

# Adoption of Islamic Bankruptcy Law Values Into Indonesian Bankruptcy Law to Protect Good Faith Debtors

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## ABSTRACT

This paper discusses the reasons of Islamic bankruptcy law values that should be adopted by Indonesia as a country with the world's largest muslim population. This study employs a qualitative research method by using secondary data. The results indicate that the current Indonesian bankruptcy law is not debtor friendly. The main problem of this issue is that Indonesian bankruptcy law does not distinguish the differences between a debtor who is not willing to fulfill his debts and a debtor who is unable to fulfill his debts. The Islamic bankruptcy law serves protection for people who are in debt as long as they have good faith. It is suggested that the government amend the current bankruptcy law by adopting the Islamic bankruptcy law values into the national bankruptcy law. Therefore, the law would provide justice for the debtors in the future especially for those who are engaged in an Islamic economic activities.

**Keywords:** *bankruptcy law, Islamic bankruptcy law, good faith debtor*

## 1. INTRODUCTION

Article 29 of Indonesia's Constitution states that Indonesia is a religious nation. This is also in balance with the first *sila* (principle) of *Pancasila*, which is *Ketuhanan Yang Maha Esa* (Belief in One Supreme God). Hazairin interpreted the basic norm from Article 29 of 1945 Constitution as there is nothing can allow actions, rules, norms that contrary to the rules of the religious that are recognized by the state. where the country is obliged to provide facilities in carrying out orders by those religions [1]. In other words, there should be no legal rules that are contradictory to the religious regulations and that legal rules (positive laws) supposed to be relevant to the religious rules.

The census that was conducted in 2010 showed that the number of the Muslim population in Indonesia reached 207.176.762 people or 87% of the total population in Indonesia [2]. With Muslims as the majority population in Indonesia, then it is very reasonable for the government to accommodate the need of those occupant regarding the implementation of the Islamic law through state power both in public and private law in the context of the development of national law [3]. One of the parts of the Islamic law that has relevance with the national law that will be discussed in this paper is the bankruptcy law.

There are several reasons why it is important to conduct research on the need to adopt the Islamic bankruptcy law values to the Indonesia bankruptcy , as follows: [4]

1. There are similarities between the Islamic bankruptcy law and the western bankruptcy law which is the pioneer of the Indonesian bankruptcy law;
2. The majority population in Indonesia that is Muslim;
3. The vast development of the Islamic economic law in Indonesia.

Based on the description above, the following sections will briefly explain about the Islamic bankruptcy law, the Indonesian bankruptcy law and how the Indonesian bankruptcy law can adopt the values of the Islamic bankruptcy law.

## 2. METHODS

This study applied a qualitative research method by using secondary data. The data were obtained through library research by analyzing relevant documents, journal articles, and current literature that are relevant to the topic that will be analyzed to provide the answer to the issues discussed in this paper.

## 3. AN OVERVIEW OF INDONESIAN BANKRUPTCY LAW

Indonesian bankruptcy law has a long history for its existence. The origin of Indonesian bankruptcy law could be traced from the Dutch colonialism era in Indonesia (*Hindia Belanda*). The first bankruptcy law that was

implemented in Indonesian can be seen from the era of bankruptcy regulations in the Commercial Law Code (*wetboek van koophandel*) which differentiated bankruptcy for merchant and non-merchant. Then, this bankruptcy rule caused complicity in the implementation until it was replaced with the Bankruptcy Rules (*Faillissement verordening*) Stb. 1905 No. 217 Jo. Stb. 1906 No. 348 [5].

After Indonesian independence, according to Article II of Transitional Rules, the law stays applicable as bankruptcy law in Indonesia by the time of *faillissement verordening*. During a monetary crisis in 1997, to fulfill the need of the Indonesian government for funds from the International Monetary Fund, the Indonesian government must have its bankruptcy law as one of the agreement in the Letter of Intent between the Indonesian government with IMF dated 1st October 1997 [6]. Indonesian government soon enacted a new bankruptcy law through a Government Regulation in Lieu of Act (*Peraturan Pemerintah Pengganti Undang-Undang*) or abbreviated as “Perpu” No. 1 of 1998 which then confirmed by the parliament as the new bankruptcy law, law No. 4 of 1998.

Bankruptcy Law No.4 of 1998 was a pro creditor law and enacted by the foreign pressures, in this case, the IMF. This matter can be seen from Article 1 paragraph 1 of Law No. 4 of 1998 which does not consider whether a debtor is solvent or insolvent [7]. In 2003, the government amended Law No. 4 of 1998 because in practice, it inflicted numerous problems and had several weaknesses. The proposed amendment was affirmed by the parliament and as a result, the Bankruptcy Law No. 37 of 2004 was enacted [8].

The amendment in Law No. 37 of 2004 did not bring significant changes from the previous law No.4 of 1998. The amendment that was made only covered: [9]

1. Definitions, including broader definition of debt;
2. Tighter and more explicit constraint regarding on who can request a bankruptcy to certain debtors, such as banking industries, insurance companies and State-Owned Enterprises;
3. The procedure and time frame on the process of bankruptcy proceedings as well as a Suspension of Payment in court.

Law No. 37 of 2004 in the practice still reminds out numerous fundamental problems. one of them is that there is no consideration whether the debtor is solvent or not. As a result, many cases arose where solvent debtors were declared bankrupt by the court only because the case situation fulfilled the requirements in Article 2 of Law No. 37 of 2004. The regulation of a bankruptcy petition is that the debtor has at least 2 creditors and 1 debt has due and can be claimed. This requirement is too undemanding for a significant legal impact that could be caused in the future.

Basically, a debtor in default cases does not perform his obligation on debts based on 2 reasons:

1. Cannot afford to pay anymore (insolvent); or
2. Simply will not pay for various reasons, for example, a debtor will not fulfill his debts because the other party has not fulfilled its obligation in a contractual relationship.

The bankruptcy that is aimed to resolve obstacles that are being confronted by the debtors in financial distress had shifted to a “scary monster”, an instrument to threaten debtors [10]. In some bankruptcy cases, a debtor cannot be declared bankrupt, for examples, Telkomsel, Prudential and Manulife cases. These three cases is the proof of how cruel Indonesian bankruptcy law is.

The current situation of Indonesian bankruptcy law is still pro-creditor and does not grant enough protection to the good faith debtors. Indonesian bankruptcy law does not explicitly distinguish between a good faith and a bad faith debtor.[11]. Each debtor will be treated equitably as long as they meet the requirements for the bankruptcy petition as regulated in Article 2 paragraph 1 Law No. 37 of 2004.

The good faith, honest and transparent debtors must be given remission such as debt relief or at least the opportunity to reorganize their business so that they can have a new start again. Both debt discharge and reorganization are not regulated in Indonesian bankruptcy law, whereas both of these are the indispensable trait in a modern bankruptcy law. With the absence of these traits, therefore a bankruptcy law does not have many differences from a debt-claiming device that is ready to “annihilate” any debtor at any time. This kind of situation has not become the actual philosophy and purpose of the bankruptcy law in general.

#### 4. AN OVERVIEW OF ISLAMIC BANKRUPTCY LAW

The basic principle of the Islamic law (sharia) is the Holy Qur’an. The Qur’an is a guide from the God (*Allah*) which was revealed to the last prophet of Islam, Muhammad SAW, during the 7<sup>th</sup> century CE [12]. Besides the Holy Qur’an, the other sources of sharia are *Sunnah* and *Hadiths* [13].

Sharia is not only about a law but also a methodology of how an Islamic scholar explore the religious and sacred texts to authenticate the will of the God. The result of this exploration will be passed as positive laws.

The majority of Muslim populations in the world stated that sharia is the main source of law in the legislation process of each state’s national law [14]. Indonesia is not a Muslim country, but with the most world’s largest Muslim population then it is quite plausible for the government to implement sharia as one of the sources for the positive law legislation, including the domain of bankruptcy law.

The foundation of the Islamic bankruptcy law concept in the Holy Qur’an is: “and if the debtor is in straitened circumstances, then [let there be] postponement to [the time of] ease. And if you give freely [i.e., voluntarily forgive the debt] it will be better for you, if you only knew” (QS Al-Baqarah 2:280). This conception is balanced with another debt concept in the Holy Qur’an, that not paying debt is not only a legal obligation but also a sin if the debtor has the ability to fulfill it: “O you who

have believed, fulfill [all your] covenants” (QS Al-Maidah 5:1). Nevertheless, it is a necessity to realize that the bankruptcy petition mechanism is governed involuntarily by the Islamic bankruptcy law which is different from the Western bankruptcy law petition that could be initiated with either a voluntary or involuntary mechanism. And it depends on the condition of the bankruptcy cases [15].

According to the *Shafi'i* school, the debtor is entitled to purpose a bankruptcy petition to the judge based on his initiative when the debtor recognized his obligations are exceeding the number of his assets. This is conducted for the debtors benefit: to begin the distribution of his assets to his creditors [16]. In sharia, 2 requirements must be met cumulatively so that the debtor is declared bankrupt. First, there should be a business or a trade element (*al-Shifat al-Tijariyah*). Second, the debtor's inability to fulfill his obligation on debts (*al-Tawaqquf'an al-Daf'i*). If the bankruptcy petition is awarded by the judge, then the debtor shall be placed under the surveillance of the judge until his assets are auctioned to fulfill his obligations to his creditors. Based on the conception above, it is obvious that the Islamic bankruptcy law governs a criterion for a debtor to be declared that bankrupt is an insolvent debtor. In terms of the debtor's assets, it is balanced with his debts and the debtor has the ability to pay up his workers, then there is no bankruptcy declaration allowed [17].

Another interesting feature from the Islamic bankruptcy law is the necessity to provide shreds of evidence concerning the inability of the debtor to fulfill his obligations in terms of the voluntary or involuntary petition [18]. If this duty is interpreted into the conception of modern bankruptcy law, then it is mandatory to conduct an insolvency test for gauging the debtor's ability to fulfill his obligations to his creditors.

## **5. ADOPTION OF ISLAMIC BANKRUPTCY LAW VALUES INTO INDONESIAN BANKRUPTCY LAW TO PROTECT GOOD FAITH DEBTORS.**

In general, based on the description in section III and IV, it can be understood that there are numerous similarities between Islamic bankruptcy law and modern bankruptcy law. One of the most dominant features, in general, is that only debtors whose debts exceed their assets (insolvent) can be declared bankrupt. According to Stacey Steele, modern bankruptcy law is the foundation of the Indonesian bankruptcy law based on the pressure from the International Monetary Fund (IMF) in 1997 [19]. In the 1997 monetary crisis that stroke most of the Asian regions, numerous Indonesian corporations were undergoing financial distress and had skyrocketing debts due to the soaring exchange rates of US dollars to Indonesian rupiah. With the Letter of Intent proposed by the Indonesian government to the IMF, bankruptcy law was enacted which at the time was a pro creditor bankruptcy law as one of the conditions that the Indonesian government had to accomplish for securing financial assistance from the IMF [20].

Two decades have passed since the IMF's "intervention" within the government especially in the bankruptcy system reform. The Indonesian government had compensated off all credits from the IMF in 2006 [21]. Nevertheless, it is unfortunate that the Indonesian government did not amend the bankruptcy law based on the ideals of the Indonesian legal aspiration, specifically the law based on Pancasila.

Pancasila as the fundamental philosophy of the Indonesian society is a unique concept and second to none in the world because it is a synthetic form of Western democracy, Islamism, Marxism, Sun Yat-Sen nationalism, and Gandhi humanism based on the materialist causa existing in the Indonesian population, particularly regarding the value of the Almighty God, the value of humanity and the spirit of kinship in mutual cooperation, ethnic reality and other cultural values [22]. Bankruptcy law as one the law that administers the economic sphere should be enacted according to Pancasila's values. The Indonesian bankruptcy law is supposed to contain the values of the Almighty God and the value of justice in it, not a capitalist influenced bankruptcy law. Ironically, the United States bankruptcy law, which is one of the most capitalist states is not as ruthless as the bankruptcy law of Indonesia which acknowledges Pancasila as the nation's fundamental philosophy of life [23].

In the Indonesian legal system, Pancasila is the State Fundamental Norm which is the most distinguished legal norm [24]. Therefore, the juridical consequences are that every Act in Indonesia must not collide with the values of Pancasila. The current Indonesian bankruptcy law is contradictory to the values of Pancasila, particularly the value of the Almighty God and Social Justice because it tends to be abused by the bad faith creditors to "eliminate" their debtors. Therefore it is sensible to adopt the values of Islamic bankruptcy to provide the element of God Almighty and Social Justice value in Indonesian bankruptcy law.

The Islamic law values that are supposed to be adopted by the Indonesian bankruptcy law, as follows:

1. A clear distinction between insolvent and solvent debtors. Solvent debtors should not be declared bankrupt. In order to collect debts from solvent debtors, debt collection mechanism should be carried out such as filling claim to the court or via non-litigation debt collection methods. For examples: mediation and arbitration;
2. The utilization of the insolvency test as a standard provision for registering bankruptcy petitions. This is very crucial to discover whether a debtor is eligible to be declared bankrupt or not.

Another reason why it is crucial to adopt the Islamic bankruptcy law values to the Indonesian bankruptcy law is the vast growth of Islamic economic law in Indonesia. According to the Islamic Finance Development Report that was released by the Financial Services Authority (*Otoritas Jasa Keuangan*) in 2016, Indonesia's Islamic finance shows positive growth. The positive growth is

indicated by the increase in Islamic bank's assets, non-bank Islamic financial services' assets, the index of Indonesian Islamic securities index as well as the index of Islamic corporation bond with 20,28%, 36,30%, 18,62%, and 19,96% respectively [25].

Simultaneously with the growth and development of Islamic economic activities, therefore the probability of disputes emerging among the participants is considerably high [26]. One of the disputes that might emerge is about bankruptcy. To retain the Islamic economic activities, in particular bankruptcy must be settled accurately and quickly. It is unreasonable if the bankruptcy disputes emerging from the Islamic economic activities that are resolved with the non-Islamic bankruptcy law. Therefore, the adoption of the Islamic bankruptcy law values as a tool for resolving bankruptcy disputes becomes essential. Then, justice for the participants associated with the Islamic economic activities can be ensured.

By adopting the values of the Islamic bankruptcy law as mentioned earlier, unquestionably Indonesia's bankruptcy law will be more "Islamic" and no longer in conflict with the values of the Pancasila. This should be the aim of every Indonesian law, particularly in the field of bankruptcy law.

## 6. CONCLUSION

Based on the description in the discussion section, it can be concluded that the Indonesian government must amend the bankruptcy law. One of the most important features that must be performed in the amendment is to consolidate the values of the Islamic bankruptcy law given that the Indonesian bankruptcy law is not a proper outcome regarding the ideals of Indonesian law.

The intended value of the Islamic bankruptcy is particularly insolvent debtor who is allowed to be declared bankrupt and the presence of an insolvency test as a standard inquiry whether a debtor is eligible for bankruptcy proceedings or not. If the values of the Islamic bankruptcy law referred before it can be adopted adequately in the bankruptcy law, then the bankruptcy law has obtained the characteristic of ideal Indonesian law, namely Pancasila-based law which is fair, civilized, and contains the values of Almighty God and Social Justice values in it. Therefore, the bankruptcy law can be utilized as it is supposed to be.

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