HOW MUCH CREDIT IS THERE IN A PROMISE: FORGING A UNIFIED LAW ON SECURED TRANSACTIONS

Ronald P. de Vera

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"I'm still moved by your 'my word is stronger than oak' thing."
– Tom Cruise, Jerry Maguire (1996)

INTRODUCTION

My father would not have been a successful businessman were it not for a cousin who generously loaned him capital and inventory to start a small business. Coming from a poor family with no property to offer as collateral, no bank's loan department would have given him the time in day. Knowing that he was fortunate to have a rare opportunity to start a business on easy credit, he wisely used that modest capital and became a successful retailer of tires.

But those times when a man's word is more reliable and valued than a written contract is now gone, trust and familiarity have been replaced by deals gone bad and credit never repaid. Business associates, friends, and even siblings nowadays don't extend credit to one another anymore. As the saying goes if you don't want to lose your friend, don't lend him your money.

My father's story is no different from that of the typical Filipino entrepreneur trying to make ends meet to improve his stake in life, and like my father waiting for that opportunity to have access to cheap credit to start a business. Sadly though, if I would ask my father now if he would return the same favor to someone who is in the same predicament as he was then, he would more likely just sigh and confirm that times have indeed changed.

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* *Cite as* Ronald de Vera, *How much credit is there in a Promise? Forging a Unified Law on Secured Transactions*, 83 PHIL. L.J. 237, (page cited) (2008).

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I. OVERVIEW

Part I of this Article will discuss the development of credit in general and its important role in the growth of the modern economy. The discussion on secured transactions will discuss how the Philippines' economic growth is hampered by the inadequacy of the existing legal framework in fostering equal access to wealth and capital. Thereafter, the legislative policies of the United States' Uniform Commercial Code and its Article 9 on Secured Transactions will be presented as a model legal framework.

Before making a thorough analytical discussion of Article 9 *vis-à-vis* the pledge and chattel mortgage legal regime, a concise examination of Philippine's legislative experience in the enactment of special laws on secured transactions will be presented in Part II. However, the inherent complexity and sizeable number of Philippine laws and regulations concerning secured transactions, effectively precludes a fine-detailed review of each of these laws. Instead, to achieve the study's undertaking to suggest areas for reform, the Article will encapsulate a concise analysis of these laws' main key points and areas of development.

Starting with the earlier laws that touch on secured transactions such as the Bulk Sales Law, Trust Receipts Law, Financial Lease Act, Circular No. 185 until the latter enacted Securitization Act, this Article will establish an analysis on whether the said laws as presently shaped are satisfactory or whether they have shortfalls that need revisiting.

Part III will expound on the various characteristics of the pledge and chattel mortgage legal regime and thereafter identify areas of concern that need attention in light of the advancements of Article 9 on certain facets of secured transactions. In relation thereto, Part IV will focus on the liberalization of the legal regime by seeking to provide alternatives on how to modernize Philippine laws and procedures that affect secured transactions. Lastly, Part V discusses the challenges that lie ahead towards the adoption of reforms presented in this study and how the country may overcome said obstacles.

II. THE ROLE OF SECURED TRANSACTIONS IN ECONOMIC DEVELOPMENT

A. DEVELOPMENT OF SECURED TRANSACTIONS

During the early times of commerce, the use of credit in the facilitation of trade was widely practiced. Among domestic merchants and the pioneers of international trade as well, there was an early realization that to use credit is beneficial not only to the borrower, but likewise to the creditor and other parties to the credit transaction as well, i.e. guarantor, etc. Also, it cannot be gainsaid that were it not for the existence of reliable and inexpensive credit, the growth of commerce, as global in magnitude as it is now, would not have been possible. Credit was, and still is, one of the biggest factors, if not the main cause, that makes global trade possible. By facilitating the movement of goods through the use of credit, a buyer is able to order and take physical possession of the bought goods without the pre-requisite of paying in cash or establishing financial capacity to fulfill the terms of the contract of sale[1]. The length of time it takes between the sale of goods by the seller and its actual delivery to the purchaser is lessened. Credit transactions reduce the transactional costs related to delay in the delivery of goods like credit interest, as well administrative costs.

On the other hand, spurred by the Second Industrial Revolution[2], businesses and trade grew in such a rapid pace in the last century that their effects were strongly felt worldwide. Demand for credit facilities in business transactions became higher and more robust. As businesses became more multifaceted and competitive, so did the transactions that were needed to make it possible, and as transactions became more complex, so did the demand for a more specialized but inexpensive credit facility.

It is unfortunate however, that the inability of the existing legal framework to allow a borrower and a willing lender to predict beforehand the legal mechanism that would apply to their credit arrangements has impeded the stability of credit transactions.

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[1] In the execution of business transactions, it is of common practice that before the goods are physically delivered, the buyer has to show his/her credit credentials to the seller-creditor. In other words, the seller needs to conduct at the very least a background check on the credit of the buyer, more so if they have not done any transactions in the past.

[2] See Benjamin Hoffart, *Comment: Permanent Establishment in the Digital Age: Improving and Stimulating Debate Through an Access to Market Proxy Approximation*, 6 Nw. J. Tech. & Intell. Prop. 106 (2007).

B. SECURED TRANSACTIONS IN THE PHILIPPINES

Of the various forms of credit agreements that came as a result of modern economic systems, secured transactions assume greater prominence. A secured transaction is a business arrangement by which a buyer or borrower gives collateral to the seller or lender to guarantee the payment of an obligation.[3] By becoming the holder of a secured interest over the collateral, the creditor receives a method of protection that increases the likelihood of being paid.[4] Consequently, by giving to the creditor this reasonable assurance that his secured credit is being protected by his secured interest over the collateral, the cost of acquiring credit becomes cheaper.[5]

However, in the Philippines it is unfortunate that secured transactions are not as widely practiced when compared to other countries whose phase of economic development is altogether not that different, but whose economies have benefited with the increase use of secured transactions.[6] Despite its huge potential to make public access to credit more efficient and inexpensive, I can only surmise that a number of factors explain why secured credit transactions is under-utilized in the Philippines. Although there is no single reason that explains why it is so, I believe that to a large extent it is the state's failure to provide a single, comprehensive, and progressive law on secured transactions.

So much has been said on why the Philippines' economy is not able to catch up with the economic development of the rest of the world. However, looking closely at the participation of the country's small and medium scale businesses in the creation of wealth and circulation of capital, which is vital in the nation's path towards economic growth, the results are not promising. Because credit is expensive, and exclusive to sophisticated

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[3] Black's Law Dictionary 629 (2nd Pocket Ed. 2001).

[4] See S. Harris, *Choosing the Law Governing Security Interests in International Bankruptcies*, 32 BROOK. J. INTL. L. 905 (2007).

[5] *Ibid.*

[6] Symposium on *Cafta and Commercial Law Reform in the Americas: The OAS Model Law on Secured Transactions: A Comparative Analysis*, 12 SW. J.L. & TRADE AM. 235 (2006).

There is some indication that Mexico's adoption of the OAS Model Law in 2000 and 2003 already may have had a salutary effect on the availability of credit in the country. At the 2005 convention of the Mexican Bankers Association in Guerrero, the Association President, Manuel Medina Mora, stated, 'Mexico's economy grew at a 4.4% rate during 2004 and... all credit sectors are growing at an annual rate exceeding 20%.' Speaking at the same convention, Alfonso Garcia Tames, Mexico's Deputy Secretary of the Treasury, was more specific on the rate of growth of the credit sectors: 'Commercial credit showed a favorable rate of growth during the last three trimesters of 2004. In fact, between 2003 and 2004, the increase in this portfolio was 16.8% in real terms. In turn, the credit to consumers also showed great dynamism, with annual rates of growth of 38.6% in the last four years. In the last trimester of 2004, the percentage of real growth was 41 percent in relation to the growth during the same trimester in the preceding year.'

big businesses that can deliver valuable collateral, small businessmen have no equal opportunity to have access to capital to either start or expand their existing business. At the same time, private creditors who have the money to lend do not do so since they are cautious of the risks associated with failing to collect their credit. Expensive and lengthy litigation is simply not an alternative that creditors would prefer to exact satisfaction of debts due to them.

In the end, would-be creditors are frustrated of their hapless situation and unhappy with the circumstance that their money remains stagnant in the bank. Knowing that they unwillingly become part of the bloodsucking cycle that exclusively makes banks and their affiliates benefit from the use of their capital, when its benefit should be trickling down to the micro enterprises that need them the most.[7] At the end of the day, the small entrepreneur remains waiting for the break that may just never come. The rich becomes richer, and the poor starve.

This being said, to contribute towards a better understanding and development of secured transactions in the Philippines, this study would refer to the international best practices of secured transactions. Article 9 on Secured Transactions of the United States Uniform Commercial Code (hereafter to be referred to as "Article 9" and "UCC", respectively, for brevity), would be used as a norm of reference in comparing the model law and Philippine law.[8]

C. THE UNIFORM COMMERCIAL CODE AND ITS ARTICLE 9 ON SECURED TRANSACTIONS

The UCC was conceived in the 1930's post-industrial period, a time when the Federal Government was keen to support nationalistic regulatory schemes.[9] After several modifications, taking from the inputs of various stakeholders such as academicians, lawyers, merchants, *etc.* the UCC as it is presented now is the fruit of the longstanding work of two institutions: the

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[7] J. Wyatt Kendall, *Comment: Microfinance in Rural China: Government Initiatives to Encourage Participation by Foreign and Domestic Financial Institutions*, 12 N.C. BANKING INST. 375 (2008).

[8] In an effort to present a more comprehensive and wider view on the matter of secured transactions, this Article will likewise often refer to the United Nations Commission on International Trade Law, *Legislative Guide on Secured Transactions: Introduction and Chapter 1*, 43, http://www.uncitral.org/uncitral/en/uncitral texts/payments/Guide_securedtrans.html (last visited July 5, 2007)[hereinafter referred to as UNCITRAL GUIDE].

[9] Adam Epstein, *Sales and Sports Law*, 18 J. Legal Aspects of Sport 67 (2008).

National Conference of Commissioners of Uniform State Law and the American Law Institute.[10]

The set policies of the UCC are to simplify, clarify, and modernize the law governing commercial transactions; to expand commercial practice; to grant autonomy to the parties in defining and controlling the terms of their agreement,[11] and to harmonize the laws of various jurisdictions.[12] American courts have held that the interpretation of the UCC should be towards the achievement of efficient and stable transactions through a uniform and predictable application of the law.[13] With these commonly desired goals, it becomes no surprise that the UCC is now the most widely used standard in several jurisdictions on commercial law. Moreover, amidst the confusion caused by the various jurisdictions' scattered rules on secured transactions, UCC has shown that way out of this quandary is by creating a singular, comprehensive law to cover all angles of secured transactions. Thus, Article 9 of the UCC became the principal law governing secured lending in the U.S.[14] It was designed to streamline the process of using a movable as collateral, and to grant the lender security interest over the said collateral with the minimum of formalities.[15]

III. PHILIPPINE LAWS GOVERNING SECURED TRANSACTIONS

A. FAILURE TO DEVELOP A UNIFIED LAW ON SECURED TRANSACTIONS

Philippine laws on secured transaction reflect a mixture of civil and common law systems. This mixture is a result of the Philippines' colonial past, wherein Spanish colonization from the 16th to the 19th centuries, saw the institution of legal system based on civil law. At the turn of the twentieth century, however, the United States defeated Spain in the Spanish-American War, and fostered laws drawing inspiriting and strength from the new colonial master's common law heritage.

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[10] Symposium, *Commercial Calamities: Is Article 2 Regulatory or Facilitatory? A Socratic Dialogue*, 68 OHIO ST. L.J. 57 (2007).

[11] First Realty Prop. Mgt. v. McDonald & Company Securities, Inc., No. 1:07 CV 2226, 2008 U.S. Dist. LEXIS 690 (January 2, 2008) (citing the OHIO REVISED CODE, § 1301.02(B)).

[12] *Ibid.*

[13] Peters v. Riggs National Bank, N.A., No. 05-CV-1379, 2008 D.C. App. LEXIS 85 (Feb. 28, 2008)

[14] Symposium, *E-Commerce: Challenges to Privacy, Integrity and Security in a Borderless World: Secured Transactions and Electronic Commerce Law: Diverging Perspectives in North and South America*, 16 MICH. J. INT'L L. 239 (2007).

[15] *Id.*

American legislation has always been a large influence in shaping the direction of commercial law in the Philippines. Unfortunately, due to the country's laggard economic performance, the development of its commercial laws came to a standstill for a long period of time. There was no stimulus in coming up with a law that is of the same mold as the UCC. Thus, we are left with a jumble of several statutes touching on the matter.

Moreover, only a few of these said laws have a direct relation to secured transactions. Some of them are found either in the Civil Code, a remnant of the Spanish Civil Law system and whose subject of legislation is too expansive and deals with secured transactions in a narrow sense, or special laws whose treatment of secured transactions is best partial and transaction-matter specific. It bears stressing too that the Civil Code and some of the special laws that will be mentioned herein were drafted in a time when secured transactions were not as widely and diversely practiced as it is now.

B. THE BULK SALES LAW: HOW TO LEAD BUSINESSES TO A CLOSE

The Bulk Sales Law is a statute that specifically deals with an enterprise's closing of business.[16] Since this law does not create any security interest in favor of a creditor, its enforcement is likewise not aimed towards the protection of a secured creditor's security interest more than it is for ensuring the outstanding creditor/s' satisfaction of credit in general. More specifically, it applies in cases when there is a disposition of all, or substantially all of the business of the debtor, i.e. sale of remaining inventory, before the final closure of business. Such sale and transfer in bulk is done outside the ordinary course of business. Thus, if the debtor fails to receive from his unpaid creditors a waiver of the latter's rights to have their credit protected under the law's operation, procedural safeguards under the Bulk Sales Law, which do not discriminate between secured and unsecured creditors, apply.[17] Specifically, before the debtor liquidates his remaining goods, machinery, etc. and receives the compensation for the same, he is obliged to make a sworn statement in writing of the names and addresses of all his creditors, and the amount due to each of them respectively.[18] Concomitantly, the former's omission to do so coupled with the failure to apply the proceeds of the conducted clearance sale to the pro

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[16] Act No. 3952 (1972). "An Act to Regulate the Sale, Transfer, Mortgage or Assignment of Goods, Wares, Merchandise, Provisions or Materials, in Bulk, and Prescribing Penalties for the Violation of the Provisions Thereof,

[17] *Id.* § 2.

[18] *Id.* § 3.

rata payment of the amounts owing to the latter would not only deem such disposition of his business' residual goods void but also subject the debtor to possible imprisonment.[19]

C. CRIMINAL SANCTIONS OF THE TRUST RECEIPT LAW

The Trust Receipts Law[20] defines a trust receipt transaction as an agreement whereby the trustor who owns or holds absolute title or security interests over certain specified goods, documents or instruments, releases the same to the possession of the trustee upon the latter's execution and delivery to the former of a signed trust receipt.[21] The trustee binds himself to hold the designated goods, documents or instruments in trust for the trustor and to sell or otherwise dispose of the goods, documents or instruments with the obligation to turn over to the proceeds thereof to the extent of the amount owing to the trustor or as agreed otherwise in the trust receipt or the goods, documents or instruments themselves if they are unsold.[22] It excludes from its coverage, however, the sale of goods, documents or instruments by a person in the business of selling goods, documents or instruments for profit who, at the outset of the transaction, has, as against the buyer, retentive title or security interest in such goods, documents or instruments, for the payment of the purchase price.[23]

A reading of the law however shows that the Trust Receipt Law is a special penal law and not a commercial law. The statute's penal clause punishes as estafa acts of misappropriation of the goods or the proceeds of their sale.[24] The Supreme Court, in upholding the constitutionality of this law against the claim that it violates the debtor's right against imprisonment for non-payment of debt, held that it is within the police power of Congress to declare such acts as *malum prohibitum*. More specifically, the failure to turn over the proceeds of the sale of goods covered by a trust receipt or to return said goods if unsold, is a public nuisance that has to be abated by the

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[19] *Id.* § 4.

[20] Pres. Decree No. 115 (1973) "Providing for the Regulation of Trust Receipts Transaction" [hereinafter TRUST RECEIPTS LAW].

[21] *Id.* § 4.

[22] *Id.* § 4.

[23] *Id.*; Under Section 3 of the TRUST RECEIPTS LAW a "document" shall refer to a written or printed evidence of title to goods. An "instrument", on the other hand, means any negotiable instrument, any certificate of stock, or bond or debenture for the payment of money issued by a public or private corporation, or any certificate of deposit, participation certificate or receipt, any credit or investment instrument of a sort marketed in the ordinary course of business or finance, whereby the entrustee, after the issuance of the trust receipt, appears by virtue of possession and the face of the instrument to be the owner.

[24] *Id.* § 2.

imposition of penal sanctions.[25] Although this law's enforcement may abate the incidence of fraud committed under the trust receipt transaction and cause added stability to secured transactions, however, measuring the law's effectiveness in attaining this goal is irrelevant in the exercise of the state's police powers.

D. THE FINANCING COMPANY ACT: MERELY DEFINING FINANCING ACTIVITY

On the other hand, in recognition of the practice by financing companies of using the financial lease system to protect their security rights over leased property, the Philippine Congress enacted the Financing Company Act of 1988[26]. Through the financial leasing system, the buyer-lessee is no longer burdened with producing a huge capital outlay to purchase what is usually a considerably expensive movable. The buyer-lessee's financial responsibility has now been eased with the payment instead of regular lease payments that usually lasts over the depreciable life of the movable. Through this financial lease system, a buyer-lessee can likewise take advantage of the tax benefits associated with increasing one's operating expenses such as lease expense, instead of considering the purchase of the asset as a capital outlay.

Under the Financing Act, however, a financial lease is categorically defined as:

> ...a non-cancelable lease contract under which the lessor purchases or acquires, at the instance of the lessee movable or immovable property in consideration of the periodic payment that is sufficient to amortize at least seventy (70%) of the purchase price or acquisition cost, including any incidental expenses and a margin of profit over an obligatory period of not less than two (2) years during which the lessee has the right to hold and use the leased property with the right to expense the lease rentals paid to the lessor and bears the cost of repairs, maintenance, insurance and preservation thereof, but with no obligation or option on his part to purchase the leased property from the owner-lessor at the end of the lease contract.[27]

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[25] Tiomico v. Court of Appeals, G.R. No. 122359, March 4, 1999; citing Lee v. Rodil, 175 SCRA 100 July 5,1989.

[26] Rep. Act No. 8556 (1988) "An Act Amending Republic Act No. 5980, as Amended, Otherwise Known as the Financing Company Act" [Hereinafter referred to as the FINANCING ACT]

[27] *Id*, § 3(d).

The difficulty that comes with this too detailed a description of what constitutes as a financial lease is that is does not leave much room for the parties to determine upon themselves how their respective financial leasing agreements would be carried out. It being that most if not all of the more important terms and conditions of a financial lease had already been pre-determined by the above-mentioned definition. However, such practice runs contrary to the recommendation of the United Nations Commission on International Trade Law's Legislative Guide on Secured Transactions[28] to allow the contracting practices to freely decide how their secured transaction will be carried out.[29]

E. ARRIVING AT THE SECURITIZATION ACT'S LEGISLATIVE INTENT

The Securitization Act of 2004 is a recent piece of legislation and has a more direct relation to the securitization of secured transactions.[30] Its *Declaration of Policy* states that it was enacted to increase capital available for the Philippines' housing sector,[31] which at the time of legislation was facing difficulty, by enticing would-be lenders in investing in the housing industry.[32] Aside from its stated policy of providing a legal and regulatory

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[28] Hereinafter the UNCITRAL Guide.

[29] See UNCITRAL Guide, *supra* note 8, par. 51; **To Allow Parties Maximum Flexibility to Negotiate the Terms of Their Security Agreement** 51. The goals and purposes being pursued by debtors and creditors in modern economies are extremely diverse, and are often specific to particular parties. The secured transactions regime should provide maximum flexibility for parties to tailor their security agreements to meet their precise needs. Mandatory rules governing their respective rights prior to default should be kept to a minimum. At the same time, where States enact other legislation aimed at, for example, consumer protection, the secured transactions regime should respect such legislation.

[30] Rep. Act No. 9267 (2004), "An Act Providing for the Regulatory Framework for Securitization and Granting for the Purpose Exemptions of Certain Laws" [hereinafter referred to as the SECURITIZATION ACT]; See also Rep. Act No. 9182 (2002, as amended in 2005), "The Special Purpose Vehicle Act of 2002" which sets out the legal, regulatory and taxation framework for banks and other financial institutions in the selling of their non-performing loans and acquired assets. The law supports the institutions in the securitization of their assets by granting tax incentives to asset management companies or special purpose vehicles. Through the SPV Act, financial institutions can now write-off from their records their non-performing loans by disposing it to a special purpose vehicle, improve the grading of their financial performance, and at the same time benefit from its tax breaks

[31] SECURITIZATION ACT, §2; Section 2. Declaration of Policy. - It is the policy of the State to promote the development of the capital market by supporting securitization, by providing a legal and regulatory framework for securitization and by creating a favorable market environment for a range of asset-backed securities. For this purpose, the State shall rationalize the rules, regulations, and laws that impact upon the securitization process, particularly on matters of taxation and sale of real estate on installment. Furthermore, the State shall pursue the development of a secondary market, particularly for residential mortgage-backed securities and other housing-related financial instruments, as essential to its goal of generating investment and accelerating the growth of the housing finance sector, especially for socialized and low-income housing. The State shall likewise pursue the development of a secondary market for other types of asset-backed securities.

[32] *Id.* §33; In an effort to entice would-be investors in participating in the state's efforts to invigorate investment capitalization in the housing industry, under Section 33 of the Securitization Act, the yield or

framework for the securitization of asset-backed securities, and promoting a secondary market for residential mortgage-backed securities, the law likewise aims to rationalize the rules, regulations, and laws that affect the securitization processes, more specifically, on issues of taxation and sale of real estate on installment.[33]

Under the Securitization Act, a Special Purpose Entity[34] is placed in-charge of issuing the certificates that serve as proofs of co-ownership in the pool of asset-backed securities (ABS). This aggregation of assets is in reality a pooling together of various institutions' loans, receivables and similar financial assets whereby ownership of the whole is transferred to the SPE. Consequently, from this pool of assets will be derived the expected cash payment stream for the repayment of the loan and the returns of the creditor's investment.[35]

It bears stressing however that in deviation from the UNCITRAL Guide's policy of increasing[36] the scope of movables that maybe the subject of a secured transaction, the Securitization Act excludes from becoming part of the pool of assets the government's receivables or future expectation of revenues arising from its imposed fees or imposts.[37] Although such receivables are not that widely traded to deserve special attention and there is no institutionalized market in the Philippines where the same can be readily acquired, it can only be surmised that the reasoning behind this limitation is that the government is apprehensive to the possibility of

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income of the investor from any low-cost or socialized housing-related asset backed securities ("ABS") shall be exempt from income tax.

[33] *Id.* §§ 28-29; The Securitization Act provides several favorable taxation treatment for transactions executed in accordance with its framework, to wit:

1) The sale or transfer of assets to the SPE shall be exempted from value-added tax ("VAT") and documentary stamp tax ("DST"), or any other taxes imposed in lieu thereof (§ 28);

(2) The transfer of assets by dation in payment (*dacion en pago*) by the obligor in favor of an SPE shall not be subject to the capital gains tax (§ 28); and

(3) The original issuance of asset-backed-securities and other securities related solely to such securitization transaction, such as, but not limited to, seller's equity, subordinated debt instruments purchased by the originator, and other related forms of credit enhancement shall be exempt from VAT, or any other taxes imposed in lieu thereof, but subject to DST. All secondary trades and subsequent transfers of ABS, including all forms of credit enhancement in such instruments, shall be exempt from DST and VAT (§ 29).

[34] Hereinafter, SPE for brevity.

[35] However, receivables that are to arise in the future shall be subject to the prior approval of the Securities and Exchange Commission and the Central Bank.

[36] UNCITRAL Guide, *supra* note 8, at par. 44; **To Allow Debtors to Use the Full Value Inherent in Their Assets to Support Credit** (44) In furtherance of the primary objective described in the preceding paragraph, the law should enable all types of debtors to utilize the full value inherent in their assets to obtain credit. In order to achieve this objective, the regime should be as comprehensive as possible. This entails permitting a broad range of assets (including present and future assets) to serve as encumbered assets. It also entails permitting the widest possible array of obligations (including future, conditional, monetary and non-monetary obligations) to be secured by security rights in encumbered assets.

[37] SECURITIZATION ACT, *supra* note 31, at §3(c).

delegating to a private institution, acting as an SPE, the duty and privilege of enforcing the satisfaction of its receivables.[38]

While this state limitation arguably serves the government's interest in maintaining the privilege of enforcing the satisfaction of its receivables, it cannot be gainsaid that it does not support efforts towards achieving the stability and growth of secured transactions. Instead, if any, this restriction will be detrimental to the development of secured transactions in the Philippines by limiting the scope of the assets that may be encumbered to obtain credit. This becomes more indefensible since the title to the negotiable government receivable has previously been transferred by the state, by way of a sale to a private party. Could it not then be said that by engaging in a strictly commercial transaction involving its unpaid receivables, the state has practically all but waived its interests thereto and should no longer have any control over the same?

In general the clear statement of the Securitization Act's policy is commendable as it lessens the judiciary's burden in arriving at an appropriate statutory interpretation. However, Act's stated legislative policy might inadvertently cause an adverse consequence. The concise statement of policy, and the law as a whole, may be so narrowly interpreted that any positive benefit that may be derived from the said law ought to be exclusive to the creation of capital in the housing industry. A more proper interpretation should see the law's contribution towards increasing the stability, predictability and attractiveness of secured credit transactions in general, regardless of the industry to which it is used or to be used.[39]

Conversely, it is worth noting that the Securitization Act has adopted at least one of the suggested best practices regarding securitization, particularly, it increased the marketability of the object of the secured interest. Under the Securitization Act, the transfer of assets to the SPE shall be in a nature of a true sale or on a without recourse basis.[40] As a result of this treatment, the market value of the ABS is amplified as the transferred assets are now placed beyond the reach of the transferee, his creditors and even his liquidators, in case of the transferee's bankruptcy.[41] Holders of

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[38] *Id.* §6(j) and (k); Under Section 6 (j) and (k) of the Securitization Act, among the functions of a Special Purpose Entity involves the management and administration of assets and the disposition of foreclosed properties.

[39] From the time of its fairly recent enactment, lacking verifiable data, it is not really yet known how effective this law came to be in the achievement of it stated objectives.

[40] SECURITIZATION ACT, *supra* note 31 at §12.

[41] *Id.*

certificates of ownership to the ABS now have a reason to feel more confident in being able to receive the return of their capital and even some profit as well.

If security holders have this sort of confidence, then their perceived exposure to adverse risks becomes lower. By way of consequence, if this type of perception exists, then the need to leverage themselves with higher interests is diminished, and this makes access to credit cheaper and more accessible.

F. CIRCULAR NO. 185: A RESTRICTED ASSET POOL

Compared to its earlier predecessor, Central Bank Circular No. 185 governing the issuance by banks and other regulated non-bank financial institutions of asset-backed securities, the Securitization Act is not as restrictive and is an improvement towards liberalism when compared to the latter. *First*, though the Circular's objective is similar with that of the Securitization Act, namely, the securitization of receivables, loans, *etc.* and the dispersion of ownership to a wider base, the class of qualified assets is more strictly delimited. The Circular provides that the type that may be placed in the asset pool shall be exclusive to the bank's internally generated receivables, particularly, credit card receivables and other assets generated in the bank's ordinary course of business – mortgage, loans, consumption loans, trade receivables, and other financial assets – that might be registered in the bank's books as outstanding receivables.[42] *Second*, although like the Securitization Act, the Circular deems the transfer of securitized assets to the trustee as akin to a true sale, nonetheless, for accounting purposes, this effect is not automatic and is subject to compliance with several mandatory requirements.[43]

In other countries, giving due regard to the contracting parties' complex motives in entering into secured transactions, and to facilitate the execution of such agreements, best practices have evolved to place greater liberality and autonomy to the parties to determine how their secured transactions will be carried out.[44] Through this Circular however, mandatory rules were not kept to a minimum when it could have opted to

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[42] CB Circ. No. 185 (1988), §1(a).

[43] *Id.*, §7(d); The three mandatory requirements that need to be complied are the following: (a) the asset has been isolated and placed beyond the reach of the seller and its creditors; (b) the SPE has the right to pledge or exchange its interest in the assets;[43] and (c) the seller has lost effective control over the transferred asset.

[44] UNCITRAL GUIDE, *supra* note 8, par. 44.

do so to ensure transparency, predictability of rights and fairness in enforcement.[45]

IV. PHILIPPINE LAW ON PLEDGE AND CHATTEL MORTGAGE *VIS A VIS* ARTICLE 9

A. PERFECTION OF SECURED INTEREST

In Philippines, the pledge agreement is more widely used than the chattel mortgage as a method of creating security interest over movable properties. It used to guarantee the fulfillment of a principal obligation,[46] and for it to be constituted, requires that the pledgor deliver the possession of the thing pledged to the pledgee. It is this physical delivery of the thing pledged which triggers the perfection of the latter's security interest over the pledged property. On the other hand, under the now obsolete thought yet to be amended Chattel Mortgage Law,[47] enacted in 1906, chattel mortgage is defined as a conditional sale of personal property to secure the performance of an obligation. Also, its method of perfection is more complex than that of a pledge.

Accordingly, for a chattel mortgage to be valid against third persons, either the property is delivered to the mortgagee or the mortgage is registered in the office of the register of deeds of the province where the mortgagor resides.[48] However, if the place of residence of the mortgagor and place where the property is situated is separate, then it has to be recorded in both places. It is peculiar how this policy unnecessarily makes the process of registration of chattel mortgage more difficult than what is necessary.[49] Especially so when from the very nature of a movable, especially if it is an intangible, under the *mobilia sequuntur personam* principle, *lex situs* would follow the domicile of its owner.

In contrast, Article 9's method of perfecting a security interest over a movable is simpler and is one of the more revolutionary innovations of the

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[45] *Id.*

[46] CIVIL CODE, art. 2085.

[47] Act No. 1508 (1906) "An Act Providing For the Mortgaging of Personal Property and for the Registration of Mortgage as Executed" [hereinafter, CHATTEL MORTGAGE LAW]

[48] *Id.*, § 4; If the mortgagor happens to reside outside the Philippines, registration shall be made in the province where the property is situated.

[49] *Id.*

UCC.[50] Under Article 9, one simply has to submit a financial statement, indicating the names of the contracting parties and the collateral covered, to the concerned filing office, and the creditor's security interest is so perfected.[51] This system also allows transparency in access to information in such a way that would-be creditors are now given the means of knowing before hand whether it is wise to give credit to an applying debtor. Searching into the filing office's database list for the name of the applicant debtor, the former can now easily confirm whether the former has any outstanding obligations, and if so, whether he has caused the attachment of a lien on the same offered collateral.

By treating all of the pre-existing security interest devices into a single, all-inclusive generic category, Article 9 likewise reduces the pernicious effect of secret liens.[52] Thus, no longer will an unrecorded conditional sale, trust receipt, or even a simulated financial lease be invoked to defeat a recorded chattel mortgage or its functional equivalent.[53] Regardless of the name given to the transaction and its supposed title-retention features, notice through filing becomes indispensable in order to affect third party rights.[54]

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[50] NY CLS U.C.C § 9-310 (2008); § 9-310. When Filing Required to Perfect Security Interest or Agricultural Lien; Security Interests and Agricultural Liens to Which Filing Provisions Do Not Apply

(a) General rule: perfection by filing. Except as otherwise provided in subsection (b) and Section 9-312(b), a financing statement must be filed to perfect all security interests and agricultural liens.

(b) Exceptions: filing not necessary. Except as provided in subsection (d), the filing of a financing statement is not necessary to perfect a security interest:

(1) that is perfected under Section 9-308(d), (e), (f), or (g);

(2) that is perfected under Section 9-309 when it attaches;

(3) in property subject to a statute, regulation, or treaty described in Section 9-311(a);

(4) in goods in possession of a bailee which is perfected under Section 9-312(d)(1) or (2);

(5) in certificated securities, documents, goods, or instruments which is perfected without filing or possession under Section 9-312(e), (f), or (g);

(6) in collateral in the secured party's possession under Section 9-313;

(7) in a certificated security which is perfected by delivery of the security certificate to the secured party under Section 9-313;

(8) in deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights which is perfected by control under Section 9-314;

(9) in proceeds which is perfected under Section 9-315;

(10) that is perfected under Section 9-316; or

(11) that is a cooperative organization security interest.

(c) Assignment of perfected security interest. If a secured party assigns a perfected security interest or agricultural lien, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

(d) Special rule for cooperative interests. Except for a cooperative organization security interest, a security interest in a cooperative interest may be perfected only by filing a financing statement.

[51] U.C.C. Article 9-502(a) (2001).

[52] Symposium, *supra* note 6.

[53] *Id.*

[54] *Id.*

B. NON-POSSESSORY SECURITY RIGHTS

While in Philippine jurisdiction it is mandatory for the creditor-pledgee to acquire possession of the pledged movable to perfect his claim thereto,[55] this is not the case under Article 9's non-possesory security interest system. Although the right of the pledgee to the possession of pledge until the debt has not been paid is not absolute as there are safeguards to protect the proprietary rights of the debtor, such as but not limited to prohibiting the pledgee from using the thing pledged without the permission of the pledgor,[56] non-possession of the pledge has its inherent disadvantages as well.

In depriving the pledgor from enjoying his proprietary right of possession over the pledged object, the pledgee prevents the pledgor from having the opportunity to easily dispose of the object. Nevertheless, when the movable is part of the inventory or raw materials that the debtor uses in creating a final product, and where the sales thereof is used in creating revenues, or when the pledged object is used in the operations of the business itself, such as machinery then the non-possession of the same may cause the abrupt disturbance or immobilization of the debtor's business.[57] As a result of such disruption deriving revenue for the payment of the indebtedness becomes more difficult.

Were the Philippines to adopt the non-possessory security interest model of Article 9, so as not to so destabilize the debtor's business and stifle his ability to pay, would it not be easier for debtors to freely dispose of the object of the pledge and also allow them to freely allocate all of their resources towards the payment of debt, without the burden of asking for the consent of the creditor-pledgee?[58]

In addition, it bears stressing that the standard of care that the creditor must faithfully comply with while in possession of the pledge cannot be less than that of the diligence of the good father of a family.[59] Thus, any loss or damage due to the creditor's fault may make him liable for damages and may also prevent him from seeking from the debtor the

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[55] Under the Chattel Mortgage Law as well, unless the mortgage has been recorded in the office of the Register of Deeds, possession to the collateral needs to be delivered to the mortgagee to perfect the right of the secured creditor thereto against third persons.

[56] CIVIL CODE, art. 2104

[57] UNCITRAL GUIDE, *supra* note 8, at p. 9.

[58] *Id.*, art. 2097

[59] *Id.* art. 2099

satisfaction of the loan. In addition, although he may protect himself from the hazard of the pledge's loss or deterioration while it is in his custody, this will inevitably cause him to incur additional costs. The payment for insurance premium, and storage costs, especially if the perishable and fragile nature of the pledge object would call for such precautionary measures, would inevitably make the cost of secured transaction more expensive.

C. AFTER –ACQUIRED COLLATERAL

Also, while Article 9 states in clear categorical terms that after-acquired property of those things that are yet to be owned and those not yet in existence may be pledged,[60] the same is not true for pledge and chattel mortgage agreements. To constitute a pledge it is necessary that the pledgor be the absolute owner of the pledged object. On the other hand, the Chattel Mortgage Law, aside from prohibiting the securing of future obligation[61] strictly provides that, notwithstanding anything that may be written in the chattel mortgage instrument to the contrary, security interests shall be limited to the properties identified under oath by the parties and the witnesses in the instrument, and may not cover "like or substituted property thereafter acquired by the mortgagor".[62]

Theoretically applying Article 9 to the Philippine retail industry, and assuming that the creditor-pledgee consents to the same, will result in the expansion of the business of local retailers by increasing inventory available for sale and allowing them to take advantage of the revolving loan facility and utilize as corresponding collateral revolving inventory. Also, by being able to use as collateral goods that are yet to be acquired in order to borrow additional working capital to replenish stocks that have already been sold, the need to execute multiple secured transactions to respectively correspond to the grant of multiple credit for the acquisition of inventory no longer becomes necessary. In the alternative, a single loan agreement may provide that the creditor will also have a secured interest not only over the debtor's existing inventory but also over the inventory that will be acquired with the use of the money that will be lent. This will make the cost of credit cheaper and more efficient. Moreover, the debtor will be able to seek for additional working capital from the lender as long as the aggregate amount of credit

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[60] Article 9-204. **After Acquired Property; Future Advances**

After Acquired Collateral

Except as otherwise provided in Subsection (b), a security agreement may create or provide for a security interest in after acquired collateral.

[61] CHATTEL MORTGAGE LAW, *supra* note 48, at § 7.

[62] *Id.*, at § 5.

extended will not be in excess of existing collateral and collateral yet to be acquired, which may be closely approximated by computing the debtor's average inventory. Lastly, because the revolving loan structure matches borrowings to the debtor's cash conversion cycle, or when sales revenues are collected, it prevents the debtor from borrowing more than it actually needs, thus avoid incurring unnecessary interest expenses.[63]

D. FACILITATIVE RATHER THAN FORMALISTIC REGULATION

The formal requirements for the creation of a pledge or a chattel mortgage – the Civil Code requirement that a pledge shall not take affect against third person if it does not appear in a public instrument, [64] and the Chattel Mortgage Law's prerequisite that the parties to the chattel mortgage, along with two other witnesses sign the chattel mortgage instrument under oath before a notary public[65] – need further revising. This requirement that both types of secured transactions must be in a public instrument is at odds with current best practices that encourage a regime wherein parties are permitted to design their own secured transactions. Any mandatory rule, if any, should be solely aimed at ensuring fairness and protecting the interest of third parties.[66]

As long as the instrument specifically identifies the parties, namely, the debtor and secured creditor, and describes the assets to be encumbered, then such instrument should be deemed sufficient and should be afforded all the effects of a perfected security interest.[67] It cannot be argued that at this age, the benefits that come with having the requirement that the form be in a public instrument is dispensable, or is no longer as important at it used to be. In fact, the Philippine Supreme Court has held that the public purpose

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[63] UNCITRAL GUIDE, *supra* note 8, at p. 5.

[64] CIVIL CODE, arts. 2096, 1625. Art. 2096. A pledge shall not take effect against third persons if a description of the thing pledged and the date of the pledge do not appear in a public instrument; Art. 1625. An assignment of credit, right or action shall produce no effect as against third persons, unless it appears in a public instrument, or the instrument is recorded in the Registry of Property in case the assignment involves real property.

The Supreme Court in Caltex Philippines v. Court of Appeals, G.R. No. 97753, August 10, 1992, has had the opportunity to rule on this issue in this wise:

"Consequently, the mere delivery of the Certificate of Time Deposits did not legally vest in petitioner any right effective against and binding upon respondent bank. The requirement under Article 2096 aforementioned is not a mere rule of adjective law prescribing the mode whereby proof may be made of the date of a pledge contract, but a rule of substantive law prescribing a condition without which the execution of a pledge contract cannot affect third persons adversely."

[65] CHATTEL MORTGAGE LAW, *supra* note 48, at §5.

[66] UNCITRAL GUIDE, *supra* note 8, at p. 13.

[67] *Id.*, at pp. 55-56.

that is being espoused in making a private document into a public document is more a matter of facilitating the said document's admissibility in evidence without presenting further proof as to its authenticity.[68] Though useful in this sense, nonetheless this has no direct relation to the objective of providing a more efficient, stable and harmonized law on secured transactions.

Such a formal requirement makes access to credit more expensive. When formalities make it more difficult to establish their priority claim, from a lender's point of view, each additional formality is a potential trap.[69] There is the possibility that failure to satisfy this formality may cause invalidation of their security interest,[70] and in order to leverage against this risk, creditors would tend to increase contractual interest rates.

E. SELF-HELP PROCEDURE IN THE SATISFACTION OF THE SECURED CREDIT

In the Philippines, as in most countries, when the debtor defaults in the payment of his indebtedness, the creditor has the remedy of foreclosing the object of the secured security in order to secure the satisfaction of what is owed to him. For example, in an extrajudicial foreclosure of the pledged property, the unpaid creditor is required to use the services of the notary public for the execution of a public auction sale. The debtor and the owner of the thing pledged, in case that the owner of the thing pledged is not the debtor, shall first be notified of the public auction sale and the amount for which the pledged object is planned to be sold.[71] It is only when no sale is consummated during the second auction that the creditor may be allowed to appropriate the pledged thing for himself, in which case he shall be deemed to have waived his entire claim.[72] In the same manner, if the secured transaction is in the form of a chattel mortgage, only after the mortgagor

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[68] Follosco v. Mateo, A.C. No. 6186, February 3, 2004.

[69] Guillermo A. Moglia and Julian B. McDonnel, *Secured Credit and Insolvency Law in Argentina and the U.S.: Gaining Insight from a Comparative Perspective*, 30 GA. J. INT'L & COMP. L. 393 (2002).

[70] *Id.*

[71] CIVIL CODE, art. 2112. The creditor to whom the credit has not been satisfied in due time, may proceed before a Notary Public to the sale of the thing pledged. This sale shall be made at a public auction, and with notification to the debtor and the owner of the thing pledged in a proper case, stating the amount for which the public sale is to be held. If at the first auction the thing is not sold, a second one with the same formalities shall be held; and if at the second auction there is no sale either, the creditor may appropriate the thing pledged. In this case he shall be obliged to give an a quittance for his entire claim.

[72] In the case of Insular Life Assurance Company, Ltd. v. Robert Young, G.R. No. 140964, January 16, 2002, the Supreme Court held that in the event that a second auction is conducted, it is not indispensable that a separate second notice be sent to the debtor in order to uphold the validity of the notarial sale. It is sufficient that the first notice likewise indicates that in the event that the secured is left unsold during the first auction that a second auction will be conducted in the specified date and place.

and the persons holding subsequent mortgages have been notified beforehand of the holding of the public auction, can the mortgagee cause the mortgaged property to be sold by a public officer in a public auction.[73] Such procedure for both the pledge and chattel mortgage regime is slow and costly, and this is another cause that makes access to credit more expensive.

In contrast, Article 9's self-help procedure does not require such an elaborate procedure and may be done outside of the judicial process. This system benefits the secured creditor by trimming down the cost and time necessary to foreclose on the collateral, as long as no breach to the peace is caused.[74] Upon default, a secured party may unilaterally sell, lease, license, or dispose of the collateral in its present condition or following "any commercially reasonable preparation or processing."[75] As long as the method, manner, time, place of the disposition of the collateral is deemed "commercially reasonable", then the secured party may unilaterally dispose of the collateral,[76] and may even participate in either the public or private proceeding.[77] As to the persons to be notified of the disposition, only an authenticated notification shall be sent to the debtor, or any secondary obligor.[78]

Should the Philippines adopts this self-help principle espoused in Article 9 and allow the parties to freely stipulate that, in case of default and after proper notification to the parties have been made, the secured creditor is authorized to take possession of the collateral and dispose of the same without the need to seek the assistance from court appointed sheriffs, we may finally put an end to much abhorred corrupt practice of mulcting parties for grease money that have blackened the image of sheriffs. Parties deplore the thought that they are being made unwilling participants to an act of bribery, paying sheriffs to perform their public duty. *Ergo*, parties

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[73] CHATTEL MORTGAGE LAW, *supra* note 48, § 14.

[74] Symposium, *supra* note 6; see U.C.C., art. 9-609 (2001).

[75] U.C.C. art. 9-610(a) (2001).

[76] *Id.*, art. 9-610(b).

[77] *Id.* 9-610(c)(2); The secured party may purchase collateral at a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

[78] *Id.* 9-611(c); If the collateral is other than consumer goods, authenticated notification shall also be sent to any other person (a) from which the secured party has received, an authenticated notification of a claim of an interest in the collateral; (b) 10 days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that (i) identified the collateral; (ii) was indexed under the debtor's name as of that date; and (iii) was filed in the office in which to file a financing statement against the debtor covering the collateral as of that date; and (c) any other party that, 10 days before the notification date, held a security interest in the collateral perfected by compliance with a statute, regulation, treaty.

sometimes no longer bother to have their secured rights enforced. With the principle of self-help however, by empowering a secured creditor to exact satisfaction of his credit, as long no breach to the peace is committed,[79] the monopoly held by the sheriffs to such an important procedure will be limited, if not extinguished altogether. Moreover, the need to seek the expensive services of notaries public and collection agencies will be lessened as well. All in all, such a scenario will make the cost of extending credit less expensive.

On the other hand, although it is quite expected that emotions would run high when a piece of property is taken against the wishes of another, absent any legitimate ground to stop the secured creditor from proceeding with this right, the debtor will instead be expected to cooperate and not resort to conduct that will only result in unnecessary legal expenses that may be debited from the proceeds of the sale of the collateral and thus cause him to receive a lesser portion therein.[80]

F. APPLICATION OF PROCEEDS

While the debtor has the right to seek the foreclosure of the thing pledged or mortgaged, in the event that the monetary proceeds of the foreclosure turn out to be insufficient to fully satisfy the debt, the right of the creditor to proceed against the other assets of the debtor for the full satisfaction of his credit would depend on the nature of the secured credit transaction and/or method of its foreclosure, i.e. judicial or extrajudicial.

For pledges, if the price of the sale is less than the amount of the principal obligation, the creditor is not entitled to recover the deficiency, even if there is a stipulation to the contrary.[81] In the same manner, in the

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[79] Symposium, *supra* note 6; American case law has had the opportunity to define what constitutes a breach of the peace in several cases. In Dixon v. Ford Motor Credit Co., 391 N.E. 2d 493 (1979), the US Supreme Court held that it is enough if the debtor firmly but politely refuses to give the creditor access to collateral. In the case of General Elec. Corp. v. Timbrook, 291 S.E. 2d. 383, 384 (1982), it was held that it is also enough if the creditor may have had to trespass on the property of the debtor carry out the possession, even if the debtor was not there and had no opportunity to make any protest the moment of trespass.

[80] Symposium, *supra* note 6; Under Article 9-608 of the Uniform Commercial Code, it allows the creditor in the application of the cash proceeds to deduct for "the reasonable expenses of collection and enforcement and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party."

[81] CIVIL CODE, art. 2115. The sale of the thing pledged shall extinguish the principal obligation, whether or not the proceeds of the sale are equal to the amount of the principal obligation, interest and expenses in a proper case. If the price of the sale is more than said amount, the debtor shall not be entitled to the excess, unless it is otherwise agreed. If the price of the sale is less (than the amount of the principal obligation) neither shall the creditor be entitled to recover the deficiency, notwithstanding any stipulation to the contrary. When the proceeds of the sale arising from the extrajudicial foreclosure of the mortgages becomes insufficient to cover the outstanding balance of the obligation, the mortgagee is entitled to claim the deficiency from the

event of foreclosure of a chattel mortgage on a thing bought on installment basis, the vendor shall be left with no further action against the purchaser in default to recover any unpaid balance, and any agreement to the contrary shall be void.[82]

Article 9's method of determining the consequences applicable to the foreclosure of collateral is much simpler in terms of enforcement and predictability. In the event of a surplus coming after the payment of all the obligations that the collateral secures, the surplus shall be returned to the debtor,[83] and in the event of deficiency, the creditor can pursue both the debtor's other encumbered collateral or unencumbered assets.[84]

V. LIBERALIZATION OF RULES ON SECURED TRANSACTIONS

This part of the Article will focus on some of the longstanding and established characteristics of secured transactions in the Philippines that need revisiting. By pointing them out in this manner, we can analyze their practicality and effectiveness in achieving a unified, modern and accessible system of secured transactions. From here on, the primordial question that needs to be answered is whether such characteristics do perpetuate the realization of these desired goals.

A. PACTUM COMMISSORIUM CLAUSES

First, under the Philippine Civil Code a *pactum commissorium* clause is simply put, void and of no binding effect. A creditor cannot unilaterally and automatically appropriate the collateral whose possession was given by way of pledge or mortgage, or dispose of them in the event of the debtor's failure to pay the indebtedness within the stipulated period.[85] As a consequence of this imposed limitation, the creditor may instead resort to demanding from his debtor an alternative method of protecting his secured

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debtor; *See* for clarification, Development Bank of the Philippines v. Zarragoza, G.R. No. L-23493, August 23, 1998.

[82] *Id.*, art. 1484: Art. 1484. In a contract of sale of personal property, the price of which is payable in installments, the vendor may exercise any of the following remedies:

Exact fulfillment of the obligation, should the vendee fail to pay;

Cancel the sale, should the vendee's failure to pay cover to two or more installments;

For the chattel mortgage on the thing sold, if one has been constituted, should the vendee's failure to pay cover two or more installment. In this case, he shall have no further action against the purchaser to recover any unpaid balance of the price. Any agreement to the contrary shall be void;

[83] U.C.C. art. 9-615(d)(1).

[84] *Id.*, at 915(d)(2).

[85] CIVIL CODE, art. 2088 (as amended)

interest, i.e. a transfer ownership over the collateral by way of *pacto de retro* sale or a sale with a right to repurchase, from which he would draw on for satisfaction of the debt in case of the debtor's default.

Creditors rely on the condition that their proprietary right, although legally considered to be an "equitable pledge", is not entirely without value, for a defective title over of a movable property may still create a clean title when transferred to a third party buyer who is acting in good faith.[86] Accordingly, this buyer in good faith will acquire a perfect title over the property that shall be free from any liens and encumbrances.[87] At the same time, the creditor, from the proceeds of the said sale to the buyer in good faith, will be able to exact satisfaction for his prior unpaid credit.

But is resort to all of these troubles in order to circumvent the prohibition against the *pactum commissorium* clause really necessary? With the need to provide an efficient and inexpensive method of conducting secured transactions,[88] it might be worth re-examining this archaic prohibition.

During the Roman Period, the reason given for Emperor Constantine's prohibition of the *pactum* was that it enabled lenders to evade the severe penalties imposed by Christianized Roman law upon usury.[89] Usury, as is it is similarly understood in the Philippines, was defined in Constantine's time as "any interest charged above and beyond the return of the principal amount"[90]. It goes without saying however that although the Philippines is a predominantly Roman Catholic country, the enforcement of the anti-usury law in the Philippines has been suspended for more than 25 years now.[91] As long as the rates are not unconscionable, parties are now given the freedom to freely agree on the interest rates of their credit transactions.

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[86] *Id.* at art. 1544; Article 1544. If the same thing should have been sold to different vendees, the ownership shall be transferred to the person who may have first taken possession thereof in good faith, if it should be movable property.

Should it be immovable property, the ownership shall belong to the person acquiring it who in good faith first recorded it in the Registry of Property.

Should there be no inscription, the ownership shall pertain to the person who in good faith was first in the possession; and, in the absence thereof, to the person who presents the oldest title, provided there is good faith.

[87] See Amending and Codifying the Laws Relative to Registration of Property and for Other Purposes, Pres. Dec. No. 1529, §44 (1978)(Phil.); This law provides that every registered owner receiving a certificate of title in pursuance of a decree of registration and every subsequent purchaser of registered land taking such certificate for value and in good faith shall hold the same free from all encumbrances, except those noted on the certificate and enumerated therein.

[88] Symposium, *supra* note 6.

[89] *Id.*

[90] *Id.*

[91] Cuaton v. Salud, G.R. No. 158382, January 27, 2004

It bears noting that adherence to this age-old policy of prohibiting *pactum commissorium* clauses retards the modernization not only of secured transactions but also of commercial and remedial law as well.[92] Also, adherence to this prohibition may result to economic waste upon contracting parties, especially so when the secured collateral are perishable or depreciable goods that may no longer have any value when made to go through lengthy litigation to acquire a judicial determination of a basis for foreclosing.[93]

B. FORMALISTIC PROCEDURAL REQUIREMENTS

Second, formal and substantive procedures in transferring title to a creditor under an equitable mortgage are less complicated as compared to enforcing a security right under a legal mortgage.[94] For example, in the execution of a chattel mortgage, compliance with several rather tenuous requirements is necessary. Posting the notice of sale in two or more public places where the property is situated for not less than 10 days is mandatory.[95] But in the Philippines, posted public notices are not as effective as, for instance, ads placed in television or billboards, and are often left unnoticed. If there are persons who do take notice and pay close attention to such posted notices, they are limited to a handful of people who are on the lookout for good deals.

On the other hand, in the case of machineries and instruments intended for an industry or works,[96] being immovables, foreclosure notices are require to be posted once a week for three consecutive weeks in a newspaper of general circulation in the place where the property is located.[97] However, Philippine jurisprudence has placed a strict interpretation to this

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[92] Symposium, *supra* note 6.

[93] *Id.*

[94] UNCITRAL GUIDE, *supra* note 8, at p.40.

[95] *Chattel Mortgage Law*, *supra* note 48, §14; See also Act 3135 An Act to Regulate the Sale of Property Under Special Powers Annexed to Real-Estate Mortgages (1924), § 3; While there is no clear definition of what constitutes a public place, it has been of accepted practice that it would refer to places where there is a high density of people and where there is a high probability that interested parties will be given adequate notice of the sale, such as for instance, markets, city hall, etc. If it so happens that the choice of location becomes a contentious issue among the parties, this matter should be resolved by the person that has been placed in charge with the responsibility of the posting of the notices (usually, the courts' sheriff) and absent any obvious abuse of discretion, his choice of venue would be followed.

[96] CIVIL CODE, art. 415(5). Such movables because of their nature and utilization are deemed as immovable property.

[97] An Act to Regulate the Sale of Property Under Special Powers Annexed to Real-Estate Mortgages, Act No. 3135, § 3 (1924)(Phil.).

statutory requirement of publication.[98] Deviations from this requirement, though slight may cause the declaration of the sale as voidable or even void.[99]

In reality, despite the seeming importance that the Supreme Court has bestowed upon this formality, publicizing the foreclosure sale does not result to an effective publicity that increases the possibility of achieving the highest bid price. The nature of the requirement itself is where the fault lies. In order to comply with the newspaper circulation requirement, it is sufficient that the newspaper's circulation is within the city or town where the property is located. Since it becomes unnecessary that the publication be of general circulation in a particular province or city, a number of "fly-by-night" newspaper companies have sprouted. These publications' main purpose of business operation is not to deliver news, but to provide cheap advertisement to those who want to achieve minimum compliance with the publication requirement at the least expense possible. Although these publications need to be accredited by the courts, compliance with the required standard to receive accreditation is easy to achieve.[100]

C. OUTDATED PROCEDURAL ENFORCEMENT REQUISITES

Third, the prescribed method of conducting the foreclosure of a chattel mortgage is outdated and impractical. The law requires that the actual sale be conducted within the municipality where the property is located or where the mortgagor is situated.[101] Although the intent should be commended, as it ensures that persons who live within the community and who are presumed to be in the best position to know the value of the chattel are able to participate in the auction sale, nonetheless, as will be discussed below, such strict application does not result in the highest price possible for the property to be foreclosed.

Information technology now allows commercial transactions to be conducted conveniently and speedily regardless of the distance and parties' location. It being so, it is backward thinking to exclude capable bidders

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[98] *See* Quano v. Heirs of Quano, G.R. No. 129279, March 4, 2003. In this case the Supreme Court declared as invalid the foreclosure sale on the ground that it did not strictly comply the statutory requirement of publication. The Supreme Court found that even if there was a prior publication of the scheduled foreclosure sale, the postponement of such sale required re-publication of the next scheduled foreclosure sale and that no waiver of the same would be countenanced.

[99] *Id.*

[100] *See* Administrative Matter No. 01-1-07-SC. Re: Guidelines in the Accreditation of Newspapers and Periodicals and in the Distribution of Legal Notices and Advertisements for Publication (October 16, 2001)

[101] CHATTEL MORTGAGE LAW, *supra* 48, at §14

from using information technology to participate in the sale, simply because they are not physically present in the place where the actual sale is being conducted. Their distance from the venue will not be an obstacle to the delivery of the purchase money to consummate the sale. In fact, the consummation of the sale may even be faster with them than those who are physically present in the foreclosure sale. This is all made possible by means of electronic information transactions. Excluding the use of such medium, and inflexibly restricting the auction sale in the vicinity where the property is located prevents a wider participation of would-be-buyers and fails to take advantage of the conveniences of technology.

In the global standard of transactions, where the movement of information is made efficient and reliable through the use of electronic technology, it is illogical for jurisdictions not to adopt to the current best practices that recognize the ability of parties to conduct business using electronic communications. The United Nations Commission on International Trade Law's Model Law on Electronic Commerce provides that where the law requires the signature of a person, it is adequate if a method is used to identify that person and to indicate that person's approval of the information.[102] If the Philippines is bent on making its domestic transactions at par with international best practices, there is no reason why bidding through the use of electronic communication in the conduct of foreclosure sales should not be allowed. On this matter, the United Nations Convention on the Use of Electronic Communications in International Contracts, states that when law requires that a communication or contract should be in writing, or provides consequences for the absence of a writing, the fulfillment of such requirement can be done electronically as long as its is accessible for subsequent reference.[103]

VI. ADOPTION OF RECOMMENDATIONS

An idea might sound good and promising, but as the saying goes, action is louder than words. The recommendations made in this paper, including the adoption of some of the distinctive advantages of Article 9, should be considered in relation to its suitability to the Philippines. Due to

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[102] *See* UNCITRAL Model Law on Electronic Commerce With Guide to Enactment, art. 7 (1996) at <www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce/1996Model.html> January 18, 2009.

[103] *See* U.N. Convention on the Use of Electronic Communications in International Contracts, art. 9(2) (2005) <http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce/2005Convention.html> January 18, 2009.

the country's poor economic condition and lack of resources, some of Article 9's distinctive systems and methods may not be apt to the way business and government functionalities are carried out in the country.

For example, the method of perfecting security rights by way of filing a financial system with the appropriate filing office may prove difficult, especially at its initial stage of implementation. Such a system would require the processing and dissemination of a formidable amount of data, where room for mistakes and inaccuracies is very little. Its implementation should be rife with uncertainty and deliberate and precise solutions ought to be provided. Whatever office or agency of the government will be placed in charge with this registry system will play an unenviable role in coming up with an effective secured transactions system. Implementing the rules alone will ultimately prove insufficient unless they are adequately supplemented by means of a secure, reliable and efficient registry system to record security interests.[104] Even in America, where the filing system is widely used, experience has shown that the system is not perfect. For instance, litigation is abundant on the issue regarding who has a preferred right between two creditors who have registered their security interest under the debtor's different names.[105]

Also, if the Philippines enacts a law that is of the same mold as Article 9 and which will likewise incorporate all laws that affect secured transactions, including those mentioned in this paper, politics will play a big factor in shaping its success or failure. Unfortunately, the history of the country's parochial politics has shown that the enactment of bills that are national in scope and commercial in nature is not so promising.[106]

A complete makeover of the legal framework on secured transactions would necessitate the restatement of most laws and the abolition of others in order that it may be subsumed into a single comprehensive law. This would surely be met with opposition and meticulous scrutiny from lawmakers regardless of political orientation. Moreover, most politicians' area of expertise would not necessarily be in the field of finance, banking, economy or law. Without sufficient knowledge of

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[104] Symposium, *supra* note 14.

[105] Joshua Edwards, *Meet the New Test, Same as the Old Test: In re Spearing Tool's Rejection of the Revised Article 9 Rules Means Secured Creditors Will Get Fooled Again*, 59 OKLA. L. REV. 657 (2006).

[106] During the last 13th Congress that had for its Session Year for the period of 2004-2007, out of the 8,734 bills that were filed altogether by both Houses of Congress, only 84 bills were finally enacted into law. Moreover, only 32 of them were of national implication; See Lala Ordenes-Cassolan, 'Congress Passes Even Fewer Laws on Bigger Budget' (2007) <http://www.pcij.org/i-report/2007/13thcongress.html>

the mechanics and nuances of secured transactions, they will be wary of any move to radically alter the landscape of law on secured transactions.

The President, in order to solve this impasse may intervene and use the strength of the executive office and his political machinery's moral ascendancy to support the passage of this bill. The President may also use the authority given to his office by the Constitution to exercise the prerogative to certify as urgent the passage of the bill if the necessity of its immediate enactment would call for it.[107] It goes without saying that the proposed bill must stand the scrutiny of the public as well to questions as to the real urgency of passing the same.

VII. CONCLUSION

The enactment of the Securitization Act of 2004 and Special Purpose Vehicle Act (SPV Act) are welcome developments in the field of secured transactions. Through the SPV Act, financial institutions can now write-off from their records their non-performing loans by disposing it to a special purpose vehicle, improve the grading of their financial performance, and at the same time benefit from its tax breaks

Still, a lot of work remains. Such laws mainly cater to big businesses and industries. Whatever fiscal benefit it may give to the country, it will only be of an indirect effect to the common Filipino and will not be largely felt. Providing access to credit for small and medium enterprises is imperative. If the Philippines is to improve its micro enterprise industry, it needs to enact legislation that will provide to them cheap access to credit, and allow them to offer their property as security at the highest possible valuation. By not limiting access to credit to large borrowers, the objective of equal distribution of wealth might be achieved and at the same time lead to the increase the large informal sectors' stake in the development of the Philippine economy.

Economists have often shared that the country's economy is moving upward, albeit slowly. There are a lot of ways of knowing whether this statement is indeed accurate. Some economists are of the opinion that a country's economic success is measured by its Gross National Product, while there are those who tag it to the country's employment rate. Whatever numerical value economists may provide to determine the country's rate of

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[107] CONST. (1987), Art. VI, §26(2)

economic success, these hardly reflect the rate of success of small and medium scale businesses. Very few studies have been done to determine how they are indeed faring in this global economy, notwithstanding the fact that small and medium businesses are the little hardy wheels that drive the country's economy.

Trust is indeed an expensive commodity and credit does not come cheap. It now behooves upon lawmakers to provide a concrete solution accounting for this largely invisible yet indispensable economic factor.

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