



The Substantive Justice Indonesia Bankruptcy Law

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ABSTRACT

Law Number 37 of 2004 was designed to balance creditors' rights with debtor rehabilitation in insolvency processes in the fair resolution of bankruptcy disputes. This normative legal research uses statutory and conceptual approaches that apply. This study identifies judicial mechanisms in the commercial court regarding the criteria for breach of contract when insolvency occurs, which may allow abuse through bankruptcy filings by debtors carried out by creditors to pursue additional objectives, which can result in the liquidation of companies.

INTRODUCTION

The development of bankruptcy law was marked by the enactment of Law No. 37 of 2004 on Bankruptcy and the Suspension of Debt Payment Obligations (PKPU). This law was drafted during the 1998 financial crisis with the aim of resolving corporate bankruptcies. The objectives of Law No. 37 of 2004 on Bankruptcy and Suspension of Debt Payment Obligations (PKPU) are to ensure legal certainty for creditors and debtors, promote fair treatment of creditors, and facilitate the economic rehabilitation of debtors. However, after two decades of implementation, a disconnect between intent and practice has emerged in Indonesia's Commercial Courts. While this law was designed as a balanced mechanism for addressing corporate financial difficulties, it has increasingly been misused as an instrument for strategic litigation and commercial warfare. The fundamental pathology afflicting the current system stems from the persistent dominance of a formalistic legal paradigm within the Commercial Courts.

When a debtor's failure to repay a single debt that has matured and is due triggers the liquidation process, this systematically precludes a substantive examination of the debtor's actual financial condition and operational viability, or the prospects for restructuring. Consequently, judicial decisions have become detached from the economic reality that should be their focus, where a breach of contract may be treated as a claim arising from temporary liquidity constraints that could trigger the complete dissolution of a company that is, in fact, still solvent.

This methodological rigidity contradicts the fundamental principles of proportionality and substantive justice that should underpin any credible bankruptcy system. This formalistic orientation has led to the widespread instrumentalization of the bankruptcy process for purposes that are fundamentally at odds with the functions intended by the law.

The phenomenon of strategic bankruptcy has become widespread, where petitions are filed not in good faith to collect legitimate debts, but as a tactical weapon to achieve additional business objectives.

Competitors in the market exploit bankruptcy mechanisms to eliminate rivals; creditors use them as a bargaining tool in unrelated commercial disputes; and dissatisfied business partners exploit them to force the liquidation of assets below fair market value. The socio-economic impact is profound: viable business entities

are prematurely liquidated, jobs are lost, supply chains are disrupted, and substantial business continuity value is permanently destroyed.

In U.S. bankruptcy proceedings, which reveal that Indonesian courts effectively turn a blind eye to matters requiring comprehensive legal and factual assessment—a shortcoming now acknowledged in the current draft of the Bankruptcy Law.

A recent study contextualizes the challenges facing Indonesia. Robert and Sirait have examined the urgency of applying the principle of good faith in Indonesia's bankruptcy regime, establishing a theoretical foundation for using good faith as a screening mechanism against abusive petitions.

Yonatan investigates the burden of proof regarding a debtor's inability to pay and the application of the presumption against abuse of the bankruptcy institution, highlighting that Indonesia's reliance on the presumption of inability to pay creates conditions conducive to institutional abuse.

Although these contributions have enhanced understanding of specific shortcomings, they have not yet formulated a comprehensive doctrinal and institutional roadmap that encompasses both the philosophical foundations and the practical implementation mechanisms necessary for transformative reform.

This study addresses this gap by proposing a fundamental reconceptualization of Indonesian bankruptcy law based on two main pillars: substantive justice and good faith. Substantive justice requires that judicial decisions produce substantively fair outcomes through a holistic evaluation of the debtor's financial health, business viability, and potential for restructuring, going beyond mere procedural compliance with technical default criteria.

RESEARCH PROBLEM

Based on the background outlined above, the research questions are formulated as follows: How can substantive justice be operationalized to shift courts from formalism to a contextual assessment of genuine insolvency? what mechanisms should good faith function to prevent abuse?

RESEARCH METHOD

This study employs a normative legal research methodology, focusing on the analysis of legal norms, principles, and doctrines to establish a comprehensive framework for reformulating Indonesian bankruptcy law. A conceptual legal approach is applied to carefully examine Law No. 37 of 2004 and its implementing regulations regarding the concepts of bankruptcy, substantive justice, and good faith.

This jurisprudential analysis provides an empirical foundation for theoretical criticism and demonstrates the real-world consequences of interpretive choices.

RESULT AND DISCUSSION

The Substantive Justice in Bankruptcy

The urgent need for substantive justice in bankruptcy proceedings stems from the irreversible consequences that a bankruptcy ruling imposes on a business entity. The current application of Indonesian bankruptcy law is characterized by default as the determining criterion, which often results in injustice. Substantive justice requires the Commercial Court to conduct an investigation designed to reach a decision that is substantively fair, not merely procedurally so.

The existing paradigm, which focuses on the factual element of default, must shift toward a comprehensive assessment of complex economic conditions, particularly in cases of bankruptcy.

Within the framework of default in bankruptcy, bankruptcy constitutes a state of ongoing financial failure, not merely a single act of non-payment. Judges must be required to investigate whether the debtor is experiencing temporary liquidity constraints (cash flow insolvency) or suffering from fundamental balance sheet insolvency, where total liabilities exceed total assets.

A large illiquid asset or one that has experienced cyclical cash flow patterns may fail to meet certain payment obligations, yet still maintain its fundamental economic viability—a distinction that is systematically overlooked by formalistic interpretations.

Pratama noted that Indonesia's failure to require a solvency test as a prerequisite for a bankruptcy declaration has resulted in solvent debtors being erroneously subjected to bankruptcy proceedings, a situation that deviates from the universal philosophy of bankruptcy law.

Going beyond balance sheet analysis, the framework of substantive justice requires courts to evaluate the debtor's business viability and future economic prospects. Judicial inquiry must determine whether the entity, if granted relief from immediate financial pressure or permitted to restructure, has a realistic potential to restore profitability. This assessment must encompass various dimensions, including the company's competitive position in the market, the quality of its products or services, management competence, and the economic viability of any proposed recovery strategy.

A manufacturing company with established brand equity and modern production facilities that is experiencing temporary difficulties in repaying its debts due to unfavorable market conditions. Such an entity is an optimal candidate for rehabilitation through PKPU rather than liquidation. The systematic disregard for

the value of business continuity—which often significantly exceeds the aggregate value of liquidated assets—is not only a legal error but also an economic waste and a dereliction of responsibility. The courts must rethink their institutional role, moving beyond the narrow function of enforcing debt collection to assume the role of guardians of economic value when circumstances require such protection.

Substantive justice demands a rigorous investigation into the causal context triggering the payment failure. Default triggered by force majeure, unexpected regulatory policy changes, or wrongful creditor actions such as unlawful asset freezing presents a scenario that is morally and economically distinct from default stemming from persistent managerial incompetence or fraudulent behavior. Granting a bankruptcy petition based on a failure to pay resulting from a tortious act for which a third party can be held liable would constitute an injustice on the part of the court. Furthermore, the principle requires careful consideration of the broader socioeconomic consequences arising from a bankruptcy ruling. The closure of a large company impacts workers, their families, supply chain participants, and the broader community's economic infrastructure.³⁰ This perspective does not suggest that companies with significant social impact deserve immunity from bankruptcy, but rather acknowledges that profound social costs must be a recognized factor in the holistic assessment required by substantive justice. This orientation naturally directs judicial preference toward rehabilitation through PKPU when there is a reasonable prospect of success, thereby aligning legal outcomes with the public interest and the constitutional goal of social justice. The application of substantive justice also requires a reassessment of the standards of proof governing proceedings in the Commercial Court. Under current practice, prima facie evidence of breach of contract often imposes an almost insurmountable burden on the debtor to actively prove its solvency, thereby creating a litigation dynamic that favors the creditor's interests. Under a substantive approach to these evidentiary requirements, the creditor may file an initial motion with a higher burden of proof to demonstrate not a breach of contract but credible indicators of the debtor's inability to repay the debt when due.

The court must be involved in case management by appointing an independent financial expert at an early stage to provide an objective assessment of the debtor's financial condition and viability, rather than merely relying on biased evidence from interested parties. In judicial proceedings, the court should sincerely pursue substantive truth rather than formalities.

The Urgency and Form of Regulatory Reformulation

The application of the principles of substantive justice and good faith has proven unattainable within the constraints of Indonesia's current legal framework and prevailing judicial culture. Therefore, a deliberate and systematically structured reform has become an urgent necessity. This reform agenda must adopt a multi-pronged approach, simultaneously targeting the revision of statutory texts, the enhancement of judicial institutional capacity, and the transformation of judicial practice norms. This urgency stems from the tangible and growing economic losses caused by the status quo, where the collapse of viable companies threatens aggregate economic growth, labor market stability, and investor confidence. Indonesia's development aspirations demand the establishment of a bankruptcy system oriented toward value preservation rather than opportunistic value destruction. According to Dulyono, Indonesia's bankruptcy regulations require deregulatory reform to improve the ease of doing business, while also asserting that the current formalistic framework constitutes a structural barrier to economic development.

Law No. 37 of 2004 plays a very important role. First, the legal definition of bankruptcy in Article 2 requires fundamental revision. The revised provision must require the petitioner to provide prima facie evidence demonstrating not merely an isolated default, but the debtor's general inability to pay debts as they become due or to prove that total liabilities exceed the value of the company's assets. This reformulation shifts the burden of proof from demonstrating a single factual event to proving the financial condition comprehensively. Second, the new statutory provisions must explicitly require that all bankruptcy and PKPU petitions be filed and pursued in good faith, with the court obligated to examine this requirement ex officio as a matter of preliminary jurisdiction. Third, the chapter of the PKPU law needs to be strengthened to prioritize business rescue over liquidation. Access requirements for debtor-initiated PKPU filings must be relaxed to allow for earlier intervention, and the procedural model must incorporate elements where the debtor retains control of more assets, thereby reducing the automatic replacement of management that often destroys the organization's value.

Statutory provisions must explicitly authorize—and indeed require—commercial court judges to exercise broad discretion in assessing the debtor's overall financial condition and the petitioner's good faith, going beyond a mechanical application of technical default criteria. To equip judicial officials for this enhanced responsibility, the establishment of permanent and specialized training programs in financial statement analysis, business valuation methodologies, and corporate restructuring techniques is essential. The goal of the reform is the creation of a specialized group of commercial court judges who possess equivalent capabilities in interpreting cash flow statements and legal precedents. The Supreme Court must demonstrate leadership by developing a coherent body of precedent that upholds substantive justice and the principle of good faith, and by providing authoritative guidance to lower courts. Institutional innovations, including a specialized

Bankruptcy Division within the Commercial Court, a mandatory mediation period prior to filing, and the strengthening of the Judicial Coordinator's authority, will further facilitate effective implementation.

In addition to legislative amendments and strengthening the capacity of the judiciary, achieving transformative reform requires a fundamental cultural shift within the broader legal community. Legal practitioners representing both creditors and debtors must move beyond the view that bankruptcy is merely a zero-sum, adversarial litigation battle. The professional mindset must evolve toward the recognition that bankruptcy law is a specialized aspect of economic regulation aimed at achieving optimal and fair solutions that maximize overall social welfare. This cultural transformation, supported by a reformed legal framework and enhanced trust in the judiciary, will facilitate the transformation of Indonesia's bankruptcy law from its current problematic configuration into a credible institution that authentically serves the goals of justice and economic progress. Riyant, through their comparative analysis of bankruptcy proceedings in Australia and Indonesia, assert that the current Indonesian system produces outcomes that contradict universally recognized bankruptcy principles, underscoring the urgency of this cultural and institutional transformation.

The findings of this research substantially support, extend, and in certain dimensions contradict existing scholarship on Indonesian bankruptcy law reform. The analysis provides strong support for the diagnostic observations of Pratama, who identified the absence of an insolvency test as a fundamental legal deficiency. Where the present study significantly extends this contribution is through development of a comprehensive operationalization framework grounded in substantive justice and good faith principles. Pratama documented the problem through doctrinal analysis; this research advances beyond diagnosis to prescribe specific legislative amendments, evidentiary standard reforms, and judicial training protocols necessary to remedy identified deficiencies. Similarly, this study validates and extends the theoretical advocacy of Robert and Sirait for rigorous good faith application in bankruptcy proceedings.⁵¹ Their work provided normative justification rooted in Indonesian insolvency principles; the present analysis operationalizes this theoretical foundation by articulating concrete indicia for evaluating petitioner and debtor good faith and integrating good faith assessment into a broader substantive justice framework that their work did not fully develop.

CONCLUSION

This research establishes that the Indonesian bankruptcy law stems from pervasive judicial formalism that reduces complex socioeconomic adjudication to mechanical procedural verification. The current system permits the law to be weaponized for strategic purposes, resulting in premature liquidation of viable enterprises, economic inefficiency, and systematic deviation from the statutory objectives of fairness and rehabilitation. Analysis reveals that substantive justice and good faith must function as interdependent principles governing bankruptcy proceedings. Substantive justice requires holistic judicial assessment of debtor financial condition, business viability, and restructuring potential rather than mere technical default verification. Good faith operates as procedural gatekeeper, mandating rigorous scrutiny of petition legitimacy to distinguish bona fide debt recovery from predatory litigation strategies.

Implementation of these principles necessitates comprehensive multi-axial reform. Legislative amendments to Law Number 37 of 2004 must refine the insolvency definition in Article 2 to require evidence of generalized debt payment inability, explicitly mandate good faith requirements with *ex officio* judicial examination, and strengthen PKPU provisions to favor business rescue through liberalized access and enhanced debtor-in-possession elements. Judicial capacity enhancement through specialized training programs in financial analysis and corporate valuation proves essential for enabling informed adjudication.

The Supreme Court must develop coherent precedential jurisprudence championing substantive justice and good faith principles while providing authoritative guidance to Commercial Courts. Institutional innovations including dedicated Insolvency Divisions, mandatory pre-filing mediation periods, and strengthened Justice Coordinator authority will facilitate effective implementation.

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