Overview of the Insolvency and Restructuring Regime in Indonesia

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Introduction

Navigating through the intricacies of the Indonesian insolvency and restructuring regime can be a daunting challenge. A quick search on the internet yields many articles highlighting potential pitfalls, such as the unpredictability of the Indonesian legal system based on Dutch civil law that does not recognize the common law concept of "precedents" (meaning that a previous decision by the courts are not binding on subsequent court decisions), or the difficulty of a foreign creditor enforcing a claim against a local debtor.

While it would be imprudent to disregard these words of caution, since the enactment of the Law No. 37 of 2004 regarding Bankruptcy and Suspension of Debt Payment Obligations (the "Bankruptcy Law") and the introduction of the concept of a court-supervised debt restructuring process, known as Suspension of Debt Payment Obligations (Penundaan Kewajiban Pembayaran Utang or "PKPU"), the Indonesian insolvency and restructuring regime has evolved significantly, and continues to evolve, into a more standardized process that debtors and creditors can rely on with growing confidence.

In this report, we explore the current Indonesian insolvency and restructuring regime to provide a high-level overview and to highlight major issues and pitfalls.

Insolvency and restructuring processes available under the Bankruptcy Law

Under the Bankruptcy Law, either a debtor or a creditor of such debtor may file a petition to the Commercial Court for either: (i) bankruptcy of the Debtor; or (ii) PKPU.

In the case of a bankruptcy proceeding, a debtor or a creditor may file a petition by providing evidence that the debtor: (i) has at least two creditors; and (ii) the debtor has failed to pay at least one due and payable debt. As the Bankruptcy Law does not recognize a debt threshold and does not require an insolvency test, debtors have been vulnerable to "rogue" insolvency claims.

One of the most notorious precedents was when one of the biggest cellular operators in Indonesia, a company with a net profit of more than USD 900m at that time, was declared bankrupt pursuant to the application by one of its creditors with a disputed claim of a "mere" USD 350,000. While the Supreme Court ultimately (and rightfully) overturned the bankruptcy declaration, the case clearly shows how easily a debtor can be declared bankrupt in Indonesia and the need for debtors to remain vigilant.

The Bankruptcy Law also does not recognize a waiting period; meaning that once a debt is due and payable, a creditor can file for bankruptcy against the debtor. The Bankruptcy Law, however, requires the applicant prove the bankruptcy requirement – the existence of at least two creditors and failure to pay a due and payable debt – in a straightforward manner. The Commercial Court has in the recent years shown inclination towards rejecting a bankruptcy petition by a creditor if the debtor can prove that the claim is disputed, provided that the dispute pertains to the existence of the claim itself (as opposed to the quantum of the debt that is being disputed).

Following a determination by the Commercial Court that a bankruptcy has occurred, a supervisory judge and a receiver is appointed by the Commercial Court to supervise and control the assets of the bankrupt debtor, and such debtor by law forfeits its right to control and manage its assets.

PKPU, in essence, provides a debtor with a specified period of court sanctioned relief from creditor enforcement and is, in that regard, analogous to Chapter 11 proceedings under the U.S. Bankruptcy Code. By imposing a moratorium on the debtor's obligation to satisfy debt payments during the course of the court-mandated suspension period, PKPU provides a debtor with a chance to avoid bankruptcy proceedings by allowing it to prepare and submit a plan to restructure its outstanding debt (a "composition plan") to its creditors for their approval.

Requirements for a creditor filing a petition for PKPU are similar to the requirements for filing a petition for bankruptcy. However, there are different requirements imposed on filing PKPU or bankruptcy petitions depending on whether the petitioner is a debtor or a creditor.

The major difference is that a petition by a debtor must first be approved by a general meeting of shareholders. The debtor also needs to obtain approval from its creditors on the names of the nominated administrators/receivers. Given that the requirement for a creditor-filed PKPU petition is less stringent, the debtor is usually motivated to arrange friendly creditors to file a PKPU petition instead.

Furthermore, creditors tend to file a PKPU petition rather than bankruptcy. This is because filing for a bankruptcy petition leaves the petitioning party vulnerable to a filing of a counter-PKPU petition by another party (i.e. another creditor or the debtor). In such a scenario, the appointed administrator is the one who is nominated by the counter-PKPU applicant and therefore the creditor-petitioner filing for bankruptcy may inadvertently end up in a scenario where it loses oversight of the selection of administrator nominees.

If, on the other hand, a creditor files a PKPU application, the only available option for the debtor to avoid a PKPU is either (i) disputing the claim, or (ii) settling the debt.

In contrast to the civil litigation process that could be relatively lengthier and more unpredictable, the Commercial Court has shown an inclination to prescribed timelines relating to bankruptcy and PKPU processes under the Bankruptcy Law. That is why a PKPU/bankruptcy process is now generally considered to be the preferred course of action over civil litigation, both by creditors who are pursuing payment of their debts, or debtors who are looking for a settlement with its creditors. This is supported by the substantial upward tick in the number of bankruptcy/PKPU applications in 2020 in comparison to 2019 (see Table 1).

Table 1: PKPU and Bankruptcy Applications (2019 - 2020)

Applications	2019	2020
PKPU	434	634
Bankruptcy	125	113
Total	**559**	**747**

Granting of PKPU by the Commercial Court

The advantage of a PKPU proceeding over a bankruptcy proceeding are (i) the shorter length of procedure to procure an outcome; and (ii) the debtor/creditor cannot file a counter petition. Under a PKPU proceeding, the Commercial Court must render a decision to commence the PKPU within: (i) where the PKPU proceeding is initiated by a creditor's petition, 20 days; and (ii) where the PKPU proceeding is initiated by the debtor's petition, three days. It should be noted that, under the Bankruptcy Law, a PKPU decision is not subject to an appeal.

As part of its decision to commence a PKPU, the Commercial Court will appoint a supervisory judge, along with an administrator who will, jointly with the debtor, manage the debtor's assets. As a general rule of thumb, the Commercial Court will appoint the administrator(s) based on the PKPU application. Administrators have an important role in the PKPU process because the administrator can:

a) verify claims submitted by creditors against the debtor's records, and either admit the amount of the debt according to the debtors' version or the creditor's version. If the creditor objects to the administrator-admitted amount, the Supervisory Judge will then decide the amount and this amount will not be subject to an appeal; and

b) assess and report on the substance of the composition plan.

This often precipitates into a "race to file" and often times results in a party filing a PKPU as a pre-emptive measure against another party filing a petition.

Key elements of the PKPU Process

Once granted by the Commercial Court, a PKPU can last for a maximum of 270 days, consisting of:

a) a temporary PKPU: 45 days (or as may be extended by the creditors) from the date on which the decision on the temporary PKPU is made; and

b) a permanent PKPU: up to 270 days from the date on which the decision on the temporary PKPU is made.

During the temporary PKPU, the debtor will be required to propose a composition plan to be voted by its creditors. Both secured and unsecured creditors whose claims have been admitted can participate in the vote. In order for the composition plan to pass, the debtor needs to meet the requisite threshold.

If the debtor is not ready to propose the composition plan within the temporary PKPU, it can request for a permanent PKPU. The determination of a permanent PKPU will also be subject to creditors voting with the same requirements as voting for a composition plan.

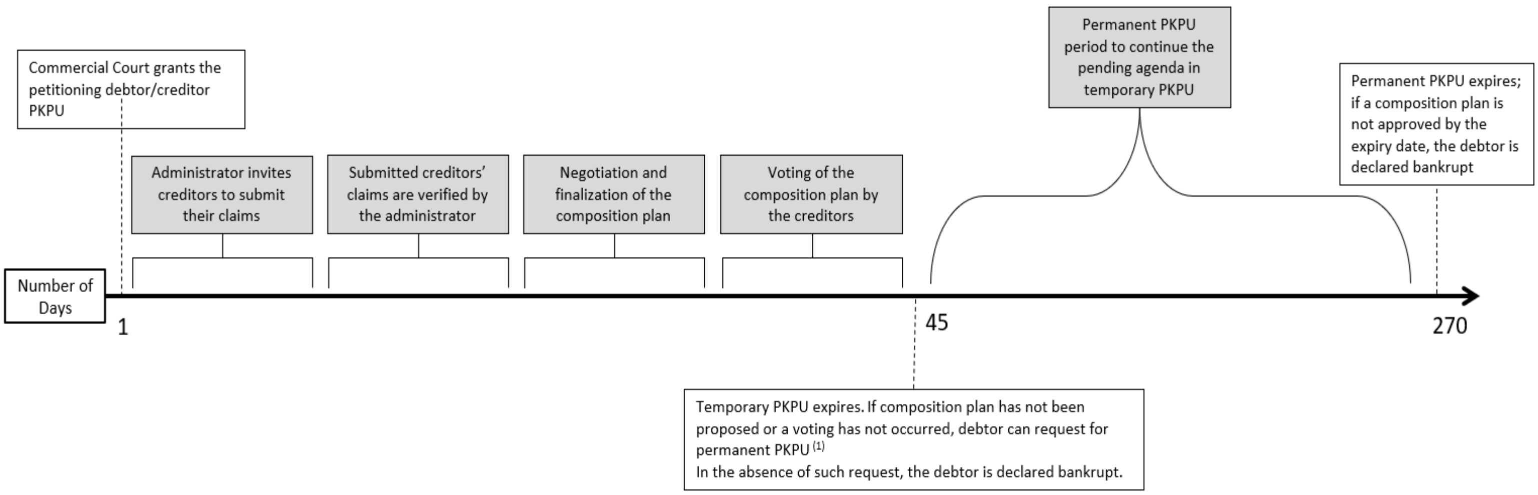
If (i) in the absence of a composition plan the debtor does not request for a permanent PKPU or (ii) a request for a permanent PKPU is rejected, then the Commercial Court will declare the debtor bankrupt.

If at any time (either during temporary or permanent PKPU) the composition plan is proposed but not agreed to by the creditors, then the Commercial Court will also declare the debtor to be bankrupt.

As there is no extension beyond the 270 days that can be requested or made in a PKPU, the parties involved have the comfort of knowing that a restructuring and insolvency process via the PKPU proceeding has a fixed period.

There are three key elements to a PKPU process, namely: (i) submission of creditors' claims to the administrators; (ii) verification of creditors' claims; and (iii) negotiation of a composition plan (see Figure 1).

Figure 1: A Typical PKPU Process Timeline



(1) Temporary PKPU may be extended by affirmative vote of: (i) at least a simple majority of unsecured creditors holding at least 2/3 of the value of all unsecured claims; and (ii) at least a simple majority of secured creditors holding at least 2/3 of the value of all secured claims.

c) Submission of creditors' claims to the administrators

Upon the commencement of the PKPU process, all known creditors are invited by the administrator to submit their claims. The information on this submission will also be published by the administrator in at least two national newspapers. The submission of a creditor's claim must typically be supported by the following documents:

i. a written statement containing the calculation, nature, and the total amount of the claim;

ii. the underlying documents for the claim, i.e. a contract, notice of default, and its supporting documents (e.g., invoices) and the Indonesian translation if the documents are in a foreign language; and

iii. for secured creditors, a statement of security right or other special right over the debtor's asset.

d) Verification of creditors' claims

Following the submission of creditor claims, the administrator verifies the claims in coordination with the debtor. As part of the wide ambit of authority and discretion granted to the administrator, the administrator also has the discretion to classify creditors into secured and unsecured classes. This can sometimes lead to scenarios where creditors dispute their classification or allegations that suspected fictious creditors were afforded voting rights in a PKPU process. From a creditor's perspective, the existence of such potential risks further emphasize the need to remain proactive in the PKPU process to ensure that an administrator does not act against creditor interests.

The determination on whether a claim is considered as secured is largely considered to be a straightforward analysis. So long as the security is a security in rem (e.g., pledge, fidusia, mortgage, or hipotek) and the security provider is the debtor (not a third-party guarantor), the claim would be determined as secured. If a secured claim is recognized by the administrator as unsecured, the said creditor can bring the dispute on this discrepancy to the supervisory judge.

One prime example in which working together with a favourable, experienced administrator and advisors through a PKPU proceeding is where a debt is structed and issued in the form of bonds or notes. Under the Indonesian legal system, the concept of a "trust" is not formally recognized. This results in a fundamental difference in the treatment between (i) creditors holding syndicated loan debts or debt which is in loan form, and creditors holding debt which is issued in the form of bond or in notes (via a trustee).

In a syndicated or bilateral loan, a creditor will typically be a direct creditor of the relevant company and will have direct right against it, thus allowing it a direct claim against the company and an ability to file claim for a PKPU.

However, debt issued in the form of bonds and notes sometimes runs into issues in PKPUs. Bonds are issued and exist in many different ways, shapes and forms. A common structure involves a trustee who holds the benefit of the covenants under the bond documents and the benefit of the debt evidenced by the bonds on behalf of a group of underlying bondholders. Those bondholders further often hold their interests in the bonds through a clearing system. Given that the Indonesian legal system does not formally recognize the concept of a trust, trustees are potentially exposed to difficulties proving debt claims against a company in a PKPU. Accordingly, in the context of a bond, there is often confusion as to whether the trustee or underlying bondholders should (or can) file for PKPU.

As mentioned, the Indonesian legal system also does not formally recognize the concept of the doctrine of precedent, and so previous decisions of the Indonesian court are not binding moving forward.

Accordingly, there has been a series of different decisions issued by Indonesian courts over the years in relation to which party should file an application for a PKPU. In some cases, PKPU filings have been made by bondholders, and in others, PKPU filings have been made by the trustee and in certain circumstances, proofs of claim in the same PKPU in respect to the same bond have been submitted by the trustee and bondholders and the Indonesian courts have partially accepted both.

As a result, in addition to submitting all supporting documents as elaborated above, creditors must be able to explain to the administrator or supervisory judge regarding the parties' right to represent the bondholder in filing the claim under the relevant indenture (e.g. the trustee). This is also applicable in a syndicated loan arrangement, where lenders may be represented by a security or facility agent in submitting the claim to the borrower in a PKPU process.

e) Negotiation and finalisation of a composition plan

While there is no requirement under the Bankruptcy Law as to the content of the composition plan and there is no standard format or requirement on the content of a composition plan, a debtor has a flexibility to draft a composition plan.

A composition plan typically details how outstanding debts are to be restructured and provides for other commercially negotiated terms such as extension and rescheduling of debt payment terms, reduced interest rates, waiver of penalties and overdue payments. It is also not uncommon for the composition plan to also include treatment for the payment arrangement of existing debt that will be due in the future or has not been identified prior or during the PKPU.

In order for a composition plan to be approved, both (i) a simple majority of unsecured creditors present, provided that they represent at least 2/3 of the value of all accepted unsecured claims held by the concurrent creditors present at the meeting; and (ii) a simple majority of the secured creditors present, provided that they represent at least 2/3 of the value of all accepted secured claims held by the secured creditors present at the hearing or meeting are required.

It should be noted that a composition plan, once approved by the requisite threshold, binds all unsecured creditors (regardless of whether an unsecured creditor has voted for or against the plan). The composition plan is also binding on secured creditors who did not vote against the plan.

The composition plan would however not be binding on secured creditors who have rejected the composition plan, and such rejecting secured creditors would become entitled to compensation that is the lesser of the value of the collateral or the actual value of their debt directly secured by the collateral rights to property. However, this has not been tested in practice as creditors will instead seek to avoid uncertainty of further litigation.

Implementation of the composition plan

Any breach by the debtor of the restructuring agreement can result in a default and may cause bankruptcy. In the event of a default, any creditor can file an application in respect of such default to the restructuring agreement, which will also be heard by the Commercial Court. If the court is of the view that a default occurs, the court can – based on its sole discretion – provide a 30-day remedy period for the debtor. If the remedy period was not provided by the court or the provided remedy period has been exhausted, the debtor will be declared bankrupt.

In several cases, in the event of a default, the debtor tried to amend the restructuring agreement to avoid bankruptcy relying on agreed amendment provisions in the restructuring agreement. In recent years however, the courts have rejected exercise of such practice of amending the restructuring agreement to avoid bankruptcy. In CIMB v. Arpeni (2019), despite the existence of (and exercise by the parties of) amendment regime in the restructuring agreement, the court still found the relevant debtor in breach of the original restructuring agreement (and therefore bankrupt).

The Supreme Court in the Arpeni case opined as follows:

a) a court-approved settlement agreement must be treated in the same manner as a final and binding court decision, and therefore cannot be amended privately by the parties; and

b) amendment to a court-approved settlement agreement contradicts the fairness and equity principle in bankruptcy law as it nullifies the assurance of the debtor’s performance under the settlement agreement.

Notable Recent Developments in the Bankruptcy Law

In 2016, the Indonesian Supreme Court issued Circular Letter No. 2 of 2016 regarding Enhancement of Efficiency and Transparency in Handling Bankruptcy and PKPU Cases in Court, dated 25 April 2016 (the “Circular Letter”).

The Circular Letter provides that in the event a debtor files a voluntary bankruptcy or PKPU, the debtor's nominees for receiver(s) and/or administrator(s) must be approved by creditors. The Circular Letter stipulates that creditors' approval of nominated receiver(s) or administrator(s) is a formal requirement that cannot be avoided. This has been met with some criticism, as obtaining creditor-approval could be inefficient from both a timing and cost perspective.

Furthermore, in recent years, the Commercial Court has granted a PKPU or bankruptcy petition filed against an insurance company by creditors other than the OJK, Indonesia’s financial services regulator. This ruling is arguably contrary to the provisions of the Bankruptcy Law which state that such institutions can only be declared bankrupt based on a petition filed by the OJK.

Additionally, many industry practitioners and experts alike have observed an upward trend of a PKPU or bankruptcy petitions being used as a way by creditors to “intimidate” the debtor (as evidenced by the 40% increase in the number of PKPU and bankruptcy petition filings in 2020, compared to 2019). Typically, by employing such tactics, a creditor files a PKPU petition with a view of gaining the upper hand in negotiations with the debtor (in exchange for revoking the PKPU petition before the Commercial Court makes a binding ruling).

Conclusion

In this report, we have examined Indonesia's bankruptcy and insolvency regime under the Bankruptcy Law and in particular the process under the PKPU proceedings which continues to garner growing popularity amongst debtors and creditors alike.

The Indonesian bankruptcy and insolvency regime continue to be a "work-in-progress", highlighted by the fact that the courts themselves seem to apply the provisions of the Bankruptcy Law in an inconsistent manner and as further highlighted by the decision in Arpeni, sometimes in a manner that is not conducive to supporting and giving the debtor an opportunity to resuscitate its business.

Certain systematic issues also remain unresolved, including the ability of "bogus" creditors to raise spurious claims thereby reduce the voting leverage of other unsecured creditors, and the lack of certainty on the part of secured creditors in receiving compensation in the case they vote against a composition plan (which in turn forces secured creditors to agree to a composition plan that they may not necessarily wish to approve).

However, it should also be noted that the bankruptcy and insolvency regime under the Bankruptcy Law is a considerably new development in Indonesia, particularly when compared against the bankruptcy and insolvency regimes in other South East Asian jurisdictions and, within less than two decades of being in existence, has provided debtors and creditors with much more streamlined and predictable alternative to litigation proceedings. The Commercial Courts also continue to exhibit their growing familiarity and confidence in interpreting the provisions of the Bankruptcy Law and have shown inclination to achieve greater consistency in their judgments following the issuance of regulations and decrees by the Supreme Court on frequently considered matters.

As may have been expected, the COVID-19 pandemic has introduced a number of additional impediments to Indonesian debtors' ability to remain solvent and there has been a significant surge in the number of both bankruptcy and PKPU petitions in 2020 compared to in 2019. The growth in the number of bankruptcy and PKPU petitions will continue to challenge the courts to optimize and refine the overall bankruptcy and insolvency regime, and we anticipate that 2021 will experience a surge of new developments and trends in the Indonesian bankruptcy and insolvency regime.