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The Comparison Between Recognition to Choice of Law in International Contracts by Courts and Arbitration in Indonesia

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Abstract

Rapid international commerce leads to the significant use of international contracts. As parties coming from different legal systems, parties' choice of law is essential. This article analyzes governance of choice of law in Indonesia legal framework and performance of courts in giving recognition to the choice of law. Using a normative approach, this article finds that Indonesia does have a lacking legal framework on the choice of law. Indonesia must rely on Article 18 General Rule on Regulations for Indonesia (Alegmene Bepaligen van Wetgeving voor Indonesia /AB) which only offers lex loci actus. Consequently, courts in Indonesia have decided on the choice of law inconsistently. In contrast, it is found that in Indonesia, the BANI Arbitration Center has clearer governance of the issue. The governance by the Center might be used to develop a better governance aimed to courts in Indonesia.

1. Introduction

Different legal systems between one country to the next is one of the hindrances of cross-border commercial activities. "The parties of an international dispute may come from different parts of the world, and their respective countries may have radical differences with regards to the political and legal system, language, customs, among others."[1] Uncertainty is inevitable in a contract that involves two or more countries because each country has its "substantive law and conflict of law rules".[2] Freedom of

[1] Baxter, I. F. (1987). International Business and Choice of Law. *The international and Comparative Law Quarterly*, 36(1), 92-115, p. 92
[2] Buys, C. G. (2005). The Arbitrators' Duty to Respect the Parties' Choice of Law in Commercial Arbitration. *St. John's Law Review*, 79 (1), 59-96, p. 65

contract principle is the leeway for the parties to decide the applicable law. This principle allows the parties to freely choose the law that is deemed most advantageous for them.
As a State known for its natural resources, Indonesia is an attractive destination for investors. However, the governance of the international contract in Indonesia is inadequate. Considering that the Indonesian Civil Code does not regulate freedom of contract principle explicitly, the discussion on freedom of contract refers to Article 1338, which stated that all valid agreements apply to individuals who have concluded them as law.

In the issue of international contract, the available legal basis is Article 18 of *Algemene Bepalingen von wetgeving voor Indonesie* (AB), otherwise known as General Rules on Legislation in Indonesia (*Peraturan Umum mengenai Perundang-undangan di Indonesia*). The aforementioned article only provides *lex loci actus* principle whilst there is already a significant development on the determination of the prevailing law. Another fact is that Indonesia has not ratified the United Nations Convention on Contracts for the International Sales of Goods nor other *lex marchantoria* that could improve Indonesia's lack of domestic governance in the matter.

Indonesia has, a matter of fact, ratified the UNIDROIT Statute of International Institute for Unification of Private Law into its legal system via the President Regulation No. 59 of 2008 concerning the Ratification of Statute of International Institute for the Unification of Private Law. However, the norms contained in such an instrument have not been integrated into Indonesia's national law. This lack of governance contributes to the judge's inconsistency in deciding on the choice of law in disputes concerning international contracts.

This article provides an analysis of the governance of choice of law in international contracts in Indonesia and the recognition of Indonesian courts over the choice of law in international contracts. This article consists of three sections – background, research methodology, and discussion.

2. Research Method

This article is written using normative legal research or doctrinal legal research method. Sources of law used in this research consists of primary and secondary sources of law. Primary source of law used are the Indonesian Civil Code (*Kitab Undang-undang Hukum Perdata*), General Rules on Indonesian Legislation (*Peraturan Umum Mengenai Perundang-undangan di Indonesia*), President Regulation No, 59 of 2008 concerning the Ratification of the Statute of International Institute for the Unification of Private Law, Indonesian National Arbitration Board Regulation, and a number of court decisions. The secondary source of law used is journal articles. The aforementioned source of law is processed qualitatively and is delivered in a descriptively.

Furthermore, this article is aimed to expand previous researches on the choice of law in international contract because it expands the analysis onto specific comparison between the governance of recognition to choice of law in international contracts by courts under the respective laws and the rule for the same issue established by the

Indonesia arbitral institution namely BANI Arbitration Center. Therefore, this article mentions its originality.

On the issue of contribution, it is expected that the article strengthens the awareness on the importance of further governance on recognition to the choice of law in international contracts by courts. The Supreme Court of Indonesia must establish a regulation to give judges' guidance in handling international contract cases involving the issue of choice of law. As for further researchers, the article is hoped to encourage them to study further the implementation of recognition to the choice of law by courts using study case method.

3. Findings and Discussion

a. The Concept of Law in International Contracts

According to Sutan Remi Sjahdeni (2009), freedom of contract principle includes the freedom to whether or not to engage in an agreement; the freedom to choose who one wishes to enter into agreement with; freedom to determine or choose clauses; freedom to determine the object of an agreement; and the freedom to adhere to or deviate from provisions that are provisional in nature (Harianto, 2016).[3] In the context of choice of law, the fifth freedom mentioned by Sutan Remy Sjahdeini is relevant. The parties have the freedom to utilize or deviate from optional provisions.

The concept of choice of law is further derived from a grammatical approach by Sudargo Gautama (2004). The use of freedom or autonomy of parties or *partij-autonomie* in Dutch is incorrect. The reason being is that both words bear the meaning of the choice of law (English) or *pilihan hukum* (Bahasa Indonesia). The underlying logic is that "both parties cannot create their laws", hence "the parties are given the freedom to choose". The choice available to the parties is "the law that the parties desire", which will apply to the contract they seek to draw.[4]

Besides Sutan Remy Sjahdeini, the analysis provided by Huala Adolf on international contract law doctrines is also in line with the recognition of the existence of the parties' freedom to choose the law. International contract law doctrines, according to Huala Adolf (2014), provides three main principles of choice of law: (1) freedom of parties principle, (2) *bonafide* principle, (3) real connection principle.[5] Huala Adolf stated that freedom of parties guarantees the agreement between parties to determine the law that will bind a contract.[6]

In relation to the purpose of the parties in choosing the applicable law, Maria Hook stated that "*by selecting the applicable law, parties are able to opt out of the objective choice of law rules of the forum – those choice of law rules that would apply in default of their choice – and submit their relationship to the chosen legal system* (Hook, 2016)." This idea conveys

[3] Harianto, D. (2016). Asas Kebebasan Berkontrak: Problematika Penerapannya dalam Kontrak Baku Antara Konsumen dan Pelaku Usaha. *Jurnal Hukum Samudra Keadilan*, II (2), 145-156, p. 150

[4] Gautama, S. (2004). *Hukum Perdata Internasional.* Bandung: PT Alumni, p. 4

[5] Adolf, H. (2014). *Dasar-Dasar Kontrak Internasional.* Bandung: Refika Aditama, p. 162

[6] *Ibid.*

that, by choosing a specific applicable law, the parties intend to enact the regulation of and create a legal relationship with said law, showing the true purpose of choice of law is to respond foreign elements within private international legal relationship, and, if possible, achieve the uniform result in any cross-border relationship.

The most important aspect of the choice of law in a contract is the effect it has on the dispute settlement method of the contract itself. Simulated by the aforementioned choice of law, in several cases, the parties may dictate the result of an arbitration proceeding. This renders that the choice of law of a contract has a significant role in determining which law will be utilized to answer the validity and execution of a contract (Gretz, 1991).

Yensen Dermanto Yatip noted three practical reasons that underlie the parties' choice of law: choice of law eases the parties to determine the law that governs the contract, provides "efficiency, benefits, and advantages" and gives a State "the incentive to compete". What is meant by efficient is that the parties may avoid the use of inefficient law, increase competition between law, and reduce uncertainty as to what laws are to be utilized (Latip, 2002)."[7]

The above description represents the idea that choice of law is known as a part of the freedom of parties in a contract. In the context of international contracts, the choice of law is a way of responding to foreign elements. The parties to a contract may determine the law which best represents the needs of both parties. Choice of law also promotes consistency in the application of law even though the legal relationship is happening in a cross-border manner. The execution of a contract is also easier since both parties share the same understanding through the law in which the contract is deemed valid and implemented.

Concerning the essence of choice of law, Maria Hook emphasized "[t]he function of a choice of law rule is to identify the law applicable to an issue or claim with foreign elements."[8] The existence of choice of law in an international contract is also related to the dispute settlement method. There are four issues of choice of law: the applicable law to settle a dispute, the applicable law for arbitration agreement, the applicable procedural law to commence an arbitration proceeding, and applicable conflict of law to determine the aforementioned applicable law.[9] Choice of law affects the result of an arbitration proceeding because the choice of law determines the validity and execution of a contract.[10]

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[7] Latip, Y. D. (2002). *Pilihan Hukum dan Pilihan Forum dalam Kontrak Internasional.* Jakarta: Fakultas Hukum Universitas Indonesia, p. 20-21

[8] Hook, M. (2015). The Concept of Modal Choice of Law Rules. *Journal of Private International Law*, 11(2), 185-211, p. 186

[9] LLC, A. L. (2017, March 28). *Choice of Law in International Commercial Arbitration*. Diambil kembali dari https://www.international-arbitration-attorney.com: https://www.international-arbitration-attorney.com/choice-of-law-international-arbitration/

[10] Gretz, C. M. (1991). The Selection of Choice of Law Provisions in International Commercial Arbitration: A Case for Contractual Depecage. *Northwestern Journal of International Law& Business*, 12 (1), 163-186, p. 171

Craig M. Gretz's view essentially concludes that the applicable law (the chosen law by the parties) is not only related to the contract itself, but also to the effect it has on the dispute settlement. The analogy drawn from an arbitration proceeding may shed light on how the choice of law may affect the result of proceedings. In settling a commercial dispute through arbitration, there exist substantial differences between material law and procedural law.[11] Procedural law is commonly defined as non-substantive law. By using Jan Paulsson's view, there two kinds of law in arbitration: applicable law in arbitration and applicable law for arbitration. The type of law applicable for arbitration includes not only procedural law, but also non-procedural law, such as arbitrability, the award for jurisdictional issues, intervention by court to support arbitration and whether it is possible to perform legal remedy towards the reasoning of the arbitral award, or is it to be put aside.[12]

The same analysis applies to settling the dispute through court proceedings. The applicable law for courts must be interpreted broader, meaning that it is not mere non-procedural law. In terms of choice of law in an international contract, according to the above-mentioned analysis, the applicable law for the court should cover the admissibility of a case and the effect of the court's decision. The aforementioned analysis is not within the general rule that stated that, concerning procedural law, admissibility, competence and legal remedy are included in the law of the forum. If such analysis is used, the applicable law becomes very broad; not only it affects the meaning of the contract, and enforcement of the contract, but also the result.

"Traditionally, choice of law is dedicated as an answer to fundamental questions on which legal systems – laws and other national legal products of same value – would prevail in a private international law dispute or be applicable in an international transaction."[13] Larry Kramer (1990) stated a slightly different view compared to the abovementioned scholars. The issue of choice of law does not only occur in the event there exists more than one law to govern or settle a dispute. For example, in a domestic or multilateral contract dispute, if a judge hears a case, s/he cannot choose from a few available laws unless such laws are applied in the facts. The first step a judge should take is to ensure that there indeed exists a conflict of laws.[14] In general, Larry Kramer's view is in line with dispute settlement under private international law. In the event there exists a private international law dispute, the judge is expected to seek foreign elements of said dispute. Whether the foreign element(s) conflict its domestic counterpart in a contract is seen by the Judge as the forum.

Discourses on the choice of law should not merely focus on the legal approach. The function of choice of law depends on our conception of the general function of a contract. "Economists generally view contract law complements the formation of a

[11] Henderson, A. (2014). Lex Arbitri, Procedural Law and the Seat of Arbitration, Unravelling Law of Arbitration Process. *Singapore Academy of Law Journal*, 26, 886-910, p. 887
[12] *Ibid.*
[13] Roodt, C. (2007). Reflection on Theory, Doctrine and Method in Choice of Law. *The Comparative and International Law Journal of Soutern Africa*, 40(1), 76-102, p. 76
[14] Kramer, L. (1990). Rethinking Choice of Law. *Columbia Law Review*, 90(2), 277-345, p. 277-291

contract in terms of the conditions desired by the contracting parties, but they will not agree to negotiation as it is costly, and hence limited."[15]
According to their view, Michel J. Whincop and Mary Keyes formulated that the law of the contract shall not exclude the agreement of the parties. On behalf of the parties' freedom of contract, the law of a contract shall provide a form that is agreed by all parties concerned. Contract law aims to strengthen the agreement of the parties and fill in any vacuum of law with provisions that may reduce the transaction cost.

In accordance with Michael J. Whincop and Mary Keyes, according to Ralf Michaels, parties' choice of law is affected by their economic interests. The economy is both private and public, and is a choice made by individuals and a State. Hence, the legal economy should concern choice of law. Choice of law shall be in the forms of applicable private and public law. Choice of law depends on the economy and benefits from economic reasoning (Michaels, 2008).[16]

Three economic models that may be used as doctrines about the choice of law: private-law model, international-law model, and combined model (Michaels, 2008). *First,* in the private-law model, if the parties have chosen their desired law, said the law must be enforced. The paradigm of a contract does not stop in just to govern: the rules of choice of law must ensure that the chosen applicable law to easily enter into the contract's scheme. This first model emphasizes on the individuals' interest to choose an efficient law. The private-law model provides predictable rules, *lex loci* application for tort liability without differentiating the location of the suffered loss and behavioral rules, opposition to general questions (e.g. characterization), *renvoi* and public policy exception.[17]

Secondly, the international-law model is very different compared to the first model, it is named international law model since it expands the economy of international law into the choice of law. The similarities this model has with the first one is that both acknowledge that a man can choose a rational decision to efficiently pursue the highest possible benefits. The differing point between the two models is that in the international law model, the actor is the State. Instead of the individuals, choice of law shall be beneficial to the State, and is done by incorporating policies into regulations. The most substantial critic this theory received is that it is difficult to determine the fine line between the government's interest and concept manipulability.[18]

Thirdly, is the combined model, combining both the private-law model and the international-law model. The objective of this model is to optimize global welfare that is calculated between individuals. In this model, the benefits of the choice of law are not only intended for individuals, but also for the State. Ralf Michael put States in the European Union as an example; how the governance of choice of law provides equally

[15] Whinchop, M. J., & Keyes, M. (1999). The Market Tort in Private International Law. *Northwestern Journal of International Law & Business*, 19(2), 215-271, p. 250
[16] Michaels, R. (2008). Economics of Law as Choice of Law. *Law and Contemporary Problems*, 71(3), 73-105, p. 105
[17] Ibid., p. 78-80
[18] *Ibid.*, p. 82-85

combination whereas though it is mostly private-law based, there also exist exceptions, tailored the government's interest.[19]

From the aforementioned description, Ralf Michael stated that the private-law model neglects the international aspect of the choice of law. On the other, the international-law model neglects the private-law aspect of the choice of law. Private international law becomes the middle ground. Hence why the combined model is considered the most relevant. One of the supporters of the combined model, Andrew Guzman, was criticized because the combined model applies party autonomy only if there is no externality of third parties.

The elaboration my Ralf Michaels can be used as an illustration that, theoretically, the existence of the choice of law is always problematic. The economic approach abovementioned explained that choice of law is inseparable from human tendency as rational maximizers that will always seek optimization of a result.

The three models described by Ralf Michaels showed that States are also subject to the choice of law, not just individuals. In a broader context, the combined model seeks to achieve global welfare. All three models depict the choice of law as dependent on the economic approach of the choice itself. Unfortunately, according to Ralf Michaels, all models have not provided the desired solution in terms of choice of law. The economic approach could be used as an illustration to govern the choice of law and cannot be ruled out. The choice of law should be viewed as individuals' and the state's efforts to maximize profits.

Not only in terms of choosing the applicable law, but the desire to maximize profit is also a determining factor in the settlement of a commercial dispute. Regarding the settlement of the dispute, the freedom of parties is the guiding principle in the commercial dispute settlement through arbitration. States often acknowledge and enforce arbitral awards that uphold the freedom of parties. This is what makes international arbitration an attractive option. The freedom of parties, however, is limited by public policy and natural justice principle. In terms of public policy principle, if a dispute brought before an arbitral tribunal revolves around multiple state's legal systems, then the public policy in each concerned State must be taken into consideration by the Arbitrator. The natural justice principle seeks for the parties' equal standing before an arbitration procedure, meaning that the parties have equal rights to a just and unbiased arbitration, and both parties have equal rights to commence a proceeding through arbitration. The freedom of parties garnered critics, *inter alia*, by Jeremy Bentham. The use of this principle is deemed as just, particularly if freedom of parties causes injustice (Dickson, 2018).[20]

The above description requires that choice of law in an international contract answers to the legal question that determines the existence and validity of such international contract, the applicable law to settle disputes, the applicable law to determine procedures of a dispute, and rules on conflict of law that arises from the

[19] *Ibid*., p. 85-87

[20] Dickson, M. O. (2018). Party Autonomy and Justice in International Commercial Arbitration. *International Journal of Law and Management*, 60(1), 114-134, p. 120

aforementioned law. The choice of law in an international contract cannot be separated from the discourses concerning private international law disputes – when faced with such dispute, the judge is expected to look for conflicting elements.
The next question revolves around how the parties choose their desired law. There are four types of choice of law, namely:[21]

1. Explicit, accompanied by many affirmative statements (*uitdrukkelijk, met zovele worrden*);
2. Tacit (*stilzwijgend*);
3. Presumed (*vermoedelijk*);
4. Hypothetical (*hypothetische partijwil*)

First is when the choice of law clause explicitly stated that a contract is governed to a certain law, leaving no uncertainty concerning the parties' intention. *Second*, the choice of law is tacitly known by deducing the parties' intention from their behavior that leads to the law concerned. Gautama stated that this choice of law of this type may be inferred from the language used, the construction of the contract, and the mention of the rules of a certain arbitration tribunal. The inclusion of the choice of a certain court as forums can also be classified as behavior that leads to choosing of law. Tacit choice of law receives several critics. Tacit choice of law supposes that there exists a desire of the parties when in reality it "merely emphasizes on the parties' will that is assumed or putting forward parties' will that is fictive in nature". This leads to concrete legal uncertainty as to the parties' choice of law.

Thirdly, the choice of law is considered known within Indonesia's internal conflict of law. Gautama indicates this to the voluntary submission to European civil law in S.1917 No.12. According to said regulation, there are four types of voluntary submission: whole (*algeheel*), partial (*gedeeltelijk*), submission for specific legal acts (*voor een bepaalde rechstandeling*), and presumptive submission (*veronderstelde onderwerping*). Hence, according to Kollewijn, the existence of choice of law is not certain. Simply put, this type of choice of law is an imposition by law.

Fourth, *hypothetisch* (hypothesis) choice of law. It is a situation where the parties gravitate towards a certain law but workaround in fiction. Judges, for example, must utilize some questions such as "have the parties thought of the applicable law? have the parties decided on which law would be deemed applicable? In the event, the parties have thought on the applicable law, which law is the closest to their criteria?" In simple terms, fiction is created to cover the absence of law chosen by the parties. The factors that may be utilized in fictions are, among others, domicile, nationality, immovable property's location, owed currency, language used in the contract, legal terms, standard form, behavior, and jurisdictional requirements.

Between the four types of choice of law, the explicit choice of law is the most recognizable and accurate, whereas the rest of them may be contested in terms of accuracy. In that context, the complexity of the implementation of the choice of law. The system of choice of law is deemed to be failed as the base of conflict of law settlement or to answer the question on satisfactory theory as the base of choice of law system. The reasons behind the system choice of law's failure to provide a basis: *first*,

[21] Gautama, S. (2004). *Hukum Perdata Internasional.* Bandung: PT Alumni, p. 28-61

the system of choice of law does not provide determinative rules, whereas it merely garners question to *lex fori* or submit said questions to foreign legal system; *second*, it is a mere fiction that an abstract conception is sufficient to be used as a certain legal system. The first reason applies to situations where, when a court is about to determine the applicable law, it is indirectly involved in the fundamental duty of achieving a just decision (Baxter, 1987).[22]

The critics from Baxter above provided a commentary on the complexity of the governance of choice of law, but other scholars have developed their view on the subject – one of them is Latip. A few alternatives in determining the applicable law if the parties involved did not provide for the choice of law are as follows:[23] *First*, the law where the contract was drawn (*lex loci contractus*), referred by Latip as the traditional approach that requires the court to view the dispute from the contract-drafting view. In a situation where in the drafting of a contract, there exists more than one contracts or the drafting of the contract cannot be determined, then "… the State in where the offer was made or was considered as the venue where the contract-drafting takes place." followed by "… if the recipient of an offer does not know where an offer was made, the offering party's domicile shall be the location where the contract was drafted." Latip emphasized that the use of *lex loci contractus* highlights the simplicity and applicability aspects. On one hand, with developments, multi-jurisdiction of a contract creates the urgency of a more realistic applicable law. On the other hand, *lex loci contractus* is supported by "those with mobility or are in transits".

Secondly, the national law of the judge (*lex fori*) as it is viewed as easier by the judge presiding over a case, by applying their own law, it will be relatively easier for the judges to settle the case in a more cost-efficient and timely manner. If the use of *lex loci contractus* is widely used for insurance agreement, *lex fori* is more frequently used in cases concerning intellectual property. The use of *lex fori* is used to avoid forum shopping. *Lex fori* is also used in a dispute concerning compensation that was brought by the heir of a victim of a plane crash involving a Turkish-flagged aircraft to the court in California. *Lex fori* was chosen as the interests belong to people residing in California, the application of strict liability, and the absence of "a greater interest from foreign law". The United Kingdom applies *lex fori* should the parties do not decide on the applicable law. In Germany, if a foreign law is used but it does not provide answers to the matter in a "clear and concrete" manner, *lex fori* will be used by the Judge instead. Even if the documentation indicating the use of foreign law cannot be determined immediately, German judges will risk the use of *lex fori*.[24]

Thirdly, the law from the most significant party to the contract (the most significant contract-relationship) is used if the parties do not decide on the applicable law in an international contract. Under the Convention on the Law Applicable to Contractual Obligations Opened for Signature in Rome on 19 June 1980 (otherwise known as EEC) stated under Article 31(1) that a contract is enforced using the law chosen by the parties. Said chosen law must be clearly expressed within the *terms of contrac*t or *circumstance of the case*. The choice of law may be designated for the contract as a whole

[22] Baxter, *Op. Cit.*, p. 94
[23] Latip, Y. D., *Op. Cit.*, p. 99-139
[24] *Ibid.*

or certain parts of the contracts. In the event where the parties decided on a foreign law with or without choice of forum but the rest of the elements of the contract pinpoint to a specific law, the prejudice of the use of other State's law cannot be put aside from said contract – otherwise known as mandatory rules. If the parties do not decide on the applicable law, Article 4 paragraph 1 of EEC stated that the prevailing law is the law of the State bearing the most significant resemblance, but *depecage* applies where a separate part of the contract may be bound by other law that is more significant.

Article 4 paragraph 3 emphasizes that the law where a good is located shall apply to movable goods, whereas Article 4 paragraph 5 provides that the provisions under Article 4 number 2, 3 and 4 shall not be used if a contract bears significant resemblance with a law of a State. *Fourth*, putative proper law. Latip cited A. Thomson "*putative proper law is the law which would be the proper law in the objective sense assuming that the contract had been effectively created*." There are critics towards putative proper law as it is deemed illogical.[25] This is affirmed by Latip, although it is not the most rational option, it may be the best.

It can be concluded that the principal of choice of law is recognized by international contract law. There are a few types of choice of law. If the parties are not explicit in determining the applicable, Yensen Dermanto Latip (2002) stated that there are alternatives in determining the applicable law, namely: the location in where the contract was drafted (*lex loci contractus*), national law of the judge (*lox fori*), the law of the most significant party to the contract (*the most significant contact-relationship*) and putative proper law. Both Latip and Gautama place the parties' choice of law as the principal reference point, and if there is no choice of law then the chance for alternative of law is open.

Another question would be which law can the parties choose. There are several laws that the parties can choose from: a (national) law of a State, customary law, international convention, international law and a combination of certain laws.[26] One of the examples is the use of Indonesian national law concerning Franchise (Government Regulation Number 16 of 1997) for international franchise contracts in Indonesia. There is also customary law otherwise known as *lex mercantoria*. Along with the existence of freedom of contract principle, *lex mercantoria* emerges in the effort of promoting uniformity of regulations under international trade. Two examples of *lex mercantoria* are the customary law in the field of L/C that is codified by the International Chamber of Commerce (ICC) in Uniform Customs and Practice for Documentary Credits (UCP 500) and Model Clauses for the Use of the UNIDROIT Principles of International Commerce Contract (UPICC Model Clauses). An example of international convention is the United Nations Convention on Contracts for the International Sale of Goods.[27] International convention applies if the parties in a contract are bound to the national laws of State Parties of said international convention.[28]

[25] *Ibid.*
[26] Adolf, H., *Op. Cit.,* p. 171-174
[27] *Ibid.,* p. 171
[28] *Ibid.,* p. 172

Adolf further stated that, though debatable, international law is law that may be chosen by the parties. In a dispute between Texaco and Libya in 1977, international law was used by the judge in deciding the case since it was stated within concession agreement that principles of international law applied if one of the parties is a State.[29] The last is a combination of laws. In line with the previous discussion, it is possible to have more than one law within a contract.[30] This concept is later known as *depecage* or split properly law. Adolf's analysis concerning depecage or split proper is in accordance Maria Hook's (2016) that choice of law in a contract is an independent agreement, and such agreement cannot be treated as an implied meaning over other agreements in a contract; such agreement also cannot conclude the putative jurisdictional basis and consent to arbitration.[31]

b. Governance of Choice of Law in International Contract in Indonesia

The governance of choice of law in international contracts in Indonesia becomes essential in the effort of supporting trade relations between States. Maria Hook (2016) compares the *common law* and *civil law* legal systems' response on the existence of choice of law in international contracts.[32] In the States adapting the *common law* system such as England, Australia, and New Zealand, the judges recognize choice of law in an international contract. In *civil law* States, Germany for example, codified eleven regulations concerning the freedom of parties in a contract in 1986 as part of a broader reformation of private international law. In France, courts recognize the freedom of parties in contracts or joint property in marriage. The same enthusiasm could be found in Switzerland, as they included regulations concerning the freedom of parties in deciding the parties' choice of law in Bundesgesetz ü ber das Internationale Privatrecht (IPRG) and its courts first started to recognize choice of law in the 19th century. Other State that has recognized choice of law is the United States from its Section 187(2) of the Restatement (Second) of Conflict of Laws AND Section 187(2) of the Uniform Commercial Code (UCC).[33]

From the data above, we can see that several States have their governance system with regards to the choice of law in an international contract, as well as a good track record in terms of implementation of choice of law in court proceedings. Maria Hook further explored the approach taken on regulating choice of law in those States. In *common law* States, discourses on choice of law are only framed with a narrow focus on the scope and effect as connecting factors.

As discussed in the previous section, the essence of choice of law covers the existence until the settlement of a dispute that arises out of the enforcement of an international contract. In such context, in regulating choice of law, especially within the sphere of an international contract, a State must take heed of an approach that ensures its current regulations accommodate the essence of choice of law itself.

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[29] *Ibid.*
[30] *Ibid.* p. 175
[31] Hook, M. (2016). *The Choice of Law Contract.* UK: Hart Publishing, p. 14-15
[32] *Ibid.*, p. 3-6
[33] *Ibid.*

Indonesian Civil Code provides that Indonesia uses the term agreement. Article 1313 of the Indonesian Civil Code stated that an agreement is an act pursuant to which one or more individuals commit to one another. Said definition of agreement garnered a few critics as this under definition, it appears to that only one side or party to a contract binds themselves to the agreement. Evi Ariyani cited Salim H. S.'s view on the definition of contract: "…legal relationship between one subject of law to the other in the field of the law of possession. One subject of law is entitled to the performance, whilst the other bears the responsibility to deliver the agreed performance."[34]

As for the agreement of the parties, the Indonesian Civil Code stated under Article 1338 that all agreements lawfully executed agreements shall bind the parties as law. This article is referred to as the basis of the freedom of contract principle since it is not explicitly mentioned anywhere within the Indonesian Civil Code. Freedom of contract is not absolute as it is limited by several articles within the Indonesian Civil Code. Article 1320, 1335, 1337, 1338 (3) and 1339 of the Indonesian Civil Code demanded, simply put, for contracts to be executed in good faith, and contracts made with illegal cause shall be deemed null and void.

The international contract is also not regulated within the Indonesian Civil Code. If seen from the freedom of contract's point of view, indeed an international contract is permissible. Within Indonesia's legal system, private international law refers to the General Regulation concerning Indonesian Legislation, specifically its Article 16, 17 and Article 18 as the most relevant in the context of an international contract. It regulates legal action, and the applicable law is the law of the State where the action was committed (*lex loci actus*).

Article 18 of the General Regulation concerning Indonesian Legislation using Wirjono Projodikoro and Abdul Hakim Barkatullah. According to Wirjono Projodikoro, Article 18 plays an important role in being the basis of consideration and determination of the validy of an action. Whereas according to Abdul Hakim Barkatullah, Article 18 is a *statuta mixta* meant as a formal rule of a legal action where the rules used are the law of the State where said legal action had happened (Syahrin, 2017).[35] Using such analysis, if simulated by using Article 18 of the General Regulation concerning Indonesian Legislation, the applicable law to determine the validity or the fulfillment of formal requirements of a contract is the law where the signing of the contract takes place.

Article 18 is in line with a classic principle in the field of conflict of law, whereas the law where the contract is made binds the parties to said contract. This principle seeks for the law where the contract was made regulates over the aspects of the contract, the aspects of the formation of a contract and the law where the contract is implemented regulates over the implementation aspects of the contract; other doctrines allow the parties to determine their choice of law during the making of the contract.[36]

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[34] Ariyani, E. (2013). *Hukum Perjanjian.* Yogyakarta: Penerbit Ombak, p. 4

[35] Syahrin, M. A. (2017). Refleksi Teoritik E-Contract: Hukum yang Berlaku dalam Sengketa Transaksi Bisnis Internasional yang Menggunakan E-Commerce. *Jurnal Lex Librum*, 3(2), 475-494, p. 486

[36] Johnston, R. (1966). Party Autonomy in Contract Specifying Foreign Law. *William& Mary Law Review*, 7(1), 37-60, p. 37

In the case of Robinson v. Bland, the legal question that was raised was: whether a gambling debt that was won in France, where the debt is unenforceable in England, where the gambling debt was null and void in England. Cited from Lord Mansfield, the general rule that formed *ex comitate et jure* is that, where the contract was made, and not where the contract is enforced, must be taken into consideration when dissecting and enforcing the contract. The exception to this is when the parties to the contract have their point of view towards the different kingdom systems.[37]

From Johnston's view it could be concluded that *lex loci actus* became a classic principle. *Lex loci actus* is also categorized as a classic doctrine. Referring to Lord Mansfield's view, the parties may deviate from *lex loci actus* if they, during the making of the contract, has their different view towards other legal systems.

Indonesian positive law does not provide a concrete answer to the application of Article 18 of the General Regulation concerning Legislation in Indonesia. On one hand, the absence of governance opens a chance for the judges to freely determine the scope of law (Mekki, 2016).[38] but on the other hand, the context of Indonesian legal system that places legislation as a formal source of law that must be followed by the judges create a dilemmatic situation.

c. The Recognition of Choice of Law in International Contract by the Indonesian Courts and Comparison with the BANI Arbitration Center

A few court decisions that were analyzed by Latip (2002) showed that Indonesian court is not consistent in terms of recognizing the choice of law of the parties in international contract.[39] An example is the Decision No. 560/1982.Pdt.G (1983) between Marubeni Corporation against PT Indokarya Nissan Motors. Marubeni gave a collateral to Bank of Tokyo Ltd. (BOT) in support of the application of loan made by the Respondent to BOT. Respondent did not fulfil its obligation to repay the loan, to the point that BOT had to charge the claimant since s/he was the sponsor. The claimant fulfilled the payment obligation and charged it back to Respondent. Central Jakarta District Court decided to favor Claimant, and Respondent was decreed to pay its debt to Claimant. Jakarta High Court affirms the District Court's decision.[40]

The case continued to cassation to the Supreme Court. In the request for cassation, Respondent argued that Jakarta District Court does not have the jurisdiction since the parties of the contract chose both formal Japanese law – both formal and material – hence the one that has the jurisdiction is Tokyo Court (Japan) has the jurisdiction to hear the case. The Supreme Court stated that in the Subrogation Agreement between parties, Jakarta Pusat District Court was chosen as the domicile for settlement and the law that applies to such agreement is Indonesian law. Hence, the Central Jakarta District Court indeed has jurisdiction over the case. The Supreme Court rejected

[37] *Ibid.*
[38] Mekki, M. (2016). The General Principle of Contract Law in the "Ordonnance" of the Reform of Contract Law. *Lousiana Law Review*, 76(4), 1193-1211, p. 1999
[39] Latip, Y. D., *Op. Cit.*, p. 160
[40] *Ibid.*, p. 161-167

Respondent's request for cassation and punished Respondent to pay its debt to Claimant. The decision above showed that, even though the parties have decided explicitly on choice of law and forum, Central Jakarta District Court still had the jurisdiction to hear the case. Another case analyzed by Latip (2002) is a case between Societe Generale against Hadi Raharja CS. In its decision, the Supreme Court emphasized the difference between choice of law and choice of forum. Societe Generale as Claimant based its lawsuit on Respondent's actions, in which the Respondent was a guarantor of Star Prospekty Pte. Ltd. In its exception, Respondent argued that West Jakarta District Court does not have the jurisdiction to hear the case as Article 6 (d) of the Collateral Agreement that said the agreement is bound to Singaporean law even though Claimant has options to go to other courts. The panel of judges at West Jakarta Disctrict Court opined that even though it is possible to file a lawsuit to other court, the fact shows that the Singaporean court is stated as a forum, both parties' domicile, disputed object, used currency (United States Dollars), *standard formulieren* used and the language used is English. By using the *theory of the most significant contract-connection*, West Jakarta District Court decided that it had the jurisdiction to examine and adjudicate the case (Latip, 2002).[41]

The dispute concerning Societe Generale against Hadi Raharja Cs. made its way to Jakarta High Court. Latip (2002) then analyzed that, in its decision, Jakarta High Court had a different opinion with West Jakarta District Court by stating that the definition of "choice of law" includes choice of law jurisdiction (choice of court) and choice of law by the parties. Jakarta High Court utilized Article 18 of the General Regulation concerning the Indonesian Legislation in determining the forum. Considering that Respondents reside in Indonesia, "procedural act is determined according to the law from the State where the procedural act is commenced that is (S.1941 No. 44), apart from the matter of which material law applies.". The panel of judges also considered *actuur sequitur forum rei* and principle of effectiveness from the decision. The judges overturned the West Jakarta District Court and instead adjudicate the case themselves. The Jakarta High Court indeed recognize choice of forum in the contract that had opened the chance for dispute settlement in other courts other than the Singaporean courts. What is astounding is the fact that the Jakarta High Court instead put aside choice of law determined by the parties in deciding the case – *lex fori* was used instead.[42]

The issues on the recognition of choice of law made by the parties to a contract by the court are also faced by other States. In the past, Singaporean courts were recorded rather unsuccessful in handling the relation and coexistence of law of the forum with the choice of law of the parties.[43] In the case John Holland Pty Ltd against Toyo Engineering Corp (Japan), Singaporean court stated that the adoption of ICC rules by the parties has given rise to an unpredicted effect, which is the exclusion of Model Law application simultaneously. In other case, such as that between Dermaja Properties Sdn Bhd v. Premium Properties Sdn Bhd, Singaporean court was excluded by the parties by

[41] *Ibid.* p. 216.
[42] Latip, Y. D. (2002). *Pilihan Hukum dan Pilihan Forum dalam Kontrak Internasional.* Jakarta: Fakultas Hukum Universitas Indonesia.
[43] Henderson, A. (2014). Lex Arbitri, Procedural Law and the Seat of Arbitration, Unravelling Law of Arbitration Process. *Singapore Academy of Law Journal*, 26, p. 886-910, p. 897

using UNCITRAL rules. As a result, the rules could not be used as a whole and could only be applied to case *ad hoc* where its role is merely as a gap filler in the forum's legal structure (Henderson, 2014).[44] Like the inconsistency found in the Indonesian courts' decision, the Singaporean court applies the law of the forum rather than following the parties' choice of law.

Comparing with the practice of the United States, in the States, according to the jurisprudence, states' courts have different view on freedom of contract. From the studied jurisprudence, Johnson (1966) formulated a category of cases:[45]

1. Cases permitting the stipulated law to govern,
2. Cases in which the court makes assumptions about the parties' intent toward the governing law,
3. Cases demanding a substantial connection to the stipulated law or demanding no conflict with public policy,
4. Cases in which the court refuses to be bound by the stipulated law,
5. Cases in which courts avoid having to use the stipulated law.

From the five categories above, it is evident that the courts in the United States showed varied response towards the parties' choice of law.

Meanwhile, in Indonesia, limited provisions within the legislation leads to the inconsistency of the judges' ruling. As a comparison, in terms of the recognition of freedom of contract, arbitration has firmer regulation rather than the court. The BANI Arbitration Center in its Article 16 on the Applicable Law of the Rules and Procedure of Arbitration in effect starting from 1 January 2018 stated:

> "The law that governs subject-matter of a dispute is the law chosen in the commercial contract concerned that give arise to dispute between parties. If the parties to the contract did not determine the governing law, the parties are free to determine the applicable law by joint agreement. Should such agreement does not exist, the Panel or Sole Arbitrator have the right to determine the necessary rules and regulations by taking into consideration the circumstances surrounding the issue."

This article stipulated that the procedure of arbitration in the BANI Arbitration Center prioritizes the parties' choice of law. If the parties did not decide on that matter, then the parties could decide by having a joint agreement. In the event where such agreement does not exist, then the arbitrators will consider the circumstances relevant to said dispute. This arrangement surely serves the arbitrator greatly in handling the case. This situation creates the differences between the implementation through court and arbitration. Even though in determining the "… taking into consideration the circumstances surrounding the issue" part is not explained in detail, at least Indonesian National Arbitration Board secures the place of the parties' choice of law.

The Rules and Procedure of the Indonesian National Arbitration Board is in line with the fundamental principle used in international arbitration. In the condition that there is no choice of law, but a dispute arises, then it is the panel of arbitrators' right to determine the applicable law. Such rules shall be considered satisfactory, but if

[44] *Ibid.*

[45] Johnston, *Op.Cit.,* p. 40

analyzed deeper, the question that must be answered is what methods the panel in can use to determine the applicable law.

When the parties to a contract did not determine their choice of law, the arbitration panel is not bound to only one national law in determining the applicable law. Arbitrators may combine a number of laws. This provision has not yet been explicitly stipulated under the Rules and Procedure of the Indonesian National Arbitration Board.

There are two developing methods relating to the authority of arbitration panel. First is *voie indirecte*, meaning to limit the authority of the arbitration panel to only determine the rules in *conflict of law* that will be used to determine the applicable law. Second is *voie directe*, which is to give the arbitration panel the authority to directly choose the applicable law or rules from the applicable law to the case at hand (Jones, 2014).[46]

An academic paper issued by the Indonesian National Arbitration Board describe further the concept of *voie indirecte* (BPHN, 2015).[47] In the part concerning contracts, it is stated within the academic paper that "the main principle of private international law and the law of the contract between different nationals is the law that is chosen and agreed upon by the parties within the agreement/contract." The expected setting is the coming into effect the law chosen by the parties and, if the parties did not choose one, "the law from the party which bears the performance which is the most characterizing for each types of contracts (*the most characteristic connection*).

The academic paper also reviews the developing theories of choice of law, *voie indirecte*, that gives the authority to the panel of judges or arbitrators to choose law in the event the parties did not do so themselves: Choice of law is the authority of the parties that enter into a(n) contract/agreement to choose the law that will be used. Choice of law is a manifestation of the freedom of contract. However, in practice, freedom of contract is limited. There are four limitations to freedom of contract, namely: only applies in the field of contract, does not breach public order, does not constitute as evasion of law and does apply to mandatory laws. In the discussion of private international law, there are two types of choice of law: explicit and tacit. A few examples of jurisprudence that are related to the discussion of choice of law are the cases of Trailer Nicolas, Solbandera and Vita Food Products v. Unus Shipping Co. There are number of theories that may be used by the judges in determining the applicable law, namely:

1. *Lex loci contractus,*
2. *Lex loci solutionis,*
3. *Lex loci executionis,*
4. *The proper law of the contract*, and
5. *The most characteristic connection*

[46] Jones, D. (2014). Choosing the Law or Rules of Law to Govern the Substantive Rights of the Parties. *Singapore Academy of Law Journal*, 26, 911-941, p. 913-914

[47] BPHN. (2015). Diambil kembali dari ttps://www.bphn.go.id: https://www.bphn.go.id/data/documents/na_ruu_ttg_hukum_perdata_internasional_(lanjutan).pdf

The excerpt of the academic research above shows that the author suggests that, in international contract, the applicable law is the law that is chosen by the parties. If the parties did not decide on the applicable law, the above five theories may be used by the judge in determining the applicable law. This suggestion is in line with the expectation conveyed by the recognition of choice of law. Not only that, if said legislation draft passes, then the judge will no longer face difficulty in determining the applicable law in international contracts.

The academic paper expose that, with the rapid development of cross-border relations between States, the need to have a special regulation concerning private international law is indeed an urgency. Regulation in the form of a Code that is "systematic and comprehensive" allows legal certainty, as the judge and law enforcer have "guidelines". On the other hand, codification has its weakness, which is being rigid. The author of the abovementioned academic research stated that though codification is rigid, it is still deemed necessary.

4. Conclusion

Analysis above shows that there is an inconsistency of courts' practices in the issue of the choice of law recognition. This article finds that the lack of governance by Indonesia laws is the cause. Indonesia still relies on the governance established by Dutch Colonial Government. As the governance was made a long time ago, it is no longer suitable for current condition. Nonetheless, a far better governance established by the BANI Arbitration Center. It is clearly stated that the tribunal shall uphold parties' choice of law and give arbiters the authority to decide the applicable law if such choice is not established.

Such condition certainly requires a response. Suggestions to add to the governance on choice of law in a contract, especially international contract, includes, referring the matter of choice of law to the Rules and Procedure of Arbitration of the Indonesian National Arbitration Board or the Academic Paper on the drafting of legislation concerning private international law by BPHN. The addition of rules includes the recognition of the parties' choice of law and the five theories that may be used by the judge to determine the applicable law if the parties did not explicitly determine their choice of law: *Lex loci contractus, Lex loci solutionis, Lex loci executionis, The proper law of the contract,* and *The most characteristic connection*.

The government and the House of Representative must be encouraged to submit a bill concerning private international law in the National Legislation Program (*Proglegnas*). The process of drafting a legislation is indeed tedious, therefore, the Supreme Court must also be encouraged to draft a regulation which contains guidelines for the judges and the parties in settling a private international law dispute. The existence of said regulation is expected to help encourage the recognition of choice of law and give several theories as options if the judges are faced with private international law dispute.

Moreover, the government needs to conduct a thorough examination on the States that often engage in commercial transaction with Indonesian citizens, legal entity, or the government, to consider the establishment of Mutual Legal Assistance concerning

private international law. The effort of helping judges by compiling foreign law instruments that are often used is also needed. This is to help the judges or other law enforcers in case they are faced with private international law disputes.

Recognition needs to be balanced by considerations and limitations, be it in under private international law principles, such as *public order*, or the prevailing laws and regulations. Legislators and judges alike must be able to balance the business interest of the parties with national interest. The governance of private international law deserves serious attention from the government and the House of Representative. Indonesia should have been increasing its response towards cross-border development. Both individual and Indonesia's interest will always be hampered if governance on this matter is delayed.

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