

## **Chapter VI**

### **BUSINESS LAW**

#### **A. COMPANY LAW**

##### **Introduction**

Since the implementation of the 25-year economic development-planning program, Indonesian economic growth can be attributed to an increase in participation of small and large business enterprises. Not only has there been an increase in assets and capital accumulation, enlistment of human resources, but also business resources (which from time to time create a business cycle). One of the business entities that dominate, in the Indonesian business sector, is the Limited Liability Company. As a created legal entity, it is necessary for an Indonesian Limited Liability Company to be supported not only by its own organs, but also by clear and concise regulations in order to maximize and utilize its organizational and managerial ability effectively and efficiently. Hence, strong and stable business entities are very important to enhance national development. It is therefore necessary to have a brief overview of business organizations within the framework of Indonesian Company Law.

## Types of Business Organizations

Indonesia's commercial sector recognizes three principal categories of business organizations: sole proprietorship, partnership (general or limited) and company. Sole proprietorship is generally used in the informal sector, since its nature and activities are of the informal sector. For example, it does not require formal registration to Indonesian authorities.

There are three types of partnership: *persekutuan perdata* (maatschap or private association), *persekutuan firma* (venootschap onder firma or firma, "FA") and *persekutuan komanditer* (commanditaire vennootschap, "CV"). The Indonesian Civil Code governs the first type of partnership whereas the rest are governed by both the Indonesian Civil Code and the Indonesian Commercial Code. It is not easy to determine absolute equivalents between these partnerships and partnerships under common law tradition; however, the *maatschap* and firma closely resemble the concept of a general partnership under the common law system whereas the *commanditaire venootschap* resembles limited partnership under common law.

The last type of business organization is under the Indonesian Company Law takes the form of Perseroan Terbatas ("PT"). It is similar to the incorporated limited liability company under the common law system. Historically, this was referred to as the Dutch corporate model known as the *naamloze venootschap* ("NV"). However, since the enactment of the new Indonesian Company Law, which repealed the provisions governing the company, many companies started to use the abbreviation "PT". There was also another form of an Indonesian incorporated company, which was intended to be used by indigenous Indonesians, so-called "*the Maskapai Andil Indonesia*" (**Indonesische Maatschappij of Aandelen or IMA**). It was governed by separate regulations, i.e. Ordinances 886. However, the promulgation of the new Indonesian company law in 1995 abolished the dualism of the Indonesian company structure - PT

under the Commercial Code and PT under IMA, and brought the Indonesian company structure into one common corporate regime: the (New) Indonesian Company Law.

Until now, there are three types of companies in Indonesia. The most common is “PT Biasa” or local companies. Even though it only has Indonesian shareholders, directors and commissioners, it is still subject to regulation by the UUPT. It is required to have a minimal capital, as stated in the UUPT. Although Government Regulation No.20 of 1994 (“PP20”) states that foreigners may acquire shares in this type of company, in practice, it is closed to foreign investment and foreign citizens are not allowed to hold positions of director or commissioner, unless the field of business is not listed on a negative list, in which a specific written approval from the relevant Minister is given. The second type is a domestic investment company referred to as “PT PMDN” (*PMDN Company*), which has certain regulatory advantages and tax concessions compared to a PT Biasa. Originally, a PT PMDN company was reserved to Indonesian shareholders, but following the enactment of PP20, the Decree of Chairman of BKPM (Investment Coordinating Board) 15/SK/1994 (“SK15”) and the current practice of BKPM, it became possible for foreign parties to acquire up to 95% of the shares in the company. Such a company with a foreign shareholder may have foreign directors and/or commissioners. To obtain status as a PMDN company, the company has to have BKPM approval for the line of business it is operating as and is required to have a minimum investment equivalent to the exchange rate as stated in BKPM’s letter of approval (specifically in rupiah) set by BKPM. Finally, there is the foreign investment company incorporated in the Foreign Investment Law of 1967 Law No. 1 of 1967 also known as the “PT PMA” (*PMA Company*). It may have foreigners as its shareholders so long as it has at least two shareholders, but it has an obligation to invest an unspecified percentage to Indonesia within 15 years. It may have foreigners as director and commissioner, enjoy certain advantages and protections against expropriation of the

investment. However, it has an obligation to report its activities regularly to BKPM. BKPM will approve the minimum investment plan of this company that is specified in both US dollars and rupiah.

### **The (New) Company Law Framework**

Ever since Indonesia's independence, business sectors and mainly business enterprises have played an important role in fostering Indonesia's economic growth. There are various regulations that govern Indonesian business organizations. Presently, the laws of Indonesian business organizations are primarily governed by the Law on Limited Liability Company, Law No.1 of 1995 (*Undang-Undang tentang Perseroan Terbatas* or "UUPT") which is considered modern Indonesian company law (referred also as the New Indonesian Company Law), the Indonesian Civil Code (*Kitab Undang-Undang Hukum Perdata* or *Burgelijke Wetboek*), and the Indonesian Commercial Code (*Kitab Undang-Undang Hukum Dagang* or *Wetboek van Koophandel*). The last two codes were first promulgated during the Dutch colonial rule.

The UUPT, consist of 129 articles and was enacted on March 7, 1995 and came into effect a year later. Prior to the enactment of UUPT the limited liability company was governed by only twenty-one articles in the Indonesian Commercial Code. The UUPT symbolizes the first major revision of the Indonesian company law since the commercial code. The promulgation of the law was a response to the rapid economic progress that needed provisions to complement international practices and the modern commercial sector. This paper will focus on the UUPT since it serves as the basis of Indonesian corporate structures.

### *Separate Legal Entity*

PT, as an Indonesian company, is a legal person who has a legal identity separate from its shareholders. Thus, shareholders are not personally liable for the obligations of the company. The shareholders have limited liability to the extent that their liability for the acts of the company can be limited to their capital contribution. Nevertheless, there are some limited possibilities to pierce this corporate veil, for instances in the event that the relevant shareholders either directly or indirectly with bad faith take advantage of the company solely for their personal interest or the relevant shareholders either directly or indirectly unlawfully use company's asset causing the company's assets to be inadequate to settle company's debts.

### *Incorporation*

There are four steps for incorporating a PT. First, execute the deed of establishment, which also includes the company's article of association before a notary in the form of a notarial deed. Second, obtain a formal approval over the deed from the Ministry of Law and Regulation. Upon approval, the deed has to be registered in the Company Registry that is maintained by the Ministry of Industry and Trade. Lastly, publish the deed of establishment in the State Gazette. It needs to be pointed out that prior to the registration and publication processes, the liability of a company can be put in the hands of its directors. In other words, in addition to the liability of the company, a personal liability of the director's may arise if the new company fails to register and publish the approved deed.

Another requirement in establishing a PT is to have at least two persons as the founders or shareholders. The eligible person can be an individual or a legal entity. With an exception for PT BUMN (State-Owned Company) can be established by a single entity, the government. The requirement to have at least two shareholders still continues. If a PT has only one shareholder and it does not offer

shares to other shareholders within six months, then the existing shareholder is personally liable for the agreements and losses of the company. The requirement to have at least two shareholders is based on contractual theory, a conception that a PT is a product of contract, thus it requires two or more shareholders at all times.

### *Share Capital and Voting Rights*

The UUPT requires a company to have a minimum authorized capital of 20 million rupiah. Issued capital must be at least 25% of the authorized capital and by the time of approval of the Articles of Association of the new company by the Minister of Law and Regulation, all the issued capital must be fully paid up. However, in the case of a PMA company and a PMDN company, usually BKPM requires a higher minimum capital level of investment.

A company may issue registered and bearer shares and may also issue non-voting shares. Furthermore, it can issue redeemable and convertible shares, cumulative and non-cumulative shares, and preference shares. However, a company must have at least one class of ordinary shares (“*saham biasa*”) with voting rights. Payment for shares can be made in cash or in other forms (“*in kind*”), but payment in kind, such as of real property in consideration for the issue of shares, requires an independent expert valuation. Under the UUPT, a company may not issue shares to itself or to its subsidiary. Subsidiary is defined as a company in which the parent company owns more than 50% of its shares or the parent company controls more than 50% of the voting rights in a General Meeting of Shareholder (“GMS”), and/or the parent company influences management control such as the appointment and dismissal of director and commissioner. However, under special circumstances, it can buy back the issued shares and hold them as ‘treasury shares’ that the company can sell at a later date. Such shares cannot be

counted to form a quorum nor can the voting rights be attached to the shares being exercised.

### Directors, Commissioners & Shareholders Meeting

Indonesian corporate structure is different from the common law system, since it adopts a two-tier management structure instead of a single-tier management. The management structure comprises of Board of Directors (“*BOD- Direksi*”) and Board of Commissioners (“*BOC-Dewan Komisaris*”). Senior officers are responsible for the company’s actual management in the operational sense is the *Direksi*. Even though there is one director, there is usually more than one. The basic functions of the *Direksi* are to manage and represent the company, and not the shareholders. The second tier is *Komisaris* (“*Commissioner*”), which has the role of supervising and advising the *Direksi*, and representing the interests of the company and not merely the interest of the shareholders. The requirement of a company to have a BOC is a significant alteration from the old provision (the Code). To date, all public companies, companies in the business of mobilizing funds from the public or companies that issue debt instruments must have at least two directors and two commissioners. The UUPT also distinguishes between the collegial nature of the BOD and the non-collegial nature of the BOC. Where a company has more than one commissioner, the BOC constitutes a council pursuant to the Elucidation that no individual commissioner can represent the company if there is more than one commissioner. In contrast, when a company has more than one director, each director has the individual authority to represent the company unless the company’s articles of association states otherwise. Although the primary responsibility of managing the company rests on the directors, in some circumstances, commissioners can exert certain managerial powers -provided by the company’s articles of association or the GMS- for instance managing the company for a specific time period. Both director and commissioner bear personal liability for

any fault or negligence committed in discharging his/her task. Although the UUPT does not define “fault” or “negligence”, it does however acknowledge the concepts of fiduciary duties. In case of breaching any fiduciary duties, shareholders who control at least ten percent of the issued shares with valid voting rights may, in the name of the company, bring a cause of action against the director or commissioner for the loss suffered by the company. Since the shareholder initiates the legal action in the name of the company, it can be considered derivative action.

Pursuant to the UUPT, the shareholders of an Indonesian company are acting via GMS. The GMS has various rights, some of which cannot be waived under any circumstances i.e. the right to approve amendments of the company’s Articles of Association and to approve a dissolution or winding up of the company, while the rest may be modified in the company’s Articles of Association. There are two types of GMS: annual and extraordinary meetings. An annual GMS is held within the last six months of the company’s fiscal year. The GMS convenes in order to approve the annual report, including its annual accounts that must comply with Indonesian Financial Accounting Standards and the signatures of the directors and commissioners required for the annual accounts. The extraordinary GMS can be convened at any time that the company deems necessary for the purposes stipulated in the UUPT or Articles of Association. In other word, a company shall undertake an extraordinary GMS for the purposes other than approving the company’s annual account, such as: merges, acquisitions or appointment of a new Direksi. Commissioner, Director or a party that controls at least 10% of the issued shares may request the meeting.

#### *Minority Shareholders protection*

The UUPT grants minority shareholder a great deal of protections as all shareholders have pre-emptive rights – a right



allowing them to maintain or increase their proportionate shares in the company before the company offers the shares to other parties. Another right comes from the provision that entitles the shareholder to control less than 10% of the issued shares with valid voting rights to request the State Court to commence an investigation panel with respect to the company in the event that the directors or commissioners are suspected of having committed an illegal act that causes loss to the shareholders, third parties or the company itself.

### Mergers & Acquisitions

Although the UUPT provides only eight articles governing merges and acquisitions, it is still a remarkable change in Indonesian corporate context because there have been no specific regulations on such business activities since Indonesia's independence. It is expected that a more detailed provision will be issued subsequently. It is important to note that even though the UUPT introduces three terms: merge, amalgamation and acquisition, it is actually governed only by a statutory merge and shares of acquisition. There are four types of merges: shares, assets, contractual and statutory merge; whereas in acquisition there are asset and shares acquisition

The term merger ("*penggabungan*") refers to a company that becomes part of another existing company. While amalgamation ("*peleburan*") refers to a transaction in which two companies dissolve in order to form a new company. The difference between a merge and an amalgamation is in a merge a company dissolves another, whereas in an amalgamation both companies involved dissolve in order to create a new company. Acquisition ("*pengambilalihan*") refers to a company or individual taking over a company through a purchase of the latter's shares. In this process, no company dissolves. A company involved in a merger, amalgamation or acquisition in general has to take two steps. First, the directors of the respective company prepare a proposal. The

proposal must then be approved by the extraordinary GMS, which must satisfy the quorum and approval requirements. Shareholders representing no less than 75% of the issued shares with voting rights must attend the meeting, and approval must be given by 75% of those attending shareholders. Second, submit an approved proposal to the Minister of Law and Regulation for the purpose of reporting or approving the proposal. The UUPT also requires merges, amalgamations, and acquisitions to take into account the interests of the minority shareholders and employees of the companies as well as the interests of the public and of competition. The right of the minority shareholders to sell their shares for an equitable price should also be protected. With respect to competition, the Elucidation states that in the even of undertaking merges, amalgamations and acquisitions, a company should prevent the rise of a monopoly which goes against public interest.

### *Dissolution*

The UUPT recognizes three ways a company can dissolve: decision made during a GMS meeting, upon the expiration of the period of existence specified in its articles of association and by order of court. The court order to wind up the company (*judicial investigation*) can also be made by request from the prosecutor for representing the public's interest or a single shareholder holding not less than 10% of the voting rights. Once the company is wound-up, it must appoint a liquidator to liquidate the company. The director will act as the liquidator in the event that no liquidator has been appointed.

### **Proposed Revisions**

Revisions are aimed at unclear and ambiguous provisions such as:

- the filing systems (registration) articles of association and amendments to the articles of association at the Ministry of Law and Regulation and the Ministry of Industry and Trade, should be simplified because it is complicated, expensive and time consuming. Even though the filing system has been computerized since 2004, however, it is still ineffective.
- the articles of association should specify only the amount of authorized capital not the amount of paid-up capital or issued capital
- the issuance of a share without nominal value should be permitted
- the meaning of ‘substantial part’ of a company’s assets should be clarified
- the meaning of acquisition should be made clearly in regards to terms such as: changing control, etc.

### **Conclusion**

The promulgation of the UUPT, at that time, reflects the political will of the Indonesian government to reform the corporate legal framework to be in sync with modern commercial activity, thus generating greater legal certainty in the Indonesian corporate sector. Even though some parts of the UUPT are merely codified, due to existing practice or government policy, problems are still encountered. The enactment of the New Company Law marks a major step in the development of the Indonesian Company Law framework. The new provisions in the UUPT that govern merges and acquisitions, duties and liabilities of directors and commissioners, and the rights of minority shareholders raise the corporate governance issues in Indonesia. At last, the UUPT can be considered a unique legislation product because it combines both civil and common law concepts. On the one hand, it preserves civil law concepts, such as the two-tier management structure and the

company (judicial) investigation, while on the other hand it also adopts common law traditions, such as provisions that deal with the duties of directors and commissioners. Hopefully, the proposed revisions of this UUPT will create a legal certainty for the future of Indonesian corporate law.

## **B. CONTRACT LAW**

### **Introduction**

The Indonesian commercial legal system is, basically, derived from the Dutch Civil Law traditions codified in the Indonesian Civil Code (*Burgelijke Wetboek or Kitab Undang-Undang Hukum Perdata*) and the Indonesian Commercial Code (*Wetboek van Koophandel or Kitab Undang-Undang Hukum Dagang*). The first code, however, serves as the basic legislation governing Indonesian contract law. Contract, is actually a part of what the Indonesian legal system recognizes as ***the law of obligation*** (*hukum perikatan or verbintenissen*), and is governed in Book III of the Indonesian Civil Code (“**ICC**”). The law of obligation recognizes two sources of an obligation; namely, an obligation resulting from contract and an obligation resulting from statute. Pursuant to Article 1313 of the *ICC*, a contract or an agreement is defined as an act by which one or more individuals bind to one another. The term of “**contract law**” is then used to define an obligation that arises as a result of this contract and is referred to as a *contractual obligation*. Therefore, contract law constitutes one of the principal sources of obligations in Indonesian law.

There are several principles with respect to contract law that are important to understanding the operation of Indonesian contract law. First, the *principle of freedom of contract* – a principle that

recognizes that each and every person has the right to enter into contract so long as it does not breach the prevailing laws and regulations, accepted decency and moral standards, and public policy. Second, *the consensual principle* – in essence a contract in itself implies a meeting of minds, and from the moment this meeting occurs a contract is formed. Thus, the consensual principle is a principle stating that a contract is considered to come into existence once the parties reach a mutual consensus. These two principles form the basis of Indonesian contract law. Other principles are contained in Book III of the *ICC* where Indonesian contract law is referred to as “*an open system*”. Generally, this has been interpreted to mean that the provisions contained in Book III are considered as an optional law, in which the parties are free to make use of or ignore those provisions. As optional law the parties are permitted to determine specific provisions regulating the contract into which they will enter including agreeing to provisions that are expressly contrary to the optional law contained in Book III. In the event that the parties opt for a standard contract and have not made any specific provisions in the contract to the contrary then the provisions of Book III apply – this is referred to as the “default rule”.

### **Elements of Contract**

Not all contracts constitute valid and binding contracts. To establish a valid and binding contract, there are four conditions to be satisfied as follows:

#### *Consent of the Parties*

The consent of the parties to enter into a contract constitutes the consensual principle and serves as the basis of contract law. A contract is considered to have consent if approval by the parties is made without duress, mistake or fraud (misrepresentation). Duress

involves an illegal mental threat including physical violence (but not an action that is permitted by law to bring as a lawsuit), blackmail and excessive influence over a person in a weakened mental state. Mistakes comprise of two types: concerning the identity of the subject matter of the contract and concerning the identity of the person that concluded the contract. Fraud is defined as a plain act performed by one party prior to the formation of a contract with the intention to deceive the other party and induce him to conclude the contract that he would not have concluded if he was to be aware of the deception. In other words, one party concludes the contract because of the deceitful act.

Nevertheless, a contract may be valid even though consent was obtained by duress, mistake, or fraud. In this case, the contract is considered to be a voidable contract, meaning that the contract can be made void but only at law and on the bringing of a successful cause of action by the injured party. The suit has to be filed within five years of the cessation of the duress or within five years of the discovery of the mistake or fraud.

### *Capacity of the Parties*

The legal capacity of a party to conclude the contract serves as the second important requirement that must be satisfied before a contract can be considered valid. Generally, all persons are legally eligible to enter into contract. Exemption is made to the following persons: a minor (a person under 21 years old, unless married), a person under official custody, and a person prohibited by the relevant law to conclude a contract.

A contract concluded by the above persons is considered to be a voidable contract. It is possible that a contract of this nature can be annulled by the court on the request of the incompetent party that entered into the contract. The obligation of the other party, however, is unaffected by the incompetence unless or until the contract is declared void. The nullification of contract based upon

the incompetence of the individual mentioned above, shall cause the assets and the parties to be returned to the state they were in prior to the entry into the contract, on the understanding, that anything granted or paid to the incompetent party, as a result of the contract, may only be reclaimed, to the extent that any such payment that is still in the hands of the incompetent party, or to the extent it appears that the settlement of payment has been beneficial to him, or that he has applied or extended the enjoyment to his use.

#### Definite/Specific Subject Matter

Third element of a binding contract is the specific subject matter. In general, anything that is tradable and determinable may become an object of a contract. A subject matter of a contract can be comprised of rights, services, or goods whether existing now or in the future. Under the *ICC*, only existing goods are tradable. Future trading is governed by a separate law. For instance, the sale of 10,000kg of jasmine tea leaves at harvest time in 2005 for USD 2/kg is considered sufficient to constitute a definite subject matter, but the sale of jasmine tea leaves for USD2/kg, does not constitute as a definite subject matter, and thus it is unacceptable.

#### An Admissible Cause

The last pre-requisite that must be satisfied for a valid contract to be created is an admissible cause. An admissible cause means that the purpose of a contract must have a lawful '*causa*'. A contract is considered to have a lawful *causa* or admissible cause if the object of the purpose of the contract breaches the existing laws and regulations, accepted decency and good moral standards, and public policy. For instance, a contract regarding the trafficking in humans would be considered to be an illegitimate contract as the purpose is contrary to the prevailing laws and regulations. Similarly, a contract for sexual-service would be contrary to the

acceptable decency and moral standards and as such would be declared invalid.

A contract that does not satisfy the third and fourth elements is considered to be null and void meaning that the law will hold that there is no valid and existing contract between the parties. A decision of this nature by a court requires that the court also issue an order that returns the parties to their respective original states prior to their entry into the voided contract.

### **Contract Formation**

The Indonesian Civil Code does not recognize theories of contract formation in the same manner as that of common law systems, particularly as it does not define when parties to a contract consented to be bound. Well established doctrines, however, provide that contract is considered to exist and therefore bind the parties when they have reached agreement; namely, when one party's offer is accepted by the other party. It is generally held that contract is formed the exact moment when this acceptance is received by the offeror. In other words, a contract is created at the moment a legitimate offer has been accepted. The offer and acceptance can be explicit or tacit. A written acceptance is effective upon receipt. It should be noted that a legitimate offer is irrevocable unless a power to revoke has been reserved.

### **Formalities**

As a general rule, there is no formal requirement for a contract to be written or registered before it is considered to be binding on the relevant parties. However, there are some situations where a contract must be concluded formally – the contract must be in writing and executed by notarial deed. For example, every transaction that deals with land, intellectual property rights, or incorporation of a limited liability company, must all be in writing



and registered in the relevant Registry Office. If a contract is to be used as evidence in a civil lawsuit, then the contract must have been entered into under seal and the applicable stamp duty paid.

### **Performance**

A valid contract shall bind the parties who have entered into it and cannot be revoked unless by mutual agreement or pursuant to provisions included in the contract, or for valid legal reasons. This serves as what the Indonesian contract law knows as the *pacta sunt servanda* principle – a principle that states a contract binds only the parties entering into it. The parties, however, are not bound only by what the contract specifically provides, but also by the nature of the contract, by reasonableness, custom, and statute. In addition, a contract shall not be detrimental or benefit a third party. Some exceptions, however, are made to conclude a contract that benefits a third party, for example, in the event of insurance. In insurance, a third party becomes the beneficiary of the contract.

A contract must also be performed in good faith. In order to preserve the application of good faith, a civil case judge, who has the power to supervise the performance of a contract in accordance to the principles of reasonableness and justice, may depart, if necessary, in rendering his decision from the contract provisions.

All rights and duties arising out of a given contract pass to the heirs of a party in the event of his death, unless the contract clearly provides otherwise.

### **Breach of Contract (Default)**

An obligor, a contracting party who has to perform an obligation in a contract, should perform his obligation at the time and in the manner agreed in the contract. Failure to do perform his obligation would constitute a breach of contract or default. Pursuant

to the Indonesian contract law, a party is considered to be in breach of contract if any one of these four conditions apply; namely, total failure to perform the obligation, failure to perform the obligation in the time specified, failure to perform the obligation properly (contrary to the terms of the contract), and performs a prohibited action specified in the contract.

Indonesian contract law provides various remedies that could be exercised against the breaching party, such as; specific performance, damages or termination of the contract. Basically, the aggrieved party to a contract has the right to sue the breaching party for specific performance, if it is still possible or reasonable for the breaching party to fulfill its obligations under the contract, especially in relation to the sale of land. Damages usually comprise of all expenditure in relation to the performance of the contract – all expenses and costs actually incurred by the aggrieved party in reliance on the contract, loss – injury to the property of the creditor resulting from the default, and interest – lost profit. Provisions contained in Book III of the *ICC* do not provide clear measures for calculating monetary damages. It imposes limitations, however, on monetary compensation. The debtor is liable only for the costs, damage, and interest which have been foreseen or which should have been foreseen at the time of the formation of contract. Damages, however, are limited to the injuries which directly result from the breach. In the event that performance is to be in the form of payment of money, the *ICC* permits the court to render a decision on interest for late or non-payment with interest not to exceed 6% per year calculated from the date the petition was filed.

### **Termination of contract**

Indonesian contract law recognizes ten ways of terminating a contract; namely, by performance, by certified tender, by novation, by compensation (set-off), by merger (confusion), by release, by destruction of the subject matter, by rescission, by

occurrence of a canceling condition, and exceeding any statute of limitation.

Performance of a contract is the most common way of terminating a contract, which denotes with the word 'payment'. Generally, only the party concerned makes the payment, however, it is also possible to have a third party do so. If the third party does this without taking the creditor's place, then the contract is terminated, whereas if the third party steps into the shoes of the creditor, then it is known as subrogation.

Certified tender plus deposit may discharge the contract in the event the creditor refuses to accept payment. If the debtor wishes to make payment by offering money or movable goods (not immovable goods), but the creditor refuses, then such money or goods are to be deposited in the court at the responsibility of the creditor.

Novation occurs when the old contract is terminated and a new contract is born. It must be done explicitly and requires the consent of both parties.

Compensation occurs automatically if someone is simultaneously a creditor and debtor of another person and the contract concerns a sum of money or a certain and similar quantity of goods. Thus, no special procedure or intervention of a third party is required.

Merger is a termination process whereby the positions of debtor and creditor unite in one person. This may occur when, for example, the debtor marries the creditor or the debtor becomes the heir of the creditor.

Release is a situation in which the creditor releases the debtor from any obligation by conclusion of a new contract. The debtor has to accept the creditor's offer to free him from the obligation.

A contract concerning a delivery of goods is terminated under the following three situations: if the goods are destroyed, if the government issues a regulation prohibiting the sale of such goods, and if the goods are lost or become damaged in such a way as to be unrecognizable. In order to terminate the contract, the destruction of the goods must precede delivery and beyond the ability of the obligor to prevent.

Rescission occurs in the event that a contract concluded by an incompetent party is declared null or a contract is concluded because of duress, mistake, fraud or anything that violates the law, morals, and public order of the community, and is subsequently annulled.

Occurrence of a canceling condition occurs in a contract by which a certain event is stated to be a cause of terminating the contract. Therefore, if such event occurs, the contract is then automatically discharged.

Running of the statute of limitations occurs thirty years after each and every contract comes into effect. The aggrieved party has the power to exercise his right to file a legal claim within 30 years of the date that the relevant contract came into force. If within such time he does not institute any such action, then pursuant to the *ICC*, all rights are discharged.

### **Types of Contract**

Indonesian contract law recognizes two basic types of contract – general contract and special contract. General contract consists of conditional contracts, temporal contracts, alternative contracts, contracts giving rise to joint and several liabilities, divisible and indivisible contracts, and contracts that contain a punishment clause. Special contract, on other hand, comprises of contracts of sale, contracts of hire-purchase, contracts of installment-purchase, contracts of lease, contracts of gift, contracts

of agency and representation, contracts of a free-loan, pledges and chattel mortgages, and contracts of warranty.

### **Conclusion**

Although Indonesian contract law is still governed by Book III of the Indonesian Civil Code inherited from the colonial period, people involved in the business sector including lawyers, advocates, judges, and the business community are relatively comfortable with the existing legislation. Therefore, the demand for reform in the Indonesian contract law sphere does not seem as high as in other areas of commercial law reform. Criticism was restricted to the implementation and enforcement of contract relating to the efficiency of the judiciary area. Serious reform to secure proper enforcement of commercial contracts is needed. Establishment of new specialized courts such as the commercial court or tax court is expected to provide greater legal certainty with respect to the enforcement of contract.

## **C. LAND LAW**

### **Preface**

The basic principles and provisions of the present land tenure structure in Indonesia can be found in the Basic Agrarian Law, Law No. 5 of 1960 (BAL), which came into effect on 24 September 1960. The nomenclature is a little misleading as the BAL does not only regulate agrarian matters it also regulates Indonesia's vast natural resources including minerals, territorial waters, fish and other marine resources, oil and gas, space, and almost all other natural resources deemed critical to the ongoing

national development of Indonesia. Nevertheless, the BAL is generally referred to as the Land Law.

According to the BAL, the pre-emptive and ultimate right is the right held by the State (*Hak Bangsa*). The underlying premise of this concept is that all of Indonesia's land and natural resources are owned by the people and as such the government of Indonesia as the elected representatives of the people are empowered to administer these vast lands and resources in the best interests of the communities and people that they serve. This right is all-encompassing in that it permits the State to regulate all matters concerning both publicly-owned as well as privately-owned land and resources and is often referred to as the *Hak Menguasai Negara* or the Right of Control over the State.

In Indonesia, Article 6 of the BAL states that all titles to land have a social function. This function is specifically that not only is the holder of land entitled to make use of the land but is in fact expected to utilize it in order to serve the general welfare of the community.

Based on the BAL, several implementing regulations have been enacted to regulate the land tenure structure in Indonesia, including different types of land titles, the rights and obligations of title holders, and measures to obtain title of land. The authority who has jurisdiction with regard to land matters is the National Land Institute (Badan Pertanahan Nasional/BPN).

Besides BAL and its implementing regulations, customary and Adat law still exist. However, these customary and traditional laws are being consumed by the uniform application of the BAL which has developed into the standard for the administration of land in Indonesia.

Despite the BAL developing into the pre-eminent source of land law in Indonesia there is a belief that the BAL enacted in 1960 is no longer reflective of the current community and public needs with respect to land law in Indonesia in the 21<sup>st</sup> century,

## **Type of Land Title and Their Particulars**

### **Primary and Secondary Titles of Land**

Under the BAL, land titles are divided into two categories; namely, primary and secondary titles. Primary Titles are derived from the state and consist of: the Right of Ownership (*Hak Milik*), the Right to Till or Exploit (*Hak Guna Usaha*), the Right to Build (*Hak Guna Bangunan*), the Right of Use (*Hak Pakai*) and the Right of Management (*Hak Pengelolaan*). All titles are required to be registered or certified. Secondary titles are titles granted by other title holders and which are based on mutual agreement and consist of leases (*hak sewa*), the right of share cropping (*hak usaha bagi hasil*), the right of land pledge (*hak gadai*) and the right of lodging (*hak menumpang*).

The title holder of both titles has the same right to make use of the Land and to utilize it by himself/herself to extract a profit from someone else although this is traditionally based on an agreement by granting one of the secondary titles.

Besides the aforementioned, there are also five important types of land that must be acknowledged by companies who wish to run businesses in Indonesia. It must be noted that each of these titles give rise to different consequences.

#### **1. Right of Ownership (*Hak Milik/HM*)**

HM is the most complex form of ownership of land in Indonesia. It is subject to planning regulations, in which the holder can use the land for any purposes, including for housing. It also entitles the holder to use the air space (the space above the land) as well as the soil beneath it. However, HM does not allow the holder to exploit the natural resources found on or under the land as this is

a right that is regulated under the provisions of Law No. 11 of 1967 on Mining.

In principle, only individuals of Indonesian nationality and the special legal entities stipulated in Government Regulation No. 38 of 1963 (government banks, cooperatives, and religious and social bodies) can hold this title. Therefore, foreigners and legal entities, such as joint venture companies, cannot hold a HM title.

There is no time limit on this title and it can be given or bequeathed to another, even on the holder's deathbed. HM is also one of the titles that makes a person eligible for a mortgage in Indonesia (*Hak Tanggungan*).

## **2. Right of Exploitation (*Hak Guna Usaha/HGU*)**

HGU is the principle title that applies to agricultural areas such as plantations, fisheries, and cattle properties. A HGU is provided by the State in order that a private legal individual or entity may utilize State-owned land. The holder is allowed to erect structures so long as it is utilizing the land subject to the granted HGU in some substantial and significant manner.

In general, the right is granted for an initial maximum period of 35 years for plantations, but can be extended for another 25 years on the submission of an application seeking the extension. The prevailing laws and regulations stipulate all necessary fees and charges associated with the application for extension process. These payments will be made to the State Treasury and constitute a form of non-tax revenue.

The HGU right cannot be granted on areas of less than five hectares and is not subject to any other limitations and large tracks of land are normally granted. However, in practice, the government will not issue a right to a plantation if the proposed plantation area is less than 25 hectares.



A HGU can be transferred and granted to another party and is eligible for *Hak Tanggungan*.

### **3. Right of Building (*Hak Guna Bangunan/HGB*)**

The holder of this title is entitled to erect and possess a structure on the land. A HGB can exist on both State and privately-owned land. Most land in local areas is subject to a HGB grant from the government with respect to residential, commercial and industrial land. The HGB title is also granted to most major development projects, such as energy and mining projects.

The right is normally granted for an initial period of up to 30 years and it can be extended for a further 20 years on application.

Based on Government Regulation No. 40 of 1996, a company, formed in the nature of investment, shall pay official costs (*uang pemasukan*) to the State Treasury for a period of 80 years which is inclusive of the initial 30-year grant, the 20-year extension and an additional renewal for a further 30 years after the issue of the HGB title by the relevant authority. The title is also eligible for *Hak Tanggungan*.

### **4. Right of Use (*Hak Pakai/HP*)**

A HP is granted against specific plots of State or privately-owned land in order that the holder of the HP title may exploit the land for productive purposes. In practice, the right is usually only granted to enter a lease or some other equivalent set of terms of agreement, rather than going through the formality of granting the right. The right can be held by Indonesian individuals or legal entities as well as by foreign residents for a maximum of 25 years and it can also be extended for another 20 years.

## 5. Right of Management (*Hak Pengelolaan/HPL*)

A HPL is given to State-owned companies and Regional Governments with respect to planning and development of State-owned land. It is usually given to those who will use the land for industrial and/or business purposes. The holder has the power to grant a HGB and a HP. Many examples exist of the use of the HPL grant such as the Pulogadung Industrial Estate and some low-cost housing projects including those developed by the State Housing Company.

The time period of the HPL is in accordance with the time in which the holder intends to use it for industrial and/or business purposes. This right is not eligible for *Hak Tanggungan*.

### Unregistered Titles of Land

Besides the rights defined in the BAL, in rural areas customary land titles, which are not registered, still exist. One of them is the Customary Right of Ownership (*Hak Milik Adat*), which by law has to be converted to a registered *Hak Milik* and must be registered since 24 September 1960. In Central Java, particularly in Jepara, the Hak Milik Adat is called *Hak Yasan* and is referred to as “*Letter C*”. This right is known in West Java as “*Girik*”. In addition to Hak Yasan, there is also Village Land (*Tanah Bengkok* or “*Tanah Jabatan*”), which is given to and can be used by the Head of the Village (*Kepala Desa*) during his/her tenure in office.

Theoretically, Tanah Bengkok cannot be sold since it is regarded as “salary” for the Kepala Desa, thus it can only be possessed and used during the term of office. However, in the event that this land is needed for the purpose of development, it can be sold under Village Decree (*Keputusan Desa/Rembug Desa*) and confirmed through Governorial Decree.

## **The Land Acquisition Process**

### **Land Acquisition Methods**

Three things must be taken into consideration when obtaining land: the status of the land, the status of the individual who will acquire the land, and the willingness of the title holder to surrender the land.

In regards to the status of land, there are two kinds of land in Indonesia, State and private.

#### **1. State Land**

The only way to obtain State land is to apply for the relevant land title through an authorized state official, as stipulated in the regulation of the Department of Home Affairs No. 6 of 1972. To obtain a land title, applicants are required to pay the associated land taxes, which is 5% of the value of land and buildings minus IDR 30 million. In addition to the PPHTB (*Pajak Penghasilan atas Pengalihan Hak atas Tanah dan/atau Bangunan* - Income Tax over Transfer of Land dan/or Building), they are also required to pay the all other official costs to the State in accordance with State Minister for Agrarian Affairs/Head of the National Land Institute Regulations No. 4 and 6 of 1998. The procedure for granting a land title is stipulated in the Minister for Home Affairs Regulation No. 5 of 1973 and which has been amended by the regulations of State Minister for Agrarian Affairs/Head of National Land Institute No. 2 of 1993 and has recently been further amended by Minister of State for Agrarian Affairs/Head of BPN Regulations No. 2 and 3 of 1999.

#### **2. Private Land**

There are four legal methods to obtain private land, but it depends on the individual who wishes to possess the land as well as the type of title that they desire. The methods are:

- a. Available land which is based on an agreement with the title holder (such as a lease agreement) is usually used on the condition that a party wishes to use a small plot of land over a short period of time, say between 3-10 years, thus it is considered to not be necessary to possess a strong title over the land.
- b. If done by direct transfer, such as sale and purchase or exchange of land, the status of the individual who wishes to possess the land will be evaluated and taken into consideration. This is to avoid the possibility that the transfer will become null or void at law, thus making the particular land subject to this agreement the property of the State. A direct transfer is frequently used for sale and purchase.
- c. Indirect transfers or the relinquishment of land title is used when a company wishes to possess land, but is not eligible to hold the title. An example of this is a company that is trying to obtain both the title of Hak Milik and Hak Milik Adat. In order to possess these titles, the owner of the land must first release his/her title over the land in exchange for an agreed price that is to be paid as part of a sale and purchase transaction. The owner then declares that s/he has released the title over the land. This release should be in written form of a Notarial Deed and or at a minimum witnessed by a notary and confirmed by relevant State appointed body. The declaration states that the owner releases title over the land for the benefit of the company. It is preferred that the declaration be made before the Head of the Regional Land Office, who will then draft a new Deed. Additionally, in order to subvert the possible rejection of the release of title by the relevant State authority the Deed of Release usually includes a clause that expressly states that in the event of rejection that the owner permits the company to transfer the “rights” to any other qualified party. Thereafter, the request

for the appropriate title should be submitted to the local Agrarian Affairs Office and the process is then complete on the issue of a certificate. The grant of land title in this procedure does not require the payment of any *uang pemasukan* to the State Treasury since the company has paid the price of the land to the owner, but there is an administration fee charged by the relevant local authority that must be paid.

- d. Expropriation – this is the last method that can be used for the purposes of obtaining land for the public’s benefit. Expropriation requires that the relevant parties, the owner and the individual who wishes to obtain the land, enter into negotiations in order to reach an agreement. In the event the parties fail to reach a mutually acceptable agreement with regards to terms and conditions to effect transfer then the law would allow for an expropriation of the property to occur. The expropriation principles are explicit that the State is subject to the law and as such must respect the rights of the individual and as a result the BAL stipulates a number of strict provisions that must be satisfied before expropriation can occur; namely, Article 18 of the BAL states that: (a) the land will be used in order to fulfill the public interest, (b) the expropriation must be accompanied by proper compensation, and (c) the expropriation must be executed based on a Presidential Decree. Once expropriation has occurred then the new owner of the land must submit the relevant applications to the relevant bodies to secure appropriate title over the land.

### **Land Acquisition for Companies in the Framework of Capital Investment**

The emergence of fierce competition between developing countries for foreign investment and the plain link between foreign

investment and the need to acquire title in land spurred the government to improve and simplify the land acquisition process for foreign investors.

According to the new regulation, Minister of State for Agrarian Affairs/Head of BPN Regulation No. 2 of 1999, in order to acquire land in accordance with the Regional Spatial Lay Out Plan, a company must be granted a location permit (*izin lokasi*), which is only valid as a transfer title permit.

### **Foreign Ownership Land/Property**

Under Government Regulation 41 of 1996 (GR 41/1996), foreign residents in Indonesia, foreign companies with representative offices in Indonesia, representatives of foreign countries (Embassies and Consulates), and representatives of international organizations are among the few categories of people who can hold *Hak Pakai*. The definition of foreign residents, as defined in GR 41/1996, is “foreigners whose presence in Indonesia gives opportunities to national developers”. Unfortunately, this definition is able to be so broadly construed that any sort of uniform application is almost impossible to effect.

## **D. CAPITAL MARKET LAW**

### **Introduction**

The essence of the capital market, in general, is the same as that of a conventional market; namely, a place where sellers and buyers meet to transact. The capital market’s primary function is to facilitate meetings between the supplier of funds and the users of funds where the underlying aim is to finalize either a mid to long-term investment. According to Article 1(13) of Law No. 8 of 1995,

the Capital Market is the forum for the activities of trading and offering securities to the public, as well as to supervise the activities of public companies that have offered securities to the public, as well as the supervision of the activities of securities related institutions and professions. The activities of the Indonesian capital market will be defined below.

The capital market is not a new development in Indonesia. On the contrary, the activities related to the trading of stocks and bonds have been a familiar line of business in Indonesia since the 19<sup>th</sup> century. The book, *Effectengids*, published by *Verreniging voor den Effectenhandel* in 1939, states that the trading of stocks has occurred since 1880. However, the major difference between the trading activities of the past and the trading activities of today is that the buying and selling of stocks and bonds in the late 19<sup>th</sup> century occurred without an official trading floor. Nevertheless, even an official trading floor is not something that is new to Indonesia as the Indonesian Capital Market of the early 20<sup>th</sup> century established the first official trading floor on 14 December 1912 in Batavia (now Jakarta). In the period between 1912 and 1925 there was significant growth in the capital market and the amounts of stocks and bonds being traded, this growth was the driving force behind the establishment of the Surabaya trading floor on 11 January 1925 and the Semarang trading floor on 1 August 1925. Currently, in 2005, there are two trading floors – Jakarta and Surabaya.

The Indonesian Capital Market closed during World War II as a consequence of the complete deactivation of the world's Capital Market systems and also because of the belief that it was neither feasible nor possible to engage in capital market activities during a war. After the war the government enacted Emergency Law No. 13 on 1 September 1951, this was later confirmed as Law No. 15 of 1952 on the Stock Exchange. This led to the reopening of Indonesia's Stock Exchange on 1 September 1952 after a closure of 12 years. The law mandated the appointment of staff to the Stock

and Financial Trade Association and this management comprised of 3 State banks and several broker-dealers and Bank Indonesia as advisor. However, the Stock Exchange survived only 6 years as Indonesia suffered heavily under a sluggish domestic and international economy and declining world-wide stock activities. Another notable cause for the declining stock exchange was the confrontationalist policies the government had adopted towards its former colonial masters, the Netherlands. The end result of this policy was that the majority of the remaining Dutch citizens and their business interests in the community chose to leave taking as much of their capital and investment with them.

This situation continued to deteriorate and was further exacerbated by tension between Indonesia and the Netherlands over West Irian as well as the nationalization of Dutch companies still with business interests in Indonesia. The nationalization of Dutch firms was based on Law No. 86 of 1958 on Nationalization and an instruction from BANAS (*Badan Nasionalisasi Perusahaan Belanda*) that prohibited the Indonesian Stock Exchange from trading any remaining Dutch company's stocks and to cease all trade in Dutch firms whose stocks were denominated in Dutch currency.

This led to a number of other related problems including the rapidly increasing rate of inflation that was seriously reducing the public's trust and belief in the the financial markets of Indonesia. This inflationary pressure resulted in a significant depreciation of the Rupiah and the rapidly deteriorating economy which culminated in the political turmoil and tragedy that was to befall Indonesia in 1965-1966.

After the closure of the Indonesian Capital Market in 1952 there had been an almost constant ebb and flow. Finally, in 1976 through the issue of Presidential Decree No. 52 of 1976, the Indonesian Capital Market Supervisory Agency (Bapepam) was established and was granted the following duties and functions:



1. Evaluate whether the companies that are to sell their shares through the capital market have complied with the requirements and are sound and fit;
2. Organize an effective and efficient capital market;
3. Extensively supervise the development of Issuers

It was anticipated that these duties and functions granted to Bapepam would allow for the creation of an orderly, fair, and efficient capital market that was able to protect the interests of both the public and investors. These duties and functions are similar to the main tasks granted to the Securities Exchange Commission (SEC) in the United States.

Finally, to clarify and strengthen these duties and functions the government enacted Law No. 8 of 1995 on the Capital Market (Capital Market Law). Bapepam falls under the auspices of the Department of Finance and the Chairperson of Bapepam is appointed by the President and reports to the Minister of Finance.

### **The Indonesian Capital Market**

The Indonesian Capital Market has undergone significant growth since it was reestablished. Today, the Jakarta and Surabaya Stock Exchanges have become the central features of the Indonesian Capital Market with each retaining their own distinct trading floor characteristics. Initially, both floors relied on manual transaction systems however the recent automation of the Jakarta trading floor with the introduction of the Jakarta Automated Trading System (JATS) has resulted in much larger volumes of trade and accountability. The JATS is a transaction system design to be integrated with the clearing and settlement system as well as integrated with the depository system to improve accountability and transparency in transactions from which it is hoped that the public' trust and belief in the system will drive future trading growth. The clearing and settlement system is managed by Indonesian Clearing

and Guarantee Corporation (KPEI) and the depository system is managed by Central Securities Depository Agency (KSEI).

The Indonesian capital market community comprises not only of Bapepam as the supervisory agency, but the Clearing and Guarantee Corporation and the Central Securities Depository Agency, both of which are Self Regulating Regulatory Bodies. However, the Law in fact mandates that under the auspices of Bapepam there are 4 self-regulatory bodies; namely, the Jakarta and Surabaya Stock Exchanges, the Clearing and Guarantee Corporation, and the Central Depository Agency. The four Self Regulatory bodies are privately-owned companies whose shares are owned by the Capital Market community. The Jakarta Stock Exchange and the Surabaya Stock Exchange were established not long after the Indonesian Capital Market was reestablished, whereas the Indonesian Clearing and Guarantee Corporation and Central Depository Agency were established based on the Capital Market Law.

The Indonesian Clearing and Guarantee Corporation (KPEI-Kliring dan Penjaminan Efek Indonesia) was founded to provide clearing and guarantee services in the settlement of stock exchange transactions in an orderly, fair and efficient manner. The KPEI was established as a limited liability company based on Deed of Establishment No. 8 dated 5 August 1996 in Jakarta by the Jakarta and the Surabaya Stock Exchanges, with each holding 90% and 10% respectively of the founding shares issued of IDR 15 billion. The KPEI received its confirmation as a legal entity from the Minister of Justice of the Republic of Indonesia on 24 September 1996 and on 1 June 1998 it received the relevant license to operate as a Clearing and Guarantee Corporation based on Decision Letter No. Kep.-26/PM/1998 of the Capital Market Supervisory Agency (*Bapepam*). Although formed and operating as a corporation, the KPEI is in fact a non-profit organization as all of its revenues are allocated to finance its operations, while its net profit, if any, is fully retained towards the continuity of its mission.

The Central Depository Agency (*KSEI-Kustodian Sentral Efek Indonesia*) was established pursuant to the provisions of the Capital Market Law and its main duties and functions are to provide orderly, appropriate, efficient central custodian and transaction settlement services. The KSEI was established on 23 December 1997 and obtained the necessary licenses to commence full operations on 12 November 1998.

Aside from the Capital Market Law there are a number of other regulations that govern the operations of the Indonesian Capital Market:

1. Government Regulation No. 45 of 1995 on the Implementation of the Activities of the Capital Market activities (this regulation revoked Presidential Decree No. 53 of 1990 on the Capital Market)
2. Government Regulation No. 46 of 1995 on the Procedure of Investigation in the Capital Market
3. Ministry of Finance Decision No. 645/KMK.010/1995 revoking Ministry of Finance Decision No. 1548/KMK.013/1990 on the Capital Market and since amended by Ministry of Finance Decision No. 284/KMK.010/1995
4. Ministry of Finance Decision No. 646/KMK.010/1995 on Stock Ownership or Mutual Funds for Foreign Investors
5. Ministry of Finance Decision No. 647/KMK.010/1995 on Stock Ownership for Foreign Investors (up to a maximum of 85% of the capital stock)
6. Ministry of Finance Decision NO. 455/KMK.010/2003 dated 17 July 2003 on Capital Requirements for Brokerage Firms
7. All Regulations issued by Bapepam since 17 January 1996

## **Current Activities in the Indonesian Capital Market**

### A. Scripless Trading

In July 2000, the Indonesian Capital Market commenced Scripless Trading to enhance market liquidity and to eliminate the occurrence of lost and forged stocks as well as to simplify the process of transaction settlement.

The introduction of Scripless Trading has meant that all previous transactions that relied on paper to be transacted have been eliminated and replaced with a computer-based electronic system allowing both the transaction and subsequent settlement to occur electronically. The owner of shares will only have a confirmation of the record and the status of the relevant shares. The implementation of scripless trading itself has led to a reduction in white collar crime within the Capital Market, particularly related to the handling of share certificates. The Capital Market Law allows for the implementation of a scripless trading system, although it is important to note that scripless trading is not specifically addressed in the Law. Article 55 of the Capital Market Law simply states that settlement may occur in a number of different ways, such as book-entry, physical delivery or other means stipulated in Government Regulations. However, the Elucidations to this Article do state that electronic settlement or settlements using new technology may be utilized to effect settlement. The remainder of the regulatory framework with respect to scripless trading has been issued by Bapepam, the Central Securities Depository Agency, and the Indonesian Clearing and Guarantee Corporation.

Scripless trading is a feature of the Jakarta Stock Exchange in comparison the Surabaya Stock Exchange currently prefers a Remote Trading system. However, since 2002 the Jakarta Stock Exchange has also allowed Remote Trading as a means to increase market access, market efficiency, and simply the procedures related to trading and the frequency with which trades may be made.

## B. The Capital Market and Islamic Law (Sharia)

As a country with the biggest Moslem population in the world it is hardly surprising that Indonesia is not only open to financial and banking activities based on Islam nor is it surprising that financial services based on Islam are offered to the public. The first significant move towards the provision of financial services based on the principles of Islam saw the establishment of Bank Muamalat Indonesia in 1990. This was quickly followed by the establishment of a number of other banks offering similar services and visions of Islamic based financial services.

The rapid development of Sharia based financial services has seen Memorandums of Understanding (MOU) signed between Bapepam and the Sharia National Committee-Majelis Ulama Indonesia (Dewan Sharia Nasional-Majelis Ulama Indonesia- DSN MUI) on 14-15 March 2003 regarding the provision of Sharia based capital market services. Later, the Sharia National Committee also signed another MOU with Jakarta Stock Exchange for the provision of Sharia based share trading activities.

To implement the provisions of the MOU, the Jakarta Stock Exchange and PT. Danareksa Investment Management established the Jakarta Islamic Index (JII). The primary purpose of the Jakarta Islamic Index is to act as a benchmark in measuring market activities based on Sharia. Currently, there are approximately 30 corporate stocks listed on the JII.

There is a fundamental difference between the conventional capital market and the capital market based that is based on the principles of Sharia. The concept of short selling on the capital market is neither a principle nor an acceptable means of transacting on the Sharia based capital market. The Sharia based capital market, in general, focuses on long-term investments. Furthermore, stock ownership means that all profit and loss is accepted as a mutual risk of the investment and assumed jointly between all stock holders.

In addition to the stocks that are issued within the Sharia based capital market system there are Sharia bonds. Sharia bonds are based on a number of acceptable Sharia principles; namely, akad (agreement) and mudharabah (profit-sharing). The Nisbah or the percentage of profit sharing will be stated before the agreements are executed. Finally, the Sharia based capital market also offers Sharia based mutual fund investments. Despite having the largest Muslim population in the world many of the financial services based on Sharia principles remain in their infancy in terms of popularity compared to other non-Sharia based financial services. Nevertheless, it is important to recognize that this is a rapidly growing segment of the capital investment community as the community becomes more aware of and comfortable with the quality of the investment options offered.

## **E. BANKING LAW**

### **Introduction**

In Indonesia, the banking industry constitutes about 93% of the total assets of the entire financial industry of Indonesia and the remaining 7% is spread among players in the non-banking industry such as insurance and multi finance corporations. The large percentage of these funds held by the banking sector is intricately linked and can trace its origins to Minister of Finance Decision No. 1062/KMK.00/1988 on the Establishment of State Banks, Regional Development Banks, National Private Banks, and Cooperative Bank. This Decision led to a huge increase in the number of operating and established Banks. A brief overview of the data indicates that in October 1988 some 124 banks were established including 13 Non-Bank Corporations. This number further

increased during the period from 1988 to 1997 where the number of established banks increased from 124 to 240 banks.

In mid-1997, the effects of the Asian monetary crisis and eventual meltdown of a number of regional economies commenced with the rapid depreciation of the Indonesian Rupiah (IDR) and worsened as a result of the political turmoil that plagued 1998 and has continued in varying degrees through to 2005. The depreciation of the IDR quickly consumed the Indonesian banking sector and many of the banks established in during the period from the confirmation of the Ministerial decision were now in danger of collapsing or had already collapsed. As banks collapsed they were being bailed out by Bank Indonesia, initially as a means to protect customer's savings and deposits but as time went on Bank Indonesia quickly realized that the financial bailing out of insolvent institutions was too costly to continue to pursue on a large scale. The financial crisis was felt hardest by bigger banks who were holding considerably larger amounts of offshore borrowings and larger percentages of non-performing loans and bad debt. Smaller banks were not immune to the financial crisis occurring around them but carrying much less bad debt and non-performing loans as a percentage of the assets meant that they were better able to weather the circling financial storm.

### *Banking Law in Indonesia*

Indonesian Banking Law has a long history and Widjanarto classified these periods of history into nine distinct phases commencing with the end of Dutch colonization through to the period of 1988-1993. The Banking Law in Indonesia can trace its post-colonization roots to Government Regulation in Lieu of Law (Perpu or Interim Law) No. 2 of 1946 which created Bank Nasional Indonesia (BNI). In 1953, Law No. 11 on Bank Indonesia was enacted. Law No. 11 of 1953 was then amended by Law No. 13 of 1968 on the Central Bank. However, in 1999, the Government

enacted another new law, Law No. 23 of 1999 on Bank Indonesia since the previous law was considered to no longer represent the current status of the banking sector in Indonesia and rather than continue to amend the original law to ensure that it remain relevant and enforceable it was determined that the best means to modernize the banking law was to draft and enact a new law therefore a new law was drafted and enacted and the old banking law was repealed in its entirety.

Banking activities in Indonesia are governed by Law No. 14 of 1967 on Banking as amended by Law No. 7 of 1992. In 1998, a further series of amendments to the Banking Law were contained in Law No. 10 of 1998.

The general financial crisis afflicting Indonesia was keenly felt in the over-exposed banking sector as the IDR continued its rapid depreciation against the United States Dollar (USD). A large number of banks had immediate liquidity problems and quickly became insolvent and despite this insolvency many continued to go about business as normal waiting and hoping that the government through the Central Bank would bail them out. During this period of rapid decline in the public confidence of the Indonesian banking sector the government elected to provide liquidity funds to banks which it considered to be critical to the recovery of the sector in the future. Many of the smaller banks in liquidity trouble were either to be consolidated into larger merged banks or liquidated. The government restructuring program for the banking sector commenced in 1998 and included the following:

1. the injection of government capital into viable banks through the issuance of recapitalization bonds;
2. the introduction of a blanket guarantee;
3. the establishment of the Indonesian Bank Restructuring Agency (IBRA);
4. corporate restructuring;



5. improvement of corporate governance; and
6. bringing supervisory and regulatory practices closer to international standards.

The roots of the problem in that precipitated the Indonesian economic crisis related to non-performing loans and considerable levels of offshore foreign debt held by both the private and public sectors. To understand how it was possible to carry so much offshore foreign debt and non-performing loans requires only a brief examination of corporate governance principles and practices in Indonesia prior to the crisis with respect to credit and risk analysis it was invariably lacking in most cases and non-existent in the others. In February 1993, Booz Allen & Hamilton forecast that problem loans (both under and non-performing) held by Indonesian banks would constitute somewhere in excess of 20% of all outstanding loans based on its analysis of figures from 1990 through to 1992 which indicated a significant increase in the percentage of poor and non-performing loans – 6% in 1990, 11% in 1991, and 17% in 1992.

In an attempt to deal with the continuing financial and banking crisis the government devised and commenced implementation of a comprehensive restructuring plan in 1999. The establishment of the Indonesian Bank Restructuring Agency (IBRA) at the end of January 1998 was intended to ensure adequate policy direction and supervision of the restructuring process. IBRA was created and established through the enactment of Perpu No. 17 of 1999 on the Indonesian Bank Restructuring Agency. The primary duties and functions of IBRA pursuant to the Perpu are:

- (i) verify customer claims under the blanket guarantee scheme;
- (ii) dispose of assets from banks that have been taken over;
- (iii) restructure and sell loans transferred from banks; and
- (iv) divest government ownership in recapitalized banks.

Aside from the establishment of IBRA to strengthen the supervision of banks, Bank Indonesia (BI) was trying to manage and integrate its supervisory functions with that of IBRA. Statements at the time indicated that BI was fully aware that the banking crisis stemmed from weaknesses in its own performance of the supervision of banks. To overcome these deficiencies BI has been concentrating and refocusing its initiatives on the following aspects:

- harmonizing the organization of bank supervision procedures, particularly regarding structure and responsibility;
- improving bank supervision management including, but not limited to, more efficient and transparent supervision, more competent supervisors, accountability and recognition, as well as reward and enforcement;
- introducing risk-based supervision;
- rectifying prudential regulations with emphasis on risk control.

Other efforts have also been undertaken to improve the stability of the Indonesian banking system, such as the introduction of new banking and central banking laws, particularly the new Banking Law of 1998, which:

- transferred the authorization for bank licensing from the Minister of Finance to BI;
- relaxed the limit on foreign ownership of Indonesia-incorporated banks, raising it to 99%;
- encourages the development of Sharia banking;
- narrowed bank secrecy provisions to cover only the information on deposits (name and amount) instead of total assets and liabilities;

- provides for more comprehensive and stricter criminal sanctions, and determines their minimum levels;
- provides for the establishment of a deposit protection scheme by 2004 at the latest;
- provides for the establishment of a temporary special agency to assist with the banking restructuring program.

The Indonesian government introduced the Act on Foreign Exchange Traffic and the Exchange Rate System in 1999 which provides a legal basis for monitoring the flow foreign currency exchange and improves the ability to enforce prudential provisions. The law requires banks to submit to BI a report containing the movement of financial assets and liabilities between residents and non-residents. Complete, accurate and timely reports that include all pertinent information regarding foreign exchange flows as a means of supporting a prompt monetary policy response. This is primarily to ensure that the stability of the Rupiah is maintained.

Information Technology (IT) is a critical reform and development issue for Indonesian banks and the banking sector generally. Overall, the utilization of IT and technology generally throughout the Indonesian banking sector was best described as poor however a recent drive towards simplifying and facilitating personal and corporate banking has seen a rapid increase in the use of IT. This development has been so rapid that the primary response from BI to ensure that the regulatory framework is in place to deal with the new issues that will arise is to issue Circulars enumerating policy and regulatory standards. It is expected that most of these Circulars will eventually be enacted into law to provide greater legal certainty. One of these IT developments that has had an immediate and significant impact on the Indonesian banking industry is 'Internet banking'. To address this rapidly developing area of banking services BI issued Circular No.6/ 18 /DPNP, dated 20 April 2004 on the Implementation of Risk Management in Internet Banking Activities. The Circular from Bank Indonesia is in

essence a set of guidelines that banks should follow and implement as part of their respective IT policy.

### **Sharia Banking In Indonesia**

Today, the Indonesian banking system also recognizes Sharia banking. Although Sharia banking has been a part of Indonesian banking services for some years the development of a Sharia banking system has only recently come to the fore as a significant alternative to traditional banking methods and practices. The driving force behind Sharia banking and financial services development is clearly demand from the public for appropriate banking and financial services that comply with the strict Sharia banking and financial principles. In response to these demands the current law through amendments to Law No. 7 of 1992 on Banking as amended by Law No. 10 of 1998, and finally Law No. 23 of 1999 on Bank Indonesia is a legislative attempt to regulate Sharia banking and banking practices.

Since the enactment of the legislation defining and regulating Sharia banking there has been considerable rapid and sustained growth of 74% annually. Bank Indonesia's primary function, as the banking regulatory authority, is to ensure the development of a sound Sharia banking system and set of governing principles.

The banking and financial crises of 1997 and 1998 highlighted that the sound fundamentals of the Sharia banking system allowed it to weather the financial and banking crisis much better than the traditional banking alternatives. The main reason behind this better performance relates to the rates of return that are paid to depositors as they are not based on strict market rates allowing Sharia banks to channel relatively lower fund management costs back to their clients.

According to the Blueprint for Islamic Banking Development in Indonesia issued by Bank Indonesia, Sharia banking development should be conducted in accordance with the actual needs and expectations of the stakeholders of the Sharia banking sector in Indonesia that includes:

- Sharia commercial banks, Sharia banks, and Sharia rural banks
- Bank Indonesia as the banking regulatory and supervisory authority
- National Sharia council (DSN)
- Muamalat Arbitration Board (BAMUI)
- Other Sharia financial institutions: Takaful (Sharia insurance), Baitul mal wat Tamwil, BAZIS, and Sharia securities companies
- Other regulatory bodies: Department of Finance and the Capital Market Supervisory Agency (BAPEPAM)
- Universities/educational institutions concerned with developing training programs on Sharia finance and economics
- Organizations and companies related to Sharia economic and finance such as: the Sharia Economic Society (MES), Association of National Sharia Banks, the Jakarta Stock Exchange, and vendors, among others.
- The general public

Further, the strategic objectives of the Sharia banking development include:

- Maintaining a high level of competitiveness while complying with Sharia principles
- Playing a significant role in sustaining the national economy and public prosperity

- Global competitiveness through compliance to international operational standards

However, the success of Sharia banking development fully depends upon the stakeholders. Therefore, a uniform vision and proper coordination are the keys to success and the factors most likely to support sustainable Sharia banking development in the future.

## **F. SECURED TRANSACTIONS LAW**

### **Introduction**

In Indonesia Hak Tanggungan (Indonesian Security Right upon Land or mortgage) and Fiduciary Security are now two widely used forms of security, especially since both are already regulated under Indonesian law with the implementation of Law No. 4 of 1996 on Hak Tanggungan and Law No. 42 of 1999 on Fiduciary Security (Undang-Undang Hak Tanggungan/ “UUHT”). While Hak Tanggungan is only over immovable property, land and land related object, the fiduciary security is designed to cover moveable property either tangible or intangible and also immoveable property that can not be encumbered with the Hak Tanggungan.

### ***Hak Tanggungan***

#### **1. Definition and Object of Hak Tanggungan**

One method of securing obligations is by a mortgage. Unlike other mortgages, which also include a pledge where a creditor can occupy the property encumbered with the relevant mortgage, the Law of Hak Tanggungan only provides the creditor

with an *in jure* right which means that there is no immediate occupancy right attached to the mortgage.

On 9 May 1996 the Indonesian Government enacted Law No. 4 of 1996 on Hak Tanggungan. This new law repealed the previous hypothec provisions contained in the Indonesian Civil Code in so far as it related to land and other assets related to the mortgaged land.

In Indonesia, the Hak Tanggungan on land and land related fixtures is the only security right under which a land title is placed as defined in the Basic Agrarian Law (“BAL”) with or without other fixtures forming a totality with the land for security of a particular loan, which gives priority to a particular creditor over other creditors. The Hak Tanggungan shall give the right to the creditor to sell the land through a public auction without the requirement of a court order permitting it to do so, as the certificate of Hak Tanggungan serves as a court order.

The land title which can be placed by Hak Tanggungan are (1) Hak Milik (right of ownership); (2) Hak Guna Usaha (right to till or right to exploit); (3) Hak Guna Bangunan (right to build); (4) Hak Pakai (right of use) and (5) Hak Milik atas Satuan Rumah Susun (Strata Title). Hak Tanggungan can also be attached to the land including the buildings and fixtures on that land.

## 2. Procedures for Placing and Registering a Hak Tanggungan

The formal procedures for placing and registering a Hak Tanggungan can be described as follows:

1. The creditor and debtor sign a credit agreement simultaneously. The debtor or the title holder of the land then signs either a power of attorney to encumber the Hak Tanggungan (Surat Kuasa Membebankan Hak Tanggungan or “SKMHT”) or a Deed granting the Hak Tanggungan (*Akta Pemberian Hak Tanggungan* or “APHT”) before the relevant Land Deed

Official (*Pejabat Pembuat Akta Tanah* or “PPAT”). The APHT must clearly identify the plot or plots of land being used as security and the total amount of the loan being secured. Any buildings, plant or others fixtures attached to the land sought to be covered in the Hak Tanggungan must also be specifically described in the APHT.

2. Within 7 (seven) working days as of the date of the APHT, the PPAT must submit the APHT and Land certificate to the Local Land Officer to register the Hak Tanggungan.
3. On the 7<sup>th</sup> calendar day following the receipt of the APHT and land certificate by the Local Land Officer, they must issue the Hak Tanggungan land book and note the date of registration. By law, at this stage, the Hak Tanggungan will be effective and will provide the creditor with the status of a preferred creditor. Thereafter, a copy of the Hak Tanggungan book and copy of the APHT shall cause the issue of the certificate of Hak Tanggungan. At the same time, the Land Office shall record the Hak Tanggungan in the original land book at the Local Land Office and the original land certificate.

Certificate of Hak Tanggungan consists of a copy of the Hak Tanggungan land book and a copy of the Hak Tanggungan Deed.

### 3. The Right of Priority

A holder of Hak Tanggungan has a priority right over other creditors upon encumbered land and has a priority right to have any outstanding loan and debt payments settled from any funds generated from the liquidation of the property subject to the Hak Tanggungan. Nonetheless, it is possible that there is multiple Hak Tanggungan against the one plot of land with each being held by a different creditor. Therefore, the priority right rank of the Hak Tanggungan is based on the date of registration of the Hak Tanggungan. Simply, the first registered Hak Tanggungan shall



have first right of settlement and each following Hak Tanggungan holder will receive payment so long as funds from the sale of the subject of the fiduciary security remain.

#### 4. The Transfer of the Hak Tanggungan

In the case that loans are transferred or assigned to other parties, the Hak Tanggungan secured for the loans are transferred also to the other parties and should be registered based on the transfer or assignment agreement. However, a new APHT is not required for this process.

#### 5. The Cancellation of Hak Tanggungan

The cancellation of the Hak Tanggungan occurs at the point in time any of the following occur: (1) cancellation of the debt secured by the Hak Tanggungan; (2) release of the Hak Tanggungan by the Hak Tanggungan Holder; (3) a clearing of the Hak Tanggungan based on a ranking stipulation by the Chief Justice of the District Court (“Roya”), and (4) a cancellation of the right to the land which is subject to the Hak Tanggungan.

#### 6. The Enforcement of Hak Tanggungan

Under the Hak Tanggungan Law, creditors have the right to immediate execution (*parate executie*) upon the debtor’s property. On the debtor’s default, the creditor may execute the secured property without having to comply with the civil procedural law and procedures of seizure. Therefore, a Hak Tanggungan holder enjoys the right of direct execution, which is a relatively simple and cost-efficient means of ensuring payment of outstanding debts. Nevertheless, unless the debtor agrees to the auction, the Auction Office, which conducts and supervises the public auction, requires a

court order for the auction, which in veritably is a costly and lengthy process.

7. The Position of the Holder of the Hak Tanggungan (mortgage) in cases of Bankruptcy

The position of the Hak Tanggungan's holder in the order of distribution of the debtor's assets remains unchanged by a declaration by the debtor of bankruptcy. However, to enforce the Hak Tanggungan (for closure), the Hak Tanggungan holder has to wait 90 (ninety) days as of the declaration of bankruptcy by the court. (Article 56A of the Bankruptcy Law)

If the Hak Tanggungan holder does not enforce its right within the specified time, the curator or receiver at any subsequent auction of bankruptcy assets will carry execute any collateral facility comprising the Hak Tanggungan holder's right to share in the proceeds of any sale. If the proceeds are insufficient to satisfy the Hak Tanggungan holder's claim, then the Hak Tanggungan holder becomes a general creditor with respect to the settlement of any remaining and outstanding debts.

**Fiduciary Security**

1. Definition of Fiduciary, Fiduciary Security, Grantor, and Grantee of the Fiduciary Security

Fiduciary security is a relatively new type of security in Indonesia. Law No. 42 of 1999 on Fiduciary Security was enacted on 30 September 1999.

Fiduciary is a transfer of the right of ownership of a property based on trust with the provision that the property transferred in still held by the owner of the subject property. Fiduciary security is a form of security right over moveable property either tangible or

intangible also over immoveable property that cannot be attached to a Hak Tanggungan (mortgage), in which the fiduciary grantor retains the property transferred that is being used as a Security to pay the loan and it provides the fiduciary grantee with a priority right over other creditors.

The fiduciary grantor is an individual or a corporation that owns the property that is to subject to the fiduciary Security. The fiduciary grantee is an individual or a corporation that is owed a debt whose payment of which is guaranteed by a fiduciary security.

## 2. The Scope of the Law on Fiduciary Security

Matters that are not within the scope of the law of fiduciary guarantee include Hak Tanggungan (mortgages) related to land and buildings so long as the regulations require registration; hypothec on registered ships whose bruto volume is 20m<sup>3</sup> or more; hypothec on aircraft; and, pledges.

## 3. The Encumbrance of a Fiduciary Security

A fiduciary guarantee is an *accessoir* agreement of an initial agreement that gives rise to one or more obligations on the relevant parties to the agreement. Granting a fiduciary security for securing those obligations must be made with a Notarial Deed in Indonesian and specifically state that it is a Fiduciary Security Deed. The Deed must, at least, note the identities of both the grantor and the grantee of the fiduciary security; all relevant data on the initial agreement that is to be secured with the fiduciary security; a description on the property which is subject to the fiduciary security; the nominal value of the security; and, the nominal value of the property subject to the fiduciary security.

Furthermore, the Deed must also specify whether the debts that are secured by the fiduciary security are existing debts, future

debts that have already been agreed in specific amounts, or a debt that can be measured at the nominal value at the time of the execution in accordance with the initial agreement that gave rise to the original obligation.

A fiduciary security can be given against more than one object, a debt that already exists, or that will accrue in the future. The provision of a fiduciary security for some future debt does not have to be contained in a separate security agreement.

#### 4. The Registration of the Fiduciary Security

The property that is the subject of the fiduciary security must be registered at the Fiduciary Registry Office. The fiduciary grantee themselves, or their attorney, or someone appointed on their behalf can complete the application for registration.

The Registry Office will then note the fiduciary guarantee in the Fiduciary Register Book, then issue and give the certificate of Fiduciary Security to the fiduciary grantee and date the certificate on the day it received the application.

The objective of the registration itself is to give legal certainty to both the fiduciary grantor and grantee as well as to any third party interest in the fiduciary security.

#### 5. The Transfer of the Fiduciary Security

The transfer of loans secured with a fiduciary security results in the transfer of all of rights and duties of the fiduciary guarantee to the new creditor by law. The new creditor must register the transfer at the Fiduciary Registry Office. The fiduciary security remains in force against the property noted in the fiduciary security irrespective of who may have physical possession of the object, except if the transfer was completed and effected in a manner which is not common within the business community. However, in order

to secure the fiduciary security interest, the transfer of a fiduciary guarantee where the object is a stock of goods, then those stocks must be exchanged for some other equivalent good or stock of equivalent value.

#### 6. The Cancellation of the Fiduciary Security

A fiduciary security is no longer valid under the following circumstances: the closure of the debt secured by the fiduciary security; the withdrawal of the right of fiduciary security by the fiduciary grantor; and the abolishment of the property that was the object of the fiduciary security.

In the event that the property that was the object of the fiduciary security is destroyed but is fully insured, then any subsequent insurance claim may replace the property of the original fiduciary security.

The fiduciary grantor must inform the Fiduciary Registry Office on the cancellation of any fiduciary guarantee and then the Office will issue a statement that the stated fiduciary security deed is no longer valid.

#### 7. The Right of Priority

A fiduciary grantee has a priority right over other creditors and has the priority to receive payments of debt from the any income gained in the execution of the fiduciary security. Moreover, those rights cannot be eliminated in the case of bankruptcy or liquidation of the fiduciary grantor since the fiduciary security is a right of security to payment of debt. Nevertheless, in the law of bankruptcy, there is also a provision that the property that becomes the object of fiduciary security is be dealt with separately to those of the other bankruptcy or liquidation assets.

### 8. The Execution of the Fiduciary Security

If the debtor or the fiduciary grantor fails to pay the debt, the property that becomes the object of the fiduciary security can be executed. The execution can be done in 3 ways:

- a. Executing title by the fiduciary grantor without the help of the court. However, in practice it is difficult to execute and enforce the security without the assistance of the court.
- b. Selling the property that is the object of the fiduciary security through public auction then utilize the resulting income to pay the debt.
- c. Selling the property that is the object of the fiduciary security by non-notarial deed. This can be done based on the agreement by both grantor and grantee of the fiduciary security provided that the agreement ensure the maximum price of the asset is reached in order to maximize the benefits derived by both parties. The conditions that must be satisfied are:
  1. The sale must be completed one year after the public notification by the fiduciary grantor and/or grantee to interested parties.
  2. Announced in two newspapers;

In case the result from execution is over the nominal security granted under the fiduciary agreement, then the fiduciary grantee must return the difference to the fiduciary grantor and if the result is not enough to pay the debt. However, where the income from the sale is insufficient to cover the outstanding debt then the liability is not expunged until such time as the remaining debt is finalized to the mutual satisfaction of the parties.

### 9. Criminal Provisions

Even though fiduciary is deemed to be a private matter, the government has enacted legislation to strengthen fiduciary

institutions, as well as to regulate individual and social morality and to prevent parties from acting without the requisite goodwill critical to successful fiduciary transactions irrespective of whether they parties are individuals or corporations. The Fiduciary Security law provides for the imposition of criminal penalties including terms of imprisonment of between 1 and 5 years and fines ranging between IDR 10 and IDR 100 million.

## **G. LABOR LAW**

A major change towards global production, concentration of capital under transnational corporations, and improved mobility of consumer goods, services, and capital brings about the arrival of a new international division of labor. The structure of the global economy has been transformed, linked to a loss of control over national economies by governments in favor of transnational financial conglomerates and international financial institutions. Given the fact that there is a relatively abundant and less skilled labor force, it is not surprising that most of the developing countries increasingly compete in providing the sites and workforces for industries which manufacture goods for the world market. *Deyo* stated that in most of the developing countries, a general observation is that occupations are characterized by low skill, low wages, job insecurity, lack of career mobility, extreme political subordination, and government policy which focused on industrial stability (repression) as an advantage to increase foreign direct investment. These occupations also tend to be associated with high levels of job turn-over, low work commitment, tenuous social bonds, the subordination of politics in labor conflict/militancy, and weak bargaining power position. Accumulated with the creation of such a global market, there are conflicting interests of national governments whether to attract foreign direct investments by

addressing more pro-business policies, or to maintain protective regulations for labor whose bargaining power appears potentially weakened by the emergence of a surplus labor force on a world scale.

Indonesia has a quite unique labor market scheme which includes both formal-modern and informal-traditional sectors. Practically, the same as many developing countries, such a dualistic scheme is characterized by a small modern sector with a larger traditional sector and the persistent movement of the massive surplus labor force from the traditional to the modern sector. However, the slow increase of the modern sector tends to stick workers at relatively constant wages as compared to wage-inflation. The government is challenged to balance its policies so that the development of the modern sector does not impede employment creation in the sector. The focus of government regulations until now has been on protections that support modern sector issues, and as such contributes a relatively small percentage to the total national employment level.

Accompanying the downfall of President Soeharto's administration, the new government's decentralization policy has allowed an atmosphere of democratization to develop that has influenced the regulation of workers' rights and standards. This leads to heated discussions on industrial relations, labor protection, as well as labor dispute issues.

The Indonesian industrial relations system has developed slowly but surely. Recently, the Government ratified 8 ILO core conventions whilst removing strict guidelines for union representation and collective bargaining. Consequently, there has been an explosion in the numbers of trade unions being declared and they have tended to range across the political spectrum, from conservative pro-employer trade unions, to moderates only concerned with collective bargaining and workplace reforms, to radicals and revolutionaries who want both political and social change (La Botz, 2001). Aside from the new trade union law that



endorses the implementation of a multiple union system at the plant level, the government also advocates the interest of employers' to maintain industrial stability by granting the exclusive or preferential bargaining right merely to the majority union. It is worth noting that this limitation is common practice in most developing countries.

Regarding strikes and lock-outs, the latest regulation explicitly states that those are basic rights to promote and to protect both employer's and worker's interests. A strike is legitimate and therefore should be permitted after prior notice to the local labor office and employer has been furnished. Another requirement to be fulfilled is that the strike should be conducted peacefully. The common reason for workers to go on strikes is a stalled, locked, or frustrated bargaining process. The new law also mandates that striking workers are to be paid continuously during any such action, unless one party brings the case to mediation or arbitration. In contrast to some other developing nations labor laws, Indonesia expressly prohibits the replacement of striking labor with any type of contract labor.

Bipartite institutions have played an important role as a consultative and social dialog mechanism concerning welfare and working conditions. It differs from collective bargaining since it focuses more on information sharing, discussion, and exploration of options. Another breakthrough in the industrial setting is the introduction of co-determination institutions. The work council is not only seen as a forum dealing with workplace issues, but is also seen as a body whose members should work in a cooperative manner.

The second issue covers policies with regard to minimum wages, overtime, severance payments, paid leave, paid annual holidays (such as Christmas or Idul Fitri bonuses), as well as social security. As a direct consequence of the on-going decentralization process, the central government has given greater authority to provincial governments to determine minimum wages as a general entry level standard. The minimum wage composition consists of

base-salary (75%) and regular-financial assistance (25%). Most decentralized minimum wage policy has a tendency to reflect the actual Price Consumer Index in a certain province or area. It also promotes social dialog between employers and employees, through mutual negotiation on the subject of non-entry level wages. The government has its own interest on minimum wages setting because it is a means to lessen poverty. In that sense, minimum wages also serve as a social safety net. Generally, governments in developing countries perceive minimum wage setting as a device to achieve low inflation and a low level of unemployment. On the other hand, annual increases of the minimum wage are troublesome as one of the consequences is that it supports a demand for higher wages by non-entry level workers. Considering that Indonesia has not fully recovered from the economic crises of 1998 any tacit support for higher wages is likely to face stiff employer resistance.

A basic guideline to calculate overtime rates has also been provided by the government. However, provincial governments may modify these rates based on a tripartite consultation.

Under the new Ministerial Decree on severance pay and the dispute resolution law, lay offs or dismissals are dependent on quite rigid standards and demand greater compliance from employers. The calculation of severance-pay totals will be based on an individual worker's length of service and the reason for his/her dismissal. Practically, such process also takes into account the economic condition of the company with respect to the final determination of severance pay due. Nevertheless, the government provides particular mechanisms to delay compliance with the above mentioned standards.

The colonial principle of no work/no pay has been revisited a number of times through particularly the current exceptions to this principle such as maternity leave, two-days leave during menstruation, death of an immediate family member, among a number of others. Bonuses, annual holiday pay, and the 12-days of annual leave which may be converted into cash have also come

under scrutiny. The need to improve social security and the protections that it affords has resulted in the establishment of a national social security system which will be implemented on a gradual basis. There are three programs, each conducted separately and each with a different target: civil servants, armed forces/police officers, and private sector workers. Yet, all programs are designed to protect workers from loss or reduced income caused by economic and social risks such as old age, industrial accidents, sickness, invalidity, unemployment, and other loss of livelihood for reasons beyond his/her control.

Labor protection is also promoted through occupational health and safety regulations, prohibition against discrimination at work – especially those regarding sex and race, as well as the abolition of forced and child labor practices. The new labor act has steadily improved child labor standards through increased minimum age requirements, compulsory basic education programs, limited line of work and working hours. Furthermore, it also includes quite comprehensive regulations concerning female workers. While not an essential issue, a restriction on night work for women will potentially lead to further debates on gender equality in the workplace. Workers also have a right to rest and leisure, as well as reasonable limitation of working hours as opposed to exploitation practices. A period of rest offers workers the chance to regain his/her lost strength, while leisure is aimed to allow workers to celebrate public holidays.

Indonesia has been recognized as the leading exporter of migrant labor. The major problem is the fact that most Indonesians working overseas enter those labor markets through informal procedures which means that they are afforded lower levels of protection and are often illegal migrants in the country of destination. The government has increasingly engaged in bilateral agreements to protect its migrant workers but much remains to be done. Improved regulatory standards and supervision systems have also been developed and implemented in order to diminish the role

of labor brokers at all levels and steps of a migrant workers' departure or repatriation to Indonesia.

With the enactment of the new Labor Law, industrial disputes are classified into four categories: opposing interests, legitimate rights, dismissals, and disputes among unions. Those disputes could be resolved through a mandatory process conducted by the government dispute councils (which are to be replaced by an Industrial Relations Dispute Settlement Court in early 2006) or voluntary arbitration. Individual dismissals are submitted to the provincial dispute councils while mass dismissals and appeals are referred to the central government dispute council. Final and binding principles of arbitration are implemented to encourage both parties to make a realistic offer in order to gain consensus, essentially a win-win solution. The new law stipulates that decisions to terminate workers must be based upon some legitimate reason. The introduction of industrial dispute courts as an alternative to the existing dispute council has also been initiated. These courts are to be formed in every district across the country. Given the poor standing of both the civil court system and the government dispute council mechanisms, industrial players are quite skeptical that this new alternative can reduce the bulk of currently pending cases.

In conclusion, sustained development of Indonesian labor law has increasingly focused on workers' basic rights while at the same time accommodating employers' interests. However, intense government involvement and control through protective labor policies have been preserved ensuring that the labor market is not nearly as liberal and open as it may become. Law is still predominant over bargains and discretionary power of employers. A new approach that provides greater voluntary accomplishment and mutual consent in regulating worker rights and standards should be endorsed without altering their characteristics.

## **H. COMPETITION LAW**

### **The History of Law No. 5 of 1999**

The term competition, and in particular monopoly, has become a common word used in Indonesia, particularly in the period known as 'reformasi' or reformation that has been a continual presence in policy discussions of the government. The need for a competition law arose as a result of the rapid spread of monopolistic business practices that were permeating all levels of business like an epidemic primarily because there was no law to stop these unfair business practices. At that time, there was only one provision in the Constitution that acknowledged competition, Section 33. Section 33 states that everything and anything that concerns the lives of Indonesian citizens, is under government protection. The Constitution did not really help to alleviate or clarify this boom in monopolistic practices. Not only was the definition of competition vague, but people also took the opportunity to exploit the vagueness of the definition to find alternative interpretations. There appeared to be an explicit link between the vagueness of the definition and the increase in monopolistic behavior in business dealings. In fact, this condition considerably worsened when combined with the ever-increasing levels of corruption and abuse of power by government officials. A direct consequence of these monopolistic and unfair business practices was that many small and medium enterprises had to close, while state-owned companies cashed in on the monopolistic practices to generate profits. One of the other most identifiable aspects of this type of monopolistic behavior and unfair business practice was a widening and stark gap that had become visible between the rich and the poor, as well as rapidly rising unemployment levels which further exacerbated the gap between the haves and the have-nots.

Consequently many Indonesians suffered, particularly the middle and low classes who were required to bear the brunt of these practices. It seemed that the government was unaware of the benefits that competition would provide to its citizens as customers of businesses. Increasing unemployment meant a significant decrease in disposable income that had traditionally supported the growth of Indonesian businesses. Simply, the greater the competition the greater the benefits enjoyed by consumers, particularly with respect to fair prices for goods and services. However, it must be noted that the government cannot take part in the competition, but this does not diminish the government's responsibility or obligation to protect its citizens from monopolistic and unfair business practices. Should these conditions be allowed to persist then the most likely outcome is a significant decrease in both domestic and foreign investment capital that has traditionally supported the rapid economic growth that Indonesia and Indonesian citizens had enjoyed through the 1970s to 1997. Investors have become afraid to risk their money in a market that does not guarantee a fair and free market or any degree of legal certainty to protect their investments or themselves personally. The guarantee is simply given when an investor is able to acknowledge that the legal and regulatory framework affords them the personal as well as professional legal protections afforded to all citizens. This guarantee includes a tacit understanding that the Government will refrain from interference in the market, particularly from manipulation of market and policy mechanisms for personal gain. To ensure that these guarantees were enforceable the realization that there was a need for significant legislative reform became apparent, particularly with respect to competition, monopolistic practices, and unfair business competition.

The intent to create laws that would regulate competition in Indonesia began to take shape around 1990. It was during this time that legal scholars, members of various political parties, non-governmental organizations, and certain government institutions

began to get together and discuss the possibility of enacting a new law. In fact, a number of different groups, including the Indonesian Democratic Party and the Indonesian Department of Trade (cooperating with the Faculty of Law of the University of Indonesia), produced a bill encompassing competition laws. The original draft of the bill was not seen as a serious attempt to address monopolistic practices or likely to be enacted. Consequently, corrupt government officials continued to perpetuate the monopolistic and unfair business practices of the past and as a result the economy continued to suffer and plummet towards crisis.

Therefore, the new government initiated a new regulation that regulated the framework for competition and unfair business practices. The DPR passed Law No. 5 of 1999 on the Prohibition of Monopolistic Practices and Unfair Business Competition (“Law No. 5/1999” or the “Anti-Monopoly Law”) on 5 March 1999. The primary objectives of this law were to improve the efficiency of the national economy in order to reach the desired levels of national prosperity, to create an environment conducive for business, to stop monopolistic and unfair trade practices, and to create both efficacy and efficiency in business.

At the same time, Law No. 5/1999 was a means to ensure that the conditions that Indonesia had agreed to in the Letter of Intent entered by the Indonesian government and the International Monetary Fund in July 1998 were fulfilled. This law was passed by the DPR on 18 February 1999, and was signed into law by the President on 5 March 1999. The provisions of the law required that 1 year was to pass before the law became effective and therefore the Anti-Monopoly Law came into force on 5 March 2000. The purpose of this delay was to provide a opportunity to socialize the law within the business community as a means of ensuring maximum compliance to the new provisions. Moreover, businesses were given an additional six-month grace period through 5 September 2000, to comply with the law. This grace period was included to ensure that businesses, the public, and others were aware if the significant

changes that were to be implemented with respect to doing business in Indonesia.

### **Law No. 5/1999**

The Law includes 11 Chapters and 53 Articles, with the major substantive law sections covering issues of prohibited agreements, prohibited activities, abuse of dominant position, exceptions, the creation of the Commission for the Supervision of Business Competition (the “KPPU”) and applicable sanctions.

Prohibited agreements cover issues of oligopoly, price fixing, price discrimination, predatory pricing (by agreement with competitors), resale price maintenance, market division, group boycotts, cartels, trusts, vertical integration, exclusive dealings concerning re-supply, tying, reciprocal dealing, and agreements with foreign parties that may result in monopolistic practices or unfair business competition.

The prohibited activities set forth in the law cover matters such as monopoly (Article 17), monopsony, market control, predatory pricing (unilaterally), determining production and other costs, conspiracies to rig bids, obtaining competitors' business secrets, and impeding the production and marketing of a competitors' products. The Law also prohibits what is known as the abuse of dominant position which is categorized into interlocking directorates, cross-share holdings, mergers & acquisitions that may result in monopolistic or unfair business practices. This section of the law also stipulates the obligations of businesses to provide notice to the KPPU when a business activity such as a merger is to be executed.

Article 50 provides exemptions for certain activities such as agreements intended to implement applicable laws and regulations, intellectual property, standard setting, joint ventures for research and development, international agreements ratified by the



government, export agreements, activities of small-scale enterprises, and activities of cooperatives aimed at serving their members. There is also exceptions for state action, defined as activities carried out by a state-owned enterprise or institution formed or appointed by the government allowing for the creation of a monopoly.

Another important element of the Law is the establishment of the Commission for the Supervision of Business Competition or the KPPU. The KPPU is the body responsible for the enforcement of the Anti-Monopoly Law. This authority and power is derived from Articles 30-37. The Anti-Monopoly Law also sets out the procedures and methods applicable to the KPPU including the power and authority to issue sanctions for any proven breach of the Law. Consequently, any alleged or reported breach of the Anti-Monopoly Law is to be heard by the KPPU and the results of the investigative process are to be announced publicly to reinforce public confidence in the accountability and transparency of the KPPU.

### **The Commission for the Supervision of Business Competition**

The KPPU commenced operations in June 2000 after the appointment of Commissioners pursuant to the conditions contained within Articles 30-37 of the Anti-Monopoly Law and Presidential Decree No. 75 of 1999. The KPPU constitutes Indonesia's first truly independent regulatory commission, as it is not a branch of government and the government is strictly prohibited from intruding on the independence of the KPPU. The KPPU has three major functions; namely, law enforcement, policy advice, and public compliance through education of the community. The first aspect, law enforcement, deals with the methods used by the KPPU to investigate, interpret and enforce the Law. Second, the KPPU is required to assist the government in the development of competition policy through submissions on the interpretation of the law so as to

ensure that government policy is indicative of a prohibition on monopolistic practices and supportive of fair and healthy business practices. Finally, the KPPU has an obligation to assist businesses and the public in understanding the provisions of the law so that full public and government compliance is achieved.

The KPPU is responsible to the nation, the president, the DPR, the judiciary, and the public. The KPPU must report to the DPR all matters relating to the appointment and dismissal of members as well as all budget related requirements. The KPPU although not directly related to the judiciary it is important to note that decisions of the KPPU may be appealed to the General Court system as a means of appellate review. To ensure accountability and transparency in the decision making processes of the KPPU, the KPPU is required to announce all decisions publicly.

The KPPU comprises of Commissioners and a Secretariat. The Secretariat comprises of four Directorates and includes professional staff. There are 11 Commissioners appointed to the KPPU, each of whom have met the requisite experience and expertise conditions. An important element of the selection procedure for Commissioners is to ensure that a candidate does not have any affiliations with any business entity. Commissioners serve a 5-year term and can be reappointed for another five year term. Commissioners have equal authority and KPPU decisions are majority decisions. The Chairperson and Vice-Chairperson are elected by and from among the Commissioners and serve for a 1-year term.

There are four Directorates in the Secretariat; namely, the Directorate for Investigation and Law Enforcement – responsible for investigating any violations of the Anti-Monopoly Law and litigating cases before the courts; the Directorate for Communication – responsible for disseminating information to businesses, the public, and the press; the Directorate for Research and Training – responsible for training professional staff and providing research in support of cases under investigation and the

competition advocacy program; and the Directorate for General Affairs – responsible for administration, finance, and personnel.

The procedure to commence an action at the KPPU requires the submission of a written report stating the alleged breach of the Anti-Monopoly Law. However, the KPPU may initiate an investigation without a report being lodged if it becomes aware of a breach of the Law that has not yet been reported. Anyone who is aware of a violation or is the injured party can make a report by revealing his or her identity. Although it is not expressly stated in the Law there is an element of whistleblower protection incorporated in the provisions that allow the KPPU to suppress the identity of any witnesses that it may call in the course of an investigation. Once a report has been received and accepted by the KPPU, then the KPPU must have commenced a preliminary investigation and made a determination as to whether there are sufficient grounds to proceed with an additional more detailed investigation of the alleged breach within 30 days. In the event that the KPPU considers additional investigation is warranted then the KPPU should commence this detailed investigation of the alleged breach. Any and all information that comes into the possession of the KPPU during the course of its investigation must be handled with appropriate care to ensure that all trade secrets are protected. Where the KPPU deems it necessary it may hear testimony from witnesses, experts, or any person considered to be able to assist in resolving the alleged breach of the Law.

All investigations undertaken by the KPPU must be formal and as such comply with the strict stipulations contained in the Law. The KPPU maintains the power and authority to call any party to provide evidence to determine the validity of any report and witnesses and experts called are required to assist to the fullest extent possible within the boundaries of the prevailing laws and regulations. Any attempt by witnesses or experts to delay or obstruct the process may be subject to sanction therefore

compliance is encouraged to ensure that these sanctions are not imposed on the relevant parties.

The permissible evidentiary tools available to the KPPU in the investigation process include: witness testimony, expert testimony, written documents or letters, and explanations from relevant parties. Any additional investigation that follows a preliminary investigation must be completed within 60 days. An extension of 30 days to this initial period is possible and will be based on reasonable necessity grounds. Essentially, these grounds will be the need for additional time to successfully complete the investigation. Once the investigation is completed the KPPU must issue a decision that states whether a breach of the Anti-monopoly Law has occurred or not. On reaching a decision on the matter the KPPU is required to read this decision in an open session, in effect a public announcement, to ensure transparency and accountability of the KPPU.

In the event that there is no objection to the decision of the KPPU, then the decision is held to be legally binding and an order of execution will be issued by the District Court to effect judgment. In the event that one of the parties wishes to appeal the decision of the KPPU, then that party must lodge an appeal to the District Court with 14 days of the decision being issued. If there is no appeal lodged within the permissible time period then the decision is deemed to be accepted by all the relevant parties. In the event that an appeal is submitted to the District Court, then the District Court has 14 days to examine the appeal and it must hand down its decision within 30 days of the initial examination commencing. Once the decision has been handed down by the District Court if the parties are still not satisfied, then an appeal in the form of cassation can be made to the Supreme Court.

The Law provides the KPPU with remedial powers, including civil remedies (Article 47) to declare unlawful agreements null and void; require restructuring of firms guilty of illegal vertical integration; issue cease and desist orders to stop activities causing

monopolistic practices or unfair business competition or the abuse of dominant position; cancel mergers or consolidations in violation of the law; order compensation for damages by violators to injured parties; impose civil fines up to IDR 25 billion (approximately USD 2.5 million) for any proven violations of the law. The KPPU can also send matters to the police for further investigation. This additional investigation may result in criminal penalties being imposed on the parties for the violations set out in Article 48. In the event that the police investigation results in charges being laid for alleged breaches of the Law then the responsible parties are liable for fines up to a maximum of IDR 100 billion (approximately USD 10 million) and terms of imprisonment of up to six months.

## **I. CONSUMER PROTECTION LAW**

In Indonesia, consumer protection is relatively new. Parliament enacted the Consumer Protection Law No. 8 of 1999 (CPL) on 20 April 1999. This law enables consumers, who have sustained any injuries caused by a dangerous product and/or service, to take legal measures against the business operators responsible.

### **Definition of Consumer, Business Operator, Goods and/or Services**

The CPL defines a consumer as any natural person who uses goods and/or services available in the market, either for self interest, family interest, others, or other living creatures that can not be used for resale (Article 1(2)). In other words, only end-consumers are protected in Indonesia. Meanwhile, a business operator is defined as any natural or legal person who, either in the form of a legal entity or some other business form, was established

and domiciled or does business within the jurisdiction of the Republic of Indonesia, either by his own or together, under a contract in the field of economics (Article 1(3)).

According to the CPL, the definition of goods is anything that is either tangible or intangible, moveable or immovable, that can be exhausted (*dapat dihabiskan*) or not, which can be sold, used, and consumed. A service is defined as a service either in the form of a job (*pekerjaan*) or as a result (*prestasi*) which is provided to the community to be used by consumers.

### **Consumers' Rights and Obligations**

Article 4 of the CPL states the rights of consumers:

- a. a Right of comfort, security, and safety in the consumption of goods and/or services;
- b. a Right to choose goods and/or services and to get those goods and/or services at the proper price and in the condition that the goods and/or services were promised.
- c. a Right of true, precise, and honest information on the condition of the goods and/or services;
- d. a Right to be heard, whether an opinion or objection (*keluhannya*), to the goods and/or services used;
- e. a Right to seek legal aide assistance during a consumer protection dispute;
- f. a Right to get guidance and education.
- g. a Right to be treated or served in a proper and non-discriminate manner.
- h. a Right to get compensation, redress and/or a replacement if the goods and/or services received were not as promised in the agreement or were unfit for purpose.

- i. any other rights granted under any other prevailing laws and regulations.

Under Article 5 of the CPL, consumers also have obligations:

- a. To read and follow the instructions and procedures to use or make use of the goods and/or services for security and safety.
- b. Act in good faith during the purchase transaction of any goods and/or services;
- c. To pay the agreed price;
- d. To participate in any consumer protection legal dispute in accordance with the prevailing laws and regulations.

### **Business Operator's Rights and Obligations**

Business operators' rights are regulated in Article 6 of the CPL:

- a. a Right to receive payment pursuant to the terms and conditions of the agreement and to refund and exchange goods and/or services;
- b. a Right to legal protection from consumers acting in bad faith;
- c. a Right to submit a proper defense in any consumer protection dispute matter;
- d. a Right to rehabilitation of the good name and reputation if the damage is legally proved not to be the fault of the business operator or of the goods and/or services sold;
- e. any other rights granted in any other prevailing laws and regulations.

A business operator under Article 7 of the CPL has the following rights:

- a. To conduct business in good faith;

- b. To supply true, correct, clear and honest information on the condition and guarantee the goods and/or services as well as provide instruction on the use, repair, and maintenance of the goods and/or services;
- c. To treat or serve consumers in a proper and non-discriminate fashion.
- d. To guarantee the quality of the goods and/or services produced or sold in accordance with the standard provisions of any prevailing laws and regulations with respect to the quality of goods and/or services sold;
- e. To provide consumers a chance to test and/or try certain goods and/or services and to give any necessary guarantee on the product made or sold in the market;
- f. To provide compensation, redress and/or replacement for any injury or damages as a result of consuming, using, and making use of the goods and/or services sold;
- g. To provide compensation, redress and/or replacement for any injury or damages if the received or used goods and/or services were not in accordance with the terms and conditions of the agreement.

The CPL in Chapter IV, Articles 8-17 prohibits business operators from certain conduct such as producing and selling goods and/or services that are unfit for purpose based on prevailing quality standards regulations; selling defective or used goods without providing full and frank disclosure on the condition of the goods and/or services; offering, promoting, or advertising goods and/or services under a false pretense; promoting goods and/or services by way of either incorrect statements or misleading information; using standard contracts where location and form are not readily identifiable or can not be seen clearly, or if its statement cannot be understood and if it prohibits other conduct.



## **Business Operator's Liability & Product Liability in Indonesia**

Indonesia does not currently have specific product liability legislation that addresses the legal liability of manufacturers and sellers to compensate users and consumers for injury or damage suffered after consuming a defective product. Although the CPL does address the matter however traditional legal concepts of privity of contract and fault-based theories of producer liability are still applied. As a consequence of the type of legal system utilized in Indonesia it is fair to say that product liability-related jurisprudence is not yet highly developed. Litigation in Indonesia generally is viewed as being counter to the social and cultural characteristics of the community and the State that prides itself on the resolution of disputes through discussion and the achieving ultimately of a consensus. It is these social norms in Indonesian society that tend to discourage litigation in favor of discussion leading to consensus and this is evidenced in the small number of claims that ever make it to court.

Product Liability in Indonesia is known as a liability on defective goods (*"tanggung jawab produk cacat"*). This kind of liability is a result of the circumstances of a product, good, or service, which puts the burden of product liability on the producers or manufacturers. This liability, therefore, puts the stress on the defectiveness of the product that caused injury to people, other people, or other goods.

Even though the CPL does not provide a specific definition for a defective good, nevertheless, it can be assumed to mean: "every product which cannot fulfill the objective of its manufacture either intentionally or negligently as a result of the process of production or any other thing that happens in the distribution process, or by not providing the safety requirements for people or their property in using it, as people would expect it to be used."

In Indonesia, there are three causes of action that consumers can use to file a product liability civil action: negligence, breach of

contract, and tort. Nonetheless, business operators in Indonesia can also be brought to the court for their alleged criminal liability for either public health or security reasons. Under Article 62, business operators that violate the provisions in the CPL can be imprisoned for a maximum term of 5 (five) years or a fine of IDR 2 billion.

### **Negligence**

In the CPL there are three provisions that govern product liability; namely, Articles 19, 23 and 28. Article 19 deals with liability of a producer, in which case the producer should provide compensation for damage, pollution and/or the consumer's financial loss as a result of consuming the goods or services that were produced or sold (Art. 19(1)). Compensation can be in the form of the return of money, replacement of the goods or services, or the provision of treatment to injury or providing compensation in accordance with the prevailing laws and regulations. Compensation must be given within seven days of the date of transaction. Nevertheless, compensation does not eliminate criminal liability, once fault has been established (Article 19(4)).

However, it is also possible that a producer may avoid compensating the consumer if the producer is able to prove that the injuries, damage, or other loss was caused by the consumer themselves and not by the good or service. However, if the producer cannot prove this and he refuses to compensate the consumer pursuant to Article 19, the consumer can take legal action ("sue") against the producer by going through the Consumers Dispute Settlement Body (*Badan Penyelesaian Sengketa Konsumen*) under Article 23.

Under Article 19, the consumer has the right to restitution if it can be proven that negligence occurred. If negligence can be proven and the business operator and or producer refuses to compensate the consumer within seven days of the date of transaction, Article 23

allows the consumer to take the business operator or producer either to court or through the Consumers Dispute Settlement Body

The CPL shifts the burden of proof to the producer, in the sense that the producer must prove that there was no negligence. Therefore, product liability, according to the CPL, is a negligence action that at the same time modifying the burden of proof to the producer.

### **Breach of contract**

Under the provisions of Article 1243 of the Civil Code, consumers who have sustained injury or damage can sue the sellers or manufacturers due to a breach of contract. This provision argues that the seller or manufacturer failed to uphold their end of the contract, thus the plaintiff should be entitled payment for costs, damages, and interest arising from the breach of contract. However, if the sellers or manufacturers can prove that their defect was caused by something unforeseeable for which they cannot be held accountable, then they are not held liable for the damages or injuries, assuming that they are not acting in bad faith. Furthermore, they do not need not pay for damages due to *force majeure* or by some unintentional occurrence, or if they were prevented from performing the contract. Under the breach of contract theory, consumers can only prevail if they are able to prove damage occurred and that the business operator or producer was aware of the defect at the time the contract was entered.

The Civil Code also states that sellers are obliged to ensure that the goods they sell are free from hidden defects. In other words, if the defects are known to the consumer, then the consumer either would not have purchased the goods or services or would have purchased it at a reduced price. Sellers are not obligated to inform consumers about visible defects in which buyers can conceivably discover for themselves. Therefore, it can be said that a breach of contract includes a breach of warranty by the producer. Since the

contract is between the producer and consumers, only consumers can bring about this course of action. The key of this theory is dependent upon the privity of contract.

### **Tort Liability**

Tort Law (*“perbuatan melawan hukum”*), also known as an “open” clause, is one of the theories available for a product liability action in Indonesia. Article 1365 of the Civil Code provides the legal foundation under Indonesia law for all tort actions by consumers who were injured by a defective product. Under this provision, it is mandatory for the person who inflicts damage upon another to compensate the victim. Furthermore, Article 1366 states that each and every person is responsible for the damage that they cause due to their negligence or carelessness.

Therefore, to be able to bring a tort claim for product liability, consumers have to provide evidence which proves that the producer was negligent (at fault), the action of the producer was an unlawful act, the consumers suffered damage, and there is a causal relationship between the tort in question and the injury or damage the victim suffered.

Product liability in Indonesia is based upon fault, in other words, consumers can only bring a product liability claim if only the producer is at fault. Under the theories of breach of contract and tort liability, the burden of proof is on the plaintiff, while under the negligence theory, laid out by the CPL, the burden of proof is on the producer. Unlike the US, which imposes the concept of “strict liability” with respect to tort claims, Indonesia only prescribes a presumption of negligence or a presumption of liability in which the producer can rebut the presumption if they can prove that they were not at fault. Hence, the principle of product liability in Indonesia is still at least one step behind the principle of strict liability.

### **Consumer Dispute Settlement Mechanism**

A consumer dispute is basically a dispute between business operators and consumers who demand redress as a result of alleged damage, pollution, or other suffering in the consumption or the usage of goods or services. There are 3 mechanisms in which consumers can settle their dispute with business operators: through the Consumer Dispute Resolution Body, litigation, or an approved ADR mechanism.

### **Consumer Dispute Resolution Body (Badan Penyelesaian Sengketa Konsumen)**

The Consumer Dispute Resolution Body (“*Badan Penyelesaian Sengketa Konsumen*” or “*BPSK*”) acts as an out of court consumer dispute mechanism. All consumers who suffer damage can sue the producer, manufacturer, or seller through this body instead of through the general court system. In some aspects, this new body is basically similar to a small claims court because the procedures involved are simple, informal, and inexpensive. If a consumer decides to go through the Consumer Dispute Resolution Body, it is the consumer’s choice if legal aid is wanted. Any consumer who wants their dispute settled by the BPSK has to file a written or oral complaint on settlement of the dispute through the secretariat of the BPSK, who in turn will then establish a committee that will consist of three people that represent the three elements of the BPSK (government, consumer, and business operators). This committee will settle the consumer dispute through conciliation, mediation or arbitration, whichever the parties decide.

All consumer disputes using the aforementioned mechanisms have to reach a settlement at least twenty-one days from the day the complaint was received by the BPSK secretariat. The decision from the BPSK is final and binding, however, each party can appeal the decision which would lead to a trial within fourteen days of the decision being delivered to all the relevant

parties. During the trial, the court has to hand down its decision within twenty-one days. If either of the parties are still unsatisfied with the verdict, the decision may be appealed to the Supreme Court within fourteen days of the decision of the trial court. The Supreme Court has to hand down its decision no later than thirty days after the petition is filed. In conclusion, a consumer dispute that commences in the BPSK and is finally resolved in the Supreme Court may take up to 100 days.

### **Litigation (In Court) Process**

Every suffering consumer can submit their complaint to the relevant District Court in an attempt to resolve their dispute with the business operator. Any complaint by a consumer on the conduct of a business operator that is alleged to have breached the CPL can be filed by the relevant consumer or their heirs; a group of consumers with the same or similar complaint with respect to the same product or service in the form of a class action; by a consumer protection group (*Consumer Protection NGO*) or by the Government or any other related institution in the event that the good or service in question resulted in huge material losses and assessable damages or there were a significant number of consumers who were affected by the breach. The procedures noted in this mechanism refer to the procedural processes of the General Courts.

### **Out of Court Settlement Mechanisms**

An out of court consumer dispute settlement occurs when the relevant parties desire to resolve the matter with respect to the amount of compensation or other reparation regarding the alleged breach of the law to guarantee that the consumer is protected from further harm and compensated for the harm already suffered. The format used is known as Alternative Dispute Resolution (“ADR”). An important provision that must be considered is Article 45(3).

This Article states that any out of court consumer protection dispute amicably settled between the parties does not void any criminal liability that may be incurred as a result of the conduct. Finally, parties that elect to attempt an out of court settlement may only return to the court to confirm their agreement. In the event the parties fail to reach a mutually acceptable agreement may the parties re-enter a court administered litigation action.

## **J. TAXATION**

The foundation of Tax Law in Indonesia is the Constitution, particularly Article 23A, which states, “Tax and other levies which are characterized as compulsory for the needs of State are to be regulated by law”. Since Indonesia gained independence in 1945, Indonesia has recognized two primary terms in taxation law; namely, tax and fiscal. There has been no agreement, particularly among the experts, on the difference between these two terms however there has been no shortage of possible interpretations. Several experts have stated that tax is a non-compulsory contribution from the individual or organization to the government to defray the expenses incurred in the common interest of all citizens without reference to any special benefits conferred by regulation. Fiscal, on the other hand is defined by Soemitro as any form of government action to receive contributions from their people for particular purposes and to be used exclusively at certain times for the purpose for which the fiscal was levied.

There are 3 basic categories of taxes in Indonesia; namely, National taxes, Regional taxes, and custom (duties and excise) taxes. National Taxes include income tax, value added tax, sales tax on luxury goods, land and building tax, and the fiscal departure tax. Regional Taxes include development tax, motor vehicle tax, and other relatively minor taxes. Customs Taxes include import duties,

export tax, and taxes on certain commodities such as tobacco, alcohol, sugar, and gasoline.

The Indonesian Government is currently undertaking a significant amount of tax reform, particularly through amendments to current legislation and the enactment of new legislation. The primary aim of these reforms is to provide taxpayers with increased fairness and greater levels of legal certainty with respect to their rights and obligations under the tax law. Furthermore, it is expected that these reforms will provide more clarity and simplicity in both procedural and technical matters. Interestingly, the reform package also introduces the possibility of self-assessment with respect to tax. The Government has recently confirmed the Tax Policy Blue Print which sets out the Government's tax policy and strategy for the decade from 2001 through to 2010. The proposed tax reform program has already commenced with some of these amendments coming into force as of 1 January 2001. The Directorate General of Taxation was responsible for drafting several amendments to three earlier tax laws, namely: Law 16 of 2000 on General Taxation Arrangements and Procedures; Law 17 of 2000 on Income Tax; and, Law 18 of 2000 on Value-Added Tax on Goods and Services and Luxury Sales Tax. The amendments include revisions to tax brackets and a number of measures designed to improve taxpayer compliance. The current prevailing tax legislation restricts the Directorate to making a request to the National Police Force to arrest delinquent taxpayers or individuals alleged to have breached any other tax law or regulation.

### **Income Tax**

The basic principles of Indonesia's Income Tax law apply to businesses and individuals alike. Taxable income is defined as any increase in economic prosperity received or accrued by a taxpayer, whether originating from within or from outside the Republic of Indonesia that may be used for consumption or to increase the



recipient's wealth in whatever name or form. It includes any remuneration in connection with work or services, business profits (with no distinction between operating and capital income), dividends, interest, rent, royalties and other income related to the use of property.

The current tax bracket system stipulates 3 brackets with a maximum tax rate of 30% applied to individuals or businesses with taxable income above IDR 50 million. Generally, taxation is self-assessed which has traditionally allowed for significant levels of tax avoidance to occur. To counter this, there is an extensive system of domestic withholding taxes to ensure regular and early collection of income tax. The withholding tax system includes severe penalties for non-compliance. In addition to the 3 brackets noted above there are special tax brackets for specific types of businesses such as petroleum companies, mining companies, geothermal power companies, foreign drilling companies, and non-resident international shipping and airline companies.

Taxable income is determined by subtracting allowable deductions from revenue. Certain expenses, such as employee benefits in kind and donations, are generally not tax deductible. In addition, interest incurred to finance the acquisition of shares is not deductible unless dividends from the shares purchased are taxable. As a general rule, taxpayers may deduct from gross income all expenses related to earning, securing, and collecting taxable income. Items that are not deductible include those incurred for the personal benefit of shareholders; benefits in kind (housing and vehicles) provided to employees, except for the provision of food and beverages for all employees, and for certain benefits in kind provided to employees in certain remote areas (including gifts, donations and support); "excessive" payments for goods or services where a special relationship is deemed to exist between the buyer and seller; and, expenses incurred in the course of producing income that is exempt from tax or subject to final tax. Formation of a reserve or allowance is generally not tax deductible, with the

exception of bad debt allowances for banks or finance leasing companies, reserves in insurance companies, and reserves for reclamation costs in the mining industry.

Taxable Income for individuals includes virtually any "increase in economic benefit" received by a taxpayer including wages, profits, prizes, gifts, and capital gains. Tax residents are taxed on world-wide income (whether or not remitted to Indonesia), although the tax authorities still lack the resources to effectively monitor and enforce full compliance where offshore income is involved.

In Corporate Tax most Indonesian companies adopt the calendar year as their financial and tax year, however under special circumstances substituted accounting periods are available. A corporation, for tax purposes, is classified as "resident" or "non-resident". Residency is determined on the basis of place of incorporation. A corporation is therefore considered "resident" if incorporated in Indonesia and non-resident if otherwise. Resident corporations are taxed on their worldwide income. Tax credits are allowed for income that was taxed outside the country. Non-residents are taxed only on income derived from Indonesian sources, subject to any relief available under double taxation agreements. However, a non-resident entity with a permanent establishment ("PE") in Indonesia, such as a branch office, is taxed on (1) the PE's income from its business or activities, and from the assets it owns and controls; (2) the income of the head office arising from business activities, or sales of goods or services in Indonesia of the same type as those sold by the permanent establishment in Indonesia; and (3) all other income, either received or accrued by the head office such as dividends, interest, royalties, rent and other income connected with the use of property, fees for services, etc, provided that the property or activities producing the income is effectively connected with the PE in Indonesia. Income attributable to a PE of a company that is resident of a treaty country should refer to the relevant treaty.

In Indonesia a PE is generally defined as an operation in which a non-resident establishes a fixed place of business in Indonesia. This would include a management location, a branch office, and an office building, among others. A PE can also be established as a result of the non-resident entity's employees providing services in Indonesia for more than 60 days in any 12-months period. For companies from those countries with which Indonesia has concluded a Double Tax Agreement ("DTA"), the relevant definition can be somewhat modified.

Expenses such as those for research and development carried out in Indonesia and eligible employee training qualify as regular allowable deductions. Indonesia has no special income tax deductions/relief for research and development and eligible employee training. The deductibility of research and development performed offshore remains unclear.

There is taxation of other particular forms of income, such as:

*Dividends* – withholding tax applies to dividends paid by Indonesian corporations. An important exception is domestic inter-corporate dividends, provided that the dividend is from the retained earnings, the shareholding of the recipient is at least 25%, and the recipient maintains other active businesses. If the recipient is a resident individual or non-corporate entity, the rate is 15% and represents an advance against the taxpayer's annual income tax.

*Interests* – interest paid by resident borrowers to resident banks or financial institutions is exempt from tax. Interest paid to offshore lenders is subject to 20% withholding tax (subject to applicable tax treaty).

*Royalties* – if the royalty recipient is a resident taxpayer, tax is withheld at the rate of 15%. If the recipient is a non-resident, tax is withheld at the rate of 20% (subject to applicable tax treaty).

*Capital Gains* – capital gains are generally taxable as ordinary income and capital losses are tax deductible. Special rules apply for publicly traded shares.

### **Value Added Tax (VAT)**

VAT is imposed upon the delivery of most categories of goods and services within Indonesia. The basic VAT rate is 10%. Imports are generally subject to VAT at a rate of 10%, but exports are effectively exempted from VAT by application of a 0% rate. Undeveloped land transfers do not attract VAT but land prepared for residential or industrial estate development is subject to a VAT of 8%. VAT liability arises at the time of delivery of the goods or services, or upon receipt of payment, whichever is earlier. As a practical matter, the date of the tax invoice (*faktur pajak*) is used to determine when tax liability arises. The taxable individual corporation must issue the tax invoice no later than the end of the month following the month of delivery or payment. Monthly returns of all taxable purchases and sales must be filed by the 20<sup>th</sup> of each month. If output VAT is greater than input VAT, the net difference is payable to the tax office. In practice, payment of tax may be delayed up to a maximum of 75 days following the day of delivery. If input VAT is greater than output VAT, the excess may be carried over to the following month to offset against that next month's output VAT. In principle, the excess of input VAT over output VAT may be refund once a year, although actual collection may be difficult and/or time consuming.

Various means of reducing the burden of VAT have been introduced. Deliveries of goods into bond zones are VAT exempt, as are goods and services to foreign aid projects, sales of cattle and poultry feed, and the import of certain specified goods and services. Services in certain sectors have been specifically exempted from VAT such as services related to medical and health care, social welfare activities, banking and insurance, radio and

television broadcasting, telephone and telegram services, educational and religious activities, public transportation, postage, labor supply, and hotel accommodation. Additionally, deferrals of VAT are available to PMA and PMDN companies on the import of Master list equipment, machinery and raw materials used in the production process. Presidential Decree No. 37 of 1998 provides for a VAT exemption on the transfer of capital goods in the form of machinery and factory equipment. Under Minister of Finance Decree No. 615/KMK.O1/1997, production companies may import raw materials free of VAT, Sales Tax on Luxury Goods and import duties, provided that the raw materials are processed and re-exported. Additionally, under the so-called PET facility (*Perusahaan Eksporir Tertentu*) established by the Minister of Industry and Trade and the Minister of Finance, specially designated exporting companies are granted a facility to purchase certain types of locally sourced basic and auxiliary materials on a VAT free basis.

### **Sales Tax on Luxury Goods**

Sales Tax on Luxury Goods is imposed at a rate of 10% to 50% on a wide range of both imported and local luxury goods. Luxury houses, apartments, condominiums and townhouses are subject to a 10% Sales Tax on Luxury Goods.

### **Land and Building Tax**

Land and Building tax is payable annually on land, buildings and permanent structure. The rate is 0.5% of the assessable value, which is set at 20% of the market value of the property except for residences with a market value in excess of IDR 1 billion in which case the assessment is 40% of the market value. The market value, in principle is revised annually. However, the first IDR 8 million per taxpayer is tax-deductible.

Special calculation formula applies to plantations, mining, and forestry business. Non-taxable objects are land and buildings used for religious worship, social affairs, health, national education and culture, graveyards and archaeological relics, protected forests, nature reserves, tourist forests, national parks, pasture under village control and other state lands, diplomatic offices and consulates (on a reciprocal basis), and specified international organizations.

### **Fiscal Departure Tax**

Every Indonesian resident departing Indonesia by air is required to pay a IDR 1 million "Fiscal Departure Tax", with limited exceptions.

### **Development Tax**

Development Tax is a municipal tax intended to aid the development of cities. Where applicable, it is levied at the rate of 10% on restaurant bills. There is also a tourism development tax of an extra 2% on the service charge imposed by some hotels and restaurants.

### **Tax Returns**

Taxpayers must prepare both monthly and annual returns. Monthly returns must be filed by the 20<sup>th</sup> day of each month for corporate tax, employee income tax, and VAT. Annual returns must be submitted within three months of the end of the financial year.

Accounts and records must be kept in Indonesia, denominated in Rupiah, and composed in Indonesian or a foreign language approved by the Minister of Finance. PMA (foreign investment) companies, permanent establishments of foreign companies, production sharing contractors, contract of work companies, and other entities with foreign affiliations are allowed to

keep records in English and accounts in US dollars, subject to approval from the Director General of Tax. PMA companies, permanent establishments, and other entities with foreign affiliations must obtain this approval at least 3 months before the beginning of the relevant accounting year or within 3 months of a new taxpayer being established. Production sharing contractors and contract of work companies must notify the Tax Office in writing at least one week before US dollar/English bookkeeping is adopted. A taxpayer who uses English (only) in its bookkeeping has to submit written notification to the Tax Office within 3 months after the beginning of the book year when English bookkeeping commences.

Where a tax assessment has been issued, an interest penalty is chargeable on tax not paid by the due date, calculated from that date until it is paid. The rate of interest is 2% per month for a maximum of 24 months. Administrative surcharges levied on under reported tax:

1. 50% of the income tax not paid or underpaid in a tax year if a tax return is not filed or not filed within the specified period as stated in the reminder letter issued by the Tax Office.
2. 100% of the income tax not withheld or under withheld, not collected or under collected, or not deposited or under deposited.
3. 100% of any VAT or sales tax on luxury goods not deposited or under deposited, in certain circumstances.

If a taxpayer corrects its own tax return (2-year limit after the tax is due or after the end of tax period or tax year) with the result that the tax owed increases, a penalty in the form of 2% interest per month is applied to the total tax underpayment, calculated from the end of the filing date for the period until the date of payment arising from the corrected tax return. Even though a tax return has been corrected or the 2-year limit has passed, a taxpayer may declare an error in the tax return as long as the Tax Office has not issued a tax assessment and the revision results in a higher taxable profit or a

lower tax loss. Any tax underpaid and the administrative surcharge of 50% of the tax underpaid should be paid before the tax return is submitted.

The Indonesian tax system is based on the principle of self-assessment. However, the Tax Office has the right to issue an assessment within a 10-year period ("statute of limitation"), if, after an audit, it considers that the taxpayer has not self-assessed the correct amount or if no tax return has been lodged. However, an assessment can be issued after expiry of the 10-year limitation period if the taxpayer has committed a criminal act. The Tax Office conducts the following types of audits:

1. full audits, which should be completed within 2 months, but may be extended to 8 months;
2. simple field audits, which should be completed within 1 to 2 months;
3. simple office audits, which should be completed within 4 to 6 weeks;
4. If any transfer pricing issues are identified, the tax audit may be extended up to 2 years, although this does not apply if the taxpayer requests a refund.

An additional tax assessment letter may be issued within the 10-year limitation period if new data and/or data previously undisclosed is discovered shows that the tax liability has been understated. An administrative surcharge of 100% is levied on such additional assessments. An additional assessment can be issued after expiry of the 10-year limitation period if the taxpayer has committed a criminal act, in which case an administrative (interest) penalty of 48% is applied to the additional assessment in addition to the above surcharge. A taxpayer may object to an assessment or an additional assessment within 3 months of its date of issue. The Tax Office has one year in which to issue a decision. The Tax Office may reduce the assessment, confirm it, or even increase it. Failure



to issue a decision means the taxpayer's objection is deemed to be accepted.

A taxpayer may submit an application to reduce or cancel administrative penalties on tax assessments (request for reconsideration) to the Tax Office. The application has to be processed within 12 months; otherwise the application is deemed to be accepted.

## **K. BANKRUPTCY LAW**

Indonesia has had a formal Bankruptcy Law since 1905, when *Staatsblad* 1905 No. 217 jis. 1906 No. 348 or *Failissement Verordening* (hereinafter “FV”) was put into effect. The Bankruptcy Law was then amended with Government Regulation in lieu of Law (*Peraturan Pemerintah Pengganti Undang-undang* or abbreviated as “PERPU”) No. 1 of 1998 (hereinafter referred to as “PERPU 1 of 1998”). A PERPU can only be enacted by the President and may be enacted without the parliament’s consideration however the subject matter of the PERPU must require emergency regulation and cannot be regulated in any other way. Nevertheless, to ensure that the President does not abuse the power of PERPU, a PERPU is required to be brought to the parliament at the first available parliamentary sitting to be confirmed or rejected as law. As stated in TAP MPR No. III of 2000, a PERPU is one rank below a Law. The PERPU power is regularly the source of debate, particularly with regard to whether an economic crisis can qualify as a state of emergency that requires PERPU regulation. At the time the underlying reason was the urgency placed on the amendments to be rapidly enacted to ensure an IMF loan disbursement. The debate still lingers whether the urgency stated equates to a state of emergency necessary for the use of the PERPU power. Nevertheless, the use of PERPU to

regulate urgent matters does avoid the often long and tedious debates of the parliament in the immediate term. However, as noted earlier before a PERPU can be enacted as a full law it must be passed by the parliament in the parliament's next sitting so the avoidance of debate and public scrutiny is not avoided in the long-term.

PERPU 1 of 1998 came into effect on 20 August 1998 and the Parliament confirmed the PERPU into Law 120 days later without making any amendments to Law 4 of 1998. Therefore, Law 4 of 1998 refers to the Amendment of the Bankruptcy Law and PERPU 1 of 1998 which were incorporated into Law 4 of 1998. The amended Bankruptcy Law became Law 4 of 1998. The Bankruptcy Law Amendment did not replace the old law but merely add provisions and amend the provisions of the FV. Furthermore, on 2004, the new Bankruptcy Law came into effect, named as Law 37 of 2004 on Bankruptcy and Suspension of Debt Payments. This new law replaces the previous Bankruptcy Law. As it is said in article 307, FV and Law 4 of 1998 are withdrawn and not legally binding anymore. Therefore, the Bankruptcy Law refers to Law 37 of 2004.

The FV has always been an unpopular legal instrument within the business community for a number of reasons, particularly the difficulty of successfully sustaining a bankruptcy claim. This is evidenced by the fact that during the 1980s and 1990s only a small number of bankruptcy petitions were ever successful and involved nominal debt values and usually against sole traders, this has often been referred to as consumer bankruptcy. Legal entities that had significant asset or debt rarely utilized the bankruptcy law or associated procedures. Indonesian bankruptcy history shows that Arafat Lyold (Sailing Company) was the only company holding huge debt and significant assets that were subject to a business bankruptcy proceeding. It is worth noting that at that time, voluntary petition was much more common than involuntary petitions were.

Bankruptcy has often been viewed as saviour or destroyer of businesses and business interests however at the beginning of 20<sup>th</sup> century bankruptcy enjoyed somewhat of a revival as businesses were looking at bankruptcy in a more favorable light. Professor Sudargo Gautama notes in his book that there were many bankruptcy petitions in civil court at that time. However, as the 20<sup>th</sup> century was ending, the 1990s saw a substantial decline in the number of bankruptcy petitions filed in civil court. The primary reason for this decline was that legal consultants advised their clients to consider the bankruptcy procedure as a dead option and whose consequences were not worth any consideration.

Since the last revision of *Staatsblaad* 1906: 348 there has in practice been no significant change to the substance of the bankruptcy law. This could be viewed as a careless oversight or a conscious minimizing of the value of bankruptcy law however it is clear that the bankruptcy law should at least reflect the current and real conditions of the business community. In the post-independence period Indonesia experienced a major transformation in business practices and unfortunately it become obvious that the Bankruptcy Law was never able to keep pace. The most obvious of these deficiencies was the inability of the Bankruptcy Law to provide protection to creditors from a bad faith debtor. Furthermore, the requirements that must be satisfied prior to filing a bankruptcy petition were extremely onerous and complicated. The FV required the creditors to prove that the debtor was in a discontinued-debt-paying position before a bankruptcy petition could be filed. Clearly this is difficult as the majority of debtors were still paying their debts despite the payments being made never being in the full amount. These difficulties were only increased by the ineffective work of the Trust Estate Agency ("*Balai Harta Peninggalan*") and the courts, which often took excessively long periods of time to resolve matters and usually treated the matters as trivial inconveniences delaying other more important matters.

The FV is the bankruptcy law inherited from the Dutch that was applied during the colonial period. This meant that bankruptcy cases were generally dealt with in the general court system and were treated the same as any other civil case. The Trust Estate Agency, a Government run institution, in essence provides the same services and function as the Trustee in the Chapter 7 US Bankruptcy Code with respect to the administration of an estate.

The previous bankruptcy law, Law 4 of 1998 (also stressed out in Law 37 of 2004 article 300), had established a special court to handle commercial cases including bankruptcy. This court was simply named, the Commercial Court. The implementation of the Amended Bankruptcy Law requires further 'implementing regulations' to facilitate and ensure compliance with the amended provisions. Presidential Decree 97 of 1999 created additional Commercial Courts in Bandung, Semarang, Surabaya, and Medan. The Commercial Court falls under the jurisdiction of the District Court, a first instance level court of the Indonesian judiciary, and is considered to be a specialized chamber of the relevant District Court, similar to Human Rights Courts and Children's Courts. Article 11 of the Bankruptcy Law stated that the new Commercial Court or 'Bankruptcy Court' is intended to be a method of last resort. Essentially, this requires that all other methods and means of satisfying payment have been exhausted and the debtor remains delinquent in their obligation to make payment on the relevant debt despite being in a position to do so or where a debtor has consistently negotiated in bad faith with respect to settling any outstanding debt obligation. Therefore, it is reasonable to state that the underlying premise of the Bankruptcy Law is to force delinquent debtors, and who have the means to pay their debts, to negotiate with their creditors a repayment schedule, or in the case of those debtors unable to pay off their debts, to expedite the liquidation of the debtor's assets. The Bankruptcy Law includes both the material and procedural elements of law to ensure compliance with and enforcement of the provisions of the law.

Basically, like other bankruptcy system the parties in Indonesian Bankruptcy Law are the debtors and the creditors with the receiver to assist them in reaching settlement. The Bankruptcy Law introduces two mechanisms to deal with the insolvent debtor. The first mechanism is the petition to declare the debtor bankrupt with the aim of liquidating the assets under Chapter II. Either the debtor or its creditor(s) can initiate this type of proceeding. The debtor under the Bankruptcy Law can be individual as well as a juridical person (a company, a bank, or any other legal entity that has legal personality). However, in Article 2 (2), (3), (4), and (5) states there are four other categories that may file a bankruptcy petition: (1) the Office of the Attorney General in the public interest (2) the Indonesian Central Bank if the debtors are banks, (3) the Capital Market Supervisory Board if the debtor is a listed company (4) the Minister of Finance if the debtor is Insurance Company . Article 4 further requires spousal consent to file a petition where a debtor is married. Under Article 2 (1) a petition for the declaration of bankruptcy has to satisfy two requirements; namely, the debtor has at least two or more creditors and the debtor has failed to pay at least one of the due and payable debts.

The second mechanism introduced under Chapter III of the Bankruptcy Law is the Suspension of Debt Payments (*“Penundaan Kewajiban Pembayaran Utang”* or *“PKPU”*). This mechanism does not aim to liquidate assets but rather encourage the debtor and creditor to restructure the debt and payment schedule. Under this mechanism Article 222 allows the debtor to request a suspension of debt payments provided there is an intention of achieving a compromise with creditors and unsecured creditors to restructure the debt. These proceedings may be initiated by the debtor and requires the agreement of a certain number of unsecured creditors. Article 224 (1) states the restructuring agreement can only take effect once it has been agreed by the court. Furthermore, Article 236 states that once a restructuring agreement takes effect it will

immediately revoke any suspension in debt payments that has been granted previously.

The Indonesian Bankruptcy Law is pro-creditor and provides for a wide variety of creditor remedies, for instance: (1) establishes an asset distribution framework that maximizes the amount of assets apportioned to creditors; (2) allows for a suspension of debt payments procedure; (3) grants broad powers to the court-appointed receiver to generate as much profit as possible on behalf of the insolvent company; and (4) Indonesia's Company Law provides for directors to be held personally liable for debts if the directors' mismanagement of the company resulted in the bankruptcy. Significantly, the Indonesian Bankruptcy Law does not result in a discharge of the debtor's debts, but rather preserves the debtor's liability to creditors even after the adjudication.

Under the Indonesian Bankruptcy Law in Article 3 (1), any natural person or entity as prescribed by the laws of Indonesia is eligible for bankruptcy if domiciled within the country. Moreover in Article 3, the petition for bankruptcy is filed in the District Court that has jurisdiction over the debtor's place of domicile.

Article 36 states that a petition for declaration of bankruptcy requires the court to immediately adjudge the debtor's status and deem the debtor bankrupt if past due debts exist. The effect of a debtor being adjudicated bankrupt is that a lien is placed over the debtor's property. In the event of a judgment of bankruptcy Article 11 notes that the debtor has the opportunity to appeal within 8 days, depending on whether the debtor had prior notice of the proceeding. However, such an appeal does not stay the bankruptcy.

After declaring a debtor bankrupt, the judge has 14 days to establish a deadline for all creditors to submit their claims to the court and to determine the time and place for a meeting of the judge, receiver, debtor, and any creditors who desire to attend as noted in Article 113. This meeting is called a verification meeting, and its purpose is to review all of the claims filed by creditors and

determine which are secured, preferred, or general, and whether or not any filed claims are being disputed. At the meeting, the receiver may demand proof to substantiate a creditor's claim and negotiate with creditors while the creditors may dispute the validity of a claim or its amount.

Article 56 (1) states that once a debtor is determined to be bankrupt creditors with a secured interest may foreclose on the secured property if this action is initiated ninety days after the declaration. Alternatively, a secured creditor may redeem his financial interest through the liquidation of the debtor's estate, as initiated by the court-appointed bankruptcy receiver. Creditors may also benefit by compelling the judge upon conclusion of the verification meeting to appoint a Creditors' Committee. The Creditors' Committee acts to advise the receiver. However, the receiver is compelled to provide the Creditors' Committee with all information sought and consult with the Committee before taking certain actions.

Conversely, a debtor may attempt to protect himself by offering an alternative plan at least eight days prior to the verification meeting that has the agreement of the general creditors to pay all or part of the debts. Any such plan must be approved by a majority of the general creditors present at the verification meeting, as well as the District Court. Upon approval of the plan, the bankruptcy is canceled and the debtor's unsecured claims are satisfied to the extent of the agreement's terms.

Once a debtor is adjudicated bankrupt, the receiver commences liquidation of the debtor's estate. Secured interests are given priority, in that all secured interests must be fully satisfied before proceeds from the liquidation may be made available to the other creditors. Provided enough money was procured through the liquidation sale, remaining creditors are entitled to payment in proportion to their filed claims. Nevertheless, creditors still seek collection of unpaid debts through mechanisms outside the legal

system, utilizing negotiation and "dubious debt collection practices that would not be acceptable elsewhere."

If a debtor elects the suspension of payments option, the commercial court must hold a hearing to determine whether the suspension of payments should be extended to a total of 270 days. If the 270-day period of suspension of payments is granted and the debtor and creditors fail to agree on a rescheduling plan, the commercial court must adjudicate the debtor as bankrupt. Conversely, if an agreement is reached on the terms of the rescheduling of debt payments, and the Commercial Court accepts the terms of the agreement, then a decision will be issued making it binding on all parties. Furthermore, a creditor or the state prosecutor can request the court to confiscate a bankrupt debtor's assets. Additionally, creditors can ask the court to nullify grants made by a debtor within the last twelve months if the debtor knew or should have known it would be detrimental to a creditor.

The new regulations also provide for debtor protection. Primarily, the new regulations allow for a 9-month suspension of debt payments, enabling debtors to work with a receiver to formulate a plan on how to pay creditors. A debtor who is unable to pay loan repayments may receive a deferral from the court if the debtor presents a proposal for settlement with the creditor.