

# Indonesia's construction sector – from the ground up

June 2016



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# Introduction

## Background

This note serves as a basic introductory overview on the Indonesian construction sector. The attached schedules provide further details on requisite licences that are generally required for a construction company, as well as the revised Negative Investment List that was promulgated on 18 May 2016 ("**List**").

## Construction sector in Indonesia

Indonesia is one of the most populous countries in the world, and has a rapidly growing economy. In order to promote and sustain growth, the Indonesia government has promoted infrastructure development. The 15-year Master plan for Acceleration and Expansion of Indonesia's Economic Development (MP3EI) launched in 2010 outlines IDR 4,000 trillion worth of investment in key economic sectors, with approximately half envisaged to be channelled into infrastructure. The government also promulgated on 18 May 2016, the new List which has relaxed restrictions on foreign investors in certain areas, thus further liberalising the construction sector. Please see Schedule 2 for further details.

## Establishing a commercial presence

There are two possible ways for a foreign construction service company to establish a commercial presence in Indonesia:

- (a) A foreign investment company ("**PMA company**"); or
- (b) A foreign construction representative office ("**Badan Usaha Jasa Konstruksi Asing / BUJKA**").

PMA companies and BUJKAs can only carry out construction projects if they are considered to be high risk, high cost or if the project requires a certain type of technology which the PMA company / BUJKA possess.

The appropriate form of legal entity would depend on several factors including the time that can be afforded to incorporate the corporate vehicle, the extent to which the foreign investor is willing to collaborate with domestic companies and whether the foreign investor is able to obtain the requisite licences.

## *PMA companies*

A PMA company does not need to enter into a joint operation with domestic companies and can carry out projects independently. A PMA company is also entitled to various exemptions such as import duty, withholding tax, and VAT exemptions.

However, a PMA company will be required to obtain the requisite construction licences. Please refer to Schedule 1 for a list of the key licences that a construction company would generally be expected to obtain.

Further, there are maximum shareholding requirements. Under the new List, for a PMA company performing construction execution or consultancy services, the maximum foreign shareholding is currently 67% (70% for ASEAN investors).

It will take around 10 months for a PMA company to be incorporated (including obtaining all the necessary operating licenses such as those listed in Schedule 1).



## **BUJKA**

Usually, the BUJKA only has to procure an SBU and a BUJKA Licence; the other licences can be held by its domestic partner ("**Badan Usaha Jasa Konstruksi / BUJK**"). A BUJKA takes around 6 months to be incorporated (including obtaining all the necessary operating licenses such as those listed in Schedule 1), which is significantly faster than the incorporation period required for the PMA company. However, it has to meet the following management requirements:

- (a) A BUJKA is required to enter into a joint operation (essentially an unincorporated joint venture) with an Indonesian construction company, the BUJK;
- (b) The BUJK has to perform at least 30% of the work value for construction execution services and at least 50% of the work value for construction execution services must be performed domestically. For construction consultancy services, the BUJK has to perform at least 50% of the work value for the construction consultancy services and all the construction consultancy services must be performed domestically; and
- (c) Unless a waiver is obtained from the Ministry of Public Works, the BUJK must be 100% owned by one or more of the following: Indonesian citizens, the Republic of Indonesia, a regional government in Indonesia, domestic private-owned enterprise, state-owned enterprises and/or regional-owned enterprises.

## **Regulatory regime**

Construction services and licences in Indonesia are regulated by Law No. 18 of 1999 on Construction Services and Government Regulation No. 28 of 2000, last amended by Government Regulation No. 92 of 2010, concerning Roles and Participation of the Construction Services Community ("**Construction Services Law**").

Apart from the Construction Services Law which generally applies to all construction projects, sector-specific regulations may apply under separate legal regimes.

For example:

- (a) Contractors under production sharing contracts (in the Indonesian upstream oil and gas sector) are also subject to specific requirements overseen by the Special Task Force For Upstream Oil and Gas Business Activities ("**Satuan Kerja Khusus Pelaksana Kegiatan Usaha Hulu Minyak dan Gas Bumi / SKKMigas**"), as described in prevailing laws and regulations from the Minister of Energy and Mineral Resources; and
- (b) A project company in the framework of public-private partnership projects would also be subject to Presidential Regulation No. 38 of 2015 concerning Cooperation Between the Government and Business Entities in the provision of Infrastructure Procurement and Regulation of the Minister of National Development Plan No. 4 of 2015 on Public Private Partnership Procedures.

Construction services fall under the supervision of the Ministry of Public Works which has the authority to set out regulations on construction business activity in Indonesia.

## **Types of construction services**

By regulation, construction services are divided into:

- (a) Construction consultancy services which include surveys, general planning, feasibility studies, operational and maintenance planning, and research;
- (b) Construction execution services which cover physical construction work; and
- (c) Construction supervisory services which include supervising construction execution services, quality assurance and process.

## Construction contracts

We set out below certain key contractual issues relevant to a construction contract.

### *Liability*

Indonesian law generally permits parties to contractually agree to limit their liability (for instance, consequential loss exclusions, liquidated damages clauses and liability caps).

There are however exceptions to this general rule. For example, certain kinds of liability, such as criminal negligence, cannot be contractually excluded. It should also be noted that the Construction Services Law provides for the decennial liability of construction service providers, namely that the provider of the construction services will remain liable for construction defects within a period of 10 years after which construction has been completed.

Any exclusions and/or limitations should also not be against public policy.

### *Governing law*

Construction contracts relating to projects in Indonesia are required to be governed by Indonesian law.

One area in which there has been regulatory uncertainty pertains to offshore construction consultancy services contracts relating to construction projects in Indonesia. It should be noted that the current regulatory treatment of such offshore contracts is ambiguous, but a broad interpretation of the regulations would require such offshore contracts to be governed by Indonesian law.

### *Language*

The Minister of Law and Human Rights has stipulated in Letter No. M.HH.UM.01.01-35 of 2009 on Clarification Request of Implications and Implementation of Law 24/2009 that, among other things, failure to implement a contract (involving an Indonesian private entity as a party) in Bahasa Indonesia does not invalidate the contract and that, in the case of a contract executed in English and Bahasa Indonesia, the parties are free to agree that the English version will prevail in the case of any discrepancy between the two versions of the contract.

However, there is jurisprudence issued by the Indonesian courts stating that the failure to execute such a contract in Bahasa Indonesia results in the contract being invalid.

As such, it is recommended for all contract documents involving Indonesian legal entities to be prepared in Bahasa Indonesia (and English, if required).

### *Currency*

Pursuant to Law No. 7 of 2011 on Currency:

- (a) Payment transactions;
- (b) Settlement obligations using money; and
- (c) Other transactions;

that take place within Indonesia, are to be in Indonesian Rupiah (“**Rupiah**”) unless an exemption applies.

Pursuant to Bank Indonesia Regulation Number 17/3/PBI/2015 on Mandatory Use of the Rupiah Currency within the Territory of the Republic of Indonesia, it is possible to apply to Bank Indonesia for an exemption to use the Rupiah in respect of contracts relating to strategic infrastructure projects. The relevant ministry needs to confirm that the contract relates to a strategic infrastructure project, and Bank Indonesia has the discretion to approve or reject such an application.



## Employment

The Indonesia Law No. 13 of 2003 on Labour generally applies to all employees working in Indonesia. This would include foreign employees as well as foreign secondees (although it should be noted that foreign secondees are regarded as employees of their host company under Indonesian law).

A foreign worker employment plan ("**Rencana Penggunaan Tenaga Kerja Asing / RPTKA**") needs to be drawn up by the business entity, following which a foreign worker employment permit ("**Izin Menggunakan Tenaga Kerja Asing / IMTA**") needs to be obtained. The business entity hiring the foreign workers will also need to arrange the visa recommendation, limited stay visa, limited stay permit card and multiple exit re-entry permit (as applicable).

There are currently no across-the-board minimum employment quotas for local employees, although restrictions may apply in certain sectors such as oil and gas.

Further, if a PMA company or a BUJKA employs foreign workers, it must also employ an Indonesian worker of the same management and technical level as a counterpart to the expatriate. It should be noted that there are time limits in the employment terms of foreign workers employed under certain construction-related roles in the oil and gas sector, including the following:

Role	Time limitation (months)
Construction manager, technical manager, design & construction specialist	36
Chief engineer, chief of design engineering, maintenance / electrical / mechanical / instrument specialist	24
Senior hydrographic surveyor, welding specialist	12

There are now no longer any requirements placed on foreign workers to have the ability to communicate in Bahasa Indonesia.



## Schedule 1 – Licensing

We list below some of the key licences that are generally required to be obtained by a construction company.

The below licences only represent some of the basic licences that a construction company may be required to obtain. Specific licences may be required for particular areas of construction. For example, an Electricity Supporting Business License ("**Ijin Usaha Jasa Penunjang Tenaga Listrik / IUJPTL**") is required for providing construction services in the power plant sector, and Registered Certificate of Oil and Gas ("**SKT Migas**") for providing construction services in the oil and gas sector.

### *Incorporation-related licences*

- (a) An In-Principle Permit from the Badan Koordinasi Penanaman Modal ("**BKPM**") – this license must be obtained by a PMA company to initiate its investment in Indonesia;
- (b) A business entity certificate ("**Sertifikat Badan Usaha / SBU**") – an SBU certifies the types of services which the business entity is able to provide, and the kind of projects which the entity is able to undertake;
- (c) A relevant certificate of expertise ("**Sertifikat Keahlian / SKA**" or "**Sertifikat Ketrampilan / SKT**") – a business entity is required to hire experts holding an SKA/SKT in respect of the types of services to be provided by the business entity;
- (d) Membership in a relevant construction association – the relevant construction association would depend on the types of services to be provided by the business entity; and

- (e) A construction services licence ("**Izin Usaha Jasa Konstruksi / IUJK**") – an IUJK can be granted in respect of one or multiple type(s) of construction services, and generally does not have geographical restrictions. For PMA companies, the IUJK is now processed and issued by the BKPM.

### **Environmental licences**

The business entity would have to acquire an Environmental Licence, and either go through the Environmental Impact Analysis ("**AMDAL**") or Environmental Management Efforts and Environment Monitoring Efforts ("**UKL-UPL**") process.

The AMDAL process applies to businesses that will have a significant environment impact. The applicant must submit a Terms of Reference, an Environmental Impact Statement (AMDAL) and an Environmental Management Plan and Environmental Monitoring Plan (RKL-RPL), which must be prepared by a certified AMDAL consultant.

The UKL-UPL applies to all other businesses. A UKL-UPL consists of a prescribed form which the applicant has to fill in, describing its activities, the environmental impact and its proposed environmental program.



## Import licences

If the imported construction materials/equipment will be re-distributed, the business entity should apply for a General Importer Identification Number ("**Angka Pengenal Importir Umum / API-U**"). However, if the construction materials/equipment will be utilized by the business entity, then the business entity should apply for a Producer Importer Identification Number ("**Angka Pengenal Importir Produsen / API-P**"). In addition to an API-U or API-P, a Customs Identification Number ("**Nomor Induk Kepabeanan / NIK**") needs to be obtained.

The common practice in Indonesia is that if the materials/equipment will be owned by the employer or form part of the project, the employer will be responsible for importing such materials/equipment using its own import licenses. Otherwise, if the materials/equipment are only used during the construction phase or will not form part of the project, the contractor will be responsible for the importation. This arrangement may differ depending on the fiscal/tax incentives (eg. import duty exemptions) available to the parties.

There is no mandatory requirement to give preference to local goods and services. However, if locally-produced machinery constitutes at least 30% of the total machine value for the construction and development works, there may be import duty exemptions for the importation of machines, goods and materials.



## Schedule 2 – Negative investment list

The List is a list of sectors which are closed to foreign participation or open with conditions. The most recent revised List was published as President Regulation No. 44 of 2016. Key changes to the List are described below.

It should be noted that the List does not apply retrospectively in respect of activities for which approval was previously obtained before a revision to the List. This principle is referred to as the grandfather principle.

### Liberalisation of certain sectors

Several sectors have become fully open to foreign ownership (ie. removed from the List) or have had their respective percentage of permitted foreign ownership increased.

Construction and projects related sectors that have been affected include:

Sector	Previous Foreign Ownership Limit	New Foreign Ownership Limit
Toll roads	95%	100%
Non-hazardous waste management	95%	100%
Construction execution services with project value over IDR50 billion	67%	70% for ASEAN investors; 67% for other investors
Construction consultancy services with project value over IDR10 billion	55%	70% for ASEAN investors; 67% for other investors





## Closure of certain sectors

On the other hand, certain sectors have become completely closed to foreign ownership. Such closure may not be as significant to foreign investors as it appears that the sectors which have been affected generally relate to small-scale agricultural or craftsman industries. The rationale behind closing these sectors largely concerns the protection of small medium enterprises ("SMEs").

Construction and projects related sectors that have been affected include:

Sector	Previous Protected Limit	New Protected Limit
Construction execution services	Up to IDR1 billion	Up to IDR50 billion
Construction consultancy services	-	Up to IDR10 billion

As evinced, there has been an increase in the existing limit of work value of construction projects that may only be performed by SMEs

## Moving forward

Overall, as the trend generally appears to be towards greater liberalisation, foreign investors may wish to consider whether there may be any new investment opportunities worth exploring, and whether or not to increase their shareholdings in existing projects.



## For further information

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