

Indemnity Clauses in Cross-Border Contracts: Reconciling Common Law Risk Allocation with Indonesian Legal Limits

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Indemnity clauses are a mainstay in international commercial contracts. Their function is straightforward in common law jurisdictions: to allocate risk, shift liability, and provide protection independent of the traditional concept of damages. However, when applied in a civil law context like Indonesia—where the concept of indemnity as a separate contractual tool is not formally recognized—these clauses often fail to operate as intended.

For legal practitioners and commercial parties engaged in cross-border deals, this presents a clear challenge: how to reconcile the expansive use of indemnities in common law with the restrictive compensatory framework of Indonesian law. More importantly, how can indemnity clauses be drafted to remain effectively enforceable in Indonesia?

The Role of Indemnities in Common Law: Expanding Beyond Contractual Fault

In common law jurisdictions, indemnity clauses serve a function that is materially different from standard contractual damages. An indemnity may be triggered without a breach and can be structured to cover liabilities that extend beyond what a party could claim under ordinary principles of foreseeability or remoteness. For example, it is not uncommon for a seller in a share purchase agreement to agree to indemnify the buyer for any tax liabilities arising pre-closing, regardless of fault or causation.

Courts in jurisdictions such as England and Singapore have repeatedly enforced indemnity clauses that would not otherwise pass the usual tests under the law of damages. This includes indemnities for pure economic loss, third-party claims, legal costs on an indemnity basis, and even regulatory penalties, provided that, among others, the drafting is clear and unambiguous.

The underlying assumption is contractual freedom. If two commercial parties agree that one shall bear certain liabilities irrespective of breach or intention, the courts would generally enforce that agreement.

The Indonesian Legal Framework: Damages, Not Indemnities

By contrast, Indonesian law does not treat indemnity as an autonomous legal mechanism. Compensation is governed by the Indonesian Civil Code, primarily Articles 1243 to 1252, which are rooted in the principle that damages flow from *wanprestasi*—or default. Article 1243 provides that a party in default is required to compensate for losses that are directly caused by the breach and that were foreseeable at the time of contracting.

This foundational principle imposes three critical constraints on indemnity clauses:

1. Fault is required: A party must be in default before liability for damages can arise, with limited exceptions.
2. Causation must be direct: Indonesian courts require a clear and provable link between the breach and the loss.
3. Loss must be actual and measurable: Speculative, indirect, or consequential losses are unlikely to be compensated, regardless of the wording in the contract.

As such, an indemnity clause that purports to impose liability without fault, or to cover indirect or contingent loss, may be unenforceable. Worse, it may be struck down for being contrary to public order or morality under Article 1337 of the Indonesian Civil Code, particularly if it seeks to exempt a party from responsibility for gross negligence or statutory violations.

The Drafting Problem: When Language Outpaces Law

One of the most common issues in Indonesian cross-border transactions is the transplantation of common law indemnity clauses into contracts governed by Indonesian law. These clauses are often broad, covering “any and all losses, costs, liabilities, and expenses” without limitation or fault. In a New York or London-seated agreement, such language is enforceable if drafted properly. In Indonesia, it raises multiple red flags.

Consider the following issues:

- A clause requiring a seller to indemnify a buyer for any third-party claim, even if unrelated to breach, is unlikely to be upheld unless the connection to contractual default is clearly established.
- An obligation to indemnify for legal fees on an indemnity basis may be unenforceable, as Indonesian procedural law does not recognize shifting full legal costs in the absence of express statutory grounds.
- A broadly worded indemnity that includes consequential or indirect damages could be deemed contrary to public policy if it leads to recovery far exceeding the actual, direct, loss.

In practice, many such clauses survive on paper but become difficult—if not impossible—to enforce in court or even in arbitration seated in Indonesia.

Navigating the Divide: Practical Strategies

Legal drafters can bridge this gap in several ways. The key is not to avoid indemnities altogether, but to reframe them in ways that remain legally meaningful within the Indonesian framework.

- Anchor indemnities to specific contractual obligations. For example, instead of indemnifying for “any and all loss,” specify that the indemnity arises from a failure to meet a defined obligation, such as providing accurate representations.
- Avoid attempting to bypass core Civil Code principles. Do not use indemnities as a substitute for liability without fault. If the obligation is truly strict, consider structuring it as a primary payment obligation rather than as a secondary compensation clause.
- Distinguish indemnities from penalty clauses. Liquidated damages may be enforceable under Article 1249 of the Indonesian Civil Code, but courts retain the right to reduce excessive amounts. Indemnities that function as disguised penalties would likely be scrutinized.
- Use governing law and arbitration clauses strategically. If the commercial logic of the deal depends on a common law-style indemnity structure, the parties may consider adopting a common law governing law clause and selecting a neutral seat of arbitration.

Indemnity clauses are not inherently unenforceable in Indonesia, but they require careful re-engineering to operate effectively. Treating indemnities as plug-and-play provisions from common law precedents ignores the fundamental differences in legal tradition, judicial interpretation, and statutory limits.

For cross-border parties, this is not merely a technical issue. It affects risk allocation, deal value, and enforcement strategy. Ensuring that indemnities are both commercially robust and legally enforceable demands cross-jurisdictional fluency.

Dentons is uniquely positioned to advise on this interface. With on-the-ground civil law expertise and global common law capability, we help clients structure indemnity provisions intended to deliver the protection they expect—without exceeding what the law will allow.

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The article above was prepared by Dentons HPRP's lawyers

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