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www.hukumonline.com
Puri Imperium Office Plaza UG 15
Kuningan, Jakarta 12319
to subscribe, call 62-21-83701827 or fax to 62-21 83701826
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New KPPU Regulation on Merger and Acquisition Transactions

Overview

The Business Competition Supervisory Commission (KPPU) has once again issued a regulation on mergers and acquisitions, in the form of KPPU Regulation No. 13 of 2010 on the Guidelines to Conduct Mergers and Acquisitions that Might Result in Monopolistic Practices and Unfair Competition ("Regulation"). The Regulation has entered into force on 18 October 2010.

Previously the KPPU had issued several regulations for businesses planning to carry out a merger or an acquisition transaction (M&A). Examples of such are: KPPU Regulation No. 1 of 2009 which set out the pre-notification obligation for businesses, and was later revoked through the issuance of KPPU Regulation No. 11 of 2010 regarding consultation obligations for M&A plans. For the consultations, the forms were further set out in KPPU Regulation No. 10 of 2010.

The Regulation, as well as the earlier series of regulations on M&A, were issued to clarify the broader Government Regulation No. 57 of 2010 on Mergers and Acquisitions that Might Result in Monopolistic Practices and Unfair Business Competition ("Government Regulation"), in conjunction with Articles 28 and 29 of Law No. 5 of 1999 on Antimonopoly and Unfair Business Practices ('Antimonopoly Law'), which in essence prohibits transactions that will result in monopolistic practices and unfair business competition.

This edition of Indonesian Legal Digest will highlight key features of the Regulation and provide analysis of the Regulation's provisions.

Purpose

The purpose of the Regulation is to set out a comprehensive guide for companies conducting M&A transactions, in order to clarify and prevent multiple interpretations of the Government Regulation, hence providing legal certainty by further regulating the consultation with the KPPU on the M&A plan, the timeline and procedure required for the approval, and the factors used in evaluating M&A transactions.

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It should be noted that the Regulation also restates and reemphasizes the M&A consultation obligations previously set out under KPPU Regulation No. 11 of 2010.

Applicability

Large scale M&A transactions that exceed certain threshold in countries such as the United States of America, Japan, and Germany, require corporations to obtain approval from their respective business competition supervisory bodies. Similarly to the practices in other countries, Indonesia also has a threshold beyond which an M&A transaction has to be reported and requires approval, with such measures being designed to ensure healthy business competition.

Under Articles 5 (2) and (3) of Government Regulation No. 57 of 2007 in conjunctions with Article 2 of KPPU Regulation No. 11 of 2010 and Chapter IV B (1) of the Regulation, the thresholds are set out for two types of businesses: those in the banking sector and those who are not. For business in the banking sector the threshold is when total assets would exceed 20 trillion IDR. For other businesses the threshold is 2.5 trillion IDR in consolidated assets of the combined company following the transaction, or 5 trillion IDR in combined revenue.

The total assets based on the consolidated assets and the combined revenue is taken by the Regulation to mean the total of all assets and revenues of both M&A parties, including their parent company, subsidiary companies, and sister companies. Excluded are any assets held abroad and all exports.

Definition

Article 1 of Law No. 40 of 2007 on Limited Liability Companies ('Company Law') contains the definitions of a merger, consolidation, acquisition, and a takeover. What is interesting is that the Regulation, pursuant to Chapter III (B), broadens these definitions, by capturing any activity carried out by a businesses that causes a concentration of control from several businesses that were previously independent; or the transfer of control from one business to another business whereas previously they were independent, resulting in a concentration of control or a concentration of the market.

Moreover, under the Regulation M&A does not solely apply to limited liability companies (PT), but also to legal entities such as firms (a legal entity that is regulated under Indonesian Commercial Code (KUHD)). Although there is no single prevailing law in Indonesia that regulates the procedure of M&A transactions, the attempt by the KPPU to address the majority of M&A transactions suggests that the KPPU intends to regulate M&A activity in an extensive manner. The various types of M&A transactions are further elaborated on in Chapter III (C).

Pursuant to Article 7 of the Government Regulation in conjunction with Chapter IV (B) (1) (b), an exception exists where the M&A transaction occurs between affiliated companies, however, this exception only applies if the KPPU is of the view that an M&A transaction would not change the market structure or effect existing business competition.

Foreign M&A

The Regulation, under Chapter IV (D), gives a mandate to the KPPU to review certain M&A transactions that take place outside of Indonesia. With the factors that are considered in assuming such jurisdiction being whether the M&A has a direct effect on the Indonesian market, whether the M&A parties conduct business activities in Indonesia directly or indirectly, or whether one of the M&A parties carries on business in Indonesia while the other M&A party sells its products in the Indonesian market. The foreign companies are also subject to the threshold requirement and the exception for affiliated companies.

Foreign M&A transactions were alse previously addressed by KPPU Regulation No. 1 of 2009, which was later revoked by KPPU Regulation No. 11 of 2010.

Evaluation Procedure

Under Articles 5 and 10 of the Government Regulation, in conjunction with Article 2 of KPPU Regulation No. 11 of 2010 and Chapter IV (A), businesses meeting the threshold are subject to an evaluation by the KPPU, with the exception of M&A transactions between affiliated businesses. The businesses undergo a pre-evaluation phase by means of a consultation with the KPPU, and a post-evaluation phase that occurs after an M&A transaction has taken effect.

Prior to the M&A transaction, businesses have the right to consult the KPPU regarding their M&A transaction in writing and orally. The consultation phase is offered to businesses to minimize the losses that might occur if it is later decided by the KPPU that the M&A transaction would result in monopolistic practices and unfair business competition, that would lead to an M&A transaction being annulled by the KPPU. As such, this early warning system serves to create business certainty.

In order to apply for a consultation, businesses have to provide the M&A agreement, and submit forms as set out under Article 2 of KPPU Regulation No. 10 of 2010 on the Notification Forms for Mergers, Consolidations, and Acquisitions. The exact type of form to be submitted depends on the type of M&A transaction, the form for mergers being the M1 form, for consolidations the K1 form, and for acquisitions the A1 form.

On every form to be submitted, businesses are also required to attach the articles of association of the parties to the M&A transaction; the company profiles that must consist of the product profile, competition profile, consumer profile, supplier profile; 3 consecutive years of financial reports from each company; the plan of the M&A transaction; other supporting legal documents for the M&A transaction; and a summary of the M&A transaction.

Timeline

Pursuant to Chapter V (C), evaluation in the consultation phase is divided into two parts, first, the initial evaluation and then the comprehensive evaluation phase. Upon the submission of the completed form the KPPU has 30 working days to conduct the initial evaluation of the M&A transaction plan.

Usually, if the initial evaluation is found to be sufficient, a comprehensive evaluation will not be conducted by the KPPU, however, if conducted, the KPPU has 60 working days to conclude the comprehensive evaluation.

Following the consultation, an evaluation will be issued by the KPPU, the evaluation may come in three types, first, being the opinion that there is no indication of monopolistic practices and unfair business competition, second, that there is an indication of a monopolistic practices, and third, an opinion stating that there is no such indication, but setting out a requirement that has to be met.

As stated in Chapter IV (C), it should be noted that even if the KPPU evaluates an M&A plan in the consultation phase, the KPPU still retains the right to re-evaluate an M&A transaction in the post-evaluation phase. Such re-evaluation is only carried out in the event that there are changes in data and/or market conditions from those provided by the businesses to the KPPU at the time of consultation, so as to prevent redundant evaluations.

Post-Notification/Evaluation

Since consultations are not mandatory, but merely recommended by the KPPU, when an M&A transaction exceeds the threshold, an obligation exists to notify KPPU within 30 working days from the date of the M&A transaction having legal effect, this is regulated pursuant to Article 29 of Law No. 5 of 1999 on Antimonopoly and Unfair Business Practices in conjunction with Article 5 of the Government Regulation and Chapter IV (B).

In notifying the M&A transaction to the KPPU, the forms and documents to be submitted are similar to those during the consultation phase, with the addition of the approval of the M&A transaction by the Minister of Law and Human Rights and the approved amended articles of association.

Timeline

Upon a complete submission of the forms as set in Article 2 of KPPU Regulation No. 10 of 2010, KPPU has 90 days to evaluate the M&A transaction. There are only two possible outcomes: there is no indication of a monopolistic practices and unfair business competition due to the M&A transaction; or there is such an indication.

If there is no indication, the KPPU will produce a document called the "no objection letter." In 2010 KPPU has conducted a number of reviews that have resulted in no objection letters, for example: the takeover PT Matahari Departemen Store Tbk by Meadown Asia Company Limited, with a combined revenue of 6.2 trillion IDR. Unilever Indonesia Holding, B.V acquisition of PT. Sara Lee Body Care Tbk, with a combined revenue of 18.4 trillion IDR. And PT. Tuah Turangga Agung takeover of PT. Agung Bara Prima, with combined revenue of 29.2 trillion IDR.

As of October 2010, there has not been an "objection letter" issued by KPPU on their official website. Presumably when the notification thresholds are reached a consultation is typically pursued, in order to avoid the possibility of the M&A transaction being annulled.

Element of Evaluation

The philosophy of the Antimonopoly Law, as set out in the recitals, is to provide an equal opportunity to participate in the production and marketing of goods and services within a healthy business climate, with the effectiveness and efficiency of the business climate stimulating economic development. In realizing this philosophy, unfair competition and the concentration of economic of power within certain businesses is to be prevented for the greater good of society.

Such philosophy in relation to an M&A transaction, which crossed the threshold, is implemented by the KPPU. The Regulation sets out the elements used by the KPPU in evaluating an M&A transaction that might result in monopolistic practices and unfair business competition.

As set out under Chapter V, there are five elements used to evaluate an M&A transaction, **the first** is evaluating the "market concentration" of the products or services provided by the companies involved in the M&A transaction. In evaluating the market concentration the KPPU uses the Concentration Ration (CRN) or the Herfindahl-Hirschman Index (HHI) methods, with a description of these methods being provided in Chapter V (A) (1). The market concentration element is an initial indicator to determine whether an M&A transaction would cause a highly concentrated market that potentially will result in monopolistic practices and unfair business competition.

Second, the "entry barrier" element is evaluated, KPPU will evaluate absolute barriers, such as governmental regulation, licenses, and intellectual property rights; and structural barriers such as the demand and supply over production, access to high technology, sunk costs, economic scale, consumers' switching costs; and also strategic advantage held by the M&A parties, such as first mover advantage, product differentiation, tying and bundling, or exclusive distribution contracts. The indication of entry barriers is evaluated by the KPPU by reviewing historical data of the respective businesses in their industry.

Third, the "anti competitive behavior" element is evaluated, here KPPU will evaluate the unilateral effects, the coordinated effects, and market closure. With respect to the unilateral effect, the evaluation will look into whether the M&A transaction will make the M&A parties gain a dominant position, which may result in the abuse of such dominant position against other businesses in the same industry. The coordinated effect, when several large competitors exist in the same industry, the M&A would lead to coordination of anti-competitive actions. Market closure is also evaluated by the KPPU, this is done by evaluating the transparency of the market to see how homogenous or differentiated are the products that are sold in the market. Anti competitive behavior is further discussed under Chapter V (A) (3).

Fourth, the "efficiency" element is evaluated, here KPPU compares the efficiency gained from the M&A transaction with the anti-competitive effect resulting from the M&A transaction. For this evaluation, the summary of the M&A transaction as set under Article 2 of KPPU Regulation No. 10 of 2010 and submitted to the KPPU will typically cover the efficiency improvements due to the M&A transaction, such as the reductions in the variable cost, marginal cost, or fixed cost.

Fifth, the "bankruptcy" element is evaluated, here, when the reason for the transaction is the possibility of bankruptcy of one of the parties, the KPPU evaluates whether leaving or staying in the industry would bring greater detriment to consumers. In evaluating the reasons for the M&A transaction the KPPU will evaluate three factors: the company's financial condition, the inability to conduct reorganization, and whether there are any other alternatives to the M&A transaction to save the business from bankruptcy.

Sanctions

Businesses that carry out an M&A transaction that results in monopolistic practices and unfair business competition are subject to sanctions in the form of administrative sanction, fines, and criminal sanctions.

As set out under Chapter VII (A) in conjunction with Articles 47 and 48 of Law No. 5 of 1999, companies that are found by the KPPU to have concluded an M&A transaction that has resulted in monopolistic practices and unfair business competition will face an administrative sanction in the form of the M&A transaction being annulled, while also being subject to a criminal fine of a maximum 100 billion IDR or a 6 months imprisonment (of the responsible company officers).

Under Chapter VII (B) in conjunction with Article 6 of the Government Regulation, businesses failing to report their M&A transactions within the 30 working day period after the issuance of the approval from the Minister of Law and Human Rights, will be subject to an administrative fine of 1 billion IDR for every day of delay, up to a maximum of 25 billion IDR.

Conclusion

The Regulation is a form of further implementation of Articles 28 and 29 of Law No. 5 of 2010 in conjunction with Government Regulation No. 57 of 2010, and serves as a guide for both the KPPU and for businesses planning to carry out M&A transactions that cross the notification thresholds.