A double-edged sword

As defaults soar, international creditors need a proactive strategy to survive Indonesian court supervised restructurings

Many international creditors, including bank lenders, bondholders and trade creditors face current or imminent payment defaults by Indonesian borrowers and guarantors in the international market. As the Indonesian economy continues its choppy ride, fuelled by depressed natural resource prices, unfavourable currency exchange rates and reduced domestic consumer spending, experts predict that Indonesian corporate defaults and restructurings could reach levels not seen since the credit crises of 1998 and 2008, during which creditors recovered on average less than one-third of their investment in Southeast Asian defaults.

Indonesian debtors are now more willing than ever to use the protections afforded by the domestic court-supervised restructuring process (called a PKPU, short for *Penundaan Kewajiban Pembayaran Utang*) to achieve a binding rescheduling of their debts and obligations. In concept, an Indonesian PKPU is similar to a Chapter 11 proceeding under the US Bankruptcy Code: the court supervises negotiation of the restructuring plan, which if approved by creditors and ratified by the court will be binding on all creditors. Verified creditors are encouraged to express their views to the court and the debtor during the plan negotiation process, and a proposed PKPU plan can be ratified by the court following approval by at least a majority in number of verified claims in each of the secured and unsecured claim classes and at least two thirds in aggregate value of claims voting in each claim class. Although the Indonesian PKPU process has become more familiar to international creditors over the past 10 years, international creditors in particular still face challenging obstacles as they attempt to enforce their rights in a PKPU proceeding. Uncertainty and inconsistency have become the norm.

> Indonesian civil law is fundamentally different from common law

Creditor troubles

Several recent controversial decisions by the Central Jakarta Commercial Court or by the court-approved PKPU administrators have rendered international creditors unable to prove or vote their claims.

In March 2016 the administrators in the Asmin Koalindo Tuhup PKPU rejected a $628 million claim by Standard Chartered Bank as lender under a facility agreement on grounds that the debt was null and void because the debtor itself failed to make a required regulatory filing with the Ministry of Energy and Mineral Resources at the time it borrowed the funds.

In December 2014 the administrators in the Bakrie Telecom PKPU rejected a $380 million claim by The Bank of New York Mellon as trustee of US dollar bonds issued to international investors. Instead, the administrators recognised a competing intercompany claim with respect to the same debt and allowed the debtor's wholly-owned subsidiary to vote the claim, disenfranchising both the trustee and the international bondholders.

In January 2016 the administrators in the Trikomsel PKPU similarly rejected SG$215 million ($159 million) in claims made by Deutsche Bank and The Bank of New York Mellon as trustees of bonds issued to international investors in the Singapore dollar market. Although the debtor ultimately withdrew its competing intercompany claim following objections by bondholders and other creditors, the bond trustees were not allowed to submit and vote the claims on the bondholders behalf. Instead the court only recognised claims filed by individual bondholders themselves in the PKPU.

These recent decisions have disenfranchised international creditors, leaving them unable to vote (and likely oppose) the proposed treatment of their claims and subjecting them to possible cram-down treatment in the PKPU. These decisions, however, should not be considered strange and unusual: recent history has taught us that the Indonesian enforcement landscape is unpredictable and the difficulties encountered by international creditors are well known.

Recall the 2006 Indah Kiat decision by the Indonesian Supreme Court which upheld lower court decisions invalidating and declaring null and void $500 million of bonds issued to international investors on grounds of legal evasion or engineering (issued by a subsidiary of Asia Pulp & Paper (APP), these bonds were part of Asia's largest bond default to date).

Although the Indonesian Supreme Court ultimately annulled the Indah Kiat decision in 2008, just one year later in 2009 the Supreme Court again reversed course in the Lontar Papyrus matter and effectively affirmed a lower court decision invalidating $550 million of international bonds on grounds similar to Indah Kiat. Unlike common law jurisdictions, Indonesia's civil law system does not recognise the doctrine of binding precedent and Indonesian courts have broad freedom to decide cases as they see fit.

PKPU administrators

Court-appointed administrators play a key role in PKPU proceedings and are given broad authority under Indonesia's Law Concerning Bankruptcy and Suspension of Payment. Among other things, the administrators have power to determine the validity of claims, resolve voting disputes, supervise the negotiation of the debtor's proposed composition plan and co-manage the debtor's assets during the duration of the PKPU proceeding. The administrators are the gatekeepers that determine whether and how a creditor is allowed to participate in the PKPU.

As the initiating party, the petitioner in a PKPU nominates one or more administrators to be appointed by the court. As such, prior to filing a PKPU petition, the petitioner is able to pre-consult with its chosen nominees to discuss a preferred approach in dealing with potentially troublesome creditors, and as a practical matter the petitioner (whether the debtor, a third-party creditor or a friendly creditor) has a first-mover advantage to control and dictate the direction of the PKPU from the outset.

As part of the claim verification process, PKPU administrators are tasked with determining whether claims submitted by creditors are legitimate or fictitious. In some instances creditors that are friendly to the debtor have been known to file suspicious claims which if admitted by the administrators would allow the debtor to control the claim for voting purposes and unfairly influence composition plan voting. Thus it is critical that international creditors anticipate potential PKPU filings and take early action after notification of a PKPU filing – including an active review of the claims list to raise objections to any suspicious or unclear claim filed by a purported creditor. In the absence of an objection, the administrators likely will approve and admit a claim as filed.

The trouble with trusts

A petitioner's ability to pre-consult with administrators can be particularly useful for a debtor with obligations under international bonds. An international bond typically is issued under an indenture or trust deed using a trustee structure with individual bondholders owning interests in a global note held through intermediary accounts with an international clearing system such as Depository Trust Company (DTC) in the US, Euroclear/Clearstream in Europe and CDP in Singapore. While these trustee based holding structures are standard and used throughout the world, the trustee structure was not created with the Indonesian legal system in mind.

Indonesian civil law is fundamentally different from common law and does not expressly recognise the role and duties of an international trustee to act for and on behalf of underlying bondholders. As a result, the international trustee's standing to submit and vote a claim in a PKPU proceeding on the bondholders' behalf has been inconsistently recognised on a case by case basis.

These inconsistencies have allowed PKPU debtors the opportunity to pre-consult with potential administrators and nominate those whom they believe will adopt a debtor-friendly approach toward recognising claims filed by international bond trustees. Sometimes only bondholders that file claims individually are recognised (such as in the 2016 Trikomsel PKPU). At other times both individual bondholders who file and the trustee are allowed to file and vote claims (such as in the 2011 Arpeni Pratama Ocean Line PKPU). And perhaps most troubling of all is the administrators' decision in the 2014 Bakrie Telecom PKPU which rejected completely the trustee's and bondholders claims in favour of the debtor's own intercompany claim for the same debt, effectively recognising the debtor as its own creditor and allowing it to control the voting! These various possibilities present a debtor with a buffet of options to consider and discuss with prospective administrators that can be used as ammunition against unsuspecting creditors.

A step forward

In June 2016, the administrators in the Bumi Resources PKPU considered the interplay between the three voting approaches mentioned above and took a positive and practical step in resolving the confusion. The international trustees, individual bondholders and the debtor's subsidiaries each had filed competing claims with respect to the same debt. The administrators considered the issues and engaged in discussions with the debtor, trustees and interested creditors to develop an approach to allow fair voting and avoid overlapping claims:

- The intercompany affiliated claim will not be allowed to vote.
- The international trustees are allowed to vote the claim on behalf of bondholders; provided that the trustees are able to show specific voting instructions received from individual bondholders for whom they are voting; and provided further that the claims voted by the trustees do not overlap with any claims voted directly by bondholders individually (to avoid double counting).
- So-called split voting through the trustees will be recognised – that is, some individual holders may elect to vote in favour of the debtor's proposed plan, while some may vote against it – and for voting purposes the trustee will be allowed to split its claim into yes and no votes.

Without doubt this more nuanced combined approach is an encouraging and inclusive solution. However, it also adds a layer of complexity requiring the administrators to monitor and review specific bondholder voting instructions transmitted to the trustees through the international clearing systems.

Administrators also will need to ensure that sufficient time is provided for bondholder/trustee communication within the often time-sensitive PKPU process where consideration of and voting on a proposed composition plan often occurs within a matter of days. International trustees typically require about two weeks to communicate a proposal to and receive instructions back from underlying bondholders by using the international clearing system as a conduit of communication.

Documentation needs

While courts and administrators should be encouraged to adopt this combined approach to voting by international trustees in future PKPUs, international banks, investors and their lawyers should also carefully consider the unique elements of the Indonesian legal system and PKPU process and anticipate the possibility of an Indonesian guarantor or obligor being subject to a PKPU in Indonesia.

The bond documentation for new deals brought to market should be reviewed to ensure that the relevant trustee, enforcement, voting and related provisions in indentures, trust deeds and other agreements are clearly drafted and precisely translated into the Indonesian language so as to be understandable by PKPU administrators, debtors and Indonesian counsel.

Terms and provisions that may seem commonplace and familiar to the international investor and their professional advisors may seem unclear to Indonesian courts less familiar with the trustee structure and the workings of international clearing systems. For example, is the trustee's authority to file and vote claims on behalf of bondholders in a PKPU sufficiently clear? Does the documentation reference a clear method of communication between the trustee and holders through the clearing systems? Are the voting mechanics clear and do they clearly reference voting instructions being provided though clearing systems? Is it

> **It is critical that international creditors anticipate potential PKPU filings and take early action after notification**

clear that the trustee is allowed to cast split votes according to bondholder instructions?

Adapting the bond documentation to add clarity and address the possibility of local Indonesian proceedings should increase the likelihood that PKPU administrators and courts will apply standard enforcement provisions as intended in Indonesia's fundamentally different legal system and PKPU process. We shouldn't assume that a standard provision will work in Indonesia simply because it has worked elsewhere in the world.

> **International creditors have learned through experience that Indonesian PKPUs pose difficult challenges to overcome**

Levelling the field

Recognising the importance and influence of administrators in the PKPU process, the Supreme Court of Indonesia recently took steps to level the playing field in regard to selection of administrators. In April 2016, the Supreme Court issued circular letter No. 2 of 2016 which requires that in a debtor-filed (as opposed to a creditor-filed) PKPU or bankruptcy petition, the nomination of administrators or receivers must be approved by creditors. Although the Supreme Court circular is silent on the manner or method for obtaining creditor approval (which presumably will be determined by the individual courts) and also does not address the phenomenon of friendly creditor filings where a friendly creditor files a PKPU petition as a proxy of the debtor, we view this amendment as a positive step toward establishing a more transparent and balanced PKPU process. We hope that as a next step the Supreme Court will consider extending these circular to all PKPU filings, regardless of whether the petition is filed by a debtor, a friendly creditor or a third party creditor and implement a clear mechanism for creditor consultation and approval of the nominated administrators.

Enforcing creditors' rights in Indonesia can be an overwhelming challenge for an international creditor that is unfamiliar with Indonesia's unique bankruptcy process and legal system. Seasoned international creditors have learned through experience that Indonesian PKPUs pose difficult challenges to overcome. The PKPU process often is seen as a sharp sword used by domestic Indonesian debtors against unsuspecting international creditors. However with forethought and a practical and proactive approach international creditors are able to blunt the PKPU sword and even turn the sword to their own advantage.

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