Enhancing Unsecured Creditors Protection in Indonesia: Analyses on The Best-Interest-of-Creditors Test and The Fairness Test

TABLE OF CONTENTS

EXECUTIVE SUMMARY .... **i**

MAIN FINDINGS .... **ii**

1. Introduction **1**
- **1.1. Problem Analysis** **1**
- **1.2. Research Question** **2**
- **1.3. Research Method** **3**
- **1.4. Outline** **4**

2. The Status Quo of Restructuring Proceedings Under Indonesian Insolvency Law **5**
- **2.1. Overview and Legal Framework of Restructuring Proceedings** **5**
  - 2.1.1. Commencement of PKPU Proceedings 5
  - 2.1.2. Classification of Creditors and Voting on The Composition Plan 7
  - 2.1.3. Court's Ratification and The End of PKPU 8
- **2.2. Protections of Unsecured Creditors Regarding Fair Treatment in Restructuring Proceedings** **9**
  - 2.2.1. Issues Under Indonesian Insolvency Law 9
  - 2.2.2. Safeguard: Court's Confirmation 10
  - 2.2.3. Supervision on The PKPU 11
- **2.3. A Recent Development on The Current Indonesian Insolvency Law** **12**
  - 2.3.1. Trends in PKPU 12
  - 2.3.2. Development of The Indonesian Insolvency Law 12

3. Principles and Good Practices Promoted in The ADB Good Practice Standards **14**
- **3.1. Background of The ADB Good Practice Standards** **14**
- **3.2. Good Practice of The Best-Interest-of-Creditors Test in The Formulation of a Reorganization Plan** **16**
- **3.3. Good Practice of The Fairness Test in The Reorganization Plan** **18**

4. Principles and Regulations in The EU Preventive Restructuring Directive **20**
- **4.1. Background and Legal Framework of The EU Preventive Restructuring Directive** **20**
- **4.2. The Best-Interest-of-Creditors Test in The Restructuring Plan** **21**
- **4.3. Standard of The Fairness Test in The Restructuring Plan** **24**

5. Comparison of The Protection and Fair Treatment of Unsecured Creditors in Composition Plans under Indonesian Insolvency Law, ADB Good Practice Standards, and EU Preventive Restructuring Directive **27**
- **5.1. Analysis of A Possible Adoption and Implementation of The Best-Interest-of-Creditors In Indonesia** **27**

5.1.1. A Comparable Concept of The Best-Interest-of-Creditors Test Under The Indonesian Insolvency Law 27
5.1.2. Comparison Between The Best-Interest-of-Creditors Under The ADB Good Practice Standard and The EU Preventive Restructuring Directive 28
5.1.3. Possible Adoption and Scenario of The Best-Interest-of-Creditors Test 29
5.2. Analysis of A Possible Adoption and Implementation of The Fairness Test In Indonesia 30
5.2.1. No More Than 100% Rule 30
5.2.2. Equal Treatment of Creditors 31

6. Conclusion 33

EXECUTIVE SUMMARY

In the event of insolvency, unsecured creditors are arguably one of the most vulnerable stakeholders. Compared to other creditors, they have neither priority over their claim nor collateral to secure getting paid. Consequently, unsecured creditors have to choose the dilemma between accepting or rejecting a composition plan. Accepting the composition plan may be unfavourable to creditors because debtor often propose huge deductions of the creditors' claims (a haircut). While rejecting the composition plan results in the liquidation of debtor in which unsecured creditors will receive whatever is left, if any. Even if the unsecured creditors do not accept the composition plan or do not participate in the insolvency proceedings, they may still be bound if it has been approved by the majority of creditors.

The purpose of this thesis is to analyse the substantive aspects of insolvency law, particularly the protection of unsecured creditors, to ensure that they do not unjustly prejudice and receive a fair treatment. Two safeguards that will be examined are the best-interest-of-creditors test and the fairness test – the latter in this context consisting of: 'no more 100% rule' and equal treatment of creditors. In some literature, the priority rule is also included in the fairness test. This thesis, however, will not address the priority rule, as the Indonesian Insolvency Law does not recognize cross-class cram down.

The main research of this thesis pertains to the following:
"To what extent can Indonesia improve protection for unsecured creditors in restructuring proceedings based on standards promoted by the ADB Good Practice Standards and the EU Preventive Restructuring Directive, with regard to (i) the best-interest-of-creditors test; and (ii) the fairness test?"

In order to address the main research question, a comprehensive examination of various sub-research inquiries will be conducted as outlined below:

1. How are the protection and fair treatment of unsecured creditors ensured in a composition plan under Indonesian Insolvency Law?
2. What are the standards for the best-interest-of-creditors test and the fairness test in ADB Good Practice Standards?
3. What are the standards on the above tests under the EU Preventive Restructuring Directive?
4. Do the ADB Good Practice Standards and EU Preventive Restructuring Directive provide more protection to unsecured creditors? If yes, what kind of amendments could be recommended for Indonesian Insolvency law based on the previous?

In this thesis, I will use both legal dogmatic and legal comparative methodologies. To enable us to understand the status quo of Indonesian Insolvency Law, I will describe and analyse the current state of Indonesian Insolvency Law, especially on the protection of unsecured creditors in formal restructuring proceedings. In addition, I will look into the concepts of the best-interest-of-creditors test and the fairness test, as advocated by the ADB Good Practice Standards and the EU Preventive Restructuring Directive. Further, a comparison will be made in order to identify similarities and differences between concepts under the ADB Good Practice Standards and the EU Preventive Restructuring Directive. Afterwards, I will examine whether the best-interest-of-creditors test and the fairness test would provide greater protection towards unsecured creditors and could be incorporated into the Indonesian Insolvency Law. Last, I will conclude this thesis and propose recommendations for the development of Indonesian Insolvency Law.

MAIN FINDINGS

The current research aims to conduct an analysis of the safeguards available for unsecured creditors, with focus on the best-interest-of-creditors test and the fairness test by examining the ADB Good Practice Standards and the EU Preventive Restructuring Directive.

The findings of the research are presented as follows:

1. There are protections available for unsecured creditors in Indonesia insolvency framework, namely under Article 285 (2) (a) of the Indonesian Insolvency Law. However, it still lacks safeguard that ensure fair treatment towards unsecured creditors, namely the best-interest-of-creditors test and the fairness test.

2. The best-interest-of-creditors test establish minimum threshold that ensure creditors, in the composition plan, will receive at least what they would get in case of a liquidation scenario. The court will examine whether the composition plan meets the best-interest-of-creditors test, upon challenge by dissenting creditors (creditors who reject the composition plan). If this test is violated, the court will refuse to ratify the composition plan.

3. As the best-interest-of-creditors test comparing the value of restructuring and liquidation, thus debtor asset valuation is crucial. A potential tension may arise regarding the inclusion of a financial expert in evaluating the debtor's assets and the pursuit of a cost-efficient insolvency process. The ADB Good Practice Standards and the EU Preventive Restructuring Directive present different viewpoints on this matter. The ADB Good Practice Standards choose the approach to incorporate an analysis of an independent expert into the composition plan. While the EU Preventive Restructuring Directive only mandates an official valuation in the event of a challenge by dissenting creditors.

4. The fairness test in this context shall mean: (i) ‘no more than 100%’ rule, in which ensuring that no creditors in the composition plan shall receive more than their claim or interests; and (ii) equal treatment of creditors, in which ensuring that creditors are not treated differently under the composition plan. Discussion on the priority rule is not included in this thesis as Indonesian Insolvency Law does not apply the cross-class cram down.

5. The standard of the ‘no more than 100%’ rule is straightforward: the creditors’ claims and interests as the maximum value that can be received in the composition plan. Under the Directive, a breach of this rule results in the non-ratification of the composition plan by the court. The ADB Good Practice Standards yet is silent on this matter.

6. The ADB Good Practice Standards and the EU Preventive Restructuring Directive have a different perspective on the equal treatment of creditors. The ADB focuses on the limitation of priority of claims, which deals with the relation between classes of creditors (vertical). Conversely, the Directive deals with the relation of creditors within the same class (horizontal), ensuring that creditors in a similarly situated condition are treated equally. The standard of equal treatment of creditors under the Directive is: creditors in the same class shall be treated equally in proportionately with their respective claims.

7. An approach combining the best-interest-of-creditors-test of the ADB Good Practice Standards and the EU Preventive Restructuring Directive might be a possible option that Indonesia can take, i.e.,

a composition plan shall be incorporated with an assessment by an independent expert. The court shall not check the best-interest-of-creditors test in *ex officio* but only at the request of dissenting creditors. The best-interest-of-creditors test protects each and every creditor from receiving less, in the composition plan, than the debtor's liquidation.

8. The fairness test may also be adopted by Indonesian Insolvency Law to ensure fair treatment of unsecured creditors. The adoption of the 'no more 100%' rule and equal treatment of creditors under the Directive will enhance the protection of unsecured creditors in the Indonesian Insolvency Law. Likewise, it is irrelevant to discuss the priority rule because Indonesian Insolvency Law does not recognize the cross-class cram down. The 'no more 100%' rule will enhance the possibility for creditors to get distribution from the limited debtor's estate. While the equal treatment of creditors will ensure that creditors in the same class is treated fairly, pro rata. The court will (in *ex officio*) check whether the composition plan has complied with the fairness test prior to ratifying it.

9. Therefore, the best-interest-of-creditors and the fairness tests may provide more protection for unsecured creditors. It will provide an extra shield to not being unfairly detrimental by the composition plan proposed by the debtor. Those tests also serve as control mechanism as provide legal basis for (dissenting) creditors to challenge the composition plan, despite being approved by the majority of creditors.

10. The efficacy of safeguards for unsecured creditors is reliant upon their integration with other provisions. One of the crucial issues under Indonesian Insolvency Law pertains to the absence of a provision specifying the minimum content of the composition plan. Consequently, debtor is not obligated to disclose their financial condition to the creditors. Whereas the debtor's financial condition is essential information for the debtor to make an informed decision on whether to accept or reject a composition plan. Therefore, it is recommended to impose obligation to creditors to provide information regarding their financial condition in the composition plan.

1. Introduction

1.1. Problem Analysis

The paradigm of debt failure has shifted from punishment to business rescue arrangement. In the Middle Ages, debtors used to be punished for not paying their debt, but now they can restructure their debt and still maintain their business activity. The failure of a debtor to pay its debt has been redefined from moral failure to economic failure. Business rescue, thus, can be regarded as a more debtor-friendly trend.[1] It is one of the objectives of insolvency law to regulate who will get a slice of the debtor's asset, how much the creditors get, and how the debtor's stakeholders are protected in the event of insolvency. As a matter of course, insolvency law must strike a balance between all parties' rights and interests so that the interests of all impacted parties are protected.[2]

The general principle in insolvency law is to distribute the assets of an insolvent company pro rata which is the so-called *pari passu* principle. According to this principle, the debtor will distribute its assets among the creditors equally, based on the amount of each creditor's claim. However, this principle is not applicable in all circumstances; for instance, a secured creditor's collateral over a debt avoids the *pari passu* principle as it will ensure they will first be paid among other creditors.[3] Unlike secured creditors, who might not be affected by a composition plan[4] and may execute their collateral as there is no insolvency, the unsecured creditors do not hold any collateral. This condition makes the unsecured creditors arguably the most vulnerable party in restructuring proceedings. Due to the cram-down[5] mechanism, the unsecured creditors are forced to be bound by the composition plan, although the composition plan might not align with their interests. For instance, the unsecured creditors shall agree to have a significant debt write-off (haircut) and long-term instalment debt payments. Thus, there should be a certain safeguard that should be met so the cram-down mechanism can function effectively.[6]

The formal restructuring proceedings, also known as "suspension of payment obligation" or *Penundaan Kewajiban Pembayaran Utang* - PKPU, under Indonesian Insolvency Law,[7] seem to have a few weaknesses, particularly in terms of protecting the interests of unsecured creditors. There is no specific regulation or reference with regard to the formulation of a composition plan in restructuring proceedings under Indonesian Law. As previously mentioned, unsecured creditors are limited in their options compared to other creditors, i.e., secured creditors who may not be subject to the approved composition plan. The absence of certain safeguards in formulating the composition plan might jeopardise the rights of unsecured creditors, especially on fair treatment in restructuring proceedings. The objective of this research is to analyse protections for unsecured creditors on fair treatment, specifically with

[1] T. Verdoes & A. Verweij, The (Implicit) Dogmas of Business Rescue Culture, International Insolvency Review, at 399-400 (2018).

[2] I. Fletcher & B. Wessels, Harmonisation of Insolvency Law in Europe: *Preadviezen Nederlandse Vereniging Voor Burgerlijk Recht* 2012: Reports Netherlands Association for Civil Law 2012, at 5 (2012).

[3] R. Jameel Mokal, Priority as Pathology: The Pari Passu Myth, Cambridge Law Journal, at 581 (2001).

[4] Composition plan is a plan proposed by a debtor which provides full or partial payment of debt towards its creditors.

[5] Cram-down is a feature in insolvency law to bind all creditors with the composition plan proposed by the debtor that has been ratified by the court, despite objections from a creditor minority.

[6] S. Gao, Cramdown, reorganization bargaining and inefficient markets: The cases of the United States and China, International insolvency review 30, at S6 (2021).

[7] The Law of the Republic of Indonesia No. 37 of 2004 on Bankruptcy and Suspension of Payment Obligation ("**Indonesian Insolvency Law**").

regard to the best-interest-of-creditors test and the fairness test. The Asian Development Bank[8] and the EU Preventive Restructuring Directive[9] have promoted these two fundamental tests in insolvency law in an effort to safeguard the interests of (unsecured) creditors in restructuring proceedings.

Best-interest-of-creditors test: The best-interest-of-creditors test or 'no creditor worse off' principle establishes a minimum standard that requires the debtor to formulate a composition plan that provides creditors with a best next-alternative scenario, i.e., better value than if the debtor were liquidated.[10] It is mandatory that the composition plan ensures that no creditor is to be provided with an amount less than what they would have received in the liquidation of the debtor's estate.[11]

Fairness test: the fairness test is related to the fair treatment of creditors after creditors are formed into classes in the restructuring proceedings that deal with the distribution of assets among creditors.[12] The fairness test in this context includes the: (i) no more than 100% rule, which means no creditors shall receive more than the full amount of their claims or receivables; and (ii) equal treatment of creditors, which means all creditors shall be treated equally. Some literature also includes the priority rule, which is connected to the rule on distribution to dissenting classes of creditors, as part of the fairness test. However, as Indonesian Insolvency Law does not recognise 'cross-class cram down', the priority rule is beyond the scope of this thesis.[13]

To ensure fair treatment towards creditors, the court must refuse to ratify the composition plan if it does not fulfil the best-interest-of-creditors test and/or the fairness test. The present thesis uses the term 'fair treatment' to refer to both the best-interest-of-creditors test and the fairness test.

1.2. Research Question

This research will analyse to what extent the 'best-interest-of-creditors test' and the 'fairness test' can provide more protection to unsecured creditors in restructuring proceedings in Indonesia. The Asian Development Bank is selected to be further discussed as it has produced the ADB Good Practice Standards, which support insolvency law reform in Asia. The ADB Good Practice Standards also cover the evaluation and comparison of the corporate insolvency laws of the Regional Technical Assistance (RETA), including Indonesia. An analysis will be conducted to determine whether Indonesia has embraced or followed the best practices set by

[8] Asian Development Bank Office of the General Counsel, Insolvency Law Reforms in the Asian and Pacific Region: Report of the Office of the General Counsel on TA 5795-Reg: Insolvency Law Reforms, Law and Policy Reform at the Asian Development Bank (2000) ("**ADB Good Practice Standards**").

[9] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualification, and on measures to increase the efficiency of procedures concerning restructuring, insolvency, and discharge of debt, and amending Directive (EU) 2017/1132 O.J. L 172/18 ("**EU Preventive Restructuring Directive**").

[10] *See* ADB Good Practice Standards 10.1 and 11 and Article 10 (2) (d) of EU Preventive Restructuring Directive.

[11] J. Garrido, et all., Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive, IMF Working Paper, at 21 (2021).

[12] S. Paterson, Debt Restructuring and Notions of Fairness, The Modern Law Review 80, no. 4, at 600.

[13] 'Cross class cram-down' is a feature in insolvency law which makes the composition plan binding upon dissenting classes of affected parties. *See* K. Axel, Rethinking Priority: The Dawn of the Relative Priority Rule and the New "Best Interests of Creditors" Test in the European Union, International insolvency review 30.1, at 76-77 (2021).

the Asian Development Bank and, if not, whether there are any obstacles or specific reasons for not doing so.

Moreover, the EU Preventive Restructuring Directive has been selected to compare as this recent legislation deals with a new approach to restructuring laws in Europe. The EU Preventive Restructuring Directive provides a framework for restructuring proceedings and certain safeguards to be implemented by the Member States. The EU Preventive Restructuring Directive is relevant to be looked at since the Indonesian Insolvency Law was heavily influenced by the Netherlands, which is a member of the European Union. Further, the Indonesian Law Development Agency (*Badan Pembinaan Hukum Nasional* – BPHN),[14] in the academic paper for the draft of the new Indonesian Insolvency Law, also referred to the trend of insolvency in Europe.[15]

My thesis will try to answer the research question: "To what extent can Indonesia improve protection for unsecured creditors in restructuring proceedings based on standards promoted by the ADB Good Practice Standards and the EU Preventive Restructuring Directive, with regard to (i) the best-interest-of-creditors test; and (ii) the fairness test?"

To answer the main research question, I will analyse several sub-research questions as follow:

1. How are the protection and fair treatment of unsecured creditors ensured in a composition plan under Indonesian Insolvency Law?
2. What are the standards for the best-interest-of-creditors test and the fairness test in ADB Good Practice Standards?
3. What are the standards on the above tests under the EU Preventive Restructuring Directive?
4. Do the ADB Good Practice Standards and EU Preventive Restructuring Directive provide more protection to unsecured creditors? If yes, what kind of amendments could be recommended for Indonesian Insolvency law based on the previous?

1.3. Research Method

Both dogmatic legal research and comparative legal research will be used as methods to answer these research questions. A review of primary sources will be conducted, including, among others: Indonesian Insolvency Law, ADB Good Practice Standards, and the EU Preventive Restructuring Directive. Furthermore, the research will also look into relevant regulations, commentaries, literature, and legal doctrines with regard to the best-interest-of-creditor test and the fairness test under the ADB Good Practice Standards and the EU Preventive Restructuring Directive. The legal comparative research method will be used by examining and comparing the current Indonesian Insolvency Law with the good practices and principles under the ADB Good Practices Standard and the EU Preventive Restructuring Directive, specifically on the rationale and implementation of the best-interest-of-creditors test and the fairness test. The research will look into journals and reports made by the Asian Development Bank and commentaries on the EU Preventive Restructuring Directive about the implementation as such and challenges with regard to the best-interest-of-creditors test and the fairness test. Finally, an analysis will be conducted to assess if such principles may be applied and accepted in Indonesia to give greater protection to unsecured creditors in Indonesian restructuring proceedings.

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[14] https://bphn.go.id/data/documents/pokja_kepailitan.pdf, last visited (28-06-2023).

[15] https://www.bphn.go.id/data/documents/naskah_akademik_ruu_kepailitan_dan_pkpu_final_2018.pdf, last visited (28-06-2023).

The objective of this thesis is to examine the issues related to the current Indonesian Insolvency Law with regard to the fair treatment of unsecured creditors during restructuring proceedings. This objective will be achieved through a comparative evaluation of the best practices and principles promoted by the ADB Good Practice Standards and EU Preventive Restructuring Directive, specifically focusing on the best-interest-of-creditors test and the fairness test. Further, this research will assess the legal implications of the best-interest-of-creditors and fairness tests and whether the two tests may offer more protection to unsecured creditors in formal restructuring proceedings under Indonesian Insolvency Law.

This thesis uses the term 'composition plan' as a substitute for the term 'reorganization plan' that is used in the ADB Good Practice Standards and the term 'restructuring plan' that is used in the EU Preventive Restructuring Directive.

1.4. Outline

In the starting point of this thesis, I will provide an overview of restructuring proceedings under Indonesian Insolvency Law. The description will focus on the protection of unsecured creditors, particularly in terms of the composition plan's outcome and distribution to creditors. Subsequently, I will look into the concepts of the best-interest-of-creditors test and the fairness test, as advocated by the ADB Good Practice Standards and the EU Preventive Restructuring Directive. A comparative analysis will be conducted to identify similarities and differences between the principles outlined in the ADB Good Practise Standards and those stipulated in the EU Preventive Restructuring Directive. Afterwards, I will analyse whether the best-interest-of-creditors test and the fairness test would provide greater protection towards unsecured creditors and could be incorporated into the Indonesian Insolvency Law. Last, I will analyse and connect all the previous discussion and propose a recommendation for the development of the Indonesian Insolvency Law. It is important to highlight that the scope of this study is limited to formal corporate restructuring proceedings and does not encompass individual or personal insolvency.

2. The Status Quo of Restructuring Proceedings Under Indonesian Insolvency Law

2.1. Overview and Legal Framework of Restructuring Proceedings

Indonesia is a country that uses a civil law legal system influenced by Continental Europe, particularly the Netherlands.[16] Until present, the insolvency law of Indonesia has been amended twice. The initial Indonesian insolvency legislation, enacted in 1906, was derived from the Bankruptcy Ordinance (*Faillissements-verordening*) of the Netherlands Indies legislation. Following the Asian financial crisis of 1998, the Indonesian government changed the Bankruptcy Ordinance by enacting Law No. 4 of 1998 under the conditionality imposed by the International Monetary Fund (IMF).[17] Further, the most recent amendment was the promulgation of Law No. 37 of 2004, which essentially consists of two fundamental insolvency procedures: bankruptcy and suspension of payment (formal restructuring).[18] It is worth mentioning that Indonesia did not adopt the UNCITRAL Model Law on Cross-Border Insolvency (Model Law).

The restructuring proceeding (suspension of payment obligation – *Penundaan Kewajiban Pembayaran Utang*, hereinafter referred to "**PKPU**") under Indonesian Insolvency law is available for natural and legal persons.[19] PKPU is the only in-court restructuring proceeding in Indonesia. Hence, Indonesian Insolvency Law provides no option for a pre-packaged restructuring.[20] The primary objective of PKPU is to facilitate a debtor in formulating a composition plan (debt restructuring) that encompasses all creditors.

2.1.1. Commencement of PKPU Proceedings

According to Article 222 of the Indonesian Insolvency Law, a PKPU petition can be submitted by both creditor and debtor (voluntary).[21] The requirements to initiate a PKPU are at least 2 (two) or more creditors of the same debtor, with at least one of the debts being already due and payable, and such debt can be proven simply and explicitly.[22] In contrast to other jurisdictions, neither a cash flow nor a balance sheet test must be met for the court to consider granting a PKPU petition. The court solely considers the existence of the debtor's debts that are due and payable and can be proven in a simple manner, without regard to the amount of debt in question. The reasoning is that the primary objective of the law is to force debtor to fulfil their financial commitments, regardless of the amount of their debt.[23]

[16] I. Soerodjo, The Development of Indonesian Civil Law, Scientific Research Journal (SCIRJ), Volume IV, Issue IX, at 30 (2016).

[17] C. Boyle, PricewaterhouseCoopers, and Morgan Stanley, The Asia-Pacific Restructuring and Insolvency Guide 2006, Globe White Page, at 79 (2006).

[18] R. Tomasic. Insolvency Law and Institutions in Indonesia, Insolvency Law in East Asia, United Kingdom: Routledge, at 355 (2006).

[19] Articles 1 (4), 1 (11), and 222 of the Indonesian Insolvency Law.

[20] L. Foo, E. Lim & N. Silalahi, Restructuring in Indonesia in Practice, INSOL International, at 13 (2022).

[21] For debtors engaged in specific sectors: banks, insurance, securities company, or certain state-owned enterprises, a PKPU petition can only be submitted by several parties or institutions specified by the law. *See* Article 223 of the Indonesian Insolvency Law.

[22] Articles 222 (1) and (2) and Article 8 of Indonesian Insolvency Law.

[23] S. Mandala, Indonesian bankruptcy law: an update, in: Asian Insolvency Systems: Closing the Implementation Gap, Paris: OECD Publishing, at 107 (2007).

The PKPU petition shall be granted by the court within three (3) days if it is initiated by the debtor or within twenty (20) days if it is initiated by the creditors.[24] Including or incorporating a composition plan in the PKPU petition is not mandatory.[25] Moreover, no appeal can be made against a court decision granting PKPU proceedings' commencement.[26] In the decision, granting the PKPU petition, the court will appoint a supervisory judge (*hakim pengawas*) and one or more administrator(s) (*pengurus*).[27] In essence, the role of a supervisory judge is to supervise the administration and settlement of the bankruptcy estate.[28] The approval of a supervisory judge is required for certain actions conducted by the administrator and/or the debtor. Furthermore, the duty of the administrator is to collaborate (jointly) with the debtor in managing the debtor's assets, as the debtor does not have the authority to manage its assets without the administrator's approval.[29] Obligations incurred by the debtor after the suspension of payments carried out without the administrator's approval can only be borne by the debtor's assets to the degree that they benefit the debtor's assets.[30]

Upon the court decision, the debtor is deemed under temporary PKPU (*PKPU sementara*), which prevents the debtor from paying its debt and postponing all claims against it (moratorium).[31] The administrator must announce the temporary PKPU and notify all identified creditors through publication in two (2) newspapers and a state gazette.[32] These announcements are deemed as obligatory measures to ensure that all creditors are adequately informed of the restructuring process, despite the possibility that creditors may still lack such information. A meeting of all identified creditors must be called by the Commercial Court, through the administrator, within forty-five (45) days of the temporary PKPU being granted. Upon the commencement of the PKPU proceedings, all known creditors are invited by the administrator to submit their claims.[33]

The debtor has a right to propose a composition plan to all its creditors.[34] During the temporary PKPU period, composition plans may be discussed and voted on, and the process may be concluded. If both secured and unsecured creditors have not mutually agreed the composition plan during this specified period, the temporary PKPU will end, and consequently, by operation of law, the Commercial Court shall declare the debtor bankrupt.[35] Subject to approval from the creditors, the debtor may still request for permanent PKPU (PKPU *tetap*) to continue the pending agenda in temporary PKPU.[36] The permanent PKPU shall not exceed two hundred seventy (270) days after the issuance of the PKPU decision. The debtor is declared bankrupt if neither a composition plan nor a vote for permanent PKPU has been approved within the allotted time.[37]

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[24] Article 225 (3) of the Indonesian Insolvency Law.
[25] Article 224 (5) of the Indonesian Insolvency Law.
[26] Article 235 of the Indonesian Insolvency Law.
[27] Article 225 of the Indonesian Insolvency Law.
[28] Article 65 of the Indonesian Insolvency Law.
[29] Articles 240 (1) and (2) of the Indonesian Insolvency Law.
[30] Article 240 (3) of the Indonesian Insolvency Law.
[31] Article 242 of the Indonesian Insolvency Law.
[32] Article 226 of the Indonesian Insolvency Law.
[33] Articles 270-272 of the Indonesian Insolvency Law.
[34] Article 265 of the Indonesian Insolvency Law.
[35] Articles 225 (4) and (5) and 226 of the Indonesian Insolvency Law.
[36] The requirements for approving permanent PKPU are identical to those for approving the composition plan. *See* article 229 (1) of the Indonesian Insolvency Law.
[37] Articles 228 (4) and (6) of the Indonesian Insolvency Law.

2.1.2. Classification of Creditors and Voting on The Composition Plan

Indonesian Insolvency Law is silent on the classification of classes of creditors in the PKPU proceedings. Nonetheless, the law recognises three (3) categories of creditors: secured, preferred, and unsecured, as stated in the elucidation of Article 2 (1) of the Indonesian Insolvency Law. The secured creditors are creditors who hold collateral (rights *in rem*) over the debtor's asset. Furthermore, preferred creditors are creditors who have preferential rights that give them priority over other creditors.[38] The unsecured creditors are the remaining creditors with no collateral and preferential rights.[39] It should be highlighted that the Indonesian Insolvency Law does not distinguish claims submitted by shareholders based on shareholder loans; creditors possessing such claims are classified as unsecured creditors.

The Indonesian Insolvency Law solely categorises creditors into two distinct groups for the purpose of voting on the composition plan, namely secured creditors and unsecured creditors. The preferred creditors are classified as unsecured creditors. The composition plan is approved if it obtains approval from both secured creditors and unsecured creditors, according to the specified criteria:[40]

1. Secured creditors, with more than half (1/2) of secured creditors present at the hearing, and such creditors represent at least two-thirds (2/3) of the total outstanding secured debts at the hearing; <u>and</u>
2. Unsecured creditors, with more than half (1/2) of unsecured creditors present at the hearing, and such creditors represent at least two-thirds (2/3) of the total outstanding unsecured debts at the hearing.

Therefore, for a composition plan to be adopted, the Indonesian Insolvency Law requires the number of creditors and value of the claim to meet specific criteria, i.e., more than half of the total number of creditors present at the hearing and two-thirds of the total amount of claims for each kind of respective creditor class. This provision shows that Indonesian Insolvency Law does not adopt the 'cross-class cram-down,' as the law requires approval from both classes: secured and unsecured, for a composition plan to be approved.[41]

It is noteworthy that not all creditors will be treated the same under Indonesian Insolvency Law. The secured creditors will only be bound by the composition plan if they vote in favour. The secured creditors who reject the composition plan shall remain unbound by the composition plan and shall be duly remunerated for the value of the claim or the collateral value (whichever is lower).[42] The implementation of the provision for dissenting secured creditors is uncertain, particularly whether a dissenting secured creditor must be compensated promptly after the composition plan is ratified.[43] Due to the fact that many debtors may lack the financial resources to provide such compensation (buying out), it is commercially and practically challenging to implement the buy-out rules.[44] On the other hand, the unsecured creditors (including the preferred creditors) are bound by the composition plan that has been ratified by

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[38] Based on Article 1139 and 1149 of the Indonesian Civil Code, the preferential rights are among others: court fees, wages of employee, lease of immovable assets, etc.

[39] Article 1134 of the Indonesian Civil Code.

[40] Article 281 of the Indonesian Insolvency Law.

[41] *See* K. Axel, *supra* note 13, at 76-77.

[42] Article 281 (2) of the Indonesian Insolvency Law.

[43] A. Kadir, PKPU Progress, International Financial Law Review 33, at 44 (2014).

[44] R. Tomasic, Insolvency Law and Institutions in Indonesia, Insolvency Law in East Asia, United Kingdom: Routledge, at 368 (2006).

the court, regardless of whether they accept or reject it.[45] Even the unsecured creditors who do not register their claim and participate in the PKPU proceedings are bound by the composition plan if their claims are admitted by the debtor.[46]

The following table presents a comparison of the treatment of secured creditors, preferred creditors, and unsecured creditors under Indonesian Insolvency Law.

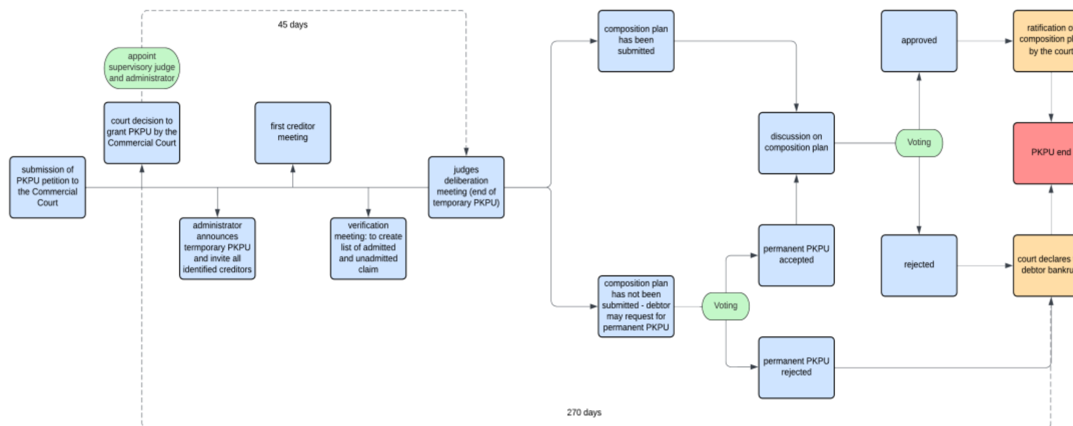
<table>
<tr><th>Class of Creditors</th><th colspan="2">Bound by the ratified composition plan</th><th>Priority of payment in liquidation</th></tr>
<tr><td>Secured creditor</td><td>No – if reject the composition plan.</td><td>Yes – if vote in favour of the composition plan.</td><td>Get paid for the value of the loan or the collateral value (whichever is lower).[47]</td></tr>
<tr><td>Preferred creditor</td><td colspan="2" rowspan="2">Yes – the ratified composition binds all creditors including those who reject or do not participate in the PKPU proceedings, as long as their claims are verified by the debtor.</td><td>Except for employee wages[48] – get paid subsequent to the satisfaction of secured creditors.</td></tr>
<tr><td>Unsecured creditor</td><td>Get paid after all the other creditors get paid.</td></tr>
</table>

2.1.3. Court's Ratification and The End of PKPU

If the composition plan is approved, the court will render a decision (*homologasi*) to ratify the composition plan.[49] The ratified composition plan binds all affected creditors, except secured creditors that vote to reject the composition plan.[50] Following the ratification of a plan, the PKPU proceeding ends, and the administrator is discharged.[51] In the event the composition plan is rejected by the creditors, the court must render a decision declaring the debtor bankrupt, and the bankruptcy proceedings shall begin.[52]

A general legal procedures in restructuring under Indonesian Insolvency Law can be facilitated by examining a flow chart, which has been prepared and presented below.

[45] Article 286 of the Indonesian Insolvency Law.
[46] Article 287 of the Indonesian Insolvency Law.
[47] See article 281 (2) of the Indonesian Insolvency Law. Any excess value of the claim that is not covered by the collateral will fall into the claim under the unsecured creditor classification.
[48] Subsequent to the Constitutional Court Decision 67/PUU-XI/2013 dated 11 September 2014, unpaid employee wages have priority over the claims of all other creditors, including secured creditors and tax authorities.
[49] Article 285 (1) of the Indonesian Insolvency Law.
[50] Article 286 of the Indonesian Insolvency Law.
[51] Article 288 of the Indonesian Insolvency Law.
[52] Article 289 of the Indonesian Insolvency Law.



2.2. Protections of Unsecured Creditors Regarding Fair Treatment in Restructuring Proceedings

As the legal effect of a ratified composition plan could bind unsecured creditors regardless of whether they approve or reject the plan (cram-down), safeguards and protections must be in place for unsecured creditors. In the absence of adequate safeguards or regulations to protect creditors, debtors may potentially exploit their authority imposed by the binding nature of a composition plan to the harm of creditors' interests. These protections are necessary to ensure that creditors receive fair treatment and that their rights are not compromised. For instance, it is common for the debtor to request a haircut in the debtor's outstanding debt, which may also involve terminating interest rates and even deducting the principal debt.[53]

2.2.1. Issues Under Indonesian Insolvency Law

There is no standard, guideline, or reference with regard to the formulation of a composition plan under Indonesian Insolvency Law.[54] The Indonesian Insolvency Law, for instance, does not require the debtor to provide financial statements to the creditors. This situation makes it difficult for creditors to understand the debtor's financial condition, particularly in cases where the debtor is a privately owned entity, as there is no reliable public record of financial information pertaining to such entities.[55] The debtor is also not obliged by law to appoint an independent financial advisor or auditor to explain the financial situation of the debtor.

Subject to debate, the issue of transparency under Indonesian Insolvency Law can potentially jeopardise the rights and interests of creditors. Without having adequate knowledge about the financial condition of the debtor, the creditors might not be able to make an informed decision as they will vote on whether to approve or reject the composition plan proposed by the debtor. The creditors might not have any knowledge and could not compare whether it is more beneficial to approve the composition plan or reject it and get payment from the liquidation of debtor's bankruptcy estate.

The composition plan agreed upon in the PKPU is, in essence, an agreement between the debtor and its creditors based on negotiations during the discussion of the composition plan. As

[53] S. Adi Nugroho, Hukum Kepailitan Di Indonesia Dalam Teori dan Praktik Serta Penerapan Hukumnya, Prenadamedia Group, at 296 (2018).
[54] L. Foo, E. Lim & N. Silalahi, Restructuring in Indonesia in Practice, INSOL International, at 20 (2022).
[55] A. Kadir, PKPU Progress, International Financial Law Review 33, at 44 (2014).

explained in the previous section, the determining factor for a composition plan to be ratified is approval from creditors.[56] In order to persuade the creditors, the debtor may need to describe its financial situation and business plan. Therefore, it could be said that the debtor may choose to disclose its financial condition not because of legal obligation but to convince its creditors to vote in favour of the composition plan.

The debtor will participate in discussions with the creditors regarding the composition plan, providing them with an opportunity to convey their objections and offer suggestions to ensure that their interests are duly considered. This process shall be carried out prior to the voting and may result in revisions to the composition plan. The discussion usually takes place during the meeting of creditors, which is led by the supervisory judge.[57] Although creditors have the right to convey their opinion regarding the composition plan, which could be viewed as a form of creditor protection, the debtor has no legal obligation to accept the creditors' suggestions. The cost incurred by the debtor for not adopting the creditors' suggestions could result in the composition plan being rejected during the voting process, leading to the debtor's bankruptcy.

2.2.2. Safeguard: Court's Confirmation

Despite the absence of standards and guidelines, the composition plan is subject to certain limitations due to the various safeguards established under the Indonesian Insolvency Law. According to Article 285 (2) of the Indonesian Insolvency Law, the court is obligated to reject the ratification of a composition plan, despite has been approved by the creditor, if certain conditions are met as follows:

a) The value of the debtor's assets is far more than what was specified in the plan.
b) Implementation of the composition plan is not adequately assured.
c) The voting outcome may have been influenced by fraudulent activities, collusion with one or more creditors, or other unfair measures, regardless of whether the debtor or any other party cooperated in this matter.
d) The administrators' fees and PKPU expenses incurred have yet to be paid, or no assurance has been offered for their payment.

The above provisions are broadly similar, if not identical, with Articles 272 (1), (2), (3) and (4) of the Dutch Bankruptcy Act. From the grammatical interpretation of the text, the court has the power not to ratify the composition plan if it finds a violation of Article 285 (2) of the Indonesian Insolvency Law. If the court, in the end, declines to ratify the composition plan, the court must subsequently declare the debtor bankrupt.[58] The provision does not imply that the court could only examine the composition plan in response to a challenge from creditors. However, according to reports from Indonesian practitioners, the court is reluctant to deviate from the result of the voting on the composition plan.[59] This situation demonstrates that the court will typically act passively and ratify the composition plan that has been approved by the creditors if there is no objection to the composition plan.

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[56] Article 281 of the Indonesian Insolvency Law.

[57] Based on email-based interviews held on March 9, 2023, with an Indonesian bankruptcy practitioner who was also a former chairman of the Indonesian Receiver and Administrators Association (AKPI).

[58] Article 285 (3) of the Indonesian Insolvency Law.

[59] C. Watters, SPVs as a barrier to cross-border insolvency proceedings: Lessons from Indonesia, Australian Journal of Corporate Law, at 252 (2017). It should be noted that as the reports were made in 2017, circumstances may have changed in the past six years.

Furthermore, the law does not state that only creditors who disagree with the composition plan are permitted to challenge it based on this provision, thus it is shall be interpreted as available to all creditors. Based on Article 284 (1) of the Indonesian Insolvency Law, the administrator, supervisory judge, and creditors are required to express their views on the substance of the composition plan. They may request the court to not ratify the composition plan on the grounds that there is a violation of Article 285 (2) of the Indonesian Civil Code.[60]

An instance can be observed in the decision of Central Jakarta Commercial Court,[61] that decided not to ratify the composition plan for reasons of violation of the provisions in Article 285 (2) (b) (c) and (d) of the Indonesian Insolvency Law. In that decision, the court considered the reports and opinions submitted by the administrator team, supervisory judges, and creditors, indicating that the composition plan contravened the Indonesian Insolvency Law. It can be argued that the administrator, supervisory judges, and creditors play a pivotal role and hold significant influence in controlling and supervising the composition plan prior to its ratification by the court. Thus, Article 285 (2) of the Indonesian Insolvency Law provision could be deemed as a control mechanism to ensure the composition plans comply with the Indonesian Insolvency Law.

Following the court's ratification of the composition plan, creditors retain the right to challenge that decision by filing an appeal to the Supreme Court.[62] Furthermore, creditors also have the right to pursue cancellation of the composition plan in the event of non-compliance with the terms of the composition plan, which may ultimately lead to the debtor's declaration of bankruptcy.[63] The difference between challenge and cancellation is that the latter relates to a composition plan that has been ratified by the court and is sought to be annulled due to debtor's default implementing the plan; there is no issue regarding the ratification of the composition plan. In a challenge, the issue is related to the ratification of the composition plan, whether it has complied with the Indonesian Insolvency Law and thus can be ratified by the court.

2.2.3. Supervision on The PKPU

With regard to the process of PKPU itself, a supervisory judge, one or more creditor, or the court may request for termination of PKPU in the event:[64]

a) The debtor, during the period of PKPU, acted in bad faith in managing their assets.
b) The debtor has harmed its creditors or attempted to do so.
c) The debtor engages in the management or transfer of its assets without obtaining authorisation from the administrator.
d) The debtor fails to do what the court ordered at the time or after the PKPU was granted or fails to do what the administrator requires in the best interest of the debtor's assets.
e) The debtor's assets are in such a state that it is no longer possible to continue the PKPU; or
f) It is unreasonable to expect the debtor to fulfil its obligations to its creditors by the time scheduled.

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[60] Articles 284 and 285 of the Indonesian Insolvency Law.

[61] Central Jakarta Commercial Court Decision No. 04/Pdt.Sus-PKPU/2018/PN.Niaga.Jkt.Pst. dated 26 September 2018.

[62] Article 285 (4) of the Indonesian Insolvency Law.

[63] Article 291 of the Indonesian Insolvency Law.

[64] Article 255 of the Indonesian Insolvency Law.

This provision could be interpreted as an instrument to limit and restrict the debtor's behaviour in order to prevent bad faith actions, as the debtor might consider the possibility of PKPU termination and bankruptcy.

Despite the aforementioned protections, the Indonesian Insolvency Law does not have any protection, especially with regard to: (i) the best-interest-of-creditors test or 'no creditor worse off'; and (ii) the fairness test. This situation may hamper the (unsecured) creditor's rights as there is no adequate protection concerning the fair treatment in the composition plan under the Indonesian Insolvency Law. A concept under Indonesian Insolvency Law that is arguably similar to the best-interest-of-creditors test is the provision under Article 285 (2) (a) of the Indonesian Insolvency Law. According to this provision, the court shall reject to ratify the composition plan, even if it has been approved by the creditor majority, if it is found that the Debtor's asset is far more greater than what is specified in the composition plan. Further analyses with regard to the best-interest-of-creditors test and the fairness test will be discussed in Chapter 5 below.

2.3. A Recent Development on The Current Indonesian Insolvency Law

2.3.1. Trends in PKPU

The PKPU, in some cases, is used for purposes other than suspension of payment (restructuring). For instance, the PKPU is used by a creditor as a tool for debt recovery.[65] The creditor takes this strategy because it is more efficient to file a PKPU petition, with a fixed time limit than to engage in lengthy civil litigation. The PKPU may also be used as a defence against a bankruptcy petition filed against the debtor.[66] Article 229 (4) of the Indonesian Insolvency Law stipulates that a PKPU petition filed after a bankruptcy petition must be decided beforehand. Hence, a debtor files a voluntary PKPU petition, as a defence, instead of going into bankruptcy proceedings.

Furthermore, practitioners have raised criticism regarding the ability of a creditor to file a petition of PKPU against a debtor.[67] This critique is based on the fact that no party besides the debtor has exact knowledge of the debtor's financial situation. Hence, it is illogical for a creditor to initiate a PKPU petition for the purpose of restructuring the debtor's debt. In addition, it is not in the creditor's best interest to suspend the debtor's payment obligation on their outstanding debts.

2.3.2. Development of The Indonesian Insolvency Law

Indonesian Insolvency Law does not provide any legal remedies to challenge the court decision that rejects the composition plan.[68] However, the Constitutional Court substantially changed the Indonesian Insolvency Law through its Decision No. 23/PUU-XIX/2021 in 2021.[69] In light of the recent ruling, it is now possible to challenge the court's decision that rejects a composition plan

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[65] S. Anisah, *Perlindungan Kepentingan Kreditor Dan Debitor Dalam Hukum Kepailitan Di Indonesia*, Total Media, at 227 (2008).

[66] S. Adi Nugroho, Hukum Kepailitan Di Indonesia Dalam Teori dan Praktik Serta Penerapan Hukumnya, Prenadamedia Group, at 296 (2018).

[67] https://www.bphn.go.id/data/documents/naskah_akademik_ruu_kepailitan_dan_pkpu_final_2018.pdf, last visited (28-06-2023).

[68] Articles 285 (4) of the Indonesian Insolvency Law.

[69] Constitutional Court Decision No. 23/PUU-XIX/2021 dated 15 December 2021.

to the Supreme Court, provided that two conditions are met: (i) the creditors initiate the PKPU, and (ii) the creditors reject the composition plan proposed by the debtor.

Based on the Indonesian parliament's website,[70] there is a plan to amend the Indonesian Insolvency Law, although most likely, it will not be completed in the near future as it is not included in the priority list.[71] Further, the Indonesian Law Development Agency (*Badan Pembinaan Hukum Nasional* – BPHN)[72] made a report on the analysis and evaluation of the current Indonesian Insolvency Law and produced an academic paper for the draft of the new Indonesian Insolvency Law.[73] However, the report and the draft do not discuss the best-interest-of-creditor and fairness criteria.

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[70] https://www.dpr.go.id/uu/prolegnas-long-list, last visited (28-06-2023).

[71] https://thelawreviews.co.uk/title/the-restructuring-review/indonesia, last visited (28-06-2023).

[72] https://bphn.go.id/data/documents/pokja_kepailitan.pdf, last visited (28-06-2023).

[73] https://www.bphn.go.id/data/documents/naskah_akademik_ruu_kepailitan_dan_pkpu_final_2018.pdf, last visited (28-06-2023).

3. Principles and Good Practices Promoted in The ADB Good Practice Standards

3.1. Background of The ADB Good Practice Standards

The Asian Development Bank ("**ADB**") was founded in 1966 with the objective of supporting economic development for the member nations in the region, both as a group and as individual countries.[74] Due to the 1997 Asian financial crisis, ADB members[75] acknowledged the need for a comprehensive legal framework and corporate debt restructuring in the private sector and attempted to reform their insolvency law. ADB members have acknowledged that modern and comprehensive insolvency law is necessary to obtain investors' trust and stimulate the economy. However, several members still have outdated laws that no longer suit the modern business climate. One of those is Indonesia, whose Bankruptcy Law was still based on the Dutch Bankruptcy Act of 1896.[76]

In response to the above challenges, in 1998, the ADB provided Regional Technical Assistance ("**RETA**")[77] to its members, aimed at establishing a regional platform to discuss common challenges in insolvency law and examining the good practices at both regional and global levels.[78] The ADB conducted individual studies for each RETA Economies (including Indonesia), conducted by local experts based on guidelines created by the ADB's international expert. The studies aim to provide suggestions for reforming and further developing the insolvency law of each member of ADB.

To establish good practice standards, the ADB conducted a comparative analysis of the formal corporate insolvency laws of RETA Economies. This project encountered various challenges due to the absence of a universal concept of insolvency law and differences in legal system traditions, political and economic policies, and court systems. Despite their differences, the RETA Economies still have some underlying basic principles in common.[79] Thus, it is possible to attain well-established standards that are relevant, suitable, and practical for the RETA Economies. In the end, the ADB published a companion volume containing two reports: (i) 'Insolvency Law Reforms in the Asia and Pacific Region'; and (ii) 'The Need for an Integrated Approach to Secured Transaction and Insolvency Law Reform.'[80] This thesis will concentrate on the first issue in which the ADB has provided good practices that RETA Economies could use to reform its insolvency laws.

In the report, the ADB distinguishes the RETA Economies into three categories: (i) Category A: English law-based RETA Economies; (ii) Category B: civil (Japanese) law-based RETA Economies; and (iii) Category C: Mixed Legal Heritage RETA Economies. Indonesia has been

[74] Agreement Establishing the Asian Development Bank (ADB Charter), 22 August 1966.
[75] Indonesia has been a member of ADB since 1966. *See* https://www.adb.org/who-we-are/about#members, last visited (28-06-2023).
[76] ADB, Technical Assistance for Insolvency Law Reform, TAR: CON 32395, at 1 (1998).
[77] The RETA 5795: Insolvency Law reform are focused on 11 Asian countries, namely: Korea, Japan, Taiwan, Hong Kong, Indonesia, Singapore, Malaysia, Thailand, India, Pakistan, and the Philippines, hereinafter collectively referred to ("**RETA Economies**"). *See* ADB, Technical Assistance for Insolvency Law Reform, TAR: CON 32395, at 3 (1998).
[78] ADB, Technical Assistance for Insolvency Law Reform, TAR: CON 32395, at 1 (1998).
[79] ADB Good Practice Standards, at 25-26.
[80] ADB Good Practice Standards, at iii.

classified into Category C by the ADB.[81] It is noteworthy that at that time, Indonesia was still utilising the Bankruptcy Ordinance, which was derived from the Dutch Law of the late 19th century. This report was notable for its set of thirty-three standards that would be used to evaluate these countries to each other and, more importantly, to a made-up absolute standard.[82]

There has not been much progress since the ADB's report publication. However, Ron Hamer,[83] who reviewed other insolvency standards such as the European Bank for Reconstruction and Development (EBRD), World Bank 'Principles,' and the United Nations Commission on International Trade Law Legislative Guide for Insolvency Law, concludes that the approaches taken in 1998 have remained largely unchanged to this day.[84] It is worth mentioning that the pioneering RETA's work has been acknowledged by The United Nations Centre for International Trade Law (UNCITRAL), which has included these good practice standards in its draft Legislative Guide on Insolvency Law.[85] Therefore, it could be said that the ADB Good Practice Standards, established by the ADB decades ago, are still relevant to be discussed and analysed in referring to comprehensive insolvency law in Asia.

Further development on the insolvency law reform in Asia was conducted by the Organisation for Economic Co-Operation and Development ("**OECD**"). The OECD released a report and conducted studies on insolvency systems in Asia, in 2001[86] and 2006[87], with the aim of providing a deeper understanding of the insolvency systems in the surveyed countries, including Indonesia. In the report, the OECD acknowledges the advantages derived from the research conducted by the ADB on comparable matters.[88] In this chapter, references will also be made to reports conducted by OECD.

It is mentioned in the ADB's report that a corporate insolvency law regime may be expected to encompass two distinct procedures, namely liquidation and rescue. The rescue process will be the main focus of this thesis, which entails the preservation of a financially distressed corporate debtor rather than its liquidation. This concept is rooted in economic theory, which suggests that liquidating all enterprises may not be necessary, and the opportunity should be granted to a profitable or potentially profitable business.[89]

The ADB Good Practice Standards cover numerous areas and aspects of formal insolvency law. As explained in the aforementioned chapters, this thesis focuses on the substantive aspect of insolvency law regarding fair treatment towards unsecured creditors in formal restructuring proceedings, e.g., the best-interest-of-creditors test and the fairness test. Thus, the subsequent discussion will focus on the formulation of a composition plan that shall consider the interest of creditors and ensure their fair treatment under the ADB Good Practice Standards.

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[81] ADB Good Practice Standards, at iii.
[82] B. G. Carruthers & T. C. Halliday, Negotiating Globalisation: Global Scripts and Intermediation in the Construction of Asian Insolvency Regimes, Law & social inquiry 31.3, at 536 (2006).
[83] Ronald Winston Harmer is the principal author of the ADB's report (ADB Good Practice Standards) and developed the framework for RETA.
[84] R. Harmer, Assessing the Assessments, International insolvency review, at 3 (2014).
[85] ADB, Law and Policy Reform in Asia and the Pacific: Ensuring Voice Opportunity & Justice, at 8 (2005).
[86] OECD, Insolvency Systems in Asia: An Efficiency Perspective, Paris: OECD Publishing, at 65 (2001).
[87] OECD, Asian Insolvency Systems: Closing the Implementation Gap, Paris: OECD Publishing, (2007).
[88] OECD, Insolvency Systems in Asia, Paris: OECD Publishing, at 65 (2001).
[89] ADB Good Practice Standards, at 17.

3.2. Good Practice of The Best-Interest-of-Creditors Test in The Formulation of a Reorganization Plan

One of the aspects emphasised by the ADB in formulating a composition plan (within the context of the ADB called reorganization plan)[90] is the nature or form of the composition plan. The ADB is of the view that the primary objective of a rescue operation is to optimise the potential return to the creditors and generate a better result than the hypothetical scenario of debtor liquidation. In accordance with this objective, an independent adviser should provide a statement of purpose to that effect. The proposed composition plan must be accompanied by an objective statement regarding the debtor's financial condition and the commercial viability of the plan. Lastly, it is necessary that a specific timeframe be mandated by the law for the submission of a composition plan to ensure both predictability and effectiveness. It is believed that imposing a time limit might put pressure on both the debtor and creditors, thereby facilitating the accomplishment of an agreement that is mutually favourable.[91]

In light of the above considerations, the ADB concluded the Good Practice Standards 10.1 and 10.2 below:[92]

Good Practice Standards 10.1 and 10.2

(1) "The law should not proscribe the nature of a plan, except in regard to fundamental requirements and to prevent commercial abuse. In particular, the law should not intrude into the 'commerciality' of a plan except to ensure that the result of a plan will provide a greater benefit to creditors than in a liquidation of the debtor

(2) The law should provide for objective analysis of a proposed plan by an independent adviser. In particular, it should be demonstrated that the proposed result or effect of a plan is commercially sound."

The formulation used in the good practice standard 10.1 indicates that it pertains to the principle of the best-interest-of-creditors test, with the objective of safeguarding that creditors receive no less than what they would have obtained had the debtor been liquidated. The approach that is taken by the ADB is similar with the World Bank Principles (2021) which stated in section C14.2 (Plan Formulation and Consideration):[93] "*There should be a flexible approach for developing the plan consistent with fundamental requirements designed to promote fairness and prevent commercial abuse."* The main idea behind this test is to prevent creditors from being taken advantage of by an unjust composition plan. Thus, a certain threshold must be met in which creditors shall receive at least more than they would have if, hypothetically, the debtor's assets were liquidated.

Further, according to the good practice standards 10.1, it is recommended that insolvency law should not concern with the nature or form of the plan. For instance, the law should not stipulate that a debt cannot be cancelled, nor should it stipulate a minimum amount that must be paid to creditors over a period of time. Essentially, the determination of the appropriate commercial

[90] As has been described before, the term 'composition plan' shall have the same meaning with the term 'reorganization plan' that is used in the ADB Good Practice Standards, *See* footnote 4.
[91] ADB Good Practice Standards, at 44-45.
[92] ADB Good Practice Standards, at 45.
[93] World Bank, Principles for Effective Insolvency and Creditor/Debtor Regimes. © World Bank, Washington, DC, at 27 (2021).

solution for the nature of the composition plan should be left to the market within the framework of insolvency law.[94] Presumably, the ADB wants to provide a flexible room for negotiation, and there might be a creative commercial solution that might be reached that could benefit all insolvency stakeholders, as long as it is within the corridor of best-interest-of-creditors test.

One potential issue that could arise is related to the valuation of the debtor's assets, which may serve as the decisive factor for creditors in determining whether they choose restructuring or liquidation.[95] The ADB suggested in good practice standard 10.2 that there should be an objective statement from an independent adviser confirming that the nature of the rescue process is to provide creditors with a better outcome than if the debtor were liquidated. Likewise, it is essential that a proposed plan should be accompanied by an independent evaluation of the commercial feasibility of such a plan.[96]

Further, in the report, the ADB indicates that apart from Singapore and Thailand, insolvency laws in the RETA Economies do not mandate that the outcome of a composition plan must provide greater benefits to creditors than the liquidation of the debtor – best-interest-of-creditors test. The lack of a mandatory objective evaluation of a plan in certain RETA economies contributes to this issue to some extent. According to the ADB's report, Indonesia partially implemented the Good Practice Standards 10.1.[97] However, The ADB provides no additional clarification regarding which aspect of the Good Practice Standard 10.1 Indonesia has partially implemented. Based on my observations, the Indonesian Insolvency Law partially implements the Good Practice Standard 10.1 as it does not interfere with the commerciality of the composition plan; but does not ensure that no creditors will be worse off, compared to liquidation, by the outcome of the composition plan.

In addition, the ADB also established the Good Practice Standard 11, as follow:[98]

Good Practice Standard 11
"The law should provide for a court or other tribunal to have a general supervisory role of the rescue process. In particular the court or tribunal should be empowered to set aside the approval of a plan if it is shown that it is not in the best interests of creditors considered as a whole."

The ADB uses the term "best interest of creditors", unfortunately, without defining its meaning. In this context, the ADB focuses on the court's authority and role to determine whether the plan approved by the majority of creditors is unfair and not in the best interest of creditors as a whole. The ADB believes that the court should not be required to 'second-guess' creditors' decisions. It does not imply, however, that a court should not examine whether the creditors' decision was obtained properly. Further, the ADB opined that it might be better if the court has a general supervisory power to review, upon challenge by affected and dissenting party. This would give a minority of creditors the right to challenge a plan by which it was obtained (such as 'insider' votes).[99]

[94] ADB Good Practice Standards, at 44.
[95] OECD, Insolvency Systems in Asia: An Efficiency Perspective, Paris: OECD Publishing, at 26 (2001).
[96] ADB Good Practice Standards, at 44.
[97] ADB Good Practice Standards, at 45.
[98] ADB Good Practice Standards, at 47.
[99] ADB Good Practice Standards, at 46

Based on the report, the ADB mentioned that the control or function of the courts is very involved in Indonesia.[100] On theoretical grounds, it seems that the court has a significant involvement in supervising the restructuring proceedings. The court has the power to reject the composition plan, even if creditors make no challenge, if it violates Article 285 (2) of the Indonesian Insolvency Law. However, in practise, the court acts passively, as it will not review whether the composition plan has complied with the Indonesian Insolvency Law if no challenge is filed against it. Thus, I disagree with the ADB report's assessment of the degree of the court's involvement in restructuring proceedings.

3.3. Good Practice of The Fairness Test in The Reorganization Plan

As described in the aforementioned paragraphs, the fairness test in the context of this thesis shall mean (i) no more than 100% rule and (ii) equal treatment of creditors. However, only the latter is specifically discussed in the ADB Good Practice Standards. The ADB gave a disclaimer stating that the standards are not intended to be exhaustive and only address the most important areas that may be deemed crucial to debtor-creditor relationships in a corporate insolvency environment.[101]

Further, The ADB emphasised that priority payments to creditors should be limited as much as possible in order to give greater effect to one of the fundamental principles of insolvency, equal treatment for creditors. It is prominent that specific exemptions exist, such as payment for secured creditors from the proceeds of collateral and remuneration of the insolvency administration. Notwithstanding the aforementioned exceptions, the objective of a modern insolvency law framework should be to limit the number of priority claims.[102]

Further, the ADB established the Good Practice Standard 13, as below:

Good Practice Standard 13
"An insolvency law regime should, as far as possible, preserve the principle of equal treatment for all creditors. Accordingly, the insolvency law should limit the number of priority claims to as few as possible."

The ADB refer to the term 'equal treatment for creditors' in this standard.[103] However, it differs from the concept of equal treatment towards creditors promoted by the World Bank,[104] which evaluates the circumstances of creditors with a similarly situated condition (creditors within the same group). The Good Practice Standard 13 compares the treatment of creditors who do not belong to the same class and, particularly, seeks to limit the claims' priority. It is arguably more akin to principle C12.3 by the World Bank,[105] which in essence restricts the prioritisation of a specific category of claims unless there exists a compelling rationale that justifies such prioritisation.

[100] ADB Good Practice Standards, at 47.
[101] ADB Good Practice Standards, at 27.
[102] ADB Good Practice Standards, at 45.
[103] ADB Good Practice Standards, at 48.
[104] World Bank, Principles for Effective Insolvency and Creditor/Debtor Regimes. © World Bank, Washington, DC, at 21 (2021).
[105] World Bank, Principles for Effective Insolvency and Creditor/Debtor Regimes. © World Bank, Washington, DC, at 26 (2021).

The ADB does not explicitly prohibit priority claims but instead advocates for their restriction to the lowest level possible. In the report, only secured creditors and the insolvency administration cost that certainly should be paid in priority to any other claim; other than that priority of claims must be limited.[106]

In the report, the ADB specifically mentions Indonesia as one of the RETA Economies that have a long list of priority claims over other creditors.[107] Furthermore, the ADB makes recommendations to review priority provisions in insolvency law by considering policy, economic, and commercial concerns.[108] Nevertheless, the ADB only focuses on general principles without offering additional clarification on the measures to restrict such priority claims and the specific standards that a claim must satisfy to be given priority.

[106] ADB Good Practice Standards, at 48.

[107] *See* Chapter 2.1.2 Classification of Creditors and Voting on The Composition Plan.

[108] ADB Good Practice Standards, at 45.

4. Principles and Regulations in The EU Preventive Restructuring Directive

4.1. Background and Legal Framework of The EU Preventive Restructuring Directive

The insolvency framework of European Union ("**EU**") Member States has traditionally been characterised by a harsh approach, whereby debtors in financial distress are typically forced into liquidation proceedings and bear a negative connotation for the insolvent party. In addition, the financial crisis of 2007/2008 resulted into the bankruptcy of numerous European companies, leaving them incapable of recovering from the financial difficulties they encountered. Following that, many Member States responded by conducting a reform towards their insolvency law, with respect to their restructuring procedures, resulting in various approaches of business rescue across the Member States.[109]

In response to this situation, It is deemed essential to establish a harmonious approach in the field of restructuring in order to facilitate a properly functioning internal market (within the EU) and ensure the resilience of European economies, while also promoting job preservation, job creation and economic growth.[110] Further, the European Commission adopted the EU Preventive Restructuring Directive in 2019 with the aim to enhance the ability of businesses to engage in restructuring.[111] It is worth mentioning that the EU Preventive Restructuring Directive is in line with other international insolvency law standards, such as the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency, the World Bank 'Principles for Effective Insolvency and Creditor/Debtor Regimes', and the World Bank Doing Business project.[112]

The Member States are expected to have implemented the Directive by 17 July 2021, with a maximum one-year extension period.[113] Although the EU Preventive Restructuring Directive provides considerable flexibility to Member States for implementation, it is evident that Member States have been urged to establish a modern restructuring framework.[114] Implementing a harmonised preventive restructuring framework across the EU seeks to establish a level playing field among Member States, thereby promoting the effective functioning of the internal market.[115]

The subject matter and scope of the Directive that need to be adopted by national legislators is specified under Article 1 of the EU Preventive Restructuring Directive. The EU Preventive

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[109] D. Christoph Ehmke, et al., The European Union Preventive Restructuring Framework: A Hole in One?, International Insolvency Review 28.2, at 185-186 (2019).

[110] Recital 8 of the EU Preventive Restructuring Directive.

[111] G. McCormack, The European Restructuring Directive, Cheltenham: Edward Elgar Publishing Limited, at 14 (2021).

[112] G. McCormack, The European Restructuring Directive, Cheltenham: Edward Elgar Publishing Limited, at 21 (2021).

[113] Article 34 of the EU Preventive Restructuring Directive.

[114] J.L.L Gant, et al., The EU Preventive Restructuring Framework: In Extra Time?, *Fizetésképtelenségi Jog* (Insolvency Law), at 1 (2022).

[115] C. G. Paulus, R. Dammann & T. Braegelmann European Preventive Restructuring: Directive (EU) 2019/102, Article-by-Article Commentary, Ed. C. G. Paulus, R. Dammann & T. Braegelmann. Oxford, United Kingdom: Hart Publishing, at 86 (2021).

Restructuring Directive is excluded to certain financial institutions, public bodies governed by national law, and non-entrepreneurial individual.[116]

The Directive provide a framework that aims to ensure financially distressed yet viable and honest business have the opportunity for restructuring while keeping their business operations and receiving a second chance, allowing them to have a fresh start and restoring stability.[117] Further, the Directive mandates that member states implement a legal framework that enables the adoption of a composition plan (within the context of the Directive called restructuring plan),[118] without prescribe rules on the commercial content of the plan.[119] Nevertheless, the EU Preventive Restructuring Directive also established certain safeguards with regard to the protection of creditors affected by the composition. In order for a composition plan to be confirmed by the court, it must comply with Articles 10 (2) and (3) of the EU Preventive Restructuring Directive, which contain, among others, the best-interest-of-creditors test and the fairness test.

The next section is going to focus on the protection of creditors prior to court confirmation of the composition plan. The primary focus of the following discussion will be to explain and examine the implementation of the best-interest-of-creditors test and the fairness test in the EU Preventive Restructuring Directive.

4.2. The Best-Interest-of-Creditors Test in The Restructuring Plan

The EU Preventive Restructuring Directive established various kinds of safeguards modelled after the modern reorganisation framework.[120] After the creditors have voted on the composition plan, the plan needs to be confirmed by the court to bind all (dissenting) creditors (cram-down).[121] One of the criteria that will be examined by the court is whether the composition plan has satisfied the best-interest-of-creditors-test, key protection for creditors that derives from the US Bankruptcy Law.[122] According to this test, a court can only confirm a composition plan if no creditor is worse off as a result of the composition plan, whether in piecemeal or a going concern sale.[123]

The EU Preventive Restructuring Directive explicitly provides a definition of the best-interest-of-creditors-test, under Article 2 (1) (6) of the EU Preventive Restructuring Directive:
'best-interest-of-creditors test' means a test that is satisfied <u>*if no dissenting creditor*</u> *would be worse off under a restructuring plan than such a creditor would be if the normal ranking of liquidation priorities under national law were applied, either in the event of liquidation, whether*

[116] Article 1 (2) of the EU Preventive Restructuring Directive.
[117] Recital 1 of The EU Preventive Restructuring Directive.
[118] As has been described before, the term 'composition plan' shall has the same meaning with the term 'restructuring plan' that is used in the EU Preventive Restructuring Directive, *See* footnote 4.
[119] C. G. Paulus, R. Dammann & T. Braegelmann European Preventive Restructuring: Directive (EU) 2019/102, Article-by-Article Commentary, Ed. C. G. Paulus, R. Dammann & T. Braegelmann. Oxford, United Kingdom: Hart Publishing, at 87 (2021).
[120] J. Garrido, et all., Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive, IMF Working Paper, at 21 (2021).
[121] M. Veder & A. Mennens, Preventive Restructuring Frameworks, in Danny Busch, Emilios Avgouleas, and Guido Ferrarini (eds), Capital Markets Union in Europe (Oxford), at 578 (2018).
[122] J. Garrido, et all., Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive, IMF Working Paper, at 21 (2021).
[123] B, Wessels, S. Madaus, Instrument of the European Law Institute: Rescue of Business in Insolvency Law, Instrument of the European Law Institute (ELI), at 42 (2017).

piecemeal or by sale as a going concern, or in the event of the next-best-alternative scenario if the restructuring plan were not confirmed."

Further, Article 10 (2) (d) of the EU Preventive Restructuring Directive stated that:
"Member States shall ensure that the conditions under which a restructuring plan can be confirmed by a judicial or administrative authority are clearly specified and include at least the following: …(d) where there are dissenting creditors, the restructuring plan satisfies the best-interest-of-creditors test."

Member states should ensure that a court is able to reject a plan if dissenting creditors receive a less than what they would get if the debtor's business was liquidated, either in: (i) liquidation: piecemeal or as a going concern; or (ii) the next-best-alternative scenario if the composition plan were not confirmed.[124] The best-interest-of-creditors test serves to protect the interests of individual creditors by ensuring that the proposed composition plan does not result in any creditor receiving an amount less than what they would have obtained in the event of the debtor's assets being liquidated.[125] This test therefore provides a minimum standard what the creditors will get, based on priority of claim, in case of hypothetical liquidation of the debtor's assets.

Valuation plays a critical role in restructuring.[126] With respect to the best-interest-of-creditors test, it is essential for creditors to know the value of the debtor's assets in order to compare what they would receive under the composition plan and in liquidation. This test look into the liquidation value – liquidation quota, which serves as a minimum recovery level entitled to each creditor. The objective is to prioritise the collection of creditor claims. A composition plan is only justifiable if the value of the business as going concern exceeds the value of the business in liquidation. Thus, for instance, it is not permissible to propose that creditors receive 50 over the course of five years under the composition plan when they could receive 50 immediately by liquidating the debtor's assets.[127]

Since comparing liquidation value and restructuring value is crucial in this context, creditors must be conscious of these valuations to make an informed decision on whether to approve or reject the composition plan. The EU Preventive Restructuring Directive requires the debtor to provide information on its assets and liabilities as part of the content of the composition plan.[128] This information is neither audited nor official because it is the debtor's own valuation of its assets. Thus, it is possible for debtors to undervalue the liquidation value stated in the composition plan in order to persuade creditors to vote in favour of the composition plan.[129] The debtor may do so to make the composition plan appear to be more beneficial to creditors than the liquidation.

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[124] Recitals 49 and 52 of the EU Preventive Restructuring Directive.

[125] J. Garrido, et all., Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive, IMF Working Paper, at 21 (2021).

[126] T. Richter & A. Thery, INSOL Europe Guidance Note on the Implementation of Preventive Restructuring Frameworks under EU Directive 2019/1023: Claims, Classes, Voting, Confirmation and the Cross-Class Cram-Down, at 42 (2020).

[127] T. Richter & A. Thery, INSOL Europe Guidance Note on the Implementation of Preventive Restructuring Frameworks under EU Directive 2019/1023: Claims, Classes, Voting, Confirmation and the Cross-Class Cram-Down, at 43-44 (2020).

[128] Article 8 (b) of the EU Preventive Restructuring Directive.

[129] J. Garrido, et all., Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive, IMF Working Paper, at 18 (2021).

The EU Preventive Restructuring Directive tends to have court involvement only if it would benefit creditors and enhance the efficiency of the restructuring process instead of making matters worse.[130] The objective is to avoid the necessity of assessing the value of the debtor's assets in each restructuring case.[131] The court will only assess the value of the debtor's business if an affected party contests a composition plan on the grounds that it does not satisfy the best-interests-of-creditors test.[132] Simply determining the liquidation value is not sufficient. The court also must determine whether the value granted to creditors under the composition plan are at least equivalent to what they would have received through liquidation of the debtor's assets.[133]

A possible dilemma may arise regarding the imposition of a requirement to incorporate an expert-prepared valuation in relation to the debtor's asset. Conducting an official valuation of the debtor's assets incurs additional expenses in the restructuring procedure. It might be a challenge especially for micro and small enterprises. However, the valuation of debtor's assets provides essential information to creditors in deciding to vote on the composition plan. The Directive further states that the inclusion of an expert opinion on the valuation of the debtor's assets is a discretionary measure available to Member States as part of the plan.[134]

The application of the best-interest-of-creditors test occurs during the pre-court confirmation phase of the composition plan, which serves as a control mechanism for dissenting creditors. Depending on national law, violation of this test may also be used as a basis to challenge the ratified composition plan.[135] Thus, it may be inferred that the application of the best-interest-of-creditors test depends on challenges from dissenting creditors. The court will not conduct an examination on its own (*ex officio*) to determine whether or not the composition plan satisfies the best-interest-of-creditors test if no affected creditor challenge the composition plan. On the other hand, the court will assess whether the composition plan has met the best-interest-of-creditors test if there are challenges to the composition plan, notwithstanding the acceptance of the composition plan by all classes. In addition, the EU Preventive Restructuring Directive does not require (insolvency) practitioners to evaluate whether the composition plan has satisfied the best-interests of creditors test.

It can be concluded that the best-interest-of-creditors test safeguards the interests of each individual creditor, including unsecured creditors, from being expropriated by the composition plan. However, this test could only be triggered if there are challenges with regard to the composition plan. Thus, it could be argued that the composition plan could be ratified even if it violates the best-interest-of-creditors test, if no creditors challenge the composition plan. Furthermore, as this test ensure the value provided in the composition plan at least more than what would that creditors receive in liquidation, the best-interest-of-creditors test may have no

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[130] I. Lynch Fannon, et al., Corporate Recovery in an Integrated Europe, Cheltenham: Edward Elgar Publishing Limited, at 198 (2022).

[131] G. McCormack, The European Restructuring Directive, Cheltenham: Edward Elgar Publishing Limited, at 177 (2021).

[132] Article 14 (1) (a) of the EU Preventive Restructuring Directive. The court may appoint an expert to determine the valuation of the debtor; see Article 14 (2) of the EU Preventive Restructuring Directive

[133] M. Veder & A. Mennens, Preventive Restructuring Frameworks, in Danny Busch, Emilios Avgouleas, and Guido Ferrarini (eds), Capital Markets Union in Europe (Oxford), at 579 (2018).

[134] J. Garrido, et all., Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive, IMF Working Paper, at 17-18 (2021).

[135] Article 16 of the EU Preventive Restructuring Directive.

impact when unsecured creditors would receive nothing in the event of liquidation (out-of-money creditors).

The application of the best-interest-of-creditors test under the Directive may be illustrated by an example, in the table below:[136]

Classes of Creditors	Restructuring Value Scenario 1	Restructuring Value Scenario 2
Secured creditors	100%	100%
Unsecured creditors	60%	20%
The best-interest-of-creditors test	comply	violate

The first scenario fulfils the best-interest-of-creditors test as the composition plan provides a restructuring value in the amount of 100% to the secured creditors and 60% to the unsecured creditors, in which no creditors receive less than what would the liquidation value (100% for secured creditors and 50% for unsecured creditors). On the other hand, the second scenario breaches the best-interest-of-creditors test as the unsecured creditors only receive 20% in the composition plan, which is less than the liquidation value (50%). Thus, in the second scenario, the dissenting creditors may challenge the composition on the ground of breach of the best-interest-of-creditors test and request the court not to ratify the composition plan.

4.3. Standard of The Fairness Test in The Restructuring Plan

The EU Preventive Restructuring Directive allows a composition plan to be confirmed by the court and binding on dissenting classes even if it is not approved by all classes (majority) of creditors. This mechanism, known as cross-class cram down, allows dissenting classes of creditors to be bound to the composition plan if certain conditions are met.[137] One of the criteria that shall be met is the term fairness test. The EU Preventive Restructuring Directive does not explicitly refer to the 'fairness test' in its provisions. However, the INSOL Europe Guidance Note on the Implementation of EU Preventive Restructuring Directive[138] explains that the fairness test consist of: (i) the priority rule;[139] (ii) no more than 100% rule;[140] and (iii) equal treatment of creditors.[141]

The priority rule deals with the protection of the interests of classes of creditors and ensures that the hierarchy (rank) of classes of creditors is respected. This rule pertains to the distribution of value between classes of creditors (senior to junior).[142] Member states may choose at their discretion to either adopt absolute priority rule or, a more flexible approach, the relative priority rule.[143] The default rule of the Directive is the relative priority rule, which stipulates that a

[136] In both scenarios, in case of liquidation, the secured creditors will receive 100% claim while the unsecured creditors will receive 50% claim.
[137] Article 11 (1) of the EU Preventive Restructuring Directive.
[138] T. Richter & A. Thery, INSOL Europe Guidance Note on the Implementation of Preventive Restructuring Frameworks under EU Directive 2019/1023: Claims, Classes, Voting, Confirmation and the Cross-Class Cram-Down, at 27-28 (2020).
[139] Article 11 (2) of the EU Preventive Restructuring Directive.
[140] Article 11 (1) (d) of the EU Preventive Restructuring Directive.
[141] Article 10 (2) (b) of the EU Preventive Restructuring Directive.
[142] N. W. A. Tollenaar, The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings, Insolvency Intelligence, Vol. 30(5), at 5 (2017).
[143] Recitals 55 and 56 of the EU Preventive Restructuring Directive.

composition plan must ensure that dissenting voting class of affected creditors receive treatment that is at least as favourable as any other class of the same rank and more favourably than any junior class.[144] While in principle, the absolute priority rule stipulates that members of a dissenting class, in composition plan, must share the restructuring value according to their rank.[145]

The priority rule only apply in a non-consensual plan scenario, cross-class cram down,[146] in which related to the vertical relation of creditors (between classes of creditors). Due to the fact that Indonesian Insolvency Law does not recognise the concept of cross-class cram-down, the priority rule falls outside the scope of this thesis.[147] The fairness test, for the purposes of this thesis, will only refer to the "no more than 100% rule" and equal treatment of creditors.

The 'no more than 100%' rule or 'the corollary to the priority rule' is relatively straightforward. Article 11 (1) (d) of the EU Preventive Restructuring Directive stipulates that (additional information and underlined by the author): "*no class of affected parties can, under the restructuring plan (composition plan), receive or keep more than the full amount of its claims or interest.*" Unlike the best-interest-of-creditors test, this rule does not provide a threshold or minimum standard but in contrary limit the maximum amount of what would the creditors may receive under the composition plan. Nevertheless, the 'no more than 100% rule' can arguably be seen as a protection for creditors as it ensures that the limited funds (debtor's assets) are distributed fairly among all creditors. In insolvency, the debtor typically does not have enough assets to satisfy all liabilities to all creditors in full. Thus, limiting the amount of value that a creditor can receive may increase the chance for other creditors to obtain more value in the composition plan.

The equal treatment of creditors or the unfair discrimination test is stipulated under Article 10 (2) (b) of the EU Preventive Restructuring Directive: "*creditors with sufficient commonality of interest in the same class are treated equally, and in a manner proportionate to their claim*." Member States must ensure that a composition plan has fulfilled the principle of equal treatment of creditors prior to court confirmation.[148]

The Directive established strict criteria for the equal treatment principle; each creditor's claim in the same class must be distributed pro rata. For instance, if a creditor belonging to a particular class is entitled to receive 40% of claims, all other creditors within the same class must also receive 40% of claims. [149] Thus, the equal treatment of creditors is concerned with the horizontal relationships of creditors as it deals with relations of creditors within the same class.

[144] Article 11 (1) (c) of the EU Preventive Restructuring Directive.
[145] C. G. Paulus, R. Dammann & T. Braegelmann European Preventive Restructuring: Directive (EU) 2019/102, Article-by-Article Commentary, Ed. C. G. Paulus, R. Dammann & T. Braegelmann. Oxford, United Kingdom: Hart Publishing, at 187 (2021). *See* Article 11 (2) of the EU Preventive Restructuring Directive.
[146] Cross-class cram down means the court can ratify a composition plan, and it will bind all affected creditors, including the dissenting class of creditors.
[147] Under Indonesian Insolvency Law, the court can only ratify a composition plan if both secured and unsecured creditors approve. *See* Chapter 2.1.3 Court's Ratification and The End of PKPU.
[148] Article 10 (2) (b) of the EU Preventive Restructuring Directive.
[149] C. G. Paulus, R. Dammann & T. Braegelmann European Preventive Restructuring: Directive (EU) 2019/102, Article-by-Article Commentary, Ed. C. G. Paulus, R. Dammann & T. Braegelmann. Oxford, United Kingdom: Hart Publishing, at 172 (2021).

The equal treatment of creditors is closely linked with the separation of creditors into classes, as it deals with treatment of creditors within the same class. The formation of creditors 'classes shall reflects sufficiently commonality of interest based on verifiable criteria. [150] Only then can it ensure that parties with equal rights are treated fairly and that affected parties are not unjustly prejudiced. [151]

[150] Article 9 (4) of the EU Preventive Restructuring Directive.
[151] M. Veder & A. Mennens, Preventive Restructuring Frameworks, in Danny Busch, Emilios Avgouleas, and Guido Ferrarini (eds), Capital Markets Union in Europe (Oxford), at 575 (2018).

5. Comparison of The Protection and Fair Treatment of Unsecured Creditors in Composition Plans under Indonesian Insolvency Law, ADB Good Practice Standards, and EU Preventive Restructuring Directive

5.1. Analysis of A Possible Adoption and Implementation of The Best-Interest-of-Creditors In Indonesia

5.1.1. A Comparable Concept of The Best-Interest-of-Creditors Test Under The Indonesian Insolvency Law

The aforementioned chapter has explained that the best-interests of creditors test is not expressly regulated under Indonesian Insolvency Law.[152] One provision that is arguably comparable to, or at least connected to, the best-interest-of-creditors test is Article 285 (2) (a) of the Indonesian Insolvency Law. This article states that the court is obliged to reject the composition plan if the value of the debtor's assets far exceeds what is stated in the composition plan.

The similarity between Article 285 (2) (a) of the Indonesian Insolvency Law with the best-interest-of-creditors test is that both deal with the valuation of the debtor's asset in the composition plan. Based on Article 285 (2) (a) of the Indonesian Insolvency Law, [153] creditors may challenge the composition plan if they disagree with the valuation of the debtor's assets specified in the composition plan. The least the creditors could do is reject the proposed composition plan if they considered the restructuring value inadequate compared to the debtor's asset.

Article 285 (2) (a) of the Indonesian Insolvency Law, however, appears to be non-functional, existing on paper but never being applied. The practical application of this article is infrequent, if not non-existent. There is no literature that discusses and explains the article's purpose and application in great details. One possible reason for the non-application this article is due to the absence of rules governing what must be included (minimum content) in a composition plan. Unlike insolvency laws in other countries such as EU Member States,[154] the Indonesian Insolvency Law does not require the debtor to provide information regarding its assets and liabilities in the composition plan. Thus, it is difficult for creditors and courts to determine whether there is a breach of Article 285 (2) (a) of the Indonesian Insolvency law due to the lack of information and transparency regarding the debtor's financial condition.

As shown in chapter 2.2.1 of this thesis, the practical issue under Indonesian Insolvency Law is asymmetric information, as creditors lack adequate knowledge of the debtor's financial situation, particularly if the debtor is not a publicly traded company. Article 285 (2) (a) of the Indonesian Insolvency Law, has provided protection for creditors, but it would function more effectively if the debtor were required to disclose information on its assets and liabilities in the composition plan.

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[152] *See* Chapter 2.2.2 Safeguard: Court's Confirmation.

[153] In conjunction with Article 284 (1) of the Indonesian Insolvency Law.

[154] Article 8 of the EU Preventive Restructuring Directive regulates the minimum content to be included in a composition plan.

However, knowing the exact value of the debtor's assets is insufficient. Under Indonesian Insolvency Law, the court may still ratify the composition plan if the majority of creditors approve it – even if, under the composition plan, creditors would receive less than the liquidation value. That is why the implementation of the best-interest-of-creditors test may offer greater protection for (unsecured) creditors, as will be explained further below.

5.1.2. Comparison Between The Best-Interest-of-Creditors Under The ADB Good Practice Standard and The EU Preventive Restructuring Directive

In principle, the best-interest-of-creditors promoted by the ADB Good Practice Standard and the EU Preventive Restructuring Directive are very similar. Both established a minimum standard: no creditors would receive, in the composition, less than what they would receive in the debtor's liquidation. However, there are several differences, which are demonstrated in the following table:

Regards	ADB Good Practice Standards[155]	EU Preventive Restructuring Directive
Application	Does not specifically mention when the best-interest-of-creditors test applies.	Applies only when dissenting creditors challenge the composition plan.[156]
Valuation of Debtor's Assets	Conducted by independent adviser and shall be incorporated in the composition plan.	The court may appoint a qualified expert.[157]

The approach adopted by the ADB appears to be more stringent than the EU Preventive Restructuring Directive, as the composition plan must be accompanied by an expert's report to ensure that it is commercially viable. On the other hand, the EU Preventive Restructuring Directive appears to avoid the mandatory valuation conducted by an expert because it could be insufficient and expensive – contrary to the maximization of creditor returns.

As discussed previously, determining the debtor's asset valuation is essential to applying the best-interest-of-creditors test, as this test compares the value of restructuring and liquidation. However, in practice, determining the valuation of restructuring and liquidation is not an easy task. In determining the liquidation valuation, for instance, it can be challenging to determine whether there is a potential buyer in a hypothetical liquidation scenario and what price could be negotiated in a hypothetical going concern sale. Moreover, even if a valuation is determined by expert testimony, there is still a chance that such expert opinion will be contested by presenting contradictory expert opinions. Consequently, valuation disputes are easy to initiate, costly, and time-consuming.[158]

The European Law Institute (ELI) suggested that issues and disputes over valuation be resolved through procedural means. The law should stipulate that any composition plan must evaluate the assets under a hypothetical liquidation scenario and include an expert opinion describing its value. Thus, each affected creditor has the opportunity to determine whether or not they agree with the valuation and know whether or not they would receive less under the plan than in an

[155] *See* ADB Good Practice Standards, at 45.
[156] Article 10 (2) (b) of the EU Preventive Restructuring Directive.
[157] Article 14 (2) of the EU Preventive Restructuring Directive.
[158] B, Wessels & S. Madaus, Instrument of the European Law Institute: Rescue of Business in Insolvency Law, Instrument of the European Law Institute (ELI), at 337 (2017).

alternative liquidation.[159] This approach appears to be comparable with the ADB Good Practice Standards 10.2, which suggests that a composition plan should be accompanied by an expert opinion evaluating the plan's debtor's value and its commercial viability.

5.1.3. Possible Adoption and Scenario of The Best-Interest-of-Creditors Test

To provide more protection towards unsecured creditors, Indonesia could adopt the best-interest-of-creditors test. This concept has actually been promoted by the ADB since 1999, but the rationale behind Indonesia's abstention from embracing it remains unknown. Even this concept is not discussed in the academic paper for the draft of the new Indonesian Insolvency Law.[160] Based on the ADB's report, Indonesian Insolvency Law only partly applied the Good Practice Standard 10.1, which is not involved in the commerciality of the plan – but do not adopt the best-interest-of-creditors test.[161]

As discussed above, Article 285 (2) (a) of the Indonesian Insolvency Law provides a right for creditors to challenge the composition plan if they do not agree with the debtor's asset that is specified in the composition plan. The protection offered by the article only relates to the value of the debtor's assets specified in the composition plan. In relation this protection, creditors may vote to reject the composition plan if, for instance, the debtor offers a restructuring value disproportionate to its assets.

Naturally, creditors will most likely oppose a composition plan perceived as detrimental to them. However, it is still possible that the majority of creditors will approve the unfavourable composition plan e.g. provide less value than what creditors would receive in debtor's liquidation. The approved composition plan, thus ratified by the court (provided it complies with the Indonesian Bankruptcy Law), results in the plan being binding on all affected creditors.[162] Thus, Article 285 (2) (a) of the Indonesian Insolvency Law does not guarantee that creditors will receive a greater value in the composition compared to the debtor's liquidation.

The best-interest-of-creditors test will provide more protection to unsecured creditors and complement the safeguard that the Indonesian Insolvency Law has under Article 285 (2) (a). It established a minimum threshold that ensures no creditors will receive less value than the liquidation. Even if the majority of creditors have approved the composition plan, it still can be challenged on the basis that such test has been breached. Thus, the best-interest-of-creditors test gives an extra layer of protection to creditors as they have the right to challenge the composition plan, even if the majority of creditors have approved the composition plan. Although the best-interest-of-creditors test does not specifically address unsecured creditors, it will also protect them, as it establishes a minimum threshold to every individual creditor (including unsecured creditors).

In addition, the approach embraced by the EU Preventive Restructuring Directive, which only requires a court to evaluate the application of the best-interest-of-creditors test in the event of a challenge by dissenting creditors, appears to be reasonable. It is illogical for creditors who voted in favour to have the ability to challenge the composition plan since they have already agreed

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[159] B, Wessels & S. Madaus, Instrument of the European Law Institute: Rescue of Business in Insolvency Law, Instrument of the European Law Institute (ELI), at 338 (2017).
[160] *See* Chapter 2.3.2 Development of The Indonesian Insolvency Law.
[161] *See* Chapter 3.2 Good Practice of The Best-Interest-of-Creditors Test in The Formulation of a Reorganization Plan.
[162] *See* Chapter 2.1.3 Court's Ratification and The End of PKPU

on it. The court will not assess the application of the-best-interest-of-creditors in *ex officio*, but only when there are challenges from dissenting creditors. I argue that it may be preferable for Indonesia to choose this approach due to considerations of cost-effectiveness and efficiency. This approach is also consistent with the practical circumstances in Indonesia, where the court has a tendency to take a passive approach in evaluating the composition plan and is unlikely to deviate from the outcome of the creditors' vote.[163] Thus, the court will only check the best-interest-of-creditors test if dissenting creditors (creditors who reject the composition plan) challenge the composition plan on the grounds of violation of such test.

Moreover, with regard to valuation, it is arguably more practical to include an expert assessment in the composition plan, following the approach suggested by the ADB. This approach may provide certainty and transparency that would benefit insolvency stakeholders.

5.2. Analysis of A Possible Adoption and Implementation of The Fairness Test In Indonesia

The Indonesian Insolvency Law lacks a mechanism to ensure that the composition plan has to satisfy the fairness test, which in this context consists of ‘no more than 100%’ and equal treatment of creditors. Furthermore, valuation also plays a role in the fairness test. Whereas in the best-interest-of-creditors test, valuation plays a role in determining the liquidation value, which becomes the minimum threshold to which every creditor is entitled, the fairness test focuses on the value of the going concern that exceeds the liquidation value (INSOL Europe use the term ‘going-concern surplus’) and the fair distribution among creditors based on their ranking.[164] Again, the priority rule is not addressed in this analysis because cross-class cram down is not permitted under Indonesian Insolvency Law.[165]

5.2.1. No More Than 100% Rule

While the ADB is silent on the 'no more than 100%’ rule, Article 11 (1) (d) of the EU Preventive Restructuring Directive stipulates that no creditors in the composition plan may receive more than the total amount of its claims or interests. The standard of this test is clear: the total amount of creditor’s claims and/or interests – set the ceiling on the composition plan. Violating this rule will result in the court's rejection of the composition plan. Unlike in the best-interest-of-creditors test in which the court will only check the test if there is a challenge towards the composition plan by dissenting creditors, in the 'no more than 100%’ rule, the court will check (*ex officio*) the fulfilment of this less even if no challenge from creditors.

Furthermore, it is noteworthy that the Indonesian Insolvency Law does not contain any provisions that prohibit creditors from receiving an amount exceeding their respective claims or interests – although, in practice, it is very uncommon to find a composition plan that gives a creditor more than the claim it has. The status quo of the Indonesian Insolvency Law provides neither creditors nor the court with an opportunity to disregard a composition plan due to violation of the ‘no more than 100%' rule. As a result, creditors who are dissatisfied with the composition (provide some creditors with more than its total amount of claims) do not have any legal right to challenge the composition plan.

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[163] *See* Chapter 2.2.2. Safeguard: Court’s Confirmation

[164] T. Richter & A. Thery, INSOL Europe Guidance Note on the Implementation of Preventive Restructuring Frameworks under EU Directive 2019/1023: Claims, Classes, Voting, Confirmation and the Cross-Class Cram-Down, at 43 (2020).

[165] *See* Chapter 2.1 Overview and Legal Framework of Restructuring Proceedings.

The debtor under insolvency is the one who is most likely in financial distress and do not have enough assets to satisfy all of its obligations to all creditors. This rule protects creditors in a sense that it guarantees that no creditor will receive more than their claims or interests; consequently, there are more assets available for distribution to all creditors. To provide greater protection to (unsecured) creditors and legal certainty, Indonesia could implement the concept set forth in the EU Preventive Restructuring Directive, which mandates that a composition plan must conform to the 'no more than 100%' rule in order to be confirmed by the court. Thus, the court will check whether a composition plan has complied with the 'no more than 100%' rule prior to ratifying it.

5.2.2. Equal Treatment of Creditors

The ADB Good Practice Standards and the EU Preventive Restructuring Directive have both addressed the equal treatment of creditors, though by means of different approaches. The ADB's equal treatment of creditors approach focuses on the relationships between different classes of creditors (vertical relationship) as it deals with a priority of claims, whereas the Directive focuses on the relationships between creditors within the same class (horizontal relationship).

The ADB Good Practice Standard, seeks to limit the claims priority unless there is a justification to deviate from it.[166] This approach uphold the *pari passu* principle, which prevents an intra-class race from enforcing claims that will be won by the strongest and most informed parties, as well as ensures unsecured creditors are treated equally. The deviation from the *pari passu* principle can only be justified if it is based on considerations of efficiency or fairness.[167] It can be said that as more claims are prioritised, the unsecured creditor's rights will be reduced.

Indonesian Insolvency framework has is a list of priority claims in which preferred creditors would be prioritised in a liquidation scenario.[168] It is arguable that there is presently no necessity to modify priority claims in Indonesia, in order to endorse more protection towards unsecured creditors. In fact, Indonesia through the constitutional court has changed the priority of claims based on consideration of protecting employee.[169] However, the factors presented by the Asian Development Bank (ADB), namely the need to take into account policy, economic, and commercial concerns,[170] are worthy to be considered.

Further, the EU Preventive Restructuring Directive under Article 10 (2) (b) stipulates that creditors who share a common interest within the same class shall be treated equally and proportionately based on their claim. Member States must ensure that a court can only ratify a composition plan if it meets the no unfair discrimination test.[171] The standard pertaining to this test is: all creditors are treated equally and proportionately in accordance with their respective

[166] The ADB Good Practice Standard, at 49.
[167] V. Finch, The Pari Passu Principle: When Everyone Is Equal?, Corporate Insolvency Law: Perspectives and Principles, Cambridge University Press, at (2002).
[168] *See* Chapter 2.1.2 Classification of Creditors and Voting on the Composition Plan.
[169] *See* Chapter 2.3.2 Development of The Indonesian Insolvency Law.
[170] *See* Chapter 3.3 Good Practice of the Fairness Test in The Reorganization Plan
[171] C. G. Paulus, R. Dammann & T. Braegelmann European Preventive Restructuring: Directive (EU) 2019/102, Article-by-Article Commentary, Ed. C. G. Paulus, R. Dammann & T. Braegelmann. Oxford, United Kingdom: Hart Publishing, at 171 (2021).

claims. Therefore, the distribution of restructuring value within the same class of creditors must be treated equally pro rata (*pari passu*).[172]

There is no explicit provision under Indonesian Insolvency Law pertaining to the concept under Article 10 (2) (b) of the Directive. To ensure fair treatment towards (unsecured) creditors, the Indonesian Insolvency Law may adopt the equal treatment of creditors under the Directive. This test will protect (unsecured) creditors, within the same class, from being unjustly treated and prevent the court from ratifying the composition plan. The court will check (in *ex officio*) whether the composition plan has fulfilled the no unfair discrimination test before ratifying it. Moreover, creditors can also challenge the composition plan in the event that they perceive a violation of the test.

[172] *See* Chapter 4.3 Standard of The Fairness Test in The Restructuring Plan; to see an example of how to apply Article (10) (2) (b) of the EU Preventive Restructuring Directive.

6. Conclusion

All insolvency frameworks analysed in this thesis arose due to the economic crisis. Ron Harmer stated that the financial crises resulted in a positive impact, which served as a catalyst for the development of insolvency laws.[173] Insolvency law thus could be regarded as a solution to the financial problem. It provides a second opportunity for a debtor to have a fresh start, with the hope that it will also benefit other stakeholders. Other alternative, insolvency law provide a legal mechanism to provide a fair distribution among creditors.

Although has been amended several times, Indonesian Insolvency Law still lack of protection especially towards unsecured creditors. Adoption of the best-interest-of-creditors test and the fairness test will provide more protection towards creditor. These two tests will complement the protections that the Indonesian Insolvency Law already has, in which may be illustrated as follows:

No more than 100% rule

Composition Plan must comply with:
(i) Article 285 (2) of the Indonesian Insolvency Law; and
(ii) Equal treatment of creditors/no unfair discrimination test.

The best-interest-of-creditors test

The no more than 100% rule will set the upper limit of a composition plan, as it cannot provide creditors with a restructuring value greater than their claims or interests. While the best-interest-of-creditors test sets a minimum threshold, what creditors will at least receive in a composition plan. Further, the equal treatment of creditors/no unfair discrimination test will ensure that (unsecured) creditors in the same class will be treated equally. Violation of any of the above tests will result in the court refusing to ratify the composition plan. To conclude, adopting the best-interest-of-creditors test and the fairness test under the Indonesian Insolvency Law will provide more protection to unsecured creditors.

Nevertheless, such protections will only be effective and enforceable if there is a well-functioning and balanced framework. The tests cannot be isolated from other provisions, for instance, with regard to the classification of creditors and information transparency. Classification of creditors and equal treatment of creditors are interconnected, as equal treatment of creditors can only function if the class of creditors be properly formed. It is also recommended that the Indonesian Insolvency Law establish the minimum content requirements for a composition plan, particularly with regard to the debtor's assets and liabilities, in order to fair treatment towards (unsecured) creditors. With transparency, creditors can assess whether the tests has been fulfilled or not.

[173] R. Harmer, Assessing the Assessments, International insolvency review, at 4 (2014).

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