

## REFORM OF ECONOMIC LAWS AND ITS EFFECTS ON THE POST-CRISIS INDONESIAN ECONOMY

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This study evaluates the effectiveness of the economic laws some of which were introduced in the IMF-led post-crisis reforms to address serious problems faced by the Indonesian economy. It is argued in the study that the economic law reform has not been as effective as expected since the implementation of a law has not conformed with legal policy. The objective of the legal policy of the Bankruptcy Act, which was enacted in accordance with IMF conditionality, was to liquidate insolvent domestic companies and to relieve foreign creditors. At the implementation stage, however, the ruling of the commercial courts was often handed down against creditors. The ineffective implementation was due to several factors; one of them was judges' defensive reaction to possible hostile takeover by foreign creditors.

### I. INTRODUCTION

**I**F the meaning of law is restricted to only legislation, Indonesia has long been reforming its laws. This occurred soon after Indonesia declared its independence from the Netherlands and possessed the right and the power to enact its own laws. The effort to reform the laws has not been limited to the fields of family law, criminal law, and constitutional law, but it includes laws that have a significant bearing on economic activities, "economic laws."

For policy-makers, reforming economic laws is considered to be important, as Indonesia's development has historically emphasized economic development.<sup>1</sup> Economic development has been the primary motivating force behind Indonesia's desire to transform itself from a traditional agricultural society to a modern industrial society similar to that of developed countries. This policy has affected the legal system, particularly the conditions whereby traditional agricultural laws must be reformed to meet the new "legal norms" required by an emerging industrial society.

<sup>1</sup> Reforms of economic laws in Indonesia can be categorized into five types as follows. First type is related to the reform of outdated economic laws, including the colonial laws and laws enacted after Indonesia's independence. Second type is related to reforms of international agreements. Third type aims at improving the investment climate. Fourth type complies with international issues, such as human rights and the environment. Fifth type aims at making Indonesia an industrial country. See Juwana (1999).

By the late 1980s, reform of economic laws had intensified due to globalization. Under the Soeharto administration, globalization had been conceived as an opportunity for Indonesia to become industrialized. Indonesia was confident that its national development policy would allow it to catch up with the economic level of other developed countries. During that period, Indonesia enjoyed high economic growth, businesses were booming, and statistics for foreign investments showed high figures. Many economic analysts saw Indonesia as one of the new “Asian Tiger” economies, following the Republic of Korea, Taiwan, and others. Indonesia had also been considered to be one of the newly industrialized economies, and even the World Bank had included Indonesia within the East Asian Miracle.<sup>2</sup>

Efforts to reform economic laws became more intensified after Indonesia was devastated by the financial crisis of 1997. Law reform was attached as conditions to loans and grants provided by the International Monetary Fund (IMF), the World Bank, and the Asian Development Bank (ADB). In addition, agreements in the context of the World Trade Organization that Indonesia had signed imposed further obligations on Indonesia to reform its laws, in particular its intellectual property rights (IPR) laws.

The objective of this paper is to examine the effectiveness of the reformed economic laws, in particular for addressing the serious problems faced by the Indonesian economy. In this paper it will be argued that the economic law reform has not been as effective as expected at the implementation stage. The causes for the ineffectiveness will be identified. These causes have become a challenge that should be addressed by the new Indonesian government. So far, the literature dealing with these issues has been limited.

## II. REFORM OF ECONOMIC LAWS

### A. *The Reformed Laws*

After the economic crisis hit Indonesia, numerous economic legislations have been repealed, amended, and introduced. In 1998, the Bankruptcy Act was amended. In the same year, the Banking Act of 1992 was amended. In 1999, the Antimonopoly Act, the Consumer Protection Act, and the Construction Services Act were introduced. During the same year, the Central Bank Act, the Arbitration Act, Fiduciary Security Act, and Telecommunications Act were amended.

In 2000, the Industrial Design Act, Integrated Circuit Act, and Trade Secrets Act were introduced. During 2000, the Trademark Act and Patent Act were amended. In 2001, the Foundation Act was introduced. In 2002, Indonesia introduced the Anti-Money Laundering Act, State Debenture Act, and Electricity Act. In the same year, the Copyright Act was amended.

<sup>2</sup> See generally, World Bank (1993).

## B. *Legal Policy for Reform*

Legislation is the part of a law passed intentionally by governments with certain purposes and reasons that can be various. Here, the purposes and reasons for enacting a certain legislation will be referred to as legal policy.

The legal policy that dictates the drafting of legislation can be separated into two dimensions. The first dimension is the so-called basic policy of certain laws. The basic policy refers to the fundamental purpose for enacting a certain law. For example, in the area of IPR laws, the basic policy is to protect inventors. The basic policy of the Bankruptcy Act can be summarized as the mechanism that offers the opportunity for an insolvent debtor to release him/herself from the burden of the inability to repay a debt and, at the same time, to enable the creditor to seize debtor assets for loan recovery.<sup>3</sup>

The second dimension of the policy is when the government, on its own or in response to pressure, decides to formulate a policy with respect to certain laws. This second dimension of policy can be found mostly in developing countries. For instance, a government may formulate a policy to enact laws in order to replace colonial laws due to the extreme aversion to the former colonial ruler. It may also adopt a policy to act like developed countries, or it may enact laws due to internal and external pressure. This category of policies will be referred to as the “enactment policy.”

Legal policy during the legislation-making process is important for two reasons. First, it acts as a guideline for drafters to translate policies and concepts into the defining provisions of the target legislation. Second, it provides guidance to the law enforcer who is in charge of the implementation of the legislation and in ensuring conformity with the adopted legal policy. At the implementation stage, law enforcement should reflect the original aims of the legal policy behind the legislation.

<sup>3</sup> A number of basic purposes for the Bankruptcy Act have been put forward by the relevant parties. The basic policies can be summarized from any law dictionary. According to Black’s Law Dictionary, a bankruptcy act is defined as “[A] federal Law (11 U.S.C.A.) for the benefit and relief of creditors and their debtors in cases in which the latter are unable or unwilling to pay their debts.”; Real Life Dictionary of the Law, gives the following definition of bankruptcy “a federal system of statutes and courts which permits persons and businesses which are insolvent (debtors) or (in some cases) face potential insolvency, to place his/her/its financial affairs under the control of the bankruptcy court.” See <http://dictionary.law.com/>; according to Duhaime’s Online Legal Dictionary, bankruptcy is defined as, “[T]he formal condition of an insolvent person being declared bankrupt under law. The legal effect is to divert most of the debtor’s assets and debts to the administration of a third person, sometimes called a ‘trustee in bankruptcy’, from which outstanding debts are paid *pro rata*.” See <http://www.Duhaime.org/dictionary/dict-b.aspx>; While according to the ‘Lectric Law Library’s Legal Lexicon On, bankruptcy is defined as “[A] process governed by federal law to help when people or entities cannot or will not pay their debts.” “. . . , the bankrupt laws are intended mainly to secure creditors from waste, extravagance, and mismanagement, by seizing the property out of the hands of the debtors, and placing it in the custody of the law.” See <http://lectlaw.com/def/b011.htm>.

Legislation in this sense is designed to promote policy goals with respect to what has been decided as legal policy at the very beginning of the legislation-making process.

### C. *The Effects*

In Indonesia, reforming legislation does not imply that the behavior of the society will instantly change. Throughout Indonesia's law reform history problems have continually been encountered at two stages. The first stage is related to the drafting process of the legislation. The second stage is when related to the implementation of the legislation.

At the drafting stage, several problems can be identified. Firstly, the legislation enacted may not address social issues faced by the society. Legislation has often been enacted for political rhetoric, for the sake of developing a legal system that resembles that of developed countries or meeting demands placed on Indonesia from international sources.

Second, the drafter sometimes does not understand the intricacies of the issues. Understanding the intricacies is important, since at the implementation stage, the law enforcement agencies will rely mostly on what is contained in the written provisions. Thus, inaccuracy in translating concepts and policies when incorporating them into the provisions will result in high levels of inconsistency between what is intended and what is in fact implemented.

Third, legal drafters in Indonesia usually translate foreign legislation instead of referring to the source countries' legislation. Translating provisions, which results in the legislation, fails to take into account the prevailing local conditions. In addition, drafters tend to follow and accept foreign experts' recommendations without question. As a result, no serious attempt to adapt the recommendations to the Indonesian context was ever made.

Fourth, drafting legislation often does not take into account the supporting legal infrastructure for such legislation to smoothly operate. To write a provision on the establishment of a certain institution is easy. The challenge, however, lies in its implementation, including aspects related to the funding of the institution or the recruitment of the members. This became a major issue since, under the Soeharto government, the legal infrastructure was not functioning as one would expect in a country. During that time, the power of the political elites had overshadowed law enforcement.

Fifth, new legislation involves the adoption of new concepts that require drastic changes in the society values. The legislation may be considered to be unsuitable for the local society as the society is not familiar with it or does not have a good understanding of the new values.<sup>4</sup>

<sup>4</sup> Yasuda (2003) noting the novelty of the competition law in East Asian society, stated, "Competi-

At the implementation stage, the problems are as follows. First, the ability of the individuals working in the enforcement agencies must be considered. Across the board, human resources in the enforcement agencies may not display a high integrity. Many have been criticized for not fully understanding the law or the principles underlying it. This has resulted in high levels of inconsistency between policy and implementation.

Second, in many cases, the text of legislations is written vaguely or inaccurately. This has created confusion for the enforcement agencies when the legislation is implemented. Also, enforcement agencies often apply the provisions wrongly. This has also resulted in the fact that the enforcement agencies reluctantly apply the provisions and the rulings will be made through a lack of compliance based on procedural matters.

Third, law enforcement can be lenient and compromised due to the law enforcer's sympathy towards the gap issue between what is embedded in the legislation and society's behavior.

Fourth, bribery and corruption still linger, even though this is not easy to prove. The public perception is that most court rulings will considerably depend on bribes. The attitude of the major clients when soliciting a lawyer is not based on his/her ability, but on whether such lawyer has good connections with the judges. Bribery and corruption have led to a weak and unpredictable enforcement of the law.

Furthermore, since some problems were not foreseen during the drafting process, they evidently cannot be addressed by the enforcement agencies when the legislation is implemented.

Sixth, lawyers are tactful and skillful in finding loopholes in the legislation, resulting in further frustration about law enforcement.

### III. REFORM OF THE BANKRUPTCY ACT AND ITS EFFECTS

#### A. *Background*

Reform of the Bankruptcy Act<sup>5</sup> was achieved by amending the *Faillissements-Verordening*, the Dutch colonial bankruptcy act of 1905,<sup>6</sup> on April 22, 1998. The amendment was associated with the pressure exerted by the International Monetary Fund (IMF) as a condition attached to meeting the government request for loans

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tion law is new in these countries, and there is no cultural basis supporting this kind of legislation. In contrast, there is firmly rooted culture that regards 'harmony' as more important value at all levels of East Asian society. This naturally tends to avoid competition, because it may cause conflicts among people, which is against the fundamental value of harmony." (p. 20)

<sup>5</sup> Throughout this paper the author will use the term "bankruptcy" by adopting the American definition. It will therefore include what English lawyers would call "the winding down of a company." In English law individuals can be bankrupt but companies are wound down, not bankrupt.

<sup>6</sup> *Staatsblad* No. 217 of 1905 juncto *Staatsblad* No. 348 of 1906.

due to the economic crisis. The condition was included in the Letter of Intent (LOI) dated October 1, 1997.<sup>7</sup>

The government initially enacted the new amended Bankruptcy Act through a Government Regulation in Lieu of Act (Peraturan Pemerintah Pengganti Undang-Undang or abbreviated as “Perpu”<sup>8</sup>) No. 1 of 1998.<sup>9</sup> At the time of the amendment, there was a debate as to whether an economic crisis qualifies as a state of emergency prompting the issuance of a Perpu. However, the government insisted that it had no choice as the amendment had to be adopted as a matter of urgency for IMF loan disbursement. Furthermore, a Perpu would avoid the anticipated long debate in parliament.

Perpu No. 1 of 1998 took effect on August 20, 1998,<sup>10</sup> and soon after it was brought to the parliament for confirmation. The parliament in September of the same year confirmed the Perpu as law without making any changes. The amended Bankruptcy Act became Act No. 4 of 1998 (hereinafter referred to as “Bankruptcy Act” or “Act No. 4 of 1998”).<sup>11</sup>

#### B. *Characteristics of the Amendments*

The reform of the Bankruptcy Act includes some 90 amendments, ranging from minor to major substantive changes. In this paper, only some of the amendments will be analyzed, in particular those that have a bearing on the later discussion.

The Bankruptcy Act basically introduces two mechanisms to deal with debtors. The first mechanism is the petition to declare the debtor bankrupt with a view to liquidating the debtor’s assets.<sup>12</sup> Either the debtor itself or its creditor(s) can initiate this mechanism. The debtor under Act No. 4 of 1998 can be a “natural” as well as a “juridical” person.<sup>13</sup> Under Article 1(1), a creditor who petitions for a declaration of

<sup>7</sup> Letter of Intent of the Government of Indonesia to International Monetary Fund (October 31, 1997), available at <http://www.imf.org/external/np/loi/103197.HTM> (accessed August 2, 2003).

<sup>8</sup> Perpu is a form of legislation enacted by the president in emergency circumstances. A Perpu fits into the legal hierarchy at one rank below that of a law or act (*undang-undang*). Under the constitution, it is required that the Perpu be brought to the parliament within one year after its promulgation to be confirmed or rejected as law.

<sup>9</sup> Government Regulation in Lieu of Act of the Republic of Indonesia, No. 1 of 1998, Government Regulation in Lieu of Act No. 1 Concerning Amendment to Bankruptcy Act, *Lembaran negara* [State gazette], No. 7, 1998. For unofficial English translation of the law available at [http://www.insolvencyasia.com/relevant\\_local\\_legislation/indonesia\\_bankruptcy\\_law/index.html](http://www.insolvencyasia.com/relevant_local_legislation/indonesia_bankruptcy_law/index.html) (accessed August 5, 2003)

<sup>10</sup> Article II stated that the Perpu would come into effect 120 days after its promulgation. Perpu 1 of 1998, Art II.

<sup>11</sup> Act of the Republic of Indonesia, No. 4 of 1998, Act Concerning the Confirmation of Government Regulation in Lieu of Act 1 of 1998 to become Act, *Lembaran negara* [State gazette], No. 135, 1998.

<sup>12</sup> The details of each mechanism are provided under Chapter I of the Bankruptcy Act.

<sup>13</sup> Debtor, however, is distinguished between bank and security companies on the one hand, and other companies, on the other hand. This is because under Article 1 (3) and (4) for bank and security companies, the application for bankruptcy rests exclusively with the authority of the central bank (Bank Indonesia) and Capital Market Supervisory Agency, respectively. See Act No. 4 of 1998, Art

bankruptcy has to satisfy two requirements.<sup>14</sup> The first requirement is that the creditor must prove that the debtor has at least two debts. The second requirement is that the debtor has failed to pay at least one of the matured debts.

The second mechanism introduced is the moratorium on debt repayment.<sup>15</sup> This mechanism does not aim at liquidation, but at giving room for the debtor to work out a solution or to restructure its debts. Under this mechanism, the debtor may request a moratorium to reach a compromise with creditors, including unsecured creditors.<sup>16</sup> A plan for compromise is initiated by the debtor and has to be agreed by a certain number of unsecured creditors. The compromise will only take effect after the court sanctions it in the form of its ruling.<sup>17</sup> Once a compromise takes effect, it will immediately end the moratorium.<sup>18</sup>

The amendment also deals with the time period required for the operation of the two mechanisms. This was intended to resolve what was perceived as uncertain and lengthy delays by the courts in handing down their rulings. In the bankruptcy mechanism, for example, a strict timetable is fixed from the time when the petition is filed until the ruling is handed down by the court. The law provides that within 48 hours after a petition is filed, a date for a hearing has to be set.<sup>19</sup> The hearing itself must be held within the following 20 days or, under certain circumstances, within 25 days.<sup>20</sup>

The Bankruptcy Act established a commercial court.<sup>21</sup> Each commercial court was structured under a district court and was considered to be a specialized chamber of that district court, similar to human rights and children courts.<sup>22</sup> The jurisdiction of the commercial court was not restricted to bankruptcy matters, but also extended to other economic law cases.<sup>23</sup> Currently, some IPR laws give jurisdiction

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1 (3) and (4). In civil law a “natural” person is an individual, a “juridical” person is a company, a bank or any other entity that has legal personality.

<sup>14</sup> Article 1 (1) of Act No. 4 of 1988 states that “[a] debtor having two or more creditors and failing to pay at least one debt which has matured and became payable, shall be declared bankrupt through a Court decision as stipulated in Article 2, either at his own petition or at the request of one or more of his creditors.”

<sup>15</sup> The details of this mechanism are provided under Chapter II of the Bankruptcy Act.

<sup>16</sup> Act No. 4 of 1998, Art 212.

<sup>17</sup> *Ibid.*, Art 269 (1).

<sup>18</sup> *Ibid.*, Art 273.

<sup>19</sup> *Ibid.*, Art 4 (4).

<sup>20</sup> *Ibid.*, Art 4 (5) and (6)

<sup>21</sup> Chapter III of the Bankruptcy Act.

<sup>22</sup> Under the Indonesian court system, courts are divided into four jurisdictions; namely, the General Tribunal, Administrative Tribunal, Religious Tribunal, and Military Tribunal. The General Tribunal has jurisdiction over criminal and most civil cases. The General Tribunal is further divided in hierarchical order into the District Court, the Appellate Court, and the Supreme Court. For a concise discussion on the Indonesian court system, see Juwana (2003).

<sup>23</sup> Act 4 of 1998, Art 280 (2). Since the commercial court was not intended to handle only bankruptcy cases, initially the law was drafted as a separate bill from the Bankruptcy Act. However, in anticipation of public criticism about the issue of two Perpus almost at the same time amid the debate of whether an economic crisis was a state of emergency, the government decided to merge the two bills.

to the commercial court to examine IPR cases.

The commercial court was first established in Jakarta within the Central Jakarta District Court.<sup>24</sup> The commercial court in 2000 was further established in Surabaya, Semarang, Makassar, and Medan.

### C. *Enactment of Reform Policies*

In the present discussion, the legal policy for reforming the Bankruptcy Act will be limited to a discussion on the policy of enactment.

Several enactment policies had already been formulated when the government decided to reform the Bankruptcy Act. However, the decisive factor came from the IMF. Therefore, the policy is commonly referred to as the IMF-influenced enactment policy. The IMF had requested the reform of the Bankruptcy Act, since it considered that Indonesia lacked a proper or appropriate legal mechanism for quick, transparent, and effective resolution of debt problems.

The IMF considered that the Bankruptcy Act reform was important for at least two reasons: first, the sheer size of Indonesia's private sector short-term debts.<sup>25</sup> These private debts, once matured, were considered to be a further threat to the ailing Indonesian economy. In anticipation of the pending problems associated with the high level of public and private debts, the IMF insisted that Indonesia should develop debt-restructuring mechanisms. Indonesia complied with the IMF insistence and several debt-restructuring mechanisms were developed; namely, the Frankfurt Agreement, the Indonesian Debt Restructuring Agency (INDRA), and the Jakarta Initiative Task Force (JITF). However, these mechanisms were of a voluntary nature and led to out-of-court settlements. A court mechanism was considered to be important to complement the existing mechanisms, especially when such mechanisms failed. For this reason, reform of the 1905 Bankruptcy Act was deemed necessary.<sup>26</sup>

The second reason was that a workable Bankruptcy Act was perceived as a means to force debtors to enter into negotiation with their creditors. Traditionally, in Indonesia, debtors very often ignored the demands of their creditors without any fear of reprisals or repercussions arising from their recalcitrance.

However, in retrospect, the objective of the Bankruptcy Act reform requested by the IMF was more to protect creditors than to avoid the adverse effects of matured private debts on the Indonesian economy. Even under the current and still unwork-

<sup>24</sup> *Ibid.*, Art 281.

<sup>25</sup> According to Bank Indonesia, the central bank, statistics for December 1997 indicated that the private external debt amounted to about U.S.\$82 billion, available at [http://www.bi.go.id/bank\\_indonesia\\_english/main/statistics/data.asp?head=80](http://www.bi.go.id/bank_indonesia_english/main/statistics/data.asp?head=80) (accessed August 3, 2003).

<sup>26</sup> The amendment was essential. Indeed, as the 1905 act might not enable to recover the loan, it was considered that the law was outdated and difficult to implement, and there was no time certainty required for the process.

able Bankruptcy Act, the predicted dire effects of matured private debts on the Indonesian economy never materialized. Hence, the IMF-influenced enactment policy was at best arbitrary and transitory.

In addition, the IMF or its advisors were not careful enough when they prescribed the Bankruptcy Act reform without having a thorough understanding of the legal problems peculiar to the Indonesian context. The nature of law in Indonesia is very different from what it is in developed countries. In Indonesia, one cannot just enact a law and instantly expect that the behavior of the society will change in accordance with the new law. In addition, the legal infrastructure in Indonesia is associated with a number of shortcomings and consequently, it cannot be reasonably expected that improvements will expedited immediately.

The objective of the enactment policy advocated by the IMF was mainly to protect the interests of foreign creditors. This can be clearly observed in the provision of Article 1 (1) of the Bankruptcy Act which does not consider whether a debtor is solvent or insolvent. The only requirement of the article is that the debtor merely has failed to repay one of its debts. Theoretically, in this sense, a debtor can be declared bankrupt and, subsequently, his assets can be liquidated in spite of the fact that the debtor may in fact be technically solvent. This is irrespective of whether the debtor owns assets with a much higher value than its liabilities. This logic deviates considerably from the basic policy of most bankruptcy laws in which the emphasis is normally placed on rehabilitating the debtor who is in distress rather than on liquidating the assets for the sole purpose of the payment of one single debt even in cases where the debtor is solvent.

By drafting a Bankruptcy Act that disregarded issues of solvency, it could reasonably be construed as having been drafted to make it easier for foreign creditors to have Indonesian debtors facing a financial crisis declared bankrupt. Hence, the Bankruptcy Act provided protection to foreign creditors but did not provide a fair treatment or equal protection to Indonesian debtors from over-zealous creditor actions.

As for the government, the enactment policy was simple. The government was forced to reform the Bankruptcy Act or it would have to face the consequences of not receiving the desperately needed loan disbursements from the IMF.<sup>27</sup> In this sense, the government executed the reform half-heartedly.<sup>28</sup> Delay in loan disbursements would have meant a loss of confidence from foreign investors in Indonesia

<sup>27</sup> However, it should be noted that the IMF was used by some government officials to promote the adoption of a policy, which, if proposed to higher authorities, would have eventually failed. By incorporating certain policy initiatives into the LOI, such policies might have a chance to be followed by the highest authority.

<sup>28</sup> The half-hearted Bankruptcy Act reform had resulted in the government's lack of support in follow-up actions. Follow-up actions never went beyond the mere minimum provision under the LOI with the IMF and seemed to cease every time a loan was disbursed. The IMF had failed to move ownership of the Bankruptcy Act reform program to Indonesia.

and its economic and legal institutions. Nevertheless, the formal language used in the reform was to respond to societal needs, in view of the national interest and the continued effort to amend obsolete Dutch colonial laws.<sup>29</sup>

Actually, societal needs had never been the driving force behind the reform of the Bankruptcy Act. Consequently, the reform did not received a wide public support.<sup>30</sup> For many Indonesians, including the Indonesian business community, the reform was not absolutely necessary. It had never been considered as part of the solution to manage the economic crisis. To the contrary, the Bankruptcy Act reform had been perceived as a means for foreign creditors to conveniently take over Indonesian businesses.<sup>31</sup>

One argument, although it is not the only argument, to support this contention is that the economic crisis had illustrated the inability of companies to pay their foreign currency loans. Prior to the economic crisis, as the exchange rates were relatively stable, there were only a few cases of inability to repay a debt. However, when the crisis hit Indonesia, exchange rates depreciated considerably without the government being able to control them.<sup>32</sup> Therefore, the foreign currency loans of local (rupiah) currency income of companies had to be paid at least at a triple rate, and in some instances even at a higher rate than that in local currency terms. This was the case irrespective of the fact that a company's performance was maintained to provide a stable income. Hence, the economic crisis resulted in the inability, but not necessarily unwillingness, of many Indonesian companies to pay their foreign currency loans.

#### D. *The Effects*

To secure the enactment policies at the implementation stage, the IMF had assisted the government in various ways. Furthermore, the IMF had monitored follow-up actions on the reform every time a loan was about to be disbursed. The IMF even cautioned Indonesia, time and again, that unworkable Bankruptcy Act and commercial court might undermine Indonesia's effort to recover from the economic crisis.

However, these efforts have been insufficient. The facts have shown that the ob-

<sup>29</sup> See General Elucidation of Act 4 of 1998.

<sup>30</sup> According to Linnan (1999, p. 3), the reform of the Bankruptcy Act "suffers from legitimacy problems beyond hidden nationalism concerns. Insolvency reform during the dark financial days of early 1998 was accomplished by a small group within government on an emergency basis. It was not subject to any broader public discussion; . . . with the result that the broader public may doubt that it benefits Indonesia more generally."

<sup>31</sup> However, many foreign companies had not aggressively taken over Indonesian companies due to political uncertainty, unfavorable investment conditions, and security concerns.

<sup>32</sup> Before the occurrence of the economic crisis in July 1997, the exchange rate for U.S. dollar to the rupiah was around IDR 2,250 to IDR 2,600. However, when the economic crisis hit Indonesia, the rupiah continued to depreciate through June 1998, reaching IDR 15,250 and at one point bottoming out at IDR 20,000.

jectives of the IMF-influenced enactment policy were not achieved at the implementation stage for several reasons.

To begin with, since some provisions of the law are too ambiguous, they have created uncertainty and unpredictability. For instance, there have been a number of different rulings on what constitutes a debt. Some rulings defined a debt only in terms of monetary indebtedness. However, other rulings considered that a debt was not restricted to monetary indebtedness. Under this definition, a debt may include a party's obligation to deliver services or goods.<sup>33</sup>

Second, many court rulings have been inconsistent with the IMF-influenced enactment policy of giving protection to creditors, especially foreign creditors. Major rulings have been controversial and almost all were unfavorable to creditors. Foreign creditors and the Indonesian Bank Restructuring Agency (IBRA) have frequently voiced their complaints to this effect.

For example, the commercial court rejected an application for bankruptcy made by American Express (AMEX) against PT. Ometraco Corp. (Ometraco).<sup>34</sup> The refusal was based on a technicality, rather than on substance. The court argued that AMEX should have filed two bankruptcy petitions against Ometraco and its subsidiary, instead of only one. Similar to this case, the commercial court had turned down the application to declare bankrupt PT. Tri Polyta Indonesia Tbk., by one of its bondholders, OCM Opportunities Fund II, due to an incorrect power of attorney.<sup>35</sup>

In another case, PT. Sumi Asih, IBRA had requested the commercial court to declare bankruptcy. The court rejected the request on the ground that the request should have been made by the banks undergoing restructuring by IBRA, and not by IBRA itself. In a different case, a request to declare bankruptcy was rejected because the creditor, at the same time, filed a law suit against the company which was requested to be declared bankrupt. The request was made by Drayton Kiln, Ltd., a British company, against PT. Dekomas Mulia Industries. The commercial court stated that it had no jurisdiction since a civil law suit was initiated and came under the jurisdiction of the general court.

In one case, the court did not recognize a debt as due and payable, regardless of the fact that the loan had been accelerated. The reason given was that the final

<sup>33</sup> Characterizing an obligation to deliver goods (for example) as a debt would be very unusual in the common law tradition where a debt usually refers to a debt of money. In the civil law tradition, however, a debt is not defined as a debt of money but includes any obligation owed. In a similar way, civil law lawyers often refer to the performance of an obligation as a payment, even if it does not involve the payment of money.

<sup>34</sup> *Amex v Ometraco*, Commercial Court Decision No. 05/Pailit/1998/PN.Niaga/Jkt.Pst dated September 28, 1998.

<sup>35</sup> "Gara-gara surat kuasa, permohonan pailit terhadap Tri Polyta ditolak" [Because of power of attorney, the application to declare bankrupt Tri Polyta was rejected], *Hukumonline*, July 18, 2003, [http://www.hukumonline.com/artikel\\_detail.asp?id=8374](http://www.hukumonline.com/artikel_detail.asp?id=8374) (accessed August 2, 2003).

repayment date had not occurred. Other examples include the decision of not recognizing a debt under a swap transaction as a valid debt.

The causes of these controversial rulings have not been determined. One argument is that judges handling bankruptcy cases may have nationalist feelings and consider that they have the duty to protect Indonesian companies from being taken over by foreign creditors.

The third inconsistency between the enactment policy and its implementation is the fact that parties who actually had contractual, tort, or other non-bankruptcy disputes with the relevant companies often used the Bankruptcy Act. An application for bankruptcy was filed by stating that the party in dispute had incurred a debt toward the applicant. The applicant then provided to the court evidence that there were other debts. By doing this, the applicant had satisfied the requirement for declaring the party in dispute bankrupt. The court then would examine these two requirements and, if it found that they were satisfied, the court would declare the bankruptcy. In such a process, the court may not determine whether the would-be-declared bankrupt party was solvent or insolvent. This is because the Bankruptcy Act does not require a party to be insolvent before a bankruptcy is declared.

PT. Modernland Realty (Modernland) was the first victim (solvent-yet-bankrupt) due to its failure to deliver some apartment units to its customers.<sup>36</sup> An insurance joint venture company, PT. Asuransi Jiwa Manulife Indonesia (AJMI), had to defend itself against several petitions of bankruptcy brought by some unsatisfied policyholders who demanded payment of disputed insurance claims.<sup>37</sup> Most recently, another joint venture company, PT. Unilever Indonesia Tbk., had to defend itself against a petition by its former forwarding company, PT. Parma Djaja whose contract was terminated earlier.<sup>38</sup> One may be surprised that an application for bankruptcy could even be filed against a solvent company with huge volumes of assets, and that sometimes such companies were indeed declared bankrupt after the applicant simply proved that it had receivables, an amount of money due to him, technically, even as low as IDR 1.

In addition, some disputes between shareholders have ended up in the commercial courts. The controversial case of AJMI, which was the object of an application

<sup>36</sup> *Drs. Husein Sani et al. v PT. Modernland Realty Ltd.*, Commercial Court Decision No. 07/Pailit/1998/PN.Niaga/Jkt.Pst. dated October 12, 1998. The Supreme Court, however, revoked the commercial court decision because the commercial court had defined the debt widely, namely as a case where there was no monetary debt involved. The obligation to deliver units of apartments could not be considered as debt.

<sup>37</sup> For example the case of *Monica Tanuhandaru et al. v PT. Asuransi Jiwa Manulife Indonesia, d/h PT. Asuransi Jiwa Dharmala Manulife*, Commercial Court Decision No. 76/Pailit/2000/PN.Niaga/Jkt.Pst. dated December 6, 2000. No ruling was handed down in this case, however, as AJMI had reached on out-of-court settlement.

<sup>38</sup> "Batalan kontrak dengan perusahaan ekspedisi, Unilever dimohonkan pailit" [Terminating contract with forwarding company, Unilever petition for bankruptcy], *Hukumonline*, February 10, 2003, [http://www.hukumonline.com/artikel\\_detail.asp?id=7407](http://www.hukumonline.com/artikel_detail.asp?id=7407) (accessed August 3, 2003).

TABLE I  
THE CASES REGISTERED AT THE JAKARTA COMMERCIAL COURT

Year	Number of Cases
1998	—
1999	100
2000	84
2001	67
2002	38
2003 (May)	12

Source: *Hukumonline* data.

by one of its shareholders, PT. Dharmala Sakti Sejahtera, and was declared bankrupt in 2002, is a good example.<sup>39</sup> This case will be discussed in detail later.

In this sense, the bankruptcy mechanism has become an alternative for dispute resolution, even though the dispute does not involve any bankruptcy issue. Large and bona fide companies usually surrender to the demands of less powerful ones if threatened or petitioned in bankruptcy. It is unfortunate that the Bankruptcy Act has been effective for this purpose.

The performance of the commercial court has become another source of disappointment. One year after its full operation, the Jakarta Commercial Court had received 100 applications, a record high. Unfortunately, in the following years, the number gradually decreased. Until May 2003, there had been only 12 registered cases for 2003 (see Table I).

The conditions of the commercial court outside Jakarta are even worse. As of April 2003, there had not been any applications for a declaration of bankruptcy in any of these courts, except for one case in the Surabaya Commercial Court.<sup>40</sup>

Recently, the commercial court infrastructure, particularly in Jakarta, has been improved considerably, although the number of cases has continued to decrease.<sup>41</sup>

According to the white paper of the Jakarta Commercial Court, the number of petitions to declare bankruptcy in 1998 accounted for 42% of all the cases submitted.<sup>42</sup> In 1999, the percentage decreased to 31%, but recorded a slight increase in the subsequent year, namely 38%. In 2000, it fell to 28% and the year after, there

<sup>39</sup> This case is considered to have been kindled by the dispute between Manulife who holds 51 percent shares of AJMI and the family of Gondokusumo, the founder of DSS who holds 40 percent shares of AJMI. The case had attracted national and international outcry mostly due to the court ruling of declaring a solvent insurance company bankrupt. At the later stage, the Supreme Court overturned the ruling.

<sup>40</sup> The case, however, was not pursued further because an out-of-court settlement had been reached.

<sup>41</sup> "Kepailitan disimpang jalan" [Bankruptcy at the crossroad], *Hukumonline*, June 16, 2003, [http://www.hukumonline\\_com-ACPengadilan.htm](http://www.hukumonline_com-ACPengadilan.htm) (accessed August 3, 2003).

<sup>42</sup> Report of Activities (Laporan Kegiatan) 1998–2003 of Commercial Court at Jakarta Pusat District Court.

was a small increase of 23%. In 2003, the percentage of requests for petition for bankruptcy accepted by the commercial court was 32%.

The decreasing number of cases is due to the disappointment in many quarters with the performance of the commercial court.<sup>43</sup> Foreign creditors, whose interests have been promoted by the IMF, are now reluctant to pursue their debt settlement through the commercial court. It was reported that, among the 100 cases filed in 1999, not a single significant foreign creditor had been successful. Even IBRA faces the same fate and will only utilize the bankruptcy mechanism as a last resort when dealing with recalcitrant debtors.

The IMF, as early as in 2000, had expressed its disappointment over the failure of the commercial court to force recalcitrant debtors to settle their debts.<sup>44</sup> Even people within the government strongly considered that the commercial court had failed miserably in its task.<sup>45</sup>

#### E. *The AJMI Case*

AJMI is the abbreviation for PT. Asuransi Jiwa Manulife Indonesia, a joint venture insurance company. AJMI had faced a number of applications for declaration of bankruptcy.<sup>46</sup> In the case that will be discussed here, the commercial court “finally” declared AJMI bankrupt.

When AJMI was declared bankrupt, the shareholders were Manulife Financial (MF), a Canadian-based insurance company which owned 51% of the shares, PT. Dharmala Sakti Sejahtera (DSS) which owned 40% of the shares, and the International Finance Corporation (IFC) which owned 9% of the shares. It should be noted that the DSS had been declared bankrupt prior to the filing of this petition.

The case was particularly controversial and received a great deal of attention domestically and internationally. The controversy surrounded the fact that the respondent to the petition was a perfectly solvent company and that the court declared AJMI bankrupt in spite of its solvency. At that time, the risk-based capital ratio of AJMI was 167.26 percent, far above the government requirement of 120 percent. Its assets were valued at IDR 1.8 trillion. Furthermore, the controversy

<sup>43</sup> See the overview section of U. S. Embassy (2000) in which it stated that “Indonesia’s Bankruptcy Law, which was amended in 1998 to establish a separate Commercial Court, has been a disappointment to creditors.”; “5 tahun Perpu Kepailitan, banyak yang kecewa dengan Kepailitan” [Five years Bankruptcy Perpu, many disappointed with Bankruptcy], *Hukumonline*, April 24, 2003, [http://www.hukumonline.com/artikel\\_detail.asp?id=7867](http://www.hukumonline.com/artikel_detail.asp?id=7867) (accessed April 24, 2003).

<sup>44</sup> “IMF Insists on Good Governance,” *Jakarta Post*, April 25, 2000.

<sup>45</sup> See remark by Bacelius Ruru as Chairman of Jakarta Initiative Task Force, “Role of Indonesian Insolvency System: Case for Optimism and Case for Caution” at Forum for Asian Insolvency Reform in Bali, Indonesia, February 7–8, 2001, available at <http://www.oecd.org/pdf/M00009000/M00009092.pdf> (accessed July 18, 2003).

<sup>46</sup> The application however was not due to the inability to pay the debt or the fact that AJMI was insolvent. Most applications had been made by policyholders who initially had their respective insurance claims denied by AJMI.

highlighted how the bankruptcy mechanisms could be invoked in what was essentially a feud between shareholders.<sup>47</sup> The case attracted foreign attention, as it became an indicator of how non-conducive the Indonesian legal system could be to foreign investment and investors. Moreover, the case became a source of bilateral tension between Indonesia and Canada. Domestically, it also received a wide attention as yet another case that highlighted the endemic corruption suspected of permeating the judiciary.

The application to declare AJMI bankrupt was submitted by the DSS's receiver on May 15, 2002. The case was examined by the Jakarta Commercial Court, which is attached to the Central Jakarta District Court.

The reasons to declare AJMI bankrupt were that the applicant proved that AJMI had two debts, one of which was due and payable.<sup>48</sup> The first debt, as claimed by the DSS, was a debt resulting from AJMI's failure to pay a dividend to DSS for the year of 1999.<sup>49</sup> The dividend should have been paid as it was agreed in a certain joint venture agreement concluded by the shareholders. One of the provisions stipulated that AJMI had to pay a dividend if it registered a profit of more than IDR 100 million.<sup>50</sup> In 1998 and 1999, AJMI had registered profits of around IDR 186 billion and IDR 306 million, respectively.<sup>51</sup>

The other debts incurred by AJMI, as argued by the DSS, were policyholder-related debts. In addition, according to the DSS, since AJMI had not paid a certain tax, AJMI had a debt toward the state.

AJMI refuted the claims submitted by the DSS by contending that at the annual shareholders meeting held in 2000, it was decided that a dividend for 1999 would not be paid to the shareholders.<sup>52</sup> Based on this shareholders' resolution, AJMI argued that it had no authority to pay a dividend. In addition, AJMI claimed that there were no outstanding debts to either policyholders or the state.<sup>53</sup>

On June 13, 2002 the judges by a vote of 2 to 1 concurred with the DSS arguments and declared AJMI bankrupt.<sup>54</sup>

<sup>47</sup> The Bankruptcy Act was used by DSS as a kind of weapon by the founder to attack Manulife. See "Corruption Lurks behind Bankruptcy in Indonesia," *Age* (Melbourne), June 27, 2002. The *Jakarta Post* writes as follows, "The bankruptcy petition launched against AJMI is seen by Manulife as part of its two-year legal battle with the Gondokusumo family, the owner of DSS, who has been accused of trying to defraud Manulife." See "Manulife Says Receiver Irresponsible," *Jakarta Post*, June 18, 2002.

<sup>48</sup> Act No. 4 of 1998, Art 1 (1).

<sup>49</sup> The amount claimed was IDR 22.4 billion.

<sup>50</sup> Joint Venture Agreement between MF and DSS dated June 10, 1998.

<sup>51</sup> DSS provided as evidence the Consolidated Financial Statement of AJMI for the years 1998 and 1999 made by Ernst & Young.

<sup>52</sup> AJMI Shareholders Resolution dated February 17, 2000.

<sup>53</sup> AJMI lawyer had even questioned the definition of debt which included the debt to the state in the form of failure to pay tax.

<sup>54</sup> Commercial Court Decision No. 10/Pailit/2002/PN.Niaga/Jkt.Pst.

The blow to AJMI continued as the receiver proposed by the DSS and approved by the court immediately announced that AJMI would cease trading and closed the offices.<sup>55</sup> The decision resulted in chaos as AJMI policyholders, employees, and its business associates were unable to carry on their normal business activities and the court did not provide any means to resolve this issue.<sup>56</sup> AJMI then requested that the court replace the appointed receiver, arguing that he may be biased in his decisions since he had links with the DSS. In addition, the receiver was not a registered member of the Lawyers' Receivers Association.<sup>57</sup> The request was accepted and the court replaced the receiver.

As for the commercial court ruling, AJMI immediately went to the Supreme Court for an appeal. The Supreme Court on July 8, 2002 overturned the ruling of the commercial court.<sup>58</sup> The ruling, however, was based on a legal technicality rather than on the substance of the petition. The Supreme Court found that when the DSS's receiver filed the bankruptcy application, he did not obtain approval from the supervisory judge. Such an approval was required as the DSS was in a state of liquidation.<sup>59</sup> This actually had been argued by AJMI when the case was still at the commercial court, but was disregarded.

Many foreign investors saw the ruling as a reflection of the poor condition of Indonesia's judicial system.<sup>60</sup> Investors' confidence in the legal system had decreased as they considered that there were no predictability and definitely no legal certainty. This, however, did not mean that the existing investors would flee; it just prevented prospective investors from coming to Indonesia.

The case disrupted bilateral ties, as the Canadian government was quick to respond to the inappropriateness of the decision to declare a perfectly solvent company bankrupt. The Canadian Secretary of State for the Asia Pacific specifically visited Jakarta to call on the Indonesian government for a reversal of the ruling.<sup>61</sup> This reaction had been considered as a form of pressure on the Indonesian government. The Indonesian government refused to intervene in this judicial matter. An

<sup>55</sup> "Manulife Says Receiver Irresponsible," *Jakarta Post*, September 29, 2003.

<sup>56</sup> "400,000 Policyholders of Manulife Face Uncertainty," *Jakarta Post*, June 15, 2002; "Manulife Clients, Employees in State of Uncertainty," *Jakarta Post*, June 16, 2002; and "Some AJMI Customers Have Started Terminating Contracts," *Jakarta Post*, June 20, 2002.

<sup>57</sup> "Manulife Seeks to Go Back in Business Soon," *Jakarta Post*, June 27, 2002.

<sup>58</sup> "Supreme Court Rejects Ruling on Manulife," *Jakarta Post*, July 9, 2002.

<sup>59</sup> Supervisory judge is the judge of the Commercial Court appointed by the judges who examine the application for bankruptcy. The supervisory judge is appointed together with a receiver after a company is declared bankrupt. The main responsibility of the supervisory judge is to oversee the receiver in managing assets of the declared bankrupt company. Under Article 67 (5), it is provided that, "To appear before the Court, the receiver must first obtain the approval of the Supervisory Judge, . . ." See Act No. 4 of 1998, Art 67 (5).

<sup>60</sup> "Manulife Case, Another Blow to Foreign Investment," *Jakarta Post*, July 1, 2002.

<sup>61</sup> "Manulife Fiasco Instigates High-Level Talks," *Jakarta Post*, June 20, 2002; and "RI Not Doing Enough in Manulife Case," *Jakarta Post*, June 21, 2002.

Indonesian high official made a remark that the Canadian government had overreacted.<sup>62</sup> Moreover, the IMF also took the opportunity of the AJMI case to request that the Indonesian government speed up the reform of the commercial court and the revision of the Bankruptcy Act.<sup>63</sup>

In a parallel event, the government, the police, and the Supreme Court launched an investigation of the three judges examining the case. The government investigation was based on the grounds of government employee's discipline, as the three judges were government employees. The three judges were also investigated by the Judges' Disciplinary Committee under the instructions of the Supreme Court on suspicion of violating professional ethics.<sup>64</sup> In addition, the police had also launched an investigation for corruption as a criminal offense.<sup>65</sup> While under the investigation, the three judges were relieved from handling all cases.<sup>66</sup> The judges had been suspended under a presidential decree.<sup>67</sup> In less than a year, based on all the investigations, it was eventually concluded that the judges had not committed any wrongdoing. Subsequently, the suspension of the three judges was lifted and they have since been reinstated to full duties as judges.<sup>68</sup>

#### IV. COPING WITH THE CHALLENGES OF LAW REFORM

Having analyzed some of the challenges facing Indonesia's economic law reform, there should be a refocusing of efforts to cope with ever-increasing and changing challenges.

First, the law reform process should be amended. The amendment should concentrate on reconciling the differences between enactment policies and the basic policies of certain economic laws. This would avoid the unfortunate situation where a law is used for a purpose other than that for which it was intended under the basic policy initiatives. To take an example, a further amendment of the Bankruptcy Act is required to incorporate the solvency test.

Legal reform in Indonesia should also minimize the desire of foreign institutions that an Indonesian legislation that is not compatible with the legal infrastructure and legal culture of Indonesia be drafted. The government must stop giving promises and other assurances to foreign investors or financial institutions that they can

<sup>62</sup> "Manulife Dispute May Affect RI's Ties with Canada, Others," *Jakarta Post*, June 22, 2002.

<sup>63</sup> "IMF Wants Reform of Commercial Court," *Jakarta Post*, June 24, 2002.

<sup>64</sup> "Council Sets Up to Probe Manulife Judges," *Jakarta Post*, August 14, 2002.

<sup>65</sup> "Ministry, Police to Join in Manulife Scandal Probe," *Jakarta Post*, July 6, 2002; and "Three Manulife Judges May Be Indicted for Bribery," *Jakarta Post*, July 25, 2002.

<sup>66</sup> "Three Controversial Manulife Judges Suspended from Duties," *Jakarta Post*, August 7, 2002.

<sup>67</sup> In Indonesia, judges are appointed, removed, and suspended under a presidential decree as one form of legislation.

<sup>68</sup> "Controversial Manulife Judges Exonerated," *Jakarta Post*, January 21, 2003; and "Controversial Manulife Judges Moved," *Jakarta Post*, August 8, 2003.

deliver certain legal reforms only to later renege on those promises and assurances. Foreign investors and financial institutions have to be given a clear picture of the status of laws in Indonesia and the consequences they have to face once legal actions are initiated and pursued.

Next, legal drafters have to be careful and precise when drafting economic laws so as to avoid creating confusion at the implementation stage. Drafters should undergo regular training to ensure that their skills are appropriate to the current conditions. Indonesia's legal education system should be overhauled, perhaps resulting in drastic and significant changes, so that graduates would be knowledgeable not only about the theory of the law but also about the practical skills required to succeed in an increasingly globalized community.

Fourth, the implementation agencies have to understand the law well before the demands of implementing it are imposed. Hence, regular and consistent training is necessary. Specialized judges and prosecutors are also needed. In addition, the agencies have to free themselves from corruption. Raising the salaries of judges and prosecutors and making gratuity payments a less enticing means of augmenting personal income could achieve this objective.

Last, the society needs to be educated on the new values embedded in the new economic laws. Law is meaningless if the society where such laws are enacted cannot comprehend or appreciate it.

It cannot be reasonably expected that the challenges that have to be met could be addressed overnight. Clearly, adequate time should be devoted to the task and sufficient funds made available for this work to be completed. The process has to be seen as a continuing development of legal institutions in Indonesia rather than a project defined with a certain time limit.

## V. CONCLUDING REMARKS

Indonesia's efforts to reform its economic laws have not resulted in the beneficial effects intended on the Indonesian economy. No significant achievement has been made, other than promulgating the laws and regulations. One of such examples is the Bankruptcy Act reform.

The effort to implement the Bankruptcy Act reform has not been effectively utilized, particularly in terms of the debt-workout mechanisms through the courts. Both foreign creditors and IBRA, whose interests have been the driving force behind the implementation of the Bankruptcy Act reform, have avoided to employ the bankruptcy mechanism.

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