

## THE APPLICATION AND IMPLEMENTATION OF “MOU” IN INDONESIAN BUSINESS PRACTICES

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### ABSTRACT

*Memorandum of Understanding (MoU) and contract are widely used in business transactions. Currently in Indonesia, MoU and contract are sometimes being used interchangeably. This research aimed to prove that MoU and contract are two different institutions with different functions. The interchangeable used of MoU and contract cannot be accepted from legal point of view. This research is a normative legal research, using secondary data. Data were collected by doing literature research. A comprehensive comparative legal research was conducted in order to understand the similarities and differences between the concept of MoU dan contract. This research found the fact that businessmen in Indonesia felt that the use of MoU terminology is more informal than contract. The court also found that there are several MoUs with legal binding commitment. In principle MoU and contract served different function. “MoU” was supposed to have no commitment, meanwhile contract detailed the obligations of the parties, eventhough they may share several common characteristics, It is suggested that businessman shall involve legal expert when drafting MoU. Good MoU will help businessmen from going to court. The same understanding of MoU will foster better growth in business among businessmen, especially in South East Asia region.*

Keywords: Memorandum of Understanding, MoU, contract, agreement.

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### Introduction

Business and laws are two different aspects in human life, however they co-existed side by side and moreover sometimes they are overlapping. Both aspects “regulate” human life. Business cannot exist without law, and law are meaningless if it cannot support human life including business. Business law was then developed from time to time to regulate business aspect of human life.

In doing business, businessman needs contracts. It can not be avoided that business dealt from a very simple contract such as sale and purchase to a very complicated and complex contract which involved many legal institutions. Such complex legal contracts were drafted by legal experts. Drafting legal contracts would is not a simple things. It might take a certain period before ot was finally approved and signed by the parties. Sometimes there are preliminary works to be done, and therefore need preliminary document to be signed before businessmen can really enter into a business transaction. A model of MoU was introduced. Nowadays, many businessmen in Indonesia like to make and sign Memorandum of Understanding (MoU). Sometimes, without trully understanding the concept of MoU, MoUs were used interchangeably with contracts. There were also many young lawyers with little experiences in business treated MoU as contract. This has rasied another issue in court of law, since there are several MoU being disputed in court of law seeking for settlement.

This research aimed to prove that MoU and contract are different. Businessmen shall not use the term MoU to replace the term of contract. MoU and contract have different functions. The interchangeable used of MoU and contract are not correct and therefore cannot be accepted from legal point of view.

This research is a normative legal research, using secondary data. Data were collected by doing literature research. To obtain the conclusion, a comparative legal research was conducted. The research was made to understand the concept of MoU and contract, the similarities and differences between them in order to provide explanation that MoU is different from contract, not only for businessmen but also for lawyers.

### CONTRACT

The root of business law in Indonesia can be found in article 1131 Indonesian Civil Code (ICC). According to the article “all movable and immovable assets of the debtor, either present or future, serve as securities for the personal obligations of the debtor.” Further, article 1132 ICC stated that “the assets serve as joint guarantees for his creditors; the proceeds from the sale of the assets is to be divided among the creditors in proportion to their loan, unless there exists a legal order of priority among the creditors.” Therefore from business perspective, there will never be a business transaction without security (Muljadi and Widjaja; 2003a) (Vollmar; 1952).

Based on article 1233 ICC, the obligations stipulated in article 1131 ICC could arise either from contract or law. This provision confirmed that businessman should aware that whenever he made a contract, automatically his assets became securities for the fulfilment of his obligation arising from the contract. Business need assurance that every transaction will be succesfull and therefore businessman need all contracts to be performed in good faith (Muljadi and Widjaja, 2003a) (Vollmar; 1952).

The regulations about contract can be found in ICC, from article 1313 ICC which defined contract up to article 1351 ICC which regulated the interpretation of contract. Article 1313 ICC defined contract as an act pursuant to which one or more individuals

bind themselves to one another. The definition tell us that for a contract to exist, two parties must be involved. These two or more parties agreed to be bound with something. This something was the obligation that must be fulfilled by the parties. If any of the parties failed to fulfil the obligation, a default condition existed (Soebekti; 1978) (Muljadi and Widjaja; 2003b).

According to article 1314 ICC, contract can be concluded gratuitously or onerously. The gratuitous contract requires only one party to the contract performed something by granting benefit to the other party, without taking any benefit for himself in return. Meanwhile in an onerous contract each party to the contract has one or more obligation that must be performed accordingly. Such obligations may be performed by one party to the other party and vice versa, such as in sale and purchase where buyer pays to seller and seller delivers good to buyer; or such obligations can also be performed by both (all) parties to the contract in a similar way, such as obligation to invest and pay capital to a company established by the parties (Muljadi and Widjaja, 2003b).

Article 1320 ICC determined the validity of a contract. According to the article, a valid contract is a contract made by free-will between two (or more) capable person (people, legal entity) agreeing on on something (one or more obligations) which is not prohibited by law (when or after the agreement between the parties were reached) (Soebekti; 1978; 1996). It must be noted that eventhough a contract was made without free-will, the law assumed that the free-will exist until it can be proven otherwise (Widjaja and Muljadi; 2003). The party who declared that there was no free-will from his side may claim for nullification<sup>1</sup> and he will bear the burden to prove it<sup>2</sup>. A capable person according to ICC<sup>3</sup>, is a person that had reached certain age (18 years old – not minors) or ever get married (before 18 and/ or divorced before 18), is not under curatele (guardianship) or by special law was declared incapable. Any contract made by those “incapable” person (minors who have not reached 18 and not yet married, people under curatele or declared incapable) was also considered valid, until the “incapable person” seek for nullification of the contract<sup>4</sup> (Widjaja and Muljadi; 2003). Upon nullification the contract was considered as never exist, and all conditions must be restored to the time before the contract was concluded (Soebekti; 1996).

A contract without anything (no obligation was created) is never treated as contract. So if there was a payment made for performance to a non-existence contract (without obligation) then the payment must be returned<sup>5</sup>. Sometimes court claim must be made for the restitution, so that the unjust enrichment obtained by the receiving party shall be nullified. Contract made with something (obligation) prohibited by or in violatiion of the law, morality and proper custom in society resulted in moral obligations (*naturlijke verbintenissen*)<sup>6</sup>. It means that performance of the obligation cannot be sought in court of the law because the law, or morality or the proper custom rejected the performance, since the performance itself will cause harm to the society. No nullification will be applicable here, because no court order can be made for the benefit of any party who consciously breached the law by making contract in violation of the law, morality and proper custom in the society (Muljadi and Widjaja; 2003b).

In business circumstances, articles 1131, 1132, 1313, 1314, 1320 ICC applied. Businessman made contract with each other because they were all in need of something or more which they can obtained thourgh the others. So it was very clear that in business contract, there was always a consideration (not gratuitous), which make the contract onerous. Each businessman to the contract has one or more obligations to be performed. Contract became the most important transactions for businessman. It is not wrong to say that no business can be done without contract.

Currently, business transactions are not as simple as before. Buying real property, shares or acquring companies are not as simple as buying car from showroom. In many circumstances, due diligences are required. Such due dilligence will involve many aspects, including economic and legal aspects. Simple due dilligence or complex due dilligence can be choosen as alternatives. However which kind of due dilligence the businessman choose, there are no certainty or commitment whether after the due dilligence was conducted, the transaction will take place. In many cases, the result of the due dilligence recommend not to proceed with the transaction. For the purpose of due dilligence itself, businessman needs to enter into a certain kind of document as preliminary document to prove that the parties involved were seriuos to fo further with the transaction.

Under ICC, all document having binding provission is known and named as contract. A contract which had not risen obligations to transact between the parties was known as contract with conditional obligation. An obligation is conditional if it is contingent on an event that may occur and is yet to occur, which either defers the obligation’s entry into force or annuls the obligation, depending on whether such event occurs or not<sup>7</sup>. All the conditions must be fulfilled in the manner they were intended and meant by the parties concerned<sup>8</sup>. In view of that, there were two conditions allowed. First was the deferred/ contingent conditions<sup>9</sup>, and second was the void conditions<sup>10</sup> (Muljadi and Widjaja; 2003a). An obligation with deferred/ contingent conditions is an obligation that is contingent on a future event that is not certain to occur, or on an event that has already occurred but is not

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<sup>1</sup> Article 1449 ICC

<sup>2</sup> Article 1865 ICC

<sup>3</sup> Article 1330 ICC

<sup>4</sup> Article 1446 ICC

<sup>5</sup> Article 1359 paragraph (1) ICC

<sup>6</sup> Article 1359 paragraph (2) ICC

<sup>7</sup> Article 1253 ICC

<sup>8</sup> Article 1257 ICC

<sup>9</sup> Article 1263 ICC

<sup>10</sup> Article 1265 ICC

known to the parties<sup>11</sup>. In the first case, the obligation is not executable until such time the event occurs; in the second case, the obligation arises when such event occurs<sup>12</sup>. On the other hand, a void condition is a condition, which if met would cause the obligation to become void and restate the parties as though the obligation has never existed<sup>13</sup>. This condition does not delay the fulfilment of the obligation; it only obliges the creditor to return what he receives, if such event occurs<sup>14</sup> (Soebekti; 1978).

In view of due diligence above, the contract entered with obligations subject to the result and recommendation of the due diligence, is a contract with conditional deferred obligations. If the result and recommendation told the parties to proceed with the transaction, then the parties continued to perform their obligations which were been detailed in the contract. If the result and recommendation caused any of the parties not to proceed further then the contract will not be enforceable anymore and deemed to be terminated. The satisfaction of the result of due diligence will be the condition precedent in the contract to proceed further. This type of contract, with conditional obligations, required all parties to discuss and agree on all terms and conditions to be drafted in the contract. Actually it is not practice or possible for businessman to discuss on something which was not clear enough. After the due diligence said yes, then the parties continued to discuss further. If due diligence said no, then no more discussion will happen. The parties need not to argue before things were clear. To fulfil such a conditions, a legal instrument must be created. Such instrument shall become an independent documents for the parties, but can also be used as the basis to start up a real transaction.

### MEMORANDUM OF UNDERSTANDING (MOU)

There is no specific definition of MoU. MoU according to Black's Law Dictionary 8th edition, has the same meaning as Letter of Intent. Letter of Intent (LoI) itself is defined as "a written statement detailing the preliminary understanding of the parties who plan to enter into a contract or some other agreement; a noncommittal writing preliminary to a contract." From the given definition, it can be understood that MoU or LoI is not a contract. As a noncommittal document, either MoU or LoI has no legal binding. It was clear that MoU served as the vehicle for establishing the requirements of a contract. Further more, Black's Law Dictionary mentioned that "businesspeople typically mean not to be bound by a letter of intent, and court ordinarily do not enforce one; but courts occasionally find that a commitment has been made." Based on this last statement, it is also clear practices proved that many businessmen had mistakenly used the terms MoU in many legal documents. Conceptually by making MoU, businessman shall make no commitment that MoU is not legally binding and therefore cannot be enforced in court of law. However in many event, businessman made commitment in the MoU and become legally binding.

MoU was utilized where people or in business case, businessmen were desired to enter into an agreement pending their mutual (rights and) obligations being set out in a formal contract. It was not meant to create binding contractual relations but rather as intention to declare a purpose. This will create moral commitment to the businessmen. Sometimes a confidentiality clause was added to assist the negotiation before they agreed on contractual terms and conditions (Arthur; 2011)

In (international) public law, MoU was also known as a non legally-binding nor legally enforceable document. By legally-binding it means that the parties in MoU intend to carry out it terms on a best-effort basis. The objective of MoU is to record their mutual understanding as to how they will conduct themselves, after than to create (international) legal rights and obligations (Malaya and Mendoza-Oblena; 2011). The unbinding or non legally-binding of MoU in international public document was also recognised by United Nations (UN; 1999).

### CONTRACT AND MOU

As a document signed by two or more parties, which was made prior to the signing of a contract, MoU shared several similar characteristics with contract<sup>15</sup>. The parties in MoU and contracts generally are the same. They shall follow the same characteristic as capable person<sup>16</sup>. As well as a valid contract, MoU shall be made with free-will. Furthermore MoU also shared something as the object of the MoU. Due diligence can be treated as an object of an MoU that must be performed. To be performed accordingly, due diligence required the cooperation of all parties in MoU, and the result and recommendation of the due diligence "bind" the parties, either to proceed further or not with the "real" transaction, eventhough MoU itself is not legally-binding and cannot be disputed in the court of law.

As a non legally-binding documents, MoU is no more than gentlemen agreement with moral obligations with best-efforts performance. The consequences of performing of MoU as moral obligation reminded us of the term moral obligations used in contracts. Moral obligations in contract arises from contract which was made with the obligations that violates law, morality and proper custom in the society (Widjaja and Muljadi; 2005). This indeed has proven that actually the making of MoU cannot be separated from the making of contracts. In making contract, there is a clear provision in Indonesian law (Article 1320 ICC) that acknowledges the requirements for making a valid contract. Meanwhile in making MoU, there is no specific requirement to as a valid MoU according to ICC, however for the purpose of clarity and consistency, the first and second requirements (the subjective conditions) for valid contract under Article 1320 ICC is still applicable for making a valid MoU. But please be noted

<sup>11</sup> Article 1263 paragraph (1) ICC

<sup>12</sup> Article 1263 paragraph (2) ICC

<sup>13</sup> Article 1265 paragraph (1) ICC

<sup>14</sup> Article 1265 paragraph (2) ICC

<sup>15</sup> Article 1320 ICC

<sup>16</sup> Article 1330 ICC

that if MoU is signed by fulfilling all the conditions required for a valid contract, especially the third conditions that contract must have obligations, then the result is not an MoU anymore, it is a contract.

Since MoU was used as preliminary document, and there is not guarantee that MoU shall proceed with a contract, in practice MoU used to have a confidentiality provision that rises obligations to all parties in MoU. The parties were required to keep everything in MoU confidential. This confidentiality commitment is binding to all parties. This is one of the logic reason why court might find binding provision in MoU. Good MoU shall not incorporate confidentiality provision in the MoU. The confidentiality obligations shall be made separately in a Confidentiality Agreement.

It is understood that businessman sometimes will not aware or be able to distinguish binding provision with non-binding provision. Involvement of legal expert is required. Legal expert can inform the businessman either a certain provision must be excluded from MoU because it has binding consequences. By having a good MoU, businessman will not dispute over enforcement of MoU in court of law. There are many cases in Indonesian court of law, where one party to the MoU claimed for the performance of one or more provisions in the MoU from the other party, because the other party denied to perform, since according to him the MoU did not have legal binding effect for both of them. If MoUs become more often being disputed in court of law, then this is not good for business. Properly made MoU becomes more important. This hopefully can provide significant effects to all businessman in doing business in Indonesia, especially ASEAN businessmen.

### CONCLUSION AND RECOMMENDATION

Businessman wants business transaction to be simple but comprehensive. Businessman wants everything in his mind to be incorporated in as simple documents. However businessman must also realize that there are law and regulations that he must comply. Therefore it is suggested that that businessman as layman shall be more careful when drafting MoU. Businessman shall at least involve legal expert in making MoU, even though MoU is not a legally-binding documents. It is for the importance of the noncommitment of MoU itself, MoU must be drafted carefully. This will at the end reduced number of cases in court of law. Finally the same understanding of MoU hopefully will foster better growth in business among businessmen, especially in South East Asia region

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