A FLAWED APPROACH? CONSTITUTIONAL COURT DECISION IMPARTS FUNDAMENTAL CHANGES ON THE ENFORCEMENT OF FIDUCIA SECURITY

An Overview

In a seemingly devastating blow to financing security, the Indonesian Constitutional Court recently issued Decision No. 18/PUU-XVII/2019 (Decision) which declared that certain provisions of Law No. 42 of 1999 on Fiducia Security (Fiducia Law) are conditionally unconstitutional, changing the way fiducia security can be enforced. Previously, having a fiducia security provides the comfort that creditors can execute security without having to go to the court. But given the Decision, there is a risk that creditors, to exercise their fiducia security rights, will have to secure the cooperation of the debtor (by the debtor agreeing that an event of default has occurred), or, in the likely event that a debtor does not, it will need to procure a final and binding court decision to do so.

We have provided below a summary of key findings, our analysis thereof, and potential risk mitigants for creditors formerly intending to enter into fiducia security arrangements.

Background

Under Indonesian law, fiducia security is used to secure debtors’ assets in the form of moveable objects, as well as immovable objects that cannot be encumbered with hak tanggungan. One of the chief appeals of a fiducia security for creditors is that it has the power of a final and binding court decision, meaning a creditor can immediately execute on the secured object without first obtaining a court decision, which may be costly and time consuming to procure.
Key Findings

The key findings of the Constitutional Court under the Decision are as follows:

(i) The terms of Article 15(2) of the Fiducia Law, which previously stipulate that a fiducia certificate has the same executory powers as a final and binding court decision, are conditionally unconstitutional unless the Article is read to mean that a final and legally binding court decision will be required if there is no consensus on default and the debtor declines to voluntarily surrender the fiducia object.

(ii) The terms of Article 15(3) of the Fiducia Law which previously stipulate that, if a debtor defaults, the fiducia holder is entitled to sell the fiducia security object on their own behalf/power, are conditionally unconstitutional unless the Article is read to the effect that the fiducia holder can only sell the fiducia object on their own behalf/power if the existence of an event of default is agreed by the creditor and debtor, or determined by way of a legal remedy.¹

From a literal reading, it could be argued that creditors intending to execute fiducia security only have two following courses of action: (i) if the debtor disagrees that an event of default has occurred and is unwilling to surrender the fiducia object, the creditor can only execute the security by way of obtaining a final and binding court decision (which would be a devastating result); or (ii) if the debtor agrees that an event of default has occurred and is willing to surrender the fiducia object, the fiducia holder can execute on its own accord.

Enforcement mechanism under the fiducia law

For context on the applicable enforcement mechanism prior to the Decision, pursuant to Article 29 of the Fiducia Law, fiducia holders can execute fiducia security in any of the following three ways:

(i) executionary title: by application of Article 15(2) of the Fiducia Law, which stipulates that a fiducia certificate bearing the words “For Justice based on the One Almighty God” (Demi Keadilan Berdasarkan Ketuhanan yang Maha Esa), has the same executionary power as a final and binding court decision;

(ii) parate executie: by application of Article 15(3) of the Fiducia Law, which stipulates that a fiducia holder holds the right to sell the security object on his/her own accord; or

¹ The definition of legal remedy is not specified under the Constitutional Court Decision, and it is unclear whether this refers to a final and binding court decision, similar to the Constitutional Court’s findings on Article 15(2) on the Fiducia Law.
(iii) **private sale**: if agreed by the fiducia holder and grantor, if by doing so the highest price which would be beneficial to both parties can be obtained.

**Analysis**

We have several concerns with the Decision.

There are two main ways to read the Decision. A more measured interpretation would be that the requirement that debtor consents to the existence of an event of default and to the surrender of the fiducia object can be satisfied by having clauses on event of default that are sufficiently clear on default triggers, so that there will be no room for debate or dispute when a default occurs and the creditor wishes to execute the relevant fiducia object (and other security) (**First Interpretation**). We note from the Decision that the Constitutional Court judges were questioning whether it is possible to clearly define an event of default. It is intriguing to further understand whether this question came from the Constitutional Court judges’ lack of experience in handling commercial and financing transactions or a genuine concern relating to the fact that the Fiducia Law does not provide such definition.

**However**, the risk exists that the Decision could be interpreted to mean that even **after** the parties have agreed to the terms of default under the main agreement, debtor’s additional consent will still be needed, after a perceived default, on whether an event of default has truly occurred and for the surrender of fiducia object (**Second Interpretation**). This interpretation may be intended, as indicated in the use of existence of event of default in the Constitutional Court’s decision and the wording of the Constitutional Court’s written considerations. Obviously, the Second Interpretation would not be practical in day to day business, and we believe that this interpretation should not apply due to the concerns set out below.

*Potentially lengthy and complicated process of enforcement*

There is a possibility for debtors in bad faith to not acknowledge the existence of a default, and to be unwilling to surrender the fiducia object. This means that court proceedings may need to be undertaken to **decide on the existence of an event of default** before fiducia security can be enforced. This may cause creditors to be held hostage by a lengthy and complicated series of legal proceedings just to recover the loan/other performance provided to the debtors.

*Affects interpretation of main agreement*

The Decision’s implication goes beyond the Fiducia Law, and beyond fiducia security. Fiducia security is accessory in nature to an underlying agreement for performance. Aside from affecting the enforcement of fiducia security, the Decision also has the effect of dictating how parties to the underlying agreement should interpret the agreement, by requiring them to resort to court proceedings if there are differences
in interpretation regardless of what the agreement stipulates. The issue of default and interpretation under the main contract is governed under the Indonesian Civil Code (ICC), which is not within the scope of review under the Decision.

**Not acknowledging past mechanism of enforcement**

An element that the Constitutional Court relied on in their written reasoning is the perceived arbitrariness of the enforcement of fiducia security, which comes from what is considered as the creditor’s ability to unilaterally seize the debtor’s assets. We are not certain that this concern is fully founded.

In terms of enforcement by way of executionary title (Article 15(2) of the Fiducia Law), there are administrative requirements in place to enforce fiducia *vis-à-vis* the fiducia certificate’s executionary title. The process should not be perceived as arbitrary; the fiducia holder is required to submit a request for enforcement to the head of the relevant district court.

In terms of enforcement by way of *parate executie* (Article 15(3) of the Fiducia Law), the creditor does not currently have free reign to execute security at will. Instead, the creditor will need to rely on the wording on event of default under the relevant loan agreement. A debtor in disagreement with the creditor on the interpretation of event of default clauses, or in the means of the creditor in enforcing its fiducia security, can seek recourse through dispute settlement mechanisms, but if it does not, the creditor should not be prevented from enforcing the security and penalized for terms that the debtor has agreed to by diminishing the power of fiducia security. As an illustration, pursuant to the Decision, a creditor may have issues in enforcing fiducia security if the debtor is silent *unless* it institutes a legal proceeding.²

Previously, if a debtor is silent, a creditor can enforce the security and the debtor can still challenge that enforcement and the means thereof. Given this fact, the idea that debtor’s constitutional right has been impaired by the provision of Fiducia Law might be an unjustified one.

**Inconsistency with nature of fiducia**

As clearly set out in the definition of fiducia under Article 1 of the Fiducia Law, the title (ownership) of the secured object is by trust considered to have been transferred to the fiducia holder conditionally, while the possession and use of the object are still retained with the fiducia grantor.

In our view, there is a mismatch between this concept and the burden of proof applied by way of the Decision. If the fiducia holder (creditor) is required to obtain the debtor’s consent or a court decision before exercising its rights over the fiducia object, this would seem inconsistent with the notion that the

² The creditor may argue that the debtor’s silence constitutes consent, but this may be further challenged.
fiducia object is “owned” by the fiducia holder by way of trust. The onus **should not be on the fiducia holder having to prove that they are entitled to exercise their rights** – **this should be an inherent right tied to their ownership.** The onus should be on the debtor, who is not the owner, to evidence why the fiducia holder cannot exercise its rights over an object under their ownership.

One reasoning that the applicant brought forth in the Decision is the need to protect the property of the debtor, with the right over property as set out under Article 28H of the Indonesian Constitution. If we acknowledge that with fiducia security ownership over the secured object has transferred to the creditor, is the creditor not entitled to the same protection under Article 28H of the Indonesian Constitution over what is now their property?

**Lack of clarity for third-party security providers and syndicated lenders**

Regardless of the interpretation applied, the Decision only addresses the interaction/agreement between debtor and creditor, which creates uncertainty for fiducia agreements where the parties are **not** the debtor and/or creditor under the main agreement. Debtors often have third-party security providers; in this circumstance, the wording of the Decision requiring debtor’s voluntary surrender of the fiducia object is not apt, as the third-party security party will be the entity holding the fiducia object and the debtor should not be relevant in this context.

Agreements may also involve multiple creditors; in which case a party may be appointed to act as security agent on behalf of all creditors. Parties may agree that the security agent may release/carry out acts relating to security with the consent of a certain percentage, but not all, creditors. In such a case, the wording of the Decision in requiring the consent of debtors and creditors to determine the existence of an event of default becomes problematic; will all creditors need to consent, despite the quorum/affirmative vote requirement that the parties may have agree to? Will the security agent’s consent come into play? These are all facets of business that the Decision does not adequately account for.

**May create uncertainty for other forms of security**

The concept of *parate executie* is also applicable for pledges. Under Article 1155 of the ICC, a creditor is entitled to sell the pledge object publicly, to use the proceeds of sales to recover the outstanding indebtedness. By saying that *parate executie* for fiducia security is limited only if the debtor agrees that there is default, it is unclear whether *parate executie* for pledge should similarly be seen as contrary to the Indonesian Constitution.

Additionally, even though not directly addressing *hak tanggungan*, the reasoning set out by the Constitutional Court may be used as a springboard to argue against the enforcement of *hak tanggungan*;
the executorial title in a fiducia certificate is similarly found in a hak tanggungan certificate (even though the nature of a fiducia certificate and a hak tanggungan differ).

Constitutional Court’s questionable authority to decide the case

The use of conditionally constitutional/unconstitutional doctrine by the Constitutional Court (as applied in the Decision) is not without controversy since its introduction in 2007. Indeed, Law No. 8 of 2011 that amended Law No. 24 of 2003 on Constitutional Court (Law 8/2011) specifically barred the Constitutional Court from precisely making this kind of decision. But within 3 months since the issuance of Law 8/2011 back in July 2011, the Constitutional Court declared that such limitation was unconstitutional even though it failed to provide any textual basis under the 1945 Constitution to support such controversial decision (citing instead the concept of judicial review under the famous constitutional case of the United States of America, Marbury v. Madison).

Such lack of coherent basis imposes a serious threat to the legitimacy of Constitutional Court decisions. By invoking specific conditions on how to read a statute, the Constitutional Court is effectively trying to impose new legal norms as a positive legislator regardless of the fact that the 1945 Constitution clearly states that the power of making new laws resides with the House of Representatives (DPR).

Despite the seemingly absolute power accompanying Constitutional Court decisions, in reality, the Constitutional Court has no executorial power, and the effectiveness of its decisions can only come from the respect of other state institutions to carry on those decisions. In practice, we have seen numerous cases where the decision of the Constitutional Court is not implemented and that the Supreme Court of Indonesia might differ in interpreting and enforcing the provisions of any statute that has been judicially reviewed by the Constitutional Court.

Given the importance of Fiducia Law on creditor-debtor relationship and the existing practice of fiducia security enforcement, it is doubtful that the Decision could make significant impact unless the Supreme Court shares the same view with the Constitutional Court. As discussed above, there are plenty arguments that can be used to argue that the First Interpretation should prevail.

In fact, there is also a possibility that the Decision might not have any impact on the dynamics between creditors and debtors, especially for complex and/or sophisticated financings. The reason is simple. For this type of financing reputation matters a lot. Accordingly, parties in such transactions may be reluctant to sway from the established market practice of fiducia security enforcement (which the Decision attempts to deviate from).
Potential mitigants

A creditor may consider the following potential mitigants to tackle the uncertainty brought on by the Decision:

(i) Setting out in agreements with debtors that the debtors specifically agree on the terms of default (including setting out default triggers as clear as possible) and that the interpretation of whether a default occurs is entirely to be made by the creditor - even with these provisions, there is still a risk that parties may still need to go to court especially when there is room to debate the existence of such default, but at least in court this can create a stronger case that a default did occur, and the prevailing interpretation should be the creditor’s.

(ii) Choosing alternative dispute settlement instead of resolving disputes in court to avoid a lengthy and complicated process if the issue of occurrence of event of default and enforcement of fiducia security arises.

(iii) Where possible, particularly for tangible moveable objects, structure transactions not as financing with fiducia security, but as finance lease, where it is clear that the ownership of the underlying object to the transaction rests with the creditor. For intangible moveable objects (such as right over shares), where lease may not be possible, parties may opt for pledge.

Closing

For the reasons indicated above, we disagree with the approach taken in the Decision. We understand that the Constitutional Court may not be able to assess fiducia security in the framework of financing holistically, as it is only review the regulations brought before it against the Indonesian Constitution, but this only emphasizes that the issue of fiducia enforcement should not be a matter to be dealt by the Constitutional Court.

It may be argued that the Decision tips the scale too far in favor of debtors, and too far against creditors’ rights. For debtors, it creates a more flexible framework, in their interest, to provide fiducia security. For creditors, however, the Decision frustrates and creates a more complicated framework for the enforcement of fiducia security, which may affect creditor’s comfort and willingness to enter into future financing arrangements.

We will be further monitoring any development regarding the Decision and will provide further updates as may be necessary.