

Implications of Pacta Sunt Servanda Principle in the Long Term Contract between the Indonesian Government and Pt Freeport Indonesia

Suherman^{1*} I Nyoman Nurjaya² Bambang Winarno³ Moh Ridwan⁴

1. Doctorate Candidate at Law Faculty of Brawijaya University, Malang

2. Professor of Legal Anthropology, Faculty of Law, Brawijaya University, Malang

3. Associate Professor of Corporate Law, Faculty of Law, Brawijaya University, Malang

4. Associate Professor of International Law, Faculty of Law, Brawijaya University, Malang

Abstract

Contract of work executed by the Indonesian Government and PT Freeport Indonesia is binding for a long term according to *pacta sunt servanda* principle, as the contract term took a period of 30 years, but the analysis finds that many provisions of the contract bring in myriad of adverse impacts to the Government and weaken its position. It is very clear that the rights and liabilities of the parties contemplated in the contract are not fairly balanced. This applies as well to the benefits and proceeds being earned by both parties. Therefore in terms of common legal principles and legal doctrines such as good faith principle, unconscionality doctrine and unjust enrichment doctrine, the essence of *pacta sunt servanda* principle set out in the contract of work is not conclusive. This shifting essence of the phrase implies that the court has the right to alter and to interfere with the content of the contract and allows a judge to waive some clauses or the entirety of the contract as it may produce consequences that is contradictory to the judge's conscience and justice.

Key words: Contract, *Pacta sunt servanda*, good faith

A. Introduction

In the course of state administration, the government is required to constantly improve the people's prosperity. The preamble of the State Constitution of 1945 explicitly stated that one of the national objectives is to bring prosperity to the people. Article 33 paragraph (3) of the 1945 Constitution provides that: "The land, the waters and the natural resources within shall be under the powers of the State and shall be used to the greatest benefit of the people."¹ In accordance to this provision, in principle, the state is tasked to organize and to enterprise the nation's natural resources. This article also obligates the state to utilise natural resources for the people's prosperity.²

The Article 8 of Law No. 1 of 1967 concerning Foreign Investment provides that foreign investment in the mining sector shall be based on a partnership with the Government on the basis of contract of work, or any other form in accordance with the applicable law regulations. Cooperation contract between the government and business entities gives rise to a commitment from a specific agreement, for it concerns the state as a public entity on the one hand and private legal entities on the other.³

Contract of work (COW) is a type of cooperation created between the Indonesian Government with foreign contractors or a joint venture between a foreign legal entity with the domestic legal entity in the field of non-oil and gas mining under the duration/term specified by both parties.⁴ The term of this contract takes a long period (30 years), In 1967, PT Freeport Indonesia for the first time sign the first-generation Contract of Work with the government of the Republic of Indonesia, which was then extended in 1991 as the fifth generation Contract which ended in 2021. The object of the contract work is agreements in the field of non-oil and gas mining, such as the mining of copper, gold, and silver.

Commitment derived from agreements, made by the Government of the Republic of Indonesia with a private legal entity, that is binding the parties is known as *Pacta sunt servanda* principle. Today, *pacta sunt servanda* principle or the power to commit under a contract made by the government for long-term contracts has led to unfavorable impacts to the State and society. There are some social impacts or social issues posed by PT Freeport to the society. In this case Indonesia becomes the party gaining the least benefit. The country only gets a very small portion compared to that obtained by PT Freeport Indonesia. It is noted that during the year 2005 to September 2010, total sales of PT Freeport Indonesia was amounted US \$ 28,816 million or Rp 259.34 trillions. The gross profit was US \$ 16,607 millions or Rp 150,033 trillions. Compare with the royalties paid to Indonesia which only amounted to US \$ 732 millions or Rps 6,588 trillions.⁵

¹. Nanik Trihastuti, *Hukum Kontrak Karya*, Setara Press, Malang, 2013, p. 2

². *Ibid.*

³. *Ibid.*, p. 4

⁴. Salim H.S, *Perkembangan Hk Kontrak Innominaat di Indonesia*, Sinar Grafika, Jakarta, 2005, p. 63

⁵. Indonesian Corruption Watch, "Menimbang Manfaat Freeport Bagi Indonesia",

So many clauses in the contract of work of PT Freeport Indonesia are proven as detrimental to the Indonesian society and the state of Indonesia. One of the clauses states that the contract is renewable for two times if PT Freeport Indonesia desires to do so. Likewise Article 23 of the contract says that:¹

"The Ministry on behalf of the Government agrees that during the term of this agreement, the Government in accordance with Law No. 1 of 1967 concerning Foreign Investment, (i) will not take any action inconsistent with the provisions of this Agreement that will lead to negative impacts on implementation of the enterprise /concession hereunder, including without limitation any act of confiscation or nationalization of the company or any part thereof, and (ii) at any time will work with the company to handle all administrative actions and rulings relating to such enterprise in the best manner in accordance with the procedures required. "

This Article 23 alone is obviously disadvantageous to the State of Indonesia, as the government can not take any measures against all acts that lead to negative impacts to the enterprise of PT Freeport Indonesia. The contract renewal should also be based on the mutual consent of both parties rather than one sided approval of either party, in this case as desired by PT Freeport Indonesia.

Based on the background as above described the issue of this study is formulated as follows: What are the implications of *pacta sunt servanda* principle in the long-term contract between the Indonesian Government and PT Freeport Indonesia?

B. Research Method

This study is classified as normative legal research, that is a study that examines and analyses statutory regulations, legal principles and norms purposed to obtain a clear picture as to the implications of *pacta sunt servanda* principle in the current legal contract. A normative legal research is a study commonly carried out in the activity of developing the discipline of law, known as the dogmatics.²

Soerjono Soekanto and Mamudji have introduced that a research being done solely by examining literatures or secondary data might be called as normative legal research or literary legal research. This normative or literary legal research includes:³ Research on legal principles, systematics, vertical and horizontal synchronizations, legal comparison and legal history.

In this study, the legal issue being examined is the implications of *pacta sunt servanda* principle in the long term contract between the Indonesian Government and PT Freeport Indonesia.

This study will analyse the issue by finding the feasible legal norms to be established, in which legal regulations, principles or foundations or doctrines are covered. This process is started by identifying some legal facts or legal issues, and then collecting law materials to be discussed as prescription. Some approaches are used: statute approach, conceptual approach, and case approach.

Sources of legal research in this study consist of primary, secondary and tertiary law materials. After that conclusions are drawn as result of analyses and discussions on the issue in the form of arguments in response to such legal issue.

C. Findings and Discussion

Pacta sunt servanda principle is originated from the latin word which means "*contracts should be adhered to*".⁴ In the book *Black's Law Dictionary*, *pacta sunt servanda* principle means "*agreement (and stipulations) of the parties (to a contract) must be observed*",⁵ or the agreement of the parties to the contract shall be notified or committed.

Based on the foregoing definitions *pacta sunt servanda* resides as an agreement executed by two parties with the binding power.

It means that either party can not leave the agreement without the other party's consent.

To understand the background of this *pacta sunt servanda* principle we have to consider the historical element, to look into society of the past or the past era. Primarily to have a look at the relations between the society and rules that they made for themselves. The Roman era had given numerous contributions to the current development of legal studies both the international law and law in general.

The Roman Empire had also given so many contributions to the international law principles or concepts.

firdausilyas.files.wordpress.com/2011/11/freeport_icw_1Nov2011.pdf, accessed on August 26, 2014, at 14.25

¹.Pemerintah Republik Indonesia dan PT. Freeport Indonesia, Jakarta, Kontrak Karya, 1991, Article 23 paragraph 3.

². Bernard Arief Sidartha, *Penelitian Hukum Normatif : Analisis Penelitian Filosofikal dan Dogmatikal, dalam buku Metode Penelitian Hukum : Konstelasi dan Refleksi*, Yayasan Obor Indonesia, Jakarta, 2009, p. 142.

³. Soerjono Soekanto dan Mamudji, *Penelitian Hukum Normatif, Suatu Tinjauan Singkat*, Jakarta, Raja Grafindo Persada, 1985, p. 15.

⁴. Edmund Jan Osmanczyk, *Encyclopedia of the United Nations and International Agreements*, Taylor and Francais, London, , 1985, p. 597

⁵. Henry Campbell, *Black's Law Dictionary*, St. Paul, West Publishing & Co, 1979, p.998

One of them is the *pacta sunt servanda* principle...¹ The *pacta sunt servanda* principle that was founded during the era of Roman law jurisdiction that took its supremacy as of 450 years B.C. had undergone four stages of development as below:²

1. First stage was *contracts re* that was based on binding power of the contract rather than the agreement. At this stage the contract was deemed as had been executed after the receiving of goods by the other party.
2. Second stage was *contracts verbis* that was based on the binding power as manifested in the articulated wordings of the contract. This binding power was created following the agreement of desires of the parties entering to the contract.
3. Third stage, was *contracts litteris* that was based on binding power of written contract. At this stage the agreement occurred and was binding by the time the willingness of the receiving party declared in writing or via documents.
4. Fourth stage, was *contracts consensus* that was based on binding power of the agreement of both parties to the contract. At this stage the parties agreed or consented the achievement as had been promised.

In the development, *pacta sunt servanda* can be traced in canonic law source, which refers the principles of *nudus consensus obligat, pacta nuda servanda sunt. Pacta nuda servanda sunt* has the meaning that the agreement of desires does not necessarily be done under the oath nor certain formality. Likewise the *nudum pactum* principle stated that the agreement of desires per se is eligible.³

The next development was the age of Renaissance and reformation which relates the *pacta sunt servanda* principle with “*sanctity of contracts*” or sacredness of contract and “*validity of contracts*”. In regard of this *sanctity of contracts* Samuel Pufendorf who is a follower of Grotius in XVII and XVIII century confirmed that:⁴

“as one of the inviolable rules of natural law that each man must keep his word without breaking it. The latter expressed the opinion that, without the principle of good faith and that of the binding force of contracts, international law would be entirely destroyed”.

Another scholar Johann Jacob Moser the founder of international law positivism argued “*that contracts could only be canceled with the consent of all interested parties*”, which means that contract is irrevocable without prior consent of the parties.⁵ In reference to the scholars’ opinions the *pacta sunt servanda* principle is highly respected and upheld in relation to this *sanctity of contract*.

In the course of international cooperation for implementing the UN Charter for example, this *pacta sunt servanda* principle has been included in the preamble of UN Charter, Paragraph 3, which says “*.... respect for the obligations arising from treaties and other sources of international law*”⁶. At Wina Convention on Agreement Law of 1969 *pacta sunt servanda* principle was included in article 26 which says “*every treaty in force is binding upon the parties to it and must be performed by them in good faith*”.⁷ Therefore, this principle has developed deliberation from its formal and abstract substance into a specific implementing regulation process where international law principles are influencing. The principle also interacts with the national law. The third paragraph of the preamble of Wina Convention of 1969 and 1986 says that “*Nothing that the principles of free consent and of good faith and the pacta sunt servanda rule are universally recognized*”.⁸ Thus, contracting freedom principle, good faith and *pacta sunt servanda principle* as the very basic principles universally applied and as the foundations to exercise the agreement.

Pacta sunt servanda principle goes hand in hand with the good faith principle. This is found in article 26 of Wina Convention of 1969 and 1986 which states that “*Every treaty in force is binding upon the parties to it and must be performed by them in good faith*”⁹. Article 36 of International Court Charter says as follows “*In the event of a dispute as to whether the court has jurisdiction, the matter shall be settled by the decision of the court*”. Upon the presence of common law principles, which one of them is the *pacta sunt servanda principle* The International Court can not refuse to hear a case due to the absence of law regulating the case, as all cases can be referred to such law principles.¹⁰

¹. Mochtar Kusumaatmaja, *Konsep-Konsep Hukum Dalam Pembangunan*, Alumni, Bandung 2002, p. 27

². Peter Mahmud Marzuki, *Penelitian Hukum*, Kencana Predana Media Group, Jakarta, 2005, p. 198-199

³. *Ibid.*

⁴. Hans Wehberg, *Pacta Sunt Servanda*, American Journal of Internasional Law, Vol. 53 Desember 1959, p. 779

⁵. J.G. Starke, *An Introduction to International Law*, London, Butterworths, 1984, hal 47.

⁶. I.I. Lukashuk, *The Principle Pacta Sunt Servanda and the Nature of Obligation Under International Law*, American Journal of International Law, Vol. 83, Juli 1989, p.515

⁷. *Ibid.*

⁸. *Ibid.*

⁹. *Ibid.*, Article 26

¹⁰. Syahmin AK, *Hukum Perjanjian Internasional Menurut Konvensi Wina 1969*, Bandung, Artico, p. 26

Based on the foregoing, the validity of *pacta sunt servanda* principle is not only to things agreed by the parties, but will also consider the other common law principles such as the good faith principle. The manifestation of *pacta sunt servanda* principle in Indonesian national law can be found in article 1338 paragraph (1) of the Indonesian Civil Code which says²¹: “All valid agreements apply to the individuals who have concluded them as law. Such agreements are irrevocable other than by mutual consent, or pursuant to reasons stipulated by the law. They must be executed in good faith.”

The application of this *pacta sunt servanda* principle in the agreement serves as the basis for the implementation of rights and obligations of the parties, that on account of this either party may request the other party to perform its obligations. However, *pacta sunt servanda* principle in countries where this principle was born has undergone a shifting to maintaining enforceability of agreement. This is because in reality the enactment of an agreement/ treaty is affected by the surrounding circumstances by the time the agreement was made. This shifting is also due to a fundamental change of circumstances as such change may affect the implementation of the agreement.¹ Other shiftings to this *pacta sunt servanda* principle were caused by the presence of other common law principles such as good faith principle and equity principle. Similar with *pacta sunt servanda* principle, the free contracting principle has also undergone shiftings, moreover this principle has been left in the Dutch NBW which emphasizes the importance of “*redelijkheid en billijkheid*” or “*reasonableness and fairness*” or “feasibility and appropriateness” in carrying out any contracting legal act.

The binding effect of a contract should also pay attention to the other common law principles such as equity principle. Any promise that does not provide equivalency / equity in its provisions, is not a reasonable agreement and thereby is not binding either.²

Therefore, this principle is strongly associated with the *pacta sunt servanda* principle. that is, any contract that has been agreed and signed by the parties but does not contain proportional value or unequal benefits to the parties, shall not be binding, as it does not reflect the sense of justice.

The binding principle of a contract must also consider the propriety and good faith, both before and during the implementation of the agreement, that if the entry into an agreement is carried out in unequal positioning and is causing inappropriate and unfair results, the agreement will be unenforceable. On grounds that such provisions actually are not agreed or approved by the party of weaker position, the agreement shall not be binding.³

If this equity principle and good faith principle are not met then the *pacta sunt servanda* principle in a contract shall not bind the parties. Therefore, the three foregoing principles are closely related and linked one to another. *Pacta sunt servanda* principle and *rebus sic stantibus* principle co-exist one to another, as the *pacta sunt servanda* principle is applied in the agreement on the basis of good faith, while the principle of *rebus sic stantibus*, the parties may postpone or withdraw from the agreement, in the event of critical circumstances, therefore, the principles are complementing between one and the other.

As explained that the enactment of *pacta sunt servanda* principle or binding effect of a contract must pay attention to the other law principles, such as the good faith principle, equity principle, *rebus sic stantibus* principle, unjust enrichment and other common law norms and principles. There are several cases in Indonesia and overseas relating to the enforcement of an agreement, to be taken into account in answering the problems addressed in this dissertation.

1. Several cases overseas:

- a. By virtue of the decision of Hoge Raad, in his decision dated February 9, 1923 (*Nederlandse Jurisprudentie*, page 676), provides that an agreement shall be executed “*volgens de eisen van redelijkheid en billijkheid*”, which means the good faith should be applied in accordance to propriety and feasibility or reasonability and fairness. This has been applied in the case of *Stork vs Haarlemshe Katoen Maatschappij* in the Decision of Hoge Raad dated January , 1926, NJ 1926, 203. The decision is an example of a decision that limits or displaces contract working power, under the reason that the contract can not be implemented with equity . The same applies with the Decision of Hoge Raad dated May 16 1967 in the case of *Saladin vs Hollandsce Bank Unie (HBU) Arrest*. Hoge Raad and NBW decisions were only applied to unfair, unreasonable, and improper contracts, as this is not in line with *pacta sunt servanda* principle.⁴
- b. The case of long term contract of 1929 to 1975 on water supply to hospitals in the case of *Staffs*

¹ Harry Purwanto, *Keberadaan Asas Rebus Sic Stantibus dalam Perjanjian Internasional*, <http://mimbar.hukum.ugm.ac.id/index.php/jmh/article/viewFile/356/210>, p.107, accessed on October 7, 2014, at 14.30

² Sunaryati Hartono, *Mencari Bentuk dan Sistem Hukum Perjanjian Nasional Kita*, Bandung, Alumni, 1974, p. 58

³ Johannes Ibrahim dan Lindawaty Sewu, *Hukum Bisnis dan Persfektif Manusia Modern*, Bandung, PT. Refika Aditama, p. 109

⁴ Agus Yudha Hernoko, *Hukum Perjanjian Asas Proporsionalitas Dalam kontrak Komersial*, Jakarta, Kencana Prenada Media Group, 2011, p. 135-140

Area Health Authority vs Staffs waterworks. The contract was made in 1929 for supplying water to hospital at prince seven *pence* per on thousand gallons and was expressed to be performed at any time thereafter. But in 1975 water price had jumped fifteen times higher than before, making the contract unfair to the parties. But this contract had no clause that regulates price adjustment and the presence of *pacta sunt servanda* principle and nominalist principle had prevented the court to change such long term contract in order to adjust the payable prince in the absence of an “*express provision*”¹ in the contract. However the court decided to cancel such contract by reason of *condition subsequent* or unreasonable or improper or unjust condition.that the water supplier was able to raise the price.²

- c. Court decision relating to the *equity* as supplementary for the justice. This practice has been developed mainly in many court decisions, for example is the case of *Llyods Bank vs Bundy QB 326*, 1975. Where Lord Denning MR showed that the misuse of condition is not the sole and independent doctrine. The doctrine is actually an expansion of power of equity principle for the court to intervene an agreement in which unequal position of the parties is found.³ The judge also declared remedy to a person for not getting free advice when agreeing a contract in which there are some unfair articles or transfer of goods for inadequate reasons, when his/her ability in the bargaining is deficient when compared to his/her own needs and wants, or due to lack of knowledge or weakness, along with unreasonable impacts (undue influence) or pressures against the benefits to the other person/s.
- d. Court decisions in United States that are able to change the content of the contract based on propriety, *fairness* and *fair dealing* principles which reject the free contracting principle, namely in the case of *Coppage vs Kansas*, 236 US 1, 17 (1915), Judge Pitney declared that it was impossible to enforce the free contracting at the same time in the absence of recognition to the bargaining positions of the parties. In fact, it is difficult to find an equal bargaining position among the parties.⁴ In addition, *Supreme Court* in America also resolved a decision in the case of *Lochner vs New York*, 1905, the Supreme Judge had adopted decision not in line with the free contracting principle, rather on the base of fairness dan fair dealing principles.⁵

2. Several cases in Indonesia:

- a. Supreme Judge Decision No. 1253 K/Sip/1973 dated October 14, 1976. In this decision the Supreme Court considered that “The interest agreed was at 20% per month but for the sake of humanity and justice the interest granted is only 3% per month, in proportion to the loans with the public banks by the time the agreement was executed.” At that time, the Supreme Judge Decision was not based on the agreement binding the parties, rather on the base of humanity and justice. The judge also decided on a good faith and propriety. At that time so many critics raised against the Supreme Court which was strictly bounded to the content of the contract, waiving the good faith, propriety and equity between the parties.⁶
- b. Decision of the Supreme Court of the Republic of Indonesia No. 3431 K/Pdt/1985 dated March 4, 1987.⁷ In this decision the Supreme Court had to consider the initial interest of 10 % per month with the principal debt of Rp 540,000,- to Plaintiff, but until the filing of the suit the respondent only paid interest of Rp 400,000,- while the principal debt was remain outstanding. In this case the Supreme Court was authorized to make an *ex aequo et bono* decision or the fairest decision. That a proper and fair rate of interest was at 1% (one persen) per month payable by the Respondent for 10 months, that is $Rp\ 5,400 \times 10 = Rp\ 54,000,-$. Therefore the interest paid by the Respondents and received by the Plaintiff was Rp 400,000,- was deemed as payment of the principal debt, that the remainder payable by the Respondents was amounted Rp 140,000 + Rp

¹. *Express provision* is a condition under the contract causing a fact or occurrence as must have happened that becoming a requirement of the contract’s binding effect (*condition precedent*) to become a liability to realise a promise as soon as possible, or a condition that will cancel a contract if occurs (*condition subsequent*) that may terminate a liability (see Arthur L. Corbin, Contract Volume One, Minnesota, West Publishing Co, 1992, p.341)

². P.S. Atiyah, *Essay on Contract*, Oxford: Clarendon Press, New York, 1986, p.341

³. T. Antony Downes, *Contract*, Blackstone Press Limited, London, 1995, p. 64

⁴. Elaine A. Welle, *Freedom of Contract and Securities Laws : Opting Out of Securities Regulation by Private Agreement*, Washington & Lee Law Review Vol. 56, 1999, p. 575

⁵. Morton J. Horwitz, *Transformation of American Law 1870-1960 The Crisis of Legal Orthodoxy*, Oxford : Oxford University Press, 1992, p. 34

⁶. Agus Yudha Hernoko, *Op.cit.*, Hlm. 133.

⁷ . Mahkamah Agung Republik Indonesia, Putusan No. 3431 K/Pdt/1985, <http://lib.atmajaya.ac.id/uploads/fulltex/173888/3431%20k-Pdt-1985.pdf>, downloaded on November 24 2014, at 10.00. See also Ridwan Khairandy, *Op.cit.*, p. 314-321.

54,000 (interest) = Rp 194,000,-

- C. The decision of Supreme Court of the Republic of Indonesia No. 1904 K / Sip / 1982 dated January 28, 1984.¹ In this case the judge intervened the engagement when one of the parties as debtor has a very weak position relating to its accounts payable. In the beginning the Plaintiff filed a suit on the base of Sale and Purchase Deed No. 05.02.1978 dated May 8, 1978. The notarial deed postulated the sole owner of a land plot at Jl. Sultan Agung No. 75 Semarang. This lawsuit was filed in connection with the imposition of sequestration over such land by the original plaintiff that is Luhur Sendoro with the original Defendants Oei Kwie Lien, Owen Herman, Dr. Soetardjo, Ny. Mursinah Soetardjo and PT Pramana. The Supreme Court in its decision considered that though the agreement was drafted in a notarial deed, where Mr. Soetardjo (Defendant III) and Ny. Mursinah Soetardjo (Defendant IV) authorized another person, namely Mr. Luluh Sendoro (Plaintiff) to among others, selling a disputed house to a third party and to himself, was considered valid, but given the history of such power of attorney, which previously started from the acknowledgment of debt by pledging the disputed house as it can not paid on time has made him as attorney to sell such house. The agreement was actually an pseudo-agreement replacing the original agreement on debt. As the debtor is also bound with the other debts under court decisions with permanent legal power, placing him in a weak position and suppressed, thus forced to sign the agreements in a notarial deed that is burdensome to him. This later agreement can be classified as unilateral agreement (eenzijdig contract) which was unfair if applied entirely against him.²

The debtor has acknowledged his debts and had pledged his house and authorized the creditors to mortgage the same. it should be deemed that the disputed house had been pledged as collateral to the lender to pay off debts, which for the sake of the justice should have an addition at 2 % per month, commencing as from the date of occurrence of debt. To be fair, the disputed house under a confiscation in other cases must be sold by way of auction for the payment of debts to the other creditors.³

The verdict of the Supreme Court Judges indicated that the Plaintiff had been declared abusing chance in circumstances or difficult economic position or heavily indebted situation, that the defendants were involuntary (not because of their own will) signed the sale and purchase deed as a replacement certificate for such accounts payable. This can be said as an improper achievement.

3. Analisa Putusan-Putusan Pengadilan

Dari beberapa putusan-putusan Mahkamah Agung (MA) RI tersebut diatas yaitu dalam Perkara No. 1253 K/Sip/1973 tanggal 14 Oktober 1976, bunga yang diperjanjikan 20% diputus oleh MA menjadi 10%. Sedangkan Putusan Mahkamah Agung Republik Indonesia No. 3431 K/Pdt/1985 tanggal 4 Maret 1987, bunga yang diperjanjikan 10% diputus oleh MA menjadi 1%. Serta Putusan Mahkamah Agung RI No. 289 K/Sip/1972, tanggal 22 Juli 1972, bunga Based on the foregoing, the Supreme Court decided that the extremely high rate of interest indicated injustice and impropriety. Therefore, in a contract the fairness principle has a very important role. This is consistent with the argument posed by Ian Mcleod which states that contractual obligations requires division of liabilities on the base of fairness principle.⁴ This principle means that the contract must be made with due regard and attention to the reasonable interests of the other parties in the agreement, as the contract is made not only for a single party.

The free contracting principle is closely associated with the good faith principle and equity principle. In assessing the good faith the judge must consider propriety and fairness. Each contract must be based on Pretium iustum referring to reason and equity and good faith as well, that the contract requires a balance between costs and benefits for both parties in the contract.⁵

The case also indicated that the judge appeared to have interfered with the content of the agreement in case of impropriety and unfairness, by changing the amount of interest payable though it was clearly defined in the contract. Under the equity principle the judge may assess whether an agreement can be implemented rationally and appropriately. The judicial practices in Netherlands has developed at a point where the contract execution should be based on rationality

¹ . Mahkamah Agung RI, Putusan No. 1904 K/Sip/1982, <http://putusan.mahkamahagung.go.id/putusan/downloadpdf/f149813/pdf>, downloaded on November 25 2014, at 11.25 Wib.

² . *Ibid.*

³ . *Ibid.*

⁴ . Ian Mcleod, *Legal Method*, London, Macmillan Press Ltd, 1996, p. 212

⁵ . Harold J. Berman, *Law and revolution, The Formation of Western Legal Tradition*, Cambridge, Harverd University Press, 1999, p. 246

and propriety.¹

When linked with the function of good faith in the implementation of the agreement, after the judge assessed irrationality or impropriety of achievements, the judge may waive or reduce the contractual obligations, that these achievements become rational and proper. The judge is allowed to reduce the interest agreed in the contract. However, the function of good faith principle can only be used in particular circumstances, in case the implementation of the agreement may lead to impropriety and unfairness.

The linkage among the free contracting principle, *pacta sunt servanda* principle, equity principle and good faith principle in contract law applied in Indonesia, especially related to examining factors for the implementation of the agreed matters, that is in the event of good faith of the parties is set out in Article 1338 paragraph 3 of the Civil Code. The application of Article 1339 of the Civil Code as a form of implementation of the equity and fairness principles. The substance of Article 1339 of the Civil Code shows the importance of propriety (equity, *bilijkheid*) in relation to the contents of the contract made by the parties.

Henry Panggabean argued on the Supreme Court's decision No. 3431 K / Pdt / 1985 dated March 4, 1987, that the judge in making the decision had used the doctrine of misuse of condition (*misbruik van omstandigheden*), which represents some sort of opportunism of the creditor against the debtor. In This case there is great possibility of misuse of condition begun with unequal bargaining position in both economic and social areas, causing unequal contracting process.²

While in the Supreme Court Decision No. 268 K / Sip / 1971 dated August 25, 1971. In the Decision of Bandung High Court it appeared that the judge have applied the principles of propriety and fairness (*naar redelijkheid en bilijkheid*) in his decision. Therefore, propriety and fairness institutions are of the public order (*van openbare order*), then if such propriety and fairness are not included in the agreement, the judge may change its content beyond what has been expressly agreed by the parties. The Bandung High Court considered that the Defendants as a civil servant (PNS) only got a small pavilion house, whereas the plaintiff who was a private person obtain larger main house, though in this case the Plaintiff was the one paying the house.

Unlike the decision of the Supreme Court which had given judgment that Plaintiff have larger family of 6 people that it is reasonable to get larger main house and the Plaintiff was also the one paying such house, while the Defendant only had less family members of 3 people, that it is reasonable that he hgot much smaller pavilion. On this basis, the appeal judges would have to apply the equity principle. The equity doctrine consider important aspects such as good faith, the parties' intentions, situations or circumstances and other aspects.³

The Supreme Court's decision N0. 1904 K / Sip / 1982 dated January 28, 1984. The Judge has intervened the agreement made by the parties, as one of the parties had a very weak position as debtor. The debtor as the defendant borne so many debts and hard economic situation, thus forced to sign sale and purchase deed to substitute credit loan deed as the original agreement. With this history or pre-contract phase, the judge considered that the Plaintiff had the opportunity to take economic advantage and had misused the condition (*misbruik van omstandigheden*).

Based on the foregoing court decisions, the propriety and fairness principles, good faith principle, the doctrine of equity or equilibrium, and the doctrine of misuse of condition (*misbruik van omstandigheden*) have been taken as consideration to the judge in order to remedy and balance (*misbruik van omstandigheden*) a contract of no equity for the parties. Though the Civil Code does not explicitly regulate the principle of good faith and the principle of equity and the principle of misuse of condition, but the provisions relating to contract law in Indonesia are implicitly contained. However the contract law in Indonesia must have been set these important principles clearly and firmly.

Today the *pacta sunt servanda* principle is no longer have the element of absolute power and continually binding, due to exemptions by the other law principles. For example, the presence of fundamental change, the absence of equity in the contract that violates propriety / decency and unfair self enrichment. The basic concept of release of liability policy is widely adopted by some countries but there are differing implementation in each individual country.

¹. Agus Yudho Hernoko, *Op.cit*, p. 5

². Henry Panggabean, *Penyalahgunaan Keadaan (Misbruik Van Omstandigheden) Sebagai Alasan Baru untuk Pembatalan Perjanjian*, Liberty, Yogyakarta, 1991, p. 58

³. O. Notohamidjojo, *Masalah : Keadilan*, Semarang, Tira Amerta, 1971, p. 27

The agreement contains binding power, but the binding shall not be limited to what have been agreed, but also to other elements insofar desired by customs, propriety and moral.¹

What about the *pacta sunt servanda* principle in long-term contracts signed by the Indonesian Government and PT Freeport Indonesia? The contract of work that has been signed by the Indonesian Government and PT Freeport Indonesia is binding in accordance with the *pacta sunt servanda* principle for a period of 30 years, but as the analysis shows, the content is much adverse the government and weaken its position. It is obvious that the contract of work which contains rights and obligations of the parties is not fair, likewise the benefits and proceeds obtained by the parties. Therefore, on account of the applicable common law principles and legal doctrines such as good faith principle, unconscionality doctrine (unequal condition) and unjust enrichment doctrine, the meaning of *pacta sunt servanda* principle contained in the work contract is not absolute, but has shifted that the court may alter and interfere with the content of the contract made by the parties and allow the judge to waive some clauses or entirety of the contract as it contradicts the conscience of a judge and the justice.

These unequal clauses containing rights and obligations of the parties can be described as follows:

1. The Company is the sole contractor or the exclusive contractor for the Grasberg quarry in Tembagapura, Irian Jaya (now Papua Province) and the company shall assume the sole management and monitoring to all mining activities (Article 2, paragraphs 1 and 3). That the government should not permit another mining company to mine in the same area in Ertzberg Papua and the Government shall not participate in the corporate management of PT Freeport Indonesia.
2. The Company may at any time waive all or any part of the contracted territory (Article 4, paragraph 5) and is allowed to terminate at any time the exploration which is considered as no longer having commercial prospects (Article 6, paragraph 2). Despite that the Government has held the guarantee of minimum charge for the general investigation and exploration, but the contract of work does not provide that the company would also have to restore the environment ravaged by Freeport after exploration, such as digging, dredging and drilling. Thus, shall not leave the environment that it has already explored.
3. Freeport company shall obtain Intellectual Property Rights (IPR) in the formulation of Article 7 paragraph 6 letter c in the work contract as follows: "The exclusive know how owned by the company, subcontractors or affiliates contained in the data or reports submitted by the company to the Ministry or the Government in accordance with the provisions of this agreement, shall only be used by the Government in relation to the implementation of this agreement and shall not be disclosed to any third parties, without the prior written consent from the Company. Such exclusive know how, insofar remains the exclusive knowledge of the company shall remain become the sole property of the company. The provisions of paragraph c of this agreement shall apply upon the termination of this Agreement in accordance with applicable legislation from time to time in connection with intellectual property rights. In the case of an exclusive know how can not be patented in accordance with the law, the company may ask the government to not to disclose this knowledge for a period of not less than three years following the termination of this agreement".²
4. The Company shall fully control and manage all matters relating to the company's operations including the production and marketing of its products. The Company shall also have the right to choose the vessel and other transportation facilities in connection with the importation of mining products (Article 10 paragraph 8 and 10). This makes the production and marketing under the full control of PT Freeport Indonesia as the government know nothing as to the quantity of minerals taken from the earth of Papua Erstberg abroad overseas for huge benefits.³
5. The Company shall have the right to enter into long-term contracts to sell its products to any third parties without the Government's consent. This is to secure the company's finance and to fulfill its obligations to the lender under this agreement (Article 11, paragraph 3).
6. Article 13 on tax and other corporate financial obligations such as royalty. Since the first contract of work in 1986 until the signing of the second-generation contract of work for copper royalties in 1991 amounted to 1.5% - 3.5%, for silver and gold amounted to 1% from the net sales instead of gross sales revenue (gross avenue). This percentage is extremely low, when we compare the same case in African countries such as Botswana, Ghana Tanzania, and Latin America countries such as Argentina, Bolivia and the Dominican Republic. Making PT Freeport's production cost as the cheapest in the

¹. Mariam Darus Badruzaman, *Kompilasi Hukum Perikatan*, Bandung, PT. Citra Aditya Bakti, 2001, p. 117

². Pemerintah Indonesia dan PT. Freeport Indonesia Compeny, *Kontrak Karya*, Jakarta, 1991, p. 8

³. Mohammad Amien Rais, *Agenda Mendesak Bangsa Selamatkan Indonesia.*, Yogyakarta, PPSK Press, 2008, P. 268

- world compared to the other countries. Freeport earns the largest benefit from its mining production.¹
7. The Company and its experts can freely save their monies outside Indonesia and shall not save it with the Bank of Indonesia and shall not convert them to rupiah (Article 15). This is detrimental to Indonesian banks, as much monies are saved in foreign banks abroad.
 8. The Government will help the company to re-allocate the residence of local people from any part of the contract area Block B or any protected areas and the Company will pay for the re-allocation and provide adequate compensation for any the settlement and personally owned including land ownership based on customary law which commoly in force (Article 18, paragraph 3). Then the government shall prioritize the interests of foreign corporations compared with the national interest at the expense of local communities, protected lands for the benefit of the nation are sacrificed and likewise the lands belonging to local customary law communities.

9. Article 20 on Default.

If the company is known to have failed in the implementation of a provision in this agreement, the company shall rectify such failure within a period of 180 days. If time to correct such failure expires, the government will close the mining areas and the company will pay a sum of money to the Government. This clause does not contain any no provision which states clearly that the Government may terminate on a contract that is binding the parties if the company fails to meet its obligations.

10. Article 21 on Dispute Settlement.

In the event of a dispute the parties will resolve it by way of consensus for conciliation in accordance with the provisions contained in the UNCITRAL conciliation provision 35/52 adopted by the United Nations General Assembly on December 4, 1980. Meanwhile, if the parties settle the dispute by way of arbitration it will use UNCITRAL rules contained in the provisions of 31/98 adopted by the United Nations (UN) General Assembly on December 15, 1976. Therefore, if the arbitration is taken by the parties to resolve dispute for they use of UNCITRAL Rules in The UN General Assembly then the place for dispute settlement will be the United States, the place of PT Freeport's Holding Company, where the company resides.

The government should be able to insist on using BANI arbitration to resolving disputes in Jakarta, Indonesia.

11. Article 22e paragraph 1 on Termination.

. "At any time during the term of this agreement, after exerting all efforts to carry out activities under this agreement, if the Company declares that the Company is unable to work, the company will consult with the Department and thereafter may submit a written request to terminate this agreement and discharged from all obligations under this agreement ". The provisions of this Article, is obviously unfair and unbalanced in terms of rights and obligations of each party. There should be another provision regulating that the Government may terminate the agreement in case of the company defaults.

12. Article 23 paragraph 3 on Cooperation of The Parties.

The Ministry on behalf of the Government agrees that during the term of this agreement. The Government in accordance with Law No. 1 of 1967 concerning Foreign Investment (i) shall not take any action inconsistent with the provisions of this Agreement, including without limitation any act of confiscation or nationalization of the Company or any part thereof, and (ii) at any time will cooperate with the Company in handling all administrative actions and rulings relating to exploitation in the best manner in accordance with the required procedures ".² Pursuant to Article 23, paragraph 3 above, the Company is greatly benefited as the government is unable to use or implement legislation that the new Mining Law No. 4 Year 2009 on Mineral and Coal Mining. This is because the company is not subject to any divestment requirements as mandated in Article 112 of Law No. 4 Year 2009 on Mineral and Coal Mining but rather refers to the provisions of the contract of work. The contract of work does not regulate the share divestment, as the contract of work for the company serves as holy book that is unchangeable, because the nature of the contract is nail down which means the contract shall not follow developing rules or regulations (permanent). The government also can not take any action inconsistent to not to nationalize the company.

The Indonesian Government must dare to renegotiate the executed contract of work, since the contract only provides one sided benefits and unfair. The government need not to afraid the threat posed by PT Freeport Indonesia to bring the dispute to international arbitration. Do not fear that if the Indonesian Government loses, the entire asset of Indonesia will be at stake. The Indonesian Government shall stand as sovereign state, in the sense that she must govern the entire nation's wealth

¹. *Ibid*, p. 266-267.

². Pemerintah Indonesia dan PT. Freeport Indonesia Compeny, Kontrak Karya, Jakarta, 1991, p. 106

for the benefit and prosperity of the Indonesian people as mandated in Article 33 UUD 1945 which further regulated in the Consideration of the Law No. 4 Year 2009 on Mineral and Coal Mining. It is stated that the management of mineral and coal should be under the powers of the State to provide significant value-added to the national economy for the people's prosperity and welfare equitably. Likewise the government shall play important role in providing significant added values to national and regional economic growth and development in a sustainable manner.¹

Contract law in Indonesia that is still referring to the Book III BW should immediately transform the principles of the new positive contract law in Indonesia such as providing good faith principle which implications have shifted and the equity principle, rebus sic stantibus principle, unjust enrichment doctrine that are not yet regulated in the Indonesian contract law. Hence foreign investors will be able to see that the Indonesian contract law is open for transformation or termination in case of the absence of propriety and fairness in the contract.

D. Conclusions

Recently the pacta sunt servanda principle is no longer have an absolute meaning as a principle binding the parties signing the contract. The implications have shifted. The parties to the agreement shall not observe limitedly to what have been agreed, but shall also consider the other factors desirable according to the customs, decency and morality. The enactment of pacta sunt servanda principle is also limited by the law principles such as the rebus sic stantibus principle, unconscionality doctrine (unbalanced condition) and unjust enrichment doctrine.

The Court is allowed to modify and interfere with the contents of the contract made by the parties, executed and binding in accordance with pacta sunt servanda principle and enables a judge to waive some clauses or the entirety of the contract as it produces results contradictory to the judge's conscience and the justice. Moreover for the long term contracts it is possible that one of the parties to modify or cancel the contract, if such contract provides unbalanced costs and benefits to the parties. There are several cases in Indonesia and overseas relating to have the shifted implications of pacta sunt servanda principle.

E. Recommendations

1. The Government must consider long-term contracts (longitudinal contracts) in terms of exploitation and use / utilisation of natural resources for the benefit of the society and its social functions. The long-term contracts should consider the amount of earnings, prosperity, justice on the base of Pancasila.
2. The government shall immediately revise the Civil Code (BW) draft primarily in relation to contract law in Indonesia. The amendment shall regulate the new law principles into positive law under the Indonesian contract law as the good faith principle of which definition has been changed, as well as the equity principle, rebus sic stantibus principle, jus cogens principle, unjust enrichment doctrine which are not yet regulated in the Indonesian contract law. In turn, foreign investors will be able to see that the contracting law in Indonesia is open for amendment or termination in the presence of impropriety and and unfairness in the contract.
3. The Government shall establish institutions such as the Constitutional Court, that all long term contracts and related to the lives of many people such as oil and gas mining contract should first be verified by the institution taking into account the values of Pancasila such as sustainability, integrity, harmony, balance, decency, fairness and the greatest benefit to society.

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