

## CORPORATE SERIES: THE IMPORTANCE OF SHAREHOLDERS' AGREEMENT IN ORDER TO ESTABLISHING A COMPANY IN INDONESIA

It is common for shareholders to encounter disputes with their partners in managing and operating a company in Indonesia. Such conflicts may arise in any type of company, whether fully owned by local shareholders or a Foreign Investment Company (PMA) where a portion or all of the shares are held by foreign investors. Initially, shareholders typically share a common vision and purpose in establishing the company and appoint a notary to assist with its incorporation, in accordance with Indonesian law. However, due to the limited information and foresight available at the outset, shareholders may eventually find themselves in disputes with one another.

### A. INTRODUCTION

#### I. Introduction of a Shareholders' Agreement

In order to incorporating a company to be a legal entity in Indonesia, we must to abide the rules under the Law No. 40 of 2007 on Company Law ("**Company Law**"). According to Art. 2 of Company Law, a company must to have: (i) purpose and objectives of the company; (ii) business activities that do not conflict with the provisions of laws and regulations, public order, and/or decency. Therefore, a company must to be clear on its purpose of the establishment.

Incorporating a company in Indonesia has a minimum of the shareholders. A potential company must meet a minimum of 2 (two) shareholders along with notary deed. The shareholders have to agree on terms that ruled under the Articles of Association ("**AOA**"). The shareholders allowed to make a separate agreement in order to providing or securing related matters that are not included in the AOA, as long as the provision in such agreement is not less than what is stated in the Company Law. This agreement called as the Shareholders' Agreement ("**SHA**").

Normally, AOA will contain general necessary matters or details of a company. On the other hand, SHA could arrange or provide for the complexity of the shareholders' interests. Essentially, SHA does not regulate by the Company Law as requirements to incorporating a company, however SHA can be made by following applicable regulations on the Indonesia Civil Code ("**ICC**").

## II. Purpose of Shareholders' Agreement

Despite the SHA is a non-mandatory, however SHA can be a benefit-maker for the company and its shareholders. The followings are the purposes and/or reasons of the importance of SHA:

- (i) regulate the reserved matters;
- (ii) regulate the shareholders' quorum requirement in details;
- (iii) representative/position of Board of Commissioners ("**BOC**") and Board of Directors ("**BOD**");
- (iv) promotes governance;
- (v) provides solution for deadlocks;
- (vi) protects confidentiality;
- (vii) protects minority shareholder;
- (viii) provides non-compete restrictions; and
- (ix) defines clear exit strategies.

In addition, there are more purposes and reasons to create a Shareholder Agreement to be considered.

## B. INDONESIA LEGAL FRAMEWORK OVERVIEW ON SHAREHOLDERS' AGREEMENT

### I. Governing Laws

In Indonesia, Company Law regulates rights and obligations of a company shareholders. The rights and obligations of the shareholders that set by Company Law only rule matters around General Meeting of Shareholders ("**GMS**"), receipt of dividends, arrangements of shares, and arrangements regarding the appointment of the **BOC** and **BOD** that outlined in the AOA.

In order to securing or providing more interests, they are free to determine the terms and conditions and/or clauses that are to be regulated in the SHA. Freedom of contract ruled in Art. 1338 ICC that might be the ground of creating a SHA has to be in line with the validity of an agreement ruled in Art 1320 ICC.

From the existing precedent regarding the SHA, SHAs can be an alternative to regulate things that are not regulated under the AOA. Thus, shareholders in order to be more specific on their rights and obligations of the company, they are allowed to bind themselves on a SHA.

## C. ESSENTIAL ELEMENTS ON SHAREHOLDERS' AGREEMENT

### I. Parties Involved

The parties involved in the SHA are all the shareholders of the company. The shareholders may be individuals or any other type of legal entity (e.g. companies). Where companies are involved as shareholders in the SHA, it may be necessary to take additional steps to ensure that the company does not circumvent certain rights contained in its own SHA.

## II. Key Clauses in A Shareholders' Agreement

### (i) Capital Structure

Though the capital structure has already arranged in the AOA, SHA can be more specific on the structure of the capital that the shareholders have issued. The further arrangements of the capital can be arranged, as follows:

- i. allocation of shares ownership;
- ii. capital increase/capital reduce procedures;
- iii. conditions on applying loans/capital from third parties;
- iv. provisions regarding the limit of retained profits; and
- v. procedure for exiting the company and the consequences of the exit of shareholders.

These arrangements can be critical to the companies' operations. Thus, each shareholder is aware of any arrangements and/or consequences of the capital structure.

In relation to point v above, by setting out clear procedures for exit strategies in the SHA, companies can avoid complications and confusion if and when a shareholder decides to leave. This can be done by outlining the reasons for the exit, whether by sale, buyout or other methods.

### (ii) Dividend Distribution Conditions

The importance of discussing dividends is to minimize future conflicts or disputes. The dividend provisions set out in the SHA can also regulate the procedure for distributing dividends, when a dividend can be paid and the payment of interim dividends before the end of the company's financial year. In addition, the shareholders may agree that the dividend may only be distributed upon the completion of several priorities (i.e., operational costs, short-term obligations, capital expenditure or investment needs of the Company, and any priority in accordance to the agreement or applicable laws).

### (iii) Confidentiality

Confidentiality provisions in the SHA can be essential to protect sensitive strategic business information. This arrangement is intended to ensure that all shareholders are legally bound to protect the company's secrets, both during their involvement and even after they leave.

This type of agreement is also beneficial in gaining or maintaining the trust of potential investors and/or business partners. Therefore, with strong confidentiality, companies will maintain its credibility before the potential investors and/or business partners.

### (iv) Non-compete Restrictions

This restriction can be considered an extension of the confidentiality provisions set forth in the SHA. It serves to prevent shareholders from establishing new

businesses that may compete with the company, both during their tenure as shareholders and after they have exited the company.

In addition, this restriction helps protect the company from potential conflicts of interest that may arise. The non-compete restriction also acts as a safeguard, ensuring that shareholders act fairly when conducting the company business or prioritizing their personal interests.

#### **(v) Dispute Resolution**

The dispute resolution clause is a crucial provision that should be included in a SHA. This is because shareholders may, at some point, encounter conflicts or obstacles that could lead to disputes.

Such disputes can be detrimental to the company, as they may hinder business growth and create uncertainty among shareholders regarding key issues. These issues may include business operations, profit distribution, capital contributions, or the transfer of shares to third parties.

By incorporating a dispute resolution clause, shareholders have a predetermined mechanism to refer to in the event of a dispute. Typically, dispute resolution begins with deliberation and mutual agreement, where shareholders first attempt to reach a compromise. If no resolution is reached, the clause may designate a competent institution to adjudicate the dispute.

### **D. CONCLUSION**

SHA serves as a vital instrument in regulating the rights and obligations of shareholders beyond the provisions of the (AOA). While not a mandatory requirement under Company Law, an SHA provides numerous advantages, including safeguarding shareholder interests, mitigating disputes, and ensuring corporate governance.

The legal foundation for an SHA in Indonesia is derived from the principle of freedom of contract under the ICC, allowing shareholders to define specific terms tailored to their business needs. This agreement can encompass critical elements such as capital structure, dividend policies, confidentiality, non-compete restrictions, and dispute resolution mechanisms. By incorporating these provisions, shareholders can establish a structured framework that promotes stability, transparency, and long-term business sustainability.

Ultimately, a well-drafted SHA enhances legal certainty and minimizes risks by preventing conflicts and ensuring that shareholders operate within clearly defined boundaries. Therefore, companies seeking to strengthen their internal governance and protect their commercial interests should consider implementing a comprehensive SHA as part of their corporate strategy.

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