Indonesia

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

Contacts

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1. INTRODUCTION

This guide provides an overview of the law and practice dealing with private M&A transactions in Indonesia, as in effect on 31 May 2022. This guide does not constitute legal advice. Anyone involved in private M&A transactions should seek specialist advice.

2. BRIEF NOTE ON INDONESIA

Indonesia is a civil law country that implements systematic laws and regulations which serve as the fundamental legal bases in many aspects, including M&A transactions. The official currency of Indonesia is the Indonesian rupiah (IDR) which is roughly IDR 14,600 to US$1.

Business licensing requirements in Indonesia are tentatively regulated under a new licensing regime following the enactment of Law No. 11 of 2020 regarding Job Creation (Job Creation Law) and Government Regulation No. 5 of 2021 regarding Risk-Based Licensing (GR 5/2021). The Job Creation Law amended and codified almost 80 laws in Indonesia across business sectors. The stated aim of the Job Creation Law is to bolster investment and create jobs by streamlining the regulatory regime and simplifying the licensing process to improve the ease of doing business in Indonesia. GR 5/2021 implements a new risk-based licensing system, whereby the required licences are determined based on the level of potential risk of a business activity. Business actors whose business licences were approved and effective before the enforcement of GR 5/2021 are exempt from having to comply with the new business licensing requirements.

However, on 25 November 2021, the Constitutional Court issued Decision No. 91/PUU-XVIII/2020 (CC Decision 91/2020) judicially reviewing the validity of the Job Creation Law. The Constitutional Court decided that the Job Creation Law is considered conditionally unconstitutional and declared procedurally flawed. As per CC Decision 91/2020, the Government has been given two years to revise the Job Creation Law. Within the said two years, the government is restrained from implementing provisions of the Job Creation Law that are strategic and have a broad impact, and the government is also not allowed to issue any implementing regulations in relation to the Job Creation Law. Despite this, the Constitutional Court determined that within the two years, the Job Creation Law and its implementing regulations remain valid and enforceable, except for matters that are strategic and have a broad impact. Therefore, the provisions under the Job Creation Law and its implementing regulations including GR 5/2021 shall remain valid until the next two years or the issuance of new regulations.

We now turn our discussion to laws that are of particular relevance to M&A transactions in Indonesia.

3. LEGAL FRAMEWORK IN INDONESIA

3.1 The Company Law

Law No. 40 of 2007 regarding Limited Liability Companies, as amended by the Job Creation Law (Company Law), contains provisions on general corporate matters related to Indonesian limited liability companies. This includes the various steps and procedures companies must comply with respect to mergers and acquisitions. The Company Law also provides the rights and obligations of and requirements and procedures for appointments and meetings of the board of directors and commissioners, including financial reporting and registration requirements with the Ministry of Law and Human Rights. We discuss several types of common M&A transactions provided in the Company Law in Section 4.

3.2 The Competition Law

Law No. 5 of 1999 regarding Prohibition on Monopolistic Practices and Unfair Business Competition, as amended by the Job Creation Law (Competition Law) regulates certain matters pertaining to competition law, such as prohibited agreements and activities, and dominant position. M&A transactions in Indonesia must comply with the Competition Law and must not result in monopolistic practices or unfair business competition. The Business Competition Supervisory Commission (Komisi Pengawas Persaingan Usaha or KPPU) supervises competition activities including M&A transactions.

There is a reporting obligation to the KPPU for companies that conduct M&A transactions for which the value of the assets or sales of the involved companies exceed a certain threshold. Under KPPU Regulation No. 3 of 2019 regarding Assessment of Merger or Consolidation, Acquisition of Shares which May Cause Monopolistic Practice and/or Unhealthy Competition (KPPU Regulation 3/2019), the asset/sales threshold is fulfilled if the acquiring party's group and the acquired party and its controlled subsidiaries together have:

(a) IDR 2.5tn (equivalent to approximately US$172.5m) or more in assets, calculated on a worldwide basis; and/or
(b) IDR 5tn (equivalent to approximately US$345m) or more in revenue generated in connection with operations in Indonesia (calculated on an annual basis by reference to the financial year occurring prior to the transaction, or in the event the revenue for that financial year reflects a reduction of at least 30 per cent from the previous financial year, calculated by reference to the average revenue figures of the previous three financial years).

3.3 The Employment Law

Employment issues are commonly triggered during M&A transactions. Law No. 13 of 2003 regarding Employment, as amended by the Job Creation Law (Employment Law), provides the rights and obligations of employees and employers when an M&A transaction occurs. Companies must consider several employment issues during an M&A transaction, such as: (1) employment status/termination; (2) severance packages; and (3) employment agreements.

In the event of an M&A, employees have the option to continue employment or to terminate the employment and receive severance payment. The only possible payment is based on termination of employment that was initiated by the employer or the employee. Examples of provisions on employment relating to M&A transactions are as follows.

Article 154A (1) (a) of the Employment Law provides that termination of employment relationships may occur due to the employer conducting an M&A transaction, and employees are not willing to continue the employment relationship, or the employer is not willing to accept the employees.

With regard to a merger, if any of the merging companies is a party to a collective labour agreement (CLA), the CLA remains valid until its expiration. If each of the merging companies is a party to a CLA, the CLA which shall be valid is the CLA which provides the most benefits to the employees. If the merger occurs between companies that are parties to a CLA and companies that are not, the existing CLA will be valid until its expiration date for all employees of the surviving company, regardless of which company was a party to the CLA.

The mechanism for the termination of employment due to an M&A will usually be regulated in the M&A plan.

3.4 Foreign direct investment (FDI) limitations

Pursuant to Law No. 25 of 2007 regarding Capital Investment (Investment Law), the participation of a foreign shareholder within an Indonesian legal entity renders that entity a foreign investment company (*perusahaan penanaman modal asing* or PMA company). Before establishing a PMA company, any applicable FDI limitations must be assessed to determine whether the PMA company to be established may be wholly foreign owned or is subject to foreign ownership restrictions.

FDI limitations and restrictions are set out in Presidential Regulation No. 10 of 2021 regarding Investment Business Activities, as amended by Presidential Regulation No. 10 of 2021 regarding Investment Business Activities (Investment List). Under the Investment List, only 37 business lines are completely prohibited for foreign ownership. The Investment List also recognises business activities in Indonesia with caps on the foreign shareholding percentage and business activities that are fully reserved for Indonesian cooperatives (*koperasi*) and micro, small and medium enterprises (MSMEs), or which require the foreign investor to partner with a local MSME.

All companies in Indonesia must be licensed for one or more business line, specifically identified by reference to a descriptive and numerical classification system known as the Indonesian Standard Business Classification (*Klasifikasi Baku Lapangan Usaha* Indonesia or KBLI), which is issued by Indonesia's Central Statistics Agency (Badan Pusat Statistik Indonesia). The most recent KBLI was issued in 2020 and contains thousands of individually classified business activities. Applicable FDI limitations, including applicable foreign ownership limits, are identified in the Investment List by reference to the KBLI number assigned to the particular business activity.

According to GR 5/2021, the determination of the business licensing that a business actor must obtain is made by reference to the risk level of the business activity in question. The risk level of a business activity is determined by: the risk of injury, damages or a combination of the probability and impact of hazard to health, safety, environment, and/or utilisation and management of resources, or hazard to other aspects caused by a business activity. GR 5/2021 categorises business activities as low, low-medium, medium-high and high risk, with different risk levels entailing different licensing and/or registration requirements. A business activity classified as a 'low' risk requires only a Business Identification Number (*Nomor Induk Berusaha* or NIB). A 'medium to low' risk business activity requires an NIB and a Standard Certificate, which is a self-proclaimed document by nature. A business activity classified as medium-high requires an NIB and a Standard Certificate that must be further verified. Finally, a 'high risk' business requires an NIB and a licence which will be based on the risk assigned to the relevant KBLI and must be further verified.

Aside from FDI limitations in the form of foreign ownership caps, FDI limitations are also in the form of minimum investment value. Pursuant to BKPM Regulation No. 4 of 2021 regarding Guidelines and Implementation of Risk-Based Licensing and Investment Facility, the minimum investment value in a PMA company is a sum greater than IDR 10bn (approximately US$684,000), excluding land and building, for each KBLI number in which the company engages.

When establishing a PMA company, the founding shareholders must determine the KBLI number(s) governing the company's proposed business activities, a process that typically will require consultations with a public notary, legal counsel and, if necessary, officials of the Ministry of Investment/Indonesian Capital Investment Coordinating Board (BKPM). The BKPM is the ministry exercising general authority over foreign direct investment in Indonesia, including the implementation of the Investment List. It also administers the Online Single Submission business licensing system.

4. TYPES OF TRANSACTIONS

This section focuses on M&A activities under the Company Law.

4.1 Mergers, consolidations, spin-offs and acquisitions

The Company Law defines and differentiates several types of corporate transactions in Indonesia.

4.1.1 Merger

A merger is a legal act carried out by one or more companies to merge with existing companies, which causes the dissolution of the merging companies but the continuing existence of the surviving company.

4.1.2 Consolidation

A consolidation is a legal act carried out by two or more companies to unify together, forming a new company, followed by the dissolution of both (or all) of the consolidating companies.

4.1.3 Spin-off

A spin-off is a legal act that fulfils any of the following requirements:

(a) All assets and liabilities of a company are transferred by law to two or more companies and the transferring company is dissolved by law.
(b) A part of the assets and liabilities of a company are transferred by law to one or more companies and the transferring company maintains its existence.

4.1.4 Acquisition

An acquisition is a legal act carried out by a legal entity in the form of a company or other entity, or by an individual, to take over all or a majority of a company's shares, whether existing or newly issued, which may cause a change in the control of the company. The Company Law does not define 'control', but it is reasonable to assume that the term refers to the capacity to determine, directly or indirectly, in any way, the management or policies of the company concerned.

Acquisitions that do not fulfil the criteria of control fall outside the acquisition requirements and procedures set out under the Company Law. Where there is a change in control through the issuance of new shares by a company, this will be considered a change in control initiated by management.

4.2 Share/asset acquisitions

When deciding to do an asset or share acquisition in Indonesia, a company must consider the issues typical in other jurisdictions, including contingent liabilities, scope of business of the target company, and other typical issues as relevant.

When conducting an asset purchase in Indonesia, acquirers should not underestimate the amount of time it typically takes to conclude a transaction in the jurisdiction. In particular, acquirers need to be aware of the following:

(a) the multitude of government agencies that may be involved in effecting the transfer of registrable assets;
(b) the procedures for acquiring good title to land; and
(c) the often time-consuming efforts needed to;
   i. obtain consents and approvals (including those from banks, third parties and government agencies);
   ii. establish a new investment company as the purchaser;
   iii. obtain all general and industry-specific licenses for the business being acquired;
   iv. apply for expatriate manpower plans and permits; and/or
   v. transfer over employees and deal with statutory benefits that vest on the transfer.

While these matters are not insuperable, they do make closing an asset acquisition more difficult and time consuming. In many respects, the business in an asset sale either needs to cease operating until all licences are obtained or otherwise operate without licences in its name (this is a consequence of licences not being transferable in Indonesia).

Conversely, share acquisitions generally require fewer consents and approvals and are less problematic.

4.3 Classes of shares

The Company Law allows Indonesian companies to have more than one class of shares. Shares of the same class give their holders the same rights. If there is more than one class of shares, the articles of association of a company must provide that one of them is common shares. Pursuant to the Company Law, the articles of association of a company may stipulate one or more classes, the following being expressly recognised by the Company Law (either singly or in combination):

(a) shares with or without voting rights;
(b) shares with the special right to nominate members of the board of directors and/or the board of commissioners;
(c) shares which, after a certain period of time, are revocable or exchangeable with another class of shares;
(d) shares granting their holders the pre-emptive right to receive dividends over the holders of other classes of shares upon dividend distributions, cumulatively or non-cumulatively; and/or
(e) shares granting their holders the pre-emptive right to receive the remainder of the company's assets in a liquidation ahead of the holders of other classes of shares.

However, there are no provisions in the Company Law dealing with ‘redeemable preference shares’ and their specific distinguishing characteristics as found in common law company legislation. The key issue is that the ability to redeem shares must follow the share buyback procedures under the Company Law, which are restrictive, or redemption occurs by way of a capital reduction (for which the relevant provisions of the Company Law specifically envisage a redemption of shares).

For completeness, you may note that the Indonesian government owns one 'golden share' in some of the Indonesian state-owned companies that have been privatised. This is a share with certain veto powers on amendments to the articles of association of the company, and rights related to the election of members of the board of directors and/or board of commissioners.

5. DOCUMENTATION AND DUE DILIGENCE

5.1 Documentation

5.1.1 Mergers and consolidations

In a proposed merger or consolidation, the board of directors of all the companies intending to consolidate or merge must prepare a plan of merger or consolidation that must be approved by the respective boards of commissioners. At a minimum, the plan must include:

(a) the names of the companies intending to merge or consolidate, and their domiciles;
(b) the reasons for, and an explanation of, the proposed merger or consolidation by the respective directors of the companies intending to merge or consolidate;
(c) the valuation and conversion procedures for the shares of the respective companies into shares of the surviving company resulting from the merger or consolidation;
(d) any amendment of the articles of association of the surviving company in the case of merger, or a draft of the deed of establishment of the new company resulting from a consolidation (in most cases, a merger will require amendments to the surviving company's articles of association; a new deed of establishment will clearly be required in every consolidation – such a deed will necessarily require the approval of the Ministry of Law and Human Rights (MOLHR);
(e) balance sheets and profit and loss statements for the last three years for the companies intending to merge or consolidate (it is implicit in this requirement that companies that have not been established long enough to be able to produce such financial results cannot merge or consolidate (although this view may be changing));
(f) a disclosure plan for the business of the companies intending to merge or consolidate;
(g) proforma balance sheets of the company post-merger or post-consolidation, prepared based on applicable accounting principles;
(h) settlement of the status, rights and obligations of the members of the board of directors, members of the board of commissioners and employees of the companies intending to merge or consolidate;
(i) settlement of the rights and obligations to third parties by the companies intending to merge or consolidate;
(j) settlement of the rights of shareholders who dissent to the merger or consolidation;
(k) names of directors and commissioners of the companies intending to merge or consolidate, and information on their honorariums/salaries;
(l) indicative timeline to complete the merger or consolidation;
(m) report on the conditions, developments and achieved results of each company intending to merge or consolidate;
(n) report on the main business of each company intending to merge or consolidate and changes that have occurred during the current financial year; and
(o) details of issues that occurred during the then current financial year that impact the business of the companies intending to merge or consolidate.

A merger or consolidation may only be completed if a plan containing the prescribed elements, together with the draft deed of merger or draft deed of consolidation, is approved by a general meeting of shareholders (GMS) of each of the companies involved. A three-quarters vote cast at the meeting is required at a GMS where a quorum of three-quarters of the shares with valid voting rights is present. Before the transaction is submitted for approval to the GMS, the directors must publish a summary of the plan in one national newspaper and make an announcement in writing to the employees at least 30 days prior to calling the GMS. Creditors have the right to object to the conclusion of a merger or consolidation within 14 days after the newspaper announcement (such objections need to be settled prior to or at the GMS in order for the merger or consolidation to proceed).

The purpose of the publication requirement is to give the parties concerned an opportunity to be informed so that, if they believe their interests may be harmed, they may take certain steps to defend those interests. This refers to a separate requirement in the Company Law that a merger, consolidation, acquisition, spin-off or consolidation plan must take into account the interests of the company, minority shareholders, employees and other affected parties. In particular, the rights of minority shareholders and employees would need to be addressed in the implementation of a merger, consolidation or acquisition plan. In addition, the implementation of the plan would also need to take into account the public interest and maintenance of healthy business competition, introducing antitrust concepts.

The deed of merger or deed of consolidation, as approved by shareholders, needs to be executed in notarial form.

5.1.2 Share acquisitions

In general, the procedures for acquiring the shares of another company are very similar to the requirements for a merger or consolidation, where the acquisition is instigated by the management of the relevant companies. The directors of each of the companies involved must prepare a plan (acquisition plan) that needs to be approved by the respective boards of commissioners, and then by a GMS of each company.

The acquisition plan must include:

(a) the names of the acquiree and acquirer, and their domiciles;
(b) the reasons for, and an explanation of, the acquisition by the respective directors;
(c) balance sheets and profit and loss statements for the last financial year from the acquirer and acquiree;
(d) the valuation and conversion procedures for the acquired shares if the payment will be made by way of shares;
(e) the numbers of the acquired shares;
(f) funding information;
(g) proforma consolidated balance sheets of the acquirer post-acquisition prepared based on applicable accounting principles;
(h) settlement of the rights of shareholders who disagree with the acquisition;
(i) settlement of the status, rights and obligations of the members of the board of directors, members of the board of commissioners and employees of the acquiree;
(j) indicative timeline to process the acquisition; and
(k) any amendment of the articles of association of the acquirer.

Similarly, a GMS of both companies that are parties to an acquisition must approve the acquisition plan by a three-quarters vote cast at a meeting where a quorum of three-quarters of the shares with voting rights is present. In addition, the acquisition plan must be published and notifications provided in the same manner as for a merger or consolidation. The deed of acquisition, as approved by shareholders, needs to be executed in notarial form.

Additionally, the Company Law stipulates that where there is a change in control of a company, notifications to creditors and employees must occur at least 30 days prior to calling the GMS to approve the transaction.

The documentation, whether all or some of the shares of the target company are purchased, normally includes a share purchase agreement and a simple deed of transfer for the shares. The latter is required by the Company Law. The buyer of the acquired shares will not be recognised unless its name has been recorded in the share register of the target company.

If the share acquisition is only partial, the legal documentation will also normally include a joint venture agreement or a shareholders' agreement (SHA) (see Section 5.1.4).

If the buyer will provide technical assistance or other services to the target company, a technical services agreement or similar agreement may also be executed.

5.1.3 Asset acquisitions

Legal documentation for an asset acquisition tends to be more complicated than documentation for a share acquisition, since the former involves the transfer of different categories of property. Different categories of property will often require different transfer documentation.

In an asset acquisition, there is typically an asset purchase agreement assigning the assets purchased in broad terms. However, there are also various deeds of assignment for specific property such as shares, intellectual property, real property and motor vehicles. Key personnel of the target company may also execute employment agreements if the business is bought as a going concern.

In an acquisition of assets transaction that involves the transfer of the entire or a substantial part of the assets of the target company, the Company Law requires the directors of the target company to obtain approval at a GMS. A three-quarters vote of shareholders and a public announcement are required.

If the company acquiring the assets is acquiring them for cash, debt, shares or other types of consideration, the type and character of the company, the amount involved and the acquiring company's articles of association will determine what corporate approvals are required. These procedures do not contain the same level of concern for the protection of non-shareholders as the procedures for mergers, consolidations, spin-offs and share acquisitions, despite the fact that there could still be significant effects on employees, competition and (presumably) other public interests. Nevertheless, a standard proper due diligence inquiry could be made, and disclosure of material information could be expected from the directors of the companies involved, in order to fulfil the relevant compliance requirements and avoid personal liability for failing to do so.

5.1.4 Shareholders agreement

A shareholders' agreement (SHA) is enforceable in Indonesia, provided that the SHA is executed in accordance with the Indonesian Civil Code (ICC).

Indonesian law recognises the principle of freedom of contract, which is codified in Article 1338 of the ICC. This article provides that the parties to a contract are free to include any provisions they wish, subject only to the mandatory provisions of Indonesian law. There are, however, other limitations to this principle. Agreements contrary to good faith or public order shall be void (Article 1337 of the ICC). In addition, Article 1320 of the ICC stipulates the requirements that must be satisfied by a contract to be valid under Indonesian law, those being: the free consent of the parties; the legal capacity of the parties to conclude an agreement; a defined object; and a lawful purpose.

Based on the foregoing, so long as the requirements under Article 1320 of the ICC have been satisfied prior to the execution of an SHA, the SHA is valid and enforceable under Indonesian law.

An SHA contains rights and obligations of a company including all matters that are reserved for the approval of certain shareholders. In the context of a private company, an SHA is commonly entered into by the shareholders and the company to ensure that the company also adheres to the provisions under the SHA.

In the context of a publicly listed company, an SHA may be questionable in terms of the existence and enforceability of the agreement. Given that a publicly listed company has many shareholders – including those whose names are specifically stated in the articles of the company, and minority shareholders whose ownership is less than five per cent or so-called 'public' – there may be an issue as to whether an SHA will also need to be signed by the minority shareholders. In practice, a publicly listed company generally discloses an arrangement among shareholders such as the SHA only if the publicly listed company is a party to the arrangement. We are not aware of any instance in which a publicly listed company has disclosed the existence of an SHA to which the public company was not a party.

In conclusion, enforcement of an SHA in a publicly listed company may become an issue as it goes against the nature of a publicly listed company, which should be fully disclosed to the public. In any event, an SHA is commonly signed by all of a company's shareholders, as such it would be difficult (if not impossible) to obtain the signatures of all shareholders if some shares have been sold to the public.

5.2 Due diligence

Due diligence is essential in M&A transactions to provide a comprehensive understanding of the condition of the target company, especially the legal and compliance aspects. It is common practice to conduct due diligence in an M&A transaction, usually prior to signing the transaction documents. The due diligence will help both the buyer and seller in determining the requirements and conditions that need to be included in the transaction documents, eg, conditions precedent, conditions subsequent and representations and warranties. Issues commonly addressed in due diligence include:

(a) general corporate matters (eg, structure and management);
(b) licences (eg, business licences and corporate licences);
(c) regulatory compliance (eg, reporting obligations, certain notifications or approvals);
(d) employment;
(e) environment;
(f) assets and intellectual property;
(g) material contracts; and
(h) disputes/litigation.

With the due diligence, the parties are able to determine what matters/actions must be taken before or after the M&A transaction is completed in order to comply with laws and regulations. Due diligence findings can also be used by the parties as the basis of negotiations. The parties will also understand the potential legal risks of the transaction and how to manage and avoid such risks.

5.3 Representations and warranties

In essence, many Indonesian companies are not keen to give comprehensive representations and warranties, instead requiring purchasers to do comprehensive due diligence on the target company or business prior to closing.

To the extent that representations and warranties are given, Indonesian sellers will be concerned to ensure that there is a short period in which claims can be made, that there are adequate materiality standards and that there are thresholds before claims can be made.

While it is common in other jurisdictions to have a disclosure letter or schedule to further mitigate a seller's risk under the representations and warranties, in Indonesia, disclosure letters or schedules are not usually prepared (although this will depend on the transaction, the advisors and the concerns of the seller).

Buyers need to be aware that enforcement of claims for breach of warranties may be difficult in an Indonesian transaction. Consequently, and while this would be resisted by the seller, buyers should consider withholding part of the purchase price until an audit has been undertaken post-closing (or for a limited time if the buyer has conducted a thorough review at the pre-acquisition stage).