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## The Legal Practice of Corporate Takeover and Mandatory Tender Offer (MTO) in the Indonesian Capital Market<sup>1</sup>

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*The number of takeover transactions is relatively less compared to other corporate actions by publicly-listed companies, (e.g. IPOs, rights issues, or material transactions). There is no research that explains or contextualizes this fact, but one may speculate that this may be due to (a) the existence of block-holders in Indonesia's corporate structure profile (structural barrier) or (b) because it is costly to carry out a takeover in light of the existing Mandatory Tender Offer (MTO) requirements (legal barrier). This article focuses on the latter problem, aiming to address the practical and legal issues pertaining to takeover transactions in Indonesia with respect to the existence of the MTO. Pursuant to the prevailing rule, in a takeover of publicly-listed companies that results in a change of control, a MTO/mandatory bid requirement must be followed with the potential acquirer making an offer to purchase all of the remaining shares of the target company according to a certain minimum price formula. Specifically the article discusses practical and creative strategies that prospective controllers employ to avoid the mandatory bid/MTO requirement, and how these strategies impact the principle of minority shareholders' protection..*

**Keywords:** takeover, Mandatory tender offer, Indonesia Capital Market.

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### Introduction

There is increasing attention given to the importance of takeover actions whether by way of asset and/or share acquisitions in support of Indonesia's unprecedented economic growth. In theory, business expansion by way of acquisition (especially through share acquisitions), or takeover, with the acquirer bringing new resources to increase the value of the target company, should accelerate the pace of the acquiring company's growth compared to

if such expansion is conducted through organic growth. From a general capital market perspective, an active takeover market reflects a vibrant economy and an aggressive approach that characterize publicly-listed companies in Indonesia today. Indeed, takeover by, and/or of, companies listed in the stock exchange is a clear sign of a dynamic and bustling Indonesian capital market.

Notwithstanding the above, the number of takeover transactions is relatively less compared to other corporate actions by publicly-

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<sup>1</sup> The majority part of this article is modified from the author's draft doctoral dissertation under the auspices of the Faculty of Law of the University of Indonesia, and Maastricht University.

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listed companies, (e.g. IPOs, right issues, or material transactions). Records show that in 2007, there were 16 takeover and mandatory tender offer (MTO) transactions that occurred in IDX, but there were no Voluntary Tender Offers (VTO).<sup>2</sup> In 2008, there were nine takeover MTO deals and no VTO.<sup>3</sup> In 2009, there were nine takeovers and MTOs for eight issuers/publicly-listed companies, as well as one VTO.<sup>4</sup> In 2010, the market saw 10 takeovers and MTO transactions and no VTO.<sup>5</sup> In 2011, there were 11 takeover and MTO transactions, as well as three VTO transactions.<sup>6</sup>

In comparison, in 2007, there were 24 IPOs, 100% more than the previous 12 of 2006, and an increasing value of 470.82% from 3.01 trillion

in 2006 to 17.18 trillion in 2007. Further, there were 25 rights issues or limited IPOs in 2007, while the previous year saw only 16 rights issue deals. The most common deal in 2007 was the issuance of corporate bonds, where the stock exchange listed 39 deals or an increase of 178.57% in number and 173.14% in value from the previous year. In 2008, there were 170 IPOs, 25 rights issues, and 20 bond issuances. In 2009, the number and value of IPO, rights issues, and corporate bond issuances were still higher than takeover deals, *i.e.*, respectively: 13 IPO deals, 15 rights issue deals, and 28 corporate bond issuances. In 2010, there were 24 IPOs, 31 rights issues, and 29 corporate bond issuances. Meanwhile, in 2011, there were 25

<sup>2</sup> See BAPEPAM-LK, Annual Report 2007, which highlighted the following transactions:

Target Company	Offeror
PT. Bank Arta Niaga Kencana Tbk	PT Bank Commonwealth Indonesia
PT AHAP Insurance Tbk	PT Asuransi Central Asia
PT Trimegah Securities	Demerara Limited
PT Bank Swadesi Tbk	Bank of India
PT Indoexchange Tbk	Integrax Berhard.
PT Mulialand Tbk	PT Muliamustika Tataindah
PT Integrasi Teknologi Tbk	Goodwill Investment Services Inc.
PT Courts Indonesia Tbk	Malaysia Retail Group Limited
PT Dyviacom Intrabumi Tbk	PT Philadel Terra Lestari
PT Anta Express Tour & Travel Service Tbk	PT Trans Lifestyle
PT Sari Husada Tbk	Nutricia International BV
PT Branta Mulia Tbk	Kordsa Global Endustriyel Iplik ve Kord Bezi Sanayi ve Ticaret AS
PT Summitplast Tbk	Sumitomo Shoji Chemical Co, Ltd
PT Pania Filament Inti Tbk	PT Pania Indosyntex Tbk
PT Toba Pulp Lestari Tbk	Pinnacle Company Ltd
PT PP London Sumatera Indonesia Tbk	PT Salim Ivomas Pratama

<sup>3</sup> See BAPEPAM-LK Annual Report 2008 (2009) (Indon.). The deals are as follows: The takeover of PT Bank Nusantara Parahyangan Tbk by ACOM Co; PT Alfa Retailindo Tbk by PT Carrefour Indonesia; PT Bank UOB Tbk by UOB International Private Ltd; PT Apexindo Prama Duta Tbk by Mira International Holdings Pte Ltd; PT BII Tbk by Maybank Offshore Service; PT Cipendawa Industri Tbk by Indo Setubara Ltd; PT Tri Polyta Indonesia Tbk by Barito Pacific Tbk; PT Tempo Scan Pacific Tbk by Bogamulia Nagadi; and PT Ades Water Tbk by SOFOS Pte Ltd.

<sup>4</sup> See BAPEPAM-LK Annual Report 2009 (2010) (Indon.). The deals are: the takeover of PT Bentoel Internasional Investama Tbk by British American Tobacco; PT Multi Agro Persada Tbk by Malvolia Pte Ltd; PT Itamaraya Tbk by Trust Energy Resources Pte Ltd; PT Bristol-Myers Squibb Indonesia Tbk by Taisho Pharmaceutical Co. Ltd; PT Indosat Tbk by Qatar Telecom; PT. Enseval Megatrading by PT Kalbe Farma Tbk; PT Bank Ekonomi Raharja Tbk by HSBC Asia Pacific Holdings (UK) Limited; and PT Petrosea Tbk by PT Indika Energy Tbk. The one VTO was for the shares of PT Citra Tubindo Tbk by Kestrel Wave Investment Limited.

<sup>5</sup> See Bapepam-LK Annual Report 2010 (2011) (Indon.). The deals are: the takeover of PT Eatertainment International Tbk by PT Mutiara Timur Pratama, PT Matahari Department Store Tbk by PT Meadows Indonesia PT Sugih Energi Tbk by PT Ramba Energy Indonesia Limited PT Multi Bintang Indonesia Tbk by Asia Pacific Breweries Ltd, PT Kageo Igar Jaya Tbk by PT Kingsford Holdings, PT Tifico Fiber Indonesia Tbk by a consortium of PT Prospect Motor, PT Hermawan Sentral Investama, PT Wiratama Karya Sejati, and Pioneer Atrium Holdings; PT Allbond Makmur Usaha Tbk by Renuka Resource Holdings, PT Aqua Golden Mississippi Tbk by PT Tirta Investama, PT Aneka Kemasindo Utama Tbk by Oil and gas Ventures Limited, and PT Titan Kimia Nusantara Tbk by Titan International Corp. Sdn Bhd.

<sup>6</sup> See Bapepam-LK Annual Report 2011 (2012) (Indon.). The deals include, among others: the takeover of PT Sara Lee Body Care Indonesia Tbk by Unilever Indonesia Holding BV, PT. Sorini Agro Asia Corporindo Tbk by PT Cargill Foods Indonesia, PT Berau Coal Energi Tbk by Vallar Investments UK Limited, PT Dynaplast Tbk by Hambali Dana Mitra (no mandatory tender offer), PT. Keramika Indonesia Asosiasi Tbk by SCG Building Materials Company Limited, and PT Eratex Tbk by PT Buana Indah Garments.

IPOs, 25 rights issues, and 40 corporate bond issuances.<sup>7</sup>

However, the same data also show that the number of takeover deals is relatively high compared to merger transactions, where the market saw only two mergers in 2007, two mergers in 2008, four mergers in 2009, two mergers in 2010, and four mergers in 2011.<sup>8</sup> Nevertheless, takeover deals are still less active than IPOs and rights issues.

From the above, it is evident that takeover transactions, while practiced more than mergers, still take a backseat to other corporate actions in Indonesia today. While still not prevalently employed, it is undeniable that the impact of takeover transactions on the development of regulations and on the Indonesian capital market in general, is significant and worthy of discussion. There is no (financial) research that explains or contextualizes this fact, but one may speculate that this may be due to (a) the existence of block-holders in Indonesia's corporate structure profile (structural barrier) or (b) because it is costly to carry out a takeover in light of the existing MTO requirements (legal barrier).

This article aims to address the practical and legal issues pertaining to takeover transactions in Indonesia. Pursuant to the prevailing rule, in a takeover of publicly-listed companies that results in a change of control, a MTO/mandatory bid requirement must be followed in which the potential acquirer must offer to purchase all

of the remaining shares of the target company according to a certain minimum price formula. As such, there is a need for an academic discussion on the practical and creative strategies that prospective controllers employ to avoid the mandatory bid/MTO requirement, and how these strategies impact the principle of minority shareholders' protection.

## Regulatory overview

### *Takeover*

Bapepam Regulation No. IX.H.1, issued by then Bapepam LK, governs takeovers of publicly-listed companies in Indonesia. As of 31 December 2012, the functions, duties and regulatory and supervisory authorities of the Bapepam-LK (the former Indonesian Capital Market supervisory authority) have been transferred to the *Otoritas Jasa Keuangan* (OJK), the Indonesian Financial Services Authority by virtue of Law No. 21/2011. Bapepam Regulation IX.H.1 was enacted in 2000, amended in 2002, 2008, and the current law is the 2011 amendment.<sup>9</sup> Regulation IX.H.1 is related to the tender offer rule, known as a voluntary public bid, which is governed by the 2011 amended version of Bapepam Regulation IX.F.1.<sup>10</sup> The 2011 amendments of Regulation IX.H.1 and IX.F.1<sup>11</sup> make clear distinctions between the rules on takeovers and mandatory bids (Bapepam Rule IX.H.1 2011) and the rule on voluntary bids (Bapepam

<sup>7</sup> See Bapepam-LK Annual Report of 2007 (2008), Bapepam-LK Annual Report 2008 (2009), Bapepam-LK Annual Report 2009 (2010), Bapepam-LK Annual Report 2010 (2011), and Bapepam-LK Annual Report 2011 (2012).

<sup>8</sup> See *Id.*, Bapepam-LK Annual Report of 2007, 2008, 2009, 2010, and 2011.

<sup>9</sup> Bapepam Regulation IX.H.1 was first enacted in the Decree of Head of Bapepam No. Kep-04/PM/2000 dated March 13, 2000 on the Takeover of Publicly-listed companies [hereinafter Bapepam Regulation No. IX.H.1 2000], and then amended and replaced by the Decree of Head of Bapepam No. Kep-05/PM/2002 dated April 3, 2002 on the Takeover of Publicly-listed companies [hereinafter Bapepam Regulation No. IX.H.1 2002]. A significant change was made by Bapepam-LK, by virtue of the Decree of Head of Bapepam-LK No. Kep-259/BL/2008 dated June 20, 2008 on the Takeover of Publicly-listed companies [hereinafter Bapepam Regulation No. IX.H.1 2008]. Various new instruments were introduced in this Bapepam Regulation No. IX.H.1 2008, the most important of which was the mandatory selling requirement.

<sup>10</sup> Bapepam Regulation IX.F.1 was first contemplated under Decree of Head of Bapepam No. Kep-10/PM/2000 on Tender Offer dated March 13, 2000 [hereinafter Bapepam Regulation No. IX.F.1 (2000)] and further amended by Decree of Head of Bapepam No. Kep-04/PM/2002 on Tender Offer dated April 3, 2002 [hereinafter Bapepam Regulation No. IX.F.1 (2002)].

<sup>11</sup> Bapepam-LK updated these two regulations by issuing: (i) the Decree of Head of Bapepam No. 264/BL/2011 dated 31 May 2011 on the Takeover of Publicly-listed companies [hereinafter Bapepam Regulation No. IX.H.1 2011] amending Bapepam Regulation No. IX.H.1 2008; and (ii) the Decree of Head of Bapepam No. 263/BL/2011 dated 31 May 2011 concerning Voluntary Tender Offer [hereinafter Bapepam Regulation No. IX.F.1 2011] amending the Rule IX.F.1 2002.

Rule IX.F.1 2011), although both regulations share similar principles.

Each version of Regulation No. IX.H.1 sets forth a similar definition of a takeover: Takeover means “an activity, either directly or indirectly, that causes any change in a company’s control.”<sup>12</sup> Under this definition, the three essential elements of a takeover are: (1) there is an activity (or action); (2) the activity (or action) can be exercised either directly or indirectly; and (3) the activity (or action) causes a change in company control. The broad definition of an “activity” can cover any activity, including a voluntary public bid. While mandatory bid is an obligatory consequence of a takeover, the condition is different in the case of a voluntary bid. Theoretically, a voluntary bid may lead to takeover, only if there is a change of corporate control. However, since there is no precedent for a voluntary bid causing a change of control of a company in Indonesia (takeover), the term “activity” has, in practice, meant a takeover resulting from share acquisitions.

In the above definition, the concept of “control” is a key factor in determining whether a takeover has occurred in Indonesia. Bapepam Regulation No. IX.H.1 (2002) defines “company controller” as any person who:

- 1) owns 25% of a Company’s shares or more, unless that person could prove that he does not control the company, or
- 2) any person that directly or indirectly has the ability to control a Company in a manner of: a) determining the designation and resignation of directors and commissioners; or b) making any changes in the Company’s Articles of Association.<sup>13</sup>

This amended the previous Bapepam Regulation No. IX.H.1. (2000) where the threshold for being in control of a company was 20% ownership. Meanwhile, Bapepam Regulation No. IX.H.1 of 2008 and 2011 both define “com-

pany controller” as “any person who owns 50% of a company’s paid-up shares or more, or any person who directly or indirectly has the ability to determine in any way whatsoever the management and/or policy of the publicly-listed company.”<sup>14</sup>

Based on the above, determining whether a shareholder is a company controller can be done through the formal shareholding composition, the quantitative approach, or the actual control of the company, the qualitative approach. *First*, if using the formal shareholding composition (quantitative) approach, it must be determined if there have been increases from 20%-25% then to 50% in the ownership threshold. The increase of this threshold is intended to enhance market liquidity and provide wider access for investors acquiring shares in the Indonesian stock market.<sup>15</sup> The takeover regulation imposes requirements on any potential acquirer for disclosures, regulatory approvals, and mandatory tender offers, etc. that might be burdensome for companies if their corporate actions constitute a takeover. Therefore, from a potential acquirer’s perspective, the threshold’s increase allows more corporate takeover activity. The 2002 Regulation, however, had a caveat for the twenty-five percent threshold; namely, that the act constitutes a takeover, “*unless the person could prove that he does not control the company.*”<sup>16</sup> Under this Regulation, the acquirer has the burden of proving that the shares to be acquired will not result in company control. This caveat was deleted after the threshold was increased to fifty percent or more under the 2008 and 2011 Regulations.

*Second*, the qualitative approach, unlike the quantitative approach, determines who has *de facto* control of the company without regard to the formal shareholding composition. The 2002 Regulation’s definition of control encompasses “any person that directly or indirectly has the ability to control a company in the manner of:

<sup>12</sup> See Bapepam Regulation No. IX.H.1 art. 1(e) (2002) (Indon.), Bapepam Regulation No. IX.H.1 art. 1(e) (2008) (Indon.), and Bapepam Regulation No. IX.H.1 art. 1(c) (2011) (Indon.).

<sup>13</sup> Bapepam Regulation No. IX.H.1 art. 1(d) (2002) (Indon.).

<sup>14</sup> Bapepam Regulation No. IX.H.1 art. 1(c) (2011) (Indon.); Bapepam Regulation No. IX.H.1 art. 1(d) (2008) (Indon.).

<sup>15</sup> Bapepam Regulation No. IX.H.1 consideration (a) (2008) (Indon.).

<sup>16</sup> Bapepam Regulation No. IX.H.1 art. 1(d) (2002) (Indon.) (emphasis added).

(a) determining the designation and resignation of members of the board of directors and commissioners; or (b) making any changes in the Company's Article of Association."<sup>17</sup> However, the 2008 and 2011 Regulations broaden the definition by adding the provision that "any person that directly or indirectly has the ability to determine in any way whatsoever the management and/or policy of the publicly-listed company" is considered a company controller.<sup>18</sup> The discussion of qualitative control relates to the fact that a takeover can be a direct or indirect activity. By introducing the concept of "indirect control," all Regulations (2002, 2008, and 2011) have attempted to cover parties who are not necessarily registered as the company's shareholder but can still exercise control over the company. For example, the indirect control provisions may apply to an "ultimate controller" a person who may not own shares, but can control, determine, and greatly influence the company's decisions, although the Regulations do not explicitly reference this concept.<sup>19</sup>

The 2000, 2002, 2008, and 2011 versions of Regulation IX.H.1 provide different definitions of a "person" who may be a controlling person that consequently is compelled to make a mandatory offer. A person can be "a natural person, a company, a legal entity, a partnership, an association, or any Organized Group."<sup>20</sup> "Natural person" refers to an individual. Meanwhile, a company can be in any legally recognized profit-seeking form, including that of a limited liability company, and it can either be a local or foreign entity.

### **Mandatory tender offer**

When a transaction is considered to be a takeover, the party taking over the company is

required to conduct a mandatory tender offer. Under Bapepam Regulation No. IX.F.1 (2002), "Tender Offer means an offer through the mass media to acquire equity securities by purchase or exchange with other Securities."<sup>21</sup> Pursuant to the most recent amendments in Bapepam Regulation Rule No. IX.H.1 (2011), a mandatory tender offer no longer refers to Bapepam Regulation Rule No. IX.F.1 (2011), which pertains exclusively to voluntary tender offers (discussed further below). As contemplated in the 2000, 2002, 2008, and 2011 versions of Bapepam Regulation No. IX.H.1, in the event of a company takeover, the new controller of the company must conduct a mandatory tender offer for all remaining shares of the company. The shares that must be purchased by the new controller are the shares owned by the shareholders prior to the announcement date of the proposed tender. However, this requirement comes with several exceptions. Under Bapepam Regulation No. IX.H.1 (2011), the following shares are exempted from the mandatory tender offer:

- a. shares owned by shareholders who have made a Takeover transaction with the new controller;
- b. shares owned by other Parties who have obtained an offer with the same terms and conditions from the new controller;
- c. shares owned by other Parties who at the same time also conduct a Mandatory Tender Offer or Voluntary Tender Offer for the shares in the same publicly listed company;
- d. shares owned by the ultimate shareholder; and
- e. shares owned by the other controller of the publicly-listed company.<sup>22</sup>

The mandatory tender offer requirement does not apply to a takeover as a result of cer-

<sup>17</sup> Id.

<sup>18</sup> Bapepam Regulation No. IX.H.1 art. 1(c) (2011) (Indon.); Bapepam Regulation No. IX.H.1 art. 1(d) (2008) (Indon.).

<sup>19</sup> For discussion concerning beneficial/ultimate ownership across jurisdictions, including Indonesia, Erik P.M. Vermeulen, "Beneficial Ownership and Control: A Comparative Study, Disclosure, Information and Enforcement", OECD (March 2012), available at [www.oecd.org/dataoecd/41/38/50068886.pdf](http://www.oecd.org/dataoecd/41/38/50068886.pdf) (citing OECD-Indonesia policy dialogue on disclosure of beneficial ownership and control, Bali on 5 Oct. 2011, in which the author quoted S. Claessen, S. Djankov and L.H.P. Lang, "The Separation of Ownership and Control in East Asian Corporations", 58 J. of Fin. Econ. 81 (2000)).

<sup>20</sup> Bapepam Regulation No. IX.H.1 art. 1(b) (2008) (Indon.).

<sup>21</sup> Bapepam Regulation No. IX.F.1 art. 1(d) (2002) (Indon.).

<sup>22</sup> Bapepam Regulation No. IX.H.1 (3)(a)(2) (2011) (Indon.). These provisions have also been incorporated in the previ-

tain legal actions. Bapepam Regulation No. IX.H.1 2008 and 2011 versions provide that the following actions do not trigger the mandatory tender offer requirement:

1. The takeover occurs due to marriage or inheritance;
2. The takeover is performed by a party who previously has no share in the publicly-listed company and the takeover occurs due to the purchase or takeover of the shares in the publicly-listed company within every 12 month period, in a maximum amount of 10% of total outstanding shares with valid voting rights;
3. The takeover occurs due to the performance of duties and authority of a government or state body or institution based on the laws;
4. The takeover occurs due to the direct purchase of the shares owned and/or controlled by a government or state body or institution as the implementation of the provision as intended in point 3);
5. The takeover occurs due to a court stipulation or decision having permanent legal force;
6. The takeover occurs due to a merger, spin-off, consolidation, or liquidation of a shareholder;
7. The takeover occurs due to a grant constituting a transfer or shares without any agreement to obtain compensation in any form whatsoever;
8. The takeover occurs due to the existence of a certain debt guarantee stipulated in a loan agreement, and a debt guarantee in the context of the restructuring of the publicly-listed company stipulated by a government or a state body or institution based on the laws;
9. The takeover occurs due to share Takeover as the implementation of Regulation Number IX.D.1 and Regulation Number IX.D.4;<sup>23</sup>

10. The takeover occurs due to the implementation of the policies of a government or state body or institution;
11. The Mandatory Tender Offer, if implemented, will be contradictory to laws and regulation; and
12. The Takeover occurs due to the implementation of a Voluntary Tender Offer based on Regulation Number IX.F.1.<sup>24</sup>

Price formulation is another main issue in the Indonesian regulations on mandatory offers. The price of a mandatory offer is essential in takeover regulations because the public must receive the same price which the acquirer offered to the controlling shareholder. In principle, there is a general shift from determining the offer price by the “highest price” to the “average highest price” approach. At first, Bapepam Regulation IX.H.1 (2000) did not distinguish between the prices for direct and indirect takeovers.<sup>25</sup> However, the general rule is that the price is determined by the highest share price within a certain period.<sup>26</sup> Bapepam Regulation IX.H.1 (2002), which has adopted the same approach, improved this rule by providing requirements differentiating between direct and indirect takeovers for determining the price of the tender offer.<sup>27</sup>

“Direct takeover” refers to the change of control over the publicly-listed company, whereas “indirect takeover” means change of control over the controller of the publicly listed company, eventually leading up to the change of control over such publicly listed company. Despite the distinction, both direct and indirect takeover will cause a mandatory tender offer, the price of which is set pursuant to the highest price within the last 90 days prior to the date of

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ous Bapepam Regulation No. IX.H.1 (2002) and Bapepam Regulation No. IX.H.1 (2008) (Indon.). See also Bapepam Regulation No. IX.F.1 art. 1(c) (2011) (describing “Substantial Shareholder” as any Person that directly or indirectly owns at least 20% of the voting rights of a company’s issued shares).

<sup>23</sup> Bapepam Regulation No. IX.D.1 governs pre-emptive rights, while Bapepam Regulation No. IX.D.4 governs capital increases without pre-emptive rights.

<sup>24</sup> Bapepam Regulation No. X.H.1 art. 15 (2008) (Indon.); Bapepam Regulation IX.H.1 art. 6(a) (2011) (Indon.).

<sup>25</sup> See generally Bapepam Regulation IX.H.1 (2000) (showing that no distinction is made that differentiates by price regardless of whether there is a direct versus indirect takeover).

<sup>26</sup> Bapepam Regulation No. IX.H.1 art. 7 (2000) (Indon.).

<sup>27</sup> Bapepam Regulation No. IX.H.1 art. 8 (2002) (Indon.).

the announcement of the deal.

Bapepam Regulation No. IX.H.1 (2008) and (2011) significantly amended the previous regulations by adopting the average highest price rule.<sup>28</sup> The 2011 Regulation states that the price is the higher between (a) the average of the highest daily trading prices on the IDX within the ninety-day period before the announcement of the tender offer or the negotiation and (b) the takeover price.<sup>29</sup> For example, if the average highly trading price on the IDX was IDR1,000 and the takeover price was set at IDR900, then the price for the mandatory takeover would be IDR1,000. This amends the 2002 Regulation, in which the price was the higher between (a) the highest trading price on IDX within the ninety-day period before the negotiation announcement and (b) the takeover price.<sup>30</sup> In 2011, Bapepam synchronized the rule concerning voluntary tender offers by adopting the average highest price approach. Therefore, the rules for mandatory and voluntary public bids use the average highest price of the traded stocks.<sup>31</sup>

There are at least two significant changes in the new rules. *First*, the announcement date under the 2008 Regulation can be made either at the commencement of the negotiation that may result in a takeover or at the completion of the takeover deal. This affects the price of the tender offer and, therefore, acquirers must decide strategically when to announce the deal, and contemplate how it may affect the tender offer price. *Second*, the 2008 Regulation adopts the “average highest price” standard instead of the

“highest price” standard. This approach reduces the price for a tender offer, which arguably can encourage a more active takeover market since potential acquirers prefer lower prices. In addition, the highest price standard can reduce the chance of market manipulation to create an artificially high price for tender offers by leaking inside information. While information leakage is difficult to monitor in Indonesia, the tender offer price is determined by the average highest price and, therefore, averaging the highest price can disperse the impact of leaked information.

## Result and Discussion

### The conceptual problem of policy objectives of the takeover rules

The policy objectives of the Indonesian takeover rules have been continuously revised over the years. As the Indonesian Stock Exchange continues to develop into an important financial center in Asia, issues such as good corporate governance, market liquidity, and investor protection become important policy objectives.<sup>32</sup> The starting point for the discussion is the theory of “the market for corporate control” as described in Henry Manne’s seminal article, arguing that stock price, in part, reflects the company’s management performance.<sup>33</sup> The market works by attaching less value to poorly managed companies, thus enabling prospective parties to take over at discounted prices.<sup>34</sup> Through the market for corporate control, as

<sup>28</sup> See Bapepam Regulation IX.H.1 art. 12 (2008), which is further adopted in Bapepam Rule IX.H.1 art. 4(c) (2011) (Indon.).

<sup>29</sup> Bapepam Rule IX.H.1 art. 4(c) (2011) (Indon.).

<sup>30</sup> Bapepam Regulation IX.H.1 art. 8 (2002) (Indon.).

<sup>31</sup> Bapepam Regulation IX.F.1 art. 4(a)–(b) (2011) (Indon.) (setting the average price of the voluntary tender offer as the higher between the offeror’s last bid, the average highest price at the stock changes ninety days prior to the announcement, the average highest price last within twelve months prior to the last trading day of such shares, or a reasonable price determined by an appraiser).

<sup>32</sup> See also for the development of the Indonesian capital market, Yozua Makes, “Challenges and Opportunities for the Indonesian Securities Takeover Regulations: A Comparative Legal Analysis”, U. of Penn East Asia Law Rev, Vol. 8 (2) (2013): 82.

<sup>33</sup> See Manne, Henry G. “Mergers and the Market for Corporate Control.” *Journal of Political Economy* 73 (1965): 110.

<sup>34</sup> Manne, Id. He argues that, ““A fundamental premise underlying the market for corporate control is the existence of a high positive correlation between corporate managerial efficiency and the market price of shares of that company. As an existing company is poorly managed – in the sense of not making as great a return for the shareholders as could be accomplished under other feasible managements – the market price of the shares declines relative to the shares of other companies in the same industry or relative to the market as a whole.” Further, “the lower the stock price, relative to what



facilitated by the capital market, if the management of a company fails to do its job efficiently, the company is subject to takeover from a more efficient team, thus a new controller. Therefore, a takeover, and the rules associated with it, is aimed to induce better corporate governance and thus increase the company's value, suggesting the disciplinary effect of a takeover on the company's management. On the other hand, facilitating the market for corporate control is not the sole objective of takeover rules. Based on a comprehensive study conducted by Goergen, Martynova, and Rennebog involving 30 European countries and more than 150 legal experts, it is argued that takeover rules must also aim at protecting the investor and developing the capital market.<sup>35</sup> With regard to investor protection, takeover rules must uphold basic corporate governance principles in order to mitigate conflicts of interests between diverse company constituencies such as management, shareholders, and stakeholders.<sup>36</sup> Another objective, which was not fully elaborated, is its importance in ensuring better development of an active capital market in a country. These three objectives are best explained by the authors when they discussed the conflicting objectives of the takeover law, that require trade-offs, as follows:<sup>37</sup>

“First, in countries with dispersed ownership, provisions aiming at providing an exit opportunity for target shareholders are likely to discourage the monitoring of managers via the market for corporate control and vice versa.. A second trade-off

arises with respect to the two main functions of takeover regulation: the promotion of efficient corporate restructuring, and the reduction of agency conflicts and the protection of minority shareholders... This constitutes a third trade-off of the regulation: promoting the expansion of financial markets, and supplying corporate governance devices aimed at protecting the rights of corporate constituencies.”<sup>38</sup>

These differences in the three policy objectives (efficient corporate control, investor protection, and established capital market) affect the structure and design of the takeover rules adopted by a country. Drawing upon the theory of “efficient sales of corporate control”,<sup>39</sup> arguably there is tension between the “market rule” that promotes efficient transaction, and the “equal opportunity rule” that encourages more protection of the existing shareholders, especially minority shareholders. The theory argues that neither of the models dominates the other by performing better in all cases because there are many factors associated with the inefficiency costs of a takeover transaction.<sup>40</sup> If the policy is aimed to promote efficient corporate control, then the law must ease the requirements for takeover, for example the absence of the mandatory bid rule. However, if the rule installs stricter controls, including the mandatory bid rule and tighter disclosure obligation, one may expect better investor protection at the expense of less M&A deals.

These are the policy choices that the regula-

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it could be with more efficient management, the more attractive the takeover becomes to those who believe that they can manage the company more efficiently.”

<sup>35</sup> Mark Goergen, Marina Martynova, and Luc Rennebog, “Corporate Governance Convergence: Evidence from Takeover Regulation Reforms”, ECGI Law Working Paper Series, 33/2005, at p.2.

<sup>36</sup> *Id.*, at p. 6.

<sup>37</sup> For example, see To quote a few, see generally Katharina Pistor et al., “Law and Finance in Transition Economies,” 8 *Econ. of Transition* 325 (2000); Bernard S. Black et al., “Final Report and Legal Reform Recommendations to the Ministry of Justice of the Republic of Korea”, 26 *Journal of Corporate Law* 546 (2001); Bernard S. Black, “The Legal and Institutional Preconditions for Strong Securities Markets”, 48 *UCLA Law Review*, 781 (2001); Cally Jordan, “The Conundrum of Corporate Governance”, 30 *Brooklyn Journal of International Law*, 983 (2005); William W. Bratton & Joseph A. McCahery, “Comparative Corporate Governance and the Theory of the Firm: the Case Against Global Cross Reference”, 38 *Columbia Journal of Transnational Law*. 213 (1999).

<sup>38</sup> *Id.*, at p. 8.

<sup>39</sup> Lucian Arye Bebchuk, “Efficient and Inefficient Sales of Corporate Control”, *The Quarterly Journal of Economics*, Vol. 109, No. 4 (Nov., 1994), at p. 957-993.

<sup>40</sup> *Id.*

tor must cope with, which idea can be traced back to the basic conceptual tension of efficiency vs. fairness in the legal system. The policy objective of the Indonesian capital market law, as mentioned in Law 8/1995, is to create an *orderly, fair, and efficient* capital market for the interest of the shareholders and the society at large.<sup>41</sup> However, ascribing importance to any notion of fairness may sometimes lead to a conflict with the objective of promoting allocative efficiency, as discussed by Kaplow and Shavell.<sup>42</sup> This philosophical debate on fairness-efficiency is then reflected in the debate about the structure of securities laws and corporate governance system. For example, a transaction might be value-enhancing and efficient in the economic sense, but not fair if the personal interests of the parties are taken into consideration. In this concern, fairness concerns urge an affirmative protection to the least-empowered parties, namely the protection of the public shareholders.<sup>43</sup> Another relevant issue in the context of takeover is the importance of protecting other stakeholders, including promoting financial stability, in a decision to change the control of the company. This relates to the question as to whether the corporate governance system of a company needs to be concerned only about the interests of its shareholders or also to cover other policy agenda.

Pursuant to this paradigm, various countries have conducted takeover regulatory reforms, as assessed by Goergen, Martynova, Rennebog, (2005) The basic idea of takeover regulatory reforms is to resolve the conflict of interests between management and shareholders, with the aim of improving investor protection.<sup>44</sup> While each reform has different policy objectives, all

are aimed either to “improve the efficiency of the external monitoring by the market for corporate control, or restrict managerial decision power with respect to the use of anti-takeover devices.”<sup>45</sup> Both objectives compel the management to pursue the interests of the shareholders, and therefore shareholder protection remains the primary interests of such reforms. This is line with the study of La Porta *et al*, (1999) arguing that better protection increases shareholders’ confidence and hence their willingness to invest.<sup>46</sup> In line with this approach, regulatory reforms must also provide better exit opportunities for minority shareholders, so that the controlling shareholder can reduce its private benefit of control that can endanger the minority shareholders.<sup>47</sup>

Amidst this tension regarding policy objective, the study argues that the Indonesian regulator has made it clear that takeover rules are also designed to further expand its capital market, making it more liquid by attracting new investors to commit more deals, and at the same time protecting their rights as shareholders. Since 2008, Bapepam-LK’s policy objectives with regard to takeover rule have been to increase the liquidity of listed stocks and to provide more access to investors to the Indonesian stock exchange.<sup>48</sup> Although the takeover rule is further revised in 2011 in order to ensure better legal certainty in relation to the mandatory sell down obligation, such policy objectives are still upheld.<sup>49</sup> In this regard, the ‘sell-down rule’ requires that an offeror that conducts a MTO and receives more than 80% of shares in a publicly held company, must then within a certain time, release back the shares acquired from the public in excess of said 80% so that those excess

<sup>41</sup> See Article 4 of Law 8/1995 (Indon.) on the vision statement of fair, orderly, and efficient capital market. The elucidation of the Law also states that capital market is established to promote economic growth, equal distribution, and welfare.

<sup>42</sup> Louis Kaplow and Steven Shavell, “Fairness versus Welfare: Notes on the Pareto Principle, Preferences, and Distributive Justice,” Harvard Law and Economics Discussion Paper No. 411 (March 2003), Available at SSRN: <http://ssrn.com/abstract=391060> p. 1.

<sup>43</sup> See OECD Principles of Corporate Governance (2004).

<sup>44</sup> Goergen, Martynova, Rennebog, p. 6.

<sup>45</sup> Goergen, Martynova, Rennebog, p. 8-9.

<sup>46</sup> La Porta, R., F. Lopez-de-Silanes, A. Shleifer, and R. Vishny, “Ownership around the world”, *Journal of Finance* 54 (1999), 471-517.

<sup>47</sup> Goergen, Martynova, Rennebog, p. 8-9.

<sup>48</sup> See consideration clause, Bapepam-LK Rule IX.H.1 (2008).

<sup>49</sup> See consideration clause, Bapepam-LK Rule IX.H.1 (2011).

shares can be held back by the public.<sup>50</sup> The purpose of this regulation is for market liquidity and to avoid publicly listed companies from going private. This means that a publicly listed company must have publicly traded shares of at least 20% in the stock exchange.

There is also dynamism in the Indonesian securities laws, as exemplified by the evolution in the Bapepam-LK regulations that facilitate more opportunities for shifting corporate control. This dynamism is seen, for example, from the historical increase of threshold for ‘change of control’ that triggers mandatory bid/MTO, from 20% in 2000, to 25% in 2002, and currently, it has been set at 50% since 2008.<sup>51</sup> Further, the change of price formula from the ‘highest price’ formula to ‘average highest price’ formula has also made takeover transactions practically cheaper than when it was under the previous MTO Price Formula. Previously, the price of shares offered under the MTO was set at the highest price of such shares within a certain time period, according to which rule the price was very prone to market fluctuations and inside dealing to increase the MTO price. However, the prevailing rule sets the MTO share price at the average highest price of such share within a certain time period (90 days), in order to get price that reflects the market price properly. Arguably, these developments would facilitate more takeover transactions with decidedly less cost.<sup>52</sup> Putting more ease into the process is the fact that the Bapepam-LK regulations also do not require the conduct of a General Meeting of Shareholders in the target company to facilitate takeover transactions.<sup>53</sup>

In short, the policy objectives of the Indonesian securities laws are to integrate all of the three recognized takeover rule objectives: efficient change of corporate control, better inves-

tor protection, and a developed (liquid) capital market. However, as further shown below, these objectives may conflict with each other in practice. The mandatory bid rule is often avoided through creative compliance strategies based on the virtue of the disclosure principle.

### **The cost of mandatory bid and its creative strategies of compliance**

From the point of view of prospective acquirers, the mandatory bid/MTO requirement may be considered costly because it compels them to offer all of the remaining shares which they might not originally intend to acquire at a certain minimum price formula. On the other hand, the mandatory bid requirement may prevent inefficient extraction of private benefits of control by the controlling shareholder.<sup>54</sup> In short, mandatory bid/MTO might restrict the number of takeover transactions, which may designate corporate control to a more efficient controller. On the other hand, mandatory bid/MTO is set in order to provide public/public shareholders the same legal and economic rights that the existing controller enjoys when it receives the takeover offer, especially with regard to the share price. The conflict between the protection of public shareholders and facilitating market for corporate control is at the central discussion of the mandatory bid/MTO requirement.

Prospective acquirers are still on the lookout for cheaper alternative strategies to take over a company, without having to comply with the mandatory bid requirements. The attendant legal issues of these strategies have never been properly assessed. While they are, for all intents and purposes, administratively compliant, their effect on the protection of public shareholders is questionable. Grant, Kirchmaier, and Kirsh-

<sup>50</sup> See Art. 3 Bapepam-LK Rule IX.H.1. (2008) (Indon.), and Art. 5 Bapepam-LK Rule IX.H.1. (2011) (Indon.).

<sup>51</sup> See Art. 1 point (d), Bapepam-LK Rule IX.H.1 (2000) (Indon.), Art. 1 point (d), Bapepam-LK Rule IX.H.1 (2002) (Indon.), Art. 1 point (d), Bapepam-LK Rule IX.H.1 (2008) (Indon.), and Art. 1 point (c), Bapepam-LK Rule IX.H.1 (2011) (Indon.).

<sup>52</sup> See Art. 7 Bapepam-LK Rule IX.H.1 (2000 (Indon.)), Art. 8, Bapepam-LK Rule IX.H.1 (2002) (Indon.), Art. 12, Bapepam-LK Rule IX.H.1 (2008) (Indon.), and Art. 4 point (c), Bapepam-LK Rule IX.H.1 (2011) (Indon.).

<sup>53</sup> See Art. 3 point (b), Bapepam-LK Rule IX.H.1 (2011) (Indon.).

<sup>54</sup> For the discussion regarding the efficiency of the mandatory bid rule, based on the “equal opportunity” principle, see Lucian Arye Bebchuk, “Efficient and Inefficient Sales of Corporate Control”, *The Quarterly Journal of Economics* (November 1994).

ner describe a similar phenomena occurring in Germany and Italy as creative compliance of the mandatory bid rule often employed by the dominant shareholder.<sup>55</sup> This section will provide a brief discussion of these creative strategies being practiced today.

Creative strategy for not complying with the mandatory bid rule is often associated with “financial tunneling”, referred to as “self-dealing by dominant shareholders and discriminatory financial transactions, such as dilutive share issues, minority freeze-outs, insider trading, and creeping acquisitions”.<sup>56</sup> Atasanov *et al* coin the term ‘equity tunneling’ to also include sale-of-control at preferential terms for controlling shareholders.<sup>57</sup> Grant, Kirchmaier, and Kirshner argue that avoidance of the mandatory bid rule –“enabling bidders to take control of companies at lower costs or to pay higher prices for controlling stakes, giving them unfair competitive advantages in the acquisition process”, constitutes financial tunneling.<sup>58</sup> Indeed, there are a number of issues left unanswered in order to make sure that takeover deals can be carried out efficiently and fairly based on the principle of legal certainty. The requirements under Indonesian law to conduct an MTO, (known in other jurisdictions as a mandatory bid rule), as mentioned, is a factor that the acquirer wishes to avoid in a takeover. In general parties wish to avoid this mandatory bid/MTO requirement through the use of certain legal strategies to structure the transaction. The requirement also creates a significant cost for companies wishing only to acquire a part, not all, of the publicly-listed companies’ shares in order to gain control in a publicly-listed company

In this regard, the article argues that mandatory bid avoidance is value decreasing only to the extent that it reduces the rights of the public shareholders over the company. When such rights are already facilitated through advanced

mandatory disclosure, the public shareholders are empowered and can make informed decisions regarding the company. The rights of public shareholders are not impaired if there is a proper disclosure mechanism in place in line with the takeover, so that the public shareholders can freely decide to exit, or to participate in the transaction. In defense of this argument, the research discusses strategies that are often employed by acquirer, namely: (1) VTO bid; (2) rights issue with change of control; and (3) strategic listing. In general, these three creative strategies, discussed below, are employed to avoid the MTO requirements for a takeover.

In a VTO bid, the offeror places a public bid for shares of a publicly-listed company, although it can also purchase the shares by negotiating directly with the controlling shareholder. The prospective acquirer can enter into a private agreement with the controlling shareholder that the controlling shareholder will sell its shares once the public bid is placed. VTO bid is a form of voluntary bid, in which the offeror can bid the shares of a publicly-listed company pursuant to the terms and conditions that offeror can freely invoke. Subsequent to the VTO bid, there is no obligation to carry out any MTO bid. This is in contrast to acquisition transaction that leads to change of control, which in turn triggers the obligation for MTO. This method avoids the requirements for an MTO/mandatory bid since by regulation once an acquirer controls (read: obtains) the controlling stake through VTO it would not be forced to further conduct MTO.

Another method to control a publicly listed company without complying with MTO requirements is by way of conducting a rights issue with change of control. In this structure, a company plans to increase its capital by issuing more shares to the public, commonly from the unissued authorized stock. At the same time, there will also be a stand-by purchaser, being

<sup>55</sup> Jeremy Grant, Tom Kirchmaier, and Jodie Kirshner, “Financial Tunneling and Mandatory Bid Rule”, 10 European Business Organization Law Review 2 (June 2009), p. 233-253.

<sup>56</sup> Johnson, Simon, La Porta, Rafael, Lopez de Silanes, Florencio and Shleifer, Andrei, Tunnelling (January 2000). Harvard Institute of Economic Research Paper No. 1887.

<sup>57</sup> Atanasov, V. A., B. S. Black, et al. (2008). "Unbundling and Measuring Tunneling." U of Texas Law, Law and Econ Research Paper(117).

<sup>58</sup> Grant, Kirchmaier, and Kirshner, Id., at p. 3.

one or more existing shareholders, that will subscribe to shares that are not subscribed to by the other existing shareholders. Once this stand-by buyer subscribes to the issued shares, the shareholdings of the existing, non-participatory, shareholders (including the public shareholders) are diluted for their non-participation in the rights issue. This results in a change of control of the company, with the standby buyer becoming the new majority shareholder, and therefore acting as the new controlling shareholder. In this respect, the acquirer will act as a stand-by purchaser to obtain its contemplated controlling shareholding in that company. Bapepam-LK IX.H.1 states that change of control resulting from rights issue is exempted from the mandatory bid obligation. In practice, issuers have managed to convince that this structure is exempted from mandatory bid obligation because the fund that is raised in the transaction goes into the company, as opposed to standard takeover in which the proceed of sales is for the benefit of the seller. Also the existing shareholders have been given the opportunity to subscribe to the newly issued shares in accordance with the respective shareholding composition of the company.

Strategic listing is also employed by acquirers to avoid the MTO requirement. In principle, the acquisition of publicly-listed company incurs a lower tax compared to the acquisition of a private company due to the special treatment under the tax regulation on transfer of publicly listed shares through the exchange. This leads to the method of ‘strategic listing’, in which the acquisition deal is made before IPO, but then the execution of the takeover (read: the actual share transfer) is carried out after the IPO. There are conflicting views as to whether this type of transaction must be followed by a MTO. On this matter, there were practices in certain transactions whereby Bapepam-LK posits that such post IPO acquisition is not subject to MTO because the proposed takeover transaction has already been disclosed in the IPO prospectus provided to the investors. This means

that, through the prospectus, the investors will have an opportunity to consider the profiles of the pre- and post- controlling shareholder in the publicly listed company.

## Conclusion

In summary, despite the high cost of MTO obligation pursuant to the prevailing securities rules, in practice there are strategies to creatively comply with the formalistic and procedural requirements as set out by the regulator (Bapepam-LK, now OJK), with respect to mandatory bid/MTO requirements. The benchmark to assess the efficacy of such action is whether the transaction causes detriment to the minority shareholders, for they are not able to receive the same treatment that the controlling shareholders enjoy with their control premium. The Indonesian regulator, Bapepam-LK, adopts a pragmatic approach to creative structures that might adversely affect public shareholders.

That being said, the benchmark to determine whether a creative strategy reduces the right of the public shareholders is the extent to which the mandatory disclosure is considered sufficient to protect the minority shareholders. The importance of the disclosure principle in takeover transactions with creative structures must be further emphasized with due regard to other possible legal mechanisms to protect the interest of the public shareholders, including to give them a well-informed decision as to their participation in the MTO.

A logical follow-up question then would be: whether disclosure is enough to justify the creative compliance strategy, and to which extent such disclosure is considered enough. Reinier Kraakman once argued disclosure can facilitate enforcement insofar as it “discourages opportunism in its own right” and “permits other legal controls that deter self-dealing decisions by corporate insiders.”<sup>59</sup> This is in line with the corporate governance role of the disclosure principle in the capital market that it can play an active role in reducing the costs asso-

<sup>59</sup> Reinier Kraakman, “Disclosure and Corporate Governance: An Overview Essay”, in Guido Ferrarini, *Reforming Company and Takeover Law in Europe*, (2004), at p. 96.

ciated with corporate governance problem.<sup>60</sup> One study finds that high disclosure standards are strongly associated with lower levels of private benefits.<sup>61</sup> In another study, La Porta *et al* (1999) find that as disclosure improves, the size of the block premium decreases.<sup>62</sup> Consequently when a new party holding a substantial portion of shares does not attempt to use its power to control the management of the company (a passive portfolio investor).

Finally, one important point to consider is the fact that particularly in the Indonesian context, the regulatory objective has been set to provide more market liquidity, in an effort to strengthen and stabilize the stock exchange as a key pillar in the country's economic growth. The objective to promote more liquid and active market and the existence of the mandatory bid rule is arguably contradictory. A liquid capital market is designed to provide flexibility for potential investors to enter and exit any company listed in the Indonesian stock exchange. This is especially evident with regard to the existence of international/foreign investor that aims to take over and actively take control over Indonesian firms. In line with the "market for

corporate control" theory that suggests that active market induces better corporate governance and management, international/foreign investors can promote better corporate governance of Indonesian firms. That said, mandatory disclosure is a principle that can bring balance between the need to have active and liquid capital market on one hand, and investor protection on the other hand, so that more deals can be concluded without undermining the rights of the minority shareholders. Further, mandatory disclosure lowers the cost of raising capital in the market<sup>63</sup> which is important to develop the system of capital market in an emerging market such as Indonesia. However, notwithstanding the important role of the mandatory disclosure rule, it does protect the public shareholders and hence does not justify avoidance of the mandatory bid obligation. Mandatory disclosure and mandatory bid, in practice, are inseparable. The information provided in a mandatory disclosure helps public shareholders make well-informed decisions on whether or not they should participate in the MTO, although it does not provide the rights to exit or sell at the premium price, as guaranteed in a mandatory bid scheme.

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<sup>60</sup> Paul G. Mahoney, "Mandatory Disclosure as a Solution to Agency Problems", 62 U. Chi. L. Rev. 1047 (1995).

<sup>61</sup> Alexander Dyck & Luigi Zingales, "Private Benefits of Control: An International Comparison", 59 J. Fin 537, 576, 579, 583 (2004).

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