

## Ratio Legis of Using Cross Collateral and Cross Default Clauses in Banking Credit Contract

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### Abstract

Existence and growth of business has been dominated by the banking system, as a buffer of economic system. There is a rapid development, due to the growth of banking industry. One of the things that develops rapidly, are the clauses in the standard contract on Banks's Credit Contract, for example cross collateral and cross default clauses. The existence of cross collateral and cross default clauses, tangent to issues of fairness in contract especially in the field of Bank's Credit. This research aims to *ratio legis* of using cross collateral and cross default clauses in Bank Credit contracts. This research used normative legal research methods, with statute approach, conceptual approach, case approach, philosophical approach, and comparative approach. *Ratio legis* of using cross collateral and cross default clauses in Bank's Credit contracts are as a strict implementation of prudential Banking principles, intend to emphasize the certainty of Debtor in fulfilling all contractual obligations to the Bank, and for the efficiency of the Bank's business activities, which must be based on good faith.

**Keywords:** cross collateral, cross default, contract, Credit, fairness

### 1.1. Introduction

The main principle of every economic activity is to balance the extensive needs of legal subjects, with limited resources. This encourages the effort in realizing an ideal economy, as envisioned in the Written Constitution of the Republic of Indonesia, namely in Fourth Paragraph of the Opening of 1945 Constitution of the Republic of Indonesia (UUD NRI 1945). It emphasizes on one of the Republic of Indonesia's foundations, which is social justice that animates the spirit of Indonesian Independence. Oppression in any case, including in economic activities, is something that is explicitly fought as mandated by the UUD NRI 1945 itself.

Refer to the philosophy of social justice above, has been more concretized in the provisions of Article 33 of the UUD NRI 1945, which mandates the fairness in the national economy that will leads to social welfare. In accordance with the aforementioned provision, the national economy needs to be constructed as a joint effort based on the principles of togetherness, and must be carried out on the basis of economic democracy with the principles of togetherness, fairness, sustainability, environmental insight, independence, and by maintaining the national economic growth and unity, which will be further realized through the Legislation (the Act). The effort in realizing the UUD NRI 1945 has been carried out through various institutions of national legislation, replacing colonial law that has the nature of capitalist idealism and tend to be oppressive.

Indonesian economy growth is still dependent and dominated by the financial services sector, particularly the Banking sector. Bank is a financial intermediary institution, which means Banks have the right to channel funds from parties who have surplus capital to parties who request the funding facility. With such characteristics, Banks grow rapidly and become institutions that offer massive funding facility.

At present, Otoritas Jasa Keuangan (OJK) supervises the Banking Industry in Indonesia based on The Act Number 21 of 2011 concerning the Financial Services Authority (the Act of OJK). It is obvious that Bank, a vast Financial Intermediary Institution is vulnerable to the practices that may cause *moral hazard*. In addition, the optimal protection of Financial Services consumers is one of the fundamental purposes of the Act of OJK.

In fact, legal subjects have various kinds of consumptive and productive needs, especially the business entities. Hence, legal subjects strive in order to meet these needs. This encourages the entities to seek sources of financing from third parties. Therefore, the entities frequently target the Financial Services Institutions, especially the Banking sector to fulfill the needs. Banks offer numerous Credit facilities, which are Working Capital Loans (WCL), Investment Loans (IL), Non Cash Loan Facilities, and Treasury Line. Each of the

Banking Credit Facilities offers different functions and benefits, which attract Debtor to request an agreement with the Bank.

The provision of the Credit Facilities require a series of complex and long process, which will be concluded with the signing of Credit Agreement. It is due to the Bank being bound by the Banking Law, the prudential principles in accordance with Article 2 of Act Number 7 of 1992 concerning the Banking in conjunction with Act Number 10 of 1998 concerning the Amendments of Act Number 7 of 1992 concerning the Banking (the Act of Banking).

In general, Banks prepare and apply each of the Credit contract in the standard form contract. Thus, the Banking Credit contract is being referred as standard contract. The Credit contract contains the terms and conditions for granting the Credit Facility. Yet, it is not exceptional for Banks to add oppressive clauses for the Debtor, including the cross collateral and cross default clauses.

Both clauses are frequently juxtaposed in the substance of the Credit contract where the Debtor is granted for more than 1 (one) Credit Facility. Cross collateral clause is unable to be separated from the existence of cross default clause, although the cross collateral clause is an additional clause concerning the security (collateral) to the principal contract namely the Banking Credit contract. Therefore, Debtors cannot avoid the existence of the cross collateral and cross default clauses in the Banking Credit contract.

The problem occurs due to a legal vacuum in the Indonesia Regulations regarding the regulations of cross collateral and cross default clauses. Banks, adhere to the principles of freedom of contract and *pacta sunt servanda* tend to demand the Debtors to approve the implementation of cross collateral and cross default clauses in the Banking Credit contract. Accordingly, Debtors, who do not have any adequate choice and tend to be in a weak position, will accept the cross collateral and cross default clauses. This reality, like a cycle that never ends and is always repeated.

## 1.2. Legal Issue

Based on the introduction above, a legal issue can be formulated, namely: “What is *ratio legis* of using cross collateral and cross default clauses in Banking Credit contract?”

## 1.3. Theoretical Basis

### 1.3.1. Theory of Justice

Justice is the center theme of Law. It has close relationship as the aim of law is justice. “The aim of law cannot be separated from the objective of state and social life, in which the value and philosophy of social life is justice... Thus, law exists to achieve universal happiness and prosperity of life physically and mentally.”<sup>1</sup> At present, John Rawls is acknowledged as the most revolutionary originator of the theory of justice. “Overall, ...there are three justice principles proposed by Rawls, which are Principle of: (1) equal liberty, (2) difference, dan (3) fair equality of opportunity.”<sup>2</sup>

### 1.3.2. Theory of Contract

Article 1233 of the *Burgerlijk Wetboek* (BW) regulates that each obligation occurs due to a contract or Law. According to Justinian: “...*obligatio est iuris fin culum quo necessitate adstringimur alicuius solvendae rei, secundum nostrae civitatis iura*. An obligation is a legal bond whereby whe a bound by the necessity of performing something according to the laws of our state.”<sup>3</sup> Furthermore, Article 1234 of the BW regulates several Debtor obligations, which is called *prestatie*. A business contract is undoubtedly reciprocal, thus business contract is called *Obligatoir* contract. “Obligatoir agreement, ...is an agreement that occurs as a result of a contract between two or more parties with the aim of establishing an obligation for one interest on other or reciprocity.”<sup>4</sup> Thus, a business contract aims to produce reciprocal economic *prestatie* among the parties that are legally enforceable. The responsibility is imposed to each party in the business contract.

Iti According to J.M. van Dunne, good faith in contractual relations is divided into 3 (three) phases, such as: “... pre-contract phase (*precontractuele fase*), the commencement of contract phase (*contractuele fase*), and post-contract phase (*postcontractuele fase*).”<sup>5</sup> The essence of the theory is that agreements or contracts should always

<sup>1</sup> Asep Warlan Yusuf, Law and Justice (*Hukum dan Keadilan*), PADJADJARAN Jurnal Ilmu Hukum, Volume 2 Number 1, 2015, p. 2.

<sup>2</sup> Darji Darmodiharjo dan Shidarta, Principles of Legal Philosophy (*Pokok-Pokok Filsafat Hukum*), Jakarta: Gramedia Pustaka Utama, December 2008, p. 165.

<sup>3</sup> Ph. J. Thomas, Introduction To Roman Law, Deventer: Kluwer Law and Taxation Publishers, 1986, p. 73.

<sup>4</sup> Herlien Budiono, General Doctrine of Agreement Law and Its Application in Notary Fields (*Ajaran Umum Hukum Perjanjian dan Penerapannya di Bidang Kenotariatan*), Bandung: Citra Aditya Bakti, 2011, p. 2.

<sup>5</sup> J.M. van Dunne, *Verbintenissenrecht Deel 1 Contractenrecht*, Deventer: Kluwer, 1993, p. 170 in Ridwan Khairandy, Good Faith in Contracts in Various Legal Systems (*Itikad Baik Dalam Kontrak Di Berbagai Sistem Hukum*), Yogyakarta: FH UII Press, September 2017, p. 186 (hereinafter referred to Ridwan Khairandy-I).

be based on good faith, from the beginning to the commencement.

The term “contract” is also used in Property contract. “The core understanding of the Property contract is a contract made by the parties with the aim of establishing, adjusting, or removing property rights. It can be concluded that Property contract will not develop an obligation. Thus, it is not subject to Book III BW”.<sup>1</sup> “...Actually, there are two kinds of property rights, which are property rights that provide comfort and property rights that provide security.”<sup>2</sup>

### 1.3.3. Theory of Security

“The term of security law originates from the translation of *zakerheidsstelling* or security of law.”<sup>3</sup> Generally, there are several law theories regarding the Security. “There are probably no two States in which the law of mortgages is the same in all particulars, but they may be broadly classified into three groups: (x) those in which the mortgage is held to pass the legal title to the land at its execution; (2) those in which it is held to pass the title upon default, and (3) those in which it is held to pass' no title until foreclosure. The first view is commonly called the legal or title theory and the last, the equitable or lien theory, while the second, which is maintained in only a few States, has no distinctive name.”<sup>4</sup> “A “*lien*” may therefore be a right to possession as security; it may be some other interest as security.”<sup>5</sup> In the *lien* theory, the ownership title of the collateral objects still remains with the owner of the property (mostly, the Debtor). Collateral object is restricted as Security. It means the collateral is only an anticipatory measure, not intended to be collected. In case that the Debtor defaults, then the collateral objects will be sold to pay off the Debtor’s liability.

### 1.3.4. Theory of Legal Protection

“...the most essential legal institution is the state. State is a substantial legal institution, which carries out the task of realizing the idea of law.”<sup>6</sup> In realizing the ideal legal idea, State needs to be able to develop adequate legal institutions in order to provide maximum legal protection to its citizen. “The law, in which in this case is contract, either by the authorities or the parties, seeks to create safeguard from the waves of loss that continue to lurk at all times. The security that is provided by the law in business world is basically divided into two types, which are external legal protection and internal legal protection.”<sup>7</sup>

“The fundamental understanding, of the definition of external legal protection is a statutory safeguard that is developed by the authorities through regulations in the form of legislation. In general, external legal protection is a barrier that is implemented by the lawmakers in order to prevent loss or infringement, where the market participants may potentially overwrite the contract. The availability of external legal protection is necessary for the authorities to keep the business order moving in a proper and fair corridor. In general, external legal protection is prepared by the authorities to anticipate the exploitation that may be conducted by the party that has superior *bargaining position* than the others.”<sup>8</sup>

“The nature of internal legal protection is a safeguard for the parties, that is built on a contract, to be stated in the contract clauses. It means that by making a contract, on the basis of freedom of contract, the parties may concede and develop their own safeguard. Internal legal protection can be well established considering that both parties have equal *bargaining position*. Assuming that the parties have equal bargaining position, then the contract is build on the interest of each parties appropriately, and it will ensure that the contract is fair”<sup>9</sup>

## 2. Research Methodology

### 2.1. Research Method

The research method that will be used in this analysis is the normative legal research. “...normative legal

<sup>1</sup> Moch. Isnaeni, Introduction to Security Law (*Pengantar Hukum Jaminan Kebendaan*), Surabaya: Revka Petra Media, February 2016, p. 132 (hereinafter referred to Moch. Isnaeni-I).

<sup>2</sup> Moch. Isnaeni, Property Law in *Burgerlijk Wetboek (Hukum Benda Dalam Burgerlijk Wetboek)*, Surabaya: Revka Petra Media, October 2016, p. 10 (hereinafter referred to Moch. Isnaeni-II).

<sup>3</sup> Salim H.S., Advancement of Security Law in Indonesia (*Perkembangan Hukum Jaminan Di Indonesia*), Jakarta: RajaGrafindo Persada, 2004, p. 5.

<sup>4</sup> Edgar N. Durfee, The Lien or Equitable Theory of the Mortgage-Some Generalization, *Michigan Law Review*, Volume X Number 8, June 1912, p. 587.

<sup>5</sup> Bernard C. Gavit, Under the Lien Theory of Mortgages is the Mortgage Only a Power of Sale?, *Minnesota Law Review*, Volume XV Number 2, January 1931, p. 149.

<sup>6</sup> Meuwissen, Meuwissen About Law Development, Jurisprudence, Legal Theory, and Legal Philosophy (*Meuwissen Tentang Tentang Pengembangan Hukum, Ilmu Hukum, Teori Hukum, Dan Filsafat Hukum*), Translated by: B. Arief Sidharta, Bandung: Refika Aditama, January 2013, p. 107.

<sup>7</sup> Moch. Isnaeni, Beam of Diorama Contract Law (*Seberkas Diorama Hukum Kontrak*), Surabaya: Revka Petra Media, 2017, p. 41 (hereinafter referred to Moch. Isnaeni-III).

<sup>8</sup> *Ibid.*, p. 41-42.

<sup>9</sup> *Ibid.*, p. 42.

research is a procedure of scientific research to find out the truth based on the logic of legal science from its normative side.”<sup>1</sup> The emphasis of the normative legal research is in accordance with the characteristic of jurisprudence, lies in the legal studies of positive law, in which include three layers of jurisprudence that consist of the study of legal dogmatics, legal theory, and legal philosophy.

## **2.2. Problem Approach**

In accordance with the research method which is normative legal research, the research analysis will be approached with several methods, which are statute approach, conceptual approach, case approach, philosophical approach, and comparative approach.

## **3. Research Analysis and Result**

Banks use line of credit as a way of managing and growing its customers' funds. Hence, it needs to be carried out professionally. Considering that the funds that are redistributed to the society are not from the Banks' funds but from the customers, therefore Banks have to be accountable to the customers for the line of credit that are provided to Debtors. It means that Banks have to prevent and resolve any Non Performing Loan (NPL) and debtors default. Credit control is needed in order to avoid the occurrence of NPL.

The Act of Banking instructs each Bank have to implement and apprehend prudential Banking principle in carrying out its business activities. It is a fundamental and important principle in Banks' loan disbursement to its Debtors. In general, Banks implement the prudential principle in the context of Preventive Control of Credit by applying Five C's of Credit. The substantial aspects of Debtors, including collateral, are carefully assessed by the Banks, as to uphold the prudential principle and avoid any NPL.

Based on above studies, Banks are demanded to be more innovative and thorough. Innovative and thorough is crucial to be applied to any complicated Credits, with a large amount of loan funds. The credits are mostly provided to big Companies or Corporations.

Banks need to be aware that the funds that are provided to the Debtors are from the Customers' funds. As a business institution, Banks are driven by a relatively large interest gains as the Debtors' loan portfolios are also relatively large. Yet, it certainly has greater risk potential than the credits with lesser amount and sole credit.

Banks cannot diminish any business risk. Nevertheless, the risks have to be controlled and prevented. Thus, Banks have to be extra prudent to the greater, more varied, and/or more complicated Credit products. The process of managing and preventing these risks leads to the complex process, the terms, and the conditions of credit approval and funds disbursement.

The credit approval and disbursement begins with the Credit application submitted by the Companies. Banks then conduct an audit based on the principle of Five C's of Credit, which is formally regulated in Article 8 of the Act of Banking and its Explanations. Character, Capacity, Capital, and Condition of economy of and/or related to the Companies as the Debtors, will be analyze thoroughly and separately in each Credit line requested by the Debtors. It is reasonable as Banks commonly apply segmentation and/or separation of Division, in the decision-making of each Credit products that are provided by the Banks.

After the analysis, Banks will draw the conclusions, regarding the willingness and ability of the Companies to return the loan, as well as the expected profits. Subsequently, Banks will issue Credit Facility Approval, where in Banking practice is called Letter of Offer (LO).

LO consists of the terms and conditions in the Credit contracts, such as covenant, terms of signing a Credit contract, effective terms and/or application of every Credit types, and so on. However, there are Banks that prefer other forms of Credit Facility Approval (not using LO), so that they only contain simpler information that tends to be unclear. This form do not accommodate the terms in the Credit contract. Debtors will only learn the terms of the Credit contract when they sign the contract. It is indeed unfair as the Debtors, including the Companies, are not given adequate chance to ask questions and/or object to the terms in the contract, even though it is simply to review and consider the risks that may be faced by the Companies when they are bound by the contractual relations based on the Credit contracts for each of the Bank Credit Facility.

Banks, as a business institution, have business interests that they seek to protect. Humanlike, Banks have the right to live, be free, and defend itself. Such pattern can be found philosophically in the study of John Rawls, which is justice as fairness that inspired from the theories proposed by 3 (three) major figures in law and philosophy, namely: John Locke, Jean-Jacques Rousseau, and Immanuel Kant.

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<sup>1</sup> Johnny Ibrahim, Theory & Method of Normative Legal Research (*Teori & Metode Penelitian Hukum Normatif*). Malang: Bayumedia, April 2005, p. 57 (hereinafter referred to Johnny Ibrahim-I).

John Locke proposed the theory of individual rights. Accordingly, the *Rechtsstaat* will develop laws that provide external legal protection for the legal rights of the legal subjects. The legal rights of Banks and Debtors, as legal subjects in the Credit contract, are given external legal protection in the Act of Banking. The Article 8 paragraph (2) the Act of Banking and its Explanations mandates that Commercial Banks are required to have and apply credit guidelines as stipulated by the OJK, one of which is the obligations in granting Credits in the form of written contracts. External legal protection, as regulated in the Act of Banking, instructs that Banks and Debtors form their own internal legal protection, through a written Credit contract, in the form of clauses. It is indeed an effort from the State to protect the Banks and Debtors interests.

External legal protection serves to balance the bargaining position of the parties in the Credit contract. It intends to prevent any exploitation from one of the superior parties, by not heeding the interest of inferior parties. The internal legal protection is also expected to indirectly balance the bargaining position of the parties. Internal legal protection is developed as product of agreement and presented in the Credit contract. As a result, the establishment of Credit contract has to base on the principles of contract law, which are freedom of contract, consensualism, *pacta sunt servanda*, good faith, and privity of contract.

Besides the personal interests of Banks and Debtors, the Act of Banking also serves to secure broader interests, which is the community, especially the Depositories. It is relevant to social contract theory that is proposed by the French Philosopher, Jean-Jacques Rousseau. This study is known to inspire the idea of John Rawls. The study states that humans are actually existences who are self-determined, free, and have personal interest. Yet, humans cannot live independently.

Based on the same interests of the parties and high credit risks, Banks takes more rigid and stiff attitudes. Since the LO process, Banks has conveyed that cross collateral and cross default pattern will be implemented in the Credit products. This patterns will commonly occur when the Debtor also secure other facility related with WCL, which is Non Cash loan and/or Treasury Line. The cross collateral and cross default pattern will eventually be regulated in the Credit contract, in the form of cross collateral and cross default clauses.

The Act of Banking instructs Banks to implement prudential banking principles, in which banks have to take precautionary actions to prevent Credit risks, especially Debtors, such as big Companies or Corporations that are granted with various Bank Credit Products. The pattern of cross collateral and cross default will connect the Collateral that has been submitted to the Bank with all Credit Facilities that have been granted by the Bank. Moreover, it merges into Credit and Security portfolio.

The pattern is also applied to minimize Credit risks such as destruction and/or loss of the Collateral, reluctance and/or late repayment of one or more Credit. Banks implement strict prudential Banking principle in handling these transactions. Therefore, cross collateral and cross default pattern is enforced as a commencement of strict prudential Banking principle.

Bank's perspective differs from the Debtor's perspective philosophically. As mentioned earlier, the third figure who inspires John Rawls in developing theory of justice is Immanuel Kant. He is known as ethical philosopher, with the theory named categorical imperative. "Expressed somewhat differently, the fundamental ethical proposition is that an act can be ethically justifiable only if it can be subsumed under a principle that would have universal application, that is, application in all human relationships."<sup>1</sup> Categorical imperative thus refers to objective standards. It means that someone will carry out anything or instructions when he is not being forced and feels that the thing must be done. Something is categorized as ethical when it is done without coercion, and that the person awares and willing to fulfill the responsibility. It is feasible as "Nature follows necessity, but the human mind is free because it can set itself purposes and have a free will."<sup>2</sup>

In accordance with the theories proposed by John Locke, Jean-Jacques Rousseau, and Immanuel Kant, John Rawls actually wishes to merge the 3 (three) theories. In the theory of Justice as Fairness, John Rawls wants to unite the natural human rights (proposed by John Locke), the willingness to unite and live together for the common good in a community (proposed by Jean-Jacques Rousseau), and the desire to do good deed without eliminating the freewill of human (proposed by Immanuel Kant).

The Credit contract contains the clauses of cross collateral and cross default. Philosophically, the clauses intend to emphasize the certainty of Debtor in fulfilling all contractual obligations to the Bank. The certainty is a form of compliance and respect, in carrying out the matters or obligations agreed upon and between the Debtor and Bank. It means the Debtor will perform his contractual obligations deliberately.

<sup>1</sup> Geoffrey C. Hazard Jr., Equality and Affiliation as Bases of Ethical Responsibility, *Louisiana Law Review*, Volume 61 Number 1, 2000, p. 174.

<sup>2</sup> Wolfgang Gaston Friedmann, *Legal Theory*, London: Stevens & Sons, 1960, p. 107.



The cross collateral and cross default patterns, indirectly improve the efficiency of Credit contracts in the implementation process. "If the regulatory norms specifically affect the personal interest, curiosity will further spur the individual's understanding of the rule of Law."<sup>1</sup> The norms contained in the Credit contract, including but not limited to the clauses of cross collateral and cross default, are the norms that specifically affect the personal interest of the Debtor. Debtor will consciously comply and fulfill the contractual obligations that have been agreed before. Debtor is also required to be thorough, cautious, and responsible for fulfilling the performances under the Credit contract, so that the interest of the parties concerned as the Security, Corporate Guarantee, and/or Personal Guarantee Provider are not damaged. In this regard, the fulfillment of the performances, arranged in the Credit contract, represents the attaining of the Company's responsibility to the Bank and related parties. The efficiency thus, has become the ratio of implementing cross collateral and cross default clauses in the Banking Credit contract. "...the law is better understood as a tool to promote economic efficiency."<sup>2</sup> Simple and efficient, are the major reason that cross collateral and cross default clauses are "quite popular and being implemented" in the Banking Credit contracts, in the form of standard contract.

The efficiency itself is actually the mandate of UUD NRI 1945. However, efficiency is not stand alone in the Article 33 paragraph (4) of the UUD NRI 1945. "Efficiency is a result of a competition. Yet, efficiency may lead to injustice. Therefore, the word "efficiency-fairness" unites in the formulation of Article 33 paragraph (4) of the UUD NRI 1945."<sup>3</sup>

As a Country with the *Pancasila* Economic System as its economic system, Indonesia is obliged to protect its stakeholders in its economic system, and the fair legal protection to the parties in the Banking Credit is no exception. "Moreover, in the realm of the Republic of Indonesia that is based on the *Pancasila*, it is appropriate if the Country does not allow ... the creation of a credit contract that specifically is left to unlimited mechanism of freedom of contract."<sup>4</sup>

It is undeniable that the original position condition proposed by John Rawls is not a fact but is a legal idea. Yet, only in the original position condition that 3 (three) principles of justice suggested by John Rawls, which are equal liberty, difference, dan fair equality of opportunity can be realized. The condition described and aspired by John Rawls, need to be supported by the existence of veil of ignorance, as the "driving motor (vehicle)" to the ideal condition.

In the Contract Law, the justice in contract can only be accomplished when the entire process in contractual relations is carried out fairly. In particular, the process of formulating, approving, and implementing the Credit contract have to be based on the principles applied in the Contract Law, which is the principle of freedom of contract, the principle of consensualism, and the principle of *pacta sunt servanda*. Still, there is a principle that seems to be marginalized from these 3 (three) principles, namely the principle of good faith. The principles of Contract Law cannot and should be prohibited to stand alone, without the consent from the principle of good faith.

As a principle in Contract Law, good faith is recognized in various legal systems from various countries in the world. In fact, good faith is also accepted and recognized internationally, through UNIDROIT Principles of International Commercial Contracts 2016, and United Nations Convention on Contracts for the International Sale of Goods (CISG). Yet, both UNIDROIT Principles of International Commercial Contracts 2016 and CISG, do not set out the meaning of good faith.

The similarity and difference of good faith could be expressed through a comparison of laws that have been carried out on legal norms regarding the good faith in Indonesia, England, Singapore, United States, France, Germany, and Netherlands. The similarity is that the countries recognize the existence of good faith in Contract Law. While the difference is that only 2 (two) countries provide the regulation regarding the meaning of good faith, which are United States and Netherlands.

The United States regulates the meaning of good faith as honesty in fact and observance of reasonable commercial standards of fair dealing, in the Uniform Commercial Code (UCC). Unlike the United States,

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<sup>1</sup> Johnny Ibrahim, Economic Approach to the Laws of Theory and Implications for their Application in Law Enforcement (*Pendekatan Ekonomi terhadap Hukum Teori dan Implikasi Penerapannya dalam Penegakan Hukum*), Surabaya: Putra Media Nusantara dan ITSPress, 2009, p. 68 (hereinafter referred to Johnny Ibrahim-II).

<sup>2</sup> Fajar Sugianto, Economic Approach To Law: Series of Economic Analysis of Law, Series II (*Seri Analisis Ke-ekonomian Tentang Hukum, Seri II*), Jakarta: Kencana, June 2013, p. 93.

<sup>3</sup> Jimly Asshiddiqie, Economic Constitution (*Konstitusi Ekonomi*), Jakarta: Kompas Media Nusantara, October 2016, p. 267.

<sup>4</sup> Sutan Remy Sjahdeini, Freedom of Contract and Balanced Protection for Parties In Banking Credit Contract In Indonesia (*Kebebasan Berkontrak Dan Perlindungan Yang Seimbang Bagi Para Pihak Dalam Perjanjian Kredit Bank Di Indonesia*), Jakarta: Pustaka Utama Grafiti, August 2009, p. 4.

Netherlands does not regulate the good faith literally. It classifies good faith directly as *redelijkheid en billijkheid* (reasonableness and fairness). It is very clear that in *Arrest Hoge Raad* in the case of *Hengsten Vereniging v. Onderlinge Paarden en Vee Assurantie (Artist De Laboureur Arrest)*, February 9<sup>th</sup>, 1923, NJ 1923, 676. While France is the only country that strictly regulates that good faith is compulsory in each process of negotiation, approval, and execution of contract, in Article 1104 French Civil Code.

The Contract Law theory and French Civil Code, require that good faith is very fundamental to be realized in every phase of contractual relationship. The existence of good faith is intended to ensure the achievement of fairness in contract. The principle of freedom of contract, consensualism, and *pacta sunt servanda*, will underlie every phase in the contractual relationship. The principle of good faith will then accompany each of these principles in order to achieve fairness. It is a fundamental requirement for good faith to be implemented so that the contracts can be performed and enforced in the Contract Law.

The pre-contractual phase (*precontractuale fase*) commences since the formulation of Credit contract. It can be referred as the pre-establishment stage of the Contract contract. At this stage, there are 2 (two) important things, which are negotiation process and contract formulation. The principle of freedom of contract has a major role in this stage. Still, the negotiation process on the Banking practices, often be disappear or never be done. Whether it begins with the Credit Application by the Debtor, or with the Credit Offering by the Bank, Debtor is enforced to follow and comply with the Credit terms and conditions that are applied in the Bank. Even if there is a negotiation process, it is only for immaterial and indirect matters that related to the Credit itself. In the practices, the Bank only explains the benefit of Credit products to the Debtor. There is no bilateral communication. It means that the Bank determines the direction of the communication.

As a matter of fact, cross collateral and cross default clauses are material matters related to the contracts in the Banking Credit. The cross collateral clause is an advanced stage of the Security extension. The clause is not limited to the “position” of objects as a Credit Collateral. Rather, it results in any object being a Credit Collateral for all Credit Facility will be a Security for each Credit Facility provided by the Bank to the Debtor. Meanwhile, the cross default clause is an advanced stage of the default provisions and matters categorized as event of default. The pattern stipulated in the Credit contract results in each contract having an influence on the entire Credit contract. When a matter is categorized as a default occurs, it will cause a default to other Credit contracts.

According to the principle of freedom of contract that is accompanied by the good faith principle, Banks and Debtors must jointly formulate the objective, purpose, and motive of the parties for the common interest. Debtors must be given an opportunity whether to accept or not the clauses of cross collateral and cross default in the Credit contracts. The decision, of course, has consequences, which is the Debtor have to provide the Collateral object with the sufficient amount and adequate value to be the Security for every Credit Facility. Thus, even though it is intended to build efficiency, it must be juxtaposed with the fairness. “The existence of standard contract does not mean that the clauses in the contract are fixed. It means that the door to negotiate and revise the clauses is closed. The parties or one of the parties may request to revise or change certain matters in the standard contract clause with a mutual agreement or agreed by the other party.”<sup>1</sup>

In pre-contractual phase, fairness is highly dependent on the stage of negotiation, formulation, and approving of the contract. Omitting these stages means that not only there is a party who has a bad faith, but it a fact that there is a breach of fundamental principle in the Contract Law, which is principle of freedom of contract. The meaning of good faith in Indonesia pre-contractual phase is quite similar with the meaning of good faith in UCC in United States. “... in the case of *Andrianus Hutabarat and ST. Osman Hutabarat v. Kristian Situmeang and Heini Panjaitan*, Supreme Court Verdict, November 5<sup>th</sup>, 1958, Number 242 K/Sip/1958. Here, the measurement or standard of good faith is dependent by the seller honesty...”<sup>2</sup> It means that in pre-contractual phase, each party have to describe all material facts honestly (honesty in fact).

Still, honesty of fact is not enough to measure the good faith in the pre-contractual phase in Indonesia. Each party is also liable to analyze the material facts. “... Supreme Court in the case of *Fatimah cs v. M. Saleh*, Putusan Mahkamah Agung number 4340 K/Pdt/1986 dated 28 Juni 1988. Here, Mahkamah Agung besides put a liability to the seller to explain the material facts, the buyers have to be responsible to analyze the facts relating to the transaction.”<sup>3</sup> The responsibility in analyzing the facts is deemed to be duty of care principle.

<sup>1</sup> Huala Adolf, *International Contract Drafting (Perancangan Kontrak Internasional)*, Bandung: Keni Media, 2011, p. 7.

<sup>2</sup> Widodo Dwi Putro, et. al., *Legal Explanation of the Buyer Good Faith Legal Protection for Buyers Who Have a Good Faith in the Land Dispute (Penjelasan Hukum Pembeli Beritikad Baik Perlindungan Hukum Bagi Pembeli Yang Beritikad Baik Dalam Sengketa Perdata Berobyek Tanah)*, Jakarta: Lembaga Kajian & Advokasi untuk Independensi Peradilan (LeIP), May 2016, p. 50.

<sup>3</sup> Ridwan Khairandy, *Sale and Purchase Contract (Perjanjian Jual Beli)*, Yogyakarta: FH UII Press, July 2016, p. 101 (hereinafter referred to Ridwan Khairandy-II).

As a result, good faith in pre-contractual phase could be realized, as when the principle of freedom of contract and consensualism are realized, so as the honesty in fact and duty of care principle. Thus, breach of the principle of freedom of contract and consensualism will happen when Credit contract approval which contains cross collateral and cross default clauses, do not pass the stage of negotiation and formulation adequately.

Contractual phase (*contractuele fase*) is the phase of performance of right and obligation of each party in the Banking Credit contract. Indonesia provides good faith in BW, as a external legal protection to shelter the parties (in this case, the parties in Banking Credit contract). Yet, the standardization of measuring the good faith needs to be defined. "The standardization of measuring good faith in Contract performance is an objective standard. In the standard, the behavior of each party in performing the contract and judgement of contract substance have to be based on the principle of reasonableness and fairness."<sup>1</sup>

The principle of reasonableness and fairness are also embraced by UCC as one of the meaning of good faith, which is the observance of reasonable commercial standards of fair dealing. The principle is also mandated in NBW as *redelijkheid* dan *billijkheid*. The performance of contract has to be initiated in *reasonableness* and *fairness*. Though good faith is also recognized in English Contract Law. Still, England does not mandate the need of adapting the principle of reasonableness and fairness in contractual relationship. "As we have seen above, English courts do not usually apply general principles in deciding cases in private law. In the particular context of contract law, we can add that there is no general principle of 'reasonableness and fairness', and certainly no general duty of 'reasonableness and fairness' of the kind stated in art. 2.1 of Book 6 of the Dutch Civil Code."<sup>2</sup>

In Indonesia, the adaption of good faith justified by several *Jurisprudentie*. "In the case of *RD Djuhana v. Go E Tji*, Number 224/K/Sip/1973, first instance court, state that all contracts that are made legally are valid as the Act for the people who made it. In the other side, the court also recognize that contracts have to be performed in good faith. In this case, the first instance court prioritize more on the principle of good faith than the principle of *pacta sunt servanda*. This attitude was justified by the Supreme Court."<sup>3</sup>

In the case of *A.M.Muhamad Zainuddin versus Zainal Abidin, et. al.*, with registration Case Number: 1253 K/Sip/1973, decided by the Supreme Court of the Republic of Indonesia (MARI) October 14<sup>th</sup>, 1976 *Jurisprudentie* rules are produced, which is: "The promised interest rate is 20% per month. For reasoning humanity and fairness the interest granted is 3% per month, in accordance with the loan interest at the State Banks at the time the contract is held"<sup>4</sup>

In 2 (two) of *Jurisprudentie*, MARI rule out the principle of *pacta sunt servanda* based on the good faith. MARI, based on the principle of reasonableness and fairness, deem the contracts that are realized without good faith as contracts that cannot be performed and enforced under the Contract Law. "Fade" the strength of the principle of *pacta sunt servanda* actually relates to the bargaining position of each party. The concept of original position that inspired by John Rawls in the perspective of the Contract Law, is a situation where each party experience fairness in contract.

The mechanism of realizing the fairness in contract is regulated by several regulations. Yet, the parties are liable to develop the internal legal protection by themselves. It functions to defend the common interest of the parties. Internal legal protection is created by passing the stages of formulation, approval, and performance of fair contract. "In fact, the parties do not always have equal bargaining position, so it may harm the party with lesser bargaining position."<sup>5</sup> Banks, that have stronger bargaining position, sometimes suppress the Debtor's party to approve and perform all Credit contracts, suitable to the Bank's wishes. It includes the impose of cross collateral and cross default clauses existence and performance in Banking Credit contracts. Whereas, in the case of *Coppage versus Kansas*, with Case Number: 236 U.S. 1, decided by the U.S. Supreme Court January 25<sup>th</sup>, 1915, confirmed that: "...it takes two to make a bargain..."<sup>6</sup>

Original position in contractual relationship can be realized as long as it is supported by the realization of the

<sup>1</sup> Ridwan Khairandy, *Freedom of Contract & Pacta Sunt Servanda Versus Good Faith: Demeanor Must Be Taken by the Court (Kebebasan Berkontrak & Pacta Sunt Servanda Versus Itikad Baik: Sikap Yang Harus Diambil Pengadilan)*, Yogyakarta: FH UII Press, October 2015, p. 75 (hereinafter referred to Ridwan Khairandy-III).

<sup>2</sup> John Cartwright, *Redelijkheid en billijkheid: a view from English law, BW-krant Jaarboek, Volume 30 Issue 1*, 2016, p. 49.

<sup>3</sup> Ridwan Khairandy, *Indonesian Contract Law in a Comparative Perspective (Part One) (Hukum Kontrak Indonesia Dalam Perspektif Perbandingan (Bagian Pertama))*, Yogyakarta: FH UII Press, December 2014, p. 142 (hereinafter referred to Ridwan Khairandy-IV).

<sup>4</sup> *A.M.Muhamad Zainuddin versus Zainal Abidin, et. al.*, Supreme Court of Indonesia Verdict Number: 1253 K/Sip/1973, October 14<sup>th</sup>, 1976, p. 47.

<sup>5</sup> Ridwan Khairandy, *Authority of Judge to Intervene on Contractual Obligations Based on the Principle of Good Faith (Kewenangan Hakim untuk Melakukan Intervensi terhadap Kewajiban Kontraktual Berdasarkan Asas Itikad Baik)*, *Jurnal Hukum Ius Quia Iustum, Volume 7 Number 15*, December 2000, p. 98 (hereinafter referred to Ridwan Khairandy-V).

<sup>6</sup> *Coppage versus Kansas*, U.S. Supreme Court 236 U.S. 1, January 25<sup>th</sup>, 1915, p. 236.



concept of veil of ignorance, through good faith. Good faith as veil ignorance, guarantee the achievement of fairness in contracts. Good faith serves to protect the parties in the Credit contract. The existence of good faith will affect each party in the contract to position the other party as contract partner. Thus, the dominant party will not impose his wishes and/or oppress those who have a lesser bargaining position, for his own sake.

Not only that, fairness also requires that those who have superiority (superior), to balance the position of the inferior party. The inferior party has to gain greatest benefit of the least advantaged, based on the theories inspired by John Rawls. Good faith as veil of ignorance, is an absolute requirement that have to be fulfilled in the contract. Without good faith, the superior party will tend to oppress the inferior party. Certain clauses are "in the hands" of the dominant party with bad faith, can be misused for bad purposes.

Banks, as the dominant party, is absolutely prohibited to suppress the Debtor. Banks is prohibited to misuse the bargaining position, and impose the formulation, approval, and performance of the cross collateral and cross default clauses, for the Bank's interest itself. Moreover, if it's for bad and destructive purposes. The patterns of cross collateral and cross default that are realized by the cross collateral and cross default clauses in the Banking Credit contract, are can be justified as long as it contains the proper *ratio legis*. *Ratio legis* meant are as a strict implementation of prudential Banking principles, intend to emphasize the certainty of Debtor in fulfilling all contractual obligations to the Bank, and for the efficiency of the Bank's business activities, in the Corporation Credit that valued greatly and complex. Yet, the *ratio legis* also has to be based on the good faith as a absolute requirement of formulation, approval, and performance of Credit contract.

#### 4. Conclusion

*Ratio legis* of using cross collateral and cross default clauses in Banking Credit contract are as a strict implementation of prudential Banking principles, intend to emphasize the certainty of Debtor in fulfilling all contractual obligations to the Bank, and for the efficiency of the Bank's business activities, in the Corporation Credit that valued greatly and complex. However, the *ratio legis* also has to be based on the good faith as a absolute requirement of formulation, approval, and performance of Banking Credit contract.

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