank must enter into a pledge agreement, and ABC must deliver any movable property to D Bank as pledgee.

3. **Question:** *Does a law require that such a security must be registered?*

Answer: There is no registration system in respect of movable property in Korea, and any security right over such movable property may not be registered. Shares provided as pledge, however, may be registered in a shareholder's registry as a "registered pledge", which seldom takes place in practice.

4. **Question:** *If yes, what requirements does the law impose upon ABC and D Bank for the registration of such a security interest? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: In so far as a registered pledge of shares is concerned, ABC and D Bank must enter into a pledge agreement, and ABC must deliver the relevant shares to D Bank as pledgee, and have the name and address of the pledgee entered in

the relevant shareholder's registry and such name stated on the relevant share certificates.

5. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: N/A.

6. **Question:** *Assuming that ABC has defaulted in respect of the repayment of the loan/finance facility made available to it from D Bank, what means or process of enforcement is available to D Bank?*

Answer: If a foreclosure agreement has been made, D Bank may acquire the movable property provided as security. Alternatively, D Bank may sell it at its discretion to apply the proceeds from the sale to the repayment of debt. D Bank may also file an application for auction of the movable property so that D Bank can share in proceeds from the auction.

7. **Question:** *Could ABC easily delay, obstruct or prevent that enforcement process?*

Answer: See answer to Third Scenario, Issue 2.

8. **Question:** *In general, what period of time might it take for D Bank to complete the process of enforcement?*

Answer: It varies, depending on the characteristics and the difficulty in the realisation of the secured property. However, in normal circumstances, it would generally take 6 months.

9. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the proceeds of the pledged property and in priority to the secured claim of D Bank?*

Answer: See answer to Third Scenario, Issue 4.

10. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of D Bank to the pledged property?*

Answer: It is possible when the pledge interest is created by operation of law. Such security is created in favour of a lessor of land, building or other structures against ABC as lessee, if, on the basis of its claims arising out of the lease against the lessee, the lessor has attached any movable property owned by ABC attached to such land, building or other structures. In such case,

priority in entitlement to dividends will be determined in accordance with the priority in time between the registration of attachment by the lessor and the acquisition of security interest by D Bank.

Fifth Scenario – creation/registration of a non-possessory security by ABC over movable property

Next, assume that E Bank, another bank/financier, agrees to lend/provide a finance facility to ABC. ABC agrees to provide E Bank with a non-possessory security over some equipment it owns. The result is that ABC would retain possession of the equipment.

Issues:

1. **Question:** *Does the law provide/permit security to be taken over equipment?*

Answer: Although not expressly provided by law, a Korean court has acknowledged and recognised the creation of Transfer Mortgage (Yang-do Dam-bo) over the entirety of equipment. Under Yang-do Dam-bo, the ownership of the debtor is transferred to the creditor in order to secure the fulfilment of the debtor's obligation. If the obligation is fulfilled, the debtor recovers the ownership to the property. If not, the ownership is finally vested in the creditor.

In addition, there is a Factory Mortgage, under which land, buildings and equipment in a factory site is incorporated into a factory estate, over which a security can be created. In such a case, it is generally the situation that equipment, as well as land and buildings in the factory site, are provided as security.

In respect of other company equipment, including construction equipment (heavy plant), ships, automobiles and aircraft, it is possible to create a mortgage over such equipment by registering the mortgage in a separate ledger. See also the answer to Fifth Scenario, Issue 6.

2. **Question:** *How would E Bank determine that the equipment is owned by ABC and is not subject to an existing security interest?*

Answer: In respect of a Yang-do Dam-bo, since Korean law does not provide a system of registering rights in movable property, it is impossible for E Bank to determine whether the equipment is owned by ABC.

On the other hand, a factory estate under the Factory Mortgage Act may not include any article subject to rights of others. Accordingly, E

Bank will be able to access the registry of the factory estate to identify a list of equipment and verify whether the equipment is owned by ABC.

3. Question: *What formal requirements does the law impose on ABC and E Bank for the creation of this form of security?*

Answer: For the creation of a Yang-do Dam-bo, a Yang-do Dam-bo, a creation agreement must be entered into, and the relevant equipment must be delivered by an “agreement on possession.” An “agreement on possession” is deemed as a type of possession under Korean law, in which a mere agreement on the transfer of possession is deemed as transfer of possession to a transferee, provided that the transferee agrees that the transferor is in direct possession of the relevant article. In other words, the transferee is in constructive possession of the relevant equipment by “agreement on possession”.

For the creation of a Factory Mortgage, a factory mortgage agreement must be entered into and a list of the relevant factory estate submitted to the competent registry office in order to effectuate the registration for preservation of ownership, which must be followed within 10 months by the registration for the creation of mortgage.

4. Question: *What requirements does the law impose upon ABC and E Bank for the registration of this form of security? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: It is impossible to register a Yang-do Dam-bo over movable property.

For the creation of a mortgage over a factory estate, a mortgage agreement must be entered into in respect of the factory estate and the registration for preservation of ownership must be effected and followed by the registration for the creation of mortgage within 10 months thereafter. In respect of an unregistered mortgage over a factory estate, the mortgagee can not assert the presence of such a mortgage against a third party.

5. Question: *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: Where an application is filed for registration for the purpose of preserving the ownership, any rights or claims in connection with the equipment constituting the factory estate should be reported to the registrar within

a certain period. Under the Factory Mortgage Act, such rights and claims that fail to be reported during the period are deemed as not existing. In this light, the registration system for a factory estate is considered reliable.

6. Question: *Assume that the ‘equipment’ mentioned above comprised motor vehicles. Does that alter any of the advice given above? In particular, apart from any general requirement to register a security over motor vehicles, does such a security have to be also registered at, for example, a motor vehicle registration/licensing office?*

Answer: For the creation of a mortgage over motor vehicles, in order for the mortgage to be valid, such mortgage must be registered in the relevant automobile ledger. If not so registered, such mortgage is invalid notwithstanding an agreement between the creditor and the debtor to create a mortgage over the motor vehicle. However, for the creation of a Yang-do Dam-bo over a motor vehicle, the relevant transfer, not a mortgage, must be registered in the relevant automobile ledger.

Sixth Scenario – creation/registration of multiple non-possessory securities by ABC over the same movable property

Next, assume that E Bank has taken security over the equipment of ABC. F Bank, another bank/financier, agrees to make a loan/finance facility available to ABC. ABC agrees to provide F Bank with a non-possessory security over the same property that has been secured to E Bank.

Issues:

1. Question: *Does the law prevent, prohibit (or does it simply not provide for) multiple non-possessory secured interests over the same property?*

Answer: Multiple non-possessory secured interests are permissible over the same movable property.

2. Question: *Would it be easy/difficult for F Bank to discover that E Bank had an existing non-possessory security over the equipment?*

Answer: As far as a factory mortgage is concerned, one can clearly verify whether any other mortgage is created over the relevant equipment by examining the relevant registry of the factory estate.

As far as a Yang-do dam-bo is concerned, it is almost impossible to discover whether any other

security is created over the relevant equipment due to the absence of a public notice system.

3. Question: *Assuming that F Bank took security over the equipment, how will priority between E Bank and F Bank be determined?*

Answer: As far as a factory mortgage is concerned, since priority is determined in the order registered, the security taken by E Bank would have priority.

As far as a Yang-do dam-bo is concerned, the bank that takes actual possession of the movable property, regardless of the order of security creation, would have priority.

4. Question: *Assuming that F Bank takes security over the equipment, would the answer to Issue 3 be any different if the security that E Bank took over the property was not registered and F Bank had no knowledge of that security?*

Answer: As far as a factory mortgage is concerned, priority is determined in accordance with the order registered. If F Bank finishes the registration of its security right before E Bank does, the security right taken by F Bank is prior to the security right taken by E Bank.

As far as a Yang-do Dam-bo is concerned, see the answer to Sixth Scenario, Issue 3.

Seventh Scenario – enforcement of non-possessory security over movable property

Next, assume that ABC has defaulted in respect of the loans/finance facilities made available to it by E Bank and F Bank such that either or both of E Bank and F Bank were able to enforce their respective securities over the equipment.

Issues:

1. Question: *What means or process of enforcement is available to either or both of E Bank and F Bank?*

Answer: Both E Bank and F Bank may file an application for participation in an auction of a factory estate for the purpose of enforcement of its security with the competent court. Such an application must be accompanied with documents evidencing the presence of the security interest. E Bank or F Bank, as the case may be, will be then entitled to the dividends of any proceeds from the sale of the factory estate.

2. Question: *Could ABC easily delay, obstruct or prevent that process of enforcement?*

Answer: See answer to Third Scenario, Issue 2.

3. Question: *In general, what period of time might it take either E Bank or F Bank to complete the process of enforcement?*

Answer: In normal circumstances, it would take 6 to 8 months.

4. Question: *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law (other than an insolvency law) provide for the payment of 'priority claims' (e.g. employee/revenue claims owed by ABC) out of the proceeds of the sale of the equipment and in priority to the secured claims of E Bank and F Bank?*

Answer: See answer to Third Scenario, Issue 4.

5. Question: *Is it possible that a security arising by 'operation of law' might intervene upon the entitlements of E Bank and F Bank to the proceeds of the sale of the equipment?*

Answer: Under Korean law, in the situation where the equipment is a ship, a holder of maritime lien over the ship takes priority in repayment to both E Bank and F Bank as holders of security interests in repayment.

Meanwhile, a holder of lien, e. g. a repairman that repaired the equipment, over the equipment covered by a factory mortgage or provided as Yang-do Dam-bo, may refuse to return the equipment until the payment obligation in connection with the equipment is fulfilled, and thereby is in practice entitled to repayment in priority to security holders.

Eighth Scenario – creation/registration of a non-possessory security by ABC over 'inventory', possibly including inventory acquired in the future

Next, assume that G Bank, another bank/financier, has agreed to lend/provide a finance facility to ABC. ABC has agreed to give G Bank a non-possessory security for the loan/finance facility over its inventory of raw materials and finished goods, an inventory that will change from time to time as finished goods are manufactured and sold and new raw materials are supplied.

Issues:

1. **Question:** *Does the law provide for/permit security to be taken over inventory?*

Answer: Although not expressly provided by law, a Yang-do Dam-bo is available, by which a security right is created over movable property upon the condition of not possessing the property. See also the answer to Fifth Scenario, Issue 1.

2. **Question:** *What formal requirements does the law impose upon ABC and G Bank for the creation of this form of security?*

Answer: A Yang-do Dam-bo agreement must be entered into between the parties, and the relevant inventory must be delivered to G Bank by an "agreement on possession". See also the answer to Fifth Scenario, Issue 3.

3. **Question:** *What requirements does the law impose upon ABC and G Bank for the registration of a security over inventory? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: It is impossible to register a Yang-do Dam-bo over movable property.

4. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: N/A.

5. **Question:** *Is it possible for ABC and G Bank to create the security in such a way that it will apply both to raw materials and finished goods?*

Answer: It is possible to create a Yang-do Dam-bo over raw materials, as well as finished goods with an agreement between the parties.

6. **Question:** *Is it possible for ABC and G Bank to create the security in such a way that it will apply to a constantly changing inventory of raw materials and finished goods (i.e. a security over after acquired/future property)?*

Answer: A Yang-do Dam-bo may be created over a constantly changing inventory, as long as it is specified as a whole, for example, by an agreement that "a security right is created over the inventory in No. 1 warehouse."

Ninth Scenario – [enforcement of a non-possessory security over inventory

Next, assume that ABC has defaulted in respect of the loan/finance facility made available to it by G Bank, such that H Bank is entitled to enforce its security over the inventory.

1. **Question:** *What means or process of enforcement is available to G Bank?*

Answer: G Bank may sell at its discretion inventory delivered from ABC, and apply proceeds from the sale to the repayment.

2. **Question:** *Can such process of enforcement be easily delayed/obstructed/prevented by ABC?*

Answer: ABC may substantially delay the enforcement of security by rejecting the delivery of inventory to G Bank. Even after the delivery of inventory from ABC to G Bank, ABC may repay debts and collect the inventory at any time prior to G Bank's disposal of the inventory.

3. **Question:** *In general, what period of time might it take G Bank to complete the process of enforcement?*

Answer: Since the sale of inventory will be made by G Bank at its own discretion, it is impossible to estimate the length of time required.

4. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the proceeds of the sale of the inventory and in priority to the secured claim of G Bank?*

Answer: Since a Yang-do Dam-bo is not a statutory secured interest, there is no law which provides priority of other rights over a Yang-do Dam-bo.

5. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of G Bank to the proceeds of the sale of the inventory?*

Answer: No, it is impossible.

6. **Question:** *If JS, a supplier, supplied raw materials to ABC under a 'retention of title' contract (such that JS was entitled to claim ownership of or a security over the raw materials until ABC had paid for them in full), what would be the position between G Bank and JS regarding entitlement/priority to those raw materials? [Note: to avoid unnecessary complication, assume that the raw materials as supplied by JS to ABC continue to exist in their 'raw' state and that they have not been incorporated into finished goods]*

Answer: Since JS continues to retain the ownership to the raw materials under the retention of title contract, the provision by ABC to G Bank of the raw materials as Yang-do Dam-bo would constitute the provision as Yang-do Dam-bo of an article owned by another person, and would therefore be legally invalid. Therefore, G Bank is deemed as having acquired from ABC no right in the raw materials. The fact that G Bank is a bona fide security holder will not alter the answer in the foregoing.

Tenth Scenario – creation/registration/enforcement of a security by ABC over 'receivables' (book debts)

Next, assume that H Bank, another bank/financier, has agreed to lend/provide a finance facility to ABC. ABC has agreed to give H Bank security for the loan/finance facility over receivables (book debts) owed to ABC by its trade debtors.

Issues:

1. **Question:** *Is the creation of such a security possible? [Note: If such a commercial arrangement would not be regarded as a security but rather as a factoring/absolute assignment/transfer of ownership arrangement, please state so and take that into account in addressing the following issues]*

Answer: Yes, the creation of such a security is possible. It is deemed as creating a security interest in the form of a pledge over receivables.

2. **Question:** *What formal requirements does the law impose on ABC and H Bank for the creation of a security over receivables?*

Answer: A pledge agreement must be entered into by and between ABC and H Bank. Also, either ABC or H Bank should obtain consent from ABC's trade debtor on such pledge, or give a notice thereof to ABC's trade debtor.

3. **Question:** *What requirements does the law impose on ABC and H Bank for the registration of a security over receivables? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: It is impossible to register a pledge created over receivables.

4. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: N/A.

5. **Question:** *Is it possible for ABC and H Bank to create the security in such a way that it will apply to and be valid over a constantly changing 'stock' of receivables?*

Answer: A security may be created over a constantly changing stock of receivables, as long as it is specified.

6. **Question:** *Assuming that ABC has defaulted in repayment of the loan/finance facility made available to it by H Bank, such that H Bank is entitled to enforce its security over the receivables, what means or process of enforcement is available to H Bank?*

Answer: H Bank may demand that the trade debtor fulfil its obligation, or the pledge may be enforced through mandatory execution by a court.

7. **Question:** *Can ABC easily delay, obstruct or prevent such enforcement process?*

Answer: See the answer to Third Scenario, Issue 2.

8. **Question:** *In general, what period of time might it take H Bank to complete the process of enforcement?*

Answer: It is impossible to estimate the length of time required if H Bank demands the trade debtor to fulfil the obligation. If a pledge is enforced through mandatory execution by a court, the total length of time required depends upon the trade debtor's cooperation. Assuming that the trade debtor does not take legal action, it would take about 6 months.

9. **Question:** Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the proceeds of the collection of the receivables ahead of the claim of H Bank?

Answer: See the answer to Third Scenario, Issue 4.

10. **Question:** Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of H Bank to the proceeds of the collection of the receivables?

Answer: No, it is impossible.

Eleventh Scenario – supply of goods to ABC by a supplier on a 'retention of title' contract

Next, assume that JS, a supplier of goods, has agreed to supply goods to ABC on credit and on terms that, although possession of the goods is given to ABC, title in the goods remains with JS until payment for the goods has been made in full.

Issues:

1. **Question:** Would such a commercial arrangement be treated as a security?

Answer: Although it would serve as a security for the payment in substance, it is treated legally as a special type of sale, not as a security.

2. **Question:** If yes, what formal requirements does the law impose on ABC and JS for the creation of such a security?

Answer: N/A.

3. **Question:** What requirements does the law impose on ABC and JS for the registration of such a security? [Please refer back to First Scenario, Issue 6 in advising on this issue]

Answer: N/A.

4. **Question:** How does the law resolve a situation in which a supplier of goods claims retention of title in those goods (whether by way of security or otherwise) and another person claims a non-possessory security over inventory? [Note: Please refer back to Ninth Scenario, Issue 6]

Answer: Since the title on the goods remains with JS, and since any person that has acquired a non-possessory security for goods not owned by the debtor is not deemed as having validly acquired such security, then as discussed in the answer to Ninth Scenario, Issue 6, the ownership of JS would have priority over non-possessory security.

5. **Question:** Assuming that ABC defaults in payment of the price payable for the goods supplied by JS, what process of enforcement is available to JS?

Answer: Since the title on the goods has remained with JS, JS could simply recover the goods, without having to take other processes of enforcement.

6. **Question:** In general, what period of time might it take JS to complete the process of enforcement?

Answer: N/A.

7. **Question:** Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the value/proceeds of the goods ahead of the claim of JS?

Answer: There is no law which provides for the priority of other rights over the ownership of JS.

8. **Question:** Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of JS to the goods?

Answer: Any holder of lien over the goods owned and supplied by JS may have priority in repayment, by rejecting the delivery of goods until any receivables arising in connection with the goods are repaid in full.

Twelfth Scenario – creation/registration of a lease to ABC of movable property

Next, assume that ABC wants to acquire equipment for use in its business operations but does not want to purchase the equipment. KL, a lease/finance company, has agreed to purchase the equipment and then to lease the equipment to KL for a term of years. A provision of the agreement provides that ABC may become the owner of the equipment upon the payment of the full lease and other charges.

Issues:

1. **Question:** *Would such a commercial arrangement be treated as a security?*

Answer: Although it would serve as financing by way of security in substance, precedents of the Korean courts consider it as a special type of agreement, rather than a security agreement.

2. **Question:** *If yes, what formal requirements does the law impose on ABC and KL for the creation of such a security?*

Answer: N/A.

3. **Question:** *What requirements does the law impose on ABC and KL for the registration of such a security? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: N/A.

4. **Question:** *Assuming that ABC defaults in payment of the lease charges, what process of enforcement is available to KL?*

Answer: Since the title on the goods would remain with JS, JS could simply recover the goods from ABC until the lease and other charges are paid in full.

5. **Question:** *In general, what period of time might it take KL to complete the process of enforcement?*

Answer: N/A.

6. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) ahead of the claim of KL to the equipment?*

Answer: No.

7. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of KL to the equipment?*

Answer: Any holder of lien over the equipment leased out by KL to ABC may take priority in repayment, by rejecting the delivery of the equipment until any receivables arising in connection with the equipment are repaid in full.

Thirteenth Scenario – creation/registration of a security by ABC over 'foreign' property

Next, assume that ABC owns movable property situated in a foreign jurisdiction and agrees to give security over that property to L Bank, a bank/financier that carries on business in the place in which ABC is incorporated.

Issues:

1. **Question:** *Does a law of the place of incorporation of ABC in any way intervene upon or seek to regulate the creation of such security?*

Answer: Article 19(1) of the Private International Act of Korea provides: "real property rights concerning movables and immovables and other rights subject to registration shall be governed by the law of the jurisdiction where the property is situated (the "lex situs")". In this light, a security created over movable property situated in a foreign jurisdiction must be governed by the law of that foreign jurisdiction.

2. **Question:** *Does a law of the place of incorporation of ABC impose any requirement for the registration of such a security in the place of incorporation of ABC?*

Answer: N/A.

3. **Question:** *Does a law of the place of incorporation of ABC seek to regulate the process of enforcement that is available to L Bank?*

Answer: Korean law provides that a security over movable property shall be enforced under the jurisdiction of the domicile court for the location of that movable property. As such, although ABC is incorporated in Korea, the law of Korea cannot regulate the process of enforcement of security over movable property situated in a foreign land.

Part Two – Commencement/Opening of Insolvency Proceedings and the Effect on Secured Transactions

A. Issues relating to information about secured property and security holders

1. **Question:** *Would it be easy/difficult to determine, by reference to a public register, the security interests that had been created by ABC, the property that was the subject of those security interests and the identity of the holders of those security interests?*

Answer: It would be easy to determine the property and identify the security interest holders.

2. **Question:** *Would it be easy/difficult to determine whether the security/property interests involving ABC were in the nature of security interests or non-security interests?*

Answer: Generally, it would be easy, but in some cases, it could be difficult.

3. **Question:** *In cases where ABC has created multiple security interests in respect of the same property, would it be easy/difficult to determine the priority between the competing security holders?*

Answer: It would be easy, because priority between the competing security holders is determined by the order in which the security is created.

B. Issues relating to validity of secured property interests

1. **Question:** *Does the Insolvency Law provide for the possible invalidity or avoidance of any of the security interests created by ABC as a result of some imperfection in the creation of security interest (e.g. for failure to observe the formalities imposed by the law for the creation of a security interest or failure to observe the requirements of the law relating to registration)?*

Answer: Although insolvency laws do not provide for such invalidity or avoidance, any imperfection in the creation of security interests invalidates such security interests under other

acts, including the KCC. Further, the Corporate Re-organisation Act provides that a receiver is entitled to dispute any secured claims reported.

2. **Question:** *Does the insolvency law provide for the possible invalidity or avoidance of any of the security interests created by ABC (despite that a security interest may have been created and perfected in accordance with other relevant law) by the application of provisions relating to creditor preferment, transactions at an undervalue or fraudulent transactions?*

Answer: Yes. Please refer to Section K of the Report produced by Lee & Ko.

C. Issues relating to interference with substantive secured property rights

1. **Question:** *In a case of insolvency, how is 'secured property' (or other 'proprietary' interests in property) treated in relation to the estate of the debtor (i.e. is the property included in the estate of the debtor or excluded from the estate) and how are the claims of the secured creditors treated?*

Answer: In bankruptcy or composition procedures, although secured property is included in the estate of the debtor, a holder of secured claims may enforce its claims separately from the procedures for bankruptcy or composition. In the case of a corporate re-organisation, a holder of secured claims may not separately enforce its claims, and such claims are redeemed in accordance with the re-organisation plan approved by the interested parties' meeting, and authorised by the court.

2. **Question:** *If the actual or anticipated proceeds or value from the sale/foreclosure of the secured property is less than the amount of the debt claim of the secured creditor, can the secured creditor claim the balance in the insolvency proceedings as an unsecured claim?*

Answer: Yes.

3. **Question:** Other than as mentioned in B1 & 2 above, does the insolvency law in any way provide for the invalidity/non-recognition of any of the secured property interests created by ABC despite that such interest has been validly created and perfected under the relevant secured transactions law?

Answer: In the case of composition, a holder of composition claims may deny any act conducted by a debtor company outside the ordinary course of business, or notwithstanding an objection thereto from the receiver.

In a case of bankruptcy or corporate re-organisation, the registration of the security creation may be denied if such registration is made at least 15 days after the relevant transaction becomes effective, and the beneficiary creditor has knowledge of the fact that there was an application for payment suspension or insolvency procedures against the debtor company. Further, the right of denial may also be exercised against a subsequent purchaser of such security having knowledge of the presence of reason for denial.

D. Issues relating to stay/suspension of enforcement powers in relation to secured property interests

1. **Question:** Does the insolvency law provide for any type of stay/suspension upon the enforcement rights of any of the secured creditors of ABC?

Answer: While the Bankruptcy Act and the Composition Act are silent on that matter, the Corporate Re-organisation Act provides for such stay/suspension with respect to the secured creditors' rights.

2. **Question:** If so, at what point in time would such stay/suspension operate?

Answer: Such stay takes effect when the competent court issues an individual order of stay at any time during the period from the filing of an application for re-organisation to the commencement of re-organisation procedures. Note that the DUIA proposes a comprehensive order of stay. Once the re-organisation procedures have commenced, the enforcement of all security interests and all procedures in progress will be suspended under the Corporate Re-organisation Act.

3. **Question:** Does such stay/suspension operate 'automatically' (e.g. through force of a law in consequence of some triggering event such as the commencement/opening of insolvency proceedings) or may it be only imposed by a court order?

Answer: See the answer to D2.

4. **Question:** If such stay/suspension does not operate automatically or until a court order has been made, does the insolvency law provide for the possibility of an 'interim' or 'temporary' stay/suspension?

Answer: See the answer to D2.

5. **Question:** If some of the transactions referred to in Part One of the case study are not regarded as secured property interests (but rather as proprietary/ownership rights), does any stay/suspension of enforcement rights extend to and apply to those transactions?

Answer: Yes.

6. **Question:** Does the stay/suspension apply even though a security holder has commenced/almost completed the enforcement process?

Answer: Yes.

E. Issues relating to liquidation

Assume that ABC is to be liquidated under the Insolvency Law:

1. **Question:** Does any stay/suspension of the enforcement powers of a secured creditor apply or continue to apply?

Answer: No. In the process of bankruptcy, no restrictions are imposed on the enforcement of the security interest.

2. **Question:** For what period of time would such stay/suspension operate?

Answer: N/A.

3. **Question:** Does the law provide that an affected security holder may apply for such stay to be lifted?

Answer: N/A.

F. Issues relating to priority claims

1. **Question:** Does the insolvency law provide for 'priority claims' to be paid ahead of the claims of a security holder?

Answer: Yes.

2. **Question:** *If so, what are these priority claims and is there any conflict between them and any priority claims as mentioned in Part One of the case study (for example in scenarios 3, 4, 7, 9 & 10)?*

Answer: Priority claims are referred to as priority claims in the proceedings of composition, bankruptcy estate claims in the proceedings of composition, and common benefit claims in the process of corporate re-organisation, all of which are similar in nature.

Though referred to as priority claims in Part One of the case study, such priority claims do not have priority in the process of insolvency unless prescribed by the insolvency laws. However, all claims mentioned earlier in Part One of the case study are recognised as priority claims under the insolvency laws, leaving no possibility of conflict in priority.

However, exceptionally, in the process of corporate re-organisation, tax claims arising prior to the commencement of corporate re-organisation procedures, except as subject to withholding at source and not due until the commencement of such procedures, do not have priority.

G. Issues relating to enforcement

1. **Question:** *Does the insolvency law provide for the enforcement of secured property interests or does it leave this to be determined by other law?*

Answer: The enforcement of secured property interests shall be executed in accordance with other laws.

2. **Question:** *Does the insolvency law provide for the enforcement/realisation of secured property interests through the insolvency representative (office holder)?*

Answer: Yes, through the trustee (in bankruptcy and composition) or the receiver (in corporate re-organisation).

H. Issues relating to corporate rescue processes [rehabilitation; reorganisation; restructuring]

Assume that ABC is under the 'rescue' process of the insolvency law, but has not yet reached the point of approval of a plan of reorganisation

1. **Question:** *Does any stay/suspension of the enforcement powers of secured creditor apply or continue to apply?*

Answer: Yes.

2. **Question:** *For what period of time would such stay/suspension operate?*

Answer: Such stay/suspension would operate until the conclusion of the rehabilitation proceedings. However, the stay/suspension would be lifted if the secured creditors obtain the separate approval of the Court.

3. **Question:** *Does the law provide for the length of the stay to be extended?*

Answer: No.

4. **Question:** *Does the law provide that an affected security holder may apply for such stay to be lifted?*

Answer: Generally, no. Only tax collecting agencies can apply for the stay to be lifted.

5. **Question:** *If so, what conditions must be established before such stay may be lifted?*

Answer: There are no specific requirements. It depends on the Court's discretion.

6. **Question:** *Does the law provide that secured property may be used during the period of stay?*

Answer: It does not contain any express provisions on the matter, but the law is generally construed such that secured property may be used to the extent necessary in the ordinary course of business.

7. **Question:** *Does this 'use' extend to the sale or other disposal of the secured property?*

Answer: Yes. However, any sale or disposal of certain assets outside the ordinary course of business is subject to approval of the competent court in the corporate re-organisation proceedings, or to approval of the trustee in the composition proceedings.

8. **Question:** *What conditions must be fulfilled before secured property may be sold?*

Answer: No uniform conditions are imposed, but it is understood in principle that the sale of secured property must neither infringe upon interests of secured creditors, nor have an adverse effect upon any rehabilitation efforts made by the debtor company.

9. **Question:** *If a plan is proposed in respect of ABC, what voting rights and powers do the security holders mentioned in Part One of the case study have?*

Answer: Secured creditors will have voting rights in proportion with the respective amounts of secured claims held by them. A plan of rehabilitation may be approved with the affirmative votes of at least $\frac{3}{4}$ of the voting rights held by the entire class of secured creditors.

10. **Question:** *Does the law provide that any of the secured creditors mentioned in Part One of the case study form a separate class of creditors for voting and plan approval matters?*

Answer: Yes.

11. **Question:** *If a majority vote in favour does this bind all security holders?*

Answer: At least $\frac{3}{4}$ of a vote in favour will bind all secured creditors, including dissenting creditors.

1. Issues relating to 'new money' financing of an insolvent corporation

1. **Question:** *Does the law provide for the possibility of raising additional working capital to enable ABC to continue in business?*

Answer: Yes.

2. **Question:** *If so, does this permit the repayment of such 'new credit' to rank as a 'super priority', ahead of the security holders mentioned in Part One of the case study?*

Answer: The claims of new credit extended do not have priority over the secured creditors in the proceedings of composition or bankruptcy, but they do have priority in the corporate re-organisation proceedings as a common benefit claims. However, the Korean Supreme Court has ruled that in applying proceeds from the disposal of the specific assets that are provided as security for the secured claims, the secured claims have priority to common benefit claims.

3. **Question:** *Is the raising of such 'new credit' subject to the consent of secured creditors, approval of creditors generally or an order of the court?*

Answer: It is subject to approval of the court.

Part Three

A. General issues relating to of security interests – rating, interest rate factor, barriers to secured lending, intersection problem areas.

1. **Question:** *In terms of quality and quantity, what rating would lenders apply between the forms of security interest examined in Part One (i.e. which are the most popular and why)?*

Answer: Immovable property mortgage is most preferred, since immovable property has a much higher value as security than other security forms.

2. **Question:** *If it is possible, please provide average term of loan and interest rates charged by lenders to corporate borrowers for loans secured by:*

- Mortgage over land;
- Pledge over movable property;
- Security over inventory;
- Security over receivables;
- Security over equipment; and
- Security over motor vehicles.

Answer: Assuming other conditions are the same, an interest rate generally increases in the following order:

- Mortgage over land
- Security over equipment

- Security over receivables
- Pledge over movable property
- Security over inventory
- Security over motor vehicles

3. **Question:** *Having regard to the issues raised in Parts One and Two, what would the banking/finance sector consider are the main barriers/drawbacks to secured lending?*

Answer: We are of the view that Korean banks do not consider any of the issues raised in Parts One and Two as serious drawbacks or barriers to secured lending. Generally speaking, the most important factors to banks in secured lending would be the sufficiency of the value of secured property itself. Also, a senior security interest created would be a major negative factor making a bank reluctant to secure lending.

4. **Question:** *What areas of the 'intersection' cause the most problems or are most problematic in the banking/finance sector?*

Answer: One of the problematic factors is that the priority between common benefit claims and secured claims are not clearly determined, and the fact that there is no guarantee by law that a secured creditor can realise in full the liquidation value of the security in the corporate re-organisation proceedings. However, as discussed in the Cross-Border Insolvency chapter, the DUIA has provisions to guarantee the liquidation value of a security.

In bankruptcy proceedings, the super priority of tax claims has severely prohibited secured creditors from receiving the dividends of proceeds.

5. **Question:** *What areas are considered to be the main areas of target for reform or improvement?*

Answer: See the answer to A4.

6. **Question:** *Do any of the issues mentioned in Parts One or Two cause problems in relation to informal work out processes?*

Answer: One of the most problematic issues is that it is difficult to force those creditors dissenting from a restructuring plan, e. g. a debt restructuring, to be bound by the plan agreed by the creditors. Another is that there are no legal grounds to guarantee that the new credit shall be repaid with priority.

B. Issues relating to internal corporate record of creation of secured property interests

1. **Question:** *Regardless of the requirements of any law to register secured property interests in a public register, does any law require that ABC must maintain an internal register or book of every security interest created by ABC and, if so, is such register or book available for inspection by a prospective creditor?*

Answer: Korean law does not require the preparation and maintenance of such a corporate record in addition to the requirement of registration in the public register.

C. Issues concerning law reform and development

1. **Question:** *In relation to the areas covered in the case study, are there any proposed reforms/developments to the laws in your country that might affect any of the issues raised in Parts One and Two of the case study?*

Answer: The DUIA, recently announced, does not contain any of the matters that might affect the answers to the issues raised in Parts One and Two of the case study. It will take at least a few months for the DUIA to become a complete bill.

D. Issues concerning domestic and international investment and finance

1. **Question:** *In relation to the remedy of 'foreclosure', are there any restrictions that intrude upon the power of a foreign lender to take possession, sell, become the 'owner' of or otherwise dispose of secured property?*

Answer: There are some obligations to file a report under the Foreign Exchange Transaction Act and the Foreigner's Land Acquisition Act, which are procedural in nature. As long as a claim arises validly and legally, there are no restrictions on the acquisition or disposal of any secured property based on such a claim.

2. **Question:** *Is it considered that domestic/foreign lending might be increased by reform/improvements to the secured lending and/or insolvency law processes?*

Answer: Laws concerning secured lending have been established in a considerably systematic manner, and are substantially efficient.

Moreover, secured lending has been used as one of the most typical tools in financing. Any amendment to the laws would therefore not result in a substantial increase in secured lending.

E. Issues concerning cross-border implications

1. **Question:** Assume that ABC is either:

- (a) a foreign company operating in your jurisdiction; or
- (b) a wholly owned subsidiary (and incorporated and operating in your jurisdiction) of a foreign company; and

assume further that insolvency proceedings are commenced/opened in respect of ABC or the parent of ABC in its place of incorporation (a foreign jurisdiction) and the foreign insolvency representative of ABC wishes to prevent any enforcement or recovery action by the secured creditors or property owners as mentioned in Part One of the case study.

In your jurisdiction, how might the foreign insolvency representative seek protection from such enforcement action?

Answer: It is not possible under the present law. The DUIA, however, permits the foreign insolvency representative to file with a Korean court an application for approval of foreign insolvency procedures, which approval will be given or rejected by the court within a month. Until such approval is made, the court may take preservation orders, including issuing an order of stay of enforcement action, in order to protect the debtor's property and the creditors' interest. Upon approval of the foreign insolvency procedures, the foreign insolvency representative may either apply for the commencement of domestic insolvency procedures, or participate in the same procedures in progress. It is also proposed that the DUIA will provide that the Korean court may cooperate with the foreign insolvency representative, or a foreign court about other matters if necessary.

Supplementary Questions

1. **Question:** To what regional inter-governmental arrangements relating to economic corporation, facilitation of trade, investment protection, or mutual recognition of administrative or judicial process is the subject country a party? (Such arrangements might include regional treaties, non-treaty agreements, cooperative schemes, or regular forums at the ministerial or official level.)

Answer: No answer provided.

2. **Question:** Which (if any) are the other countries that are party to such arrangements.

Answer: No answer provided.

3. **Question:** Does any such arrangement refer to and deal with insolvency, either specifically or within the generality its terms?

Answer: No answer provided.

4. **Question:** Which ministry or agency has or would have responsibility for negotiating and administering arrangements on mutual recognition in the field of insolvency?

Answer: No answer provided.



Asian Development Bank

Promoting Regional Cooperation in the
Development of Insolvency Reform

RETA 5975

Draft Country Report for Singapore Conference
Intersection of Secured Transactions and
Insolvency Law Regimes

Philippines

Part One – Creation, Registration and Enforcement of Secured Transactions

Asia Business Corporation (“ABC”) is a company incorporated in your country and conducts its business from there.

First Scenario – the creation/registration of security by ABC over immovable property – land

B Bank is a bank/financier. It agrees to lend/provide a finance facility to ABC and ABC agrees to provide security for the loan/finance over land owned by ABC.



Issues:

1. **Question:** *In your country would the usual nature of the ownership or title of ABC to the land be freehold, leasehold or other (e.g. land use right)?*

Answer: The usual nature of ownership or title of ABC to the land would be freehold or ownership in fee simple (i.e. ownership which is full and absolute).

2. **Question:** *Is it the case the ownership/title of the land of ABC would be registered in a land registration system?*

Answer: The Philippines follows the Torrens System of land registration. Under this system, once a parcel of land has been registered, a certificate of title covering the land is issued. The original of the certificate of title remains on file with the Office of the Register of Deeds having jurisdiction over the land. A duplicate copy of the title is issued to the owner. Once the title is issued, the title becomes incontrovertible after one year from the date the land was registered. When the owner sells the land, his certificate of title is cancelled and a new certificate is issued to the new owner.

3. **Question:** *Would it be easy/difficult for B Bank to determine that ABC was the owner/had title to the land in question? [Please expand by commenting on the reliability and certainty of the registration system and the nature and state of the land registration system – single or multiple registry; centralised/local registry; manual/computer based; reliability of registered information; difficulties of searching etc]*

Answer: It would be relatively easy to determine that ABC was the owner of the land in question, so long as a copy of the title over the property is available. A Torrens title is generally conclusive evidence of the ownership of the land. A strong presumption exists that Torrens titles are regularly issued and that they are valid. The certificate of title serves as evidence of an indefeasible title to the property. Third parties can rely on the face of the title as to the ownership. Actual title checks and verification may also be conducted manually in the appropriate Registry of Deeds where the property is located. There is, however, no central registry, nor is the registry computer based. The registration must be made with the office of the Register of Deeds having jurisdiction over the territory where the property is located.

4. **Question:** *Does any land ownership/title registration system extend to the registration of the proposed security that ABC will create in favour of B Bank?*

Answer: The system of land registration extends to registration of the proposed security that ABC will create in favour of B Bank. Under Section 60 of Presidential Decree No. 1529, otherwise known as the Property Registration Decree, mortgages and leases shall be registered in the manner provided in Section 54 (see Question 6). The owner of registered land may mortgage or lease it by executing the deed in a form sufficient in law. Such a deed of mortgage or lease and all instruments which assign, extend, discharge or otherwise deal with the mortgage or lease must be registered, and take effect upon the title only from the time of registration.

5. **Question:** *What formal requirements does the law impose upon ABC and B Bank for the creation of a security over land?*

Answer: Security over land is created by the execution of a real estate mortgage by ABC in favour of B Bank. The real estate mortgage agreement must be signed by the persons executing the same, in the presence of two witnesses, who shall sign the instrument as witnesses to the execution. The real estate mortgage agreement shall appear in a public document (i.e. a document acknowledged before a notary public or other public officer authorised by law to take acknowledgment). In addition, in order that a mortgage is validly constituted, the document in which it appears must be recorded in the Register of Deeds. However, while an unrecorded mortgage is not binding on third parties who have no actual knowledge of the mortgage, it is nevertheless binding between the parties.

6. **Question:** *What requirements does the law impose upon ABC and B Bank for the registration of a security over land? In particular, if registration is required, what is the effect of non-registration in relation to:*

- (a) *the parties, and*
(b) *third parties?*

Answer: Under Section 54 of the Property Registration Decree, all interests in registered land less than ownership shall be registered by filing with the Register of Deeds the instrument which creates or transfers, or claims such interests, and by a brief memorandum made by the Register of Deeds upon the certificate of title

and signed by him. A similar memorandum shall also be made on the owner's duplicate. The parties are also required to pay the appropriate registration fee(s) imposed by the Register of Deeds prior to registration.

If the instrument is not registered or recorded, the mortgage is nevertheless binding between the parties, but not to third parties who have no actual notice of the mortgage.

7. **Question:** *Is a building erected upon the land treated as part of the land (so that if ABC takes security over the land it also includes/covers the building) or, if not, what must ABC do to take security over the building?*

Answer: In the absence of any stipulation to the contrary, a mortgage executed over a parcel of land includes all buildings, structures and other improvements on the land, even if the deed of mortgage does not mention the inclusion of these buildings, structures or other improvements.

8. **Question:** *Is plant and equipment (e.g. heavy plant and equipment that is clearly fixed or attached in a permanent way to the land or buildings) treated as part of the land (so that if ABC takes security over the land it also includes/covers the plant and equipment) or, if not, what must ABC do to take security over the plant and equipment?*

Answer: Plant and equipment which are clearly fixed or attached in a permanent way to the land or building take on the character of immovable or real property. A real estate mortgage executed over the land includes such plant and equipment attached to the land, unless there is a stipulation to the contrary.

If, however, machinery is not permanently affixed to a building or to a parcel of land, then whether it is categorised as real or personal property depends on several factors, of which the most important is whether or not the machinery tends directly to meet the needs of an industry or works i.e., whether the industry can function properly without it. If the machinery tends to meet the needs of an industry or works, then it is real, even if by nature it is movable.

Second Scenario – creation/registration of multiple security interests by ABC over the same land

Next, assume that B Bank has taken security over the land of ABC. C Bank, another

bank/financier, agrees to make a loan/finance facility available to ABC. ABC agrees to provide security to C Bank over the same land that B Bank has taken security.

Issues:

1. **Question:** *Does the law in any way prevent, prohibit (or does it simply not provide for) multiple secured interests over land?*

Answer: Philippine law does not prohibit, nor does it provide, for multiple secured interests over land.

2. **Question:** *Would it be easy/difficult for C Bank to discover that B Bank had an existing security over the land?*

Answer: It is relatively easy to discover whether B Bank has an existing security over the land, assuming the mortgage in favour of B Bank was duly registered and recorded with the Register of Deeds. The title over the land would contain an annotation of the prior mortgage in favour of B Bank. Actual title check and verification with the appropriate Register of Deeds where the land is located will also show a similar annotation in the original title over the land of the prior mortgage in favour of B Bank.

On the other hand, it may be more difficult to discover whether B Bank has an existing mortgage over the land if the mortgage is unregistered. As mentioned, however, this unregistered mortgage in favour of B Bank will not bind C Bank absent actual knowledge of the existence thereof by C Bank.

3. **Question:** *Assuming that C Bank took security over the land, how will priority between B Bank and C Bank be determined?*

Answer: Assuming both mortgages have been duly registered, priority will be determined based on the date of registration. Prior registration of the mortgage in favour of B Bank means that the mortgage in favour of B Bank will be superior over the mortgage in favour of C Bank.

4. **Question:** *Assuming that C Bank took security over the land, would the answer to Issue 3 be any different if the security that B Bank took over the land was not registered and C Bank had no knowledge of that security?*

Answer: If the mortgage in favour of B Bank over the land was not registered and C Bank had no knowledge thereof, C Bank's mortgage will be superior to and would obtain priority over that of B Bank's mortgage.

Third Scenario – enforcement of security over land

Next, assume that ABC has defaulted in respect of the loans/finance facilities made available to it by B Bank and C Bank such that either or both of B Bank and C Bank were able to enforce their respective security over the land.

Issues:

1. **Question:** *What means or process of enforcement is available to either or both of B Bank and C Bank?*

Answer: A real estate mortgage may be foreclosed either judicially or extrajudicially. In foreclosure proceedings, the property given by way of security is sold at public auction and the proceeds of the sale are then used to pay or settle the obligations secured by the mortgage. It is foreclosed judicially if the mortgagee files a complaint in court for foreclosure of the mortgage pursuant to the Rules of Court. It is foreclosed extrajudicially if the mortgagee causes the sale of the property in a public auction in accordance with Act No. 3135, through a sheriff or notary public, pursuant to a power or authority granted to the mortgagee in the mortgage deed.

2. **Question:** *Assuming that the default of ABC is quite clear, could ABC easily delay, obstruct or prevent any such process of enforcement?*

Answer: From a strict legal point of view, it is relatively difficult to delay, obstruct or prevent foreclosure. There have been instances, however, where Philippine courts have been lenient in granting temporary restraining orders or writs of preliminary injunctions against foreclosures. In addition, the relative ease in obtaining stay orders in rehabilitation proceedings, which have the effect of restraining enforcement, delay the process of enforcement of security.

3. **Question:** *In general, what period of time might it take for B Bank or C Bank to complete the process of enforcement?*

Answer: It may take from 1 to 3 years to enforce a mortgage judicially. An extrajudicial foreclosure of mortgage generally takes around 1-3 months to complete.

4. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law (other than an insolvency law) provide for the payment of 'priority claims' (for example employee, revenue claims owed by ABC) out of the proceeds of the sale of the land and in priority to the secured claims of B Bank and C Bank?*

Answer: There is no law which provides for the payment of priority claims out of the proceeds of the sale of the land and in priority to the secured claims of B Bank and C Bank.

5. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the secured property entitlements of B Bank and C Bank to the proceeds of the sale of the land?*

Answer: We are not aware of any possible security arising by operation of law which may intervene upon the secured property entitlements of B Bank and C Bank to the proceeds of the sale of the land. The proceeds of the sale of the foreclosed property will be used to pay or settle the obligations secured by the mortgage and related costs. If the proceeds of the sale exceed the secured obligations of B Bank and related costs, the excess will be paid to the junior encumbrancer (e.g. secured obligation of C Bank). Any excess will be paid back to the mortgagor. If there is a balance due to the mortgagee after applying the proceeds of the sale, the mortgagee is entitled to recover the deficiency through an ordinary action for collection.

We bring to your attention, however, a case decided by the Philippine Supreme Court, *Carried Lumber Co. vs. ACCFA*, 63 SCRA 411 (1975), wherein a "materialman's lien" recognised under Article 2242 (4) of the Civil Code of the Philippines, i.e. claims of furnishers of materials used in the construction, reconstruction or repair of buildings, shared pro rata with the claim of the mortgagee over the warehouse the materials of which were furnished by the former, despite the absence of insolvency proceedings. As explained below, the majority of the law practitioners in the Philippines believe that Articles 2241-2242 of the Civil Code, which refer to concurrence and preference of credits only apply when there are insolvency proceedings and the debtor has been declared insolvent. However, the *Carried Lumber Co.* decision has not been overturned.

Fourth Scenario – creation/registration/enforcement of a possessory security by ABC over movable property

Next, assume that D Bank, another bank/financier has agreed to lend/provide a finance facility to ABC. ABC has agreed to give D Bank security for the loan/finance facility by a 'pledge' of certain movable property owned by ABC (e.g. shares). The result is that D Bank will have actual possession of the property.

Issues:

1. **Question:** Does a law govern the creation of the type of security proposed between ABC and D Bank?

Answer: Book IV, Title XVI, Chapters 1 and 2 (Articles 2085 to 2123) of the Civil Code of the Philippines governs the creation of pledges. A pledge is a contract whereby the debtor delivers to the creditor or to a third person by common agreement a movable thing for the purpose of securing the fulfilment of a principal obligation.

2. **Question:** What formal requirements does any such law impose upon ABC and D Bank for the creation of this form of security?

Answer: Under Article 2093 of the Civil Code, in order to constitute the contract of pledge, the thing pledged must be placed in the possession of the creditor, or of a third person by common agreement. Moreover, a pledge shall not take effect against third persons if a description of the thing pledged and the date of the pledge do not appear in a public instrument, i.e. acknowledged before a notary public.

3. **Question:** Does a law require that such a security must be registered?

Answer: The law does not require that a pledge must be registered in order to be valid. However, as far as shares of stock are concerned, where the parties have agreed to give the right to vote on such shares to the pledgee, such a right may be exercised by the pledgee and shall bind the corporation only if the pledge instrument stipulated is recorded in the books of the corporation, as required by Section 55 of the Corporation Code of the Philippines.

4. **Question:** If yes, what requirements does the law impose upon ABC and D Bank for the registration of such a security interest? [Please refer back to First Scenario, Issue 6 in advising on this issue]

Answer: If the pledge instrument giving the right to vote on the shares of stock subject of the pledge is not recorded or registered in the books of the corporation, the corporation is not bound by such an agreement with respect to the right of the pledgee to vote on such shares.

5. **Question:** Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]

Answer: N/A.

6. **Question:** Assuming that ABC has defaulted in respect of the repayment of the loan/finance facility made available to it from D Bank, what means or process of enforcement is available to D Bank?

Answer: Under Article 2112, the creditor to whom the credit has not been satisfied in due time, may proceed before a Notary Public for the sale of the thing pledged. This sale shall be made at a public auction, and with notification to the debtor and the owner of the thing pledged in a proper case, stating the amount for which the public sale is to be held. If at the first auction the thing is not sold, a second one with the same formalities shall be held; and if at the second auction there is no sale either, the creditor may appropriate the thing pledged. In this case he or she shall be obliged to give an acquittance for his or her entire claim.

Under Article 2115, the sale of the thing pledged shall extinguish the principal obligation, whether or not the proceeds of the sale are equal to the amount of the principal obligation, interest and expenses in the proper case. If the price of the sale is more than this amount, the debtor shall not be entitled to the excess, unless it is otherwise agreed. If the price of the sale is less, neither shall the creditor be entitled to recover the deficiency, notwithstanding any stipulation to the contrary.

7. **Question:** Could ABC easily delay, obstruct or prevent that enforcement process?

Answer: If ABCs default is clear, it is theoretically relatively difficult to obstruct or delay enforcement.

8. **Question:** *In general, what period of time might it take for D Bank to complete the process of enforcement?*

Answer: Enforcement may take from 1 to 2 months.

9. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the proceeds of the pledged property and in priority to the secured claim of D Bank?*

Answer: There is no law which provides for the payment of priority claims out of the proceeds of the pledged property and in priority to the secured claim of D Bank.

10. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of D Bank to the pledged property?*

Answer: We are not aware of any possible security arising by operation of law which might intervene upon the entitlement of D Bank to the pledged property. However, see our discussion in the Third Scenario, Issue 5 with respect to the Carried Lumber Co. case.

Fifth Scenario – creation/registration of a non-possessory security by ABC over movable property

Next, assume that E Bank, another bank/financier, agrees to lend/provide a finance facility to ABC. ABC agrees to provide E Bank with a non-possessory security over some equipment it owns. The result is that ABC would retain possession of the equipment.

Issues:

1. **Question:** *Does the law provide/permit security to be taken over equipment?*

Answer: Yes. Act No. 1508, as amended, also known as the Chattel Mortgage Law, governs the creation of security over movable property.

2. **Question:** *How would E Bank determine that the equipment is owned by ABC and is not subject to an existing security interest?*

Answer: Unlike real property, movable or personal property is not covered by certificates of title. E Bank would have to rely on the representation of ABC that it owns the equipment and this cannot be independently verified. There is, however, a Chattel Mortgage

Register where chattel mortgages must be registered in order to be valid against third parties. Actual verification on whether there is an existing chattel mortgage over the equipment owned by ABC may be made by manually searching the records of the appropriate Chattel Mortgage Registry. There is, however, no central registry, and the records are not computerised.

3. **Question:** *What formal requirements does the law impose on ABC and E Bank for the creation of this form of security?*

Answer: A chattel mortgage shall be signed by the persons executing the same, in the presence of two witnesses, who shall sign the mortgage as witnesses to the execution, and each mortgagor and mortgagee, or, in the absence of the mortgagee, his agent or attorney, shall make and subscribe an affidavit of good faith made substantially in the form required under the Chattel Mortgage Law, under which an affidavit must be signed by the parties to the mortgage as above stated. A certificate of the oath signed by the authority administering the aforementioned affidavit of good faith shall be appended to the mortgage and recorded therewith. The agreement shall include a description of the mortgaged property which shall be such as to enable the parties to the mortgage, or any other person, after reasonable inquiry and investigation, to identify the same.

4. **Question:** *What requirements does the law impose upon ABC and E Bank for the registration of this form of security? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: The mortgage shall be registered or recorded in the Office of the Register of Deeds of the province in which the mortgagor resides at the time of making the mortgage, or, if he or she resides outside the Philippines, in the province in which the property is situated. If the property is situated in a different province from that in which the mortgagor resides, the mortgage shall be recorded in the office of the register of deeds of both the province in which the mortgagor resides, and that in which the property is situated. Payment of the appropriate registration fees is also required prior to registration. Other special laws require the registration of a chattel mortgage over specific movable property with other government agencies (e.g. a chattel mortgage over a motor vehicle must be registered/recorded with the Land Transportation Office, a chattel mortgage over vessels must be registered with the Philippine Coast Guard).

A chattel mortgage agreement which is not registered with the Chattel Mortgage Registry is

nevertheless binding upon the parties, but void against third persons, unless such third persons have actual knowledge of the mortgage.

5. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: There is no central registry and it is not computer based. A search would have to be conducted manually and in each relevant office of the Register of Deeds. The books can be quite voluminous, and there is no index or summary which may be searched quickly. The entries are instead arranged in accordance with the date of registration.

6. **Question:** *Assume that the 'equipment' mentioned above comprised motor vehicles. Does that alter any of the advice given above? In particular, apart from any general requirement to register a security over motor vehicles, does such a security have to be also registered at, for example, a motor vehicle registration/licensing office?*

Answer: In addition to registration in the Chattel Mortgage Registry, the mortgage over a motor vehicle should also be recorded in the Land Transportation Office under the Revised Motor Vehicles Law. The same general requirements apply in order to create a chattel mortgage over a motor vehicle.

Sixth Scenario – creation/registration of multiple non-possessory securities by ABC over the same movable property

Next, assume that E Bank has taken security over the equipment of ABC. F Bank, another bank/financier, agrees to make a loan/finance facility available to ABC. ABC agrees to provide F Bank with a non-possessory security over the same property that has been secured to E Bank.

Issues:

1. **Question:** *Does the law prevent, prohibit (or does it simply not provide for) multiple non-possessory secured interests over the same property?*

Answer: While the Chattel Mortgage Law does not specifically contain a provision allowing for the creation of multiple chattel mortgages over the same movable property, Section 13 impliedly allows for their creation. Section 13 gives to a person holding a subsequent mortgage the right to redeem the mortgage by paying or delivering

to the mortgagee the amount due on the mortgage, and the reasonable costs and expenses incurred by such breach of condition before the sale. Moreover, Article 319 of the Revised Penal Code penalises a mortgagor who shall sell or "pledge personal property already pledged"¹, or any part thereof, under the terms of the Chattel Mortgage Law, without the consent of the mortgagee written on the back of the mortgage and noted on the record of the mortgage in the office of the Register of Deeds in the province where the property is located.

2. **Question:** *Would it be easy/difficult for F Bank to discover that E Bank had an existing non-possessory security over the equipment?*

Answer: As mentioned, F Bank can conduct an actual search with the appropriate Chattel Mortgage Registry. However, as the registry is not centralised nor computer based, it is relatively cumbersome to do an actual search. Aside from having to conduct the search manually, there is a need to check every registry book in each and every local registry applicable for the relevant period.

3. **Question:** *Assuming that F Bank took security over the equipment, how will priority between E Bank and F Bank be determined?*

Answer: As in the real estate mortgage, priority will be determined on the basis of the date of registration of the chattel mortgage with the Chattel Mortgage Registry. The mortgage with the prior registration will have priority over, and will be superior to, a mortgage with a later registration.

4. **Question:** *Assuming that F Bank takes security over the equipment, would the answer to Issue 3 be any different if the security that E Bank took over the property was not registered and F Bank had no knowledge of that security?*

Answer: If the chattel mortgage in favour of E Bank over the property was not registered and F Bank had no knowledge of that security, the chattel mortgage created in favour of F Bank will obtain priority over that of E Bank, assuming that F Bank's chattel mortgage is duly registered.

¹ We believe that this provision really covers a chattel mortgage

Seventh Scenario – [enforcement of non-possessory security over movable property]

Next, assume that ABC has defaulted in respect of the loans/finance facilities made available to it by E Bank and F Bank such that either or both of E Bank and F Bank were able to enforce their respective securities over the equipment.

Issues:

1. **Question:** *What means or process of enforcement is available to either or both of E Bank and F Bank?*

Answer: A chattel mortgage may be foreclosed judicially or extrajudicially. A chattel mortgage is foreclosed judicially if the mortgagee files a complaint in court for foreclosure of the mortgage pursuant to the Rules of Court, but subject to the provisions of the Chattel Mortgage Law on the requirements for the sale of the mortgaged property. It is foreclosed judicially if the mortgagee causes the sale of the property in a public auction in accordance with Section 14 of the Chattel Mortgage Law.

2. **Question:** *Could ABC easily delay, obstruct or prevent that process of enforcement?*

Answer: If ABC's default is clear, it is theoretically relatively difficult to delay, obstruct or prevent enforcement.

3. **Question:** *In general, what period of time might it take either E Bank or F Bank to complete the process of enforcement?*

Answer: Generally, it may take 1 year to complete the enforcement of a mortgage chattel mortgage judicially. An extrajudicial foreclosure of chattel will generally take around 1 to 2 months to complete.

4. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law (other than an insolvency law) provide for the payment of 'priority claims' (e.g. employee/revenue claims owed by ABC) out of the proceeds of the sale of the equipment and in priority to the secured claims of E Bank and F Bank?*

Answer: There is no law which provides for the payment of priority claims out of the proceeds of the sale of the equipment and in priority to the secured claims of E Bank and F Bank.

5. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlements of E Bank and F Bank to the proceeds of the sale of the equipment?*

Answer: We are not aware of a possible security arising by operation of law which might intervene upon the entitlements of E Bank and F Bank to the proceeds of the sale of the equipment. However, see our discussion in the Third Scenario, Issue 5 with respect to the Carried Lumber Co. case.

Eighth Scenario – creation/ registration of a non-possessory security by ABC over 'inventory', possibly including inventory acquired in the future

Next, assume that G Bank, another bank/financier, has agreed to lend/provide a finance facility to ABC. ABC has agreed to give G Bank a non-possessory security for the loan/finance facility over its inventory of raw materials and finished goods, an inventory that will change from time to time as finished goods are manufactured and sold and new raw materials are supplied.

Issues:

1. **Question:** *Does the law provide for/permit security to be taken over inventory?*

Answer: The Chattel Mortgage Law applies to the creation of a security interest over chattels in general. A chattel mortgage may be constituted over present inventory.

2. **Question:** *What formal requirements does the law impose upon ABC and G Bank for the creation of this form of security?*

Answer: See answer to Fifth Scenario, Issue 3.

3. **Question:** *What requirements does the law impose upon ABC and G Bank for the registration of a security over inventory? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: See answer to Fifth Scenario, Issue 4.

4. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: See answer to Fifth Scenario, Issue 5.

5. **Question:** *Is it possible for ABC and G Bank to create the security in such a way that it will apply both to raw materials and finished goods?*

Answer: The description of the chattels subject of the mortgaged must expressly include both raw materials and finished goods. See also the answer to Issue 6 below.

6. **Question:** *Is it possible for ABC and G Bank to create the security in such a way that it will apply to a constantly changing inventory of raw materials and finished goods (i.e. a security over after acquired/future property)?*

Answer: As a general rule, the Chattel Mortgage Law does not allow a chattel mortgage over future property. A chattel mortgage shall be deemed to cover only the property described therein and not like or substituted property thereafter acquired by the mortgagor and placed in the same depository as the property originally mortgaged, notwithstanding anything in the mortgage to the contrary. The Philippine Supreme Court has, however, carved out exceptions to this rule, such as in the case of drug, grocery and dry goods stores whose stocks-in-trade are constantly sold and substituted with new stock. The Supreme Court held in one case that “[A] stipulation in the mortgage, extending its scope and effect to after-acquired property, is valid and binding... where the after-acquired property is in renewal of, or in substitution for, goods on hand when the mortgage was executed, or is purchased with the proceeds of the sale of such goods, etc (11 C.J., p.436)”: *Torres v. Limjap*²

Present practice in the Philippine financial community has extended the exception to inventories of raw materials, goods in process and finished goods. Many lawyers believe that inventories are continually being consumed and subsequently replaced, and are of the same nature as stocks-in-trade; thus they claim that inventories qualify for this exception. The court has not, however, categorically ruled on this issue.

Ninth Scenario – enforcement of a non-possessory security over inventory

Next, assume that ABC has defaulted in respect of the loan/finance facility made available to it by G Bank, such that H Bank is entitled to enforce its security over the inventory.

1. **Question:** *What means or process of enforcement is available to G Bank?*

Answer: See answer to Seventh Scenario, Issue 1.

2. **Question:** *Can such process of enforcement be easily delayed/obstructed/prevented by ABC?*

Answer: See answer to Seventh Scenario, Issue 2.

3. **Question:** *In general, what period of time might it take G Bank to complete the process of enforcement?*

Answer: See answer to Seventh Scenario, Issue 3.

4. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of ‘priority claims’ (e.g. employee, revenue claims owed by ABC) out of the proceeds of the sale of the inventory and in priority to the secured claim of G Bank?*

Answer: See answer to Seventh Scenario, Issue 4.

5. **Question:** *Is it possible that a security arising by ‘operation of law’ might intervene upon the entitlement of G Bank to the proceeds of the sale of the inventory?*

Answer: See answer to Seventh Scenario, Issue 5.

6. **Question:** *If JS, a supplier, supplied raw materials to ABC under a ‘retention of title’ contract (such that JS was entitled to claim ownership of or a security over the raw materials until ABC had paid for them in full), what would be the position between G Bank and JS regarding entitlement/priority to those raw materials? [Note: to avoid unnecessary complication, assume that the raw materials as supplied by JS to ABC continue to exist in their ‘raw’ state and that they have not been incorporated into finished goods]*

Answer: The rule is that the mortgagor must be the absolute owner of the thing mortgaged, and must have the free disposal of the property in order for the chattel mortgage to be valid. Thus, it is believed that a retention of title in favour of JS would effectively remove the goods from the lien created by the chattel mortgage over the raw materials. G Bank therefore did not obtain any security or priority over the raw materials. The issue has not been ruled upon in the Philippine courts.

² 56 Phil. 141 (1931)

Tenth Scenario – creation/ registration/enforcement of a security by ABC over ‘receivables’ (book debts)]

Next, assume that H Bank, another bank/financier, has agreed to lend/provide a finance facility to ABC. ABC has agreed to give H Bank security for the loan/finance facility over receivables (book debts) owed to ABC by its trade debtors.

Issues:

1. **Question:** *Is the creation of such a security possible? [Note: If such a commercial arrangement would not be regarded as a security but rather as a factoring/absolute assignment/transfer of ownership arrangement, please state so and take that into account in addressing the following issues]*

Answer: Taking security interest over receivables remains a controversial matter among Philippine lawyers. Many financial institutions accept assignments of receivables as security for credit accommodation, provided that the Deed of Assignment is notarised on the basis of Article 1625 of the Civil Code, which provides that an assignment of credit or right shall produce no effect as against third persons unless it appears in a public instrument. Many lawyers believe that since the aforementioned provisions fall under Title VI which governs “Sales”, the assignment of credit contemplated therein is an absolute assignment of creditor or sale of credit, and not an assignment of credit by way of security.

Some lawyers maintain that an assignment of receivables by way of security must partake the nature of a chattel mortgage or pledge. In their view, in order for an assignment as a security to bind third parties, the assignment should either be registered in the Chattel Mortgage Registry (in which case, it is a chattel mortgage), or else an evidence of the obligation assigned as security should be delivered to the creditor (in which case, it is a pledge).

Some lawyers utilise a Deed of Absolute Assignment in favour of the lender, which also creates an implied trust for the borrower, on the basis of Article 1454 of the Civil Code which provides that: “If an absolute conveyance of property is made in order to secure the performance of an obligation of the grantor toward the grantee, a trust by virtue of law is established. If the fulfilment of the obligation is offered by the grantor where it becomes due, he may demand the reconveyance of the property to him.” The assignment is documented as an

absolute assignment in favour of the lender whereby the borrower assigns, transfers and sets over the lender absolutely and unconditionally all of the borrower’s right, title and interest in respect of the receivables whereupon all such right, title, interest and benefit of the borrower to the receivables shall vest upon and accrue in favour of the lenders immediately. The assignment contains specific language to the effect that it is intended to ensure the payment by the assignor of the loan, and the excess of the proceeds from the assets assigned over the amount of the outstanding loan, shall be reconveyed to the borrower.

2. **Question:** *What formal requirements does the law impose on ABC and H Bank for the creation of a security over receivables?*

Answer: If the intention is to create a pledge, the requirements discussed for constituting a pledge will apply. If the intention is to create a chattel mortgage, the requirements for constituting a chattel mortgage will apply. If the intention is to make an absolute assignment, then the assignment must appear in a public instrument.

3. **Question:** *What requirements does the law impose on ABC and H Bank for the registration of a security over receivables? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: Generally, there is no registration requirement unless it takes the form of a chattel mortgage, in which case, the requirement for registering chattel mortgages apply.

4. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: See answer to Fifth Scenario, Issue 5.

5. **Question:** *Is it possible for ABC and H Bank to create the security in such a way that it will apply to and be valid over a constantly changing ‘stock’ of receivables?*

Answer: See answer to Eighth Scenario, Issue 6.

6. **Question:** *Assuming that ABC has defaulted in repayment of the loan/finance facility made available to it by H Bank, such that H Bank is entitled to enforce its security over the receivables, what means or process of enforcement is available to H Bank?*

Answer: See answers to Seventh Scenario, Issue 1 or Fourth Scenario, Issue 6.

7. **Question:** Can ABC easily delay, obstruct or prevent such enforcement process?

Answer: If ABC's default is clear, it is theoretically relatively difficult to delay, obstruct or prevent enforcement.

8. **Question:** In general, what period of time might it take H Bank to complete the process of enforcement?

Answer: See answers to Seventh Scenario, Issue 3 and Fourth Scenario, Issue 8.

9. **Question:** Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the proceeds of the collection of the receivables ahead of the claim of H Bank?

Answer: There is no law which provides for the payment of priority claims out of the proceeds of the collection of the receivables ahead of the claim of H Bank.

10. **Question:** Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of H Bank to the proceeds of the collection of the receivables?

Answer: We are not aware of a possible security arising by operation of law which might intervene upon the entitlement of H Bank to the proceeds of the collection of the receivables.

Eleventh Scenario – supply of goods to ABC by a supplier on a 'retention of title' contract

Next, assume that JS, a supplier of goods, has agreed to supply goods to ABC on credit and on terms that, although possession of the goods is given to ABC, title in the goods remains with JS until payment for the goods has been made in full.

Issues:

1. **Question:** Would such a commercial arrangement be treated as a security?

Answer: No. Since title in the goods remains with JS, JS retains full ownership of the goods, except as to possession.

2. **Question:** If yes, what formal requirements does the law impose on ABC and JS for the creation of such a security?

Answer: N/A.

3. **Question:** What requirements does the law impose on ABC and JS for the registration of such a security? [Please refer back to First Scenario, Issue 6 in advising on this issue]

Answer: N/A.

4. **Question:** How does the law resolve a situation in which a supplier of goods claims retention of title in those goods (whether by way of security or otherwise) and another person claims a non-possessory security over inventory? [Note: Please refer back to Ninth Scenario, Issue 6]

Answer: JS is still considered to be the owner of the goods. Thus it is believed that ABC cannot validly constitute a chattel mortgage. No valid non-possessory security over the inventory remains in favour of the other person/creditor.

5. **Question:** Assuming that ABC defaults in payment of the price payable for the goods supplied by JS, what process of enforcement is available to JS?

Answer: This arrangement is not treated as a security. The usual recourse available for JS is to demand for the return of the goods or payment of the price.

6. **Question:** In general, what period of time might it take JS to complete the process of enforcement?

Answer: The action will take the form of an ordinary action for collection, which will usually take 2 to 4 years in the trial court.

7. **Question:** Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the value/proceeds of the goods ahead of the claim of JS?

Answer: N/A.

8. **Question:** Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of JS to the goods?

Answer: N/A.

Twelfth Scenario – creation/registration of a lease to ABC of movable property

Next, assume that ABC wants to acquire equipment for use in its business operations but does not want to purchase the equipment. KL, a lease/finance company, has agreed to purchase the equipment and then to lease the equipment to KL for a term of years. A provision of the agreement provides that ABC may become the owner of the equipment upon the payment of the full lease and other charges.

Issues:

1. **Question:** *Would such a commercial arrangement be treated as a security?*

Answer: No, a lease financing arrangement is not treated as a security under Philippine law.

2. **Question:** *If yes, what formal requirements does the law impose on ABC and KL for the creation of such a security?*

Answer: N/A.

3. **Question:** *What requirements does the law impose on ABC and KL for the registration of such a security? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: N/A.

4. **Question:** *Assuming that ABC defaults in payment of the lease charges, what process of enforcement is available to KL?*

Answer: Ordinary civil action for the payment of the lease or return of equipment.

5. **Question:** *In general, what period of time might it take KL to complete the process of enforcement?*

Answer: The enforcement action in Issue 4 will take approximately 2 to 4 years in the trial court.

6. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) ahead of the claim of KL to the equipment?*

Answer: N/A.

7. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of KL to the equipment?*

Answer: N/A.

Thirteenth Scenario – creation/registration of a security by ABC over 'foreign' property

Next, assume that ABC owns movable property situated in a foreign jurisdiction and agrees to give security over that property to L Bank, a bank/financier that carries on business in the place in which ABC is incorporated.

Issues:

1. **Question:** *Does a law of the place of incorporation of ABC in any way intervene upon or seek to regulate the creation of such security?*

Answer: Philippine law does not seek to regulate the creation of a security over movable property situated in a foreign jurisdiction. Philippine law adopts the *lex situs* rule under Article 16 of the Civil Code, which provides that real property as well as personal property is subject to the law of the country where it is situated.

2. **Question:** *Does a law of the place of incorporation of ABC impose any requirement for the registration of such a security in the place of incorporation of ABC?*

Answer: No. Registration of chattel mortgage is required to be made in the place where the property is located.

3. **Question:** *Does a law of the place of incorporation of ABC seek to regulate the process of enforcement that is available to L Bank?*

Answer: No.

Part Two – Commencement/Opening of Insolvency Proceedings and the Effect on Secured Transactions

A. Issues relating to information about secured property and security holders

1. **Question:** *Would it be easy/difficult to determine, by reference to a public register, the security interests that had been created by ABC, the property that was the subject of those security interests and the identity of the holders of those security interests?*

Answer: It is relatively easy with respect to a real estate mortgage. The general rule is that an innocent purchaser for value (which includes an innocent lessee, mortgagee or other encumbrancer for value), takes registered property free from liens and encumbrances other than statutory liens and those recorded in the certificate of title. Thus, those who have a lien over the property usually promptly have the lien annotated on the certificate of title to the property through the Register of Deeds having jurisdiction over the place where the property is located. Note however, that a statutory lien (i.e. taxes, worker's lien, unpaid vendor's lien, and contractor's lien) subsists and binds the whole world even without the benefit of registration under the Torrens system, because everyone is presumed conclusively to know the law which provides for such liens. Thus, those who have statutory liens often do not annotate the title to the property.

A chattel mortgage is also required to be registered in a Chattel Mortgage Register. In many cases, the subject of chattel mortgages are building and/or equipment which are mortgaged separate from the land on which they may be found. In such a case, they are also annotated in the certificate of title covering the land.

2. **Question:** *Would it be easy/difficult to determine whether the security/property interests involving ABC were in the nature of security interests or non-security interests?*

Answer: It would be relatively easy, assuming that the interest is annotated or registered. The annotation usually indicates the nature of the interest.

3. **Question:** *In cases where ABC has created multiple security interests in respect of the same property, would it be easy/difficult to determine the priority between the competing security holders?*

Answer: Relatively easy. The law clearly provides specific rules in the event of concurrence and preference of credits: Articles 2236 to 2251, Civil Code. Further, the date of annotation, which, in some cases may be crucial in determining the relative priority of claims, is also indicated.

B. Issues relating to validity of secured property interests

1. **Question:** *Does the Insolvency Law provide for the possible invalidity or avoidance of any of the security interests created by ABC as a result of some imperfection in the creation of security interest (e.g. for failure to observe the formalities imposed by the law for the creation of a security interest or failure to observe the requirements of the law relating to registration)?*

Answer: No. The formalities affecting the validity of the creation of security interests are found in other laws, not the Insolvency Law. However, the same grounds can be raised in the insolvency proceedings to declare invalid, void or unenforceable certain security interests.

2. **Question:** *Does the insolvency law provide for the possible invalidity or avoidance of any of the security interests created by ABC (despite that a security interest may have been created and perfected in accordance with other relevant law) by the application of provisions relating to creditor preferment, transactions at an undervalue or fraudulent transactions?*

Answer: Yes. Under Section 61 of the Insolvency Law, claims of creditors who have received any preference made or given by the debtor in violation of the Insolvency Law may not be proved. Under Section 70 of the Insolvency Law, fraudulent transfers of property, made within 30 days before the filing of the petition for insolvency, with a view of giving

preference to a creditor (where the creditor has reasonable ground to believe that (i) the debtor is insolvent, (ii) the disposition is made with a view to prevent the property from coming to the assignee in insolvency or to prevent the property from being ratably distributed among the creditors) are void, and the assignee may bring an action to recover the property or its value. Under Section 37 of the Insolvency Law, actions may be brought against persons who, having notice of the insolvency proceedings, or having reason to believe that such proceedings are about to be commenced, conceal, embezzle, or dispose of any property of the debtor, for the recovery of the property or for double its value.

C. Issues relating to interference with substantive secured property rights

1. **Question:** *In a case of insolvency, how is 'secured property' (or other 'proprietary' interests in property) treated in relation to the estate of the debtor (i.e. is the property included in the estate of the debtor or excluded from the estate) and how are the claims of the secured creditors treated?*

Answer: Property subject to a mortgage or pledge does not pass to the assignee-in insolvency, unless the secured creditor surrenders his security.

A secured creditor has the following options: (a) he may waive his rights under the security or lien, prove his claim in the insolvency proceedings, and share in the distribution of the assets of the insolvent debtor, or (b) he may maintain his rights under his security or lien: Section 59, Insolvency Law.

If the secured creditor maintains his rights under his security or lien, he has again two options: (a) fix the value of the property subject of the mortgage, pledge, or lien, or (b) ask that the property be surrendered to him.

The value of the property may be fixed either by agreement between the creditor and the receiver, or if there is no receiver, by a judge, or in a sale directed by a judge. When the value of the property is less than the obligation it secures, the secured creditor will be admitted in the insolvency proceedings as a creditor for the balance. If its value exceeds the debt secured, the assignee may convey the property to the creditor and waive the debtor's right of redemption upon receiving the excess from the

creditor, or the assignee may sell the property subject to the claim of the creditor.

If the secured creditor asks that the property be surrendered to him, it is the duty of the assignee to deliver to him the property encumbered, and the creditor's claim shall be deemed satisfied: Section 59, Insolvency Law; *Union vs. Central Capiz*³; *Chartered Bank vs. Imperial*⁴

2. **Question:** *If the actual or anticipated proceeds or value from the sale/foreclosure of the secured property is less than the amount of the debt claim of the secured creditor, can the secured creditor claim the balance in the insolvency proceedings as an unsecured claim?*

Answer: See C1.

3. **Question:** *Other than as mentioned in B1 & 2 above, does the insolvency law in any way provide for the invalidity/non-recognition of any of the secured property interests created by ABC despite that such interest has been validly created and perfected under the relevant secured transactions law?*

Answer: Yes. The Insolvency Law provides that claims barred by the Statute of Limitations may not be proved.

D. Issues relating to stay/suspension of enforcement powers in relation to secured property interests

1. **Question:** *Does the insolvency law provide for any type of stay/suspension upon the enforcement rights of any of the secured creditors of ABC?*

Answer: Unless the security holder opts to surrender his security and participate in the insolvency proceedings, he is not affected by the order declaring the debtor insolvent. Thus, it has been held that the institution of proceedings to declare a debtor insolvent, and the subsequent declaration of insolvency, do not necessarily have the effect of suspending an action for foreclosure against the insolvent. The mortgage creditor is not obliged to take part in the insolvency proceedings for the recovery of his claim against the debtor judged insolvent. He may maintain a separate suit against the insolvent debtor for the recovery of his secured credit until he obtains a final judgment, and he may enforce this judgment against the property

³ 47 Phil. 44.

⁴ 48 Phil. 931.

mortgaged. The proceedings instituted by said creditor cannot be suspended whilst the insolvency proceedings are pending, and he does not have to wait for the decision in those proceedings (insolvency) or to abide by the decision, for the reason that the mortgage which the creditor holds as security for the payment of his debt constitutes a real right on the property mortgaged.

However, there are cases to the effect that actions for secured claims already begun are suspended until the assignee is elected. Upon election of the assignee, the action will be continued in the same court where it was filed⁵ Actions for secured claims may be commenced during insolvency proceedings by leave of the insolvency court. It will be granted as a matter of form, but the action will be suspended until the election of an assignee in insolvency. Thereafter, the action will continue in the same court where it was filed. No separate foreclosure proceedings may, however, be validly instituted without the previous consent of the court where the insolvency proceedings are pending.⁶

2. **Question:** *If so, at what point in time would such stay/suspension operate?*

Answer: Subject to D1 above, whilst the insolvency proceedings are pending.

3. **Question:** *Does such stay/suspension operate 'automatically' (e.g. through force of a law in consequence of some triggering event such as the commencement/opening of insolvency proceedings) or may it be only imposed by a court order?*

Answer: Subject to D1 above, upon the granting of the order declaring the petitioner insolvent, all civil proceedings against the debtor are stayed. However, there is support for the view that the suspension does not operate automatically upon the granting of the order declaring the petitioner insolvent. Under Section 60 of the Insolvency Law, it would appear that an application for suspension must be made by the debtor, or any creditor or the assignee. It is only upon such application that all civil proceedings against the debtor are stayed.

4. **Question:** *If such stay/suspension does not operate automatically or until a court order has been made, does the insolvency law provide for the possibility of an 'interim' or 'temporary' stay/suspension?*

Answer: Subject to D1 above, no.

5. **Question:** *If some of the transactions referred to in Part One of the case study are not regarded as secured property interests (but rather as proprietary/ownership rights), does any stay/suspension of enforcement rights extend to and apply to those transactions?*

Answer: N/A.

6. **Question:** *Does the stay/suspension apply even though a security holder has commenced/almost completed the enforcement process?*

Answer: N/A.

E. Issues relating to liquidation

Assume that ABC is to be liquidated under the Insolvency Law:

1. **Question:** *Does any stay/suspension of the enforcement powers of a secured creditor apply or continue to apply?*

Answer: Under the Insolvency Law, creditors holding mortgages, pledges, attachments or executions on the property of the debtor duly recorded in the Register of Deeds may opt not to participate in the insolvency proceedings. In such a case, they may proceed with the enforcement of their securities pending the insolvency proceedings.

On the other hand, the aforementioned secured creditors may choose to participate in the insolvency proceedings. In this case, they waive their rights under the security and share in the distribution of the assets of the debtor, or they may have the value of the encumbered property appraised and then share in the distribution of the assets of the debtor for the balance of the credit. Under Section 60 of the Insolvency Law, no creditor, proving his debt or claim, shall be allowed to maintain any suit against the debtor, but instead shall be deemed to have waived all right of action or suit against him or her, and all proceedings already commenced, or any unsatisfied judgment already obtained, shall be deemed to be discharged and surrendered.

2. **Question:** *For what period of time would such stay/suspension operate?*

Answer: See E1.

⁵ *O'Brien vs. Del Rosario*, 49 Phil. 657.

⁶ *Cu Unjieng vs. Mitchell*, 58 Phil. 476.

3. **Question:** Does the law provide that an affected security holder may apply for such stay to be lifted?

Answer: No.

F. Issues relating to priority claims

1. **Question:** Does the insolvency law provide for 'priority claims' to be paid ahead of the claims of a security holder?

Answer: Yes. The Insolvency Law follows the rules on Concurrence and Preference of Credits found in the Civil Code (Articles 2236 – 2251), as well as the Labor Code.

2. **Question:** If so, what are these priority claims and is there any conflict between them and any priority claims as mentioned in Part One of the case study (for example in scenarios 3, 4, 7, 9 & 10)?

Answer: Taxes and assessments on specific movable and immovable property enjoy absolute preference. Other liens attaching on specific movable and immovable property enjoy no priority among themselves, but must be paid concurrently and pro rata. The pro rata rule, however, does not apply to credits annotated in the Registry of Property by virtue of a judicial order, attachments and executions, which are preferred as to later credits.

Wages and other monetary claims of labourers provide a special problem because of conflicting jurisprudence. Under Article 110 of the Labor Code, "(i)n the event of bankruptcy or liquidation of an employer's business, his workers shall enjoy first preference as regards their wages and other monetary claims." There are varying interpretations of this provision by the Supreme Court. The prevailing view is, it seems, that, when the creditors claims do not attach to any specific property, it is an ordinary preferred credit, although it is now first in the list.⁷ The other view is that wages and other monetary claims of workers should be paid in full even before taxes and other claims of the government.⁸

G. Issues relating to enforcement

1. **Question:** Does the insolvency law provide for the enforcement of secured property interests or does it leave this to be determined by other law?

Answer: Enforcement of secured property interests is governed by other laws and rules.

2. **Question:** Does the insolvency law provide for the enforcement/realisation of secured property interests through the insolvency representative (office holder)?

Answer: No.

H. Issues relating to corporate rescue processes rehabilitation; reorganisation; restructuring

Assume that ABC is under the 'rescue' process of the insolvency law, but has not yet reached the point of approval of a plan of reorganisation.

(N.B. In the Philippines, rehabilitation proceedings are governed by a different set of laws i.e. Presidential Decree No. 902- as amended, the Rules of Procedure on Corporate Recovery issued by the Philippine Securities and Exchange Commission and the Interim Rules of Procedure on Corporate Rehabilitation issued by the Philippine Supreme Court. Rehabilitation proceedings were originally under the jurisdiction of the Securities and Exchange Commission pursuant to P.D. 902-A. However, Republic Act No. 8799, otherwise known as the Securities Regulation Code transferred jurisdiction over rehabilitation proceedings to the Regional Trial Courts ("RTC"). Pursuant to the SRC, the Supreme Court of the Philippines promulgated the Interim Rules of Procedure on Corporate Rehabilitation (the "Interim Rules"), which governs the procedure for corporate rehabilitation with the RTC. Our answers in Parts H and I below relate to rehabilitation proceedings under the Interim Rules).

1. **Question:** Does any stay/suspension of the enforcement powers of secured creditor apply or continue to apply?

Answer: Yes. The Interim Rules provide that if the Court finds the petition for rehabilitation to be sufficient in form and substance, it will issue a stay order which, among others, shall stay all enforcement of all claims against the debtor: Section 6, Rule 4. The word 'claim' covers claims or demands of whatever nature and kind against the debtor or its property, including claims of secured creditors: Section 1, Rule 2.

2. **Question:** For what period of time would such stay/suspension operate?

Answer: The stay order shall be effective from the date of its issuance until the dismissal of the

⁷ *Development Bank of the Philippines vs. National Labor Relations Commission*, 183 SCRA 328 (1990); *Banco Filipino vs. National Labor Relations Commission*, 188 SCRA 700 (1990); *Hautea vs. National Labor Relations Commission*, 230 SCRA 119 (1994).

⁸ *Philippine National Bank vs. Cruz*, 180 SCRA 206 (1989).

petition or termination of the rehabilitation proceedings. The petition shall be dismissed if no rehabilitation plan is approved by the court upon the lapse of 180 days from the date of the initial hearing: Section 11, Rule 4.

3. Question: *Does the law provide for the length of the stay to be extended?*

Answer: The court may grant an extension beyond the 180-day period only if it appears by convincing and compelling evidence that the debtor may successfully be rehabilitated. In no instance, however, shall the total period exceed 18 months from the date of the filing of the petition.

4. Question: *Does the law provide that an affected security holder may apply for such stay to be lifted?*

Answer: Yes. An affected security holder may apply to the court to terminate, modify, or set conditions for the continuance of the stay order, or relieve a claim from the coverage thereof: Section 12, Rule 4.

5. Question: *If so, what conditions must be established before such stay may be lifted?*

Answer: A stay order may be lifted upon showing that:

- any of the allegations in the petition, or any of the contents of any attachment, or the verification has ceased to be true;
- a creditor does not have adequate protection over property securing its claim; or
- the debtor's secured obligation is more than the fair market value of the property subject of the stay and such property is not necessary for the rehabilitation of the debtor.

Under this section, the creditor shall lack adequate protection if it can be shown that:

- the debtor fails or refuses to honour a pre-existing agreement with the creditor to keep the property insured;
- the debtor fails or refuses to take commercially reasonable steps to maintain the property; or
- the property has depreciated to an extent that the creditor is under-secured.

Upon showing of lack of adequate protection, the court shall order the rehabilitation receiver to:

- make arrangements to provide for the insurance or maintenance of the property; or
- to make payments or otherwise provide additional or replacement security such that

the obligation is fully secured. If such arrangements are not feasible, the court shall modify the stay order to allow the secured creditor lacking adequate protection to enforce its claim against the debtor, provided, however, that the court may deny the creditor the remedies in this paragraph if such remedies would prevent the continuation of the debtor as a going concern, or otherwise prevent the approval and implementation of the rehabilitation plan: Section 12, Rule 4.

6. Question: *Does the law provide that secured property may be used during the period of stay?*

Answer: The Interim Rules do not expressly provide that the secured property may be used during the period of stay. However, since the debtor under rehabilitation continues to operate during the proceedings, it may continue to use a secured property even during the period of stay.

7. Question: *Does this 'use' extend to the sale or other disposal of the secured property?*

Answer: No. As a matter of fact, the rehabilitation receiver is empowered and mandated to prohibit and report to the court any encumbrance, transfer, or disposition of the debtor's property outside of the ordinary course of business or what is allowed by the court: Section 14 (n), Rule 4.

8. Question: *What conditions must be fulfilled before secured property may be sold?*

Answer: If a property must be sold other than in the ordinary course of business during the rehabilitation proceedings, court approval is necessary.

9. Question: *If a plan is proposed in respect of ABC, what voting rights and powers do the security holders mentioned in Part One of the case study have?*

Answer: Security holders do not have the right to vote on the plan. The Interim Rules, however, give creditors the opportunity to oppose or comment on the petition for rehabilitation: Section 6, Rule 4. Moreover, in considering the rehabilitation plan, the Rehabilitation Receiver is supposed to meet with the creditors to discuss the plan with a view to clarifying or resolving any matter connected therewith: Section 21, Rule 4. The creditors are also given the right to submit a revised or substitute rehabilitation plan for the final approval of the court: Section 22,

Rule 4. However, the court may approve a rehabilitation plan even over the opposition of creditors holding a majority of the total liabilities of the debtor if, in its judgment, the rehabilitation of the debtor is feasible and the opposition of the creditors is manifestly unreasonable: Section 23, Rule 4.

10. Question: *Does the law provide that any of the secured creditors mentioned in Part One of the case study form a separate class of creditors for voting and plan approval matters?*

Answer: No. The Interim Rules follow the “equity is equality” principle under which both secured and unsecured creditors are treated alike pending rehabilitation proceedings.

11. Question: *If a majority vote in favour does this bind all security holders?*

Answer: No. Under the Interim Rules, the rehabilitation plan must be approved by the court, not the creditors. Once the court approves the plan, the plan and its provisions shall be binding upon the debtor and all persons who may be affected by it, including the creditors, whether or not such persons have participated in the proceedings or opposed the plan, or whether or not their claims have been scheduled: Section 24, Rule 4.

I. Issues relating to ‘new money’ financing of an insolvent corporation

1. Question: *Does the law provide for the possibility of raising additional working capital to enable ABC to continue in business?*

Answer: The Interim Rules does not expressly provide for the possibility of raising additional working capital to enable ABC to continue its business. The idea, however, is that pending rehabilitation, the corporation is allowed to continue with its operations and do what is required or necessary for the ordinary course of business, subject to the approval of the Rehabilitation Receiver and the court, if necessary.

2. Question: *If so, does this permit the repayment of such ‘new credit’ to rank as a ‘super priority’, ahead of the security holders mentioned in Part One of the case study?*

Answer: There is no law or rule giving ‘super priority’ to new money raised during rehabilitation proceedings.

3. Question: *Is the raising of such ‘new credit’ subject to the consent of secured creditors, approval of creditors generally or an order of the court?*

Answer: There is no law or rule specifically governing this matter.

Part Three

A. General issues relating to of security interests – rating, interest rate factor, barriers to secured lending, intersection problem areas.

1. **Question:** *In terms of quality and quantity, what rating would lenders apply between the forms of security interest examined in Part One (i.e. which are the most popular and why)?*

Answer: (1) Real estate mortgage, (2) chattel mortgage (security over equipment, inventory, motor vehicle) and (3) pledge, are the most preferred and common forms of security arrangements for banks and other financial institutions, in the order given. Real property does not depreciate, and cannot be concealed to avoid satisfaction of the obligation. A pledge of equipment, inventory or motor vehicle is usually not practicable, since the same are often used in the business of the borrower. However, pledges of shares of stock are common.

2. **Question:** *If it is possible, please provide average term of loan and interest rates charged by lenders to corporate borrowers for loans secured by:*

- *Mortgage over land - N/A*
- *Pledge over movable property - N/A*
- *Security over inventory - N/A*
- *Security over receivables - N/A*
- *Security over equipment - N/A*
- *Security over motor vehicles - N/A*

3. **Question:** *Having regard to the issues raised in Parts One and Two, what would the banking/finance sector consider are the main barriers/drawbacks to secured lending?*

Answer: The indiscriminate issuance of Temporary Restraining Orders (TRO) or writs of injunctions restraining foreclosures.

4. **Question:** *What areas of the 'intersection' cause the most problems or are most problematic in the banking/finance sector?*

Answer: The most problematic area is the intersection between secured lending and rehabilitation principally because : (a) the right of secured lenders to enforce their security pending rehabilitation is stayed; (b) a secured lender is

treated on an equal footing with unsecured creditors; and (c) secured creditors to not have a right to vote on the rehabilitation plan.

5. **Question:** *What areas are considered to be the main areas of target for reform or improvement?*

Answer: Revision of the Insolvency Act.

6. **Question:** *Do any of the issues mentioned in Parts One or Two cause problems in relation to informal work out processes?*

Answer: Yes.

B. Issues relating to internal corporate record of creation of secured property interests

1. **Question:** *Regardless of the requirements of any law to register secured property interests in a public register, does any law require that ABC must maintain an internal register or book of every security interest created by ABC and, if so, is such register or book available for inspection by a prospective creditor?*

Answer: We are not aware of any law which would require ABC to maintain an internal register or book of every security interest created by ABC.

C. Issues concerning law reform and development

1. **Question:** *In relation to the areas covered in the case study, are there any proposed reforms/developments to the law/s in your country that might affect any of the issues raised in Parts One and Two of the case study?*

Answer: Yes. There is now pending in Congress a proposed Corporate Recovery Act which provides for an integrated and comprehensive insolvency and rehabilitation scheme for financially distressed corporations.

D. Issues concerning domestic and international investment and finance

1. **Question:** *In relation to the remedy of 'foreclosure', are there any restrictions that intrude upon the power of a foreign lender to take possession, sell, become the 'owner' of or otherwise dispose of secured property?*

Answer: Yes. In consonance with the provision of the Constitution prohibiting foreigners from acquiring or owning land in the Philippines, Republic Act No. 133 (as amended by Act 4882) provides that a foreigner or his or her successor-in-interest cannot bid or take part in a foreclosure sale of real property. A foreigner cannot take possession of the real property during the existence of the mortgage and before default, but can take possession of the real property after default and solely for the purpose of foreclosure. In no case is this to exceed 5 years from actual possession, and such possession must be in accordance with the procedure for judicial foreclosure.

2. **Question:** *Is it considered that domestic/foreign lending might be increased by reform/improvements to the secured lending and/or insolvency law processes?*

Answer: Yes.

E. Issues concerning cross-border implications

1. **Question:** *Assume that ABC is either:*
 - (a) *a foreign company operating in your jurisdiction; or*
 - (b) *a wholly owned subsidiary (and incorporated and operating in your jurisdiction) of a foreign company; and*

assume further that insolvency proceedings are commenced/opened in respect of ABC or the parent of ABC in its place of incorporation (a foreign jurisdiction) and the foreign insolvency representative of ABC wishes to prevent any enforcement or recovery action by the secured creditors or property owners as mentioned in Part One of the case study.

In your jurisdiction, how might the foreign insolvency representative seek protection from such enforcement action?

Answer: We are not aware of any law or regulation, but this may be a proper subject for consideration in the proposed Corporate Recovery Act now pending before Congress.



Asian Development Bank

Promoting Regional Cooperation in the
Development of Insolvency Reform

RETA 5975

Draft Country Report for Singapore Conference
Intersection of Secured Transactions and
Insolvency Law Regimes

Thailand

Part One – Creation, Registration and Enforcement of Secured Transactions

Asia Business Corporation (“ABC”) is a company incorporated in your country and conducts its business from there.

First Scenario – the creation/registration of security by ABC over immovable property – land

B Bank is a bank/financier. It agrees to lend/provide a finance facility to ABC and ABC agrees to provide security for the loan/finance over land owned by ABC.



Issues:

1. **Question:** *In your country would the usual nature of the ownership or title of ABC to the land be freehold, leasehold or other (e.g. land use right)?*

Answer: The type of ownership or title of ABC to the land would generally be freehold. Leasehold, land-use rights or other kinds of claim to rights are less acceptable as security to project finance or syndicated loans.

2. **Question:** *Is it the case the ownership/title of the land of ABC would be registered in a land registration system?*

Answer: Yes, once the land of ABC is used for security, a written mortgage agreement would be officially recorded before the competent officer of the respective land office. The borrower (ABC) should bear all costs of the registration.

3. **Question:** *Would it be easy/difficult for B Bank to determine that ABC was the owner/had title to the land in question? [Please expand by commenting on the reliability and certainty of the registration system and the nature and state of the land registration system – single or multiple registry; centralised/local registry; manual/computer based; reliability of registered information; difficulties of searching etc]*

Answer: As explained above, the official mortgage endorsement will be made on both the title deed of ABC, and the official deed retained at the land office. The registration system is reliable. After completion, the lender or its authorised lending bank shall be the party in possession of ABC's mortgage title deeds throughout the term of the loan, or until the payment, if any, of the settlement of the debt is clear. A release and cancellation of mortgage registration will then be removed from the title deeds. The registration will be done manually. The information is reliable and can be easily researched, provided one can arrange for a search at the local registry. Therefore, it would be easy for B Bank to determine that ABC was the owner/ had title to the land in question.

4. **Question:** *Does any land ownership/title registration system extend to the registration of the proposed security that ABC will create in favour of B Bank?*

Answer: Yes, a security over land can and must be registered in order to be binding on the parties, and to rank in priority to other securities.

5. **Question:** *What formal requirements*

does the law impose upon ABC and B Bank for the creation of a security over land?

Answer: For the creation of a security over the land, the law imposes the formal requirement upon ABC and B Bank that the said security has to be made under written contract of mortgage. A contract of mortgage must specify the property mortgaged and must contain, in Thai currency, either a certain sum or a maximum amount for which the mortgaged property is assigned as security.

6. **Question:** *What requirements does the law impose upon ABC and B Bank for the registration of a security over land? In particular, if registration is required, what is the effect of non-registration in relation to:*

- (a) *the parties, and*
(b) *third parties?*

Answer:

The requirements imposed by the law upon ABC and B Bank for the registration of security over land are:

- the owner of property as mortgagor must consent to the registration of the mortgage against title to the land; and
 - a contract of mortgage must be made in writing and registered by the competent official.
- (a) The effect of non-registration in relation to the parties is that the debt will not be secured. Although the debt under the loan will still be contractually enforceable, the debt will be treated as unsecured.
- (b) The effect of non-registration in relation to the third parties is that a third party acting in good faith and without knowledge of the contractual arrangements between ABC and B Bank could enter into and, if registered, secure a mortgage over the land which would rank as a secured debt in priority to that between ABC and B Bank.

7. **Question:** *Is a building erected upon the land treated as part of the land (so that if ABC takes security over the land it also includes/covers the building) or, if not, what must ABC do to take security over the building?*

Answer: Yes, a building erected upon the land is treated as part of the land on the condition that such building was erected upon the land before the date of the mortgage.

A mortgage over land does not extend to the buildings erected by the mortgagor upon such land after the date of the mortgage, unless there is a special clause in the contract to that effect. However in this case, the mortgagee can have such buildings sold with the land, but he can exercise his preferential right only against the price obtained for the land.

8. **Question:** *Is plant and equipment (e.g. heavy plant and equipment that is clearly fixed or attached in a permanent way to the land or buildings) treated as part of the land (so that if ABC takes security over the land it also includes/covers the plant and equipment) or, if not, what must ABC do to take security over the plant and equipment?*

Answer: Yes, plant and equipment is treated as part of the land if the said plant and equipment is fixed or attached in a permanent way to the land or the buildings before the date of the mortgage, unless the registration form of the mortgage has already specified that the mortgage of land includes the plant and equipment which is fixed after the date of the mortgage. A mortgage does not extend to the fruits of the mortgaged property, except after the mortgagee has notified the mortgagor or transferee of his intention to enforce the mortgage.

Second Scenario – creation/registration of multiple security interests by ABC over the same land

Next, assume that B Bank has taken security over the land of ABC. C Bank, another bank/financier, agrees to make a loan/finance facility available to ABC. ABC agrees to provide security to C Bank over the same land that B Bank has taken security.

Issues:

1. **Question:** *Does the law in any way prevent, prohibit (or does it simply not provide for) multiple secured interests over land?*

Answer: Nothing in the law prevents or prohibits multiple secured interests over the land. However, it would usually be the case that B Bank as first mortgagee would be the holder of the land title deed, so B Bank would have to be informed and consent to registration of the secured security to C Bank. If B Bank does not give the land title deed to ABC, ABC could not give the deed to C Bank as security over the land, or for registration purposes.

2. **Question:** *Would it be easy/difficult for C Bank to discover that B Bank had an existing security over the land?*

Answer: It is easy for C Bank to discover that B Bank took security over the land by checking at the local land registry. The process takes only one day at the local registry, or fifteen (15) days at the land centralised registry.

3. **Question:** *Assuming that C Bank took security over the land, how will priority between B Bank and C Bank be determined?*

Answer: When one and the same property is mortgaged to several mortgagees, they rank according to the respective dates and time of registration. Therefore B Bank (the first mortgagee) ranks in priority to C Bank (as the second mortgagee).

4. **Question:** *Assuming that C Bank took security over the land, would the answer to Issue 3 be any different if the security that B Bank took over the land was not registered and C Bank had no knowledge of that security?*

Answer: A contract of mortgage must be made in writing and registered by the competent official. If B Bank's mortgage was not registered, B Bank would not have the right over the land. If C Bank registers without knowledge of the contract between ABC and B Bank, C Bank's loan will be secured by the registered mortgage, and rank in priority to ABC's debt to B Bank.

Third Scenario – enforcement of security over land

Next, assume that ABC has defaulted in respect of the loans/finance facilities made available to it by B Bank and C Bank such that either or both of B Bank and C Bank were able to enforce their respective security over the land.

Issues:

1. **Question:** *What means or process of enforcement is available to either or both of B Bank and C Bank?*

Answer: B Bank and C Bank have to file the complaint against ABC with the court. If the court renders judgment in favour of B Bank and C Bank, B Bank and C Bank must request the Court to appoint an executing officer to seize such land and sell it at public auction. In such a case, B Bank, as the first registered mortgagee will have priority to receive payment first.

2. **Question:** *Assuming that the default of ABC is quite clear, could ABC easily delay, obstruct or prevent any such process of enforcement?*

Answer: In practice, it is possible for ABC to delay or obstruct such process of enforcement, but difficult to prevent it. ABC's lawyer may file technical motions to delay enforcement. ABC may file an objection to the sale of the land. This can be done three times. However an executing officer can refuse the objection if there are not good reasons for the objection, and then sell the land. In such a case, ABC may file a petition with the Court seeking an order to oppose such sales.

3. **Question:** *In general, what period of time might it take for B Bank or C Bank to complete the process of enforcement?*

Answer: In Thailand, the process of enforcement is commenced after the court appoints the executing officer. The mortgagee cannot seize or sell the land itself. The enforcement process is completed if and when no objection to the auction sale is made by any party, and the plaintiff receives complete payment from the Legal Execution Department. In general it takes at least 6 months for B Bank or C Bank to complete the process of enforcement if such security can be sold at the first public auction. The sale of the land will be easily sold at the public auction if such land is in a good location, and the appraisal value of the land is not high. If the land is not in a good location, it is very difficult to sell. In such a case, it might take over a year or more to complete the process. Delays can also be caused by the backlog of cases at the Execution Department, and the consequent high case-load of each individual executing officer.

4. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law (other than an insolvency law) provide for the payment of 'priority claims' (for example employee, revenue claims owed by ABC) out of the proceeds of the sale of the land and in priority to the secured claims of B Bank and C Bank?*

Answer: Thai law (other than insolvency law) does not provide for the payment of 'priority claims' to be paid out of the mortgaged property in preference to secured creditors.

5. **Question:** *Is it possible that a security arising by 'operation of law' might*

intervene upon the secured property entitlements of B Bank and C Bank to the proceeds of the sale of the land?

Answer: There are no securities arising by operation of law. However it is usual for the Execution Department sale by auction terms to require the buyer to bear all costs of the transfer, which will include any unpaid land tax, which will then be collected at the time of registering the transfer of the land to the buyer.

Fourth Scenario – creation/ registration/enforcement of a possessory security by ABC over movable property

Next, assume that D Bank, another bank/financier has agreed to lend/provide a finance facility to ABC. ABC has agreed to give D Bank security for the loan/finance facility by a 'pledge' of certain movable property owned by ABC (e.g. shares). The result is that D Bank will have actual possession of the property.

Issues:

1. **Question:** *Does a law govern the creation of the type of security proposed between ABC and D Bank?*

Answer: Title XIII of Book Three of the Civil & Commercial Code recognises and governs the creation of pledges.

2. **Question:** *What formal requirements does any such law impose upon ABC and D Bank for the creation of this form of security?*

Answer: The formal requirements which are imposed upon ABC and D Bank for the creation of this form of security are:

- The security must be made as security for performance of an obligation.
- The moveable property is to be delivered to the pledgee, or, if the parties to the pledge agree, the pledged property can be kept by a third person.
- If the pledged property is a right represented by a written instrument, the pledge is void unless such instrument is delivered to the pledgee and the debtor is notified in writing of the pledge.
- If an instrument to order is pledged, such pledge will not be valid vis a viz third persons unless the pledge's creation is endorsed upon the instrument. No notification to the debtor under such instrument is necessary.

- If an instrument, issued to a named person which is not transferable by endorsement, is pledged, the pledge must be stated on such instrument, and will not be valid against the debtor under such instrument or third persons, unless notification is made to such debtor.
- If a named certificate for shares is pledged, such pledge will not be valid against the company or other third persons, unless the creation of the pledge is entered in the company's share register book, and in the case of pledge to the public company, the pledge is registered at the company share register book, and also at the Thailand Securities Depository Co Ltd.

3. **Question:** *Does a law require that such a security must be registered?*

Answer: Pledges of shares for private companies must be registered in the share register book of the company as per the answer to Fourth Scenario, Issue 2. Pledges of shares in public listed companies must be registered at the Thailand Securities Depository Co. Ltd.

4. **Question:** *If yes, what requirements does the law impose upon ABC and D Bank for the registration of such a security interest? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: The requirement that the law impose upon ABC and D Bank for the registration of such a security interest are as set out in the answer to First Scenario, Issue 6 and to this Fourth Scenario, Issues 1 and 2.

5. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: The Registration system for public listed shares is safe and reliable. The reliability of the system of registering private company shares depends on the diligence of the company in maintaining its share register, but if the procedures are followed then it is reliable.

6. **Question:** *Assuming that ABC has defaulted in respect of the repayment of the loan/finance facility made available to it from D Bank, what means or process of enforcement is available to D Bank?*

Answer: The process of enforcement available to D Bank is that D Bank must first notify ABC company in writing to perform its obligation within a reasonable time as fixed in the notice. If ABC company fails to comply with the notice, D Bank is entitled to sell the pledged property, but only by public auction. Prior to such sales, D

Bank is required to notify ABC company in writing of the time and place of the auction. If the notification is impracticable, D Bank may sell the pledged property by public auction one month from the time the obligation came due.

7. **Question:** *Could ABC easily delay, obstruct or prevent that enforcement process?*

Answer: ABC can delay, obstruct or prevent that enforcement process by filing the case with the court, and apply for an emergency injunction order to prohibit D Bank selling the pledge property if ABC can prove to the court that there are sufficient grounds for the court to grant such order against D Bank. E.g. there is no real debt between D Bank and ABC, and D Bank is acting in bad faith, or the pledged property does not belong to ABC.

8. **Question:** *In general, what period of time might it take for D Bank to complete the process of enforcement?*

Answer: In general, it takes approximately 20 days to one month for D Bank to complete the process of enforcement if the sale can be made at the first public auction.

9. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the proceeds of the pledged property and in priority to the secured claim of D Bank?*

Answer: Other than formal insolvency proceedings, there are no "priority claims" imposed by law that would rank in priority to the rights of D Bank.

10. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of D Bank to the pledged property?*

Answer: There are no securities by the operation of law which would intervene upon the entitlement of D Bank to the pledged property.

Fifth Scenario – creation/registration of a non-possessory security by ABC over movable property

Next, assume that E Bank, another bank/financier, agrees to lend/provide a finance facility to ABC. ABC agrees to provide E Bank with a non-possessory security over some equipment it owns. The result is that ABC would retain possession of the equipment.

Issues:

1. **Question:** Does the law provide/permit security to be taken over equipment?

Answer: The law only permits “mortgages” over limited categories of movable property, namely:

- ships and vessels of six tons and over or launches and motor boats over five tons;
- floating houses;
- beasts of burden; or
- other movables for which specific laws allow registration.

The latter includes industrial machinery of certain classes. Pledges of equipment can only be made if possession is granted to the pledgee. Any other arrangement between parties whereby equipment is used as security would be contractually enforceable, but not “secured”, and therefore an unreliable form of security.

2. **Question:** How would E Bank determine that the equipment is owned by ABC and is not subject to an existing security interest?

Answer: If the equipment is of a type that can be registered (e.g. industrial machinery), then E Bank would be able to check at the Central Machinery Registry, the Department of Industrial Works, or other relevant registry to determine ownership and the existence of any prior securities.

3. **Question:** What formal requirements does the law impose on ABC and E Bank for the creation of this form of security?

Answer: The security must be made in writing, and specify the amount or obligation which is secured. It must also be registered at the relevant registry.

4. **Question:** What requirements does the law impose upon ABC and E Bank for the registration of this form of security? [Please refer back to First Scenario, Issue 6 in advising on this issue]

Answer: The security must be registered. The same principles stated in the answer to First Scenario, Issue 6 apply.

5. **Question:** Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]

Answer: The registration system is relatively safe and reliable, although it can be cumbersome and time consuming to make accurate searches.

6. **Question:** Assume that the ‘equipment’ mentioned above comprised motor vehicles. Does that alter any of the advice given above? In particular, apart from any general requirement to register a security over motor vehicles, does such a security have to be also registered at, for example, a motor vehicle registration/licensing office?

Answer: Although there is a register of motor vehicle ownership, the register does not record security interests, and as such there is no ability to register such securities. The normal practice is for the creditor to take title to the motor vehicle, and lease it back to the debtor, with a contractual obligation to return ownership upon final payment, i.e. a form of hire purchase.

Sixth Scenario – creation/registration of multiple non-possessory securities by ABC over the same movable property

Next, assume that E Bank has taken security over the equipment of ABC. F Bank, another bank/financier, agrees to make a loan/finance facility available to ABC. ABC agrees to provide F Bank with a non-possessory security over the same property that has been secured to E Bank.

Issues:

1. **Question:** Does the law prevent, prohibit (or does it simply not provide for) multiple non-possessory secured interests over the same property?

Answer: The law will not prevent multiple non-possessory secured interests over the same property if such property is of a type that can have securities registered against it.

2. **Question:** Would it be easy/difficult for F Bank to discover that E Bank had an existing non-possessory security over the equipment?

Answer: It would be easy to discover that E Bank had an existing non-possessory security over the equipment by examining the registration at the authorities relating to such equipment, provided the equipment is of a type against which securities can be registered.

3. **Question:** Assuming that F Bank took security over the equipment, how will priority between E Bank and F Bank be determined?

Answer: Priority will be determined according to the date and time of registration of the security. Thus if E Bank registered first, it will take priority.

4. **Question:** Assuming that F Bank takes security over the equipment, would the answer to Issue 3 be any different if the security that E Bank took over the property was not registered and F Bank had no knowledge of that security?

Answer: The same principles as set out in the answer to First Scenario, Issue 6, apply to this type of registered security.

Seventh Scenario – enforcement of non-possessory security over movable property

Next, assume that ABC has defaulted in respect of the loans/finance facilities made available to it by E Bank and F Bank such that either or both of E Bank and F Bank were able to enforce their respective securities over the equipment.

Issues:

1. **Question:** What means or process of enforcement is available to either or both of E Bank and F Bank?

Answer: E Bank and F Bank have to file a complaint against ABC with the court. Once the court renders judgment for E and F Bank, they have to request the court to appoint an executing officer for the sale of the equipment by public auction, in a similar procedure to that which governs the sale of land as described in our answers to the First Scenario. E Bank, who had registered the mortgage prior to F Bank, shall be satisfied first.

2. **Question:** Could ABC easily delay, obstruct or prevent that process of enforcement?

Answer: Although the law prohibits ABC from delaying, obstructing or preventing the process of enforcement, in practice ABC may file technical motions to delay enforcement. Moreover, ABC is entitled to file an objection to the sale of the equipment. This can be done three times, but an executing officer can refuse the objection if there is not a good reason. Delays can also arise from the backlog of cases at the Execution Department.

3. **Question:** In general, what period of time might it take either E Bank or F Bank to complete the process of enforcement?

Answer: The period of time to complete the process of enforcement is hard to specify. In practice, the shortest period is 6 months if no objection to such enforcement is raised by any other party. However, longer periods, for example one year, are common.

4. **Question:** Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law (other than an insolvency law) provide for the payment of 'priority claims' (e.g. employee/revenue claims owed by ABC) out of the proceeds of the sale of the equipment and in priority to the secured claims of E Bank and F Bank?

Answer: There are no "priority claims" imposed by law that would intervene in priority to the claims of E Bank and F Bank.

5. **Question:** Is it possible that a security arising by 'operation of law' might intervene upon the entitlements of E Bank and F Bank to the proceeds of the sale of the equipment?

Answer: There are no such "priority claims" or securities "by operation of law".

Eight Scenario – creation/registration of a non-possessory security by ABC over 'inventory', possibly including inventory acquired in the future

Next, assume that G Bank, another bank/financier, has agreed to lend/provide a finance facility to ABC. ABC has agreed to give G Bank a non-possessory security for the loan/finance facility over its inventory of raw materials and finished goods, an inventory that will change from time to time as finished goods are manufactured and sold and new raw materials are supplied.

Issues:

1. **Question:** Does the law provide for/permit security to be taken over inventory?

Answer: The law does not provide for, but does not prohibit, the creation by way of contract of such a security over inventory. There is no ability to register such a security and so it is of limited value. Pledges, which are possessory securities, are therefore more common.

2. **Question:** What formal requirements does the law impose upon ABC and G Bank for the creation of this form of security?

Answer: This type of security is merely contractual, and thus the only requirement is that it be made in writing.

3. **Question:** *What requirements does the law impose upon ABC and G Bank for the registration of a security over inventory? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: There is no official registration of such securities. However, under the Accounts Law, the accountant has to record all inventories in the Goods Control Book. Such a record must be kept at ABC Company so that the auditor of the company can check the stock at the end of the accounting period.

4. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: See the answer to Eighth Scenario, Issue 3.

5. **Question:** *Is it possible for ABC and G Bank to create the security in such a way that it will apply both to raw materials and finished goods?*

Answer: The parties can specify both raw materials and finished goods in their agreement.

6. **Question:** *Is it possible for ABC and G Bank to create the security in such a way that it will apply to a constantly changing inventory of raw materials and finished goods (i.e. a security over after acquired/future property)?*

Answer: The parties could specify that the securities apply to future property in their agreement, but the courts would only enforce such contractual term over goods acquired, and would not enter any speculation as to whether or not goods would be acquired.

Ninth Scenario – enforcement of a non-possessory security over inventory

Next, assume that ABC has defaulted in respect of the loan/finance facility made available to it by G Bank, such that H Bank is entitled to enforce its security over the inventory.

1. **Question:** *What means or process of enforcement is available to G Bank?*

Answer: G Bank has to file the complaint against ABC with the court. Then, if the court renders a judgment in favour of G Bank, G Bank must appoint an executing officer to enforce the judgment.

2. **Question:** *Can such process of enforcement be easily delayed/obstructed/prevented by ABC?*

Answer: See the answer to Seventh Scenario, Issue 2.

3. **Question:** *In general, what period of time might it take G Bank to complete the process of enforcement?*

Answer: See the answer to Seventh Scenario, Issue 3.

4. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) out of the proceeds of the sale of the inventory and in priority to the secured claim of G Bank?*

Answer: No, the law does not provide for the payment of "priority claims" out of the proceeds of the sale of the inventory, and in priority to the secured claim of G Bank.

5. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of G Bank to the proceeds of the sale of the inventory?*

Answer: See the answer to the Seventh Scenario, Issue 5.

6. **Question:** *If JS, a supplier, supplied raw materials to ABC under a 'retention of title' contract (such that JS was entitled to claim ownership of or a security over the raw materials until ABC had paid for them in full), what would be the position between G Bank and JS regarding entitlement/priority to those raw materials? [Note: to avoid unnecessary complication, assume that the raw materials as supplied by JS to ABC continue to exist in their 'raw' state and that they have not been incorporated into finished goods]*

Answer: If title to the raw materials is retained by JS and the raw materials have not been mixed or processed, then JS would take priority over G Bank, provided JS can prove its title by express contractual term(s) reserving its title.

Tenth Scenario – creation/ registration/enforcement of a security by ABC over ‘receivables’ (book debts)

Next, assume that H Bank, another bank/financier, has agreed to lend/provide a finance facility to ABC. ABC has agreed to give H Bank security for the loan/finance facility over receivables (book debts) owed to ABC by its trade debtors.

Issues:

1. **Question:** *Is the creation of such a security possible? [Note: If such a commercial arrangement would not be regarded as a security but rather as a factoring/absolute assignment/transfer of ownership arrangement, please state so and take that into account in addressing the following issues]*

Answer: A “security” over receivables is in fact a full assignment of the right to such receivables. As such, it is possible in law provided the formalities are followed.

2. **Question:** *What formal requirements does the law impose on ABC and H Bank for the creation of a security over receivables?*

Answer: The agreement of transfer of claims must be prepared in writing and signed by both parties. The fact of the transfer, identity of the transferee and payment instructions must be notified to the debtor. However, note that as a matter of practice, the transferee (in this case H Bank) usually appoints the transferor (ABC) to act as its agent for all collection and notification tasks.

3. **Question:** *What requirements does the law impose on ABC and H Bank for the registration of a security over receivables? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: Registration is not available.

4. **Question:** *Is the registration system safe and reliable? [Please refer back to First Scenario, Issue 3 for the information required in relation to this issue]*

Answer: Registration is not available.

5. **Question:** *Is it possible for ABC and H Bank to create the security in such a way that it will apply to and be valid over a constantly changing ‘stock’ of receivables?*

Answer: The parties could specify in their agreement that the security applies to changing stock.

6. **Question:** *Assuming that ABC has defaulted in repayment of the loan/finance facility made available to it by H Bank, such that H Bank is entitled to enforce its security over the receivables, what means or process of enforcement is available to H Bank?*

Answer: If the assignment of receivables has been properly made and notified to the debtor, H Bank could enforce directly against the debtor. However, the procedure would be the same as if ABC were enforcing, that is filing a complaint in court and, upon receipt of judgment, transfers to the execution officer for enforcement via the Execution Department. H Bank would have the added requirement of proving its right as transferee of the debt, and that proper notification had been made to the debtor.

7. **Question:** *Can ABC easily delay, obstruct or prevent such enforcement process?*

Answer: See the answer to Seventh Scenario, Issue 2.

8. **Question:** *In general, what period of time might it take H Bank to complete the process of enforcement?*

Answer: The time of filing a complaint in the court, to receiving judgment against the Debtor in the court of first instance could take one year, and enforcement via the Execution Department could take at least another 6 months after judgment.

9. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of ‘priority claims’ (e.g. employee, revenue claims owed by ABC) out of the proceeds of the collection of the receivables ahead of the claim of H Bank?*

Answer: The third parties shall only have priority to the receivables if, and when they have the evidence to show that they have a better claim to the receivables, for example that title is already transferred to them.

10. **Question:** *Is it possible that a security arising by ‘operation of law’ might intervene upon the entitlement of H Bank to the proceeds of the collection of the receivables?*

Answer: See the answer to the Seventh Scenario, Issue 5.

Eleventh Scenario – supply of goods to ABC by a supplier on a ‘retention of title’ contract

Next, assume that JS, a supplier of goods, has agreed to supply goods to ABC on credit and on terms that, although possession of the goods is given to ABC, title in the goods remains with JS until payment for the goods has been made in full.

Issues:

1. **Question:** *Would such a commercial arrangement be treated as a security?*

Answer: The retention of title will be recognised as a contractual right between the parties.

2. **Question:** *If yes, what formal requirements does the law impose on ABC and JS for the creation of such a security?*

Answer: ABC and JS must have entered into an Agreement for the Sale of Goods that contains an express retention of title.

3. **Question:** *What requirements does the law impose on ABC and JS for the registration of such a security? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: Registration is not available.

4. **Question:** *How does the law resolve a situation in which a supplier of goods claims retention of title in those goods (whether by way of security or otherwise) and another person claims a non-possessory security over inventory? [Note: Please refer back to Ninth Scenario, Issue 6]*

Answer: See the answer to the Ninth Scenario, Issue 6. The one who claims retention of title in goods shall have a better right than the person who claims a non-possessory security over inventory. However, title must be proven, and this can be problematic when goods have been mixed or processed.

5. **Question:** *Assuming that ABC defaults in payment of the price payable for the goods supplied by JS, what process of enforcement is available to JS?*

Answer: Theoretically JS can take the goods back because the title to the goods remains with JS. However any form of “self help” seizure is very difficult to conduct, unless the retention of title clause includes an irrevocable license to enter the premises and repossess the goods. Even then there are many legal technicalities which could delay or even prevent the process.

The more usual alternative would be for JS to file the case to the court to request the remaining payment or return of the goods.

6. **Question:** *In general, what period of time might it take JS to complete the process of enforcement?*

Answer: See the answer to the Seventh Scenario, Issue 3.

7. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of ‘priority claims’ (e.g. employee, revenue claims owed by ABC) out of the value/proceeds of the goods ahead of the claim of JS?*

Answer: See the answer to the Tenth Scenario, Issue 9.

8. **Question:** *Is it possible that a security arising by ‘operation of law’ might intervene upon the entitlement of JS to the goods?*

Answer: See the answer to the Seventh Scenario, Issue 5.

Twelfth Scenario – creation/registration of a lease to ABC of movable property

Next, assume that ABC wants to acquire equipment for use in its business operations but does not want to purchase the equipment. KL, a lease/finance company, has agreed to purchase the equipment and then to lease the equipment to ABC for a term of years. A provision of the agreement provides that ABC may become the owner of the equipment upon the payment of the full lease and other charges.

Issues:

1. **Question:** *Would such a commercial arrangement be treated as a security?*

Answer: This commercial arrangement is deemed by the law to be a Hire-Purchase. It is a contractual right, and not registrable as a security.

2. **Question:** *If yes, what formal requirements does the law impose on ABC and KL for the creation of such a security?*

Answer: The Hire-Purchase must be created by specifying in the contract that an owner of a property lets it out on hire, and promises to sell it to the hirer, or that it shall become the property of the hirer, conditionally on his making

a certain number of payments. The contract must be made in writing.

3. **Question:** *What requirements does the law impose on ABC and KL for the registration of such a security? [Please refer back to First Scenario, Issue 6 in advising on this issue]*

Answer: There is no requirement for registration.

4. **Question:** *Assuming that ABC defaults in payment of the lease charges, what process of enforcement is available to KL?*

Answer: If ABC defaulted in two successive payments, or breached any material part of the contract, all previous payments are forfeited to KL, and KL is entitled to resume possession of its property. In case of breach of contract by default of the last payment, KL is entitled to forfeit previous payment and resume possession of the property only after the expiration of one instalment period.

5. **Question:** *In general, what period of time might it take KL to complete the process of enforcement?*

Answer: KL can resume possession over the property after ABC defaults, as described in Twelfth Scenario, Issue 4.

6. **Question:** *Assuming that no formal insolvency proceedings have yet been commenced/opened in respect of ABC, does a law provide for the payment of 'priority claims' (e.g. employee, revenue claims owed by ABC) ahead of the claim of KL to the equipment?*

Answer: The law provides that if several persons claim to have acquired the same movable property under different titles, the person who is in possession of the property is preferred, provided that he has acquired it for value and has obtained possession in good faith. Therefore, if a third party bought the goods with good faith, he will have greater priority over the entitlement than KL.

7. **Question:** *Is it possible that a security arising by 'operation of law' might intervene upon the entitlement of KL to the equipment?*

Answer: See the answer to Twelfth Scenario, Issue 6.

Thirteenth Scenario – creation/registration of a security by ABC over 'foreign' property

Next, assume that ABC owns movable property situated in a foreign jurisdiction and agrees to give security over that property to L Bank, a bank/financier that carries on business in the place in which ABC is incorporated.

Issues:

1. **Question:** *Does a law of the place of incorporation of ABC in any way intervene upon or seek to regulate the creation of such security?*

Answer: There is no law which intervenes with the creation of this arrangement. However, because the property is not in L Bank's possession, this arrangement shall not be treated as a pledge unless the parties agree that the property shall be kept by a third person in the foreign jurisdiction.

2. **Question:** *Does a law of the place of incorporation of ABC impose any requirement for the registration of such a security in the place of incorporation of ABC?*

Answer: There is no requirement for registration. The parties shall be bound according to the agreement which both parties have entered into.

3. **Question:** *Does a law of the place of incorporation of ABC seek to regulate the process of enforcement that is available to L Bank?*

Answer: L Bank may file the case to the court, but whether or not the judgment of the court will be enforced in the foreign jurisdiction depends on the law of a country in which the property is located.

Part Two – Commencement/Opening of Insolvency Proceedings and the Effect on Secured Transactions

A. Issues relating to information about secured property and security holders

1. **Question:** *Would it be easy/difficult to determine, by reference to a public register, the security interests that had been created by ABC, the property that was the subject of those security interests and the identity of the holders of those security interests?*

Answer: It depends on whether the property is movable or immovable property, and whether a register exists. For movable property, a debtor can pledge such property to a creditor as collateral. It is difficult to determine the property that is the subject of such possessory security interests, and the identity of the holders of those security interests, if such property is not required to be registered at any authorities.

For movable property for which a security register exists, and immovable property such as land, building etc., it is easy to determine, because the law requires the registration of such security.

2. **Question:** *Would it be easy/difficult to determine whether the security/property interests involving ABC were in the nature of security interests or non-security interests?*

Answer: Further to our answer to Thirteenth Scenario, Issue 1, those non-registered “security” interests are very difficult to discover. Registered securities can be relied upon as being securities.

3. **Question:** *In cases where ABC has created multiple security interests in respect of the same property, would it be easy/difficult to determine the priority between the competing security holders?*

Answer: It would be easy to determine the priority of multiple security interests in respect of the same property by examining the date and time of registration. The first registration of security shall have priority right over the secured property except for preferential mortgage. The preferential mortgage shall have a prior right, although the registration date occurs after other creditors.

B. Issues relating to validity of secured property interests

1. **Question:** *Does the Insolvency Law provide for the possible invalidity or avoidance of any of the security interests created by ABC as a result of some imperfection in the creation of security interest (e.g. for failure to observe the formalities imposed by the law for the creation of a security interest or failure to observe the requirements of the law relating to registration)?*

Answer: Yes, the Insolvency Law provides for the possible invalidity or avoidance of any of the security interests created by ABC as a result of failure to observe the formalities imposed by the law for the creation of a security interest or failure to observe the requirements of the law relating to registration. For example, if possession of pledged property was not transferred to the pledgee, or if that pledgee transferred possession of it to a third party without the pledgor’s consent, the security of the pledge could be challenged and avoided for imperfection.

2. **Question:** *Does the insolvency law provide for the possible invalidity or avoidance of any of the security interests created by ABC (despite that a security interest may have been created and perfected in accordance with other relevant law) by the application of provisions relating to creditor preferment, transactions at an undervalue or fraudulent transactions?*

Answer: Yes. Under the rehabilitation process, Sections 90/40, 90/41, and insolvency process, Sections 113, 114, 115 of the Bankruptcy Act B.E. 2483 provides an assumption of fraudulent transactions if the creation of such a transaction results in a disadvantage to other creditors while the debtor gains an inappropriate return from such a creation.

C. Issues relating to interference with substantive secured property rights

1. **Question:** *In a case of insolvency, how is 'secured property' (or other 'proprietary' interests in property) treated in relation to the estate of the debtor (i.e. is the property included in the estate of the debtor or excluded from the estate) and how are the claims of the secured creditors treated?*

Answer: The secured property can either be treated as the property in relation to the estate of the debtor or outside the estate of the debtor. The reason is that under Insolvency Law, a secured creditor can file its claim for repayment of debt by waiving the security and claim for all outstanding debt, or appraise the value of the secured property and claim for the remaining balance.

Under Section 95 of the Bankruptcy Act B.E. 2483, the secured creditor shall have the right over the secured property even if the application for repayment of debt is not filed with the official receiver. If the secured creditor files the application with the official receiver, such creditor shall be treated as a secured creditor only if it states in the application that it is the secured creditor. If such creditor fails to identify itself as the secured creditor in the said application, such creditor shall be treated as an unsecured creditor.

In practice, a secured creditor will file the application for repayment of debt with the official receiver as an unsecured creditor only when the secured property has devalued, and the expenses of enforcement do not make it worthwhile.

2. **Question:** *If the actual or anticipated proceeds or value from the sale/foreclosure of the secured property is less than the amount of the debt claim of the secured creditor, can the secured creditor claim the balance in the insolvency proceedings as an unsecured claim?*

Answer: Yes, the secured creditor can file a claim for repayment of debt for the remaining balance if such claim is filed within 2 months after the announcement of the receivership order against the debtor is published in the government gazette.

3. **Question:** *Other than as mentioned in B1 & 2 above, does the insolvency law in any way provide for the invalidity/non-recognition of any of the secured property interests created by ABC despite that such interest has been validly created and perfected under the relevant secured transactions law?*

Answer: Yes. A secured creditor must identify itself as such in its application, as set out more fully in the answer to C1.

D. Issues relating to stay/suspension of enforcement powers in relation to secured property interests

1. **Question:** *Does the insolvency law provide for any type of stay/suspension upon the enforcement rights of any of the secured creditors of ABC?*

Answer: The provision of stay/suspension upon the enforcement right of any of the secured creditors in Thailand is stated only in Section 90/12 of the rehabilitation process under the Bankruptcy Act. This becomes effective from the date the court accepts the application for rehabilitation. Under the Section, the secured creditor is prohibited from enforcing the secured property.

2. **Question:** *If so, at what point in time would such stay/suspension operate?*

Answer: The stay/suspension protection period operates from when the Court accepts the application for the business rehabilitation, until the rehabilitation process is accomplished, or the Court repeals a rehabilitation order. However, the creditor who suffers from such stay may seek a court approval to enforce the security as follows:

- *Security on Land* – The creditors might file a motion with the Court seeking an order to allow the creditors to enforce the security on the grounds that the land which is the security is not a substantial matter for the debtor's business. In this case, the secured creditor of land also has a right to request the Court for enforcement if it considers that the application for debtor's business rehabilitation does not give enough protection to the creditor's rights.
- *Non-possessory security over movable property* – The creditor can file a motion to the Court for approval to enforce against the secured property on the ground that such secured property is not necessary or of major concern to the debtor's business.

- *Lease financier* – If the object of the lease agreements is not a substantial matter for running the debtor's business, the creditor can file a motion with the Court requesting approval to enforce the security.

3. **Question:** *Does such stay/suspension operate 'automatically' (e.g. through force of a law in consequence of some triggering event such as the commencement/opening of insolvency proceedings) or may it be only imposed by a court order?*

Answer: The stay/suspension, under section 90/12 of the Bankruptcy Act. B.E.2483, operates as an automatic stay, which is automatically enforced by the law from the date the court accepts the application for business rehabilitation.

4. **Question:** *If such stay/suspension does not operate automatically or until a court order has been made, does the insolvency law provide for the possibility of an 'interim' or 'temporary' stay/suspension?*

Answer: There are no provisions under the Bankruptcy Act for an "interim" or "temporary" stay/suspension.

5. **Question:** *If some of the transactions referred to in Part One of the case study are not regarded as secured property interests (but rather as proprietary/ownership rights), does any stay/suspension of enforcement rights extend to and apply to those transactions?*

Answer: The stay of enforcement would not apply to the retention of title by JS and the assignment of receivables to H Bank because the title to the raw materials and the right to receive and enforce the debt (respectively) have been fully transferred to the creditors. However if those transactions occurred within the 3 months preceding the date of the application for rehabilitation, the Official Receiver would have the power to investigate, and if necessary void the transactions if the Official Receiver considered them to be an attempt to unfairly favour the creditors.

6. **Question:** *Does the stay/suspension apply even though a security holder has commenced/almost completed the enforcement process?*

Answer: Under the Bankruptcy Act. B.E.2483, the provision of stay/suspension shall be applied in any cases which might affect the debtor's property

and its business. In the event that a security holder has commenced or almost completed the enforcement process before the restriction period, but the period is not yet completed, such creditor shall be forced by law to cease its performance of execution or seizure. The security holder is able to make a request to the Court for approval to continue its enforcement.

E. Issues relating to liquidation

Assume that ABC is to be liquidated under the Insolvency Law:

1. **Question:** *Does any stay/suspension of the enforcement powers of a secured creditor apply or continue to apply?*

Answer: From the time the court orders receivership of the company, secured creditors have three options, namely:

- To file a claim as a secured creditor, and waive their right to enforce the security; or
- To file an appraisal of the security (with the intention to enforce it itself), and claim the balance between the appraised security and the total debt; or
- To ask the Official Receiver to enforce the security or on behalf of the creditors'.

Under the first and third options, the stay continues to apply, but under the second, if the appraised value is accepted by the Official Receiver (who has 4 months to decide), the stay will not apply to enforcement of that asset.

2. **Question:** *For what period of time would such stay/suspension operate?*

Answer: See the answer to E1.

3. **Question:** *Does the law provide that an affected security holder may apply for such stay to be lifted?*

Answer: Other than the three options, described in our answer to E1 regarding how the secured creditor wishes to file its claim, the law does not allow an affected security holder to apply for the stay to be lifted.

F. Issues relating to priority claims

1. **Question:** *Does the insolvency law provide for 'priority claims' to be paid ahead of the claims of a security holder?*

Answer: The priority claims are specified in Section 130 of the Bankruptcy Act and rank, in order of priority, as follows:

- administration expenses of the deceased debtor;

- expenses of the receiver in managing the debtor's assets;
- funeral expenses of the deceased debtor;
- fees in collecting assets;
- fees of petitioning creditor and counsel's fees as the court or receiver prescribe; and
- taxes and wages.

2. **Question:** *If so, what are these priority claims and is there any conflict between them and any priority claims as mentioned in Part One of the case study (for example in scenarios 3, 4, 7, 9 & 10)?*

Answer: The priority is as per our answer to F1 above. These do not conflict with the scenarios in Part One because there are no such priority claims relevant to the scenario in Part One.

G. Issues relating to enforcement

1. **Question:** *Does the insolvency law provide for the enforcement of secured property interests or does it leave this to be determined by other law?*

Answer: If the creditor selects the second option of those options listed in E1, once the appraised value is approved by the Official Receiver, the creditor can enforce the security using the procedures under ordinary law. However if the first or third options are selected, the Official Receiver will conduct enforcement according to Insolvency Law, but the procedures (sale by public auction) are very similar. The only significant difference is that the creditors in general meeting can vote to sell the asset directly, rather than sell by way of public auction.

2. **Question:** *Does the insolvency law provide for the enforcement/realisation of secured property interests through the insolvency representative (office holder)?*

Answer: The Official Receiver will be the sole person to have the full authority to collect the debtor's assets under the enforcement, and sell such collected properties under the insolvency law, except where the secured creditor has elected the second option to enforce the security itself.

H. Issues relating to corporate rescue processes [rehabilitation; reorganisation; restructuring]

Assume that ABC is under the 'rescue' process of the insolvency law, but has not yet reached the point of approval of a plan of reorganisation

1. **Question:** *Does any stay/suspension of the enforcement powers of secured creditor apply or continue to apply?*

Answer: From the day on which the court makes an order accepting the petition, the re-organisation clause provides that: "No action or petition shall be brought to the court for adjudication or order to dissolve the juristic person who is the debtor. If there has previously been such action or petition brought to the court, the court shall suspend the trial of the said case". The clause applies to the enforcement powers of secured creditors, such that no secured creditor can enforce payment of debt against the asset, which is security, unless otherwise approved by the court with whom the petition is filed.

2. **Question:** *For what period of time would such stay/suspension operate?*

Answer: From the day on which the court makes an order accepting the petition until the expiration of period of time for implementation of the plan, or the date on which the plan is successfully accomplished, or the date on which the court dismisses the petition or disposes of the case or repeals the order for a business re-organisation, or cancels the business re-organisation, or places the debtor under absolute receivership.

3. **Question:** *Does the law provide for the length of the stay to be extended?*

Answer: The period of time of stay is indicated under the re-organisation law, as answered in H2. Thus, the length of the stay cannot be extended.

4. **Question:** *Does the law provide that an affected security holder may apply for such stay to be lifted?*

Answer: Creditors and persons whose rights have been subjected to limitations of rights may submit an application to the court which accepted the petition, for an order amending, modifying or annulling limitations on their rights.

5. **Question:** *If so, what conditions must be established before such stay may be lifted?*

Answer: The conditions that must be established before such a stay may be lifted are as follows:

- the assets or security are not necessary for the business re-organisation; or
- re-organisation does not sufficiently protect the rights of secured creditors.

Upon receipt of the application pursuant to above, the court shall proceed with its consideration thereof as an urgent matter. If it appears to be a case under the first point, the court shall issue an order as it deems appropriate to protect the benefits of the applicant, and if it appears to be a case under the second option, the court may issue an order to proceed with amendments so that the rights of secured creditors will be sufficiently protected.

6. **Question:** *Does the law provide that secured property may be used during the period of stay?*

Answer: Under the re-organisation procedure, the law specifies that no secured creditor shall enforce payment of debt against the asset which is security, unless otherwise approved by the court with whom the petition is filed. From such clause it shall be deemed that the law prohibits only the enforcement procedure of the secured property by the secured creditors during the stay period, but does not prohibit using the secured property during the stay period.

7. **Question:** *Does this 'use' extend to the sale or other disposal of the secured property?*

Answer: As mentioned above, the law does not prohibit using the secured property during such stay period. This use does not include sale or other disposal of the secured property, unless it is with the Planner/Plan Administrator's approval.

8. **Question:** *What conditions must be fulfilled before secured property may be sold?*

Answer: *The Creditors* – No secured creditor shall enforce payment of debt against the asset which is security unless otherwise approved by the court with whom the petition is filed.

The Debtor – The Debtor shall not dispose of, distribute, transfer, let, pay debt, create debt or do any act which creates encumbrances over his asset, except where such act is essential so that the debtor may carry on his business as normal,

unless otherwise ordered by the court with whom the petition is filed.

9. **Question:** *If a plan is proposed in respect of ABC, what voting rights and powers do the security holders mentioned in Part One of the case study have?*

Answer: The voting rights and powers that the security holders in Part One have will depend on the outstanding figure which the debtor owed to the creditors. The re-organisation law of Thailand prescribes that the voting rights and powers do not depend on whether the creditors are secured creditors or unsecured creditors, but rather it depends on the outstanding figure that the debtor owed such creditors.

10. **Question:** *Does the law provide that any of the secured creditors mentioned in Part One of the case study form a separate class of creditors for voting and plan approval matters?*

Answer: Normally, the Plan administrator will rank the class of the creditors for voting and plan approval matters. Although there are two secured creditors, this does not mean that both will be ranked into the same class. By means of this, the Part One creditors can be either ranked into the same class as the secured creditors, or can be ranked in a separate class.

11. **Question:** *If a majority vote in favour does this bind all security holders?*

Answer: Of course, if the majority vote from the creditors is in favour, it will also bind all the security holders.

I. Issues relating to 'new money' financing of an insolvent corporation

1. **Question:** *Does the law provide for the possibility of raising additional working capital to enable ABC to continue in business?*

Answer: *The re-organisation procedure* – If approval of the majority of the creditors is passed, the debtor is able to find the new additional working capital to enable ABC to continue its business.

The Bankruptcy procedure – Only the secured creditor can raise additional working capital to enable ABC to continue its business.

2. **Question:** *If so, does this permit the repayment of such 'new credit' to rank as a 'super priority', ahead of the security holders mentioned in Part One of the case study?*

Answer: Normally, the new credit usually ranks as a super priority ahead of the security holders mentioned in Part One of the case study. However this must be passed by the majority vote of the creditors, as well as having an order given by the court.

3. **Question:** *Is the raising of such 'new credit' subject to the consent of secured creditors, approval of creditors generally or an order of the court?*

Answer: The new credit has to pass the consent of the secured creditors, approval of creditors, and then finally it will pass the consideration by the court.

Part Three

A. General issues relating to of security interests – rating, interest rate factor, barriers to secured lending, intersection problem areas.

1. **Question:** *In terms of quality and quantity, what rating would lenders apply between the forms of security interest examined in Part One (i.e. which are the most popular and why)?*

Answer: Mortgages and pledges (as possessory securities) are the most popular because of the relative certainty offered by a registered security over land (in the case of mortgages), and to possession and control of the secured asset (in the case of pledges). Registered securities over special movable property (e.g. industrial machines) are widely used, but would be rated below mortgages and pledges because of the greater practical difficulty of enforcing against a movable asset in the debtor's possession, and the usually higher rates of depreciation of such assets.

2. **Question:** *If it is possible, please provide average term of loan and interest rates charged by lenders to corporate borrowers for loans secured by:*

- *Mortgage over land*
- *Pledge over movable property*
- *Security over inventory*
- *Security over receivables*
- *Security over equipment*
- *Security over motor vehicles*

Answer: The above-mentioned order is not absolutely fixed by the Thai banking/finance sector. Banking/finance institutions usually consider interest rates on a case by case basis. Although the loan is secured by the security interest, the

banking/finance institution shall consider the type of business, loan objective, business related person, and type of security interest.

In Thailand, security over immovable property is most favoured because of the ability to register, and the certainty that it cannot be misappropriated and it suffers no or lower depreciation. Because of the difficulties in enforcing, and the risks associated with less certain securities, e.g. security over receivables, these are less favoured and usually, but not always, incur higher interest rates. However, the lender shall consider interest on a case by case basis. In some cases, the movable property is the substantial part of business or has more value than the immovable property. Thus the lender might accept such movable property as its security interest, and charge a lower interest rate than usual.

3. **Question:** *Having regard to the issues raised in Parts One and Two, what would the banking/finance sector consider are the main barriers/drawbacks to secured lending?*

Answer: The main barriers/drawbacks to secured lending in the banking/finance sector relate to the assessment of debtors and the property offered as security interest, and to enforcement of security interests.

There is no credit bureau which enables banks or other lenders to quickly check the credit rating or history of potential debtors. Those forms of property that have security registers are divided amongst different governmental departments, and there is inadequate centralisation of those registers. The limited choice of securities available, e.g. there are no floating charge debentures and vehicle securities are by way of hire purchase, means that lenders are sometimes reluctant to lend on the basis of the securities

that are available. Possessory securities (pledges) over movable property are cumbersome to administer for institutional lenders, and hire purchase over vehicles means the lender has a large number of depreciating assets in its name. It is also difficult for lenders to obtain accurate estimates of the value of potential secured assets.

The many steps to enforcement, the inability to take “self-help” and the requirement to sell by public auction via a government department means that enforcement is seen as slow, labour-intensive and inflexible.

4. Question: *What areas of the ‘intersection’ cause the most problems or are most problematic in the banking/finance sector?*

Answer: The areas of the “intersection”, which cause the most problems or are most problematic in the banking/finance sector, are the property appraisal and actual purpose of the business borrower.

Appraisals are only an estimated value, and the valuation profession is not highly developed, and/or is sometimes subject to influence, giving inaccurate estimates on which banks must rely.

The actual purpose of the business borrower is also one of the causes of the banking/finance sector’s problems. Sometimes, the business borrower applies for business loan, but in fact, the full amount of the loan is not used for the business, with the balance being misappropriated in various ways.

In addition, traditionally in Thailand, the personal relationship between the business borrower (e.g. a managing director or shareholder) and the lender has been very important, and has contributed to the high level of non-performing loans in the banking/finance sector. Borrowers with “status” or strong relationships were, and in some cases still are, provided with loans with inadequate or no proper security, on the basis of “status” or “relationship” with the bank. However the pressure of reform after the 1997 currency crisis has reduced (but not eliminated) this practice.

5. Question: *What areas are considered to be the main areas of target for reform or improvement?*

Answer: In Thailand, the law concerning security interests and the legal proceedings to enforce such over are currently being reviewed.

Presently, the type of properties which can be used as a security interest are only tangible properties. It does not include intangible property, such as Intellectual property, which

often has more value than tangibles. The Thai government is currently considering a “Floating Charge Law”. If and when this law is issued, the borrower will be able to use its trademarks, copyright, or patents, etc. to secure loans.

However, even though this proposed law has not yet been issued, the borrower might use such intellectual property to be secured by the loan, by making the agreement with the lender. In such agreement, it will contain the term of “default of payment”, which shall specify that in case of default, the borrower shall transfer its intellectual property to the lender. Thus enforcement is by way of contract.

A major target of reform is to expedite legal proceedings. Since the Central Bankruptcy Court was established, it introduced continual hearings whereby whole blocks of time were allocated for continual hearings, rather than dates spaced out over many months or one at a time. This procedure has been adopted by other courts. However it is recognised that further reform will be required to more radically expedite the process.

6. Question: *Do any of the issues mentioned in Parts One or Two cause problems in relation to informal work out processes?*

Answer: Informal procedures between groups of creditors, as an alternative to formal procedures are not common or favoured. A problem with an informal work-out process is that if just one creditor, or another creditor not invited to take part, commences formal bankruptcy procedures, then all the creditors must join those procedures, or else risk losing their position in the formal procedures. In such a case any informal arrangements risk being overturned by the Official Receiver on the ground that such arrangements unfairly favour those creditors taking part.

B. Issues relating to internal corporate record of creation of secured property interests

1. Question: *Regardless of the requirements of any law to register secured property interests in a public register, does any law require that ABC must maintain an internal register or book of every security interest created by ABC and, if so, is such register or book available for inspection by a prospective creditor?*

Answer: The Civil and Commercial Code, the Security and Exchange Act B.E. 2535 and the Public Company Limited Act B.E. 2545 require

that public companies maintain an internal register or book of every security interest created by the company. It is available for inspection by prospective creditors. However the only obligation on private companies is to file an annual financial statement to the Commercial Registration Department, Ministry of Commerce and while this gives some indication as to levels of debt, securities are not necessarily listed.

C. Issues concerning law reform and development

1. **Question:** *In relation to the areas covered in the case study, are there any proposed reforms/developments to the law/s in your country that might affect any of the issues raised in Parts One and Two of the case study?*

Answer: For some time a draft law, known as the Foreclosure Law, has been considered and is now currently pending consideration and review by the Council of State. As such it is still very much subject to change, but its content will probably affect the issues raised in Part One and Two.

D. Issues concerning domestic and international investment and finance

1. **Question:** *In relation to the remedy of 'foreclosure', are there any restrictions that intrude upon the power of a foreign lender to take possession, sell, become the 'owner' of, or otherwise dispose of secured property?*

Answer: Foreigners cannot own land. Otherwise there is no restriction that intrudes upon the power of a foreign lender to take possession, sell, become the "owner" of, or otherwise dispose of secured property if such secured property is movable property. Immovable property, such as land can also be the secured property which a foreign lender can take possession of, sell, or dispose, but cannot be registered as the owner, as that is prohibited under the Land Law.

2. **Question:** *Is it considered that domestic/foreign lending might be increased by reform/improvements to the secured lending and/or insolvency law processes?*

Answer: Yes, it is considered that domestic/foreign lending might be increased by reform/ improvements to the secured lending and/or insolvency law processes. Some issues frequently mentioned as areas for improvement include:

- shorter enforcement times;
- "self help" remedies for creditors (i.e. to reduce or eliminate the role of the Execution Department);
- allowing sales of assets other than by public auction; and
- reducing the ability of debtors to use minor technical issues and postponements to delay enforcement.

These would require significant legal and bureaucratic reforms to come into effect.

E. Issues concerning cross-border implications

1. **Question:** *Assume that ABC is either:*
 - (a) *a foreign company operating in your jurisdiction; or*
 - (b) *a wholly owned subsidiary (and incorporated and operating in your jurisdiction) of a foreign company; and*

assume further that insolvency proceedings are commenced/opened in respect of ABC or the parent of ABC in its place of incorporation (a foreign jurisdiction) and the foreign insolvency representative of ABC wishes to prevent any enforcement or recovery action by the secured creditors or property owners as mentioned in Part One of the case study.

In your jurisdiction, how might the foreign insolvency representative seek protection from such enforcement action?

Answer: If the foreign insolvency representative does not obtain the judgment rendered by the Thai Court, it would not be possible for such a representative to seek a stay or suspension of such enforcement action. However, if the Thai Court ordered ABC under receivership before the enforcement process is completed, it would also not be possible for such a representative to seek a stay or suspension of such an enforcement action, because the foreign insolvency representative will be deemed a "foreign creditor" by Thai law.

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