How lawyers win land conflicts for corporations: Legal Strategy and its influence on the Rule of Law in Indonesia

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3 Buying Opportunities, Selling Dreams[1]

Not long ago, economists predicted that Indonesia would become one of the world's new economic giants, possibly becoming one of the 'MINT' countries: Mexico, Indonesia, Nigeria, and Turkey.[2] During the past decade, investment banks have been advocating investment in the Indonesian market to benefit from the sharp rise in Indonesia's domestic consumption. There is also an emerging urban middle class, which demands better living conditions and is willing and able to pay for them. To facilitate investments, the Indonesian government has opened the market to private developers (Dieleman 2011).

On the other hand, Indonesia appears to be neither an easy nor safe place to do business. The World Bank's 'Doing Business' report[3] ranks Indonesia 114th out of 189 countries in the general ease of doing business. Indonesia is even lower when it comes to enforcing contracts, ranking 172nd.[4] Investors face other challenges, including registering property, navigating the inadequate land administration system, and dealing with a lack of infrastructure.

This combination seems to indicate that Indonesia conforms to the common investment pattern of high opportunities that come with high risks.[5] However, if investors can overcome the difficulties inherent in doing business (i.e., enforcing contracts and dealing with the legal-administrative system), the Indonesian market combines highly lucrative investment opportunities with comparatively low risks. In other words, experienced

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1 I would like to express my gratitude to Prof. Stewart Macaulay for his extensive comments and suggestion on an earlier draft of this chapter.

2 The term MINT was developed by economist Jim O'Neill, who previously invented the term BRIC countries (i.e., Brazil, Russia, India, and China). http://www.bbc.com/news/magazine-25548060. Last visited: 15 November 2015.

3 A report comparing business regulations in 189 economies. World Bank. 2014. Doing Business 2015: Going Beyond Efficiency. Washington, DC: World Bank. DOI: 10.1596/978-1-4648-0351-2.

4 According to the Global Benchmark Complexity Index 2015 report published by the TMF Group, Indonesia is the second most complex country in the world in terms of compliance. The TMF Group assists companies in doing business in various jurisdictions. http://www.tmf-global-compliance.com/. Last accessed: 28 April 2016.

5 In fundamental principles of finance, there is a positive correlation between returns and risks. The competitive nature of the market maintains this equilibrium. See Brealey, R. A., Myers, S. C., & Marcus, A. J. (2015). *Fundamentals of corporate finance* (8th ed., pp. 356–385). New York, NY: McGraw-Hill.

investors or repeat-players may have a disproportionate advantage because the playing field is not level.

In 2012, two developments made investments in Indonesia even more attractive.[6] First, Fitch Ratings, Inc.[7] again categorized Indonesia as an investment grade country. Second, the Indonesian parliament passed a land acquisition bill designed to make land for development projects easier to acquire, including for projects to build satellite cities or new towns, malls, and the infrastructure surrounding them. This is also expected to facilitate the issuance of licenses for plantation and mining.[8]

The 2012 enactment of the Land Acquisition Law is an important development, which allows companies to acquire land under the reasoning that it will facilitate the country's economic development and thus prosperity for the people. However, the law has some shortcomings, as I will further clarify in this chapter. I will show the practice repeat-players perform in acquiring land and reducing the risks involved in doing business in Indonesia by dealing effectively with the legal-administrative system and reveal the underlying cause of disputes that may arise from 'doing business'. This chapter will first illustrate the typical land acquisition mechanism for urban development, how businesses are organized, the business culture and surrounding legal framework, and how the repeat-players form and perform contract relationships.

3.1 Typical process and organization of land acquisition for urban development projects

Land acquisition for urban development projects in Indonesia can involve different kinds of purposes. Theoretically, the legal procedures for these different purposes depend on whether the project is meant for a public interest (e.g., construction of roads and schools) or commercial interests (e.g., most housing developments, shopping malls, factories, and offices). Also, theoretically, a government can only enforce its eminent domain power on landholders in cases of public interest, rather than commercial interest. The Land Acquisition Law for development in the public interest

6 These developments are seen as 'gifts'. Credit Suisse, 2012. Indonesia Market Strategy. Asia Pacific/Indonesia, Equity Research, Investment Strategy. Copy with the author. These kinds of reports are only distributed to clients of investment banks. See also UBS Investment Research at www.ubs.com/emresearch.

7 A statistical credit rating organization designated by the United States Securities and Exchange Commission, whose authority stems from its regulation and enforcement of capital market rules (e.g., the Foreign Corrupt Practices Act), is considered by companies in Indonesia, especially those which are publicly listed and (quasi)state-owned.

8 For Palm Oil plantations see The World Bank Group Framework and IFC Strategy for Engagement in the Palm Oil Sector, 2011. http://www.ifc.org/wps/wcm/connect/159dce004ea3bd0fb359f71dc0e8434d/WBG+Framework+and+IFC+Strategy_FINAL_FOR+WEB.pdf?MOD=AJPERES.

(hereinafter Land Acquisition Law or Law No. 2/2012) intended to follow this principle by stating that it is to provide 'an efficient and humane, democratic, and just mechanism in order to acquire land to facilitate development.'[9]

However, laws and regulations (including the Land Acquisition Law) governing government land-takeovers 'for public purposes' are too malleable. Bakker and Reerink (2015) found that the meaning of public purpose and the variety of actors allowed to acquire land are too broad, the actors including public (governmental) institutions,[10] quasi-public corporations,[11] and private companies. The later Presidential Regulation confirms this, as it went even further by allowing private companies to be the drivers of the land acquisition process.[12] Additionally, Bedner (2016) found the law to be too constraining for landholders, with access to a grievance mechanism being so time-limited[13] as to decrease the opportunity[14] for people to access and utilize it.

In addition to the points made by Bedner, Bakker, and Reerink, this law is potentially problematic because people may be criminally prosecuted under it if they receive compensation and the evidence of the land right they presented is invalid, while in theory the evidence could retroactively be invalidated by a competent official.[15] This indicates an opportunity for

9 Preamble (b.) of Law No. 2/2012.

10 Such as Ministries and Provincial, Regency, or City Governments.

11 These are for-profit state corporations, which are divided into three types under Law No. 19/2003 on State Corporations: (1) *Perusahaan Perseroan*; limited liability company with 51% of its shares are owned by the government, (2) *Perusahaan Perseroan Terbuka*; limited liability company with publicly listed shares, and (3) *Perusahaan Umum*; owned fully by the government with no issued shares.

12 Presidential Regulation No. 148/2015 added the definition of institutions which need land and can drive the process of land acquisition with '[…] business entities having authority based on agreements from state institutions, ministries, non-ministerial state institutions, provincial government, regent/city government and State-owned Institutions/State-owned Corporations having special task from the government to provide infrastructure for public purpose.' Before the presidential regulation, this was only possible if a private company had the controlling interest in a quasi-public corporation.

13 Articles 23–39 of the Land Acquisition Law describe four relevant time limits: (1) 14 or 30 days to file a lawsuit at a first instance court against land acquisition decisions, (2) 30 days for the first instance court to take a decision, (3) 14 days to appeal directly to the Supreme Court (without going through an appeal court), and (4) 30 days for the Supreme Court to give its final decision. This does not mean that the land acquisition process will be suspended during this time. It is possible to request a suspension by the court, but as we have seen in Chapter 1 (with the confiscation and injunction procedure), the process is not an expedited one.

14 This is compared with previous ministerial and presidential regulations concerning land acquisition for public interests, e.g., Ministry of Interior Regulation No. 15/1975, Presidential Decrees No. 55/1993, No. 36/2005, and No. 65/2006.

15 Landholders are responsible for the legality (*keabsahan*) of their evidence of land rights (Art. 41(4)) and are criminally liable if it is later found that the evidence was falsified (Art. 41(6)).

government to limit citizens' rights.[16] Therefore, it is important to know how much protection is provided by having a land certificate (which is the government's acknowledgment of land rights) when a more powerful party (e.g., the government, wealthier citizens, and corporations) wants to acquire the land, regardless of purpose. Moreover, what if there is a different 'owner' than the one who controls or occupies the land? Whose 'legal interests' are being protected?

I investigate these questions by considering actors in development projects. How do they obtain the projects? What makes a development project succeed (e.g., houses and roads are built) or fail (i.e., the project remain an idea)? What causes the failure?

As I will show in the description of the typical business model below, in practice, it is not the intention of development (whether it is to build infrastructure to improve welfare or to build commercial spaces to be leased or sold for profit) that differentiates the process of acquiring land. Instead, the differentiation comes from the (economic) opportunities and risks the land development project entails.[17]

3.1.1 Business model / process in acquiring land

The process of acquiring land for both public and commercial interest projects depends almost solely on whether the land intended for a development project has been registered or not, as that is where the difference of cost, complexity, and players involved is found. The typical business model of land acquisition projects involves four groups of players: local business people, regional heads,[18] property developers, and investors.

Non-registered land

State registration formalizes land rights. If land is not registered, the state has not recognized land rights in relation to that parcel. If land targeted for a development project has not been registered, local business people collaborate with regional heads to obtain permission and support to take control of the plot. This can happen at a very early stage when developers associate themselves with candidates running for election on a *quid pro quo* basis (for more, see Mietzner 2011). The candidate for regional head includes a land

16 The practice of facilitating corporate land acquisitions has happened before. During an argument about what was to happen to fuller *eigendom* (European-based rights) in relation with the 1875 *vervreemdingsverbod*, which would have prevented European enterprises from acquiring land with *adat* rights, the government responded by enacting Emergency Law No. 21/1952, prescribing a new form of 'extraordinary corporation', which could hold either European or *adat* land rights. See Lev (1965).

17 The data used for this chapter is from my participant observations, and interviews with land developers, bankers, and investors in land development projects.

18 Regional heads refer to the Mayor, District Head, and Governor.

development project as a part of their 'vision and mission, regardless of whether it is for a public interest or commercial purpose. When they are elected, the new regional head proposes to the Regional Representative Council (*Dewan Perwakilan Rakyat Daerah* or DPRD) that the project become part of the development plan[19]. There is no funding formally required at this stage, only support from their constituents at the Regional Representative Council to approve and include the project in the spatial and budget allocation (see also Moeliono 2011).

If the local business people have not been able to secure a relationship with the regional head before an election, they will need the service of a broker. These brokers[20] are lower-rank officials who have access to the regional head, or a private 'professional' middleman with experience in navigating a government institution.

Exchange relationships need to be formalized or made into a *legal* form, to be able to set out the terms and conditions of the relationship and to allow the possibility—however minimal—of enforcing the agreement. The relationship between local business people and regional heads cannot be direct, as the regional heads are public officers and are not allowed to enter into contracts in return for electoral campaign funding or promise to allocate non-registered land (considered state land) for urban development projects.[21] In other words, business people try to put this illicit arrangement in writing to have something on paper that creates a sense of obligation. Even though it is not legally enforceable, it can be useful as a tool for bargaining or blackmailing. A written agreement is beneficial for the business people but poses risks for the regional head or brokers, so whether or not the agreement is made in writing depends on the bargaining power between them.

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19 There are two kinds of development plans: (1) *Rencana Pembangunan Jangka Panjang* (Long-term Development Plan), which is planned for 20 years, and (2) *Rencana Pembangunan Jangka Menengah* (Mid-term Development Plan), which is planned for a 5 years.

20 A broker is used in every stage of land acquisition process; from licenses, land clearing, and certification. They are referred to in Indonesian as *calo* or *makelar,* which means middleman. They are officials from NLA office, state officials and relatives of those. They are known to be unprofessional in the sense that they are not bound by any ethics code or institutional regulations, making them non-hesitant to do everything necessary to gain profit. See Badan Pembinaan Hukum Nasional, 1993. Analisa dan evaluasi hukum masalah Calo dalam jual beli tanah. Proyek Pusat Perencanaan Pembangunan Hukum Nasional, pp. 9–12.

21 A report by Indonesian Corruption Watch states that more than half of all parliamentarians are serving as directors, commissioners, or business owners; all positions involving potential conflicts of interest. The report does not include parliamentarian family member businesses of the Parliament members' family. Indonesia Corruption Watch, 2015. Hasil Penelitian Potensi Konflik Kepentingan Anggota DPR RI 2014–2019. http://www.antikorupsi.org/id/doc/hasil-penelitian-potensi-konflik-kepentingan-anggota-dpr-ri-2014-%E2%80%93-2019. Last accessed: 22 February 2016.

After the private exchange relationship between local business people and local authorities has been established, the land development project needs to be made public. However, the government needs to provide legitimacy for its choice to appoint the local company for the project. This is a delicate task, as too much transparency regarding the collaboration could result in allegations of corruption later on. The most common approach is for the government to announce a tender. This is now done electronically through websites called *Layanan Pengadaan Secara Elektronik* (Electronic Procurement Service), which state the terms and conditions of participating in the bidding process. The tender mechanism has loopholes. From the government's side, the tender can be designed to have a very particular bidding arrangement and arbitrary requirements to limit competition for the benefit of the target cooperation company. From the target company's side, it can involve other 'shadow bidders' making the process seem fair and equitable. The 'shadow bidders' are shell corporations or special purpose vehicle companies owned and controlled by the local business people or their relatives.[22]

After winning the tender, the company enters into a written contract (often called *Perjanjian Kerjasama* or Co-operation Agreement) with the government. At that point, the government recognizes the company's control over developing the land.

Registered land

If land is registered, it means that the NLA has issued a land certificate over that plot, giving a legal entity the right to own, lease, use, manage, build, or cultivate it.[23]

For local and national companies, it is simpler to acquire registered land than unregistered land because it is instantly ready to be offered to investors and they do not have to deal with the complexity of bureaucracy (as we have seen previously). In most cases, the land will not be sold, but the investors will arrange mergers and acquisitions with the company whose name is stated on the land certificate[24] by obtaining a stake in the company and making the company part of the investor's subsidiary or purchasing the company's controlling shares. This is less costly than having to pay for procedures of transferring and registering land under a new name.[25]

22 For special purpose vehicles in the Indonesian real property market, see Watanabe, Masakazu. 1998. New Directions in Housing Finance. International Finance Corporation, pp. 113–126. http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2002/02/16/000094946_02020504015422/Rendered/PDF/multi0page.pdf#page=121. Last visited: 24 November 2015.

23 These rights are those that the umbrella agrarian law (Law No. 5/1960) recognizes.

24 This does not necessarily mean that the company has physical control over the land.

25 Interview BT, JK, LC, ES, SK, MA, OS.

Land clearing

Before the property developer can start implementing the project or building, there are usually people that they need to remove who are living on the land targeted for development. Officially speaking, clearing land or removing people means that the property developer is buying the plot from the people. These people are usually farmers or the urban poor with semi-permanent or permanent houses, and they may not have a land certificate (i.e., they may not have registered their land) (see also Reerink 2011).

Land developers (companies) cannot legally own non-registered land. Land has to be registered before it can be developed. Occupied non-registered land has to first be acquired by a citizen (through registering their landholding with the National Land Agency) or by the government (through a process called release of rights, i.e., *pelepasan hak*).[26] The process is regulated by the Land Acquisition Law,[27] which states that the government can only acquire land because of public interest and defines what kinds of development are considered to be in the public interest (e.g., 'social and public facilities and green public spaces'[28]). The Land Acquisition Law states, '[l]andholders *must* release their land for development after compensation is given or based on a final and binding court decision'.[29] To fulfill the requirement of giving compensation, in practice, a land developer will often leave a sum of money for the court (through a consignment).

Furthermore, a local government can acquire land for development without referring to the Land Acquisition Law.[30] The local government can still acquire registered land (rights recognized by the government) by arguing that because the government has decided (with a decision letter (*Surat Keputusan*) issued by a regional head)[31] that the land is to be cleared for development, people occupying the land and refusing to vacate are acting against the law and are mere squatters without rights. This announcement works as a scare tactic in bargaining compensation with landholders.

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26 For the release of rights, the company has to first obtain an *ijin lokasi*. There also exists a Hak Pakai (right to use), but the Hak Pakai cannot be used as an encumbrance to receive bank loans.

27 Law No. 2/2012.

28 Article 10(l) Law No. 2/2012.

29 Article 5 Law No. 2/2012.

30 The government have used Temporary Law No. 51/1960, which mentions no compensation scheme for land clearing. See, e.g., Jakarta Bukit Duri land clearing case. http://www.hukumonline.com/berita/baca/lt581b6d7028065/korban-gusuran-gugat-uu-larangan-penggunaan-tanah-tanpa-izin. Last accessed 26 February 2019.

31 Articles 19 (6) and 21 (6) Law No. 2/2012 give authority to the regional head (provincial head/governor) to determine locations of development plots in the public interest and make final decisions on whether or not land development project will be carried out.

When the land is registered, a development company will just find the entity listed in the land certificate and acquire land directly from them, making the land clearing payment more straightforward and the risks more manageable (i.e., decreasing the unpredictability of funding or overpaying). There are fewer parties to deal with, and the whole procedure of acquiring land for a 'public interest' can be bypassed.

To start the development of a project, normally a joint co-operation with a big Jakarta property development company[32] will acquire a large amount of capital to clear the land and fund construction. This co-operation is either a joint venture (where the local company that won the tender sets up a new company with the big property developer) or joint operation agreement. I encountered sale and purchase agreements (of land, shares, or entities holding rights/licenses), forms of transfer (such as trust, *cessie*,[33] and BOT[34]) or joint operation (KSO[35]), and joint ventures.

Clearing both registered and non-registered land requires a lot of funding.[36] The purpose of funding ranges from compensating and reimbursing those moving to (in cases of forced land clearance) renting bulldozers, negotiating with the 'squatters', and paying enforcement personnel. This is rather tricky, as there is no threshold for how much funds they will require. It will depend on the requests by local leaders, and on the parties needed in the land clearing process, which are a local task force (*Satuan Polisi Pamong*

32 These are companies listed in the Indonesian Stock Exchange (IDX). The property and real-estate companies listed include: Agung Podomoro Land, Alam Sutera Realty, Bekasi Asri Pemula, Bumi Citra Permai, Binakarya Jaya Abadi, Bhuwanatala Indah Permai, Bukit Darmo Property, Sentul City, Bumi Serpong Damai, Cowell Development, Ciputra Development, Ciputra Property, Ciputra Surya, Duta Anggada Realty, Intiland Development, Duta Pertiwi, Bakrieland Development, Megapolitan Developments, Fortune Mate Indonesia, Gading Development, Gowa Makassar Tourism Development, Perdana Gapuraprima, Greenwood Sejahtera, Jakarta International Hotels, Jaya Real Property, MNC Land, Lamicitra Nusantara, Eureka Prima Jakarta, Lippo Karawaci, Modernland Realty Ltd., Metropolitan Kentjana, Metropolitan Land, Metro Realty, Nirvana Development, Indonesia Prima Property, PP Property, Pakuwon Jati, Ristia Bintang Mahkotasejati, Roda Vivatex, Pikko Land Development, Danayasa Arthatama, Suryamas Dutamakmur, and Summarecon Agung, Sitara Propertindo. Building construction companies listed include: Acset Indonusa, Adhi Karya (Persero), Nusa Konstruksi Enjiniring, Jaya Konstruksi Manggala Pratama, Nusa Raya Cipta, PP (Persero), Total Bangun Persada, Wijaya Karya (Persero), and Waskita Karya. Industrial estate companies listed include: Bekasi Fajar Industrial Estate, Puradelta Lestari, Kawasan Industri Jababeka, Lippo Cikarang, Mega Manunggal Property, and Surya Semesta Internusa. Source: www.idx.co.id. Last visited: 9 November 2015.

33 Assignment Deed, interpretation into practice from Indonesian Civil Code Article 613–624.

34 Build, Operate, and Transfer. A model commonly adopted between a state institution (owner of land) and an investor seeking to develop the land and eventually return it to the owner. See Soerodjo (2016)).

35 *Kerjasama Operasi*. Ibid.

36 This often comes from a provincial government's budget. For example, Jakarta Legal Aid Foundation reported that 96% of the sources of funding for land clearing in Jakarta come from provincial government budgets (Januardy et al. 2016:22).

Praja or *Satpol PP*) and police officers,[37] and in most cases,[38] also the national army.[39] Although it is rare for the national army to take action, a couple of personnel are usually standing by on the day of the land clearing, to show enforcement power to the people.[40]

Having a land certificate (i.e., land rights having been registered with the state) should provide authority to the landholder on whether or not to transfer their land rights, which means tenure security for the landholder. Ironically, in this case, the security of tenure is actually reduced when the land is registered because it is easier for investors to acquire the land. When the state has not recognized land rights (i.e., when the land is not registered), the plot is less favorable or not attractive enough for the developer or businesses to acquire through funding because the process is perceived to be complicated, expensive, and unpredictable.

Funding the construction

Once the land has been cleared, there are two ways to get funding for construction on the plot of land. The two sources of funding are (1) financial institutions or individual investors, and (2) direct consumers. Financial institutions or individual investors provide funding (capital) through investment banks, hedge funds, and private equity.[41] Direct consumers are middle-class people who have money to buy a house or enough disposable income to invest in a second home and rent it out. Basic Agrarian Law states that only Indonesian citizens are allowed to own land and limits the time foreigners are allowed to hold and use land.[42]

A syndicated loan scheme is used to get funding from financial institutions and foreign investors. In this scheme, the land certificate, along with shares of the company that holds the land rights will be put under collateral in the form of a mortgage certificate (*Sertifikat Hak Tanggungan*) to a security agent. A global real-estate valuation company will do a valuation of the project.[43] An issuer will use the result of the valuation to raise funds from financial institutions, which will purchase notes or bonds (i.e., the total loan

37 See the involvement of national police, e.g., in the Bukit Duri case http://megapolitan.kompas.com/read/2015/08/20/12305601/Pemerintah.Tak.Mau.Ganti.Rugi.karena.Kampung.Pulo.Tanah.Negara.

38 Interview JK, PR, BT.

39 The role of the national army in land clearance is significantly reduced compared to the New Order era. See development of this practice and relationship between the army, state, and land clearance processes in Davidson (2015).

40 LBH Jakarta report (Id) also states that civil servants from Public Utilities Maintenance (*Penanganan Prasarana dan Prasarana Umum*) and *Dinas Kebersihan* (Sanitary Agency) are also often involved.

41 Interview BT, ES, LC, SK, AL, and participant observations. For an overview about hedge funds and private equity, see Stowell (2010).

42 Article 26(2) BAL.

43 E.g., Colliers, Jones Lang LaSalle, and Knight Frank.

amount diversified into small parts) from the issuer, who often also acts as an underwriter.[44] The issuers/underwriters of notes/bonds are financial institutions that arrange the transaction or provide a larger part of the loan. They will offer share prices to their distribution networks and set an interest rate. A security agent is an institution with the authority to enforce the use of collateral (i.e., liquidate land rights) when the loan is not performing. The mortgage certificate is registered in the name of the security agent who also governs the management of the loan. Security agents are usually international investment banks such as HSBC, Credit Suisse, and Bank of America Merrill Lynch. The security agent also has the duty of dispersing and managing cash in the loan, although it can be a different financial institution in one scheme, depending on the scheme's complexity. The more complex a loan scheme is, the more specific a financial institution's role is in managing and governing an investment scheme through contract relationships.

To get funding from the consumers, the developer will create a building plan with a projected image of their expected results, advertising dreams such as happiness, comfortable living, a 'green' environment, and an image of a family. These projected images take the form of flyers and brochures distributed in malls, with big letters advertising low down payments and low interest for the public to purchase individual house units, apartments, or office space, and to start paying installments by way of signing a PPJB.[45] The collection of the down payment and installments will then be used to fund the construction. Consumers are aware of this scenario, and look for a reputable developer to invest their 'dream' in, because of risks that the project could be unfinished, which has happened quite often.[46]

The loan scheme for consumers usually goes as follows: consumers subscribe to a loan from a bank to purchase the (unfinished) house, which serves as collateral for the loan. This loan program is a banking product called KPR (*Kredit Pemilikan Rumah* or House-owner Credit). Consumers usually subscribe to a local bank (i.e., a state bank or private bank), which are often appointed by the developer. Sophisticated consumers will look

44 An underwriter is an entity that administers the issuance and distribution of securities in the form of equity interest over land from an issuer.

45 PPJB or *Perjanjian Pengikatan Jual-Beli* is a notarial deed signed between an intended seller and purchaser, promising a sale of property before actually selling and buying the property. The actual sale and purchase, or transfer of property, will be through the signing of a Sale and Purchase Deed (AJB or *Akta Jual Beli*).

46 There are a number of cases for this. There are even concerns that developers are only selling brochures without having any intention to build the land development project. Complaints include apartments not being delivered even though they have been paid for in full, not being ready for occupation even though the due date has passed, houses not being built on time, and bad construction quality (Kompas, 29 November 2015 p. 12). As a result, how-to and tip books about investing in and safely buying real-estate are widespread in Indonesia. For instance: Benny Lo. 2012. *Jangan Beli Properti sebelum baca buku ini!* (Don't buy property before you read this book!), VisiMedia.

into two things to make sure that the project will be realized: the developer's reputation and financial situation.[47]

As we can see from this model, the products investors buy are not the land itself, but a claim over income from rights and uses to the land in the form of shares or investment products.[48] In these transactions, there are several relationships involving different players with different roles. It is, therefore, useful to know how these relationships are organized in Indonesia.

3.1.2 Business organization

To understand how business is organized in Indonesia, first, we have to understand how different actors gain access to business activities. Actors need to access two kinds of networks through which they may obtain projects. These interconnected networks are the state officials' network and business people's network. State officials use connections and skill to provide services to businesses, while business people use money alongside connections and skill.

During the New Order, the term 'Ali-Baba' was used to describe the organization of big businesses in Indonesia. The term implies that businesses in Indonesia involved either political backing or the army ('Ali'), in charge of licenses and ensuring a politically smooth operation, and Chinese-Indonesian business people ('Baba') who brought capital, trading networks, and business skills into the organization.[49] With these combined strengths, contracting with Ali-Baba companies provided little security for other (smaller) companies, since enforcing contracts through courts was

47 Consumers determine a developer's reputation by word of mouth and relate it to the reputation of banks that disburse the KPR, usually in cooperation with the developer. They gather information at project launching events, check the SIPPT (i.e., that the development project has fulfilled spatial planning requirements), check the land certificate for certainty that the developer already controls the land, and that the company name is already in the land certificate. As a pre-litigation strategy for consumers, they can go to *Badan Penyelesaian Sengketa Konsumen* (Consumer Dispute Settlement Body) by using Law No. 8/1999 about Consumer Protection and Law No. 1/2011 about Housing and Residential areas.

48 Stakes over certified land are bought and sold through a secondary market, through buying a stake in a mortgage certificate or *Hak Tanggungan*. There, a stake is removed from politics, since government participation is not needed in the transaction, and proceeds go to a 'hidden' investor (beneficial owner). To fix this, since February 2015, all financial transactions by governmental institutions are being monitored through the World Bank's SPAN (*Sistem Perbendaharaan dan Anggaran Negara*) system. See http://www.worldbank.org/in/news/press-release/2015/11/11/indonesia-centralized-database-of-government-financial-transactions-improves-budget-spending-and-accountability. Last accessed: 12 December 2018.

49 For police, it is referred to as a parman economy (*partisipasi teman*), i.e., the hidden flow of gifts, capital, and other commodities from ethnic Chinese capitalists that is channeled to police officers (Baker 2013).

largely pointless. The 'Ali' could ensure socio-political backing and influence enforcement agencies (Antons 2007:12).[50]

The Chinese-Indonesian businesses grew so immensely with the Ali-Baba system that it became a 'Chinese problem' (e.g., Tan 1991; Mackie 1991).[51] Ethnic Chinese have specific cultural traits that remain strong despite attempts from the New Order to assimilate and acculturate them to become 'Indonesian'. These cultural traits still govern the way they do business today, namely the use of personal networks (*guanxi*), Confucian work ethics, and ethnic affinity (Koning 2007:129). Relationships in the business people's network, involving mostly Chinese-Indonesians, are centered in family and are thus exclusive of other ethnicities.[52] The Chinese-Indonesian business people stay in a closed network centered on family relationships.

I mentioned at the beginning of this section that the business people's network requires money alongside connections and skill. Where there is no foreign investors or a syndicated loan, capital for land development projects can only be inherited or obtained through family relationships; through marriages or by being a 'family friend'. Family friends belong to the inner circle of the most powerful members of the family. They may be friends, relatives, classmates, or neighbors. They became close to all members of the family and are permitted to attend family functions, such as weddings, funerals, and other life events. To become a family friend requires 'good *bibit, bebet,* and *bobot*[53]'. *Bibit* (i.e., seed, as per the literal translation) means pedigree and the person's family status. *Bebet* means the kind of social environment and connections a person has, and *bobot* (i.e., literally translated as weight) means their education and skills. Essentially, in this context, there has been a close or long relationship where lots of trust has been built, which makes the relationship equivalent to a family relationship.

The main idea of *reformasi* was the elimination of corruption, collusion, and nepotism. Even though the roles of political backers were reduced after *reformasi*, there are still lots of politicians and previous army generals owning or holding stakes in big corporations (Schwarz 1999; McLeod 2000; Antons 2007). Business relationships have also become more secure as methods of coercion become riskier and less probable. The focus has shifted from Soeharto's crony capitalism to a wider network of capitalist oligarchy,

50 This model of mixing government and private business interest is not new. For example, in colonial times, the director of Deli Company in East Sumatra (incorporated in 1869), Jan Theodoor Cremer, was also the Minister of Colonial Affairs (Lindblad 1996:220).

51 Chinese-Indonesians were only a very small minority (roughly 3%) yet had a major grip on economy and businesses, making them the target of resentment by indigenous Indonesians.

52 In the 1990s, Chinese-Indonesians controlled about 80% of all corporate assets, 160 out of 200 largest enterprises in Indonesia, and every reported billionaire was Chinese-Indonesian (Yeung 1999:104).

53 The term originated from Javanese and was commonly used throughout Indonesia. Personal communication with linguist Nazarudin, 5 June 2016.

which includes alliances between the leading politico-bureaucratic and capitalist families (Robison and Hadiz 2004; 2013). However, now, the political and military backers need to appear to have a 'legal', formalized role in business relationships. This condition raises the importance of contracts for regulating relationships and as reference points for operations.

Meanwhile, the capitalist families remain in a culture of close-knit groups centered on family relationships, and they govern the dominant form of economic structure (Redding and Whitley 1990:85). For example, Mochtar Riady (born Lie Mo Tie), the founder and Chairman of one of the largest land developer company, Lippo Group, is the brother-in-law of Mu'Min Ali Gunawan,[54] the founder of Panin Group, which runs one of Indonesia's largest banks in the housing credit business, Panin Bank. Panin Group also runs an insurance and securities house. Mochtar Riady's daughter is married to Tahir, who owns Mayapada Group and is an 'advisor' to Army General Moeldoko.[55]

Families own 95% of businesses in Indonesia. In family businesses, there are wider opportunities to structure complex organizations of companies while still keeping full control and power over the business, e.g., by putting a relative's name as the controlling shareholder of a company but retaining actual company management with the beneficiary owner (i.e., the head of the family).[56]

The culture of collaboration between politico-bureaucrats with capitalist families is still visible in how businesses are organized in Indonesia. Even though there is no longer as clear a division between political and economic power as before, the organization of business relationships remains the same. One party provides the majority of funding while the other is expected to fulfill an obligation or task (e.g., provide licenses and expertise) for the benefit of both. Business people need state officials to get projects going, but they cannot interact directly with one another.

During the New Order, this interaction was easy. The most visible example is the relationship between President Soeharto and a Chinese-Indonesian businessman Lim Sioe Liong. After *reformasi,* their relationship was heavily criticized, and there were widespread demonstrations aimed at

54 I was able to find this out by tracing names from various newspaper obituaries and wedding invitations.

55 TNI installs tycoon Tahir as advisor. http://www.thejakartapost.com/news/2014/09/19/tni-installs-tycoon-tahir-advisor.html Last accessed 19 September 2014.

56 In 2014, PricewaterhouseCoopers issued its seventh survey on family businesses globally and also issued a specific report on Indonesian family businesses. According to the report, in family businesses and business groups, decision-making is more efficient. However, complexities can create inefficiencies. Professionalism in running this type of business organization is also a key concern. PriceWaterhouseCoopers. Survey Bisnis Keluarga 2014, Indonesia. http://www.pwc.com/id/en/publications/assets/indonesia-report-family-business-survey-2014.pdf. Last visited: 10 November 2015. (See also Wijaya 2008; Arifin 2003).

eliminating corruption, collusion, and nepotism. State officials are supposed to act for the good of the public. They are not supposed to have relations with business people because it will lead the public to believe that the state official is in the businessman's pocket; the New Order problem remains fresh in the public's memory. This makes it more difficult for State officials and business people to enter into relationships. Both business people and State officials are aware of this problem, which is why they hide their relationships by forming companies and having the flow of money go through subsidiaries, to make their transactional relationships indirect and hide that money is passed from business people to State officials. Their relationship becomes transactional instead of being based on the rules of office that should govern them.

To hide these relationships, business people and State officials need a broker who can bridge their networks and manage their contractual relationships. In between these two networks, the local business people usually act as a broker since they are already in a close relationship with their local or regional officials. Commercial lawyers are another category of brokers who supported the bridge between these two networks, as they are the ones who can create business forms that can be used to hide ownership and create a barrier to make a direct relationship seem indirect. For this purpose, the transactions are performed under the guise of a company. 'Nobody is buying land using their personal name nowadays,' was a common statement I heard during my interviews.[57]

Commercial lawyers need to structure business transactions that serve dilemmatic functions; legitimizing transactions and managing connections but hiding ownership and providing opportunities to avoid taxes.[58]

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57 The statements are from lawyers and managers in firms that are active in acquiring a claim to properties under dispute by acquiring shares in clients' companies, or contracting with clients for part of the land or a certain percentage of the land purchase price as the lawyers' fee as a way to fund the dispute for the law firm, a topic we will return to in Chapter 4.

58 Buying land using a company is more tax efficient. In a direct (personal name) sale and purchase transaction of land, the seller needs to pay 5% of the transaction value as income tax, the buyer usually pays 5% of the transaction value as transfer tax, and potentially another 10% VAT. These were reduced to 2,5% in 2016 by Government Regulation No. 34/2016. However, the implementation is still debatable since the regulation states that it is only applicable to taxpayers whose main occupation is transferring land and/or building (Article 2). However, if the transaction is using a company (buying shares in a company that holds the land title), the buyer is only subjected to 0,1% tax to none for shares of public listed companies and 25% of capital gain for shares of private companies. Even though 25% seems to be a higher number than 5% + 5%, it is 25% from profit (capital gain) instead of 10% from transaction price, meaning that the actual amount of tax for buying land through purchasing company shares is significantly lower than buying land rights directly to the personal owner. Additionally, a private company can be listed in the capital market first, making it a public listed company to avoid the 25% tax.

Creating a complex business group structure serves these functions (Dieleman & Boddewyn 2011), a structure for selling and buying land, and creating or holding a stake in land development projects.

The situation suggests that the business activities concerning land acquisition for development are exclusive and have a close-knit structure. Relationships are complex, tangled, and rife with conflicts of interest. Part three of this chapter will analyze whether that is why it is hard to enforce contracts in Indonesia or whether there are other reasons. What does breaching contracts entail, and how do repeat-players operate and deal with risks? Does the law provide any remedy to level the playing field?

3.2 Corporate governance

The process and organization described above show that business activities regarding land acquisition do not only concern land laws, but laws regarding business management, which focus on creating, maintaining, and enforcing agreements. Corporate governance involves rules and principles to ensure that corporations function and compete effectively and ethically. These rules and principles regulate stakeholder and corporate rights and responsibilities and include procedures for decisions in corporate affairs. Here, 'company' refers to a single entity and 'corporation' refers to the wider structure of corporate or financial groups containing one or more entities (i.e., companies and natural persons) engaging in financial activities.

As we will see from the brief overview of the legal framework on corporate governance below, laws on corporate governance are quite comprehensive. Besides these laws, all institutions have their own detailed regulations and are also subjected to sectoral regulations governing specific areas of business. For example, some corporate lawyers specialize in manufacturing but do not know about mining. Others only know how to register patents but do not know what to do in an Initial Public Offering.[59] The variety of regulations stems from 'ego-sectoral-ism' (Arnscheidt 2009), i.e., where each government institution strives to be the most powerful and most authoritative in their own sector, which in turn creates overlapping or conflicting rules. It is hard for a general practitioner (litigator) to keep up (let alone comply) with these regulations because they are very industry specific. This makes the practice (of corporate lawyers) exclusive and over-specialized. These overly detailed rules combined with the vague civil and criminal code makes practice hard to predict.

59 Interview MI, HS.

Indonesian Company Law and Investment Law

For almost 150 years, companies in Indonesia were regulated by the Commercial Code (*Kitab Undang-undang Hukum Dagang* or KUHD), originating in the Dutch era with *Staatsblad* 1874-23 until some clauses were changed in 1971. Twenty-four years later, Law No. 1/1995 about the Limited Liability Company (*Undang-undang Perseroan Terbatas,* hereinafter the 1995 Company Law) was enacted as an independent regulation, not part of the allegedly outdated Indonesian Commercial Code and Indonesian Civil Code. The 1995 Company Law was meant to unify company regulations and to follow business and economic development. Its main goal was to protect the interests of investors and shareholders by giving rights to minority shareholders to commence Shareholder Meetings (RUPS): a procedure required for making binding decisions concerning a company.[60] It classified two types of shares: shares with and without voting rights.[61] Before this, shares came with the voting rights of 'one man one vote'.[62] The law also gave rights to any shareholder to file a lawsuit against the company in a district court, if a company action caused them to suffer personal losses.[63] This means that since the enactment of the 1995 Company Law, investors with equity interests but without controlling or regulatory power over the company were protected. In other words, the law gave investors the ability to intervene in decision-making when it caused them losses.

In 2007, the 1995 Company Law was replaced with Law No. 40/2007, and the Capital Investment Law (Law No. 25/2007) was enacted. Before this Capital Investment Law, there were two separate laws regulating investments by source of capital. Foreign Capital was regulated by Law No. 1/1967 and National Capital was regulated by Law No. 6/1968. The Capital Investment Law merged the two sources of capital into one law and now provides 'conveniences' [64] for investors concerning land titles and licenses.

A company is defined under the current 2007 Company Law as a legal entity with limited shareholder liability, having an independent legal status and ability to enter into contracts in its own name. Indonesian companies have a two-tiered system where there is an executive board and a supervisory board. Companies may sue and be sued, and may issue shares and bonds. The capital structure is divided into three: (1) a minimum of Rp. 50.000.000- in authorized capital or Rp. 10.000.000.000- in foreign investment companies, (2) paid-up capital, and (3) issued capital, 25% of which must be from the company's authorized capital. The 2007 Company Law

60 Articles 66 and 67 Law No. 1/1995. See also Articles 71,73, and 74.
61 Articles 46 and 72 Law No. 1/1995.
62 Article 54 KUHD as changed by Law No. 4/1971.
63 Article 54 Law No. 1/1995.
64 Articles 21 and 22. The Constitutional Court (Decision No. 21-22/PUU-V/2007) annulled the ability for investors to apply up front for the maximum length of time provided to hold land title without having to apply for extensions, although the Court kept the 'conveniences'.

regulates that issued capital must be paid-up.[65] Before this, a shareholder could technically be indebted to the company for their unpaid shares.[66]

Properties such as land, building, and machinery can also be a form of capital[67] through a procedure referred to as *inbreng*, which means a capital injection of goods. When the object is land, *inbreng* is similar to a sale and purchase in terms of applicable taxes,[68] and the land title has to be registered under the name of the receiving company. Before *inbreng* (as compared to a sale and purchase), an appraisal needs to determine the value of the land, which opens an opportunity for the company to have a lower valuation, which in turn subjects them to lower taxes.[69]

State-owned corporations are also subject to Company Law because of their form as limited liability companies, and they are also bound by Law No. 19/2003 about State-Owned Corporations. The Company Law has weaknesses. One of the key weaknesses is that it does not regulate group companies or subsidiary companies, so relationships within a company group remain subject to the vague Indonesian Civil Code, as I will explain below.[70]

Laws and oversight on business and banking practices

In lending and borrowing money, companies and corporations are subjected to banking and financial regulations, namely Insurance Business Law,[71] Law No. 5/1999 about the prohibition of monopolistic practices and unfair business competition, and the Law on the Indonesian Central Bank.[72] In 2004, a law on the Deposit Insurance Corporation was also established[73].

65 Article 33(1) Law No. 40/2007.

66 Personal communication with Aditya Prabowo, lawyer June 2016.

67 Article 34 Law No. 40/2007.

68 See footnote 58 above.

69 There is a safeguard mechanism that requires the *inbreng* to be announced in a newspaper, although this is not effective since parties could take certain measures for the announcement to remain undetected (e.g., publishing it in an obscure newspaper with small font).

70 In the Netherlands, this is regulated in Book II of Dutch Civil Code. I am grateful to Dr. C. de Groot who pointed this out to me.

71 Law No. 2/1992.

72 Law No. 23/1999, which was revised with Law No. 3/2004.

73 Law No. 24/2004 was enacted at approximately the same time as Bank Indonesia's approval to merge three banks, which led to a case that serves as an example of laws enacted to facilitate specific political and economically significant deals: The Bank Century case. The case was politically significant in that the government decided to bail out the bank following the 2007 financial crisis. The case was related to allegations of corruption and caused the then-popular Minister of Finance, Sri Mulyani Indrawati, to leave her post and an inquiry into the Governor of Bank Indonesia, Boediono, who later became the Vice President. See Kimura, Ehito. 2011. Indonesia in 2010, A Leading Democracy disappoints on Reform. Asian Survey, Vol. 51 No. 1, pp. 186–195 and von Luebke, C. 2010. The Politics of Reform: Political Scandals, Elite Resistance, and Presidential Leadership in Indonesia. Journal of Current Southeast Asian Affairs, 29(1), 79–94.

The actual Indonesian name of the law is the Law on *Lembaga Penjamin Simpanan* (literally translated as the law on an entity guaranteeing savings), which is in accordance with its purpose of establishment. 'The Deposit Insurance Corporation' (as the World Bank reports[74] refer to it) functions similarly to the American Federal Insurance Deposit Corporation, which is the body handling failing banks[75] and meant to guarantee the public can withdraw money from their accounts.[76]

A number of bodies were established to, e.g., oversee and enforce violations of these laws. These bodies include the Corruption Eradication Commission (Law No. 31/1999, which was revised by Law No. 30/2002), the Commission for Supervision of Business Competition (Law No. 5/1999), and the Center for Reporting and Financial Transaction Analysis (or PPATK, with Law No. 25/2003), which analyses, reports, and enforces the law on money laundering (Law No. 15/2002).

The Indonesia Financial Services Authority (*Otoritas Jasa Keuangan* or OJK) has the regulatory and supervisory function for financial services activity in banking, capital market, and non-bank financial institutions. OJK was established by Law No. 21/2011, replacing the functions of the Capital Market and Financial Institutions Supervisory Agency (*Badan Pengawas Pasar Modal dan Lembaga Keuangan*, known as *BAPEPAM-LK*).[77] The OJK can also establish regulations in the financial services industry.[78] It is led by a Commissioner Board who are elected by the parliament based on nomination by the President.[79] In 2015, OJK issued a regulation establishing its authority to investigate and criminally prosecute in the jurisdiction of the

74 See, e.g., World Bank, 2010. Improving access to financial services in Indonesia at http://www.bi.go.id/id/perbankan/keuanganinklusif/berita/Documents/World%20Bank%20Report%20-%20Improving%20Access%20to%20Financial%20Services%20in%20Indonesia.pdf. Last accessed: 9 June 2016.

75 The Bank of Indonesia decides which kinds of banks are considered failing banks, and the deciding committee consists of the Minister of Finance, Bank Indonesia, and the Deposit Insurance Corporation.

76 Deposit Insurance Corporation law was then revised in 2009 with Law No. 7/2009.

77 Together with International Finance Corporation of World Bank Group, they published the first edition of the corporate governance roadmap and manual in 2014. The roadmap was designed to strengthen corporate governance in Indonesia, and to bridge internationally recognized best practices with local laws, codes and regulations (IFC. Indonesia Corporate Governance Manual. First Edition. http://www.ifc.org/wps/wcm/connect/64185f0042cc3ab0b145fd384c61d9f7/Indonesia_CG_Manual_Feb2014.pdf?MOD=AJPERES. Last visited: 10 November 2015, and Factsheet, The Indonesian Corporate Governance Roadmap and Manual. http://www.ifc.org/wps/wcm/connect/acd25a0042e8cf29af60ef384c61d9f7/CG+Roadmap+and+Manual+Factsheet.pdf?MOD=AJPERES. Last visited: 17 November 2015).

78 Article 8 Law No. 21/2011.

79 Article 11(1) Law No. 21/2011.

financial service sector, which is an important but new regulation, so it is currently unknown how it works in practice.[80]

The 1995 Company Law granted the District Court oversight authority, which the 2007 Company Law moved to the Ministry of Law and Human Rights. The law also includes registration and compliance mechanism for companies, changed the classification of companies, and described corporate governance in more details. The 2007 Company Law referred to a series of government regulations needing to be enacted, detailing the procedures of corporate actions, such as regulations about mergers and acquisitions. The Law regulates the compliance relationship between a company and the government. It also regulates the relationship within a company, such as the obligation to shareholders and its Board of Directors and Commissioners, what qualifies as the company's liability, and which liability is the personal liability of its Board or shareholders. The Company Law states that a company is a legal entity established out of an 'agreement'. Because of this, a company needs to have more than one shareholder, and it has to fulfill the conditions required for the validity of an agreement, which are regulated by the Civil Code.[81]

Thus, since the Company Law does not regulate group and subsidiary companies and despite claiming to be separate from the outdated Indonesian Civil Code, most contractual relationships remain subject of the Civil Code.

Indonesian Civil Code

The Indonesian civil code regulates relationships between parties and the principles of their rights and obligations. It is important to note that there is no authoritative translation of the Indonesian civil code, which is from the Dutch colonial *Burgerlijk Wetboek voor Indonesie (Staatsblad No. 23/1847)*, or Civil Code for Indonesia. The Supreme Court in 1963 declared that the civil code will only serve as guidance and should be regarded only as a

80 OJK Regulation No. 22/POJK.01/2015. This is a rather important authority since the 1995 Capital Market Law (Law No. 8/1995) is the only law that explains what constitutes a conflict of interest, meaning OJK could theoretically also investigate and prosecute parties with conflict of interests. The law defines the meaning of 'affiliated party' as those with '*(a) family relationships out of marriage and descendants until second generation, horizontally and vertically; (b) relationships with employees, director or commissioner; (c) a relationship between two companies in which one or more members of Board of Director or Board of Commissioners are the same; (d) a indirect and direct control relationship between companies and a party; (e) relationships between two controlled companies, directly or indirectly, by the same party; or (f) relationships between a company and the majority shareholder*'.

81 An agreement is valid if there is (1) consent of the individuals who are thereby bound (Bw.28, 1321v.), (2) capacity to conclude an agreement (Bw. 1329v.), (3) a specific subject (Bw. 1332v.), and (4) an admissible cause (Bw.1335v.; Civ. 1108). In other words, an agreement requires agreement (*overeenkomst*), competence (*bevoegdheid*), fixed subject matter (*onderwerp*), and permissible cause (*geoorloofde oorzaak*).

document describing one group of unwritten laws.[82] In practice, different Indonesian translations of the civil code are still being used, though lawyers perceive it as a source of uncertainty and opportunity.[83]

This uncertain status and lack of authoritative translation create an attitude of taking all precautions to promote an impression of certainty, even though it is unnecessary. For example, people create and legalize documents with notarial deeds so that they have a better chance of being found valid if contested (see more examples in Chapter 4). This means that the practice surrounding the Civil Code is inefficient, and enforcing the Civil Code is ineffective against those with capital.

The Civil Code consists of four books: the first about *orang* (person(s)), the second on *barang* (objects, often referred to as law on property), the third about *perikatan* (the word is from *ikat*, which means to bind[84]), and the fourth about *pembuktian dan daluwarsa* (evidence and expiry).

In 1983, a workshop was commenced with the support of the Ministry of Justice to codify the civil code. The codification program was part of the government's five-year development plan (*PELITA IV*).[85] The workshop prioritized the codification of *perikatan* (see the discussion about obligations in section 3 of this chapter) because it claimed to be the most necessary (and the most 'neutral') legal foundation for economic development, facilitating both national and international agreements.[86] However, codification never occurred.

Indonesian Criminal Code and Criminal Procedure Code

As previously mentioned, there are a lot of criminal clauses in the legal framework of corporate governance. The Indonesian Criminal Code, like the Civil Code, is from the Dutch colonial era of *Wetboek van Strafrecht voor Nederlandsch-Indie*, which was enacted with *Staatsblad* No. 732/1915 but was never officially translated. However, unlike the Indonesian Civil Code, the Indonesian Criminal Code was made into law or recognized by the Indonesian government in 1946 with Law No. 1/1946.

82 Supreme Court Circular Letter No. 3/1963.

83 Interview with AS, OS, DK, AR. During participant observation, I found that lawyers keep copies of different Civil Code books published by different publishers for their reference. For example, Dikti and Hukumonline provide different versions online. jdih.ristekdikti.go.id/v0/?q=system/files/perundangan/16221176582.pdf and https://www.hukumonline.com/pusatdata/downloadfile/lt5243d51900ee3/parent/17229. Last accessed 26 February 2019.

84 '*per- … -an*' creates an abstract noun that indicates the process of performing the action to which the verb refers.

85 See Badan Pembinaan Hukum Nasional, Lokakarya Hukum Perikatan Nasional, Badan Pembinaan Hukum Nasional, Departemen Kehakiman, Jakarta Timur, 1983.

86 Id p. 7

The Criminal Procedure Code or *Kitab Undang-undang Hukum Acara Pidana* popularly known as KUHAP was enacted in 1981, which declares that the colonial procedural code HIR (*Het Herziene Inlandsch Reglement* or *Staatsblad 1941 No. 44*), Emergency Law No. 1/1951, and all its related regulations were void.[87]

The articles which are most used in the context of corporate governance are those on the crimes of fraud[88] and embezzlement.[89] A person (e.g., a director of a company) transferring money to another person or legal entity can be accused of fraud and embezzlement, especially when the legal basis of the transfer (such as sale and purchase agreements and shareholder resolutions) is void. This means that the person who signs a transfer document is criminally liable for their (contractual) action.[90]

Corporate governance in Indonesia is centered on 'self-dealings' and conflicts of interest, which observers can see as problems of unprofessional management and opportunistic or incompetent employed managers (cf. Fitzpatrick 2004). However, at the heart of it, corporate governance in Indonesia concerns problems in social and private contractual relationships between government institutions and officials, and its beneficial owners and family-owned conglomerates.[91] There are many specialized rules surrounding business practices, but the foundation of these rules, the Civil Code, and legal procedures are ineffective in regulating business relationships. This shows that parties do not have many limitations in shaping and managing their relationships as they wish. How do parties manage and structure these business and contractual relationships? Are there other (informal) rules that make parties perform their agreements? What does successful collaboration look like? What causes the failure of land acquisition and development projects? Why is it hard to enforce contracts in Indonesia?

87 Since then, a number of attempts have been made to revise both the Criminal Code and Criminal Procedure Code by forming working groups and ongoing discussions in parliament, but the 1946 Criminal Code and 1981 Criminal Procedure Code remain valid, despite some articles being revised or annulled by the Constitutional Court.

88 Article 378 Indonesian Criminal Code.

89 Article 372 Indonesian Criminal Code.

90 During participant observation, I found numerous cases—and strategies—based on this.

91 This is following Fitzpatrick's account in Businesses in Indonesia: new challenges, old problems / edited by M. Chatib Basri and Pierre van der Eng, 2004, Tinkering around the edges: inadequacy of corporate governance reform in Post-crisis Indonesia, pp. 178 – 190. However, I disagree with narrowing the problems to, as Fitzpatrick puts it, the 'interaction between institutional corruption and family-owned conglomerates.'

3.3 Causes of disputes in business relationships

Disputes start with project distress, which happens when a development plan (e.g., land development) cannot continue to the next phase or cannot be completed. Project distress is part of a causal chain of events. It leads to the financial distress of a company or corporate group, meaning that a company is unable to fulfill its obligations, which can lead to restructuring and bankruptcy.[92]

In a land development project, there are different interests derived from different relationships. For example, a dispute can stem from a party being unable to perform their obligations because of a conflict of interest. In this situation, the party is combining multiple interests into one transaction or obligation. Santen (2010:82-86) distinguishes three kinds of relationships: *corporate relationships*, meaning relationships involving a company and parties that belong to the structure of the corporate group, *commercial relationships*, meaning relationships with parties that are contracting with the company from outside the corporation, and *public relationships*, meaning relationships with the government, courts, and pressure groups such as NGOs and the media. For Santen,[93] this *public relationship* is not commercial. I found this to be different in Indonesia. A *public relationship* in the Indonesian context may still be commercial, even though the actors with whom the company is in a relationship with also have the role of being public officials. When either or some of these relationships become difficult, they become the source of project distress.

Distress in *corporate relationships* can be caused by disagreements between shareholders, and between shareholders and management. It happens largely because the beneficiary (shareholders or investors) loses control over the 'manager', i.e., someone appointed to manage the company such as directors and commissioners or someone who is posing as such but does not perform actual management or oversee the company's operations. Company Law states that the Board of Directors can act for and on behalf of a company in and outside of court.[94] There is no educational or professional requirement for joining a Board of Directors or Board of Commissioners, which leads some company owners to appoint a straw person to avoid civil

92 See, e.g., Stijn Claessens, Simeon Djankov, Leora Klapper. 2003. Resolution of corporate distress in East Asia, Journal of Empirical Finance, Volume 10, Issues 1–2, pp. 199–216 and Clark and Ofek. 1994. Mergers as a Means of Restructuring Distressed Firms: An Empirical Investigation. Journal of Financial and Quantitative Analysis Vol. 29, No. 4.

93 Santen's analysis was based on Dutch, German, and British laws concerning legal and economic monitoring of financial distress.

94 Article 1(5) Law No. 40/2007. Although the capacity to act for and on behalf of a company is prescribed in UUPT, the Articles of Association can regulate the processes and details of the representation (Article 98(2) Law No. 40/2007). It is important to note that a director can issue power of attorney for anyone to represent them without prior approval from other management members or through a Shareholder Meeting.

and criminal liability.[95] An example of disagreement is when this straw person refuses to sign a legal document (such as a Power of Attorney or transaction documents) at the request of the beneficiary.

Transactions to acquire land normally involve exchanges of money in return for land title. However, from the business model and organization explained above, a contractual relationship for land acquisition is not the exchange of land for money, but the exchange of services to provide land title for money. By service, I mean the service of public officials arranging or producing licenses and registrations for land acquisition.

The second cause of disputes derives from the informal rules of behavior that establish hierarchies between parties. The obligation to respect elders, employers, *bapak* (fathers), or patrons may prevent parties from making rational plans, and from gauging the ability of the counterparty to perform obligations. The embedded hierarchy prevents parties from further asking the dominant parties to explain what they mean, and the obligation to be subservient prevents the dominated parties from speaking their mind.

Furthermore, it is not clear what acting in good faith means. The principle of fairness in doing business is referred to as *cengli*.[96] In an Indonesian dictionary, *cengli* is described as 'as it should be', reasonable, or honest.[97] This refers to a kind of win/win situation. If both parties behave with *cengli*, they will expect to profit from the relationship. Alternatively, failed relationships in business are often described as the other party not being *cengli*.[98] In other words, they are not truthful, not acting on their promises, and making inaccurate offers. The application of *cengli* is emotional and relational. For example, even though a contract is due, it is not *cengli* to demand payment when the debtor is in mourning. This is the Indonesian business culture of good faith.

In practice, *cengli* often serves as a guide for the concept of good faith.[99] However, it is currently too undefined and ambiguous when distress arises,

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95 Article 93(1) states that 'anyone who are capable in performing legal action can be appointed except those whom within 5 (five) years before the appointment (a) has been declared bankrupt; (b) a member of the Board of Directors or Commissioners of a company which is bankrupt; or (c) criminally convicted of actions which causes state monetary loss and/or related to financial sector.' Furthermore, although UUPT regulates that management should be independent, companies practice this requirement only as a form of compliance, not to actually manage or monitor the company. Siregar & Utama. 2008. Type of earnings management and the effect of ownership structure, firm size, and corporate-governance practices: Evidence from Indonesia, The International Journal of Accounting, Volume 43, Issue 1, pp. 1–27.

96 The word might originate from the Confucian concept of *jen* and *li* (see, e.g., Wei-Ming Tu, 1968 and Chew and Lim, 1995).

97 Pusat Pembinaan dan Pengembangan Bahasa (Indonesia). 1989, Kamus besar bahasa Indonesia / tim penyusun kamus, Pusat Pembinaan dan Pengembangan Bahasa Departemen Pendidikan dan Kebudayaan: Balai Pustaka Jakarta.

98 Or *bo cengli.*

99 The formal legal term of good faith is *itikad baik*. Alternatively, bad faith is referred to as *itikad buruk*.

and there is no body of case law to help explain the meaning of *cengli* in particular situations. This is a problem, especially where there is no common profit since it triggers different expectations about outcomes, and the parties are free to change their minds. This situation indicates that when parties make a contract, it is as if they are performing a ritual, where certain procedures (traditions) cannot be clarified or changed.

Socio-legal scholars have observed that distress in contracts is caused by differences in interpretation and outlook (foreseeing, gauging) (Macaulay 1963), customs and behavior (Merry 1992; Dari-Mattiacci & Defains 2007).[100] Macaulay (1963:56) explained that in the United States, contracts play a minor role if problems arise. In Indonesia, this goes even further because the importance of interpersonal relations far outweighs (business) rationality and prevents parties in (contract) negotiations to express the (business) rationality and consider potential risks and losses.

Additionally, violating obligations could mean different things because what is referred to as 'obligations' is vague. Is it the obligation to be subservient to the older (or more dominant) party in a relationship, or the obligation to provide what is promised in a written contract? This condition further suggests that there is little equality in contract law, and brings us back to a question about the role of lawyers. When parties hire lawyers to negotiate, write, or enforce contracts, do they level the playing field or do lawyers follow the same informal rules?

Obligations: Lost in translation or strategies in translation?

According to Indonesian Company Law,[101] a person (shareholder) is not personally liable for the *perikatan* (obligation) their company makes.[102] This law is the foundation of limited liability in Indonesia. However, there is long-term confusion about the term *perikatan.* Massier (2008:219) found that this term is understood in two different ways by jurists depending on their existing knowledge of Dutch. These two schools of thought are separated into whether the legal scholar understood *perikatan* as *verbintenis,* which is a Dutch concept of obligations, and *perikatan* as a stand-alone Indonesian term.

According to the Indonesian Civil Code, *perikatan* occurs if obligations arise either from an agreement or from law to provide something, perform, or not perform an action (Articles 1233 and 1234 Indonesian Civil Code or *Kitab Undang-Undang Hukum Perdata* or Civil Code). A *perikatan* which arises out of agreements or contracts occurs 'when one or more persons bound themselves into an agreement with another person' (Article 1313 Civil

100 See, e.g., Merry (1992:209–226) who painted a picture about disputing neighbors and their fundamental disagreements, sourced from different lifestyles. Also, consider an illustration of disputes arising out of two different customs about the right of way in 17th-century Italy (Dari-Mattiacci and Deffains 2007).

101 Law 40/2007.

102 Article 3 Law No. 40/2007.

Code), and a *perikatan* which arises out of law occurs as a legal consequence of a certain action, or when regulated by law (Article 1352 Civil Code). This means that *perikatan* according to the Civil Code are obligations arising from relationships notwithstanding the source of the relationship: out of 'law', which makes it a subject of Tort Law, or out of agreements, which makes it a subject of Contract Law.

Satrio, an Indonesian legal scholar whose books are widely used in law schools throughout Indonesia, states that *perikatan* is a part of or the content of an agreement (Satrio 1992:3). By citing Pitlo, a Dutch legal scholar on the subject of *verbintenissenrecht* (or *Verbintenis* Law), Satrio (1992:16) mistakenly understood that *perikatan* in Book III of the Civil Code is merely about assets, wealth, or property relations. Kusuhamidjojo (2015:11) citing Satrio, states that *perikatan* and contracts are the same; the only difference between the two being whether an agreement is written or unwritten.

Many Indonesian jurists agree that *perikatan* is only a subject of Book III of the Civil Code, which they regard as an 'open system,' meaning that it can be set aside as parties wish (e.g., Satrio 1992:3; Setiawan 1987:11). Under this line of thought, they argue that the whole Book III of the Civil Code can also be declared as non-binding under the principle of freedom of contract, which entails freedom *from* contract.

Consequently, law students are taught that Book III can be set aside and serves only as non-binding guidance.[103] This thought develops from a misinterpretation of Subekti's seminal book. Subekti is a famous legal scholar and previous Head of the Supreme Court. In his book *Hukum Perjanjian* (Subekti 2002:13), he explained that Contract law is an open system because the Civil Code is meant to fill the gap of a lack of consideration by parties to the contracts they have written. If something is not regulated in the contract, Book III is applicable. However, this actually means that Book III serves as a minimum standard of contract. Even though parties are allowed to regulate their relationship differently from what is stated in Book III, it is not to be disregarded or declared inapplicable.

Moreover, both articles about tort and breach of contract are in Book III, which means that according to some, they are free to set aside articles on tort. However, other legal scholars argue that it is not possible to set aside tort because of 'azas' or principle.[104] These conflicting interpretations cause unclear conditions in determining whether a party is defined either as guilty of tort (Article 1365 Indonesian Civil Code) or breach of contract (*wanprestasi*).

Currently, *perikatan* as understood as the more established concept of Dutch *verbintenis* is diminishing together with the generation of jurists who were trained and educated during colonial times. Discussions about *perikatan* only emerge nowadays when there are disputes on whether a party

103 This originated from an interpretation of the Dutch legal term *aanvullendrecht*, which literally means additional law, described by Indonesian legal scholars in their books (e.g., Satrio 1993).

104 Interview OS.

shall be found liable for tort or breach of contract. The questions are merely about which kind of *perikatan* the party in question shall be bound by, assuming that there is always a form of *perikatan*. The meaning and concept of *perikatan* itself, however, are no longer discussed.

According to the principle of freedom to contract, all *perikatan* can arguably be declared non-binding, meaning that anyone is free to make contracts and set out their terms and conditions '*as long as it does not violate laws, prevailing regulations, norms and public order and by observing requirements for validity of agreements*.'[105] The confusion surrounding the concept and meaning of 'law' in *perikatan* (i.e., is it civic duty, customs, norms, religious values, public order, or all of those?) and the concept of *perikatan* itself enables the making of contracts or clauses in an agreement void or voidable, allowing parties to escape their obligations.

This confusion is useful for lawyers. It means that they have a wider range of arguments to use depending on their client's situation. They claim that an agreement has to be both valid and enforceable, or due and payable. Even though a contract is due, both creditor and debtor can claim that it is not enforceable or payable because it was not performed in good faith,[106] which is an exceedingly abstract concept. The closest explanation of good faith in the Civil Code states it is a 'permissible cause'[107] for an agreement to be valid, but in the Indonesian translation of the code, it is referred to as the Islamic term of *halal*.[108] The vagueness of this concept makes enforcing an agreement extremely difficult.

Furthermore, attempting to enforce an agreement may be difficult because it causes disputes about different interpretations of the agreement, which are originated from different interpretations on *how* the agreement should have been performed. This is prevalent, for example, in contracts in English. Contracts drafted in English have to be translated into Indonesian by a 'sworn translator'[109] before being submitted to a court. This translation can be crucial for the court's later interpretation.[110]

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105 Article 1338(1).

106 Article 1338 Civil Code

107 Article 1336 states: 'In the event that no cause is specified but that there is an existing permissible cause, or if there is a permissible cause other than the one specified, the agreement shall be valid.' 'Permissible' is translated from the Dutch word *geoorloofde*.

108 Related articles are Articles 1335, 1336, and 1337. Other than halal, 'kesusilaan' and ketertiban umum are also mentioned, which are vague. For more about the Islamic term of halal, see Y. Qaradawi. 1997. The Lawful and the Prohibited in Islam, Al-Falah Foundation, Cairo. pp. 6–10.

109 The sworn translator has to pass a qualification examination commenced by Universitas Indonesia and the Governor of Jakarta. If they pass the examination with grade A, they can be sworn in by Jakarta's Governor.

110 Because of the importance, it is common practice to have a lawyer translating the contracts, and the 'sworn translator' will add their stamp. This is beneficial for both the lawyer and the translator, as the lawyer can choose which words to use and the translator does not have to work for their fee, which is usually calculated based on the number of pages translated.

Translation strategies are used not only when translating contracts into Indonesian, but also when citing articles in the Civil Code. As I mentioned before, the Civil Code is originally in Dutch, and an authoritative translation does not exist. Lawyers admitted that they use the translation that is most beneficial to their cause in their briefs and pleas, but claimed that discussions in the courtroom have never reached that level. For example, when citing the first part of Article 1365 of the Civil Code, which regulates tort, there are two different translations:

1) *'Tiap perbuatan yang melanggar hukum dan membawa kerugian kepada orang lain, […]'*, i.e., 'Every action which violates the law and brings damages to another, […]'; and
2) *'Tiap perbuatan melawan hukum yang membawa kerugian kepada orang lain […]'*, i.e., 'every action against the law bringing damages to another.'

These two versions (there may be many others) seemingly are not very different, but the effect is actually crucial. The first version implies that an action violating the law alone would not be sufficient to be called *perbuatan melawan hukum* (an unlawful act or tort). Where the word 'and' is used in the article, there also have to be damages to another. The second version implies automatic cause and effect; that every action violating the law always brings damages to another. The last part of this article concerns consequences in terms of repayment of losses or damages.

These slightly different translations provide potential arguments about whether or not one should repay losses or damages and under what condition. What if they caused damages but did not violate the law? What if they violated the law but did not cause damages? These are the kinds of fundamental questions that should emerge more in courtrooms and be developed through judicial reasoning in court decisions.

3.4 Conclusion: The nightmare of enforcing agreements

This chapter has shown that tenure security or the lack of it is a moot point in land market transactions. Whether or not land is certified, the investors can acquire it, but the procedure is rife with conflicts of interest and prevailing informal rules. Acquiring non-certified land is more complex than acquiring certified land. This makes certified land more attractive for investors, and in turn, reduces tenure security for the (formal) landholders.

There are many business practice regulations, but they are ineffective at preventing illicit relationships between government or public officials ('Ali') and businessmen ('Baba'). Conflicts of interest are rampant in these relationships, and personal relationships and networks are more important than other rational and impersonal standards such as equality and fairness. They reflect the conditions of a 'prismatic' society, where family and community influence bureaucratic decision-making (cf. Riggs 1964), and

the dominant character of *guanxi*, which is a value structure holding social networks the most important in doing business, requiring gift-giving and reciprocity (Dawis 2009:78, Koning 2007:129, Tan 2000). This means that the law is applied differently to some than to others, and strong informal rules function as obstacles against enforcing contracts.

These strong informal rules are supported by the vagueness of the Civil Code and reinforce hierarchical relationships between parties. Negotiations are guided by best-case scenarios emphasizing a common profit between contracting parties. The resulting lack of planning means that consequently, even a small obstacle in a land development project can turn into a nightmare. Because of the dominance of personal relationships and networks, socio-legal research into the requirements of behaving in such networks (such as *cengli* as described in section 3.3) and its application is needed in order to find out how some contracts get performed and others are not. Contracts are not about performing a single act, but a sequence of interrelated actions. If one of these actions is not performed, it affects the entire constellation of the land development project.

Tensions and dilemmas between the overly detailed, sometimes overlapping, and conflicting rules of corporate governance, with overly broad and ambiguous underlying rules that are supposed to govern party and practitioner behavior and conduct are creating a dichotomy of practices between non-litigating and litigating lawyers. The transactional (non-litigating) lawyers focus on the technical rules and draft contracts in-line with the overly detailed, sometimes overlapping and conflicted black-letter laws, and the ambiguity of the underlying rules allows *brokers* and *fixers* to retain their practice.

The dichotomy generates three opportunities for strategies in avoiding obligations: (1) setting aside contracts when the contract is not favorable by instead using tort law, but parties can also (2) set aside the forum (i.e., the authority of courts or judicial decisions), and even (3) set aside law by utilizing and interpreting articles in the ambiguous Civil Code. The vague translation of the Civil Code sustains informal rules, e.g., by requiring a *halal* cause for a contract to be valid, which is a distortion of 'permissible cause' to one of religious concept. The courts have interpreted what constitutes an unlawful action (tort) too broadly and allowed the use of it as a defense against breach of contracts (*wanprestasi*). Furthermore, there is no established precedent or case law to guide parties about how to behave in good faith, specifically in performing contracts.

In Chapter 1, I described a kind of forum shopping in commercial land disputes that addresses all potentially available forums rather than choosing the most favorable one. Even then, there are still opportunities to set all the results aside even after using all of the available forums; creating a condition of extreme inefficiency.

The inability to rely on the private law of contracts and torts pushes parties to use criminal law, which in turn makes the 'game' of acquiring and investing in land more ferocious. It creates an uneasy and unsafe business

environment, as the World Bank describes it, but at the same time constitutes a free business environment. As many lawyers put it, it is 'like doing business in a jungle.' This situation is problematic for a well-functioning market, yet it is sustained because of the opportunity to use the system for manipulative strategies. We will see more of those in the next chapter.