A GUIDE TO BUSINESS LAW IN ASIA

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CHAPTER EIGHT

THE LEGAL AND REGULATORY ENVIRONMENT FOR BUSINESS IN POST-REFORM INDONESIA

Veronica L. Taylor

1. INTRODUCTION: POST-REFORM LEGAL AND INSTITUTIONAL CHANGE IN INDONESIA

The watershed for Indonesia's extensive political and legal reform was undoubtedly the Asian financial crisis of 1997 and the fall of the Soeharto regime in 1998, the former exposing the fragility of a once high-growth economy weakened through predation by the President and his coterie. A broadly-shared goal of the subsequent legal and institutional reforms has been to distance the Indonesian political, economic and legal systems from the post-war authoritarian rule and the institutionalized corruption of the Soeharto New Order government (1966-98). The post-Soeharto governments of B.J. Habibie (1998-99), Abdurrahman Wahid (colloquially called "Gus Dur") (1999-2001), Megawati Soekarnoputri (2001-04) and now Susilo Bambang Yudhoyono (colloquially called "SBY") (2004-present), although different in composition and character, stand for a period of unprecedented legal and regulatory reform in Indonesia. Between 1998 and 2008, the country democratized and the institutionalized political role of the army was significantly reduced through major constitutional amendments, electoral reforms and human rights advances. Legal reform relating to business, however, has proceeded more fitfully, with some acceleration under the SBY government elected in 2004. On this analysis, the reform of the legal and regulatory environment for business in Indonesia, particularly as it affects foreign parties, is very recent indeed.

1.1 Economic Profile of Post-1997 Indonesia

At a superficial level, Indonesia looks in better economic shape in 2008 than it did in 1997. Glass and concrete towers are still being erected in Jakarta; advertising attests to new market entry by foreign investors in a range of economic sectors; and perceptions of risk factors have decreased. Financial system regulation — the fragility of which was a key factor in the 1997 financial crisis — has been overhauled. Fears of terrorism have receded in the wake of the criminal trials dealing with the Bali bombing, the JW Marriott Hotel bombing in Jakarta in August 2003 and the conviction of the alleged leader of Jemaah Islamiah, Abu Bakar Bashir.[1] In June 2008 the U.S. lifted its travel warning on Indonesia.

At the same time, the core vulnerabilities of the Indonesian economy remain. The basic orientation of government remains toward industry protection rather than an open economy, although democratic reform has now loosened the central government's and ruling elites' control over the regionally-located natural resources.[2] Some of this sentiment is grounded in the constitutional principle that "the national economy shall be organized as a co-operative endeavour based on the family principle" (*Constitution of the Republic of Indonesia of 1945*, Article 33),[3] but it also reflects a structural reality: large-scale domestic businesses and groups (often Chinese-Indonesian owned) dominate small and medium-sized businesses and neither has a stake in rapid market-opening.

Legal uncertainty continues to be widely reported in both the English language and vernacular press, including celebrated instances of commercial arbitration agreements that had not been honoured[4] and bankruptcy proceedings that had been hijacked by the debtor.[5] The political difficulties of privatisation were illustrated in Mexico's Cemex SA de CV struggle to operationalize a 51 per cent share in PT Semen Gresik after government divestiture from the publicly-listed company. The foreign acquirer was hampered by anti-privatisation management and politicians in its regional subsidiary, PT Semen Padang.[6] Foreign investments such as this one have been complicated by the policy shift toward regional autonomy and the devolution of legal powers to regional governments required by Law No. 22 of 1999 on regional government and Law No. 25 of 1999 on financial balance between the central and regional governments.[7] Often the scope of the delegation is unclear and this confusion creates rent-seeking opportunities for regional governments, uncertainty for investors and often unhealthy regulatory competition as regions attempt to "race to the bottom" to relax environmental safeguards and other regulatory standards.

By 2008 Indonesia has announced that it would leave OPEC because it is no longer an oil-exporting nation. Moreover, its geo-political position as a middle-income country in Asia will continue to make it vulnerable to competing economies with lower labour costs and higher levels of technology and foreign investment, such as China and, increasingly, Vietnam.

In response, one of the signature developments of the SBY period has been stronger pro-business rhetoric and an attempt to build on the new laws and regulatory institutions, introduced since 1998, that seek to reshape business activities. Key reforms since 1998 include the establishment of a new Constitutional Court and Commercial Court; the overhaul of court administration under the Supreme Court; and the inauguration of new regulatory institutions including a Competition Commission, Anti-Corruption Commission and Anti-Corruption Court. Another outgrowth of the period has been extensive reform of commercial law statutes. The areas affected include banking, capital markets, corporations, intellectual property, competition law and public procurement. At the same time the legal profession has been re-regulated through statute and legal education incrementally reformed to allow more emphasis on business law. Many of these changes were effected through IMF loan conditionality in the wake of the 1997 financial crises or through subsequent World Bank or bilateral donor support. At the same time government attempted to re-regulate the legal profession and legal education has also been incrementally reformed to allow more emphasis on business law.[8]

Despite this rapid and wide-ranging legal and regulatory change, Indonesia's legal institutions remain connected to pre-existing political, economic and social structures. Modern Indonesian law remains a

1 *Australian*, 5 September 2003: 11.

2 Timothy Lindsey, "Constitutional Reform in Indonesia: Muddling Towards Democracy" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008) at 37.

3 1945 Constitution, Article 33. See David K. Linnan, "Indonesian Law Reform, or Once More into the Breach: A Brief Institutional History" *Australian Journal of Asian Law* at 1-34, reprinted in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

4 For example, Jakarta Post, 3 September 2003: 6.

5 Timothy Lindsey and Veronica Taylor, "Rethinking Indonesian Insolvency Reform: Contexts and Frameworks" in Timothy Lindsey, ed., *Indonesia: Bankruptcy, Law Reform & the Commercial Court* (Sydney: Desert Pea Press, 2000); David K. Linnan, "Commercial Law Enforcement in Indonesia: The Manulife Case" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

6 Jakarta Post, 21 August 2003: 3.

7 Leo Schmit, "Decentralisation and Legal Reform in Indonesia: The Pendulum Effect" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

8 Hikmahanto Juwana, "A Legal Education Reform Agenda for Indonesia" (2006) 1 *Asian Journal of Comparative Law* 208-222.

complex system of plural legal sources and norms, including *adat* (or customary) law; *syariah* (or Islamic) law; colonial legislation; independence-era national legislation; donor-assisted substantive and procedural reforms; post-*reformasi* laws creating new legal and regulatory institutions; and privately created transnational commercial law.[9] The system has become much more complicated since 1997. Key drivers here include: (i) an increase in new regulatory law; (ii) the creation of a large number of specialized new agencies and courts; (iii) an attempt to overhaul court administration under the Supreme Court; (iv) the ongoing fragmentation and overlap in jurisdiction among competing Ministries and agencies; (v) devolution of some regulatory law to the regions; (vi) new autonomy granted to Aceh Province in the wake of the 2005 tsunami and provincial reconstruction; and (vii) the increased prominence of Islamic law generally and extension of Islamic commercial institutions, including Islamic banking and dispute settlement.[10] Not all of these changes directly impact business conducted by foreign entities with or within Indonesia, but cumulatively they are creating confusion and capacity stresses that will take years to resolve.

This chapter discusses the legal and regulatory environment for doing business in Indonesia by focusing on commercial contracts as a fundamental element of any foreign investment or trade arrangement. The regulatory environment for contracts is assessed by looking at some of the relevant government regulatory agencies, attorneys, notaries, courts, bailiffs, ADR institutions, professional associations, trade associations, university law faculties, law libraries, legal publishers, law reform NGOs and enabling technologies, that support the institution of contract in some way. What is striking about Indonesia is the (still) apparent fragility of these implementing and supporting institutions that determine the shape and enforceability of contracts. While counterpart institutions are developing quickly and are taken for granted in other modern economies in Asia, Indonesia still carries the legacy of the Soeharto regime's deliberate emasculation of lawyers and legal institutions.

Much of the analysis in this chapter is based on my interviews with stakeholders in the universities, practising Bar, donor community, government agencies and foreign investor organizations in Indonesia in 2003 as part of a USAID-funded assessment of commercial and legal

[9] See Timothy Lindsey and Mas Achmad Santosa, "The Trajectory of Law Reform in Indonesia: A Short Overview of Legal Systems and Change in Indonesia" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

[10] Abdullah Saeed, "Indonesian Islamic Banking in Historical and Legal Context" in Timothy Lindsey, ed., *Indonesia: Law and Society*, *ibid.*

institutional reform for Indonesia.[11] An earlier version of this chapter provides a more detailed analysis and critique of that study.[12]

2. INSTITUTIONAL ENVIRONMENT FOR COMMERCIAL CONTRACTING AFTER 1997

In Indonesia prior to the Asian financial crisis of 1997, the legal enforceability of contracts was neither a national nor a foreign investor priority. The economy had grown steadily on the back of revenues from oil and other natural resources such as forestry and fishing and foreign investors in those sectors were well able to design their projects legally and politically to float above the domestic legal system. Foreign legal advisors in Jakarta had very low expectations of legal institutional support for international contracts at that time. Rather than relying on legal enforceability *per se*, the transactions were shielded from challenge by lawyers' relationship networks with government officials, by formally excluding Indonesian law as the law of the contract, by letters of comfort attesting to compliance with Indonesian regulatory law, by judicious use of bribes and, if all else failed, by resort to off-shore arbitration, usually in Singapore.[13] Domestically, contract seemed to be strongly relational and had almost no points of intersection with statutory law or court-based dispute resolution. In other words, commercial contracts both at the small and medium-sized enterprise ("SME") level and at the multinational enterprise ("MNE") level seemed to be "supported" by largely informal means, such as self-help, reputation, community norms and sanctions, political patronage, or the shadow of police or military intervention.

Those comforting informal arrangements came unstuck for many companies in the wake of Indonesia's financial crisis in 1997. Commercial cash flow problems, bankruptcies and the end of the Soeharto regime caused many foreign investors to discover the weakness of contract law and the Indonesian court system, particularly when trying to recover in

[11] Booz Allen Hamilton, "Commercial Legal and Institutional Reform (CLIR) Assessment Report for the Republic of Indonesia: A Seldon Project Initiative" (October 2003); online: <http://www.bizlawreform.com/country_assess/indonesiaassessment.pdf>.

[12] Veronica L. Taylor, "Contracts and Legal Advisors in Indonesia; an Institutional Assessment" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

[13] Veronica L. Taylor, "The Transformation of Indonesian Commercial Contracts and Legal Advisers" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 1999) at 279-90.

insolvency proceedings.[14] The paradigm story from this period is the dispute between Canadian insurer Manulife Finance Corporation and its former Indonesian joint venture partner concerning the Indonesian subsidiary PT Asuransi Jiwa Manulife (Manulife Indonesia), created in 1985. By 1999 the Indonesian joint venture partner and minority shareholder in Manulife Indonesia, Dharmala Sakti Sejahtera ("DSS"), part of the Dharmala group of companies, had become insolvent and in 2000 was delisted from the Jakarta Stock Exchange. Manulife sought to purchase the Dharmala stake in Manulife Indonesia in an auction organized by DSS's curator (receiver) in bankruptcy. This triggered retaliation by the former joint venture partner, in which a string of fictive debts were alleged and the subsidiary Manulife Indonesia repeatedly attacked in bankruptcy proceedings, to the point where it was placed in bankruptcy by an Indonesian court.[15] The parent Manulife countered with legal actions in Hong Kong and Singapore and through Canadian government representations to the government of Indonesia alleging corrupt actions by the Indonesian bankruptcy court. The bankruptcy court ruling was eventually overturned in an accelerated proceeding by the Supreme Court.[16]

Manulife is usually understood as a cautionary tale of how formal legal institutions in Indonesia can be manipulated against foreign investors, but as Linnan points out, it originated in the era of informal or politically-secured transactions and involved an Indonesian partner that other Chinese-Indonesian businesses regarded as reputationally problematic. Most of the externally-mandated legal and institutional changes that followed the insolvencies of the post-1997 period were designed to resolve precisely the problems that arose in the Manulife case. As we will see, however, formal changes to the legal system have yet to dramatically transform commercial contract law and practice in Indonesia when viewed from the standpoint of an intending foreign investor or business partner.

Prior to 1997 it was difficult to find government officials or lawyers prepared to express confidence in Indonesia's formal legal institutions, including the courts. This did not make Indonesia unique; there are many legal systems in transition (and also post-industrial economies) in which

[14] Timothy Lindsey and Veronica Taylor, "Rethinking Indonesian Insolvency Reform: Contexts and Frameworks" in Timothy Lindsey, ed., *Indonesia: Bankruptcy, Law Reform & the Commercial Court* (Sydney: Desert Pea Press, 2000).

[15] Litigated under Law No 4 of 1998 on Bankruptcy, the series of amendments to the existing Bankruptcy Law enacted in the post-financial crisis period. This was completely replaced by Law No 37 of 2004 on Bankruptcy and Suspension of Payments.

[16] David K. Linnan, "Commercial Law Enforcement in Indonesia: The Manulife Case" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

informal contracting is the norm in particular settings. What development economists assert, however, is that exclusive reliance on informal enforcement for contract creates high transaction costs and may thwart economic growth because parties are limited to transaction partners with whom they have relational safeguards or informal enforcement mechanisms that function as proxies for relational ties.[17] The corollary is that if an effective state-subsidized system of contract enforcement, including courts, is available and is functioning, this allows parties to both "bargain in the shadow of the law" and — as a last resort — formally enforce a contract or recover a debt at reasonable cost.

A further assumption in development thinking is that complex, high-value transactions are more likely to require formal institutional support from the state and civil society. One manifestation of this idea is the investment in specialist courts and jurisdictions. The key Indonesian example is the donor-supported creation of the 1998 Commercial Court and its bankruptcy and intellectual property rights divisions.

Gillian Hadfield's essay "Contract Law is not Enough"[18] is an influential summary of new institutional economics thinking about what modern legal systems provide in the way of institutional support for contractual commitments. A key contribution of her analysis is that focussing in abstract on "the courts" in transition economies is unhelpful when we know that contract enforcement actually relies on a much wider range of institutional actors in developed common law systems. In particular she identifies self-enforcement, reputation and organization (for example, vertical or horizontal integration, technology and contract law).[19]

In relation to legal institutions, Hadfield's analysis is nuanced: it does not suggest that courts come into being magically or that they will automatically deliver an efficient mode of contract enforcement. Instead, she sees cost and access to courts being influenced by, *inter alia*:

- court coordination (the rules relating to giving notice, scheduling trials, court space, parties, lawyer and witnesses, as well as sanctions for non-appearance).[20]

[17] World Bank, "Doing Business in 2004: Understanding Regulation" (Washington DC: World Bank and Oxford University Press, 2004) at 41-42; online: <http://www.doingbusiness.org/Documents/DB2004-full-report.pdf >.

[18] Gillian K. Hadfield, "Contract Law is Not Enough: The Many Legal Institutions That Support Contractual Commitments" (April 2004) *Law and Economics Working Paper Series, Working Paper 3 (University of Southern California Law School)*; online: <http://law.bepress.com/usclwps/lewps/art3>.

[19] *Ibid.*, at 7.

[20] *Ibid.*, at 13.

- information systems for tracking cases and reliably storing documents and evidence.[21]
- auxiliary service providers (process servers, notaries, police, bailiffs);
- motivations of court service providers to uphold rules and resist corruption;
- judges' human capital (accurate application of the law, education, motivation and incentives for operating in a fair and efficient manner);[22]
- legal education and availability of legal information to update judges' knowledge and enable them to learn new areas and develop legal reasoning;
- lawyers' incentives to invest in educating a judge about a particular case (for example, rules against *ex parte* meetings with judges);[23]
- cost burdens for correcting error (for example, through the appeal process or bureaucratic supervision or auditing);[24]
- incentives to bribe arising from the failure of other institutions (for example, title registries, banks);
- political influence on judicial decision-making;
- technology that allows automated assignment of cases, electronic filing and electronic publishing of decisions;
- quality of legal service provided by lawyers (in turn influenced by the quality of legal institutions that produce and support lawyers, such as legal education, professional organizations and judicial oversight of the legal profession).[25]

Hadfield puts considerable emphasis on the nature and quality of the many institutional actors necessary to make contracts function and dispute resolution work at each stage of the process. As she points out, "Contracts are essentially products designed by lawyers".[26] Thus, she argues:

> [l]ow quality legal services reduce the value of contract law; so too do legal services that lack fidelity to the client's expectation that contract law

[21] *Ibid.*, at 14.
[22] *Ibid.*, at 16.
[23] *Ibid.*, at 17.
[24] *Ibid.*, at 18.
[25] *Ibid.*, at 22-24.
[26] *Ibid.*, at 26.

> (whether in drafting a negotiation or in enforcement and defense) will be implemented on the basis of the relevant facts and principles. Lawyers may corrupt the value of contract law by acting against their client's interest in exchange for a bribe or in collusion with other professionals; they may also corrupt the value of the contract law in a longer-term sense when, acting consistently with the interests of their clients, they transmit bribes to court personnel or judges. Corruption of lawyers is only recently coming into view as an important factor in the corruption of the legal system as a whole in developing and transition economies.[27]

Unlike many in the development field, Hadfield does not assume that the benefits of reducing transaction costs and the efficient processing of disputes will be self-evident in transition economies, nor that local legal and political constituencies will automatically embrace these.

Thus, in Hadfield's analysis, contract law is not enough. Contracts will operate efficiently and effectively only to the extent that the surrounding institutions — including the legal profession — exist and function at the appropriate level of competence and integrity. To date the findings from Indonesia have not been encouraging in this regard. In relation to efficiency, as one foreign lawyer in Jakarta put it:

> [t]he laws are OK, but the procedures for the judiciary are straight out of the nineteenth century.[28]

Or, in the words of a donor legal advisor:

> [t]he push for efficiency is quite alien. People [in the courts] are only now beginning to talk about this. Up until now it was treated as a foreign donor priority and rejected for that reason.[29]

As with efficiency, an external "push" for transparency in court proceedings is also frequently met with resistance. The problems of corruption in the Indonesian court system are well-documented.[30] As one widely-invoked example suggests, you do not so much bargain in the shadow of the law in Jakarta, as in the car park of the law — who to bribe and at what rate is a delicate chain that can begin with the attendants outside the court building. The problem is pervasive and complex. As a foreign lawyer puts it:

> [o]ne aspect is the notion on the part of judges (and clerks) that the courts function as a business, or as a personal fiefdom; since advocates are free

[27] *Ibid.*, at 24.
[28] Foreign legal consultant, Jakarta, 2003.
[29] Legal reform advisor, Jakarta, 2003.
[30] For example, Timothy Lindsey and Howard Dick, eds., *Corruption in Asia: Rethinking the Governance Paradigm* (Sydney: The Federation Press, 2002) and Veronica L. Taylor's, "Anti-Corruption and Asian Legal Professions" in the same book at 37-49.

to practice anywhere but judges are not, there is a kind of entitlement idea: "It's my turn now"... .[31]

Or, on the other side of the equation:

> [s]ome entrepreneurs use the courts as tool to justify their actions. Every step is a tool to make money. There is no sense of the public interest.[32]

In the following sections, I assess in turn the different institutional components and actors that shape contract design and enforcement in Indonesia.

3. LEGAL FRAMEWORK FOR CONTRACTS

Indonesia's *Civil Code of 1847* is the foundational source of contract doctrine in Indonesia and is supplemented with special laws and regulations governing particular contract types, such as franchises. The Code is dated and formalist and remains in its original Dutch language with numerous unofficial Indonesian translations,[33] with the result that, for high-value or complex transactions, both Indonesian and foreign attorneys either contract around the Code provisions or develop their own application of the provisions by analogy. One example is the use in practice of the common law device of trust, which is alien to Indonesia's civil law, Code-based system. A more complicated example is the attempt to fit e-commerce transactions into the existing contract law framework.[34]

Commentary on the Code — as in other civil law systems — is provided by legal academics, but the volume and quality of academic legal writing is not yet at a level comparable to that of other civil law jurisdictions in advanced economies in Europe and Asia. There is no evidence that judges feel particularly concerned about fashioning a responsive jurisprudence that would take account of new transaction types and, in any case, the system for reporting court decisions is still not well established:

> Supreme Court decisions are hard to handle; there is a lot of retyping and endless recitation of the parties' arguments. The actual decision is [often] poorly argued, so it is extremely difficult for attorneys to absorb [the reasoning] in the [legal] community. This is a device because the Court is so divided — you maximize the areas of agreement. It shows how weak the institution is.[35]

Most lawyers regard judges as relatively competent if the contract question is a simple one, but inclined to formalist interpretations that were unhelpful in practice. As one commentator said of the Supreme Court:

> [t]he question of what constitutes a "debt" has been argued interminably, for example a payment due versus an obligation to deliver goods ... there is no effort to bind itself or to create jurisprudence. A blanket of civility stops people from arguing to a logical conclusion...[36]

Although the situation is somewhat different in the Commercial Court, where decisions are reported and where dissents are also recorded, observers remain skeptical:

> [dissents] create mixed signals. We assume that the system will hold together. But dissents don't really create accountability. We assume that these are real positions, but [we know] that there have been corrupt dissents in at least one case.[37]

3.1 Scope of "Contracts"

The contract assumed for the purposes of the 2003 study and for this discussion is a supply contract, sale of land or a joint-venture agreement between two commercial actors of relatively equal stature, whether domestic or foreign. This tracks the approach in the World Bank "Doing Business" survey instrument and the earlier research by Djankov, La Porta *et al.* on which it is based.[38] One problem with this approach is that it under-describes contracting practice in a stratified economy such as Indonesia's. If we were to adopt, for example, the typology of the economy suggested by Brietzke and Timberg, at minimum we would consider the regulatory framework, practice and relevant supporting institutions for contracts concluded by:

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31 Foreign legal consultant, Jakarta, 2003.

32 Indonesian lawyer, Jakarta, 2003.

33 Gary F Bell, "The Importance of Private Law Doctrine in Indonesia" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

34 For example, Duane Gingerich and Christian Teo, *E-com Guide Indonesia* (2001), B&M Consultants and Hadiputranto, Hadinoto & Partners, Jakarta; online: <www.bakerinfo.com>.

35 Law reform advisor, Jakarta, 2003. Recitation of the parties' arguments is a feature of reporting of decisions in many other civil law countries, and lack of clarity in reasoning is also a feature of other transitional legal systems as well, but the criticisms of the Indonesian courts are apt.

36 Law reform advisor, Jakarta, 2003. This controversy was current in 2003 and arose from the fact that the definition of a "debt" was clear under the *Civil Code* but not in an insolvency sense under Law No 4 of 1998 on Bankruptcy. It was clarified by Law No 37 of 2004 on Bankruptcy and Suspension of Payments, which completely replaced the 1998 Law.

37 Law reform advisor, Jakarta, 2003.

38 World Bank, "Doing Business in 2004: Understanding Regulation" (Washington DC: World Bank and Oxford University Press, 2004) at 110; online: <http://www.doingbusiness.org/Documents/DB2004-full-report.pdf>.

(1) brokers and dealers in goods, services and finance;

(2) foreign-dominated corporations ("MNCs") including those with politician, bureaucrat or government involvement;

(3) domestic companies including those with politician, bureaucrat or government involvement;

(4) government-controlled and regulated enterprises;

(5) individual proprietorships of larger than "cottage" size;

(6) cooperatives and other non-profits;

(7) subsistence farming, fishing, forestry or handicraft/cottage industry;

(8) entities involved in trade and aid, equity and debt inflows; and

(9) labour and consumers.[39]

We would also consider contract practice and institutional support for contract across a range of industries or economic sectors and transaction types, such as production-sharing agreements in the energy sector, employment contracts, consumer contracts, credit contracts, franchising and licensing agreements, government procurement contracts[40] or contracts formed in electronic commerce. We would also weigh these according to their significance in the Indonesian economy, which is still dependent on sectors such as oil and gas, agriculture, aquaculture and forestry, foreign-invested manufacturing, construction, tourism and so on.

3.2 Legal Pluralism and Legal Formalism

Being more precise about the scope and type of contract is also important because Indonesia is not a unitary, single-source legal system in which formal contracting is the norm. Anyone familiar with Indonesian

[39] Paul H. Brietzke and Thomas A. Timberg, "An Economic Reform Agenda for Indonesia?" USAID Report Number PEG 46 ECG, USAID/Jakarta, (1999); online: <http://unpan1.un.org/intradoc/groups/public/documents/apcity/unpan018843.pdf> (last accessed 5 May 2006) at 20.

[40] An example of policy change in this sector is the July 2006 decree by the SBY government that exempts a state utility, Listrik Negara (National Electricity), from the requirement to submit power contracts to a public tendering process. Designed to limit opportunities for corruption, the open bidding system is now criticized as being time-consuming. The exemption, on the other hand, is expected to speed up the award of contracts for power plant construction to Chinese companies including Shanghai Electric Power, which will be underwritten by Chinese banks financing: *International Herald Tribune*, "Indonesia sidesteps open bids" (July 9, 2006); online: <http://www.iht.com/articles/2006/07/09/bloomberg/sxrupiah.php>.

legal history knows that legal pluralism remains a core characteristic of the contemporary legal system. Here are three illustrative examples:

- *Islamic banking:* Policy makers in Indonesia are increasingly focused on Islamic banking and the creation of financing methods compliant with *syariah*. On the one hand, Islamic banking is centrally regulated through the secular banking system. On the other hand, there has been a perceptible growth in both *syariah* securities, in customized dispute resolution for Islamic banking transactions and in the scope of authority given to religious law to deal with businesses related to *syariah*. Some observers are inclined to dismiss these developments as being based on synthetic instruments that mimic conventional banking and financing techniques. However, many younger reformers see the expansion of Islamic banking and related *syariah*-based transactions as creating institutions that are both legitimate and more appealing than corrupt and dysfunctional secular regulatory institutions in Indonesia.

- *Informal Contracting in Central Java:* Customary contracting in Central Java was described as embodying a verbal agreement, conducted following a prominent custom and accompanied with advance money (*panjar*) as a binding sign. Generally, urban contracts follow the rural pattern, but differences between urban and rural practices can also lead to friction. For example, in a rural community there may be, by custom, someone who can authenticate the contract, while in an urban community such a person would only be a witness, and the validity of the contract can be challenged by other actors. In a contract using advance money, if the party who gives the *panjar* fails to keep a promise, he or she will lose the payment; if the receiver of the advance money breaks his or her promise, he or she must return the advanced money, together with a fine equal to that amount (a total of 200 per cent). By contrast, contracts under the *Civil Code* are valid without advance money and if one of the parties breaks their promise (*wanprestasi*) the other party can sue for cancellation of contract, restitution or substitute performance plus compensation for loss.

- *Pecinan (Chinese community) norms:* Ethnic Chinese communities have their own contract practices. In Jakarta the *Pecinan* (ethnic Chinese-Indonesian business community) area is Glodok. One example is the *Pecinan* in the old part of Semarang covering Kranggan, Depok, Beteng, Jagalan, Gang Pinggir, Gang Tengah and Gang Lombok, and also the surrounding areas. In making contracts within their community, *Pecinan* can rely simply on a letter or phone call and trust. Payment can be made with a cheque signed by the debtor with a Chinese character (referred to as a "white cheque"). The sanctions for breaking a promise (*wanprestasi)* are loss of relationship; if a party cheats another party in the group he or she will be expelled from the group, although this will never be litigated.

3.3 Notaries

In relation to formal contracting, if a document is required by the parties or by statute — such as for sale of land transactions — the ordinary service provider is the notary. In Indonesia, as elsewhere in the civil law world, notaries are a vocational group regulated by government that plays a role in creating and authenticating contract documentation. Notaries are regulated under *Reglement op het Notaris Ambt in Indonesie* (Stb. 1860: 3), and its latest implementing regulation, the Ministry of Justice Decree No. M-01.H.T.03.01 of 2003. They are organized as the Indonesia Notary Association (Ikatan Notaris Indonesia or INI). End users are generally satisfied with the quality and the quantity of notaries. Notary fees are considered reasonable and tend not to act as a disincentive for the formation of contracts. This perception is different from that of many American-trained attorneys, who tend to see notaries as rent-seekers who are simply adding to transaction costs. In many transition economies, of course, notaries are acting as lawyer-substitutes for non-elites, but this is an issue that demands more and better empirical research. The Indonesia Notary Association ("INI") reported that they support contract law development by proposing changes and refinements to the *Civil Code* and related commercial laws. How they do this, and with what effect, was not clear.

3.4 Professional Legal Associations

Looking at local lawyers in Indonesia in the early 2000s, it was hard to avoid the conclusion that there is no cohesive "legal profession".[41] The overarching characteristic of lawyers within the system has been fragmentation. Like judges, lawyers in Indonesia were deliberately undermined during the Soeharto era.[42] This also impaired professional competence. Thus it is not surprising that the relatively new organization for capital market consultants was the most engaged in proposing changes and refinements to the laws affecting commercial transactions, or that there remained widespread apathy toward professional self-development and training (other than programs funded by international donors).

Many lawyers had only a nodding acquaintance with legal ethics as generally understood in developed economies; some members of IKADIN, for example, had reportedly refused to sign a pledge not to bribe judges,[43] which is consistent with public statements made by some attorneys in relation to institutionalized corruption in the courts.

Despite these structural challenges, the legal profession has also featured notable social justice advocates and government critics. Litigators, rather than consulting (or business) attorneys, have always been in the forefront of reform efforts,[44] institutionalized in organizations such as the Indonesian Legal Aid Foundation (known by its Indonesian acronyms LBH or YLBHI). The generation of activist lawyers who eventually saw off their opponent Soeharto also laid the groundwork for (and in many cases actively supported the establishment of) the non-profit legal reform groups and NGOs that today are the most professionalized and effective advocates of legal reform across public, civil and commercial spheres. The most prominent of these is the Center for Indonesia Law and Policy Studies (PSHK), which sits at the centre of a relational network of legal reform NGOs.

The new Advocates Law, No. 18 of 2003, attempted to unify a highly disaggregated and mutually hostile group of associations by mandating that there be either a voluntary merger of the associations or that what self-regulatory powers these groups currently have will vest in the government. Generally, the consensus was that most Bar associations did not engage in meaningful training for their members; did not regulate members' professional standards or ethical conduct; and did not as an association engage in *pro bono* activity, such as advising government on desirable legal reforms. Indonesia at that point had eight national Bar associations (IKADIN, AAI, IPHI, HAPI, SPI, AKHI, HKHPM and APSI).[45] As one senior Indonesian lawyer put it delicately at the time, "There is a lot of personal ambition involved."[46]

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41 Veronica L. Taylor, "Anti-Corruption and Asian Legal Professions" in Timothy Lindsey and Howard Dick, eds., *Corruption in Asia: Rethinking the Governance Paradigm* (Sydney: The Federation Press, 2002) at 37-49.

42 See generally Daniel S. Lev, "Between State and Society: Professional Lawyers and Reform in Indonesia" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008) (previously published as *Working Paper No 2* (November 1992) by the Law Department of the School of Oriental and African Studies, University of London).

43 Indonesian Lawyer, Jakarta, 2003.

44 Daniel S. Lev, "Between State and Society: Professional Lawyers and Reform in Indonesia" *supra* note 42, at 73.

45 Those eight Bar associations are IKADIN (Ikatan Advokat Indonesia — Indonesian Lawyers' [Advocates] Association); AAI (Asosiasi Advokat Indonesia — Indonesian Lawyers' Association); IPHI (Ikatan Penasehat Hukum Indonesia — Indonesian Legal Advisors'

By 2006, however, considerable institutional evolution had occurred. A single Bar Association (PERADI) was established, a code of ethics was promulgated, and in 2006 the first unified "Bar exam" in Indonesia was conducted. In this way, the first steps in formation of a unified professional organization are in place. The long-standing systemic undermining of the legal profession, however, continues to manifest in a number of ways. For example:

- The "new" national professional organization is a re-casting of a Soeharto-era idea.[47]
- When lawyers lobby for law reform or are consulted by government on law reform, they tend to act in their individual capacity.
- Lawyers are widely identified as a source or channel for bribes to judges and other government officials.
- There is a major disconnect between the character of legal education and the needs of private practice, both in the commercial and non-commercial spheres.
- No organizational pressure is applied to lawyers to require them to upgrade their qualifications or knowledge, at a time when legal issues globally are becoming highly complex.
- Until very recently, no professional code of ethics constrained lawyers and no organizational norms channelled ordinary lawyers toward public interest or *pro bono* work (one consequence being that "NGO lawyering" has been spun off as a kind of separate specialist profession).
- Lawyers are frequently drawn into business activities and areas of conflict of interest and so have a very reduced capacity to act as authoritative monitors of government, or of private sector conflicts of interest or breach of good governance principles.

Association); HAPI (Himpunan Advokat dan Pengacara Indonesia — Indonesian Lawyers [Advocates and Non-trial Lawyers] Organisation); SPI (Serikat Pengacara Indonesia — Indonesian Lawyers' Union; AKHI (Asosiasi Konsultan Hukum Pasar Modal — Association for Capital Market Law Consultants); HKHPM (Himpunan Konsultan Hukum Pasar Modal — Organisation for Financial Legal Consultants); APSI (Asosiasi Pengacara Syariah Indonesia — Association for *Syariah* [Islamic] Lawyers). Traditionally, *advokat* referred more to a trial attorney or a barrister, while *pengocara* suggested a nonlitigious role. but this distinction has now become blurred.

46 Indonesian Lawyer, Jakarta, 2003.

47 Daniel S. Lev, "Between State and Society: Professional Lawyers and Reform in Indonesia", *supra* note 42, at 79.

3.5 Foreign Lawyers

The Indonesian legal market, of course, also includes numerous foreign lawyers, practising as legal consultants for Indonesian or foreign law firms, or within foreign corporations or other service providers. For the most part this is a business law "consulting" field, where attorneys practice only the law of their own jurisdiction and do not advise on Indonesian law, although the latter prohibition is often honoured in the breach. The high-value or complex contracts needed to support foreign investment are typically produced within a small circle of local law firms that dominate the legal market, or the foreign lawyers or firms that operate in conjunction with these domestic practices. Foreign firms cannot operate directly in Indonesia, but may do so within a relationship with a local firm. Many of the long-term foreign legal advisors and foreign law firms in Jakarta have been key players in the legal and regulatory reforms referred to in the chapter and thus are well-positioned to advise foreign clients on how to navigate the new regulatory landscape.

Foreign attorneys to date have not been permitted to practice in Indonesian courts, although few would seek to. A major problem for any international lawyer or firm in Indonesia is maintaining sufficient distance from bribes demanded by court or government officials. Foreign attorneys may — and do — act in private commercial arbitrations, although as discussed below, this practice is largely conducted outside Indonesia.

4. IMPLEMENTING INSTITUTIONS FOR COMMERCIAL DISPUTE RESOLUTION

Enforcing a contract that has encountered problems in Indonesia is, in practice, limited to self-help, litigation or commercial arbitration, usually outside the country.

4.1 Informal Resolution of Commercial Disputes

In Indonesia, as elsewhere, people seldom go to court if they can avoid it. Most businesspeople prefer to resolve disputes through discussion and negotiation. There is also, however, considerable diversity in the norms governing disputes. Beyond statutory law, contracts and commercial custom are also part of *adat* or customary law. Like formal modern law, however, *adat* can also be subverted to serve the interests of the powerful in a community: there are numerous examples of project agreements being deliberately breached by a powerful player at the local level at the expense of less powerful local people. *Adat* in this case offers little practical recourse. Some commercial communities such as the ethnic

Chinese in some locations have a well-developed set of norms that do not require state intervention. In urban areas, people may deliberately avoid the courts in order to maximize their gains, whether legitimately or not. There is anecdotal evidence that in debt collection, for example, local thugs are used to intimidate debtors who are slow to pay. Further anecdotes reference the use of police, prosecutor or army connections pressed into service to pressure a transaction partner. None of these examples are particularly unique to Indonesia — they have counterparts in both developed and transition economies.

4.2 Litigation and Arbitration

For general commercial contracts the general court system's district court is the court of first instance (Law No. 14 of 1970 on the Principles of Judicial Authority[48] (amended in 1999 and replaced by Law No. 4 of 2004)). In practice, judgment is often given by one judge only at this level. The High Court is the court of appeal and a further cassation appeal can be brought to the Supreme Court. The Jakarta Commercial Court was established in 1998 with a bankruptcy and (from 2003) an intellectual property jurisdiction.[49]

The key systemic weakness here is that the Supreme Court, which oversees this unified court system, is deeply distrusted and is regarded as "being one of the most corrupt institutions in Indonesian and its competence is also subject to much criticism".[50]

Indonesia also has a state-run *syariah* judicial system that operates though a national network of Religious Courts. These courts predominantly deal with marriage, divorce and inheritance, but are now also being used to adjudicate cases arising from the "Islamic economy".[51] By contrast to the Supreme Court, Indonesia's *syariah* courts enjoy a high level of legitimacy and support from both the general public and from users.

The 2000s saw a wave of new, specialist courts created in Indonesia, one of which was the tax court created by Law No. 14 of 2002 under the Ministry of Finance, with judges from the Ministry of Finance. This is an administrative body handling tax disputes between the government and

[48] Also translated as the Law on Judicial Power.

[49] Four regional branches of the Commercial Court *were established* in 1999, but their caseloads are negligible. An international case would be brought in the Jakarta court.

[50] Timothy Lindsey, "Constitutional Reform in Indonesia: Muddling Towards Democracy" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008) at 46.

[51] *Ibid.*, at 51.

private sector. Some lawyers acting for private sector parties believed that "the tax court is always in favour of the government".[52] Other lawyers assert that, in fact, private parties do win in the tax court and the court itself has practices that would be helpful if adopted in other courts.

As a formal matter, domestic and international commercial arbitration is supported by Law No. 30 of 1999. Indonesia takes a territorial approach to distinguishing domestic and international commercial arbitration — domestic awards are those rendered anywhere within the national boundaries of Indonesia and international awards are those rendered where the arbitral venue is outside Indonesia. To be enforceable, domestic awards must be registered within 30 days of the award with the District Court "having jurisdiction over the respondent (Art 1(4)) — that is, the District Court having jurisdiction over the location of the losing party's domicile or location of assets. Domestic awards are automatically enforceable through execution by the District Court, and although data on enforcement is incomplete, the trend appears to be that awards are executed by District Courts as a matter of course."[53]

International arbitration awards can be submitted directly to the District Court of Central Jakarta for issue of orders of enforcement. Practice to date has been for the District Court of Central Jakarta to issue the orders of execution promptly, based on the original award and the original copy of the agreement forming the basis of the award (with official translations of both), and provided that the local Indonesian diplomatic mission has certified that the country in which the award was rendered has diplomatic relations with Indonesia and is a contracting state to an international convention regarding the implementation of foreign arbitration awards. Enforcement of foreign arbitral awards since 1999 has been mixed, although the majority of awards have been upheld.[54]

Where the parties have not chosen arbitration in a contractual dispute resolution clause, neither the laws defining the courts nor Indonesian procedural law originally contemplated court-annexed mediation or arbitration (or ADR), but that situation is now changing, as discussed below.

Some courts and judges refuse to encourage settlement by the parties through arbitration, mediation or reconciliation since the case has already been submitted to the court. Other judges suggested that they "always"

[52] Indonesian Lawyer, Jakarta, 2003.

[53] Karen Mills, "Enforcement of Arbitral Awards in Indonesia and Other Issues of Judicial Involvement in Arbitration" KarimSyah Law Office, Jakarta (unpublished, (2005); online < http://www.arbitralwomen.org/files/publication/4310102632224.pdf>.

[54] *Ibid.*

encourage the parties to settle their dispute amicably. Most of the judges interviewed in 2003, however, refused to enforce ADR decisions — as distinct from commercial arbitral awards — being of the opinion that "it depends on the parties", meaning the parties should rely on self-help. In 2003, however, the Supreme Court issued Supreme Court Regulation of 11 September 2003 dealing with court-annexed mediation. Although it was initially unclear what kind of implementing support would be introduced to make this workable, it has been followed in some cases.[55] Needless to say parties and their lawyers were also able to use the new procedure tactically as a way of prolonging litigation.[56] The Japanese government aid agency, JICA, is now engaged in a training project with the Supreme Court to both revise Supreme Court Regulation No. 2 of 2003 and create capacity among judges to carry out court-annexed mediation.

4.3 Appellate System

As with other civil law systems, each of the secular courts, permits an automatic right to appeal on the basis of both facts and law and to the Supreme Court on the basis of law (*kasasi* or cassation). While this system of appeal functions well in civil law systems in Asia such as Japan, Korea and Taiwan, the appeals process in Indonesia is widely perceived as problematic for the following reasons:

- Automatic appeal can operate to diminish accountability. Judges at the lower levels are absolved from responsibility for inadequate decisions because that decision, once appealed, has no binding power.
- The relationship to new regulatory agencies' decisions is unclear. In the *Indomobil Case*, the first major competition case appealed up to the Supreme Court in 2003, the District Court was asked to enforce the Competition Commission (KPPU — Komite Pengawas Persaingan Usaha) determination but instead sought to reopen the case.[57] The parties tendered new evidence, despite the 30-day time limit imposed under Law No. 5 of 1999 for consideration of competition cases by the court and despite a letter from the Chief Justice of the Supreme Court instructing lower courts to review competition decisions only for procedural flaws.[58]
- The Supreme Court itself exercises no discretion in the selection of cases. The Supreme Court backlog (fluctuating between 20,000 and 10,000 cases between 2003 and the present) may be attributable to the judges' workload and responsibility for checking on lower level courts, but can also be explained by refusal to dismiss frivolous or unsuitable appeals. Much of the current backlog in the courts of general jurisdiction can also be explained by the failure to summarily dismiss frivolous suits.

The *Code of Civil Procedure* of 1847 requires decisions to be rendered according to law and in writing, although this seems to be honoured in the breach. The law defines the procedures for enforcement of judgments, but in practice there seems to be considerable confusion about the legal concepts necessary for execution of judgments. There has been a prolonged debate about the meaning of "injunction" in the intellectual property statutes and whether this was a form of temporary or permanent relief. Likewise, in the attachment of assets there are complaints from practitioners that the entire asset is seized or attached, when this bears no relation to the amount of the claim being enforced.

While the legal framework for commercial contracting is basically clear enough, the inefficiency of the courts has been a key obstacle to formal enforcement. Most of the judges interviewed for the 2003 study said that the laws are quite adequate for court regulation and there are clear detailed internal regulations and operating procedures for the judges and the administrative staff. Common complaints included:

> [h]uman resources quality and quantity are lacking: there is insufficient staffing to carry out the duties of the courts; insufficient authority and support to carry out the duties; insufficient funding through the state budget or fees collected; and insufficient salaries to retain qualified judges and qualified administrative staff. The courts and judges themselves lack legal information and there is no active and current court web site.[59]

Some judges also told us that there is no general consistency in the understanding of the role of the courts, and that the lack of trust from society [toward the courts] reflects this.

55 Foreign legal consultant, Jakarta, 2003.

56 Indonesian lawyer, Seattle, 2006.

57 John R. Davis, "The Competition Commission: A New Kind of Player in Indonesia's Legal System" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

58 Commentators point to ambiguities in the drafting and interpretation of Law No 5 of 1999 as being additional contributing factors. See generally, John R. Davis, "The Competition Commission: A New Kind of Player in Indonesia's Legal System", *ibid.*

59 Judges' responses, Jakarta, 2003.

> The courts are not established and operating effectively with respect to resolving commercial contract disputes. Litigation at the district court is not limited to commercial cases, so judges' lack of specialization is a big problem, which in turn produces unproductive courts.[60]

Most of the Indonesian lawyers interviewed gave similar responses regarding the low quality and slow speed of court procedures:

> [m]ost judges in Jakarta have no specialization. The same judge must handle criminal, commercial and civil cases; all judges handle all litigation cases. The reason for the slow speed of court procedures is overloaded cases.[61]

Although both judges and lawyers thought that overwork and lack of staffing were contributing factors, there is persuasive evidence on the donor side that the courts are actually overstaffed and underworked. Both performance monitoring for judges and reduction in judicial recruitment have been stymied by the courts, in part because in a corrupt system this is a money-making exercise — under previous Chief Justices, candidates were able to buy their positions.[62]

No one we spoke to in 2003 was satisfied with the performance of the courts. There is almost complete consensus among end users and outside observers that the courts are not an efficient, transparent, accountable, competent and reliable venue for commercial dispute resolution. In particular:

- Transparency is compromised by the almost universal practice of attorneys bribing judges, court clerks, and other court staff and outside contractors.[63] Appointment and rotation of judges are seen as business opportunities. Judges who have suffered low pay, low status and difficult living conditions in the provinces or in the early years of their career regard a posting in Jakarta as an opportunity to take their turn to be beneficiaries of the corruption economy.
- Accountability is lacking because the courts are organized on public service principles that do not seek to measure work output or quality and provide no meaningful mechanism for performance appraisal of judges. There are arguably far too many judges currently appointed for the workload that exists. Judges' decisions are not routinely published and are not made available to the public.

60 Judge, Jakarta, 2003.
61 Lawyer, Jakarta, 2003.
62 Donor representative, Jakarta, 2003.
63 To be sure, there are Indonesian attorneys who do not pay bribes. In many cases, however, they structure their practice to avoid litigation.

- Judges' competence to hear commercial cases is often questioned. Despite many and various donor-funded projects delivering judicial training, many judges do not have the basic legal education, the ability or the diligence to become conversant with modern commercial law. This is consistent with the judiciary being a low prestige professional occupation during the Soeharto years and thus attracting applicants from the lower, rather than the upper, range of law graduates.
- Reliability is lacking in the courts because there is no system of binding precedent, even within the Supreme Court itself. In practice, virtually any decision may be subsequently overturned or ignored by another court. Both majority and dissenting options in the Commercial Court may be abused as an opportunity to provide legal justification for illegal or illegitimate conduct by parties.

While in theory court fees for commencing a lawsuit are relatively inexpensive, interviewees pointed out that there is no incentive for parties to use the courts for contract disputes. In practice, the actual fee is uncertain and so is the end result. This, of course, is an indirect way of saying that the final cost depends in part on what a party is prepared to pay in order to influence the outcome.

The application of law in litigated contracts is also unclear. Most interviewees agreed with the proposition that the courts are willing to apply the substantive law chosen by the parties for the contract, based on the principle of freedom of contract. They also agreed that courts are required to render decisions based on published laws and through written documentation. A few courts, for example, the Central Jakarta District Court, are willing to deal with international conventions that are already ratified by the Indonesian government and trade usage or international practice that is not contrary to law and public policy. The same court has experience with the application of the substantive law of other forums, provided that it is stated exclusively in the contract and provided also that there are no other alternative clauses. Most other courts, however, do not examine cases based on prevailing laws and regulations and often use incorrect or inaccurate legal grounds for the decision.

Interviewees regarded the courts as lacking transparency in decision-making and as being sometimes biased toward foreigners in disputes with nationals. (This was an interesting reversal of the perception of many foreign lawyers and business people). Most of them said that there is no transparency in the process of rendering the decision, or in the calculation of damages. The Supreme Court by 2003 had carried out some administrative reforms and had introduced computerization, but this provided public access only to confirm the progress of the Supreme Court cases, not for the entire court system (for example, its general administration, court dockets and judges' decisions). Public access to the court reports remained very limited, although copies were available for private purchase by attorneys or other interested parties. The courts do collect data on filings and disposition and do publish this in annual reports. What is also clear, however, is that even attorneys have difficulty requesting data from the courts at other times in other forms. Many court officials do not see provision of court information to the public at little or no cost to be part of their duties.

4.4 Systemic Reform to the Courts

The systemic problems of the court system have had a long gestation and are well understood in Indonesia. Several important reforms have been designed to address these. The first was the reorganization of the administration of the courts, planned from 2004. Up to 2003, court budgets and personnel (most court personnel including judges are civil servants) were regulated by the Ministry of Justice, while the Supreme Court was responsible for the procedural operations of the general courts and the Commercial Court. The National Development Agency (BAPPENAS) housed a Legal Steering Committee that included a subcommittee responsible for steering the Commercial Court. In 2004, to comply with the five-year time frame set out in Law No. 35 of 1999 on Judicial Authority (subsequently replaced by Law No 4. of 2004 concerning Judicial Powers), the Ministry of Justice transferred budgetary and human resource powers to the Supreme Court to create a so-called "one-roof system" of court administration. Within this scheme, responsibility for legislative drafting would continue to be, for the most part, with the Ministry of Justice or with the Ministry responsible for (or asserting control over) a particular subject matter.

The so-called Supreme Court Blueprints on which this reform was based were developed with broad-based donor assistance led by the IMF, including funding from USAID and in consultation with the Court and with external stakeholders. They represented the first far-reaching institutional reform plans for a state agency that essentially sought to remake the operations of the institution and coordinate donor activity in relation to judicial reform.[64] While donors publicly expressed support for the Chief Justice of the Supreme Court, privately legal observers were

[64] Zacky Husein and Sebastian (sic) Pompe, "Opinion and Editorial: Supreme Court Blueprints: An Innovative Reform Plan" *Jakarta Post* (November 11, 2003); online: <http://www.thejakartapost.com/news/2003/11/11/supreme-court-blueprints-innovative-reform-plan.html>.

skeptical about whether the court system would ever become functional in Indonesia. Much has been written about the repeated and usually unsuccessful efforts to forge strong, self-sustaining, corruption-free and functional legal institutions in Indonesia, first within the disabling political arrangements of the Soeharto era,[65] and then during the Habibie,[66] Wahid and Megawati periods of *Reformasi*.[67] With the shift to a new government under Susilo Bambang Yudhoyono, many commentators have been hopeful that a corner has been turned: that the Supreme Court leadership is evincing the intention to reform and that new specialist courts, such as the Constitutional Court and the Anti-Corruption Court, are functioning reasonably well — or at least better — in their early stages. Whether these institutions do in fact flourish will, of course, be easier to determine in hindsight.

The Constitutional Court, created under Law No. 24 of 2003, was not intended to be a direct economy regulator. However, during its first five-year term, under the leadership of Chief Justice Jimly Asshidiqie, the court has entered the field of commercial regulation by bringing down significant decisions on the constitutionality of privatization of utilities. It is still too early to predict the future trajectory of the court's stance on economic matters, but its initial stance has been to relax standing rules to allow third parties, particularly NGOs, to bring a wide range of disputes to the court.

In parallel with these court reforms, an Independent Judicial Commission was created through Law No. 22 of 2004, responsible for recruiting and supervising the conduct of all "judges and justices". The Independent Judicial Commission (*Komisi yudisial*) was established pursuant to a constitutional amendment in 2000, Article 24B, which contemplated an independent judicial commission to propose candidates for appointment as justices of the Supreme Court and further authority "to maintain and ensure the honour, dignity and behaviour of judges". Members of the Commission were to be appointed and dismissed by the President with the approval of the Parliament (DPR), with the structure, composition and membership of the Commission to be regulated by law. The Indonesian Parliament enacted Law No. 22 of 2004 on the Judicial

[65] For example, Daniel S. Lev, "Judicial institutions and legal culture in Indonesia" in Claire Holt, ed., *Culture and Politics in Indonesia* (New York: Cornell University Press, 1972); Sebastiaan Pompe, *The Indonesian Supreme Court: A Study of Institutional Collapse* (New York: Southeast Asia Program Publications at Cornell University, 2005).

[66] Nadirayah Hosen, *Reform of Indonesian Law in the Post-Soeharto Era (1998-1999)* (Unpublished PhD thesis, Faculty of Law, University of Wollongong, 2003).

[67] Timothy Lindsey, ed., *Indonesia: Law and Society* (Leichardt, NSW: The Federation Press, 1999).

Commission on August 13, 2004, and President Susilo Bambang Yudhoyono swore in the inaugural members of the Commission on August 2, 2005. Within a short time, the Judicial Commission had come into conflict with the Supreme Court about the scope of its authority to supervise justices of the Supreme Court. Initial scrutiny of financial impropriety or claims of corruption resulted in a proposal to remove half of the Supreme Court justices. The Commission summoned the Chief Justice of the Supreme Court before it, but lacked power to impeach. A number of Supreme Court judges launched an action against the Commission in the Constitutional Court, which responded with a decision in favour of the judges. The court found that for the Judicial Commission to have powers to discipline judges would offend the doctrine of separation of powers.[68] In the meantime, Supreme Court Chief Justice Bagir Manan, despite extensive criticism of his institutional leadership and allegations of corruption, was re-elected by 44 of the 48 active judges on the Supreme Court on May 2, 2006. Although scheduled to retire in October 2006, by extending the mandatory retirement age for judges, the Chief Justice effectively allowed himself to continue to serve until at least October 2008.[69]

Both the "one roof" judicial system reforms and the Independent Judicial Commission are likely to take years to work through.

5. NEW REGULATORY INSTITUTIONS

Part of the government's donor-assisted drive to strengthen legal and regulatory institutions in Indonesia has resulted in the creation of a wave of new independent agencies and adjudicatory bodies. Three of these, the Anti-Corruption Commission, the Anti-Corruption Court and the Competition Commission are broadly intended to level the playing field for business in Indonesia by cleaning up corrupt or collusive business practices.

The ubiquity of corruption in Indonesian legal, political and bureaucratic settings has carried forward from the Soeharto era to the present. Commentators point out, however, that in the new, more fluid political environment, it has become "retail" rather than controlled by the upper levels of the polity as it was under Soeharto. The SBY government was elected in part on an anti-corruption platform and his presidential predecessors made incremental reforms to put in place anti-corruption laws and institutions.

[68] Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

[69] Paras Indonesia, "Supreme Court Chief Retained Despite Scandals" (May 03, 2006): online <http://www.parasindonesia.com/read.php?gid=290>.

The most significant of these is the Anti-Corruption Commission (KPK), established by Law No. 20 of 2001, amending Law No. 31 of 1999 Concerning Eradication of Corruption; and in Law No. 30 of 2002 Concerning the Anti-Corruption Commission. The primary purpose of the Commission as set out in Art. 6 of Law No. 30 of 2002 is coordinating and supervision of other agencies responsible for eradicating corruption; investigating and prosecuting corrupt acts, conducting corruption prevention activities and monitoring state administration. Article 11 of the same law makes explicit its jurisdiction relating to prosecuting corruption involving law enforcement officers and government officials, cases causing significant public concern and cases involving state losses over approximately USD $150,000.[70]

Law No. 30 of 2002 also establishes the role and authority of commissioners and prescribes the establishment of the Specialized Court for Criminal Corruption (*Pengadilan Khusus Tindak Pidana Korupsi*), which is now functioning. The Anti-Corruption Court is part of the District Court of central Jakarta, although it has jurisdiction to hear cases brought from anywhere in Indonesia. The court differs from the general court in being hybrid — "ad-hoc" judges sit with "career" judges in mixed panels and this is replicated at both the appellate and Supreme Court level.[71]

5.1 Competition Commission

The Commission for Supervision of Business Competition ("Competition Commission") (the KPPU) was established under Law No. 5 of 1999. Its commissioners were appointed in 2000 and have handled upwards of 150 decisions to date. As of 2004, 15 were resolved with full decisions by panels of the KPPU.[72]

The early years of the KPPU were dogged by procedural difficulties. In part this was predictable because the KPPU was established as an independent regulatory body separate from the executive and other branches of government — an entity not recognized under Indonesia's

[70] Stewart Fenwick, "Measuring Up? Indonesia's Anti-Corruption Commission and the New Corruption Agenda" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

[71] *Ibid.*

[72] John R. Davis, "The Competition Commission: A New Kind of Player in Indonesia's Legal System" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

Constitution. The courts have not explicitly challenged the KPPU's ability to decide cases, but the degree of deference that the Supreme Court will accord to the KPPU's decisions is still unclear. Appeals from KPPU decisions are filed in the District Courts.

In the first few years of its operations, the KPPU interpreted Law No. 5 of 1999 in a fairly restrictive way, arguably reflecting the reality of low government demand for aggressive application and low social awareness of the benefits of competition regulation.[73] The Law covers oligopoly (Article 4); Price Fixing (Articles 5 and 11); vertical integration (Article 14); closed agreements or tying (Article 15); market control (Article 19), tender (Article 22); dominance (Article 25); double positions/conflicts of interest (Article 26) and cross-shareholdings (Article 27). Five of its early cases concerned collusion in tendering and three violations of the law were found; this is the most developed areas of the Commission's policy to date. Significantly one of the violations was found against multinational Caltex for organizing a tender for pipe in a way likely to lead to collusion.[74]

By 2007 the KPPU had developed a wider-ranging approach. In a late 2007 decision, now on appeal to the courts, the Commission found under the cross-shareholdings provision that a foreign parent and its Indonesian subsidiary could be treated as a single economic entity if the foreign shareholder has "material influence in the management of the [Indonesian subsidiary]". If upheld this would implicate minority as well as majority shareholders in acts of their company, as well as joint-venture partners.[75]

The law also contemplates the issuance of the *Government Regulation on Mergers and Acquisitions* (Articles 28 and 29), which will require M&A activity to be reported to the KPPU and permit the KPPU to prohibit the transaction within 30 days of it taking place.

6. SUPPORTING INSTITUTIONS

Beyond the courts and new adjudicatory institutions, we should also consider the other kinds of institutional support relating to the formation, performance and enforcement of commercial contracts.

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[73] *Ibid.*

[74] *Ibid.*, at 879.

[75] Hadiputranto Hadinoto & Partners, "Indonesian Anti-Trust Authority Lowering the Standard for Shareholders' Liability" (2008); online : <http://www.hhp.co.id>.

6.1 Bailiffs

Bailiffs in theory are charged with sufficient legal authority to enforce judicial decisions as prescribed in the relevant court decision. However, most of the interviewees considered bailiffs to be completely ineffective at enforcing decisions. One reason was that bailiffs rely upon the assistance of the police department, which was not guaranteed. In practice, attempts to execute judgments often encounter problems such as intervention from a third party, or the existence of multiple applications to attach or confiscate the same property. Foreign legal consultants acting for foreign investor clients in high-value transactions were unambiguous in naming bailiffs as corrupt agents who are quite willing to use attachment as a technique for extracting rents from parties to litigation, post-judgment:

> ... [t]he courts have become a weapon of economic terrorism. Bailiffs will blackmail you by refusing to remove an attachment, even when ordered to do so. A "clerical error" can be used as the basis [for extortion].[76]

6.2 Arbitration Bodies

BANI (the Indonesia National Arbitration Board) is usually cited as the private sector commercial arbitration organization with a list of commercial arbitrators. Other specialist arbitration institutions in Indonesia also operate, including BAMUI (Badan Arbitrase Muamalah Indonesia, or the Indonesian Muamalah Arbitration Board). BAMUI is associated with one of the major *syariah* banks, Bank Muamalah, and is primarily designed to resolve disagreements about *syariah* banking and insurance transactions, mostly within that bank. BAPMI (Badan Arbitrase Pasar Modal Indonesia) is the Indonesian Capital Market Arbitration Board. In the wake of the financial crisis, the Jakarta Initiative also established a procedure for mediated work-outs in insolvency matters that offered procedural incentives to parties who would otherwise have had to proceed through the Commercial Court.

Despite the proliferation of acronyms, in practice, commercial arbitration in Indonesia is underdeveloped. There is a lack of trained arbitrators and only a couple of arbitrators credentialed by international bodies. BANI itself is regarded by some observers as an unreliable monopoly and no less corrupt than the courts. Other observers are more hopeful, pointing out that the prominent lawyers who make up the ranks of experienced

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[76] Foreign legal consultant, Jakarta, 2003.

arbitrators in Indonesia are themselves among the leading thinkers and reformers of the older generation.

While arbitral awards are perceived as being generally enforced by the courts, only about 30 foreign arbitral awards had been registered between 1991-2003,[77] and few had actually been enforced. At least one major foreign arbitral award was annulled by the Supreme Court (the *Kahara Bodas* case) and views divide about whether this was correctly decided.[78] More optimistic practitioners also point out that the court enforcement statistic is misleading because it fails to capture the significant number of arbitral awards that are voluntarily complied with.

The practical reality for large commercial transactions requiring arbitration is that these are carried out offshore, usually in Singapore, in compliance with contractual provisions drafted for that purpose. Creating viable commercial arbitration and mediation services in Indonesia is partly conditional on solving the problems of the courts, where final responsibility for enforcing arbitral awards or mediation agreements would lie. Under current conditions Indonesia cannot possibly provide arbitration services that could compete effectively with Singapore, Hong Kong, Malaysia or, in the near future, China. Another way of viewing the situation, of course, is to see this relatively underdeveloped institution as one of the available "hopes" for the Indonesian legal system.[79]

6.3 Law Schools

A strong criticism of legal education in Indonesia by recent graduates of leading law faculties is, however, that their courses do not track the needs of legal practice, particularly in relation to complex transactions. Some of the explanation for this is structural. There are more than 300 law faculties in Indonesia and no formal consensus about what constitutes a core curriculum for legal education. An ongoing challenge has been to persuade professors to remain on campus rather than pursuing practice and consulting opportunities to supplement their income.[80]

A further structural handicap is that many of the most capable scholars have been pressed into government service during the *reformasi*

[77] *Ibid.*

[78] See, for example, Jakarta Post, 3 September, 2003. *Kahara Bodas Company v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, Final Award (18 December 2000) (March 2001) 16 *Mealy's International Arbitration Report* C2-C17.

[79] Indonesian lawyer, Seattle, 2006.

[80] Hikmahanto Juwana, "A Legal Education Reform Agenda for Indonesia" (2006) 1 *Asian Journal of Comparative Law* 208-222.

period. A notable example is Dr. Erman Rajagukguk, who while directing graduate legal studies at University of Indonesia and teaching in a number of public law schools, simultaneously served as Deputy Cabinet Secretary under four administrations up to 2005. He led a team responsible for checking and shepherding legislation through approvals by the Legislature, Cabinet and President. The volume and complexity of work involved following the financial crisis in 1997 was enormous.[81] To the credit of Dr. Rajagukguk and his key academic colleagues, there has been a concerted effort to build indigenous capacity for research and higher degrees in law in Indonesia, as an offset to the scholarship support provided through bilateral donors such as the Netherlands, Australia, Japan and the U.K.[82]

Creating new legal institutions without a new generation of legal professionals able to interact in global policy arenas seems optimistic at best. This is particularly so in Indonesia, where much of the local legal scholarship is still in the bibliographic, formalist tradition. Scholarship in fields adjacent to contract such as competition law, intellectual property and e-commerce is still relatively underdeveloped and relies heavily on foreign sources of information.[83] Empirical legal research using fieldwork to observe actual transacting patterns is still very rare and the supplement to formal treatises tends to be anecdotal or the legal scholar's personal experience.

All of these characteristics are well-understood by legal education reformers in Indonesia,[84] but the implementation will be incremental at best. In the meantime, it would be unrealistic to expect Indonesian law faculties — as institutions — to lead reform debates in commercial law, even though individual scholars may be involved as government advisors in an individual capacity.

6.4 Legal Publishing and Legal Information

There is still no national legal repository library in Indonesia and senior Indonesian figures who were active in law reform in the 1960s and 70s, when asked about this, tended to want to recite old battles, rather than

[81] Personal communication, 2003.

[82] USAID discontinued its scholarship and training program for graduate legal studies in 2003, a remarkable policy mismatch with its declared intention to support economic growth by reforming the court system.

[83] Gary F. Bell, "The Importance of Private Law Doctrine in Indonesia" in Timothy Lindsey, ed., *Indonesia: Law and Society*, 2d ed. (Leichardt, NSW: The Federation Press, 2008).

[84] Hikmahanto Juwana, "A Legal Education Reform Agenda for Indonesia" (2006) 1 *Asian Journal of Comparative Law* 208-222.

focus on contemporary needs.[85] It has only been relatively recent that major law faculties have been able to identify law libraries as an institutional priority and work to refurbish and restock them. They have also begun to subscribe to international legal information sources including products (for example, Westlaw) supplied by multinationals. Indonesian publishers do publish reference material relating to the *Civil Code* and contract law, treatises and books containing specimen contracts, and periodicals and journals. The best-developed indigenous digital legal information resource (<www.hukumonline.com>) is, however, a combination of free and subscriber-based information developed by young lawyers in the NGO sector. While this is a laudable effort and deserves support, it somewhat obscures the failure of the government to provide or support a "national content" digital legal information service.

6.5 Trade and Special Interest Groups

Trade and industry associations in Indonesia, as elsewhere, are both aware of international standards in their field and adopt standardized or "form" contracts. These are commonly used in business fields such as insurance, mining and gas, and capital markets. The professional associations, trade and special interest groups do not have specialized committees dedicated to contract law and its enforcement. What input members have with government policymakers tends to be individualized. On the government side, each government department has its own standardized forms for government procurement of goods and services. These are regulated by Presidential Decree No. 18 of 2000 (as amended) concerning Implementation Guidance for Government Procurement of Goods and Services.

Foreign investor associations, foreign consulates and trade offices provide input as groups to policymakers and other trade associations on international standards in commercial contracting and also advocate for new commercial practices, a digital signatures law being one example. Analysis of large Indonesian corporations and their recent transactions, as compiled by foreign chambers of commerce and consulates, also comprise some of the most reliable credit information available in the Indonesian market.

85 Personal communications, 2003.

7. TOWARDS EFFECTIVE CONTRACT LAW?

It is clear that Indonesia remains somewhat isolated from global developments in both standardizing and enforcing contracts. So, for example, Indonesia in 2003 was not a member of the *UN Convention on Contracts for the International Sale of Goods*, 1489 U.N.T.S. 3 (1980) and the government did not consider this to be an urgent matter. In the 2003 interviews, respondents noted Indonesia's participation in the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958, while recognizing that the courts are not particularly well-equipped to enforce foreign arbitral awards in practice. As a formal matter, the Indonesian judicial system does not recognize and enforce foreign judicial judgments, and as a practical matter this is unlikely to change; the likelihood of entering into reciprocal agreements is dampened by what is publicly said (and internationally known) about how judgments are reached in Indonesian commercial litigation.

End-user criticism of contract in Indonesia was restricted to areas of implementation and enforcement. The Ministry of Justice was described as having a "one-gate" policy for legal drafting and as having issued many laws and regulations concerning contract law, investment and their implementing institution. Much of this activity was financed with international lending and donor assistance for law reform. The style of legal reform here, as in other areas, is to use informal channels for input from stakeholders and to publish the draft legislation after the law has been passed.[86] To be sure, public hearings and seminar style discussions with stakeholders prior to passing legislation have been introduced in Indonesia in recent years, but seem to be more associated with post-2000 regulatory areas where there has been more legislative activity than in contract. Old ways die hard. As one of our academic researchers put it:

> [p]rincipally, the government has the key role in improving laws and regulation. Participation from the private sector does not have a significant role, without invitation to participate from the government.[87]

If business and private sector players feel sidelined in the legislative process, they are even more marginalized by the courts. One academic reporter said:

> [t]he business community understands and agrees with the mandate of the courts with respect to contract interpretation and enforcement. However, the low quality of the courts is the main concern of the community. They

86 Foreign legal consultant, Jakarta, 2003.

87 Legal academic, Jakarta, 2003.

> do not pressure the courts to improve their services; they simply discuss the case in seminars or workshops. ...
>
> ... The courts do not have internal plan for improving the administration of justice; and do not have system of accountability for its performance to the government and do not have mechanism for obtaining feedback from the private sector.
>
> ... The courts provide written decisions, and all regulations, forms, applications and other important documents and information necessary for using the courts available to litigants, but that information must be asked for and is mostly not for free.
>
> ... End-users feel that services and execution by courts are not satisfactory because they are not transparent, are discretionary, discriminatory, and unreasonably priced, all the way up to the Supreme Court. The end-users feel that they do not have adequate opportunities to provide feedback to the courts. The decisions by the courts are unpredictable for similar facts and circumstances, inappropriate under existing law, incomprehensible and not supportive of a market-oriented economy because of their high cost and time consuming nature.[88]

These lawyers and business people may have been aware of the Supreme Court blueprints for reforms in 2003 but were clearly not persuaded that dramatic institutional change was occurring.

Neither the World Bank's Doing Business Indicators,[89] or the USAID-funded Assessment of Indonesia in 2003 ranked it at the top of investment-friendly transition economies.[90] In fact, the World Bank indicators for "enforcing contracts" in 2004 put Indonesia in the company of Bulgaria and Mexico.[91]

The donor response has been predictable; foreign donors, including USAID, have identified the courts as being a key target for funding, both after the 1997 crisis and from 2003 onwards. Whether the court system has the capacity to absorb funding at this level and whether the reorganization of the court system will bring about dramatic improvements in how

88 Lawyer and Business respondents, Jakarta, 2003.

89 World Bank, "Doing Business in 2004: Understanding Regulation" (Washington DC: World Bank and Oxford University Press, 2004); online: <http://www.doingbusiness.org/Documents/DB2004-full-report.pdf>.

90 Booz Alien Hamilton, "Commercial Legal and Institutional Reform (CLIR) Indicators for the Republic of Indonesia: A Seldon Project Initiative" (October 1999); online: <http://www.bizlawreform.com/country_assess/Indonesia/indicators.pdf>.

91 World Bank, "Doing Business in 2005" (Washington DC: World Bank and Oxford University Press, 2005); online: <http://www.doingbusiness.org/ExploreTopics/enforcing-contracts>.

courts deliver services, produce legitimate decisions and enforce them are issues about which key observers continue to have serious doubts.