

# Legal issues: **Indonesia**

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Formal insolvency proceedings and restructurings are recent developments in the legal landscape of Indonesia. As part of the general continuation in force of Netherlands-Indies legislation in existence at Indonesia's independence, Indonesia inherited the Bankruptcy Ordinance, first enacted by the Netherlands-Indies government in 1906. In 1998, the Indonesian government amended the Bankruptcy Ordinance for the first time through Government Regulation In Lieu of Law No. 1, which was enacted by Law No. 4 of 1998 (the "Bankruptcy Law"). When the economic crisis abruptly occurred in 1997, there was an almost complete absence of formal insolvencies in Indonesia for reasons that include:

- ▲ The non-confrontational nature of Indonesian business mores.
- ▲ Perceived difficulties in the administration of justice in Indonesia which ranged from inadequate training of judges to inexperienced litigation lawyers and to more fundamental impediments such as corrupt practices.

In this context, we now examine the collection and restructuring of Indonesian debt.

## 1 Describe the nature and the effectiveness of the following processes:

### a) Civil unsecured debt collection remedies.

The enforcement of unsecured debt commences by filing a claim with the District Court situated at the place where the debtor has its usual place of abode, unless agreed otherwise. However, any District Court judgment is subject to appeal through the Court of Appeals and cassation procedures before the Supreme Court. Thereafter, there is a possibility of civil review before a different chamber of the Supreme Court. This tiered system of appeals can result in a lengthy and expensive judicial process. Pending appeal, no order can be enforced. Therefore, an appeal represents an instrument for debtors to delay the enforcement of a creditor's debt.

An unsecured creditor can also petition for the debtor's bankruptcy in the Commercial Court, the procedure and consequences of which are considered in Section 1d.

### b) Secured property enforcement remedies.

Security over assets in Indonesia is generally taken by the following means:

- ▲ A mortgage (known as *hak tanggungan*) over immovable property.
- ▲ A fiduciary transfer of ownership for security purposes on movable property.
- ▲ A pledge over movable property.
- ▲ A fiduciary assignment for security purposes over intangible property.

While in principle enforcement of a creditor's security may be undertaken without recourse to the courts, practice is different:

- ▲ A mortgage holder enjoys the right of direct execution without writ of execution. However, unless the debtor agrees to the auction, the Auction Office, which conducts and supervises the public auction, inevitably requires a court order for the auction.
- ▲ In the absence of cooperation from the debtor, the creditor has to institute legal proceedings to reclaim possession of the goods subject to a fiduciary transfer, after which the goods must also be sold in a public auction.
- ▲ As a pledge requires the pledged property to be brought outside of the possession of the pledgor, re-possession of pledged property is normally less problematic, although pledged goods must also be auctioned after repossession.
- ▲ In order to enforce a fiduciary assignment of receivables, each debtor of a receivable must be notified to pay the assignee, and the creditor's only recourse against a debtor who disregards such notification is to institute legal proceedings against it.

The court proceedings to foreclose on secured assets are substantially the same as for the enforcement of unsecured debt detailed in the first paragraph of Section 1a with the attendant disadvantages.

c) Any special debt collection or secured property remedies that are available to banking sector creditors?

There is no effective system of summary judgment proceedings in cases involving a legitimate dispute as to the validity and amount of the debt. The Indonesian Bank Restructuring Agency has widespread powers to recover assets of the banks under its supervision.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors?

Under the Bankruptcy Law, one or more creditors may file for the debtor's bankruptcy once the following test for bankruptcy is satisfied:

- ▲ The debtor must have at least two creditors.
- ▲ The debtor must have failed to pay at least one of its debts which has become due and payable.

If the debtor is a bank, only Bank Indonesia (the central bank) may petition for its bankruptcy and if the debtor is a securities company, only BAPEPAM (the Capital Markets Supervisory Board) may so petition. A bankruptcy petition may also be filed by the debtor itself or, if the public interest so requires, the Public Prosecutor.

In reality, the Commercial Court has so far not consistently interpreted this bankruptcy test. Some examples to date include:

- ▲ Not recognizing that the debt was due and payable even when the loan had been accelerated because the final repayment date had not occurred.
- ▲ Not recognizing debt under a swap transaction as valid debt for these purposes.
- ▲ Disallowing an unpaid claim for damages to be the basis of a bankruptcy filing.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

Only one formal corporate rescue process is available, namely the suspension of payments (moratorium) under Chapter II of the Bankruptcy Law. The Commercial Court is required under law to grant a petitioning debtor provisional moratorium and to appoint a Supervisory Judge and an administrator to assist the debtor in managing its estate. The debtor will still be entitled to manage and dispose of its assets jointly with the administrator.

The Commercial Court is required to call a meeting of the unsecured creditors within 45 days of the grant of a provisional moratorium. At this meeting, the unsecured creditors must either approve the composition plan (or rescue package), assuming that such a plan is submitted to the Commercial Court by the debtor, or agree to convert the provisional moratorium into a permanent moratorium for a period of up to 270 days from the date of grant of the provisional moratorium. The decision requires the affirmative votes of more than half in number of the unsecured creditors who are present in the meeting, who represent at least two thirds of the amount of the unsecured claims of the unsecured creditors present at the meeting. If no plan is submitted and the unsecured creditors fail to extend the moratorium, the bankruptcy will be pronounced.

No later than 14 days after acceptance of the plan by the unsecured creditors, the Commercial Court must decide whether or not to ratify the plan. Dissenting creditors may express their views against the plan. The Commercial Court may refuse to ratify the plan only on limited grounds, which include:

- ▲ If the implementation of the plan is not adequately assured (e.g. the debtor's assets are clearly inadequate to support the distribution to the creditors).
- ▲ If the plan was concluded fraudulently or under undue influence of certain creditors.

A composition plan, once ratified, becomes final and binding on the unsecured creditors. A plan can be submitted only once, and if rejected by the unsecured creditors, or not ratified by the Commercial Court, bankruptcy will immediately be pronounced and all the debtor's assets will be liquidated thereafter.

During a suspension of payments, the debtor is only excused from making payments to its unsecured creditors. However, if the debtor fails to pay the secured creditors during this period, secured creditors are unable to enforce security rights, as they will inevitably be subject to a stay of proceedings for the same period as the moratorium.

**f) Informal corporate rescue processes.**

Given the enforcement difficulties highlighted above, the preferred route of creditors tends to be negotiation on a private basis with co-operative Indonesian debtors.

In order to facilitate such restructuring negotiations, the Jakarta Initiative Task Force (“JITF”) and the Financial Section Policy Committee (“FSPC”) were established. The JITF mediates in debt-restructuring negotiations among Indonesian debtors and their creditors, and has drawn up mediation rules for that purpose. It has the authority to require Indonesian debtors to participate in the mediation and to report unco-operative debtors to the FSPC, who may in turn request the Attorney General to file for the debtor’s bankruptcy. In practice, the JITF has considerable leeway to conduct the restructuring negotiations in a manner it deems appropriate.

**g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.**

There are no other corporate insolvency related processes available under special legislation.

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**2 What is the effect upon debt enforcement and secured property enforcement processes of:**

**a) An adjudication of corporate bankruptcy/liquidation?**

The general rule on distributing the proceeds of a bankrupt’s estate is one of equality of creditors, subject to statutory priority rights of certain categories of creditors.

First in priority are specific statutorily preferred creditors whose preference relates only to specific assets. After such creditors have been paid, general statutorily preferred creditors (e.g. employees, inland revenue, etc.) are paid from the proceeds of the bankrupt’s estate. Finally, the unsecured creditors receive their *pro rata* share of the remaining proceeds, if any. Note that the cost of the bankruptcy is shared *pro rata* among the statutorily preferred creditors and the unsecured creditors.

The general rule is that secured creditors may enforce their security rights as if there were no bankruptcy, subject to any applicable stay of enforcement. If a secured creditor fails to enforce its security within two months after the date on which the bankruptcy enters the liquidation phase, the secured creditor will be liable to share in the bankruptcy costs.

**b) The commencement of a formal corporate rescue process?**

The requirements on the debtor, the processes involved during this period and the effects of the moratorium on unsecured and secured creditors are described in Section 1e.

**c) The initiation of an informal corporate rescue process?**

In theory, creditors are entitled to exercise their legal remedies (including taking court action) against a debtor during restructuring/rescheduling negotiations. However, in practice, a “cooling-off” period of at least a few weeks after negotiations have irretrievably broken down is recommended. This is to alleviate the risk that the courts may refuse enforcement action on the grounds that the creditor is still engaged in negotiations with the debtor.

If the JITF is involved in mediating the negotiations, the end result will be one of the following: i) the parties will reach a negotiated solution, or ii) the mediator will determine that no mutual agreement can be reached. If the latter is the case, a final mediation meeting is then held, at which the parties may attempt to resolve outstanding disputes. If the parties cannot come to an agreement within 30 days of the final mediation meeting, the JITF will circulate its final mediation report to the parties, and may also file that report with the FSPC. The parties may introduce the final

report in any legal proceedings. The FSPC may refer the final report to the Attorney General to institute bankruptcy proceedings where the debtor has acted in bad faith during the mediation. Parties involved in a JITF mediation can only terminate the JITF mediation by mutual agreement.

d) **The initiation of an insolvency, or insolvency-related, process under any special legislation.**

The debtor may apply for a provisional moratorium. The Commercial Court is required by law to grant this provisional moratorium, and is further required to call a meeting among the debtor's unsecured creditors within 45 days (see Section 1e).

If the debtor does not apply for a provisional moratorium following a petition by a creditor for its bankruptcy, it will be declared bankrupt if it fails to successfully contest the petition.

Secured creditors can enforce their rights as if there were no bankruptcy. However, many secured creditors will tend not to embark on enforcement proceedings before the general courts that will inevitably be stayed upon the imposition of a suspension of payments, or the declaration of bankruptcy. In fact, the initiation of bankruptcy proceedings can be advantageous to the secured creditor, as it should entitle a secured creditor to enforce security in the Commercial Court, thus avoiding the time delays associated with appeals in the general courts.

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3 **What is the effect on the management of a corporation of:**

a) **An adjudication of corporate bankruptcy/liquidation?**

The debtor company and its directors lose the right to manage and dispose of its assets (see Section 4a for more details).

b) **The commencement of a formal corporate rescue process?**

Upon the grant of a suspension of payments, the debtor's directors retain their powers to manage and dispose of its assets, provided that such powers are exercised jointly with the appointed administrator.

c) **The initiation of an informal corporate rescue process?**

During rescheduling/restructuring negotiations, the board of directors retains full management control of the debtor. However, creditors will often require, in consideration of temporarily suspending their enforcement rights, the establishment of monitoring arrangements, cash-flow escrow arrangements, creditor approval for material expenditure, new indebtedness, payment of dividends and/or the creation of security over assets.

d) **The initiation of an insolvency, or insolvency-related, process under special legislation?**

The transfer of management duties and powers to a receiver may be granted by an interim order of the Commercial Court immediately after a bankruptcy petition has been filed, if the danger of embezzlement can be shown to exist.

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4 **Who is responsible for "case management" control and administration:**

a) **A corporate bankruptcy/liquidation?**

The receiver is responsible for the full administration and control of the bankruptcy. The Supervisory Judge generally oversees the performance of the receiver's duties and must grant approval with respect to certain material transactions, such as termination of contracts and sale of assets. The Supervisory Judge will also hear petitions from the creditors and the debtor relating to the actions of the receiver.

The Commercial Court may appoint a creditors' committee to advise the receiver. If the receiver does not follow the committee's recommendation, the committee may appeal to the Supervisory Judge for a ruling on the matter.

In addition, a creditors' meeting must be convened when so requested by at least five unsecured creditors representing at least 20 percent of the aggregate admitted unsecured claims. Generally, proposals at a creditors' meeting will be adopted if approved by more than one half of the votes cast, with a creditor having one vote for every Rp10 million of debt.

**b) A formal rescue?**

Please refer to Section 3b above.

**c) An informal rescue?**

If negotiations are conducted within the JITF framework, a Senior Case Manager will be assigned to the matter. This person will conduct preliminary meetings to report on the suitability of the case being submitted to mediation and the issues to be mediated. The JITF will then appoint a permanent mediator to oversee the mediation process.

The permanent mediator is in charge of the negotiation, decides when accelerated dispute resolution would be appropriate, and has ultimate responsibility for producing the final mediation report referred to in Section 2c above and calling the mediation process to a close in the absence of timely agreement.

**d) A case of corporate insolvency under any special legislation?**

There is no other special legislation that applies in these circumstances.

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**5 Who has the responsibility for the preparation of the plan of rescue under:**

**a) A formal rescue?**

The debtor must submit a rescue plan during the moratorium period, failing which it will be declared bankrupt. The plan may be pre-negotiated with creditors holding the majority of its unsecured debt required to approve the plan (see Section 1e). Once negotiations are concluded with an undertaking from such unsecured creditors that they will approve the plan, the debtor can proceed to file for a suspension of payments and present the pre-negotiated plan for approval by the unsecured creditors.

There are no specific regulations governing the content of a composition plan, which may include elements of debt cancellation, debt rescheduling, "cash-sweeps", convertible debt and/or conversion of debt into equity. The precise contents will be determined by negotiation.

The Bankruptcy Law provides that only the unsecured creditors are entitled to vote on the composition plan. However, if the secured assets are valuable to the continuing business of the debtor and/or the plan will depend on the revenue generated by the secured assets, then in a pre-negotiated composition plan, the secured creditors are likely to be involved in the negotiations and, if it is to be successful, in practice, would have to be in agreement with the plan.

**b) An informal rescue?**

Outside the suspension of payments process, restructuring plans will require the approval of all creditors whose debts are involved in the restructuring, unless the documentation which evidences the debt provides otherwise.

**c) A case of corporate insolvency under any special legislation?**

There is no other special legislation that applies under these circumstances.

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**6 How are the different classes of creditors treated in relation to:**

**a) A corporate bankruptcy/liquidation?**

Unsecured creditors rank behind statutorily preferred creditors. Secured creditors can continue to enforce their rights as if there is no bankruptcy, subject to an automatic 90 days' stay commencing from the date of the bankruptcy declaration. Once the stay is lifted, the secured creditor is free to enforce its security, and must do so within two months after the commencement of the liquidation phase of the bankruptcy. Otherwise, it will be liable to contribute to the bankruptcy costs.

b) A formal rescue?

Section 5a sets out the respective rights of unsecured and secured creditors to approve a composition plan presented in a suspension of payments.

c) An informal rescue?

During restructuring/rescheduling negotiations, the secured and unsecured creditors are entitled to enforce their rights unless they have entered into a standstill or similar agreement with the debtor. Each creditor is also entitled to demand payment from the debtor of its debts. However, this may result in the payment to only some of a debtor's creditors, which may jeopardize restructuring discussions and can in specific circumstances be invalidated if bankruptcy ensues.

d) A case of corporate insolvency under any special legislation?

No such special legislation applies under these circumstances.

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7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

Unsecured creditors who voted against an approved composition plan are, subject to ratification by the Commercial Court, bound by the terms of the plan. Legally, the original terms of the debt are amended to reflect the terms of the composition plan.

A secured creditor is entitled to enforce its rights as if there is no bankruptcy, and will theoretically have no say in the composition plan. However, a debtor may ensure that its secured creditors agree to the plan in circumstances discussed in Section 5a.

b) An informal rescue?

The restructuring plan must be approved by all creditors whose debts are involved in the restructuring (unless relevant credit documentation provides otherwise). Any dissenting creditor is not bound by the restructuring and can file for the debtor's bankruptcy.

c) A case of corporate insolvency under any special legislation?

There is no other special legislation that applies under these circumstances.

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8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?

When a company is in financial difficulties, the cost of working capital funding inevitably increases and will likely require the giving of security by the company. When a company is in suspension of payments, it is entitled to borrow new funds and can provide security for such financing with the approval of the administrator. Such security would rank behind existing security on the same assets only. These new lenders enjoy a position of advantage in that they are not subject to the moratorium and must be paid in full when the debts fall due.

b) An informal rescue?

Outside of the suspension of payments regime, there is no rule that new financing will be treated with any priority if the company later applies for suspension of payments.

c) A case of corporate insolvency under any special legislation?

There is no other special legislation that applies under these circumstances.

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9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation?

Certain transactions favoring one creditor over other creditors can be annulled by an "*actio Pauliana*". The test for whether a pre-bankruptcy transaction can be annulled is as follows:

- ▲ The transaction qualifies as a legal act, was voluntarily undertaken, i.e. without contractual obligation to do so and has had a detrimental effect to the creditors.

- ▲ The parties to the transaction knew or should have known that the transaction was prejudicial to the creditors.

There is a rebuttable statutory presumption that such knowledge exists if the transaction was performed within one year prior to declaration of bankruptcy and was:

- ▲ At an undervalue.
- ▲ For the granting of security for debts which are not yet due.
- ▲ Entered into between the debtor and certain related parties.

The payment of a debt due and payable may be annulled if it is shown either that the creditor knew that a bankruptcy petition was pending, or that the payment was the result of collusion between the debtor and the creditor.

**b) A formal rescue?**

The test for invalidating an antecedent transaction by an “*actio Pauliana*” is the same as in Section 9a above. However, there is no rebuttable presumption of knowledge of prejudice otherwise available in a formal bankruptcy.

**c) A case of corporate insolvency under any special legislation?**

There is no other special legislation that applies under these circumstances.

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10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

- a) A corporate bankruptcy/liquidation?
- b) A formal rescue?
- c) An case of corporate insolvency under any special legislation?

A secured property transaction can be invalidated by an “*actio Pauliana*” if it is preferential. The test for whether a secured property transaction can be invalidated following a corporate bankruptcy and in a formal rescue is set out in detail in Section 9 above.

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11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

Indonesia is not a party to any treaty relating to international insolvency issues and the Bankruptcy Law addresses international aspects summarily. It adopts the universality principle, under which an Indonesian bankruptcy encompasses all of the debtor’s assets wherever they are located. The universality principle is obviously limited to the extent that such principle is or is not accepted by the jurisdiction in which the assets are located.

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## 1 Is the restructuring/insolvency legislation generally:

### a) Understood?

Prior to the economic crisis that hit Indonesia in the second half of 1997, the insolvency legislative framework was based on laws implemented by the Dutch in 1905. This legislation had seen virtually no large-scale commercial liquidation or insolvency since that time. The law was mainly used for voluntary procedures instigated by the debtors themselves.

As a result of the Asian financial crisis, Indonesia overhauled its bankruptcy legislation. A new law was enacted in September 1998. The law was purposely constructed as a framework and was intended to be read in accordance with the principles of the Civil Code and Commercial Code, leaving it open to interpretation. This approach depends upon the capability of the judiciary to uphold the principles within the law. Several decisions to date demonstrate that the Commercial Court, set up to administer the bankruptcy code, appears not to fully understand the law or the principles underlying it. Most decisions of the court have tended to favor the local applicant over the foreign creditor and the government as a creditor.

Those applications that do succeed are placed in the hands of a licensed curator, the western equivalent of a liquidator or receiver, who is selected by the court. A supervisory judge is appointed by the court to supervise the conduct of the administration. Both curators and supervisory judges are generally inexperienced in this sort of law and its application, particularly in asset recovery and business reorganization. While these parties may understand the mechanics of the law, they do not generally understand the principles behind it and therefore do not apply it consistently. As a result, debtors and creditors generally lack confidence in using the law as an avenue of defense or collection.

Debtors largely view the threat of bankruptcy as a tactic used by bank creditors in debt negotiations, yet it is not seen as a serious threat. Debtors generally would not use the legislation as a chance to create “breathing space” from their creditors. If a judgment is made against a debtor, enforcement depends largely on the debtor’s cooperation. As a result, debtors do not need to understand the law if there is no effective way to enforce it.

Different types of creditors view the process differently. Foreign bank creditors who have experience in similar laws from other territories in which they operate have a better understanding of the concepts behind Indonesian law and are better prepared to consider the bankruptcy option. However, the poor application of the bankruptcy law has diminished its viability. Local bank creditors and some foreign bank creditors (particularly other Asian-based banks) have no experience with the law and generally do not consider bankruptcy as an option, unless they are with a syndicate of a foreign bank or with the Indonesian Bank Restructuring Agency (“IBRA”).

The Supreme Court interpretation of the law would appear to exclude trade creditors from making application under the law. This conflicts with both the definition of debt under the law and the interpretation made by the Commercial Court. Trade creditors are generally more comfortable with using traditional means of debt collection via their personal relationship with the debtor. If a debtor goes into bankruptcy, most trade creditors have little or no understanding of their rights and obligations.

### b) Being followed and/or available opportunities being taken up?

For reasons explained above, the opportunities the law provides for creditors and debtors are generally overlooked. The principles underlying the law provide for the equitable treatment of creditors, a framework for investor protection, opportunities for corporate reorganization and minimizing the deterioration of assets. There is not enough consideration given to the commercial aspects of the task, even though the letter of the law is followed and a supervisory judge guides each curator. More value can be salvaged from assets and closed businesses.

As noted earlier, both debtors and creditors use the legislation as a tool in negotiations for restructuring debts. The process and appointment is not an end in itself, as enforcement of the law where understanding is so low is difficult and depends on the co-operation of debtors.

**c) Being enforced by relevant authorities?**

Enforcement of the Bankruptcy Act occurs through the Commercial Court, which has had little experience in such matters. Consequently, rulings have been inconsistent and some even illogical. Enforcement of the rulings has been problematic. Uncooperative debtors and creditors have little to stop them from taking property or assets, and debtors particularly have many avenues with which to disrupt businesses. Securing police assistance is difficult because they too have little understanding of the law and the powers conferred by the court on the curator.

Those debtors with knowledge of the law and the system of law enforcement here have an advantage in manipulating outcomes to their advantage. Creditors' claims of fraud and embezzlement are being overlooked by authorities and the court. An interesting example is of the Canadian life insurer, Manulife Finance Corporation, who attempted to buy out the share of its Indonesian business owned by its bankrupt local partner through an open auction run by the court-appointed curator. Near the end of proceedings a lawyer claiming to represent the true owner of the shares, a British Virgin Islands company called Roman Gold, stepped forward. Since then the sale has been in limbo, with the proceeds unusually being awarded to the custody of the police. Manulife claims its partner had illegally sold its 40 percent stake in the venture, whereas the partner claims to have sold its stake to a company called Harvest Hero International Ltd in 1996. Roman Gold claims to have purchased its stake from a Western Samoan registered company called Highmead Ltd days before Manulife made its own purchase from the curator. In an unusual twist, Manulife's vice-president in Indonesia spent some time in jail for his troubles, only being released supposedly on the intervention by the Indonesian president acting on a plea from the Canadian president.

Co-incidentally, Highmead Ltd was a member of a loan syndicate arranged by Harvest Hero, a Hong Kong, China registered company that is meant to have lent US\$160m to PT Panca Overseas Finance in the second half of 2000. This unsecured loan came in the midst of protracted negotiations between Panca and its creditors, including several foreign banks and the International Finance Corporation ("IFC") (a member of the World Bank Group) who are owed around US\$68m. The IFC claims in its petition to bankrupt that Panca created these fictitious creditors in order to block their petition to bankrupt the company and accept Panca's restructuring proposal that offered all creditors, including the recent ones, a payment of 17 cents in the dollar on their debts. The other members of the syndicate are all registered in either Western Samoa or the Bahamas. Harvest Hero, according to the IFC submission, has paid up capital of HK\$2, no telephone listing in Hong Kong, China, nor any permit to lend money there. Harvest Hero's registration papers lists the address of one of its directors, the one who signed the loan agreement with Panca, as a restaurant selling chicken and noodles in North Jakarta. The restaurant's proprietor has never heard of the director or Harvest Hero.

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**2 Broadly speaking, in practice, does the restructuring/insolvency legislation tend to lead to:**

**a) Early recognition and action on financial difficulties experienced by a corporation?**

The legislation is not generally applied within the early stages of financial difficulties. It is commonly used as a "last resort" within the final stages of a restructuring to bully uncooperative debtors, or to force dissenting creditors into compliance. It is sometimes used as a compromise outcome whereby creditors takeover a debtor's business via liquidation. In return, the debtor is released from other obligations, such as personal guarantees.

As a result of the economic collapse, the majority of businesses have been unable to pay their debts. Most businesses would be technically classified as insolvent, but due to the lack of enforceability of not only this legislation, but of normal repayment terms, financial difficulties can be delayed almost indefinitely, unless creditors have the ability to impact the debtor's day-to-day business.

**b) Restructuring alternatives as opposed to liquidation, and if not, why not?**

In the absence of an enforceable legal framework with which to collect debts, most restructuring tends to be a negotiated settlement between debtor and creditor. The legislation does not tend to lead to any action, but is used as a tool in the negotiation process.

A negotiated settlement is viewed as a better outcome to liquidation for all stakeholders, even in cases where businesses were not viable and liquidation may have been more appropriate. Other factors that can make liquidation an unattractive option are as follows:

- ▲ When there is no real break-up value for a business, or a prospect of sale and continued operation by existing stakeholders is seen as the only option.
- ▲ When liquidation requires creditors to write-off rather than provide for a bad debt.
- ▲ When potential social problems could arise from placing large numbers of people, often from the same community, out of work without alternative means of support (i.e. no other work or social safety net).

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**3 What are the main practical difficulties being encountered in:**

**a) The preparation of restructuring plans?**

**b) The implementation of restructuring plans?**

Based on PricewaterhouseCoopers' experience, in Indonesia there are many practical difficulties faced by debtors and creditors in negotiating a restructuring plan.

The expectation gap between debtor and creditor often leads to initial negotiations being slow and unproductive. This is accentuated when the debtor and creditor have a history of not trusting or co-operating with each other. In this situation both parties will often make unrealistic demands that impede useful commercial negotiations.

Generally, creditors are not in a strong position to force negotiations, due to the ineffectiveness of the legal system. At the same time, debtors will often use this to their advantage in negotiations.

The Jakarta Initiative Taskforce ("JITF"), a body set up by the government to facilitate restructurings, was seen as a positive move to accelerate corporate restructuring. However, the implementation of the JITF was delayed, and only in the second half of 2000 had it gained influence and begun assisting with restructurings.

The IBRA is a creditor in many of Indonesia's restructurings. Numerous changes to IBRA's management since its inception have led to delays in restructuring negotiations. Changes within the Indonesian government and the unstable political environment have also impeded significant progress.

In addition, IBRA often has sets of "rules", with which it must comply in approving any restructuring proposal, that bear no relation to the commercial aspects of the situation. For example, it is difficult to get them to agree to any debt write-off, even if they agree that the company can only sustain a much lower debt burden.

The unstable economic environment, particularly the value of the Rupiah, has also resulted in companies changing their financial projections, resulting in the renegotiation of restructuring deals.

Companies with syndicated loans involving large lender groups can sometimes find it difficult to get agreement from all participants. This is particularly difficult where the restructuring is complex and the terms of the deal are difficult to communicate to such a large group.

Once a restructuring is agreed, implementation of the plan can also face practical difficulties. Legal documentation, particularly on the more complex transactions, can be very extensive. This is time-consuming and can lead to the re-negotiation of parts of the plan as unforeseen legal issues arise.

Regulatory issues can also impede the implementation, such as limitations on the terms for issue of warrants to lenders and debt for equity conversions. There are other cases where shareholders have acquired their shareholding through debt settlements but legal documentation has not been properly agreed. This leaves shareholders in such a position that they do not have the legal authority to implement the restructuring plan they have agreed. Also, tax and capital market regulations have not been set up to contemplate such an environment as the current one. Consequently, there has been, and will continue to be, a need to review these regulations. Tax treatments of debt write-offs or foreign exchange losses have come under scrutiny and continue to be fine-tuned.

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4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

In our experience in Indonesia, the vast majority of corporates restructure their debt/equity structure rather than their business operations. The focus has been on rescheduling and debt write-offs without consideration to the underlying business that supports the repayment of any new arrangements. It appears that as the economic recovery continues in Indonesia, the corporate sector will concentrate on restructuring business operations and creating shareholder value after debt restructuring is complete.

Restructuring of only the debt/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, and/or debt forgiveness.

The restructuring of business operations could be a key factor in driving future growth in Indonesia. Businesses expanded very quickly in the pre-crisis period, often without adequate research and planning. This has resulted in substantial inefficiencies from an operational and financial perspective. Those companies that become efficient will be best placed to handle any further shocks to the economy.

Often the independent accountant appointed by creditors identifies operational issues that could be improved. However, these issues are very rarely investigated further for the following reasons:

- ▲ There is no incentive for debtors to restructure their business operations during debt restructuring negotiations with creditors. Improved financial performance through operational restructuring will result in creditors negotiating for a higher level of debt. This is not in the interest of the debtor.
- ▲ Management's time is normally consumed by debt restructuring negotiations leaving insufficient time to consider restructuring of business operations.
- ▲ Restructuring of business operations usually involves capital expenditure that may not be agreeable to creditors during times of debt restructuring. Unless there is a very compelling business case, creditors would prefer the company to use excess cash to repay debt.
- ▲ Restructuring can often cause disruptions to business operations and impact cash flow. Default risk is high during the early years of a restructuring agreement and companies cannot afford such interruptions to their operations.
- ▲ Lenders are reluctant to negotiate a debt restructuring based on financial forecasts that are predicated on significant changes to the business. This only increases the risk, as it is already difficult to have agreement from all parties on financial forecasts predicated on the existing business structure.

While business restructuring activity in Indonesia has been minimal, we are aware of one significant case where operational restructuring has been negotiated between debtor and creditors. The debt restructuring incorporated significant changes to the group ownership structure so that different business lines would be more attractive to investors. This created additional shareholder value and was crucial in persuading creditors to convert debt to equity.

The restructure also involved significant capital expenditure that was approved by creditors and was funded from cash flow that would have otherwise repaid debt. This was negotiated as part of the restructuring, but only after vigorous analysis convinced creditors that it was financially viable given the level of risk.

This is a rare case, as most restructurings are of the debt/equity structure and not of business operations.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

As noted above, the majority of restructuring in Indonesia to date has involved debt/equity swaps and debt haircuts. Some restructuring includes asset sales where the proceeds are applied to debt, but those completed to date have not included, to any significant extent, new funding either by way of equity or debt.

A number of restructurings have been undertaken on a “cashless basis”, involving the rescheduling of debt repayment obligations to match forecast future cash flows. A number of these have been based on projections that assume an early return to pre-crisis economic conditions.

The instability of the political situation, as well as the volatility of the currency, has deterred most foreign investors from investing in Indonesian corporations. This is particularly the case as other countries in Asia, such as the Republic of Korea and to a lesser extent Thailand, show improving economies and a commitment to political and economic reform. The long-term “patient” capital required continues to show interest in the country, but these equity investors generally get frustrated with unrealistic price expectations and long protracted due diligence and negotiation periods.

Since the recapitalization program started, there have been an increasing number of banks with sufficient capital to lend, yet no significant new lending is occurring. This is possibly a result of banks adhering to stricter credit policies, or merely the inability of a significant number of restructurings to be completed. Also, recapitalization bonds held by banks are returning 13 percent relatively risk-free (i.e. Indonesian Government) and thereby stifling the incentive to risk capital in the corporate sector.

The following factors will contribute to new capital being employed in this country for restructuring:

- ▲ Political and exchange rate stability.
- ▲ Preparedness of owners to cede management control.
- ▲ More realistic valuation expectations for both companies and their existing creditors.
- ▲ Business restructuring strategies along with debt restructuring.
- ▲ Restructuring government support for the banking and finance sector to encourage lending/investment.

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