



The Second Forum for Asian Insolvency Reform (FAIR)

Bangkok, Thailand 16 – 17 December 2002

In partnership with

The Government of Japan

and

The World Bank



Hosted by the

The Ministry of Justice of the Kingdom of Thailand



*Informal Workouts in Indonesia: JITF Incentive And Sanction System :
Mr. Bacelius Ruru, Jakarta Initiative Task Force Indonesia*

INFORMAL WORKOUTS IN INDONESIA: JITF INCENTIVE AND SANCTION SYSTEM

**By: Bacelius Ruru
Chief Executive Officer, Jakarta Initiative Task Force**

I. Background

Regardless of how far or how fast an emerging economy has grown, it remains vulnerable to systemic economic collapse. Such collapse is almost always marked by over-leveraging within the corporate sector that can, in the worst cases, overwhelm the capacity of corporations to restructure. Without corporate sector debt restructuring, the real sector is cut off from necessary capital, and employment and tax revenue are sacrificed. In order to cope with such corporate sector paralysis in the face of systemic economic collapse, the public sector frequently steps in and involves itself in the corporate debt restructuring process.

Public sector debt restructuring programs are created as government initiatives to accelerate the speed of corporate debt restructuring. At their simplest, these programs may simply serve to educate parties regarding restructuring “best practices.” Alternatively, they may involve some form of mediation with respect to debt disputes. Other programs may put in place a relatively formal set of procedural guidelines designed to add structure to the debt restructuring process. Still other programs may involve the government directly in substantive restructuring negotiations in the role of decisionmaker.

This paper discusses the practical choices made by the Government of Indonesia (the “GOI”) in designing and implementing its public sector programs for dealing with corporate sector debt restructuring.¹ The first section deals with some of the factors impacting debt restructuring in Indonesia, the second section outlines the GOI’s program, focusing on the incentive and sanction system currently in place under the Jakarta Initiative Task Force (“JITF”), and the final section includes a brief discussion of the effectiveness of the GOI’s program, as well as suggestions for future reform.

II. FACTORS IMPACTING PUBLIC SECTOR RESPONSE TO CORPORATE DEBT CRISES

In fully-developed economic systems, the informal workout process familiar to most restructuring professionals provides a workable alternative to litigation. In emerging markets, however, a combination of factors can cause the informal workout

¹ General issues regarding informal workout techniques in Indonesia and their relationship with the Indonesian courts’ interpretation of the Indonesian bankruptcy laws is discussed in the paper submitted by Samuel Tobing, Chief Operating Officer of the Jakarta Initiative Task Force.

process to break down. Each of these factors is relevant, not only because they explain why emerging market corporate debt restructuring is troublesome, but also because they serve as guidelines for the design and implementation of public sector programs. Each is discussed separately below.

A. Lack of Substantive Restructuring Experience

The success of informal workout negotiations depends heavily on the talent and knowledge of those in charge of the discussions. In particular, a thorough understanding of restructuring "best practices" is invaluable in settling disputes and shaping deal structures. Well into an economic crisis, it is likely that experience with restructuring will be developed and, to the extent it is not, outside professionals will make themselves available. However, at the onset of a crisis, particularly in a country that has been experiencing substantial economic growth, it will be unlikely that appreciable market knowledge will be in place to deal with the crisis efficiently. In the absence of such experience and market knowledge, the pace of informal workout discussions will suffer as the parties struggle to "reinvent the wheel".

B. Weak Framework for Enforcing Creditors' Rights

As mentioned at length in the paper submitted by Mr. Tobing, the effectiveness of out-of-court workout negotiations is heavily dependent on the strength and predictability of in-court insolvency procedures. In countries where the legal rights of the parties are unclear in the event of debt default, or where one party or the other possesses insufficient legal remedies, the parties will be left with inadequate rules upon which to base their debt restructuring decisions. In the absence of such guidance, the parties will have no way to adequately assess their respective negotiating leverage, and stalemate will frequently result.

C. Need to Coordinate with Financial Sector Restructuring Programs

Because economic crises in emerging economies are often systemic in nature, the need frequently arises to restructure both the corporate sector and the domestic financial sector, which can itself be brought to the edge of collapse through its exposure to distressed corporate loans. This, of course, can provide policy makers with an opportunity or a threat, depending on how coordination is handled. By utilizing government involvement through nationalized banks, corporate restructuring can be accelerated. On the other hand, poor coordination can result in government financial sector actors behaving at odds with espoused corporate sector policy goals. Either way, the systemic nature of emerging market debt crises presents unique challenges for policy makers seeking to coordinate government activity.

D. Cultural Differences

In fully-developed economies, those engaged in informal workout discussions frequently come from a common business culture. However, the cross-border nature of much emerging market financing virtually ensures that cross-cultural issues will arise. The adversarial nature of debt restructuring negotiations can be counted on to exacerbate these differences, resulting in unnecessary friction if the discussions are not handled diplomatically. Similarly, in addition to basic issues of business culture, different attitudes toward “rescue culture” may be evidenced, with varying views being expressed toward, for instance, the primacy of creditor rights versus corporate rehabilitation. Although it is likely that these differences will become less important as time passes and the various parties increase their exposure to one another, at the initial stages of an economic crisis, cultural differences should not be underestimated as a source of friction and delay in informal workout negotiations.

III. GOI PROGRAM FOR CORPORATE SECTOR DEBT RESTRUCTURING

The primary program adopted by the GOI for dealing with corporate sector debt default was the Jakarta Initiative Task Force (“JITF”), which was created in 1998 as a voluntary mediation program to foster speedy resolution of corporate restructuring negotiations. At inception, the JITF was formulated primarily to address points A and D, above, namely, the lack of restructuring expertise present in Indonesia at the time of the crisis as well as conflicts in business and restructuring culture that were expected to surface once restructuring negotiations were underway.

Over time, however, it became clear that the JITF was needed to address a different set of needs. It was, in fact, the case that, at the onset of the crisis, little experience existed with debt restructuring in Indonesia and, additionally, radically different views of rescue culture were evidenced by debtors and creditors. The JITF has always played a constructive role in this regard; however, over time, these issues have largely resolved themselves, as local restructuring expertise has been developed and all parties have gained a greater understanding of each other. On the other hand, points B and C, above, namely a lack of creditors’ rights and need for coordination with financial sector restructuring programs, have turned out to be the key tasks facing the JITF.

As discussed separately by Mr. Tobing, the revised Indonesian bankruptcy law has never been implemented in a way that creditors view as transparent. This has, in turn, resulted in an unwillingness of creditors to use the Commercial Courts as a forum to settle debt disputes and has increased calls for the JITF to serve as an alternative forum, one possessing more structure than a strictly voluntary mediation body. Similarly, given the sheer size of the distressed loan portfolio administered by the Indonesian Bank Restructuring Agency (“IBRA”), that body has emerged as the preeminent force in Indonesian debt restructuring, and a greater need has arisen for the JITF to coordinate out-of-court debt restructuring discussions with the activities of IBRA.

With these needs in mind, the format of the GOI's corporate restructuring strategy was amended in early 2000 in a number of important aspects. First, the Indonesian Financial Sector Policy Committee ("FSPC") was created as a ministerial level committee to oversee both IBRA and the JITF and to make specific decisions on behalf of the GOI with respect to corporate debt restructuring. Since creation, the FSPC has met regularly to discharge this duty. Second, the form of the JITF was revised to include so-called "structured mediation" provisions, essentially creating a time-bound mediation process which, once initiated, ceases to be completely voluntary.

Under the revised JITF mediation procedures, uncooperative parties are defined as those which fail to adhere to the mediation schedule put in place by the JITF, or fail to attend meetings with sufficient negotiating authority. In the event that the debtor company participates in the JITF program in good faith, it and its creditors are provided with a number of specific incentives, including the following:

- Targeted tax relief, including a 30% discount on tax payable as a result of debt forgiveness, the conversion of withholding tax payments to a cash basis, and the ability to shield gain realized as a result of a debt-for-equity swap from taxation.
- Protection from delisting from the Jakarta Stock Exchange, so long as the company is classified as restructuring in good faith.
- With respect to financial institutions, limited waivers of legal lending limit ("LLL") regulations of Bank Indonesia.²

In the event a company is classified as uncooperative by the JITF, then limited sanctions are applied. All of the foregoing incentives are denied the company and, in addition, the JITF is instructed to prepare a report outlining the company's misconduct. This dismissal report is filed with the FSPC which, in theory, is empowered to refer the matter to the Indonesian Office of the Attorney General for the institution of bankruptcy proceedings.

IV. EFFECTIVENESS OF GOI CORPORATE RESTRUCTURING PROGRAM AND SUGGESTIONS FOR FUTURE REFORM

The creation of the Indonesian FSPC to coordinate government decision making in connection with corporate debt restructuring issues has been extremely successful. On numerous occasions, thorny issues which had prevented informal workout deals from being completed were resolved through FSPC edict for the benefit of all parties,

² It must be noted that these incentives are set to expire at year-end, 2002, and it is presently unclear which, if any will be extended. The JITF has experienced an upsurge of cases in recent months as debtors attempt to finalize restructurings prior to the expiration of the JITF incentives.

and coordination between the JITF and IBRA has been improved dramatically as a result.

The JITF structured mediation program has resulted in a marked increase in the number of cases for which memoranda of understanding were achieved. As of the date of this paper, over US\$18 billion in debt had reached at least the MOU stage under JITF mediation. In particular, the JITF has received favorable comments regarding its ability to provide a forum, as an alternative to the Commercial Courts, within which orderly restructuring negotiations can take place.

As to the incentive and sanction system under the JITF, the results have been mixed. An appreciable number of companies have sought out the JITF tax incentives, and the existence of such incentives have, in a number of cases, provided leverage necessary to modulate debtor behavior and to force the completion of restructuring deals. Though less sought after, the other JITF incentives have played a constructive role in motivating companies to negotiate their obligations in good faith.

On the other hand, the JITF sanctions, exercised through a referral of matters to the FSPC, have had limited impact. For certain companies, there does exist a marked reluctance to see the JITF dismiss a matter and file a critical report with the FSPC. However, because of doubts regarding the effectiveness of the Commercial Courts, the threat of subsequent action by the Office of the Attorney General has not been taken seriously by most debtors. As a result, the JITF has been left with only limited sanction power against uncooperative parties.

As mentioned elsewhere, use of the secondary market for the repurchase of debt by original equity holders has served to inject liquidity into a number of distressed corporations and to thereby permit restructurings to proceed. Against this backdrop, the existence of the Indonesian FSPC and the JITF have provided a useful forum to contain negotiations so that progress can be made. In this limited sense, the JITF has served as an alternative to the Commercial Courts, but it is there that the similarity ends. Still missing from the system is a concrete sanction which can be brought to bear against uncooperative debtors, and in the absence of such sanction, the GOI's corporate sector restructuring efforts have served as a helpful, but limited playing field upon which the various actors can contest their views regarding debt valuation.

In the future, it is suggested that any public sector restructuring program be designed with specific reference to the operation (effective or not) of existing judicial mechanisms. Absent a functioning system for the enforcement of creditors' rights, expectations must be moderated regarding the ability of any public sector effort to force accelerated restructuring.