Chapter 3
The Development of New Customary Contract Law

Since 1967 Indonesia has taken an ever increasing open door policy with regard to foreign investments and foreign trade.

Since then thousands and thousands international contracts have been concluded, both between Indonesia private companies and foreign companies, as well as between Indonesian state companies and transnational corporations.

From the beginning, foreign contract models have simply been adopted and translated in the Indonesian language, without much thinking and research, whether those foreign concepts are in line with Indonesian contract – and business law, or not. On the contrary, very often the principles of Indonesian contracts law has been thwarted and re-interpreted, in order to accommodate the foreign concepts into Indonesian law.

Through the 35 years or so of intense foreign influence, especially of American law in Indonesia, Indonesian Contract and Business Law has astrayd far from what it theoretically should have been, given the fact that our Civil and Commercial Code of 1849 looks almost the same as it was some 150 years ago, except for a change of the Indonesian company law.

Indeed, our Contract Law, especially with regard to international contracts, mainly consists of thousands of contracts which together may be said has become the source of customary law as agreed to by both Indonesian and foreign business partners. With respect to foreign investments, banking – as well as the capital market, government administrative regulations decide on the form of the contract and other aspects of the contracts, very often making exceptions to the rules and principles laid down in the Civil Code. So that now we have numerous laws and regulations on specific contracts, while the Law on

Contracts in the Civil Code of 1848 only serves as the general principles of Contract Law in Indonesia.

Credit contracts, technical assistance contracts, management contracts, investment contracts, license contracts, franchise contracts, sale of goods contract have mostly been made along American models with a few modification in order that the foreign party's obligations and responsibilities are minimized, while the Indonesian partner's obligations are maximized.

The whole operation of the investment, starting from the land on which the factory or business is to be established, loan and credit, operation costs, including that of raw materials and machines, design and licenses, labour and manpower problems (except for off-shore personnel) up to negotiation – and administration costs and taxation have been made the responsibility of the local partner of the Joint Venture Company, whereby most of the operation costs of the Joint venture are the gains of the foreign partner of the Joint Venture before even the profits after tax will be divided between the foreign – and the local partner.

What is more, those foreign experts, loans, raw material and machineries, designs and plans of operation, are thereby calculated twice : both as the foreign party's investment (enjoying all kinds of tax-holidays and other facilities) as well as money and goods sold to "their own" (Joint Venture) Company in Indonesia.*

Nevertheless, at that time the policy of the New Order Government under ex-President Soeharto was of the opinion that Indonesia should open our doors widely for modernization, industrialization and foreign investments. This heavily economics oriented approach intentionally disregarded all protests and warnings coming from the legal professions, saying that so many of the foreign investment contracts were not only contrary to Indonesian (and universal)

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* See also Sunaryati Hartono (diss) :"*Beberapa Masalah Transnasional dalam Penanaman Modal Asing di Indonesia*" (Transnational Problems of Foreign Investments in Indonesia), Binacipta, Bandung., 1973.

principles of Contract Law, such as violating the principles of fairness and of balance, which the UNIDROIT Principles expressly states as contracts which can be re-negotiated, or could become in-valid.

Most economist, ministers and decision-makers even arrogantly answered that "no revolution can be made with lawyers" when Indonesian lawyers pointed out the mistakes, lopsidedness and unfairness of the investment contracts made and agreed by the President c.q. The (Foreign) Investment Board, especially when one considers that the foreign investors are usually transnational corporations, while their local partners consist of economically and technologically traditional and small local corporations, by any standard. No wonder that in this Reformation Era many members of Parliament (*Dewan Perwakilan Rakyat*) insist on having the contracts agreed by many a state company, such as *Perusahaan Listrik Negara (PLN), Pertamina,* and others, to be cancelled or renegotiated.

The Trend Away from Purely Civil Law Contracts

In any case, during the more than 30 years or so after 1967 i.e. when the Foreign Investment Law was first promulgated, a huge number of investment contracts came into being, which although not completely in line with the principles and rules of the Indonesian Contract Law and Law of Obligations as regulated in the Civil Code, were more or less respected and implemented by the government, and courts and recognized as new customary Contract Law.

There is, however a big difference between these investment contracts compared to the "ordinary" civil contracts regulated by the Civil Code.

Because the foreign investment contracts, although concluded before the investment permit of the (Foreign) Investment Board, will become binding only after the Joint Venture has obtained the necessary permit of the (Foreign) Investment Board (BKPM) and/or the relevant Ministerial Departments.

The civil contracts concluded before the permit is issued by the BKPM is to be regarded as binding only after and upon the condition of the BKPM permit being issued.

Therefore investment contracts are not purely civil contracts, but are governed by a mixture of private-and public law rules.

In other words : eventhough each of the contracts (such as loan, sale of goods, license contracts and the like) would be perfectly valid when standing alone, nevertheless, as part of an investment contract they are subject to the public rules of administrative and public policy.

This also applies to real estate contracts, insurance contracts, retail contracts, etc., whereby foreign investors or companies are involved.

It is therefore that a pure private law approach to contracts concluded in Indonesia is not appropriate any more, as is the case also in other states, such as in the United States, where each import contract should conform to the Food and Drug Act first, before anything else.

The Rise of Standard Contracts and International Contracts

With the industrialization of Indonesia and big business since the 1970s involving the growth of companies and banks, the use of standard contracts came into being.

Of course, before that Indonesia already made use of standard contract, such as in transportation, banking and insurance, but it is only during the 1970s that the use of standard contracts, especially in the banking, real estate and import/export sector started to be used on a big scale.

Unfortunately the law of obligations in Indonesia has no regulations for such standard contract and even the judiciary has never made any difference between the implementation and implication of standard contracts and "ordinary" contracts, where the bargaining power of both parties are considered relatively equal.

No wonder that this lack of legal sensitivity of the lawyers, and especially of the courts lead to unjust decisions and injustice, because they disregarded the principles of balance and equality as a factor which could decide on whether a contract is valid and fair, or not. What was important to the government and the judges was only that the contract was signed, making the contracts ipso facto valid. The fact that big companies could impose almost everything to weak parties for whom the contracts could be a matter of life ad death, thereby excluding most responsibilities for themselves, while imposing all kinds of obligations to the weaker party, were simply out of their considerations.

In the near future, therefore Indonesia would have to introduce a Law on Standard Contracts, like the regulation on General Standards (*Algemene Voorwaarden*) in the Netherlands where the differences of bargaining power between the parties will be considered and the consequences are regulated, in order to come to fairer arrangements.

The Need for a Law on International or Transnational Contracts

Like a Law in Standard Contracts, we also need a Law on International Contracts, where the international conflict laws and principles are explicitly spelled out.

Because at present no important industrial or business operation is any more conducted without foreign credit, foreign management, foreign technology, foreign imported raw materials and what not, or even without the products or services being exported abroad.

Business in Indonesia therefore, is not any more conducted internally between Indonesians, but almost always involves one or more foreign parties or elements. Only very small businesses are conducted between Indonesians, making Indonesia a part of the global market in the real sense of the word.

The view as if international contracts are only exceptions to the rule therefore is contrary to what we see in practice, at least in Jakarta.

Involvement of international trade and business organizations, even the IMF, IFC, the World Bank, the Asian Development Bank and UNDP, which are the channels for (business) development in Indonesia, all these organizations think in terms of international law and International contracts and agreements, to which the Indonesian government and the Indonesian people have to live by.

A separate law on International Contracts seems therefore also necessary, especially because with international contracts in Indonesia not only private international law applies, but also international conventions and treaties, such as the International Convention on the Settlement of Investment Disputes, etc.

Hence, more appropriate would be the notion of transnational contracts since both public and private international law rules and principles will have to be considered, when making and interpreting international or transnational contracts in Indonesia.

The Law on Government Contracts

A further category of newly grown contracts after the 1970s are the government contracts, i.e. standard Contract concluded with government agencies or with state companies.

Although such instruments are called contracts, they have but little to do with contracts properly so called. In fact they rather represent a list of condition stipulated by the government agency or the state company to which the private party i.e. an Indonesian (or foreign company) has to abide by. Such government contracts are therefore Standard Contracts for which public law is applicable.

Up to the present time considerations of fairness are still unrecognized, such as for instance that eventhough it lies in the power of the government to raise the prices of goods and services in general (which are relevant to the contract), nevertheless the private contractor is not allowed to make changes in the price or the time of performance or the quality of the work. This of course is theory. In fact, often it would be impossible to abide by the conditions agreed, but some of bribe will be enough to have the performance of the contracts agreed by the respective governmental agency or state company, modified.

Therefore, instead of this illegal way of doing business I would prefer to recognize the principles of force majeure, of balance and of hardship to be recognized as factors or reasons for renegotiation, as regulated by the UNIDROIT Principles of International Commercial Contracts.