CHRISTIAN TEO & PARTNERS
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NEW APPROACH TO CONSTRUCTION FAILURE LIABILITY – IMPORTANT IMPLICATIONS FOR HEAVY INDUSTRY[1][2][3][4][5]

INTRODUCTION

A 2020 construction services regulation has given "new life" to Indonesia's long existing but largely overlooked liability regime for defective construction of buildings and other facilities.

It may well be that the Government's focus on infrastructure development and its expectation that numerous new infrastructure projects will be "rolled out" in the next few years has resulted in concern that Indonesia has not previously done enough to protect users of buildings and other facilities from the consequences of defective construction.

This regulation is particularly interesting because of the overt encouragement it provides to construction services providers and building/facility owners to co-operate in obtaining insurance coverage against building/facility failure. The likely "windfall" opportunity being created for insurance companies is obvious.

Poor quality construction services and resulting defective building/facility integrity can have very serious implications for energy, infrastructure, mining and oil & gas companies. As such, all companies operating in these industries should be taking careful note of Indonesia's revamped approach to liability for defective construction of buildings and other facilities.

In this article, the writer will first review the relevant provisions of the 2020 construction services regulation and then look at the various ways in which this regulation improves the recovery prospects for parties suffering damage or loss as a result of defective construction of buildings and other facilities.

BACKGROUND

The colonial era Indonesian Civil Code ("**ICC**") has long made provision in respect of (i) general liability for damages or losses to others occasioned by wrongdoing and (ii) more specific liability for damages or losses arising out of the construction or use of defective buildings.

With respect to general liability for damages or losses to others occasioned by wrongdoing, ICC Articles 1365, 1366 and 1367 provide that:

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[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 December 2020 – January 2021 edition of Coal Asia Magazine.

> "*Every unlawful action that causes damage to another person obliges the person causing the damage to compensate for the damage.*
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> *Everyone is responsible not only for the damage caused by his deed but also for the damage caused by his negligence or carelessness.*
>
> *A person is responsible not only for the damage caused by his own deed but also for damage caused by persons under his responsibility or by property under his supervision.*"

ICC Articles 1365, 1366 and 1367 are understood as creating the **potential** for general "tort liability" although this concept is not nearly as well-developed in Indonesia (being a civil law country) as it is in common law counties such as Australia, North America, Singapore or the United Kingdom.

In principle, ICC Articles 1365, 1366 and 1367 **might** well be applicable to construction services providers and building owners which are negligent in connection with the construction or maintenance/operation of buildings and other facilities. Much remains unclear, however, about the actual scope of ICC Articles 1365, 1366 and 1367. Because of this lack of clarity, ICC Articles 1365, 1366 and 1367 are usually only relied upon as a matter of last resort and when there is no other more certain basis for liability available.

More specific **potential** liability for damages or losses arising out of the construction or use of defective buildings is provided for in ICC Articles 1369 and 1609.

ICC Article 1369 provides that:

> "*The **owner** of a **building** is responsible for any damage caused by its collapse, entirely or partially, if this happens due to negligence in maintenance or because of a **defect in its construction or array**.*"

ICC Article 1609 provides that:

> "*If a **building**, **contracted and built at a certain price**, **decays** wholly or partly through a defect in the construction thereof, or even because of the **unsuitability of the soil**, the **architects and contractors** shall therefore be responsible **during ten years**.*"

It might be thought that ICC Article 1369 would be sufficient to create a clear basis for the liability of building owners if their negligence leads to the collapse of a building/facility resulting in damage or loss to third parties. Likewise, it might be thought that ICC Article 1609 would be sufficient to create a clear basis for the liability of architects and contractors (**i.e.**, "construction services providers") if their negligence leads to the collapse of a building/facility resulting in damage or loss to third parties. This, however, has **not** proved to be the case and research has revealed very few, if any, cases in which ICC Articles 1369 and 1609 have been successfully relied upon to establish the liability of building owners and/or construction services providers for damage or loss suffered by third parties in connection with the use of buildings/facilities. That seemingly surprising reality is probably due to a combination of (i) the lack of much meaningful development of the concept of tort liability as

a whole in Indonesia, (ii) the uncertain meaning and scope of key terms/words, used in Articles 1369 and 1609, such as "*building*", "*negligence in maintenance*", "*defect in construction or array*", "*contracted and built at a certain price*", *"decay*", "*during 10 years*", "*unsuitability of the soil*" etc., (iii) the absence of clear minimum standards for building construction and maintenance, (iv) the relatively non-litigious nature of Indonesian society and (v) the cost and uncertainty of Indonesian legal proceedings. With regard to this last factor, it would be simply beyond the knowledge and financial capacity of most construction workers and individual building users, who suffer damage or loss in connection with a building failure, to even think of (far less seriously proceed with) instituting legal proceedings against the owner of or construction services provider in respect of a "failed" building/facility.

In the energy, infrastructure, mining and oil & gas industries, there has long been speculation as to whether or not such things as (i) power plants, (ii) bridges, railways and toll roads, (iii) mineral processing & refining facilities and tailings dams and (iv) pipelines and storage tanks qualified as "buildings" for the purpose of ICC Articles 1369 and 1609.

Government Regulation ("**GR**") No. 22 of 2020 re Implementation of Law No. 2 of 2017 re Construction Services ("**GR 22/2020**") was issued in April 2020 and revokes a number of previous regulations including (i) GR No. 28 of 2000 re Business and Role of Construction Services Community as most recently amended by GR No. 92 of 2010, (ii) GR No. 29 of 2000 re Construction Services Implementation as most recently amended by GR No. 54 of 2016 and (iii) GR No. 30 of 2000 re Supervision of Construction Services Implementation.

GR 22/2020 does **not**, however, revoke ICC Articles 1369 and 1609. Instead, GR 22/2020 creates a parallel and much more certain route for recovery in respect of "failed" buildings/facilities.

ANALYSIS AND DISCUSSION

1. Overview of GR 22/2020

The apparent intention of GR 22/2020 is to (i) rectify the inherent weaknesses of ICC Articles 1365, 1366, 1367, 1369 and 1609 when it comes to creating a certain basis of potential liability for damage or loss in connection with the design, construction, maintenance, and operation of buildings/facilities in Indonesia and (ii) greatly reduce, if not eliminate altogether, the need for court proceedings in order to recover for damage or loss suffered in connection with building/facility failure.

The implementation of GR 22/2020 turns on a number of key concepts including:

(a) "**Buildings**", being the physical form of the result of Construction Services;

(b) "**Building Failure**", being the collapse or malfunctioning of a building after the final handover of the Construction Service result;

(c) "**Construction Services**", being construction consultancy services and construction work whether performed separately or in combination (**i.e.**, "**Integrated Construction Work**");

(d) "**Expert Assessors**", being individuals, groups or institutions given the authority to carry out assessments and make determinations of the cause of Building Failure;

(e) "**Security, Safety Health and Sustainability Standards**", being the required levels or standards of security, safety, health of construction worksites and social security for workers as well as local environmental management and environmental management technical guidelines in the implementation of Construction Services;

(f) "**Service Providers**", being contractors and sub-contractors performing Construction Services; and

(g) "**Service Users**", being owners and other parties (called "**work givers**") which "use" Construction Services (Article 1 of GR 22/2020).

2. Key Provisions of GR 22/2020

2.1 **Liability of Service Providers**: Service Providers are liable for Building Failures:

(a) resulting from Service Provider non-fulfilment of relevant Security, Safety, Health and Sustainability Standards; and

(b) **occurring during the first ten years after final Building handover** if the contract specified minimum useful life of the relevant Building is at least ten years or otherwise for the contract specified minimum useful life of the relevant Building if the contract specified minimum useful life of the relevant Building is less than ten years (Articles 85(1), 86(1) and 86(2) of GR 22/2020).

2.2 **Liability of Service Users**: Service Users are liable for Building Failures:

(a) resulting from Service User non-fulfilment of relevant Security, Safety, Health and Sustainability Standards; and

(b) **occurring after the end of the contract specified minimum useful life of the relevant Building** which, in the case of a Building with a contract specified minimum useful life of not less than 10 years, means during the eleventh and subsequent years after final Building handover (Articles 85(1) and 86(3) of GR 22/2020).

2.3 **Determination of Cause of Building Failure**: The cause of a Building Failure and the potential liability of a particular Service Provider or Service User for that Building Failure is to be determined by an Expert Assessor **whose determination is final and binding on all relevant parties** (Article 85(2) and (4) of GR 22/2020).

2.4 **Nature of Liability for Building Failure**: Where Service Providers and/or Service Users are liable for Building Failure, this liability may be in the form of:

(a) an obligation to "replace" (**i.e.**, rebuild) or repair the relevant Building by the relevant Service Provider; and/or

(b) an obligation to pay damages by the relevant Service Provider or the relevant Service User (Article 85(5) of GR 22/2020).

2.5 **Determination of Amount of Damages**: Following the determination of an Expert Assessor that a particular Service Provider or Service User is liable for a particular Building Failure, the amount of damages payable by the particular Service Provider or Service User is to be determined by so-called "Authorized Parties" including asset appraisers, public accountants, the Audit Board of Indonesia, independent auditors, law enforcement authorities and other "Ministries/Bodies" (Article 85(3) of GR 22/2020).

2.6 **Damages for Building Failure**: Relevant damages for Building Failure, resulting from Service Provider/Service User non-compliance with relevant Security, Safety, Health and Sustainability Standards, are (i) compensation for loss of life, (ii) compensation for personal injury resulting in permanent disability, (iii) compensation for medical treatment in respect of personal injury and (iv) compensation for destruction, damage or loss (Article 90(3) of GR 22/2020).

2.7 **Insurance**: Service Providers and Service Users may obtain insurance coverage, in the form of professional indemnity insurance and building insurance, for liability for Building Failure, thereby effectively transferring to the relevant insurance company responsibility for the financial consequences of liability for Building Failure (Article 90(5) of GR 22/2020).

The premium for any insurance coverage against Building Failure is:

(a) to be shared between the Service Provider and the Service User; and

(b) the Service Provider's share of the insurance premium is to be a component of the Construction Service fee it is entitled to from the Service User (Article 90(6)(b) of GR 22/2020).

2.8 **Sanctions for Non-Compliance with Security, Safety, Health and Sustainability Standards**: Service Providers and Service Users which do not comply with relevant Security, Safety, Health and Sustainability Standards face sanctions in the form of:

(a) written warnings;

(b) administrative fines of 5% of the value of the work that is not in compliance with the relevant Security, Safety, Health and Sustainability Standards;

(c) suspension of Construction Service activities;

(d) inclusion on a "blacklist";

(e) suspension of business license; and

(f) revocation of business license (Article 63 of GR 22/2020).

3. Assessment of GR 22/2020

3.1 **Elimination of Much Uncertainty**: GR 22/2020 goes a long way in terms of eliminating much of the uncertainty that surrounds the intended scope of ICC Articles 1369 and 1609.

The definition of "Buildings" is sufficiently broad to make clear that it is **not** confined to office buildings and/or residential buildings but, rather, includes any physical form that results from Construction Services. This, logically, includes energy, infrastructure, mining and oil & gas facilities such as (i) power plants, (ii) bridges, railways and toll roads, (iii) mineral processing & refining facilities and tailings dams and (iv) pipelines and storage tanks. Energy, infrastructure, mining and oil & gas companies are major users of Construction Services and, as such, are now in a much stronger position than they were previously to recover for Building Failure resulting from Service Provider non-compliance with Security, Safety, Health and Sustainability Standards.

Likewise, (i) requiring Service Providers and Service Users to comply with relevant Security, Safety, Health and Sustainability Standards and (ii) making clear that Building Failure, attributable to non-compliance with relevant Security, Safety, Health and Sustainability Standards, will result in liability for the non-compliant Service Providers and Service Users, makes much more certain the circumstances in which liability for Building Failure arises. Although the Security, Safety, Health and Sustainability Standards are still something of a "work in progress", Minister of Public Works & Housing Regulation No. 21 of 2019 re Guidelines for Construction Safety Management Systems sets out in considerable detail what Security, Safety, Health and Sustainability Standards (otherwise known as "SKK") comprise and how they are to be determined.

3.2 **Continued Focus on Fault Based "Decennial" Liability**: It is important to understand that GR 22/2020 continues to require the establishment of "fault" or "wrongdoing", in the sense of Service Provider/Service User non-compliance with relevant Security, Safety, Health and Sustainability Standards being the cause of the relevant Building Failure, before any Service Provider/Service User liability for that Building Failure arises. In other words, GR 22/2020 does **not** impose a regime of so-called "strict liability" for Building Failure. In this regard, GR 20/2020 does not differ in any material respect from ICC Articles 1369 and 1609 which, however, are much less clear as to what is the relevant fault or wrongdoing that must be established in respect of architects, contractors and building owners before they can be held liable for building "collapse" or "decay".

GR 22/2020 also continues to use the fairly arbitrary time period of a maximum of 10 years for the liability of Service Providers for Building Failure. So-called "decennial" liability is a feature of ICC Articles 1369 and 1609. At best, 10 years is a very "rough and ready guestimate" of for how long it is appropriate to hold a Service Provider liable, after final handover of the relevant Building to the Service User, for Building

Failure that is the result of the Service Provider's non-compliance with relevant Security, Safety, Health and Sustainability Standards. "Decennial" liability is, however, an approach that is used in various jurisdictions apart from Indonesia.

It is not unreasonable to question why it should matter, in terms of liability, how long after final handover Building Failure occurs if it can be established that the Building Failure is the result of the relevant Service Provider's non-compliance with applicable Security, Safety, Health and Sustainability Standards. A maximum liability period of 10 years, for claims against Service Providers in respect of Building Failure, is also inconsistent with the ICC limitation period of 30 years for general claims.

3.3 **Reliance on Expert Assessors and Authorized Parties**: The role of Expert Assessors and Authorized Parties is of paramount importance in the implementation of GR 22/2020 given (i) Expert Assessors are charged with responsibility for determining the cause of Building Failure and **their determinations are final and binding** while (ii) Authorized Parties are charged with responsibility for determining the amount of damages payable in respect of Building Failure resulting from non-compliance with relevant Security, Safety, Health and Sustainability Standards.

The intention appears to be that liability for Building Failure and the damages payable in respect of Building Failure, resulting from non-compliance with relevant Security, Safety, Health and Sustainability Standards, will **no** longer have to be determined by way of expensive, protracted and uncertain court proceedings as would be the case for anyone wanting to recover for Building Failure in reliance upon ICC Articles 1369 and 1609. This can only be a good thing given the widely recognized lack of transparency and potential for interference in Indonesian court proceedings as well as the ability of well-resourced defendants in Indonesian court proceedings to pursue multiple levels of appeal if they lose in the first instance and thereby postpone the successful plaintiff's recovery almost indefinitely. Somewhat curiously, though, the determinations of Authorized Parties are **not** expressed to be final and binding. Accordingly, litigation may still be possible in the case of damages determinations by Authorized Parties.

It must be readily acknowledged, however, that Expert Assessors and Authorized Parties are also opened to being manipulated by unscrupulous and well-resourced parties. Accordingly, taking the process of determining the cause of Building Failure and assessing damages for Building Failure away from the Indonesian courts does **not** necessarily eliminate the potential problems of lack of transparency and interference in the process.

3.4 **Residual Uncertainty as to what is Meant by "Loss"**: Despite the many improvements made by GR22/2020, it leaves unclear to whether or not loss of revenue, loss of profit and other forms of so-called "economic loss" can be recovered from Service Providers and Service Users in respect of Building Failure caused by non-compliance with relevant Security, Safety, Health and Sustainability Standards. In this regard, Article 90(3)(d) of GR 22/2020 merely refers to compensation being recoverable for "*destruction, damage or **loss** resulting from Building Failure*".

While individuals and their families will, typically, be primarily concerned about recovery for death and personal injury resulting from Building Failure, companies are

much more likely to be concerned about the economic consequences for them of Building Failure.

In the energy, infrastructure, mining and oil & gas industries, Building Failure can have a major negative impact on a company's financial performance where it is a facility, important to operational continuity, that is the subject of Building Failure. The cost of replacing or repairing physical damage to (i) power plants, (ii) bridges, rail ways and toll roads, (iii) mineral processing & refining facilities and tailings dams and (iv) pipelines and storage tanks, while significant, can be greatly overshadowed by the resulting loss of revenue and reduction/elimination of profit during the time it takes to affect the physical repair or replacement of the facility.

Having regard to the above, it is unfortunate that GR 22/2020 does **not** make clear that the recoverable "loss" for Building Failure, caused by non-compliance with relevant Security, Safety, Health and Sustainability Standards, includes all forms of economic loss as well as physical damage or loss. In the absence of recovery for economic loss being specifically dealt with in GR 22/2020, companies and their legal advisers will have to turn to general principles of Indonesian law in order to determine what types of economic loss, if any, are recoverable in the case of tort-like situations. Unfortunately, the general principles of Indonesian law are not particularly helpful in this regard. While foreseeable loss of profit may be recoverable as a form of "interest" in the case of breach of contract claims, the position is less clear in the case of tort claims as this area of the law is substantially undeveloped in Indonesia.

3.5 **Opportunities for Insurance Companies**: GR 22/2020 would seem to offer particularly interesting opportunities for insurance companies.

Much of the uncertainty that previously surrounded potential liability for Building Failure, pursuant to ICC Articles 1369 and 1609, has been eliminated by GR 22/2020. Accordingly, Service Providers and Service Users should, rightly, be concerned that the risk of them being held liable for Building Failure has become significantly more immediate and real with the issuance of GR 22/2020. It would not be surprising, therefore, if Service Providers and Service Users now see a greatly increased need for proper insurance coverage, in respect of liability for Building Failure, then was perhaps previously the case.

The writer reads GR 22/2020 as overtly encouraging Service Providers and Service Users to obtain professional indemnity insurance and building insurance as an efficient means of effectively protecting themselves against the financial consequences of liability for Building Failure. It is surely very notable that GR 22/2020 expressly provides that (i) the financial consequences of liability for Building Failure may be "assigned" to insurance companies, (ii) Service Providers and Service Uses should share the premium for insurance coverage in respect of Building Failure and (iii) the premium share of Service Providers should form part of the Construction Services fee due to them from Service Users. The Ministry of Public Works & Housing seems to have done everything, short of making it compulsory for Service Providers and Service Users to insure against Building Failure, to promote the local insurance industry. Looked at in a more positive light, though, this may be seen as further evidence of an intention, on the part of the Government, to make it

considerably easier to recover damages for Building Failure than was previously the case pursuant to ICC Articles 1369 and 1609.

Greater Service Provider/Service User reliance on insurance also, arguably, makes it less likely that it will be necessary for parties, suffering damage or loss as a result of Building Failure, to resort to litigation in order to recover that damage or loss. This, of course, assumes that insurance companies pay claims, arising out of insured Building Failures, on a timely basis.

Finally, having insurance coverage for Building Failure substantially eliminates the risk that Service Providers and Service Users may simply refuse to accept the liability determinations of Expert Assessors and/or refuse to pay the damages assessments of Authorized Parties. The existence of insurance coverage means that, once a damages assessment has been made by Authorized Parties, it is the relevant insurance company (not the relevant Service Provider or Service User) that effectively becomes responsible for paying the damages assessment.

SUMMARY & CONCLUSIONS

Indonesian law has long recognized that architects, contractors and owners may be liable for certain types of Building Failure. However, the precise circumstances in which that liability arises, and its scope have always been very uncertain.

GR 20/2020 has now removed much of the previous uncertainty regarding liability for Building Failure and, in the process, made it far more likely than was previously the case that Service Providers and Service Users will be held liable for Building Failure where it is the result of non-compliance with relevant Security, Safety, Health and Sustainability Standards.

The energy, infrastructure, mining and oil & gas industries are all major users of Construction Services. Problems with the performance and reliability of physical facilities resulting from deficient Construction Services are also not uncommon in the energy, infrastructure, mining and oil & gas industries. Accordingly, companies operating in these industries should be mindful of the improved likelihood of being able to recover for the failure of any physical facilities resulting from deficient Construction Services following the issuance of GR 22/2020. The lack of certainty, however, as to whether GR 22/2010 makes economic loss recoverable in the case of Building Failure is likely to be a continuing problem for heavy industry.

Insurance companies are also likely to be major beneficiaries of GR 22/2020 given the overt encouragement GR 22/2020 gives Service Providers and Service Users to obtain professional indemnity insurance and building insurance to avoid the financial consequences of Building Failure resulting from their non-compliance with relevant Security, Safety, Health and Sustainability Standards.

Service Providers will be understandably concerned about their increased risk of liability for Building Failure.

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