Securing Loans by Mortgage or Pledge Over Machines and Equipment

Source: Italmec Siam

Manufacturers or producers in Thailand require machines and equipment and, more importantly, funds for their operations in addition to manpower. To finance such machines and equipment and purchases to raise funds, operators would typically mortgage them to the bank for loans.

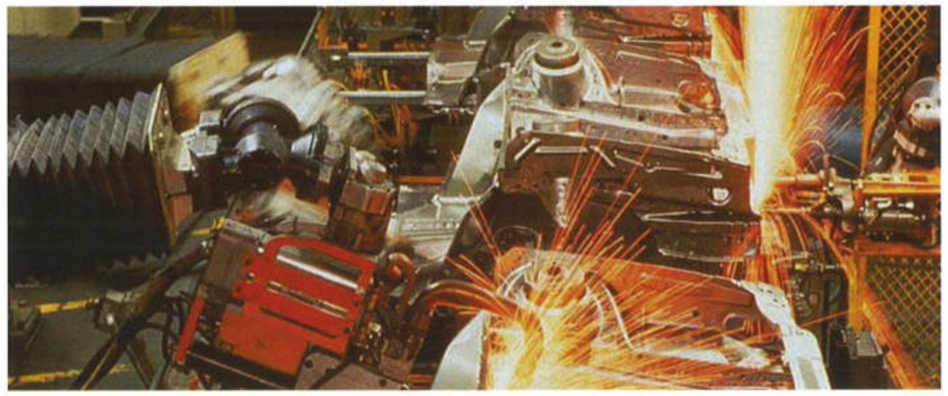
Why is mortgage or pledge important? A secured creditor under the Bankruptcy Act means a creditor who has a right over the property of the debtor in relation to a mortgage, a pledge, a right of retention or a preferential right to recover debt out of the debtor's property before other unsecured creditors.

A mortgage in Thai law is to solve the problem where the owner of property needs funds and the property at the same time. To enable the owner to use the property whilst capitalizing on the property value, a mortgage agreement was established under Section 702 of the Civil and Commercial Code (the Code) whereby the mortgagor registers or "marks" his property to another person called the mortgagee as security for a debt without delivery of property. The property that can be mortgaged is restricted to immovable property. However, paragraph 2 of Section 703 of the Code provides that, if duly registered, the following movable property can be mortgaged:

(1) boats with an unladen weight of 5 tonnes or more;
(2) rafts;
(3) draught animals; and
(4) certain movable property specified by law as registrable for the purpose of mortgage.

This fourth type of property is what we will focus on in this article. Under Section 5 of the Machine Registration Act B.E.[1] 2514 (1971) (the **Act**), a machine[2] that has its ownership registered under the Act can be mortgaged under Section 703 (4) of the Code and Sections 1299 to 1301[3] of the Code shall apply mutatis mutandis. A manufacturer and owner who wishes to mortgage his machines must therefore register them with the Central Office (or Provincial Office) for Machine Registration under the Act first by submitting inter alia an application form for machine registration, the applicant's registration documents, in relation to a company, identity documents of the authorised signatory(ies), a power of attorney (if applicable), a list of machines to be registered indicating the number and price , a map showing the location of the plant or building where the machines are situated, the machine installation plan, the relevant licences and permits, a letter of consent of the owner of the property in the case of premises belonging to others, photos and evidence of ownership of the machines. The registration process includes a 5 days public notice before registration. If no objection is raised in this time, the applicant may pay the registration fee (not exceeding 500 Baht per machine exceeding 100,000 Baht, up to 10,000 Baht per plant) plus 100

1 *Buddhist Era, 543 years before the Common Era.*
2 *A machine, under Section 3 of this Act, means "a piece of equipment having several parts which uses any one or a combination of hydropower, steam, fuel, wind, gas, electricity or other power to produce energy, change or convert energy, or transmit energy, and includes flywheels, pulleys, belts, shafts, gears or other interrelated equipment."*



Baht for every registration mark, up to 1,000 Baht per plant. The Central Office or Provincial Office for Machine Registration will issue a Machine Registration Certificate to the owner of the machine(s) on its compliance with all requirements.

To enforce a mortgage, the creditor is obliged under Section 728 of the Code to file a complaint with the court to seize the mortgaged property and sell it by auction. The foregoing can only take place after the creditor has given notice with an indication of a reasonable period of time for which the debtor shall pay the debt, and the debtor has failed to do so.

Another means of securing debt with machines without registration is the pledge of machines. The significant action required under Section 747 of the Code is that the property, or the machine must be delivered to another person (the pledgee) to secure the debt. The right of possession upon the machine must be transferred to the pledgee. Although disputes arise regarding the execution of this type of transaction, i.e., actual delivery of the property or machines to the pledgee, the transaction is still common, in particularly amongst commercial banks.

In practice, the machines that are pledged are those used in the pledgor's production line and is not practicable to deliver the machines to the bank (pledgee) pursuant to the intention of Section 747 of the Code. Thus, in order to avoid any legal dispute regarding the validity of the pledge, the lending bank (and pledgee) and the borrower (pledgor) agrees to appoint a third party as a "custodian" of the machines, instead of actually delivering the machines to the pledge. Such third party may be a director of the pledgor or any third party, whereby, there is no physical delivery of the machines to the pledgee.

In any case, past Court precedents concluded that if the intention of entering into this type of custodian agreement is to enable the debtor (pledgor) to benefit from the pledged property, then it shall be regarded that the pledgee allows the pledged property to return to the possession of the pledgor, which results in the termination of the pledge pursuant to Section 769(2) of the Code.[4]

Thus, although the exercise of the pledge is feasible and may be applied as a vehicle to use machines as assets, and used as collateral for indebtedness against the bank, which is more practicable and less time consuming compared to the registration of machinery mortgage, but if in fact, there was no physical delivery of the machines, whereby the right of possession is still with the pledgor, dispute may arise and affecting the rights of the lending bank in enforcing the pledge. This is because the intention of the law is that the right of possession of the pledged property must be physically delivered to the pledgee. Otherwise, if the pledgor is still entitled to benefit from the pledged property, then it is considered that the pledged property is returned to the pledgor, whereby terminating the pledge and the rights of the pledgee to enforce the pledge.

Summary

Mortgage and pledge of machinery has entirely different legal effect, i.e., the right of possession/ right of ownership, rights and preferential rights upon the machinery. As illustrated above, the pledge of machinery is more simple and less time consuming, as no registration of pledge is required, and therefore, not necessary to first register the machinery, which takes time. However, this type of transaction may raise disputes regarding the physical delivery of the machines to the pledgee, which in practice is not, or may not be done.

On the other hand, for machinery mortgage, the Central Office for Machinery Registration has designated rules and principles for the registration of machinery mortgage. The machineries must first be registered and must be the types specified in the Ministerial Regulations in order to be eligible for mortgage registration. Rights of the parties in a machinery mortgage transaction is protected by the clarity of the documentation and procedures, type of legal agreement, which must be in the form required by law. Thus, the execution of the transaction and procedures is clearly designated, not merely the interpretation of the legal provisions as in a pledge transaction.

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3 *The provisions of these sections are in relation to the requirements that transactions relating to the property must be in writing and registered with the official and that the right over the property, if not registered, shall not be enforceable against any third party who acquired such right in good faith, for value, and has registered such right in good faith.*
4 *Supreme Court Decision Nos. 2448/2551 (2008) and 5603/2554 (2011)*