

# Defective Arbitration Clauses: Simple yet Tricky

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In this short article, we provide a brief overview of defective arbitration clauses based on the statutory framework under Indonesian Law, how the law has been applied by the courts in Indonesia, and the importance of preventing defective arbitration clauses.

According to Law No. 30 of 1999 concerning Arbitration and Alternative Dispute Resolution ("**Indonesian Arbitration Law**"), arbitration terms must be written and included in the contract, as is the case in most jurisdictions. The Indonesian Arbitration Law also requires several necessary conditions that the parties to the arbitration clause must meet.

The arbitration provision is frequently called the "midnight clause" because the parties frequently negotiate such conditions at the very last minute, just before an agreement is finalized, with less attention to its precise wording. This lack of attention by the parties to the specifics of such agreements can result in the absence of one or more of the crucial components of an arbitration clause, which would then make the arbitration clause invalid.

## Statutory Provisions on Arbitration Clauses

According to Article 1, paragraph (3) of the Indonesian Arbitration Law, the parties may include an arbitration clause in a contract before a disagreement develops or enter into a separate arbitration agreement on the occurrence of the dispute. If the parties decide to submit a dispute to arbitration after it has already arisen, they must then make a written agreement as provided in Article 9 paragraphs (1) and (2) of the Indonesian Arbitration Law.

The elements necessary to all arbitration clauses, whether included in the original agreement or in a separate arbitration agreement, are mentioned in Article 9 paragraph (3) of the Indonesian Arbitration Law are:

1. disputed issues;
2. full names and places of residence of the parties;
3. full name and place of residence of the arbitrator or arbitral tribunal;
4. where the arbitrator or arbitral tribunal will make decisions;
5. full name of the secretary;
6. dispute resolution period;
7. a statement of willingness from the arbitrator; and
8. a statement of willingness of the disputing parties to bear all costs necessary for the settlement of the dispute through arbitration.

## View on Defective Arbitration Clause under Indonesian Arbitration Law and the New York Convention

Below are examples of defective arbitration clause:

*"Any dispute which arises shall be settled by Arbitration."*

*"Any disputes or differences arising out of this contract shall be arbitrated in a 3rd Country, under the rule of a 3rd Country and in accordance with the rules of procedure of the International Commercial Arbitration Association."*

The above arbitration clauses does not refer to any specific arbitration body nor any mechanism to appoint the arbiters. The arbitration clauses also lack the components mentioned in Article 9 paragraph (3) of the Indonesian Arbitration Law.

Furthermore, Article 11 paragraph (1) of the Indonesian Arbitration Law provides:

*“Existence of a written arbitration agreement contained in the agreement will eliminate the rights of both parties to submit the settlement of the dispute or contention to the District Court.”*

Thus, the existence of a written arbitration clause contained in the agreement nullifies the parties' right to submit disputes or differences of opinion to the District Court invalid, according to Article 3 and Article 11, paragraphs (1) and (2) of the Indonesian Arbitration Law. Except in certain circumstances outlined in the Indonesian Arbitration Law, the District Court is required to decline and not get involved in settlement of a dispute that has been settled by arbitration.

In line with the above, the United Nations Conference on International Commercial Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (**“New York Convention”**) in Article 2 paragraphs (2) and (3) of the New York Convention clearly states as follow:

*“2. The term “agreement in writing” shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.*

*3. The court of a Contracting State, when seized of an action in a matter in respect of which the sympatries have made an agreement within the meaning of this article, shall, at the request of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed”*

When the validity of the arbitration clause comes into question, it will be difficult for the parties to settle the dispute, considering the Indonesian Arbitration Law clearly states that there is no room for the District Court to examine or get involved in the case, while equally the New York Convention's view is that arbitration proceedings cannot be conducted if the arbitration agreement (clause) is null and void, inoperative or incapable of being performed. An expansive interpretation of the arbitration agreement (clause) refers to a broad understanding of the exceptions stated in the provision. This broad interpretation poses a risk to the validity of numerous arbitration agreements, ultimately limiting the overall scope of arbitration.

It is crucial to pay attention to the details in the arbitration clause. Even when the parties have fulfilled the elements under the Indonesian Arbitration Law, the courts could assume the power to resolve the dispute. In practice, such defects are commonly found in arbitration clauses through some of the abovementioned elements being lacking. Another example of a defective clause is where the parties' intention to submit disputes to arbitration is unclear, such as through the use of the word “may” in the clause. Instead, the intention of the arbitration clause must be conveyed by wording such as “shall” or “will” to reflect certainty.

Failure to do so may render the arbitration provision unenforceable. In this case, some courts have ruled that the word “may” in an arbitration agreement gave each party the option to choose what form of dispute settlement to use. As a result, the party that feels wronged can opt for a different form of conflict resolution outside arbitration, including going through the courts.

Again, the above proves that it is crucial to pay attention to the details of the arbitration clause. Preparing arbitration clauses without high precision can drastically impact the outcome of a case. Even if the arbitration clause meets the essential elements under the Indonesian Arbitration Law, the courts are still able to intervene in the disputes as the judges in Indonesia have their own independence in examining the case.

## Key Points

Arbitration agreements that contain flaws can have serious consequences. Engaging in a court battle to determine the arbitration clause's validity is a significant waste of time and effort in such situations. To avoid or at least minimize these adverse outcomes, it is crucial for the parties to craft the language of the arbitration clause carefully. During negotiations, the parties should discuss the potential ramifications of their decisions if either or both parties decide to institute arbitration proceedings.

If a defective arbitration clause is discovered after a dispute arises between the parties, they may choose to negotiate and come to a decision on a new arbitration agreement or clause. If that is not feasible, one party may consider initiating a tort lawsuit in the relevant district court, providing additional facts about the case to demonstrate that the ongoing dispute is not simply a result of defaulting on the agreement.

## Dentons Arbitration Toolkit

We understand that each jurisdiction may have different approach in arbitration proceedings. For ease of reference, Dentons have prepared an arbitration toolkit which provides a quick snapshot on the laws and practices relating to arbitration proceedings across different jurisdictions, which can be accessed through the following link:

<https://publisher.dentons.com/experience/dashboard/international-commercial-arbitration>

Please contact us for further details on the procedure and to obtain advice on proper arbitration clauses.

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*The article above was prepared by Dentons HPRP's lawyers*

*This publication is not intended to be a comprehensive review of all developments in the law and practice, or to cover all aspects of those referred to. Readers should take legal advice before applying the information contained in this publication to specific issues or transactions or matters. For more information, please contact us at [dentons.hprp@dentons.com](mailto:dentons.hprp@dentons.com).*

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