

***Enforcement of Security Interests  
and of Unsecured Debt  
in Indonesia***

***a Summary***

***(including a Summary of  
new Bankruptcy Legislation)***

prepared by

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## ***Enforcement of Security Interests in Indonesia***

Certainly everyone involved in business in Indonesia is aware of the new Bankruptcy legislation which went into effect in August of 1998, and the new commercial court set up to administer these bankruptcies. And, as expected, the new court is experiencing teething pains. But even once the process attains certainty and consistency, bankruptcy legislation should not be looked upon as a panacea. Creditors, particularly secured creditors, need to remember that once a bankruptcy action is commenced, their security rights will be put on hold. And bankruptcy brings all creditors out of the woodwork, so that what assets the debtor has may need to be spread rather thinly. Most debtors and creditors are still trying to arrange re-structuring. Some creditors may prefer either to await better results before bringing their own debtors before this forum, or to pursue their rights through other means. Some may choose to arbitrate, some to litigate, and some to move to enforce the security directly.

We shall discuss bankruptcy later on, but first let us look at the alternatives, which were, and are, available even before August, 1998. As long as no bankruptcy action has been commenced, for a creditor with an enforceable security interest, there are advantages to pursuing these first, and the sooner the better. For those who prefer this option, how does one proceed?

A debtor who has not been declared bankrupt may request the court to declare a moratorium, for part or all of its debts, of not greater than 270 days in order to encourage amicable settlement among the creditors. If such is granted, the court will appoint an administrator to work together with the debtor in administering the assets.

So far, decisions of the new commercial court have not met the expectations of the business and legal community. It is hoped that increased education of the judges in complex commercial transactions, coupled with a possible further new bankruptcy law, will soon improve the situation. At the moment, however, we do not recommend application for bankruptcy where there is any other viable alternative..

### **THE DEMAND**

The first step in any case, if this has not already been done, is to make a clear and unequivocal demand upon each of the debtors against which one wishes to proceed: (i) stating that they are in default in payment of their obligations; (ii) referring to the instrument under which they are in such default; and (iii) demanding payment in full of the outstanding obligations, stating the amount demanded, and allowing a certain number of days for such payment, which need not be more than eight, unless there is something in the documentation which requires longer notice.

If this demand is not complied with, the creditor may then proceed to take steps for enforcement, although a second demand letter, this time from local legal counsel, is often quite effective in at least bringing the debtor to the negotiating table.

This demand requirement is based upon Indonesia's national philosophy, *Pancasila*. The demand letters are evidence that a final attempt has been made to settle the matter in an amicable manner before resort to the courts for resolution.

## **WHICH SECURITY TO ENFORCE**

The simplest and quickest enforcement procedures are: (i) foreclosure on mortgages, provided these have been properly registered in the appropriate land title office and, preferably, if the creditor is holding the original title certificate (*Sertipikat*); and (ii) execution against pledges of shares, provided the original share certificates are in the possession of the creditor.

In legal proceeding practice in Indonesia a creditor is obliged to enforce any mortgage over land, buildings or seagoing vessels first, and then any pledge over shares, before it can commence an ordinary lawsuit to enforce other security. Only if the creditor finds that the proceeds from the enforcement of the mortgage and/or pledge are not sufficient to recover its full claim, can he claim the balance through an ordinary lawsuit. The rationale for this is that these two enforcement procedures are relatively quick, whereas an ordinary lawsuit may take years before a decision becomes final and binding.

## **ENFORCEMENT PROCEDURES**

### **Execution of Mortgage:**

Creditor (through its local counsel) registers its application for enforcement at the District Court designated in the loan documentation or that having jurisdiction over the location of the mortgaged property.

Within one to three weeks, upon request, the Chief Justice of the District Court will issue an order to summon the debtor and the land owner, if the debtor is not the registered owner, to appear before the Chief Justice on a scheduled date. If the debtor and/or the owner appear, they will be issued with a reminder to pay their debt within eight days from the date of such appearance.

If they do not appear, or if the above period of eight days lapses without any settlement or payment having been made, upon request the Chief Justice will issue an attachment order. Within two or three weeks, the bailiff will confiscate the mortgaged property.

Within two to four weeks after confiscation, upon request, the secretary of the court will arrange an auction date with the State Auction Office, which date is normally set approximately two months from the date of attachment.

The secretary of the court will then advertise the auction in a newspaper twice. If there is no buyer in the auction, the secretary will set up a new auction date and advertise again.

The total process should take between four to six months, depending upon the workload of the auction office, as well as the caseload of the relevant court.

### **Execution of Share Pledge:**

If there is no mortgage, or if the proceeds from the execution sale is insufficient, the next step is to seek to enforce any pledges of shares being held.

Shares are very often pledged as security for various obligations in Indonesia. Most pledge instruments recite that the holder of the pledge has the right to sell the shares without court action, and many creditors also hold separate power of attorney authorising them to sell such shares. If the registered owner of the shares allows such a sale by the creditor, the terms of the documentation can be followed provided, as mentioned above, the actual share certificates are in the possession of the creditor. (A pledge is only valid if the pledged property is in the possession of the pledgee.)

However, since Indonesian law requires court action to enforce any security interest, unless actual title, as well as possession, has passed, if the creditor objects to a private sale pursuant to the language of the pledge, the pledge can only be enforced through the courts.

Interestingly, in practice, there is no precedent for the execution of such pledges through the courts. The procedure, however, is basically the same as that for enforcement of mortgage.

#### **Ordinary Lawsuit - for other Security:**

If a debtor is not willing voluntarily to comply with the provisions of their security instruments, other than mortgages and pledges as discussed above, there is no other way for the creditor to pursue its claim but to file a lawsuit in the appropriate District Court, i.e. that having jurisdiction over the domicile of the debtor or such other court as may be specified in the loan or security documentation.

The court procedure is as follows:

The creditor, as plaintiff, lodges a Statement of Claim and Request for Attachment to the competent District Court. The Chief Justice of the District Court will appoint the presiding judges (normally a panel of three) within one or two weeks after the lodgment.

The presiding judges fix a date, within four to five weeks after the lodgment, for the first court hearing and order the clerk to summon the parties to appear at such hearing. At this stage, the presiding judges may agree to issue a writ of attachment on the debtor's and/or the guarantors' assets if requested by the plaintiff. (But note, attachment at this stage is rare and requires evidence of a strong possibility that such assets will not be available later. Perishable goods, or those belonging to or under the control of a non-resident, for example, are more likely to be attached at this stage than others.)

After the first hearing, a series of further hearings, usually one to two weeks apart, will be conducted for the exchange of documents and arguments and verification until the presiding judges deliver their judgment. This process normally takes approximately six months.

#### **Appeals**

The losing party will have 14 days in which to lodge an appeal to the High Court against the District Court judgment. Such appeal is considered on documents only and no witnesses nor oral arguments are heard. The process of this appeal may take approximately one year. (If no appeal is lodged within the 14 day period, however, the District Court decision becomes final and binding and can be executed.)

If a party is unsatisfied with the High Court decision, it may, within 14 days of notice of that decision, appeal again to the Supreme Court. In current practice, because of the enormous case load in the Supreme Court, it can take as long as two to four years to obtain a Supreme Court decision. This decision is, however, final and binding and may be executed against the security, all in accordance with the decisions.

## NEW BANKRUPTCY LEGISLATION

Let us now consider the bankruptcy option. Indonesia's present Bankruptcy Law was promulgated in 1906 while the country was still under Dutch rule. This law was initially replaced by Law No. 4 of 1998; and in 2004 a new Law No. 37 of 2004 was promulgated to replace Law No. 4 of 1998, effective as of 18 October, 2004. Law No. 37/2004 was enacted to modernize the old law in various respects and make it more efficient. There were some important provisions originated by Law No. 4/1998 including: the establishment of a new Commercial Court dedicated to Bankruptcy only (with its jurisdiction later extended to intellectual property rights cases as well) designed to decide matters in a very short time-span, and also provision for appointment of a Receiver or Administrator.

For Bankruptcy cases, the Commercial Court must render its judgement not later than 60 (sixty) days from registration of the application for bankruptcy. There is no normal appeal process to the High Court. An unsatisfied party's only recourse is to apply directly to the Supreme Court for cassation, within 8 (eight) days of the commercial court's judgement. The Supreme Court must then decide the matter within 60 (sixty) days of receipt of the cassation petition. Appeals in other types of cases can normally take as long as five to six years to come up before and be decided by the Supreme Court. A decision on a petition for a declaration of bankruptcy which has become final and binding, may also be subject to for judicial review by the Supreme Court.

### **Procedure:**

Any creditor may file a request to declare a debtor bankrupt if such debtor has at least 2 (two) creditors and ceases to pay either principal or interest on a debt. Before the judgement is made, the creditor(s) may make a request to the court for attachment of the debtor's assets or to appoint a Receiver to take over the debtor's business and maintain its assets. Every action related to the debtor's assets must have the Receiver's permission. It is the Receiver's obligation to protect the interests of both debtor and creditors.

The Receiver can be a state-owned or private entity, but is normally a qualified legal or financial consultant registered with the Department of Justice. The Receiver is responsible to manage the bankrupt's assets and may be personally liable if negligent. In order to take any new loan, to secure which the bankrupt's assets shall be encumbered by mortgage, fiduciary transfer, or the other lien, the Receiver must first lodge a request with the Supervising Judge, and must satisfy the condition that such bankrupt's assets have not been pledged to guarantee other loans.

Any debtor who has at least 2 (two) creditors may itself request the court to declare a moratorium for part or all of its debts, of not greater than 270 days, in order to encourage amicable settlement with its creditors. If such moratorium is granted, the court will appoint an administrator to work together with the debtor in administrating its assets.

Up until now, decisions of the commercial court have not met the expectations of the business and legal community. It is hoped that increased education of the judges in complex commercial transactions, and the application of Law No. 73/2004, will soon improve the situation. At the moment, however, we do not recommend application for bankruptcy where there is any other viable alternative.

## CONCLUSION

As can be seen from the above summary, a full court process can take as long as four to six years to attain a final and binding decision through an ordinary lawsuit. Enforcement of mortgage or share pledge takes no more than six months. Bankruptcy now may be even quicker but will not necessarily result in an advantageous position for the secured creditor.

Generally our advice to creditors is first to conduct a careful due diligence analysis of all loan and security documentation to ascertain: (i) what, if any, defects are contained in the documents, or existed with regard to their authorisation and/or execution; and (ii) which security can be enforced in what manner and time frame. Even where debtors have not as yet failed to service their obligations, it is best to be prepared, and aware of the options for legal recourse when and if the same should become necessary.

Once the situation is clear, an attempt should be made to sit down with any defaulting debtor to work out a re-structure or re-schedule of the debts in a manner that is feasible for such debtor, thereby allowing its business to continue. Restructuring also gives the creditor the opportunity to cure any defects existing in the old documentation. If such attempt is rejected, or fails, it is time to take enforcement measures.

Where the creditor is holding a valid and properly registered mortgage over land or buildings, enforcement proceedings should be taken against such security as early as possible. Share pledges should be enforced next. We should then make a determination as to what further steps ought to be taken, such as bankruptcy or resort to arbitration or litigation, based upon the nature and strength of the remaining security, the condition of the debtor, and the number and nature of other creditors.

These are difficult times for almost everyone in Asia, and particularly in Indonesia. If one cannot expect to solve all of one's problems to one's full satisfaction, at the very least one needs to be as fully informed of one's own situation as possible. Only in that way can one be prepared to protect one's rights as best one can now, and structure future transactions on a more solid footing. KarimSyah's experienced debt restructure and recovery teams are at your service to assist in all phases of this endeavour.

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