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Covering your bases

Mergers and acquisitions in Indonesia have the potential to implicate a myriad of laws and regulations, says Jonathan Streifer of Soewito Suhardiman Eddymurthy Kardono (SSEK), and parties looking to undertake such transactions would be wise to keep the most important areas of law, and the issues arising under them, in mind.

Mergers and acquisitions in Indonesia are principally governed by Law No. 40 of 2007 regarding Limited Liability Companies (the *Company Law*). The *Company Law* defines a merger as “a legal act of one or more limited liability companies to merge with another limited liability company(ies) which results in the transfer by law of the merging company’s assets and liabilities to the company it merges into, upon which the merging company’s status as a legal entity shall cease by operation of law.” An acquisition under the *Company Law* is distinguished from a merger, and is defined as a legal act of a legal entity or individual to acquire a company’s shares that results in a change of control of the acquired company. Both a merger and acquisition are therefore statutorily governed acts that require compliance with particular provisions of the *Company Law*.

Mergers and acquisitions necessarily implicate many other areas of law including Indonesia’s *Labor Law* (Law No. 13 of 2003 regarding Manpower); tax laws and regulations; the *Investment Law* (Law No. 25 of 2007 regarding Capital Investment) and implementing regulations, including a recent and important Presidential Regulation and regulations of Indonesia’s Capital Investment Coordinating Board, known as *Badan Koordinasi Penanaman Modal* (BKPM); antitrust and unfair business competition laws and regulations; and industry specific laws and regulations,

particularly in regulated industries such as mining and telecommunications.

This article discusses these various aspects of conducting a merger or acquisition in Indonesia, with a focus on mergers and acquisitions of shares between privately held companies. Readers should be mindful that mergers and acquisitions involving public companies are governed by the *Company Law* but also implicate special rules under capital markets laws and regulations, including tender offer and material transaction rules.

Merger vs acquisition

In Indonesia, a company typically obtains control of another company through a share acquisition. Mergers are generally much less common unless they are undertaken for operational or tax reasons, as further discussed below. The *Company Law* does not contemplate or permit a foreign company to merge with an Indonesian company, and a share acquisition is the only structure under which foreign companies can acquire Indonesian companies, unless the foreign company first establishes an Indonesian subsidiary to undertake the merger.

In a share acquisition, *Company Law* compliance is only required if there is a change of control. Often, the threshold question of determining whether a transaction involves a change of control is easily determined; for

instance, where a party acquires a majority of the share capital and controls the board of directors and board of commissioners of the company being acquired, change of control will be obvious. Under other circumstances, the question may require further factual analysis. For example, an Indonesian shareholder may hold all of the issued share capital of an Indonesian company. If the Indonesian shareholder disposes of half of that shareholding to a foreign party, it is not always clear whether a change of control has occurred, particularly if the Indonesian shareholder retains control of the company's board of directors. In this example, the Indonesian shareholder will likely have less control than prior to the share sale but will still retain control, and the legal conclusion may be that no change of control has occurred to therefore require compliance with the *Company Law*.

Similar issues arise where changes of shareholding occur in a company that has several shareholders but no single majority, and no single party controls the board of directors. In such cases, the analysis must typically extend to review of the Articles of Association and shareholders' agreement, as well as other agreements among or between the shareholders and/or the company, to determine where control resides prior to and after the change in shareholding.

Company Law compliance

As noted above, mergers and acquisitions are statutory acts that must comply with the relevant provisions of the *Company Law*. Mergers are typically less common than acquisitions in Indonesia because the *Company Law* provisions governing them are viewed as more burdensome than

those applicable to an acquisition. Additionally, because tax-free treatment of a merger is typically only confirmed by the Indonesian Tax Office (ITO) after the merger is completed, there is some exposure if the ITO does not ultimately approve tax-free treatment for the transaction.

The parties to a merger must prepare a merger plan that includes, among others, the names and domiciles of the companies planning to conduct the transaction, the reasons for the merger as provided by the board of directors of each company, the procedures for valuation and conversion of the shares of the merged company into shares of the surviving company, the financial statements of both companies for the last three years, the draft amendment of the Articles of Association of the surviving company, a pro forma balance sheet of the surviving company using Indonesian generally accepted accounting principles, and other requirements in respect of the settling of obligations to third parties, employees and members of the board of directors and board of commissioners of each company.

An acquisition can be undertaken through a purchase of existing or new shares, and the *Company Law* distinguishes between the two structures. A further reason as to why acquisitions are more common in Indonesia is that while an acquisition of new shares requires preparation of an acquisition plan (which contains some but not all of the elements of a merger plan), an acquisition of existing shares can typically be undertaken without preparing such plan – all that is required, as is further discussed below, is an announcement of the acquisition in an Indonesian newspaper, notification to creditors and employees, and shareholder approval.



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Jonathan Streifer

“It is prudent to individually notify known creditors of the proposed transaction, particularly if they are banks or other financial institutions.... Any objections from creditors must be settled before the proposed transaction can proceed, although it is not clear under the *Company Law* whether, in an acquisition, creditors of both companies have a right to object or whether this right is limited to creditors of the company being acquired”

The *Company Law* requires that at least 75 percent of the company’s shareholders attending a duly held general meeting of shareholders approve a merger or acquisition. The quorum to hold such a general meeting is the presence or representation of shareholders holding 75 percent of the shares with valid voting rights. If a quorum is not reached, a second meeting may be held at which a quorum of two-thirds of the voting shares is sufficient – in these circumstances, an affirmative vote of two-thirds of such shares is required to approve the merger or acquisition. The corporate approvals required for a foreign party to conduct an acquisition of an Indonesian company should follow the constitutional documents of and laws applicable to the foreign party.

The merger or acquisition must be announced by the party undertaking such activity in at least one Indonesian newspaper no later than thirty days prior to the notice of the general meeting of shareholders to approve the transaction, together with a summary of the merger or acquisition plan, as applicable. The proposed merger or acquisition must also be announced to employees at the same time. Although the *Company Law* seems to require that the company undertaking the merger or acquisition make the announcement, in practice a joint announcement by both involved companies is typically made, and in an acquisition of existing shares the names of the selling shareholders are also disclosed. It is also usual practice for the board of directors of the company being acquired to make the announcement of the proposed transaction to its employees, who, as discussed further below, are the only employees in such a transaction to acquire rights to benefits under Indonesia’s *Labor Law*.

It is prudent to individually notify known creditors of the proposed transaction, particularly if they are banks or other

financial institutions. Creditors have fourteen days after the newspaper announcement to file an objection to the merger or acquisition. If no objection is filed within such time, creditors are deemed to have agreed to the transaction. Any objections from creditors must be settled before the proposed transaction can proceed, although it is not clear under the *Company Law* whether, in respect of an acquisition, creditors of both companies have a right to object or whether this right is limited to creditors of the company being acquired.

Minority shareholders can also object to a merger or acquisition, in which case their sole remedy is to require that their shares be purchased by the company at a “reasonable price,” as stipulated in the *Company Law*. This right is to cause the company, rather than its shareholders, to purchase the shares at such price. However, if the number of shares proposed to be sold by the minority shareholder exceeds the 10 percent limit on company share repurchases under the *Company Law*, the company must use its best endeavors to identify a third party to purchase the shares, which could include existing shareholders. The *Company Law* does not provide any guidance regarding what price may constitute a reasonable price, although it would seem to require some reasonable relationship to market price. The minority shareholder cannot in theory prevent the implementation of the merger or acquisition even if there is no agreement on the price of the shares.

If there are no objections from creditors, the merger or acquisition can be completed following approval obtained at the general meeting of shareholders of the relevant companies and following the execution of a deed of merger or acquisition before an Indonesian notary in the Indonesian language. The deed of merger or acquisition must be

“The permitted percentage of shareholding by the foreign party in the target company may be regulated by the Negative List, and thus this list should be consulted prior to undertaking a merger or acquisition to determine whether the relevant business sector is open to foreign investment and, if so, whether any conditions apply”

submitted to the Minister of Law and Human Rights (MOLHR) together with any amendments to the Articles of Association of the merged companies or acquired company. Amendments to the Articles of Association must be approved by or notified to the MOLHR, as applicable.

The result of the merger or acquisition should be announced in at least one Indonesian newspaper within thirty days of the effective date of the transaction.

The Investment Law and BKPM

Investment by a foreign company in Indonesia is typically undertaken through establishment of an Indonesian company or purchase of shares in an existing company. If the foreign investor owns an Indonesian company, that company can also undertake a merger or acquisition.

Foreign investment implicates the *Investment Law* and implementing and related regulations, including regulations of BKPM. Of particular importance is the most

recent Presidential Regulation No. 36 of 2010 regulating investment sectors closed and conditionally-open to investment (the Negative List). In theory, all business sectors not on the Negative List are open to foreign investment without conditions.

BKPM has jurisdiction with respect to foreign and other capital investment in all industries in which the relevant technical departments (e.g. the Department of Industry) have delegated licensing and other authorities to it. Certain departments and ministers – including, importantly, the Department of Finance and the Minister of Energy and Mineral Resources – have not delegated all or some of their authority to BKPM at this time.

However, for most other industries and business sectors – including most manufacturing, trade and other types of services – BKPM is the relevant agency licensing foreign investment, and BKPM approval will be required for any acquisition of shares by a foreign party as a condition to completing a merger or acquisition. The permitted percentage of shareholding by the foreign party in the target company may be regulated by the Negative List, and thus this list should be consulted prior to undertaking a merger or acquisition to determine whether the relevant business sector is open to foreign investment and, if so, whether any conditions apply.

If the target company is not already licensed by BKPM, as is the case with many Indonesian companies that do not require capital investment facilities offered by BKPM (such as relief on import duty on capital equipment), the target company will need to be converted to a Foreign Capital Investment Company – known as a *Penanaman Modal Asing* (PMA Company) – with the approval of BKPM before the merger or acquisition can be completed. Any changes to shares in an existing PMA Company, through merger, acquisition or otherwise, also require BKPM approval.

BKPM approval is obtained through submission to it of the relevant application. If one or more of the companies to a merger or acquisition is in a regulated industry such as mining or telecommunications, the license and permits of such companies and other sources of law should be reviewed to determine whether any other governmental approvals from the relevant technical department or other governmental agency are required. For example, acquisition of shares in a mining company holding a mining business license – known as an *Izin Usaha Pertambangan* (IUP) – typically requires the approval of the government agency that issued

the IUP, which in many cases is the regional government in the area where the mining site is located.

Labor Law

A merger or acquisition will trigger certain rights – principally employee rights – under the *Labor Law*. An underlying policy of the *Labor Law* is that employees should have a choice of which employer they work for and in a merger or acquisition, the change of ownership takes away that right. Therefore, the employee should have the right to choose whether to continue his or her employment with the “new” employer or terminate such employment.

In an acquisition, an employee can terminate his or her employment with the company being acquired, however employees of the acquiring company do not have such rights. An employee choosing to terminate his or her employment is typically entitled to severance pay of one month’s salary for each year worked, up to a maximum of nine months’ salary. Employees who have worked for more than three years and less than six years are entitled to another two month’s salary for long-service pay, and for each three year increment of employment thereafter the employee is entitled to another month’s salary for long-service (up to a maximum of ten months’ salary if the employee has worked for twenty-four years or more). Employees are additionally entitled to other compensation in the amount of 15 percent of the aggregate amount of the severance pay and service pay.

In a merger, an employee of the target company also has the right to terminate his or her employment. Contrary to the situation in an acquisition, however, the employer also has the right to terminate an employee of the merged company. In such cases, the employee is entitled to receive a so-called “double severance” package consisting of double severance pay calculated as above, in addition to long-service pay, if any, and an amount equal to 15 percent of the aggregate amount of the double severance and long-service pay.

Anti-monopoly and unfair business practices

The relevant law in this area is Law No. 5 of 1999 regarding the Prohibition of Monopoly and Unfair Business Practice (the *Anti-Monopoly Law*). The *Anti-Monopoly Law* and important decisions of the Competition Supervisory Committee – known as *Komisi Pengawas Persaingan Usaha* (KPPU) – should be reviewed in respect of any merger or acquisition that results in a company acquiring a

significant share of a particular market or where the proposed transactions has other elements that may violate the *Anti-Monopoly Law*.

The KPPU has also recently issued KPPU Regulation No. 1 of 2009 regarding Pre-Notification for Merger, Consolidation and Acquisition, which provides procedures for a party to obtain pre-clearance for a merger or acquisition if there is concern that the proposed transaction could be later reviewed by the KPPU as potentially violating the *Anti-Monopoly Law*. Obtaining prior clearance from the KPPU for a merger or acquisition will preclude later review assuming there are no changes in the transaction structure as approved by the KPPU.

Tax-free mergers

Under applicable tax rules and regulations, a merger can be conducted on a tax-free basis by using the book value of assets being transferred pursuant to the merger if certain conditions are met. Such tax-free treatment must be approved by the Directorate General of Taxation, typically after the merger has been completed. Approval may be obtained if (a) the purpose and objectives of the merger is to create strong business synergies and capital and not for the avoidance of tax, and (b) the companies conducting the merger have settled all of their tax obligations. The tax consequence of using book value for asset transfers is, among others, that there will be no gain or loss on the transfer of assets, and thus no income tax on such transfers.

Carry forward tax losses of the extinguished company can be used to offset gains in the surviving company after the assets of the surviving company have been revalued, and the losses have been used to offset the revaluation and certain other conditions are met. This can be an important tax reason for undertaking a merger, particularly between related companies.

Finally, in a merger, the shareholders are generally treated on a tax-neutral basis which can also be an advantage when compared to an acquisition which is typically a taxable event.