

Whither the Personal Property Security Act

Jose Maria G. Hofileña*

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* '90 LL.M., Harvard Law School; '87 LL.B., *valedictorian*, Ateneo de Manila University School of Law. The Author is the Dean of the Ateneo de Manila University School of Law, from 2018 to present. He is also a professional lecturer on Commercial Law Review, Corporation Law, Banking Law, Foreign Investments and Investment Incentives Law, and Insurance Law at the said university. The Author's previous work for the *Journal* include *Gone Without a Trace: A Re-Examination of Bank Secrecy Laws and Anti-Money Laundering Laws in Light of the 2016 Bangladesh Bank Heist*, 62 ATENEO L.J. 90 (2017) , which he co-wrote with Jason L. Sy.

I. PLEDGE AND CHATTEL MORTGAGE CHALLENGES: DETERMINING EXISTENCE AND PRIORITY

When subjecting personal property to a security interest or lien in order to secure the payment or performance of an obligation in favor of a creditor or an obligee, it has been of long-standing commercial practice in the Philippines to constitute and perfect either a pledge or a chattel mortgage.¹

The laws governing pledges and chattel mortgages have been in place in statute for a significantly long time. The law on pledge is found in Title XVI, Chapter 2 of Republic Act No. 386, otherwise known as the Civil Code of the Philippines,² while the laws governing chattel mortgages are essentially sourced from the Chattel Mortgage Law, Act No. 1508, as amended.³ Together with these, there exists an extensive array of judicial decisions on pledges and chattel mortgages issued by the Supreme Court over many decades, further refining the rules on these types of security devices, such as a pledge not being valid without actual possession,⁴ and the difference between a chattel mortgage of a vessel and a chattel mortgage of another personalty.⁵

Though such rules have been in place for a considerable amount of time, their widespread application and enforcement in secured transactions in the Philippines have engendered a generally uniform set of concerns for lenders and the lawyers who advise them. Principally, these would be as to: (a) the ability to unqualifiedly ascertain whether personal property are encumbered by an existing lien, and (b) whether a lienholder can be fully assured that its lien is in fact a first priority security interest.

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1. HECTOR S. DE LEON & HECTOR M. DE LEON, JR., *COMMENTS AND CASES ON CREDIT TRANSACTIONS* 402 (2016 ed.).
 2. An Act to Ordain and Institute the Civil Code of the Philippines [CIVIL CODE], Republic Act No. 386, arts. 2093–2123 (1950).
 3. An Act Providing for the Mortgaging of Personal Property, and for the Registration of the Mortgages so Executed [Chattel Mortgage Law], Act No. 1508 (1906) (as amended).
 4. *Pacific Commercial Co. v. National Bank*, 49 Phil. 236, 242 (1926).
 5. *Philippine Refining Co., Inc. v. Jarque*, 61 Phil. 229, 232 (1935) (citing *Rubiso and Gelito v. Rivera*, 37 Phil. 72, 76 (1917) & *Arroyo v. Yu de Sane*, 54 Phil. 511, 517 (1930)).

The challenge in the ability to definitively determine if personal property is encumbered by a pledge or a chattel mortgage arose essentially from the manner by which perfection of these security interests was achieved, taking into account as well extant conditions of the country's information systems.

In the case of a pledge, on top of documentation formalities,⁶ perfection is accomplished by an actual or constructive delivery of the pledged property to the creditor or obligee, or to an agreed third party.⁷ This manner of perfection does not lend itself easily to a discovery of the existence of a pledge by persons not parties to the pledge transaction. For one thing, there is no mandatory public and searchable registry of pledges under Philippine law. In addition, even if it is the case that the instrument creating the pledge must be contained in a notarized (and, hence, public) document, there is likewise no easily accessible public and searchable registry of notarized instruments.

It is for this reason that parties to a pledge transaction are constrained to rely on contractual representations and warranties of the pledgor and legal remedies against contract breaches.

In the case of chattel mortgages, a registration in a publicly accessible chattel mortgage registry is necessary to perfect a chattel mortgage.⁸ The exceedingly numerous chattel mortgage registries, however, are scattered all over the country, administered by each office of registers of deeds located generally in each city and province in the Philippines. Thus, in order to be able to conduct a search on existing chattel mortgages on specific personal property, one would have to undertake extensive physical due diligence investigations on every such chattel mortgage registry.

Consider this challenge in addition to the fact that the entries in chattel mortgage registries were, for a long time, in handwritten form without an efficient indexing of all annotations. These conditions and constraints did not allow unqualified legal counsels' opinions to be given on whether personal property was free of, or subject to, a chattel mortgage.

These complications elevated when the same personal property became the subject of multiple liens, whether of the same or different type of security interest. In particular, in the event that personal property was subject to several

6. CIVIL CODE, art. 2096.

7. *Id.* art. 2093.

8. Chattel Mortgage Law, § 4.

encumbrances, ascertaining priority among them was not effortless — much less, automatic.

The hornbook rule in the Philippines is that among several liens on the same property, priority is determined based on the time of perfection — whether the lien was created by way of a chattel mortgage or by a pledge. Given the different modes by which a perfected security interest could be created, one can appreciate the challenges to arriving at conclusive determinations as to priority. In the absence of a single registry that could provide ready and binding information as to the sequential order of the creation of security interests on movable property, it would be essential to introduce proof of relevant facts, which is a decidedly more cumbersome process.

II. ENTER THE PERSONAL PROPERTY SECURITY ACT

On 17 August 2018, the Congress approved Republic Act No. 11057 which law bore the sesquipedalian title, “An Act Strengthening the Secured Transactions Legal Framework in the Philippines, Which Shall Provide for the Creation, Perfection, Determination of Priority, Establishment of a Centralized Notice Registry, and Enforcement of Security Interests in Personal Property, and for Other Purposes.”⁹

The title of the statute evinces an appreciation by the lawmakers of the extant challenges to unqualifiedly ascertaining the existence and priority of liens over personal property and hints at the introduction of a national and unified registry system as a solution that would finally permit such conclusive determinations to be made.

In the statement of the statute’s Declaration of Policy, it is evident that the expectation is for an increase in creditor comfort that would in turn result in heightened willingness to finance against the security of personal property, which is perceived to be the readily available collateral that micro, small, and medium scale enterprises possess.¹⁰

9. An Act Strengthening the Secured Transactions Legal Framework in the Philippines, Which Shall Provide for the Creation, Perfection, Determination of Priority, Establishment of a Centralized Notice Registry, and Enforcement of Security Interests in Personal Property, and for Other Purposes [Personal Property Security Act], Republic Act No. 11057 (2018).

10. *Id.* § 2.

“It is the policy of the State to promote economic activity by increasing access to least cost credit, particularly for micro, small, and medium enterprises (MSMEs), by establishing a unified and modern legal framework for securing obligations with personal property.”¹¹

Senator Paolo Benigno A. Aquino IV described the objectives of the Personal Property Security Act, and its domino effects in his sponsorship speech for this legislative measure —

This measure will encourage financial institutions to lend to more Filipinos by, one, expanding what banks consider as acceptable collateral and, two, reducing the risks associated to movable collaterals.

First, this measure will broaden the utilization of movable assets like bank accounts, accounts receivable, inventory, equipment, vehicles, agricultural products, and even intellectual property rights.

...

The major challenge of this measure, and those tasked to implement it would be to reduce the risk of accepting movable collaterals through an efficient, comprehensive, and centralized registry.

The Personal Property Security Act pursues the design, establishment, and operation of a unified, centralized, online notice-based national collateral registry to assure banks that the collateral being submitted has not been utilized for another loan.

...

With the Personal Property Security, our financial institutions increase their income by issuing more loans, Filipinos will have better access to lower-interest loans, and more Filipino families can grow their business and livelihood for a brighter future.¹²

In sum, the principal author of the Personal Property Security Act pinned his hopes on the certainty and stability that a centralized registry for the recording of publicly accessible information with respect to security interests

11. *Id.*

12. Paolo Benigno Aquino IV, Senator, *Co-Sponsorship Speech: Senate Bill No. 1459 or the Personal Property Security Act*, Sponsorship Speech Delivered at the 17th Congress, Senate of the Philippines (May 22, 2016) (transcript available at <https://www.bamaquino.com/co-sponsorship-speech-senate-bill-no-1459-personal-property-security-act> (last accessed Nov. 30, 2019)).

on personal property will engender, as the key to increasing the credit ratings of smaller borrowers.¹³

As will be pointed out hereunder, however, the new law provides a legal framework that may fall short of that objective in that the registry for security interests in personal property may not be as “central” as the sponsorship speech may make one believe.

III. TYPES OF COLLATERAL COVERED

The Civil Code provides that “[a]ll movables which are within commerce may be pledged, provided they are susceptible of possession.”¹⁴ These would include “[i]ncorporeal rights, evidenced by negotiable instruments, bills of lading, shares of stock, bonds, warehouse receipts and similar documents[.]”¹⁵

A chattel mortgage, on the other hand, could be constituted on all kinds of personal properties.¹⁶

Similarly, the Personal Property Security Act extends its application to all types of movable property whether tangible or intangible.¹⁷ An express statutory exclusion is made, however, with respect to aircraft and ships, the creation, perfection, and enforcement of security interests over which will continue to be governed by existing special laws.¹⁸

While all types of personal property (other than aircraft and ships) may be subjected to a security interest under the Personal Property Security Act, the manner by which such security interest may be created and perfected varies depending on the type of personal property that is given as collateral.¹⁹

Accordingly, the new law separately identifies and contains special requirements, with respect to personal property consisting in intermediated

13. *Id.*

14. CIVIL CODE, art. 2094.

15. *Id.* art. 2095.

16. Chattel Mortgage Law, § 2.

17. Personal Property Security Act, § 4.

18. *Id.*

19. *See* Personal Property Security Act, § 5.

securities.²⁰ Intermediated securities pertain to securities or investment properties as to which there is a securities intermediary in constructive possession of such collateral.²¹ In contrast, non-intermediated securities refer to securities in respect of which there is no securities intermediary.²²

Similarly, the Personal Property Security Act specially treats of personal property, consisting of deposit accounts maintained with banking institutions.²³ In the past, there were gray areas in the matter of whether or not a pledge or chattel mortgage could be constituted over a bank deposit account. Under the new law, however, it is clear that the bank deposit accounts may be encumbered with a security interest.²⁴

Commodity contracts — which are contracts that deal with commodities that are traded in a commodity exchange — are likewise personal property that are given special mention and treatment under the new law.²⁵

In addition, accounts receivable and goods that are the subject of a purchase money security interest are also specially treated in the Personal Property Security Act.²⁶

Finally, the law provides that the identifiable or traceable proceeds from the sale of collateral subject to a security interest may themselves be considered as personal property susceptible of being encumbered by the same security interest constituted upon the collateral that was sold.²⁷

That there are various special rules within the same statute that exclusively apply to special kinds of collateral suggest that the expressed legislative policy

20. Personal Property Security Act, § 3 (b) (1).

21. *Id.*

22. *Id.* § 3 (d).

23. *Id.* § 3 (b) (2).

24. *Id.* §§ 3 (b) (2); 12-13 (a); & 18 (a)-(d).

25. *Id.* § 3 (b) (3).

26. Personal Property Security Act, §§ 3 (c) (3); 3 (j); & 23.

27. *Id.* § 8 (a).

to establish “a unified and modern legal framework for securing obligations with personal property”²⁸ may actually be compromised by the statute itself.

IV. PARTIES TO A SECURITY INTEREST TRANSACTION

The typical secured transaction contractual structure requires an underlying principal contract in respect of which a subsidiary security contract provides protection against a failure to perform.²⁹

Consistent with this basic structure, the Personal Property Security Act describes the following as the relevant parties in a security contract and sets out in its provisions their respective rights and obligations.

A. Grantor

A grantor is the person (who may or may not be the debtor or obligor in the underlying principal contract) “who grants a security interest in collateral[.]”³⁰ That is to say, the equivalent of a pledgor in a pledge and a mortgagor in a chattel mortgage.

In addition, however, the law includes as grantors:

- (1) “[a] buyer or other transferee of a collateral that acquires its right subject to a security interest;”³¹
- (2) “[a] transferor in an outright transfer of an accounts receivable;”³² or
- (3) “[a] lessee of goods.”³³

To be sure, the statutory definition could be more precise.

28. *Id.* § 2 (emphasis supplied).

29. Cornell Law School Legal Information Institute, Secured Transaction, *available at* https://www.law.cornell.edu/wex/secured_transaction (last accessed Nov. 30, 2019).

30. Personal Property Security Act, § 3 (c) (1).

31. *Id.* § 3 (c) (2).

32. *Id.* § 3 (c) (3).

33. *Id.* § 3 (c) (4).

A grantor as a “buyer or other transferee of a collateral that acquires its right subject to a security interest”³⁴ should pertain to any person who acquires collateral that is subject to a lien in that the lien, consistent with the universal notion of a perfected security interest, should attach to the collateral regardless of its subsequent ownership. Thus, the creditor or obligee may enforce the security interest against the encumbered collateral without concern as to any subsequent voluntary dealings on such personal property.³⁵

On the other hand, the inclusion in the definition of a grantor of “[a] transferor in an outright transfer of an accounts receivable”³⁶ may engender a bit of confusion. The concept of a security interest, as inherent in both a pledge and a chattel mortgage, is that a secured creditor and obligee receives an assurance that there is property that can be proceeded against in satisfaction of a principal obligation.³⁷ The right of the secured party is in essence then not on the original pledgor or mortgagor necessarily but on the collateral.

In the foregoing provision of the Personal Property Security Act, however, the original grantor (i.e., who constituted the security interest on collateral consisting of receivables) will remain to be a grantor even if the encumbered receivables have been transferred by him to another person and even if such transfer of the collateral was on an “outright transfer” basis.³⁸

Finally, the new law rather hastily includes a “lessee of goods” as a grantor seemingly suggesting, perhaps unfairly, that all such lease transactions are disguised security interest transactions.³⁹

B. Secured Creditors

The secured creditor is the person for whose benefit a security interest was created.⁴⁰ While such statement would have generally been simple yet sufficient, the framers of the law added that “[f]or the purposes of registration

34. *Id.* § 3 (c) (2).

35. *Id.* § 46 (a).

36. Personal Property Security Act, § 3 (c) (3).

37. Cornell Law School Legal Information Institute, *supra* note 29.

38. Personal Property Security Act, § 3 (c) (3).

39. *Id.* § 3 (c) (4).

40. *Id.* § 3 (i).

and priority only, [a Secured Creditor] includes a buyer of account receivable and a lessor of goods under an operating lease for not less than one (1) year.”⁴¹

The definition of “secured creditor” may be somewhat unfortunate in its language in that it implies that in all cases of title-transferring assignments of accounts receivable and short-term operating leases, the buyer and lessors, respectively, will at all times be deemed as a secured creditor having the benefit of a security interest.⁴²

C. Intermediaries

The Personal Property Security Act also grants and imposes certain rights and obligations upon intermediaries, whether securities intermediaries such as brokers and dealers and deposit taking institutions (i.e., banks) who have possession of specific types of encumbered personal property.⁴³ Interestingly, such intermediaries may be given preferential rights over the secured collateral that may be superior to the security interest of the secured creditor.⁴⁴

D. Registry

The Personal Property Security Act introduces into the personal property security interest regime a “centralized and nationwide electronic registry [to be] established in the Land Registration Authority (LRA) where notice[s] of [] security interest[s] and [] lien[s] in personal property may be registered[.]”⁴⁵

As intimated earlier and as will be discussed subsequently, the registry would have served an extremely efficient way of ascertaining if specific personal property is encumbered by a security interest. However, the provisions of the new law appear to make it possible for certain types of security interests to have priority even if not registered in the registry or done so at a later date to earlier registrations over the same property.⁴⁶

41. *Id.*

42. *Id.*

43. *Id.* § 3 (b).

44. Personal Property Security Act, § 18 (a).

45. *Id.* § 3 (h).

46. *Id.* § 18.

V. CREATING THE SECURITY INTEREST

The meat of the Personal Property Security Act is in the aspects of creating, perfecting, and enforcing security interests in personal property.

A security interest is “a property right in collateral that secures payment or other performance of an obligation, regardless of whether the parties have denominated it as a security interest, and regardless of the type of asset, the status of the grantor or secured creditor, or the nature of the secured obligation[.]”⁴⁷

A security interest over personal property is created by the relevant parties’ execution of a security agreement.⁴⁸ It is essential for this purpose that the written agreement clearly evinces the intent of the parties to create a security interest whether on existing personal property or future personal property although in this latter case, the actual security interest arises only when the grantor acquires the same as well as the power to encumber it.⁴⁹

The collateral subject of the security agreement must be sufficiently described as to enable the parties to identify the same.⁵⁰

The law also provides the relatively novel concept that the security interest in the collateral described in the security agreement extends to “identifiable or traceable proceeds” generated from the sale of the encumbered collateral.⁵¹ Under the laws on pledge and chattel mortgage, no such extension is automatically enjoyed by the secured creditor because the creditor’s interest attached to the encumbered collateral itself regardless of who takes ownership thereof subsequent to the perfection of the lien.

Note, however, that even as the security interest of the secured creditor extends to the identifiable or traceable proceeds, the “security interest shall continue in [the] collateral notwithstanding sale, lease, license, exchange, or other disposition of the collateral,”⁵² except if the buyer (or lessee) acquired

47. *Id.* § 3 (j).

48. *Id.* § 5.

49. *Id.* § 5 (b).

50. Personal Property Security Act, § 7.

51. *Id.* § 8 (a).

52. *Id.* § 9.

the same without knowledge of an unregistered security interest (even if perfected) or if otherwise agreed by the parties.⁵³

Effectively, the Personal Property Security Act enables the security interest of the secured creditor to expand so as to encompass both the proceeds of a sale of the collateral as well as the collateral itself.

VI. PERFECTING A SECURITY INTEREST

The concept that an unperfected security interest is valid and binding only between the parties is maintained under the Personal Property Security Act.⁵⁴ Conversely, upon “perfection, a security interest becomes [binding on] third [persons].”⁵⁵

The new law prescribed three modes by which a security interest can be perfected — registration in the registry, possession of the collateral by the secured creditor, or by control by an intermediary.⁵⁶ Security interests in tangible assets “may be perfected by registration or possession”⁵⁷ while perfection of security interests over collateral in the form of “investment property [or] deposit account[s] may be [achieved] by registration or control.”⁵⁸

A. Perfection by Registration

As mentioned earlier, the registry is to be “established and administered by the [Land Registration Authority]”⁵⁹ and will provide for an electronic means for registering searchable security interests over personal property.⁶⁰ The documents filed with the registry in order to register, amend, or terminate

53. *Id.* §§ 9 & 21.

54. *Id.* § 11 (b).

55. *Id.*

56. Personal Property Security Act, § 12.

57. *Id.* § 12.

58. *Id.*

59. *Id.* § 26 (a).

60. *Id.* § 26 (b).

security interests constitute public records and the registry's electronic records themselves constitute official records.⁶¹

A security interest is registered by the filing of a notice that

- (1) “identifies the grantor by an identification number[;]”⁶²
- (2) “identifies the secured creditor ... by name;”⁶³
- (3) “provides an address for the grantor and the secured creditor[;]”⁶⁴
- (4) “describes the collateral;”⁶⁵ and
- (5) confirms the tender of the prescribed fees.⁶⁶

The filing of such notice must have been authorized by the grantor in the security agreement or other written instrument.⁶⁷ Curiously, however, Section 28 (e) of the Personal Property Security Act states that “*a notice of lien may be registered by a lien holder without the consent of the person against whom the lien is sought to be enforced.*”⁶⁸ It remains unclear how those two provisions harmonize although it is submitted that the perfection of a security interest should require the consent of the parties to the security agreement.

The notice of security interest (hence, the security interest itself) becomes effective at the time it is “discoverable” in the registry.⁶⁹ It will remain “effective for the duration of the term indicated in the notice” unless otherwise extended or terminated by a subsequent filed notice.⁷⁰

61. *Id.* § 27.

62. Personal Property Security Act, § 28 (a) (1).

63. *Id.* § 28 (a) (2).

64. *Id.* § 28 (a) (3).

65. *Id.* § 28 (a) (4).

66. *Id.* § 28 (a) (5).

67. *Id.* § 28 (c).

68. Personal Property Security Act, § 28 (e) (emphasis supplied).

69. *Id.* § 30 (a).

70. *Id.* § 30 (b).

An amendment notice is permitted to be filed in the registry which may include an amendment caused by including additional collateral in the coverage of the existing security interest or by including an additional grantor.⁷¹ In these cases, the amendment notice becomes “effective [in respect of] the additional collateral or grantor from the date of [] registration” of the amendment notice.⁷²

An amendment notice is “effective only as to each secured creditor who authorizes it.”⁷³

In the event an amendment to the notice is warranted and the secured creditor disputes the same (as for instance there is a discrepancy in the collateral covered or compliance with the terms of the security agreement), the grantor may proceed to court to secure a coercive order for an amendment notice to be filed.⁷⁴

A security interest may be terminated with the filing with the registry of a termination notice.⁷⁵ A grantor may even seek the intercession of a court in case a termination notice is refused to be filed in proper cases.⁷⁶ However, while unmentioned in the Personal Property Security Act, it is submitted that a security interest should also be deemed legally terminated once the secured principal obligation has been fulfilled.

B. Perfection by Possession

The Personal Property Security Act provides that a security interest over personal property may be perfected by “possession of the [encumbered] collateral by the secured creditor[.]”⁷⁷ As the new law does not provide any limitation, such perfection should ensue whether the possession is actual or constructive.

71. *Id.* § 32 (e).

72. *Id.*

73. *Id.* § 32 (d).

74. Personal Property Security Act, § 39.

75. *Id.* § 34.

76. *Id.* § 42 (a).

77. *Id.* § 12 (b).

C. Perfection by Control

Under the Personal Property Security Act, a security interest in personal property consisting of deposit accounts or investment properties may be perfected by control through (a) “[t]he creation of the security interest in favor of the deposit-taking institution or the intermediary;”⁷⁸ (b) “[t]he conclusion of a control agreement”⁷⁹ over the collateral; or (c) “[f]or [] investment property that [are] electronic securit[ies] not held with an intermediary, the notation of the security interest in the books maintained by or on behalf of the issuer for the purpose of recording the name of the holder of the securities.”⁸⁰

A “control agreement” is a written agreement among securities or commodity intermediary or a deposit-taking institution, as the case may be, and the grantor and secured creditor under which the intermediary or deposit-taking institution “agrees to follow the [unilateral] instructions [of] the [S]ecured [C]reditor” with respect to the secured collateral.⁸¹

VII. RULES ON PRIORITY

Perfection is the act that binds the whole world to the security interest enjoyed by a secured creditor.⁸² Among secured creditors who claim to have a security interest in the same collateral, priority is determined on the basis of the time of perfection with the earlier in time being preferred.⁸³

Under the old personal property security regime, where personal property could be encumbered generally under a pledge or a chattel mortgage, in the event the same property is subjected to multiple liens whether of the same or different kinds of security arrangements (i.e., whether pledge or chattel mortgage), priority is ascertained on the basis of the time of perfection.

While that concept is not set aside completely by the Personal Property Security Act, the new law introduces rules of priority that grant preferences in

78. *Id.* § 13 (a) (1).

79. *Id.* § 13 (a) (2).

80. Personal Property Security Act, § 13 (a) (3).

81. *Id.* § 3 (b) (1)-(2).

82. *Id.* § 11 (b).

83. *Id.* § 17.

certain instances, on the basis of who is the secured creditor in possession or control of the collateral or by what means perfection was achieved.⁸⁴ In other words, there may be occasions where a subsequently perfected security interest may have priority over an earlier one.

In line with the law:

- (1) Where the security interest is over collateral that is a deposit account, if the secured creditor is the deposit-taking institution or the Intermediary, such secured creditor “shall have priority over any competing security interest perfected by any method.”⁸⁵ Thus, a deposit-taking institution or Intermediary will always be assured of a first claim on deposit accounts even if a security interest thereon had earlier been given to, and perfected in favor of, another party.

Moreover, a “security interest in a deposit account or investment property ... perfected by control shall have priority over a competing security interest” perfected by another means subject to the preferential rights of the deposit-taking institution or intermediary.⁸⁶

- (2) “A security interest in a security certificate perfected by the secured creditor’s possession of the certificate shall have priority over a competing security interest perfected by registration of a notice” of a security interest over the same collateral in the registry, even if the registration was of a date earlier than the grant of possession.⁸⁷
- (3) A security interest in collateral consisting of “electronic securities not held with an intermediary [which is] perfected by a notation of the security interests in the books ... of the issuer [of such electronic security,] shall have priority over a security interest in

84. *Id.* § 18.

85. *Id.* § 18 (a).

86. Personal Property Security Act, § 18 (b).

87. *Id.* § 18 (e).

the same electronic securities perfected by any other method” such as by control or registration.⁸⁸

In addition, “[a] security interest in electronic securities not held with an intermediary [which is] perfected by [control] shall have priority over a security interest in the same [electronic] securities perfected by registration of a notice in the [r]egistry.”⁸⁹

- (4) A security interest in an instrument or negotiable document that is perfected by possession shall have priority over a security interest in the same instrument or negotiable document that is perfected by registration — even an earlier registration to the date of possession.⁹⁰

The foregoing are examples of situations in which the law grants priority rules that do not follow a priority in time rule. The Personal Property Security Act includes some other situations for which special priority rules apply such as in the case of “purchase money security interests” and security interests over livestock.⁹¹

As mentioned earlier, once perfected, the lien on the collateral remains attached to the personal property despite its subsequent transfer to another person.⁹² Moreover, the security interest extends to the proceeds realized by the original grantor from such sale.⁹³

However, the Personal Property Security Act states that “[a]ny party who obtains, in the ordinary course of business, any movable property containing a security interest shall take the same free of such security interest, provided he was in good faith. No such good faith shall exist if the security interest in the movable property was registered prior to his obtaining the property.”⁹⁴

88. *Id.* § 18 (f).

89. *Id.* § 18 (g).

90. *Id.* § 19.

91. *Id.* §§ 23-24.

92. Personal Property Security Act, § 9.

93. *Id.* § 8 (a).

94. *Id.* § 21.

This provision thus indicates that despite the means by which perfection is attained, registration of the security interest with the registry is vital in order not to lose the security interest when the encumbered collateral is transferred to a purchaser who, in good faith, is unaware of the existence of the security interest.⁹⁵ To the extent then that perfection is supposed to assure the secured creditor of a right to proceed against personal property over which the secured creditor enjoys a perfected security interest, that new provision of law renders such perfected security interest vulnerable. This is a new concept altogether in the world of secured financing.

VIII. ENFORCEMENT OF SECURITY INTERESTS

Under the previous personal property security regime, in order to enforce a pledge or a chattel mortgage, a foreclosure sale was necessary, which was required to be at a public auction.⁹⁶ There were likewise rules as to whether or not deficiency judgments were allowed (not allowed in foreclosures of pledges)⁹⁷ in case the proceeds from the public sale were insufficient to satisfy the secured obligation. There were also provisions that governed any redemption rights that the owner of the personal property sold at a foreclosure sale may be entitled to.

Similar to these old laws, the Personal Property Security Act provides for enforcement rules. There are certain notable departures, however, from the laws that governed enforcement of pledges and chattel mortgages.

A. Disposition or Retention of Collateral

Upon a default in the obligation in respect of which a security interest over personal property was created and perfected, the secured creditor has the right to undertake a commercially reasonable public sale, or private sale if the “collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed price quotations.”⁹⁸ The new law permits a

95. *Id.*

96. CIVIL CODE, art. 2112.

97. *Id.* art. 2115.

98. Personal Property Security Act. § 49.

private sale to be conducted provided there is an established means for determining market value.⁹⁹

The successful buyer at such enforcement sale will take the collateral free from any security interest.¹⁰⁰

In the event the proceeds generated from the sale exceed the amounts owed, “[t]he secured creditor shall account to the grantor for any surplus[.]”¹⁰¹ Conversely, if the proceeds are insufficient, unless otherwise agreed, the debtor will continue to be liable for any deficiency.¹⁰² This ability to claim any deficiency from the debtor has addressed one of the pressing concerns regarding enforcement of pledges in that the laws on pledge did not permit the secured party to claim any deficiency.

Regardless of the manner of enforcement sale chosen, the secured creditor is required to provide a disposal notice to the grantor, other secured creditors and others who may have timely expressed having claims over the collateral to be sold.¹⁰³ The disposal notice must identify such persons, the collateral, the method and details of the intended disposition.¹⁰⁴

In a reversal of the *pactum commisorium* prohibition, the Personal Property Security Act now expressly allows a secured creditor to retain the collateral in satisfaction of the obligation owed to it provided such retention results from an approved proposal given prior to the retention by the secured creditor to the grantor, other secured creditors, and other claimants.¹⁰⁵

99. *Id.* § 49 (b).

100. *Id.* § 53 (a).

101. *Id.* § 52 (b).

102. *Id.*

103. *Id.* § 51 (a).

104. Personal Property Security Act, § 51 (c).

105. *Id.* § 54.

B. Right of Redemption

A right of redemption is available to the grantor, other secured creditors, and other claimants to the collateral.¹⁰⁶ Such right of redemption is exercised by the full payment or performance of the secured obligation.¹⁰⁷

The right of redemption must be exercised before the earlier of the date when “the collateral is sold[,] ... disposed of, ... or retained by the secured creditor or [of] the conclusion of an agreement by the secured creditor” for the sale or disposition of the collateral.¹⁰⁸

In the event an enforcement sale was commenced by a junior secured creditor, the senior secured creditor has the statutory right to take over the enforcement process.¹⁰⁹

C. Special Enforcement Rules

The law provides for certain special rules that apply in the enforcement of security interests if the collateral consists of particular kinds of personal property.¹¹⁰

Thus, where the collateral over which the security interest was created consists of assigned receivables, the secured creditor may provide instructions to the account debtors of such receivables to pay the sums due under their accounts directly to the secured creditor.¹¹¹

Where the encumbered collateral are negotiable documents the security interest over which had been perfected by possession, the secured creditor may “proceed [on the] negotiable document [itself] or [on the] goods covered by the negotiable document[s.]”¹¹²

106. *Id.* § 45.

107. *Id.* § 45 (a).

108. *Id.* § 46 (b).

109. *Id.* § 46 (a).

110. Personal Property Security Act, § 48.

111. *Id.* § 48 (a).

112. *Id.* § 48 (b).

Where the collateral involved are deposit accounts, a direct set-off is allowed if the secured creditor is the deposit-taking institution.¹¹³ Alternatively, the secured creditor enjoying a security interest over a deposit account may, consistent with the applicable control agreement, “instruct the deposit[]taking institution to [directly] pay” the secured creditor from amounts on deposit in such accounts.¹¹⁴

IX. WHERE TO NOW?

Despite the enactment into law of the Personal Property Security Act and the subsequent issuance by the Department of Finance in October 2019 of its enabling regulations, its full implementation is still subject to the establishment and full operation of the registry by the Land Registration Authority.¹¹⁵

In the meantime, existing pledges and chattel mortgages remain in legal effect and priority and, when the Personal Property Security Act is eventually implemented, will continue as such if it is perfected in accordance with the new law.¹¹⁶

There is likely going to be a phase of implementation clumsiness when the law finally takes effect because of the shifts in long-established paradigms stemming from the novel concepts that it has introduced. A considerable period of growing pains and learning curves may be the order of the day as the financial community gets used to the new regime.

Included in the aspects that will expectedly require clarification is how to deal with arm’s length outright assignments of receivables and short-term leases of goods which the law appears to conclusively characterize as security arrangements rather than pure sales and leases.

The Philippine financial market, including financing companies and credit investigation agencies among others, will have to bid goodbye to the pledge and chattel mortgage era and get used to a new system where priority in time rules do not always apply depending on the secured creditor and personal properties involved. It is not anticipated that lenders will abandon their boilerplate checklist requirement for contractual representations and

113. *Id.* § 18 (c).

114. *Id.* § 48 (d).

115. *Id.* §§ 26 & 68.

116. Personal Property Security Act, §§ 55-58.

warranties from grantors affirming the absence of liens on collateral given that the searchable registry would not be conclusive as to assets being free from security interests.

It would be interesting to observe whether lenders would still derive comfort from imposing a lien on bank deposits considering that if a bank, even subsequently, becomes a secured creditor of the same grantor, then the bank's security interest may trump that of the earlier lender.

Thus, as to whether or not the new legislative enactment will genuinely advance its avowed policies and result in “encourag[ing] financial institutions to lend to more Filipinos by, one, expanding what banks consider as acceptable collateral and, two, reducing the risks associated to movable collaterals[,]”¹¹⁷ time, and perhaps a lot of it, will be needed to be able to tell.

¹¹⁷. Aquino, *supra* note 12.