Issue 141, 29/1/2010

Indonesian
Weekly Law Digest

Indonesian Legal Digest *is a service of*
PT Justika Siar Publika *owner and operator of*
www.hukumonline.com
Puri Imperium Office Plaza UG 15
Kuningan, Jakarta 12319
to subscribe, call 62-21-83701827 or fax to 62-21 83701826
or email layanan@hukumonline.com

Mandatory Pre-Notification for Merger and Acquisitions - 'Final' Draft Government Regulation

Overview

The next incremental step towards standardized enforcement of competition law in Indonesia will take form in the nearly-finished Draft Government Regulation on mandatory pre-notification for mergers and acquisitions. The last draft was circulated on 14 January 2010, and the regulation will apparently be issued within the first 6 months of this year. In essence, any prospective merger or acquisition that meets certain size criteria will soon necessitate pre-notification to - and require subsequent approval from - the Commission for the Supervision of Business Competition, or 'KPPU' - the principal implementer of Law No. 5 of 1999 on the Prohibition of Monopolistic Practices and Unfair Business Competition (Law 5/1999).

Mergers and acquisitions are the exclusive subject of Articles 28 and 29 of Law 5/1999, where it is maintained that post-notification of a concluded deal that meets certain criteria (that has until now never been specified in an implementing regulation) must be submitted to the KPPU within 30 days of conclusion. Although lacking implementing regulation and other factors play a role, in short, the KPPU currently has little real capacity to intervene prior to a deal being done. As such, the KPPU has been largely restricted to reactive, punitive actions against already-concluded transactions.

Legal certainty has been difficult to secure: case-by-case hindsight interventions can be difficult to anticipate, especially since lacking coordination between the KPPU and other government agencies has resulted in mixed expressions of state approval for different deals. Apart from the fact that the legal certainty of a merger, acquisition, or consolidation could not be guaranteed prior to any dealings, KPPU interventions have often been predestined to arduous court proceedings.

For a brief overview, see: ILB No. 1287 25/1/2010.

Table of Contents

Issue 141, 29/1/2010

Purpose

A pre-notification mechanism could allow the KPPU to intervene before an unhealthy merger, acquisition, or consolidation takes substantive form. The KPPU's *modus operandi* could shift from a punitive to preventive one. Meanwhile, legal certainty could be guaranteed to prospective mergers, acquisitions, or consolidations. This would help Indonesia to cultivate a welcoming investment climate. In that vein, it is important that the KPPU consolidate a standardized, predictable 'repertoire'; if supported by inter-agency coordination, the coming regulation makes this possible.

Instrumental Provisions

At the instrumental level, the coming regulation will, at long last, elaborate an implementation of Articles 28(3) and 29(2) of Law 5/1999, which call for further provisions on: (a) prohibitions regarding mergers, acquisitions, and consolidations, and; (b) details around transaction values at which point notification to the KPPU is required.

Regarding point (a): *pre-notification as a method for prohibition*. The KPPU will require pre-notification in the form of a written report of a prospective deal within 30 days of initial agreement and/or related documents being formulated.

The KPPU will initially examine the pre-notification report with consideration to market concentration, which it will likely assess by way of the *Hirschman-Herfindahl Index Method*, to determine if the proposed deal will lead to anti-competitive market concentration - generally regarded as when 3 or less actors (or groups of actors) control 75% or more of a given market. If the KPPU determines that the market concentration is reasonably low, it will simply issue approval. However, if the market concentration is deemed high, it will conduct a 'full analysis' with consideration of market barriers, unfair business competition potential, efficiency, and the potential for bankruptcies. Either way, the KPPU will issue a decision in one of three forms: approval, conditional approval, or rejection of the proposal.

Regarding point (b): *mergers, acquisitions, or consolidations requiring pre- and (ostensibly) post-notification*. According to the final draft, mergers, acquisitions, or consolidations will need to be reported if the exchange between parties meets or exceeds any of the three following criteria: (i) IDR 2.5 trillion value of assets; (ii) IDR 5 trillion value of sale, and; (iii) lead to the singular possession or control of equal to or more than 50% of a given market share. Collectively, these define the 'minimum threshold limitation' at which a prospective deal must be reported. One specific exception is made for the banking sector, however, relating only to criteria (i): pre-notification is required only if the value of assets exceeds IDR 20 trillion.

Although it is not explicitly stated in the draft regulation, Ahmad Junaidi, the Head of KPPU Public Relations, confirmed to *hukumonline* (28/1) that the coming draft regulation will repeal and replace KPPU Regulation No. 1 of 2009 on [Voluntary] Pre-notification of Mergers, Consolidations, and Acquisitions. This is so for the reason of *lex superiori derogat lex inferiori* - a higher regulation, in this case Government Regulation, holds sway over a lower regulation, in this case KPPU Regulation.

Pre-notification Form and Required Supporting Documents

The form(s) required for pre-notification reports will be provided by the KPPU, and more than likely be contained in the final regulation's Attachments. As set out in Article 17 (2 & 3) of the draft, required supporting documents will include: company profiles, summary of merger or acquisition plan, the value of relevant assets or net sales value, signatures from company executives, financial reports for the last 3 years of operations, and articles of association from each company involved.

Dispute Mechanism

Rejected pre-notification proposals can be appealed with the court of first instance, and subsequently with the Supreme Court, as set out by Supreme Court Regulation No. 3 of 2005. In the event of appeal, the Court will review the case to assess whether the prospective deal is or will cause a violation of Law 5/1999.

Enforcement

According to Article 11 of the draft regulation, failure to submit a pre-notification report could result in two forms of administrative sanctions: (i) annulment of the acquisition, merger, or consolidation process, and; (ii) a fine up to the amount of IDR 25 billion.

For the reason that the coming pre-notification regulation will be issued in the form of 'Government Regulation' - not simply rules stipulated by the KPPU - the approval-related decision of the KPPU is, unless appealed within the given time, considered legally binding on the pre-notifying parties. An essential enforcement question (for those who are skeptical of their chances of a successful appeal, and decide that despite KPPU pre-notification rejection, following through is critical for their business) is thus: what happens if a pre-notification proposal is rejected by the KPPU, but the respective parties engage in the merger, acquisition, or consolidation anyways?

Article 47 (2) of Law 5/1999 confers authority on the KPPU to, among other things, cancel (i.e., annul the contract of) a merger, acquisition, or consolidation, as well as order a business actor to cease activity that is deemed anti-competitive. Meanwhile, Article 48 (1) allows the KPPU to impose a criminal fine between IDR 25 and 100 billion, as well as imprisonment for up to 6 months for a business actor violating the Law's provisions. Article 49 (a) also allows for the revocation of a business license.

Although those articles grant the KPPU substantial disciplinary power, it must be noted that at the 'business end' of enforcement, no law enforcement agency is actually subordinated to the KPPU - unlike the Courts. To that extent, the lingering question is: what would happen in the event that a party or group of parties obstinately refused to comply with all KPPU decisions? The KPPU simply cannot knock on doors to collect fines, imprison violators, freeze, seize, or auction assets; coordinated compliance of other law enforcement agencies with KPPU decisions is required - such consistency is not always present in Indonesia. For that reason, although outside the scope of this inquiry, there is certainly much debate around centralizing real enforcement authorities in the KPPU.

Coordination of Pre-Notification Approval with Other Agencies

A critical element of legal certainty (necessary to cultivate a welcoming investment climate) is regulatory consistency. To that extent, it is essential that KPPU pre-notification approval (or rejection) decisions are consistent with the decisions and communications of other governmental financial supervisory agencies, such as the Capital Market and Financial Institution Supervisory Agency ('Bapepam-LK'), among many others.

At least within the regulatory framework, there is legal synchronization between many government agencies. Article 84 of Law No. 8 of 1995 on Capital Markets (the Capital Market Law), for example, effectively states that whenever public companies are conducting mergers or acquisitions, they must obey the existing relevant regulations - implicitly referring to the provisions and implementing regulations of Law 5/1999. In that same manner, any regulation relating to mergers, acquisitions, consolidations - indeed any market activity - can (and must) be synchronized with Law 5/1999, including its implementing regulations.

Until now however, obligatory pre-notification has not been a facet of Law 5/1999 or its few implementing regulations. For that reason, the KPPU has ended up sanctioning certain business arrangements long after those deals had secured approval from other financial agencies.

The 2007 case of the KPPU against Singaporean state-linked investor, Temasek Holdings, is illustrative. Through a series of linkages, Temasek Holdings effectively controlled both PT Indosat Tbk. and PT Telkomsel Tbk, which together accounted for some 75% of Indonesia's more than 80 million-strong telecommunications market.

The issue was essentially created by the Indonesian government's approval of the divestment of state-owned PT Telkom shares in PT Indosat to a controlled subsidiary of Temasek Holdings. For the reason that PT Indosat was a public company, it fell within the scope of Bapepam-LK, which issued approval for the acquisition. Thus, both the government and capital market agency approved the deal - it was only consequent to its conclusion that the KPPU was able to intervene to the contrary. With reference to Law 5/1999, the KPPU declared the arrangement unlawful, and was subsequently mired in court proceedings. Although the Supreme Court finally ruled in favor of the KPPU, ultimately the case highlighted the lack of legal certainty and investment security in Indonesia.

Conclusion

The frustrated case of Temasek Holdings - only one of many like it - illustrates clearly the necessity of a KPPU pre-notification process. In a way, it is the missing link that ties the financial supervisory agencies together. As mentioned previously, each agency's supporting regulations variously provide that for any merger, acquisition, or consolidation to be legal, consideration must first be made to the prevailing relevant regulations - effectively, Law 5/1999 and its implementing regulations. Once the Draft Government Regulation on KPPU pre-notification is enacted as an implementing regulation of Law 5/1999, it will need to be

Issue 141, 29/1/2010

factored into any consideration of a merger, acquisition, or consolidation. Thus, any deal that meets the minimal threshold limitation criteria - that is, anything with a remote possibility of having a monopolistic, anti-competitive, or otherwise market-harming outcome - will first need to be pre-notified, assessed, and approved (or rejected) by the KPPU.

A direct implication of that is legal certainty for prospective mergers, acquisitions, or consolidations: before parties get too far into their dealings, they can know exactly where they stand; do they, or do they not have the blessings of the Indonesian government. Once a deal is done, cancellation of the arrangement can be highly damaging to a business that has transferred capital, restructured its organization, established new products or services, and so on; allowing the KPPU to intervene beforehand could well be essential.

Not only does KPPU pre-notification support regulatory consistency, helping to cultivate a welcoming and secure business environment, but it also does much to eliminate the possibility of events like the 2007 Temasek Holdings case from happening in the future. Moreover, it could well liberate the indwelling potential of the KPPU to develop itself as a predictable, effective institution, and the guardian of healthy Indonesian market activity.

Of course, the previous discussion paints a rosy picture. The law is one thing, enforcement quite another - particularly in Indonesia. As this inquiry discussed, the pre-notification mechanism does nothing to bestow enforcement authority upon the KPPU. At the end of the day, if parties do not voluntarily comply with the KPPU, it relies upon shared understanding with real law enforcement agencies - the Courts, prosecutors, police, and so on - to translate its decisions into concrete realities. In so far as it relates to mergers, acquisitions, or consolidations, whether pre-notification makes a truly substantive difference to 'business as usual' in Indonesia is contingent upon that reality.