

Legal Express

Security Interest under Thai Laws

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Introduction

Thailand adopts a civil law system similar to that of the continental Europe in that all the laws are written and embodied in codes or statutes. Thai judicial structure follows the traditional pattern of the Courts of First Instance, the Courts of Appeal and the Supreme Court. Precedent, albeit persuasive, do not establish binding principles of law but lower courts tend to follow decisions of the Supreme Court.

Regulatory Platform

The primary sources of laws that deal with a creation of security interest are the Civil and Commercial Code of Thailand (as amended) (the “CCC”), the Business Security Act B.E. 2558 (2015) (the “BSA”) and the Securities and Exchange Act B.E. 2535 (1996) (the “SEC Act”). Whilst the term “security interest” may have different connotations, the term shall for the purpose of this note mean the preferential right of a particular creditor in a property which may be sold or disposed of upon default of a debtor in order to satisfy the obligations for which the security interest is secured. This note, however, does not deal with statutory liens or preferential rights which, by operation of law, confer the security interest to holders of the assets and of the preferential rights over the assets.

Forms of Security Interest

Currently, there are four forms of security interest recognised under Thai laws, namely mortgage and pledge under the CCC, business security under the BSA and security interest over scripless securities under the SEC Act. Whilst there are other legislations dealing with mortgage or pledge as well as procedure and type of property which can be mortgaged or pledged under them, they do not change or supersede the general principles involving mortgage or pledge set out in the CCC. Further, despite the fact that Thai law does not recognise an assignment by way of security as a security interest, lenders commonly take a conditional assignment of contractual rights and regard that as a form of security to the extent their security interest over those rights cannot be created under the BSA.

Mortgage

Mortgage is available for immovable assets, certain rights to use immovable assets as prescribed under the Rights over Leasehold Asset Act B.E. 2562 (2019) (i.e. Sap-Ing-Sith) as well as those movable assets listed in Section 703 of the CCC, such as machineries which are registered under the Machinery Registration Act B.E. 2514 (1971) (as amended). Mortgage of land may include present and future buildings as well as other kinds of structure attached to the land. However, a mortgage of the mortgagor's own building or structures attached to the land owned by others requires consent of the landowner.

In order to create a mortgage, the CCC requires that a contract of mortgage be made in writing and registered with the competent authority. Upon registration, the mortgagee will be recognised as a secured creditor and will have priority in the mortgaged property over ordinary creditors. Further, the mortgage will attach to the mortgaged property even if its ownership is subsequently changed or transferred.

It is important to note that the CCC currently limits the liability of a third party mortgagor to the value of the mortgaged property at the time of enforcement or foreclosure of the mortgaged property and any contractual provisions in contradiction thereof will be void, unless otherwise permitted by laws.

The CCC also requires the mortgagee to comply with the notice requirements and procedures prescribed thereunder prior to its being able to enforce the mortgage either by way of public auction or foreclosure. Whilst there is no compulsory grace period, the mortgagee may commence a court action to enforce the mortgage only after the debtor fails to perform its obligations within a reasonable period which must not be less than sixty days upon receipt by the debtor of a mortgage enforcement notice given by the mortgagee. A copy of such notice must also be provided to the third party mortgagor within fifteen days of delivery to the debtor, otherwise the third party mortgagor shall be released from liabilities in relation to any interest, compensation or encumbrances arising after the lapse of such period.

As regards foreclosure, the mortgagee may do so through the court only if all the following conditions are satisfied: (i) a written notification is given to the debtor and the third party mortgagor (if any) in accordance with the above notice requirements; (ii) the debtor fails to pay interest for a period of five years or more; (iii) the value of the collateral is less than the obligations due; and (iv) there must be no other registered mortgages or preferential rights in respect of the mortgaged property.

Additionally, after the underlying obligation becomes due, the mortgagor may by a written notice require the mortgagee to enforce the mortgaged property by way of a public auction without the need for a specific order of the court provided that there must be no other registered mortgages or preferential rights in respect of the mortgaged property. Such public auction must be held within one year upon receipt of such notice by the mortgagee, otherwise the mortgagor shall be released from liabilities in relation to any interest, compensation or encumbrances arising after the lapse of such period.

Pledge

The security interest in a form of a pledge is available for movable assets and certain types of intangible assets, e.g. instruments or rights represented by instruments. In general, the CCC simply requires that in order to create a pledge, the pledged property be delivered to the pledgee and no other procedures are required to formalise the pledge. The pledge will be

extinguished if (i) the obligation secured is extinguished otherwise than by prescription; or (ii) the pledged property is returned to the possession of the pledgor.

If a debtor fails to perform its obligations within the (reasonable) period prescribed in a pledge enforcement notice given by the pledgee, the pledgee may sell the pledged property by way of a public auction, provided that the pledgor is notified in writing of the time and place of the auction. If the pledgee is unable to notify the debtor or the pledgor, he may sell the property by way of a public auction only after one month from the date the secured obligations have become due. There are other interesting aspects concerning pledge under Thai laws as follows:

- **Share Pledge**

The CCC requires that the creation of a pledge of shares (either listed or non-listed shares) be entered into the share register book of the relevant company. Otherwise, such pledge may not be set up against the company or a third person.

- **Bank Account**

Despite the Supreme Court has consistently ruled that a pledge of bank account is neither valid nor enforceable under Thai laws, it was the market practice in Thailand for the lenders to take a pledge of a bank account together with a conditional assignment and largely rely on a set-off right available under Thai laws prior to the implementation of the BSA.

- **Inventory**

As Thai laws require that the pledged property be delivered to the pledgee, the taking of a pledge over inventory often proves impracticable due to the nature of their constant movement through sale or use in the manufacturing process.

Business Security

The business security is recognised under the BSA as another form of security interest whereby a security provider grants security over assets to a security receiver to secure performance of obligations (regardless of whether the obligations belong to the security provider or a third party), without having to deliver such assets to the security receiver. The BSA provides for a broader range of assets that can be legally used as security, including (i) business; (ii) claims; (iii) movable property used in the security provider's business, e.g. machinery, inventories, or raw materials used in manufacturing goods; (iv) immovable property, only if the security provider directly engages in a real estate business; (v) intellectual property; and (vi) any other assets as prescribed in the ministerial regulations. In addition, the business security is allowed not only over existing movable and immovable properties but also assets which the security provider will acquire in the future pursuant to an agreement or any legal relationship.

The business security agreement is required to be made in writing and registered with the Business Security Registration Office which is established under the auspices of the Department of Business Development, the Ministry of Commerce as well as provide registration information (e.g. date and time of registration, the secured debt, details of secured assets, enforcement events, etc.). Information on whether an asset is used as security under the BSA will be available for public search through a centralised system.

Once the agreement is registered, the creditor shall be regarded as a secured creditor under Thai bankruptcy law and shall have preferential rights over the secured assets, including the right to receive payment from the enforcement of security in priority to other unsecured

creditors. Unlike a pledge under the CCC, the BSA allows the security provider to possess, use, exchange, dispose of, transfer and mortgage the secured asset during the secured period, including using it as a security to secure other performances except by way of pledge in which case the pledge will be void.

Whilst the BSA has become another important method to create the security interest over the assets which the pledge and the mortgage under the CCC are not practicable, this form of security interest is currently limited to certain creditors as prescribed under the BSA and not available to offshore lenders except for those participating in loan syndication with Thai bank lenders.

Security over Scripless Securities

Pursuant to Section 228/1 of SEC Act, scripless securities which are deposited with the Stock Exchange of Thailand through Thai Securities Depository Co., Ltd, (“TSD”) and which are not collateral given to a securities company pursuant to Section 195 of the SEC Act, may be placed as collateral for the obligations of a debtor in accordance with the procedures set out in the TSD Regulations concerning Securities Registration. The creditor who accepts securities as collateral in this regard shall have a preferential right in such securities, in a manner similar to the pledgee.

In order to create the security interest over the scripless securities, a depositor must record the use of the scripless securities as collateral through the electronic media provided by TSD, and upon completion of such record, TSD will suspend the withdrawal or transfer of the secured scripless securities during a security period and will record the creation of such security in the electronic media of TSD. The creation of the security over the scripless securities will be valid and binding upon (a) the parties to the transaction once TSD’s system has acknowledged receipt of the record of the security made by the depositor; (b) the depositor once the depositor submits the record of relevant information into the electronic media of TSD and (c) upon a company issuing the scripless securities and a third party when TSD has entered a record in an account prepared in accordance with the rule, conditions and procedures as specified in the notification of the Stock Exchange of Thailand.

Assignment of Rights/Receivables

Assignment of rights is valid if it is made in writing. However, the assignment can be set up against the debtor and a third person only if a notice of assignment is given to the debtor or a written consent to the assignment is obtained from the debtor. An assignment which is conditional upon an occurrence of certain events such as events of default under financing documents has generally been regarded by lenders as analogous to a security interest, regardless of whether such an assignment creates a security interest under Thai laws. Whilst there is no special procedure for enforcement of the assignment, the assignee (lender) could simply assume the right of the assignor (borrower) upon the assignment becoming effective against the debtor.

Guarantee

Whilst a guarantee which is another traditional form of security recognised under Thai laws does not fall within the scope of “security interest” for the purpose of this note, certain issues and requirements under the current guarantee laws warrant particular attentions of those wishing to take a security in this form. In brief, a guarantor’s liabilities are limited only to those specifically referred to in the guarantee agreement and a guarantee for future or conditional obligations shall specify certain prescribed particulars in order to ascertain the guarantor’s

liabilities. Thus, the concept of unlimited guarantee which was largely used in the Thai financing arrangement is no longer permitted and any agreement which (i) imposes a joint liability of the debtor and the individual guarantor; or (ii) requires the guarantor to waive certain defences other than those permitted by laws will be void.

Further, a written notice must be provided to the guarantor as a precondition to guarantee enforcement and a failure to serve such notice within sixty days from the date on which the debtor is in default will release the guarantor from liabilities in relation to any interest, compensation or encumbrances arising after the lapse of such period.

Effect of Insolvency

Bankruptcy

Under Thai laws, the right of a secured creditor is not affected by any bankruptcy proceedings against the debtor. As such, the secured creditor is entitled to enforce its claim over the assets given as collateral without being required to share the proceeds with any other creditors.

Business Reorganisation

Although the business reorganisation proceedings stay the enforcement rights of secured creditors, the Bankruptcy Act provides certain rights and remedies to the secured creditors. For example, a secured creditor may request the court to cancel the restriction in respect of its right to enforce such security if it can prove to the satisfaction of the court that such restriction is not necessary for the business reorganisation or where its secured status has not been adequately protected e.g. for losses in market value of the security. Further, the secured creditor may, with the court's approval, enforce the security without submitting a debt claim in the proceedings but the secured creditor must allow the planner or the receiver to inspect the security.

This document is solely intended to provide an update on recent development in Thailand legislation and is not purported to provide a legal opinion, nor a legal advice to any person.

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