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LEGAL RISKS AND MITIGATION IN ESTABLISHING A LIMITED LIABILITY COMPANY THROUGH FOREIGN DOMESTIC JOINT VENTURE AGREEMENT

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Abstract

This study analyzes the legal risks and benefits in establishing a limited liability company (PT) through a joint venture scheme between Foreign Direct Investment (PMA) and Domestic Investment (PMDN) in Indonesia. The research uses qualitative methods by reviewing legal documents such as Joint Venture Agreements (JVA) and Articles of Association (AoA), as well as Indonesian investment regulations. The study identifies key risks including inconsistencies between JVA and AoA, disproportionate governance structures, conflicting objectives between PMA and PMDN, and violations of foreign ownership limits under the Positive Investment List. These risks potentially cause operational conflicts and legal sanctions. Additionally, differences in legal backgrounds increase the chance of misinterpretation of ambiguous contract clauses. To mitigate these risks, the research suggests harmonizing the JVA and AoA, involving legal advisors familiar with Indonesian law and international business practices, and implementing clear governance and dispute resolution mechanisms such as arbitration. The findings aim to guide stakeholders in managing joint ventures effectively and legally compliant in Indonesia.

Keywords: ***Joint Venture, Foreign Investment, Legal Risk, Governance, Indonesian Law***

INTRODUCTION

The term Joint Venture is very common in business and investment activities. In Indonesia, Joint Ventures are often used by Foreign Direct Investment (PMA) entities in collaboration with Domestic Investment (PMDN) entities to optimize market potential. A Joint Venture is a form of business cooperation where two or more companies or entities come together to achieve specific business objectives by sharing risks, responsibilities, profits, and resources. A Joint Venture is usually temporary and established for a specific project. According to a legal terminology dictionary, a Joint Venture is defined as follows:

Joint Venture is a business undertaking by two or more parties in which profits, losses and control are shared. Though the term is often synonymous with partnership, a joint venture may indicate an enterprise of more limited scope and duration, though there is the same mutual liability of the participants for debts and torts of the venture. In a Joint Venture, a foreign party forms a partnership with a domestic entity already present in the market that the foreign party wishes to enter. For instance, the foreign party may bring new technology or business practices into the venture, while the local party already possesses commercial relationships and the necessary legal compliance, as well as being rooted in the industry within the domestic region. The distinctive features of a Joint Venture, according to Aminuddin Ilmar (2017) in the context of foreign investment, are:

1. A new company or legal entity is established by private foreign individuals or entities in cooperation with national capital.
2. The capital of the joint venture consists of "know-how" and equity capital provided by the parties, with management and decision-making powers in accordance with the proportion of shares held.
3. The parties establishing the company retain their own existence and independence.
4. Cooperation occurs between foreign and national capital.

Although foreign investment in Indonesia is permitted to be conducted directly, Joint Ventures are perceived to offer several advantages, particularly for high-risk investments or for foreign investors who are new to the Indonesian business environment. Here are some advantages of a Joint Venture: From the perspective of foreign investors, certain business sectors are closed off unless partnering with a local entrepreneur through a Joint Venture. This creates new business opportunities for foreign parties that would not have been accessible otherwise. Foreign investors may also wish to leverage the experience or access of the local party, such as strong distribution networks. Another advantage is that working with local entrepreneurs facilitates easier access to raw materials for production. Additionally, collaborating with local parties fosters a sense of nationalism, reducing the perception of total foreign domination, and helps maintain good relations with the local government.

From the perspective of local entrepreneurs, a Joint Venture provides access to significant foreign capital, which is crucial in certain capital-intensive industries. Local entrepreneurs also gain the opportunity to enter international markets already established by foreign parties. By forming a Joint Venture, local businesses can produce for global markets. Lastly, local entrepreneurs can gain access to new technology—something that would be very expensive to acquire independently and is only realistically accessible through cooperation with foreign businesses.
PMA refers to investment activities carried out in Indonesia by foreign investors, either using entirely foreign capital or in partnership with domestic investors. This is regulated under Article 1 (3) of Law No. 25 of 2007 on Investment (Investment Law). However, Article 5 (2) specifies that PMA must take the form of a Limited Liability Company (PT). Thus, a Joint Venture that forms a business entity as a PT must, in accordance with Article 7 (1), ensure that after the parties sign the deed of establishment of the PT, the foreign investor is fully subject to and must comply with all relevant regulations pertaining to the joint venture's activities, without exception. This is based on Law No. 40 of 2007 on Limited Liability Companies (Company Law), as amended, repealed, and/or supplemented by the Job Creation Law. The legal relationship between the parties in a Joint Venture Agreement (JVA) is contractual in nature, meaning it is based on the principle of freedom of contract under Article 1338 of the Indonesian Civil Code. However, it may differ depending on the type of JV agreed upon, namely:

a. Contractual Joint Venture: The legal relationship is purely private law-based through an agreement, so each party remains legally independent. The agreement governs each party's contributions, risk sharing, and rights and obligations. There is no asset or liability separation—everything is based on the contract.
b. Incorporated Joint Venture: The legal relationship is formed through a new legal entity (typically a PT). The parties become shareholders in the JV company. The relationship is governed by the Deed of Establishment, the company's articles of association, the Shareholders Agreement, and the Joint Venture Agreement. There is an internal relationship among the parties as shareholders and an external relationship through the JV entity (e.g., commercial contracts). Liability is limited according to share ownership. Disputes are resolved through mechanisms in the JVA and/or arbitration.

Joint Ventures in Indonesia usually involve two shareholders without any affiliated relationship. Thus, there is a mix of corporate cultures, values, visions, missions, work methods, legal perspectives, and more. As such, while Joint Ventures offer several advantages as mentioned above, they also present potential legal risks arising from these differences—such as conflicting interests, legal systems, and corporate structures. A Joint Venture will be accompanied by an agreement between the parties, commonly referred to as a Joint Venture Agreement (JVA).
Research Problems Identified:

1. How do legal risks arise in the establishment of a Limited Liability Company (PT) through a Joint Venture Agreement between Foreign Direct Investment (PMA) and Domestic Investment (PMDN)?
2. How can the legal risks associated with the establishment of a Limited Liability Company (PT) through a Joint Venture Agreement between Foreign Direct Investment (PMA) and Domestic Investment (PMDN) be effectively mitigated through legal instruments and regulatory compliance under Indonesian law?
   If the objectives of this study in the context of article preparation are achieved, it is expected to contribute both theoretically and practically.

Theoretical Contribution:

This research aims to contribute to the advancement of legal scholarship by serving as a reference for future studies and expanding scientific insight in the field of law, particularly in relation to two key areas: first, the development and interpretation of Indonesian legal provisions concerning the establishment of Limited Liability Companies through Joint Venture Agreements; and second, the broader enrichment of knowledge in business and investment law, especially as it pertains to the dynamics between foreign and domestic investment structures. This research is expected to offer practical legal insights for stakeholders. For the government and policymakers, it highlights the importance of establishing clearer and more comprehensive regulations on Joint Ventures to enhance legal certainty and strengthen Indonesia's appeal to foreign investors. For business actors, investors, and legal practitioners, the study provides valuable guidance in designing and structuring Limited Liability Companies through Joint Venture Agreements in accordance with Indonesian law, thereby supporting more secure and effective business collaborations. Thus, this research is expected to contribute to the development of legal and investment practices in

Indonesia and enrich the existing literature with practical solutions and relevance to current Indonesian legal conditions.

METHODOLOGY

In this article, the author aims to address the above issues using a normative juridical approach, a legal research method that studies the applicable legal norms, particularly in the form of laws and regulations, court decisions, and legal doctrines. This method analyzes the law in a normative framework, emphasizing the application of prevailing legal rules to answer the legal issues raised. This method aims to understand and evaluate the law based on primary legal materials (e.g., statutes, government regulations, court decisions), secondary legal materials (e.g., textbooks, academic articles, expert commentaries), and tertiary legal materials (e.g., legal dictionaries and other sources providing clarification of legal terms and concepts used in this research). Through this approach, the study aims to identify and analyze potential legal issues and provide more applicable recommendations related to risk mitigation in the establishment of Limited Liability Companies through Joint Venture Agreements.

RESULT AND DISCUSSION

Examining legal risks in the establishment of a Limited Liability Company (PT) through a Joint Venture between Foreign and Domestic Investors

A Joint Venture Agreement (JVA) between Foreign Direct Investment (PMA) and Domestic Investment (PMDN) offers many potential benefits, but it also entails legal, commercial, and operational risks. First, there is the risk of inconsistencies between the Joint Venture Agreement and the Articles of Association of the Limited Liability Company (PT) registered with the Ministry of Law. This is a significant legal risk and could lead to the nullification of the agreement. While a JVA governs the relationship between the parties involved in a joint venture, the Articles of Association are the legal document that regulates the internal organization of the PT and form the operational foundation of the PT under Indonesian law. Inconsistencies between the two can lead to various legal and operational issues that threaten the sustainability of the joint venture.

One potential inconsistency is the difference in governing law used in the JVA between PMA and PMDN. For example, a JVA may be governed by foreign law, whereas a Limited Liability Company must comply with Indonesian law as stipulated in Article 1 paragraph (1) of the Company Law (UUPT). Therefore, even if the JVA is subject to foreign law, matters related to the establishment, organizational structure, general meetings of shareholders, the authority of the directors, and so on must still comply with the Company Law. This creates legal uncertainty and practical difficulties in enforcing the provisions of the JVA. Other legal risks may arise from inconsistencies in the provisions on share ownership and profit-sharing between PMA and PMDN in the JVA versus what is stated in the PT's Articles of Association. In the JVA, the parties might agree to distribute profits based on their respective capital contributions. However, this must align with the Articles of Association registered with the Ministry of Law. If the Articles of Association prescribe different rules for profit-sharing or ownership, it can lead to differing interpretations of the parties' rights and obligations.

Further inconsistencies may arise when the JVA regulates the management structure of the PT. For example, the JVA might require that strategic company decisions (such as acquisitions or expansions) be jointly approved by all parties, but the Articles of Association may not contain such provisions or may stipulate different rules regarding who is authorized to manage and make strategic decisions for the company. While the JVA may divide voting rights and management roles based on capital contributions and roles, if the Articles of Association lack provisions for balanced management or diverge from the JVA, legal uncertainty ensues. Another potential legal risk involves the dissolution or liquidation of the PT. The JVA and the Articles of Association must align to prevent conflict. If the JVA stipulates a dissolution mechanism that differs from that in the Articles of Association, confusion and uncertainty may arise during the winding-up process. While the JVA often governs matters relating to joint venture termination, in practice, PT dissolution must follow the procedures laid out in the Articles of Association and Indonesian law. Misaligned procedures can result in one party feeling disadvantaged, especially if expectations formed under the JVA are not met.

Discrepancies may also occur when one party seeks to amend the Articles of Association after the PT has been established. A JVA that lacks clear procedures for amending the Articles of Association can result in misunderstanding when changes to status or roles are proposed. Second, there is the risk of imbalanced governance and decision-making. In a joint venture, there is potential for unequal decision-making, which can disadvantage one party. Vague governance provisions can cause confusion and conflict in the future. Governance and decision-making imbalances are significant legal risks when forming a PT. If management roles, responsibilities, and decision-making rights are not clearly defined in the agreement and Articles of Association, tensions may arise and harm long-term business relationships. A key source of imbalance is the unequal voting rights and managerial control between PMA and PMDN. A foreign investor (PMA) may want to maintain greater control over the company, especially regarding strategic decisions such as market expansion or technological changes. On the other hand, the domestic partner (PMDN) may prefer greater control to protect national or local interests. This imbalance can cause future disputes if decision-making power does not reflect the parties' contributions.

Imbalances may occur if one party dominates the organizational structure outlined in the JVA and Articles of Association. Typically, strategic decisions in a joint venture require approval from both parties, usually at the General Meeting of Shareholders (GMS). Article 75 of the Company Law stipulates that the GMS has powers not granted to the Board of Directors or Board of Commissioners, within the limits set by law and/or the Articles of Association. However, if in practice one party wields more influence, it can lead to imbalanced decisions that harm the other party. While the JVA may allocate voting rights based on capital contributions, operational and strategic management differences can result in one party dominating. For example, if the PMA contributes more capital but the PMDN controls the board structure or executive appointments, the decision-making process may be imbalanced and misaligned with each party's investment.

Business interests between PMA and PMDN may also diverge—PMA might focus on international expansion or new product development, while PMDN could prioritize domestic sustainability, job creation, and local industry development. Differences in priorities can cause tension, especially regarding resource allocation and company direction. Inconsistencies between JVA provisions and actual PT management can arise from a lack of detailed regulations on decision-making practices. A JVA may outline an ideal decision-making process, but daily operational practices may differ if there is no shared understanding of authority and responsibilities. For instance, a JVA may state that major decisions require a board comprising representatives from both parties, but in practice, only one party may dominate board decisions.

Ultimately, it is the responsibility of shareholders and the board of directors to define the joint venture's operating and governance model—that is, how shareholders interact with the JV, their shared expectations for its development, the board's involvement versus management's, and how governance elements collaborate. Although these matters are typically outlined in the Articles of Association and shareholder agreements, such documents often lack practical guidance for real-world governance. This imbalance is worsened if the JVA lacks a clear dispute resolution mechanism. Conflict-resolution mechanisms like arbitration or mediation should be explicitly stated to address disagreements and avoid escalation. Third, there is the risk of violating foreign ownership limits. One of the most significant legal risks in a JVA between PMA and PMDN concerns breaches of foreign ownership restrictions as regulated under Indonesian law. Indonesia enforces foreign ownership limitations in specific sectors, particularly those listed in the Negative Investment List (DNI) issued by the Investment Coordinating Board (BKPM).

When establishing a PT through a Joint Venture between PMA and PMDN, BKPM's approval is required to ensure compliance with the DNI. If the new PT exceeds the permitted foreign ownership limit, the business license may be suspended or revoked by BKPM. For instance, if after establishment, BKPM finds that the ownership structure violates legal provisions, it may revoke the business license or request restructuring. This may delay operations and cause losses for both parties. Furthermore, the violating party may face legal sanctions, damaging the company's reputation and business relationships. Finally, in JVA contexts, differing interpretations or implementation can often lead to major legal disputes. The root causes include:

- Ambiguity: Poorly worded clauses in the JVA may lead to differing understandings of rights and duties, for example, on profit-sharing proportions.
- Experience gap: PMA and PMDN may have different business cultures—PMA might be aligned with international standards while PMDN follows local practices, leading to confusion in management and execution.
- Legal system differences: A JVA between parties from different legal systems (e.g., Common Law vs. Civil Law) adds complexity. If the PMA comes from countries like the US or UK (Common Law), the drafting will be more complex and detailed than if it comes from Civil Law countries.
- Diverging goals: PMA and PMDN often have different strategic goals. If not clearly expressed, this leads to conflicting interpretations about the venture's direction.
- Execution issues: Even with clear agreements, one party may feel the other isn't fulfilling obligations, e.g., on funding or resource management—especially when market conditions change unexpectedly.

Mitigation Strategies Under Indonesian Law

a. Mitigating Inconsistencies between JVA and PT Articles of Association

Careful drafting of the PT's Articles of Association to reflect the JVA's provisions is crucial—particularly share allocation, roles and obligations, and management structure. Article 1(1) of the Company Law states a PT must be established by an agreement that adheres to its Articles of Association. Therefore, these must explicitly reflect the JVA's provisions. Any amendment must follow Article 21 of the Company Law, which regulates changes to the Articles of Association, including shareholder approval and notarization.

Harmonizing the JVA with Law No. 6 of 2023 (Article 45) amending the Law on Foreign Investment requires aligning investment terms with applicable regulations. As such, the JVA must comply with the PT's Articles of Association.

Flexibility and restructuring capacity should also be built into the JVA. Amending a JVA can be complex, time-consuming, or even impossible. To avoid this, contracts should allow for periodic updates (e.g., every 15–20 years), performance-based clauses, sole risk clauses, and ownership transfer provisions to simplify exit or ownership changes.

b. Mitigating Unbalanced Governance and Decision-Making Risks

To prevent imbalance, the JVA must include clear governance and decision-making mechanisms. Article 2(3) of the Company Law allows the Articles of Association to specify these provisions, subject to Indonesian law, including the authority of PT organs (GMS, Board of Directors, and Board of Commissioners). The JVA should detail each party's role, per Article 92 of the Company Law, which states the Board of Directors manages the PT while the Board of Commissioners supervises. Another mitigation strategy is to appoint senior individuals to the board with the appropriate mix of skills, experience, incentives, and commitment to realizing the company's shared goals. These individuals must also be free from conflicts of interest. The company should regularly evaluate board performance and ensure that its structure reflects evolving business needs. Additionally, mechanisms for rotating board seats or balanced representation between the PMA and PMDN parties can support fairness in strategic decision-making.

The governance system should also include clear decision-making protocols. These protocols may take the form of supermajority voting requirements, veto rights on strategic matters, or forming committees comprising representatives from both parties. These mechanisms ensure that no party dominates decision-making and that both can negotiate fairly and transparently. Establishing a clear dispute resolution mechanism in the agreement is also critical. Mediation and arbitration clauses (e.g., under BANI or SIAC) should be included to avoid prolonged and expensive litigation in the event of conflict. These clauses can provide certainty regarding the process and applicable law in resolving disputes. Furthermore, the agreement must stipulate the rights and obligations of each party to prevent ambiguity. The agreement must clearly state the capital contribution of each party, the allocation of voting rights, dividend policies, and corporate exit procedures.

c. Mitigating the Risk of Violation of Foreign Ownership Restrictions

To mitigate the risk of violating foreign ownership limitations, parties must conduct due diligence and review the latest regulations, particularly the Presidential Regulation on the Positive Investment List (e.g., Presidential Regulation No. 10 of 2021 and its amendments). This regulation stipulates which business sectors are open, restricted, or closed to foreign investment and to what extent. Before entering into a JVA, the parties should consult with the Investment Coordinating Board (BKPM) or a legal advisor to ensure that the ownership structure complies with the prevailing investment regulations. The JVA and the PT's Articles of Association must reflect this ownership proportion. Transitional mechanisms should also be prepared in case of changes in investment regulations. The agreement may include exit clauses, share buyback options, or conditional shareholding structures that adjust according to regulatory changes. This ensures that the PT can adapt quickly without violating the law. The use of nominee arrangements—i.e., disguising foreign ownership through Indonesian parties—is prohibited under Indonesian law and can result in the agreement being declared null and void (see Article 1335 of the Civil Code on unlawful cause). Therefore, the shareholding structure must be genuine and transparent.

d. Mitigating the Risk of Differing Interpretations and Execution of the JVA

To prevent varying interpretations, the JVA must be drafted using clear, consistent, and detailed language, especially in clauses related to obligations, profit-sharing, decision-making, dispute resolution, and exit strategies.

The parties must also ensure that the JVA aligns with Indonesian contract law principles (Book III of the Civil Code), particularly regarding legal consent, lawful cause, and certainty of terms (Articles 1320 and 1338 of the Civil Code).

Cross-cultural understanding is also essential. Both parties must communicate transparently and continuously to align expectations. PMDN actors must understand the corporate culture and international standards expected by PMA parties, while PMA parties must respect local norms, regulations, and business practices.

It is highly recommended that both parties conduct legal and operational due diligence prior to entering into the agreement. This helps ensure mutual understanding and readiness to fulfill obligations. In cases of execution failure, the JVA should include force majeure clauses, penalty provisions, or renegotiation mechanisms. These provisions provide flexibility and legal certainty if one party cannot fulfill their obligations due to reasons beyond their control.

CONCLUSION

The establishment of a limited liability company (PT) through a joint venture scheme between Foreign Investment (PMA) and Domestic Investment (PMDN) offers potential benefits but is not without various legal risks. One of the main risks is the inconsistency between the contents of the Joint Venture Agreement (JVA) and the Articles of Association (AoA) of the PT that has been registered. Such inconsistency can lead to operational conflicts, especially if there are differing provisions regarding management structure, profit-sharing, or decision-making mechanisms. Another issue arises when governance arrangements are disproportionate—for example, the dominance of one party in the General Meeting of Shareholders (GMS) or the board of directors—which may create imbalance and potentially lead to conflict. Divergent objectives between the PMA and PMDN parties can also trigger friction, particularly if not anticipated in the agreement. Furthermore, violations of foreign ownership limits stipulated in the Positive Investment List (PIL) may result in administrative sanctions, including the revocation of business licenses, if Indonesian legal requirements are not met.

Other risks include differing interpretations of the agreement due to contrasting legal backgrounds. This is often caused by differences in legal systems and business cultures, which increase the likelihood of misinterpreting ambiguous clauses in a JVA and may result in disputes between the parties. To mitigate these risks, it is essential for the parties to draft the JVA and AoA in a harmonious and consistent manner, involving legal advisors who understand both Indonesian law and international business practices. The agreement must include fair allocation of authority, clear limitations on decision-making, and effective dispute resolution mechanisms such as arbitration. With this approach, the joint venture can be carried out in a stable, sustainable manner that complies with all applicable legal provisions.

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