

# Nominee Agreement: Legality in Disguise

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## OVERVIEW

With the majority of its industrial and business sectors experiencing rapid development in recent times, Indonesia is transforming into a key and significant player in the global economy. The ongoing challenge is to find a balance between making the nation an attractive place for investors to expand their businesses and provide for the flow of large scale foreign investment. At the same time putting appropriate limits on and managing such foreign investment that will gain importance with the upcoming commencement of ASEAN Economic Community (AEC).<sup>1</sup>

Like all sovereign states, Indonesia must give due consideration to protecting its national interests against foreign parties whose objectives may be more profit than social orientation. While in principle Law [No. 25 of 2007](#) on Investment (“Investment Law”)<sup>2</sup> ensures equal treatment for every investor in Indonesia, foreign investors are required to comply with all applicable laws and regulations in force in Indonesia.<sup>3</sup>

One such regulations is Presidential Regulation [No. 39 of 2014](#) on List of Business Sectors that are Closed and Conditionally Open for Investment (“Negative Investment List”)<sup>4</sup> which specifies restrictions and limitations on foreign shareholdings in certain businesses sectors in Indonesia. As a way to accommodate these restrictions and limitations, foreign parties commonly enter into what is referred to as a nominee arrangement with an Indonesian party.

<sup>1</sup> As background information, one of the objectives of AEC is free investment flow amongst ASEAN members, including Indonesia. For more information on AEC, see [ILD No. 355](#)

<sup>2</sup> For more information on this regulation, see [ILD No. 62](#)

<sup>3</sup> Art. 6 (1) *juncto* Art. 16 letter f, Investment Law

<sup>4</sup> For more information on this regulation, see [ILD No. 357](#)

Nominee arrangements are also often used by foreign parties to circumvent certain prohibitions on land and property ownership, as regulated under [No. 5 of 1960](#) on Basic Agrarian Provisions (“Agrarian Law”).<sup>5</sup> According to available data, currently there are around 50 thousand foreigners owning land and/or property in Bali Island through nominee arrangements.<sup>6</sup>

According to Black’s Law Dictionary, a nominee is defined as “one designated to act for another as his representative in a rather limited sense. It can be used to signify an agent or trustee. It has no connotation, however, other than that of acting for another, in representation of another, or as the grantee of another.”

Based on the above definition, in the Indonesian context, foreign parties act as the beneficiary and Indonesian parties as the nominee under nominee schemes. In particular, the beneficiary/trustee structure is a product of English common law and a concept that is not directly recognized under Civil Law countries, including under the Indonesian legal system. However, while perhaps a form over substance issue, similar arrangements may be implemented in Indonesia under the Third Book of the Indonesian Civil Code (“ICiC”), which sets out provisions on agreement law, embracing an open system. This system enables the parties to set an agreement based on their needs, other than what is recognized under the ICC.<sup>7</sup>

In that regard, there are two main types of agreement under the ICC which are subject to general provisions set under the ICC, as follows:<sup>8</sup>

- a. *Nominaat* agreements, which refer to agreements that are recognized (named) and clearly regulated under ICC, e.g. loan agreements or sale and purchase agreements; and
- b. *Innominaat* agreements, which refer to agreements that are developed from common practices after the ICC was established.

Nominee agreements are classified as an *innominaat* agreement,<sup>9</sup> which in principle can be legally concluded. Unfortunately, the validity and binding power of nominee agreement is often challenged in relation to its use in circumventing prohibitions under applicable laws and regulations in regard to investment or land ownership, particularly when such agreements result in disputes between parties involved.

## PURPOSE

This week’s Indonesia Law Digest (ILD) will discuss nominee agreements in relation to investment and land ownership in Indonesia, covering:

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<sup>5</sup> For more information on this regulation, see ILD [No. 323](#)

<sup>6</sup> See “[Negara Rugi, 50 Ribu WNA Kuasai Tanah di Bali](#)”

<sup>7</sup> I.G. Rai Widjaya, *Merancang Suatu Kontrak* (Bekasi: Kesaint Blanc, 2003), page 33 (hereinafter the book will be referred to as “**Merancang Suatu Kontrak**”)

<sup>8</sup> Art. 1339, ICC

<sup>9</sup> Miggi Sahabati, “*Perjanjian Nominee dalam Kaitannya dengan Kepastian Hukum Bagi Pihak Pemberi Kuasa Ditinjau dari Undang-Undang Pokok Agraria, Undang-Undang Penanaman Modal, dan Undang-Undang Kewarganegaraan*,” Master Program of Law Faculty of Universitas Indonesia, Jakarta: 2011, page 23

- a. Validity of nominee agreement under the ICC;
- b. Types of nominee arrangements that are used for foreign investment and land ownership by foreign parties; and
- c. The binding power of a nominee agreement.

## VALIDITY OF NOMINEE AGREEMENT UNDER THE ICC

As an *innominaat* agreement, a nominee agreement must comply with the general provisions on agreement set out in the ICC's Third Book. In that regard, a nominee agreement is deemed valid if it meets the requirements under ICC Article 1320, as follows:

- a. There must be consent between the parties that conclude the agreement;
- b. The agreement is concluded by competent individuals;
- c. There is a specific object regulated under the agreement; and
- d. The agreement is concluded for an admissible cause.

The first and second requirements are often categorized as subjective requirements, as they relate to the subject of the agreement. Meanwhile, the last two requirements are referred to objective requirements as they relate to the agreement's object.<sup>10</sup>

Violation of the subjective requirements may cause an agreement to be voidable. In that case, one of the parties may request the court to cancel the agreement. On the other hand, violation of an objective requirement causes the agreement to be null and void. By that, the agreement will be deemed to have never existed and any legal acts will be reinstated to the original state prior to agreement.<sup>11</sup>

In addition, an agreement must also be concluded in accordance with general principles that underlie the ICC, including:

- a. Freedom of contract, based on the open system of the Third Book of the ICC and ensures that every party is able to conclude an agreement with any other party, in any matter and form, provided that the agreement does not violate applicable laws and regulations, public order, and decency;<sup>12</sup>
- b. Be consensual, requiring that an agreement is concluded when the parties have reached a meeting of minds or consensus regarding the agreement's content;<sup>13</sup>
- c. *Pacta sunt servanda*, meaning a valid agreement is binding as law on its parties;<sup>14</sup> and
- d. Privy of contract, which provides that an agreement only binds its parties and must not harm nor benefit third parties, except for reasons provided under Article 1317 of ICC regarding agreements for third parties.<sup>15</sup>

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<sup>10</sup> Page 55, Merancang Suatu Kontrak

<sup>11</sup> Idem.

<sup>12</sup> Art. 1337 *juncto* Art. 1338 (1), ICC

<sup>13</sup> Art. 1320 *juncto* Art. 1338, ICC

<sup>14</sup> Art. 1338 (1), ICC

<sup>15</sup> See Art. 1340 of ICC. The examples of agreements for a third party include freight forwarder agreements or life insurance agreements. (Herlien Budiono, *Ajaran Umum Hukum Perjanjian dan Penerapannya di Bidang Kenotariatan*, (Bandung: PT Citra Aditya Bakti, 2011), page 159)

### Consent of the Parties

Pursuant to consensual principle, an agreement is concluded when there is consent between the parties to the agreement. However, the ICC regulates that consent must not be given under the following circumstances:<sup>16</sup>

- a. Error, due to unclear description of the agreement's subject and/or object (substance);<sup>17</sup>
- b. Force by either party to the agreement or a third party, which frightens the coerced party and causes him/her to consent to the agreement;<sup>18</sup> or
- c. Fraud, if without such deceit the consent would not have been given.<sup>19</sup>

The element of consent in an agreement relates to the principle of freedom of contract based on which the parties may decide the agreement between them based on their needs. Up to this stage, a nominee agreement in principle is allowed. However, it must be noted that freedom of contract is limited to the provisions of applicable laws and regulations, public order, and decency.<sup>20</sup>

### Competence of the Parties

The element of competence relates to the subject of the agreement as the holder of rights and obligations under the agreement. Under Article 1329 of ICC, every individual is entitled to conclude an agreement, unless declared incompetent by the law. In this regard, incompetency refers to minors or individuals under guardianship.<sup>21</sup> If an agreement is entered into by a corporation, an incompetent party would be anyone beside a member of the board of directors, as specified in the company's articles of association.<sup>22</sup>

In general, Article 330 of the ICC defines minors as individuals who have not reach the age of legal majority (21 year old) and have not been married. Meanwhile, Article 433 of ICC refers to individuals under guardianship as any adult who is in a continuous state of simple-mindedness, insanity, rage, or with a lavish attitude.<sup>23</sup>

For the purpose of discussion in this ILD, the parties to nominee arrangements are foreigners as the beneficiary and Indonesian parties as the nominee. According to Law [No. 12 of 2006](#) on Citizenship ("Citizenship Law"), every individual who is not an Indonesian citizen will be deemed a foreigner.<sup>24</sup> For this purpose, Article 4 of the Citizenship Law sets out the criteria for individuals who are deemed as Indonesian citizens, including:

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<sup>16</sup> Art. 1321, ICC

<sup>17</sup> Art. 1322, ICC

<sup>18</sup> Art. 1324, ICC

<sup>19</sup> Art. 1328, ICC

<sup>20</sup> Art. 1337, ICC

<sup>21</sup> Previously, Article 1330 also included married women as incompetent individuals, however, this provision has been revoked by Supreme Court Circular Letter [No. 3 of 1963](#).

<sup>22</sup> Pursuant to Article 98 (1), Law No.40 of 2007 on Limited Liability Company

<sup>23</sup> Guardianship is based on a court decision upon a request from the incompetent individual, his/her family, or even a public prosecutor. (Art. 434 *juncto* 435, ICC)

<sup>24</sup> Art. 7, Citizenship Law

- a. Any individual who become an Indonesian citizen based on applicable laws and regulations and/or on agreements between the Indonesian government with other countries before the Citizenship Law came into force; and
- b. Children born from wedlock between Indonesian citizens, or between an Indonesian citizen and a foreign national.

### Object of an Agreement

An agreement must have a specific object for which the object must be tradable. The quantity of the object may be uncertain, provided that its quantum can be later determined or calculated.<sup>25</sup> Furthermore, the ICC also enables an agreement to be concluded for an object that will only be available in the future, except for inheritance.<sup>26</sup>

In many cases, a nominee arrangement may, but not necessarily, provide for the beneficiary to own certain objects which the law prohibits for them from holding. One such scenario is the object of a nominee agreement for investment being the ownership of shares of a limited liability company may be limited or restricted to foreign parties under Indonesian laws and regulations, e.g. the Negative Investment List.<sup>27</sup>

As background information, foreign direct investment in Indonesia must be conducted in the form of limited liability company (*perseroan terbatas*) that is established under Indonesian laws and domiciled in Indonesia.<sup>28</sup> Pursuant to Law [No. 40 of 2007](#) on Limited Liability Company ("Company Law"), a limited liability company is a legal entity that is established based on an agreement, the purpose of which is to act as a vehicle to conduct business activities with its authorized capital transformed to shares.<sup>29</sup>

Furthermore, a limited liability company must be established by two or more parties based on a notarial deed and drawn up in the Indonesian language. The parties may be Indonesian or foreign individuals and/or legal entities.<sup>30</sup>

A nominee agreement for investment is often used by foreign investors to control more shares than what is allowed under the Negative Investment List, or simply to hold the rights that are attached to shares.<sup>31</sup> In the extreme, in substance but not necessarily in form, a nominee agreement may also be used by foreign investors to become the sole shareholder of the company they invest in.

A further object of nominee agreements under the discussion in this ILD relates to Indonesian land, which is governed under the Agrarian Law that divides land into several categories based on the rights

<sup>25</sup> Art. 1332 *juncto* Art. 1333, ICC

<sup>26</sup> Art. 1332, 1333, and Art. 1334, ICC

<sup>27</sup> See ILD [No.357](#)

<sup>28</sup> Art. 5 (2), Investment Law

<sup>29</sup> Art. 1 (1), Company Law

<sup>30</sup> Art. 7 (1) and its elucidation, Company Law

<sup>31</sup> According to Article 52 (1) of the Company Law, a company's shareholders are entitled: (i) to attend the general meeting of shareholders and cast their votes at the meeting; (ii) receive the dividends or assets remaining from a liquidation; and (iii) to enforce other rights provided under the Company Law.

attached to the land. Each type of land rights serve as basis for determining the parties that are entitled to hold certain rights as listed below:<sup>32</sup>

Right over Land	Entitled Owner
Freehold ( <i>hak milik</i> )	Freehold land may be owned by : a. Indonesian citizens; <sup>33</sup> and/or b. Other legal entities determined by the government such as state-owned banks, agrarian cooperatives, and religious and social entities. <sup>34</sup>
Right to Farm ( <i>hak guna usaha</i> )	Right to farm may be owned by: <sup>35</sup> a. Indonesian citizens; and b. Indonesian legal entities.
Right to Build ( <i>hak guna bangunan</i> )	Right to build may be owned by: <sup>36</sup> a. Indonesian citizens; and b. Indonesian legal entities.
Right to Use ( <i>hak pakai</i> )	Right to use may be owned by: <sup>37</sup> a. Indonesian citizens; b. Indonesian legal entities; c. Ministries, non-ministerial government institutions, and regional governments; d. Religious and social entities; e. Foreigners domiciled in Indonesia; f. Representative offices of foreign corporations; and g. Foreign missions and representatives of international organizations.
Leasehold ( <i>hak sewa</i> )	Land under leasehold is available for: <sup>38</sup>

<sup>32</sup> Art. 16, Agrarian Law

<sup>33</sup> Art. 21 (1), Agrarian Law

<sup>34</sup> Art. 21 (2) of Agrarian Law *juncto* Art. 1 of Government Regulation [No. 38 of 1963](#) on Designation of Corporations Permitted to Hold Land Rights

<sup>35</sup> Art. 30 (1), Agrarian Law

<sup>36</sup> Art. 36 (1), Agrarian Law

<sup>37</sup> Art. 39 of Government Regulation [No. 40 of 1996](#) on Right to Farm, Right to Build, and Right to Use Land

<sup>38</sup> Art. 44 (1) and Art. 45, Agrarian Law

	a. Indonesian citizens; b. Non-residents; c. Indonesian legal entities; and d. Representatives of foreign corporations.
Right to Clear Land <i>(hak membuka tanah)</i>	n/a
Right to Collect Forest Products <i>(hak memungut hasil hutan)</i>	n/a
Right to Manage <i>(hak pengelolaan)</i>	Land with a right to manage may be granted to government institutions, such as regional government institutions, state-owned and regional-owned enterprises, and other government corporations assigned by the government. <sup>39</sup>

From the table above, it can be seen that foreign parties are only allowed to hold land attached to as a right to use or leasehold. Nominee agreements are usually entered by foreigners to hold property under a freehold, right to farm, or right to build land right.

### Admissible Cause

Pursuant to ICC, an agreement is unenforceable if it doesn't have a cause or is concluded based on false or prohibited causes. A cause is prohibited if it's restricted under applicable laws and regulations or contravenes public order or decency.<sup>40</sup>

In that sense, a nominee agreement may still be enforceable, unless the cause is proven to be prohibited or if it violates applicable laws and regulations, public order, or public decency. The fact remains, however, that nominee practices are mostly used by foreign parties to circumvent restrictions and limitations under Indonesian laws and regulations.

In regard to investment, a nominee practices are clearly prohibited. The Investment Law explicitly prohibits domestic and/or foreign investors from concluding an agreement with a cause of specifying shares ownership for and on behalf of another party. Furthermore, the Investment Law also provides that such agreements and statement will be deemed null and void.<sup>41</sup>

<sup>39</sup> Art. 67 (1) of Minister of Agrarian Matters and Head of National Land Agency Regulation [No. 9 of 1999](#) on Procedures to Grant and Annul Rights to State Lands and Rights to Manage

<sup>40</sup> Art. 1335 *juncto* Art. 1337, ICC

<sup>41</sup> Art. 33 (1) and (2), Investment Law

Nominee agreements for land ownership are also prohibited if the basis is to transfer restricted land rights to foreign parties. As listed above, foreign parties are only entitled to land under a right to use or leasehold. More specifically, the Agrarian Law has expressly states that freehold land can only be owned by Indonesian citizens or legal entities as determined by the government.<sup>42</sup>

Based on the above, the Agrarian Law operates such that the following parties must release their freehold land:<sup>43</sup>

- a. Foreigners who inherit freehold land or obtain such land due to a marriage with an Indonesian citizen;<sup>44</sup>
- b. Indonesian citizens who lose their Indonesian citizenship; or
- c. Indonesians with dual citizenship.

The release of a freehold right under the above must be realized within one year after a party obtains land (point a), loses his citizenship (point b), or secures foreign citizenship (point c). If not, the freehold right will be deemed as removed by law and the land will be taken over by the state.<sup>45</sup>

Further, the Agrarian Law also prohibits any sale and purchase, exchange, grant, or activity which directly or indirectly transfers freehold land to a foreign citizen or legal entity (unless the legal entity is determined by the government). Any such transfer will be deemed as null and void and result in the respective land being returned to the state.<sup>46</sup>

As a consequence, any nominee agreement that provides for the transfer of freehold land to a foreign party will be deemed as not having an admissible cause as it violates the above provisions.

## TYPE OF NOMINEE ARRANGEMENT

The concept of a nominee is usually incorporated under a nominee agreement which specifies the scope of the nominee arrangement, including the rights and obligations of the parties in carrying out the nominee practice. Nominee agreements are often supported or even transformed into other forms of agreements which disguise the nominee practice. An interesting question to ponder is under what circumstances could an apparent nominee arrangement move from being a nominee arrangement to becoming a true mutually beneficial cooperative arrangement, a joint venture of forms?

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<sup>42</sup> Art. 21 (1) and (2), Agrarian Law

<sup>43</sup> Art. 21 (3) and (4), Agrarian Law

<sup>44</sup> Law [No. 1 of 1974](#) on Marriage (“**Marriage Law**”) recognizes joint property under a marriage, including the marriage between Indonesian citizens and foreigners. However, this obligation may be exempted if the married couple have a pre-nuptial agreement which separates the couple’s property during marriage. (Art. 35 *juncto* Art. 29, Marriage Law)

<sup>45</sup> *Idem*.

<sup>46</sup> Art. 26 (2), Agrarian Law

### Nominee Agreements for Investment

The following agreements are often used by foreign investors to obtain control over their investment:<sup>47</sup>

a. Loan agreement and pledge of shares agreement

The beneficiary will provide certain funds as loan to the nominee to subscribe shares in a certain company. Following the loan agreement, the beneficiary and nominee will also enter into an agreement under which the nominee pledges the issued shares subscribed for using the loan.<sup>48</sup>

b. Assignment of dividend agreement

The nominee transfers his rights to receive dividends as a shareholder to the beneficiary.

c. Irrevocable power of attorney for General Meeting of Shareholders (“GMS”)

The nominee authorizes the beneficiary to request the following: (i) hold a GMS; and (ii) attend and cast votes in the relevant company’s GMS. The power of attorney usually waives Articles 1813, 1814 and 1816 of ICC in order to make it irrevocable which is actually contrary to Article 60 (4) of the Company Law that does not allow the transfer of voting rights to be separated from share ownership.

d. Irrevocable power of attorney to sell shares

The nominee irrevocably authorizes the beneficiary to sell the nominee’s shares

### Nominee Agreements for Land Ownership

The types of agreement that are usually used to materialize nominee arrangements to obtain land for foreigners are as follows:<sup>49</sup>

a. Land ownership agreement including a power of attorney

The nominee will acknowledge that land registered under his name actually belongs to the beneficiary who provided the funds to purchase the land. In addition, the nominee will provide an irrevocable power of attorney to authorize the beneficiary to conduct any activities on the land.

b. Option agreement

The nominee will provide the beneficiary with options to purchase the land that was purchased by the nominee with the beneficiary’s fund.

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<sup>47</sup> See [“Regulations on Foreign Investment Restrictions and Nominee Practices in Indonesia”](#) written by David Kairupan for *Mimbar Hukum* (Volume 2, Number 2, June 2013), page 322 - 325

<sup>48</sup> According to Article 60 of Company Law, shares are movable goods which can be collateral in the form of a pledge or fiducia security. For more information on pledge, see ILD titled [“The Truth about Security Interests: Movable Property”](#)

<sup>49</sup> Sumardjo, Maria S.W., *Alternatif Kebijakan Pengaturan Hak atas Tanah beserta Bangunan bagi WNA dan Badan Hukum Asing*, Second Edition (Jakarta: Kompas, 2008), page 14-15

c. Lease Agreement

The nominee will lease the land to the beneficiary for a certain lease period, with an option for an extension.

d. Grant with Testament (*Hibah Wasiat*)

The nominee will grant his land and properties to the beneficiary.

e. Loan Agreement

The beneficiary will provide certain funds as a loan for the nominee to purchase the land. Following the loan agreement, the beneficiary and the nominee will enter into an agreement which uses the respective land as collateral for the loan under a mortgage mechanism.<sup>50</sup>

## BINDING POWER OF NOMINEE AGREEMENTS

Based on the above, it can be reasonably concluded there are serious questions about the validity of so called nominee arrangements between foreign parties and Indonesian parties for investment and land ownership purposes. The general nature of such arrangements is to circumvent applicable laws and regulation, and nominee practices are expressly prohibited under the Investment Law and Agrarian Law which deems them null and void.

In this regard, some foreign parties (beneficiaries) go as far as formalizing nominee agreements by having them made into an authentic deed before a notary. The intent is that a notarial deed will provide more legal certainty and may be used as a powerful instrument to evidence their rights over the agreement's objects (shares or land), particularly if there is a dispute between the beneficiaries and the nominees.<sup>51</sup>

Noteworthy, however, is that a notarial deed does not necessarily provide a better position for the beneficiary as there are still many potential issues regarding the validity of the nominee agreement itself which in favor of the nominee, despite the agreement being drafted using a notarial deed. Additionally, a beneficiary should also note that a notarial deed may only become strong and admissible evidence if it meets the following criteria:<sup>52</sup>

- a. Made in compliance with Law [No. 30 of 2004](#) on Notaries, as amended by Law [No. 2 of 2014](#);<sup>53</sup> and
- b. Provides three authentication powers (*kekuatan pembuktian*): physical, formal and material.

<sup>50</sup> Pursuant to Article 25 of Agrarian Law, freehold lands may be used as collateral for mortgage. For more information on mortgage, see ILD [No. 306](#).

<sup>51</sup> Binding court's decision on disputes regarding default against nominee agreement are available on <http://putusan.mahkamahagung.go.id/main/pencarian/?q=nominee>

<sup>52</sup> See "[Akta Notaris Sebagai Alat Bukti Tertulis yang Mempunyai Kekuatan Pembuktian yang Sempurna](#)"

<sup>53</sup> For more information on these regulations, see ILB [No. 2305](#) and ILD [No. 338](#).

## CONCLUSION

There is little doubt that nominee arrangements raise serious questions about their validity and enforceability. Despite such concerns, and for historical and other reasons, the fact remains that many nominee arrangements currently exist for both investment and land ownership purposes. The question then becomes, what should be done about existing arrangements and also going forward? Are there a number of serious time bombs waiting to explode, will practical considerations solve the problem, or can more refined arrangements be formulated that properly accord with the law?