



# What happens if your Indonesian partner fails to perform?

## Anne Hung

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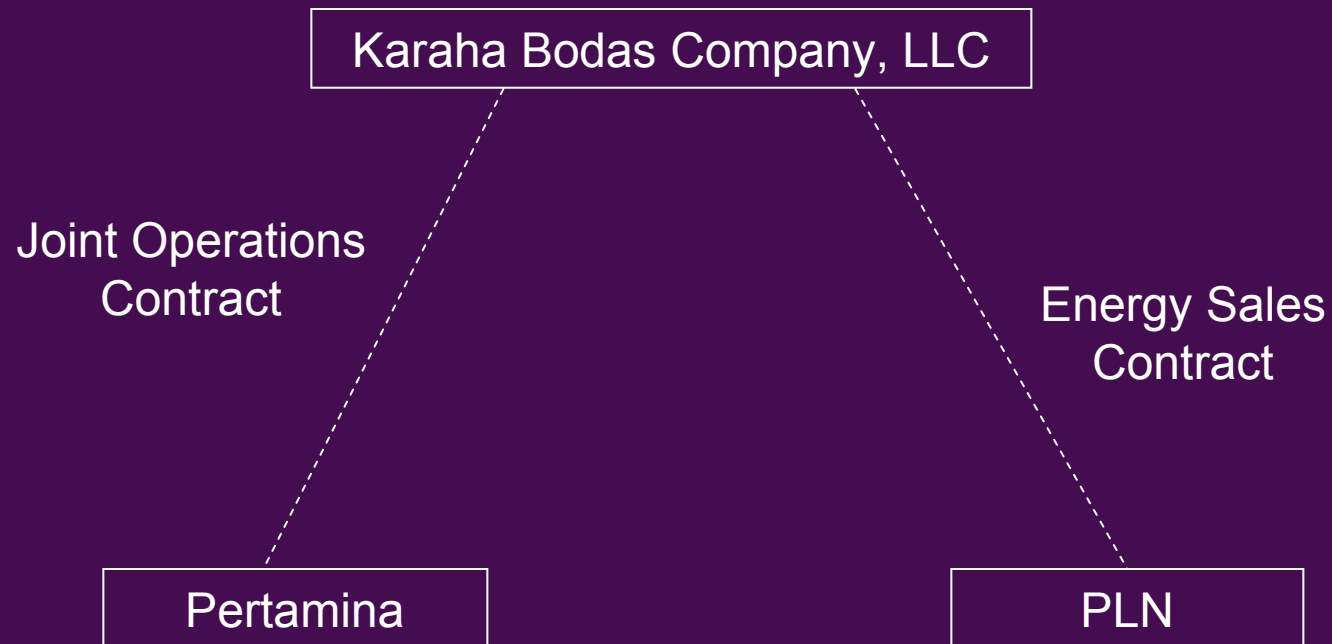
# Business in Indonesia

- World Bank Group rankings of 155 economies
- Indonesia's rankings:
  - 107<sup>th</sup> for ease of securing rights to property
  - 145<sup>th</sup> for ease of enforcing contracts. The cost of enforcement is 126.5% of debt
  - 116<sup>th</sup> for ease of closing a business. Average recovery rate from an insolvent firm is 13.1c in the dollar
- Overall rank: 115<sup>th</sup> for ease of doing business

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## Case 1

# Karaha Bodas Company (KBC)



## KBC – Arbitral Award

- Pertamina & PLN: we cannot be held liable for acts of the Indonesian government
- Arbitral tribunal held Pertamina and PLN had contractually assumed risk and were therefore in breach
- Tribunal awarded KBC US\$261 million plus interest
  - (\$111.1m in damages to cover expenditure and \$150m in future lost profits)

## KBC – Enforcement of Award

- Pertamina had assets (bank accounts) in United States
- KBC sought to enforce award in US
- Issue whether funds were property of Pertamina or Indonesian government
- In 2004, KBC retrieved US\$29m of the frozen funds

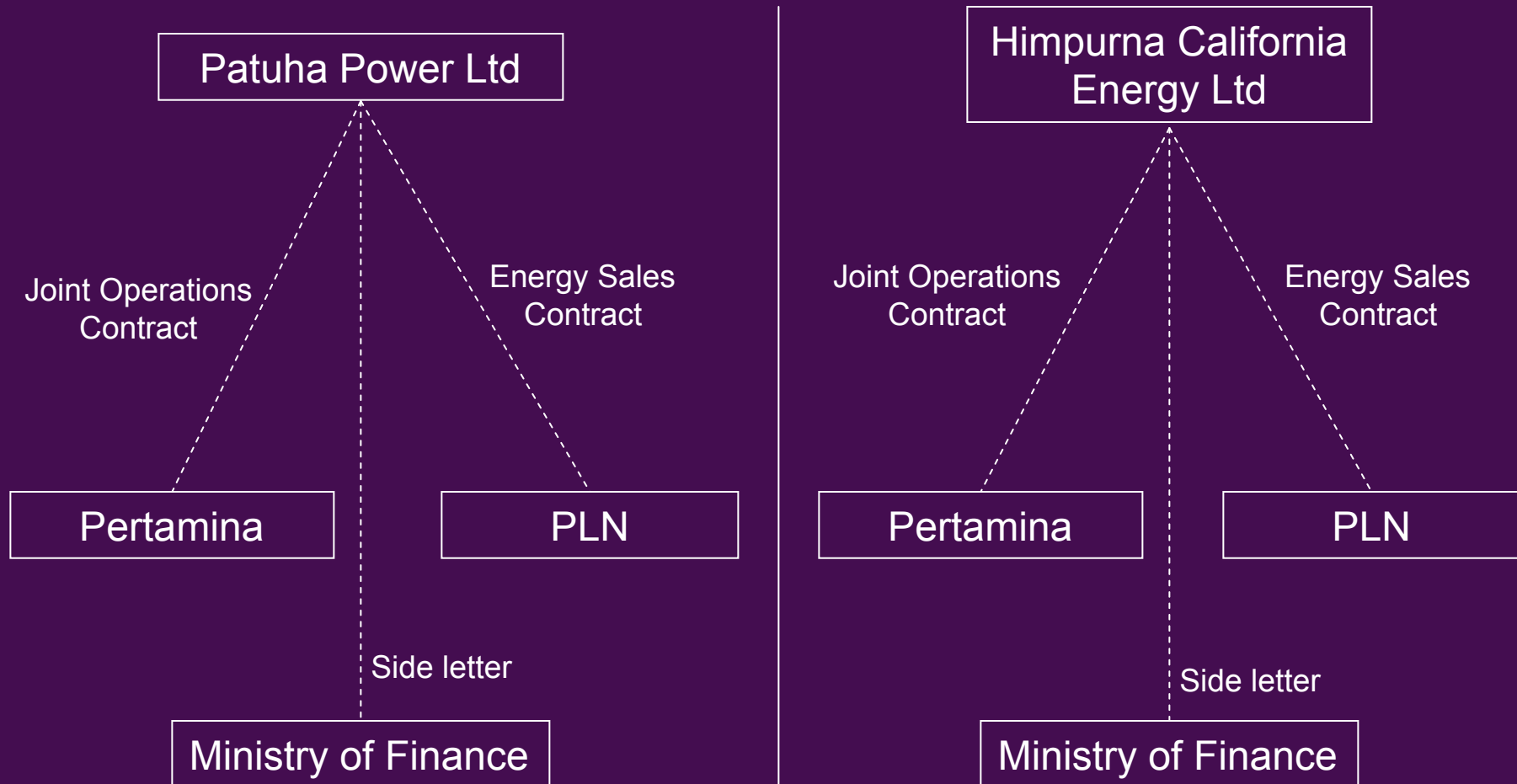
## KBC – Recourse to Indonesian Courts

- In 2002, Indonesian Central District Court annulled the award (on Pertamina's request) and imposed a fine of \$500,000 a day if KBC attempted to enforce award
- In 2004, Indonesian Supreme Court overturned District Court's decision on basis that Pertamina had appealed to Swiss Court
- Award still unpaid: Pertamina and Indonesian government allege corruption in KBC project

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## Case 2

# The Himpurna and Patuha power projects



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## Himpurna & Patuha – Arbitral Award

- First arbitration: against PLN under the ESCs, held in Jakarta
- ESCs were ‘take or pay’ contracts. PLN obligated to pay whether or not it took delivery of electricity
- Tribunal did not consider economic crisis or presidential decrees an excuse to depart from contractual obligations
- Awarded US\$391 million to Himpurna and US\$180 million to Patuha
  - Amounts represented full recovery of expenditure made but less than 10% of lost profit claim as this was seen as an abuse of right



# Himpurna & Patuha – Enforcement

- PLN did not pay award
- Second arbitration in The Hague against Indonesian government to enforce guarantees made in contracts and side letters
- Second tribunal found Indonesian government liable to pay awards
- Recourse to political risk insurance policy

## Lessons for Foreign Investors

- Arbitration may not provide the best outcome for either party
- Arbitration as last resort?
- Look for offshore assets of Indonesian partner – bank accounts and hard assets
- May need to consider proceeding to freeze assets pending arbitration