



Application Of The Pari Passu Clause In PT PLN Loan Restructuring

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Abstract

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As a state-owned public utility, Perusahaan Listrik Negara (PLN) is crucial to Indonesia's provision of energy. The debt contractual agreement becomes a reference in the context of restructuring, and for that reason, the written terms have a significant impact. The pari passu provision is among the most significant parts of the contract. However, as of right now, PLN is still using the ratable payments to creditors idea rather than the pari passu concept that has been modified by the IMF. By demonstrating the demands of the organization and the effects of applying the idea, the research aims to demonstrate methods to implement a new concept. It offers findings on how to implement the new pari passu idea, which is comprehensive and applicable to PT PLN, by applying Kotter's 8-Step Change Model technique.

Keywords: *Pari Passu, Restructuring, Debt*

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INTRODUCTION

The State Electricity Company (PLN), as a state-owned public utility company, plays an important role in electricity supply in Indonesia. The provision of generators, transmission networks, and distribution is carried out by PLN in an optimistic manner. In PT PLN's Electricity Supply Business Plan (RUPTL) for 2021–2030, it can be seen that there is a roadmap for the development of systems, networks, and infrastructure in all provinces of Indonesia. In addition, PLN is also expected to be able to realize the 35,000 MW program as part of the Acceleration of Electricity Infrastructure Development in Presidential Regulation Number 14 of 2017. In PT PLN's 2021 annual report, it is recorded that the construction costs carried out by PLN during 2021 amount to 167 trillion rupiah. Consisting of accelerated programs, routine construction, and project development that is being carried out by PLN in 2021.

To achieve this, adequate funding is needed to be allocated to projects designed by PLN. Support from the government in carrying out the 35,000 MW program is provided by guaranteeing PLN's debts, which become government debts. As stated in PMK Minister of Finance Regulation No. 135/PMK.08/2019 regarding procedures for implementing government guarantees for accelerating electricity infrastructure development, this means that PLN's debt will be borne by the government if PLN is unable to repay its debt at any time. Which includes the principal debt, interest that is due, and other costs incurred..

In carrying out debt management, it is known that PLN has carried out several restructurings. Darmawan Prasodjo, Main Director of PT PLN, said one of PLN's main programs is debt restructuring through debt refinancing. This is also a

mandate from the Minister of BUMN in order to improve PLN's financial condition. In 2020 and 2021, PLN will be successful in managing its debts so that the debt can be depreciated up to 50 trillion rupiah using the refinancing method.

In the context of restructuring, the debt contractual agreement becomes a reference, and for that, the written clauses are very influential. One of the most important clauses in the contract is the *pari passu* clause. In Latin, *pari passu* means "in the same step" or "equal" (Buchheit & Pam, 2003). Varottil (2008) says *pari passu* requires the company to make payments to creditors in a proportional or *pro rata* manner; the company can't make payments to a number of creditors with the exception of the other payments. This concept is known by PLN as "equal treatment" for each creditor it has. PLN's financial report states that all of these debts are not specifically guaranteed but are guaranteed by all of the company's assets, and the rights of the bondholders are *pari passu* without special rights with the rights of other creditors (PLN, 2021). The *pari passu* clause concept applied by PLN still uses the old concept, namely making payments to debtors on a *pro rata* or *ratatable* basis. Where there is no determination of the ranking of the creditors and all creditors are considered the same.

However, Varottil's research, entitled *Sovereign Debt Documentation: Unraveling the Pari Passu Mystery*, shows that there are deficiencies in the application of the *pari passu* system. This research raises Elliot's case, which is a company vulture fund, as well as a creditor from a Peruvian bank, namely Banco de la Nacion (Nacion). Bank Nacion, which adopted the *pari passu* clause, committed a violation by only paying its debts to Euroclear. Following this case, several arguments arose against the average payout interpretation of the *pari passu* clause. For one thing, some creditors have been given priority on payment by convention. Apart from the Peru case, there is the Argentina case, which is related to this *pari passu* clause. In 2001, Argentina defaulted on more than \$80 billion of its bonds. Argentina makes payments to convertible bond holders while continuing to withhold payments to other creditors.

Reflecting on previous cases in various countries, there were problems related to the application of the old *pari passu* clause. Moreover, there is a proposal by the IMF, as an international monetary system institution, to reform the *pari passu* clause. So the researchers also argue that changes need to be applied to PLN to mitigate related risks that will arise in the future. These risks include legal, reputational, financial, and operational risks.

The research was conducted at PT PLN, which is the sole provider of electricity in Indonesia, covering the generation, transmission, distribution, and sale of electricity to the general public and industry. The commodity being sold is actually energy, not electricity; for example, consumers pay for kilowatt-hours, which is power multiplied by time, which is energy. The electric power company PLN owns the entire infrastructure, from generating stations to transmission and distribution infrastructure. For this reason, electric power is seen as a natural monopoly. The industry is heavily regulated, with price controls, and owned and operated by the government.

If we look at previous research, there are several studies regarding debt at PLN. Mustika and Rosantina (2000) examined debt restructuring planning by projecting financial statements, namely by using a cash flow forecast report with

several sensitivity analyses. Rowi and Setiyono (2020) examine PLN's capital structure, which indirectly examines PLN's debt structure. From this study, it was found that the optimal capital structure of PT PLN (Persero) was achieved at a composition of 40% debt and 60% equity and a WACC value of 15.6%. If you look at the research conducted by Rasia Hafizha (2022), which analyzes PLN's debt by clustering, It was found that 5 out of 38 loan sources were in the category of urgently needing more attention, and 33 others were in the category of needing more attention.

This research is very important to do because it is in accordance with the framework of the International Monetary Fund regarding sovereign debt, which requires reform related to the pari passu concept. In addition, considering that PLN has not yet implemented the pari passu concept from the IMF and still applies the concept of ratatable payments to each of its creditors, the existence of PLN is very important for modern life. Not only that, PLN also influences many aspects, including economic and social. As a state-owned company, PLN is also expected to be able to provide benefits for the benefit of society at large.

Pari passu new concept by IMF

After the reforms carried out by the IMF in 2014, this clause changed its meaning to "pari passu" in the context of "equal legal ranking." In the Box Taxonomy of Sovereign Pari Passu Clauses (IMF, 2014), According to legal experts, the pari passu provisions currently used in international currency are divided into two types, namely::

1. Referring rating: – The first main category of the pari passu clause only refers to the rating of unsecured and unsubordinated external debt. A typical “rating” clause could be read as follows: “a debt instrument rated pari passu with all other unsecured and unsubordinated external debt of the issuer.” (This is the result of the discussion of the default case from the Grenada case.) A modified version of this clause may exclude certain legislative actions by the borrower from the general requirement that unsecured debts be ranked equally.
2. Referring ratings and payouts – The second major category of pari passu clauses includes references to ranking payouts. There are two main formulations:
 - One-sentence formulation: – “Bond ratings are and will be rated, pari passu in payment rights with all current and future unsubordinated external debt.” (This is the result of the formulation of cases of defaulted Peruvian debt contracts as well as some of Grenada's defaulted loans.)
 - Two sentences: – “The bond will constitute . . . direct, unconditional, unsecured, and subordinate obligations of the issuers and will always be rated pari passu and without preference among themselves.” “Creditors' debt-based payment obligations will at all times have a rating of at least the same as all other current and future unsecured and non-subordinated foreign debts.” (This is the default bond formulation result from the Argentina case.)

METHODS

This research approach is used in order to reveal in detail how to apply a new concept by demonstrating organizational needs, as well as the impact of implementation. In Table 1, we describe the just method of doing strategy change using the theory of Kotter's 8-Step Change Model (Kotter, 1996).

Pari Passu Change Methodology with Kotter's 8-Step Change Model

| No. | Kotter's 8-Step Change Model | Method |
|-----|---|--|
| 1. | Create a sense of urgency | Explain how to diagnose and identify threats so that something changes. |
| 2. | Build a guiding coalition | Explain how to form a team that is voluntary and has the same vision of being actively involved in communicating change. |
| 3. | Form a strategic vision and initiatives | Explain how to shape vision and initiative change. |
| 4. | Enlist a volunteer army | Explain how large-scale change can happen. |
| 5. | Enable action by removing barriers | Explain how to remove barriers to making change. |
| 6. | Generate Short-term wins | Explain how to identify what constitutes success. |
| 7. | Sustain acceleration | Explain how to increase effort after the first success. |
| 8. | Institute change | Explain how ensure change continues until it is strong enough to displace old habits. |

The research location is the place where the research process will be carried out. Researchers want to show the need for the application of the lung passu concept according to the IMF at the PT PLN company. The research period is from January to June 2023. This research was carried out by examining the case data that occurred. The subjects in this study were obtained from the results of the documentation based on the considerations of the cases investigated.

In this research, observations and studies will be carried out regarding factual data from the implementation of pari passu that occurred at PT PLN. Then, provide ideas for implementing a new pari passu concept that has not been implemented at PT PLN. The data source comes from secondary sources. Secondary data is taken from documents such as financial statements and documents supporting the cases under investigation. In this case, the researcher is trying to retrieve data from the atmosphere and conditions that occur without any element of manipulation or engineering so that the data obtained will fulfill the required data validation. Efforts to obtain valid data are carried out by digging up information according to the focus being studied. Data reporting is arranged in a descriptive form, and then the researcher draws conclusions.

RESULTS & DISCUSSION

Results

If you look at what has been encountered in the cases in Peru and Argentina in the restructuring process, There were problems related to the law, and there was litigation by creditors; therefore, the IMF changed the pari passu concept, which became the core of the problem. Specifically, a change regarding "ratatable" or pro-

rata payments to each of its creditors to become "equal legal ranking" to provide a ranking identity to its creditors.

In making changes, PLN needs to develop existing strategies so that these changes are carried out properly. Therefore, researchers try to describe what PLN can do to make changes related to the pari passu clause in accordance with Kotter's theory (see table 2).

Table 2. Pari Passu Change Action Plan with Kotter's 8-Step Change Model

| No. | Kotter's 8-Step Change Model | Action Plan |
|-----|---|---|
| 1. | Create a sense of urgency | From the results, it appears that currently PLN is still using paripassu, an old concept that has not yet been refurbished. This update is very necessary, as described by the IMF, to strengthen the framework of contractual loans and avoid future litigation related to loan restructuring. Potency: this risk is necessary communicated to stakeholders' interests, especially in the finance division, as well as creditors involved to do the initiation change clause. |
| 2. | Build a guiding coalition | Build a team core, especially in the PLN Finance Directorate, for communicating changes and following through on them. The team needs to involve a number of parties that can realize change in a maximum manner, like parties from the managerial and board of directors levels. |
| 3. | Form a strategic vision and initiatives | The core team can explain the impact of the pari passu clause on restructuring loans to the head of the finance directorate. This team will collect detailed information, mainly creditor, type of debt, interest, risk attached, guarantee, and whether the creditor is a creditor outside the country (external indebtedness). Stage a dialogue or forum with domestic and foreign creditors, such as banks and member countries, about the benefits of the proposed contract terms. The team needs to provide periodic progress reports with respect to the status of the proposed contractual provisions. |
| 4. | Enlist a volunteer army | Involve more parties to carry out changes together, like creditors (banks, public, other countries) Conduct voting at the meeting of debt holders regarding changes |

| | | |
|----|------------------------------------|--|
| | | Hold change discussions with the Ministry of Finance, Ministry of Energy and Mineral Resources, Directorate General of Electricity, etc. Involve experts and consultants to formulate and calculate the rating to be given. |
| 5. | Enable action by removing barriers | Removing barriers such as inefficient processes and hierarchies will provide the freedom needed to work across the board and finish a number of tasks to achieve change. |
| 6. | Generate Short-term wins | Identify what has been a success and communicate that as often as possible. This will generate the spirit to continue to apply change. As it is a number of accepting creditors, the new concept of <i>pari passu</i> in contractual the loan. |
| 7. | Sustain acceleration | Work harder after the first success. Credibility will improve systems, structures, and policies and initiate change after change until change becomes a reality. |
| 8. | Institute change | Articulate the relationships between applications' new <i>pari passu</i> clauses and organizational success. Make sure it persists until it's strong enough to replace the old clause. |

Discussion

Sergio J. Galvis (2017), in his journal, reveals that revising the *pari passu* clause provides important long-term progress and significantly reduces problems in debt restructuring situations. The impact of changing this clause for PLN is:

1. Changes in the payment mechanism from the amendment to the *pari passu* clause by changing the *pari passu* clause, which regulates the procedure for payment to creditors during restructuring. Then changes also occurred in the PLN creditor debt payment scheme during the restructuring. The old *pari passu* concept adopted a pro-rata or ratatable payment scheme that divided funds in proportion and equally among each creditor. While the new *pari passu* concept adopts a payment scheme that uses rankings, foreign debt (external debt) that is not subordinated (senior or higher than subordinated debt) must be paid first. After the lender of unsubordinated debt is paid, the remaining money goes to preferred stockholders, subordinated debt, and common stockholders. In some cases, it is possible that some subordinated debts will not receive payment from this restructuring (ICMA, 2014).
2. PLN will adopt a ranking system according to seniority or tranches. Not all types of debt financing are created equal. When comparing debt to equity, debt always has seniority in the order of payment. When comparing unsecured debt to secured debt, secured debt comes with seniority. For example, bonds guarantee to receive payment before the bond is guaranteed. This concept

is known as the "contribution rating" to debtor bankruptcy (Rahmansyah and Dillon, 2022):

- 1) Preferred creditor (preferred creditor). The preferred creditor is entitled to receive full payment of the bankruptcy estate. The priority bills are tax bills and post-bankruptcy/suspension payment claims, such as:
 - Recipient/administrator fees;
 - Expert honorarium appointed by the supervisory judge;
 - Costs for liquidating bankruptcy assets or costs incurred during the process of deferring payments;
 - Post - bankruptcy/suspension of payment financing;
 - rent of a bankrupt house or office; and
 - Employee wages.
- 2) Guaranteed creditors (separatist creditors). This is a creditor holding mortgage rights over part or all of the debtor's assets.
- 3) Unsecured creditors (concurrent creditors). This rating is as follows:
 - Special obligatory preferred creditors whose preferences relate only to certain assets;
 - Common law priority creditors; and
 - Unsecured creditors who are not favored.
3. Providing fairness and a sense of equality to each creditor whose debt is being restructured.

The new *pari passu* provides an understanding of equal legal ranking, where creditors are identified based on their seniority level or tranches. Each of these levels will be assigned a different payout rate in the restructuring, based on conditions (risk level, yield, guarantee, and agreement). Not equalizing the nominal debt payments at the time of restructuring according to the legal level, will give a sense of justice because of the different status of creditors. There are other creditors who are entitled to be given payments with a larger nominal, other creditors who are given a smaller nominal, and also other creditors who are not paid according to their rank.

4. Providing signals to investors and creating a good environment in a state of restructuring

Debt-related changes involving legal changes or amendments will provide a signal to investors and creditors. Changes in a positive direction are expected to provide a positive signal to investors and creditors, especially during tough times such as debt restructuring. This signal is also expected to reduce the problem of collective action in debt restructuring situations (ICMA, 2014). Creating trust and a sense of fairness at a critical time is urgently needed, and PLN is committed to developing and following up-to-date, appropriate, and well-reviewed debt provisions. In addition, government debt restructuring is expected to be able to anticipate, minimize, and manage the impact on the domestic economy and financial system.

5. Can avoid breaches in providing pro-rated payments to creditors - this often happens, as in the cases of Peru and Argentina (Buchheit and Lee, 2018).

In the cases of Peru and Argentina we can see that the debtor, or the company that issued the debt, could carelessly make payments to some creditors and ignore others in the restructuring process. This is due to the possibility that there is a special relationship between the debtor and a creditor, the existence of creditors from other

countries that can affect the existence of the creditor's claims, administrative negligence, or even negligence in calculating pro-rata distribution to creditors (ICMA, 2014). These things are a violation of the old *pari passu* clause and can be prosecuted by law. Therefore, debtors or companies are exposed to high legal and reputational risks.

6. Avoiding litigation from creditors regarding injustice in restructuring actions. Malm, Soyeh, and Kanuri (2023) find that litigation can affect firm-level operating performance for several reasons. First, legal action can tarnish the company's affiliation with clients, investors, and other stakeholders. Additionally, several major lawsuits in court over a number of years would bankrupt the company. Second, litigation can affect managerial decision-making and ultimately undermine the sustainability of future earnings, a major factor contributing to corporate performance. Third, the existence of litigation creates reputational costs that are detrimental to the company being sued and results in unfavorable contract terms.

7. Reducing audit fees that will arise from litigation risk

Abbott, Gunny, and Pollard's (2017) research found that investors demand higher audit effort in the form of higher audit fees in both private and public equity settings. That auditors are sensitive to factors that increase litigation exposure, such as the number and magnitude of lawsuits filed against auditors related to the company (Cassell et al., 2018).

CONCLUSION

In 2021, PLN's debt-to-equity ratio was recorded at 1.42x, lower than 2020's 1.63x. PLN seeks to minimize debt costs so as to maximize company value. Therefore, PLN's policy of seeking funding through debt always takes into account the financial risks that may arise in the future. Currently, PLN is still using the draft *pari passu* clause by making payments pro rata to the whole creditor, which doesn't fit the concept of the *pari passu* clause by the IMF. The reforms recently passed by the IMF will involve a provision in a *pari passu* clause explaining that this clause does not require equal payments to all creditors but only equal legal ratings. PLN implemented the new *pari passu* into the contract restructuring loans by implementing Kotter's 8-Step Change Model, with steps create a sense of urgency. Build a guiding coalition, Form a strategic vision and initiatives, Enlist a volunteer army, enable action by removing barriers, generate short-term wins, sustain acceleration, and institute change. The impact that will be received by PLN in changing and implementing the new *pari passu* according to the IMF is: change mechanism payment out of existence amendment *pari passu* clause; PLN will adopt system rank according to seniority or tranches; avoid breaches in providing pro-rata payments to creditors; avoid litigation from creditors regarding unfairness in restructuring actions; provide justice and a sense of equality to each debtor creditor that is restructured; deliver a signal to investors and create a good environment in the circumstances of restructuring; and make nominal payments to every creditor different; however, not in total..

CONFLICT OF INTEREST

Concerning the research, authorship, and publication of this paper, the author(s) reported no potential conflicts of interest.

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