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DECLARATION OF HONOUR

I declare that the paper, titled "Using Singapore (and other offshore jurisdictions (e.g., NY and UK)) to restructure Indonesian companies" is my own work, that it has been prepared independently and that all references to, or quotations from, the work of others are fully and correctly cited.

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Signed
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Short Paper - ***Using Singapore (and other offshore jurisdictions (e.g., NY and UK)) to restructure Indonesian companies***

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Table Of Contents

1. INTRODUCTION

Indonesia is a leading exporter of natural resources. Its commodity companies, like those everywhere, are subject to unpredictable pricing of their products in the international markets. While risks can be mitigated under long term supply agreements, highly levered, commodity producers are periodically at risk of default if prices fall for a sustained period. Restructuring then becomes necessary. Given that Indonesian commodities companies are financing themselves with US dollar offshore debt under foreign law credit agreements, this means that any such restructurings will be cross border in nature.[1]

Generally, if a company has only a few creditors (e.g., a single syndicated loan with a few lenders) it makes sense, and it is common in Indonesia, for the borrower to negotiate waivers and extensions with its lenders, even if they are offshore lenders. However, where borrowers have debts consisting of multiple loans and bonds, a privately negotiated settlement may be impracticable. In that case, using the courts can be the best (and sometimes the only) solution. This is particularly the case when the debt includes offshore bonds (as opposed to loans). The reason is that bondholders are dispersed and can be unidentifiable in the bond clearing systems (e.g., Euroclear, Clearstream and DTC), compounded by the fact that New York law governed bonds can require 100% consent for changes to the "money terms" such as maturity date and interest rate, making out-of-court restructurings nearly impossible. Whether a court restructuring is a necessity or just the most efficient way to restructure the debts, borrower and creditors alike need to consider which court, meaning what jurisdiction? This short paper reviews the options for Indonesian companies, principally being commodity companies with offshore debts but other companies as well that borrow in the offshore credit markets. The likely jurisdictions to consider, given the location of the Indonesian company's assets, the legal structure of its debts and the governing law of its credit agreements are (a) Indonesia, (b) England, (c) New York and (d) Singapore. However, the conclusion of this short paper is that where a court process is needed, the use of Indonesian courts will typically be required to close off the risk of claims in Indonesia, and if a court process is required elsewhere, it will be in addition (not in substitution) to the court process in Indonesia, though in a new development, we have

[1] Other Indonesian companies that finance themselves with US dollar offshore debt have been homebuilders and textile companies, both of which have recently struggled to repay US dollar debts. Some of those companies are PT Pan Brothers Tbk, PT Duniatex Group, PT Sritex Group, PT Modernland Realty Tbk.

seen some Indonesian companies use a Singapore scheme to restructure their US dollar bonds without any court process in Indonesia[2].

2. BACKGROUND – INDONESIA COMMODITY COMPANIES AND THEIR CREDIT AGREEMENTS

2.1 A country with many natural resources

Indonesia, comprising more than 10,000 islands located on the "ring of fire" at the equator, is a country rich in natural resources such as oil, natural gas, coal, tin, copper, gold and nickel with agriculture products like rice, palm oil, rubber, etc. These commodities make up a large portion of the country's exports, with palm oil and coal as the leading export commodities.[3] Indonesia is also the largest economy in Southeast Asia and according to the World Bank (2020) has a GDP greater than US$1 trillion.[4]

2.2 Indonesia's commodities companies are dependent on international financing

Prior to the turn of the century, Indonesia looked outwards to international oil and mining companies to develop its natural resources before eventually requiring these external investors to dispose their stakes to local companies, especially in certain industries deemed crucial to the Indonesia economy, such as oil, metals and coal. However local commodity companies lacked the financial resources to develop their concessions and generally to finance their businesses. So, this necessitated they borrow, and this financing was, and remains, US dollar based. As global commodities are priced in US dollars, so borrowing in US dollars becomes a natural hedge. If an Indonesian commodity producer were to borrow in the local currency, Indonesian Rupiah, and export its product in US dollars, its bottom line would oscillate with the foreign exchange rate. So, while commodity exporters may source part of its US dollar funding locally from Indonesian banks, the bulk of their US dollar borrowing will be in the offshore US dollar markets where they receive better pricing. As a result, Indonesian commodity companies have a substantial amount of foreign debt denominated in US dollars.

[2] E.g., PT MNC Investments Tbk, PT Pan Brothers Tbk.
[3] According to the World Bank, the top five exported products by Indonesia are: coal, palm oil (excl. crude), natural gas, bituminous coal and crude palm oil. See https://wits.worldbank.org/CountrySnapshot/en/IDN/textview
[4] See https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=ID

Such offshore financing takes the form of loans (e.g., syndicated, revolving, term, etc.) and bonds (e.g., high yield, convertible). Generally, loan documentation (other than for security which is governed in accordance with the laws of the jurisdiction where the security is located) is based on Loan Market Association ("**LMA**") standard forms and is governed by English ("**UK**") law. Bonds on the other hand, are typically governed by either UK law or New York law. In short, Indonesian commodities companies typically have a lot of US dollar foreign debt, which is governed by either UK or New York law, and subject to UK or New York courts. The choice of UK and New York courts are preferred by foreign investors over Indonesia courts. However, as foreign judgements are generally not enforceable in Indonesia, the trend has been to include arbitration provisions in the documentation as arbitral awards can be enforced in Indonesia[5]. Foreign court decisions on the other hand are not enforceable in Indonesia pursuant to Article 436 (1) of the *Reglement op de Burgelijke Rechtvordering* ("**Rv**"). Further, Article 436 (2) of the Rv provides that disputes may be re-examined and decided by an Indonesian court - a foreign court decision can only be evidence in a new case brought in Indonesia.

2.3 Tax structures and security provisions in credit agreements of Indonesian companies

In Indonesia, withholding tax is 20% and under standard terms for both loans and bonds, withholding tax is grossed up by the borrower. As Indonesian commodity companies finance themselves under high yield loans or bonds, interest payments are relatively high and so withholding tax can add materially to the cost of capital. To lessen (or erase) this additional cost, companies structure their debt to take advantage of double taxation agreements ("**DTAs**") and other tax incentives.

In the case of bonds, to take advantage of DTAs for withholding tax, it is common for offshore bonds to be issued by a special purpose vehicle ("**SPV**") in another jurisdiction and the bond proceeds then lent to the parent Indonesian company which would guarantee the bonds. In the past, it was common to use Dutch incorporated SPVs because of zero withholding tax in the Indonesia-Dutch DTA which was later raised to 5%. The use of the Dutch SPV structure was the subject of much litigation in Indonesia

[5] Indonesia has ratified the 1958 New York Convention and promulgated Supreme Court Regulation No 1/1990 as its implementing regulation for the recognition and enforcement of foreign arbitral awards.

and in one case it was held to be invalid.[6] Instead, increasingly, the SPVs used are Singaporean incorporated entities. While the structure for Singapore SPVs is the same, market participants seem to feel that because the double taxation treaty between Indonesia and Singapore is a more reasonable 10% (rather than 0 or now 5%), it is less likely to be subject to attack by the Indonesian tax authorities or by the courts. Bonds issued by the Singapore SPV to offshore investors pursuant to a Singaporean tax incentive scheme known as "qualifying debt securities" or QDS are also exempt from Singapore withholding tax. So only the 10% withholding tax imposed by Indonesia applies. That amount is grossed up by the Indonesian company. Foreign investors are also comfortable with Singapore as the domicile for the SPV as there is general confidence in the judicial system in Singapore.

The Indonesia-Singapore DTA is also used in the case of offshore loans, where most of the lenders will be a Singapore branch of an international bank. Interest payments made by Indonesian companies to Singapore based branch offices of international banks are subject to the reduced 10% withholding tax of the Indonesia-Singapore DTA. As Singapore aims to promote itself as a regional funding centre, banks, finance companies and certain approved entities are exempt from paying withholding tax on their funding. So similar to the bonds, the Indonesian company would be responsible for grossing up the 10% withholding tax imposed by Indonesia on interest payments on the loans.

Given that Indonesian commodity companies are financing their commodity businesses, it follows that most of the key assets of these companies are in Indonesia and therefore subject to Indonesian law. This is especially true when enforcement entails seizing and disposing of physical land or concession agreements, where domestic laws restrict foreigner ownership and control. Creditors therefore like to have additional security over offshore assets, and Indonesian companies that can arrange security offshore should be able to benefit from a lower funding rate from lenders. So both the lender and borrower look for ways to structure transactions with an element of offshore security. Foreign security usually takes the form of a charge over long term sales agreements and of offshore bank accounts. It is common to have a US dollar debt service account in Singapore or New York. In larger transactions, a cash management agreement is sometimes put in place where revenues go through a locked box arrangement and the

[6] In March 2009 the Indonesian Supreme Court refused to review a lower court ruling in the case of PT Lontar Papyrus Pulp & Paper Industry that the notes structure was invalid.

portion used for debt service is then channelled into offshore bank accounts for debt repayment.

3. INDONESIA COURTS - PKPU

If an Indonesian commodity company's most valuable assets are in Indonesia, one would think that Indonesia courts should then be a good choice for restructuring those debts. However, the Indonesian court restructuring process (the Suspension of Debt Payments or "**PKPU**") has been the subject of much criticism. Notwithstanding, it is difficult for creditors (and borrowers) to get around the Indonesian PKPU process since Indonesia has not signed up to UNCITRAL Model Law on Cross-Border Insolvency of May 30, 1997 ("**UNCITRAL Model Law**") and its courts do not recognize foreign court judgements.

3.1 Summary of the PKPU process

Indonesian current bankruptcy laws arose as a result of the 1997 Asian financial crisis. The PKPU is a short set of rules that is regulated under the Indonesian Bankruptcy Law.

PKPU is a step before bankruptcy to be initiated by either the debtor or the creditor to provide opportunity for the debtor to submit a composition plan (akin to a restructuring plan) ("**Composition Plan**") to all its creditors which proposes its future payment method – basically a court-supervised debt restructuring. PKPU proceedings are conducted in the Indonesian Commercial Courts.

The key characteristics of a PKPU are as follows:

(a) No insolvency test to apply but same requirements as bankruptcy filing:

(i) the subject debtor has two or more creditors and has failed to pay at least one debt that has become due and payable (or otherwise matured).

(ii) if it is the debtor rather than a creditor which initiates the PKPU proceedings, the debtor must additionally prove to the Court that it is unable to pay the unpaid debt.

(b) Divided into two stages:

(i) PKPU-S (Temporary PKPU) – for 45-days maximum.

(ii) PKPU-T (Permanent PKPU) - the maximum period for both the PKPU-S and the PKPU-T together is 270 days.

(c) The panel of judges granting a PKPU petition will appoint a supervisory judge and one or more administrators to lead the PKPU proceedings.

(d) Creditors have the option as to whether or not they wish to register for the PKPU proceedings.

(e) However, all of the debtor's creditors (and not just those creditors who register for and participate in the PKPU) will be bound by any Composition Plan which is approved by those creditors who do participate in the PKPU proceedings and ratified by the Court.

(f) Creditors will vote on the Composition Plan. Two classes of creditors – secured and unsecured. The Bankruptcy Law requires that a majority in number and at least 2/3rds in claim value of the members of each class in attendance vote to approve the Composition Plan or to extend the PKPU-S into a PKPU-T, as relevant.

(g) A successful vote and judicial ratification mean an approved Composition Plan.

(h) Any failed vote means the panel of judges must terminate the PKPU proceedings and must additionally place the debtor in liquidation bankruptcy.[7]

An important characteristic of PKPU is that it is a debtor process and not in respect of specific debts. So, it is not possible for a PKPU to be done in respect of some of the borrower's debts and not others.

[7] Regulated under the Indonesian Bankruptcy Law, particularly in Articles 222 – 294.

3.2 International creditors have reservations for PKPU process

In many instances, the PKPU process works well for both creditors and lenders when the restructuring terms are informally agreed prior to the PKPU filing. The PT Bumi Resources Tbk. restructuring is a good example. [8]

However, many international creditors are still of the view that the Indonesian PKPU process is fraught with uncertainty given past decisions by PKPU administrators and Indonesian courts. Creditors worry that PKPU administrators, who may be selected by the borrower, will not recognize their claims. In particular, there have been instances where the PKPU administrators did not recognize the bond trustee in respect of a bond issued by subsidiary SPV as a creditor of the parent guarantor under a guarantee, thereby precluding them from voting in the PKPU process. [9]

Moreover, some Indonesian borrowers have gone on the offensive and have sued creditors to, among other things, invalidate their debt obligations and sought damages from creditors exceeding the original proceeds of the debt issued.

3.3 Indonesia's refusal to recognize foreign restructurings means debtors and creditors have little choice other than Indonesia PKPU for a court restructuring

That Indonesia does not recognize foreign judgements and does not have a policy in place to recognize foreign restructuring proceedings,[10] leads to a situation where both lenders and borrowers are stuck with Indonesia for fear that a restructuring done in a court outside of Indonesia will not be recognized within Indonesia. As mentioned above, given that the assets of Indonesian commodities companies are within Indonesia, then a court restructuring outside of Indonesia is almost impossible except in some very limited situations, which are discussed below.

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[8] In full disclosure I note that I was international legal counsel to the borrower in that case.

[9] PT Bakrie Telecom Tbk ("**BTEL**") underwent a PKPU restructuring in 2014 and is the subject of ongoing litigation in US Bankruptcy Court in respect of a subsequent Chapter 15 application to recognize the PKPU. In that PKPU the administrators for the PKPU refused to recognize the Bank of New York Mellon as the trustee for bondholders.

[10] However, the Indonesian Commercial Court last year refused to accept a PKPU petition by Maybank in respect of PT Pan Brothers Tbk. due to a moratorium over the company from the Singapore courts. This unusual situation may have had more to do with the Indonesian government's position that textile companies like Pan Brothers should not be put into restructuring for fear that they could then be held insolvent, leading to mass layoffs of their employees at a time when the economy is already suffering during the Covid-19 pandemic.

4. UK COURTS – SCHEME OF ARRANGEMENT

As discussed above, US dollar syndicated loan agreements for Indonesian borrowers are overwhelmingly governed by UK law. UK governed loans under LMA standard documentation require 100% consent of lenders to undertake fundamental changes. Although 100% seems a difficult threshold to achieve, in practice because there are a limited number of lenders that can be identified, one can have access to them and try to seek a compromise. Some international bonds issued by Indonesian companies are also governed by UK law, but these typically require less than 100% consent (e.g., 66 2/3%) to amend the fundamental terms.

If an Indonesian company can consensually negotiate all their UK governed credit agreements, then there is no need for a court restructuring vis-à-vis those UK governed credit agreements. For example, assuming there is a combination of UK loans and US bonds (something quite common for Indonesian debtors), it may be possible to consensually restructure the UK governed loans according to their terms and then deal with the US bonds separately in a court restructuring. On the other hand, if there is no consensual restructuring in respect of the UK credit agreements, then a court restructuring will need to be done. Under such circumstances a UK court approved scheme will be necessary given that the Gibbs rule necessitates that UK governed credit agreements must be restructured by a UK court.[11] But given the circumstances that Indonesia does not recognize foreign court restructurings or foreign court judgements, it would also be necessary for a PKPU to be done in Indonesia as well.[12]

[11] Broadly, the Gibbs rule requires that only English courts compromise debts governed by English law. The English courts have recently failed to recognise orders granted in foreign jurisdictions (see Bakhshiyeva v Sberbank of Russia & Ors and Chang Chin Fen v Cosco Shipping (Qidong) Offshore Ltd). In the latter case, the Scottish courts refused to recognise moratoria obtained in the SG High Court on the basis that to do so would prejudice the rights of a creditor to claim under its English-law governed debt, which stood outside the proposed SG schemes.

[12] It has been reported that Indonesia's flagship carrier, PT Garuda Indonesia (Persero) Tbk is seeking to restructure its English law governed debt via a UK scheme and thereafter, a PKPU. An English scheme requires approval by at least 75% in value of each class of the members or creditors who vote on the scheme, being also at least a majority in number of each class. This is more achievable than a consensual restructuring. However, an English scheme would take considerable time, perhaps two years or more. The process would therefore be significantly more protracted than a consensual restructuring of the English law debt documents. The main concern is the risk that an Indonesian court could refuse to recognise an English court judgement. This approach would therefore not address the jurisdictional risk in Indonesia which is why PT Garuda is pursuing a concurrent PKPU.

5. NEW YORK COURTS – CHAPTER 11 AND CHAPTER 15

It is common for Indonesian issuers to issue bonds under New York law, especially for high yield bonds. New York governed bonds are preferred by many creditors specifically because they require 100% consent of all bondholders for any fundamental changes. These bonds can be particularly difficult to amend due to the 100% consent requirement. While it may be possible to seek a Chapter 11[13] in a US bankruptcy court entailing submitting a reorganization plan and then having creditors vote on the plan, the more efficient way to deal with New York bonds given that Indonesia courts will not likely recognize the Chapter 11 proceedings, is to do a PKPU in Indonesia and then seek recognition as a foreign proceeding in the US under Chapter 15.[14] With a Chapter 15 order in place, the bankruptcy court will recognize the restructuring in Indonesia and bondholders would no longer be able to enforce the bond in the United States (including in New York State courts).

6. SINGAPORE COURTS – SCHEME OF ARRANGEMENT

Recently Singapore has amended its restructuring and insolvency law extensively. The amendments came into effect on 30 July 2020 and there has been a big push to encourage regional debtors including those from Indonesia to use the Singapore courts as a forum to restructure their debts. They have adopted elements of US Chapter 11 plus Model law including cram down of classes, pre-packed schemes, DIP financing, etc. The threshold for a Singapore scheme is a majority in number of creditors representing at least 75% of the value of those voting, for each class of creditors.

As mentioned above, it is common to use Singapore SPVs to issue bonds, so in those instances there is a readymade connection with Singapore. In addition, many Indonesian borrowers have their offshore US dollar accounts (e.g., collateral account, interest reserve account, escrow account etc.) in Singapore and generally speaking, the Singapore courts have been very flexible in allowing borrowers to establish sufficient nexus.

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[13] Chapter 11 is a reference to chapter 11 of the US Bankruptcy Code which generally provides for a reorganization of the debtor. In 2019, PT Arpeni Pratama Ocean Line Tbk filed a proposal under Chapter 11 in connection with a restructuring of its NY governed bond which was approved by bondholders but subsequently the company was put into liquidation by a decision of the Indonesian Supreme Court. See Supreme Court Decision No.718 K/Pdt.Sus-Pailit/2019, dated 10 September 2019..

[14] Chapter 15 is a reference to chapter 15 of the US Bankruptcy Code which was added in 2005. It is the US domestic adoption of the Model Law on Cross Border Insolvecy promulgated by UNICTRAL

The issue with using Singapore courts to restructure Indonesian company debts is again that an Indonesian court would likely not recognize a Singapore scheme of arrangement leaving the company open to the risk of claims in Indonesia.[15] Notwithstanding, Singapore schemes are being used by Indonesian companies in select circumstances.

As mentioned above, Indonesian PKPU cannot be used to restructure only some of a borrower's debts, but Singapore courts can do so. So Indonesian companies have been using Singapore schemes of arrangement to specifically restructure their New York bonds. A particularly thorny problem, given the 100% consent requirements to amend the "money terms" of New York governed bonds. Furthermore, in instances where a Singapore scheme of arrangement has been implemented for New York governed bonds, the Issuer can then seek Chapter 15 recognition in the US for the Singapore scheme, thereby preventing any bondholders (or the trustee) from bringing a claim in New York courts.

Of course, as mentioned above, the Singapore scheme may not be enforceable in Indonesia. But this is much less of an issue for a bond then a loan. A bondholder does not normally have standing to make a claim under the terms of a New York governed bond. Typically, the claim needs to be made by the trustee (and only if the trustee refuses to make a claim where it is obligated to do so does a bondholder then have the right to make a claim). Given that the trustee is an international bank or agent, it will likely not submit a claim in contravention of a scheme approved by the Singapore courts. So essentially there is no one to bring the claim in Indonesia. In the case of a loan, so long as a lender does not feel beholden to Singapore courts it can bring its claim. In the last few years, we have seen a number of Indonesian companies restructure their New York governed bonds in Singapore courts.[16]

7. CONCLUSION

Given that Indonesia hasn't signed up to the UNCITRAL Model Law and its courts do not recognize foreign court judgements, when it comes to restructuring an Indonesian company's offshore debts, it can be said generally that all roads lead to Indonesia courts.

[15] But see Maybank Indonesia Tbk petition last year to put PT Pan Brothers Tbk into PKPU and the Indonesian court dismissed the PKPU application on the basis that a Singapore court had already granted moratorium to the debtor and that there were on going proceedings in Singapore.
[16] E.g., PT MNC Investments Tbk, PT Pan Brothers Tbk and PT Berau Coal Tbk have all restructured NY governed bonds as part of a Singapore scheme.

If a UK court scheme is required due to the Gibbs rule, then likely the UK court scheme would be in addition to the Indonesian PKPU and not in place of it. Similarly with respect to a US Chapter 11 proceeding or a Singapore Scheme. The interesting development that we have seen only recently, are Indonesian borrowers using Singapore schemes to restructure New York governed bonds. It is an interesting solution to what is a difficult problem given the 100% consent requirement of New York governed bonds. But in other instances, for example, where loans cannot be restructured consensually, the PKPU process is imperative to close out any risks of claims in Indonesia. If someday Indonesia adopts the Model Law or gives comity to foreign judgements, then this may change.