

## Indonesia's New Construction Law

### Overview

On Thursday 15 December 2016 the House of Representatives passed the new Law on Construction Services ("**New Construction Law**") that replaces the previous law ("**Law No. 18/1999**"). The New Construction Law was enacted by the President of the Republic of Indonesia on 12 January 2017 as Law No. 2 of 2017 on Construction.

Official copies of the New Construction Law have not been published yet. However, we have reviewed the draft New Construction Law which has been passed and expect only minor changes due to editing.

The New Construction Law provides more details than Law No. 18/1999. Although, most of the articles of the New Construction Law are the same as those of Law No. 18/1999 and its implementing regulations with further clarification provided, the New Construction Law introduces the following significant changes:

**a. Tender Requirements:** Under the New Construction Law and the implementing regulation to be issued, the tender requirements that used to apply to the appointment of a construction service provider now only apply to construction projects which are funded by the state budget and "*construction projects for public services*". However, the New Construction Law does not explain what constitutes "*construction projects for public services*".

In the past, the strict tendering requirement created problems for some projects, particularly privately funded projects for which a limited or public tender was not commercially feasible. Under the New Construction Law, a tender is no longer required to appoint a construction contractor for privately funded projects.

**b. Prevailing Language:** One of the highlights of the New Construction Law is the change to the requirement regarding the prevailing language of a construction contract. Previously, the parties to a construction contract could agree on the prevailing language in the event of any inconsistency between the two versions. Now, under the New Construction Law, the Indonesian version of the construction contract must prevail.

This new requirement could be an issue for projects involving international parties as the contracts are usually negotiated in English and an Indonesian version of the contract is only drawn up to comply with the prevailing laws and regulations and for reference. Now, the parties must rely on the version translated into Indonesian language, which in some cases may not be 100% accurate as there may be no exact Indonesian equivalent of some technical terms.

**c. Subcontracting:** The New Construction Law distinguishes between the types of construction services which are deemed general and those which are deemed specific in more detail and only main work deemed to be specific work may now be subcontracted. Under Law No. 18/1999 only work which required specific expertise could be subcontracted but no further details were provided to decide what construction services required specific expertise.

### Main Provisions

Based on our review of the draft law which has been passed, the New Construction Law covers the following matters:

1. the responsibilities and authorities of government;
2. types of construction services;
3. form of a construction business entity;

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4. business requirements;
5. foreign construction services providers;
6. appointment of construction service providers;
7. prevailing language;
8. construction services collateral;
9. construction manpower;
10. construction security, safety, and continuity;
11. building failure;
12. information systems for construction services;
13. dispute settlement; and
14. sanctions.

Each section will be discussed further below.

## **1. The Responsibilities and Authorities of Government**

The New Construction Law introduces the responsibilities and authorities of both central government and local government. The new law aims to divide the monitoring tasks between the levels of government.

## **2. Types of Construction Services**

The New Construction Law merges the Construction Planning services and Construction Supervision services in Law No. 18/1999 into one category namely Construction Consultancy Services. It also further elaborates on types of activity which are general or specific under each of the construction services.

Under the New Construction Law, Construction Services consist of:

- a. Construction Consultancy services;
- b. Construction Work services; and
- c. Integrated services between Construction Consultancy and Construction Work services.

The services are divided into general and specialist services as follows:

### **a. Construction Consultancy services**

General Business classification: (1) Architecture; (2) Engineering; (3) Integrated engineering; and (4) Landscape architecture and spatial planning.

The above includes the following activities: (1) Assessments; (2) Planning; (3) Drafting; (4) Supervision; and/or (5) Construction-organization management.

Specialist Business classification: (1) Scientific and technical consultancy; and (2) Examination and technical analysis.

The above includes the following activities: (1) Surveying; (2) Technical examinations; and/or (3) Analysis.

### **b. Construction Work services**

General Business classification: (1) Buildings; and (2) Civil construction.

The above includes the following activities: (1) Construction; (2) Maintenance; (3) Demolition; and/or (4) Reconstruction.

Specialist Business classification: (1) Installation; (2) Special construction; (3) Pre-fabricated construction; (4) Building finishing; and (5) Equipment rental.

The above includes the construction work activities relating to certain parts of buildings or the construction of other physical forms

### **c. Integrated services between Construction Consultancy and Construction Work services**

Business classification of integrated construction service consists of: (1) Buildings; and (2) Civil construction. The above includes the following activities (1) Design; and (2) Engineering, Procurement and Construction.

The general and specialist activities will affect the types of works that may be subcontracted by construction services providers. According to the New Construction Law, construction services providers may only subcontract main work categorized as specific work.

### 3. Form of a Construction Business Entity

The New Construction Law's explanation of the qualifications of Construction Business Entities is more comprehensive than the law it replaces. Construction services can be provided by an individual or a business entity, with or without legal entity status. Construction business entities are categorized as:

- a. individuals and small sized business entities, which can only provide construction services involving low risk, low cost and low tech;
- b. medium sized business entities, which can only provide construction services involving medium risk, medium cost, and medium tech; and
- c. large sized business entities, which can only provide construction services involving high risk, high cost, and high tech.

The qualification of a particular business entity will be determined according to its annual sales, availability of manpower, financial capacity and ability to provide adequate construction tools. The details of how this is determined will be regulated further under a Ministry of Public Works Regulation.

### 4. Business Requirements

The New Construction Law provides details of the licenses and certificates that providers of construction services must have, namely:

- a. Individuals who wish to provide construction services must have an Individual Business Registration Certificate.
- b. Business entities wishing to provide construction services must have a Business License and a Business Entity Certificate. Large and medium sized business entities also require an Experience Registration Certificate.

### 5. Foreign Construction Services Providers

Under the New Construction Law, foreign construction services providers must prioritize the use of local content over foreign content, take into consideration local knowledge and must transfer technology.

Foreign entities may perform construction activity in Indonesia by either:

- a. establishing a Foreign Investment Company ("**Joint Venture Company**"), which must have a large scale qualification and must obtain a Construction Business License and a Business Entity Certificate (SBU); or
- b. establishing a Foreign Construction Services Business Entity ("**BUJKA**"), which must have the required certificates, an Indonesian business license, establish a joint operation with certified national business entities, and only provide construction services involving high risk, high cost, and high tech. The New Construction Law also imposes new requirements for establishing a BUJKA which were not imposed under Ministerial Regulation Number 10/PRT/M/2014, i.e. the head of the BUJKA must be an Indonesian national and a BUJKA must hire more local manpower than foreign manpower.

### 6. Appointment of Construction Service Providers

The provisions regulating the appointment of a construction services provider under the New Construction Law are quite different from those under the old construction law. The old construction law required all construction services providers to be appointed through a public tender or limited tender and, in special cases, a direct selection or direct appointment was possible. Under the New Construction Law, the tender requirement only applies to the appointment of construction services providers for construction work which is funded out of the state budget. It also states that a service user may not appoint an affiliate company as a construction services provider for a public facility without a tender or selection.

However, in practice this requirement may be broader than first appears, such as for PLN projects or projects funded by state owned entity using subsidies or public service obligation of which are allocated under the state budget.

The New Construction Law states that further provisions on appointment of construction service providers will be regulated under a Governmental Regulation. Pending the implementing regulation, it is unclear whether the tender requirement is now only required for projects funded by the state budget, or whether it extends to projects funded by private parties.

### 7. Prevailing Language

The New Construction Law provides a very strict view of Law No. 24 of 2012 on National Language, Etc. and requires the Indonesian language to be the prevailing language in the event of a dispute. Under Law No. 18/1999, the parties could agree on which language would prevail in the event of any inconsistency.

This may lead to some issues if the contract used is an international standard form of construction contract (e.g. the FIDIC contract), as no official Indonesian translation may be available. Given this, the parties will have to rely on a translated version as the prevailing version, which in some cases may not be 100% accurate.

## 8. Construction Services Collateral

Users of construction services are required to supply proof of their financial capacity to settle any obligations (i.e. proof of collateral, information supplied by a bank or non-bank institution, etc.) and/or demonstrate a commitment to enter into the relevant work contract by providing collateral. Providers are also required to deposit collateral to cover their compliance with their various contractual obligations in the following forms:

- a. tender collateral, i.e. collateral which is deposited by tender participants with the procurement unit before the due date of the tender;
- b. performance bond;
- c. down-payment collateral, i.e. collateral which is deposited by a service provider before receiving a down payment from its users;
- d. maintenance collateral, i.e. collateral which is deposited by the service provider with the user during the relevant term of the cover (i.e. between the first handover and the second handover of the results of any work); and/or
- e. objection-appeal collateral, i.e. collateral which is deposited by any provider who is seeking to process an objection appeal.

## 9. Construction Manpower

Under the New Construction Law, construction manpower must complete a competency test organized by a Professional Certification Agency (*Lembaga Sertifikasi Profesi*/"LSP"). This will allow them to secure a working-competency certificate which must then be registered with the Ministry. Additionally, construction workers may also secure a certificate acknowledging their professional experience by registering with the Ministry. Foreign manpower must have a Professional Competence Certificate which is registered with the Ministry and in accordance with their certificate of competence under the laws of their country of origin, as required in Article 74.

## 10. Construction Security, Safety, and Continuity

The New Construction Law introduces a new requirement regarding construction security, safety and continuity. The construction services provided must comply with the Construction Security, Safety, and Continuity Standards. These standards include those in the following areas:

- a. materials;
- b. equipment;
- c. security and safety;
- d. procedures;
- e. quality of work;
- f. maintenance;
- g. worker-protection programs; and
- h. protection of the environment.

The above standards are to be regulated by the relevant technical ministries.

In addition, the user and/or the provider must agree to meet the above standards in the following:

- a. the results of any construction assessment, planning and/or drafting process;
- b. the formulation of any technical process which relates to construction, maintenance, demolition and/or reconstruction;
- c. the implementation of any construction, maintenance, demolition and/or reconstruction activity;
- d. the use of materials, equipment and/or technology; and/or
- e. the results of the construction services.

A service provider failing to do so may be subject to several administrative sanctions.

## 11. Building Failure

Under the New Construction Law, the party liable for the losses/damage caused by a building's failure is no longer determined according to time, but by whether the parties met the Construction, Security, Safety and Continuity Standards. Previously, this approach was known as construction failure under Government Regulation Number 29 of 2000 on Providing Construction Services. The New Construction Law explains the qualifications, requirements, rights and duties of expert assessors in more detail, such as:

- a. Service providers/users are liable for any losses/damage caused by any Building failure due to non-compliance with the Construction,

Security, Safety and Continuity Standards.

- b. A service provider's period of liability is determined according to the anticipated lifetime of the planned construction, as specified in the Construction Contract. If the specified term is more than 10 years, the service provider shall be liable for building failures occurring during the interval between the handover and 10 years of the handover.
- c. A building failure must be confirmed by an expert assessor.
- d. An expert assessor must have a Professional Competence Certificate, experience in planning/implementing and/or supervising construction services, and be registered as an expert assessor.
- e. The expert assessor must determine the level of compliance with the Construction, Security, Safety and Continuity Standards, the cause of the failure, the party liable for the losses and damage caused by the failure, and submit its assessment to the Minister as a recommendation.

## **12. Information Systems for Construction Services**

Under the New Construction Law, the central government must organize and provide an accurate and integrated information system to save all required data and information from the user or the provider of construction services and also the related institutions.

## **13. Dispute settlement**

Any dispute must be settled by deliberation to reach a consensus. When consensus cannot be reached, then the Parties must follow the procedures of dispute settlement as stated in the Construction Work Contract, which are mediation, conciliation and arbitration. Further provisions regarding dispute settlement will be set out in the Government Regulation.

## **14. Sanctions**

Any failure to comply with the New Construction Law is subject to progressive administrative sanctions, i.e. written warnings, a suspension, or written warnings and administrative fines, etc., as provided by Article 89. Unlike the Law 18/1999, no criminal sanction applies under the New Construction Law.

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