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Misuse of Bankruptcy Petitions by Creditors: The Case of Indonesia

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This study aims to examine the principles and practices of Indonesian bankruptcy law. It is crucial for investors who will put their capital in Indonesia, so that they do not become subject to the misuse of bankruptcy law instruments in Indonesia. Indonesia bankruptcy law has a number of weaknesses that allow creditors to misuse bankruptcy instruments for their own benefit at the expense of debtors. The weakness is twofold. First, there is no minimum debt limit that can trigger an application for bankruptcy. Second, insolvency tests before the bankruptcy request is made, are absent. Some misuse of bankruptcy laws has led to solvent companies acting as bankrupt debtors.

Key words: *Bankruptcy, misuse, weaknesses, Indonesia.*

Introduction

In 1998 reforms changed much of the political and state order. Borrowing the typology proposed by Nonet and Selznick (2008) regarding post-1998 policy reform, many changes led to a more responsive and autonomous law, compared to the legal order in the New Order and Old Order regimes, which involved a more repressive law. One economic reform related to bankruptcy law. Law No. 4 of 1998 fundamentally changed the principles of bankruptcy and bankruptcy settlements, as did Law No. 37 of 2004. Both laws have progressively changed the basic concepts, philosophies, and principles of previously applied bankruptcy laws.

Bankruptcy law in Indonesia has special characteristics, which investors should know before investing their capital in Indonesia. The purpose is to avoid them becoming victims of bankruptcy misuse by irresponsible parties who take advantage, at the expense of investors. Bankruptcy law is, in fact, a commercial solution to get out of debt problems. It squeezes a debtor who lacks the ability to repay the debts to their creditors. If debtors are not put into bankruptcy, there will be problems in the distribution of their assets to pay creditors, which, in the end, becomes an injustice.



In Indonesia, bankruptcy is intended not only for companies that experience such financial distress, that they are incapable of paying their debts. It can also be used as a debt collection instrument that is not activated by corporate financial difficulties. Declercq stated that a bankruptcy petition has to state the facts and circumstances that constitute *prima facie* evidence that the debtor has ceased to pay its debts. This is the case when there are at least two creditors, one of whom has a claim that is due and payable, and the other which the debtor either cannot pay, refuses to pay, or simply does not pay (Declercq, 2002).

In bankruptcy law globally, some of the principles commonly adopted include *paritas creditorium* (equality of creditors), *pari passu pro rata parte* (equally managed without preference), debt collection and pooling, debt forgiveness, universal principles, territorial principles, and principles regarding commercial exit from financial distress.

Bankruptcy is expected to function as an alternative to financial conflict or stalemate. It is expected to more effectively, efficiently, and proportionately settle debtor's obligations to creditors. Miles (1996) said that bankruptcy law is designed to provide financial relief to the overburdened debtor, and to assure that all creditors with claims against the debtor have an opportunity to receive their due share from the bankruptcy estate. Harold F. Lusk (1986) described the bankruptcy functions as follows: (1) to protect creditors from one another, (2) to protect creditors from their debtor, and (3) to protect the honest debtor from his creditors. To accomplish these objectives, the debtor is required to make full disclosure of all his property and to surrender it to the trustee. Provisions are made for examination of the debtor, and for punishment of the debtor who refuses to make an honest disclosure and surrender of his property. The trustee of the bankrupt's estate administers, liquidates, and distributes the proceeds of the estate to creditors. Provisions are made for the determination of creditor rights, the recovery of preferential payments, and the disallowance of preferential liens and encumbrances. If the bankrupt has been honest in his business transactions and in his bankruptcy proceedings, he is granted a discharge.

Law No. 37 of 2004 on Bankruptcy and Suspension of Debt Payment Obligation is hereafter referred to as the Indonesian Bankruptcy Law. In accordance with the general global principles in the bankruptcy law regime, some of its principles are partially regulated, while others are not regulated, and some aspects are even regulated with ambiguity.

In judicial practice, there is a disparity in the application of the principles and norms set out in the Indonesian Bankruptcy Law. Some bankruptcy cases have made investors grow anxious, such as the bankruptcy of PT. Telekomunikasi Seluler, PT. Asuransi Jiwa Manulife Indonesia, and PT. Prudential Life Assurance. Even though the correct decisions are far more numerous,



there are a few large cases where bankruptcy misuse can threaten legal certainty for investors who invest their capital in Indonesia.

From the aforementioned point, it is necessary to examine the root problems of the bankruptcy of large companies, especially foreign investment companies. The root of the problem is reviewed from the regulation of the general principles of bankruptcy in the Indonesian Bankruptcy Law. In addition, it is necessary to study the court decisions, both right and wrong.

Methodology

This paper is qualitative research. This paper examines and finds the principles, norms, and practices misusing bankruptcy petitions in court, under Indonesian bankruptcy law. This research employed a normative legal research method with a statute approach, a conceptual approach, and a cases approach. The legal objects studied were amassed from authoritative legal material, i.e. legislation and court decisions, as well as secondary legal objects such as relevant papers and scientific studies. This author intended to conduct theoretical-normative and praxis studies of the principles and norms/settings of bankruptcy law in Indonesia, as well as studying the practice of bankruptcy law in court. The research objects are various laws and regulations, as well as the decisions of the commercial court and the Supreme Court, being the primary factors in the determination of the legal basis of bankruptcy in Indonesia. Thus, both inductive and deductive reasoning were utilized in this study.

Results and Discussion

The Norms of Indonesian Bankruptcy Law

The principle regulation of *paritas creditorium* in Indonesian Bankruptcy Law appears, among others, in Article 1 paragraph (1), Article 2 paragraph (1), and Article 21. These articles further elaborate Article 1131 and 1132 of the Indonesian Civil Code or ICC, which determines that the debtor's assets are a guarantee for repaying their debts to all of their creditors (Hoff (1999)).

Article 1 of the Indonesian Bankruptcy Law defines bankruptcy. It is a general confiscation of all assets owned by a bankrupt debtor whose management and settlement is carried out by the curator under the supervision of the Supervisory Judge, as stipulated in this Law. This article affirms that by, being declared bankrupt, the debtor's assets are in the status of a court confiscation.

The bankruptcy requirement stipulated in Indonesian Bankruptcy Law is that bankruptcy must fulfill two conditions, namely having two or more creditors and not paying off one debt



that is due and collectible. This provision is clearly regulated in Article 2 paragraph (1) of Indonesian Bankruptcy Law. More explicitly, the general explanation of Indonesian Bankruptcy Law states that the main requirement for being declared bankrupt is that a debtor has at least two (2) creditors and does not pay off one of the due debts. This regulatory easiness triggers legal subjects to submit bankruptcy petitions to other legal subjects more conveniently, thus obscuring the meaning of bankruptcy itself.

Therefore, the Bankruptcy Law in Indonesia adheres to the debt principle in a broader concept. Yet it does not adhere to the principle of limiting the amount of debt as found within the bankruptcy systems of other countries, namely Singapore and Hong Kong. This condition can be viewed as a lack or even an Indonesian weakness. The juridical argument is that the law should stipulate the minimum value of debt which is the basis for filing bankruptcy applications. Otherwise there will be a deviation in the bankruptcy, from a rapid liquidation of the debtor's financial condition, which does not allow him to pay his debts to his creditors so as to prevent unlawful execution from creditors, to a mere collection tool (debt collection tool). In addition, the absence of restrictions on the minimum amount of debt might inflict a financial loss for those creditors who have far greater debt owed by the debtor.

The principle of *pari passu prorata parte* can be seen in several provisions in the Indonesia Bankruptcy Law, including Article 189 paragraphs (4) and (5) and the Explanation of Article 176 letter 'a' of the Indonesian Bankruptcy Law. Article 189 paragraph (4) refers to the Payment to Creditors (a) who have privileges, including the denied privileges, pawn holders, fiduciary guarantees, security rights, mortgages, or collateral rights over other materials, insofar as they are not paid according to the provisions referred to in Article 55. It states that they can be made from the sales of objects to which they have special rights or are pledged. Meanwhile, the Explanation of Article 176 letter 'a' states that what is meant by 'pro rata', is the payment according to the size of the respective accounts.

A structured creditors principle can also be found in Indonesian Bankruptcy Law. Normatively, to examine the scope of creditors in bankruptcy, Article 1 paragraph (1) of Law Number 4 of 1997 (previous Bankruptcy Law) can be used as a reference. It states that debtors who have two or more creditors and do not pay at least one debt that has fallen due and collectible, are declared bankrupt with the decision of the authorized Court, as referred to in Article 2, both by their own petition, or at the request of one or more creditors. This Article only states that one of the conditions for submitting a bankruptcy petition is the presence of two or more creditors, which, in this case, includes all creditors in the bankruptcy law. The law does not put any limitation that the bankrupt conditions or those who are eligible to file bankruptcy petitions are unsecured creditors only. Therefore, the creditors included in the scope of Article 1 paragraph (1) are all creditors, whether secured creditors, separatist



creditors, or preferred creditors. All creditors have the same right to file a bankruptcy petition against their debtors.

Indonesian Bankruptcy Law also clearly states that, if a debtor has two or more creditors and does not pay off at least one debt that has fallen due and collectible, he/she is declared bankrupt under a court decision, both upon their own request and upon the request of one or more creditors. The bankruptcy includes all of the debtor's assets at the time of the bankruptcy statement, along with everything they have obtained during bankruptcy, and constitutes a general confiscation of all of the debtor's assets. This provision is the implementation of debt collection and debt pooling principles.

Debt collection inclines more on the provision of material requirements for a legal subject that can be put into bankruptcy. The principle of bankruptcy contained in Article 2 paragraph (1) and Article 1 paragraph (1) of the Indonesian Bankruptcy Law strongly holds that bankruptcy is a debt collection institution. The requirements for bankruptcy are only two conditions. One, the debtor has debts that are due and collectible which have not been paid in full and, two, they have two or more creditors. The Indonesian Bankruptcy Law does not provide further requirements other than these two matters. It does not require a certain minimum debt amount or an insolvency situation where the debtors' asset is far less than the liabilities. The debt collection principle in the Bankruptcy Law is more directed at the ease of making a bankruptcy petition.

Indonesian Bankruptcy Law does not comprehensively regulate territorial principles and universal principles in relation to cross-border bankruptcy/insolvency. There are only three articles, namely, Article 212-214, which regulate the provisions of international law. If further analyzed, the three articles do not represent the section titles, namely the provisions of international law.

Sovereignty is a common principle in this world. Sovereignty also means that the decision of the commercial court in Indonesia cannot be carried out beyond the country's jurisdiction. Article 21 of Indonesian Bankruptcy Law states that bankruptcy covers all debtors' assets, including everything obtained during bankruptcy, when the decision on bankruptcy is pronounced. This article does not implicitly regulate the extent to which the general confiscation status is applicable to the assets of the bankrupt debtor. However, if studied further, Indonesia Bankruptcy Law intends to adhere to the universal principle. This is reflected in the provisions of international law as stipulated in Article 212, 213 and 214. The three articles indicate that the area of the general confiscation of bankruptcy assets is to be taken care of and cleared by the curator for the benefit of bankrupt debtor's unsecured creditors, based on the *pari passu pro rata parte* principle as stipulated in Article 1132 of the Indonesian Civil Code. It is not limited to the debtor's assets within Indonesian law



exclusively, but also includes the assets of the bankrupt debtor beyond Indonesian jurisdiction.

Indeed, the sovereignty principle prevents the universal principles adopted by Indonesian Bankruptcy Law being automatically followed by foreign countries. In other words, the bankruptcy decisions imposed by the Indonesian commercial court cannot automatically be carried out beyond Indonesian jurisdiction, except if there is a mutual agreement to recognize and implement the bankruptcy decisions from their respective courts. This condition is also referred to as mutual recognition and enforcement of the court decision of contracting countries (Ricardo Simanjuntak, 2005). The verdict of the commercial court can only be applied as evidence of relitigation efforts, carried out in a court of a foreign country where the debtor's assets are located.

The principle of commercial exit from financial distress is not followed by bankruptcy provisions in Indonesia. The principle adopted in the Bankruptcy Law is the easiness for putting legal subjects into bankruptcy, in relation to debt collective proceeding. This proposition is evident from the determination of material requirements to put a legal subject into bankruptcy, i.e. to have two or more creditors where one of the debts is due and collectible. The easiness principle of bankruptcy is even corroborated with a simple evidence provision. In addition, bankruptcy is a legal institution that must be considered as parallel with the termination of limited liability companies as stipulated in Indonesian Company Law, which is not a separate or even opposing provision.

The Weakness of Bankruptcy Regulations that Cause Misuse

From the Indonesian bankruptcy regulation mentioned above, it is known that there are a number of weaknesses that allow creditors to misuse bankruptcy instruments for their own benefit, at the expense of debtors. The weakness is first, there is no minimum debt limit that can apply to bankruptcy. Second, the absence of insolvency tests before the bankruptcy request.

In the Indonesian Bankruptcy Law there is no regulation regarding minimum debt that can be submitted as a basis for a bankruptcy request. This is different from bankruptcy regulations in other countries, such as in Singapore and Hong Kong. In Singapore, there is a minimum debt requirement that is the basis for filing for bankruptcy, that is, Sin\$ 10,000 (ten thousand Singapore dollars). This can be seen in the Singapore Bankruptcy Act, which states as follows:



In order to be entitled to present a bankruptcy petition against a debtor, the creditor must satisfy the following : “the debt owned to the petitioning creditor is not less than S\$ 10,000,- or such other sum prescribed by the minister” (Denis Campbell 1992).

Likewise in the Hong Kong bankruptcy legal system there are restrictions on the minimum value of debt as a basis for filing a bankruptcy request that is a minimum of HK \$ 5,000. This is regulated in the Hong Kong Bankruptcy Act, as follows:

*The creditor can only present a petition if the following conditions are satisfied : “the debt owed by the debtor to the petitioning creditor or to two or more petitioning creditors in aggregate must be at least **HK\$ 5,000,-**”.*

Limitation of the nominal value of debt, as a basis for filing for bankruptcy, is intended to limit the application for bankruptcy to creditors who have a small amount of debt (below the minimum) and limit the scale of bankruptcy handling. Besides that, the limitation is intended as a form of legal protection for the majority creditors, from the misuse of minority creditors.

The second weakness is that in Indonesian bankruptcy law, no insolvency test is required before applying for bankruptcy. Filing a petition only requires debts that have fallen due and payable, where the debtor cannot pay one of his debts and at least two creditors exist. Both requirements can be proved in a simplistic way. This easy requirement of filing a bankruptcy petition has both advantages and harms, especially for solvent debtors who act in good faith, from the abuse of the bankruptcy instrument.

Application of an insolvency test before or during a bankruptcy petition investigation is a form of legal protection for soluble debtors with good faith before or during a bankruptcy petition. An insolvency test is a debtor’s capability test to pay debts, consisting of a company’s cash flow test and balance sheet. A cash flow test checks the amount of cash in and cash out, and relates it to the company’s ability to pay some of its debt obligations. If the cash flow test’s result is negative, the company is categorized as insolvent. Conversely, if a positive result is obtained in a cash flow test, the company is solvent.

Balance sheet tests compare whether the total assets and total liabilities of the asset value is less than liabilities. If so the company is considered insolvent. On the other hand, if the standing liabilities are less than total asset of the company, the company is a solvent company.

Legal protection is granted to a solvent company if it is facing bad-faith creditors who want to abuse a bankruptcy instrument for their own benefits or others’. It is significantly to protect the solvent company with good faith. On the other hand debtors who act in bad faith should not be protected from bankruptcy although they are solvent companies.



Bankruptcy declared for a solvent debtor who has bad faith is still relevant. It is unfair to protect a debtor with bad faith from a bankruptcy that is happening to him.

This insolvency test is related to the purpose of the bankruptcy instrument explained previously. The fundamental purpose of bankruptcy is the management, collection and distribution of bankrupt assets, for paying a debtor's debt obligation to his creditors. To collect bankrupt assets, all the debtor's assets will be under a confiscation condition. If a debtor's assets are not under such condition, the possibility to trade a debtor's assets and to do partial confiscation like *conservatoir beslag* (CB) is wide open. By being declared bankrupt, all assets by law are called as general confiscation.

A company that has a larger amount of assets than its standing liabilities has no relevance to a debtor's asset dispute among creditors. Creditors who come later will still receive fulfilment from a debtor's assets. If a debtor's assets are more than his liabilities, the Article no 1131, 1132, 1133, and so on so forth of Indonesian Civil Law is still guaranteed its fulfilment. Fulfilment can come in two ways. First, the debtor can voluntarily pay his debts with the assets he has. Second, creditors can sue the debtor who involuntarily pays his debts for breach of contract to the court, so that the debtor's assets will be executed for the fulfilment of the standing debts.

An insolvency test instrument is the protection given to solvent debtors against creditors who act in bad faith or abuse the bankruptcy instrument. With an insolvency test instrument, debtors who pass the test cannot be declared bankrupt. Therefore, if companies that have very bright business prospects and good payment ability are declared bankrupt, it will disadvantage many stakeholders. Perhaps only a handful of bad-faith creditors are put in a more favourable position, but the majority of stakeholders including the debtor, other creditors, labourers, goods/services providers, consumers and other related stakeholders will be jeopardized by the debtor's bankruptcy. It is the classic situation of where law must provide fairness or justice to major stakeholders.

However, an insolvency test can be applied to all bankruptcy petitions. For instance, debtors who have bad faith to not pay debts are not eligible for legal protection from bankruptcy although they are highly soluble. This is because the law has to be blind. The law must be enforced regardless of individuals and individual's interests. Debts are still debts that have to be paid though breach of contract mechanisms or bankruptcy petitions.

Cases of Misuse of Bankruptcy Petition

Bankruptcy Case of PT. Manulife Indonesia



PT. Asuransi Jiwa Manulife Indonesia (PT. AJMI) was filed for bankruptcy by PT Dharmala Sakti Sejahtera (PT. DSS). PT. AJMI as a respondent for bankruptcy was a life insurance company, established by Manulife Financial Corporation Canada with 51 percent shares. PT. DSS held 40 percent of the shares, and the International Finance Corporation (IFC) held 9 percent of the shares with total assets of 1,812 trillion when the bankruptcy petition was filed. The respondent was filed for bankruptcy where Paul Sukran acted as the curator of PT. DSS as the applicant because PT. AJMI was asked to pay for the dividends, amounting to 32.7 billion. However, PT. AJMI did not fulfill it. PT. AJMI was finally stated bankrupt by the Commercial Court at the Central Jakarta District Court by decree number 10/Pailit/2002/PN/Niaga.Jkt.Pst.

The bankruptcy petition of PT. AJMI did not comply with the principles and provisions of Indonesian Bankruptcy Law. This was because the bankruptcy applicant was the debtor's own shareholder. Meanwhile, PT. DSS, as the shareholder, billed PT. AJMI for a dividend payment. The principles violated in the bankruptcy petition of PT. AJMI were the principles of structured creditor and debt pooling. In the structured creditor principle, the creditors who can apply for bankruptcy petition are the secured creditors, preferred creditors, and concurrent creditors. PT. DSS was not a creditor to PT. AJMI because PT. DSS was included as a shareholder. Meanwhile, the dividend, which was considered as the right of PT. DSS, was not considered as a debt. In the end, the dividend distribution to shareholders was carried out through a corporate mechanism, such as the general meeting of shareholders. In addition, the general meeting of shareholders determined the distribution of dividends from the corporation.

The bankruptcy petition of PT. AJMI was finally revoked by the Supreme Court by decree number 021/K/N/2002.

Bankruptcy Case of PT. Prudential Indonesia

PT. Prudential Life Assurance (PT. PLA) was filed for bankruptcy by PT. PLA's insurance agent itself, a Malaysian citizen named Lee Boon Siong. The petition was on the basis that PT. PLA was obliged to pay compensation for insurance agency services, based on the agency cooperation agreement they had made. The agency cooperation agreement was unilaterally revoked by PT. PLA within three months before the bankruptcy petition. The total fee claimed by Lee Boon Siong reached 5.6 billion rupiahs. The bankruptcy petition for PT. PLA was approved by the judge at the Central Jakarta Commercial Court, and PT. PLA was stated bankrupt under the court decision number 13/Pailit/2004/PN. Niaga.Jkt.Pst.

The bankruptcy petition of PT. PLA did not meet the principle of commercial exit from financial distress. This was because PT. PLA was not in financial distress to pay its



obligations to both the insurance customers and stakeholders, including its insurance agents. The dispute between the insurance agent and the insurance company itself was more of a dispute regarding the interpretation of the cooperation agreement they had made. This was proven by the revocation of the agency cooperation agreement by PT. PLA three months before the bankruptcy petition. Therefore, this dispute was more appropriately resolved in a public civil court.

In the end, the bankruptcy petition of PT. PLA was revoked by the Supreme Court by its decree number 8K/N/2004.

Bankruptcy Case of PT. Telkomsel Indonesia

PT. Telekomunikasi Seluler, also known as Telkomsel, is the largest cellular telephone service company in Indonesia. PT. Telkomsel was filed for bankruptcy by its own partner, PT. Prima Jaya Informatika, the company that supplied and distributed Prima Cards Top-Up Voucher and Starter Pack for Prepaid SIM card, labelled as Prima Cards. The cooperation agreement between PT. Telkomsel and PT. Prima Jaya Informatika consisted of an agreement that required Prima Jaya to sell 120 million top-up vouchers and 10 million starter cards with the pictures of Indonesian national athletes annually. However, Prima Jaya was only capable of selling 524,000 Telkomsel top-up vouchers and starter cards. Since PT. Prima Jaya did not meet the target, PT. Telkomsel refused to provide the items ordered by Prima Jaya in the following order. For the refusal to provide the ordered goods, PT. Prima Jaya filed a bankruptcy petition for PT. Telkomsel. The judge at the Central Jakarta Commercial Court in decision number 48/PAILIT/2012/PN.NIAGA. JKT. PST granted the bankruptcy petition and stated that PT. Telkomsel was bankrupt with all legal consequences.

The bankruptcy petition of PT. Telkomsel shocked the investment world in Indonesia. This was because some of PT. Telkomsel's shares were owned by Singaporean investors, and some parts of the shares were owned by the Indonesia Government. In addition, the company's assets or capitalization reached 50 trillion rupiahs (equivalent to five billion USD). The bankruptcy petition of PT. Telkomsel did not comply with the principle of commercial exit from financial distress. This was due to the financial condition of PT. Telkomsel, which was actually solvent. Moreover, the actions taken by PT. Telkomsel of not giving goods ordered by PT. Prima Jaya was a result of PT. Prima Jaya's default, namely not being capable of meeting the predetermined target. PT. Telkomsel's action was justified based on the *exceptio non-adimplity contractus* principle, which meant the defiance to fulfill obligations because the opposing party did not fulfill its obligations first.

Conclusion



Indonesian bankruptcy law contains a number of weaknesses that allow creditors to misuse bankruptcy instruments for their own benefit, at the expense of debtors. The weakness is first, there is no minimum debt limit that can apply for bankruptcy; second, the absence of insolvency tests before the bankruptcy request.

Investors need to obtain adequate legal protection against the misuse of the bankruptcy petition. In practice, there was a number of bankruptcy misuse cases that were very detrimental to the investors' interests, such as in bankruptcy cases of PT. Asuransi Jiwa Manulife, Prudential Life Assurance, and PT. Telekomunikasi Seluler Indonesia.



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