THE RESTRUCTURING REVIEW

TENTH EDITION

Editor
Christopher Mallon

THE LAWREVIEWS

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Pheo M Hutabarat and Rosna Chung[1]

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

In 2017 Indonesia's economy has improved. The recent Standard and Poor's credit rating upgrade shows improvements of the country's fiscal management and credibility. Economic outlook is positive due to a supportive global economy and strong domestic fundamentals. Private consumption is growing supported by a stable rupiah and muted inflation. Fiscal policy in 2017 has made a strong start, with improved revenue performance and quality of expenditure, supporting economic growth. Private consumption growth has been robust, supported by a stable rupiah and muted inflation. Investment growth continues to be strong on the back of the ongoing recovery in commodity prices, continued reforms to improve the business environment, lower financing rates, and better business sentiment.

In 2017 the government issued various regulations, including the following:

a On 17 March 2017 the Indonesian Financial Services Authority (OJK) issued Circular Letter No. 12/SEOJK.03/2017, implementing OJK Regulation No. 56/POJK.03/2016 on the Share Ownership in Commercial Banks. This regulation requires any foreign shareholder who intends to own more than 40 per cent of a bank's shares to obtain a recommendation from the supervisory authority of their country of origin.

b On 27 March 2017 the OJK issued OJK Regulation No. 13/POJK.03/2017 on the Use of Services Rendered by Public Accountants and Public Accounting Firms in Financial Services Activities. This regulation stipulates among others that parties conducting financial services activities are required to use the services of public accountants and public accounting firms that are registered with the OJK. The appointment of the public accountants and public accounting firms will be conducted through a general meeting of shareholders by taking into account a recommendation from the board of commissioners and audit committee.

c On 6 April 2017 the OJK issued Circular Letter No. 16/SEOJK.03/2017 on the Submission of Information on Foreign Customers Related to Taxes in the Context of International Automatic Exchange of Information (AEoI) by using the common reporting standard (CRS). The regulation requires financial-service institutions, which include commercial banks, securities companies, custodian banks, life insurance companies and sharia life-insurance companies, to report information relating to their foreign customers to the OJK by 2018 at the latest. Foreign customers are individual or corporate customers who satisfy the following criteria: (1) existing customers that fit into the lower (below US$1 million) and upper (above US$1 million) account

1 Pheo M Hutabarat and Rosna Chung are partners at Hutabarat, Halim & Rekan.

balance-value brackets; and (2) new customers, either from participating jurisdictions or passive, non-financial entities that do not operate within participating entities that do not operate within participating jurisdictions, and that have account balances above US$250,000.

d On 7 April 2017 the OJK issued OJK Regulation No. 14/POJK.03/2017 on Recovery Plan for Systemic Banks. This regulation sets the requirements for systemic banks to prepare and submit recovery plans to the OJK, or within six months after the banks being classified as systemic banks. Systemic banks are also required to have a guideline for the recovery plan, which is prepared by taking into account the governance principle to support the implementation of a recovery plan.

e On 18 April 2017 the OJK issued Circular Letter No. 18/SEOJK.02/2017 on the Information-Technology Governance and Risk Management for Information-Technology-Based Lending Services, which is the implementation of OJK regulation No. 77/POJK.01/2016 on Technology-Based Lending Services. This regulation stipulates requirements for the providers of IT-based lending services (providers) to: (1) place their data centre and disaster-recovery centre within Indonesian territory; (2) prepare an electronic system-strategic plan that supports the company's business plan; (3) prepare a disaster-recovery plan, which must be reassessed at least once a year, and submit the plan to the OJK; (4) implement proper procedures for the management of changes in the business process and electronic system; (5) employ human resources that possess sufficient IT knowledge; (6) if using outsourcing services, providers should apply the principles of prudence, sustainability, and appropriate risk management; and (7) maintain the confidentiality and availability of all personal data, transaction data, and financial data.

f On 5 May 2017, Bank Indonesia issued Regulation No. 19/7/PBI/2017 on Carrying Foreign Banknotes Through Indonesian Customs. This regulation will come into effect as of 5 March 2018. With the issuance of this regulation, as of March 2018 carrying paper banknotes through Indonesian customs within the limit of 1 billion rupiah or its equivalent may only be carried by permitted bodies, namely to banks and non-bank money changers, which have obtained a permit and approval from Bank Indonesia to carry paper banknotes, as well as rupiah processing service companies registered with Bank Indonesia.

g On 8 May 2017, the government issued Government Regulation in Lieu of Law No. 1 Year 2017 on Financial Information Access for Tax Purposes. This regulation is issued to support Indonesia's commitment through AEoI that implements the use of CRS. According to this regulation, the Directorate General of Taxation is authorised to obtain transparent access to financial information stored in financial service institutions such as banking, capital market, insurance, or other financial service institutions for the purpose of taxation.

h On 20 July 217, Indonesia's central bank issued Regulation No. 19/9/PBI/2017 on Commercial Paper Issuance and Transactions in the Money Market. Based on this Regulation, non-bank companies can issue commercial paper maturing in one year or less and trade the notes in the secondary market. The new Regulation will take effect on 4 September 2017.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

Formal restructurings are initiated through courts and governed by the Bankruptcy Law Number 37 of 2004 on Bankruptcy and Suspension of Payment (the Bankruptcy Law). The Bankruptcy Law provides an opportunity for borrowers to enter into debt restructuring by applying for a suspension of payment obligations, as well as the option to apply for bankruptcy.

i Payment obligations

Suspension of payment obligations

Both a borrower who has more than one lender and a lender can apply for a suspension of payment obligations. However, it should be noted that for certain lines of business (such as banks), only Bank Indonesia has the right to apply for the suspension of payment obligations. The Financial Services Authority is the only institution that may initiate suspension of payment obligations against security companies the Stock Exchange, the Clearing Guarantee Institution and the Central Securities Depository, while the Minister of Finance will be the only authority that may initiate suspension of payment obligations against insurance and reinsurance companies, pension funds and state-owned enterprises that involve the public interest.

Although there are no mandatory features of a suspension of payment obligations, as mentioned above, the approval of the lenders and the Commercial Court is required before the plan becomes effective.

Formal restructuring will be applicable in respect of both secured and unsecured lenders. Upon receipt of a petition for formal restructuring (voluntary suspension of payment obligation) submitted by a borrower or a lender, the Commercial Court will immediately issue an order for the temporary suspension of payment obligations by the borrower. Following that, the administrator will convene a meeting of lenders to vote on a proposed composition plan, or the conversion of the temporary suspension of payment obligations into a permanent suspension of payment obligations, and the duration of the suspension. The meeting of lenders must be held within 45 days from the date the Commercial Court approved the temporary suspension of payments. The lenders may supervise the implementation of the court decision by granting a permanent suspension of payments for a period that shall not exceed 270 days from the date of the court decision.

The plan must be approved by:

a more than half of the unsecured lenders present at the meeting who represent at least two-thirds of the total unsecured debts of the lenders who attend the meeting; and

b more than half of the secured lenders present at the meeting who represent at least two-thirds of the total secured debts of the lenders who attend the meeting.

In the event that the plan is not approved, or the borrower fails to comply with the provisions of an approved plan, the supervisory judge will inform the Commercial Court, which will issue a further order declaring the borrower bankrupt. There is no avenue of further appeal against such a decision.

A suspension of payment cannot be applied for with regard to:

a secured lender's receivables;

b debt incurred and payable in relation to maintenance fees, supervisory fees or school fees. The supervisory judge must determine the total outstanding accounts payable that do not have preferential rights prior to the suspension of payment; and

c accounts payable with preferential rights.

To ensure that bankruptcy cases are handled efficiently and transparently, the supervisory judge has the authority to request information on ongoing cases from the receivers and oblige the receiver to submit a working schedule at a creditor's meeting. If the receiver fails to provide information relating to the case after receiving two requests from the judge, or fails to adhere to the working schedule, then the supervisory judge has the authority to:

a summon and request an explanation from the receivers;

b send a written warning to the receivers with copies also being sent to the Association of Receivers and Administrators and the Minister of Law and Human Rights; and

c propose new receivers to the panel of judges in the Commercial Court.

Management during suspension of payment obligations

During a suspension of payment obligations, all corporate actions must be conducted jointly by the administrator and borrower, and liabilities incurred by the borrower without the approval of the administrator after the suspension of payment can only be imposed on the assets of the borrower as long that they have benefit over the borrower's assets. A new loan can be obtained provided that it will increase the value of the borrower's assets. The borrower can also impose its assets with security rights such as a mortgage, fiduciary security or pledge, provided that these assets are free of encumbrances and such action has been approved by the supervisory judge.

ii Informal restructuring initiatives

Informal restructuring initiatives are implemented out of court in the following forms:

a reschedule of the terms of payment;

b debt-to-equity swap;

c sale of business; and

d voluntary liquidation of a company.

Reschedule of the terms of payment

Restructuring of only the debt or equity structure is common practice in Indonesia. The general approach is for a company to reschedule debt that it can service, for example, in tranches with a grace period on principal repayment and concessional interest rates. The portion of debt that is not serviceable is normally dealt with in a number of ways, such as subordination, convertible bonds, straight equity conversion, warrants or debt forgiveness.

Rescheduling of the terms of payment is implemented by dividing the outstanding loan into tranches that are either sustainable or unsustainable. Sustainable tranches can be paid over the short term or even in cash. Unsustainable tranches can be paid over a longer period of time. Securities can also be increased to include new securities if necessary, depending on the amount of the outstanding loan.

Debt-to-equity swap

This option is usually taken if the borrower is not able to repay its loan but there is a possibility that it will be able to improve its financial condition in the future.

Some of the advantages of debt-to-equity swaps are that the company will be released from interest expenses and the lenders will have the opportunity to receive dividends.

Notwithstanding these advantages, the disadvantages of debt-to-equity swaps include the fact that the lender will lose its rights over the securities and its priority rights because shareholder loans are considered subordinated loans; and that shareholders cannot file a bankruptcy petition against their own company.

It should be noted that the following problems can arise in debt-to-equity swaps:

a if there are restrictions under the regulations in Indonesia for foreign shareholders to hold shares in a particular line of business in accordance with the negative list of investment issued by the government, then a foreign shareholder cannot hold the shares in the company; and

b if the company is a publicly listed company, and the debt-to-equity swap transaction is not approved by the shareholders because the debt-to-equity swap transaction will cause dilution of the existing shareholders.

Sale of business

The main objective of such restructuring is to separate or insulate the viable parts of businesses from the non-viable operations of an insolvent company or group of companies. This restructuring can be implemented in a situation where a restructuring within the same legal entity is no longer possible from the lender's point of view.

Voluntary liquidation of a company

There are two types of liquidation in Indonesia: voluntary liquidation by shareholders of a company and a forced liquidation initiated by lenders.

Voluntary liquidation will be adopted by the shareholders through an extraordinary general meeting of shareholders. In a voluntary liquidation, after it is announced by the liquidator in the newspapers, the lenders may have the right to register their claims to the liquidator, and the lenders may also object to the distribution plan proposed by the liquidator. If claims or objections registered by the lenders within a period of 60 days from the date of such announcement have been rejected by the liquidator, the lenders may lodge a civil lawsuit to the relevant district court within a period of 60 days from the date of such rejection. If the lenders have not registered their claim during the liquidation process, they still may lodge their claim to the relevant district court within two years after the closing of the liquidation process, with the condition that there are still remaining assets to be distributed to the shareholders.

All of the workout arrangements explained above can be worth considering by lenders if the borrowers agree to and are cooperative about restructuring their debts, and the lenders will have the opportunity to recover their receivables after the implementation of the transaction.

iii General issues with restructuring

The gap between the expectations of the borrower and the lender often leads to initial negotiations being slow and unproductive. This is accentuated when the borrower and lender have a history of not trusting or cooperating with each other. In this situation, both parties will often make unrealistic demands that impede useful commercial negotiations.

iv Enforcement of security

Indonesian security consists of two types:

a real security rights, which relate to specific assets of a borrower, such as a mortgage on land and a building or hypothec, a vessel, a pledge, a fiduciary transfer and a fiduciary assignment. Real security rights (rights *in rem*) are absolute rights with the following characteristics:
- they have preference (*droit de preference*);
- they pertain only to specific property or goods of a borrower;
- they are exercisable against any parties; and
- they follow the encumbered property of goods in the hands of whoever such property or goods may thereafter be in (*droit de suite*); and

b personal security rights, which relate to a certain (individual or corporate) party that has agreed to provide security for a borrower's debts, such as in personal or corporate guarantees. Personal security rights (rights *in personam*) are rights that establish a direct relationship with a specific (individual or corporate) party, and therefore can only be exercised against that party and assets of that party in general. They create no preference with respect to any particular assets.

Except for a mortgage or hypothec and a fiducia security, most security documents are enforced through normal civil proceedings at court, and are preceded by three demand letters served against the grantor of such security.

Enforcement of a mortgage or hypothec and a fiducia security can be done through a public auction or private sale. The parties may choose a private sale if this method will result in the highest price benefiting all parties. A private sale must be announced in two local newspapers at the place of the assets, and the sale can only be conducted one month after such publication and provided that there is no objection from any parties to such intention.

Bankruptcy has no effect on lenders who hold a mortgage, hypothec or fiducia as security (also referred to as secured lenders), except that secured lenders are stayed from enforcing their rights for maximum period of 90 days commencing from the date of the grant of bankruptcy. Once the stay period is lifted, secured lenders are free to enforce their securities, but must do so within two months of the commencement of the state of insolvency or else they will, upon subsequent enforcement of their security, become liable to contribute to the costs of the bankruptcy. The state of insolvency is stipulated in Article 178 Paragraph 1 of the Bankruptcy Law, and will immediately commence when no composition plan has been offered, the composition plan has been rejected or its ratification has been refused by the Commercial Court. Following the state of insolvency, the receiver will distribute the bankrupt estate to the lenders.

v Duties of directors of companies in financial difficulties

Indonesian Law Number 40 of 2007 (the Company Law) has made it mandatory for every Indonesian company to have three organs: a board of directors, a board of commissioners and a general meeting of shareholders.

The board of directors is responsible for the management of the company, while the board of commissioners has the duty to supervise the manner in which the board of directors manages the company in the interests of the company. The general meeting of shareholders consists of shareholders of the company, and has the right to appoint and terminate members of the board of directors and board of commissioners. In addition, there are also corporate actions that require the approval of the general meeting of shareholders.

The board of directors is required to perform the following obligations:

a submit an annual report that also contains the financial statement of the company to the general meeting of shareholders within six months after the end of the financial period. Such annual report must first be reviewed and approved by the board of commissioners;

b submit a business plan that also contains the budget plan for the next financial year prior to the commencement of the new financial year, to be approved by the board of commissioners and general meeting of shareholders;

c prepare and maintain a shareholders register and special register of shareholders that record the ownership of shares in the company and in other companies of the members of board of directors and board of commissioners, as well the ownership of shares of their immediate family members;

d maintain the resolutions of shareholders, the board of directors and the board of commissioners, and all other corporate documents;

e call a general meeting of shareholders as necessary or if based on the request of a shareholder, the board of directors or the board of commissioners;

f obtain approval from the general meeting of shareholders before conducting corporate action that requires approval from the shareholders;

g notify the Minister of Law and Human Rights of any change in the composition of the board of directors and the board of commissioners or the shareholders within 30 days from the date of the shareholders' resolution approving the change;

h record any transfer or pledge of shares in the shareholders' register;

i notify lenders should there be any reduction in the capital of the company, and publish such notification in at least one newspaper within seven days after the date of the shareholders' resolution approving such reduction;

j in a merger, acquisition or consolidation, the board of directors has the obligation to prepare a transaction plan and announce the proposed transaction in newspaper; and

k in a liquidation, in addition to the announcement of such liquidation, the board of directors can also act as the liquidator of the company.

Each member of the board of directors will be jointly and severally liable for losses suffered by the company or shareholders if he or she violates the articles of association, or the prevailing laws and regulations; or if he or she fails to comply with his or her duties, or in the event the company has been declared bankrupt because of the fault or negligence of the board of directors and the assets of the company are not sufficient to cover the losses incurred in the bankruptcy.

It should be noted that a director will not be held personally liable if he or she can prove that:

a he or she has managed the company prudently, in good faith and in accordance with the objectives and purposes of the company, the articles of association and the prevailing laws and regulations;

b the loss suffered by the company is not a result of his or her wrongful actions or failure to comply with his or her duties, where he or she do not have any conflict of interest with the management of the company that causes the loss, and he or she has taken all necessary action to prevent such loss occurring; and

c in the occurrence of the bankruptcy of the company, the director can prove that he or she has managed the company prudently and in good faith, and the bankruptcy has not occurred as a result of his or her negligence or fault, and he or she has taken all necessary actions to prevent the occurrence of the bankruptcy.

If a company has been declared bankrupt, the board of directors is no longer entitled to manage the company, and the authority to manage the bankruptcy estate will be assigned to a receiver designated by the Commercial Court. However, in the case of a suspension of payment obligations, the board of directors must jointly manage the company with an administrator appointed by the Commercial Court.

The board of commissioners has duties to supervise the company, and to give advice to the board of directors in the interest of the company and according to the purposes and objectives of the company. The duties of the board of commissioners include reviewing the annual report and approving the budget plan prepared by the board of directors, as well as reporting on the performance of their duties to the shareholders during the annual general meeting of shareholders.

Each member of the board of commissioners will also be jointly and severally liable for losses suffered by the company if he or she fails to perform his or her duties prudently and in good faith, except if he or she can prove that:

a he or she has conducted the supervision of the company prudently and in good faith, and in accordance with the objectives and purposes of the company, the articles of association and the prevailing laws and regulations;

b he or she does not have a personal interest in the management of the company that causes such loss;

c he or she has advised the board of directors to take all necessary actions to prevent the occurrence of the loss; and

d in the occurrence of bankruptcy, he or she can prove that the bankruptcy was not due to his or her fault or negligence, and he or she has carried out his or her supervision duties prudently and in good faith, and he or she has taken all necessary actions to prevent the occurrence of the bankruptcy.

vi Clawback actions

The Bankruptcy Law allows that certain transactions made prior to the bankruptcy that favour one lender over another can be annulled. Article 41 of the Bankruptcy Law provides that voluntary transactions (that is, transactions entered into without any contractual obligation to do so) of the borrower undertaken one year before the declaration of bankruptcy that cause

a loss to the lenders may be nullified if it can be proved that, at the time of the transaction, the borrower and the counterparty knew or should have known that the transaction would cause a loss to the lenders.

If a transaction is annulled, all assets of the borrower received by the counterparties to the transaction must be returned to the bankrupt estate.

A transaction that the borrower is contractually obliged to perform can be annulled if, at the time of the transaction, the lender knew that a bankruptcy petition was pending and that the transaction was a result of collusion between the parties.

III RECENT LEGAL DEVELOPMENTS

The Minister of Law and Human Rights issued Regulation No. 2 of 2017, which is an amendment to Regulation No. 11 of 2016 on Guidelines for Determining Fees for Receiver and Administrators. In this amended regulation, the government has reduced the amount of fees to be received by: (1) an administrator in the case of suspension of payment obligation, and (2) a receiver if a bankruptcy ends with insolvency.

IV SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND MOST ACTIVE INDUSTRIES

Based on data published on the website of the Commercial Court of Jakarta, during 2016 there were 140 cases of suspension of payment obligations, and from January 2017 to the end of June 2017, there were 98 applications for suspension of payment obligations at the Commercial Court of Jakarta.

In practice, suspensions of payment obligations are followed by debt restructuring, and it is common practice that the lender and borrower agree to reschedule the terms of the payment of the loan or exercise a debt-to-equity swap, or to a combination of these two options.

V INTERNATIONAL

As it is not a Member State of the EU, the EC Regulation is not applicable in Indonesia. Nor has the country adopted the UNCITRAL Model Law.

Submission to and a judgment of a foreign court will not be enforceable by the Indonesian courts unless there is a bilateral treaty between Indonesia and the country in which the judgment was rendered. To date, no bilateral treaties have been signed by Indonesia to enable the enforcement of a foreign judgment in Indonesia. A non-Indonesian judgment may, however, be given such evidentiary weight as an Indonesian court considers appropriate, and a re-examination of the issues de novo would be required before an Indonesian court to enforce a claim in Indonesia that is the subject of a foreign judgment.

However, Indonesia has ratified the 1958 New York Convention and promulgated Supreme Court Regulation No. 1 of 1990 in conjunction with Law Number 30 of 1999 on Arbitration and Alternative Dispute Resolutions, which is the implementing regulation for the recognition and enforcement of foreign arbitral awards.

Enforcement of international arbitration awards can only be handled by the Central Jakarta District Court. International arbitration awards will only be recognised and enforced in Indonesia if they fulfil the following criteria:

a the international arbitration award is rendered by an arbitrator or arbitration panel in a country that is bound to Indonesia by a bilateral or multilateral treaty on the recognition and enforcement of international arbitration awards;

b the international arbitration awards are limited to awards that are included within the scope of commercial law under Indonesian law;

c international arbitration awards that may be only enforced in Indonesia are limited to those that do not conflict with public policy;

d an international arbitration award may be enforced in Indonesia after obtaining a writ of execution from the Chairman of the Central Jakarta District Court; and

e international arbitration awards that involve Indonesia as one of the parties to the dispute may only be enforced after obtaining an *exequatur* from the Supreme Court of the Republic of Indonesia, which will then delegate it to the Central Jakarta District Court.

No appeal or cassation to the Supreme Court may be made against a decision of the Chairman of the District Court of Central Jakarta who recognises and enforces the international arbitration award. However, a cassation to the Supreme Court may be made against a decision of the Chairman of District Court of Central Jakarta for refusing to recognise and enforce and international arbitration award.

After the Chairman of the Central Jakarta District Court has issued the writ of execution, further enforcement will be delegated to the chairman of the district court that has jurisdiction to enforce it.

VI FUTURE DEVELOPMENTS

There is no legislation on restructuring pending in Indonesia. In view of the country's current economic climate, it is possible that the amount of non-performing loans will increase, resulting in a rise in the amount of debt restructuring either through formal or informal procedures. This is reflected in the growing number of applications for suspension of payment obligations at the Commercial District Court during the past year.

Appendix 1

ABOUT THE AUTHORS

PHEO M HUTABARAT

Hutabarat, Halim & Rekan

Pheo M Hutabarat is one of the founding partners of Hutabarat, Halim & Rekan. His areas of specialisation encompass capital markets and securities; banking and finance; project finance; energy and natural resources; corporate and investment; mergers and acquisitions; insolvency and corporate reorganisations; commercial disputes and litigation; real property; franchise, agency and distribution; and manpower and human resources.

Mr Hutabarat is a licensed capital market legal consultant and a licensed advocate in Indonesia. He is a member of the Indonesian Association of Capital Market Legal Consultants, the Association of Indonesian Advocates, INSOL International, the International Bar Association and the Inter-Pacific Bar Association.

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Rosna Chung is a partner at Hutabarat Halim & Rekan and leads the banking and finance and capital markets and securities practice groups. In addition, her areas of specialisation also encompass real property and land; corporate matters and foreign investment; mergers and acquisitions; and insolvency.

Ms Chung is a member of the Indonesian Association of Capital Market Legal Consultants and is licensed as a capital market legal consultant. She is also a licensed advocate and a member of the Association of Indonesian Advocates. In addition, Ms Chung is a licensed receiver and administrator, and is a member of the Indonesian Receiver and Administrator Association. In the international sphere, she is a member of INSOL International and IR Global.

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