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Competition Authority Amends MCA Notification Rules, Adds Substantive New Provisions on Remedies, Foreign MCA

1. Introduction

On 27 August 2012, the Indonesian Competition Supervisory Authority ("KPPU") issued a regulation amending the rules governing the notification of mergers, consolidations and acquisitions ("MCA"), which amendments include the introduction of a number of substantive new provisions governing the consultation process prior to the consummation of an MCA transaction, and the KPPU's authority over foreign MCA deals.

The new regulation (No. 3 of 2012 / "New Regulation") was issued pursuant to the mandate set out in Articles 28 and 29 of the Fair Competition Act (No. 5 of 1999), as elaborated by Government Regulation No. 57 of 2010, which in essence prohibit transactions that result in "monopolistic practices and/or unfair business competition." Before discussing the changes introduced by the New Regulation, it may be instructive to briefly describe the MCA notification regime applicable in Indonesia.

2. MCA Notification Regime in Indonesia

Under Government Regulation No. 57 of 2012, as put into effect by KPPU Regulation 10/2011, Indonesia applies a hybrid system that combines voluntary pre- and mandatory post-MCA notification.

Voluntary pre-MCA notification is referred to as a "consultation process" that enables the parties to obtain some assurance from the KPPU as to the legality of their transaction through the issuance by the KPPU of an opinion. This provides the notifying parties with an indication as to whether the merger is likely to be challenged by the KPPU following its consummation, thus enabling them to amend the merger structure or propose remedies if the KPPU indicates that it has an objection to the merger. However, even if the parties elect to pre-notify, they are still required to post-notify the KPPU following the consummation of the transaction. In addition, pre-merger opinions are not binding on the KPPU as they are merely advisory in nature -- the KPPU continues to have the power to investigate mergers following their consummation. In reality, the non-binding nature of voluntary notification makes the reliability and usefulness of the system questionable.

The mandatory post-merger notification requirement arises in the case of an MCA transaction ("Qualified Transaction") that satisfies the following parameters: (i) a total asset value of Rp 2.5 trillion; and/or (ii) total annual turnover of the surviving entity of Rp 5 trillion. A higher threshold applies if two or more of the parties operate in the banking sector, in which case the transaction must be notified should the surviving entity have assets exceeding Rp 20 trillion in value. Should only one the parties operate in the banking sector, then notification must be made if the surviving entity has assets in excess of Rp 2.5 trillion. Qualified Transactions must be reported to the KPPU within 30 working days following their consummation.

3. Changes under the New Regulation

3.1. Consultation Process

One of the most far-reaching changes effected by the New Regulation is the introduction of provisions governing the consultation process following a voluntary pre-notification. The lack of detail as regards this process prior to the issuance of the New Regulation was a significant weakness in Indonesian competition law, and undermined the effectiveness of voluntary notification during the pre-transaction stage.

As before, the commission will evaluate a pre-notification so as to determine whether the proposed transaction has any anticompetitive implications. Such evaluation has regard to the following aspects: (a) market concentration; (b) obstacles to market entry; (c) potential for anticompetitive behavior; (d) economic efficiency; and/or (e) insolvency.

The KPPU has the authority to issue three types of opinion:

- Statement of No Objection – a finding that the proposed deal entails no anticompetitive risks
- Statement of Objection – a finding that the proposed deal entails anticompetitive risks
- Statement of Objection with Directions – a finding that the proposed deal entails anticompetitive risks, plus recommendations from the KPPU for negating these risks

In formulating the directions contained in a Statement of Objection with Directions, the KPPU is required to consider comprehensive solutions that are capable of being put into practical effect by the parties. The parties are required to comply with these directions if they wish to ensure that their transaction is in compliance with the Fair Competition Act.

3.2. Remedies

Upon the issuing of directions by the KPPU following a finding of a likely substantial lessening of competition, the New Regulation affords the parties the opportunity to propose remedies to the KPPU so as to negate the potentially anticompetitive aspects of the deal prior to its consummation. The possible remedies that may be acceptable to the KPPU, as listed in the New Regulation, are as follows:

- structural remedies (such as divestment of assets or shares; other pro-competition remedies);
- Behavioral remedies (examples given in the New Regulation: remedies related to intellectual property rights, exclusive contracts, consumer switching costs, bundling/tie-ins, supply and demand constraints)
- Remedies related to pricing and output,
- Other pro-competition remedies.

3.3. Process of Proposing Remedies

Upon the Commission concluding that there would be a substantial lessening of competition if an MCA deal were to go ahead, it will request the parties to present it with proposed remedies. After the proposed remedies have been appraised by the Commission, it will decide whether they are acceptable or otherwise. Should the remedies be accepted, the Commission will issue a Statement of No Objection, or a Statement of Objection should they be rejected.

Upon receipt of an adverse opinion from the KPPU (i.e., that the proposed deal will result in a substantial lessening of competition), the parties must proposed their remedies to the KPPU within not more than 14 working days after the date of notification of the adverse opinion.

Should the KPPU accept the proposed remedies, it will issue a Statement of No Objection. Should the opposite be the case, it will issue a Statement of Objection.

4. Foreign MCA Deals

Another significant change is introduced by the New Regulation through a widening of the criteria for bringing foreign MCA deals within the scope of Indonesian competition law. The New Regulation defines a “foreign MCA transaction” as one that occurs outside the jurisdiction of Indonesia and which has a direct impact on the Indonesian market, namely, where (a) all of the parties to the transaction carry on business in Indonesia either directly or indirectly, such as through a controlled company; or (b) only one of the parties carries on business in Indonesia but the other party has sales in Indonesia; or (c) only one of the parties carries on business in Indonesia but the other party has a sister company that carries on business in Indonesia. Any such deals will now come within the authority of the KPPU provided that they are not conducted between affiliates and that they satisfy the parameters established by the New Regulation (see Section 2 above).

Item (c) is a new addition, and while no definition of “sister company” is given, it is nevertheless clear that it significantly expands the jurisdiction and authority asserted by the KPPU.

The New Regulation is at pains to stress that the KPPU has jurisdiction over foreign MCA deals that satisfy the above conditions, and that it will not hesitate to assert this jurisdiction. In addition, it emphasizes that foreign parties are under the same duty to notify the commission and have the same rights to engage in pre-MCA consultations as Indonesian parties.

Meanwhile, a Qualified Transaction involving an investment in an Indonesian party by a foreign party, through a share acquisition, for example, is not regarded as a foreign MCA, but rather as a local MCA as the transaction occurred within Indonesia’s jurisdiction.

As regards other transactions that might constitute Qualified Transactions, these will be assessed on a case-by-case basis by the KPPU to see whether they have a detrimental effect on competition in the Indonesian market, and whether the KPPU has the authority to intervene.

5. Sanctions

Unlike its predecessor, the New Regulation does not contain a section on sanctions for late notification, which are instead dealt with in a separate KPPU regulation (Regulation 4/ 2012). However, neither Regulation 4/2012 nor the New Regulation provides clear information about how to determine the effective date of a foreign MCA deal. This is important as liability to sanctions arises in most cases if a Qualified Transaction is not notified to the KPPU within 30 days of its effective date.

By contrast, the effective date of local transactions are clearly defined, namely

a) Merger: the date on which approval is given by the Ministry of Law and Human Rights for the amended articles of association of the surviving entity or on which notice of amendment is received by the ministry, as the case may be;
b) Amalgamation: the date on which approval is granted by the Ministry of Law and Human Rights for the deed of incorporation of the new entity;
c) Qualified Transaction in the form of an acquisition of a public company's shares: notice must be furnished within not more than 30 days subsequent to the date of the Stock Acquisition Disclosure; and
d) Where one of the parties to the MCA deal is an unincorporated entity, notice must be furnished within not more than 30 days subsequent to the deal's closing date.

6. Other Changes

For the first time, the New Regulation makes it clear that even if the notification parameters, as described in Section 2 above, are not satisfied, a proposed MCA transaction may still be in violation of the Fair Competition Act.

In addition, the New Regulation puts in place more detailed rules governing the calculation of the value of assets and turnover for the purpose of the notification parameters, stressing that such values are to be based on the assets/turnover of all direct and indirect subsidiaries owned by the ultimate parent.

Another new provision requires notification, should the notification parameters be satisfied, in a situation where company A gains a controlling stake in company B through an increase in its capital contribution.

The New Regulation also makes it clear that for MCA purposes, state enterprises are not to be considered as affiliates, thus bringing any MCA deals between such enterprises expressly within the ambit of the Fair Competition Act.

7. By Way of Comparison

Internationally, there are a number of different MCA notification regimes in existence. The most common is compulsory notification of a proposed MCA transaction to the competition authority prior to its consummation (known as compulsory pre-MCA notification), which is the system applied by the US and European Union, to name just two heavyweights. The reasons adduced in favor of compulsory pre-notification are that dismantling a consummated merger transaction is impractical, expensive to enforce, cannot restore the market to its previous condition, distorts market operation, and harms the general public and innocent shareholders. However, compulsory pre-MCA notification is expensive, both for the regulator (which has to review each and every submission) and intending MCA partners (who have to bear the costs of notification).

By contrast, the UK, Australia and a number of other jurisdictions tend towards voluntary pre-merger notification. Typically, the relevant legislation prohibits MCA deals that substantially lessen competition, but does not compel pre-merger notification. Instead, parties to a transaction are given the option of voluntary notification before they consummate the merger. The regulator, however, can challenge a completed merger that was not notified. These governments believe that compulsory pre-notification imposes excessive costs, especially in cases where an MCA deal does not create competition problems. The chief drawback here is the difficulty involved in unraveling a consummated transaction, plus the expense associated with post-MCA monitoring.

There are also a number of jurisdictions that apply a compulsory post-merger notification regime, including Argentina, Japan, and Russia, although these are very much in the minority.

8. Conclusion

While the discussion on remedies in the New Regulation may appear rather simplistic (compared with the voluminous international literature on the issue), the fact that some flesh has been put on the bones of the voluntary pre-notification process goes some way to removing a glaring weakness in the Indonesian competition law regime (even if the non-binding nature of the KPPU's responses continues to makes the reliability and usefulness of the system somewhat questionable).

As regards foreign MCA transactions, the failure to provide a mechanism for determining the closing date of such transactions is an obvious loophole that will need to be closed for the sake of legal certainty.

On a more general note, doubts continue to haunt the efficacy of the compulsory post-notification system applied by Indonesia given the difficulties associated with undoing large MCA deals after they have been consummated (witness the Temasek and Carrefour cases in recent years). In reality, the KPPU has long been in favor of switching to a compulsory pre-merger notification regime (along the lines applied in the EU and US), but to date its arguments have fallen on deaf ears in both government and the national legislature. Given the weaknesses in the KPPU's capacity to conduct post-MCA monitoring, it is our view that a switch to a compulsory pre-merger notification system would be the best way forward for Indonesian competition law if it is to achieve its stated objectives, namely, to ensure fair competition and the discouragement of monopolies and other forms of restraint on trade.

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