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Rethinking Indebtedness according to the Principles of Justice and Equality

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Abstract *The law's objective is to uphold the principle of justice. Contractual debts, interest-bearing debts, unsecured debts, and debts with payment terms are all included in restructuring plans. All debts must be accompanied by a contract. If the business defaults, the contract serves as proof of debt. This research focuses on Indonesia's bankruptcy law. This study employs an empirical qualitative legal method. The study recommends categorizing debt according to its source, duration, function, and collateral. Debts classified as restructuring must waive their collateral rights. This debt grouping is consistent with finance's capital structure theory. This research will revolutionize the current concept of debt restructuring. The study will serve as a resource for all business actors who have documented debt. Debt is uncommon in developing countries such as Indonesia. Entrepreneurs in developing countries have established business relationships*

based on mutual trust. The study's limitation is that it does not take industry type into account. Additionally, this research has implications for a firm's total cost of capital as a result of changes in the risk model and creditor roles, particularly in developing countries. This study proposes a system of debt classification based on principles of justice and equity. This classification is made not only on the basis of the guarantee's type, but also on the basis of the agreement's duration and financial principles. The purpose of this study is to examine bankruptcy law in developing countries. Knowledge of bankruptcy law will add value to investors and banks on a global scale.

Keywords Indebtedness, Principles of Equality, Principle of Justice

1. Introduction

Numerous retail businesses have declared bankruptcy as a result of the Covid-19 pandemic. For example, in the United States, 50% more businesses filed for bankruptcy in 2020 than in 2019.¹ Others filed for Chapter 11 bankruptcy protection during the 2008 financial crisis and the ensuing bankruptcy, while others, such as General Motors, were rescued from bankruptcy by the United States government.²

Additionally, Worldcom, Enron, and Lehman Brothers were all large corporations that declared bankruptcy during the 2008 financial crisis.³ Consumer

¹ Lauren Thomas, "The 10 Biggest Retail Bankruptcies of 2020," *Cnbc*, 2020, <https://www.cnbc.com/2020/12/26/the-10-biggest-retail-bankruptcies-of-2020.html>.

² Sean P Mcalinden and Yen Chen, "After the Bailout: Future Prospects for the U.S. Auto Industry," *Center for Automotive Research*, No. December 2012 (2012), <http://www.cargroup.org/wp-content/uploads/2017/02/After%20the%20Bailout%20Future%20Prospects%20for%20the%20U.S.%20Auto%20Industry.pdf>.

³ Ty Haqqi, "15 Biggest Companies That Went Bankrupt," 2021, <https://finance.yahoo.com/news/15-biggest-companies-went-bankrupt-094001224.html>.

demand has been impacted by the Coronavirus. Numerous large retailers, including GNC, Hertz, JCPenney, Gold's Gym, Sizzler, and Virgin Atlantic, have filed for Chapter 11 bankruptcy protection as a means of financial restructuring.⁴ Additionally, several companies outside the United States have filed for bankruptcy, including Muji (Japan), Hypermart (Indonesia), and Ramayana (Indonesia).⁵

Under Chapter 11, bankruptcy is a reorganization in which the business continues to operate and is eligible for new financing. However, the court requires that the reorganization plan be submitted to creditors for approval, and the majority of creditors with rights.⁶ Chapter 13 is not synonymous with company liquidation.⁷

A financial reorganization proposal includes a strategy for repaying creditors for the company's debts.⁸ The company declared bankruptcy due to its inability to pay maturing debts. Secured or unsecured creditors are both possible.

⁴ Emily Pandise, "One Year into Pandemic, Main Street Bankruptcies Continue," *NBC News*, 2020, <https://www.nbcnews.com/business/consumer/which-major-retail-companies-have-filed-bankruptcy-coronavirus-pandemic-hit-n1207866>.

⁵ Fortune, "Companies Filing Bankruptcy during COVID: List of Top Companies That Filed for Chapter 11 amid Coronavirus Pandemic," *Fortune*, 2020, <https://fortune.com/2020/08/04/companies-filing-bankruptcy-2020-due-to-covid-list-filed-chapter-11-coronavirus-pandemic/>.

⁶ U.S. Courts, "Chapter 7 - Bankruptcy Basics | United States Courts," *United States Courts*, 2020, <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics>.

⁷ Karikari Amo-Gyarteng, "Financial Characteristics of Distressed Firms: An Application of the Altman Algorithm Model," *Journal of Corporate Accounting & Finance* 30, No. 1 (2019): 63–76, <https://doi.org/10.1002/jcaf.22367>.

⁸ Arturo García-Santillán, "An Algorithm to Renegotiate Debt through Equivalent Equations and Transaction Costs: A Proposal for the Field of Financial Education," *International Electronic Journal of Mathematics Education* 14, No. 1 (2019): 123–36, <https://doi.org/10.12973/iejme/3981>.

Secured/collateral creditors make loans contingent upon the provision of a predetermined type of guarantee. Generally, guarantee creditors are financial institutions, and the loans are medium- to long-term in nature, unless they have matured.⁹

Unsecured creditors obtain loans without collateral. In essence, these are business partners or parties who owe money on a short-term basis, such as employee salaries or payables.¹⁰ Employee receivables are categorized as preferred receivables.

Both types of creditors are involved in a financial reorganization proposal. The company must obtain authorization from both types of creditors.¹¹ Each creditor's voting provisions are tailored to the applicable laws and regulations in each country. Creditors are classified according to their exposure to secured and unsecured debt. The debt is secured by the collateral held pursuant to a credit agreement.¹² A claim right is a legal term that refers to a right that imposes responsibilities, duties, or obligations on third parties with respect to the right-holder. The guarantee may include double, triple, or more pledges and must be consistent with applicable laws and regulations.

⁹ Idris Yahaya Adamu, "Idea of Collateral and Guarantor in Islamic Bank Financing," *SEISENSE Journal of Management* 1, No. 5 (2018): 49–57, <https://doi.org/10.5281/zenodo.1474664>.

¹⁰ Richard Jr Hunter and John H Shannon, "Managing Financial Stress for Debtors and Creditors in the Midst of a Pandemic Part II: Bankruptcy," *International Journal of Business Management and Commerce* 5, No. 3 (2020): 11–20, <http://ijbmcnet.com/images/Vol5No3/1.pdf>.

¹¹ Serhiy O. Yuldashev and Valentyna P. Kozyreva, "Classification and Protection of the Rights of Creditors in Bankruptcy Cases," *Scientific Works of National Aviation University. Series: Law Journal "Air and Space Law"* 2, No. 51 (2019), <https://doi.org/10.18372/2307-9061.51.13792>.

¹² M. Hadi Shubhan, "Deconstructing Simple Evidence in Bankruptcy Petition for Legal Certainty," *Indonesia Law Review* 9, No. 2 (2019), <https://doi.org/10.15742/ilrev.v9n2.527>.

Both types of creditors are included in a financial reorganization proposal. The business must secure approval from both types of creditors.¹³ Each creditor's voting provisions are tailored to the country's specific laws and regulations. Creditors are classified according to secured and unsecured debt. The debt is secured by claim rights to collateral held pursuant to a credit agreement.¹⁴ A claim right is a legal term that refers to a right that imposes responsibilities, duties, or obligations on third parties in relation to the right holder. The guarantee may contain two, three, or more pledges and must reflect fairness under applicable laws and regulations.

This research focuses on Indonesia's bankruptcy law. Indonesia is a member of the G20 and has the world's fourth largest population. In 2022, Indonesia will assume the G20 Presidency. Indonesia's economy will attract a large number of foreign investors, making bankruptcy research critical for investors and banks.

Justice is a value that must be realized through the legal system. Law is conceived as a universally applicable principle of justice that applies to all humankind.¹⁵ This theory considers the law in isolation from the facts. Furthermore, rules are eternally applicable, whereas norms derive from God, the universe, and human reason. Additionally, the law is not time-bound, whereas

¹³ Yuldashev and Kozyreva, "Classification and Protection of the Rights of Creditors in Bankruptcy Cases."

¹⁴ M. Hadi Shubhan, "Legal Protection of Solvent Companies from Bankruptcy Abuse in Indonesian Legal System," *Academic Journal of Interdisciplinary Studies* 9, No. 2 (2020): 142–48, <https://doi.org/10.36941/ajis-2020-0031>.

¹⁵ Mahrus Ali, "Pemetaan Tesis Dalam Aliran-Aliran Filsafat Hukum Dan Konsekuensi Metodologisnya," *Jurnal Hukum IUS QUIA IUSTUM* 24, No. 2 (2017): 213–31, <https://doi.org/10.20885/iustum.vol24.iss2.art3>; Iffaty Nasyiah, "Potential Criminal Action in Shadow Banking Practice," *Proceedings of the International Conference on Engineering, Technology and Social Science (ICONETOS 2020)* 529, No. Iconetos 2020 (2021): 128–33, <https://doi.org/10.2991/assehr.k.210421.020>.

justice is rooted in the human mind, universally and eternally applicable, and realized by humans.

The law's goal is justice, and achieving it requires humane values such as morality and an understanding of what is right and wrong to do.¹⁶ On the basis of human judgment, the principle of justice distinguishes between good and evil.¹⁷ According to Aristotle, justice can be distributive, awarding individuals based on their service, or cumulative, awarding everyone an equal share of their services.¹⁸ All creditors have distributive justice because they all lend money to the business for development.¹⁹

According to Rawls, justice is "fairness dispensed by the court through judgment".²⁰ To the person adjudicating, the courts or judge provide justice. Similarly, equity is a fundamental principle of sound corporate governance.²¹

¹⁶ Weda Kupita, "State Administrative Court as a Means to Realize Justice," *SHS Web of Conferences* 54 (2018): 03007, <https://doi.org/10.1051/shsconf/20185403007>.

¹⁷ Henry Halim, "Asas Keadilan Dalam Syarat Sahnya Perjanjian dalam Pasal 1320 KUH Perdata," *Jurnal Ilmu Administrasi Negara & Bisnis* 3, No. 2 (2018): 1–12, <http://jurnal.stiaindragiri.ac.id/site/index.php/jiaganis/article/view/93>.

¹⁸ Ayman Alshaabani et al., "Impact of Distributive Justice on the Trust Climate among Middle Eastern Employees," *Polish Journal of Management Studies* 21, No. 1 (2020): 34–47, <https://doi.org/10.17512/pjms.2020.21.1.03>.

¹⁹ Agus Nurudin, "Bankruptcy and Postponement of Debt Payments for Large Companies," *International Journal of Economics and Business Administration* VIII, no. Issue 2 (2020): 388–95, <https://doi.org/10.35808/ijeba/469>.

²⁰ John Rawls, *Justice as Fairness* (London, Routledge, 1970).

²¹ Saparila Worokinasih and Muhammad Lutfi Zuhdi Bin Mohamad Zaini, "The Mediating Role of Corporate Social Responsibility (CSR) Disclosure on Good Corporate Governance (GCG) and Firm Value," *Australasian Accounting, Business and Finance Journal* 14, No. 1 Special Issue (2020): 88–96, <https://doi.org/10.14453/aabfj.v14i1.9>.

Friedman defined law as "the content, structure, and culture of the legal system".²² As a result, the law is enforced through legislation as well as through the empowerment of the legal apparatus and facilities. However, society's legal culture must be supportive of law enforcement. This legal culture is reflected in the credit agreement's compliance and adherence to its terms.

Numerous philosophical, religious, political, and legal studies have been conducted on issues pertaining to justice.²³ A matter of justice cannot easily be determined to be just. Typically, justice responses are insufficient and are still debatable. Additionally, various formulations of justice are relative formulations, encouraging individuals to present their cases to legislators and judges for consideration.²⁴

Justice is concerned with available resources and morals, whereas legislation, including a judge's decision as a law enforcer, incorporates material and spiritual components. According to Al-Ghazali, achieving justice without spiritual guidance is a violation of humanity's principles. It is a divine attribute because it pertains to both worldly human life and God's realm. As such, religious practitioners should apply and implement it. Justice is a moral obligation that

²² Wahyu Suwarni, "Obstacles to Enforcement of Book Copyright Law in Indonesia Based on The Legal Structure, Legal Substance, and Legal Culture," *International Journal of Advanced Research and Publications (IJARD)* 3, No. 3 (2019): 153, <http://www.ijarp.org/published-research-papers/mar2019/Obstacles-To-Enforcement-Of-Book-Copyright-Law-In-Indonesia-Based-On-The-Legal-Structure-Legal-Substance-And-Legal-Culture.pdf>.

²³ Bahder Johan Nasution, "Kajian Filosofis Tentang Hukum dan Keadilan dari Pemikiran Klasik Sampai Pemikiran Modern," *Al-Ihkam: Jurnal Hukum & Pranata Sosial* 11, No. 2 (2017): 247, <https://doi.org/10.19105/al-ihkam.v11i2.936>.

²⁴ Zahir Shah, Manzoor Ahmad, and Naveeda Yousaf, "An Appraisal of Justice in Pakistan from the Prism of Platonic Justice," *South Asian Studies* 32, No. 1 (2017): 267, <http://journals.pu.edu.pk/journals/index.php/IJSAS/article/view/3105>.

requires society to provide virtue, goodness, and equality based on righteousness through the use or enforcement of the law.

Justice is defined as the legality of an act that dictates whether it is just or unjust. According to Kelsen, justice is legality or a legal standard that is permissible under the law.²⁵ However, written law cannot provide the justice that a judge's decision provides. Decisions are frequently discussed, criticized, and serve as the focal point of legal reform. The judge, not the king or the government, is the author of the law.²⁶ Bankruptcy has specific rules that must be followed. A peace proposal must be approved by a judge in court.²⁷

Justice embodies peace, which is defined as submission to authority accompanied by acceptance as a form of liberation.²⁸ Peace and justice are necessary components of any society.²⁹ A financial restructuring proposal is similar to a peace proposal; it is accepted by the parties as a new agreement.

²⁵ Deden Muhammad Surya, "Pemutusan Hubungan Kerja Pada Pekerja/Buruh Dengan Dasar Menolak Mutasi Ditinjau dari Perspektif Asas Kepastian Hukum dan Asas Keadilan," *Jurnal Wawasan Yuridika* 2, No. 2 (2018): 169, <https://doi.org/10.25072/jwy.v2i2.182>.

²⁶ Indra Rahmatullah, "Filsafat Realisme Hukum (Legal Realism)," *Adalah Buletin Hukum & Keadilan* 5, no. 3 (2021): 11–22, <https://doi.org/10.15408/adalah.v5i3.21395>.

²⁷ Jennifer Payne, "The Role of the Court in Debt Restructuring," *Cambridge Law Journal* 77, No. 1 (2018): 124–50, <https://doi.org/10.1017/S0008197318000016>.

²⁸ Lokindra Hari Bhattarai, "Shifting of Governance and Justice: A Reference of Nepal," *Molung Educational Frontier* 10, No. 2011 (2020): 121–33, <https://doi.org/10.3126/mef.v10i0.34078>; Suwinto Johan, "Separatist Creditors Problems on Postponement of Debt Payment Obligations Based on the Supreme Court's Decree Number 30/KMA/SK/I/2020," *Fiat Justisia: Jurnal Ilmu Hukum* 15, No. 3 (2021): 207–20, <https://doi.org/10.25041/fiatjustisia.v15no3.1956>; Bhattarai, "Shifting of Governance and Justice: A Reference of Nepal"; Justus Ngala, NAZEEM Ansary, and Olanrewaju Abdul, "Determinants of Bridging Loan among Small and Medium Sized Enterprises in the South African Construction Industry" (University of Johannesburg, 2017), <https://doi.org/10.15224/978-1-63248-131-3-67>.

²⁹ Tanius Sebastian, "Masalah Metodologis Ilmu Hukum Indonesia," *Veritas et Justitia* 4, No. 1 (2018): 59–87, <https://doi.org/10.25123/vej.2913>.

If ethical considerations are incorporated into the agreement-making process, agreements may achieve justice. Numerous contracts violate the principle of justice as a result of one party's monopoly. For instance, one party may possess a hegemonic good, while the other requires it.³⁰ Additionally, one party can impose its will on the other or is forced to sign the agreement.

In the event of bankruptcy, the principle of justice is effective at protecting the debtor's interests. Specifically, it provides protection against creditors' arbitrary actions against debtor assets.³¹ At the time of default, debtors are protected from creditor claims. Bankruptcy protects debtors under the Bankruptcy and Suspension of Debt Payment Obligations Law (UU PKPU).

The principle of justice can apply to customers who deposit funds in banks, necessitating the need to understand the risk of loss. The customer or the financial institution may suffer loss, demonstrating a lack of regard for the justice principle. The principle of justice is a fundamental tenet of economic activity, particularly Islamic economics.³² Additionally, economic activities, particularly Islamic economics, are guided by a variety of principles, one of which is justice.

³⁰ Thomas Christiano, "Equality, Fairness and Agreements," *Journal of Social Philosophy* Special Is (2013), https://www.tse-fr.eu/sites/default/files/medias/stories/sem_12_13/IAST/paper_christiano.pdf.

³¹ Serlika Aprita and Rio Adhitya, "Penerapan 'Asas Keadilan' Dalam Hukum Kepailitan Sebagai Perwujudan Perlindungan Hukum Bagi Debitor," *Jurnal Hukum Media Bhakti* 3, no. 1 (2019): 46–56, <https://doi.org/10.32501/jhmb.v3i1.44>.

³² Siti Nur Shoimah and Dyah Ochtorina Susanti, "Penerapan Asas Keadilan Pada Transaksi Penyimpanan Dana Nasabah Di Bank Syariah Berdasarkan Akad Mudharabah," *Dialektika* 5, No. 1 (2020): 23–38, <http://ejournal.uniramalang.ac.id/index.php/dialektika/article/view/409>; Momon Ardiansyah, Siti Hamidah, and Dewi Astuti Mochtar, "Perwujudan Asas Keadilan dan Keseimbangan dalam Pembuatan Akta Persekutuan Komanditer Berdasarkan Akad Mudharabah," *Jurnal Ilmiah Pendidikan Pancasila Dan Kewarganegaraan* 4, No. 2 (2020): 321–27, <https://doi.org/10.17977/um019v4i2p321-327>.

A win-win solution is an effective method of resolving a contract dispute in a business contract. It reflects the principle of equality or proportionality in problem solving. The principle of equality states that an agreement is binding if the parties' interests are aligned. It is applicable to current and prospective debtors under credit or financing agreements. In a deal based on good faith, etiquette, customs, and laws, the principle of equality is emphasized. These factors help maintain a balance between the parties in order to ensure justice, as an unbalanced agreement is not legally binding and can be cancelled.³³

Standard agreements or clauses govern the relationship between financial institutions and their customers. A financial institution creates a standard agreement or clause and requires the customer to sign it, even though the contract does not reflect equality.³⁴ Additionally, these agreements are generated as a result of the parties' disparate bargaining positions, and their formation is facilitated by economic considerations. The arrangement encourages the development of standard contracts with inequalities resulting from the parties' unequal economic power. The actions of the parties determine the equality, content, and implementation of an agreement.³⁵

Apart from standard agreements, other parties recognize guarantees for loans obtained by financial institutions when the company is insolvent. The guarantees continue to favor financial institutions. By and large, the relationship between debtors and financial institutions remains unbalanced. Debtors have a

³³ Muhammad Irayadi, "Asas Keseimbangan Dalam Hukum Perjanjian," *Jurnal HERMENEUTIKA* 5, No. 1 (2021): 1–6, <https://doi.org/10.33603/hermeneutika.v5i1.4910>.

³⁴ Suwinto Johan and Ariawan, "Consumer Protection In Financial Institutions," *Legality : Jurnal Ilmiah Hukum* 29, No. 2 (2021): 173–83, <https://doi.org/10.22219/ljih.v29i2.16382>.

³⁵ Aryo Dwi Prasnowo and Siti Malikhathun Badriyah, "Implementasi Asas Keseimbangan Bagi Para Pihak dalam Perjanjian Baku," *Jurnal Magister Hukum Udayana (Udayana Master Law Journal)* 8, No. 1 (2019): 61, <https://doi.org/10.24843/jmhu.2019.v08.i01.p05>.

lower social standing than creditors and therefore require loans. Likewise, creditors have the authority to approve loans and select debtors.

Creditors' power runs counter to the legal philosophy's foundation of fundamental values. Injustice and inequality are antithetical to the legal philosophy. The Collateral Act places a premium on financial institutions' interests, highlighting the inequity and imbalance between debtors and creditors.³⁶ The proportionality principle is applied throughout the agreement's exchange of rights and obligations between the parties.³⁷

Commutative justice ensures that debtors and creditors are treated equally in financing agreements. This equality is accomplished through the deal's terms, which avoid violating the principle of justice.³⁸ The court may annul the agreement if it violates the principle of equality under the law.³⁹

In financing agreements, commutative justice entails equality between debtors and creditors. This equality is accomplished through the deal's contents,

³⁶ Emilian Ciongaru, "The Principle of Separatio of Powers - Constitutional.," *Challenge of the Knowledge Society, Public Law*, 2017, 411–15, <https://www.bib.irb.hr>; M. Najib Imanullah, "Equalizing the Bank Position and Businesses in Credit Agreement With The Guarantee of Mortgage," *Yustisia* 7, No. 1 (2018): 173–89, <https://pdfs.semanticscholar.org/f8a8/f7742ceb721f288a9d4d40c70c259b9ca89d.pdf>.

³⁷ Ifada Qurrata A'yun Amalia and Endang Prasetyawati, "Karakteristik Asas Proporsionalitas dalam Pembentukan Klausul Perjanjian Waralaba," *Jurnal Hukum Bisnis Bonum Commune* 2, No. 2 (2019): 173, <https://doi.org/10.30996/jhbbc.v2i2.2513>.

³⁸ Dwi Ratna Indri Hapsari and Kukuh Dwi Kurniawan, "Consumer Protection in the Banking Credit Agreement in Accordance with the Principle of Proportionality under Indonesian Laws," *Fiat Justisia: Jurnal Ilmu Hukum* 14, No. 4 (2020): 337, <https://doi.org/10.25041/fiatjustisia.v14no4.1884>.

³⁹ Tiar Ramon, "Kriteria Keseimbangan Dalam Perjanjian Kredit Bank Untuk Mewujudkan Keadilan Komutatif," *Jurnal Hukum Ius Quia Iustum* 26, No. 2 (2019): 372–90, <https://doi.org/10.20885/iustum.vol26.iss2.art8>.

which avoid violating the principle of justice.⁴⁰ If the agreement violates the principle of equality under the law, the court may vacate it.⁴¹

A mutual agreement entails equal rights and obligations on the part of the seller and the buyer in connection with the sale and purchase of the company's shares. It entails the seller's obligation to deliver the shares sold, the buyer's payment obligation, and their equality of rights. Additionally, the agreement's contents must be balanced between the two parties, so that buyers and sellers are in an equal position with respect to one another.⁴²

A business contract between two parties is constructed using efficiency standards as a guide. Business requires something efficient and rapid, whereas equality demonstrates contractual justice, which contradicts contract freedom.⁴³

Secured creditors make loans and collect collateral for goods in accordance with the terms of a credit agreement. In comparison to unsecured loans, creditors with collateral prefer collateralized financial institutions.⁴⁴ By providing competitive interest, the collateral value mitigates the risk.⁴⁵

⁴⁰ Hapsari and Kurniawan, "Consumer Protection in the Banking Credit Agreement in Accordance with the Principle of Proportionality under Indonesian Laws."

⁴¹ Ramon, "Kriteria Keseimbangan Dalam Perjanjian Kredit Bank Untuk Mewujudkan Keadilan Komutatif."

⁴² Deny Slamet Pribadi, "Penerapan Asas Proporsionalitas/Berimbang Dalam Perjanjian Kemitraan," *Yuriska: Jurnal Ilmiah Hukum* 10, No. 1 (2018): 29, <https://doi.org/10.24903/yrs.v10i1.265>.

⁴³ Johan, "Separatist Creditors Problems on Postponement of Debt Payment Obligations Based on the Supreme Court's Decree Number 30/KMA/SK/I/2020."

⁴⁴ Chau H.A. Le and Hieu L. Nguyen, "Collateral Quality and Loan Default Risk: The Case of Vietnam," *Comparative Economic Studies* 61, No. 1 (2019): 103–18, <https://doi.org/10.1057/s41294-018-0072-6>.

⁴⁵ G Calcagnini and F Farabullini G Giombini, "Loans , Interest Rates and Guarantees : Is There a Link ?," 2009, <https://www.researchgate.net/profile/Giorgio->

Unsecured creditors, such as suppliers who offer trade payables, provide unsecured debt.⁴⁶ Rent, employee salaries, and tax liabilities are additional unsecured creditors. Unsecured debt is short-term in nature and is primarily determined by accounting records.⁴⁷

2. Method

In connection with the background and research questions, this prescriptive legal research aims to safeguard creditors confronted with insolvency.⁴⁸ This research is conducted by examining secondary or library materials. Normative or literature legal research includes research on legal norms and principles, the systematics of statutory regulations, the level of vertical and horizontal synchronization between applicable laws and regulations in Indonesia for matters related to criminal acts in the financial service industry. In normative law, this research uses a statutory approach by researching statutory regulations as a whole. This statutory approach is an approach using legislation and regulations. This method analyzes regulations, identifies, and adapts to criminal acts in the

Calcagnini/publication/46476976_Loans_Interest_Rates_and_Guarantees_Is_There_a_Link/links/09e4150b7132b3d339000000/Loans-Interest-Rates-and-Guarantees-Is-There-a-Link.pdf.

⁴⁶ María Cantero-Saiz, Begoña Torre-Olmo, and Sergio Sanfilippo-Azofra, "Creditor Rights, Monetary Policy, Financial Crisis, and Trade Credit," *BRQ Business Research Quarterly*, 2021, <https://doi.org/10.1177/2340944420988294>.

⁴⁷ Xia Chen et al., "Corporate Social Responsibility and Financial Statement Comparability: Evidence from China," *Journal of Asian Finance, Economics and Business* 7, No. 11 (2020): 001–011, <https://doi.org/10.13106/jafeb.2020.vol7.no11.001>.

⁴⁸ Mahmud Marzuki, *Penelitian Hukum: Edisi Revisi - Prof, Revisi* (Jakarta: Kencana Prenada Media Grup, 2017), https://www.google.co.id/books/edition/Penelitian_Hukum/CKZADwAAQBAJ?hl=id&gbpv=1&dq=Penelitian+Hukum:+Edisi+Revisi&printsec=frontcover.

financial services industry and corporate crimes. Normative legal research materials include primary legal materials, secondary legal materials, and tertiary legal materials or other supporting materials. This research's primary legal materials are the 1945 Constitution of the Republic of Indonesia, laws, and other regulations related to the research topic. Secondary legal materials used are literature reviews in the form of books, legal journals published in scientific journals related to research topics, seminar results/call for papers, and scientific articles. Tertiary legal materials explain the primary and secondary legal materials, including news coverage on the internet.⁴⁹

Additionally, it rethinks the concept of grouping creditors based on guarantees from existing financial science principles and capital structure theory. The primary data source was material on existing bankruptcy laws and regulations. Additionally, secondary data on default and debt classification were gathered from the published literature. These sources included journals, books, articles, and proceedings from academic conferences.⁵⁰ Other materials included financial science capital structure theory and information on corporate bankruptcy as a result of COVID-19.

⁴⁹ Suwinto Johan, "Sanctions in Financial Services, Developing A Conducive Financial Industry In Indonesia," *Humaniora* 13, No. 1 (2022): 9–15, <https://doi.org/10.21512/humaniora.v10i3.5874>.

⁵⁰ Suwinto Johan and Ariawan Ariawan, "Keterbukaan Informasi UU Pasar Modal Menciptakan Asymmetric Information dan Semi Strong Form," *Masalah-Masalah Hukum* 50, No. 1 (2021): 106–18, <https://doi.org/10.14710/mmh.50.1.2021.106-118>.

3. Result & Discussion

A. Debt Scheme and Its Development in Indonesia

Numerous businesses are experiencing operational difficulties as a result of the pandemic. Cash flow difficulties are a result of business difficulties. Insolvency occurs when a business is unable to repay its maturing debt. Inability to pay debts creates legal complications. Financial distress begins with insolvency. Insolvency can result in bankruptcy if a restructuring plan is not implemented.

For instance, a company may seek a postponement of debt repayment obligations under the Indonesian Bankruptcy Act if it is unable to pay its maturing debt. If the debtor and creditor are unable to reach an agreement on a reconciliation proposal after 335 days, the debtor must declare bankruptcy.

Debt is a source of financing for businesses. Every business requires resources, most commonly debt, in order to expand. Debt can take various forms, including short- and long-term debt, secured and unsecured debt, bilateral and multilateral debt, and committed and uncommitted loans.

Debt is a source of funding for businesses, but it can also be a source of problems. Businesses that are unable to manage their cash flow and debt repayment will face difficulties. If a business is unable to repay its debts, bankruptcy will result.

Asian countries were hit by a financial crisis in 1998. Numerous businesses become insolvent. Numerous international banks lend to businesses in Asia, particularly Southeast Asia. Global banks must write off debts owed to Southeast Asian corporations.

Indonesia, the world's largest country in terms of population and GDP, is also experiencing a financial crisis. Numerous businesses are unable to repay their debts. The Indonesian Rupiah's (IDR) exchange rate against the United States

Dollar (USD) increased from IDR 1,800/USD on August 1, 1997 to IDR 14,800/USD on January 8, 1998. Currency depreciation resulted in many businesses having negative equity. This condition of currency depreciation also resulted in negative growth for the Indonesian economy. Numerous businesses face insolvency.

The Indonesian government established the Jakarta Initiative as an institution to assist in debtor-creditor negotiations. The Jakarta Initiative is making little progress. The International Monetary Fund extended a loan to Indonesia (IMF). The IMF is advocating for bench regulations. Indonesia enacted bankruptcy legislation.

This bankruptcy law is intended to settle disagreements between debtors and creditors. Additionally, this bankruptcy law provides for debt restructuring. Additionally, this bankruptcy law provides a faster resolution time of 335 days, as opposed to lengthy civil debt disputes.

However, bankruptcy law is generally protective of creditors' interests. Global bank creditors account for the lion's share. Thus, bankruptcy law raises several considerations that are deemed to be detrimental to the debtor's interests.

Debt serves as a source of financing and a driving force in the economy of a country. Additionally, debt demonstrates a high degree of trust between creditors and debtors. The state incurs debt in order to develop the country. A business borrows money to expand its operations. Individuals borrow in order to enjoy life.

When a debtor defaults, debt becomes a critical issue. Mass defaults can be detrimental to a country's economic system. Economic harm has occurred on numerous occasions, including the 1998 Asian crisis, the 2008 global crisis, and the 2020 Covid-19 crisis.

Mass failures and bankruptcies have occurred in a number of countries. It happened in Indonesia in 1997-1998, when hundreds of firms needed to be rescued

from bankruptcy. This occurred during the Covid-19 pandemic, which lasted from 2020 to 2022. Many businesses have defaulted on their responsibilities.

Default and bankruptcy occur as a result of insolvency. Bankruptcy may result in the liquidation of a business. Liquidation affects the financial sector on a systemic level. Bankruptcy categorizes debts according to the type of collateral used. The current classification is based on the type of collateral that has been the subject of numerous creditor complaints. The current category makes no distinction between the type of debt and the maturity date.

Classifying debt according to the type of collateral has a number of disadvantages. By ignoring the terms of the debt and its source, the collateralized obligation category subverts the justice and balance of creditors' rights.

Various sorts of financial reengineering emerge as technology and innovation advance. The classification of corporate debt has changed as a result of this financial reengineering. Corporate debt is complicated by the fact that it is both secured and unsecured. Creditor rights do not just apply to loan interest.

Zero-coupon bonds, asset-backed securitization, leasing, medium-term notes, and a variety of other hybrid loans have all contributed to the development of this type of loan. Each product has its own set of features, such as creditor rights and debtor duties.

B. Justice and Edquality in Debt Scheme in Indonesia

Creditor rights should be paid in full and on an equal footing. Creditors' rights, which are represented by accounts payable, are equated to those of other payable. This is deemed unjust by accounts payable creditors or suppliers. Additionally, creditors of short-term loan debt contend that debt restructuring is unjust. Creditors whose debts have not yet matured are also considered to be

mature creditors. This divergence has resulted in the belief that the current restructuring method lacks credit justice and balance.

The principle of equality reflects the agreement's balance between its parties. In debt transactions, equality is a balance between debtors and creditors, as well as between individual creditors. This balance adheres to the *pari passu* principle, which is critical when determining the seniority of a loan. The equality principle is illustrated in Figure 1.

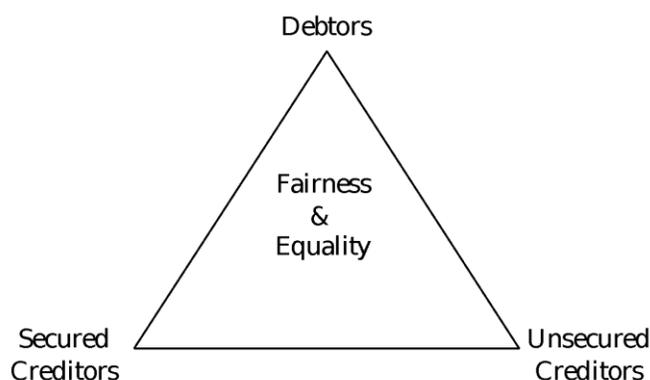


FIGURE 1. The Triangular Position of the Creditor, Guaranteed Creditors, and Unsecured Creditors
Source: research results

The creditor who makes the initial loan is in the same position as those who make subsequent loans. This position reflects the priority of payment, which is determined by the guarantees obtained and the liquidation order of the company. Payments have been made to the creditors who made the initial loan, and the debt balance has decreased. The collateral value will exceed the agreement's collateral coverage ratio.

Secured and unsecured loans both reflect the execution of the collateral immediately upon the debtor's default. In this case, the creditor who has a

guarantee has the authority to enforce it. In contrast, the priority principle reflects the order of payments to equal-standing creditors.

Control of collateral goods creates inconsistencies for creditors under the priority principle. Each creditor who has collateral retains ownership of that collateral and has no dealings with other creditors. Additionally, they require the *pari passu* or priority principle when sharing collateral with other creditors. The equality principle applies to *pari passu* but not when the priority principle is in effect.

Lending and borrowing are forms of distributive justice in which each creditor is compensated for their services. According to distributive justice, the company should return creditor services.

Unsecured creditors or suppliers contribute to the company's short-term viability. They do not charge interest, require no agreement or collateral, and offer discounts to businesses that pay their debts on time. Additionally, they are prioritized in their balance sheet above other creditors, indicating the payment due date. This priority principle means that they are given precedence over unsecured creditors.

TABLE 1. Different Types of Creditors

No.	Description	Secured Creditors (Loan)	Unsecured Creditors (Account Payable)
1	Collateral	V	X
2	Interest	V	X
3	Payment Term	V	V
4	Agreement	V	X
5	Impact to Business	V	V

Note: V = Exist

X = Do Not Exist

Source: research results

Creditors who provide guarantees or financial institutions contribute to the company's long-term viability. Their financing is used for long-term investments such as the construction of factories and infrastructure, as well as the acquisition of machinery. Additionally, the proceeds serve as collateral for the loan, serve as a source of revenue, and serve as a guarantee for a credit agreement. The following table 1 summarizes the distinctions between secured and unsecured loans.

Grouping creditors according to the type of guarantee violates the justice principle. The law classifies creditors as secured or unsecured. Both types of creditors have distinct characteristics and cannot be compared due to the supplier's lack of creditor status.

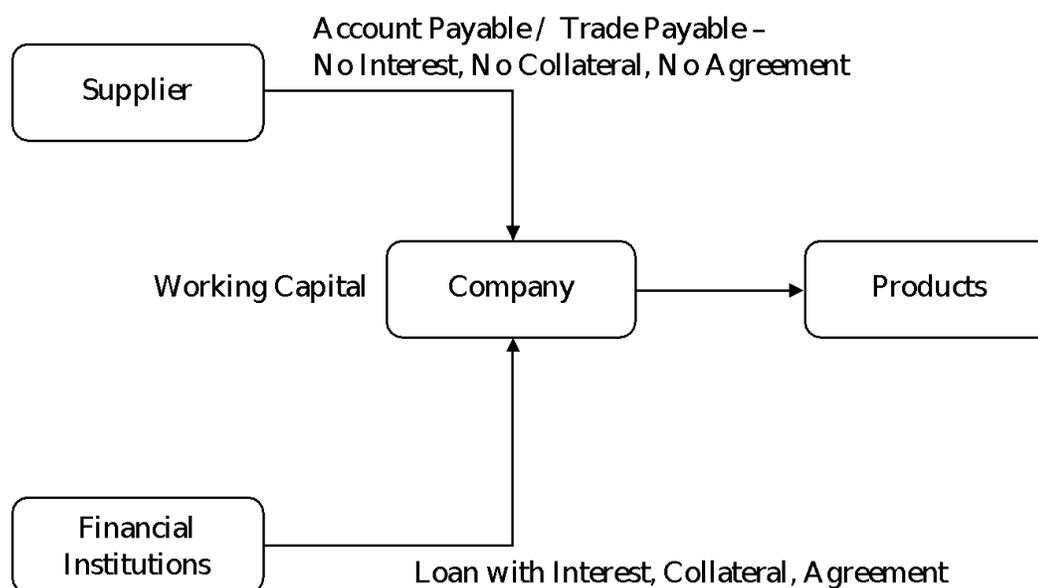


FIGURE 2. Loan Characteristics

Source: research results

Suppliers sell merchandise to the company but do not adhere to the credit agreement's terms. Additionally, they do not enter into financing agreements, do not earn interest, and do not own collateral. Suppliers and salary payables directly associated with the short-term manufacturing process are not debt, but rather a company obligation that has been delayed due to bankruptcy, as illustrated in Figure 2.

According to the principle of justice, the company is required to pay this obligation in the event of bankruptcy. However, because it is not a loan, it is not converted into a financial restructuring agreement.

The company seeks the optimal financing structure for its asset investments. In this regard, the optimal financing combination is defined by the capital structure theory as the sources of debt.⁵¹ It includes interest rates, risk, loan duration, and asset adjustments.⁵²

The capital structure classifies debt according to its maturity date, implying that the closer the debt position is to maturity, the greater the debt position, and vice versa. Capital is listed last because it represents the shareholders' equity, as illustrated in Figure 3. As with the previous accounting post, a shareholder's loan is added to the capital.

⁵¹ Mumtaz Hussain Shah and Atta Ullah Khan, "Factors Determining Capital Structure of Pakistani Non-Financial Firms," *International Journal of Business Studies Review (IJBSR)* 2, No. 1 (2017): 46–59.

⁵² Suwinto Johan, "Potential Systemic Risk Effects of Credit Relaxation in the Financial Industry as the Effect the COVID-19," *Jurnal Manajemen Bisnis Dan Kewirausahaan* 4, No. 4 (2020): 87–93, <https://doi.org/10.24912/jmbk.v4i4.8661>.

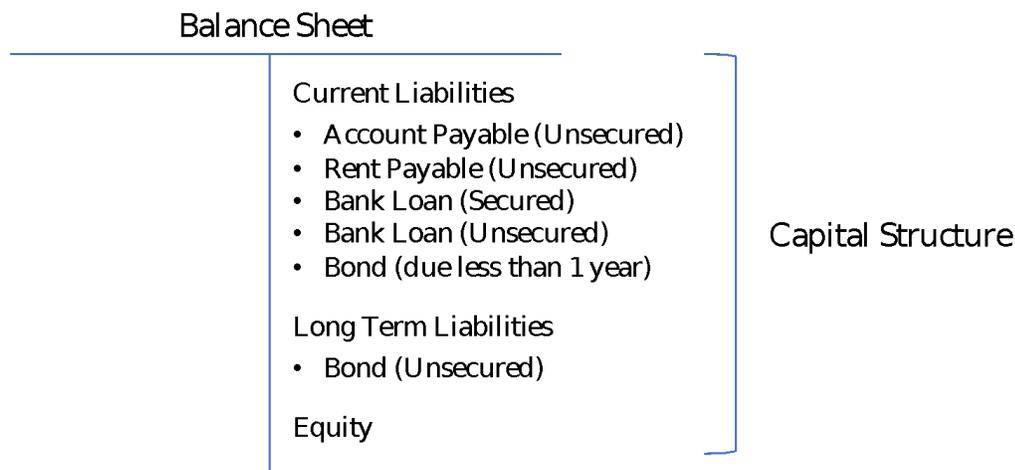


FIGURE 3. Debt Grouping Based on the Theory of Capital Structure
Source: research results

The classification of secured and unsecured creditors based on the outcome of bankruptcy proceedings disregards the fairness of debt maturation. All debts are restructured to maintain the same loan term and are repaid pro rata. This creates an inequitable situation between creditors who have repaid their short-term loans and new creditors who provide long-term loans. Creditor grouping must take the maturity period into account by including the tenure factor in risk assessments. As a result of the risk, the longer the term of the loan, the higher the interest rate.

Creditor grouping must consider the debt's source, duration, function, and guarantee in accordance with the principles of equality and justice and the capital structure theory. As illustrated in Figure 4, this grouping satisfies justice, equality, and capital structure theory between creditors and creditors. Debt is sourced from third parties, whereas debt owed by shareholders is not restructured because it is in the last position during liquidation.

The terms are classified as short-term (less than a year) and long-term (greater than a year). This classification ensures that creditors with past-due and collectible debts are treated fairly. When the short-term debt is between one and three years, the long-term debt is multiplied by three to nine years. Additionally, the debt settlement proposal adheres to this timeline.

The debt function indicates the intended use of funds or sources of financing. Trade receivables are the primary source of funding and have the most debt. Other receivables, such as rent, salary, or other debts, are categorized as short-term.

Debts are classified as secured or unsecured. Debts secured by collateral are calculated when the borrower has completed the guarantee but has not yet balanced and taken the final position. Additionally, they are not included in the debt calculation and are capable of managing collateral. The collateral's excess value over the debt must be returned. The unsecured loan includes the absence of collateral to secure the debt.

Debt grouping serves the interests of all stakeholders in a business, including shareholders, creditors, suppliers, and all other stakeholders with payables. This classification complies with the principles of justice and equality, as well as the capital structure theory as shown in Figure 4.

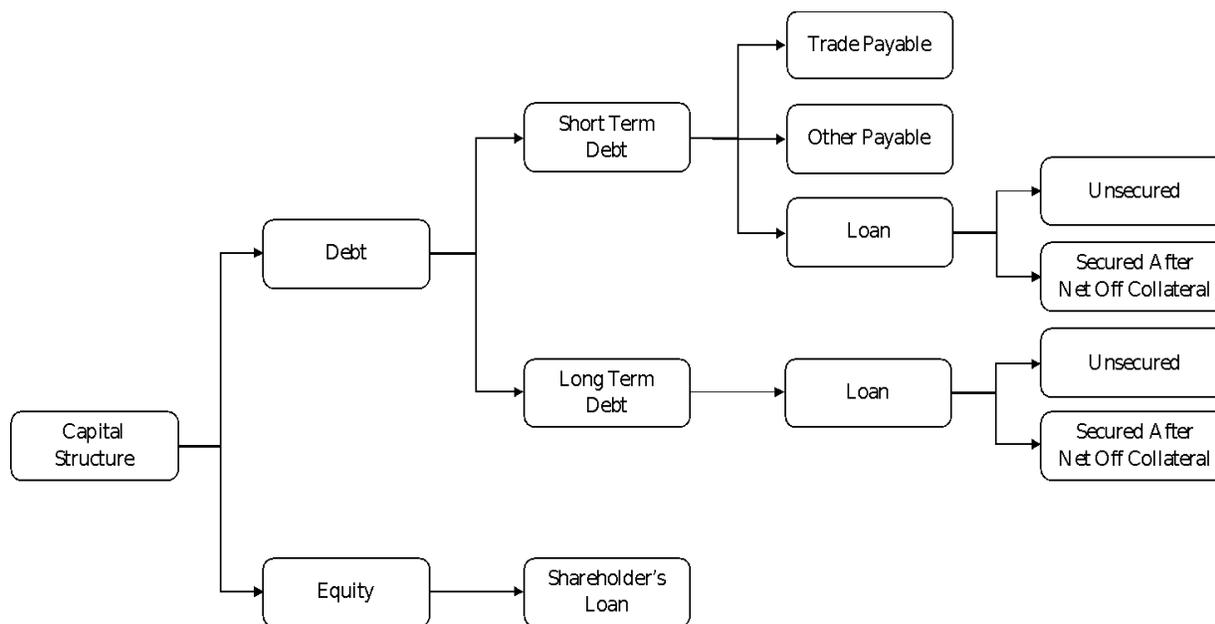


FIGURE 4. Debt Grouping

Source: research results

Debt classification based on the term, source, duration, and collateral of the loan is preferable to debt classification based on the type of collateral. Guarantees come in a variety of forms. Leasing is a method of financing that isn't the same as taking out a loan. The concept of rent a production equipment is known as leasing. The leasing business owns the production equipment. A leasing firm provides the company with production equipment. Leasing, on the other hand, is one of the company's financial sources. The leasing has debt in the form of rental costs at the time of default. The rent due has not yet been paid. The lease payment is required at the end of the lease term. Because of the means of production, leasing might be characterized as secured. However, because it does not guarantee rental payments in the event of a default, leasing can be characterized as unsecured.

Furthermore, asset-backed securitization (ABS) has its own set of characteristics. ABS refers to the sale of a company's collection rights. This right to make a claim is passed on to the buyer. Additional than the processing of these claims, the claim selling company has no other responsibility. Factoring and other types of debt have gained in popularity. So, even if merely considering secured and unsecured elements, debt classification must be reassessed.

4. Conclusion

Grouping debt based on collateral violates justice and equality principles. As a result, secured debts should not be considered in restructuring proposals. Trade obligations are also excluded from restructured debts due to the requirement for agreements and interest bearing. This study proposes categorizing debt according to its source, duration, function, and guarantee type. The restructuring category includes debt that does not include collateral. The capital structure theory is used to classify debt in this study. This study has theoretical and managerial consequences. The study recommends, in theory, that a single variable of collateral be eliminated as a factor in debt classification. Many more factors must be considered when classifying debt. Other financial variables, such as funding sources and loan period, are included in this study. In practice, research leads to a better and more equitable debt restructuring strategy. Debt restructuring will take longer because there are so many things to consider. The loan recovery rate will be affected by a longer duration. When debt restructuring happens, this study has flaws in the execution of debt classification. The time it takes to restructure will be extended if classification considers several variables. Other study on this classification can be developed by conducting interviews with legal and economic practitioners. In addition, study on the balance sheets of corporations in default

can be done using simulations. Simulation is critical to carry out in order for the suggested debt classification to be in line with current practice. The simulation will provide you feedback on your debt classification strategy. Economic, financial, and legal views must all be considered in debt restructuring research. This study cannot be based solely on one science.

5. Declaration of Conflicting Interests

The authors state that there is no conflict of interest in the publication of this article.

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*We say we value the legacy we
leave the next generation and then
saddle that generation with
mountains of debt.*

Barack Obama

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