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# Working the triangles in Indonesia: mediating debt restructuring disputes Part 2

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## ADR developments in the region

# Working the triangles in Indonesia: mediating debt restructuring disputes

## Part 2

**Patrick Cavanagh**

For Part 1 of this article see (2001) 4(2) ADR Bulletin 26.

Prior to the Asian currency crisis the value of overseas syndicated loans to Indonesian corporations was an estimated US\$140 billion. The crisis resulted in approximately 60 per cent of these loans going into default. The predominant reason for this was that the repayments were required in US\$ while income was generated domestically in rupiah. As a result of the massive movement of rupiah against the US\$ the repayments increased by a factor of 400 per cent. The average syndicated loan is estimated to be US\$75 million.

### Specific problem for creditors

The problem for creditors has been the inadequacy of a viable legal option due to wide perceptions of judicial corruption, political interference from the executive and the varying levels of judicial competence. Despite substantial misgivings by all parties, a negotiated settlement is often the only commercial option. In negotiation jargon, it is better than the 'best alternative to a negotiated agreement'.

In addition, there has been a number of instances of missing secured chattels or properties. The securities on inspection have often proved to be overvalued by corrupt certifiers or simply 'part built' when corrupt certifiers had approved loan payments on completed projects. A further complication for creditors is the Government's stated preference for viable companies to be allowed to continue trading. The Government has a clear preference for workers to remain in some

form of employment rather than add to the social problem of unemployment. The perception that local companies enjoy judicial favouritism at the expense of foreign companies is widely held.

### Settlement options

#### Future security for loans

Given that the value of property and chattels has dropped substantially, even if a substantial debt 'haircut' or discount is provided by creditors it is difficult to find sufficient collateral to secure future loans. By the time the matter has been referred to the Jakarta Initiative Task Force (JITF) most of the available securities have either been disposed of or pledged to a prior or subsequent party. It is not uncommon for multiple lenders to claim priority on the same security.

It is only in the last 12 months that a land registry allowing for inspection of land titles has come into existence. Prior to this, lenders advanced money on land on the uncorroborated undertaking of the borrower that no prior security existed. There have been cases where the borrower was not the owner of the pledged land. Lenders accepted photocopies of title deeds and advanced money which was then used to purchase the pledged land and so further loans were obtained against the same property. Again, it was only in November 2000 that a central register of pledged securities was created. This welcome development only deals with future securities lodged after this date.

One widely used option for settlement has been the use of convertible bonds. This system allows loans to be secured against

a guarantee of future payment. The bond is usually given priority for repayment in the event of a company failure. The term of the bond and the order of preferential securities are negotiable items.

### Future management

Given that the existing management failed to undertake any hedging mechanism against a drop in the local currency and relied on the 'business as usual' maxim, the need for a change in management is often a priority for lenders. As a majority of defaulting companies are private companies, such a proposal, often made as a condition precedent for any loan restructuring, is an extremely sensitive and emotional issue. Many of the private companies are managed by the second generation of the family that created the business. Such close family ties, linked with the obvious public loss of face for the retiring management, create an additional barrier that needs creative negotiation skills.

A negotiated agreement involving the oversight by a creditor's nominee or the establishment of escrow accounts under joint control are common options for settlement.

### Sharing the loss

Given the borrower's strong perception that 'it is not my fault', with similar statements coming from the lenders, the additional task for the mediator is how to allocate loss between two 'innocent parties'. It is possible that such highly charged subjective views are questionable but such an analysis does not assist in settlement. Given that all parties to these negotiations are commercially astute, all borrowers are aware of the 'going rate' for loan discounts. It is not uncommon, where lenders have not offered any discount but have extended the loan, that the negotiations have become deadlocked. The borrowers complain that they have not been offered 'the same deal as everyone else'.

The standard opening discount demand from the borrower is 50-65 per cent. The standard rate of recovery for lenders is 35 per cent. There are individual cases of ➤

➤ recovery as low as 15 per cent and as high as 100 per cent. Given the wide knowledge of this information, the mediator can provide information on the parties' initial positions if they are claiming or offering discounts in the 'insult zone'.

### **Inter-creditor disagreement**

As previously noted, the loans that were advanced were often syndicated. The number of individual lenders in a syndicate varies from five to 60 different institutions. These individual corporations have diverse national origins. It is usual to have individual syndicate members from Japan, Singapore, US, Britain, Germany, Hong Kong, Taiwan, Korea, Holland and Indonesia.

As all mediators know, the more parties there are, the more potential there is for problems. A large amount of the mediator's efforts is expended on not only negotiating with different parties but between individual members of the same party. It is unrealistic to expect a 'united front' from the lenders and disagreement between creditor syndicate members is inevitable. This arises from different perceptions as to the degree of honesty, competence and transparency that exists in individual cases. This, combined with the large sums involved and the substantial discounts requested by the borrower, results in disagreement.

One option for dealing with this predictable problem is to require the establishment of a creditors' committee. Such a committee should be representative of all classes of creditors and it has the task of negotiating with the debtor and reporting back to the rest of the creditors. The recommendations of the committee require ratification by the majority of the syndicate.

### **Short term and long term solutions**

All mediators are aware that any issue can be divided into solutions in the short and long term. Such a division allows parties a 'trial run' and, psychologically, a short term proposal has a higher chance of acceptance. Such proposals can provide the basis for permanent solutions as parties' expectations are conditioned by realities. Given this knowledge, it is a further settlement option to have short term proposals that

will revert to the status quo after an appropriate period. An example of this would be a short term change in management or shareholding but allowing for a reversion once certain conditions were met. These could be repayment terms or increased trading and profit levels. These short term/long term solutions also allow for the borrower to 'save face' with the extended family or commercial community that are keeping a 'watching brief' on the negotiations.

Another standard settlement option when there are questions of credibility and reliability over financial data provided by the borrower is to require any accounts or financial forecasts and cash flow to be independently certified by reputable accounting and legal third parties. This option is now a standard part of any debt restructuring negotiation and has proved an extremely profitable area of work for international legal and accounting firms with staff and resources in Jakarta.

### **Conclusion**

These settlement options for mediators in debt restructuring negotiations contain some features unique to the Indonesian corporate sector, but also contain many standard issues for mediators involved in standard commercial or family matters. It remains a widely held fiction that commercial matters which are mediated have their own individual characteristics. This has not been the writer's experience. The problems experienced in this sector would be familiar to any mediator undertaking neighbourhood, legal aid, work place, discrimination or court connected mediations. The emphasis on the use of skilled, process driven mediators experienced in the field of negotiation has proved successful in Indonesia. As at 20 July 2001 more than US\$12 billion of restructuring mediations have been completed by JITF, with only US\$70 billion to go. ●

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