



Contractual Guidelines and Issues to Consider in Investing and Setting up in Indonesia

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Overview of Presentation

- **Investment**
 - Framework
 - Mining Services Industry
- **Contract**
 - Background
 - Framework



Investment - Overview

- One law covering all investment (domestic and foreign)
- The law deals with “direct” and not “indirect” (capital market) investment – which is the role of capital markets law
- Foreign investors must generally invest through a limited liability company (exceptions in oil and gas)
- All companies established in Indonesia are “Indonesian entities”
- An investment is limited only by the life of the company which owns the project (although relevant operating licenses must be gained and renewed as required)
- 100% foreign ownership is available



Investment - Overview

- The role of the Investment Coordinating Board (**BKPM**) is coordination, analysis and promotion
- BKPM will review, assess and ultimately approve or reject any applications by foreign investors to establish a foreign investment company in a particular sector
- BKPM will rely upon the recommendation of the relevant technical ministry. In the case of mining services companies, the Minister of Energy and Mineral Resources (**MEMR**) or his delegate the Director-General of Minerals and Coal (**DGMC**) acts as the technical ministry



Key Legislation

General

- Law No 40/2007 on the *Limited Liability Companies*
- Law No 25/2007 on *Capital Investment* (Foreign Investment Law)
- Presidential regulations on business activities closed or open to investment with restrictions (the *Negative List*)
- Civil Code (which establishes the principles upon which contracts are formed)

Law 25/2007 covers all investment activity, but it has particular relevance for foreign direct investment (**FDI**)



Key Legislation

For Mining

- Law on Mineral and Coal Mining Number 4 of 2009 (**Mining Law**)
- Mining Services Business Regulation issued by the MEMR No. 28 of 2009 (**Regulation 28**)
- Procedures and Requirements for Approval of Applications for Participation of Subsidiaries and or Affiliates in the Mining Services Business Regulation issued by the Director General of Minerals, Coal and Geothermal No. 376 of 2010 (**Regulation 376**)



Impact for Investors

Foreign Investment Law:

- Foreign and domestic investors are **equal** before the law and all investors shall be treated equally
- Rights granted to foreign investors are
 - the right to transfer assets and repatriate capital, after-tax profits and dividends, expatriate salaries, etc.
 - taxation reduction and exemptions and accelerated depreciation in certain circumstances
 - rights to land, immigration and import facilities



Typical Vehicles

- A legal entity incorporated under Indonesian law and domiciled in Indonesia, unless a particular law provides otherwise
- Limited liability company either wholly foreign owned or a joint venture with one or more Indonesian partners. Either foreign individuals or foreign legal entities may be founders of such companies
- These companies are commonly referred to as **PMA** (Penanaman Modal Asing) companies



Typical Vehicles

- Foreign ownership of PMA company may be 100% of the issued capital. However restrictions of foreign capital apply in certain sectors, especially in the health, construction, education, and transport sectors
- Mining is not a closed or restricted sector and accordingly foreign investors can hold up to 100% of a PMA mining services company, subject to a potential obligation to divest up to 5% of their shares within 15 years of the commencement of commercial operations
- Foreign investors may also purchase shares in an existing Indonesian mining services company, but such company's status must be converted into a PMA company (if not already a PMA company)



What type of services?

- Regulation 28 divides mining services into 2 categories: “core” mining services and “non-core” mining services

Core mining services

- Any consultation, planning, implementation and equipment testing that relates to
 - General survey
 - Exploration
 - Feasibility study
 - Mining construction
 - Transportation
 - Mining environment
 - Post-mining and reclamation
 - Occupational health and safety



What type of services?

Core mining services

- Any consultation, planning and equipment testing that relates to
 - Mining
 - Processing and refining
- Note that there is no reference to a mining services company **implementing** mining or processing and refining



What type of services?

Non-core mining services

- Services other than the core mining services that provide “services to support mining business activities”
- Examples include heavy equipment sales and rentals, catering services, security services or cleaning services, as long as they are specifically provided for the mining industry



Restrictions on services that can be provided

Foreign owned mining services companies

- Mining companies are obliged to give priority to local and national mining services companies
- Can only employ a foreign owned mining services company if there are no local or national mining services companies that have the necessary financial and/or technical capability to provide the services
- Must publish an announcement to determine whether there are available national or local mining services companies



Restrictions on services that can be provided

Subsidiaries or affiliates

- A mining company requires DGMC approval before it can appoint a subsidiary or affiliate to provide mining services
- Approval will only be given if there are no local or national mining services companies that have the necessary financial and/or technical capability to provide the services
- Must publish an announcement to determine whether there are available national or local mining services companies
- The terms subsidiary and affiliate are narrowly defined



What license do you need?

- **Core mining services** - a Mining Services Business Permit (**IUJP**)
- **Non-core mining services** – Registration Certificate (**SKT**)
- Issued by
 - DGMC to carry out operations throughout Indonesia
 - Governor to only carry out operations in a single province
 - Regent / Mayor to only carry out operation in a single region
- License generally valid for 3 years and can be extended



PMA – Setting up

- Obtain BKPM approval for the establishment of the PMA company
- Lodge the company's Deed of Establishment with the Ministry of Law and Human Rights and obtain approval for the establishment of the PMA company
- Obtain certificate of domicile
- Register for tax
- Company's Deed of Establishment must be published in a supplement to the State Gazette
- Make application for the IUJP or SKT



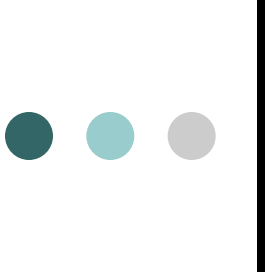
Obligations of mining services companies

- In undertaking their activities, mining services companies have the following obligations
 - To use Indonesian products
 - To employ local sub-contractors
 - To employ local manpower
 - To attempt to undertake environmental management efforts in accordance with the prevailing laws and regulations
 - To comply with occupational health and safety requirements in accordance with the prevailing laws and regulations



Obligations of mining services companies

- To assist in the development of a community development and empowerment program, including improving education and training, health and local economic growth
- To prepare and submit reports on the mining services company's activities to the issuer of the IUJP of SKT



Overview - Contract

- Indonesian contract law fundamentally has similar objectives to other systems
- Allows business/ persons who want to do business to enter into agreements freely and seek enforcement from a court or tribunal
- Key differences between Indonesian and common law contracts
 - **basis for contracts** – The Indonesian civil law (i.e. continental European based), not common law
 - **contract formation** – no consideration and claims for misrepresentation
 - **allocation of risk** – different risk and basis for loss/ compensation
 - **remedies** – primarily compensation



The Background of Indonesian Contract Law

- Contracts in Indonesia are governed by either
 - Adat (customary) law
 - the Indonesian Civil Code and other statutory laws
- Adat law governs contracts between members of the indigenous population in a village setting but does not apply to complex or modern transactions
- Accordingly the Indonesian Civil Code would normally apply to all contracts between mining companies and mining services companies



Contract Formation under the Civil Code

- The Civil Code requires that 4 elements be present before a contract can be formed:
 - Concluded based on the **free will** of the parties (*Consent*)
 - Concluded by **legally competent** parties (*Capacity*)
 - Agreed upon a **definite object** (*Subject Certain*)
 - Agreed upon a **legal purpose** (*Lawful Purpose*)
- A contract becomes the “law” between the parties and cannot be terminated without the consent of the parties or by virtue of a court judgment



Formation continued

- **Consent** - a contract is voidable if it is concluded by means of fraud, duress, or mistake. This does not mean the contract is invalid
- Little legislation that impacts on the formation of the contract
 - Anti-Monopoly Law
 - Consumer Protection Law
 - Construction Law
- Nothing similar to Australian Trade Practices Legislation
- An action to avoid a contract by a party on the grounds of fraud, duress or mistake can only be brought within 5 years from the discovery of these causes of action



Formation continued

- **Capacity** – “incompetent persons” are:
 - Any person under 21 years of age or under official custody
 - Incapable party can bring an action to annul contract within 5 years. Obligations of the other party are not affected
- **Subject certain** - both the object of the performance (e.g. goods) and the performance itself (e.g. delivery) must be determinable
 - A contract may cover rights, services, goods or things whether existing or will come into existence – provided the subject is determinable
- **Lawful purpose** – contract is void if its object is unlawful, contrary to good morals or public policy – e.g. contract for the distribution of illicit drugs or for gambling



Moment of “Creation”

- The “coincidence” of intention is the moment a legitimate offer has been accepted (either or both being explicit or tacit)
- A legitimate offer is irrevocable unless a power to revoke has been reserved
- If offer is not accepted within the period of its validity then it terminates. If no period is provided then it terminates within a reasonable time
- No mutuality of consideration – can have one party benefiting from a contract and the counterparty receiving nothing
- No formal requirements in most cases – the four elements only
- Contracts can be formed orally and only certain transactions require the formality of a notarial deed, e.g. transfer of land
- No requirement for use of company seal



Performance

- Every contract must be **performed** in *good faith* and cannot be terminated unless by consent or by court order
- The obligation of good faith is also applicable to pre-contractual negotiations
- The parties are not only bound by the explicit terms of the contract, but also by what is commonly imposed by custom, reasonableness, and law
- “Reasonableness” only applies in the absence of any statutory provision or custom to resolve an issue
- The effect of the concept of reasonableness is that a judge is free to deviate from the letter of the contract if such deviation is necessary to ensure good faith



Performance continued

- The Civil Code provides that as a general rule the purchaser bears risk of loss from the moment a contract of sale for a specified item is concluded. This will be applied to a contract if the contract does not specify otherwise
- A contract can be made for the benefit of a third party if such party is named as a beneficiary and has ratified the contract before it is revoked
- Obligations under a contract are generally not considered to be joint and several unless the contract specifically states that they are



Default

- A default does not occur merely because a party fails to fulfil an obligation under a contract
- Necessary to follow certain formalities before a default will occur
- Generally necessary to first serve a demand for performance (*somasi*) by the clerk of the District Court or by registered letter
- While case law indicates that an oral demand may be sufficient, better to document the demand by written notice
- Breach of contract will occur if defaulting party does not fulfil its obligations after receiving the demand



Termination

The Civil Code recognises 10 ways to terminate a contract including

- Performance
- Payment into court
- Novation
- Set-off
- Release
- Destruction of subject matter
- Default/breach but will require a court order unless Art.1266 and 1267 of the Civil Code have been waived
- A condition for cancellation becomes effective
- Statute of limitations, generally 30 years



Remedies

- Generally an aggrieved party is free to sue for specific performance
- The party in breach is obliged to compensate for
 - “Expenditure”, which includes any actual cost incurred by the aggrieved party in relation to the contract
 - “Losses”, which include any damage/injury to the property of the aggrieved party by reason of the breach
 - “Interest”, meaning *lost profit*, the maximum interest allowed for damages is 6% per annum
- Limitations on damages
 - Foreseeable at the time the contract concluded
 - Direct result of the breach.
- Damage claims are limited by *force majeure*



Practical Tips

- Need to check the Articles of Association to determine
 - who can bind a company
 - whether the objects of the company permit the company to enter into the contract
- Waiver clause of Articles 1266 and 1267 of the Civil Code which provide that a court order is required in order to terminate a contract
- Generally, parties are free to agree on whatever terms they wish, providing for lawful purpose
- Beware of making offers prior to signing a contract and if an offer is made always reserve the right to revoke before acceptance



Practical Tips

- Be aware that there is no requirement for consideration
- Use a Dispute Resolution/Jurisdiction clause which refers a dispute to a specific valid dispute resolution process (e.g. arbitration) and/or a specific District Court – otherwise the relevant forum will generally be the Court where the defendant is resident and domiciled
- Severability clause – to avoid the whole contract being rendered voidable or void for want of a contravening provision
- Events of Default clause – to clearly identify what conduct or omissions constitute “Default” that give reason to terminate the contract
- Spousal consent



Practical Tips

- Documentary evidence has different “weight”.
 - **Notarial deed:** the deed is prepared by the notary himself, in a specific format. There is a presumption, if the document is presented before a court, that the agreement embodied in the deed is fact, except if proven otherwise
 - **Notarisation** of a document (**Legalisasi**), a document is prepared by the parties, but signed before a Notary, and the Notary provides his attestation on the document
 - **Registration** of a document (**Waarmerking**), a document that has been signed is registered with a Notary
 - A document signed **under hand**, consider having at least 2 witnesses attend and attest
 - Stamp duty of Rp6,000 must be affixed on each document that will be used as evidence



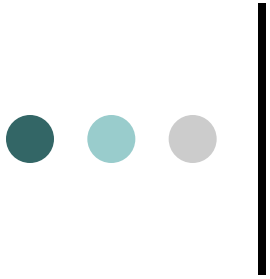
Practical Tips

- Should you use a “notarial deed”?
- Advantages include
 - Notary confirms that parties are authorised to sign
 - Notary confirms that parties understand the content of the agreement
- Disadvantages include
 - Notary must prepare the contract and this can take time and can lead to errors in the document
 - Additional cost
 - Notary may insist on reading contract
- Consider whether to use notarisatation of the document when the Notary will confirm that parties are authorised to sign the document



Practical Tips

- Ensure that any agreement reached during negotiations is made subject to internal review and sign-off. Make this a condition precedent
- Be aware of the requirement to use the Indonesian language or dual language documents



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