CHRISTIAN TEO & PARTNERS
(in association with Stephenson Harwood LLP)

IS COVID-19 A FORCE MAJEURE EVENT FOR INDONESIAN INDUSTRY?[1][2][3][4][5]

INTRODUCTION

The major problems caused, in Indonesia and elsewhere, by Covid-19 have resulted in some companies looking at the possibility of obtaining temporary relief from their ongoing contractual obligations by declaring force majeure.

The temptation to declare force majeure has been noticeably present in the Indonesian energy, infrastructure and mining industries where the fall-out from Covid-19 has delayed important projects, cast doubt on the financial viability of other projects and resulted in much reduced revenue for many companies.

Force majeure is, however, a complicated subject that is often misunderstood, especially in the context of financial difficulty and what to do about employee obligations. Accordingly and without in any way seeking to downplay the problems caused by Covid-19, it would be a serious mistake to assume that companies will necessarily be able to rely on force majeure as legally excusing contractual non-performance merely because they are operating in the financially hard-hit, Indonesian energy, infrastructure and mining industries. The reality is it depends on multiple considerations which will differ from contract to contract.

In this article, the writer will look at what is meant by force majeure for Indonesian law purposes and whether or not Covid-19, together with the Government's response to the same, should properly be classified as force majeure for companies operating in the local energy, infrastructure and mining industries.

BACKGROUND

The human tragedy, personal hardship and economic cost caused by Covid-19, in Indonesia, is undeniable.

In terms of human tragedy and personal hardship, Indonesia had **officially** recorded as of mid-May (i) some 15,000 cases of Covid-19 and (ii) more than 1,000 deaths attributed to Covid-19 but with the actual numbers of Covid-19 cases and deaths believed to be much higher. In addition, the Ministry of Manpower is reporting that more than 2 million Indonesians have already lost their jobs, with this number predicted to rise to between 2.9 million and 5.2 million over the coming months.

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[1] Bill Sullivan, Senior Foreign Counsel with Christian Teo & Partners and Senior Adviser to Stephenson Harwood LLP.

[2] Bill Sullivan is the author of "*Mining Law & Regulatory Practice in Indonesia – A Primary Reference Source*" (Wiley, New York & Singapore 2013), the first internationally published, comprehensive book on Indonesia's 2009 Mining Law and its implementing regulations.

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[5] An earlier version of this article appeared in the May – June 2020 edition of Coal Asia Magazine.

The economic cost of Covid-19 has also be very great indeed. Indonesia's economy has slowed significantly, with the Ministry of Finance reporting economic growth of only 2.97 percent in the first quarter of 2020, compared to previous projections of above 4 percent. Economic growth projections for 2020 as a whole vary widely but one international forecasting group is predicting year on year economic contraction of 1.3 percent for Indonesia in 2020. Consumer confidence has been badly affected, with a recent Bank Indonesia survey showing the lowest level of consumer confidence in at least 12 years. Indonesia is now clearly at risk of surrendering much of the progress that has been made over the last 10 years in terms of poverty reduction.

The impact of Covid-19 on the energy, infrastructure and mining industries has been particularly severe. Bank Indonesia has reported large declines in the market prices of many of Indonesia's most important mineral exports including coal, copper concentrate and nickel. Lockdowns in some of Indonesia's most important export destinations, notably China and India, have also disrupted mineral exports from Indonesia, particularly of coal, Likewise, restrictions imposed by Provincial and Regional Governments, on the movement of people into areas of Kalimantan and Papua as a response to Covid-19, have caused significant problems for energy, infrastructure and mining companies operating in these areas. Finally, the government-ordered closure of many offices in Jakarta and elsewhere has caused serious administrative challenges for numerous companies operating in the local energy, infrastructure and mining industries.

Human tragedy, personal hardship and economic loss does **not**, however, automatically equate to force majeure.

Law No. 24 of 2007 re Disaster Management ("**Disaster Management Law**") is meant to provide a legal framework for the Government to deal with disasters like Covid-19. The Disaster Management Law draws a clear distinction between "Natural Disasters" and "Non-natural Disasters".

Article 1.2 of the Disaster Management Law provides that a "**Natural Disaster**" is a disaster caused by natural events or a series of natural events such as earthquake, tsunami, volcanic eruption, flood, hurricane, drought or landslide. Meanwhile, Article 1.3 of the Disaster Management Law provides that a "**Non-natural Disaster**" is a disaster caused by non-natural events or a series of non-natural events such as failure of technology, failure of modernization, **epidemic** and plague.

Notwithstanding the existence of the Disaster Management Law, the Government has been undeniably slow and inconsistent in dealing with the Covid-19 crisis.

In an endeavor to address the Covid-19 crisis, the Government recently issued Government Regulation No. 21 of 2020 re Large Scale Social Limitations ("**PSBB**") to Expedite the Handling of Covid-19 ("**GR 21/2020**"). The elucidation to GR 21/2020 states that Covid-19 is a "Non-natural Disaster" consistent with Article 1.3 of the Disaster Management Law.

By way of implementation of GR 21/2020, the Minister of Health ("**MoH**") has issued MoH Regulation No. 9 of 2020 re Guidelines for PSBB to Expedite the Handling of Covid-19 ("**MoHR 9/2020**").

Specifically focusing on the need to address employment related issues in light of Covid-19, the Minister of Manpower ("**MoM**") has issued MoM Circular Letter No. M/3/HK.04/III/2020 of 2020 re Protection of Employees/Workers and Business Continuity in connection with the Prevention and Management of Covid-19 ("**MoM Circular M3/2020**").

MoM Circular M3/2020 recognizes that companies, which are forced to limit/shut down their operations due to the Covid-19 situation, may have to adjust (i) employee salary amounts and/or (ii) the terms of salary payment otherwise due to their employees for the purpose of ensuring business continuity.

The Jakarta Provincial Government has been the most proactive in terms of giving effect to PSBB through the issuance of Governor of DKI Jakarta Regulation No. 33 of 2020 re Implementation of PSBB to Handle Covid-19 in DKI Jakarta Province, which introduces specific PSBB measures for Jakarta by way of the implementation of MoHR 9/2020.

ANALYSIS AND DISCUSSION

1. Force Majeure - General Indonesian Law

The Indonesian law concept of force majeure is dealt with in Articles 1244 and 1245 of the Indonesian Civil Code ("**ICC**") which provide that:

> "*A debtor shall be liable for compensation, losses and interest if he/she cannot prove that **the non-performance of a legal obligation or the late performance of such legal obligation is caused by something unforeseeable, for which he/she cannot be held liable, even in the absence of his/her bad faith***".
>
> "*There is no compensation for costs, losses or interest if, because of uncontrollable circumstances or because of coincidence, the debtor is prevented from delivering or performing his/her obligation or committing a prohibited action.*"

Having regard to ICC Articles 1244 and 1245, an event must fulfil the following criteria in order to qualify as "force majeure" for Indonesian law purposes:

(a) be an unforeseeable event;

(b) have prevented a party from performing his/her contractual obligations; and

(c) the party's inability to perform his/her contractual obligations must not be due to that party's fault.

ICC Articles 1244 and 1245 are particularly notable for their lack of specificity as to just what particular events qualify as force majeure. It is not an overstatement to say that, in fact, any event will qualify as a force majeure event, **for the purposes of ICC Articles 1244 and 1245**, so long only as the above three criteria are met.

Provided the three criteria are met, there is nothing, in principle, to prevent an economic or financial crisis qualifying as a force majeure event **for general Indonesian law purposes**. In Judicial Review Decision No. 285PK/Pdt/2010, a Judicial Review Panel of Judges accepted

that the 2008 global financial crisis or "Great Recession" had sufficiently adversely affected certain Indonesian borrowers, being palm oil companies with businesses involving thousands of traditional farmers, so as to excuse the failure of these borrowers to fulfil their loan obligations to domestic banks.

2. **Force Majeure – Contract**

Notwithstanding 1 above, commercial contracts governed by Indonesian law typically seek to very much limit the scope of force majeure otherwise recognized by ICC Articles 1244 and 1245. The relevant contract's definition, if any, of force majeure will prevail over ICC Articles 1244 and 1245. This is because Indonesian law recognizes the principle of freedom of contract (see ICC Article 1338) which allows parties a great deal of latitude in setting their contract terms and then treats the same as being enforceable between the parties subject only to a couple of minor exceptions.

Well-drafted commercial contracts will, at a minimum, typically specify:

(a) a detailed list of particular events which, if they occur **and** prevent/materially impede a party from carrying out part or all of its contractual obligations, will be regarded as force majeure events for the purposes of the relevant contract only;

(b) the consequences of the occurrence of the specified force majeure event, being (i) temporary suspension of the relevant contractual obligation and **possibly** (ii) automatic termination of the relevant contract or a right to early termination of the relevant contract by the counterparty if the force majeure event continues to prevent/materially impede performance by the other party for longer than a certain period; and

(c) the procedures that must be followed in order to establish the occurrence of a force majeure event and benefit from the suspension of performance, such as the party declaring the force majeure event must (i) notify the other party within X days of the occurrence of the event of force majeure, (ii) be able to evidence that its non-performance is directly caused by the force majeure event and (iii) take all reasonable steps to overcome the event of force majeure and resume performance of its contractual obligations as soon as possible.

The list of events specified as force majeure events in commercial contracts (i) can and does vary considerably from contract to contract but, typically, includes a mixture of particular natural events (**eg**, earthquakes, hurricanes, tsunamis etc) and particular non-natural events (**eg**, war, acts of terrorism, industrial action, changes in law etc) as well as (ii) sometimes a "catch all" inclusion along the lines of "*and any other event that materially impedes or prevents a party from performing part or all of its obligations under this contract*."

It is also not uncommon, in well drafted commercial contracts, to find a specific **exclusion** for financial difficulties/crises and/or a provision that a party's payment obligations cannot be postponed due to the occurrence of a force majeure event other than when the relevant force majeure event is a payment transfer system problem. This type of exclusion highlights the typical reluctance of drafters of commercial contracts to accept that the increased cost of performing contractual obligations or reduced revenues derived from a contractual relationship should ever, in and of themselves only, excuse continued performance of contractual

obligations. The underlying idea is that commercial contract parties should not be easily relieved from the consequences of having made what proves to have been a "bad bargain" in light of changing economic or financial conditions. When present in a commercial contract, an exclusion for financial difficulties/crises and/or payment obligation problems caused by force majeure will mean that a party suffering financial difficulties or the fallout from a financial crisis cannot rely on the reasoning in Judicial Review Decision No. 285PK/Pdt/2010 to successfully invoke force majeure as excusing its non-performance of payment obligations.

Having regard to the above, it is important to carefully review the force majeure clause in the contract documenting a particular commercial relationship, project or transaction in order to determine (i) whether or not a certain occurrence qualifies as a force majeure event for that contract and (ii) if it does, what are the consequences of the occurrence of the same in the case of that contract. In other words, in commercial contracts there is **no** such thing as "one size fits all" when it comes to what qualifies/what does not qualify as a force majeure event and, if it is a recognized force majeure event, what are the consequences of its occurrence in the case of that contract. **It all depends on the relevant contract and the relevant party**.

It is also critically important to remember that establishing the existence of force majeure essentially involves a two-part enquiry. First, is the event that has occurred recognized as a **potential** force majeure event for the purposes of the particular contract (**eg**, pandemic or government decree)? Second, even if the event in question is recognized as a potential force majeure event for the purposes of a particular contract, is it a **relevant** force majeure event in the sense that its occurrence and continuation has prevented/materially impeded a certain party from carrying out part or all of its obligations under the particular contract? At the risk of belabouring the point, a certain event may be both a potential force majeure event and a relevant force majeure event in the case of a particular party to a particular contract while the very same event may only be a potential force majeure event but not a relevant force majeure event in the case of another party to the same contract or neither a potential force majeure event nor a relevant force majeure event in the case of a different party to another contract. **Again, it all depends on the relevant contract and the relevant party**.

3. Covid-19 as Force Majeure Event

The fact that the Government has declared Covid-19 to be a "Non-natural Disaster" does **not** mean that it will not be a force majeure event in some cases.

For general Indonesian law purposes (**i.e.**, ICC Articles 1244 and 1245), the categorization of Covid-19 as a "Non-natural Disaster" is irrelevant in terms of whether or not Covid-19 meets the three requirements of force majeure as set out in 1 above. It can scarcely be doubted that Covid-19 and the Government's response to the same (i) was unforeseeable, (ii) will have caused some (but definitely not all) parties to be unable to perform their contract obligations and (iii) needless to say, this inability to perform is not the fault of the parties concerned.

For commercial contract purposes, the categorization of Covid-19 as a "Non-natural Disaster" is perhaps somewhat more relevant, than for general law purposes, in terms of whether or not Covid-19 amounts to force majeure but is still far from conclusive. At most, this categorization means that parties to commercial contracts cannot rely on any of the natural events specified in their commercial contracts in order to establish Covid-19 as a force majeure event. These parties are, however, still left with the non-natural events specified in their commercial

contracts as well as with any all-inclusive language along the lines of "*and any other event that materially impedes or prevents a party from performing part or all of its obligations under this contract*."

Regardless of whether force majeure is governed by general Indonesian law or by commercial contract, the correct approach to analysing whether or not Covid-19 has given rise to a force majeure event is the same in each case. It is necessary to ask in each case:

(a) Which party is claiming Covid-19 as a force majeure event?

(b) What is the obligation that the relevant party says it cannot perform or is materially impeded from performing as a result of Covid-19?

(c) Has the relevant party been prevented/materially impeded from performing the relevant obligation as a result of Covid-19?

4. Covid-19 and the Energy, Infrastructure & Mining Industries

4.1 **Preliminary Remarks**: There are undoubtedly many genuine cases of force majeure in the Indonesian energy, infrastructure and mining industries as a result of Covid-19 and the draconian (but necessary) response of various levels of government to the same.

4.2 **Producers**: Coal and metal mineral producers, which have been unable to meet their coal and metal mineral supply obligations, to domestic or foreign buyers, as a result of the shutdown of or reduction in production due to Covid-19 manpower shortages, disruptions to shipping or temporary import restrictions, should be able to claim force majeure as these are commonly recognized force majeure events in well-drafted commercial contracts for the sale and purchase of commodities. There should be no penalties for non-performance in these cases unless the relevant contract is particularly restrictive.

Some coal and metal mineral producers are, however, apparently operating under the misconception that Article 113 of the 2009 Mining Law ("**ML Article 113**") allows them to avoid the immediate performance of their contractual obligations to third party, **private sector and non-government entities** if their applications to suspend mining activities, on the grounds of force majeure in the form of Covid-19, are approved by the Ministry of Energy & Mineral Resources ("**ESDM**"). This is simply **not** correct. While it is true that ML Article 113 does allow for a one-year suspension of mining activities on the basis of force majeure and following approval from ESDM, ML Article 113 is only concerned with ensuring that the term of the relevant mining business license is not deemed to continue running while the mining business license holder is unable to continue its mining activities due to force majeure. During the period of ESDM approved suspension, the relevant mining business license holder is, at most, relieved of the need to perform its mining business license, financial payment obligations **to the Central, Provincial and Regional Governments** (**eg**, payment of deadrent in respect of the mining concession area). The relevant mining business license holder is **not** thereby also automatically relieved of any of its contractual obligations to third party, private sector and non-government entities such as banks, goods suppliers and services providers. ML Article 113 is actually **irrelevant** to the contractual

obligations of mining business license holders to third party, private sector and non-government entities. A mining business license holder, with an ESDM approved ML Article 113 suspension for force majeure, must separately establish the requirements for force majeure in the case of each contract with third party, private sector and non-government entities before it will be relieved of the performance of any of those contractual obligations.

4.3 **Goods & Services Providers**: Goods and services providers, which have been prevented by restrictions on the movement of people into areas of Kalimantan and Papua, from delivering goods and performing services contracted for by operators and owners of energy, infrastructure and mining projects, should also be able to make out a good claim of force majeure and thereby avoid any penalties for non-performance subject to individual contract peculiarities.

4.4 **Building Owners & Landlords**: Similarly, building owners in Jakarta and elsewhere, who have been obliged to temporarily prevent or restrict access by energy, infrastructure and mining company tenants to their leased/rented office space as a result of mandatory PSBB measures, can surely make out a good claim of force majeure as well and thereby avoid any penalties for non-performance unless the relevant contract contains some unusual exclusions.

4.5 **Borrowers & Debtors**: More problematic, however, are energy, infrastructure and mining companies seeking debt relief from their bankers or wanting to avoid/delay paying their goods suppliers and service providers on the basis of claimed force majeure in the form of financial difficulties as a result of reduced revenue from disrupted operations or falling mineral commodity prices. Financial difficulties/crises (short of bankruptcy) are often (but not always) expressly excluded in commercial contracts from qualifying as force majeure because financial difficulties/crises do not usually make it legally or physically impossible to repay loans/pay interest on loans or pay suppliers and services providers but, rather, merely make it more onerous and, hence, less attractive to do so given the relevant party's changed financial position. Likewise, as previously pointed out in 2 above, it is not uncommon for well drafted commercial contracts to make clear that force majeure can never excuse non-performance of payment obligations.

In the event, however, that the relevant loan agreement or goods supply/services agreement has not been carefully drafted to exclude financial difficulties/crises or make clear that payment obligations can never be excused on the grounds of force majeure, energy, infrastructure and mining companies may still be able to rely on the reasoning in Judicial Review Decision No. 285PK/Pdt/2010.

4.6 **Tenants**: Energy, infrastructure and mining companies, which are tenants of leased/rented premises temporarily closed to them as a result of Covid-19, are also unlikely to be able to claim force majeure as justifying their non-payment or reduced payment of the agreed rent. The reality is that Covid-19 is **not** preventing them or materially impeding them from performing their fundamental obligation, as tenants, to pay the agreed rent.

The fact that tenants are being denied access to their leased/rented premises is **not** a force majeure situation at all from the tenant's perspective as opposed to from the

landlord/owner's perspective. There is a tendency, in this type of situation, to confuse force majeure with another legal concept which is likely to be much more applicable/relevant; namely, frustration or impossibility. Article 1254 of the ICC provides:

> "*All conditions that are intended to do something that cannot be done, something that is contrary to morality, or something that is prohibited by law are void and render agreements conditioned upon them not in effect.*"

Tenants may be able to rely on ICC Article 1254 to have their leases set aside on the grounds that government mandated closure of offices means that it is impossible for them to have the benefit of what they have contracted for; namely, occupancy of the leased/rented premises. This, however, will often not provide tenants with what they actually want; that is, relief from paying the agreed rent until such time as they are able to, once again, occupy their leased premises and business returns to normal. It is, no doubt, with this in mind that the Jakarta Provincial Government has encouraged landlords and tenants to negotiate a reduced rental arrangement until such time as the Covid-19 crisis passes and business returns to normal.

4.7 **Employers**: Non-payment of employee salaries and termination of employees on the basis of claimed force majeure, as a consequence of Covid-19, is particularly problematic.

MoM Circular M3/20202 allows adjustments to (i) salary amounts and/or (ii) the terms of salary payments to employees **so long as the employees consent to the same**. In other words, employers may **not** unilaterally decrease salary amounts or change the terms of salary payments and without prior notice to or discussions with the employees concerned. More particularly, employees must agree (**i.e.**, "consent") to the proposed reduced salary amounts or proposed extended salary payment terms.

MoM Circular M3/2020 is silent on the issue of permitted labour downsizing or employee termination due to increased efficiency needs in the time of Covid-19. Accordingly, MoM Circular M3/2020 will **not** assist employers wanting to terminate employees on the basis of claimed force majeure.

Article 164 of Indonesia's Manpower Law, however, allows employers/companies to terminate an employment relationship due to **permanent** business/company closure ("**Permanent Business Closure**") arising from efficiency reasons ("**Termination Due to Efficiency**"). In this case, the terminated employee is entitled to receive a compensation package consisting of 2x Severance Pay, 1x Long Service Pay and Compensation Pay ("**Maximum Compensation Package**").

In the case of Termination Due to Efficiency, a company:

(a) may terminate the employment relationship without having to serve three warning letters on the relevant employee; but

(b) is still legally required to conduct a bipartite negotiation with the relevant employee prior to terminating the employment relationship ("**Bipartite Negotiation**").

If the Bipartite Negotiation is successful (**i.e.**, the company and the employee reach a settlement), the parties will then need to (i) formalize the settlement in the form of a settlement agreement and (ii) register the settlement agreement at the relevant Industrial Relations Court. If, however, the Bipartite Negotiation is unsuccessful, the parties will be required to settle the termination dispute by way of involving the Manpower Office and the Industrial Relations Court.

The **obvious problem**, though, with relying on Article 164 of the Manpower Law, as a solution to company financial problems brought on by the Covid-19 crisis, is that companies are wanting to terminate employees **so that they can avoid the need for Permanent Business Closure**.

If there is no Permanent Business Closure, it is recommended companies proceed with a voluntary resignation approach ("**Voluntary Resignation**"), as opposed to Termination Due to Efficiency, so as to avoid:

(a) any potential termination dispute involving the manpower authorities should the Bipartite Negotiation fail to reach a successful outcome; and

(b) the possibility of the employer having to pay the Maximum Compensation Package as required in the case of Termination Due to Efficiency.

Employers may structure an employee's termination (i) as a Voluntary Resignation, (ii) by documenting the Voluntary Resignation with a detailed settlement arrangement between the employer and the employee and (iii) involving the payment of compensation by the employer to the employee. Voluntary Resignation is, though, hard to implement on a large scale and the compensation demanded by employees, asked to participate in a Voluntary Resignation, can be very considerable.

SUMMARY AND CONCLUSIONS

Covid-19 has, directly or indirectly, resulted in many companies finding themselves in very difficult financial circumstances. It is understandable, therefore, that these companies are actively looking for ways to postpone performing contractual obligations that have become increasingly burdensome as a result of much reduced revenue.

Force majeure may, in some cases, be properly invoked by companies to suspend performance of their contractual obligations while so long as the Covid-19 crisis continues. This, however, is **not** likely to be so nearly as often as many business people seem to think.

The requirements for establishing force majeure, whether at general law or in commercial contracts, **are strict and not otherwise easily met**.

Financial difficulty (short of actual bankruptcy)/crisis will often **not** qualify as a force majeure event in well drafted commercial contracts and for the purpose of excusing non-performance of payment obligations. In the absence of a commercial contract, however, Indonesian general law is more accepting of financial difficulty/crisis as a potential force majeure event.

Except to the limited extent permitted by MoM Circular M3/2020, employers in the energy, infrastructure and mining industries have **no** legitimate basis for believing that Covid-19 and claims of force majeure will change their legal obligations to employees in respect of payment of salaries and continuity of employment.

The force majeure provisions of commercial contracts vary widely. Accordingly, there is no such thing as "one size fits all" when it comes to what qualifies as force majeure in commercial contracts, how it must be established and what are the consequences of force majeure.

Although not very satisfactory from a business certainty perspective, the only correct answer, as to whether or not Covid-19 is a force majeure event, is "**it depends**"!!!

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This article was written by Bill Sullivan, Senior Foreign Counsel with Christian Teo & Partners and Senior Adviser to Stephenson Harwood LLP. Christian Teo & Partners is a Jakarta based, Indonesian law firm and a leader in Indonesian energy, infrastructure and mining law and regulatory practice. Christian Teo & Partners operates in close association with international law firm Stephenson Harwood LLP which has ten offices across Asia, Europe and the Middle East: Beijing, Dubai, Hong Kong, London, Paris, Piraeus, Seoul, Shanghai, Singapore and Yangon.

Get in touch

Bill Sullivan

T: +62 21 5150 280
M: +62 815 8506 0978
E: bsullivan@cteolaw.com

Christian Teo

T: +62 21 5150 280
M: +62 818 124 747
E: cteo@cteolaw.com

Claudius Novabianto

T: +62 21 5150 280
M: +62 818 0858 9235
E: cnbianto@cteolaw.com