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ABSTRACT

In his article *Formation of Contract and Contract Law through Multinational Joint Ventures: Indonesia, China and the Third World*,* Orlan Lee is optimistic about the development of a new brand of contract law that will serve the goals of both developing countries eager to utilize the capital and technology of Western firms and multinational businesses interested in expanding their international trade. China and the third world hold promise for future international joint ventures, while experience with Indonesian mineral and petroleum development after nationalization offers guidance from the past.

Applying Western contract law to agreements with socialist governments presents unusual difficulties: title to resources and equipment must remain in the governing socialist nation, and contracts are generally open to ongoing renegotiation. Nonetheless, a "law of the parties" is gradually developing in which the terms of the contract arise from the relative bargaining power of the contracting parties and in turn act as constraints on the exercise of that power. Lee examines Indonesian mineral and petroleum contracts and finds that economic power governs the dealings of the parties rather than either Indonesian or Western contract law. While ongoing negotiation of these development contracts makes foreign investors uneasy, the socialist form of contracting may teach us that ongoing negotiation is cheaper than the ongoing litigation of our own system.

Following the nationalization of industry in Indonesia between 1957 and 1965, foreign investors were stripped of their ownership and contractor status. Instead, they became creditors loaning capital to Indonesia to be repaid by the government from a share of the production. While the Indonesian government could impose this new relationship on existing petroleum producers, the agreements with mineral companies remained "contracts of work" containing many of the provisions of the old concession agreements. This difference in treatment resulted from higher world demand for petroleum and consequent diminished bargaining power of petroleum producers. To attract mineral developers, Indonesia was forced to make tax concessions and give investors title to their equipment.

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* 17 The Int'l Law. 257 (1983).

In the years that followed, joint venture agreements were not governed by dogmatic principles of nationalization or socialism, but rather by the respective economic needs of the parties. As the Indonesian economy faltered and the government sought more foreign investment, it was forced to offer more favorable terms. The Indonesian government became a shrewd bargainer using governmental control of tax rates, royalty payments, export duties and loan guarantees as bargaining chips. Despite the revolutionary values behind its positions, Indonesia was motivated by acute self interest.

The introduction of modern business techniques solidified Indonesia's already strong bargaining position. Gradually, government officials became more aware of Western corporate concerns with investing in and insuring equipment they did not own and in paying both domestic and Indonesian taxes. This awareness helped Indonesia to manipulate the structure of ownership, control, risk and return to certain companies in ways which offered more to favored investors and in turn gave Indonesia more bargaining power.

Lee further demonstrates how the "law of the parties" has operated by looking at three generations of mineral development contracts. In 1967, the government sought to attract foreign investment in minerals by offering very favorable terms to the first investor, followed by hard bargaining with these companies thereby attracted. Indonesia offered one copper developer tax incentives, royalty payments and a favorable contract of work (first generation). Immediately thereafter, Indonesia received mineral contract offers in which it could dictate more of its own terms (second generation).

In the third generation of mineral contracts from 1977 to the present, Indonesia has been able to negotiate even more favorable contracts. This has resulted from a more stable political regime, an improved Indonesian economy, and increasing mineral prices in world markets. Indonesia can impose standardized mineral contracts along with pressure on contractors to train and promote Indonesians. In the third generation, the terms of mineral contracts remain distinct from the favorable petroleum production sharing agreements. However, in practice, the two types of joint venture agreements operate in essentially the same manner. This reflects the increased sophistication and bargaining power of the Indonesian government.

In his final analysis, Lee offers some practical advice to foreign investors who are looking for opportunities in developing socialist countries. He counsels that all terms of an agreement should be clearly defined, thus reflecting his thesis that the "law of the parties" rather than the law of any particular nation applies.

He also makes some suggestions about foreign exchange, domestic tax consequences, the use of local personnel and methods of settling disputes. All these tips are aimed at enhancing the bargaining power of the investor, reflecting Lee's notion that the law of the parties develops from the economic exigencies of each particular case.

In contracting with China and third world countries, economic power will shape the agreement, which in turn will govern the parameters of the ongoing negotiation. Western legal traditions and socialist ideology will play a relatively small role. Although this analysis demonstrates a lack of certainty in the contract itself, it offers the reassurance that at least the participants are parties to terms of their own making.

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