New Currency Law: Effort to Maintain Confidence in Rupiah

On 28 June 2011, the House of Representatives (DPR) passed new legislation on the national currency, the rupiah, which was promulgated as Law Number 7 of 2011 ("Currency Law"). The Currency Law, which entered into immediate effect, was enacted pursuant to article 23B of the Constitution, which requires matters concerning the national currency to be regulated by law.

The enactment of the new legislation seems to signal a determination on the part of the government to enforce the use of the national currency in respect of the vast majority of financial transactions conducted in Indonesia. In doing so, the government argues that this is necessary "to uphold the dignity of the national currency." In this regard, the government is merely resurrecting a provision that was introduced in 1968 by the Central Bank Law (No. 13 of 1968), and which was subsequently superseded by similar provisions of Law No. 23 of 1999 on Bank Indonesia, as lastly amended by Law No. 6 of 2009.

The Currency Law contains provisions governing the physical characteristics of the national currency, currency management, obligations concerning the use of rupiah and the suppression of counterfeiting, as well as criminal sanctions related to the use, counterfeiting, destruction, and forgery of rupiah.

Of particular interest to practitioners and clients is that the Currency Law makes it mandatory to use the national currency for the settlement of all transactions conducted within the territory of the Republic of Indonesia, subject to a number of exceptions. This provision is of immediate effect, meaning that it applies even to obligations agreed on before, but settled after, the coming into force of the legislation.

Requirement to Use National Currency

The Currency Law requires all transactions conducted within the territory of Republic of Indonesia to use rupiah.

Article 21 of the Currency Law stipulates that the rupiah shall be used for the following purposes:

a. payment of transactions;
b. the settlement of other obligations that must be discharged using money: and / or
c. other financial transactions

conducted within the territory of the Republic of Indonesia, save for:

(a) transactions related to the national budget;
(b) grants / donations given by or to a foreign party;
(c) international commercial transactions:
(d) bank deposits denominated in foreign currency; and
(e) international financing transactions.

Violations of the obligation to use the national currency as set out in article 21 of the legislation are subject to a maximum term of imprisonment of one year and a fine of up to Rp 200,000,000 under article 33(1).

These sanctions focus on payment transactions and would appear to be primarily aimed at the payor as it is the payor that is responsible for tendering payment in settlement of its obligations. It would seem illogical for the payee to be held guilty of an offense for accepting payment in a foreign currency in a case where the payor refuses to make it in rupiah.

Of the above exceptions, those that will be of greatest interest to business generally are (c) and (e). In discussing these, it is unclear as yet how the legislation will be applied in practice. In this regard, the stances adopted by Bank Indonesia, the Ministry of Finance, and, of course, the National Police and Prosecution Service, as the ultimate enforcers of the legislation, will be major determinants. Now let us look at Exceptions (c) and (e) in greater detail:

Exception (c): International Commercial Transactions

This exception suggests that payments made by or to overseas counterparts will be exempt from the ambit of the legislation. However, the question arises as to what exactly "international" means? Should it be construed as applying to a transaction between an Indonesian company and the Indonesian branch office of a foreign-based company, particularly where the goods and / or services involved are provided entirely within Indonesia? Further, what is the situation as regards a multinational company that operates a permanent business establishment in Indonesia? As no definition of "international" is given in the legislation, it will be necessary to determine this on a case-by-case basis. Accordingly, we would advise the exercise of caution and use rupiah for settlement purposes, save where an unambiguous exemption applies.

Exception (e): International Financing Transactions

The legislation also fails to afford a definition of what constitutes an "international financing transaction." However, logic would dictate that loans extended by an Indonesian lender to an overseas borrower, and vice versa, could be denominated in foreign currency. However, would a foreign currency-denominated loan extended by the local office of the commercial lending arm of a foreign government or international organization be exempt from the legislation? What about the Indonesian office of a foreign bank or other financial services provider – would it be able to extend a foreign currency-denominated loan to an Indonesian borrower?

Logic would also dictate that the Currency Law will not affect the ability of Indonesian corporations to issue or trade in foreign currency-denominated financial instruments as part of the international financial system. However, if we were to interpret the legislation narrowly, it would appear to prohibit the domestic trading of such instruments where they are issued by one Indonesian corporation to another (although not to a non-Indonesian corporation). It would also appear to prohibit the extending of US dollar-denominated loans by Indonesian banks as part of purely domestic financing arrangements.

Contractual Implications

From the contractual perspective, we do not believe that agreements that violate the provisions of the Currency Law will be automatically rendered null and void. This is because (i) the Currency Law does not specifically state that a violation of its provisions would result in the voiding of an agreement, and (ii) such violation would not automatically vitiate an agreement for breach of Article 1320 of the Indonesian Civil Code, i.e., the lawful cause requirement. However, it should be noted that the issue of an agreement's validity should be approached on a case-by-case basis in the light of all the facts, and that different views may exist.

We believe that as the focus of the law is firmly placed on the settlement or payment stage, it should still be permissible for invoices to be issued in foreign currency, with the amount invoiced being subsequently converted into and paid in rupiah. This would accord with both business logic and normal business practice. Should a business opt to pursue this path, it would be advisable to insert a clause in the contract stipulating the procedures or mechanism for conversion from foreign currency to rupiah so as to minimize the potential for future uncertainty and disputes.

In most cases, however, it will be best to adjust contracts in order to ensure the use of rupiah in transactions conducted in Indonesia from the outset so as to avoid unnecessary complications.

Prohibition on Rejecting Settlement in Rupiah

Article 23 of the Currency Law prohibits the rejection of rupiah for payment or settlement purposes within the territory of the Republic of Indonesia. Exceptions are permitted if: (i) there are doubts as to the genuineness of the proffered currency, or (ii) the use of foreign currency has been previously agreed upon in writing for payment or settlement of an

obligation (see below). A violation of this provision is subject to a maximum term of imprisonment of one year and a maximum fine of Rp 200,000,000.

As regards exception (ii) above, the precise intention of the drafters is somewhat unclear as, if this exception were to be interpreted literally, it would leave an gaping loophole in the legislation and pretty much render article 21 toothless. Only time will tell how this exception will be interpreted in the overall context of the legislation.

The Currency Law is also silent as to what is the status of the payor is in a situation where the payee rejects settlement in rupiah. If the payor then makes payment in another currency, will this constitute a violation of the obligation to use rupiah established by article 21(1)?

Conclusion

The national currency, the rupiah, must be used in financial transactions conducted within Indonesia. Although this requirement existed since 1968, it was not enforced. It is now being reasserted through the Currency Law, which arms the government with the powers and tools needed to do enforce its provisions.

Given the current lack of clarity over the precise extent of the obligations imposed by the legislation to use the national currency, we would advise that businesses err on the side of caution, and take care to ensure that the requirements of the legislation are complied with in full so as to avoid uncertainty and possible penal sanctions.

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