

## RESTRICTION ON THE RIGHTS OF SECURED CREDITORS IN BANKRUPTCY PROCEEDINGS

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### Abstract

The enactment of Law No. 37/2004 upon Bankruptcy and Suspension of Payment (UUK-PKPU) as the “lex specialist” of the Collateral Law and Civil law has caused several legal problems to the creditors holding collateral over assets of their debtors, commonly known as secured creditors, in terms of management and settlement on bankruptcy estate. Such problems included: First, there is a normative conflict between Bankruptcy law and collateral law, in particular regarding to the principle of executorial and the principle of preference right. Second, there is a restriction on the right of secured creditors in terms of management and settlement on bankruptcy estate.

### Keywords

limitation of right, creditors holding the security assets, integration

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## Introduction

The establishment of Government Regulation in Lieu of Law No. 1/1998 respectively amended by the Law No. 4/ 1998 and revised by the Law No. 37/2004 on bankruptcy and suspension of payment (UUK-PKPU) inevitably related to the monetary crisis in Indonesia in 1998 (Rachbini, 2001). The general description of the Government Regulation in Lieu of Law No. 1/ 1998 dealing with the amendment of the Regulation on bankruptcy itself admitted such factor. Mentioned in the description of that Government Regulation in Lieu of Law that the impact of such monetary flaming caused a huge challenge on national economic particularly in business competence to develop the company or keep the business survive.

The Regulation on bankruptcy and suspension of payment (UUK-PKPU) was established for business purpose to cope with payable-receivable issues in a fair, quick, transparent, and effective way, thus, it would protect the creditor's right to have access into the bankrupt debtors' assets if, somehow, the debtors did not pay their bills. However, it was designed no to inflict the related debtors' interest. In further international financial society, a thorough reformation on legal mechanism of bankruptcy would be considered critical. William E. Holder suggested that:

*"With the technical assistance of the IMF Legal Department, The Indonesian government undertook an intensive review of the law, with a view to its modernization. Several important features were immediately apparent. First, Indonesia's bankruptcy legislation, promulgated as an ordinance in 1906 along the lines of the Dutch model, had essentially been left on the shelf. (Holder, 2001).*

Traditionally, the regulation of bankruptcy was set under *Faillissement verordenen* Stb. year 1905 No. 217 Jo. Stb. year 1906 No. 348 based on the article II of transitional rules of the Constitution 1945 and it prevailed before new revision was established. *Faillissement verordenen* Stb. year 1905 No. 217 Jo. Stb. year 1906 No. 348 set 2 chapters: Chapter I dealt with bankruptcy in general, and Chapter II concerned on the suspension of payment (PKPU). However, since most of the regulation mentioned in *Faillissement verordenen* Stb. year 1905 No. 217 Jo. Stb. year 1906 No. 348 did not correspond to the development and the needs of law for the society, the government established the Government Regulation in Lieu of Law No. 1/1998 which was then amended by the Law No. 4/ 1998 on bankruptcy and suspension of payment (UUK-PKPU). It was then completed in Law No. 37/ 2004 on Bankruptcy and Suspension of Payment (UUK-PKPU).

The establishment of this current body was expected to be an alternative body to cope with debtors' liabilities on the creditors in effective, efficient, and proportional manner (Shubhan, 2009). The purpose of establishing UUK-PKPU as a novel regulation of bankruptcy in Indonesia was for business interest in order to deal with payable-receivable issues in fair, quick, transparent, and effective manner (Puspa, 1977). The researcher argued that in payable-receivable settlement practices, this current legal body of bankruptcy was expected to overcome NPL (Non-Performing Loan) in fair, definite, transparent, and effective way. It could be recognized since such coping had been always through execution of fiduciary agency (e.g., an execution of collateral took longer time, especially when resistance existed either from debtors or the third party).

### Characteristics of Bankruptcy Law

Etymologically, bankruptcy relates to the term "bankrupt". This term was found in Dutch, French, Latin, and English. In French, it named "*faillite*" which was identified as a stoppage of doing payment. Individuals who stopped paying their bills were called "*Le faillite*". In English, it was known the term "*to fail*", and in Latin was known as "*failire*". The Dutch would use the term "*failliet*" indicating as bankrupt. The term 'bankrupt' itself was defined as a state on which an individual or a company could not pay any of term the judge decided (Puspa, 1977). Drawing on Henry Cambell Black (1990), *Bankrupt is the state or condition of a person (individual, partnership, corporation, and municipality) who is unable to pay its debt as they are, or became due*". It argued that the definition of the term 'bankrupt' was associated with 'incapability' to pay.

The term 'bankruptcy' Indonesia used in current days was a translation of the term '*faillissement*' derived from Dutch. The legal system of Britain, USA, and other countries following common law had recognized the term "*bankruptcy*". It was derived from the common term '*bancarota* or *bankruptcy*' used by Italian merchants in the middle age years ago. Such term was literally defined as *broken bench* (Lieberman&Siedel). Bankruptcy was defined as anything related to 'bankrupt'. In Black's Law Dictionary, bankrupt was defined as *the state or condition of a person (individual, partnership, corporation, and municipality) who is unable to pay its debt as they are, or become due. The term includes a person against whom an involuntary petition has been filed, or who has filed a voluntary petition, or who has been adjudged a bankrupt* (Widjaya, 2009). Based on such definition, it could be concluded that the definition of the term 'bankrupt' was in association with debtor's incapability to pay their due-date bills/liabilities.

However, the article 1 act (1) UUK-PKPU defined 'bankruptcy' as a general confiscation of bankrupt debtor's assets which administration and handling was through curator under the supervision of supervisory judges. The legal body of bankruptcy is a unit provided by law to overcome the payable-receivable issues between debtors and creditors. The intent of amendment and revision of this bankruptcy law was that the resolving mechanism of payable-receivable issue of bankruptcy could be conducted based on the principles of a fair, definite, beneficial, quick, transparent, and effective judicature as what the justice seeker expected (Azed, 2010) These principles were consistent with the special principle of commercial courts as mentioned in a consideration letter *c* and *f* the Law No. 4/ 1998 and the general description in 6<sup>th</sup> paragraph the Law No. 37/ 2004 on UUK-PKPU, those were: fair, quick, transparent, and effective. The latter three principles - quick, transparent, and effective- contained the procedures of quick judicature and the collateral procedures of bankruptcy estate for the creditor's interest. The principle of fair, on the other hand, was used to concern on both the creditor's and debtor's interests in equal and proportional manner.

Drawing on *Failissements verordenen*, bankruptcy aimed to protect the unsecured creditors in order to get their collateral (*jus in rem/zekelijk recht*) over the debtor's assets (Suyatin, 1993). Such inference came from the definition of bankruptcy mentioned in *Memorie van Toelichting* that defined bankruptcy as a legal confiscation on the debtor's assets for the creditor's interest (Gautama, 1998). This was consistent with the principles mentioned in article 1131 BW, "*Alle de roerende en onroerende goederen van den schuldenaar, zoo wel tegenwoordige als toekomstige, zijn voor deszelfs persoonlijke verbintenissen aansprakelijk*". The Law imposed such principle to assure the creditor that the debtor would pay their liabilities (Gautama, 1998).

The principle of Indonesia bankruptcy law is inseparable from the principle of civil law since it, as a sub-system of national civil law, is an intact part of civil law and civil procedural law. Indonesia bankruptcy law mostly concerns on confiscation and execution. Thus, the law of bankruptcy was an intact unit associated with the regulation of confiscation and execution mentioned in civil procedural and collateral laws. The principle of Indonesia bankruptcy law was generally set in article 1131 BW and the special principle mentioned in Law No. 37/ 2004 (Sinaga, 2012). The general principle of Indonesia bankruptcy law was set under the article 1131 BW named as *Paritas Creditorium* and in article 1132 BW named *pari passu prorate perte*, indicating that every creditor had equal rights over the debtor's assets, unless certain motives to be priority was considered exist.

In addition, the special principle of Indonesia bankruptcy law mentioned in Law No. 37/ 2004 on UUK-PKPU was clearly set in its description stating that the establishment of this regulation relied on the principles of bankruptcy. The principles (as explicitly mentioned by the word 'include') included: First, *the principle of equilibrium*. The notion considered as the manifestation of this principle was that, on one hand, there was a stipulation to prevent any misuse of regulation and bankruptcy bodies by bad debtor, and on the other hand, there was a stipulation to prevent any misuse of regulation and bankruptcy bodies by non-prudent creditor.

Second, *the principle of business sustainability*. In UUK-PKPU, it was likely that a prospective debtor company was sustainable. The ratio of this stipulation was solely to optimize the bankruptcy estate. Third, *the principle of fairness*. This principle defined that a stipulation on bankruptcy could meet the sense of fairness for the related parties. This principle was to prevent any arbitrariness from the collection parties in the attempt of paying each of debtor's liability by ignoring other creditors.

The forth, *the principle of integration*. Integration in UUK-PKPU contained a definition that the formal legal system and the collateral law were one intact unity from civil law and national civil procedural law. Hence, with this principle, it was not possible that the principles in this bankruptcy law conflicted with the principles of collateral law such as collateral right, mortgage, lien, or fiduciary.

In Indonesia bankruptcy law article 2 UUK-PKPU, creditor of bankruptcy included separatist creditor, preferred creditor, and unsecured creditor. There were debates among scholars in defining separatist creditors. Munir Fuady argued that the term 'separatist' was connoted as separation since a creditor's position was separated from other creditor. It indicated that the creditor could sell and obtain the gain by themselves separated from the general bankruptcy estate (Fuady, 1996). Mariam Darus Badruzaman (1996) noted that as a creditor with collateral right had preferred right and positioned as separatist creditor. Mariam Darus Badruzaman distinguished the creditor's right from their position which account receivable was secured by collateral (*jus in rem/zekalijk recht*). Such right was considered as preferent since it was characterized under the Law as creditor with prioritized payment. The position as separatist creditor was due to the fact that the creditor had separable right from the other preferred creditors which account receivable was secured by the collateral.

Separatist creditors are creditors holding collateral over assets of their debtors, commonly known as secured creditors, who could do immediate execution. This type

of creditor would not be affected by the statement of bankruptcy. It indicated that their rights to conduct execution would remain run as if there were not any debtor's bankruptcy. Creditors with lien, fiduciary, collateral right, and mortgage or collateral of other objects were all characterized into separatist creditor. Such separation was intended as separating the right of executing any collateral from bankrupt debtor's assets. Thus, separatist creditors had a primary position in bankruptcy proceedings, in relation to the right over the collateral for their account receivable. As long as the value granted to the separatist creditors did not exceed the value of the collateral and of the creditor's authority over such collateral, bankruptcy proceedings would not affect the payment encounter of the creditor's accounts receivable.

Dealing with the priority order for creditors in bankruptcy matter, it could particularly be seen in the stipulation of the article 60 act (2) JO. 189, act (4) UUK-PKPU, mentioning that the payment was for creditors:

- a. With privileged rights, including the privileged rights to be denied; and
- b. With lien, fiduciary, collateral right, mortgage, or collateral rights of other object, as long as they were not paid as what mentioned in article 55, could be conducted they could execute their collateral as long as they had privilege right or as long as the collateral was pledged to them.

Based on the stipulation, the priority order among creditors in bankruptcy proceedings was as follows.

- a. Creditors with privilege right by the regulation, had higher position than secured creditors, such as: account receivable/tax arrears (article 21 act 7, Law No. 6/ 1983, as amended by Law No. 9/ 2004 on General Provision and Procedures of Tax) noted that the state had privilege on tax arrears of the taxpayer's assets and bankruptcy costs (in accordance to the provision of the article 191 UUK-PKPU in which the entire bankruptcy costs was charged to each collateral of bankrupt estate and, thus, it was paid preceded the separatist creditor).
- b. The account receivable of special preference (article 1131 BW and account receivable of general preference (article 1149 BW), referred to account receivables in relation to the given collateral of bankruptcy estate.
- c. Separatist creditors which comprised secured creditors, including: collateral right, mortgage, fiduciary, and lien.

- d. Concurrent creditor, including creditors without any given collateral.

Consistent with article 1132 BW stating that it became collateral for every related creditors; the benefits from selling/executing the collateral would be divided fairly based on the amount of each account receivable, unless there were legitimate motives among the creditors to be preceded. Based on such provision, it could be seen that, in broad manner, creditors could be classified into 2 categories, ordinary creditor and preferred creditor.

Concurrent creditors constituted creditors without any right to get refund in preference over other creditors. This type of creditor should share with other creditors in proportional manner or known as *pari passu*. It was calculated based on the amount of their account from the sale proceeds of bankrupt estate unencumbered with any collateral right. The common legal used for this type of creditor was *unsecured creditor* (Sjahdeni, 2008). In contrast, preferred creditors had priority on refund over other creditors. The account receivable of this creditor was preferred or prioritized over other creditors.

Preferred creditors, based on the article 1133 BW, derived or established from a privilege right, lien, and mortgage. Consistent with this article, the preferred creditors could stand from privilege right, a given right (under the regulation) was granted to creditors and thus their position was higher than other creditors, solely seen from the nature of the account receivable and from fiduciary agency such as lien, mortgage, collateral right, and fiduciary. Consistent with article 1134 BW, lien and mortgage or fiduciary agencies were imposed higher rather than privilege right, unless it was inversed under a given regulation. Overall, the classification of creditors in accordance to the provision of BW was as follows.

- a. Privileged creditor mentioned by the Law was higher than collateral, such as national cash or tax (article 1137 BW);
- b. Creditor holding collateral over assets of their debtors, such as lien, mortgage, collateral right, and fiduciary (article 1134 act [2] BW);
- c. Privileged creditor over particular assets as mentioned in article 1139 BW (article 1135 BW Jo. 1138 BW);
- d. Privileged creditor over common movable and immovable assets as mentioned in article 1149 BW; (article 1135 BW Jo. Article 1138 BW);

e. Concurrent creditor (article 1131 BW Jo. Article 1132 BW)

Among the principles embedded in secured creditors, 2 (two) primary principles inconsistent with current established regulations of bankruptcy in Indonesia included: first, executorial principle of secured creditors. An executorial right given to the party holding collateral (e.g., collateral right, fiduciary, lien, and mortgage) was a right, under the regulation, provided for creditors holding collateral. Furthermore, in collateral right, a right to execute the collateral was set under the article 6, Law No. 4/1996 (UUHT) Jo. Article 20 UUHT. In fiduciary context, the executorial right was set under the article 15 act (2) the Law No. 42/1999 on Fiduciary. Moreover, in mortgage context, the provision of executor was set under the article 1162 BW. Finally, in lien context, the executorial right was set under the article 1155 BW which regulated the right to immediately execute the collateral as the repayment of loan when the debtors broke their agreement. Thus, collateral always set the provision for the secured creditors immediately execute their collateral under the term of particular condition that the debtor was tort and the sale would be preceded through auction.

It was expected that the executorial right allowed the secured creditors immediately execute their collateral in fast and simple manner without any preceded accusation for that execution. This executorial right –a right execute the collateral when the debtor was trot/broke the agreement- attracted people to provide loan with collateral right. However, with the provision of bankruptcy law (UUK-PKPU) particularly in article 56 act (1) UUK-PKPU, an executorial right for secured creditors was suspended in 90 (ninety) days counted from the debtor was considered bankrupt. Moreover, consistent with article 59 act (1), article 59 act (2), and article 59 act (3) UUK-PKPU, the executorial right for secured creditors prevailed in 2 (two) months right after the insolvency decision (in fact, it was difficult in practice). It also prevailed on any collateral that actually did not belong to the bankrupt debtors (thus, it was not supposed to include in bankruptcy estate). Consistent with article 59 act (2) UUk-PKPU, secured creditors over collateral objects would lose their executorial right if the due date (two months after the creditor's insolvency was decided) was over.

Preference rights constituted a right to be preferred in terms of loan repayment if the debtor was considered trot/broke. In the context of secured creditors, this type of right was set under the article 1 act (1) UUHT. In the context of creditors with mortgage, this type of right was set under the article 1162 BW. Whereas, in the context of creditors with fiduciary, this type of rights was set under the article 1 act (2) Law of Fiduciary,

and lien was set under the article 1150 BW. With preference right, secured creditors would be pleased to have repayment in precedence over the other creditors. However, article 39 act (2) UUK-PKPU mentioned that wages was considered as bankruptcy costs which repayment was in precedence over the secured creditors. Additionally, article 60 act (2) UUK-PKPU also mentioned that under the demand of curator or privileged creditors (based on article 1139 BW and 1149 BW), it was a must for secured creditors to submit some parts of the sale result which amount was equal to the privileged loan when they immediately execute their collateral.

### Right Restriction

The establishment of bankruptcy law, under the Law No. 37/ 2004 on bankruptcy and suspension of payment (UUK-PKPU), as a positive regulation in civil code was considered as *lex specialis derogate lex generalis* of collateral law in particular, and civil law in general. The juridical implication for secured creditors in terms of management and settlement of bankruptcy estate based on UUK-PKPU as *lex specialis derogate lex generalis* was that there were some restrictions on rights for secured creditors over their collateral in a process of management and settlement of bankruptcy estate. First, general confiscation on bankruptcy set under the article 1 act (1) UUK-PKPU. Second, period of suspension (staying period) set under the article 56 act (1) UUK-PKK. Third, curator's right to sell bankruptcy estate if it was movable objects. This provision was set under the article 56 act (3) UUK-PKPU. Forth, the range of periods allowed to execute the collateral was two months. It was set under the article 59 act (1) UUK-PKPU. Fifth, the creditor must submit the collateral objects (including the third party's belonging) to the curator. This was set under the article 59 act (2) UUK-PKPU. Sixth, the settlement of collateral objects by curators was by paying the least amount between the market price of collateral objects and the amount of loans secured by collateral objects. It was mentioned in article 59 act (3) UUK-PKPU. Seventh, there would be contract retractions in terms of alienation for the rights of land, mortgage, or fiduciary and it was set under the article 34 UUK-PKPU. Eighth, the presence of curator's rights to require some parts of sale proceeds to be submitted when the execution was immediately conducted themselves by the secured creditors. It was consistent with article 60 act (2) UUK-PKPU. Ninth, wages was included as loan of bankruptcy estate and it was set under the article 39 act (2) UUK-PKPU. Tenth, there was a payment levels for creditors. This point put the privileged creditors into the top position over the secured creditors. It was set under the article 60 act (2) UUK-PKPU Jo. article 189 act (4) UUK-PKPU.

## Conclusion

Dealing with management and settlement of the collateral, there were two primary principles inconsistent with the principle of bankruptcy law and the principles of collateral. First, *executorial principle*. In bankruptcy law, executorial principle actually relied on curators, whereas, in the context of collateral law, it referred to the secured creditors. Second, *preference principle*. In the context of bankruptcy law, preference right for creditors holding collateral or separatist creditors was under the privilege right (article 1139 BW and article 1149 BW), labor rights, and bankruptcy costs. In the context of collateral law, preference rights for secured creditors was higher than privilege rights (article 1139 BW and article 1149 BW), labor rights, and bankruptcy costs. In addition, drawing on the norm of bankruptcy law which referred to *lex specialis* (derived from the collateral law and civil law in general), it found 10 (ten) restrictions over the separatist creditors' rights in terms of bankruptcy estate management and settlement

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