

# The Year of Living Foolishly: An Examination of Some Odd Decisions of the Initial Year of Indonesia's Commercial Court

Bruce A. Markell\*

## Introduction

Before 1998, Indonesian corporate and personal insolvency law was governed largely by a 1905 Bankruptcy Ordinance (“Ordinance”) as well as certain provisions in the Civil Code.<sup>1[1]</sup> Both acts dated from the Dutch colonial period.

With 278 Articles, the Ordinance was until 1998 the main insolvency legislation in Indonesia.<sup>2[2]</sup> When the Ordinance first came into force in 1906, the Dutch-administered colonial system based on legal pluralism still prevailed. Under that system, certain regulations applied only to specific population groups based on ethnic lines. At the commencement of its operation, the Ordinance only applied to Europeans and did not apply to indigenous Indonesians or foreign nationals such as the Chinese. In 1924, the application of the Ordinance was extended to Chinese and other foreign nationals; by the 1980s, the old distinctions based on population groups had been generally discarded and the Ordinance, for all practical purposes, applied to all individuals and corporations in Indonesia.<sup>3[3]</sup>

On April 22, 1998 Indonesia issued a new regulation on insolvency procedures - the Bankruptcy Regulation (“Regulation”).<sup>4[4]</sup> The Regulation was promulgated in the form of a Government Regulation Substituting A Law (*Peraturan Pemerintah Pengganti Undang-undang*, or *perpu*). It substantially amended the Ordinance, including the establishment of a Commercial Court (*Pengadilan Niaga*) devoted exclusively to bankruptcy matters..

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\*Doris S. and Theodore B. Lee Professor of Law, University of Nevada, Las Vegas. Professor Markell can be reached at [bmarkell@nevada.edu](mailto:bmarkell@nevada.edu).

<sup>1[1]</sup>*Faillissements-verordening*, State Gazette No. 217 of 1905 and State Gazette No. 348 of 1906.

<sup>2[2]</sup>Curiously, the original text was Dutch, and there never was an official translation of the Dutch into the native Bahasa Indonesian language. BENNY S. TABULUJAN, *INDONESIAN INSOLVENCY LAW 9* (1998).

<sup>3[3]</sup>TABULUJAN, *supra* note , at 6-7 (1998).

<sup>4[4]</sup>Government Regulation in Lieu of Law Number 1 of 1998 concerning Amendments to the Bankruptcy Law (*Perturan Pemerintah Pengganti Undang-undang Normor 1 Tahun 1998 tentang Perubahan atas undang-undang Kepalilitan, Lembaran Negara 1998 no. 87, Tambahan Lembaran Negara No. 3761*).

According to Article II of the Regulation, the amendments took effect 120 days after the date the new regulation was promulgated. The amendments thus took effect on August 20, 1998. The end result is that the Ordinance continues to govern corporate and personal insolvency, but, after 20 August 1998, it would incorporate a bundle of new provisions introduced by the Regulation. The Regulation's amendments ultimately became law as well,<sup>5[5]</sup> and the provisions of the Ordinance as so amended are referred to in this paper as the "Law."

### The New Law's Text

One key area in which the Regulation changed the Ordinance was in the standard of insolvency necessary to commence bankruptcy proceedings. The old standard — that of "the debtor is in the position of having ceased to pay his debts" — was thought to be too vague.<sup>6[6]</sup> One reform that was thought to be of great use was the changing of this standard. The final text states that:

(1) A debtor who has two or more creditors and does not pay at least one debt which has fallen due and has become payable is to be declared bankrupt by a decision of the authorised Court as referred to in Article 2, either at the application of the debtor himself, or at the request of one or more of his creditors.<sup>7[7]</sup>

This standard thus became effective in August of 1998. It was a new standard in a country not known for its resort to bankruptcy courts (or courts of any stripe) to resolve commercial issues. Indeed, some reports are that, in *all* of Indonesia, "in the

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<sup>5[5]</sup>Law Number 4 of 1998 concerning Enactment of Government Regulation in Lieu of Law Number 1 of 1998 concerning Amendments to the Bankruptcy Law into Law (*Undang-undang Nomor 4 Tahun 1998 tentang Penetapan Peraturan Pemerintah Pengganti Undang-undang Keppalitan Menjadi Undang-undang, Lembaran Negara 1998 No. 135, Tambahan Lembaran Negara No. 3778*).

<sup>6[6]</sup>Jerry Hoff, *Bankruptcy Law in Indonesia* 15, reprinted in *INDONESIAN BANKRUPTCY LAW* (PT. Tatanusa, Jakarta: 1999).

<sup>7[7]</sup>LAW, Article 1(1). This translation appears in *TABULUJAN*, *supra* note , at 43. A slightly different translation appears in *INDONESIAN BANKRUPTCY LAW*, *supra* note , Laws at 1, which reads:

(1) A debtor who has two or more creditors and has failed to pay at least one debt which is due and payable, shall be declared bankrupt by a decision of the competent Court as intended by Article 2, either upon his own petition, or upon a petition of one or more of his creditors.

ten years between 1984 and 1994 only 13 bankruptcies were filed: nine individual bankruptcies, and four company bankruptcies.<sup>8[8]</sup>

It is no secret that the new scheme immediately fell prey to problems, and that these problems have led to harsh criticism of the scheme employed. In this article, I want to look at some of the key legal issues that emerged in the first year of the new regime, and to see what the nature and resolution of these problems indicate about law reform generally, and in countries such as Indonesia specifically.

## The Problems

The reasons for the turmoil during the first year of operation of the new Indonesian bankruptcy are many, but can be traced in large part to a series of decisions from the commercial courts and the Supreme Court that strike many (including many Indonesians) as just plain wrong, and wrong in a terribly significant way. These decisions, for the most part interpreting Article 1(1)'s standard of insolvency, seemingly mangle simple concepts that constitute the standard. In particular, the concepts of what a "debt" is; what an "entity" is; and when a claim is due were all involved in many of the central cases.

### *Concept of a "Debt"*

Under the standard in Article 1(1), a debtor may be placed into bankruptcy if it owes at least one debt that is due and payable. Thus, there must be a "debt," which most would commonly understand to be a liability on a claim.<sup>9[9]</sup> But early on, the Indonesia Supreme Court held that the right of a purchaser of real property to recover advance payments made when the seller stopped agreed upon construction was not a claim. The reasoning of the Court was that a debt consists of principal and interest only, since that had been the focus of the need for amendments. Since the amount of repayment did not fit into this dichotomy, it was not a claim.<sup>10[10]</sup>

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<sup>8[8]</sup>Leslie Burton, *An Overview of Insolvency Proceedings in Asia*, 6 ANN. SURV. INT'L & COMP. L. 113 (2000), quoting Roman Tomasic, et al., *Insolvency Law Administration and Culture in Six Asian Legal Systems*, 6 AUSTL. J. OF CORP. L. 248, 262 (1996).

<sup>9[9]</sup>See 11 U.S.C. § 101(12).

<sup>10[10]</sup>In re PT. Modernland Realty Ltd Tbk., Cassation Decision No. 03/K/N/1998, digested in *INDONESIAN BANKRUPTCY LAW, Summaries of Supreme Court Decisions, supra note*, at 5. As a result, the bankruptcy was dismissed. Modernland later reached an out of court restructuring. *Indonesia's Modernland Restructures \$US 142 MLN in Debt*, ASIA PULSE (Dec. 24, 1999)

After this decision, the Commercial Court made a contrary decision with respect to an obligation to purchase the capital stock of a firm.<sup>11[11]</sup>

### *Concept of an “Entity”*

There is no doubt that the concept of artificial legal entities can cause problems. A corporate group, with a holding company and subsidiaries, is usually treated as a set of different entities, each with its own assets and creditors. When the issue was raised early on in Indonesia, however, the Commercial Court seemed to take a contrary view.

In the PT. Ometraco cases, separate bankruptcy petitions were filed against both a parent and its finance subsidiary over non-payment of a US\$60 million loan (under a US\$125 million facility) to the subsidiary guaranteed by the parent. The petitioners in each case were a diverse group of Indonesian and international banks, lead by American Express Bank’s Singapore office.<sup>12[12]</sup> The holding company had issued a guaranty of the subsidiary’s debts, and also apparently had direct exposure on loans to members of the bank group.

The Commercial Court, however, dismissed the case against the parent on the grounds that only one petition should have been filed as the parent and the subsidiary formed one economic unit. This finding was ultimately rejected by the Supreme Court,<sup>13[13]</sup> thereby restoring some certainty with respect to different legal entities. The same opinion, however, created more confusion with its ruling as to whether the debts were due and payable.

### *Concepts of “Maturity” and “Acceleration”*

Debts have due dates, either as stated in the obligation or upon demand of one of the creditors. Creditors also often employ contractual clauses which allow them to move forward, or accelerate, the due date if the debtor defaults in some way. These acceleration clauses are a standard feature of modern commercial law.

In the *Ometraco* case, however, the credit involved was a revolving credit facility, under which credit was made available four consecutive periods of time on

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<sup>11[11]</sup>In re PT. Jutai Kertanegara Prima Coal and Mrs. Iswati Sugianto, Case No. 18/Pailit/1998/PN.Niaga/Jkt.Pst.

<sup>12[12]</sup>The subsidiary’s case was In re PT. Ometraco Multhi Artha., Case No. 04/Pailit/1998/PN.Niaga/Jkt.Pst.; the parent’s case was In re PT. Ometraco Corporation Tk., Case No. 05/Pailit/1998/PN.Niaga/Jkt.Pst., *aff’d in part and rev’d in part* Cassation Decision No. 01/K/N/1998.

<sup>13[13]</sup>In re PT. Ometraco Corporation Tk., Cassation Decision No. 01/K/N/1998.

conditions agreed upon at the outset. According to the Supreme Court, the definitions of First Maturity Date and Final Maturity Date were clear in the agreement. These dates were respectively twenty-four months after the date of the first Drawing, or in respect of an extension, the date falling thirty-six months after the date of the first Drawing.<sup>14[14]</sup>

However, what the Supreme Court overlooked was that these maturity dates related to the availability of the credit facility as a whole, and not to any specific loans already drawn under the facility. The meaning of these maturity dates was that the borrower could no longer draw new loans under the facility. The Court confused these “termination” dates with due dates of loan, and thus overlooked the obvious due date of loans already drawn.

The case of *PT Dharmala Agrifood*, although ultimately resolved in creditors’ favor, also shows the price of delay and the cost of an inexperienced judiciary.<sup>15[15]</sup> In this case, the debtor had argued that non-payment of interest, when principal was not yet contractually due, did not make the debt “matured and ... payable” as required by the law. It also argued that the contractual payments due to one of the creditors were null and void as they arguably violated Bank of Indonesia regulations, as they were ‘derivatives’ of the type used in highly sophisticated financial transactions. The commercial court agreed, and its decision was upheld initially by the Supreme Court. Only after a request for a rehearing did the Supreme Court reverse itself and the commercial court.

It may be, as noted by a highly respected Indonesian attorney, that “the complex structure of international finance and its terminology such as events of default, acceleration of debt maturity, syndicated loans, commercial papers, forward transactions and derivatives were very new and incomprehensible to the country’s [new] commercial court.”<sup>16[16]</sup> The ultimate result in *Dharma Agrifoods*, however, may point the way to a shared understanding of these terms, and with that a shared understanding of the applicability of Indonesian bankruptcy laws.<sup>17[17]</sup>

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<sup>14[14]</sup>This description of the facts draws heavily on *INDONESIAN BANKRUPTCY LAW*, *supra* note , *The Declaration of Bankruptcy*, at 19-21.

<sup>15[15]</sup>The facts are taken from articles appearing on February 16 and April 19, 1999, in the Jakarta Post.

<sup>16[16]</sup>Kartini Muljadi of Kartini and Partners, as quoted in the Jakarta Post, January 26, 1999.

<sup>17[17]</sup>Also potentially troubling is the decision of the commercial court in the PT Nassau Sports Indonesia case. There, the bankruptcy petition was dismissed because the petitioning creditor was a bank which held property of the debtor as security, and the court apparently believed that a secured creditor could not initiate bankruptcy, given its remedies against the debtor’s property. *JAKARTA POST*, February 16, 1999. While possibly good policy, there appears to be nothing in

Finally, the case of *PT Hutama Karya*<sup>18[18]</sup> raises similar concerns. There, the Supreme Court dismissed a bankruptcy case on the grounds that the creditor petitioning the bankruptcy did not prove, as required by the law, that there were at least two creditors holding unpaid matured claims. The reason, however, that the proof failed was that the debtor had settled with one of the creditors, leaving only one unpaid creditor before the court. This decision is problematic in that it creates a situation that is ripe for favoritism; the debtor will seek to pay off (if it can) all but one of the creditors seeking bankruptcy. In many legal systems, the status of the debts are frozen as of the date of the petition, and any settlements reached after filing require court approval as fair to all creditors (which would not be the case, for example, if one creditor was paid in full while all others were not).

## Conclusion

These decisions present troubling issues. Each of them, in their own way, involve a basic building block of modern commerce. Each of them faltered in interpreting local law in way consistent with most creditors' expectations. That such miscues occurred with respect to the very first section in a code filled with interpretive questions was not lost on commercial entities. Indeed the claim was made that many settled cases that might have been brought, and likely settled for less than some believed they should.

This claim, however, is not supported by the rates of filing of bankruptcy cases. In the first 4 months of the new Law, 31 bankruptcy cases were filed for a monthly filing rate of 7.75 cases per month.<sup>19[19]</sup> From and after January, 1999 and through August of 2000, 152 additional petitions were filed for a filing rate of approximately 7.6 cases per month.<sup>20[20]</sup>

This raises obvious points for discussion by the panel. Is the failure to meet expectations:

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the law on this point, and indeed, the law gives the secured creditor an unsecured claim if the value of its collateral is less than the amount of its debt. Articles 56(3); 128

<sup>18[18]</sup>The facts are taken from articles appearing on April 19 and 20, 1999, in the Jakarta Post.

<sup>19[19]</sup>INDONESIAN BANKRUPTCY LAW, *supra* note , *Summaries of Commercial Court Decisions* at 65.

<sup>20[20]</sup>See LORENZO GIOGIANNI, UMA RAMAKRISHNAN, RHODA WEEKS, PETER DATTELS, PERRY PERONE, INDONESIA: SELECTED ISSUES 52 (IMF Staff Country Report No. 00/132, October 2000).

- A failure of the new law to address adequately local cultural concerns regarding the stigma and proper uses of bankruptcy?
- A failure by creditors to apprehend the responsiveness of Indonesian courts to essentially foreign creditors' concerns?
- A consequence of protectionist measures by local Indonesian courts?
- A result brought about by simple inexperience and lack of training?
- A consequence of imposing mature commercial concepts on an immature legal system?
- A result of graft and corruption?
- A combination of all of the above?

These questions matter. Aside from the case of Indonesia, they bear on the efficacy of any imposition of legal reforms as a condition of monetary or other aid. And even if the results appear unique to Indonesia — such as the extent (but not the presence of corruption) — does that mean that such legal reforms should be abandoned as futile?

I am sure the panelists will have views on these issues.