



INDONESIAN BANKRUPTCY LAW: AN UPDATE

by **Subianta Mandala**

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INDONESIAN BANKRUPTCY LAW: AN UPDATE

by Subianta Mandala*

The Law on Bankruptcy of June 1905, as amended in 1998 during Indonesia's economic crisis, has been fully replaced. The new Indonesian Bankruptcy Law (Law Number 37 of 2004 on Bankruptcy and Suspension of Payment) was promulgated on 18 October 2004. But, the new law has yet to obtain legitimacy due to inadequacies in the amendments made in 1998 and some fundamental problems in the judiciary itself, which are now being addressed by a Judicial Commission that was established on 2 August 2005.

The following important provisions have been made in the new law: 1) definitions; 2) more detailed limitations on who may file bankruptcy petitions; and 3) procedures and time frames involved in the process of bankruptcy and suspension of payment of companies in Indonesia.

1) Definitions

To avoid different interpretations, the new law contains clearer definitions of the legal principles, concepts and words used in the law.

A loan is defined as an obligation that: can be measured/stated in the form of money; can be either in Indonesian currency or any foreign currency; will mature directly or contingently; is based on an agreement or laws; and will entitle the creditor to be compensated from the debtor's assets in the event of default.

Maturity (due and payable) is defined as the obligation to repay a loan that is due in accordance with an agreement, or is due based on a sanction or fine imposed by an authorised government agency, or based on a decision of a court or arbitrator.

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Maturity means that a debtor, who has two or more creditors and does not repay in full at least one debt which is due and payable, can be declared bankrupt by the court. The requirement that the loan be repaid in full was not in the old bankruptcy law. If the above conditions are met, then a petition for bankruptcy may be filed with the relevant commercial court.

2) Petitions

Subject to the specific limitations mentioned below, a bankruptcy petition or suspension of payment submission may be based on the debtor's own application or an application by one or more of its creditors. Specific procedures and limitations apply for the following legal entities: 1) Bank Indonesia is the only institution authorised to file a bankruptcy petition (or suspension of payment petition) relating to a bank; 2) the Capital Market Supervisory Board is the only institution authorised to file a bankruptcy petition (or suspension of payment petition) relating to a security company, the stock exchange, a guarantee clearing institution, or a central securities depository; and 3) the Ministry of Finance is the only institution authorised to file a bankruptcy petition (or suspension of payment petition) relating to an insurance or re-insurance company, pension funds, and state-owned enterprises that operate in the public interest. (State-owned enterprises that operate in the public interest are those whose capital is entirely owned by the government of the Republic of Indonesia.)

Public prosecutors may also submit bankruptcy petitions in the event that: a company (debtor) has two or more creditors and fails to repay at least one due and payable loan, and no bankruptcy petition has been filed against such debtor, and the reason for filing the bankruptcy petition is to protect the public interest. "Public interest" refers to the following: 1) the debtor has absconded; 2) the debtor has embezzled part of its assets; 3) the debtor owes money to state-owned enterprises or another entity which collects money from the public; 4) the debtor has obtained a loan which is derived from the accumulation of public money; 5) the debtor does not show good faith or is uncooperative in solving its matured debts; or 6) other reasons that according to the public prosecutor are within the scope of the public interest.

3) Procedures and time frame

The following are the relevant procedures and time frame for a bankruptcy proceeding:

- 1) A bankruptcy petition will be submitted by the court registrar to the chairman of the commercial court within two days after the date of registration (extended from the previous 24 hours);
- 2) Within three days after the date on which the bankruptcy petition was registered, the court will review the application and determine the date of hearing (the previous time frame was two days);
- 3) The bankruptcy decision must be felled within 60 days from the date the bankruptcy petition was registered (previously 30 days);
- 4) The bankruptcy decision must be sent by express registered mail to: the debtor, the applicant, the receiver, and the supervisory judge, within three days of the date on which the decision was read (previously within two days by registered mail or via courier);
- 5) A petition for cassation (appeal to the Supreme Court) or civil review (by the Supreme Court of its decision), can be submitted only to the court registrar who will forward it to the counterparty within two days of the date the petition was registered (previously the party who filed the petition had to also distribute it to the other counterparty on the date of registration, and the time frame for the court register to send the application was 24 hours);
- 6) The counterappeal must also be distributed by the court registrar to the applicant within two days of the date on which it was received;
- 7) The appeal hearing must be conducted within 20 days of the date the application was received (as before);
- 8) The decision must be made within 60 days from the date the application was received (previously 30 days);
- 9) A copy of the decision must be delivered by the registrar of the Supreme Court to the registrar of the district court within three days after the date on which the decision was read (previously the Supreme Court had to deliver copies to the registrar, applicant, counterparty, receiver and supervisory judge within two days);

In bankruptcy proceedings, a summons issued by the court registrar will be deemed to be validly received by the debtor if the summons has been issued by registered express mail at least seven days before the first hearing is to be conducted.

Receiver

A receiver must be independent, have no conflict of interest with the debtor or creditor, and not be handling more than three bankruptcy and suspension of payment cases.

The right to manage the company under bankruptcy status

It is clear that despite a debtor company losing its right to control and manage its assets from the date the bankruptcy decision has been declared (from midnight at the beginning of that date), the board of directors (BoD) and the board of commissioners (BoC) of the company will remain responsible for the day-to-day activities of the company, provided that any and all corporate actions that will cause a decrease in the bankruptcy estate must be under the sole authority of the receiver. This is a significant amendment. However the BoD and BoC will have no right to conduct any corporate action which may decrease the value of the bankruptcy estate.

Transfer of funds and transactions on the stock exchange

The new law has also made it clear that if before the declaration of bankruptcy: 1) a fund transfer has been made through a bank or other financial institution, such transfer must be continued (this is to guarantee the legal certainty of the fund transfer to be conducted through the bank); and 2) a security exchange transaction has been conducted on the stock exchange, then such transaction must also be continued (this is to ensure the legal certainty of capital market transactions on the stock exchange).

Detention

Based on the new law, a debtor who is under detention (*gijzeling*) by the police or the public prosecutor must be released immediately once the bankruptcy decision has been declared. It should be noted that this differs from the previous law which provided that such debtors will be released only when the bankruptcy status has obtained legal certainty (*in kracht van gewijsde*).

Employment relationship

Under the new law, an employment relationship may be terminated by either the employer (the company) or the appointed receiver, subject to the provisions of the prevailing labour laws, provided that at least a 45 days' notice is sent before the termination (the old law mentioned that the time

frame was limited to at least six weeks). The new law also clearly provides that after the date of the declaration of bankruptcy, any unpaid salary prior to or after the declaration of the bankruptcy decision will be a part of the debt of the bankruptcy estate.

Suspension of payment

With regard to the suspension of payment, it is interesting to note that the new law provides that an unsecured creditor may file a petition for suspension of payment. Previously, only the debtor was entitled to file such a petition.

If a petition for suspension of payment is filed by a debtor, the court must approve the temporary suspension within three days after the petition was registered, and appoint a supervisory judge and one or more administrators that will jointly manage the debtor's asset with the debtor. On the other hand, if the petition is filed by a creditor, the court will approve the temporary suspension of payment within 20 days, and appoint a supervisory judge and one or more administrators that will jointly manage the debtor's assets with the debtor.

Immediately following the declaration of temporary suspension of payment, the court, through the administrator, must call the debtor and creditor by registered mail or courier to appear in a hearing to be conducted within 45 days from the date the temporary suspension of payment was declared. In the event that the debtor is not present at such hearing, the temporary suspension of payment will immediately terminate and the court must declare the debtor bankrupt.

Under the new law, the court will determine the granting of suspension of payment based on the votes of both unsecured and secured creditors, with the approval vote of more than half of each type of creditor that is present at the hearing as long as creditors represent at least two-thirds of the total outstanding receivables payable to respective secured and unsecured creditors who are present at the hearing.

4) Ongoing issues

Risks

The general risks that those using the bankruptcy legislation face are both the lack of experience and the lack of knowledge on the part of those with the responsibility to administer the law. The special risk that debtors

face is the relative ease with which a declaration of bankruptcy can be obtained. But this was the specific intention of the drafters of the law—to force debtors to pay. While this ease is the basic criticism that the law faces, it is its basic strength in the hands of genuine creditors.

Who may petition?

Who may petition for bankruptcy? Art 2(1) defines this as a creditor of a debtor with two or more creditors with at least one debt due and payable. The creditor must, therefore, establish in his petition:

1. That there is another creditor besides himself; and
2. That a debt (not necessarily his own) is due and payable and has not been settled in full.

It is important that the amount of the debt be clearly established and that the debt is due and payable. It is not sufficient that an invoice has been issued. An invoice must always state when the amount becomes due and payable. And it is not sufficient that the creditor claims that the debt is due. It must be clear that the debtor acknowledges the debt, but refuses to pay. It is this point that has caused much controversy in some recent high profile cases (*e.g.* the Manulife matter), where the court did not grasp this basic requirement, and brought the law into disrepute.

It is not for the creditor to claim that it is clearly solvent. That is not the basic issue. It is firstly and above all the duty of the claimant to show that an agreed debt has not been paid in full, and then it is the duty of the creditor to explain why it has not paid all its debts.

Does bankruptcy mean insolvency?

Unlike in other jurisdictions, this is not the case in Indonesia. Bankruptcy is a simple declaration pursuant to Article 2 that a debtor with two or more creditors has not fully paid a debt which is due and payable. It is a separate issue from insolvency. Insolvency may follow. Formal insolvency does not occur until a composition (plan of action) is either not presented or is rejected.

Bankruptcy was a difficult declaration to achieve previously. The old repealed law provided that bankruptcy (still not insolvency) would be pronounced “if it appears... that the debtor’s condition is such that he has stopped making payments”. So, judges previously held that if a debtor paid even a small fraction of an agreed payment, he could not be declared bankrupt. This confusion has now been cleared away.

May a petition be withdrawn?

The nature of a bankruptcy petition is that there is always more than one creditor whose interests are to be considered. This distinguishes it from other civil actions. However, it appears that a petition may be withdrawn before bankruptcy is declared. After bankruptcy has been declared, progress on the matter becomes the decision of all creditors.

May a secured creditor petition?

The law is silent, meaning that a secured creditor may petition. While this is an issue of some debate, the fact is that the law does not prevent a secured creditor from petitioning.

Is there a minimum debt?

There is no minimum debt. But, there is public criticism of this coming from “big business”. The basic purpose of the law is to force debtors to pay, regardless of the amount they may owe, big or small.

What if there is an arbitration agreement?

It may be necessary to arbitrate to determine whether a debt is in fact due and payable, and/or the amount of the debt. If there is no doubt regarding this, then a petition for bankruptcy may be made. This is then no longer a matter of arbitration, but debt recovery.

What if a debtor pays a reduced amount of agreed instalments?

The new law clarifies beyond doubt that a debt must be settled in full, or the debt may become the basis for a petition for bankruptcy.

Liabilities of directors and commissioners

Directors (Company Law Article 85) and commissioners (Company Law Article 98) may be held liable for fault or negligence. But fault and negligence are not defined. Some commentators view this as placing reliance on the common law concept of fiduciary duty.

There are provisions in the Criminal Code (KUHP) to deter directors and commissioners from entering into certain loans, but it is not clear whether these provisions would extend to penalties for continuing to trade when in a state of inability to repay (common law insolvency). The Bankruptcy Law itself is silent on this matter though, under common law,

unless a director is fully informed and acts reasonably, he or she can be held personally liable for all faults of the company.

Can a guarantor be declared bankrupt?

The Indonesian Civil Code has been interpreted by the Supreme Court to mean that the civil status of the principal debtor cannot be transferred to a guarantor, even though the guarantor can be held responsible for the primary debt. Therefore, the guarantor cannot be declared bankrupt. However, if the guarantor waives its preferential rights (as is generally required by creditors), then it appears it may be able to be declared bankrupt.