BANKRUPTCY: A LEGAL COMPARISON

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ABSTRACT

Bankruptcy is public information on the economic status of its liabilities have exceeded the assets. Thus, bankruptcy is a declared state of insolvency pronounced by a court. This informational difference has economic consequences whereby a hint of a possible insolvency of a financial firm can lead to its bankruptcy. This Paper tries to explore and compare how Bankruptcy is governed by Western Law, Indonesian Law and Islamic Law.

Keywords: Insolvency, Bankruptcy, Indonesian Law, Western Law, Islamic Law.

INTRODUCTION

The term insolvency and bankruptcy carries a respective meaning but sometimes used interchangeably. Insolvency is a state of private information whereby the total assets have fallen short of total liabilities. Meanwhile, Bankruptcy is public information on the economic status of its liabilities have exceeded the assets. Thus, bankruptcy is a declared state of insolvency pronounced by a court. This informational difference has economic consequences whereby a hint of a possible insolvency of a financial firm can lead to its bankruptcy (Sharma & Vyas, 2017).

A state of less than public information can result in rumors, expectations and a different kind of behavior from the counterparties of the distressed individual or institution than that in a state of public information. In the former case creditors try to take advantage of their own information unsure if others have same or different information. While in later case everyone is approaching the issue with same knowledge without any asymmetry of information.

This paper are trying to explore more regarding bankruptcy in the terms of pertains to negative net worth. A shortfall in cash-inflows compared to the planned cash-outflows required to meet the present obligations can create an event of default but it does not necessarily create an insolvent state i.e., negative net worth or bankruptcy. Furthermore, this paper is trying to compare on how bankruptcy are govern and regulated under Western Law (in this paper focus on American Law), Indonesian Law and Islamic Law. To be able to see the differences, this paper also conducting a case study based on the bankruptcy of Arcapita Group in Malaysia.

Bankruptcy in Western Law Perspective

Bankruptcy is a constitutional right of protection against creditors. It allows consumers and businesses to make a fresh start when they owe so much money relative to their income that they cannot afford to pay their debts. Depending on the specific type of bankruptcy that is filed, most of the debts owed by a consumer or a business will be wiped out or the debts will be reorganized so that the consumer or business can afford to pay them. In exchange for the financial fresh start that bankruptcy provides, however, the consumer or business may have to give some of their assets back to their creditors. Furthermore, the bankruptcy will remain in the

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consumer's credit history for up to ten years and during that time, if the consumer is approved for new credit, the cost of that credit will be high. If you are like most consumers who are struggling to pay their bills, even though you know that filing for bankruptcy will help you deal with your financial situation, you may not be sure that you want to take that step. After all, you have worked hard throughout your life and you have been willing to make sacrifices to pay your bills. As a case in point, when your financial troubles began, you probably tried everything you could think of to turn your financial situation around. In the United States, bankruptcy is governed by federal law. The United States Constitution (Article 1, Section 8, and Clause 4) authorizes Congress to enact uniform Laws on the subject of Bankruptcies throughout the United States. Congress has exercised this authority several times since 1801, most recently by adopting the Bankruptcy Reform Act of 1978, as amended, codified in Title 11 of the United States Code and commonly referred to as the Bankruptcy Code (Aghion et al., 1992). The Code has been amended several times since, with the most significant recent changes enacted in 2005 through the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Some law relevant to bankruptcy is found in other parts of the United States Code.

Article I, Section 8, of the United States Constitution authorizes Congress to enact uniform Laws on the subject of Bankruptcies. Under this grant of authority, Congress enacted the Bankruptcy Code in 1978. The Bankruptcy Code, which is codified as title 11 of the United States Code, has been amended several times since its enactment. It is the uniform federal law that governs all bankruptcy cases (Kimhi, 2010).

The procedural aspects of the bankruptcy process are governed by the Federal Rules of Bankruptcy Procedure (often called the Bankruptcy Rules) and local rules of each bankruptcy court. The Bankruptcy Rules contain a set of official forms for use in bankruptcy cases. The Bankruptcy Code and Bankruptcy Rules (and local rules) set forth the formal legal procedures for dealing with the debt problems of individuals and businesses. There is a bankruptcy court for each judicial district in the country. Each state has one or more districts. There are 90 bankruptcy districts across the country. The bankruptcy courts generally have their own clerk's offices. The court official with decision-making power over federal bankruptcy cases is the United States bankruptcy judge, a judicial officer of the United States district court. The bankruptcy judge may decide any matter connected with a bankruptcy case, such as eligibility to file or whether a debtor should receive a discharge of debts. Much of the bankruptcy process is administrative, however, and is conducted away from the courthouse. In cases under chapters 7, 12, or 13, and sometimes in chapter 11 cases, this administrative process is carried out by a trustee who is appointed to oversee the case. A debtor's involvement with the bankruptcy judge is usually very limited. A typical chapter 7 debtor will not appear in court and will not see the bankruptcy judge unless an objection is raised in the case. A chapter 13 debtor may only have to appear before the bankruptcy judge at a plan confirmation hearing.

Usually, the only formal proceeding at which a debtor must appear is the meeting of creditors, which is usually held at the offices of the U.S. trustee. This meeting is informally called a 341 meeting because section 341 of the Bankruptcy Code requires that the debtor attend this meeting so that creditors can question the debtor about debts and property. A fundamental goal of the federal bankruptcy laws enacted by Congress is to give debtors a financial fresh start from burdensome debts. The Supreme Court made this point about the purpose of the bankruptcy law in a 1934 decision: It gives to the honest but unfortunate debtor a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing

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debt. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (Brown, 2014). This goal is accomplished through the bankruptcy discharge, which releases debtors from personal liability from specific debts and prohibits creditors from ever taking any action against the debtor to collect those debts.

Chapter 7 Liquidation under the Bankruptcy Code

A chapter 7 bankruptcy case does not involve the filing of a plan of repayment as in chapter 13. Instead, the bankruptcy trustee gathers and sells the debtor's nonexempt assets and uses the proceeds of such assets to pay holders of claims (creditors) in accordance with the provisions of the Bankruptcy Code. Part of the debtor's property may be subject to liens and mortgages that pledge the property to other creditors. In addition, the Bankruptcy Code will allow the debtor to keep certain "*exempt"* property; but a trustee will liquidate the debtor's remaining assets. Accordingly, potential debtors should realize that the filing of a petition under chapter 7 may result in the loss of property.

To qualify for relief under chapter 7 of the Bankruptcy Code, the debtor may be an individual, a partnership, or a corporation or other business entity. 11 U.S.C. §§ 101(41), 109(b). Subject to the means test described above for individual debtors, relief is available under chapter 7 irrespective of the amount of the debtor's debts or whether the debtor is solvent or insolvent. An individual cannot file under chapter 7 or any other chapter, however, if during the preceding 180 days a prior bankruptcy petition was dismissed due to the debtor's willful failure to appear before the court or comply with orders of the court, or the debtor voluntarily dismissed the previous case after creditors sought relief from the bankruptcy court to recover property upon which they hold liens. 11 U.S.C. §§ 109(g), 362(d) and (e). In addition, no individual may be a debtor under chapter 7 or any chapter of the Bankruptcy Code unless he or she has, within 180 days before filing, received credit counseling from an approved credit counseling agency either in an individual or group briefing. 11 U.S.C. §§ 109, 111. There are exceptions in emergency situations or where the U.S. trustee (or bankruptcy administrator) has determined that there are insufficient approved agencies to provide the required counseling. If a debt management plan is developed during required credit counseling, it must be filed with the court. One of the primary purposes of bankruptcy is to discharge certain debts to give an honest individual debtor a fresh start. The debtor has no liability for discharged debts. In a chapter 7 case, however, a discharge is only available to individual debtors, not to partnerships or corporations. 11 U.S.C. § 727(a)(1). Although an individual chapter 7 case usually results in a discharge of debts, the right to a discharge is not absolute, and some types of debts are not discharged. Moreover, a bankruptcy discharge does not extinguish a lien on property.

Chapter 13 Individual Debt Adjustment

A chapter 13 bankruptcy is also called a wage earner's plan. It enables individuals with regular income to develop a plan to repay all or part of their debts. Under this chapter, debtors propose a repayment plan to make installments to creditors over three to five years. If the debtor's current monthly income is less than the applicable state median, the plan will be for three years unless the court approves a longer period for cause. If the debtor's current monthly income is greater than the applicable state median, the plan generally must be for five years. In no case may a plan provide for payments over a period longer than five years. 11 U.S.C.

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§1322(d). During this time the law forbids creditors from starting or continuing collection efforts.

Any individual, even if self-employed or operating an unincorporated business, is eligible for chapter 13 relief as long as the individual's unsecured debts are less than $360,475 and secured debts are less than $1,081,400. 11 U.S.C. § 109(e). These amounts are adjusted periodically to reflect changes in the consumer price index. A corporation or partnership may not be a chapter 13 debtor. Id. An individual cannot file under chapter 13 or any other chapter if, during the preceding 180 days, a prior bankruptcy petition was dismissed due to the debtor's willful failure to appear before the court or comply with orders of the court or was voluntarily dismissed after creditors sought relief from the bankruptcy court to recover property upon which they hold liens. 11 U.S.C. §§ 109(g), 362(d) and (e). In addition, no individual may be a debtor under chapter 13 or any chapter of the Bankruptcy Code unless he or she has, within 180 days before filing, received credit counselling from an approved credit counseling agency either in an individual or group briefing. 11 U.S.C. §§ 109, 111. There are exceptions in emergency situations or where the U.S. trustee (or bankruptcy administrator) has determined that there are insufficient approved agencies to provide the required counseling. If a debt management plan is developed during required credit counseling, it must be filed with the court.

Bankruptcy in Indonesian Law

Munir Fuady (2002), one of Indonesian Law Scholar defines bankruptcy as a general confiscated over Debtor's assets so that there will be settlement being made between the debtor and creditor or so that assets can be divided equally between all the creditors. R. Subekti, the other Indonesian Law Scholar said that bankruptcy is a joint effort to getting an equal payment by all of those is owed. Meanwhile, Purwosutjipto (1978) defined bankruptcy is everything that has connection with the action of bankruptcy. Bankruptcy is a condition where someone or some institution stops paying (all of their debts).

Black's Law Dictionary defines bankruptcy as the state or condition of a person (can be individual, partnership, corporation, municipality) who is unable to pay its debt as they are, or become due. The term includes a person against whom a voluntary petition has been filed, or who has been adjudged a bankrupt (Garner, 2004). According to that definition, we can see that the definition of bankruptcy is being connected with the inability of a debtor to pay their already matured debts, and that inability must be followed by a real action by filing a sue to the court to be declared as bankrupt. That file a suit can be done voluntarily by the debtor itself or by the request from the third party.

Meanwhile, in Indonesian Bankruptcy Law, according to the Indonesian Act Number 37 Year 2004 on Bankruptcy and Suspension of Obligation for Payment of Debts Article 1 Paragraph (1), Bankruptcy shall mean general confiscation of all assets of a bankrupt debtor that will be managed and liquidated by a curator under the supervision of Supervisory Judge as provided for herein.

Principle of the Law of Bankruptcy:

Equality: It means there must be equal treatment to both the debtor and creditor. It means that in one party there are rules that can preventing the misuse of the authority by dishonest

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debtor and at the other hand there are some rules that can preventing the misuse of the authorities by dishonest creditors.

Business Continuity: It means that even though the debtor already is sued to the court to be declared as bankrupt, but they still can runs their profitable business as usual.

Justice: Rules about bankruptcy must be fulfilling the sense of justice to all parties. This principal also being used to preventing arbitrary creditors who imposing the payment for theirs claim without thinking about the other creditors who have the same intention.

Integration: It means that the formal legal system must be according with the material legal system which is an integral unity from its national civil law and civil procedural law.

Requirements for Debtor to be Filed a sue as Bankrupt

If the debtor wants to be declared as bankrupt, they must meet with the requirements which stated on Indonesian Bankruptcy law. Indonesian Act Number 37 Year 2004 Article 2 Paragraph (1) said:

> *"A debtor having two or more creditors and failing to pay at least one debt which has matured ad became payable, shall be declared bankrupt through a court decision, either at his own petition or at the request of one or more of his creditors."*

According to the article above, we can conclude that the requirements for the debtor to be declared as bankrupt are:

1. Debtor must having at least two creditors: This requirements also being mentioned in Indonesian Civil Code (*Burgerlijk Wetboek/BW)* Article 1132 which stated that generally the distribution of debtor's assets must done by all of the creditors according to their portion. Or in legal terms it should be distributed by *pari passu pro rata pare.*
2. Debtor must at least didn't pay one of their debts to one of their creditor: Didn't pay in this situation means that the debtor didn't pay the debt that they should pay. If the debtor didn't pay their debt only for once, then they can't be considered as the condition that they didn't pay their debts.
3. The debt that the debtor didn't pay must be matured and can be collected: The debt that already mature means that debt has reach its maturity and debtor must pay off that debt. Can be collected means that even though that the debt hasn't reach it's maturity yet, but maybe the creditor can be asking to collect that debt to the debtor because the debtor commit default or breach of contract.

Parties who may file a Bankruptcy Petition

Not everyone can file a bankruptcy petition to the court. According to Indonesian Bankruptcy law, parties who can be filing a Bankruptcy petition to the court are:

1. The Debtor itself: The Debtor who is filing a petition for their self must be able to explain and prove that they have at least one creditor and also they have at least one debt that they didn't pay to at least one of their creditor.
2. Creditors: One or more creditors can filing a petition to the court to declaring that their debtor is bankrupt, as long as their debtor having at least 2 or more creditors and didn't pay their debts.
3. Attorney General: attorney General can file a bankrupt petition for reasons of public interest. Which means by public interests in here are: Debtors run away; Debtor embezzling their assets; Debtor having debt to State-Owned enterprises or other institution that collecting funds from people; Debtor having debt that comes from collecting people's money; Debtor didn't have the good intention or didn't cooperate to solving their already mature debts; On any other things that the attorney general thinks it was a public interests.

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4. Bank Indonesia (Indonesian Central Bank): Bank Indonesia can filing a bankruptcy petition to the court if the debtor is a Bank. But it must be based on the evaluation of financial condition and the banking condition in general.
5. BAPEPAM (Indonesian Capital Market and Financial Institution Supervisory Board): BAPEPAM having the full authority to filing a Bankruptcy petition in case that the debtor is a securities company, stock exchange, etc.
6. Ministry of Finance: Ministry of Finance can filing a Bankruptcy petition if the debtor are insurance company, re-insurance company, State-Owned enterprises that have the activities in public interests.

Procedures and Time Frame

The following are the relevant procedures and time frame for a Bankruptcy proceeding based on Indonesian Bankruptcy law (Mandala, 2007):

1. A bankruptcy petition will be submitted by the court registrar to the chairman of the commercial court within two days after the date of registration.
2. Within three days after the date on which the bankruptcy petition was registered, the court will review the application and determine the date of hearing.
3. The bankruptcy decision must be felled within 60 days from the date the bankruptcy petition was registered.
4. The bankruptcy decision must be sent by express registered mail to: the debtor, the applicant, the curator, and the supervisor judge, within three days of the date on which the decision was read.
5. A petition for cassation (appeal to the Supreme Court) or civil review (by the Supreme Court of its decision); can be submitted only to the court registrar who will forward it to the counterparty within two days of the date the petition was registered.
6. The counter appeal must also be distributed by the court registrar to the applicant within two days of the date on which it was received.
7. The appeal hearing must be conducted within 20 days of the date the application was received.
8. The decision must be made within 60 days from the date the application was received.
9. A copy of decision must be delivered by the registrar of the Supreme Court to the registrar of the district court within three days after the date on which the decision was read.

In bankruptcy proceedings, a summon issued by the court registrar will be deemed to be validly received by the debtor if the summons has been issued by registered express mail at least seven days before the first hearing is to be conducted.

The Effect of Bankruptcy on the Debtor

As the Debtor has been declared bankrupt based on a court decision, therefore according to Article 22 of Indonesian Bankruptcy law he has lost by the power of law of theirs right to master and manage theirs assets. And as of that time the Debtor's assets shall be included in the bankrupt's assets, managed by the Curator appointed by the Commercial Court. To manage that bankrupt's assets, in accordance with Article 13 of the Indonesian Bankruptcy law, the Curator's duty is among others to list the Debtor's debts and the Creditor's claim. This duty precedes his duty to pay claims of each creditor. The Curator must beforehand list whomever to be the Creditors, check the authenticity of the claim of each Creditor, ascertaining the amount or value any claim.

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The bankruptcy decision by the court does not mean that the Debtor would lose his competence to conduct legal acts in general, but only lose theirs power or authority to manage and transfer theirs assets. Thereby, the Debtor is still able to conduct legal acts.

The Curator and Supervising Judge

Article 13 paragraph (1) of Indonesian Bankruptcy Law stated that in the bankruptcy decision, the judge should appoint:

1. The Supervising Judge.
2. The Curator.

According to Article 63 of Indonesian Bankruptcy Law, the Supervising Judge's duty is to monitor the management and settlement of the bankrupt's assets conducted by the curator. Still according to the same Article, The Curator conducts the management and settlemet of the bankrupt's assets, and being monitored by the Supervising Judge.

The position of the Supervising Judge is one of the vital importance, because according to Article 64 of Indonesian Bankruptcy Law, in prior of taking a decision regarding something connected with the management and settlement of the bankrupt's assets, the Commercial Court is obliged to listen beforehand to the opinion of the Supervising Judge.

Efects of Bankruptcy on the Creditors

Different Effects for Different Types of Creditors: The creditors affected by the bankruptcy are not all in the same position. Preferred or secured creditors have a priority claim on the proceeds of the sale of any assets that have been pledged as security in their favor, whether a pledge, fiducia, mortgage or privilege. Unsecured/concurrent creditors, on the other hand, share in the division of the remaining assets and obtain satisfaction of their debts in a proportionate percentage. Unsecured/concurrent creditors will share the money proportionately, rather than having a situation where the first creditor to apply will be the first to receive payment. From the date of the declaration of bankruptcy, the unsecured/concurrent creditors can obtain satisfaction of their claims only in bankruptcy procedure and not through individual enforcement proceedings (McKenzie, 2017).

It is important to note that only creditors having a claim against the bankrupt debtor at the time of the bankruptcy declaration may claim payment from the proceeds of the bankrupt's assets. Also note that the payment obligations of the debtor that arise after the bankruptcy declaration cannot be paid from the proceeds of the bankrupt's assets, unless the fulfillment of the payment obligation brings benefits to the bankrupt's assets.

Indonesian Bankruptcy Law and Indonesian Civil Code (*BW)* provide general protection to the interests of creditors. Under those laws, a creditor has the right to request the court to annul any voluntary legal acts of a debtor if the creditor can show that the debtor and its counterparty, when doing those voluntary acts, had knowledge that the action would jeopardize the creditor's interest. This protection is known as Actio Pauliana.

The burden of proof in the action would rest on the debtor if the voluntary act that jeopardizes the creditor's interest was carried out within one year before the date of the

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bankruptcy declaration. If the act was done earlier than one year before the date of the bankruptcy declaration, the burden of proof in the action would rest on the creditor.

Legal Efforts against the Commercial Court Decision

Against the Commercial Court decision, either related to the bankruptcy petition or the Petition for Suspension of Debt Payment, a legal effort could be conducted. Such direct legal effort can be in the form of submitting Cassation petition to the Supreme Court. Such is provided in Article 8 Paragraph (1) and Article 282 Paragraph (2) in Indonesian Bankruptcy law. In other words, against the Commercial Court decision no appeal efforts can be conducted at the high court.

Besides cassation, another legal effort available to the unsatisfied party is the Civil Review. The possibility of filling the civil review petition is stipulated in the provision of Article 11 and Article 286 Paragraph (1) in Indonesian Bankruptcy Law. According to Article 11 in Indonesian Bankruptcy Law, against the Supreme Court decision on the cassation petition, having obtained permanent legal force, a civil review can be filled at the Supreme Court.

As provided in Article 286 Paragraph (2) in Indonesian Bankruptcy Law, the request for a civil review can be filled if:

1. Important new written evidence are found, which if had been known previously at the court proceeding, would have resulted in a different decision.
2. The Commercial Court has made a major flaw in applying the law.

Indonesian Bankruptcy Law does not determine what is meant by a major flaw in applying the law as referred to in Article 286 paragraph (2) point b in Indonesian Bankruptcy Law. The elucidation of this article does not indicate anything. The absence of the definition of major flaw in applying the law in Indonesian Bankruptcy Law may provoke unsatisfied parties to file easily a civil review against any court decision having obtained permanent legal force. This matter shall only cause a delay to the proceeding obtaining a court decision.

Bankruptcy in Islamic Law

Islamic law lays down rules for iflas, the condition of being unable to pay one's debt (insolvency), and for taflis, the official act or procedure of declaring the person muflis or insolvent. Debt restructuring, defaults, triggers for events of default, ross default, debt acceleration and debt suspension mechanism such as US Chapter 11 proceedings are all relatively new concepts to Islamic law.

Insolvency happens when debtor is unable to pay the liabilities. The probability of insolvency increases with the increase in debt in the capital structure of firms. Islam give us guidelines in insolvency and bankruptcy (Farahni, 2020). According to Salman Syed ALI (2013), to understand the theory of bankruptcy and to develop models for bankruptcy resolution in Islamic finance clarity on the following aspects is essential:

1. Islam prohibits interest.
2. Money is recognized as medium of exchange and a facilitator with no intrinsic potential to grow or increase in value by time.

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3. Debt is not prohibited but not encouraged. It does not mean a neutral stance towards debt. Debt is rather discouraged.
4. Debt cannot be extinguished except by payment in full (ada) or by its forgiveness (ibra) from the creditors. There is no other way to discharge debt.
5. Justice (adal) and Benevolence (ihsan) are fundamental in all dealings. In debt contracts, it translates into insisting the debtor to keep his promise of timely repayment and encouraging the creditors to show leniency is case debtor is in financial difficulty to extend time and/ or forgive full or part of the debt.

The words insolvency and bankruptcy are sometimes used alternatively, however there is a difference. Insolvency is a state of private information (known to the individual agent himself) or at most common knowledge (known to some others around) that total assets have fallen short of total liabilities.

Bankruptcy is public information of this fact when everyone knows that everyone knows about an economic agent that its liabilities have exceeded the assets. That is why bankruptcy is a declared state of insolvency pronounced by a court.

On face, this appears to be only a philosophical difference or splitting the hair, however this informational difference has economic consequences. A state of less than public information can result in rumors, expectations and a different kind of behavior from the counterparties of the distressed individual or institution than that in a state of public information. In the former case creditors try to take advantage of their own information unsure if others have same or different information. While in later case everyone is approaching the issue with same knowledge without any asymmetry of information.

Allah said in Quran, *"If, however (the debtor) is in straightened circumstances, (grant him) a delay until a time of ease; and it would be for your own good-if you but knew it-to remit (the debt entirely) by way of charity*". Indeed, if the creditors forgive the debtor, it will be the act of charity for them.

However Islamic banks are not charitable body, but commercial institutions with shareholders who are seeking dividends and capital gains, and depositors, including those with investment accounts, who are expecting profit sharing pay-outs. There is a conflict of interest between those being financed and an Islamic bank's owners and depositors. Debt forgiveness on a large scale will result in declining shareholder value and zero profits for investment account holders. Regulators will also be concerned with excessive debt forgiveness, as if the bank fails, in most jurisdictions governments will be obliged to bail out the bank using taxpayers' money (Mayer et al., 2012).

Islamic Approach towards Insolvency and Bankruptcy

There are two main characteristics on Islamic approach towards insolvency for both parties; debtor and creditor. First approach is they have rights for each party. This means that Islamic law emphasizes balance approach to creditors and debtors in the case of insolvency and bankruptcy. Therefore, it cannot be said that Islamic law is protecting the rights of debtors only; it also protects the rights of creditors. On the part of debtor, Islamic law puts guidelines:

1. The debt, either created through loan (qard), credit purchase, lease, partnership and etc., must be paid.
2. Debt settlement is considered as obligation to fulfill the covenant in which the Quran said many times and of of them is "*O you who believed, fulfill (all) contracts…" (*Quran 5:1).

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3. A debtor delaying paying a debt or an obligation without a valid excuse, even to a wealthy person, is unjust (ẓulm). For this reason, some sort of punishment and penalty is allowed.
4. In the case of default and inability to pay back debt due to economic hardship, he should consult the creditor asking for more time and facilities to settle the debts.

On the part of the creditor:

1. The debt created from him essentially emerged from his social responsibility and moral commitment of benevolence.
2. He has the right to get back the debt from debtor, but this does not mean he has the authority or power to exploit the debtor by threatening or by increasing the amount of debt.
3. In the case of default, the creditor is expected to ease debtor by giving more time or other ways in which the debtor could reduce and hence settle the debt accordingly. This is based the Quran (2: 280) which says if a person is in difficulties, let there be respite until a time of ease. And if you give freely (i.e., if you forgive the debt voluntarily) it would be better for you, if only you knew.

Second, that balance approach and position of debt settlement and bankruptcy comes from the Islamic values expected to be hold by both the creditor and debtors. In this regard, both the debtor and creditor are expected to have the prescribed norms and values in debt creation, settlement also in case of insolvency as guided by the Islamic principles. Some of the guidelines are as follows:

1. Debt due to delayed payment, under Islamic law, will not increase over time. It is unlawful in Islam to either lend or borrow a sum of money at interest. This is in contrast with a draconian system (i.e. riba jahiliyyah) which strongly favored creditors whereby if the debtor sought a reprieve, it came at the price of a doubling of the debt. This make the debtor has a lifetime opportunity to reduce it down. In other word, the amount of debt can only go down over time, whereby the debtor can eventually settle it back any time in his life.
2. Islam requires a fair treatment and avoidance of punishment for an inability to pay back debt due to economic hardship.
3. In Islamic framework for debt settlement in the case of insolvency and bankruptcy, the debt settlement is done through recourse to the assets. Debtor's asset could be utilized to pay off his debts. In recent development of sukuk, an asset-backed sukuk whereby the sukuk holders had claims to specific assets.
4. Under Islamic concept of settlement (sulh) a creditor could accept a compromise or reduction of the debt. The moral theory for such reduction is that creditor would make a donation or charitable forgiveness of the remaining balance as propagated in the Quran (2: 280).
5. Judge (qadi) also plays very central in finding appropriate resolution to the cases brought before him. A bankruptcy proceeding is commenced by the creditor. The burden, in Islamic law, is on the creditors to show proof of the debt and that the debt had become due.

One important point need to be stress here is that every step and planning have to be taken before an entity falls into trouble. The maxim which says harm shall be eliminated shall be the guiding principle here. Islam always stresses the importance of planning and avoiding any harm from happening. Insolvency, no doubt is considered as harm not only to individual but also to society and the economy in general.

Therefore, it is the role of the regulator and governments to ensure all mechanisms are intact in order to prevent insolvency. If, despite all the measures, it happened, then there must also be the mechanism to ensure minimal impact of such happening to individual, society and economy. It is important to note that such planning become mandatory and compulsory if without it may harm the nation and ummah.

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Finally, Islam emphasis the principle of justice to all parties related when there is case of insolvency. What is important is the role of the court to ensure that justice is done to everyone and no one party should be given preference over the others. Islam does not rank the rights of the parties involve when claiming their rights; rather it is left to the wisdom of the court to determine the rights of all are protected.

Case Study: Bankruptcy of Arcapita Group in Malaysia

Arcapita Bank was incorporated in November 1996 as a Bahrain Joint Stock Company, and operates under an Islamic wholesale banking license issued by the Central Bank of Bahrain (CCB).

Arcapita, through its debtor and non-debtor subsidiaries is a global manager of Shariah-compliant investments and operates as an investment bank. Arcapita was privately owned by approximately 360 shareholders, with approximately 70% of its equity held by prominent individuals and institutions based predominantly in the Gulf region and the remaining approximately 30% beneficially held by Arcapita's management.

The Arcapita Group operated primarily as an investment company that provided investment opportunities to high net worth individuals, family offices, institutions and sovereign wealth funds whom wishes to conform to Islamic Shariah rules and principles.

The Arcapita Group sponsored its first investment in 1997 as private equity investments in assets based in the United States. In 2001, the Arcapita Group expanded its investment portfolio to include real estate assets.

Arcapita Group was an unable to obtain liquidity as a result of the 2007 global economic downturn and debt crisis. This affected the Group's ability to refinance a US$1.02 billion Syndicated Murabahah Facility that was due on March 28, 2012. The company was obliged to seek protection from the courts after hedge funds that had bought into the secondary market refused to agree to a consensual out-of-court debt restructuring.

In lieu of the bankruptcy petition, the group management is considering a voluntary bankruptcy filing under Chapter 11 of the United States Bankruptcy Code. They could use the Chapter 11 framework since it had assets in the United States and this framework presented the most appropriate and efficient vehicle for a comprehensive restructuring for all debtors. The principal objective of Chapter 11 proceeding is creating and implementing a plan of reorganization. Thus, a debtor fall in this category may continue its business and remain in possession of its property as a "*debtor in possession*" during the proceeding.

Arcapita's plan will transfer its assets into a new holding company which will dispose of them over time to pay off creditors, effectively a gradual wind-down of the firm. Under the court-approved restructuring plan, Arcapita is to be split into two entities: one which will hold the existing company assets as they are sold down to pay creditors, with a second in charge of the process' management. On the other hand, the U.S. court also had to approve a rare $350 million debtor-in-possession financing from Goldman Sachs, arranged to fund Arcapita's wind-down operations.

The primary financing arrangements under the Plan are two new Murabaha facilities and a sukuk issuance. The "*New Murabaha Facilities*" are comprised of an "*Exit Facility*" and a "*New SCB Facility*". The Exit Facility is used to provide working capital which takes out the existing SCB Facility with a first lien (highest priority debt) on the obligors' assets into junior-

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liens (second mortgage) on the New SCB Facility. The "*New SCB Facility*" is a new Murabaha facility. The Sukuk Facility is a newly issued unsecured sukuk facility that is subordinate to the New Murabaha Facilities. These are repaid primarily from the proceeds of asset dispositions.

Arcapita has become the first GCC Company to emerge from U.S. bankruptcy under Chapter 11 rules, in a move that could help clarify how Islamic finance is treated in Western courts. The case could prove to be a step forward for the Islamic finance industry by offering a degree of certainty as to how Western courts treat contracts and disputes that make reference to Shariah (Singh & Sheng, 2011). While Chapter 11 process, also the first to use a debtor-in possession financing which complied with Islamic finance principles such as a ban on interest, ensured Arcapita's existing portfolio could be sold without a firesale.

The regulators and the courts have adopted and approved the economic substance approach to legal issues of relevance to Islamic finance since the forms of the Shariah-compliant transactions are not disruptive of the analysis.

In the case of U.S, Islamic principles are not actually codified in law. Thus the absence of Shariah law makes notoriously difficult for Western courts to deal with. The complexities of addressing Arcapita bankruptcy issues in the context of Shariah-compliant debtors are the second of its kind, after the East Cameron oil and gas sukuk. It is gratifying to note that the Bankruptcy Courts in the United States have striven to adhere to Shariah principles in both of these bankruptcy proceedings, including the financial and corporate restructurings and reorganizations.

True debt restructuring is somewhat of an alien concept in the Middle East. The region's bankruptcy laws are largely untested especially the bankruptcy law in Bahrain, where Arcapita is based in, has never been used. Instead, such situations tend to be worked out through privately negotiated deals, typically involving a so-called amend and extend, whereby a company amends its credit agreement and extends the debt maturities to avoid a default.

CONCLUSION

Bankruptcy declaration process is initiated by the creditors and a settlement would be initiated by the action of the court itself. Shariah Laws of insolvency and indebtedness allows a finely balanced resolution towards the dispute of rights between creditors, debtors as well as other stakeholders. A strict ration of capital and debt to be observed when it comes to windup and insolvency.

Although there is a lot of different perspective and definition on bankruptcy as discussed in the Western as compared to particularly on the Indonesian Law point of view, Shariah Laws may find a universal solution towards this matter at hand.

A key element to the success of Shariah compliant restructurings is the involvement, and ongoing dialogue with, the relevant Shariah boards from the outset. It is clear from recent Shariah compliant restructurings that Shariah boards are willing to revisit the fundamental principles of current Shariah compliant financing arrangements and are open to considering other innovative structures. The key to all of them has been balancing the interests of multiple Shariah boards with sometimes competing interests of a diverse creditor group.

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