

## Indonesia Employment Law Update - Promotion to Directorship May Entail Termination Payment

February 2023



On 15 December 2022, the Supreme Court issued Circular Letter No. 1 of 2022 (“**Circular Letter 1 / 2022**”) which summarises the outcome of its civil chamber’s meeting earlier in 2022. Circular Letter 1 / 2022 serves as Supreme Court’s guidance for Indonesian courts in adjudicating disputes. Circular Letter 1 / 2022 accommodates Supreme Court’s view with respect to the treatment of employees who are appointed to directorship.



This publication discusses the basic principles of Circular Letter 1 / 2022 which classifies the appointment of an employee to directorship of a company as an event that ends an employment relationship. This leads to the consequence the appointed employee being entitled to receive termination compensation payment. In that context, the implementation of this principle should also be observed from the viewpoint of the applicable manpower laws and regulations.



### The provisions of Circular Letter 1 / 2022

Pursuant to Circular Letter 1 / 2022, in the event an employee is appointed by the shareholders to serve as a director of the employing company, the employment relationship between such appointed employee and the company will effectively end. This will entitle the employee to receive compensation for the termination of his or her service as an employee of the company.

Circular Letter 1 / 2022 clarifies that for the purpose of calculating the termination payment:

- > the employee’s latest salary (prior to his or her appointment as director) will be used as the basis for the calculation of the termination payment; and
- > the service period should be calculated from when the employee started his or her employment in the company and ended on the date on which the employee is appointed as a director of the company.

However, there is no clarity as to which statutory formula should be applied to calculate the termination payment or what termination ground will be relevant in this scenario considering that the applicable laws do not specifically recognise promotion to directorship as a reason for terminating an employment relationship. Circular Letter 1 / 2022 only provides that the termination payment amount “*shall be calculated in accordance with the applicable laws*”<sup>1</sup>.

1 The relevant applicable laws primarily consist of the Manpower Law and GR 35 / 2021.

## Regulatory provisions under the manpower laws and regulations

Government Regulation No. 35 of 2021 on Fixed Term Employment Agreement, Outsourcing, Working Hour and Resting Hour, and Employment Termination (“**GR 35 / 2021**”), serving as the implementing regulation of Law No 13 of 2003 on Manpower (as amended) (the “**Manpower Law**”)<sup>2</sup>, sets out the permissible grounds for termination of employment and the statutory formula to calculate employees’ entitlement upon employment termination. The applicable statutory formula varies, depending on the ground for the termination of employment. However, of the permissible grounds of termination as provided for in GR 35 / 2021, none appears to be broad enough to capture the scenario where a termination is triggered by the appointment of the relevant employee to directorship (which is practically comparable to a promotion). One exception would be in a scenario where the employee resigns from his or her current position ahead of the appointment to directorship, in which case the formula for resignation should apply.

## How did the court view and decide on the issue?

In the absence of further guidance from GR 35 / 2021 and Circular Letter 1 / 2022, we have observed past decisions of the Supreme Court on disputes involving demand from former permanent employees who were appointed as directors of the company for termination payment. In 2018 and 2019 on two separate occasions<sup>3</sup>, the Supreme Court has decided that former employees who were appointed to directorship are entitled to termination payment. The decisions were aligned with the principles of Circular Letter 1 / 2022 that: (i) the employment status is terminated on the effective date of the appointment by the shareholders of the relevant employee as a director; and (ii) the salary used as the basis for termination payment calculation is the latest salary prior to such appointment. In both cases, the Supreme Court granted the former employee with two times severance pay, one time service pay, and rights compensation pay. The Supreme Court, unfortunately, did not discuss in detail on the specific rationale for applying this formula in both cases, apart from noting that such termination was not due to the fault of the employee.

A different formula was applied recently in 2022<sup>4</sup> when the Supreme Court ruled in a case of a similar nature and granted the appointed employee with one time, instead of two, severance pay. The Supreme Court in this case applied this formula simply by considering propriety and justice and noting that the company did not have any rule on the amount of termination payment payable to an employee who was promoted to directorship.

An interesting point to note from the above three cases is that although the decisions on the 2018 and 2019 cases were issued before the enactment of GR 35 / 2021 and the decision on the 2022 case was issued after the enactment of GR 35 / 2021, the Supreme Court did not consider GR 35 / 2021 as a determining factor in deciding that one time severance pay must be applied. This underlines that there remains uncertainty surrounding the amount of termination payment payable following an employee’s promotion to directorship and therefore, this must be approached with caution. Prior to the enactment of GR 35 / 2021, the Supreme Court took the position that an employee’s promotion to directorship is equivalent to an ‘*employer-initiated*’ termination of employment and hence, the two times formula would have been used. That is the case notwithstanding the fact that such formula was not particularly specified in the relevant regulations as the formula that must be applied when a person is promoted to directorship.

## What’s next?

The view of the judiciary on the applicable multiplier in this type of case remains to be seen. To reduce the risk of being required to pay out severance payment until the end of the directorship period, employers should consider documenting the termination of employment when promoting employees to directorship, and setting out clearly the terms of the termination, including the payable termination payment. Subject to commercial considerations, it may also be prudent to take this opportunity to clarify the effect of any past directorship promotion, particularly if such promotion did not clarify the employment relationship status and was not followed with the payment of severance package.

2 The Manpower Law has recently been amended further by Government Regulation in lieu of Law No. 2 of 2022 on Job Creation. However, the amendment does not affect GR 35 / 2021 (and the provisions on termination of employment therein) which remains in force as at the date of this publication. Government Regulation in lieu of Law No. 2 of 2022, despite entering into force immediately on 30 December 2022, is still undergoing a process before the parliament to be enacted as a law subject to the parliament’s approval to be given in a plenary session.

3 Decision No.1051 K/PDT.SUS-PHI/2019 and Decision No.PK/PDT.SUS-PHI/2018.

4 Decision No.948K/Pdt.Sus-PHI/2022.

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