Chapter 5 The Academic Draft for a Bill of the Law of Obligations

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1. In response of the need for a national Law of Contract and of Obligations the National law Reform Agency (*Badan Pembinaan Hukum Nasional*) of the Department of Justice formed a research team to draft and Academic Draft for the Bill of Obligations.

   The law making procedure is as follows :

   First a team of university professors or recognized experts in the specific field of law to be regulated is asked to conduct a research, resulting in an Academic Draft for a Bill.

   The Academic Draft, which may be drafted by anyone, including the *National Law Reform Agency* or BPHN, or any ministerial department is then sent to the Directorate General for Legislation in the Department of Justice, where a new team of some 20 (twenty) people is formed to draft the Bill itself.

   After the Bill is completed and agreed by the respective Minister, including the Minister of Justice (and Human Rights), the Bill is registered in the Parliamentary National Legislative Program (*Program Legislatif Nasional*) and in due time the Bill will be discussed and debated in Parliament, until finally it is agreed by and between Parliament and the Government.

   The final step consist of the signing and enacting of the Bill by the President and the publications of in/through the State Gazette.

2. The following is a preliminary research report conducted for the National Law Reform Agency of the Department of Justice on a Bill for a National Law of Obligations, which considered amongst others : the use of the term

"obligation". The term "obligation" is used quite correctly since it corresponds with the Dutch word "*verbintenis*", denoting that a legal connection has been made between two parties that imply rights and obligations. On the one hand, one party has the right to demand, while the other party is obligated to fulfil that demand (Prof. Subekti,SH).

3. Whereas, the term "agreement" is a translation of the word "*overeenkonst*", which is an event where two persons or parties agree upon something. This event covers a series of promises (Prof. Subekti,SH ibidem).

4. For these reasons, all terms used in this paper denoting "*verbintenis*" are translated into "perikatan" ; and all terms denoting "overeenkomst" are translated into "perjanjian".

5. There is still another term that is being used lately, namely the term "contract". This term has a narrower connotation as it is limited to its meaning as "written business contracts".

   Therefore we still suggest to use the term "perjanjian".

6. Another word that is often used next to "perjanjian" is the word "persetujuan" for agreement. To my mind, "persetujuan" refers to the process of events, while "perjanjian" refers to the end-result of that process. In this context we talk about written agreements and oral agreements.

7. Consistency in the difference in meaning between obligation (*verbintenis*) on the one hand and agreement on the other is shown in the explanation to Article 1233 BW [1]: "*Alle verbintenissen ontstaan of uit overeenkonst*, of de wet", meaning that obligations originate either from an agreement or from legislation.

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[1] BW is the abbreviation of Civil Code or CC.

8. Referring to Article 1233 BW, we arrive at the core problem of our system in the Law of Obligations.

   The principle that an obligation originates, on the one hand from an agreement and on the other from legislation, can, according to the writer be adhered to.

9. When this principle is acceptable, then all following articles on the Law on Obligations that, in fact, are an explanation of this system, must, as a consequence also be acceptable.

10. The Law is a comprehensive system. And the Law on Obligation is no exception. To make partial exceptions on the Law on Obligation will collapse the very system of the Law.

11. If, by this reasoning the principle system on the Law of Obligations is acceptable, then the next question will be, how must we approach the body of explanations of this Law, article per article?

    Since the total system on the Law on Obligations with explanations of each of its articles form one inseparable entity, then the explanations of its articles must also be accepted. Exceptions will be only in those areas that have already been regulated in part or in toto in our national legislation, as, for instance, in the Law of agreements on Lease and Rents.

12. By mentioning this fact, the writer in no way denies that our Law on Obligations has partly become out-dated. It will, indeed, be ideal that Indonesia possesses a National system on the Law of Obligations, which is whole, complete and according to our legal aspirations.

    But, legislative drafters understand that the forming of a National Law on Obligations is no easy task.

13. Legislative drafters usually find themselves facing with two extreme alternatives.

Either to overhaul the old legislation; or to accept and take over the old legislation. Because of their extreme nature, they both have their drawbacks and shortcomings.

14. But, if we must make a choice between the two, the writer prefers the second alternative.

Firstly, because drafting a new Law on Obligations already poses many problems from the outset that require a long time of discussions.

Secondly, the complete overhaul of old legislation with a completely new one, unless well prepared, will result in a Law that is far from perfect.

Thirdly, and this is most important, the Law on Obligations is a neutral area of law and does not contain sensitive substance.

Fourthly, in fact some regulations in the Law of Obligations in the CC have references that are quoted widely by the public when concluding agreements, both written as well as oral.

Fifthly, the Law may be perfected through case law.

When we study the renewal of the Civil Law in the Netherlands, for instance, we see that its process had taken no less than half a century. This luxury, however, this country can not afford.

15. What has been referred to above applies in particular to the national aspects of the Law on Obligations.

However, in its international context, and in this era of globalization, the area of law, in particular the Law on Obligations, is influenced by the Convention Law and the Community Law. (see Roy Goode, Reflections on the Harmonization of Commercial Law,.....)

Here, what is meant by Convention Law is for instance, the Vienna *Convention on the Sale of Goods*, while Community Law covers, among others, the "Directives to the European Economic Community"

Roy Goode further mentions that the Law on Obligations in its international context is faced with issues that are now better known as the harmonization of laws.

Harmonization of laws may be achieved through the following means:

1. A multilateral convention without a Uniform Law as such:
2. A multilateral convention embodying a Uniform Law;
3. A set of bilateral treaties;
4. Community legislation, typically a Directive;
5. A model Law;
6. A codification of custom and usage promulgated by an international non-governmental organization;
7. International trade terms promulgated by such an organization;
8. Model contracts and general contractual conditions;
9. Restatements by scholars and other experts.

Sooner or later Indonesia must face these issues, especially in this era of regional groupings where neighbouring countries need to harmonize their laws.

16. One of the first areas that will be impacted by regionalization, and for that reason needs to be harmonized first, is the Law on Obligations.

How do we approach the issue of harmonization? Although harmonization of laws is within the area of International Civil Law, yet in drafting the Law of Obligations we must be aware of possibilities.

17. Outside the impact of globalization on our National Law of Obligations, there are several matters that need our attention when we adjust or change the Law of Obligations in its present form as found in the Third Book of the Civil Code.

First and foremost is the principle of consensus. We all agree that the principle of consensus will be the basis for our future Law of Obligations. However, we must focus on the *moment* when such consensus is reached. Until now generally it is understood that consensus is reached at one certain point in time. In reality, in its development, this consensus is reached not only at a certain moment, but in fact, it forms a process. In this connection we know of the process at pre-contract, at time of signing the contract, and during implementation of contract. Therefore, when we are now asked about the exact moment that an obligation is born, which in Article 1233 of BW is so readily formulated with the wordings that obligations are born from an agreement, - then we are faced with a problem that is not so easily answered.

18. "*Informatieplicht*" (obligation to inform) and "*Onderzoeksplicht*" (obligation to investigate)

During the last decade a new thought has developed namely that parties bound in a contract, will each have obligations to perform.

In outline it can be said that the creditor (the party who extends something/goods and receives something in return) is obliged to provide sufficient information on what he is extending. Conversely, the debtor party (the party who receives something/goods and for that reason extends an amount for payment) must investigate or research and act prudently, so

that the counter-performance received is commensurate with performance provided and vice versa. With this explanation, the writer has arrived at the second Article of the Law of Obligations which says that an obligation is aimed to provide something, to perform something and to not perform those actions as formulated in Article 1234 BW.

Or, jumping further to Article 1338 BW , this mentions that a contract must be made in good faith.

With the obligation to inform and the obligation to investigate, the term "good faith" must be placed in a different context than heretofore has been understood.

This is even before discussing aspects that have caused the decline of the supremacy of the principle of freedom to make agreements.

The decline in the supremacy of the principle to make agreements brings us to even more basic questions in our Law of Obligations, which must force us to change several of its principles and articles.

19. Does the principle of freedom to make agreements still exist?

The principle of freedom to make agreements is one of the cornerstones of our Law of Obligations. The regulations on the Law of Obligations, at least in its written form, is found in the Third Book of the Civil Code (BW).

The existence of this principle is reflected in Article 1338 of the Civil Code that mentions that all agreements that are legally based will act as Law to those parties who made these. This means that those parties entering an agreement can agree on any matter between them. For as long as whatever is agreed upon is legal, meaning not in contradiction with the law, social

order and morals, the agreement is binding to those parties in the same way as laws are. And therefore, they may not contravene it.

However, with time, the freedom to make contracts has declined, as parties in the contract are no longer allowed to agree on matters as they wish. In certain cases, parties are not bound to what they have agreed in the contract. This indicates a decline in the supremacy of the freedom to make contract.

There are several reasons for this that originate from the internal developments of the law of contracts itself, as well as from outside, which we will discuss as follows:

20.The Role of the Legal System

An agreement does not exist in a vacuum. Despite the fact that Article 1338 BW clearly mentions that all agreements that are legally made are binding as law for those who signed, this however, does not mean that the law as found in the agreement made by both parties can be separated from the legal system that covers it.

Article 1338 BW uses the words *"yang dibuat secara sah"* (legally made). This means that whatever has been agreed upon by the parties is valid as law, for as long as whatever has been agreed is legal, meaning not contravening the law, social order and morals.

In the case where the agreement contravenes the law, social order and ethics then the contract is invalid by law *(van rechtswege nietig).*

The fact that the freedom to contract is limited by the legal system that covers the contract, - resulting in the fact that whatever has been agreed by the parties must not contravene the law, social order and morals, - this

forms a logical constraint that ensues from the fact that a contract is allowed to exist only within a certain legal system.

The wish to introduce a "lex-mercatoria", especially in the framework of international civil laws must for this reason remain a wish. The fact remains that contract law still remains part of the legal system of a given country.

21. The Principle of Good Faith.

From the very beginning the principle of good faith has influenced the law on contracts. This principle was even identified in the statutes. Line 3 of the above-mentioned article, i.e. Article 1338 BW mentions that all agreements must be made on good faith.

What does "good faith" actually denote? In the law on contracts good faith is based on its being reasonable and just. The first is concerned with reason and the second with emotions. Both principles remind us of the concept of *(kecermatan yang patut dalam hidup bermasyarakat)* as mentioned in Article 1365 BW on acts violating the law.

Good faith in the contractual context indicates that there is a legal relationship between two or more parties. While the term "*kecermatan yang patut dalam pergaulan hidup bermasyarakat*" is used where no agreement has taken place.

Good faith implies that there is a contractual relation, and therefore is called a relationship concept. Whereas "*kecermatan serta kepatutuan dalam pergaulan hidup bermasyarakat*" is used in its general concept. However, in fact, the meaning of both is the same, says Prof. Mr. P.L. Wehry in his explanations on "Legal Developments of Good Faith in the Netherlands".

Still citing Prof. Wehry, good faith has two functions. Both these functions impact on the principle of freedom to contract.

22. Two Functions of Good Faith.

Its first function :

Good faith can add to the contents of a contract and can also add to the meanings of wordings in the laws on contract.

For example, in 1921 the High Court in Holland made a verdict on corporations or firms (HR.10 February 1921; NJ No.409), : "that although the law does not prevent a firm to establish another firm which competes with the old firm, but based on good faith, this is not allowed"

Therefore, in this case good faith adds, fills in discrepencies and completes that are not yet regulated by law. Is then the general principle of law not good faith?

Its second function

In its second function, good faith limits and annuls. This second function has actually been accepted in the doctrine before WWII, although the legal system of the time was still reluctant to concede.

Most famous example was the verdict of the High Court of the Netherlands on the amount of debts related to the rapid fall of the German Mark in 1931. The verdict is known as Mark is Mark Arrest.

The verdict is concerned with the question as who must bear the risk of fluctuating exchange rates in a loan contract? According toe Article 1756

BW such risk is with the creditor. Based on this article, however, in the 1931 verdict that the debtor only needed to repay the amounts of Marks he borrowed from the creditor, despite the fact that the value of the Mark had dropped drastically. (The original loan was DM125,000 at a rate of DM1=F.0.69; while at time of repayment the value of DM125,000 had dropped to below 1 cent.). The principle on good faith may limit the implementation of Article 1756 BW.

The Indonesian legal system has for long now made a fairer formulation. The Implementation of Article 1756 BW is limited by the principle of good faith. This formulation is used when there are fluctuations in the exchange rate, even when this is not mentioned earlier.

Most recent verdict based on this formulation was made in 1988 on the case of S.T. Silalahi against Suryono & co.

The Supreme Court ruled that to solve a civil case involving changes in exchange rate, the formulation used is that risks on rates of exchange must be borne by both parties in equal measure using the price of gold as benchmark. This formulation has become common jurisprudence until today.

23. Undue Influence

Thus far the law knows 3 (three) reasons why a contract is no longer binding to those who made it, these are reason of force, misleading and fraud. In the case where one of the three reasons have caused losses to one party, because there has been force, misleading or fraud, an annulment of the contract can be requested. Therefore, we see that, in fact the freedom to contract is already limited. Indeed, Article 1338 BW stipulates that what binds the two parties to the contract with the force of law are such agreements as what they themselves have legally put into the

contract, insofar as this does not contravene the system of law, social order and morals.

In its further development, reasons mentioned in the law, including force, misleading and fraud are no longer the only reasons used to free a person from the obligations of contract.

Now, there is a fourth reason that is used to release a person from the obligations of contract, which lies outside the scope of law (at least in this country). This reason is known as undue influence (*misbruik van omstandigheden*).

Seen from the point of balance between the two parties in a contract, then an existing imbalance becomes one item in undue influence, which is not the imbalance between delivery and counter-delivery.
Rather, such imbalance has its emphasis on the process of the contract. Therefore, the school on undue influence does not only justify the doctrines on undue causes (*ongeoorloofde oorzaak*), but rather focusses on impaired will. The party that is under undue influence is not free to determine his will. One speaks, therefore, of impaired will (*wilsgebrek*), as the fourth reason for annulment of contract besides the elements of force, misleading and fraud. The imbalance must be sought in the position of the parties involved in a contract.

There having been a loss suffered as a result of such imbalance of positions becomes a condition in the case of undue influence.

The annulment of a contract for reason of undue influence is not annulled through law. Such annulment may be requested by the party who feels the loss. This annulment may also occur even to a contract made before a notary.

Annulment does not need to involve the entire contract. Partial annulment is also permitted.

In 1985 The Supreme Court made a ruling which is better known as the Luhur Sundoro case, with legal implications as follows:

- Despite the fact that the contract made in a notary act is legal, - where one person empowers another to sell the house in dispute to a third party or to himself, however, taking into consideration its history where the letter of attorney was made as a result of the house being made a collateral until such time of repayment, and as debts were not repaid in time, the contract was changed into a power of attorney to sell the house, - such a contract becomes a quasi contract, being in fact a *replacement of its original contract regarding loans.*

  Furthermore, as the debtor was already tied to other loan contracts that already passed verdicts by the courts, and were, therefore, in force, the debtor was as a consequence placed in a weak position and under duress. When he was then forced to sign the items of contract in the notary act to justify him, the ensuing contract may then be classified as a one-sided contract, which *in casu* is unjust if wholly enforced upon the debtor."

- Because the debtor had admitted to his debts and had placed his house as collateral, furthermore, had given power to the creditor to (*hipotik*) the house, it must be concluded that the house in dispute had been promised to the creditor as repayment of his debts, which for the sake of fairness must be added with 2% per month, counting from the date that the debt was made.

  For fairness sake, the house in dispute that was already impounded for other cases, must therefore be auctioned to repay other creditors."

The basis for such ruling reminds us of considerations in the Dutch case law on "*misbruik van omstandigheden*" or undue influence. According to the doctrine and jurisprudence of that country, m.v.o is an impairment of the fourth will besides that of the other three classical impairments of force, misleading and fraud. Ever since the new Civil Code was enforced in this country, m.v.o. or undue influence as the fourth impairment of will has been installed in the legal system.

There is a Dutch fairy tale that is often cited to describe undue influence, which Prof. Mr. JLP Cohen relates as follows:

Once upon a time there was a daughter of a wheat miller, who found herself placed in a difficult situation, because her parents boasted that she could weave wheat into gold thread.

The king believed and asked the girl to demonstrate her ability. If she succeeded the king would take her as queen. If not, then she would be killed. In this very difficult situation, suddenly there appeared a goblin, who said that he could help her with her task on one condition, that once the girl became queen, she must give her first born child to him.

It is, therefore, not surprising that the girl immediately agreed to the proposition, but it is also not surprising that when the girl became queen, she failed on her promise.

The moral of the lesson is: a promise is binding. But there is no obligation when it is given under duress.

24. Development of Standard Contracts

A contract or agreement always implies that there are two parties involved, whether they are debtor and creditor, or seller and buyer.

A contract follows an agreement. Despite the fact that, according to the latest thoughts, an agreement can not be viewed as merely one point in the entire process of the agreement, the fact that there is agreement always implies that there has been negotiations. An agreement occurs only after due process of negotiations where all conditions in the agreement had been discussed.

The term "process" also implies that a time frame was required.
Therefore, nowadays, an agreement is no longer considered as a mere point or moment in the process towards that agreement. In 1989 J.B.M.Vranken issued a book in the Netherlands entitled: "*Mededelings, Informatie and Onderzoeksplichten in het verbinterissenrecht*"
(Announcements, Information and Investigative responsibilities in the Law of Obligations). The title clearly explains its contents. In the Law of Obligations there exists the responsibility to announce, inform and investigate. Parties to the contract are responsible to inform each other and investigate all aspects pertaining to the contract. The aim being to attain a well-balanced contract that is founded on equal consent by both parties.

What happens in practice does not always follow this advice. In general, one of the parties to the contract who holds a position of monopoly, will always try to determine conditions one-sidedly. The other party, who holds no bargaining position must usually accept whatever conditions are mentioned in the agreement, on the basis of *take it or leave it.*

This situation is seen daily, whether these conditions are prescribed by a laundry, hotel or photo-printing. This does not even stop here. Large companies who hold monopolistic positions have already printed their draft contracts ready for signing by his business partner. This is also done by state companies such as in Telecommunications, Public Utilities etc.

Does the freedom to contract then still exist in this case? Although this practice is widely accepted and is allowed, the question remains as in how far do these private companies (who hold monopolies) have the authority to determine conditions of contract, that, in fact, according to Article 1338 BW is provided to both parties to the contract? From the point of view of Article 1338 BW a contract is, in fact, a law. And where all contracts are made according to a specific standard model, then, what is actually happening here is,- to borrow the term of the Dutch writer, Sluijter,- private legislation.

This is because those conditions as determined by the company in the above contract have become law, and, therefore, no longer form an agreement. Pitlo even goes so far as to call this a "dwang-contract", or a mandatory contract. Nonetheless, another well-known writer, Asser Rutten in his book "*Handleiding tot de Beoefening van het Nederlands Burgerlijk Wetboek*, 1974, states that " Every person who signs an agreement is responsible for the contents (of the agreement) which he (or she) has signed. Whenever a person adds his (or her) signature to a form of agreement on a book, that signature raises confidence that the signatory is aware of and wants the book, whose form he (or she) has signed. It is not possible for someone to sign any (agreement) whose contents he is not aware of". (Prof. Dr. Mariam Darus Badrulzaman SH, "Asas Kebebasan Berkontrak dan Kaitannya dengan Perjanjian", Buku/Standard, Makalah pada Upgrading Notaris, 27 April 1993.)

However, up to now this country has no regulations on standard contracts. In my view, negative excesses of a standard contract may be eliminated by using the theory of good intentions and abuse of circumstances.

One point is clear, though, and that is that with proliferation of standard contracts, the principle of freedom to contract is reduced.

25. The Law as an Instrument for Economic Policy Making

The decline in the freedom to contract is also caused by the use of law as instrument for Economic Policy-making. The use of law as instrument for economic policy-making is not new. During the world economic crisis in the 1920's, the Netherlands introduced what it called "*Crisiswetgeving*", which are legislation to overcome the economic crisis. In Indonesia this kind of legislation was used in the 1950's, that even emerged in the form of the Criminal Economic Law. Here interaction was created between the law and the economy. And as a result a new branch of learning was established, that of Economic Law.

The most apparent trait of Economic law is its regulating role. This regulatory role of law, taken in its widest sense, - aimed to propel growth and development of the economy,- is the reason why the law remains no longer the basis for legal policies only. (What we now see is that) the role of law has now shifted to become an instrument of policy-making.

The shift in the role of law then caused changes in the structure and form regulating the laws themselves. Especially laws in their written form.

Ever since the French Revolution it was an established fact that Laws (in their formal sense) are the chief products and form of Legislation.
Laws as a product of parliament, and viewed as a means to limit the powers of the King (read: the Authorities) – have recorded all principles of law that are required to regulate life in society. In its later development, Laws no longer occupy a central position. Especially since the growth and development of Economic Law. The reason for this lies the process of its inception, where Economic Law was based on delegated legislation. Here we see regulating law by delegation of power.

For these reasons, the principles of Economic Law do not all appear in the form of Laws (in their formal sense). They appear in such forms as Government Regulations, Presidential Decisions, Ministerial Decisions etc. Most recent example (in the 1980s) in this country are regulations known as Paktri, Pakto, Pakdes etc. which in essence are policies made by the Authorities in the field of economy in the form of written regulations (laws).

As example, Ministerial Decision of the Minister of Finance No.1548 dated 4 December 1990 to regulate (!) the stock market, refers to Law No. 15 of 1952. Article 7 of this Law establishes that contravention of any rules in this regulation made by the Minister of Finance based on the Law, is a crime. Although this is not unusual in delegated legislation, these authorities must be used with care, especially when these are linked to legislation and legalities. To cite the words of Prof. Padmo Wahjono, the formation of laws based on delegated legislation must not divert from the most important principles of legislation, namely the ranking of strength (hierarchy) of regulations. Regulations of lower rank must not contain legal norms which are outside, or worse still contravene those of higher rank. It is natural that a Government Regulation may not be made against the Law. However, it must be conceded that this principle is not always adhered to.

Furher, Mr. NG Kalergis-Mavrogenis, legal writer of the Netherlands, in his book : The power and non-power of the legislator,1978, says that excessive use of delegated legislation may result in non-power of the legislator. The power of the legislator has then shifted to the executive, or to the administrator. Therefore, regulations will then be channeled through the function of the administration.

The impact of the development of economic law is mostly felt in the area of Civil Law, especially in the field of Law of Obligations and Contracts. The growth of economic law runs parallel with the receding of the freedom to

contract. Economic Law that appears in its form as Public Law, is mandatory in nature. As a result, the essential nature of regulation in the Law of Obligations recedes to the background.

What do we face in delegated legislation?

First of all, for a certain length of time, we will face a situation that is equal to a vacuum in the rule of law. Whenever, for example a certain article in a specific law mentions that ensuing regulations will be established in a Government Regulation, then this means that for a certain period, until those ensuing regulations are established, we will find a vacuum in the law.

Secondly, over and above that – and this is most important – we actually face a vacuum in the provision of norms. The substance of these norms have (through such measures) been relegated by the legislators (meaning the Government and Parliament) to the executive.

Now more and more aspects of Contract Law show traits of public law that are mandatory in nature. Therefore, the basic principle of Contract Law that gives freedom to both parties to commonly agree on what will be accepted as law and binding to both parties, is now no longer completely valid.

The principle of freedom to contract is in fact founded on the assumption that both parties involved in the contract are of equal strength, seen from the social as well as economic aspects. In reality this is rarely found. So that, therefore, the question is not so much on how we may give equal treatment to both parties, as to what measure of quality do we give to each party, in order that they may both be on an equal level.

Here we see the positive role of Economic Law at work. The authorities have come down by issuing regulations and laws that provide protection to

the party that is socially and economically in weaker position. This is seen, for instance, in the case of consumer protection and product liability. Decision of the Minister of Finance no. 48 of 1991 dated 19 January 1991, on the subject of leasing, shows this kind of protection. The Decision says that leasing is a guided contract. A guided contract, according to noted writer Polak, is a contract whose conditions are based, not only on the basis of freedom to contract and on mutual consent by both parties, but whose minimal requirement must be to protect the weaker party.
This can be seen for instance in Article 8 of the above Decision.

However, when we compare this with similar regulations in the Netherlands on contract to buy and sell by installments, we see that the above-mentioned Ministerial Decision does not yet contain norms that are substantial in nature. Article 1576 C of the Civil Code of that country, governing buying and selling by installments, includes a default clause. This is a condition in the agreement where the deadline falls before due date. This clause is applicable where if one installment has been made, at least one tenth of total value of sales price must be paid; and in the case where several installments have been made, at least one twentieth of total value of sales price must be paid.

We foresee that regulating laws in Economic Law will have no small impact on the general development of Indonesia's Laws of the future.

26. In the context of international civil matters, the freedom to contract is often punctuated by a choice of law, which is limited by - what is known as - public policy.

Both parties agree that in the implementation of the contract and its implications, the contract shall adhere to the law of choice. Therefore, the principle question here must be whether the parties may choose their choice of law regardless? The answer to this is: negative.

The main issue in the choice of law is the balance between the freedom to contract on the one hand and public policy (*ketertiban umum*) on the other.

On the one hand the principle of freedom to contract justifies a choice of law. On the other hand, public policy limits the extent of choice.

"Choice of law in civil and commercial matters is characterized by two contradictory phenomena: party autonomy and mandatory rules of a public law nature" (Rene van Rooi, Maurice V. Polak, Private International Law in the Netherlands)

Choice of law may be made for as long as this does not contravene public policy.

Supreme Court Regulation No.1 of 1990 on the system in the implementation verdicts involving Foreign Arbitration says that what is meant with the term "public policy" are basic principles pertaining to the entire legal and social system of Indonesia".

Choice of law may also not mean " avoidance of law". In the doctrine, avoidance of law is sometimes called choice of law, in its incorrect meaning; whereas "choice of law" must be made with its correct meaning.

In choice of law we are faced with points of contacts, including citizenship, domicile, and location of item. Choice of law may be made only where relevant points of contact exist.

However, an avoidance of law, is precisely an effort to influence those points of contact. For example, relevant parties may change their citizenship, location of item in question or location where the contract was made.

Choice of law may only be made in the area of contract law; this is the area that is known as regulating law. Choice of law is prohibited for example in the area of forced law.

Even in contract law, the freedom to make a choice of law is limited. Choice of law, for instance is prohibited in labour contracts.

Choice of law can only be justified when there exists a point of contact.

In the meantime, choice of law of both parties may be set aside when a stronger point of contact is in existence that is stronger than the actual choice of law itself. The following example cited by Prof. Kollewijn is often quoted, as follows:" When an Argentine citizen and a Dutch citizen, both domiciled in the Netherlands make a contract for goods to be transported from Domburg to Groningen and both parties choose to act under Argentine law, then, according to Kollewijn the choice of the Dutch law by the judge is a far stronger (choice)".

Therefore, choice of law is limited by particular systems of law only, namely those that have the most characteristic connection. It is not allowed to choose a law that has no connection whatsoever with the contract. Choice of law *may be made only with bona fide intention.* (Summary from Prof. Mr. Dr. S. Gautama, Pengantar Hukum Perdata Internasional Indonesia, 1977).

27. The Impact of the Era of Globalization

The freedom to contract is also effected by the era of globalization. With more transnational contracts made, more agreements were made by parties in Indonesia, in particular between an Indonesian and a foreign party who have chosen jurisdiction under foreign law.

In the context of choice of law we see that the jurisdiction of a foreign law – limited by the principles of public policy as explained above – has been, in this instance, chosen on purpose by parties involved in the contract. Here the word "on purpose" is used, as the possibility exists that choice of law was made in secret. Whereas, as a result of globalization, it is also possible that regulating laws of one country crosses its geographic borders without intention and not on purpose, even against the will of parties involved in the contract. Here we see the indications of *transnational reach of national regulations.*

In this ever-smaller world, more and more transnational relations occur in the area of law. Facing the impact of law (and economy) from overseas, countries do not all take the same stance and attitude. Take for instance the attitude of the Latin American countries. In the last decade there was what is known as the Calvo Doctrine (originating from Carlos Calvo, an Argentine lawyer), who was of the principle that *"a foreigner by entering a country to do business implicitly consents to be treated as are national firms. This means that a foreign firm does not have the right to invoke the protection of its own government in investment disputes."* These Latin American countries, are, for instance reluctant to join the Centre for Settlement of Investment Disputes (ICSID). The Board of arbitration of ICSID opens the possibility for settling disputes on capital investment between a foreigner and the government where investment is made.

However, lately the implementation of the Calvo Doctrine by Latin American countries seems to have relaxed. More and more countries now offer protection towards foreign ownership through what is called as *investment guarantee agreements.*

We have from university days been taught on the limitations of validity of legal regulations. This refers to the scope and range of jurisdiction of certain regulating laws, its time of validity, persons who are included under

the regulation, and limitation pertaining to the territory where this jurisdiction prevails.

As to the latter, the territory of jurisdiction is bounded by the territory of the country where jurisdiction is made which at the same time reflects the sovereign boundaries of that country.

"Although the jurisdiction of national laws is normally limited to the particular nation, the reality is that actions taken outside the national boundaries can affect competition within the national market", thus Robock & Simmonds, in International Business & Multinational Enterprises, 1989. P. 188 and on.

It is on the basis of these principles of thought that certain countries, through their actions, expand their country's *reach of jurisdiction* into territories of other nations. "In recognition of this reality the US Courts have extended the US antitrust laws to actions abroad that substantially affect the commerce of the US and competition in the US market", say Robock & Simmonds further. In this context, for example, a verdict made by a foreign arbitration body outside the territory of the United States on a commercial contract, which contravenes the Antitrust Law of the United States, can not be validated and may not be implemented within the United States. Thus, indirectly the Anti Trust Law of the United States has acquired the power of *extra-territorial reach*, that extend to cases outside the territorial jurisdiction of the United States.

Indirectly, this also limits the freedom of the parties to bind themselves in a contract (of arbitration).