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Corporate M&A

Indonesia: Trends & Developments

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Trends and Developments

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Overview of the Indonesian Market

Indonesia is a country with enormous economic resources (both human and natural). In December 2019, the World Bank reported that Indonesia, a diverse archipelago nation of more than 300 ethnic groups and the world's fourth most populous nation, was the largest economy in Southeast Asia and had charted impressive economic growth since overcoming the Asian financial crisis in around 1998. Indonesia's GDP has steadily risen, from USD823 in 2000 to USD3,932 in 2018.

The above facts make Indonesia very attractive to investors. The statistics of the Indonesia Investment Co-ordinating Board (*Badan Koordinasi Penanaman Modal* or BKPM) recorded 126 different countries of origin for investors in Indonesia, contributing a total of USD28.2 billion derived from 30,354 investment projects realised in Indonesia in 2019. Singapore, China, Japan, Hong Kong, Netherlands, Malaysia, South Korea, the USA, British Virgin Islands and Australia are the top ten countries of origin in terms of number of realised investment projects and investment amount. The total investment realisation in 2019 increased approximately 12.2% from the same period in 2018, which is almost a tripling of the 4.1% increment in 2018 compared to 2017.

Indonesia's 2020-24 Infrastructure Development Plan

With a strong commitment from the incumbent Indonesian government, led by President Joko Widodo (or Mr Jokowi), to continue accelerating multiple aspects of development, focusing on infrastructure and human resources in Indonesia, many believe Indonesia has years of sustainable economic and investment growth ahead.

Prior to assuming his first term of office in 2014, Mr Jokowi committed to developing infrastructure in various area of Indonesia as one of his government's main focuses. That commitment was implemented in a 158.4% increase in infrastructure spending during Mr Jokowi's first term. For his second five-year term, Mr Jokowi remains highly committed to accelerating Indonesia's infrastructure development, as can be shown in the 2020-2024 National Medium-Term Development Plan. The Indonesian government's main infrastructure projects include the construction of 58 new water-dams, 2,000 km of toll roads, seven new seaports, 25 new airports, and the completion of a 35,000 MW power project (the Fast Track II programme). These ambitious infrastructure development plans call for approxi-

mately USD412 billion in investment, which will be financed by the Indonesian government (40%), state-owned enterprises (25%), and the private sector (35%). For 2020 alone, the budget for infrastructure has been increased by 4.9% (IDR423.3 trillion compared to IDR399.7 trillion in 2019). The increases in the 2020 budget for infrastructure are mainly allocated to road infrastructure projects aimed at the completion of 837 km of road construction, as well as 6.9 km of spanned bridges, 238.8 km of railway track construction, three new airports, 49 water-dams, and 5,224 low-cost apartment units and 2,000 houses for low-income citizens by the end of 2020.

In addition, Mr Jokowi confirmed the plan to relocate the capital city of Indonesia from Jakarta to East Kalimantan. The Indonesian Minister of Public Works and Housing, Basuki, announced that the ground breaking is planned to take place in the fourth quarter of 2020. It is planned that the new capital will be built on approximately 180,000 hectares of state land, this will, obviously, require massive infrastructure projects.

Considering the Indonesian government's progressive plans, outlined above, Mr Jokowi's Minister of Finance, Ms Sri Mulyani, has publicly invited co-operation between private companies and state-owned enterprises through development financing requirements, and she aims to receive funding of approximately IDR19.7 trillion from the private sector through public-private partnerships (PPPs).

Foreign Investment – M&A

Indonesian law requires foreign investment to be conducted through an Indonesian limited liability company (PT), with an exception for upstream oil and gas and construction services, which can be done through a direct joint operation between foreign entities and local entities. As a result, the number of cross-border M&A transactions in Indonesia is continuously increasing. The BKPM records that, foreign direct investment contributes more than 50% of total investment realisation in Indonesia.

General foreign investment in Indonesia is regulated under investment laws and regulations, with the BKPM as the government authority authorised to, and responsible for, supervising the investment. Investment in certain sectors – such as banking, financial institutions, insurance, mining, and oil and gas – is subject to separate regulatory regimes. Most investment licences

are now processed by the BKPM through the so-called “online single submission (OSS) system”, a centralised and electronically integrated business licensing system introduced by the Indonesian government in mid-2018, which has proven to be more efficient and transparent.

The Indonesian government issues, from time to time, the so-called “negative list”, which classifies foreign investment in certain lines of business – also known as *Klasifikasi Baku Lapangan Usaha Indonesia* or KBLI – as either prohibited, or subject to greater scrutiny and restrictions. This includes limitations on foreign ownership, requirements for local partnership, limited permitted locations, and requirements for special licences. Under the prevailing negative list, a “distributor not affiliated with production” is limited to a maximum 67% foreign ownership (previously 33%) and freight forwarding is limited to 67% foreign ownership (previously 49%). E-commerce is now open for 100% foreign investment within a partnership scheme.

An exemption to the limitations set out under the negative list applies for indirect or portfolio investments made through the Indonesian Stock Exchanges. Portfolio investment is not defined by the regulation but, in practice, it is generally accepted that it means minority investment through capital markets without control, and where only intended for capital gain.

Funding

The traditional funding alternatives are bank loans, shareholders loans, corporate bonds, warrants or initial public offering. For early stage (start-up) companies, the recent trend of funding alternatives includes investments from ultra-high net worth individuals and crowdfunding platforms. Prominent sources of funding for growth-stage companies include large cap private equity houses and other tech giants, investing directly or indirectly through venture capital funds. There is also a trend for investment in fintech companies fuelled by big conglomerates, eg, Lippo-backed OVO and EMTEK-backed DANA.

In the final quarter of 2019, the news reported that Kredivo, a P2P lending platform, secured debt funding of USD20 million from Partners for Growth V, L.P. (PFG); and that Modalku received debt financing from Netherlands-based Triodos Investment Management. Another 22 funding rounds for fintech start-ups were announced and approximately USD100 million in total disclosed amounts were reported in November 2019. Most of this was injected by venture capital or private equity firms.

Closing Structure of Private M&As

The tools and techniques used in foreign direct investment (private M&A) depend on the characteristics of the business of the target and the negotiating circumstances of the parties.

A locked-box mechanism is more common for transactions involving companies with dynamic business activities and a wide range of customer portfolios, such as banks or multi-finance companies.

An escrow is common for specific deals where certain conditions or procedures are to be fulfilled by the buyer and seller within the same timeframe or in interconnected deals which require payment to be fully paid up/made before the other connected deal is completed, or where there is a price adjustment agreed by the parties after the completion.

Another alternative is a price adjustment mechanism, which allows the parties to adjust the purchase price after completion (if, for example, the valuation of the assets/shares decreases).

Fundamental pre-closing conditions, depending on the characteristics of the deal and business line, are: (i) government approvals (if required by specific regulations); (ii) the internal corporate approval of the parties and acquired company; (iii) creditors’ consent; and (iv) announcements to the creditors and employees. Post-closing conditions are more administrative requirements by nature and include, for example, a notification to the authorised government and the creditors and a newspaper announcement. This includes a merger notification report to the Indonesian Antitrust Supervisory Commission (KPPU) when the threshold set under the regulation is met.

Major Issues Affecting M&A Deals

To support the target of infrastructure development, the Indonesian government has introduced various new policies and regulations to ensure a conducive political and economic ecosystem. The sudden change in government policies and/or regulations has profoundly affected Indonesia’s status as a potential target M&A market.

Accordingly, businesses will have to assess the new situation and adapt to the changing regulatory requirements by reconsidering how a deal is structured and which financing strategies will work best for them. Indonesia has quite a unique and complex regulatory and government monitoring system, with multi-layered regulations depending on the type of business, nature of investment, company status (private or public) and geographical location (central or regional).

Furthermore, businesses are generally supervised by the Indonesian government through various government authorities, depending on their business characteristics. For example, general foreign investment in Indonesia is subject to the BKPM’s regime; with the exception of specific types of business, particularly in the banking and non-bank financial institution sectors as well as public companies, which fall within the authority of

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the Financial Services Authority (OJK). To compound the issue, Indonesia adopts a policy of regional autonomy, where local governments have specific authority to regulate specific activities within their territorial jurisdiction. The common issues in many sectors include, among others: (i) the considerable overlap and inconsistency between national and regional regulations; and (ii) the obscurity and multiple interpretations of certain regulatory requirements. Thus, it is very important for investors to solicit full support from local counsel who really understand not only the literal meaning of the relevant regulation but also the practical implications and policies, and those who have the capacity to bridge the communication gap and advise the most appropriate and legally doable structure for the contemplated M&A transaction.

The key regulation applicable to all M&A transactions involving limited liability companies, regardless of the type of business, is Law No 40 of 2007 (and its implementing regulations) concerning limited liability companies.

Recent Regulatory Updates

Significant regulatory updates and changes in 2019 that have a direct impact on foreign investors' interest in Indonesian market are listed below.

New merger control rule

Through the issuance of Regulation No 3 of 2019, the Indonesian Business Competition Supervisory Commission has expanded the scope of the merger report, which initially covered only share acquisition, but now also includes asset acquisition. This being any transfer of assets allowing the acquirer to exercise or increase control in the relevant market. Similar threshold to share acquisition apply: (i) combined assets value, as recorded in the financial statements, exceeding IDR2.5 trillion (or approximately USD178 million); or (ii) combined sales value in Indonesia exceeding IDR5 trillion (or approximately USD357 million).

Enforcement rule of fiducia security

On 6 January 2020, the Indonesian Constitutional Court (the Constitutional Court) rendered a controversial binding decision, namely decision No 18/PUU-XVII/2019 (the Decision), following its judicial review of provisions under Law No 42 of 1999 concerning Fiducia Security (the Fiducia Law) relating to the statutory right to summary execution or self-executory rights vested in creditors (ie, the fiducia security grantees). Initially, the Fiducia Law essentially granted a right to summary execution (*recht van parate executie*) to a creditor, allowing the creditor to immediately sell the security property without obtaining a prior court order. This right is evidenced by the fiducia certificate issued in favour of the creditor as provided in Article 15 (2) of the Fiducia Law, which explicitly stipulates

that the fiducia certificate bears an executory title equivalent to a final and binding court decision. In the Decision, the Constitutional Court found that the right to summary execution vested in the creditor is somewhat partial, whereby the debtor as the fiducia security grantor is deprived of either the ability or the opportunity to defend itself against the "one-way" determination of its default by the creditor. On this basis, to ensure balanced protection for the debtor and the creditor, the Constitutional Court gave a somewhat-stretched interpretation of Article 15 (2) of the Fiducia Law, holding that the executory title contemplated in the fiducia certificate is enforceable and valid only to the extent that: (i) there is a mutual agreement between the fiducia security grantor and fiducia security grantee on the occurrence of default; and (ii) the fiducia security grantor willingly surrenders the security property to the fiducia security grantee or its designated party. Otherwise, the executory title granted under the fiducia certificate is not directly enforceable, and consequently the enforcement of the fiducia security should follow the ordinary security enforcement process through Indonesian civil court proceedings. In line with that, the Constitutional Court also made a limiting constitutional interpretation of Article 15 (3) of the Fiducia Law, holding that either a mutual agreement between the creditor and the debtor or the commencement of legal proceedings (*upaya hukum*) is required to determine the occurrence of the debtor's default.

Insurance – foreign ownership limitation

On 20 January 2020, the Indonesian government enacted Government Regulation No 3 of 2020 (GR 3/2020), amending the previous Government Regulation No 14 of 2018 on Foreign Ownership in Insurance Companies (GR 14/2018). Many believe GR 3/2020 shows a friendlier face to foreign investors and therefore demonstrates the Indonesian government's support of foreign investment. Previously, GR 14/2018 required a private insurance company intending to increase its issued and paid-up capital to ensure that, at least 20% of the additional capital, was subscribed for by Indonesian shareholders or otherwise offered for sale on the stock exchange – resulting in automatic dilution of the existing foreign shareholders with more than an 80% stake (grandfathered foreign shareholders). Through GR 3/2020, the Indonesian government has lifted the above requirement and established a new anti-dilution provision, allowing grandfathered foreign shareholders to subscribe for additional shares in the event of the company's decision to raise its capital, provided that their existing shareholding percentage remains the same or is not increased.

Negative investment list

It has been reported that in order to promote the Indonesian market to foreign investors, the Indonesian government is currently working to replace the current negative list with a more investment-friendly "positive list" to allow a more relaxed

threshold or full foreign ownership in a greater number of business sectors.

Omnibus laws

One of the biggest hurdles in attracting investors to Indonesia is overlapping and contradictory legislation, not only at the central government level but also at the regional level. This situation has caused great confusion and delays to businesses when implementing their investment plans. To improve the country's investment climate, the Indonesian government is planning to introduce two Omnibus Laws, namely: (i) Omnibus Law on Job Creation (*Cipta Kerja*); and (ii) Omnibus Law on Taxation (*Perpajakan*), both intended to serve as "super-integrated" regulations harmonising (by way of amending, revoking, or supplementing) various existing overlapping laws and regulations. With these Omnibus Laws, businesses can simply refer to one or two centralised and integrated regulations when identifying the latest changes to various existing laws and regulations.

The Omnibus Law on Job Creation focuses on the simplification of investment procedures, business licensing, employment (including foreign worker employment and immigration requirements), research and innovation incentive support, land procurement and special treatments to promote the growth of micro, small and medium enterprises. On the other hand, the Omnibus Law on Taxation offers specific tax incentives, including a reduction in corporate income tax (with a further 3% reduction applicable to certain qualified publicly listed companies), and a tax exemption on qualified dividends. Those incentives are intended to reduce the tax expenses of investors and are eventually expected to encourage them to reinvest the extra gains in Indonesia.

Employment – outsourcing rule

In August 2019, the Indonesian government amended several basic rules on outsourcing in Indonesia, which provide a degree of clarity on the registration of outsourcing agreements and the outsourcing business licensing process.

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Luky I. Walalangi is an Indonesian-qualified lawyer, with almost two decades of experience. He has assisted various foreign companies in their complex investments and acquisitions (including assets and portfolio loans acquisitions) and corporate restructurings in Indonesia and

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Hans Adiputra Kurniawan is a bright and talented Indonesian-qualified lawyer, with more than eight years of experience in various banking and finance matters, foreign direct investment, and mergers and acquisitions. He has worked on significant deals in the past few years and earned

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