

## Indonesian Contract Law

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## Introduction

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 Indonesian private companies and foreign companies, as well as between Indonesian state companies and transnational corporations.

From the beginning, foreign contract models have just 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. On the contrary, very often the principles of Indonesian contract 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 been astray far from what it theoretically should have been, given the fact that our Civil and Commercial Code of 1848 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 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 regulations decide on the form of the contract and other 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.

Entering into the 21<sup>st</sup> century with its global economy, and its e-commerce, it is understandable that Indonesia cannot any more rely on such an outdated Contract Law,

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even if they only represent the “General Principles of Contract Law”.

Contract law is regarded as part of Indonesian private law, particularly as part of the Law of Obligations. Indonesian law is often described as a member of the “civil law” group as found in Continental European countries such as France and Holland, as opposed to the common law systems such as those in the United Kingdom and its former colonies. Part of Indonesian Private Law as inherited from the Dutch colonial Government are two codifications i.e. the Civil Code (*Burgerlijk Wetboek*) and the Commercial Code (*Wetboek van Koophandel*). Those codes were originally derived from the French codification as enacted on March 21, 1804 which we know as the Code Napoleon. Therefore, the existing contract law which applies in Indonesia today, consists of the Netherlands-Indies Law of Obligations as contained in the Civil Code of 1848. Hence, we feel that a number of provisions should be modernized, repealed, or replaced with new and internationally compatible norms as the Civil Law of the Netherlands has already been changed. Whilst other norms which are still relevant may be maintained.

As a new emerging economic country and part of the world society, Indonesia cannot avoid the current trend of globalization of law which tend to harmonize to a certain degree all legal norms of the world, especially in economic and business relations. This might be imposed by a single coercive regional and global organization and as a consequence of the memberships of regional and global cooperation such as the WTO (World Trade Organization)<sup>1</sup>, APEC (Asia Pacific Economic Cooperation) and AFTA (Asean Free Trade Association). AFTA will fully enter into force in 2003, and WTO in 2020.

The economic and financial crisis<sup>2</sup> in fact coincides with the first stage of implementation of those regional and global liberalization forces, which needs even more certainty and predictability of international commercial contracts.

## **A. Brief History of Contract Law in Indonesia**

Before the Dutch ruled over the Indonesia Archipelagos, each tribe or clan living on these islands were governed by their own Customary or Adat Law, which also included Contract Law. Although the rules differed one from the other, but they had 3 (three) features in common, which Prof. Van Vollenhoven described as “(1) communal,

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<sup>1</sup> Ratification of the Agreement on Establishing World Trade Organization by Act No. 7 of 1994.

(2) cash and carry, and (3) concrete .

In 1855 article 131 of the Netherlands Indies State Law (State Gazette No. 2 of 1855) legally divided the Indonesian population into three groups, i.e. :

- (a) Europeans, including Japanese;
- (b) Foreign Orientals; and
- (c) Indigenous Indonesians.

Article 163 of that law ruled that:

- (a) the Civil and Commercial Code applied to Europeans and Japanese;
- (b) The Civil Code and the Commercial Code, concept for those parts concerning personal law, marriage and inheritance also applied to Foreign Orientals.
- (c) Indigenous Indonesians were not governed by the so-called “European Laws”, except in the case they legally obtained the same status as “Europeans” by Decision of the Governor-General.

Hence the Civil and Commercial Code never applied to Indonesians. Except in the most exceptional case, when an Indonesian request to the Governor-General was granted to be regarded as an European. This was possible only, in the case he had a Dutch education, married a Dutch or European woman, spoke Dutch at home with his wife and children, became a Christian and was completely living in a Dutch environment.

For the bulk of Indonesians, however, the Civil Code and hence Contract Law as contained in the Civil Code, never applied, and Indonesians have nothing to do with so-called European Law.

It was only since 1967, after the Foreign Investment Law was promulgated that the Company Law under the Commercial Code and the Contract Law under the Civil Code were made applicable to (indigenous) Indonesian citizens by Governmental Regulation, which later was confirmed by the courts through case law. Whilst the “European” Contract Law and Company Law were still a novelty for Indonesians, at the

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<sup>2</sup> Since the middle of 1996 up to the present time

same time foreign elements (especially American legal principles and clauses were introduced in the Investment Contracts between foreign investors and Indonesian businessmen. The use of the English language combined with the underlying English legal concepts of Contract – and Company Law resulted in a terrible mixture of rules and clauses in the Investment Contracts resulting in a state of confusion as to what the law really is, and how a clause should be legally interpreted by lawyers and judges.

That is why, especially with the dawn of electronically agreed contracts, coinciding with the globalization of commerce and investments in the 21<sup>st</sup> century, it is high time that Indonesia reforms and modernizes its Contract Law to the needs of Indonesians, as well to those of the international business world.

### **Background of the Indonesian Civil Code**

It is often said that Indonesian Civil Law belongs to the group of the Continental “Civil Law Systems”, as opposed to the “Common Law Systems”.<sup>3</sup>

This description is not wrong to the extent that much of Indonesian law derives from the Dutch and the French. However, the statement is not entirely true.

As Sudargo Gautama<sup>4</sup> said that when the first Dutch ships landed in the Indonesian Archipelago, they did not find a juridical “empty land”. The land was full of legal institutions. There was diversity of laws from the beginning of the days of the VOC (*Vereenigde Oost Indische Compagnie*) or United East Indian Company. From the beginning of Dutch colonization, the inhabitants of the Indonesian Archipelago, have been divided for legal purposes into various “population groups” (*bevolkingsgroepen*). This distinction was not entirely based on racial differentiation, but was also based on economic considerations. There was also a distinction between residents and non-residents, Dutch nationals and foreigners, but no distinction was more important than the division into population-groups, as regulated by State Gazette 1855 No. 2.

For example, matters concerning daily transactions in private life, such as what kind of contracts one could enter into, whether one could own land and where, from whom one could inherit and in what ways ; all such matters depended on the population group one belonged to. This was so, because different rules of contract law, property law and inheritance law existed for each group. Each group had its own legal system,

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<sup>3</sup> Timothy Lindsey, *An Overview of Indonesian Law*, in *Indonesia Law and Society*, Sydney: the Federation Press, 1999, p. 1.

<sup>4</sup> Sudargo Gautama, *The Commercial Laws of Indonesia*, Bandung : Citra Aditya Bakti, 1998, p. 3.

separate regulations administered by separate government officials and regulated by separate codes or laws. Very different systems of law existed side by side in Indonesia for centuries, although transactions between the various groups were possible which was governed by principles and rules of Interpersonal Law. In special cases unified regulations were made like in the case of the Criminal Code, which applied to all groups of inhabitants.

## **B. Application of the Civil Code and General Principles of Contract Law**

Part of Indonesian Private Law as inherited from the Dutch are the Civil Code (*Burgerlijk Wetboek*) and the Commercial Code (*Wetboek van Koophandel*). These codes (except for a few exceptions), were practically Dutch translations from the French Code Civil and Code du Commerce. The Civil Code was promulgated in Indonesia by Government Announcement on April 30, 1847, Government Gazette 1847 No. 23 and applied since the 1<sup>st</sup> January 1848.

Article II (the Transitional Regulation) of the Indonesian Constitution of 1945 states that all the existing state institutions and regulations will still apply, as long as no new ones have been established in accordance with this Constitution. This provision was made, in order to prevent a legal vacuum. Hence the old regulations and codes before our independence on August 17<sup>th</sup>, 1945 continue to apply till the present time. Nevertheless, the Government assisted by the National Law Reform Agency (Badan Pembinaan Hukum Nasional) is scrutinizing which of the old laws will have to be replaced by new ones. Some 400 laws and/or regulations will have to be replaced by new ones.

The recent development pertaining to contract law and commercial transactions has been the enactment of Act No. 1 of 1995 on the Limited Liability Company (PT), the Fiduciary Securities Act (No. 42 of 1999), and the Futures Trading Contract by Act No. 32 of 1997. Standard contracts are regulated in specific regulations such as Act No. 8 of 1999 on Consumer Protection and Act No. 18 of 1999 on Construction Services. At present a bill is being prepared for Mining Activities including mining and license contracts. Provisions concerning contracts which are prohibited can be found in Act No. 5 of 1999 concerning the Prohibition of Monopoly and Unfair Business Competition.

## **Contract Law as a Source of Obligations**

The Civil Code was promulgated in the year 1848 together with the Commercial Code. The law of contracts under the Civil Code (*Burgerlijk Wetboek*) is laid down in Book III of the Civil Code, starting with Article 1233 through Art. 1456. The 5<sup>th</sup> Chapter of Book III (art. 1457 to art. 1850 CC) regulates the so-called “nominated” or specific contracts, such as sale of goods, barter, hiring, etc.

Book III of the Civil Code, under the heading “Obligations”, contains :

- (a) the law of contracts as the principal source of obligations,
- (b) the management of affairs without mandate, and
- (c) the law of torts or wrongful acts.
- (d) Nominated contracts.

Every obligation is born either by agreement or by legislation<sup>5</sup>. There is no definition on what obligation is in the Civil Code. Legal science stipulates that obligation is a legal relation between two or more persons which site within the field of the law of property, establishing to one party the right to get something or have something to be done by the other party, who has the obligation to fulfill such right. Legal relations happen every day, so the law grants “rights” to one party, and “obligation” to the other party and vice versa. Elements of obligations are : legal relations, property, parties, and something to give or to be done (*prestatie*)<sup>6</sup>. If one of the parties does not respect or breaches such legal relationship, the law will be enforced in order that the relationship will be fulfilled or restored. For example : A agrees to sell a bicycle to B. As a result of that agreement, A is obliged to give his bicycle to B and at the same time has the right to its price from B, whilst B is obliged to pay the price of that bicycle to A. If A does not fulfill his obligations, then the law will “force” him to do so by legal means.

However, not all social relations result in the enforcement of the law of obligations. An agreement to go for an outing or a picnic will not bear an obligation, because such agreement is not an agreement in the legal sense. Such agreement falls within the category of moral obligations, because the non-performance of the obligation results in a reaction from other members of society as a bad attitude. The non-

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<sup>5</sup> Article 1233 Civil Code.

<sup>6</sup> Mariam Darus Badruzaman, *Civil Code Book III and Its Explanation* (KUHPerdata Buku III Hukum Perikatan dengan Penjelasan), Bandung, Alumni, 1993, p. 3.

performance party will be hated by the other, but it is non-actionable before the court.

Sources of obligations are agreements (contract) and legislation. <sup>7</sup> Obligations born by Law can be born by mere Law (*uit de wet alleen*) or as a result of human action (*uit de wet ten gevolge van 's mensens toedoen*) <sup>8</sup>.

Furthermore obligations as a result of human actions can be lawful or unlawful acts or torts (*onrechtmatige daad*).<sup>9</sup>

Obligations born by mere Law are obligations between the parties concerned (with or without intention of the parties). For example : date of expiration (*verjaring*) is an event where the legislators determine an obligation to a particular person. Because of the date of expiration, someone might be released from doing something or acquiring a right or obligation to do for something ; the death of a person will result in legal obligations to his heirs, the birth of a child results in the obligation to the parents in order to take care of their infant (Article 321 Civil Code).

Obligations which arise from the Law as a result of human lawful acts are for instance a voluntarily handling of other people's interests (*zaakwaarneming*), because the Law determines that some rights and duties must be performed by the handles, similar to the rights and duties in such cases as if an agreement was made. Article 1354 Civil Code states that "if someone, without having obtained an order for it has voluntarily handled another person's matters, he has an obligation to continue and finish that matter (business) until the people represented is able to do that matter by himself. The person, whom the other person has represented, has an obligation to compensate all costs which was spent on his behalf.

Obligations resulting from the Law but caused by unlawful acts is enacted in Article 1365 of the Civil Code, saying that those who causes another person to suffer losses, based on his fault, must restore the losses.

As Article 1233 Civil Code states that "obligations are born from contract or from legislation". That means that Law and Contracts are sources of obligations. This gives the impression as if the sources of obligations are only limited to those two sources mentioned above. However, based on the extensive interpretation on natural obligations in an Supreme Court decision of March 12, 1926, obligations can also be based on good faith or decency (good deed) as a source of a "natural" obligation

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<sup>7</sup> Article 1233 Civil Code.

<sup>8</sup> Article 1352 Civil Code.

<sup>9</sup> Article 1353 Civil Code.



(*natuurlijke verbintenis*) which can not be sued before the court to obtain full compensation, but if performed, releases the performer of his obligation.

### **General Provisions and Open System of Book III of the Indonesian Civil Code**

The law of contract is an “open system”, which means that everybody is free to make any kind of contract. Special contracts or “nominated contracts” are regulated in the Civil Code being only the most popular kinds of contracts. Because Book III of the Civil Code is an open system, the articles in Book III actually provide only General Guidelines of Contract Law. With such general provisions, people could conclude whether or not they have made a legally valid contract.

### **Freedom of Contract**

The freedom to make contracts of whatever kind is regulated in Article 1338 paragraph 1 of the Civil Code, which provides that all contracts which have been legally concluded, have the same force as a legislative act for the parties who had concluded the contract. As a consequence of the open system of the law of contracts, the provision laid down in Book III of the Civil Code have the character of optional law. This means that the parties are free to ignore those provisions by making for themselves rules in their contracts deviating from or even contrary to those provisions laid down in Book III<sup>10</sup>, except that they cannot deviate from the basic rules of legality, justice, good intentions and fairness, whenever the parties have not made any provision concerning a certain matter in the contract.

Book III of the Civil Code consists of a General Part (art. 1233 – 1456), containing the general rules of the law of obligations and contracts and a Special part regulating special contracts (art. 1457 – 1855). The general principles of the law of contracts in the Civil Code form the principles not only for contracts regulated in the Civil Code itself, but also for those regulated in the Commercial Code and in other special acts or regulations.

Most articles of the law of contract, private law in general, are additional legal provisions (*aanvullend recht*), which apply in case the parties had not agreed otherwise. The additional legal provisions also apply only when both parties consent to that. Here the legislators made a fiction of presumed intention of the parties. Such fiction is needed

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<sup>10</sup> R. Subekti, *The Law of Contracts in Indonesia, Remedies of Breach*, Jakarta : Haji Masagung, 1989.

in order to synchronize with the principle of consensus of the parties. Apart from that, such legal presumption is needed to determine the rights and duties of the parties and also to prevent any legal dispute, or for the sake of legal certainty.

The elements of obligations are : the parties, legal relations, property, and something to give or to be done (*prestatie*).<sup>11</sup>. In Book III the law of obligations is part of the law of property (*vermogensrecht*), which distinguishes between absolute rights and relative rights. Absolute rights (or rights in rem) are regulated in Book II of the Civil Code, whilst relative rights are regulated in Book III of the Civil Code. Property rights are rights which have economic value or can be counted in sums of money. So it should be clearly understood that the obligation to give or do something (*prestatie*) valued in money or other economic value has an important role in the law of obligation. This legal character is to be distinguished from the moral obligation which are not enforceable by law.

The Civil Code also regulates a number of so called “nominated” contracts, such as the contract of sale, barter or exchange, lease, contract of labour, partnership, association, donation, deposits, loans, “natural contracts” like gambling and life annuity, agency, guarantee and compromise.

Contracts of insurance and transportation overseas are regulated by the Commercial Code, and contracts of transportation over land and by air are regulated by special laws or ordinances.

Other commercial transactions have been provided by many Laws outside the Civil Code and Commercial Code such as the Contract for the establishment of a Limited Liability Company (PT) regulated in Act. No. 1 of 1995 on Liability Company, Fiduciary Securities in Act. No. 42 of 1999, and Futures Trading Contracts in Act. No. 32 of 1997. Standard contracts have been enacted in special rules such as in Act. No. 8 of 1999 on Consumer protection and Act No. 18 of 1999 on Construction Service, while at present a bill is being prepared for mining activities, including mining and license contracts. Finally, in Act. No. 5 of 1999 concerning Prohibition of Monopoly and Unfair Business Competition there are provisions on contract clauses, which are prohibited.

## **Definition and Scope of Contract Law**

Chapter II of Book III of the Civil Code concerns “Obligations born from

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<sup>11</sup> Mariam Darus Badruzaman, *Civil Code Book III and Its Explanation (KHUPerdata Buku III Hukum*

Contract or Agreement”. The use of the words “contract” or “agreement” in Book III have identical meaning, Article 1313 of the Civil Code define a contract (or agreement) as an “act by which one or more persons bind themselves towards two or more other persons, with the intention to create obligations”.

The term “act” between two or more persons in this article should be understood as “legal act”, because both parties are required to consciously know or could or should have known of the legal consequence which would occur in the future. Hence the parties intentionally were engaged in such act for the purpose of its legal consequence. In other words, the legal consequence was indeed something that was intended by the parties. For example in the decision of the Court of Central Jakarta in the case between **Alfa Indonesia** vs, **Jakarta Lloyd** No. 64/1979, the defendant posed that the shipping agreement included a special agreement (*benoemde overeenkomst*). Article 506 of the Civil Code namely stated that a Bill of Lading is a letter in which was written that on a certain date the carrier received a certain (kind or amount of) goods to be delivered at a certain place of destination where it should be delivered to a certain person. The bill of lading also contains a set of conditions for transfer goods. Therefore it was convincingly clear that the **Bill of Lading** was indeed a unilateral declaration (*eenzijdig*) made by the carrier/defendant and that it was not an agreement between the two parties (*overeenkomst*) as stipulated in Article 1313 Civil Code.

The law of Book III of the Civil Code concerns contracts in the field of private law. Agreements in public institutions or organizations are not covered by the Civil Code. Public law concerns public law relations, namely relations between states or between public institutions and organizations. However, in the last thirty years increasingly the state conclude contracts with individual persons or private companies concerning private law matters. Such as whenever the government has to buy computers or stationeries from a private company for the purpose of government procurement.

In recent times there are two opinions on that issue. If the state acted in the quality of the state (*iure imperii*) the legal relationship results in a public law relation. Whereas if the state acted in her economic capacity (*iure gestionis*)<sup>12</sup> as for instance as a state company, private law on the matter should be settled by private law provisions. In such case the provisions of Book III of the Civil Code apply.

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*Perikatan dengan Penjelasan*), Bandung : Alumni, 1993, p. 3.

<sup>12</sup> Compare with Barry E. Carter and Phillip R. Trimble, *Foreign Sovereign Immunity and the Act of State Doctrine*, Boston : Little, Brown & Co., 1991, pp. 449 – 697.

For example in the decision of the District Court (*Residentiegerecht*) of Batavia, March 18, 1927 in the case of “**Excess Teaching Hours**”.<sup>13</sup> A, a mathematic teacher, who was appointed by the Department of Education became Head of a Preparatory Team for the opening of the Medical School in Surabaya, had been given the task to give mathematic lessons to the student candidates. The task as a teacher has exceeded the number of teaching hours agreed upon, because the change of teaching schedules from the Department of Education.

Based on those reasons he sued the Department of Education c.q. State in order to pay the “excess of teaching hours”. The legal reasoning of the Court Decision said that the legal relationship between plaintiff and defendant was a relation between employee and the state. Such relationship was not a private agreement, but had a public law character. Article 40. I.S. (*Indische Staatregeling*) stipulates that payment of wages for public employees is unilaterally decided by the state. Therefore, intervention by another party, even though by the Court, was not excepted. This indicated the difference between public law and private law. In other words, the private law provisions in Book III do not applied for agreement in the field of public law.

This was the situation in 1927. But recently there is a group of lawyers, who have modified this theory, saying that in specific cases Book III CC might be applicable to government contracts.

### **General Conditions for Validity of Contract**

Article 1320 Civil Code provides for the general conditions by which a contract is valid. Such conditions concern the subject and the object of the contract. This article stipulates that for a contract to be valid, it must comply with 4 (four) conditions, namely : (1) consent between those who bind themselves (the parties); (2) capacity of the respective parties to conclude an obligation;, (3) a certain (specific) subject matter, and (4) a legal cause.

When the conditions mentioned above are fulfilled, a contract is complete and valid. The validity of a contract is, as a rule, not bound to formalities. Only by exception the law prescribes formalities for a certain number of contracts.<sup>14</sup> The first two conditions are conditions pertaining to its subject, and the last two conditions are

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<sup>13</sup> Translated from J. Satrio, *Hukum Perikatan, Perikatan Yang Lahir dari Perjanjian*, Bandung : Aditya Citra Bakti, 1995, pp. 30 –32.

conditions pertaining to its object. A contract containing defective subject, namely concerning the consent of the parties or whenever one party has not obtained the capacity to conclude an obligation, does not invalidate such contract (*nietig*), but often only raises the possibility for the other party to claim that the contract is void (*vernietigbaar*).

On the contrary, whenever the subject matter is not certain or whenever the cause is not legal, such defects on the object of the contract result in the contract being void by law.

### **1. Mutual Consent Between Those Who Bind Themselves**

In concluding a contract there has to be at least two persons who take opposite positions and have the intention to come to a mutual agreement (consent). Hence, a consent means a meeting of minds<sup>15</sup>.

According to Prof. Sudargo Gautama :

*“By a free consensus (meeting of minds) is meant that both parties have voluntarily given their consent or have voluntarily agreed to the contract. According to article 1321 of the Civil Code the consent is not valid when it is the result of error, coercion or deceit”.*

The mere meeting of minds between two persons would not sufficiently conclude an obligation. The core consent is indeed an offer which was accepted by the other party. Offer and acceptance could come mutually from both parties. Therefore, the elements of offer and acceptance is very important to determine the birth of a contract. Unfortunately, the legislator did not provide a pattern which could be used to determine to what extent an offer or an acceptance is binding.

According to Sudargo Gautama<sup>16</sup> the principle of consensus concerns the formation of a contract. Generally no formal requirements are needed to make a contract binding. The mutual consent of the parties will be sufficient. The exceptions however made by the law are :

(a) Besides the mutual consent of the parties, the delivery of the subject will

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<sup>14</sup> R. Subekti, op. cit.

<sup>15</sup> R. Subekti, op. cit.

<sup>16</sup> Sudargo Gautama, *Essays in Indonesian Law*, Bandung : Citra Aditya Bakti, 1991, pp. 188 – 189.

be required to make the contract binding. This is the case in the following contracts : depository (sect. 1694 Civil Code); loan for use (sec. 1749 Civil Code); loan for consumption (sect. 1754 Civil Code).

- (b) As regards certain contracts the mutual consent is required to be made in a certain written law form, namely an authentic deed (contract of donation, Article 1692 Civil Code), and the formation of a limited liability company, (Article 30 Commercial Code) or private deed (contract of compromise, Article 1851 Civil Code).

In the Netherlands it has been enacted in the *Nieuwe Burgerlijk Wetboek* (*New Civil Code*) Article 217 to 225. Here the legislator gave some provisions on offer and acceptance. According to Articles 219 – 225, a contract is formed by an offer and its acceptance. Articles 219 – 225 apply unless the offer consists of another juridical act or usage produces a different result. An offer is valid, null and void, or subject to annulment according to the rules which are applicable to multilateral juridical acts.

There are at least 4 (four) theories regarding the doctrine of consensus, namely : the Will's theory (*wilstheorie*), the sending theory (*verzendtheorie*), the knowledge theory (*vernemingstheorie*), and the trust theory (*vertrouwenstheorie*). The will's theory states that consensus is reached at the moment both parties have expressed their will, for instance by writing a letter to the other party. The sending theory says that consensus is reached at the moment the will to except is expressed by the acceptor to the offeror. The knowledge theory states that consensus is reached whenever the offeror should have known that his offer was accepted. And the trust theory states that consensus is reached, whenever one can reasonably presume that the offer has been accepted by the acceptor.

Asser <sup>17</sup> divided conditions for the validity of contract, in the core part (*wezenlijk oordeel*) or “essensialia” and the non-core part (*non wezenlijk oordeel*) or “naturalia” and “aksidentalia”. Essensialia is a condition which is mandatory to a contract, something without which the contract cannot exist (*constructive oordeel*). Such are the conditions of consensus and the object of a contract. Naturalia is a part which “naturally” adheres to a contract, such as the obligation to assure that no defect goods shall be sold (*vrijwaring*). Aksidentalia means conditions adhered to a contract

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<sup>17</sup> See Mariam Darus Badruzaman, *ibid*.

which should be expressly agreed upon by the parties, such as the provisions on the parties' domicile.

## **2. Capacity of the Parties**

Everybody is capable of concluding a contract, except those who are declared incapable by law. According to Article 1330 of the Civil Code, the following are incapable of concluding contracts : minors, those who are under guardianship and married women. By a decision of the Supreme Court in 1963, the provision as regards married women is declared illegal, so that now married women are capable of concluding contracts, without the assistance of their husbands. In case an incapable person has concluded a contract, his/her legal representative has the right to demand before the court the annulment of the contract. The person himself also can demand annulment, when he becomes capable or regains his capability. It is understood that the other party (that is the party who is capable) has no right to demand annulment of the contract.

## **3. A Certain Subject Matter**

By a certain subject matter is meant a clear description of what is agreed to resulting in the certainty of the subject matter. This is necessary to enable the Judge to determine the duties of each party, when there arises a dispute. For example : a contract of sale of "rice for one hundred dollars"; shall be declared null and void for the reason that a certain subject matter is lacking, as it is not clear what kind or quality of rice is sold; moreover nothing is said about the quantity.

## **4. A Legal Cause**

By a legal cause is meant that what has to be performed by either party is not contrary to the law, public order or public morality. A contract whereby one of the parties undertakes to commit a crime is null and void, because it has an illegal cause.

From what is said above, we can draw the conclusion that, in case of incapacity of one of the parties or in case of lack of free consensus, the injured party has to demand the annulment of the contract from the judge. In such cases the contract is voidable. On the other hand, in case of ambiguity about the subject matter, or in case of illegal cause, the contract is null and void from the start. In these cases the judge shall ex officio declare the contract null and void. In case of incapacity of one of the parties or in case

the imperfectness of the contract, whereas in the case of ambiguity about the subject or in the case of an illegal cause he is supposed to know the imperfectness of the contract at first sight.

The action for annulment of a voidable contract shall be brought within five years. This period shall begin : (1) In case of incapacity of one of the parties from the time that the incapable person becomes capable or gains his capacity; (2) In case of error, coercion or deceit, from the moment of detection or discovery of the error or the deceit or from the moment the coercion has ceased (Article 1454 of the Civil Code).

### **Breach of Contract**

There are four different manifestations of breach of contract, i.e. whenever : (a) The debtor has not done anything to carry out his duty; (b) the debtor has done his duty but not equivalent to what was promised in the contract; (c) The debtor has fulfilled his task, but too late; and (d) The debtor has done something that is contravention to the contract.

In all these cases the debtor is considered to be in default, as he has been neglecting his contractual duties. The law has laid down certain sanctions for such a debtor.

### **Debtor's Fault**

Where the debtor has done something that is in contravention to the contract, it is obvious that he is in default. Also when a time limit is fixed in the contract for carrying out the duty and the debtor has passed this time limit, it is clear that the debtor is in default. But in other case, the creditor has first to remind or to summon the debtor to fulfill his contractual duties, as for instance, when the debtor has to pay a sum of money and it is not stipulated when he has to make the payment, or when the performance by the debtor, according to the creditor is not equivalent to what was promised in the contract.

According to judicial decisions an oral reminder is enough. To be safe, it is advisable for the creditor to remind by registered letter, so that he has proof of the reminder. According to the Civil Code there are four sanctions attached to a breach of contract : Compensation (costs, damages, and interest) : Cancellation of the contract; Transfer of risk of responsibility for the object of the contract; Payment of cost procedure; when it leads to recourse to a court.



Article 1266 of the Civil Code provides for a claim of cancellation of the contract against a debtor who is in default to fulfill his obligation. The cancellation of the contract is meant as a punishment for a debtor who has neglected his duties. Indeed it is sometimes felt hard by a debtor, especially when he has already incurred expenses for the fulfillment of his contractual duties. Article 1266, therefore, provides that the court could allow a period of grace to the debtor to give him an opportunity to perform. When the court is of the opinion that a cancellation of the contract will be disastrous to the debtor, while his fault is not serious, the court will refuse to cancel the contract, though, possibly, he will entertain a claim for compensation.

The right of a seller in a cash sale to reclaim the goods sold and already delivered to the buyer in case the buyer neglects his duty to pay the price of the goods, is in fact a right to cancel the sale without the intervention of the court. This right is to be exercised by the seller within thirty days from the date of the sale while the goods are still in the possession of the buyer (Article 1145).

### **Preliminary Research Report on the New Law of Obligation (by *Setiawan, S.H.*)**

1. This report is a preliminary research report conducted for the Law Reform Agency of the Department of Justice.
2. 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 “*overeenkomst*”, 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<sup>18</sup>: “*Alle verbintenissen ontstaan of uit overeenkomst, of de wet*”, meaning that obligations originate either from an agreement

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<sup>18</sup> BW is the abbreviation of Civil Code or CC.

or from legislation.

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

### 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 discrepancies 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 to 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 (*ongeeoorloofde 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 Cahen relates as follows:

Once upon a time there was 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 verbintenissenrecht*”

(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 Badruzaman 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.

Further, 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. Kollwijn 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 Kollwijn 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).

## **Conclusion**

From the discussions above, the reader may have seen how complicated the problems of legal reform are in Indonesia.

*Firstly*, the majority of Indonesians still live in their traditional environment, unaware of the pressures and demands of international business in an age of globalization.

*Secondly*, while the principles of (old) Dutch Contract Law has been recently introduced to the group of Indonesian businessmen, other (esp. American) principles of Contract and Company Law has at the same time been adopted in many Investment Contracts through specific clauses, such as clauses for arbitration by an American arbitration board, or other provisions, which are strange to Indonesian Contract Law, but not always illegal, if it has never been regulated.

What is more, all this has been made possible on the basis of the principle of freedom of contract.

*Thirdly*, while Indonesia still adheres to the pre-war legal theories, the Netherlands has already adopted its law to the needs of the 21<sup>st</sup> century by promulgating a New Civil Code, which also contains provisions which formerly formed part of Dutch Commercial Law.

*Fourthly*, in the meantime, international conventions and model laws have come into existence, making it possible for Indonesian legislative drafters to study them and use them as a model for our New Contract Law, which – as we have seen – is not only to be found in Book III of our Civil Code, but is scattered over a large number of other laws and regulations, including our Commercial Code.

*Fifthly*, Therefore before we can really embark on drafting a comprehensive Law of Contract in Indonesia, we will first have to study all those separate laws and regulations, and compare their principles with those of the International Conventions and Model Laws.

*Sixthly*, The conclusion we reach now is that a new Law of Contract Law can

at best consist of a list of general principles of Contract Law to be observed, which is in accordance with international practice and theory, but which does not violate the Indonesian idea of fairness, good faith and justice.

*Seventhly*, If so, the Indonesian Contract Law will maintain its feature of an “Open System”, which allows for special regulations for specific contracts, provided the general principles of the Law of Contract are still upheld. This in fact results in an Indonesian Law of Contracts, rather than a Law of Contract.

Jakarta, 7 November 2000.