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Key Takeaways of Bonds and Guarantees in Indonesian Construction Projects

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In today's global landscape, infrastructure has increasingly become the cornerstone of sustainable national growth. Indonesia, emerging as one of the leading investment nexus in Southeast Asia, has attracted a wave of foreign investors eager to participate in the nation's rapid development. From the construction of smelter facilities, electric vehicle and battery manufacturing plants to luxury hotels, data centers, and commercial complexes. The scales and ambition of these projects reflect Indonesia's growing economic confidence and its strategic importance as a regional hub.

As financial safeguards in securing the completion of such construction projects, investors and project owners place significant reliance on the provision of bonds and guarantees which are critical instruments in ensuring the continuity and completion of the project.

Bonds and Guarantees

A. General Explanation on Bonds and Guarantees

In the context of construction, it is common for contractors to provide guarantees to the project owners. These assurances, such as bonds or guarantees, serves as security mechanisms designed to mitigate performance and financial risks. These instruments are primarily regulated under the provisions of the Indonesian Civil Code ("**ICC**") and relevant banking and insurance regulations.

Generally speaking, the parties involved in the issuance of a bond or guarantee are usually (the "**Parties**"):

1. The Principal: The contractor who is obligated to perform the work.
2. The Beneficiary: The project owner who receives the guarantee from the Principal via the Guarantor.
3. The Guarantor: The bank or insurance company (surety) that issues the bond or guarantee on behalf of the Principal.

Should the Principal fail to meet their obligations to perform certain works or have breached certain clauses in the construction agreement, the Guarantor compensates the Beneficiary up to the value stated in the instrument of bond or guarantee. These instruments may take a variety of forms, *inter alia*, bank guarantees or surety bonds.

Article 1820 of the ICC, governs guarantees, including bank guarantees ("**BG**"). A BG is a written undertaking by a commercial bank to pay a specified amount to the Beneficiary upon the Principal's default, once the required conditions are met.[1] In general, a BG has two main characteristics: (1) it is a conditional obligation, meaning the Guarantor must disburse the amount guaranteed once the specified conditions are fulfilled – typically, those conditions are stated in the terms and conditions in the application for the issuance of BG ("**TNC**"); and (2) the fulfilment of those conditions is determined by the Beneficiary's submission of the required documents in accordance with the Principal's TNC.

In contrast, which typically involves only the execution by the applicant (usually the Principal), surety bond is a three-party agreement entered into among the Parties, in which the Guarantor, relying on its trust in the Principal, guarantees to the Beneficiary that only if the Principal fails to perform or make payment under the agreement, the Guarantor will assume responsibility and fulfil the Principal's obligations.

In essence, bonds and guarantees are terms not differentiated in nature per se, as both instruments serve the same core function of providing security and acting as collateral to ensure the Beneficiary of the Principal's performance.

However, the primary distinction between a BG and a surety bond lies in the nature of the Guarantor. A BG is invariably issued by a bank acting as the Guarantor, whereas a surety bond is always issued by an insurance company serving in that capacity.

B. Types of Bonds and Guarantees for Government Projects

As mentioned above, Indonesian regulatory framework specifically on the ICC as well as procurement and banking regulations provides only a general stipulation for guarantees and does not regulate their specific types.

However, specifically for government projects, the type, value, and timing of each bond or guarantee are specifically governed by PR 12/2021.[2] Under Articles 30-35 of PR 12/2021, several types of guarantees apply at different stages of a construction project, including:

[1] Article 1 paragraph (9) of Financial Services Authority Regulation No. 26 of 2024 regarding Expansion of Banking Business Activities ("**POJK 26/2024**")

[2] Refers to Presidential Regulation No. 12 of 2021 as amended by Presidential Regulation of 46 of 2025 regarding Amendment to Presidential Regulation No. 16 of 2018 regarding Government Procurement of Goods and/or Services ("**PR 12/2021**")

Types of Bonds	Purpose
Bid Bond *(Jaminan Penawaran)*	Ensures the seriousness of the bidder (Principal). If the winning bidder withdraws from the tender or bidding process of the project, this bond will be forfeited.
Performance Bond *(Jaminan Pelaksanaan)*	Guarantees that the Principal will perform its works in accordance with the agreement. Such bond will be forfeited if the Principal violates the agreement.
Advance Payment Bond *(Jaminan Uang Muka)*	Ensures that the advance payment provided by the project owner is used properly for project mobilization and preparation.
Maintenance Bond *(Jaminan Pemeliharaan)*	Guarantees that the contractor will repair any defects or damage that occur during the maintenance period.
Appeal Bond *(Jaminan Sanggah Banding)*	Specific to government projects, this bond is submitted when a bidder files an appeal against the tender result.

C. Guarantees and Bonds under FIDIC

The FIDIC Book, a widely adopted standard form of construction projects, also recognizes several forms of security instruments intended to safeguard the Beneficiary. For instance, the security instruments under the FIDIC Silver Book (EPC/Turnkey Contract).[3] These instruments commonly include performance security, tender/bid bonds, retention money bonds, and advance payment guarantee.

A performance security is a guarantee – typically also in the form of a BG or surety bond provided by the Principal to secure the due and proper performance of its contractual obligations. A tender or bid bond is furnished at the tender stage to ensure the Principal's commitment to enter into the construction agreement if awarded. A retention money bond operates as an alternative to the Beneficiary withholding retention money in cash; instead, the Principal provides a bond guaranteeing the rectification of defects or non-performance during the relevant period. An advance payment guarantee secures the Beneficiary's recovery of any advance payment disbursed at the outset of the project, ensuring that such payment is properly utilized for project preparation and mobilization.

Collectively, these instruments function as risk-mitigation mechanisms rooted within the contractual framework.

D. Common Types of BG in Indonesia

In Indonesian practice, BG are generally categorized into two principal types: (i) Conditional BG; and (ii) On-demand BG.

The main difference between the two lies in their activation mechanism, as follows:

1. **Conditional BG:** requires the Beneficiary to prove that the Principal breached its obligations and that a loss resulted, usually through an objective-third party decision/award, e.g., adjudicator's decision or a court or arbitral award.
2. **On-demand BG**: allows the Beneficiary to demand payment from the Guarantor without having to prove any breach by the Principal, with a valid demand typically being sufficient.

Things to Consider

Bonds and guarantees constitute derivative agreements, which, while deriving their formalization from the principal agreement (in this case the construction agreement), retain an independent legal standing. Each instrument generally contains specific provisions governing matters such as drawdown procedures, claim requirements, and validity periods.

Given this characteristic, from the perspective of the Beneficiary, it is essential that each instrument clearly stipulates:

1. Governing law and dispute resolution forum, ensuring enforceability and legal certainty;
2. Drawdown procedures and claim requirements, including timelines, documentary evidence, and method of submission; and
3. Validity periods and expiry conditions to avoid lapse of coverage during project execution.

Failure to clearly regulate these aspects often leads to disputes or rejected claims, thereby undermining the Beneficiary's protection and its ability to safeguard rights or mitigate risks associated with ongoing projects.

Furthermore, Indonesian regulations require any security company (acting as a Guarantor) to obtain prior approval from the Indonesian Financial Services Authority (*Otoritas Jasa Keuangan*) before commencing its business operations. Accordingly, it is highly advisable to select guarantors that are duly accredited and possess a strong reputation for reliability and compliance.

Commonly Encountered Problems

Considering our extensive experience representing foreign clients, we understand that foreign investors often prefer guarantees or bonds issued by foreign banks or financial institutions. While this arrangement may provide a sense of comfort and flexibility to the client, especially where the client has an existing credit line or long-term relationship with the Guarantor, such structure may present practical challenges when it comes to enforcement and dispute resolution – if the related parties and the project involve Indonesian parties or Indonesian territories.

In particular, enforcement issues often arise when:

1. The Guarantor is a foreign (non-Indonesian) institution, while the Beneficiary is an Indonesian entity; and
2. The guaranteed instrument is governed by foreign law and subject to foreign jurisdiction, making it difficult to execute or enforce within Indonesia.

[3] Refers to International Federation of Consulting Engineers Book, Second Edition 2017 ("**FIDIC Silver Book**")

In such cases, if a dispute arises between the Beneficiary and Guarantor; even if the Beneficiary obtains a favorable arbitral award or court judgment in connection to such dispute, the enforcement process may face hurdles.

Solutions to Overcome Such Challenges

To mitigate potential legal and practical risks, it is advisable to:

1. Where possible, adopt Indonesian governing law and jurisdiction, and clear dispute resolution forum; and
2. Ensure that the Guarantor is a reputable and financially stable institution, preferably with a presence in Indonesia.

Conclusion

Bonds and guarantees form an integral part of risk management in Indonesian construction projects. Beyond serving as contractual formalities, they represent a critical layer of financial assurance that ensures project performance and continuity.

Should you require any further information or wish to discuss the above matters in greater detail, please do not hesitate to contact us at abraham.harryandi@dentons.com. We would be pleased to provide any additional assistance as needed.

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