

# REGULATION ON FOREIGN INVESTMENT RESTRICTIONS AND NOMINEE PRACTICES IN INDONESIA

David Kairupan\*

Postgraduate Program, Faculty of Law Universitas Pelita Harapan, Tangerang  
Lippo Village, Tangerang, Banten 15811

## *Abstract*

---

*Certain provisions of Presidential Regulation No. 36 of 2010 concerning Negative Investment List are not clearly stipulated. In relation to the restrictions of foreign investment in certain business sectors as specified in the Negative Investment List Article 33 para. (1) and (2) of the 2007 Investment Law expressly prohibits investors from entering into any nominee shareholding documentation. Notwithstanding, many nominee shareholding practices are still employed in Indonesia, aiming to circumvent such restrictions. This paper addresses certain issues on Presidential Regulation No. 36 of 2010 and nominee shareholding practices in Indonesia.*

**Keywords:** *negative list, nominee, PMA, KBLI.*

## *Intisari*

---

Beberapa ketentuan dalam peraturan Presiden No. 36 Tahun 2010 yang mengandung ketentuan Daftar Negatif Investasi tidak dirumuskan secara jelas. Sehubungan dengan pembatasan kepemilikan modal asing di beberapa sektor usaha, Pasal 33 ayat (1) dan (2) Undang-Undang Penanaman Modal No. 25 Tahun 2007 secara tegas melarang penanam modal membuat dokumen-dokumen yang terkait dengan kepemilikan saham secara nominee. Namun demikian, praktik kepemilikan saham secara nominee masih sering dilakukan di Indonesia untuk menghindari pembatasan tersebut. Tulisan ini akan membahas beberapa permasalahan yang berhubungan dengan Peraturan Presiden No. 36 Tahun 2010 dan praktek kepemilikan saham secara nominee di Indonesia.

**Kata Kunci:** daftar negatif, nominee, PMA, KBLI.

## *Pokok Muatan*

---

A. Introduction .....	314
B. Discussion .....	314
1. Regulations on Negative List of Investment in Indonesia.....	314
2. Regulations on Negative List under Presidential Regulation 36/2010.....	316
3. Nominee Arrangement Practice in Indonesia.....	321
C. Conclusion .....	325

---

\* Correspondence address: david\_kairupan@yahoo.com

## A. Introduction

Generally speaking, foreign investment activities in a certain country are restricted by regulations issued by the origin country of the foreign investor (governance by the home nation), the host country where the investment is made (governance by the host nation) and the relevant international laws (governance by multinational organizations and international law).<sup>1</sup> The regulations, including restrictions on foreign investment made by the host country, are basically the authority of the country arising from its sovereignty.<sup>2</sup> However, sovereignty of the host country is limited by international laws, including international conventions where the host country becomes the contracting party, such as agreement of World Trade Organization on Trade Related Investment Measures.

Restrictions on foreign investment may be imposed when the foreign investment enters into a country (entry requirements) or when the foreign investment operation is undertaken in the host country (operational requirements). In Indonesia, such restrictions are manifested through among others regulations on List of Closed Business Sectors for Investment and Open Business Sectors for Investment Subject to Certain Investment Requirements or commonly known as Negative List of Investment (“Negative List”).

For the purpose of avoiding certain restrictions on foreign shareholding in Indonesian companies as stipulated in the Negative List or for any other reasons, nominee shareholding practices in companies are frequently found in Indonesia. Although such nominees shareholding is not legally recognized under the Indonesian legal system, even expressly prohibited under Article 33 paragraphs (1) and (2) of Law No. 25 of 2007 (the “Investment Law”), it is still commonly used in practice.

This article will briefly analyze the Negative List regulations in Indonesia under the prevailing regulations and discuss the practices and regulations of nominee shareholding in Indonesia.

## B. Discussion

### 1. Regulations on Negative List of Investment in Indonesia

The Negative List is generally governed under Article 12 of the Investment Law providing for that all business sectors are open for investment, unless business sectors which are declared to be closed and open subject to certain requirements. The Elucidation of such provision further provides that business sectors which are closed or open subject to certain requirements for investments shall be specified in a Presidential Regulation and classified in a certain list made based on a classification on business sectors and business types applicable in Indonesia, namely classification based on the Standard Classification of Indonesian Business Sectors (*Klasifikasi Baku Lapangan Usaha Indonesia* or known as “KBLI”) and/or the International Standard for Industrial Classification (ISIC). Therefore, in order to understand the business sectors applicable in Indonesia, particularly the business sectors specified in the Negative List, before undertaking the proposed investments in Indonesia investors need to ensure the proposed business sectors as contained in KBLI.

The current KBLI is KBLI 2009 as contained in Regulation of Chairman of the Statistics Central Agency (*Biro Pusat Statistik*) No. 57 of 2009 regarding Standard Classification of the Indonesian Business Sectors (“KBLI 2009”). In the past, to identify and understand whether a business sector is open or prohibited for investment, investors required to scrutinize Technical Guidelines on Investment Implementation (*Petunjuk Teknis Pelaksanaan Penanaman Modal*) issued

<sup>1</sup> Ralph H. Folsom, Michael W Gordon, dan John A. Spanogle, 2005, *Principles of International Business Transactions, Trade & Economic Relations*, Thomson West, St. Paul, pp. 557-563.

<sup>2</sup> M. Sornarajah, 2004, *The International Law of Foreign Investment*, Cambridge University Press, Cambridge, p. 97.

by the Investment Coordinating Board (*Badan Koordinasi Penanaman Modal* or known as “BKPM”). Such Technical Guidelines on Investment Implementation was revised from time to time according to the economic development at that time.<sup>3</sup>

Decision on closed business sectors for investment is made based on the following criteria: (1) health; (2) moral belief; (3) culture; (4) environment; (5) national defense and safety; and (6) any other national interests.<sup>4</sup> While, decision on open business sectors for investment subject to certain requirements is made in the national interests, i.e.: (1) protection of natural resources; (2) protection and development of cooperatives and micro, small and medium-sizes enterprises (*usaha mikro, kecil, menengah dan koperasi* or known as “UMKMK”);<sup>5</sup> (3) supervision of production and distribution; (4) technology capacity development; (5) participation of domestic capital; and (6) cooperation with enterprises designated by the Government.<sup>6</sup>

In compliance with Article 12 of the Investment Law, in 2007 the Government therefore issued Presidential Regulation providing for criteria and requirements of business sectors which are closed for investment and open for investment subject to certain requirements, i.e. Presidential Regulation No. 76 of 2007 concerning Criteria and Requirements on Classification of Closed Business Sectors and Open Business Sectors Subject to Investment Requirements (“Presidential Regulation 76/2007”). In term of Negative List, the Government issued Presidential Regulation No. 77 of 2007 regarding List of Closed Business Sectors and Open Business Sectors Subject to Investment Requirements (“Presidential Regulation 77/2007”).

Another issue which should be taken into account to understand the Negative List is that the regulation on restrictions of business sectors which are closed or open subject to certain requirements is applicable not only for foreign investments (*penanaman modal asing* or known as “PMA”) but also for domestic investments (*penanaman modal dalam negeri* or known as “PMDN”). The Negative List may be periodically evaluated and revised in view of the economic development and national interests based on analyses, facts and inputs with regard to investments.<sup>7</sup> Presidential Regulation 77/2007 containing the prevailing Negative List at the time of the enactment of the Investment Law in 2007 set forth that such Presidential Regulation is valid for 3 years as of the enactment, or if it is necessary, it will be reviewed in view of the requirements and the situation development. As a matter of fact within less than a half year as of its enactment, such Presidential Regulation was amended by Presidential Regulation No. 77/2007 regarding Amendments to Regulation No. 77 of 2007 on Closed Business Sectors and Open Business Sectors Subject to Investment Requirements (“Presidential Regulation 111/2007”).

The Negative List as governed under Presidential Regulation 77/2007 in conjunction with Presidential Regulation 111/2007 was eventually re-amended in 2010 by virtue of Presidential Regulation No. 36 of 2010 on Closed Business Sectors and Open Business Sectors Subject to Investment Requirements (“Presidential Regulation 36/2010”) revoking Presidential Regulation 77/2007 and Presidential Regulation 111/2007. Several amendments to Negative List indicate the requirements, which

<sup>3</sup> For example, Technical Guidelines on Investment Implementation of 1998 and 2002. Before that, investment guidelines issued by BKPM was named Business Opportunity Information (*Informasi Peluang Usaha* or IPU) issued in 1995 and amended by Addendum IPU of 1996.

<sup>4</sup> Article 12 paragraph (3) of the Investment Law.

<sup>5</sup> Micro, Small and Medium Enterprises are governed under Law No. 20 of 2008 regarding Micro, Small and Medium-Size Enterprises (“Law 20/2008”). Cooperatives are governed under Law No. 17 of 2012 on Cooperatives.

<sup>6</sup> Article 12 paragraph (5) of the Investment Law.

<sup>7</sup> Article 17 paragraph (1) Presidential Regulation 76/2007.

keep changing in accordance with the dynamic economy development. The current Negative List as specified in Presidential Regulation 36/2010, is now being planned to be revised again by the Government to enlarge the opportunity of foreign investors in certain sectors.<sup>8</sup>

In defining the closed business sectors and the open business sectors subject to certain requirements, the Government has to take basic principles into account, i.e.: simplicity, compliances, transparency, legal certainty and regional unity.<sup>9</sup> Furthermore, Article 12 of Presidential Regulation 76/2007 provides that the open business sectors comprise as follows:

1. Business sectors which are open subject to requirements on protection and development of UMKMK, where such business sectors may only be undertaken based on fairness and feasibility considerations;<sup>10</sup>
2. Business sectors which are open subject to partnership requirements, comprising allocated business sectors and unallocated business in consideration of business feasibility;<sup>11</sup>
3. Business sectors which are open subject to requirements on capital ownership requirements, where there are limitations of foreign capital ownership;
4. Business sectors which are open subject to requirements on certain locations, where there are restrictions on certain administrative regions for certain investments;
5. Business sectors which are open subject to requirements on special licenses in the form of recommendation from governmental or non-governmental institutions/bodies having supervisory

authority over certain business sectors, including by way referring to regulations dealing with monopoly or mandatory cooperation with certain state-owned companies (*Badan Usaha Milik Negara* or known as BUMN).

## 2. Regulations on Negative List under Presidential Regulation 36/2010

Article 1 of Presidential Regulation 36/2010 provides for business sectors being prohibited to be undertaken in the investment activities, which are further specified in the List of Closed Business Sectors for Investment as contained in Appendix I of such Presidential Regulation. In the Appendix I there are 6 closed business sectors closed for investments, i.e.: (i) agriculture; (ii) forestry; (iii) industry; (iv) transportation; (v) communication and information; and (vi) culture and tourism. Each business sector as abovementioned is spelt out into several specific sub-business sectors, totaling 20 business sectors.

Furthermore, Article 2 of Presidential Regulation 36/2010 sets forth business sectors which may be undertaken subject to certain requirements, i.e.: (i) business sectors **allocated for UMKMK**; (ii) business sectors **subject to partnership requirements**; (iii) business sectors **subject to capital ownership requirements**; (iv) business sectors **subject to certain locations**; and (v) business sector **subject to special licenses**. Such business sectors are further spelt out in Appendix II of Presidential Regulation 36/2010, i.e. List of Open Business Sectors Subject to Certain Requirements consisting of 17 business sectors, i.e.: (i) agriculture; (ii)

<sup>8</sup> Editorial, "Revision of Negative List of Investment Elargens Foreign Opportunities", *Bisnis Indonesia*, 5 August 2011, p. 1.

<sup>9</sup> See Articles 5 and 6 Presidential Regulation 76/2007. In this Presidential Regulation it is explained *inter alia* that what is referred by "transparency" principle is that the Negative List must be clear, detailed, measurable and not multi-interpretation as well as based on certain criteria.

<sup>10</sup> Criteria on Micro, Small and Medium-Size Enterprises can be read in Law 20/2008. An enterprise is classified as **micro-size enterprise** if the maximum amount of its net worth is Rp50,000,000 excluding land plot and building used for business and the maximum amount of its annual sales Rp300,000,000. While an enterprise is classified as **small-size enterprise**, if its net worth is greater than Rp50,000,000 up to a maximum amount of Rp500,000,000, excluding land plot and building used for business and the annual sales is greater than Rp300,000,000 up to a maximum amount of Rp2,500,000,000. Moreover, criteria of **medium-size enterprise** is that its net worth is greater than Rp500,000,000 up to a maximum amount of Rp10,000,000,000, excluding land plot and building used for business, and its annual sales is greater than Rp2,500,000,000 up to a maximum amount of Rp50,000,000,000.

<sup>11</sup> To understand partnership arrangements, in addition to Law 20/2008, it is also important to take Government Regulation No. 44 of 1997 on Partnership into account.

forestry; (iii) maritime and fishery; (iv) energy and mineral resources; (v) industry; (vi) defense; (vii) public works; (viii) trade; (ix) culture and tourism; (x) transportation; (xi) information and telecommunication; (xii) finance; (xiii) banking; (xiv) manpower and transmigration; (xv) education; (xvi) health; dan (xvii) safety. Each of the business sectors as aforementioned is spelt out into several specific sub-business sectors, totaling 274 business sectors.

Pursuant to Article 4 of Presidential Regulation 36/2010, Articles 1 and 2 of such Presidential Regulation as abovementioned, are **not applicable for indirect investments or portfolio investments where the transactions are undertaken through capital markets.** Notwithstanding, Article 4 of Presidential Regulation 36/2010 does not further elaborate the definition of “indirect investments or portfolio investments where the transactions are undertaken through capital markets.”

Broadly speaking the concept of direct investment is frequently distinguished with terminology of portfolio investment.<sup>12</sup> Direct investment is commonly construed as investment activities dealing with; (i) transfer of funds; (ii) long-term project; (iii) the purpose of regular income; (iv) the participation of the person transferring the funds; and (v) business risk.<sup>13</sup> Whereas portfolio investment is usually related to investments undertaken through capital markets or on a stock exchange by way of purchasing certain securities and as such it does not deal with long-term projects. The income resulting from portfolio investment is therefore short-term in the form of capital gain arising from the sale of securities instead of regular income. Investors

in portfolio investment do not interfere with the company management and therefore it is closely related to investment risks of the securities instead of risks of the business engaged in by the target company or the company where the investments have taken place.

In order to understand the meaning of “indirect investments or portfolio investments where the transactions are undertaken through capital markets”, it is important to review the substances of Articles 37 and 38 of Regulation of Chairman of BKPM No. 12 of 2009 regarding Guidelines and Procedures on Investment Applications. Pursuant to such provisions, PMA and PMDN companies shall obtain In-Principle License on Amendment if there is any amendment with regard to: (i) the business sector, including type and capacity of production; (ii) capital investment in the company; and (iii) the term of project completion. In the context of any shareholding changes in open companies (PT Tbk), such In-Principle License on Amendment is not required if such shareholding change occurs on the shareholding categorized as public shareholders, while if the change occurs on the shares owned by the founding shareholder or the controlling shareholder for at least 2 years and the transaction is undertaken on the domestic stock exchange, the open company is obliged to obtain such a In-Principle License on Amendment.<sup>14</sup> In the articles of association of an open company, the shareholding categorized as portfolio investment is usually stated as “public shareholders” (*masyarakat*) or construed as non-controlling shareholders. In case there is transfer of shares owned by “public shareholders” on the stock exchange, such transfer of shares of the open company

<sup>12</sup> M. Sornarajah, *Op.cit.*, p. 7.

<sup>13</sup> Rudolf Dolzer dan Christoph Schreuer, 2008, *Principles of International Investment Law*, Oxford University Press, New York, p. 60.

<sup>14</sup> The Company Law defines open limited liability company as **public limited liability company** or **limited liability company undertaking public offering of shares** in accordance with the prevailing regulations on capital markets. Public company is defined as company which fulfills criteria on the number of shareholders and paid-up capital in accordance with prevailing regulations on capital markets. Under Law No. 8 of 1995 on Capital Markets term used for public limited liability company is **Public Company** being defined as company owned by at least 300 shareholders and having paid-up capital of at least Rp3,000,000,000 or any other number of shareholders and paid-up capital determined by Government Regulation. Furthermore, in the Capital Market Law term having similar meaning with term **limited liability company undertaking public offering of shares** as used in the Company Law is **Issuer** which is defined as party undertaking public offering.

does not need approval of General Meeting of Shareholders (“GMS”) and it is not subject to first refusal right of the other shareholders as stipulated in Articles 58 and 59 of Law No. 40 of 2007 on Limited Liability Companies (the “Company Law”). As such the liquidity of shares of such open company will not be affected.

Given the above, Article 4 of Presidential Regulation 36/2010 setting forth that Articles 1 and 2 are not applicable for indirect investments or portfolio investments where the transactions are undertaken through capital markets are basically **incorrect**. **Firstly**, Article 1 of such Presidential Regulation basically provides for business sectors, which are prohibited for investment activities, such as cultivation of cannabis as specified in the agricultural business sector or the operation and management of weighbridge. Such prohibitions as governed under Article 1 and further specified in Appendix I of Presidential Regulation 36/2010 should not be declared “not applicable” for portfolio investments. **Secondly**, investment restrictions as stipulated in Article 2 and further specified in Appendix 2 Presidential Regulation 36/2010, are generally applicable no matter of direct investment or indirect investment (portfolio investment).

Article 4 of Presidential Regulation 36/2010 should have regulated that only foreign investment restriction which is not applicable to portfolio investment instead of the entire provisions of Negative List as governed Articles 1 and 2 of Presidential Regulation 36/2010. As aforementioned, it is because the provisions on investment restrictions in certain business sectors under Article 1 in conjunction with Appendix I of Presidential Regulation 36/2010 and certain requirements on investments under Article 2 in conjunction with Appendix II of Presidential Regulation 36/2010 (other than restriction on foreign investment) must be taken into

consideration by and applicable for companies (open companies) of which their shareholding structure has portfolio investment or indirect investment. Hence, investment requirements with regards to business sectors allocated for UMKMK, business sectors subject mandatory partnerships and business sectors subject to certain locations and specific licenses are also applicable for companies having portfolio investment in their shareholding structure.

In practice, the exemption of the requirement on maximum foreign shareholding for the portfolio investment may become a loophole, by way of dividing the shareholding of the foreign investor into several companies acting as special purpose vehicles through the mechanism of collective custodian (*Penitipan Kolektif*) applicable to public companies.<sup>15</sup> As an example, this can be seen in the mining business sector prior to the enactment of Law No. 4 of 2009 concerning Mineral and Coal Mining (“Mining Law”). Prior to the enactment of the Mining Law, PMA was not allowed to participate in mining business activities undertaken under Mining Concession (*Kuasa Pertambangan*). Several foreign investors who wished to invest in companies having Mining Concession, conducted a kind of backdoor listing arrangement, whereas the core business of the open company being a target company is changed into mining or any other business relating to mining and such open company became a holding company of the companies having Mining Concession. In order to prevent the status conversion of such open company into a PMA company, the foreign investors would become public shareholders categorized as portfolio investment.

In the context of business restructuring giving rise to change of shareholding as a result of merger, acquisition or consolidation, Article 5 of Presidential Regulation 36/2010 regulates as follows:

<sup>15</sup> To understand the mechanism of “collective custodian”, it is advisable to read the book of Gunawan Widjaja, 2006, *Seri Aspek Hukum dalam Pasar Modal: Penitipan Kolektif*, Rajawali Pers, Jakarta.

1. Shareholding limit of foreign investor in investment company receiving merger shall refer to the approval letter of such company;
2. Shareholding limit of foreign investor in the acquiring investment company shall refer to the approval letter of such company;
3. Shareholding limit of foreign investor in the new company as a result of consolidation shall refer to the regulations applicable at the time of establishment of such new company resulting from consolidation.

To understand the provision of Article 5 of Presidential Regulation 36/2010, it is necessary to understand the meaning of merger, acquisition and consolidation as defined in the Company Law. Merger is a legal action conducted by one or more limited liability companies to merge with another existing limited liability company, causing the assets and liabilities of the merging limited liability company to be transferred by the operation of law to the limited liability company receiving the merger, and subsequently the legal entity status of the merging limited liability company shall legally wound up. In the context of Article 5 (a) of Presidential Regulation 36/2010, the limit of foreign shareholding that must be addressed to is the amount of foreign shareholding in limited liability company receiving merger or the surviving company.

Acquisition under the Company Law is defined as a legal action conducted by a legal entity or individual to acquire shares in a limited liability company causing the transfer of control over such limited liability company. Unlike Law 1/1995 concerning Limited Liability Companies, the acquisition of limited liability company is no longer construed as the acquisition of all or substantial part of shares of a limited liability company, but more it more emphasizes to the transfer of control of the acquired limited

liability company (corporate control transaction), although the acquired shares do not constitute all or substantial part of the total issued shares of the acquired limited liability company or target company.<sup>16</sup> In Article 5 (b) of Presidential Regulation 36/2010, the limitation of foreign shareholding refers to the foreign shareholding of the acquiring investment company. This is definitely incorrect, as the limitation of foreign shareholding, which should have been complied within acquisition of a limited liability company, is the foreign shareholding of the acquired company or target company. Another unusual issue in term of the provision of Article 5 (b) of Presidential Regulation 36/2010 is that the acquiring party, as a matter of fact is not necessarily in the form of a limited liability company, as it may be in the form of foreign individual or foreign business entity which is not a limited liability company in Indonesia. Article 5 (b) of Presidential Regulation 36/2010 should have been revised, so that it does not create ambiguity.

Meanwhile the consolidation in the Company Law is defined as a legal action conducted by two or more limited liability companies, to amalgamate one another by way of establishing one new limited liability company, which by law shall obtain the assets and liabilities of the limited liability companies which have amalgamated, and the legal entity status of the limited liability companies having amalgamated shall be legally wound up. In the context of Article 5 (c) Presidential Regulation 36/2010, the limitation of foreign shareholding, which must be complied with is the foreign shareholding of the limited liability company established for the purpose of such consolidation.

Another interesting issue with regard to the regulation on Negative List is Article 6 paragraph (1) of Presidential Regulation 36/2010 setting forth as follows:

---

<sup>16</sup> David Kairupan, "Corporate Control Transaction in Acquisition under the Indonesian Law," *Jurnal Hukum dan Pembangunan*, No. 3, July 2009, pp. 326-346.

In the event that the foreign investment undertakes business expansion in the same business sector and such business expansion requires capital increase by way of issuing new shares with pre-emptive rights to order securities (rights issue) and the domestic investor cannot participate in such capital increase, the provision concerning pre-emptive rights of foreign investor shall apply pursuant to the laws and regulations with regard to limited liability companies.

The abovementioned provision actually intends to regulate the non-participation of the local partner or the domestic shareholder in the capital increase of PMA company in connection with its business expansion. Notwithstanding, if it is further analyzed, in such provision it is not entirely clear, whether such PMA company increasing the capital is an open company (open limited liability company) or ordinary limited liability company. The term “rights issue” in the context of the capital increase is basically recognized for open companies as provided for in Regulation IX.D.1 concerning Pre-emptive Rights to Order Securities, Appendix of Decree of Chairman of BAPEPAM No. KEP-26/PM/2003 dated 17 July 2003 instead of close companies. In the process of capital increase of an open company, before the shares are issued, the open company shall issue Pre-emptive Rights to Order Securities or known as HMETD (*Hak Memesan Efek Terlebih Dahulu*). This HMETD may be sold or purchased or transferred to another party, including a party that is not a shareholder within a certain trading period, before such HMETD is exercised into shares. In the event that the HMETD holder intends to transfer such HMETD, in fact in such HMETD transfer there is no pre-emptive right of the foreign investor as regulated in Article 6 paragraph (1) of Presidential Regulation 36/2010. Such rights to be prioritized in connection with the capital increase in practice are also known as “pre-emptive right”. Therefore, the wording of Article 6 paragraph (1) of Presidential Regulation 36/2010 should be revised so that the purpose

of such provision can be clearer in practice. Another provision that also needs to be taken into consideration is Article 6 paragraph (2) of Presidential Regulation 36/2010, which sets forth as follows:

In the event that the capital increase as referred to in paragraph (1) causes the amount of foreign shareholding to exceed the maximum limitation as specified in the Approval Letter, then within 2 (two) year period, the excess of such foreign shareholding must be adjusted with the maximum limitation as specified in the Approval Letter, by ways of: (a) the foreign investor shall sell the excess of its shares to a domestic investor; (b) the foreign investor shall sell the excess of its shares through public offering undertaken by the company of which its shares are owned by such foreign investor in domestic capital market; or (c) the company as referred to in paragraph (2) letter b shall purchase the excess of shares owned by such foreign investor and it shall be treated as treasury stocks, with due observance to Article 37 of Law Number 40 of 2007 concerning Limited Liability Companies.

The provision of Article 6 paragraph (2) constitutes a further regulation of Article 6 paragraph (1), in the event that the domestic investor does not participate in the capital increase conducted by a PMA company. If such capital increase causes the amount of foreign shareholding to exceed the maximum limitation as specified in the Investment Approval Letter, then such excess of foreign shareholding shall be subject to mandatory divestment requirement within a period of two years, so that such foreign shareholding shall be re-adjusted according to the required maximum limitation. Such requirement with regards to the period of two years should expressly stipulate when such period shall be commenced, for example since such capital increase is lawfully made resulting in the foreign shareholding exceeding the required maximum limitation. Accordingly, it may be interpreted that two years is calculated since the capital increase is approved by or is reported to Minister of Law and Human Rights.

As a matter of fact, in practice prior to a capital increase is undertaken, Board of Directors or the shareholders of a company usually will ascertain whether the proposed capital increase will contravene Negative List or the requirements on foreign shareholding limitation as specified in the Approval Letter of its investment. This is because at the time of the application process of In-Principle License on Amendment, if the foreign shareholding exceeds the maximum limitation requirements, BKPM will usually question this particular issue. However, in view of Article 6 of Presidential Regulation 36/2010, it may be implied that non-compliance with the requirements on maximum limitation of foreign shareholding is allowed, if it results from the issuance of new shares of PMA company, in which the domestic investor does not participate in such capital increase. If a non-PMA company undertakes a capital increase, where the local shareholder does not participate in such capital increase, and there is a strategic investor being foreign party participating in the subscription of the new shares, will the non-compliance with the requirements on maximum limitation of foreign shareholding in such company be allowed in the context of Article 6 of Presidential Regulation 36/2010? Moreover, if such capital increase results from debt and capital restructurings in the company, in which there is debt conversion into equity in such company (debt-to-equity swap), will the non-compliance with the requirements on maximum limitation of foreign shareholding is allowed in the context of Article 6 of Presidential Regulation 36/2010? Such non-compliance circumstances are basically not allowed given that prior to the capital increase in the framework of business expansion is undertaken, as a matter of fact the company, the shareholders or the strategic investor are required to initially adhere to Negative List.

Article 6 paragraph (2) of Presidential Regulation 36/2010 as aforementioned provides for the mechanism of mandatory divestment, which shall be conducted within a period of two years

in the event that the requirements on maximum limitation of foreign shareholding are breached. The first alternative is a mechanism known as direct sale, in which the foreign investor sells its shares to a domestic investor. The second alternative is through public offering, whereas the relevant foreign investor undertakes divestment of its shareholding through a public offering undertaken by the company in domestic capital market. The question is whether this alternative merely refers to initial public offering or known as IPO, or also includes public offering of shares conducted by the foreign shareholder after such PMA company has conducted IPO, or also known as secondary offering as regulated in Regulation IX.A.12 concerning Public Offering by Shareholder, Appendix of Decree of Chairman of BAPEPAM No. Kep-05/PM/2004 dated 9 February 2004. If the public offering of shares is conducted by the shareholder as regulated in Regulation IX.A.12, the lock-up period requirements as regulated in Regulation IX.A.6 concerning Restrictions of Shares Issued Prior to Public Offering, Exhibit of Decree of Chairman of BAPEPAM No. Kep-06/PM/2001 dated 8 March 2011 must also be taken into account. Article 1 of such Regulation IX.A.6 sets forth that:

Any party obtaining shares and or any other Equity Securities of the Issuer at the price and or conversion value and or exercise price of below the price of initial Public Offering of shares within 6 (six) months prior to the filing of the Registration Statement with Bapepam, shall be prohibited from transferring part or all title of the shares and or the Equity Securities of the Issuer until 8 (eight) months after the Effectiveness of the Registration Statement. Such prohibition shall not be applicable to any shares and or any other Equity Securities directly or indirectly owned by the Central Government, Regional Government or National Banking Restructuring Agency (*Badan Penyehatan Perbankan Nasional*).

### 3. Nominee Arrangement Practice in Indonesia

In discussing issues relating to Negative List,

it is necessary to discuss issues concerning nominee arrangement in Indonesia, as this arrangement is often used by foreign investors to avoid restrictions of foreign shareholding in certain business sectors in Indonesia. Indonesian law basically does not recognize the concept of 'trust' or 'trustee' as known in common law system. Under Indonesian legal system, there is no distinction between beneficial owner and legal owner, although in certain cases particularly in Collective Custodian (*Penitipan Kolektif*) as specified in Article 56 of the Capital Market Law or any other capital market practices such as Trustee (*Wali Amanat*) in bond issue, such concept of trustee as a matter of fact has been recognized in the laws and regulations on capital markets.<sup>17</sup>

As an example, A is registered as a shareholder in a limited liability company (legal owner), meanwhile the money used for the share subscription in such limited liability company is originated from B, and the shareholding of A in such limited liability company is actually intended in the interest of B as another party. In this case, B is intended to become the actual shareholder and to be entitled to enjoy all rights upon shares in such company, including voting rights and rights to receive dividends arising from such shares (beneficial owner). Legally speaking, the arrangement made by A and B does not bind any third parties, as the third parties basically merely recognize A as the shareholder of such limited liability company, as stated in the relevant articles of association. In the deed of establishment or articles of association, A is recorded as the legal owner as well as the beneficial owner of the shares of such limited liability company, and it shall not be stated that A holds such shares for the benefit of B.

Article 33 paragraphs (1) and (2) of the Investment Law expressly regulates the prohibition on nominee shareholding, as follows:

- (1) Any domestic investor and foreign investor conducting investment in the form of limited liability company are prohibited from making any agreement and/or any statement expressly setting forth that the shareholding in such limited liability company is for and on behalf of another party.
- (2) In the event that domestic investor and foreign investor make such agreement and/or statement as referred to in paragraph (1), such agreement and/or statement shall be declared null and void.

The Elucidation of paragraph (1) of Article 33 of the Investment Law reinforces that the purpose of this provision is to avoid any occurrence, where a limited liability company is legally owned by a party, however in reality or substantively the owner of such company is another party.

If this is analyzed, the provision of Article 33 paragraphs (1) and (2) of Investment Law constitutes an affirmation that nominee agreement/documentation is not recognized under Indonesian legal system. Legal/registered owner and beneficial owner are not separated under Indonesian legal system. Without such regulation, Indonesian legal system as a matter of fact does not recognize nominee agreement/document, in other words, it goes without saying. However, it is important to note that in the nominee arrangement in Indonesia, the nominee shareholders do not sign any agreement and/or statement expressly setting forth that their shareholding in a limited liability company is for and on behalf of another party as regulated in Article 33 paragraph (1) of the Investment Law.

The nominee arrangement between a principal investor and a nominee shareholder is usually undertaken based on a set of documents and agreements which commonly recognized under Indonesian legal framework, such as

<sup>17</sup> This is discussed in details in the book originated from the dissertation of Gunawan Widjaja of Law Faculty of University of Indonesia. Please see Gunawan Widjaja, 2008, *Transplantasi Trusts dalam KUHPerdata, KUHD dan Undang-Undang Pasar Modal Indonesia*, Rajawali Pers, Jakarta. Please also read the dissertation of Felix Oentoeng Soebagio in Law Faculty of Gajah Mada University, which is stated in a book in Felix Oentoeng Soebagio, 2006, *Hukum tentang Akuisisi Perusahaan di Indonesia*, Pusat Pengkajian Hukum, Jakarta, pp. 17-24.

loan agreement, pledge of shares agreement, assignment agreement and power of attorney. Therefore in practice, the principal investor and the nominee shareholder do not sign any nominee agreement or nominee statement, but enter into a nominee arrangement. The following is an explanation concerning agreements usually used in the nominee arrangement in Indonesia: (1) Loan Agreement between the principal investor as the lender and the nominee shareholder in which such loan will be used by the borrower to pay for the subscription of shares in a certain company; (2) Pledge of Shares Agreement between the principal investor as the party receiving the pledge (pledgee) and the nominee shareholder (pledgor), in which the shares issued upon the payment made with such loan, are pledged by the nominee shareholder to the principal investor; (3) Assignment of Dividend Agreement between the principal investor and the nominee shareholder, in which the right to receive dividends distributed by the company to the nominee shareholder as the shareholder is transferred to the principal investor; (4) Irrevocable Power of Attorney for GMS in which the nominee shareholder as a shareholder in such company authorizes the principal investor to request for convening GMS, to attend and to cast votes in the relevant company's GMS. Notwithstanding the above, it is important to note that the Elucidation of Article 60 paragraph (4) of the Company Law expressly provides for **a legal principle, which does not allow transfer of voting rights separated from the share ownership**. Therefore, the power of attorney for GMS made on a irrevocable basis, meaning it cannot be revoked by the authorizer, usually by waiving the provisions of Articles 1813, 1814 and 1816 of the Indonesian Civil Code, is basically contrary to the legal principle as specified in Article 60 paragraph (4) of the Company Law; (5) Irrevocable Power of Attorney to Sell Shares granted by the nominee shareholder to the prin-

cipal investor, in which in the event of certain occur-rences, the principal investor may sell the shares owned by the nominee shareholder.

In addition to the above documents, nominee arrangement is often furnished with other relevant documents such as option agreement, loan agreement with the target company, along with collaterals in the form of assets owned by the relevant company. The nominee arrangement as abovementioned is basically employed by using such documents recognized under Indonesian legal framework, such as those regulated in the Indonesian Civil Code ("KUHPer"). For examples, Article 1754 until Article 1769 concerning lending and borrowing agreement, Article 1150 until Article 1161 concerning pledge, Article 613 concerning assignment and Article 1792 until Article 1819 concerning granting of power of attorney. Hence, the documents prepared for the purpose of nominee arrangement are not nominee agreements or nominee statements as stipulated in Article 33 paragraph (1) of the Investment Law.

Not with standing the above, the legality of the nominee arrangement is certainly questionable in the view of Article 1320 KUHPer providing for the requirements on the validity of agreement, namely (i) mutual agreement to bind each others; (ii) legal capacity of the parties to enter into an agreement; (iii) a certain subject-matter; and (iv) a legal or valid cause. In case any of the first two requirements is not satisfied, it may cause an agreement to be "voidable", whilst if any of the last two requirements is not satisfied, it may cause an agreement to be "null and void".<sup>18</sup> The nominee arrangement made to avoid the requirements on foreign shareholding restrictions as specified in Negative List may be categorized as an agreement contravening the prevailing law, in other words, there is no legal or valid cause, so that it shall be null and void. The question is, what about if such nominee arrangement is made for the purpose

<sup>18</sup> Subekti, 1979, *Hukum Perjanjian*, Intermasa, Jakarta, hlm. 17-21.

of avoidance of certain requirements under certain prevailing laws and regulations, would such nominee arrangement be null and void?

Generally speaking the prohibition and consequence of the violation of prohibition referred to in Article 33 paragraphs (1) and (2) of the Investment Law does not necessarily cancel a nominee agreement which has been made by the parties outside of Indonesia, based on a legal system recognizing nominee concept or separation between legal owner and beneficial owner. For example, A is a legal owner being registered as a shareholder of PT X, whilst the beneficial owner

of PT X shares owned by A is B. The nominee agreement between A and B made outside of the Indonesian jurisdiction pursuant to foreign laws which recognizes nominee concept, basically shall not become null and void as regulated in Article 33 paragraph (2) of Investment Law. This is because what A and B has made is outside the Indonesian jurisdiction. Another interesting issue to be analyzed is that in KBLI 2009, the concept of trust or nominee is in fact recognized as part of business sector in Indonesia. The following are several business sectors in KBLI 2009 referring to trust or nominee concept:

**Table 1 – Business Sector Nos. 643, 6430, 64300 in KBLI 2009**

CATEGORY/CODE	TITLE - DESCRIPTION
643	<p><b>TRUST, FINANCING AND SIMILAR FINANCIAL ENTITY</b>            This category includes a legal entity established to pool shares or securities or any other financial assets, without managing, on behalf of shareholders or beneficiaries (those who receive the benefits). The portfolio shall be customized to achieve specific investment characteristics, such as diversification, risk, rate of return rate and sensitivity to price volatility. This entity earns interest, dividends and other property income, however has little, even no employment and no revenue from the sale of services. It does not include trustee (<i>wali amanat</i>) and financing which earns revenue from the sale of goods or services, holding company activities, pension funds and management of funds.</p>
6430	<p><b>TRUST, FINANCING AND SIMILAR FINANCIAL ENTITY</b>            This sub category includes a legal entity established to pool shares or securities or any other financial assets, without managing, on behalf of shareholders or beneficiaries (those who receive the benefits). The portfolio shall be customized to achieve specific investment characteristics, such as diversification, risk, rate of return rate and sensitivity to price volatility. This entity earns interest, dividends and other property income, however has little, even no employment and no revenue from the sale of services.            This sub category includes:            - Open-end investment funds;            - Closed-end investment funds;            - Trusts, estates or agency accounts, supervised on behalf of the beneficiaries based on trust agreement or testament or agency agreement.            - Unit investment trust funds.            This sub category does not include:            - Funds and trusts that earn revenue from the sale of goods or services, see the sub category of KBLI according to its main activities.            - holding company activities, please see 6420            - Pension funds, see 6530            - Management of funds, see 6630</p>
64300	<p><b>TRUST, FINANCING AND SIMILAR FINANCIAL ENTITY</b>            This category includes a legal entity established to pool shares or securities or any other financial assets, without managing, on behalf of shareholders or beneficiaries (those who receive the benefits). The portfolio shall be customized to achieve specific investment characteristics, such as diversification, risk, rate of return rate and sensitivity to price volatility. This entity earns interest, dividends and other property income, however has little, even no employment and no revenue from the sale of services. This category includes open-end investment funds; closed-end investment funds; trusts, estates or agency accounts, supervised on behalf of the beneficiaries based on trust agreement or testament or agency agreement; unit investment trust funds.</p>

If it is further analyzed, the above business sector is like a limited liability company designed to conduct certain investment (such as shares, securities or other financial assets), where the ownership of such investment is carried out for and on behalf of shareholders or beneficiaries. The above business sectors are generally similar to what is known as private equity. Although the private equity practice in Indonesia is recognized, however the regulatory framework of private equity in Indonesia is not sufficiently clear and therefore it requires further analysis.

### C. Conclusion

Based on the abovementioned, the regulations on the restrictions of foreign investment as provided for in Presidential Regulation 36/2010 needs to be reviewed and revised in order to avoid any misleading information and legal uncertainty. Several provisions of Presidential Regulation 36/2010, which need to be clarified and revised, among others: (a) Article 4 setting forth that the provisions of Articles 1 and 2 are not applicable

to indirect investment or portfolio investment of which transaction is made on capital market; (b) Article 5 letter (b) providing for the ownership limitation of foreign investor in connection with acquisition; (c) Article 6 providing for the issue of new shares in connection with business expansion of PMA company and mandatory divestment in the event that such foreign shareholding exceeds the required limitation as a result of the issue of new shares.

The sentence regulating prohibition of nominee shareholding as specified in Article 33 paragraphs (1) and (2) of the Investment Law also needs to be reviewed and revised, so that its scope becomes clearer. Such prohibition should not only refer to agreements and/or statements expressly setting forth nominee shareholding, but also refer to **all nominee shareholding arrangements**. In this matter, it is also important to address and clarify whether the prohibition as specified in Article 33 paragraphs (1) and (2) of the Investment Law exempts business sectors Nos. 643, 6430 and 64300 contained in KBLI 2009.

## BIBLIOGRAPHY

### A. Books

- Dolzer, Rudolf and Christoph, Schreier, 2008, *Principles of International Investment Law*, Oxford University Press, New York.
- Folsom, Ralph H., Michael W, Gordon, and John A. Spanogle, 2005, *Principles of International Business Transactions, Trade & Economic Relations*, Thomson West, St Paul.
- Soebagjo, Felix Oentoeng, 2006, *Laws on Corporate Acquisition in Indonesia [Hukum tentang Akuisisi Perusahaan di Indonesia]*, Pusat Pengkajian Hukum, Jakarta.
- Sornarajah, M., 2004, *The International Law of Foreign Investment*, Cambridge University Press, Cambridge.
- Subekti, 1979, *Law of Contracts [Hukum Perjanjian]*, Intermedia, Jakarta.

Widjaja, Gunawan, 2006, *Series on Legal Aspects in Capital Markets: Collective Custodian [Seri Aspek Hukum dalam Pasar Modal: Penitipan Kolektif]*, Rajawali Pers, Jakarta.

\_\_\_\_\_, 2008, *Transplantation of Trust in the Civil Code, the Commercial Code and the Indonesian Capital Market Law [Transplantasi Trusts dalam KUHPdata, KUHD dan Undang-Undang Pasar Modal Indonesia]*, Rajawali Pers, Jakarta.

### B. Journal Articles

- Kairupan, David, "Corporate Control Transaction in Acquisition under the Indonesian Law," *Jurnal Hukum dan Pembangunan*, No. 3, Juli 2009.

### C. Newspaper Articles

Redaktor Bisnis Indonesia, "Revision of Negative List of Investment Elargens Foreign Opportunities, [Revisi DNI Perbesar Peluang Asing]", *Bisnis Indonesia*, 5 Agustus 2011.

### D. Regulations

Law Number 8 of 1995 on Capital Markets (State Gazette of the Republic of Indonesia of 1995 Number 64, Supplement of the State Gazette of the Republic of Indonesia Number 3608).

Law Number 25 of 2007 on Investment (State Gazette of the Republic of Indonesia of 2007 Number 67, Supplement of the State Gazette of the Republic of Indonesia Number 4724).

Law Number 40 of 2007 on Limited Liability Companies (State Gazette of the Republic of Indonesia of 2007 Number 106, Supplement of the State Gazette of the Republic of Indonesia Number 4756).

Law Number 20 of 2008 on Micro, Small and Medium- Size Enterprises (State Gazette of the Republic of Indonesia Number 93, Supplement of the State Gazette of the Republic of Indonesia Number 4866).

Presidential Regulation Number 76 of 2007 on Criteria and Requirements on Classi-

fication of Closed Business Sectors and Open Business Sectors Subject to Investment Requirements.

Presidential Regulation Number 77 of 2007 on List of Closed Business Sectors and Open Business Sectors Subject to Investment Requirements.

Presidential Regulation Number 111 of 2007 on Amendments to Regulation Number 77 of 2007 concerning Closed Business Sectors and Open Business Sectors Subject to Investment Requirements.

Presidential Regulation Number 36 of 2010 on Closed Business Sectors and Open Business Sectors Subject to Investment Requirements.

Decree of Chairman of BAPEPAM Number Kep-06/PM/2001 on Restrictions of Shares Issued Prior to Public Offering.

Decree of Chairman of BAPEPAM Number Kep-26/PM/2003 on Pre-Emptive Right to Order Securities.

Decree of Chairman of BAPEPAM Number Kep-05/PM/2004 on Public Offering by Shareholders.

Regulation of Chairman of Investment Coordinating Board Number 12 of 2009 on Guidelines and Procedures on Investment Applications.