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Foreign Investment, Corporate and M&A Issues in Indonesia

by
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Foreign Investment

- Generally open unless specifically restricted
 - Negative list
 - Limited prohibited sectors (e.g. retailing, “local” transport, media, concession of natural forests)
 - Certain requirements are set out for investments in certain business sectors (e.g. local participation, location of project)

Foreign Investment

Cont'd....

- Laws and Regulations
 - Apart from the Negative List, certain laws and regulations provide specific local participation requirements (e.g. financial services, banking, insurance, securities, plantations)

Foreign Investment

Cont'd....

- Foreign Investment Approvals
 - General Investment – Capital Investment Coordination Board (BKPM)
 - liaises with “technical department” of relevant ministry

Foreign Investment

Cont'd....

- Indonesianisation Requirement
 - For an investment company which is 100% owned by foreign investors, over a 15-year period after commercial production, an unspecified amount (assume 5%) must be divested to local companies or Indonesian citizens
 - Mining – depends on contract of work

Investment Structures

- Generally all investment must be made through an Indonesian company; exceptions include:
 - production sharing contracts in oil and gas sectors
 - bank branches
- Branches not recognized except for banks

Key Corporate Issues

- No trusts under Indonesian Law
 - Nominee arrangement as an alternative
- Comparative Issues
 - Boards of Management
 - Commissioners (non executive/supervisory)
 - approve certain matters
 - consider in a joint venture giving commissioners reserve matters

Key Corporate Issues

Cont'd....

- power to suspend directors
- no alternate commissioners - only another commissioner can attend and vote
- usually non resident
- president commissioner powers
- only shareholders can change board

Key Corporate Issues

Cont'd....

- Directors (executive management)
 - president director
 - » acts for company, including execution of documents, unless restricted
 - no alternate directors - only another director can attend and vote
 - usually resident (work permit issues)
 - only shareholders can change directors

Key Corporate Issues

Cont'd....

- usually no regular board meetings
- third parties do not look for board approvals unless articles of association specifically require

Key Corporate Issues

Cont'd....

- Minority protection under Company Law
 - 66 $\frac{2}{3}$ % : changes to articles and share buy backs
 - 75%: merger, consolidation, liquidation, sale of all/substantial assets
 - rights of examination

Mergers & Acquisitions Issues

SHARES ACQUISITIONS

- Due Diligence
 - Challenging to say the least
 - corporate governance poor
 - In-house counsel
 - enforcement lax
 - sometimes two sets of financial records
 - absence of documents
 - poor documentation/issues in documentation

Mergers & Acquisitions Issues *cont'd....*

- Public searches
 - in many instances a power of attorney is required from the target to do a search (e.g. land, litigation, arbitration)
 - unreliable given information not up to date
 - in many instances no “official” search result is available
- Assessment to be made re conditions precedent, protection in agreements (reps and warranties etc.)

Mergers & Acquisitions Issues *cont'd....*

- Issues involved in Share Acquisitions
 - Articles of Association may include preemptive rights; usually requires existing shareholder approval of transfer of shares
 - What is required?
 - Signed agreement conditional on waiver/process being followed?

Mergers & Acquisitions Issues *Cont'd....*

- If pre-emption is exercised to what extent do non-selling shareholders get the same terms and conditions (as shareholders should they get the benefit of operational representations and warranties?)
- Existing Shareholders Agreement
 - Commonly include restrictions on share transfer (change of ownership provisions) or pre-emptive rights

Mergers & Acquisitions Issues *cont'd....*

- Approvals
 - Relevant Consents
 - Consent may be required from lenders, government and other third parties
 - Capital Investment Coordination Board (BKPM)
 - Transfer of shares requires prior written approval; same for change in composition of Board of Directors and/ or Commissioners.

Mergers & Acquisitions Issues *cont'd....*

– Other Government Agencies

- Depending on the business sector of the target company

– Ministry of Law and Human Rights (MOLHR)

- After BKPM approval and closing, Articles of Association must be amended to reflect changed shareholding structure; changes must be reported and acknowledged by MOLHR

Mergers & Acquisitions Issues *cont'd....*

- Department of Industry and Trade (DOIT)
 - Change of Shareholding and/ or change to Board of Directors and/ or Commissioners composition needs to be reported to DOIT; changes reported in State Gazette.

Mergers & Acquisitions Issues *cont'd....*

- Employment: Share Acquisition - Change in control issues (severance and compensation)
 - employee right to demand termination (1 x payment)
 - only permanent employee has right to demand termination

Mergers & Acquisitions Issues *Cont'd....*

- Shareholder agreements – standard terms but
 - BKPM approval required for share transfers based on shareholders resolution
 - increases in issued capital (investment expansion) requires BKPM approval
 - resulting in default mechanism etc being subject to BKPM approval

Mergers & Acquisitions Issues *Cont'd....*

- target company's cost but cost can be apportioned by contract
- employer does not have right to terminate
- negotiated resignation arrangements to avoid labor tribunals
- no obligation to re-hire
- employee salaries and certain benefits cannot be cut

Mergers & Acquisitions Issues *cont'd....*

- Taxes

- Sale of assets: VAT applicable to certain asset transfers, land 5% creditable tax on transfer for seller; 5% final tax for purchaser
- Sale of shares: capital gain classified as income (could be offset against losses), double tax treaties apply (need tax domicile letters and statement of permanent establishment)

Mergers & Acquisitions Issues *cont'd....*

- Regulatory Timeline
 - Shareholders by resolution approve:
 - Transfer of shares.
 - Change of Board of Directors and/ or Commissioners
 - Waiver of pre-emptive rights, if applicable.

Mergers & Acquisitions Issues

- Submission of application to BKPM in relation to transfer of shares and/ or change of Board of Directors and/ or Commissioners (estimated 2 – 4 week waiting period)
- Signing, then closing of the S&P Agreement.
- After closing, report to MOJHR, registration at DOIT and publication in the State Gazette (this is normally handled by a notary)