

of an interest in after-acquired property<sup>324</sup> and that registration determines priority.<sup>325</sup> The fidusia must exist, however, and only registration brings it into existence.<sup>326</sup>

265. As a result, one may not file for an advanced ranking of priority and then later file the security interest in any of the countries.

266. In most cases, a state monopoly supplies the registry services. Typically, monopoly service, public or private, has less incentives for providing better service than would competing providers. This basic rule may extend to registry or filing office services. Reform often takes the form of allowing private operation or competing operators.

## F. Economic Consequences of Problems in Publicity

267. The registration systems add great cost to secured credit in the five RETA countries. Those requiring permission of the authorities delay filing, which increases the risk of loss of priority. In principle, a guarantee by the authorities might offset cost. As a practical matter, however, this amounts to little more than the right to sue the state for damages. The rarity of such suits testifies more to their likely fruitlessness than to the rarity of errors. The typical privately secured party benefits more from having a lawyer, with an immediate financial interest in doing a good job, check the accuracy of papers underlying a filing. Broadly, this feature of registries produces costs with no offsetting gains.

268. Registration lies at the heart of a non-possessory secured lending system. Without a good filing system, no law of security interests, no matter how modern, can have an economic impact.

## VIII. PROBLEMS IN ENFORCING SECURITY INTERESTS

269. The prospective creditor, and therefore the debtor, needs to know that a secured creditor could enforce its rights in the way best suited to protect them. In some circumstances, perhaps the creditor should sell the collateral. For example, the market value of the collateral may be declining. Other circumstances may require the creditor to supervise the continuing use of the collateral. Suppose a machine serving as collateral is half built, for example. To revert briefly to the Quebec law as an illustration of how one jurisdiction approaches this,<sup>327</sup> a secured creditor may exercise its rights in a broad range of movables in one of several ways:

- take possession of the collateral (if an enterprise owned it) and administer its use or disposal;
- take the collateral in full payment of the debt;
- sell the collateral (if an enterprise owned it) by public auction, bids, or private sale;
- have the court sell the collateral;
- take possession and administer the collateral temporarily, conserving it but not disposing of it.

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<sup>324</sup>The Fidusia Law permits advance registration for assets that can be described, when a maximum value of the loan can be set. Indonesia ILAG Reviewer #2, citing Fidusia Law, Art. 14(3). §30.3.1.2.

<sup>325</sup>Indonesia Local Lawyer. §30.4.1.

<sup>326</sup>Indonesia ILAG Reviewer #2. §30.4.1.3.

<sup>327</sup>J. Claxton, *Security on Property and the Rights of Secured Creditors under the Civil Code of Quebec* (1994) at 145-147.

In addition, Quebec law permits the creditor to sue the debtor personally to enforce the debt.

270. An even more flexible approach is to allow the parties to designate how the secured creditor can enforce its rights. Claxton<sup>328</sup> identifies “rights of inspection, rights to obtain financial statements, cash flow statements, rent rolls, rights to impose financial performance tests, to consult the auditors, to appoint one, rights to appoint a controller or have a full time inspector present and to cause his co-signature on cheques or on work orders, rights to approve capital expenditures, budgets, major contracts, etc.” These rights, which a major creditor might demand, would be used to protect the secured creditor’s interests in all the debtor’s assets.

271. In the five RETA countries, one does not find such a broad range. Taking possession of the collateral and selling it through self-help is very limited, even for hybrid security interests such as financial leases and conditional sales. The interests of other claimants to the collateral impede enforcement by the secured creditor. Practice and substantive law limit the power of parties to a secured transaction contract to specify methods of enforcement. Civil courts play the central role in enforcement, but criminal courts are also brought in.

272. The prospective creditor must also be confident that, if the debtor defaults, the secured creditor can enforce its rights expeditiously. Just how fast varies with the collateral. If it is perishable, such as vegetables that secure a loan to a grocer, a delay of more than a few days may destroy the value of the collateral. If the collateral is computers, a delay of 12 months may render them obsolete. A major source of delay, in most countries around the world, is the courts. A secured creditor forced to rely on the judiciary to enforce its rights often faces untenable delays. Self-help allows the creditor to move much faster. Self-help conflicts, or appears to conflict, however, with principles in many legal systems that no one should decide legal matters involving himself. This principle guides the law particularly in code countries and militates against self-help. The common practice by powerful creditors of using strong-arm tactics to enforce their interests reinforces opposition to self-help.

273. The five RETA countries demonstrate these problems. Code countries in this report—Indonesia, Thailand, PRC—largely prevent self-help and require the creditor to rely on courts to enforce its interests. Even the common law countries, however, drive secured creditors into the courts and away from self-help. Collection requires two steps in these countries. Broadly, the creditor first requests a court order for seizure of the property; second, the creditor sells the property under a court-administered process of appraisal and auction. In the common law systems, and for some specifically identified goods taken as collateral, the use of a bailiff or a limited use of self-help short-circuit only parts of these steps. The reliance on courts to enforce most security interests leads to periods of enforcement that last years.

274. This chapter documents the effect of channeling enforcement through the courts in each country. It begins with the limitations on self-help, then turns to the use of courts. It briefly revisits the problems of competing claims, discussed in Chapter VII, to examine their effect on enforcement. It disposes of the issue about special enforcement powers for banks. Arbitration, which may be an alternative to the courts, is seen to be insufficiently independent of them. Throughout, and near the end of this chapter, rules governing enforcement of hybrid security interests are contrasted with the rules for strict security interests, and the differences found to be small. Finally, creditors in most countries can resort to criminal sanctions, shifting enforcement to the government and criminal courts.

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<sup>328</sup>J. Claxton, *Security on Property and the Rights of Secured Creditors under the Civil Code of Quebec* (1994) at 148.

**A. Self Help: Repossession or Seizure of Collateral by a Creditor Without Breach of Peace or Court Order**

275. A secured creditor usually needs to possess the collateral in order to apply its value against the defaulted debt.<sup>329</sup> The ease of taking possession will be very important for a prospective creditor, who will incur a cost with every delay. So the creditor will want to be able to take possession of the collateral from the debtor, preferably without recourse to courts or other activities that would slow recovery. This is the rationale for self-help. (When the creditor already possesses the collateral, as it does with the normal pledge, these issues are moot. The delays the creditor may face trying to sell the collateral are discussed below.)

276. Self-help is very limited in all five RETA countries, as Table VIII-1 shows, however whether the collateral is subject to a strict security interest or a hybrid one in which the creditor owns the collateral.

<b>Table VIII-1. Self-Help. Creditor repossession or seizure without breach of peace or court order when collateral is in possession of debtor</b>			
<b>Country</b>	<b>Type of Security Interest</b>		<b>Summary: Need to Use Courts</b>
	<b>Strict</b>	<b>Hybrid</b>	
<b>India</b>	Usually need court order	No statutory law; usually need court order even for lease	Largely: cannot contract for self-help
<b>Pakistan</b>	Usually need court order to avoid breach of peace. Banks are allowed some self help.	Usually need court order given possible breach of peace.	Largely
<b>Indonesia</b>	Fid.transfer needs court order if debtor does not agree in advance. Fidusia may take possession without court order	No rule (apparently)	Varies with security interest
<b>PRC</b>	Need court order	Need court order	Always
<b>Thailand</b>	Need court order	Self-help after notice	Varies for strict and hybrid interests

277. For strict security interests, the general rule is that the secured creditor must use courts to enforce its interests. The law in PRC and Thailand makes this rule explicit. In PRC, a mortgage holder may not repossess, may only seek court enforcement (or negotiate voluntary delivery).<sup>330</sup> In Thailand, a mortgage holder must first demand payment, in advance and in writing. Then the mortgagee must get court judgment, seizure by government official, and public auction.<sup>331</sup> If

<sup>329</sup> See discussions below for exceptions to this in the five RETA countries.

<sup>330</sup> PRC Local Lawyer and ILAG Reviewer, citing Guaranty Law Art. 53. §31.1.

<sup>331</sup> Thailand Local Lawyer and ILAG Reviewer #3. §31.1.

contested, the process may take from 3 to 6 years.<sup>332</sup> Case law, rather than statute, governs in India and Pakistan, forcing creditors into the courts. In India, the creditor must sue for the debt in all cases except the English mortgage—one in which no party is Hindu, Moslem, or Buddhist. A collection agent may take possession unless the collateral is in a factory or house.<sup>333</sup> In Pakistan, while no law prohibits self-help, normally the creditor needs a court order to avoid breach of peace.<sup>334</sup> In Indonesia, for fiduciary transfer or assignment the creditor must file a civil suit and sell the collateral. The creditor cannot take possession of the collateral unless the debtor agrees, in which case the debtor normally also agrees that any acts by the creditor to take possession will not breach the peace.<sup>335</sup>

278. Exceptions exist for some strict security interests. Certain institutions may be excepted. In Pakistan, banks have special legislated power as plaintiffs “to directly realize the collateral.”<sup>336</sup> Certain types of security interest may be excepted. In India, an English mortgage does not require the creditor to sue.<sup>337</sup> This set is small, however. In Indonesia, the holder of a fidusia can take possession of the collateral<sup>338</sup> without a court order (because registration is the equivalent of a court order), sell the collateral by public auction<sup>339</sup> or, with the debtor’s permission, private auction one month after notice in local papers.<sup>340</sup> The creditor cannot appropriate the collateral for its own use).<sup>341</sup>

279. For hybrid security interests, such as conditional sales and financial leases, the classical distinction between ownership interests and lesser security interests is not strong enough to permit self-help in most countries. The logic of this distinction allows self-help only in Thailand. Thailand permits self help after the creditor gives written notice to pay. For hire purchase, the creditor may enter the debtor’s premises and even use force (but in practice the creditor usually does so with police present).<sup>342</sup> This form of self-help is probably also permitted for conditional sales in Pakistan.<sup>343</sup> The Thai creditor, who is after all the owner, has broad discretion to keep and use the collateral, or sell it through public or private sale.<sup>344</sup> Elsewhere, however, the owner-creditor is hampered. The absence of statutory law for hire purchase and lease finance in India and Pakistan seems to make creditors reluctant to use self help. In India, the contract usually gives the creditor a right to take possession, but it is limited by the constitutional right to privacy, forcing the creditor to go to court to take possession.<sup>345</sup> In Pakistan, possession is permitted without court order, but the likelihood of breach of peace makes creditors seek court judgment as it must for a strict security interest.<sup>346</sup> Legislation for hybrid interests could settle this uncertainty. Law in the PRC explicitly requires court enforcement.<sup>347</sup> Apparently Indonesia has no rule.

<sup>332</sup> Thailand Local Lawyer and ILAG Reviewer #3. §31.1.

<sup>333</sup> Indian Local Lawyer. §31.1.

<sup>334</sup> Pakistan Local Lawyer. §31.1.

<sup>335</sup> Indonesia Local Lawyer. §31.1.

<sup>336</sup> Pakistan Local Lawyer, citing Banking Companies (Recovery of Loans, Credits, Advances and Finances) Act, §16. §31.1.

<sup>337</sup> Indian Local Lawyer. §31.1.

<sup>338</sup> Indonesia Local Lawyer, and ILAG Reviewer #2, citing Fidusia Law, Art. 30. §31.1.

<sup>339</sup> Indonesia Local Lawyer, citing Fidusia Law, Art. 29(1)(b), and ILAG Reviewer #2, citing Fidusia Law, Art.15(2), which treats the registration certificate as having the same executive force as a court decision. §31.1.

<sup>340</sup> Indonesia Local Lawyer, and ILAG Reviewer #2, citing Fidusia Law, Art. 29(1)(c). §31.1.

<sup>341</sup> Indonesia Local Lawyer, citing Fidusia Law, Art. 33. §31.1.

<sup>342</sup> Thailand Local Lawyer, citing CCC, §574 and §1336. §31.1.

<sup>343</sup> Thailand ILAG Reviewer #2. §31.1.

<sup>344</sup> Thailand ILAG Reviewer #3. §31.1.

<sup>345</sup> Indian Local Lawyer. §31.1.

<sup>346</sup> Pakistan Local Lawyer. §31.1.

<sup>347</sup> PRC Local Lawyer and ILAG Reviewer, citing Guaranty Law Art. 53. §31.1.

280. The result is that opportunities for self-help are limited in all countries, more often for strict security interests than hybrids. A functional approach to the law of security interests would find this indefensible.<sup>348</sup>

281. If the debtor and creditor could agree by contract when self help is appropriate, despite the general rule against it, that agreement could alleviate the creditor's concerns about long and costly delays. Self-help should be particularly effective for such intangibles as receivables. The secured creditor can turn to the obligor and require direct payment. The countries need common rules about the rights and duties of the obligor to facilitate this form of self-help.

282. The five RETA countries limit the parties' effective control over the use of self-help. Each has a different way to limit them. The locations where parties can agree to the exercise of self help are limited in two important ways in India. Despite the agreement, the creditor needs a court order for collateral located in the home or factory.<sup>349</sup> Generally, the debtor cannot contract away the sanctity of its home or workplace, so "in most cases of plant and machinery, finance or computer loan or loan to acquire consumer assets," not even a contract can give a right to enter the property.<sup>350</sup> The range of techniques for self-help is limited in Indonesia for the holder of a fidusia. The law lists the ways in which a holder may enforce its interests and prohibits any other, even if the parties want it.<sup>351</sup> Allowing the parties to a pledge to agree about how the creditor takes possession but requiring enforcement through the courts eliminates the major advantages of self-help.<sup>352</sup> The rules may also limit the ways in which the creditor may dispose of the collateral. Indonesia does so by directing the creditor to sell mortgaged property, rather than take possession.<sup>353</sup> The law may permit agreement, yet the courts ignore it. Contracts in Pakistan usually specify the methods a creditor may use, but the courts nevertheless stay the use of those techniques on petition from the debtor.<sup>354</sup> The law in PRC is ambiguous and unsettled in PRC. No statute addresses self-help directly. PRC law includes a principle of freedom to contract, which suggests parties should be able to agree about possession. Other general legal principles, however, appear to strike self-help down.<sup>355</sup> The law prohibits advance agreement in Thailand.<sup>356</sup> See Table VIII-2.

283. For hybrids, the rule is largely similar.<sup>357</sup> Ownership conveys no extra self-help power at the time of contracting. The only stand-out is Indonesia. The practice, in leasing in Indonesia for example, lets the debtor give the creditor a power of attorney to repossess without court order. Yet doubts exists about whether the power of attorney will be enforceable.<sup>358</sup>

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<sup>348</sup>For a discussion of the functional approach to secured transaction law, see Chapter XI.

<sup>349</sup>India Local Lawyer. §31.2.

<sup>350</sup>Indian Local Lawyer. §31.1.

<sup>351</sup>Indonesia Local Lawyer, citing Fidusia Act, Art. 32. §31.2.

<sup>352</sup>Indonesia Local Lawyer. §31.2.

<sup>353</sup>Indonesia Local Lawyer. §31.2.

<sup>354</sup>Pakistan Local Lawyer. §31.2.

<sup>355</sup>PRC Local Lawyer, citing Contract Law of 1999, Art. 7, and General Principles of Civil Law of 1986, Art. 7.

<sup>356</sup>Thailand Local Lawyer, citing CCC §§711, 756. §31.2.

<sup>357</sup>In Pakistan, for example the rules are the same for hybrid interests. Pakistan Local Lawyer, citing Sale of Goods Act, §§4, 5, and 25(1). §31.5.2.

<sup>358</sup>Indonesia Local Lawyer. §31.2.

<b>Table VIII-2. Advance Agreement about Creditor Possession After Default</b>		
<b>Country</b>	<b>Advance agreement is binding for:</b>	
	<b>Strict security interests</b>	<b>Hybrid security interests</b>
<b>India</b>	Yes, if property is outside home or factory No, otherwise (need court order and workers may obstruct)	
<b>Pakistan</b>	Contracts always provide for manner of possession, but court order is required to take possession (delays)	
<b>Indonesia</b>	Pledge: can agree, but need court enforcement Fidusia: must use legislated techniques, but law does give right to take possession	Leasing: common practice to grant creditor right of self-help, but may not be enforceable
<b>PRC</b>	Ambiguous	
<b>Thailand</b>	No	

## **B. Use of Courts to Possess or Seize Collateral**

284. Since courts are the major vehicle by which a creditor may take possession of collateral after the debtor defaults, their efficiency and fairness determines the usefulness of secured credit. The potential creditor needs to know how the courts will protect its interests. The short answer in each of the five RETA countries is that the multiple steps required of the creditor slow the recovery, in some cases for very long periods of time. The discussion that follows examines the process by which the holder of a strict security interest uses the courts to slow decisions and extend the time to complete judicial action. At the end, differences in the treatment of hybrid interests are explored. The next section discusses the rules governing how the creditor disposes of the collateral once it has taken possession.

### **(i) Overview of the Creditor’s Steps to Take Possession through the Courts**

285. While the process varies by country, the steps a secured creditor must take generally start with notice to the debtor, judicial hearing and decision, appeal, and execution of the decision, which in this case concerns the creditor’s right to possess the collateral. Each of these steps takes time even if the process works smoothly. Some countries lengthen the time by adding steps, further delaying possession. Others speed it up for certain types of creditors.

286. *Delays before trial.* While notice to the defendant is normal in a suit that is not ex parte (as in Thailand<sup>359</sup>), PRC adds a requirement that the creditor and debtor negotiate<sup>360</sup> before the creditor can sue for possession.<sup>361</sup> The rule exists as part of a broader national policy to promote extra-

<sup>359</sup>Thailand Local Lawyer. §31.3.

<sup>360</sup>PRC Local Lawyer, citing Guaranty Law, Art. 53. §31.3.

<sup>361</sup>PRC Local Lawyer, citing Guaranty Law. §31.3.

judicial dispute resolution. The problem is that requiring the parties to try to solve their conflict slows the process for enforcing the security interest.

287. *Bypassing a full trial.* The time and cost of using the courts are discussed in below. To reduce the delays inherent in full trial, Pakistan gives banks a summary trial procedure if the debtor offers no bona fide defense.<sup>362</sup> If the bank is a secured creditor, it may obtain an interim decree for “the undisputed part of [its] claim. . . .”<sup>363</sup> Even this summary procedure, however, takes much longer than self-help.

288. *Procedures affecting the length of the trial.* Parties to a suit engage in mediation (in PRC) or conciliation (in Indonesia<sup>364</sup>) as part of the trial process. It is not obvious whether these rules lengthen or shorten the proceedings. They may shorten the trial if a previously recalcitrant party realizes that it will not succeed and compromises, thus ending the trial. They may lengthen the trial if they force the parties to participate when neither is willing to compromise.

289. Execution may be speedy or slow, once the court has decided the merits of the creditor’s claim against the collateral. Generally, some countries require the creditor to obtain the court’s order to execute against the property, while others permit immediate execution. Later sections explore the range.

290. Even when the collateral is in the creditor’s possession (as a pledge, for example), a court review may slow enforcement. In Indonesia, if the debtor challenges the creditor’s proposed sale of pledged collateral, the creditor may have to seek a court order to sell. The State Auction Office requires creditor to get a court order, in some instances.<sup>365</sup> This was not identified as a problem in the four other countries.

291. The following two parts describe methods that slow the decision.

**(ii) Defenses to Delay Decision**

292. An expeditious hearing of the merits allows the creditor to demonstrate merely the validity of its secured interest and the reason to exercise it (usually just the failure to pay the debt). The debtor defends by demonstrating the opposite. This takes time, but other defenses that have less to do with the merits can delay a decision for much longer in most of the countries. Only in PRC was the best defense described as appeal, allowing the debtor to delay enforcement by three months.<sup>366</sup> See Table VIII-3.

293. Dilatory defenses to slow the court process were identified in several of the countries. These included, in Pakistan for example, denying notice was received, filing unnecessary applications, and calling for adjournments because lawyers are not available, witnesses would not be properly notified, or government agencies (and others) have not produced documents.<sup>367</sup> These defenses could delay by many months. India<sup>368</sup> and Thailand<sup>369</sup> reported similar tactics.

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<sup>362</sup> Pakistan Local Lawyer, citing Banking Companies (Recovery of Loans, Credits, Advances and Finances) Act, 1997, §§9-19. §31.3.1.

<sup>363</sup> Pakistan Local Lawyer, citing Banking Companies (Recovery of Loans, Credits, Advances and Finances) Act, 1997, §§10 and 11. §31.3.1.

<sup>364</sup> Indonesia Local Lawyer, describing each step. §31.3.1.

<sup>365</sup> Indonesia Local Lawyer. §31.1.

<sup>366</sup> PRC Local Lawyer. §31.4.1 and §31.4.2.

<sup>367</sup> Pakistan Local Lawyer. §31.4.1.

<sup>368</sup> India Local Lawyer. §31.4.2.

<sup>369</sup> Thailand Local Lawyer. §31.4.1.

294. Fraudulent defenses were reported in Thailand and implied in Pakistan. It was common for the debtor to assert defenses based on statements of fact that were not true.

<b>Table VIII-3. Debtor's best defenses to delay and length of delay (months)</b>						
<b>Country</b>	<b>Slow court process</b>	<b>Fraud</b>	<b>Merits</b>	<b>Third parties intervene</b>	<b>Court's discretion</b>	<b>Appeal</b>
<b>India</b>	Yes		Yes			
<b>Pakistan</b>	Deny notice, seek adjournment, file unnecessary applications (many)	Implied				
<b>Indonesia</b>				Yes (60)	Yes (2-3)	
<b>PRC</b>						Yes
<b>Thailand</b>	Yes	Yes	Yes			Yes (36-72)

295. An appeal to the trial court's discretion substantially slows the court's decision in Indonesia. The judge has full discretion to delay for "exceptional circumstances," which could put execution off for 3 to 6 months. This gives the court substantial leeway.

296. Joining issue on the merits can be a very effective delaying tactic, even if the debtor expects eventually to lose. In Thailand, delays on the merits (such as failure of creditor to advance funds as agreed, so that the debtor collapsed) can take 3 to 6 years to litigate through appeal.<sup>370</sup> In India, common defenses on the merits include unreasonable condition, no default, no legal obligation to pay, and unlawful debt.<sup>371</sup>

297. A third party may be brought in to challenge the secured creditor's interest, in Indonesia. The third party may be the owner of the collateral, by statute, or may even be another secured creditor by court decisions.<sup>372</sup>

298. In short, much room exists for delay. The longer the delay, the less is the cost of the ultimate decision to the debtor.

**(iii) Delay by the Trustee in Reorganization or Bankruptcy**

299. A potential secured creditor wants assurance that if the debtor enters bankruptcy or liquidation proceedings, it can assert its interests without delay (or loss of priority, which is discussed above). In the case of reorganization, the potential secured creditor will require assurance that any delay will be for a brief and reasonable period of time and that the purpose of such delay will be to determine whether the debtor will be reorganized for the benefit of creditors. The secured creditor

<sup>370</sup>Thailand Local Lawyer. §31.4.1.

<sup>371</sup>India Local Lawyer. §31.4.2.

<sup>372</sup>Indonesia Local Lawyer and ILAG Reviewer, citing Civil Procedure Law, HIR Art. 207(2) and (3). §31.4.1.

can assert its interest without delay in two countries (see Table VIII-4). In Pakistan, the secured creditor, with an interest that has not been challenged as a fraudulent preference, is outside reorganization, bankruptcy, or insolvency.<sup>373</sup> In PRC, the liquidation group (analogous to a trustee) has no power to suspend enforcement of a security interest because the collateral is not an asset of the bankrupt.<sup>374</sup> In a third country, Thailand, the secured creditor may not be subject to a stay when the debtor enters ordinary bankruptcy. However, the rule is ambiguous. There is no stay at least for pledged assets in the creditor's possession, but disagreement exists about whether property in the debtor's possession is subject to a stay.<sup>375</sup> (We lack information for India.)

Country	No power	Automatic	Varies	
			Bankruptcy	Reorganization
India	na	na		
Pakistan	No power			
Indonesia		Yes	90 days	270 days
PRC	No power			
Thailand	In some circumstances	In some circumstances	Automatic: except perhaps pledges creditor possesses	Automatic: all

300. The secured creditor faces an automatic stay in two countries. Reorganization in Thailand prompts an automatic stay<sup>376</sup> to allow the debtor to return to economic viability. The secured creditor is expected to participate in this effort. Indonesia provides an automatic stay of 270 days for reorganization<sup>377</sup> and 90 days for bankruptcy,<sup>378</sup> after which the creditor may enforce the security interest. To protect the interests of the secured creditor, the Indonesian receiver or administrator must separate the secured goods from the bankrupt's assets. An automatic stay to encourage successful reorganization is not uncommon among countries, but it results in some uncertainty at the outset about when a secured creditor can enforce its security interest.

**(iv) Time for Judicial Action**

301. The effect of judicial delays is to lengthen the time a secured creditor will take to enforce its claims to the collateral. In some cases this may have damaging effects. Many types of collateral

<sup>373</sup>Pakistan Local Lawyer, citing *Hansraj vs. Official Liquidator, Dehra Dun Mussoorie Electric Tramway Co. Ltd.*, supra, and Companies Ordinance, 1984, §§408-411, Provincial Insolvency Act, 1920, §§53-54, and Insolvency (Karachi Division) Act, 1909, §§55-56. If the secured creditor agrees to become subject to the proceedings, it loses this exemption. §31.4.2.

<sup>374</sup>PRC Local Lawyer, citing Civil Procedure Law of 1991, Arts. 203 and 204. §31.4.2.

<sup>375</sup>Thailand Local Lawyer and ILAG Reviewer #2, citing BA §110. §31.4.2.

<sup>376</sup>Thailand Local Lawyer and ILAG Reviewer #2, citing BA §90/12 par. 1 nos. 6 and 7. §31.4.2.

<sup>377</sup>Indonesia Local Lawyer and ILAG Reviewer #2, citing Bankruptcy Law Art. 231A and 217(4). §31.4.2.

<sup>378</sup>Indonesia Local Lawyer, citing Bankruptcy Law Art. 56A. §31.4.2.

may need to be realized quickly because they may have a short life span or their market value may decline. The creditor, in addition, has a carrying cost which could become quite high if the delay lasts a long time. A delay of more than a few days in some cases, or weeks in others, can cause

substantial loss. A potential creditor that can reasonably anticipate long delays must either build the uncertain additional cost into the price of the credit or not advance funds.

302. In none of the countries do the courts act fast. The time secured creditors need to gain possession of the collateral ranges from perhaps six months, for certain security interests in Indonesia, to many years in India. In Indonesia, the fidusia and perhaps the pledge, are entitled to immediate enforcement. The goal for the Indonesian courts is to complete the proceedings within 1 month, but they actually take up to 6 months in practice.<sup>379</sup> Regular court enforcement, for the other security interests, could take 3-5 years, despite court efforts to speed the process.<sup>380</sup> In PRC, the process takes about 1 year on average, half the time through the court of the first instance and at least another 6 months on appeal.<sup>381</sup> In Thailand, if the defendant delays, it can take 3 years.<sup>382</sup> Pakistan approaches India's length, taking from 5 to 7 years.<sup>383</sup> And in India, a general claim in a civil court, giving an order of delivery and possession or attachment and sale, through execution, ordinarily takes 7 to 10 years.<sup>384</sup>

303. Faced with these remarkable delays in enforcement, India and Pakistan tried summary procedures in limited circumstances. Thailand is about to institute them at the time of this writing, but cannot be reassured by the experience of India and Pakistan. In India, debt recovery tribunals offer fast track execution for cases filed by financial institutions. The tribunals, however, only speed the time to a decision about the rights of the parties. They do not speed up the execution of that decision.<sup>385</sup> (Financial institutions in India lack, but want, a statutory right to possession and sale, as well as contempt powers for the tribunals.)<sup>386</sup> In Pakistan, the summary trial takes 1-2 years, plus 2-3 years for appeal, plus time to execute (not reported here).<sup>387</sup> The special procedures reduce the normal enforcement period, but still take too long. Against this track record, Thailand's hope that its new summary procedure takes only up to 1 year<sup>388</sup> may be optimistic.

304. The costs these delays impose on the creditor may often far outweigh the out-of-pocket costs the creditor bears trying to enforce the security interest. Court costs tend to be low to moderate, and capped. This is reported in Indonesia<sup>389</sup> and PRC,<sup>390</sup> at least. Thailand's courts impose a cost of 2.5% of the value in the dispute, up to the equivalent of \$5,400. Enforcing an undisputed mortgage is 1%, up to the equivalent of \$2,700.<sup>391</sup> It is not obvious why the court's costs should be related to the value of the debt. A cost of 2.5% to enforce a low interest, short term loan can raise its cost substantially. A cap limits the expense in Thailand, however. Creditors may also bear the cost of seizure, as they do in Indonesia, where these costs vary.<sup>392</sup> Lawyers costs vary

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<sup>379</sup>Indonesia Local Lawyer. §31.3.2.

<sup>380</sup>Indonesia Local Lawyer, citing Indonesian Supreme Court Circular Letter No. 3 of 1998. §31.3.2.

<sup>381</sup>PRC Local Lawyer, citing only Guaranty Law Art. 53 as a very general source, and interviews. §31.3.1.

<sup>382</sup>Thailand Local Lawyer. §31.3.2.

<sup>383</sup>Pakistan Local Lawyer. §31.3.2.

<sup>384</sup>Indian Local Lawyer. §31.3.2.

<sup>385</sup>Indian Local Lawyer and ILAG Reviewer #3. §31.3.2.

<sup>386</sup>Indian Local Lawyer. §31.3.2.

<sup>387</sup>Pakistan Local Lawyer. §31.3.2.

<sup>388</sup>Thailand Local Lawyer. §31.3.2.

<sup>389</sup>Indonesia Local Lawyer, citing Indonesian Supreme Court Circular Letter No. 3 of 1998, amending Circular No. 5 of 1994. §31.3.2.

<sup>390</sup>PRC Local Lawyer, citing only Guaranty Law Art. 53 as a very general source, and interviews. §31.3.1.

<sup>391</sup>Thailand Local Lawyer. §31.3.2.

<sup>392</sup>Indonesia Local Lawyer, citing Indonesian Supreme Court Circular Letter No. 3 of 1998, amending Circular No. 5 of

more. In PRC,

lawyers' fees range from low (\$100) to high (\$100,000s) depending on the case.<sup>393</sup> We lack information for the other countries.

<b>Table VIII-5. Time Needed for Judicial Action to Seizure of Property</b>			
<b>Country</b>	<b>Through court of first instance</b>	<b>With appeal</b>	<b>Special Procedures</b>
<b>India</b>	7-10 years		2-3 years to award, much longer to recovery
<b>Pakistan</b>	3-4 years + execution	2-3 years	1-2 years + execution
<b>Indonesia</b>	Immediate enforcement: 1-6 months' Regular enforcement: 3-5 years	6 months for each level (best case) + 3-6 months to execute	
<b>PRC</b>	6 months	longer	
<b>Thailand</b>	3 years		up to 1 year

**(v) The Process when the Creditor Retains Title: Seizure and Possession with Hybrid Security Interests**

305. Compared to strict security interests, hybrid security interests such as financial leases and conditional sales are often assumed to offer the creditor a greater opportunity for self-help, at least in jurisdictions where ownership conveys greater rights than those conveyed by a security interest. This assumption, if true, would make hybrid interests superior from the creditor's perspective. Retained ownership interests, however, can undermine normal commerce, particularly if clear and accessible publicity is not available (see the earlier discussion of publicity). From a functional business perspective, retained ownership does the same job for the creditor as a security interest.

306. In these five RETA countries, however, the hybrid security interest rarely conveys enforcement rights that are, in practice, superior to the strict security interest. In most cases, a financial lease and a conditional sale are both enforced in effectively the same manner as strict interests. This outcome may seem appropriate from a functional perspective, but in several cases it occurs due to a failure of the legal system. In India, the enforcement of a financial lease is less effective than that of a strict security interest (Table VIII-6).

307. Hybrids are essentially substitutes for strict security interests at law in four countries (see Table VIII-6). This is true for conditional sales in Indonesia,<sup>394</sup> India, PRC, and Thailand. In India, for movable collateral in debtor's possession, creditor/owner has no right to foreclose and can only sue for the payment due, then launch execution and attachment proceedings.<sup>395</sup> In PRC, the

<sup>393</sup> PRC Local Lawyer, citing only Guaranty Law Art. 53 as a very general source, and interviews. §31.3.1.

<sup>394</sup> Indonesia Local Lawyer. §31.5.

<sup>395</sup> India Local Lawyer and ILAG Reviewers #3. §31.5.

creditor/seller, as owner, may ask the buyer to return the property and, if the buyer does not return it, may turn to the courts.<sup>396</sup> In Thailand, in bankruptcy the creditor/owner must give written notice

<b>Table VIII-6. Comparison of Process to Seize or Possess Collateral When Creditor Retains Title (Hybrid Security Interest) or Holds Strict Security Interest (SSI)</b>				
<b>Country</b>	<b>Financial Lease Rights Are:</b>		<b>Conditional Sale Rights Are:</b>	
	<b>Similar to SSI</b>	<b>Superior to SSI</b>	<b>Similar to SSI</b>	<b>Superior to SSI</b>
<b>India</b>	Same or inferior		Same	
<b>Pakistan</b>	In practice	In theory, generally. Self help gives use of criminal courts, police	In practice	In theory
<b>Indonesia</b>	Same		Same	
<b>PRC</b>	Rescind lease with notice, ask for possession, then sue		Request debtor to return collateral to creditor, then sue	
<b>Thailand</b>	Reorganization: collateral material to business cannot be repossessed Bankruptcy: After notice, may use self-help		Reorganization: collateral material to business cannot be repossessed Bankruptcy: after notice may use self-help	

but may then exercise self-help, even using force (but usually getting police help), and keeping or disposing of the collateral freely.<sup>397</sup> In reorganization, however, if the collateral is material to the business, the creditor/owner may not repossess it.<sup>398</sup> The same procedural differences govern holders of strict security interests (see above).

308. The financial lease carries enforcement rights that are similar to those of a strict security interest in Indonesia,<sup>399</sup> PRC, and Thailand. In PRC, where the creditor/owner may give notice rescinding the financial lease and then repossess the property, but the creditor/owner cannot use self-help, violence, or deceit.<sup>400</sup> These enforcement rights are about the same as those of the holder of the strict security interest. They may have a slightly stronger claim due to ownership, but it is not supported in cases. In Thailand, the process for conditional sale is the same as for financial leases.<sup>401</sup>

<sup>396</sup> PRC Local Lawyer and ILAG Reviewers #1 and #2, citing Contract Law of 1999, Art. §31.5.

<sup>397</sup> Thailand Local Lawyer and ILAG Reviewer #3. §31.1.

<sup>398</sup> Thailand ILAG Reviewer #2, citing BA §90/12, par. 1, no. 8. §31.5.

<sup>399</sup> Indonesia Local Lawyer. §31.5.

<sup>400</sup> PRC Local Lawyer and ILAG Reviewers #1 and #2, citing Guaranty Law Art. 97, Contract Law of 1999, Arts. 7 and 248, and General Principles of Civil Law of 1986, Art. 7. §31.5.

<sup>401</sup> Thailand ILAG Reviewer #2, citing BA §90/12, par. 1, no. 8. §31.5.

309. Hybrids appear to have superior enforcement rights in Pakistan in the abstract, but are similar in practice. A financial lease gives the creditor/owner has the legal right to reclaim its property (this is a lease, after all, not a security interest at law), but in practice the creditor/owner is likely to seek private security agencies or police help, which requires filing a criminal complaint for assets unlawfully held.<sup>402</sup> This complaint takes the parties to court, but the criminal courts rather than the civil courts used by other secured creditors.<sup>403</sup> For a conditional sale in Pakistan, the creditor/owner has the legal right to reclaim its property (this is a sale, not a security interest at law), but in practice the creditor/owner is likely to seek police help, which requires a court order.<sup>404</sup>

310. The financial lease conveys enforcement rights in contract law similar to those of the strict security interest in India, but a statute renders the lease inferior to strict interests. For movable collateral in the debtor's possession, the creditor/owner has no right to foreclose and can only sue for the payment due, then seek execution and attachment proceedings.<sup>405</sup> This is the same process that the holder of a strict security interest must pursue. The financial lease, however, conveys greater opportunities for debtor delay, by statute. A debtor, with collateral that is lease financed plant and machinery, may try to move the case before the Board of Industrial Financial Reconstruction (under the Sick Industries Act), which stays the secured creditor's claim.<sup>406</sup> This protects the debtor more than a strict security interest.

### **C. Disposing of the Collateral: Sale and Use by the Secured Creditor**

311. This section shifts from the procedures to seize the collateral to the those governing its application to the debt it secures.

#### **(i) Sale by Secured Creditor of Collateral It does not Possess**

312. One way to short-circuit the many delays in taking possession, described above, would be to give the secured creditor the power to sell collateral it does not possess, after the debtor defaults. Perhaps a general right to sell the collateral would be too broad because it could be unfair to the debtor. This inequity could be offset, however, by giving the debtor the ability to give this power to the creditor by contract, as part of the security agreement.

313. In only one of the countries, however, does the creditor have a general right to sell collateral it does not possess (see Table VIII-7). In Indonesia, the creditor may sell the collateral by public auction or private sale, with notice to the debtor and published in two regional papers.<sup>407</sup> In Indonesia, the parties may contract this way, but they are restricted to the range of actions, including sale, specified in the Fidusia Act. They cannot, for example, agree that the creditor will own the collateral on default.<sup>408</sup> India and Pakistan allow parties to contract for non-possessory sale. The creditor may acquire the power by contract with the debtor in Pakistan.<sup>409</sup> The creditor can sell the collateral subject to the contract and the requirement that the creditor notify the debtor of the sale.<sup>410</sup> In both countries, however, the court is needed to enforce the right, and in India, the court examines

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<sup>402</sup> Pakistan Local Lawyer. §31.3.

<sup>403</sup> Pakistan Local Lawyer. §31.5.

<sup>404</sup> Pakistan Local Lawyer. §31.5.

<sup>405</sup> India Local Lawyer and ILAG Reviewers #3. §31.5.

<sup>406</sup> India Local Lawyer. §31.4.2.

<sup>407</sup> Indonesia ILAG Reviewer #2, citing Fidusia Law Art. 29(1) lit.(b) and (c), and Art. 29(2). §32.1.

<sup>408</sup> Indonesia Local Lawyer, citing Fidusia Act §§32 and 33. §32.2.

<sup>409</sup> Pakistan Local Lawyer. §32.2.

<sup>410</sup> Pakistan Local Lawyer, citing Contract Act of 1872, §176 for pledges and hypothecations, and Banking Companies (Recovery of Loans, Credits, Advances, and Finances) Act, 1997, §§16 and 18 for suits by or against banks. §32.1.

the reasonableness of the agreement. This substantially qualifies the contractual power.

314. Sale is prohibited in the other countries for varying reasons. When a debtor defaults in PRC, a secured creditor cannot sell collateral it does not possess because the accepted procedure requires negotiation and litigation.<sup>411</sup> A non-possessory mortgagee in Thailand is not allowed to sell the collateral on its own. Sale, requires default,<sup>412</sup> a court decision, and public auction. PRC<sup>413</sup> and Thailand<sup>414</sup> also deny the parties the flexibility to provide by contract that the creditor has the power to sell.

<b>Table VIII-7. Sale by Secured Creditor of Collateral It Does Not Possess</b>		
<b>Country</b>	<b>General Right to Sell</b>	<b>Right by Contract</b>
<b>India</b>	No	Yes, but need court to enforce
<b>Pakistan</b>	No	Yes, but need court to enforce
<b>Indonesia</b>	Yes	Yes
<b>PRC</b>	No	No
<b>Thailand</b>	No	No

**(ii) Process to Sell Collateral, from the Time when the Creditor Achieves the Right to Sell the Collateral to its Receipt of Funds**

315. Having won, or contracted, the right to sell the collateral after the debtor defaults, the creditor generally must use the judicial process to execute the right. This section reports the procedures that the creditor must follow to do so, concluding with special rules for holders of hybrid security interests.

**(a) Steps If a Judicial Process must be Used**

316. Assuming the creditor has the right to sell (which normally means a court decision to that effect), many steps are required before the creditor may receive the proceeds from selling the collateral through court procedures. Each step is time consuming. They explain, as a group, why execution through the judicial system takes so long. The steps, set out in Table VIII-8, generally include contacting the judgment debtor, obtaining a judicial decision to sell, perhaps seizing the collateral if that has not yet been done, allowing time for appeal, perhaps—as a separate step—requesting the court to execute the judgment, carrying out the sale, and only then transferring the assets to the purchaser and the payment to the secured creditor.

<sup>411</sup>PRC Local Lawyer, citing Guaranty Law Art. 53. §32.1.

<sup>412</sup>Thailand ILAG Reviewer #2, citing CCC §§711, 728. §32.1.

<sup>413</sup>PRC Local Lawyer. §32.2.

<sup>414</sup>Thailand Local Lawyer, citing CCC §§711, 756. §32.2.

317. Each country's procedures are summarized as follows:

*India:* The creditor first seeks an order to deliver possession or an order to attach and sell, and then seeks a claim for execution of the order.<sup>415</sup>

*Pakistan:* After the creditor files a petition to execute the judgment and notifies the debtor, the Court Auctioneer is appointed, the property is seized, the auction is scheduled, notice is published, and the auction is held, with objections to the auction made and resolved, and collateral and payment transferred.<sup>416</sup>

Table VIII-8. Steps to Sell Collateral By Judicial Process, From Time Creditor Obtains Right to Sell							
Country	Contact Judgment Debtor	Judicial Decision to Sell	Seize Collateral (if needed)	Appeal	Request Execution	Sale	Transfer Assets, Payment
India	Notify	Order to attach and sell	Yes	Permitted	File claim	Publish notice	Deduct court fees
Pakistan	Notify	File petition	Yes	Permitted	Not separate	Publish notice	
Indonesia	Notify 30 days before auction	Request auction		n.a.	Not separate step	Newspaper ad 15 days before	
PRC	Negotiate	Yes +mediate		Permitted	Yes		
Thailand	Notice	Writ of execution	Justice Ministry	n.a.		Official notice	Deduct court fees

*Indonesia:* Assuming a public auction is sought, the creditor must request the auction, notify the debtor 30 days before the auction and publish notice in two regional papers 15 days in advance.<sup>417</sup> These rules apply to the fidusia (and arguably the pledge), even though the fidusia contract has the force of a final court decision, which permits immediate enforcement. The creditor still needs a writ of execution from the Chairman of the district court.<sup>418</sup> (For a private sale, the process depends on the contract.)

*PRC:* The creditor must negotiate with the debtor, then seek and obtain a judgment to sell or auction the collateral (a step that includes mediation), Appeal must be made within 15 days

<sup>415</sup>India Local Lawyer and ILAG Reviewer #3. §31.3.2.

<sup>416</sup>Pakistan Local Lawyer. §32.3.1.

<sup>417</sup>Indonesia Local Lawyer. §32.3.1.

<sup>418</sup>Indonesia Local Lawyer and ILAG Reviewer #2, citing Herziene Indonesisch Reglement (HIR), Art. 224 and RBG, Art. 195(1) and 206(1). §31.3.1.

of a verdict. Finally, the creditor must request execution.<sup>419</sup>

*Thailand:* The creditor first serves notice of judgment on the debtor, and then applies for a writ of execution of judgment has an official of the Department of Judgment Execution (in the Ministry of Justice) seize the collateral, post notice of sale, then conduct the auction, and pay the proceeds to the creditor after deducting court costs.<sup>420</sup>

The opportunity for delay is great because of the multiple steps.

318. Notice to the judgment debtor is standard in all countries, but PRC requires the creditor to negotiate with the debtor before seeking the judicial order to sell. This is discussed above.

319. When two judicial decisions, rather than one, are needed for the sale to take place, delays can be extensive.

320. Appeals also open the door for long delays. In Indonesia, for example, the debtor may raise new legal issues concerning only compliance with the judgment, failure to observe the requirements of the seizure, or a possible seizure of exempt property. While this rule is supposed to limit the court's role and speed the process by providing finality for the earlier decision, the judge has discretion to delay the court's decision for a long time, and sometimes does so for five years.<sup>421</sup>

**(b) Cost and Time**

321. As a result, it should not be surprising that the time needed simply to execute a judgment can be extremely long. A potential creditor anticipating delays measured in years would reasonably decide not to advance funds against security. As Table VIII-9 shows, execution in India takes from

Table VIII-9. Time (in months) to Use Judicial Process to Sell Collateral							
Country	Contact Judgment Debtor	Judicial Decision to Sell	Seize Collateral (if needed)	Appeal	Request Execution	Sale	Transfer Assets, Payment
India	36-72 (estimate) Special Debt Recovery Tribunals for Banks: 24-36						
Pakistan	24-36						
Indonesia	1 - 60						3
PRC	6 (normal) to 12+ (with court approval)			3+	n.a.		
Thailand	n.a.						

3 to 6 years, and the Special Debt Recovery Tribunals for banks and financial institutions reduce the time to enforce to only about 2 to 3 years.<sup>422</sup> Execution in Indonesia may take up to 5 years,<sup>423</sup>

<sup>419</sup>PRC Local Lawyer, citing Guaranty Law, Arts 53 and 71, and Civil Procedure Law of 1991, Arts. 112, 124, 127, 128, 147, and 216. §32.3.1.

<sup>420</sup>Thailand Local Lawyer. §31.3 and §31.3.1.

<sup>421</sup>Indonesia Local Lawyer and ILAG Reviewer, citing Civil Procedure Law, HIR Art. 207(2) and (3). §31.4.1.

<sup>422</sup>The entire process, from first recourse to courts to establish creditor's rights in the collateral, takes 7 to 10 years, so

although it can also take as little as 4 months. Pakistan takes 1 to 3 years.<sup>424</sup> In PRC, the process in the lowest court normally takes 6 months, but may be extended (by up to another 6 months) by this court in special circumstances and by the appellate court for longer. An appeal to the first appellate court takes another 3 months, and more time if the court's president permits.<sup>425</sup> We do not have the average time for Thailand.

322. The cost that these delays impose on the creditor, and therefore on the debtor, have to be significant. In addition are the out of pocket court costs. The court costs take priority over the rights of the secured creditor in India<sup>426</sup> and Thailand,<sup>427</sup> where all enforcement costs are deducted from the sale proceeds, and in Pakistan<sup>428</sup> and Indonesia,<sup>429</sup> where only the auction or sale costs are deducted. In Indonesia, public auction fees are a significant 14.2% of the sale price, and shared by seller and buyer.<sup>430</sup> (Private auction fees depend on the auction house.) Data for PRC are not available. See Table VIII-10.

Table VIII-10. Priority of court costs, in a judicial sale, over the secured creditor		
Country	Court costs with priority over the secured creditor:	
	All enforcement costs	Only auction or sale costs
India	Yes (except bankruptcy)	Yes (for bankruptcy)
Pakistan	Yes if by contract, but nominal	Yes
Indonesia		Yes
PRC	n.a.	n.a.
Thailand	Yes	

323. Note that, once again, the country differences in the rules do not follow the line between code and common law.

**(iii) Power of Creditor with Hybrid Interests to Sell the Collateral without Court Help**

324. When the security interest is a hybrid, such as a financial lease or conditional sale, the creditor has much wider ambit to sell the collateral (see Table VIII-11). The creditor has this power in

assuming that somewhat more than half is spent establishing the claim, then executing against the collateral would take about 36 to 72 months. See India Local Lawyer and ILAG Reviewer #3. §31.3.2.  
<sup>423</sup>Indonesia Local Lawyer and ILAG Reviewer, citing Civil Procedure Law, HIR Art. 207(2) and (3). §31.4.1.  
<sup>424</sup>Pakistan Local Lawyer. §32.3.2.  
<sup>425</sup>PRC Local Lawyer. §32.3.2.  
<sup>426</sup>India Local Lawyer. §31.5.  
<sup>427</sup>Thailand Local Lawyer. §31.5.  
<sup>428</sup>Pakistan Local Lawyer. §31.5.  
<sup>429</sup>Indonesia Local Lawyer, citing ICC Art. 1139(1). §31.5.  
<sup>430</sup>Indonesia Local Lawyer, citing Minister of Finance Decree No. 47/KMK.O1/1996. §32.3.2.

PRC<sup>431</sup> and Thailand<sup>432</sup> by statute, in India<sup>433</sup> and Pakistan<sup>434</sup> if the contract provides, and in Indonesia in practice, since there is no regulation on point. However, in Indonesia, although the parties to a fiduciary transfer or assignment may negotiate sale as a method of enforcement when the creditor has possession of the collateral, the debtor may contest the sale in court.<sup>435</sup>

<b>Country</b>	<b>Creditor can Sell</b>	<b>Governing Rules</b>	<b>Creditor Can Keep Collateral</b>
India	Yes, if in contract	Contract law	Yes, if contract allows
Pakistan	Yes, if in contract	Contract law	If contract allows
Indonesia	Yes, in practice	Public auction, or seek court sale	No, with some exceptions
PRC	Yes	Contract, Auction laws	Yes by contract
Thailand	Yes	None	Yes by contract

325. The rules governing the sale are set by the contract or contract law in India,<sup>436</sup> Pakistan,<sup>437</sup> and Thailand.<sup>438</sup> In PRC, the contract sets the rules, within statutory requirements.<sup>439</sup> Indonesia limits the parties' choice, requiring a public auction, which would take place through the courts, or directing the creditor to ask the court to determine the method of sale.<sup>440</sup>

326. Enabling the creditor to keep the collateral without a sale gives the creditor more flexibility but places the debtor at risk that the creditor will abuse its power by holding and using collateral with greater value than the defaulted debt. The parties may contract to allow the creditor to keep the collateral rather than sell it, in India,<sup>441</sup> Pakistan,<sup>442</sup> Thailand,<sup>443</sup> and, subject to the Auction Law, PRC.<sup>444</sup> Indonesia prohibits contracting for such a right, to protect the debtor from the possibility that the creditor undervalues the collateral.<sup>445</sup>

<sup>431</sup> PRC Local Lawyer, citing Contract Law Arts. 134 and 248. §32.6.

<sup>432</sup> Thailand Local Lawyer. §32.6.

<sup>433</sup> India Local Lawyer and ILAG Reviewer #3, noting that no statute governs the hybrid interests. §32.6.2.

<sup>434</sup> Pakistan Local Lawyer, citing Banking Companies (Recovery of Loans, Credits, Advances and Finances) Act, §§16 and 18. §32.6.

<sup>435</sup> Indonesia Local Lawyer and ILAG Reviewer #2 citing ICC Art. 1155(1). §32.6.

<sup>436</sup> India Local Lawyer and ILAG Reviewer #3, noting that no statute governs the hybrid interests. §32.6.2.

<sup>437</sup> Pakistan Local Lawyer, citing Code of Civil Procedure, 1908, Order 21, Rule 72. §32.6.2.

<sup>438</sup> Thailand Local Lawyer. §32.6.2.

<sup>439</sup> PRC Local Lawyer, citing Contract Law Arts. 134 and 248. §32.6.2.

<sup>440</sup> Indonesia Local Lawyer, citing ICC Arts. 1155, 1156. ILAG Reviewer #2 notes that the Fidusia Law does not apply to the sale of these hybrids. §32.6.2.

<sup>441</sup> India Local Lawyer and ILAG Reviewer #3, noting that no statute governs the hybrid interests. §32.6.2.

<sup>442</sup> Pakistan Local Lawyer, citing Code of Civil Procedure, 1908, Order 21, Rule 72. §32.6.2.

<sup>443</sup> Thailand Local Lawyer. §32.6.2.

<sup>444</sup> PRC Local Lawyer, citing Guaranty Law Arts. 33, 53, 63, and 71. §32.6.2.

<sup>445</sup> Indonesia Local Lawyer, noting that the holder of a fiduciary transfer or assignment might be able to petition the court to keep or own collateral because a pledgee may do so, and ILAG Reviewer #2. §32.6.2.

**D. Claims Competing Against Those of a Secured Creditor**

327. The prospective creditor must know whether its claim as a secured creditor would be subordinate to the claims of others. This issue is one part of a major study by the ADB of insolvency laws and systems,<sup>446</sup> and need not be re-examined in detail here. In addition, this report addresses the arguments favoring a high priority for secured creditors, earlier. Here this report presents the major other claimants facing secured creditors in the five RETA countries. Many exist, substantially increasing the uncertainty faced by the prospective creditor.

**(i) Homestead and Exempt Property Provision**

328. The countries exempt from the property a secured creditor may seize household goods, key tools for livelihood, and, in some cases, types of income owed as well as other property (see Table VIII-12). India's list<sup>447</sup> is much more extensive than the others. Pakistan is a close second, but it is not clear if the exemptions apply only to unsecured claims or, as in India, to mortgages as well.<sup>448</sup> In Indonesia, protected property includes debtor's animals and tools that are significant to making a living,<sup>449</sup> minimal portion of income (determined by the supervising judge).<sup>450</sup> Thailand's protected property includes personal and household effects and tools for a livelihood, both up to specified amounts, maintenance allowances set by court, payments by employers to surviving spouses,<sup>451</sup> many types of specified property, including certain agriculture products.<sup>452</sup> PRC solves the problems these exemptions are supposed to fix by prohibiting mortgages on property it wants to protect, including educational, health, and medical facilities owned by schools and social welfare organizations.<sup>453</sup> We do not know if PRC protects the items identified in Table VIII-12.<sup>454</sup>

Country	Household Goods	Key tools for livelihood	Income	Other
<b>India and Pakistan</b>	Yes	Yes (includes cattle, seed grain, animals, milk (in some States))	Laborers' wages, salaries,* some provident fund payments, others	Farm produce portion protected by State life insurance dues, rent control residence interests, certain allowances, movables exempt by law on mortgaged land
<b>Indonesia</b>	Yes	Yes (+ animals)	Minimal portion	
<b>PRC</b>	n.a.	n.a.	n.a.	Yes
<b>Thailand</b>	Yes*	Yes*		

- subject to ceiling

<sup>446</sup> ADB, Report on RETA 5795: *Insolvency Law Reforms in the Asian and Pacific Region* and "The Need for an Integrated Approach to Secured Transactions and Insolvency Law Reforms", *Law and Policy Reform at the ADB, Vol. I, 2000 edition*.

<sup>447</sup> India Local Lawyer, citing Civil Procedure Code, 1908 §60. §33.1.2.

<sup>448</sup> Pakistan Local Lawyer, citing Civil Procedure Code, 1908, §§60 and 61, as qualified by ILAG Reviewer. §33.1.2.

<sup>449</sup> Indonesia Local Lawyer, citing HIR Civil Procedural Law Art. 197(8) and RBG Art. 211, Tax Collection Law Art. 15, §33.1.

<sup>450</sup> Indonesia Local Lawyer, citing Bankruptcy Law Art. 20. §33.1.

<sup>451</sup> Thailand Local Lawyer, citing CPC §§284-287. §33.1.

<sup>452</sup> Thailand Local Lawyer, citing Land Reform for Agriculture Act 1975 §28 (land distributed in land reform), Act Governing Leasing of Land for Agriculture 1981 §53 and Seizure of Farmers' Property Act 1932 §5 (various crops). §33.1.

<sup>453</sup> PRC Local Lawyer, citing Guaranty Law Art. 37. §33.1.2.

<sup>454</sup> PRC Local Lawyer, citing Guaranty Law Art. 31. §33.1.2.

329. When the secured creditor holds a strict security interest, a broad range of people are generally able to claim that these exemptions protect them (see Table VIII-13). They are all interested parties in PRC<sup>455</sup> and Thailand.<sup>456</sup> The range of interested parties is very wide in India because the exemptions are numerous.<sup>457</sup> The debtor is effectively the major claimant in Indonesia, where the exemptions are given by type of property rather than type of person.<sup>458</sup> Information for Pakistan is not available.

<b>Table VIII-13. Claimants for Protection</b>		
<b>Country</b>	<b>Claimants</b>	<b>Claimant Debtor with Hybrid Security Interests</b>
<b>India</b>	All interested parties	Debtor may claim exempt artisan's tools and farmer's homestead protection
<b>Pakistan</b>	Debtor (at least)	No
<b>Indonesia</b>	Debtor, some 3rd parties	No
<b>PRC</b>	All interested parties	Yes
<b>Thailand</b>	All affected persons.	No

330. When the secured creditor holds a hybrid interest through a financial lease or conditional sale, the debtor may claim an exemption in India, where an agreement is void if it alienates exempt or homestead property.<sup>459</sup> The same rule applies in PRC, even though the creditor owns the collateral.<sup>460</sup> This is remarkable. It is the fact that the debtor does not own the property that prevents the debtor from claiming the exemptions in Indonesia,<sup>461</sup> Thailand,<sup>462</sup> and Pakistan.<sup>463</sup> In Pakistan, as one would expect, exempt properties receive almost no financing.<sup>464</sup>

**(ii) Bankruptcy: The Priority of a Security Interest**

331. The goal of the secured creditor is to be able to enforce its interests outside the bankruptcy proceedings. The alternative may lead to the creditor contemplating long delays recovering against the defaulted debt, or a priority so low that it recovers little or nothing. In India the secured creditor is not outside bankruptcy (see Table VIII-14). As described above, secured creditors of companies rank pari passu with workmen's dues.<sup>465</sup> In the other countries, however, despite exceptions, qualifications, and occasional lack of legal clarity, the secured creditor is outside bankruptcy. This is

<sup>455</sup> PRC Local Lawyer. §33.1.2.

<sup>456</sup> Thailand Local Lawyer, citing CPC §296. §33.1.2.

<sup>457</sup> India Local Lawyer, citing Civil Procedure Code, 1908, §60. §33.1.2.

<sup>458</sup> Indonesia Local Lawyer, citing ICC Art. 1131. §33.1.2.

<sup>459</sup> India Local Lawyer, citing Civil Procedure Code, §60(1A). §33.2.

<sup>460</sup> PRC Local Lawyer, citing Civil Procedure Law of 1991, Arts. 222 and 223. §33.2.

<sup>461</sup> Indonesia Local Lawyer. §33.2.

<sup>462</sup> Indonesia Local Lawyer. §33.2.

<sup>463</sup> Pakistan Local Lawyer, citing many cases including Mst. Rewati through Mukhtar-i-am Hakim L. Manohar vs. Chiranj, AIR 1944 Lahore 20. §33.2.

<sup>464</sup> Pakistan Local Lawyer. §33.2.

<sup>465</sup> India Local Lawyer, noting that the rules differ for individuals in major cities or other cities, and for companies, and citing Companies Act, 1956, §529(a). §36.1.

so in PRC.<sup>466</sup> In Pakistan, generally secured creditors are outside bankruptcy, but if the assets do not pay the unsecured debts, taxes, and other preferences (wages and certain benefits), the floating charge has lower priority (see Chapter VI on Priority, above).<sup>467</sup> In Indonesia, every secured creditor is outside bankruptcy proceedings provided it enforces its interest within 2 months of the debtor's insolvency; beyond that time, the receiver enforces and the secured creditor must reimburse its costs.<sup>468</sup> In Thailand, the pledge, and perhaps the mortgage, are outside bankruptcy.<sup>469</sup> The exceptions and qualifications can be important, however.

Table VIII-14. Priority of the Security Interest in Bankruptcy				
Country	Outside Bankruptcy	Highest Priority	High	Moderate
India	Yes, but subject to certain interests.	Company debtor: pari passu with workmen's dues	Non-company debtor: lower than government, salary and wages for last 4 months, benefits, bankruptcy costs, state finance corporation	Floating charge
Pakistan	Yes, generally, with court permission			Floating charge
Indonesia	Yes: hypothec, mortgage, fiduciary transfer and assignment (must enforce in 2 months from insolvency)			
PRC	Yes			
Thailand	Pledge, perhaps mortgage		Mortgage, perhaps	

### E. Banks' Special Procedures to Seize Collateral

332. Banks could have a special or super position over other secured creditors, even those first-in-time.

333. Banks in these five RETA countries, however, have no special powers to seize and sell collateral for their advances on their own in any of the countries (see Table VIII-15). They have no special procedures using the courts or government agencies in PRC<sup>470</sup> or Thailand.<sup>471</sup>

334. Banks do have access to special procedures in the other countries. Banks in Pakistan have a summary trial procedure, which applies if the defendant cannot make a prima facie case against

<sup>466</sup> PRC Local Lawyer. §36.1.

<sup>467</sup> Pakistan Local Lawyer and ILAG Reviewer, citing Companies Ordinance, §405(5). §36.1.

<sup>468</sup> Indonesia Local Lawyer, citing Bankruptcy Law of 1998, Arts. 56, 47, and 177. §36.1.

<sup>469</sup> Thailand Local Lawyer and ILAG Reviewer #2 did not resolve whether Bankruptcy Act §95 applies only to possessory pledges or also to mortgages. §36.1.

<sup>470</sup> PRC Local Lawyer. §37.2.

<sup>471</sup> Thailand Local Lawyer. §37.1.

the creditor's suit.<sup>472</sup> Banks in India hoped to rely on the special debt recovery tribunals created in 1993 to speed the recovery process for financial institutions. They have their own recovery methods and officers. The tribunals are, however, under constitutional challenge now.<sup>473</sup> State banks in Indonesia turn over their bad debts to the State Receivables Agency (BUPN). BUPN's enforcement letter has the enforcement power of a final, binding court judgment. The bailiff can seize the property directly on the authority of the enforcement letter and, when BUPN issues a letter of sale, auction the collateral through an auction house.<sup>474</sup>

<b>Table VIII-15. Banks' Special Procedures to Seize and Sell Collateral</b>		
<b>Country</b>	<b>Special Bank Power to Seize Collateral</b>	<b>Special Bank Power to Sell Collateral</b>
<b>India</b>	No. The special debt recovery tribunals are challenged as unconstitutional, but if they survive their summary procedures will speed banks' recovery	
<b>Pakistan</b>	A summary procedure for banks moves their claims through the courts faster than other secured creditors	
<b>Indonesia</b>	Not for banks themselves, but two State Agencies have special powers to manage bad debts, including seizure and sale of collateral. In addition, banks can temporarily buy collateral (1 year), unlike other secured creditors.	
<b>PRC</b>	No.	No.
<b>Thailand</b>	No	No.

335. Once again the division is not simply between code and common law countries.

#### **F. Arbitration as an Alternative to Enforcement Through the Courts**

336. Arbitration could offer secured creditors speedier enforcement than the courts. Each country permits arbitration, but practical problems pose constraints to the use of arbitration.

337. The countries give parties broad scope to structure arbitration by contract (see Table VIII-16), although some arbitration laws may be better than others. For example, India and Pakistan both relied on the sixty year old Arbitration Law of 1940. While Pakistan still uses this law, however, India adopted a new law in 1996. In Pakistan, as a result, the parties may select one of only three options under the Arbitration Law: contractual (parties structure the arbitration outside the courts), court intervention during arbitration with no pending suit (a party asks the court to decide issues concerning the arbitration agreement), and arbitration order by the court during a suit.<sup>475</sup> In India, however, the 1996 Arbitration and Conciliation Act gives parties wide discretion to structure arbitration.<sup>476</sup> Similarly, parties in PRC<sup>477</sup> and Thailand<sup>478</sup> have broad discretion choosing methods of

<sup>472</sup> Pakistan Local Lawyer, Banking Companies (Recovery of Loans, Credits, Advances, Finances) Act, 1997, §§9-19. §37.1.

<sup>473</sup> India. Local Lawyer. §38.

<sup>474</sup> Indonesia Local Lawyer. §37.1.

<sup>475</sup> Pakistan Local Lawyer, citing Arbitration Act, 1949, Chapters III and IV. §38.1.

<sup>476</sup> India Local Lawyer, citing Arbitration and Conciliation Act, 1996 generally and §§7 and 11-13 specifically. §38.2.

<sup>477</sup> PRC Local Lawyer, citing Arbitration Law of 1994 and Contract Law of 1999, Art. 128. §38.2.

<sup>478</sup> Thailand Local Lawyer. §38.1.

arbitration, and the law in Indonesia does not limit the parties' ability to choose any arbitration method,<sup>479</sup> but identifies the types of issues that can be settled by arbitration.<sup>480</sup>

338. Practical constraints, however, may be severe in some of the countries. A bureaucratic constraint in India could stifle the use of arbitration by government-owned financial entities, which are important sources of finance. These agencies do not pursue arbitration because if they lose, the Comptroller, Auditor General, and even the Central Bureau of Investigation might investigate them for improper actions.<sup>481</sup> In Pakistan, disputes involving parastatals often have the Minister who oversees the parastatal acting as arbitrator, which brings a political dimension to efforts to resolve a commercial dispute.<sup>482</sup> Thailand reports no major constraints.<sup>483</sup>

<b>Table VIII-16. Use of Arbitration to Enforce Security Interests</b>			
<b>Country</b>	<b>Scope of Parties' Power to Structure Arbitration</b>	<b>Constraints to Use of Arbitration</b>	<b>Enforcement of Award</b>
<b>India</b>	Broad scope to structure by contract	Investigate state bank for improper behavior if it loses arbitration	Award has force of court decision, can enforce immediately
<b>Pakistan</b>	Broad	Minister for parastatal may be arbitrator	Court enforces
<b>Indonesia</b>	Broad	No major constraints	Court enforces by writ of execution
<b>PRC</b>	Broad		Court enforces
<b>Thailand</b>	Broad	No major constraints	

**(i) Role of Courts Enforcing the Arbitral Award**

339. The courts participate in enforcement in at least three of the countries, Pakistan, Indonesia, and PRC (see Table VIII-17). In India, the court is not needed to enforce the arbitral award. The following summarizes the process in each country:

*India:* a party can apply to the court to set aside the award for failure to comply with statutory procedures, but after that application (or the period allowed to apply) the award is final and binding, and is enforced in the same way as a court decision.<sup>484</sup>

*Pakistan:* arbitrators file their award in court, which hears parties' objections, reviews the award, and returns it to the arbitrators if any issue is undetermined or indefinite in a way that affects execution, or if the award may be illegal. This may leave the court some discretion to influence the substance of the award. The award is void if the arbitrators do not reconsider.

<sup>479</sup>Indonesia Local Lawyer, citing RV Arts. 615-640 and the Arbitration Law Arts. 22-26. §38.1.

<sup>480</sup>Indonesia Local Lawyer, citing Arbitration Law, Art.5. §38.1.2.

<sup>481</sup>India Local Lawyer. §38.1.2.

<sup>482</sup>Pakistan Local Lawyer. §38.1.2.

<sup>483</sup>Thailand Local Lawyer. §38.1.2.

<sup>484</sup>India Local Lawyer, citing Arbitration and Conciliation Act, 1996, §36. §38.2.2.1.

The court enters judgment after the time to object passes.<sup>485</sup> Enforcement follows the ordinary process, but appeal is limited to failure to meet the terms of the award.<sup>486</sup>

*Indonesia*: the arbitration award is enforced through the courts by writ of execution and the court enforces the writ.<sup>487</sup> The award may be appealed to an appellate court.<sup>488</sup>

*PRC*: failure of one party to carry out the award allows the other to ask the court to enforce it. If the court finds the award unlawful, it may decline to enforce it as being against the public interest. This gives courts very broad discretion.<sup>489</sup>

## (ii) Desirability of Arbitration

340. Arbitration emerges as a possible, but not unblemished, substitute for court enforcement in some circumstances (see Table VIII-17). Arbitration produces a faster award, compared to courts, in Indonesia,<sup>490</sup> India (6 months to 2 years),<sup>491</sup> and Pakistan (1 to 3 years unless the awards are not sound).<sup>492</sup> The time is about the same as the time in courts in PRC<sup>493</sup> and Thailand (up to 3 years).<sup>494</sup>

341. Arbitration costs less than using courts in only two countries: Pakistan, assuming that the award is not litigated through all court levels (see below),<sup>495</sup> and PRC, because the arbitration award cannot be appealed and also because some arbitration tribunals deliberately keep their costs below the courts to attract business.<sup>496</sup> Arbitration costs at least as much as courts in India<sup>497</sup> and more in Indonesia<sup>498</sup> and Thailand.<sup>499</sup> See Table VIII-17.

342. A major issue for arbitration, as a substitute for the judicial system, is whether the award is final, other than being subject to review for compliance with existing legal standards for arbitration (usually by legislation) or, instead, can be reviewed on its merits by the courts. If the latter, arbitration becomes largely a device that one party can use to delay a final decision. In all five RETA countries, the courts may review the procedure followed by the arbitrators. Only in India is the arbitration award final and binding on the parties as well as persons claiming under them.<sup>500</sup> Only procedural grounds, such as incapacity of a party, invalid agreement, improper notice, or failure to comply with the agreed process, may prevent enforcement.<sup>501</sup> The court also has a discretionary power to stay execution so parties can adjust their claims or to prevent multiple proceedings.<sup>502</sup> This power may slip some laxity into enforcement.

<sup>485</sup> Pakistan Local Lawyer, citing Arbitration Act, 1940, §§14-19, 30-33, and 39. §38.1.2.

<sup>486</sup> Pakistan Local Lawyer, citing Code of Civil Procedure, 1908. §38.1.2.

<sup>487</sup> Indonesia Local Lawyer, citing Arbitration Law Arts. 59-64 and RV Art. 634. §38.1.2.

<sup>488</sup> Indonesia Local Lawyer, citing RV Art. 541, and noting that no cessation is possible, citing RV Art. 642. §38.1.2.

<sup>489</sup> PRC Local Lawyer. §38.2.1.

<sup>490</sup> Indonesia Local Lawyer. §38.2.2.1 and §38.2.2.2.

<sup>491</sup> India Local Lawyer. §38.2.2.1.

<sup>492</sup> Pakistan Local Lawyer. §38.2.2.1.

<sup>493</sup> PRC Local Lawyer. §38.2.2.1.

<sup>494</sup> Thailand Local Lawyer. §38.2.2.1.

<sup>495</sup> Pakistan Local Lawyer. §38.2.2.2.

<sup>496</sup> PRC Local Lawyer. §38.2.2.2.

<sup>497</sup> India Local Lawyer. §38.2.2.1.

<sup>498</sup> Indonesia Local Lawyer. §38.2.2.2.

<sup>499</sup> Thailand Local Lawyer. §38.2.2.1.

<sup>500</sup> India Local Lawyer. §38.2.2.1.

<sup>501</sup> India Local Lawyer, citing Arbitration and Conciliation Act, 1996, §34. §38.3.

<sup>502</sup> India Local Lawyer, citing Arbitration and Conciliation Act, 1996, §34, and *Judhister v. Surendra*, AIR 1969 Ori. 233. §38.3.

Country	Time to enforce award (months)	Cost of arbitration (compared to courts)	Award: subject to court review of —		Arbitration is seen as fair compared to courts
			Substance	Procedure	
<b>India</b>	6 to 24	Not less than courts	No	Yes	Yes: shortage of skilled personnel, judges:
<b>Pakistan</b>	12-36	Less than courts.	No, but some court discretion	Yes	
<b>Indonesia</b>	Less than courts	Probably over courts	No, unless it violates public policy or morals	Yes	Yes
<b>PRC</b>	Same as court	Less than courts	No, unless it violates public interest	Yes	Yes
<b>Thailand</b>	to 36	Over courts	No, but court reviews relevant law	Yes	Yes

343. When the court’s ability to exercise such broad discretion carefully is suspect, however, the potential creditor will assume that the court can slow the final decision if it should choose to do so. The “legality” review, applied in Pakistan and Thailand, is narrower than the other tests. In Pakistan, the court mainly reviews procedural issues, such as the arbitrators’ lack of jurisdiction. However, the court’s power to determine if the award is illegal, as noted above, may give it some discretion to influence the substance of the award.<sup>503</sup> In Thailand, the court may refuse to enforce the (domestic) award for procedural reasons if the award reflects an “unjustified act or procedure” or exceeds the scope of the agreement or relief sought. The Thai courts may also refuse to enforce a domestic arbitration award for substantive reasons, if it is contrary to the relevant law.<sup>504</sup> PRC and Indonesia give courts a more general mandate. In Indonesia, for domestic Indonesian arbitration, enforcement can be prevented for procedural reasons, such as if the award is not submitted to the appellate court<sup>505</sup> within 30 days after it is given or if no arbitration agreement exists. Domestic arbitration in Indonesia may also be overturned for substantive reasons, when it contradicts public policy or morals.<sup>506</sup> In PRC, the arbitration award is binding and neither party may appeal to the courts, but the court may refuse to enforce an award that is against society’s public interest.<sup>507</sup>

<sup>503</sup> Pakistan Local Lawyer, citing Arbitration Act of 1940, §§30 and 33. §38.3.

<sup>504</sup> Thailand Local Lawyer, citing Arbitration Act 1987, §24. §38.3.

<sup>505</sup> Indonesia Local Lawyer, citing RV Art. 541, and noting that no cessation is possible, citing RV Art. 642. §38.1.2.

<sup>506</sup> Indonesia Local Lawyer, citing Arbitration Law Arts. 59, 62, and 70. Rules for enforcing arbitration awards made abroad are more complex. §38.3.

<sup>507</sup> PRC Local Lawyer, citing Arbitration Law of 1994, Arts. 57 and 63, and Civil Procedure Law of 1991, Art. 217. §38.2.1 and §38.3.

344. Finally, apparently arbitration is considered fair, compared to courts, in India,<sup>508</sup> Indonesia,<sup>509</sup> PRC,<sup>510</sup> and Thailand.<sup>511</sup> Pakistan did not respond.

345. In short, arbitration may be a workable substitute to enforcement through the courts in India. Arbitration is faster, binding (not subject that is, to substantive review), and fair, but it costs at least as much as the courts. The call is closer in the other countries, where an advantage in cost or time is off set by a disadvantage in the other as well as the possibility that the award is not binding. In all cases, however, the delay is far longer than the time self-help would take. Not even arbitration, however, seems to offer the summary relief at least some types of creditors will need. Arbitration also does not address the needs of third parties with higher priority than the contestants.

### G. Court Review of Hybrid Security Interests: Rescission of Financial Leases

346. An appeal of the financial lease, to the potential creditor, is that the creditor can rescind the lease if the debtor defaults and then, as owner, reclaim the collateral. This should allow the creditor to enforce its interests quickly and without concern that the collateral would be part of a bankrupt's assets and subject to bankruptcy proceedings. The only challenge by the debtor would be whether the creditor had exercised its power to rescind according to the scope of the contract and the law.

347. Among the five RETA countries, only PRC limits court review to the rescission (see Table VIII-18). There, on notice to rescind the financial lease, the owner may immediately reclaim the property, but if the debtor refuses to return it, the owner must ask the court, or perhaps the arbitration body, to rule on the validity of rescission.<sup>512</sup> This means that the time to recover the property may be very short, or only several months at most.

Country	Scope of Court Review		Time (months)
	Broad: Ordinary court review	Limited: Only rule on rescission	
<b>India</b>	Yes	No	36-48 (and police may not help in some States)
<b>Pakistan</b>	Yes, except for financial institutions	No	Same as other collateral
<b>Indonesia</b>	Yes	No	Same as other collateral
<b>PRC</b>	No	Yes	Fast to several months
<b>Thailand</b>	Yes	No	36+

<sup>508</sup> India Local Lawyer. §38.3.

<sup>509</sup> Indonesia Local Lawyer. §38.3.

<sup>510</sup> PRC Local Lawyer. §38.3. Also, arbitration through the PRC International Economic Trade and Arbitration Commission is considered fair internationally. §38.2.1.

<sup>511</sup> Thailand Local Lawyer. §38.3.

<sup>512</sup> PRC Local Lawyer, citing Contract Law of 1999, Arts. 242, 248, and 96. PRC's 1999 Contract Act specifically provides for financial leases, unlike India, Pakistan, and Indonesia. 39.2.

348. The financial lease does not give the creditor this speed in the other countries, where the court review is broad. Ordinary court proceedings apply, and recovery time is the same as for other collateral, in Indonesia<sup>513</sup> and Pakistan,<sup>514</sup> although in Pakistan when a financial institution is

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<sup>513</sup>Indonesia Local Lawyer. §39.1 and §39.2.

<sup>514</sup>Pakistan Local Lawyer. §39.2 and §31.3.2.

involved, the special enforcement rules for them come into play (see above).<sup>515</sup> The process is similar in Thailand where the creditor, after sending notice to end the lease and return property, asks court or the arbitrators to repossess property<sup>516</sup> or, perhaps, repossesses it through self-help.<sup>517</sup> Recovery time could exceed three years.<sup>518</sup> In India, the situation may be even more dire. Ordinary courts, applying contract law, may take 3-4 years to win a court order to repossess equipment.<sup>519</sup> But in some states, the police will not help the creditor recover the collateral, making the recovery time indefinite, or infinite.<sup>520</sup>

349. These four countries have equated hybrids such as financial leases with strict security interests, which is the goal of the functional approach to secured transactions. The outcome, however, is perverse. The problems enforcing strict security interests are legion, so the creditor holding a financial lease finds its recovery slowed to the speed of the rest. PRC, which unlike most of the other countries, specifically provides for financial leases by law, treats their enforcement differently from strict security interests. The outcome benefits the creditor, reducing the recovery time to a few months at most. The equation of hybrids and strict security interests poses difficult legal issues in many countries, but for these four, it reflects a legal system that has not yet come to grips with the complexity of secured transactions.

#### H. Criminal Procedures to Enforce Security Interests: Debt Imprisonment

350. The criminal courts, and more broadly the criminal justice system, can be an expensive and often corrosive substitute for using civil courts to enforce security interests. Four of the five RETA countries use criminal courts to secure some credit, while one—Indonesia—does not (see Table VIII-19).

351. Imprisoning a debtor for default on debt generally is available as a form of enforcement in only one of the five RETA countries. The law does not provide for imprisonment in India,<sup>521</sup> PRC,<sup>522</sup> or Thailand.<sup>523</sup> In Indonesia, the Civil Procedure Law and the Bankruptcy Law permit imprisonment of the debtor for insufficient assets and delinquency, respectively, but in 1964 a Supreme Court circular advised courts against imprisonment and it ended as a punishment.<sup>524</sup>

352. Banks may obtain the arrest of debtors in Pakistan who break the security agreement.<sup>525</sup> This is the sole case of a broad use of criminal courts to protect secured creditors and is limited to banks. It is not clear why they should have such a power. For other types of secured creditors in Pakistan, default on a debt does not justify imprisonment.<sup>526</sup>

<sup>515</sup> Pakistan Local Lawyer. §39.1.

<sup>516</sup> Thailand Local Lawyer. §39.1.

<sup>517</sup> Thailand ILAG Reviewer #2 (see discussion above about repossession). §39.1.

<sup>518</sup> Thailand Local Lawyer. §39.2.

<sup>519</sup> India Local Lawyer. §39.2.

<sup>520</sup> India Local Lawyer. §39.2.

<sup>521</sup> India Local Lawyer, citing Civil Procedure Code, §51(c). §40.1.

<sup>522</sup> PRC Local Lawyer, citing Negotiable Instruments Law of 1995, Art. 107, and Penal Code of 1997, Art. 194. §40.1.

<sup>523</sup> Thailand Local Lawyer, citing Act Governing Offences Arising from the Use of Cheques, 1991, §4. §40.1.

<sup>524</sup> Indonesia Local Lawyer, citing HIR Civil Procedural Law, Arts. 209-223 and Bankruptcy Law, Art. 88. §40.1.

<sup>525</sup> Pakistan Local Lawyer, citing Banking Companies (Recovery of Loans, Credits, Advances and Finances) Act, §19. §40.1.

<sup>526</sup> Pakistan Local Lawyer, citing Code of Civil Procedure, 1908, §§51 and 55, and Rule 37 of Order 21. §40.1.

<b>Table VIII-19. Imprisonment as a Substitute for Collateral</b>			
<b>Country</b>	<b>Imprisonment of the Debtor Helps to Ensure Debt is Serviced if Default is on:</b>		
	<b>Debt in general</b>	<b>Post-Dated checks</b>	<b>Secured Debt to Banks</b>
<b>India</b>	No (except male judgment debtors)	Yes	
<b>Pakistan</b>	No (except male judgment debtors)	Yes, with criminal intent	Yes, with criminal intent
<b>Indonesia</b>	Yes by code, but courts stopped doing so in 1964	No	
<b>PRC</b>	No	Yes	
<b>Thailand</b>	No	Yes	

353. Post-dated checks, however, do serve as a device to draw on the criminal courts to protect creditors in all countries except Indonesia and possibly PRC. In India, it became a criminal offense in 1988 to pay a debt by writing a check against insufficient funds.<sup>527</sup> Punishment is up to 1 year in prison, a fine of twice the value of the check, or both. “If the person committing the offence is a company, every person responsible for issuing such a cheque shall be deemed to be guilty of offence.”<sup>528</sup> Since the penalty is based on a contractual obligation, however, the offense must be one of gross bad faith. In Pakistan, post-dated checks (as well as trust receipts) are used to secure debts because default can lead to criminal prosecution, but dishonesty must be established.<sup>529</sup> In Thailand, creditors commonly take post-dated checks because a person who issues a check knowing funds were insufficient could be imprisoned.<sup>530</sup> In PRC, people who write bad checks are subject to imprisonment for up to life and a fine of up to \$70,000.<sup>531</sup> Many cases have been prosecuted, but it is not clear how many, if any, of the checks were held as a substitute for collateral.

## I. Economic Consequences of Enforcement Problems

354. Slow and costly enforcement represents the greatest barrier to using personal property as collateral. Relative to real estate, personal property often has a lower unit value, depreciates faster, or has a shorter economic life, and a much greater chance of disappearing. Payment of account receivables takes place in 30-60 days. Agricultural commodities often perish quickly. Even storable agricultural commodities will depreciate rapidly if they do not receive proper care, a difficult task under court supervision and an unrealistic expectation for the defaulting debtor. For other

<sup>527</sup> India Local Lawyer, citing Negotiable Instruments Act, 1881, §138. §40.1.

<sup>528</sup> India Local Lawyer, citing Negotiable Instruments Act, 1881, §138. §40.1.

<sup>529</sup> Pakistan Local Lawyer, citing Penal Code, 1872, §§406, 420. §40.1.

<sup>530</sup> Thailand Local Lawyer, citing Act Governing Offences Arising from the Use of Cheques, 1991, §4. §40.1.

<sup>531</sup> PRC Local Lawyer, citing Negotiable Instruments Law of 1995, Art. 107, and Penal Code of 1997, Art. 194. §40.1.

equipment, one to three years may represent a substantial fraction of its economic life. For a flour mill and bakery enterprise, some goods, such as bread, depreciate very fast. Others may last longer, such as packed dry foodstuff. Different enterprises provide endless examples; most enterprises have property with a broad range of economic lives.

355. Slow and costly enforcement imposes a high price expressed in loss of access to credit. A period of collection and sale of one to three years makes most movable property useless as collateral.

356. For certain types of collateral, notably accounts receivable, opportunities exist to set common rules governing secured creditors and obligors. With the rights of obligors clear and fair, secured creditors should be able to approach them independently of the courts.

357. A lengthy stay on secured creditor rights during corporate reorganization may reduce the value and affect the use of property with a short economic life. One solution, to abolish the stays, would run counter to trends in reorganization around the world that rely on binding secured creditors at least temporarily and may not address other policy considerations.<sup>532</sup> Other solutions are to shorten the stays and making them discretionary rather than automatic in legal systems where the courts will not abuse their discretion. If reorganization affects a small fraction of the movable property, as it does in the United States, this may not appear as a substantial problem to potential creditors. Ironically, it may also not appear serious in a country like Thailand, where defects in creation mean that collateral is mostly tangible/fixed capital and not raw materials/inventory or other such movables.

## **IX. HOW PROBLEMS IN SECURING TRANSACTIONS WITH MOVABLE PROPERTY HURT CREDITORS AND DEBTORS**

### **A. The Enterprise Interviews**

358. Structured interviews with creditors and debtors confirmed the very limited role that movable property plays as collateral for debt and the low levels of access to credit by key groups, compared to what one would expect. This section presents the methodology, explains its focus on creditors as a way to understand debt, and summarizes the findings.<sup>533</sup>

#### **(i) The methodology**

359. The previous chapters set out an economic analysis of the law. They examined how the legal framework for secured transactions in the five RETA countries would affect the incentive of creditors to make advances. The supply of credit would affect the debtors' likely access to credit when they possessed different types of collateral. Based on these legal findings, the study developed hypotheses about how different creditors would behave. Teams in each of the five RETA countries interviewed financial firms and other enterprises, such as dealers, who operate as both creditors (they sell on credit) and debtors (to fund their business). The interviewers asked structured questions designed to learn how creditors give credit to debtors with different types of collateral. Some interviewees confirmed that debtors' accounts of loan contracts were broadly consistent with the accounts of creditors.

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<sup>532</sup> "The Need for an Integrated Approach to Secured Transactions and Insolvency Law Reforms", *Law and Policy Reform at the ADB, Vol. 1, 2000 edition*.

<sup>533</sup> This chapter is based on the Enterprise Interviews, separately available from the ADB.