NEWSLETTER

NISHIMURA & ASAHI

Indonesia: Statutory liabilities in the case of building failure

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1. Introduction

In construction projects, the nature and type of defects can vary dramatically, as can the point in time at which they become apparent, and the liabilities of the contractor with regard to the defects. As detailed below, Indonesian law imposes statutory liability both on employers and contractors regarding "building failure", which cannot be avoided by the construction contract between the two parties. In order to manage the risk of the contractor related with its liabilities toward the defects, it is crucial to first distinguish between **building defects** and **building failure**, as the provisions and treatment for these matters differ significantly.
In this article, we will focus on the regulation of contractor liabilities in the case of building failure.

2. The Concept of Building Failure under the Indonesian Construction Service Law

Indonesia's current Construction Service Law is provided for under Law No. 2 of 2017 on the Construction Service, last amended by Government Regulations in Lieu of Law No. 2 of 2022 on Job Creation ("**Law No. 2**"), effective from 12 January 2017.

Generally after the issuance of Law No. 2, all provisions under Law No. 2 apply to construction work in Indonesia, including the provisions on building failure as summarized below, which also apply to buildings completed in 2017 or thereafter, especially if building failure took place after the issuance of Law No. 2, i.e., on 12 January 2017. It is important to note, however, that the concept of building failure was initially introduced in the first Indonesian construction law, Law No. 18 of 1999 on Construction Service (dated 7 May 1999, "**Law No. 18**"), which was later revoked by Law No. 2. Building failures that occurred prior to the enactment of Law No. 2 are subject to the provisions of Law No. 18.

As with Law No. 18, Law No. 2 recognizes the concept of building failure, and defines **building failure** as **collapse** and/or **malfunction** of a building after the final handover/delivery of the building.

While Law No. 2 does not offer an explicit explanation regarding building defects, generally a **building defect** is understood as a shortfall in the architectural or structural design process, resulting from a failure to design or construct the building in a reasonably adept manner, aligned with the employer's reasonable expectations. Building defects do not necessarily render a building unusable. This distinguishes them from building failures, where a "collapse and/or malfunction" of the building results in the employer being unable to use the building; however, a building defect can lead to a building failure.

Based on Law No. 2 and MPWH Regulation No. 8 of 2021 on Expert Appraisers, Building Failure and Assessment of Construction Building Failure ("**Reg No. 8**"), which is the implementing regulation of Law No. 2 on building failure:

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(a) building failure will be determined by an appraiser[1] who will be appointed by the Minister of Public Works and Housing ("**MPWH**");[2]

(b) the MPWH must appoint the appraiser no later than 30 (thirty) working days from the receipt of the report on the occurrence of the building failure;[3]

(c) the appraiser must issue the assessment report to the MPWH through the Construction Services Development Board (*Lembaga Pengembangan Jasa Konstruksi*), as well as the relevant stakeholders no later than 90 (ninety) working days from the date of his appointment, which report shall include, among other things, causes of the building failure, determination of the amount of losses, as well as proposals for the amount of compensation that must be paid by the responsible party, determination of the party responsible for the building failure and the period of repair and payment of losses;[4]

(d) the appraiser's fee shall be borne by the party who is at fault for the building failure based on the appraiser's report;[5]

(e) the service provider (read: the contractor) shall replace or repair the building failure if it results from its fault in the event that the Construction Services do not meet the standard of Security, Safety, Health, and Sustainability;[6]

(f) the contractor shall be liable for the building failure within the period determined in accordance with the construction lifespan plan, i.e., the period during which the contractor is responsible for building failure;[7]

(g) in the event that the construction lifespan plan is more than 10 (ten) years, the contractor shall be liable for the building failure within a maximum period of 10 (ten) years after the date of final delivery of the building;[8]

(h) the service user (read: the employer) shall be liable for the building failure that occurs after the period during which the Contractor is responsible;[9]

(i) **the provision period of liability for the building failure as outlined in points (f) and (g) above must be stated in the construction work contract**;[10] and

(j) the appraiser's assessment report shall be final and binding on the parties, and there are no specific procedures available to dispute such an assessment report.[11]

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[1] Article 60 (2) of the Law No. 2.

[2] Article 60 (3) of the Law No. 2.

[3] Article 60 (4) of the Law No. 2.

[4] Article 61 (2)e of the Law No. 2 and Article 38 (5) of the Reg No. 8.

[5] Article 30 (2) of the Reg No. 8.

[6] Article 60 (1) in conjunction with Article 63 of the Law No. 2.

[7] Article 65 (1) of the Law No. 2.

[8] Article 65 (2) of the Law No. 2.

[9] Article 65 (3) of the Law No. 2.

[10] Article 65 (4) of the Law No. 2. - Law No. 2 does not specify the consequences for failing to include this information. Despite this ambiguity, arguably it is understood that the designated liability period adheres to the standards set forth in Law No. 2, although in practice, it is possible that the contractor may argue that the absence of a designated liability period for building failure implies that such period will only follow the maintenance period indicated in the construction agreement, even if such period only refers to building defects.

[11] Article 38(4) of the Reg No. 8.

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3. The Concept of the Building Defects under the Indonesian Construction Service Law

Law No. 2 and its implementing regulation, namely Government Regulation No. 22 of 2020 as amended by Government Regulation No. 14 of 2021 do not specifically regulate building defect treatment. Instead, this provision depends on the parties' arrangement in the construction agreement.

Under Article 47(1).c of Law No. 2, the liability of the contractor, including any maintenance period and the obligations of the contractor, shall be included in the construction contract between the contractor and the employer/owner. Therefore, **generally**, the scope of contractor liability (read: its obligations to rectify the defect) including the liability period will be **subject to the relevant construction contract**.

Unlike building failure, there are no specific provisions in Law No. 2 and its implementing regulations on the liability period of the contractor concerning building defects.

In practice, we understand that the liability period for building defects is not too long and, in most cases, is usually within the range of three to six months after the handover period and, in some uncommon cases, up to 12 months. As the determination of such liability periods will depend on the agreement of the parties to the construction contract, such liability periods may vary on a case-by-case basis. Generally, there are no specific guidelines under the prevailing laws and regulations regarding the determination of defects liability periods.

4. Whether the Contractor also will be liable for monetary claims outside the Indonesian Construction Service Law

As provided by Law No. 2 and summarized in Section 2 above, in the case of building failure that results in losses and damages to the employer, the contractor is legally obligated to indemnify the employer. This indemnification may include providing compensation to the employer based on the appraiser's report, which includes, among other things, an assessment of the extent of the losses and recommendations for the compensation amount that should be paid by the party responsible.[12]

The appraiser's assessment report is final and binding on the parties and there are no specific procedures to dispute such an assessment report. However, if a party wishes to claim for further compensation from the other party, it is a common Indonesian dispute practice for the aggrieved party to initiate a lawsuit against the contractor in the dispute settlement forum specified in the construction agreement, and it is possible that a court may consider such an argument.

Under Indonesian law, specifically the Indonesian Civil Code ("**Civil Code**"), a civil claim for the compensation must be based on either (a) a breach of contract (*wanprestasi*); or (b) an unlawful action (similar to torts / *perbuatan melawan hukum*). The possible remedies are explained in more detail below.

Breach of contract

A civil claim based on breach of contract can be made if there is a specific relationship between the parties under the construction agreement and the claim originates from such breach of agreement; for instance, the liability of the contractor for the building failure has been included in the construction agreement and the contractor fails to comply with it.

[12] Article 31 (3) and Article 38 (2) of the Reg No. 8.

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Breach of contract claims are regulated by, amongst others, Civil Code Articles 1238,[13] 1239,[14] 1243,[15] and 1267.[16]

Based on these Articles of the Civil Code, it can be concluded that if the debtor does not carry out what has been agreed in the agreement ("**Defaulting Party**"), the Defaulting Party can be declared to have breached the agreement by the creditor ("**Non-Defaulting Party**") and consequently, the Defaulting Party is obliged to compensate the Non-Defaulting Party for **costs, damages and interests**, after the Non-Defaulting Party has issued **a written declaration of default** against the Defaulting Party.

These provisions provide a ground for the Non-Defaulting Party to claim certain rights against the Defaulting Party in the event of a breach of contract, including the right to demand: (a) fulfilment of obligation, (b) compensation, (c) fulfilment of obligation with compensation, (d) termination of the obligation (or the agreement), and/or (e) termination of the obligation (or the agreement) with compensation.

Unlawful act (similar to or known as 'tort')

In addition to a civil claim by the Non-Defaulting Party based on a breach of the agreement, another option for the Non-Defaulting Party is to file a lawsuit against the Defaulting Party on the basis of the underlying unlawful act, relying on one of the following grounds:

(a) Failure to comply with the building failure responsibility provision as provided by Law No. 2

Considering that the responsibility for building failure is provided by Law No. 2, failure to comply with this requirement can be regarded as a violation of Law No. 2. Therefore, for instance, legally, the non-compliance of the contractor regarding standards of Security, Safety, Health, and Sustainability[17] can be deemed unlawful actions. As Law No. 2 provides a maximum statutory liability period for the contractor in the case of building failures, contractual agreements between an employer and a contractor cannot override such statutory liability.

Consequently, in accordance with the provision in Article 1365[18] of the Civil Code, the employer will have the right to claim against the contractor, which "in practice" may include a claim for rectifying the issues and a compensation claim. This provision has been interpreted to allow a range of claims based on almost any **violation of Indonesian law or imprudent behavior**.

(b) The contractor is obliged to compensate for tangible and intangible damages

An employer may claim for:

i. tangible (actual) damages, i.e., the actual losses suffered by the plaintiff due to the unlawful act;

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[13] Article 1238 of the Civil Code provides that the "*debtor shall be declared in default (breach) by an order, or a similar deed, or by the virtue of the obligation itself, when it implies that the debtor shall be in default with only the passing of the stipulated time period*".

[14] Article 1239 of the Civil Code provides that "*every agreement to do something, or not to do something, if the debtor fails to meet his obligations, shall be settled by way of compensation of costs, damages and interests.*"

[15] Article 1243 of the Civil Code provides that the "*compensation for cost, damage and interest for the non-fulfilment of an obligation shall become obligatory, if the debtor, after have been declared default, remains in default in fulfilling the obligation, or in case that the obligation to do a certain act or to give something, can only be performed by the debtor after the lapse of the stipulated time period.*"

[16] Article 1267 of the Civil Code provides that "*the party against whom the obligation is not fulfilled may opt **to compel the counterparty to fulfill the agreement where such fulfillment is still possible**, or demand the termination of such agreement, **with compensation of costs, damages and interests**.*"

[17] Article 60 (1) in conjunction with Article 63 of the Law No. 2.

[18] Article 1365 of the Civil Code provides that "*a party who commits an unlawful act which causes damages/losses to another party shall be obliged to compensate such damages/losses*".

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ii. intangible damages, such as **lost profits** (i.e. those that reasonably could have been expected but for the default), which are claimable provided that the plaintiff can prove them. There is no cap/limitation of liability provided under the Civil Code for intangible damages. However, the court may consider such a limitation based on the contract value, fairness, common practice and public policy; or

iii. compensation in the form of *natura* or return of condition to its original state - as if no default has occurred.

The Civil Code does not limit potential claims submitted based on an unlawful action. In practice, for an unlawful act lawsuit, the plaintiff will normally include the claims above.

5. Actions to Consider

It should be noted by potential parties to such contracts, notwithstanding the defect liability period / defect notification period provided in each construction contract, the employer and the contractor may be still subject to statutory liability, as provided in Law No. 2, in the case of building failure.

Currently, many construction agreements in Indonesia do not include clear provisions regarding the treatment of building failures. To prevent unnecessary disputes between parties, which inevitably will be time consuming and costly if there are defects in a construction project, it is always advisable for the parties to clearly differentiate between building defects and building failure in the construction agreement, along with specific remedies.

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