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# Working the triangles in Indonesia: mediating debt restructuring disputes, Part 1

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# Working the triangles in Indonesia: mediating debt restructuring disputes

## Part 1

*Patrick Cavanagh*

'Indonesia suffered disproportionately during the Asian economic burnout and its economic difficulties continue.'

The broad parameters of the current Indonesian economic crisis are well known. Indonesia suffered disproportionately during the Asian economic burnout and its economic difficulties continue. One factor contributing to this situation is the inability of many Indonesian businesses to deal with corporate debt.

Compounding the effects of the economic slowdown and defective financial regulation, a massive deterioration in the exchange rate has inflated the amount of dollar denominated private sector external debt. This in turn continues to threaten the viability of the banking system.

The total level of distressed debt is estimated to be US\$59 billion, with the total of loans to the Indonesian commercial community assessed at US\$119 billion.

Corporate debt restructuring is one of a number of preconditions for full economic revival. As part of a multi-faceted economic recovery effort, the Government of Indonesia, supported by the IMF and the World Bank, created the Jakarta Initiative Task Force (JITF) in November 1998.

The JITF provides advice and mediation services to facilitate debtor-creditor restructuring agreements. The process is time bound and the mediator plays an active role in restructuring the process and also in applying penalties in the event of non-compliance.

### Restructuring processes

In general terms, restructuring can be completed in one of two ways: formal or informal. The first requires an effective insolvency law, while the latter depends on the activities of the banking and commercial

sectors, with some input from governmental agencies.

Indonesian restructuring belongs to the latter category. This informal process has been influenced by, and enjoys the support of, the international banking and financial community. The object is to reach agreement on debt restructuring between the creditors and the debtor. Traditionally, these informal restructuring processes have been totally voluntary, but the reality of the Indonesian program is that sanctions can be imposed on 'unco-operative' parties.

A recent review by the Asian Development Bank of the different informal restructuring programs currently operating in Asia (*Guide to Restructuring in Asia* Asian Development Bank (2001) 6) identified the main elements in these processes as follows.

- The creation of a forum for negotiation. Although it may seem a somewhat abstract notion, this involves the development of a commercial environment in which a debtor and its creditors may come together to negotiate.
- The appointment or selection of a 'lead creditor' to provide motivation, leadership, organisation and administration to enable negotiations to commence and advance.
- The selection of a 'steering committee' that is representative of creditors and the debtor to assist the lead creditor and to act as a provisional sounding board for proposals in respect of the affairs of the debtor.
- A 'standstill' that takes the form of an agreement for the suspension of adverse actions by both creditors and the debtor during a defined time period to enable negotiations to occur. ➤



➤ • The engagement of professional expert advisors from a variety of possible disciplines.

• The provision of information regarding the debtor, its business activities and its current financial and trading position.

All of these elements feature in the current Indonesian scheme.

The ultimate objective of any debt restructuring scheme is to maximise the value of the company and to lessen the social and financial consequences of corporate failure. In an ideal scheme this laudable aim is met by incorporating certainty, predictability, stability, connected efficiency and transparency.

For present purposes, the challenges for the outside mediator in developing the negotiation environment between debtor and creditors in the Indonesian context are significant.

### Predictable problems for the mediator

There are a number of problems that face a mediator in debt restructuring matters in Indonesia. Some of these will be familiar to most practising mediators and some are quite specific to Indonesia and to the subject matter under discussion.

The familiar problems are as follows.

- The financial, commercial and legal issues are complex.
- The debts and the amounts in dispute are large. The minimum debt level that allows entry into the Indonesian program is AU\$20 million and the larger disputes involve many billions of dollars.
- There are multiple parties representing the lenders. As most of the loans were financed by syndicates of banks it is not unusual to have 10-50 parties representing the borrowers. Most commercial mediators are aware of the problem of negotiating with such a large group with disparate aims and competing objectives.
- Some parties honestly believe that the problem is 'not their fault'. They are emotionally involved, for example they have a close attachment to their family run business that may employ many thousands of long term employees. Any failure of the company will have dire social and economic consequences to the community. The prospects for any

dismissed employees obtaining alternative employment are minimal.

- There are difficult factual questions about the future capacity of the company to pay any rescheduled debts or to comply with the terms of negotiated agreements.
- It is difficult and time consuming to establish the negotiating authority of parties, especially those representing overseas corporations.
- There are often inter-party creditor disputes over what should be the appropriate response to the difficult financial position of the company, for example liquidation or resuscitation.

'... commercial mediators who deal with parties without any procedural assistance will be intrigued by the powers available to their counterparts in this debt restructuring program in Indonesia.'

### Specific problems for the mediator

The specific problems are related to the prevailing legal, social and economic constraints in Indonesia which restrict the number of alternatives that are generally available to mediators in Australia.

The first and most important constraint relates to confidence in the existing legal system. There is a widely held view that 'any case can be bought' and that judicial incompetence and corruption is widespread. The newly appointed Chief Justice was recently reported as claiming that approximately 75 per cent of judges are corrupt. Many commercial practitioners resident in Jakarta believe that this figure is understated. The recently appointed Attorney General has identified the existence of a 'court mafia' and estimated that it will take two decades to remedy the problem.

A contributing factor may be the low status and financial return afforded to members of the judiciary. Judges currently earn US\$95 per month. While this represents a

substantial increase on their previous monthly salary of US\$65 per month, these low salaries increase user scepticism of competency levels and honesty.

It is widely believed that local creditors enjoy favoured treatment over the foreign creditor, and even over the Government when acting as a creditor. (The Government often has this status as it acts as a repository for the debts of failed banks.)

Allied with this belief is a strong perception that political considerations play a major role in court determinations, and that many cases are determined on matters other than the merits. This all provides a complex environment in which debt restructuring mediations take place.

A further problem for the mediator is the lack of confidence in the stability of the currency. This leads to reluctance among the parties to conclude agreements as the exchange rate may move to their disadvantage. At the time many of the loans were negotiated, the rate of exchange was US\$1 = 4000 rupiah. The figure is currently US\$1 = 11,500 rupiah. This means that loan repayments have increased 300 per cent during the course of the loans. Most economists predict that while the current political instability exists the currency will continue to be highly volatile.

In addition, there is the problem of little agreement as the 'facts' in many of the negotiations. There is a widespread belief among lenders that funds have been misused or placed outside the jurisdiction. It is common to find in negotiations that the explanations as to 'where did the money go' are regarded with complete scepticism. A general view that corruption was and continues to be a reality in public life leads the mediator to question constantly the accuracy of information provided at the mediation.

### Remedies

Those commercial mediators who deal with parties without any procedural assistance will be intrigued by the powers available to their counterparts in this debt restructuring program in Indonesia.

A 'carrot and stick' approach has been incorporated into the rules. These allow a mediator ➤

➤ to reward a co-operative party and punish those who are seen as non-compliant. These rules are binding on all participants. The mediator has the specific power to order that:

- all parties shall attend all scheduled meetings; and
  - all parties shall send representatives 'knowledgeable about the issues involved and who possess sufficient ability to discuss such issues'.
- In addition, the rules provide the following:
- a failure to participate 'in good faith' will be grounds for remedial action;
  - all parties shall retain 'competent professionals', share information on a transparent basis and respect the legal rights of the parties;
  - the Government may direct a party to participate;
  - within five days of referral a case manager will be allocated;
  - within 10 days of referral an initial meeting with the referring party will be held;
  - within 20 days of referral the mediator will hold a meeting with the other party;
  - within 30 days of referral a preliminary report by the mediator on the issues is to be distributed, together with a preliminary schedule;
  - within 40 days of referral the negotiations shall commence — if no agreement on the schedule is possible then the case manager will issue determinations on timing;
  - a matter may be dismissed by the case manager as 'not appropriate', to be accompanied by a draft report which will

comment on compliance or non-compliance with the schedule, a statement on facts of negotiation and current status;

- if, within 30 days of the draft report, parties are unable to resolve issues, the final report is to be issued and there is a discretion to file with 'appropriate government authorities'.
- any party may introduce the report into 'any litigation for any purpose'.

If the case manager finds 'bad faith' the Attorney General can initiate bankruptcy proceedings.

Such procedural assistance is of real benefit to the mediator. However, it also involves the mediator moving into a dual role in which the mediator acts also as a referee or umpire. These procedural rules reflect the reality of the current Indonesian political and economic climate.

Some mediators adopting and wishing to retain a neutral stance decry the presence of these extra 'sticks'. Yet they have proved effective and largely responsible for the successful restructuring of US\$12 billion in corporate debt. It appears that in this area, at this time, such adaptations to the mediation model are justified.

Part 2 of this article will identify the array of 'tools in the toolbox' that are used as options for settlement. ●

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