

Client Alert

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Constitutional Court Interpreted Creditors' Rights to Fiducia Security

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Judgment

The Constitutional Court recently issued a judgment interpreting Article 15 paragraph (2) and its elucidation, as well as Article 15 paragraph (3) of Law No. 42 of 1999 on Fiducia Security ("**Fiducia Law**"). The court did not invalidate these provisions, but provided a constitutional interpretation of these provisions, as follows:

1. Article 15 paragraph (2) and its elucidation must be interpreted to mean that the creditor must apply for a Civil Court's assistance to possess and sell the fiducia object if there is no agreement on default *and* the creditor refuses to surrender the fiducia object voluntarily to the creditor.
2. Article 15 paragraph (3) must be interpreted to mean that the creditor cannot determine the debtor's default unilaterally; rather, it must be based on the parties' agreement *or* a certain legal process.

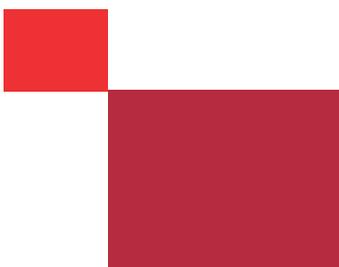
The Constitutional Court judgments are final, binding, and not subject to appeal.

The judgment was rendered following an application for constitutional review of the above provisions by two individuals who had placed their car as fiducia security for their loan. The creditor possessed the car following the debtor's default.

Article 15 paragraph (2) of the Fiducia Law

This provision stipulates that: "*The Fiducia Security Certificate as mentioned in paragraph (1) has the same executorial power as a court decision that has become final and binding.*"

The Court interprets this provision to mean that such an executorial power must be exercised through a judicial process if two conditions are fulfilled, namely: (1) there is no agreement on default; and (2) the debtor refuses to surrender the fiducia object voluntarily to the creditor. If these conditions are fulfilled, the Court has seemingly banned creditor's unilateral actions in taking over the security object and selling it without a court decision. In these circumstances, creditor will need to apply to a Civil Court for its assistance in enforcing their right to take possession of the fiducia security object from the debtor.





The rationale behind the judgment seems to rely on the argument that debtor must be afforded their constitutional right to defend themselves against accusations of default. In paragraph 3.14, the court states that "*In Article 15 paragraph (2) of [the Fiducia Law], it can be simply understood that a fiducia certificate gives a very significant right to . . . the creditor . . . because . . . the creditor may, at any time, take over the fiducia object from the debtor and subsequently sell it to anyone . . . for the reason that the executorial power of the certificate is equal to a court decision that is final and binding.*"

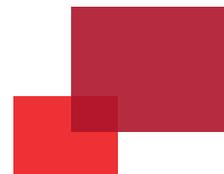
Therefore, the court continues, "*on one hand, there is an exclusive right given to the creditor and on the other hand, there is a disregard of the debtor's right to legal protection, which is the right to defend themselves against the accusation of a breach of contract.*" Further, in paragraph 3.15, the court also affirms that the original concept of *fiducia* showed an "*imbalance of bargaining positions between the debtor and creditor because the debtor is the party in need*" and that "*the action of the creditor in unilaterally executing the fiducia security . . . without a process of execution . . . could potentially result in an abuse and "inhumane" acts, such as physical and psychological threats that are often made by creditors (or their representatives) against debtor.*"

Although the Civil Court's assistance in enforcing the creditor's right is done through summary proceedings, the proceedings may give room for legal maneuvering to frustrate the enforcement proceedings which can potentially delay the execution process against the fiducia object. While it is not expressly articulated by the Constitutional Court, it seems that the Constitutional Court intended for the Civil Court to oversee the creditor's right to enforce the fiducia object if both conditions mentioned below are fulfilled.

First condition: "Lack of agreement on default" - Does the court require the debtor's admission of default?

What the court refers to as "*lack of agreement on default*" is not entirely clear. Does it mean that the debtor must admit being in default, or does it mean that as long as there is an underlying agreement stipulating conditions of default and the debtor has fulfilled any of those conditions, they may be deemed in default?

It seems that the latter should be the interpretation, because it serves better the court's reasoning. The court repeatedly writes in paragraphs 3.14 and 3.16 that the debtor's right must be protected, i.e., the right to defend themselves against an accusation of default. However, it is difficult to rationalize that the judgment still requires the debtor's admission of default to enforce the fiducia security when they have bargained for their rights by including the conditions of default in the agreement. If the judgment is interpreted as requiring the debtor's admission of default, it can be potentially used by delinquent debtor to frustrate the enforcement of the creditor's rights. It is difficult to conceive that this is the Constitutional Court's intention to qualify the meaning of the Fiducia Law.



Second condition: "Debtor objects to surrendering the fiducia security voluntarily"

Another condition imposed by the court is "*the debtor objects to surrendering the fiducia security.*" The court opines that if debtor does not consent to hand over the object, the creditor must apply for an execution request to the Civil Court, as they may not take over the object by themselves.

Presumably this condition does not apply if the creditor does not need to hold the fiducia object to sell the fiducia object.

It is also worth noting the court only addresses this condition in its review of Article 15 paragraph (2), whereas Article 30 of the Fiducia Law obliges the debtor to hand over the fiducia object to the creditor. Correspondingly, the elucidation to Article 30 provides that the creditor has the right to take over the fiducia security object. Article 30 was neither reviewed nor interpreted by the court.

Article 15 paragraph (3) of the Fiducia Law

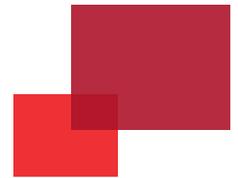
This provision stipulates that "*If debtors are in default, creditors have the right to sell the fiducia object by themselves.*"

According to the Constitutional Court, Article 15 paragraph (3) must be interpreted to mean that the creditor cannot determine the debtor's default unilaterally; rather, it must be based on the parties' agreement *or* certain legal process.

First condition: the existence of breach of contract is not determined unilaterally by the creditor - it must be based on the parties' agreement

The court's discussion of a breach of contract is derived from the court's consideration that the concept of breach of contract is often unclear. As stated by the court in paragraph 3.16, "*the issue is when a 'breach of contract' is deemed to have occurred and who has the right to make such a determination? The answers are unclear under this Law*". Therefore, the court opines that there is legal uncertainty regarding "*when the debtor should be deemed in default; whether in each tranche in which the debtor failed to pay or was late in paying, or from the due date of the payment*".

As elaborated above, the judgment should be interpreted as not requiring an admission of default by the debtor if there is an agreement between the creditor and debtor underlying the fiducia certificate in which conditions of default are stipulated, and the debtor has fulfilled any of those conditions. Arguably the creditor does not unilaterally call for the debtor's default if the agreement has clearly provided conditions of default. This argument may serve better the Constitutional Court's reasoning.



Second condition: what is the meaning of "based on a legal action resulting in the determination of a breach of contract"?

The court adds that besides an agreement between the creditor and debtor, a breach of contract may also be determined as a result of a "legal action" (*upaya hukum*). The court does not elaborate on this, but based on the court's consideration that debtor has the right to defend themselves against an accusation of default, this finding seems to mean that the court refers to a lawsuit to obtain a court decision on whether or not the debtor has committed default.

As shown by the term "or" used by the court, this condition is alternative to the first condition (agreement on default). Therefore, it is not required that both conditions be fulfilled.

Impacts of the Judgment

The judgment leaves open the possibility of multi-interpretations, which may be used to frustrate enforcement proceedings, for example, by claiming that the debtor must first admit default. If the correct interpretation requires the debtor's admission of default, there may be a significant increase in the volume of cases that the Civil Court must handle. It remains to be seen whether Civil Courts are prepared for the possible backlog of requests to execute fiducia security. Such a backlog could delay recovery of assets by creditor.

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