INTERNATIONALIZING BUSINESS MOVEMENT IN THE GLOBALIZATION OF MARKETS AND ECONOMICS FROM THE PERSPECIVE OF INDONESIA BUSINESS LAW

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THE ROLE OF INTERNATIONAL CONTRACTS IN SECURING INTERNATIONAL BUSINESS

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Introduction

While international business transactions are hardly new to Indonesian lawyers, they have become an increasingly prominent part of the business landscape in which they advise. This is unsurprising, and a trend that seems set to continue in view of the following:

- The increasing inter-connectedness of the global economy and the drivers of "globalization", including technological innovation, mobility of capital and the growth of multi-national enterprises.
- The size, continued growth and global importance of Indonesia's economy, with Indonesia being the world's fourth most populous country and its economy the largest in South-East Asia.
- The need for investment in Indonesian infra-structure (power generation, ports, public transport etc).
- Investment grade ratings awarded Indonesia by international rating agencies.
- Significant ongoing M&A activity in Indonesia including foreign investment in technology and "new economy" sectors (eg Chinese internet company Tencent Holdings' $1.2 billion investment in ride-hailing service Go-Jek Indonesia).
- The Indonesian government's expressed commitment to regulatory initiatives designed to attract investment.

What is an international contract?

There is no universally accepted definition of an "international contract". The UNIDROIT (International Institute for the Unification of Private Law) Principles of International Commercial Contracts (2016) recognise this in stating:

> *"The international character of a contract may be defined in a great variety of ways. The solutions adopted in both national and international legislation range from a reference to the place of business or habitual residence of the parties in different countries to the adoption of more general criteria such as the contract having "significant connections with more than one State", "involving a choice between the laws of different States", or "affecting the interests of international trade".*

The key feature of an international contract is that the laws of more than one country will or may be relevant to issues arising under or in connection with the contract. These may include (among others) questions as to validity (which itself entails consideration of many issues), interpretation, enforcement and remedies. The most obvious example of an international contract is one where the contracting parties come from different countries, but this is not the only circumstance in which consideration of the laws of more than one jurisdiction may be necessary.

What is an international contract?

Examples:

- International trade in goods (export and import). International trade transactions inevitably involve consideration of shipping/transport arrangements in addition to the sale contract, and often related credit arrangements (eg documentary credits).
- Foreign investment (whether, from an Indonesian perspective, inbound investment or outbound) and related shareholder or joint venture agreements.
- Cross border M&A transactions.
- Cross border financing
- Cross border IP and other licensing agreements.

International transactions often involve a combination of the above. For example, a power project may involve foreign investment in a project company (with a shareholder agreement between local and foreign shareholders) and project financing from one or more foreign lenders, in additional to local offtake and other arrangements.

Why are international contracts unique?

Contracts are central to most commerce, and not intrinsically more important in international transactions than they are in domestic transactions.

International transactions present unique challenges because of the need to consider the application (or possible application) of the laws of more than one jurisdiction, which tends to add to the level of complexity.

Contracting parties generally seek clarity and certainty as to the consequences of their agreement. While complete certainty is rarely possible, the scope for uncertainty or unforeseen consequences tends to be greater in the context of an international transaction. Determining which country's laws apply to any particular issue arising under or in connection with an international contract may be a difficult challenge.

Example

Take the following example (which is somewhat oversimplified and purely for illustrative purposes): Singco (a Singapore company) will enter into a joint venture agreement with PT X under which they will establish a new Indonesian company, PT Newco, to develop a power plant, to generate power to be supplied to PLN. An international syndicate of banks will provide a loan to PT X to enable it to develop the power plant, and the loan will be secured by security over PT X's assets and shareholders' shares in PT X. There will be credit support from a foreign export credit agency.

Apart from questions of which law or laws will "govern" the various contracts for such a transaction (there will be many of them, and choice of governing law will be considered later), it can be seen that, in addition to Indonesian law, Singapore law will be relevant, as will the laws under which the export credit agency operates. The laws of each jurisdiction in which banks in the lending syndicate are incorporated (or in which their respective lending offices are located) will also be potentially relevant.

Local due diligence and the local legal landscape

While the example I have given is an international transaction, Indonesian law will clearly be of paramount importance, whatever "governing law" may be chosen in the contracts required for its implementation. (I will later address choice of governing law.) The role of Indonesian counsel will be critical. It is likely that each of the principal parties will engage Indonesian counsel, and their respective responsibilities will depend on who they are advising. Indonesian counsel advising the syndicate of lending banks (or the agent bank representing the syndicate) will probably be most probing in their due diligence and analysis, as the lending will, presumably, be premised on the validity and enforceability of the underlying power project contracts. Issues they will need to consider are likely to include, among others, the following (and I stress that the following list of issues is far from exhaustive):

- The general question of whether the transaction and its constituent components are permitted under Indonesian law, and whether there are any relevant restrictions or prohibitions. For example, whether Singco is permitted under Indonesia law to hold shares in PT Newco and, if so, whether there are any restrictions of the level of Singco's shareholding in PT Newco.
- What licenses and governmental approvals will be required under Indonesian law?
- Requirements for the establishment of PT Newco.

Local due diligence and the local legal landscape (continued)

- What legal due diligence will need to be conducted to check that PT X (and possibly other Indonesian parties) is duly established and has the necessary power and authority to enter into the contracts to which it will be party?
- What corporate approvals will be required on the part of PT X and PT Newco (and possibly other Indonesian parties)?
- What is the regulatory regime for the supply of power to PLN, including as to pricing?
- Over what assets of PT Newco can security be taken, and in what form should the security be taken?
- Are there any applicable foreign exchange controls or restrictions on payments in a currency other than Indonesian Rupiah? (Exceptions to mandatory use of Rupiah under Law No. 7 of 2011 on Currency include international trade and international financing transactions.)
- What "formalities" must be complied with (for example, requirements that documents be prepared or witnessed by a notary or PPAT and registration requirements)?
- Language requirements (particularly in view of the provisions on language in Law No. 24 of 2009).
- What contractual terms are prescribed or prohibited or otherwise affected by Indonesian law?
- Tax implications (though it may be that specialist tax advisors are engaged to advise on tax questions).

There is no comprehensive system of international commercial law

International transactions do not take place within an all-encompassing system of "international commercial law" displacing national laws. National laws remain central to questions concerning the validity of international contracts and the rights and obligations of parties under them. Determining which national laws will apply (and to what particular issues), and the extent to which party autonomy allows for this to be settled by an express choice of law, are key considerations in international contracts. Further consideration will be given to these questions.

There have been attempts to harmonise commercial laws between nations, both through "hard law" initiatives (treaties and conventions that become national law through ratification) and "soft law" initiatives (guiding principles). While a degree of harmonisation has been achieved in specific areas, questions arising under international contracts are in most cases resolved by reference to national laws (whether the chosen "governing law" or the laws which, according to the relevant conflict of laws rules, apply in the circumstances).

There is no comprehensive system of international commercial law

Having earlier made reference to the UNIDROIT Principles of International Commercial Contracts, I should explain that these principles do not have the force of law and are not binding (unless the parties to a contract expressly agree that they are to apply – in which case they are incorporated in the contract, and do not become law). I understand that these principles have yet to receive wide recognition in the international business and legal communities.

One international instrument that has been widely adopted as national law is the United Nations Convention on Contracts for the International Sale of Goods (CISG). CISG has (thus far) been ratified by 89 countries (including Indonesia). According to its terms, CISG applies to "contracts of sale of goods between parties whose places of business are in different States", when (a) "the States are Contracting States" or (b) "when the rules of private international law lead to the application of the law of a Contracting Sate". Where, according to its terms, CISG applies to a contract for the sale of goods, it will apply unless the parties agree in the contract to exclude it. Its application is not dependent on express adoption in the contract. (Note: In order to determine whether (and to what extent) CISG does or would apply, regard must be had to Articles 1 through 6 of CISG and any reservations made in its ratification by a relevant Contracting Sate.)

Determining which laws will apply - conflict of laws/private international law

The terms "conflict of laws" and "private international law" are used to refer to the rules that determine which country's laws are applicable to an international contract, or a particular aspect of it. This is a notoriously complicated area, and not a topic I will attempt to address in detail. I hope that following general observations will suffice for present purposes.

- International contracts almost invariably contain a choice of law clause, by which the parties agree on which country's (or state's) laws will govern the contract. Indonesia is among the many countries whose national laws recognise, in principle, party autonomy to agree on which laws will govern their contract, but subject to certain qualifications. The qualifications differ from country to country. A valid and enforceable choice of governing law does not mean that all issues arising in connection with the contract will fall to be determined under the chosen governing law.

- There are no universally recognised "conflict of las/private international law" principles. Each country has its own conflict of laws rules, and they vary significantly from one country to another. It may be a matter of conflicting laws or opinion which country's conflict of laws rules apply. Whether an express choice of governing law is valid and, if so, which matters under or connected with the contract fall to be determined according to the chosen law, may be depend on the forum and the application of national laws other than the chosen law. For example, I understand that an Indonesian court would apply Indonesian law to these questions, which may lead to a result different from that under the chosen governing law (as to whether the choice of law is valid and, if so, as to what matters are covered by the chosen governing law).

Determining which laws will apply - conflict of laws/private international law (continued)

- Different rules (as to which laws are applicable) will probably apply to different issues. For example:

  - Did a contracting party have the legal capacity to enter in the contract and, in the case of a corporate contracting party, were the necessary corporate approvals obtained?
  - Were the applicable requirements for a binding contract to have been formed between the parties satisfied?
  - Was there compliance with applicable formalities (eg notarisation or registration)?
  - Was the contract in the required language?
  - What law applies to interpretation of the contract and to determining whether there has been performance of the contract in compliance with its terms?
  - What remedies are available against the defaulting party in the event of a breach of contract?

Choice of governing law

Most international contracts contain a choice of law clause by which the parties agree on which laws will govern the contract, for example:

> "This Agreement shall be governed by and interpreted in accordance with the laws of [country/state X]".

This is a fairly typical governing law clause, in my experience. Beyond the scope of this presentation is consideration of the necessity for the addition (as there often is) of, "without regard to conflict of law principles".

Will the choice of governing law be recognised and by whom, and in what circumstances will the chosen governing law be applied? These are key questions.

Indonesia is among the many countries whose national laws recognise the principle of "freedom of contract", including the freedom of the parties to agree on which law will govern their contract, subject to certain limitations. The specific limitations on the freedom of the parties to agree on which law will apply differ from one country to another, though there will often be a degree of similarity. Which country's laws will be determinative of whether a choice of governing law is valid is among the questions to be considered in the context of an international contract.

Choice of governing law

In 2015, The Hague Conference on Private International Law approved "Principles of Choice of Law in International Commercial Contracts (Hague Principles). The Hague Principles do not have the force of law and are not binding. It is, however, interesting to note that their terms include the following:

- *"No connection is required between the law chosen and the parties or their transaction.*
- *The Principles shall not prevent a court from applying overriding mandatory provisions of the law of the forum which apply irrespective of the law chosen by the parties. The law of the forum determines when a court may or must apply or take into account overriding mandatory provisions of another law."*

The Hague Principles differ from Indonesian law in at least one respect, in that (as I understand it) for a choice of law to be valid under Indonesian law there must be a sufficient connection between the chosen law and one of the parties or the transaction to which the contract relates.

I also understand that a choice of law other than Indonesian law will not be accepted by an Indonesian court to the extent that any provisions of the chosen law are incompatible with mandatory law or public policy or moral principles in Indonesia.

Choice of governing law

Which law should be chosen and to what matters will the law chosen apply?

- There are various reasons why a party to a contract may have a preference for a particular governing law. These may include party familiarity with home country laws, or a preference for laws of long-standing application and interpretation in international commerce (eg English or New York law).

- Questions over the choice of governing law in an international contract should not be divorced from consideration of how and where disputes will be resolved and questions of enforcement.

- I understand that the key principles under Indonesian law on recognition of the choice of a foreign law to govern a contract are: (a) there must be a "sufficient connection", (b) a choice of foreign law will not be accepted by an Indonesian court to the extent that any provisions of the chosen law are incompatible with mandatory law or public policy or moral principles in Indonesia; and (c) foreign laws will only be applied by an Indonesian court to the extent that the relevant content of those laws is proven to the satisfaction of the court (and whether such content is so proven is at the discretion of the court).

Choice of governing law

- To what issues arising under or in connection with an international contract will the chosen governing law apply? Almost certainly not all of them. It is unlikely that the chosen governing law will displace the national law applicable to whether a contracting party had contractual capacity or authorisation, for example. What other issues will fall be determined according to laws other than the chosen governing law? Another question that will fall to be determined by application of the relevant conflict of laws rules.

- The Hague Principles earlier mentioned state that: *"The law chosen by the parties shall govern all aspects of the contract between the parties, including but not limited to: (a) interpretation; (b) rights and obligations arising from the contract; (c) performance and the consequences of non-performance, including the assessment of damages; (d) the various ways of extinguishing obligations, and prescription and limitation periods; (e) validity and the consequences of invalidity of the contract; (f) burden of proof and legal presumptions; (g) pre-contractual obligations."* I have mentioned that these principles are not law or binding and are not universally accepted. They do illustrate the need to consider what issues will actually fall to be determined in accordance with chosen governing law of an international contract.

Dispute resolution

Dispute resolution in international transactions is an important and complex topic, and is the subject of another presentation in this seminar. I will merely note that the chosen forum for dispute resolution (particularly where disputes are to be resolved in the courts) may be relevant to the choice of governing law, and that dispute resolution by arbitration is often favoured in international contracts involving Indonesian parties, given that foreign court judgments are not enforceable in Indonesia, while international arbitral awards in commercial matters rendered in any of the many countries which are party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 are, in principle, enforceable in Indonesia (under Indonesian Law No. 30 of 1999 on Arbitration and Alternative Dispute Resolution).

Legal opinions

I conclude by briefly addressing legal opinions, as they are a common feature of significant international transactions, particularly financing transactions.

In the example transaction given, it is likely that Indonesian counsel advising the lenders would be required to give a "closing opinion", as condition precedent to the lenders providing funds to PT Newco. The opinion sought would likely be (in summary) that the contracts to which the opinion relates (which will include but probably not be limited to the loan agreement and security documents) are valid, binding and enforceable as a matter of Indonesian law, with certain other issues to be addressed. Closing opinions of this kind are well known to Indonesian law firms regularly engaged in international financing transactions.

Needless to say, legal opinions are not guarantees, and they are rarely unqualified. There are qualifications generally accepted as "standard" qualifications (for example, that enforcement is subject to bankruptcy laws). If there are transaction specific qualifications, and the issues have not already been raised by local counsel, negotiation of the legal opinion may serve to illuminate them.

A question which often arises in relation to such legal opinions is the extent to which local counsel can opine on the validity and enforceability of a contract expressed to be governed by a foreign law.

Thank you