

Insights and Commentary from Dentons

The combination of Dentons and Hanafiah Ponggawa & Partners (Indonesia) offers our clients access to 9000+ lawyers in 167 locations and 73 countries around the world.

This document was authored by representatives of Hanafiah Ponggawa & Partners prior to our combination's launch and continues to be offered to provide clients with the information they need to do business in an increasingly complex, interconnected and competitive marketplace.

Highlights on the New Construction Service Law in Indonesia



Objectives

The government has enacted a new regulation on construction services in Law No. 2 of 2017 concerning Construction Service (the “**New Construction Law**”) to replace Law Number 18 of 1999 (the “**Old Construction Law**”). In general, the implementation of construction services should ensure public order and legal certainty, but it seems that for some practitioners the Old Construction Law could not meet the demands of good governance and the dynamics of the implementation of construction services, and therefore, it was necessary to accommodate some concerns from the practitioners by improving the regulation of construction services.

What’s New?

Some of the new features in the New Construction Law which had not been covered by the previous law, are: (i) the distribution of authority between the central and regional government institutions with regard to the construction services, (ii) provisions related to construction manpower (experts) (iii) the possibility of forming a Dispute Counsel (*Dewan Sengketa*) as an alternative for dispute settlement, (iv) system of information for construction services, (v) removal of criminal sanctions.

The above provisions generally are to attract and enhance the participation of construction business practitioners in order to involve them in the development of the Indonesian economy. The government hopes that this New Construction Law, as an implementation of its nine Priorities Agenda (known as *Nawacita*), will accelerate more equal national development throughout Indonesian territory.

Construction services play an important and strategic role in the national development in any country. Besides supporting various fields of development, construction services also contribute to the growth and improvement of various industrial goods and services. The construction services and management of construction services that are being promoted by the government need an active participation from private investors, both local and foreign. This participation should be positively supported by a variety of policy packages that support the national investment climate, including the legal certainty investors.

Business Type and Form of Construction Service

The New Construction Law provides the following business types of construction services:

- a. construction consultation service business;
- b. construction work business; and
- c. integrated construction work business.

The above types and forms of construction services are completely different from the services regulated by the Old Construction Law. In addition, the processes obtain licenses for the above construction activities are now fully within **the authority of regional government institutions**. However, to date, the implementing regulations have not yet issued by local governments, which may hamper the investor in running its business activities.

Registration and Certification

In terms of construction licenses, the New Construction Law also provides for types of licenses: (i) Individual Business Registration Certificate (*Tanda Daftar Usaha Perseorangan* or “**TDUP**”) for sole trader and (ii) **Business License** for legal entity construction service providers, granted by the **Regional Government** of the regency/city depending on the domicile.

A legal entity construction service provider is also required to have the following certificates issued by the Minister of Public Works and Public Housing (“**Minister**”):

1. Business Entity Certificate; and
2. Registration of Experience (specifically for medium and large scale).

In light of the above, implementing regulations which specifically govern the above provisions need to be issued by the relevant authorities.

Foreign Construction Service Business Entity (*Badan Usaha Jasa Konstruksi Asing* or “BUJKA”)

The government is aware that the development of national construction needs participation from foreign capital. Under the New Construction Law, a foreign entity may engage in construction services in the form of (i) representative office; and/or (ii) joint venture company.

Specifically for the representative office, there are some requirements for a foreign entity which is going to participate in construction business activities must comply with, such as obtaining the representative office license, the chairman of the representative office must be an Indonesian citizen, giving priority to local materials and technology, transfers of technology, the number of Indonesian employees must be higher than foreign, etc.

Pursuant to the Negative List Regulation, foreign participation in the field of construction services business activities using high technology and/or high risk and/or work values of more than Rp. 50,000,000,000 (fifty billion Rupiah) is a maximum of 67% (sixty seven percent) for foreign capital investment and a maximum of 70% for investors from ASEAN countries. Meanwhile, a construction service business activity using low or medium technology and/or low or having medium risks and/or work values of up to Rp. 50,000,000,000 (fifty billion Rupiah) is reserved for the Small and Middle Enterprises.

Building Failure

In the event that the implementation of the construction service does not comply with the determined standards, the construction service provider and/or construction service user will be responsible for the Failure of Building which would be **further examined by the (expert) appraisal**. The appraiser will be designated by the Minister no later than 30 (thirty) business days as from the receipt of report on the occurrence of Failure of Building.

Furthermore, the construction laws provide that the construction services provider must compensate or fix a Failure of Building which is proven due to the fault of the construction services provider. In addition, the law also provides that, if the building is estimated to have a construction lifetime of 10 (ten) years or more, construction service provider must then be responsible for any Failure of Building for 10 (ten) years as from the date of acceptance of construction service.

Sub-Service Provider Provision

In the implementation of construction service, the construction service provider and sub-construction service provider must:

1. have the consent of the construction service user in accordance with the agreement;
2. meet standards of security, safety, health and sustainability; and
3. prioritize Indonesian citizens as the leader of the project organization.

The New Construction Law provides that, the main work may only be granted to a specialized sub-construction service provider who also has to be approved by the user of the construction service.

Dispute Settlement

The New Construction Law adds a new provision that the parties may form a dispute council and the members of the dispute council will be selected based on the principles of professionalism and neutrality with regard to the disputing parties. The dispute council's decision, however, will not be final and bind the parties. Hence, the good faith of the parties to comply and follow such decision will be very necessary or else they will find another way to challenge such decision through litigation or arbitration.

Sanctions

The Government of Indonesia has release the sanctions that may be imposed on the construction services parties by **the elimination of the criminal sanctions** for certain legal acts as previously provided in the Old Construction Law (unless the court stipulates otherwise). However, administrative sanctions are still applicable in various forms, such as written warning until the revocation of the construction business licenses.

Grandfathering Provisions

Any institutions formed pursuant to the implementation regulation of the Old Construction Law will still have the authority to give certification and registration of construction business entities and labor until the institutions referred to in the New Construction Law have been formed.

How can HPRP assist?

...

How can HPRP assist?

Hopefully, the New Construction Law will attract the State and Investors and ultimately have a mutual benefit for both of them. The government hopes that the enactment of this law will attract investors to invest their money in Indonesia as there are some new benefits and securities for investment provided for the investor, such as the assurance of the payment from the user of the construction service, the elimination of criminal sanctions, the possibility a Dispute Council (*Dewan Sengketa*) to settle any dispute. The New Construction Law, however, also provides some new provisions and limitations which are still unclear and will be further regulated in the implementing regulations.

In light of the above, both government and investors must have a good understanding in interpreting any of the new clauses provided and the reliability of the implementation of such law in the field, which needs to be further tested. In this regard, HPRP can give any general advice on construction services in Indonesia including the incorporation of the construction companies and obtaining mandatory licenses, investment models, financing and borrowing structures, reviewing Indonesian versions of the construction contract, feasible structures to protect the interests of (foreign) investors facing a limitation on foreign participation, and in particular how the provisions of this New Construction Law may impact these transactions. We can also periodically provide you any legal updates on the matters and regulatory compliance under the New Construction Law in order to protect your investment in Indonesia.

For more information and assistance, please contact **Andre Rahadian** (Partner) on +62-21-570-1837 or email arahadian@hplaw.co.id or **Hendra Ong** (Partner) on +62-21-570-1837 or email hendra.ong@hplaw.co.id or your regular contact at HPRP.

The article above was prepared by Andre Rahadian (Partner), Hendra Ong (Partner), and Dinda Triwijanarko (Associate Lawyer).

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 hplaw@hplaw.co.id.

No part of this publication may be reproduced by any process whatsoever without prior written permission from Hanafiah Ponggawa & Partners.