DENTONS HPRP

New Ruling On Fiduciary Security Enforcement

Decision of the Constitutional Court (Mahkamah Konstitusi – "MK") No. 18/PUU-XVII/2019, which was issued on 6 January 2020 ("MK Decision") provided an interpretation for Article 15 paragraphs (2) and (3) of Law of the Republic of Indonesia No. 42 of 1999 concerning Fiduciary Security ("Fiduciary Security Law") which has lead to changes on how fiduciary security will be enforced. This will have a number of impacts on financing transactions.

The Concept of Fiduciary Security

Under the Fiduciary Security Law, fiduciary is defined as a transfer of ownership of goods based on trust with the condition that the transferred ownership of the goods remains in the control of the owner of the goods. Fiduciary security itself is then defined as the right over movable goods, whether tangible or intangible, and immovable goods, in particular, buildings that can not be secured with mortgages as referred to in Law of the Republic of Indonesia No. 4 of 1996 on Mortgages, which remain in the control of the fiduciary assignor, as collateral for the repayment of certain debt, which gives priority to the claim of the fiduciary assignee (creditor) over other creditors'.

For the fiduciary assignor, the advantage of this type of security is to enable the fiduciary assignor to continue utilizing the object used as collateral for the financing. Meanwhile, apart from its financing being secured with a collateral, this mechanism also benefits creditors by allowing creditors to enforce the security if the debtor or the fiduciary assignor has committed an event of default without the need to obtain a court judgement which usually involves a long process and additional legal costs.

The enforcement mechanism provided in the Fiduciary Security Law, is as follows:

1. execution of the executorial title by the fiduciary assignee;
2. sale of the goods by the fiduciary assignee through a public auction and deduction of outstanding payment of its claim from the proceeds from the sale;
3. a private sale with the agreement of both the fiduciary assignor and fiduciary assignee if thereby the highest price is obtainable to the benefit of the parties. The sale referred to herein can be made after 1 (one) month has passed after written notification given by the fiduciary assignor and assignee to the parties concerned and published in at least 2 (two) local newspapers.

MK Decision Highlights …

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The background of the MK decision was repossession of a car by a multifinance company. The case raised a question of whether Article 15 of the Fiduciary Security Law is unconstitutional.

Article 15 of the Fiduciary Security Law provides as follows:

> *"(1) Fiduciary certificates shall include the following words "For the Sake of Justice Under One Almighty God".*
> *(2) The fiduciary certificate referred to paragraph has the same power as enforceable court decisions that have absolute legal force.*
> *(3) If the debtor breaches the contract, the fiduciary assignee has the right to sell the object of fiduciary on his own behalf."*

MK granted part of the judicial review of Article 15 paragraph (1), paragraph (2) and paragraph (3) of Fiduciary Law relating to fiduciary guarantee certificates which have an executorial power. That is, if the debtor breaches a contract (default), the creditor has the right to sell the goods of collateral by auction on his own authority. Finally, in the MK Decision, MK stated that:

"1. The phrases "executorial title" and "equal to a legally binding court decision" in Article 15 (2) of the Fiduciary Security Law, shall be deemed unconstitutional in so far as they are not interpreted to mean that the execution of a fiduciary security certificate shall be implemented through the use of the same mechanisms and procedures as court decisions that have absolute legal force if there is no agreement as to what constitutes default and if the debtor does not release the fiduciary goods voluntarily;

2. The phrase "default" in Article 15 (3) of the Fiduciary Security Law, shall be deemed unconstitutional if it is not interpreted to mean that the occurrence of a default shall be based on an agreement of the debtor and creditor through certain legal proceedings which ultimately determine that a default has occurred."

Based on this, a breach of contract should not be determined unilaterally by the creditor, but should fulfill the following factors:

a. the event of default is to be agreed between the creditor and the debtor; and
b. the debtor releases the fiduciary goods voluntarily

Otherwise, the creditor will need to enter a court proceeding to determine an event of default in order to enforce the collateral security.

Possible Backlash

In practice, however, the likelihood of a bad-faith debtor admitting to a default and surrendering the fiduciary goods to the creditor voluntarily is very low with the result that the default will have to be determined via a court decision.

This will render fiduciary security unfavourable for financial institutions, due to the difficulty that these financial institutions will face in executing the fiduciary security. When creditors are no longer able to execute the fiduciary security immediately when there is a breach of contract, their business process may be disrupted. This is especially unsustainable for multi-finance companies that mostly hold fiduciary guarantees for goods, especially vehicles. Cost-wise, executing the fiduciary security may be more expensive than the value of the security object itself.

In addition to this, an additional burden may be faced by district courts, as the large number of financial institutions and the fact that the fiduciary security is the go-to security used by these financial institutions, may increase potential for disputes in the district courts. This leads to the question of whether the district courts have sufficient resources to deal with such disputes between a creditor and a debtor.

Now What?

Tackling the potential issues now seems to be the question. Financial institutions that have long relied on fiduciary security will have to come up with ways to avoid having to go in to court just to determine the occurence of a default. It is therefore, in this regard, essential to ensure that the financing agreement provides a proper list of events which would constitute a default , and an additional provision, in effect, to avoid a court decision being necessary to determine an event of default.

The foregoing , in our view, would have to be further reviewed on a case by case basis. A thorough look by legal professionals at individual financing agreements and fiduciary security agreements would enable this.

The practical challenge would be in having the debtor releasing the fiduciary goods voluntarily. In the case of a dispute, it is quite possible that the debtor will refuse to do it, even more so if the debtor is acting in bad faith. In such a case, in the absence of any other solution or consideration, litigation would be the choice if the expected outcome from a continuing collection would still be worth the costs. Scrutinizing the debtors' credit worthiness before extending them financing is a preventive meassure that would reduce future risks.

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