

ARBITRATION, ALTERNATIVE DISPUTE RESOLUTION AND THE IMPORTANCE OF STAKEHOLDER ENGAGEMENT IN INDONESIA

by Piers Gillespie*

A. INTRODUCTION

Indonesia has struggled with a series of diverse challenges within its legal system for decades. The persistence of endemic judicial corruption has meant that shrewd business people have often avoided the formal legal system and preferred to seek alternative resolution of business disputations wherever they can. Indeed, for many years now there has been an increasing recognition of the need for an alternative to litigation to bring about the fast and effective settlement of commercial business disputes in Indonesia.¹ This article will therefore, focus on alternative dispute resolution ('ADR') in Indonesia, but also suggest that the inclusion of competent stakeholder engagement ('SE') processes should be an intrinsic part of the dispute resolution process for businesses in Indonesia.

An important premise of the stakeholder approach is the acceptance that successful work and how it is carried out in organisations is fundamentally about relationships — relationships between a firm and its employees; relationships of employees with one another; relationships between a firm

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National Indonesian Arbitration Board (BANI) regulation clauses accurate at time of research.

1 Fitri Wulandari, 'Commercial Dispute Centre Officially Opened by Minister', *The Jakarta Post* (Jakarta), 15 September 2004; E Thor *et al*, 'Rural Centres for Alternative Dispute Resolution and Peace Making for Resolving Conflicts in the Pacific Rim: The Case of Indonesia and Arizona', Unpublished Document (2003).

and its investors, suppliers, partners, regulators, and customers.² Stakeholder engagement provides a framework — albeit an imperfect one — for any organisation to deal with these diverse relationships and to acknowledge how important they are in all forms of business endeavours. Unfortunately, this lesson is often overlooked, and a legal approach is often used for dispute resolution in international business whereas in the case of offshore cross-cultural investment, it should often only be seen as providing part of a residual form of security secondary in nature to the existing bilateral relationship itself.³

To further examine the potential of stakeholder theory and its use as part of a dispute avoidance methodology in Indonesia, a brief overview of the Indonesian judicial system is necessary. Section B will focus on the Indonesian legal system and ADR in Indonesia, and provide a comparison of the 1999 Indonesian Arbitration and Alternative Dispute Resolution Act ('A&ADR Act 1999') with the provisions delineated in the United Nations Commission on International Trade Law ('UNCITRAL') Model Law on International Commercial Arbitration. It will outline the role of the Badan Arbitrase Nasional Indonesia — the Indonesian National Arbitration Board ('BANI') in modern times and discuss how the Indonesian courts have often been able to usurp the role of BANI by taking over cases that have legitimate arbitration clauses in their contracts.

Section C of the article will then assess the theory of SE and delineate why it should be incorporated as part of a dispute avoidance process in Indonesia. The discussion will consider some of the critiques of SE, but conclude that the theory offers too much potential for it not to be considered as part of a relationship-focused business approach. The article will conclude with a case study of an Indonesian business dispute involving a multinational company from 1999 to 2000. This case study shows how, due to the state of the Indonesian judicial system, the Indonesian courts were able to essentially 'take over' a dispute that should have been arbitrated. It will also demonstrate the inability of the multinational company and their legal counsel to look at the dispute *sans* the narrowing lens of a fundamentally 'lawyered' approach.⁴ Fundamental to the article's analysis is the consideration of how pre-emptive stakeholder relations and relationship building may help in avoiding recourse to formal legal process in a country where the judicial system is generally

2 Leana Carrie and Denise Rousseau, *Relational Wealth* (2000), Oxford University Press: London, p 13.

3 S Lane Deakin, 'Trust or Law? Towards an Integrated Theory of Contractual Relations between Firms' (1994) 21 *Journal of Law and Society* 337.

4 Todung Lubis, 'International Arbitration Developments in Indonesia', *The Jakarta Post* (Jakarta), 10 December 2004.

considered corrupt. Whilst there are many occasions when involving the court is the only remaining strategy, the article will suggest that taking this option as the first approach in a country such as Indonesia is not only naïve and narrow-minded, it also disregards the considerable potential SE has to develop collaborative alternative resolution processes.

B. THE INDONESIAN LEGAL SYSTEM AND ADR IN INDONESIA

1. *An Overview of Indonesian Law*

In a broad sense, Indonesia uses a civil law system similar to that found in European nations such as France, Germany and the Netherlands.⁵ This results from the historical Dutch colonial domination of Indonesia, which saw the Dutch legal system implemented across the archipelago. A cursory examination of the original concepts of the 1945 Constitution confirms the profound influence this domination has had on the Indonesian legal system, with well over 400 pieces of Dutch legislation remaining in force in the Indonesian civil code. Much of Indonesia's existing constitutional legislation can still be traced back to the Dutch institutions, legal interpretations and even the laws existing at that time.⁶ Indeed, even today it is not uncommon when reading Indonesian legal briefs and outlines that the Indonesian language of Bahasa is interspersed with confusing-looking Dutch terms from the 17th century.⁷

In many ways, Indonesia is still struggling with the ongoing challenge of creating a truly Indonesian legal system. The challenge relates to the process of

5 For reasons of brevity, this article will not focus on the uniqueness of the Indonesian legal system, which is perhaps more accurately described as a mix of several legal systems interwoven and operating simultaneously. There is the secular law of the nation state; the religious courts and religious edicts given by *ulama* and Islamic leaders; and there is the continuing influence of *adat* law, or local custom, on local communities. All of these systems remain influential across the archipelago. For more information on the interplay between the differing legal systems, see MB Hooker, *A Concise Legal History of South East Asia* (1978), Clarendon Press: Oxford, and Ratno Lukito, 'Law and Politics in Post-Independence Indonesia: A Case Study of Religion and Adat Courts' (1999) 6 3 *Studia Islamika* 1–31.

6 Sunarti Hartono, 'Indonesia's Legal Reform in a Nutshell' (2002) 7 *Uniform Legal Review* 990.

7 Tim Lindsey (ed), *Indonesia: Law and Society* (1999), Federation Press: Leichardt, p 1. Indeed, the Indonesian Parliament, the MPR, today still closely resembles the Hoger Huis; the Indonesian Legislature, the DPR, is akin to the Dutch Parliament; and the Attorney General's Office resembles the *Raad De State*. See Hartono, *supra*, n 6 at 990.

replacing a colonial legal system with an indigenous nation-wide legal system that simultaneously can take into account the diverse traditional cultures and religions, fit the needs of a modernising society, and yet still somehow remain uniquely 'Indonesian'.⁸ The fact that it has taken so long to introduce a completely indigenous legal system is neither due to laziness nor a lack of intellectual perspicacity on the part of the early Indonesian leaders who were tasked with defining what sort of law the newly independent country should have. Whilst the new leaders sought to abolish the colonial pluralist system by replacing colonial statutes, *adat* law (local customs) and *shari'ah* law (Islamic law) with fresh new statutes, it was to be a large and time-consuming project, and the critical issues of unifying the country and dealing with the concerns of poverty, disease and hunger for the majority of the population were to be more of a focus.⁹ Accordingly, transitional provisions allowed for all existing institutions and regulations valid as at the date of independence to continue to be valid pending the enactment of new legislation in conformity with the Constitution.¹⁰ The effect of this was to add the new legislation and other laws produced by the government of independent Indonesia virtually on top of the existing, essentially colonial mixture of *adat*, *shari'ah* and Dutch jurisprudence.¹¹

In more recent times, the legal system has ebbed and flowed but remained largely bereft of fundamental change up to the present period because it benefited both of Indonesia's first two Presidents, Sukarno and Suharto, in keeping the law this way.¹² Throughout the 32 years of the repressive Suharto regime in Indonesia — a military-backed regime that was run with an iron

8 Tim Lindsey and MB Hooker, 'Public Faces of *Shar'iah* in Contemporary Indonesia: Towards a National Madhhab' (2003) 10 23 *Studia Islamika* 5.

9 Aliza Za'inuddin, *A Short History of Indonesia* (1980), Cassell: NSW. The task was also made all the more complex by the reality of the virtually non-existent logistical support across the archipelago in the national court system, an issue which has not been overcome to this day. See Tim Lindsey and MB Hooker, 'Public Faces of *Shar'iah* in Contemporary Indonesia: Towards a National Madhhab' (2003) 10 23 *Studia Islamika* on the logistical and physical state of Indonesian courts today.

10 Hartono, *supra*, n 6 at 990. Article II of the Constitution states that 'All Government institutions and regulations which existed on 18 August 1945 will continue to exist and apply unless expressly changed by law.'

11 Despite these similarities, there is also evidence of new ideas and examples of new thinking in the 1945 Constitution, which consistently spring from the state philosophy laid down in the Preamble. These include, among others, the right to work for a decent living (Art 27(2)) and the right to assemble and organise (Art 28). See Hartono, *supra*, n 6 at 990.

12 Real reform has been resisted for years, particularly during the Suharto regime, which relied on the exercise of far-reaching executive authority and the grant of commercial monopolies almost exclusively to the President's inner circle. See

fist and which only came to an end in 1998 – reform of the legal system was not what could be termed a development priority.¹³ As a consequence, many Indonesians do not believe in the notion of the ‘rule of law’ because they have had virtually no experience of such a concept.¹⁴ Consequently, the present day judicial system is deeply corrupt, usually incompetent and generally ineffective.¹⁵ The judicial system remains a legal system beset by problems such as a lack of appropriate legal training for senior officials and judges, poor salaries for judges and court officials, antiquated facilities, and an extremely low level of general state funding for a functioning legal system. Allegations of corruption, collusion and government interference remain prevalent throughout the entire judicial decision-making process, and much of Indonesian society has lost any remaining faith in the court system that they have been so reluctant to use for many years.¹⁶

2. *Dispute Resolution in Indonesia*

Since 1998, the Indonesian legal system has been the focus of many attempts at legal reform, with far-reaching legislation being implemented on many issues as diverse as regional autonomy; a circumscription on the role of the armed forces in Parliament; the implementation of a limited *shari’ah* law in Aceh; and many other issues.¹⁷ Unfortunately, however, one of the realities of the

David Jenkins, *Suharto and His Generals* (1984), Ithaca Press: New York, Cornell University Modern Indonesia Project No 64.

13 Gary Goodpaster, ‘The Rule of Law, Economic Development and Indonesia’, in Lindsey, *supra*, n 7 at 22. For more on this see Harold Crouch, *The Army and Politics in Indonesia* (1978), Cornell University Press: New York.

14 Arief Budiman, quoted in Introduction, Lindsey, *supra*, n 7 at 7. Under the New Order government led by Suharto, the law was consistently manipulated to maintain political power, and the expression ‘law of the ruler’ was heard more often than ‘rule of law’.

15 Daniel S Lev, ‘Between State and Society: Professional Lawyers and Reform in Indonesia’, in Lindsey, *supra*, n 7 at 145. See also Tim Lindsey, ‘Black Letter, Black Market and Bad Faith: Corruption and the Failure of Law Reform’ in Chris Manning, *Indonesia in Transition: Social Aspects of Reformasi and Crisis* (2000), Zed Books: London, p 279.

16 Simon, Butt, ‘The Eksekusi of the Negara Hukum: Implementing Judicial Decisions in Indonesia’, in Lindsey, *supra*, n 7 at 247. Indonesian judges continue to lack the recognition, salary, prestige and aura of judges associated with the judiciary in other jurisdictions internationally. Bernhard Quinn, ‘Patrimonial or Legal State? The Law on Administrative Justice of 1986 in Socio-Political Context’, in Lindsey, *supra*, n 7 at 262.

17 The process generated extreme excitement, and was colloquially known by Indonesians as ‘reformasi’ – reformation. For more on this period, see Adam

continued on the next page

law reform process in Indonesia post-Suharto is that although there are many laws that have been subject to considerable reform, it is very hard to actually locate any successfully reformed laws.¹⁸ The result has meant that the vast bulk of Indonesian law takes the form of constantly changing, contradictory, interconnected and conflicting governmental decrees and decisions, presidential decrees, directives and instructions, ministerial decisions and other forms of subordinate law made by the executive.¹⁹ This creates the obvious difficulty and uncertainty in identifying the formal instrument under authority of which bureaucratic decisions are made in the modern Indonesian state.²⁰

In terms of ADR in Indonesia, because ex-President Suharto had managed to effectively control the judiciary essentially as an extension of the bureaucracy, there has been no modern history of any functioning formal mechanism for rational transaction management or dispute resolution.²¹ As a result, alternative, irregular and informal methods of dispute resolution and transaction management increased to fill the vacuum created by a popular fear of the court and politics, which more often than not took the form of petty corruption and facilitation payments, as well as more sophisticated traditions of informal dispute resolution.²² The creation of this system was not principally the product of an inherent cultural propensity to informal systems and not a supposed Asian preference for harmonious and informal dispute resolution processes. Rather, it was more closely related to what was a rational response to the state's failure to provide a relevant and formal system of 'hard law' that works. As Lindsey notes, where legal injustice is seen to be a reality of daily life, people will utilise different methods and avenues — corruption, threats, violence — to impose their will on the system in order to bring about personally advantageous outcomes.²³

Schwartz, *Indonesia: A Nation in Waiting* (1999), Allen and Unwin: Sydney; Manning, *supra*, n 15.

18 Lindsey, *supra*, n 15 at 278. The consensus as to why the vast majority of the modern attempts to implement legal reform in Indonesia have failed is because the reform has often been focused thematically and literally on the black letter reform of several hundred defective statutes and regulations, and has failed to take into account the social realities of a culture and a people that have spent the best part of a generation trying to avoid law.

19 Hartono, quoted in Bernhard Quinn, 'Patrimonial or Legal State? The Law on Administrative Justice of 1986 in Socio-Political Context' in Lindsey, *supra*, n 7 at 257.

20 Quinn, *supra*, n 19 at 259.

21 Lindsey, *supra*, n 7 at 279.

22 *Id* at 289.

23 *Ibid*.

Given such an environment, formal alternative dispute resolution processes, or court-sanctioned mediation, were not acknowledged in Indonesia until a few years preceding the opening of BANI by the Indonesian Chamber of Commerce in 1977. Unfortunately, BANI has struggled to gain significant legitimacy in Indonesia since that time. Widespread ignorance amongst both business people and lawyers continues to exist with regard to the role arbitration plays in conflict resolution, the variety of conflict resolution mechanisms available, and the role BANI plays.²⁴ As the Indonesian legal expert Daniel Lev points out, the fact that both formal and informal mediation is seen as the primary competition to more formal representational roles demonstrates the ignorance surrounding both BANI's role and general ADR processes in Indonesia.²⁵

In Indonesia, dispute resolution can be divided into two forms: informal and formal. With multinationals, when a serious disputation occurs with an issue threatening the continuation of a relationship, the foreign party will most likely seek to immediately enforce its strict legal rights against the Indonesian party using formal recourse and bypassing the informal process outlined above. Once this stage commences, the foreign party's main concern, given that it expects a favourable outcome, will be the implementation of the decision or award against the Indonesian party via the courts or arbitration. Having made the decision to pursue formal, or what Green calls non-consensual, dispute resolution, two options remain: litigate or arbitrate.²⁶ If the decision is taken to litigate, a foreign party is likely to have considerable difficulties in pursuing litigation in Indonesian courts, although this situation has improved markedly over the past few years. Nevertheless, for the reasons given above, mistrust of the Indonesian court system is common among foreign observers and their legal advisers.²⁷ In order to manage this in-country risk, prudent

24 Stephen B Green, 'Arbitration: A Viable Alternative for Resolving Commercial Disputes in Indonesia?' in Lindsey, *supra*, n 7 at 294.

25 Lev, *supra*, n 15 at 298. Notwithstanding the ignorance relating to BANI, there is a considerable amount of generic information on business dispute and conflict resolution in Indonesia that includes the sweeping and general advice that Indonesians avoid confrontation and adversarial systems of dispute resolution, and prefer to settle conflicts by consultation and consensus. Such cultural stereotyping is often misguided. If an adversarial method of dispute resolution is considered by one party to be the best option in the circumstances, this strategy will overshadow any other as a means of resolving a dispute. Indeed, there are many cases where aggressive litigation has been used precisely as such a tool in Indonesia, with the case study analysed in Section D a salient example of this phenomenon. See Green, *supra*, n 24 at 295.

26 Green, *supra*, n 24 at 299.

27 Veronica Taylor, 'Asian Contracts: An Indonesian Case Study', in A Milner and M Quilty, *Australia in Asia: Episodes* (1998), Oxford University Press: Melbourne, p 175.

foreign businesses usually insist on a contract clause specifying that disputes will be resolved by an arbitration panel in a third country, but this approach has its limitations, given that if a matter relating to a contractual agreement involving an Indonesian party is to be upheld, it will only be possible to ultimately enforce the award through an Indonesian court.²⁸ This means that arbitration through BANI is increasingly being used to arbitrate disputes between multinational businesses and Indonesian partners.

3. *Role of BANI*

BANI is an organisation that offers arbitration services throughout Indonesia and provides binding advice regarding questions that evolve out of contractual disputes. Since the mid-1990s, it has consisted of both local and international arbitrators and has seen its profile and reputation grow over the past ten years.²⁹ BANI aims to participate in the law enforcement process in Indonesia through the application of arbitration and alternative dispute resolution processes and assist in resolving disputes in the various sectors of trade, industry and finance.³⁰ BANI will incorporate procedures and rules agreed on by both parties into the individual arbitration process, and will often hear and decide a dispute according to international rules of procedure, such as the International Chamber of Commerce ('ICC') or UNCITRAL Rules.³¹ If the parties outline no specific rules but nevertheless have a clause for arbitration in the business contract, BANI will follow its own procedural rules in conjunction with the regulations primarily contained in arts 35 through 51 of the Indonesian A&ADR Act 1999.³²

28 Green, *supra*, n 24 at 290.

29 Interview with international financial journalist Heather Waugh, 12 January 2006. Following the 1998 economic and political crisis, BANI has had a significant increase in the number of cases it hears relating to debt restructuring and bankruptcy because many are now companies eager to avoid the complications of potentially corrupt district courts, preferring instead to try their luck in arbitration.

30 See BANI website at <http://www.bani-arb.org/bani_main_eng.html> (accessed 31 August 2007), art 1. The organisation provides services for dispute settlement through arbitration and other forms of alternative dispute resolution, such as negotiation, mediation, conciliation and binding opinions.

31 BANI Regulations, art 1 (Arbitration Agreement) and A&ADR Act 1999, arts 31 and 34. Article 31 of the A&ADR Act 1999 provides the means for the parties to designate any rules, and art 34 allows the designation of any arbitral institution on the provisos of mutual agreement on the procedure and that the chosen rules do not conflict with the provisions of the arbitration law.

32 BANI Regulations, art 3(j).

In terms of its outlook, BANI regulations are more condensed than either the ICC or the UNCITRAL Rules, with only 39 individual articles in the regulations.³³ The regulations are generally similar to standard arbitration rules worldwide.³⁴ However, it is clear that international lawyers retain considerable scepticism regarding BANI and its services in Indonesia. A study of foreign lawyers' perceptions of BANI and Indonesian arbitration by Stephen Green revealed that most international lawyers did not recommend arbitration in Indonesia using BANI.³⁵ It is not known whether it is because of concerns over BANI's perceived lack of professionalism, or because the majority of BANI arbitration is not in English (the rules stipulate that as the dispute is taking place in Indonesia, the language to be used in arbitration is to be Bahasa Indonesia),³⁶ or whether it is simply a matter of international lawyers, to use a euphemism, 'protecting their patch'. The study notes that the international lawyers who did not recommend using BANI admitted that they had 'negligible direct or indirect experience of arbitration with BANI', and Green concludes his study by stating that 'there ... is no denying that foreign lawyers lack an awareness of BANI's rules and services and the potential benefit it offers to clients'.³⁷ This has certainly been the author's experience in a number of high-profile cases involving multinationals, where at various times in an ongoing dispute, opportunities for communication and discussion rather than litigation appeared to be crying out for the multinational to take.³⁸

Unsurprisingly, enforcement of BANI awards has not always been problem-free. Although an award made by BANI has the same legal force as a district

33 BANI Regulations, art 5 and UNCITRAL Arbitration Rules, Arts 10–15 provide a good comparison.

34 A comparison with the arbitration rules in the two closest arbitration centres to Indonesia, the Singapore International Arbitration Centre ('SIAC') and the Australian Centre for International Commercial Arbitration ('ACICA'), demonstrates this; the Singapore and Australian rules are more detailed but the BANI regulations contain many of the same articles.

35 Green, *supra*, n 24 at 290. It is important to note that the study is quite dated; it is now over five years old and during that time there have been significant changes to BANI's procedures and experience in international arbitration. Nevertheless the fact that the international firms often bring in lawyers from overseas with little knowledge about Indonesia, its judicial system, or its recent history means that stereotypes about Indonesia and the judicial system are difficult to shake off.

36 BANI Regulations, art 14(1). This may be one reason why international lawyers have demonstrated considerable cynicism towards the organisation and its processes, as we shall see shortly.

37 Green, *supra*, n 24 at 291.

38 *Ibid.* Two suggested disputes here would be the *Manulife Financial* dispute from 2000–2002 and the tyre giant *Goodyear* and their issue in 2003 relating to intellectual property rights within Indonesia.

court decision, it can be nullified by a district court if proven, among others, that:

- the decision is rendered beyond the limits of the agreement;
- the decision is given by virtue of an agreement that has expired;
- procedural formalities have been infringed;
- matters have been decided upon that were not claimed;
- any falsification of documents has occurred; or
- that the decision was based upon either fraud or guile that is discovered after the decision was made.³⁹

These qualifications are broader than the grounds given for the annulment of awards in the UNCITRAL Model Law on International Commercial Arbitration ('UNCITRAL Model Law').⁴⁰ Nevertheless, of the two formal mechanisms for resolving a dispute between foreign and Indonesian parties to a private agreement, Green suggests that domestic arbitration in Indonesia via BANI appears to be the least problematic when it comes to the critical issue of enforcement.⁴¹

4. *The Indonesian Arbitration and Alternative Dispute Resolution Act (Law 30 of 1999) ('A&ADR Act 1999')*

Domestic and international arbitration in Indonesia is now governed by Law 30 of 1999 on Arbitration and Alternative Dispute Resolution and is generally referred to in Indonesia as the Arbitration Law. The most salient features of the Act can be summarised as follows:

- (1) the law applies to both foreign and domestic arbitrations;
- (2) if the parties to a contract have agreed to arbitrate as a first measure, the courts have no jurisdiction over the dispute;
- (3) the parties are free to choose any rules, provided the rules do not conflict with the Arbitration Law;
- (4) the law is final and binding unless it is shown to have been fraudulently applied.⁴²

39 BANI Regulations, arts 39–40. See also A&ADR Act 1999, art 70(a)–(c).

40 Karen Mills, 'Indonesia: Country Overview' in *International Comparative Legal Guide*, available online at <http://www.iclg.co.uk/books/ia/page3.php?page=country_in.htm> (accessed 31 August 2007).

41 Green, *supra*, n 24 at 293.

42 See the A&ADR Act 1999, arts 99, 65, 3, 31(i), 51 and 70(c). In general, there is no appeal from an arbitration award. Application may be made to annul either domestic or international awards, but only on very limited grounds, primarily involving withholding of decisive documentation, forgery or fraud. Although the court may not review the reasoning in an award, it may only execute a domestic

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The A&ADR Act was enacted in 1999 largely because it was deemed that the current Indonesian regulations applicable to dispute resolution were no longer sufficient to address the complex developments in the business world and law in general.⁴³ Upon assent, the Act replaced arts 615–651 of the Civil Procedure Rules of the Republic of Indonesia.⁴⁴ It sought to assist in regulating the resolution of disputes or differences of opinion between parties having a particular relationship who have entered into an arbitration agreement that explicitly states that all disputes or differences of opinion arising from a legal relationship will be resolved by arbitration or through alternative dispute resolution.⁴⁵ The Act begins with a general provisions section outlining the relevant definitions, with chapters following on the (1) conditions of arbitration; (2) appropriate procedures to be followed; (3) enforcement and annulment of the arbitral award; and (4) conditions under which an arbitrator's mandate may be terminated.⁴⁶ A series of transitional and closing provisions conclude the Act.⁴⁷

a. *Terminology of the A&ADR Act 1999: Comparison with the UNCITRAL Code*

As in other countries, the A&ADR Act 1999 provides Indonesia with a caveat related to public policy. Indeed, the A&ADR Act 1999 has many of the same 'clausal exigencies' and opportunities for interpretation as there are for other countries within international arbitration laws. In the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ('New York Convention'), Art V provides signatory countries with a number of possible clauses that could be used to deny or refuse the implementation

award if both the nature of the dispute and the agreement to arbitrate meet the requirements of the law and if the award is not in conflict with public morality and order. See also Mills, *supra*, n 40 at 9.

43 A&ADR Act 1999, Considerations Section, clause (b).

44 A&ADR Act 1999, art 81.

45 A&ADR Act 1999, art 2. This article is relevant to the case study outlined in Section D, *infra*.

46 A&ADR Act 1999.

47 A&ADR Act 1999, Ch 11. Compared to other international arbitration laws, and particularly the arbitration rules in both SIAC and ACICA, the Act is considerably shorter in length, with far fewer qualifications and terminology definitions, arguably enabling it to be interpreted in a more open manner. See the ACICA Rules available online at <<http://www.acica.org.au/arbitration-rules.html>> (accessed 31 August 2007); for the SIAC Rules, see <<http://www.siac.org.sg/rules.htm>> (accessed 31 August 2007).

of international arbitration awards within the secular state via the use of the phrase 'public policy'.⁴⁸

The use of the phrase 'public policy' has been a tool that has been used to deny the enforcement of international arbitration awards across the world, but it is apparent that the clause was a type of 'necessary evil' needed to ensure the completion and signing of the New York Convention. Predictably, the A&ADR Act 1999 follows suit in this regard, with the phrase 'public order' used in much the same way.⁴⁹ A number of points are of interest here. The use of the phrase 'public order' in clause (c) rearticulates the principle of public policy being legitimately used to nullify an individual international arbitration agreement. The notion of 'public order' is undefined in both the A&ADR Act 1999 and the current BANI Regulations, although previously in the 1985 BANI Regulations, the definition was taken to the broadest extreme with it being explained as 'the basic principles of the entire legal system and society in Indonesia'.⁵⁰ Indeed, the Indonesian phrase 'public order' itself is, the author suggests, even more open to a sovereign interpretation than the UNCITRAL phrase 'public policy', which connotes a relationship more closely linked to government policy. Furthermore, the phrase 'public order' is particularly apt for a country like Indonesia, which possesses over 300 distinct ethnic groups spread across 13,000 islands, and is a country that has experienced significant public disorder via ethnic unrest and disputation continuously throughout its short history.⁵¹ Given this background, the phrase is one that is open to extremely broad interpretation for Indonesia, and anything remotely connected (or indeed not connected, but nevertheless arguable) to public order will be regarded in the most sensitive fashion.

Secondly, the phrase 'falling within the scope of commercial law' in clause (b) is also open to interpretation.⁵² This phrase is used at the beginning of the A&ADR Act 1999 in art 5, which stipulates that only disputes of a commercial nature, or those 'concerning rights which under the law and regulations fall

48 Art V(2) states: 'Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that (a) the subject matter of the difference is not capable of settlement by arbitration under the law of that country; or (b) the recognition or enforcement of the award would be contrary to the public policy of that country.'

49 See A&ADR Act 1999, art 66(c).

50 BANI Regulations 1985, art 4(2), cited in Robert N Hornick, 'Indonesian Arbitration in Theory and Practice' (1991) 39 *American Journal of Comparative Law* 576.

51 For a good overview of this, see Za'inuddin, *supra*, n 9. For an overview of how ethnic unrest and conflict remains in Indonesia, see Schwartz, *supra*, n 17.

52 See A&ADR Act 1999, art 66(b).

within the full legal authority of the disputing parties, may be settled through arbitration'.⁵³ This clause enables significant room for disputing parties to go to the district court and argue that arbitration may not be applicable in a particular case or disagreement. No further explanation of what is meant by 'commercial' is given in the Indonesian Act.⁵⁴ In contrast, the UNCITRAL Model Law provides a far more detailed explanation of what it means by 'commercial'.⁵⁵

Thirdly, one of the most important articles in the A&ADR Act 1999 is art 3, which outlines the jurisdictional limitations of the courts in relation to contracts that have legitimate arbitration clauses. It states that:

... [t]he District Court shall have no jurisdiction to try disputes between parties bound by an arbitration agreement.⁵⁶

Despite this unambiguous clause, Indonesian courts have often become involved in cases even where there have been explicit arbitration clauses in business contracts. In particular, it is the district courts in Indonesia that have used various provisions within the Act to justify their involvement, and particularly those provisions that have been left open to the possibility of interpretation. The UNCITRAL Model Law outlines where it actually envisages court involvement, including, among others, a challenge to the mandate of an arbitrator (Arts 11, 13 and 14); the appropriateness of the jurisdiction of the

53 A&ADR Act 1999, art 5(1).

54 Neither in Chapter One (the General Provisions section) of the A&ADR Act 1999, nor anywhere in the document is there an explanation of what is meant by the word 'commercial'. It is left up to interpretation whether it is to mean what is delineated in the UNCITRAL Model Law, especially given that the A&ADR Act 1999 is not based on the UNCITRAL Model Law and the text has little resemblance to the UNCITRAL Model Law. See Mills, *supra*, n 40.

55 The UNCITRAL Model Law, Part 1, Art 1, Scope of Application states that: 'The term commercial should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency; factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; carriage of goods or passengers by air, sea or road.' The UNCITRAL Model Law thus explains the term fully, emphasising the width of the suggested interpretation and indicating that the determinative test is not based on what the national law may (necessarily) regard as 'commercial'. The A&ADR Act 1999 does not have this broad UNCITRAL Model Law definition in its provisions section.

56 A&ADR Act 1999, art 3.

arbitral tribunal (Art 16); and the setting aside of the arbitral award (Art 34).⁵⁷ The Indonesian A&ADR Act 1999 omits a parallel explanation on where it envisages possible court involvement.

There are a number of other differences that exist between the A&ADR Act 1999 and the UNCITRAL Model Law. One difference is that the former applies to all arbitrations held within the territory of the archipelago of Indonesia, meaning that there is no distinction between 'domestic' and 'international' with regard to the nationality of the parties, or the location of their project or dispute.⁵⁸ This means that the only effective difference between a domestic arbitration — one that is held in Indonesia — and an international arbitration is the arbitration procedures (potentially) and the venue for the enforcement of the award.⁵⁹ Another difference that has been used quite regularly by Indonesian courts as a justification to take over particular cases is that the A&ADR Act 1999 does not specifically require a court to refer to arbitration a dispute that is brought before it where there is an agreement to arbitrate.⁶⁰ It only states that the courts do not have the jurisdiction to hear such a case.⁶¹ This has further opened up the possibility of a court deciding to hear a dispute even in the event there is an arbitration clause between the parties, and it has been used regularly by the Indonesian courts in recent times.

C. STAKEHOLDER ENGAGEMENT (SE) AND ADR

1. *Explaining Stakeholder Theory: Breakthrough or False Hope?*

Although the general concepts pertaining to SE have been present in corporate planning throughout the past half-century,⁶² stakeholder theory has really only risen to prominence during the past 15 years.⁶³ Its rise has occurred simultaneously with the increasing questioning and decline of stockholder

57 UNCITRAL Model Law on International Commercial Arbitration (1985) UN Document No A/40/17/Annex One: Explanatory Note by the UNCITRAL Secretariat, 'Salient Features of the Model Law' (15).

58 Mills, *supra*, n 40.

59 *Ibid.*

60 This point is picked up by Karen Mills in her overview. See Mills, *supra*, n 40.

61 *Ibid.*

62 See CL Barnard, *The Functions of Executives* (1938), Harvard University Press: Cambridge, Mass, cited in Timothy Rowley, 'Moving beyond Dyadic Ties: A Network Theory of Stakeholder Theories' (1997) 22(4) *Academy of Management Review* 888.

63 Rowley, *supra*, n 62 at 887. In this context, network theory and dyadic relationships, both key areas in industrial marketing and purchasing ('IMP'), are also closely related to recent developments in stakeholder theory.

theory — the idea that shareholder returns were the only important yardstick for businesses.⁶⁴ By the 1990s, a range of academic publications and practical business experience were suggesting that stockholder theory was an outdated idea; that in Edward Freeman's words:

[W]e can safely say that the idea of stockholder theory is, or at least should be, intellectually dead. We should now get on with the task of connecting stakeholder theory with traditional normative conceptual schemes.⁶⁵

Stakeholder thinking has led to a view of the firm as an entity embedded in a complex web of relationships with other entities.⁶⁶ Because of this, attention to the interests and well being of those who can assist or hinder the achievement of the organisation's objectives is crucial.⁶⁷ The theory has consequently centred around two related streams: (1) defining the stakeholder concept itself; and (2) classifying stakeholders into categories that provide an understanding of individual stakeholder relationships.⁶⁸

2. *Rational Premise and Promise of SE*

Modern business and management theorists believe that managers need to know about an organisation's external stakeholder groups for the purpose of survival, economic well being, controlling damage, winning friends and coalition building.⁶⁹ The stakeholder view of the corporation suggests that a series of collaborative linkages and behaviours based on shared knowledge, familiarity and trust, can increase revenue, reduce risks and improve

64 R Edward Freeman, 'The Politics of Stakeholder Theory: Some Future Directions' (1994) 4(4) *Business Ethics Quarterly* 214. A recent alternative view to this is seen in IB Lee, 'Efficiency and Ethics in the Debate about Shareholder Primacy' (2006) 31 *Delaware Journal of Corporate Law* 533–587.

65 *Ibid.* Note that although stockholder theory is widely seen as untenable, not everyone accepts this in an unproblematic fashion; see Kenneth Goodpaster, 'Business Ethics and Stakeholder Analysis' (1991) 69 *Business Ethics Quarterly* 53–72.

66 Robert Phillips, *Stakeholder Theory and Organisational Ethics* (2003), Berrett-Koehler Publishers: San Francisco p 13, and Jorg Andriof, *Unfolding Stakeholder Thinking* (2003), Greenleaf Publishing: USA.

67 Phillips, *supra*, n 66 at 16. Note that in this way, stakeholder theory is similar to a large degree to alternative methods of strategic management such as resource dependence theory. See Jeff Frooman, 'Stakeholder Influence Strategies' (1999) 24(2) *Academy of Management Review* 191–205 for more on this relationship.

68 Rowley, *supra*, n 62 at 889.

69 Ronald K Mitchell, 'Towards a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' (1997) 22(4) *Academy of Management Review* 859.

the operating efficiencies of the firm in ways that preserve and enhance operational wealth.⁷⁰ Much of the legitimacy and impetus for those advocating stakeholder theories comes from the notion of fairness and its importance in a bilateral relationship. Social psychologists have studied this carefully by looking at the distinction between distributive and procedural justice, and among their findings has been the fact that people not only have an interest in the fairness of the final outcomes of a distributive process, but are also concerned about the 'justness' of the process of distribution itself.⁷¹ As Lund notes, among the major findings of procedural justice research is the fact that people are more accepting of outcomes when the procedures for distribution are perceived as fair — even in situations where the outcome is undesirable.⁷² The fundamental point here is that outcomes are not the only things that matter in human relationships; the perceived fairness of the procedures employed in a relationship is also a determinant of whether people feel they have been treated fairly and appropriately. Among the most important determinants of the fairness of a particular procedure is the degree of control within the process. Given that the perceived justice of an outcome is substantially determined by the perceived fairness of the process used in the distributive decision-making, it follows that greater participation in decision-making will lead to an increase in the believed fairness of the outcome.⁷³ The major idea of stakeholder theory is, therefore, that relevant stakeholders should have appropriate interaction with an organisation, or a business relationship, either to obtain 'buy-in' to the process or for more normative reasons relating to moral obligations towards stakeholders.

70 James E Post, *Redefining the Corporation: Stakeholder Management and Organisational Wealth* (2002), Stanford University Press: USA, p 56. Organisational wealth is implied to mean here the capacity of an organisation to create value over the long term. The author will not focus on the topic of the link between increased profitability and socially responsible companies; see Stuart Berman, 'Does Stakeholder Orientation Matter?' (1999) 42(5) *Academy of Management Journal* 488–507; DJ Wood, 'Corporate Social Performance Revisited' (1991) 16 *Academy of Management Review* 691–718 for more on this topic.

71 This topic is beyond the scope of this article, but important nonetheless. For more information, see Jason Colquitt, 'Justice at the Millennium: A Meta-Analytic Review of Organisational Justice Research' (2001) 86(3) *Journal of Applied Psychology* 425–445; Jerald Greenberg, 'Organisational Justice: Yesterday, Today and Tomorrow' (1990) 16(2) *Journal of Management* 399–432; and Robert Phillips, 'The Limits of Stakeholder Theory' in Phillips, *supra*, n 66 at 15.

72 EA Lind, *The Social Psychology of Procedural Justice* (1988), Plenum Press: New York, cited in Robert Phillips, 'The Limits of Stakeholder Theory' in Phillips, *supra*, n 66 at 25.

73 Phillips, *supra*, n 66 at 26.

3. Challenge of Table Setting in SE: Who is Invited?

One of the central challenges for SE is the overwhelming desire to find a normative justificatory framework for all stakeholder situations; a search for a 'one size fits all' approach. The problem is that there is no such thing. Every stakeholder approach is unique and can be unpacked into a number of individual stakeholder theories, each of which has its own normative core that is inextricably linked to ideas relating to the way that people feel that corporations should be governed, and the way that managers should act. These approaches will depend on individual subjective viewpoints, be they a feminist approach, a business approach, an ecological approach, or any other definitive viewpoint. Therefore, as Freeman has suggested, any attempt to further define what is meant by stakeholder theory is always going to be misguided because of the impossibility of finding an appropriate, unquestionable and consensus-making moral base.⁷⁴ All of the normative, descriptive, instrumental and metaphorical notions of modern 'stakeholder theory' are tied together in particular political constructions in order to yield not one, as some of the literature may sometimes suggest, but a number of possible 'stakeholder theories'.⁷⁵ In this way the theory is simply a genre of the stories of the way that we could, or would like, things to be.⁷⁶

The complexity inherent in this ethical approach is that it is highly subjective in its selectivity and what one organisation may see as part of its responsibility another may totally dismiss.⁷⁷ The attempt, therefore, to describe one overarching normative stakeholder theory is not much more than a 'disguised attempt to smuggle a normative core past the unsophisticated noses of other academics and business people who are just happy to see the end of the stockholder orthodoxy'.⁷⁸

74 Freeman, *supra*, n 64 at 214.

75 *Ibid.*

76 *Ibid.* There are a myriad of other moral considerations that simply do not fall within the purview of stakeholder obligations that are also important and need to be addressed; ethical matters such as the importance of honesty, of keeping one's word in dealings with others, and so on.

77 An example of two companies with differing stakeholder approaches operating in the same industry is that of BP Indonesia and Exxon Mobil, both operating large-scale oil and gas projects in Indonesia. It is unlikely that Exxon Mobil would be in unison with BP Indonesia on what it would delineate as part of its corporate social responsibility ('CSR') gamut. For an example of BP's international approach see: <<http://www.bp.com/modularhome.do?categoryId=4760&contentId=7009216>> (accessed 31 August 2007). For an example of Exxon Mobil in Indonesia, see: <http://www2.exxonmobil.com/Corporate/Newsroom/Newsreleases/Corp_xom_nr_130802.asp> (accessed 31 August 2007).

78 Freeman, *supra*, n 64 at 214.

a. *Classifying Stakeholders into Categories*

Another perennial issue for stakeholder theory is the confusion relating to stakeholder identity. Whilst considerations of stakeholder interests are nowadays deemed by nearly all to be important, determining just who is a legitimate stakeholder creates considerable argumentation and results in the feeling that the absence of a rigorous normative underpinning represents a gap in the theory itself.⁷⁹ In attempting to answer the issue of selecting stakeholders, stakeholder theorists offer a variety of methodologies on how questions of stakeholder identification might be answered and many writers have attempted to develop an approach to assist in this process.⁸⁰ Stakeholders are at times identified as primary or secondary; as owners and non-owners; as actors or as those acted upon; as voluntary or involuntary; as influencers or non-influencers, and so on.⁸¹ Unfortunately, much of this typology is unhelpful, for what is desired is an outline that can assist in explaining to managers to whom they should be actually paying attention.⁸²

One problem for many of the stakeholder theorists is how to manage entities that have no legitimate relationship with an organisation yet still require attention. This is particularly relevant in a developing country such as Indonesia where there will be times when groups who are not traditionally legitimate may indeed require the most attention. Indeed, in this author's experience, it is these organisations – the ones with no longer any real legitimacy in terms of a direct relationship with an organisation – that have the potential to do great damage if ignored.⁸³ Clearly it is less immediately obvious why an organisation should have to engage with those groups which

79 Phillips, *supra*, n 66 at 84.

80 See, for example, Mitchell, *supra*, n 69; Jeff Frooman, 'Stakeholder Influence Strategies' (1999) 24(2) *Academy of Management Review* 191–206; JB Barney, 'Trustworthiness as a Source of Competitive Advantage' (1994) 15 *Strategic Management Journal* 175–190; T Jones, 'Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics' (1995) 20 *Academy of Management Review* 404–437; and Stuart Odgen and Robert Watson, 'Corporate Performance and Stakeholder Management: Balancing Shareholder and Customer Interests in the UK Privatised Water Industry' (1999) 42(5) *Academy of Management Journal* 526–538 for four different approaches. Many other theorists are published in the *Academy of Management Review*.

81 Mitchell, *supra*, n 69 at 854.

82 *Ibid.*

83 Indeed, as Freeman states: 'Although managers may not think that certain groups are legitimate in the sense that their demands on the firm are inappropriate, there will nevertheless be occasions when managers had better give legitimacy to these groups in terms of their ability to affect the direction of the firm or suffer the consequences.' See Freeman, *supra*, n 64 at 45.

are not significantly related to a firm's operations.⁸⁴ Freeman approaches this problem by reducing all stakeholder interest into what he terms 'prudential interest', and suggesting that a relevant stakeholder is one whom the corporation affects, and in turn, may some day come back to affect the firm's operations.⁸⁵ Such a nihilistic approach by definition, however, must include anyone remotely connected to an organisation, and it seems unable to rule out any group from stakeholder status.⁸⁶ If this is the case, and everyone is a stakeholder of everyone else, then what value is added by the use of the term 'stakeholder'?⁸⁷ Indeed, the inclusion of all groups that may be potentially affected by a managerial decision drives the framework straight back into the 'abyss of stakeholder proliferation and intractability from which the theory of stakeholder identification and salience was intended to save it'.⁸⁸

Phillips utilises a useful approach in which he distinguishes key stakeholders as ones that an organisation would have additional moral obligations *over and above* the obligations one is presumed to have to human beings in general.⁸⁹ Phillips suggests the principle of 'stakeholder fairness' as a means to define which groups are and are not stakeholders, in the sense of having stakeholders deserving of additional moral obligations. It is based upon the notion that some stakeholders merit greater moral considerations in managerial decision-making than others, but that there are other stakeholders nevertheless who might still have a significant effect upon the organisation and its goals.⁹⁰

For Phillips, normative stakeholders are defined as those entities to which the organisation has a moral obligation of stakeholder fairness over and above that due to other social actors. One example would be the local community surrounding a multinational mining company, or the long-term contracted employees who are to be downsized in Seattle because the operations are to

84 As Hermati notes, business managers still have enormous problems with this idea. Many businesses 'simply don't see why stakeholders should have a say in their policies ... and some simply don't want to interact with NGOs or women's groups.' See Minu Hermmati, *Multi-Stakeholder Processes for Governance and Sustainability — Beyond Deadlock and Conflict* (2002), Earthscan: London, p 6.

85 Freeman, *supra*, n 64 at 212.

86 Phillips, *supra*, n 66 at 81.

87 *Id* at 82.

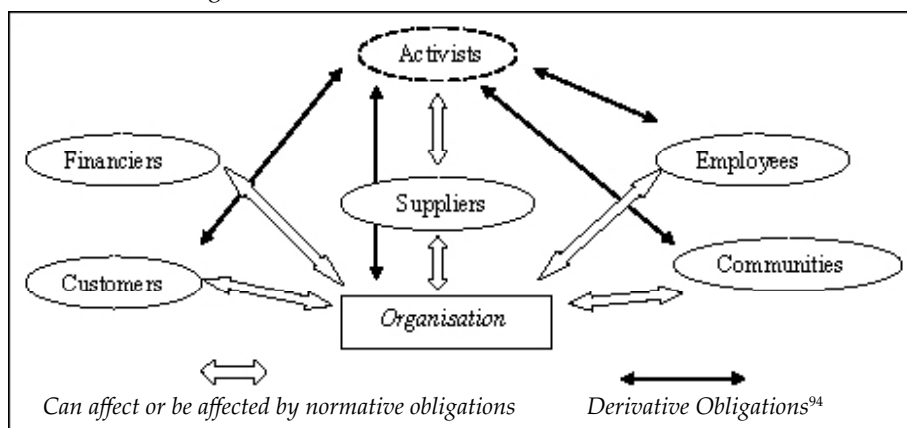
88 *Id* at 130.

89 *Id* at 82.

90 *Id* at 125. Before defining the two main categories, two comments are necessary. Firstly, it is difficult to definitively draw clear lines between various stakeholders using this taxonomy, particularly as status can change as a result of time and the relevant issue. Secondly, within the stakeholder categories themselves, the level of managerial action and obligation will not generally be uniform. See Phillips, *supra*, n 66 at 133.

be outsourced to Shanghai.⁹¹ The normative approach is limited to positive obligations arising in an organisational context. In contrast, legitimate derivative stakeholders are those groups whose actions and claims must be accounted for by managers due to their potential effects upon the normative stakeholders. Attention to derivative stakeholder demands is hence logically secondary, although these demands may still occupy significant managerial attention at any one time.⁹² Managerial attention to these groups – for example, the media – is legitimate, but as this legitimacy is derived from their ability to affect the organisation and its normative stakeholders, consideration of these groups is therefore limited.⁹³ Figure one demonstrates the difference between normative and derivative stakeholders.

Figure One: Normative and Derivative Stakeholders



To deny that a group is a normative stakeholder is not to take anything away from the group to which it was previously entitled, but what it does do is deny the existence of any additional obligation of stakeholder fairness.⁹⁵ In this way, the premise of differentiating between normative and derivative stakeholders is the notion that by improving the specification of stakeholder management, improved clarity and precision regarding the concept of legitimacy and, therefore, the selection of stakeholders will occur.⁹⁶

91 *Id* at 125.

92 *Id* at 134.

93 *Id* at 126. Favourable media coverage is an example of this sort of instrumentality; the organisation may wish to assist in the coverage but still has no obligation by virtue of this coverage to attend to the well being of the media organisation.

94 *Id* at 127.

95 *Id* at 125.

96 *Id* at 134.

4. *Stakeholder Engagement as a Part of ADR: How It Can Help*

Perhaps the major challenge for stakeholder theorists in obtaining greater legitimacy for their position is the fact that advocates of the approach often have to justify their efforts to those who believe that SE does not measurably improve shareholder wealth.⁹⁷ The problem with this is that any justification for stakeholder relations often needs to be couched in the narrow terms of directly maximising shareholder wealth, when SE is more of a moral issue in nature and not directly a financial or property rights argument.⁹⁸ For most managers, focusing proactively on strategies intended to influence stakeholders instead of on the response strategies of firms seems at first a counter-intuitive approach to strategic management theory.⁹⁹ After all, if stakeholder theory is managerial in orientation, shouldn't managers be focusing on current actions, and not on possible actions by derivative stakeholders sometime in the future?¹⁰⁰ As can be seen, there is a dissonance between these two arguments: one is traditionally seen as creating wealth, and the other is seen as taking wealth away and spending it on groups that are not intimately or immediately involved in the organisation. Neither argument is completely accurate, and a paradox lies in the fact that there is an ethical problem whichever approach management takes.

The fact that stakeholder advocates have often had to attempt to quantify their strategy in economic terms demonstrates the short-sightedness of conventional business approaches. Although stakeholder theory may never have as clear a link to competitive advantage as other dominant theories of strategic management, it clearly has implications for a firm's performance. Knowing that a stakeholder may influence a firm in the future is critical knowledge for any manager and fundamental to any risk management approach.¹⁰¹ Neither

97 *Id* at 156.

98 Although not the focus of this article, there are many writers who have drawn a direct relationship between CSR, SE and financial performance. See, for example, Shawn Berman, 'Does Stakeholder Orientation Matter? The Relationship between Stakeholder Management Models and Firm Financial Performance' (1999) 42(5) *Academy of Management Journal* 488–507; Joshua Margolis and James P Walsh, *Misery Loves Companies: Whither Social Initiatives by Business?* (2001), Harvard Business School Working Paper No 01-058; Lawrence Erlbaum, *People and Profits: The Search for a Link between Company Social and Financial Performance* (2001), Mahwah: NJ.

99 Frooman, *supra*, n 67 at 203.

100 *Ibid.*

101 Michael Johnson-Cramer, 'Re-examining the Concept of Stakeholder Management' in Jorg Andriof (ed), *Unfolding Stakeholder Thinking: Relationships, Communication and Performance* (2003), Greenleaf: Sheffield, p 160.

stakeholder theorists nor conventional business analysts are able to accurately predict the potential costs that will accrue to an organisation as a result of a business relationship that may 'go wrong' in the future. Indeed, it is virtually impossible to quantify how expensive a relationship may become without a long list of assumptive-based predictions. Despite this, undertaking forecasts of this nature — and again, particularly in countries like Indonesia — is an essential part of business decision-making.¹⁰²

One analyst, Julia Robbins, has looked closely at the relationship between attempts at corporate SE and whether such a process assists in minimising conflict.¹⁰³ Robbins's findings suggest that the use of initial collaboration with stakeholders did minimise the opportunities for later conflict and she also found that once participating companies had experienced a successful collaborative experience, they consistently switched to using collaborative measures as a first tactic when faced with other controversies in the future.¹⁰⁴ Robbins concluded that whilst conflict is always inevitable, it is the manner in which it is dealt with that is the key to success. As one participant noted, 'collaborations with stakeholders is just part of managing our business well; it just so happens that it also helps us avoid conflicts'.¹⁰⁵

The fact that it is so difficult to quantify the long-term consequences that may arise from a bad strategy, such as a decision to litigate, does not mean it should be avoided in an organisation's decision-making process. Although the idea of managing a derivative stakeholder for many years may seem difficult to accept, it needs to be considered and compared against the reality that taking the litigious example approach above may well result in an uncertain future with an angry and motivated local enemy in their own country. In this way, to not consider the many alternatives available means failing to see the

102 If, for example, a multinational knows that by taking a litigious approach to dispute resolution there is little guarantee of success in the courts and the process will mean that the organisation will now have a determined and powerful business enemy for life, this needs to be weighed up against the potential costs of ongoing SE with this potentially powerful foe.

103 Julia Robbins, 'Stakeholders and Conflict Management: Corporate Perspectives on Collaborative Approaches' in Andriof (ed), *supra*, n 101 at 162. As part of her research, Robbins undertook interviews with 20 individuals from Canadian companies in the natural resources field who had played key roles in deciding how to address conflict with external stakeholders. She sought to investigate whether it is possible to avoid or minimise the use of adversarial approaches, and instead use collaborative approaches as a first tactic and not as a secondary alternative to be tried after all adversarial approaches have failed to address conflict with external stakeholders.

104 *Id* at 170.

105 *Id* at 176.

potential in alternative dispute resolution options and failing to genuinely consider undertaking holistic decision-making processes. Regardless of its epistemic foundations, be they truly altruistic or instead merely selfish in nature, an organisation that undertakes SE will have a powerful framework for deriving and interpreting ethical relationships with external groups through an approach that is naturally more open to a variety of dispute resolution processes.

D. MULTINATIONAL BUSINESS CASE STUDY AND FAILURE OF COMMUNICATION (2000)

1. *The Case*

The 1999/2000 Indonesian case study outlined briefly below is indicative of a number of the central themes within this article: the weakness of the Indonesian legal system; the ineffectiveness of BANI; the way Indonesian courts are able to ignore arbitration agreements; and the inability of the multinational to consider alternative dispute resolution processes in terminating a 25-year business relationship.¹⁰⁶ The case related to the multinational company's (hereafter 'the company') decision to divide its product distribution network into over-the-counter ('OTC') and prescription ('RX') drug product channels. In early 1999, a new company President Director arrived in Indonesia, and, concerned with the existing monopoly distribution arrangement, took the decision to transfer one half of the company's distribution contract in order to diversify the distribution network.¹⁰⁷ The distributor, a large and powerful Chinese-Indonesian distribution company which had contracts with many of the major multinational pharmaceutical and confectionery companies in Indonesia, had previously held both the contracts in an exclusive arrangement with each contract worth approximately USD\$12 million a year.¹⁰⁸ Upon assessing the distribution contract with the distributor, the company noticed that there was no termination clause except in the case of default on either side, which was not applicable.¹⁰⁹ Devoid of a convincing legal argument for

106 For a good media overview in English of the case as a background, see Todd Callahan, 'Analysis: Courts in Indonesia have failed big business', *The Straits Times* (Singapore), 5 July 2000, available online at <<http://www.malaysia.net/lists/sangkancil/2000-07/frm00040.html>> (accessed 31 August 2007), or 'Swiss Roche tangled in Indonesian dispute', *Business Asia* (Singapore), 12 May 2000, available online at <http://www.bizasia.com/legal/_jcw3/swiss_roche_tangled_indonesian.htm> (accessed 31 August 2007).

107 Personal notes of the then President Director of the company, 14 November 1999.

108 *Ibid*; Callahan, *supra*, n 106.

109 *Ibid*.

default, the company opted to take advantage of art 18.1 of the distribution contract, which allowed it to withdraw any one of the two divisions at any time.¹¹⁰ The other relevant clause in the contract relating to the new business strategy stipulated that in the event of a dispute arising between the parties, either respective party had to request arbitration with the intent of reaching an amicable settlement.¹¹¹ The company, however, bypassed the arbitration clause, choosing instead to use art 18.1 in order to terminate one half of the distribution contract.

Needless to say, the distributor was not impressed by the business decision. After a number of months in which business continued as usual, on 26 August, in an extraordinary turn of events, the company was notified that the distributor had decided to sue for loss of future income in the South Jakarta District Court, seeking USD\$41 million in damages.¹¹² Additionally, a court attachment order had frozen the company's assets at the factory, including the plant, land, equipment, raw material, and the factory's semi-finished and finished products, effectively meaning that the company was unable to continue its business.¹¹³ The distributor, clearly outraged by the decision, had also decided to ignore the contractual arbitration clause and went straight to the South Jakarta court to obtain the order they desired. As the distributor was an experienced and successful Chinese-Indonesian company that had thrived during the Suharto years, it was not surprising that they were able to get such an extraordinary *ex parte* decision by the South Jakarta District Court in such a short time. The court decision also suggests that the distributor was not only well aware of their derivative stakeholders, but had in fact been nurturing these relationships for some time.

2. Failure to Utilise SE as a Part of the Dispute Resolution Process

The sudden turn of events demonstrated a number of important points. Firstly, although it was obvious before, the case was another clear indication that the Indonesian judicial system was not functioning in any rational 'legal' sense. The distribution contract had an arbitration clause, but the judges who imposed the attachment order also chose to effectively ignore it, arguing that as the case was purely a legal dispute and not one involving technical business matters, it did not come under BANI's jurisdiction.¹¹⁴ The distributor's lawyer of course backed the judgment, stating that only technical business matters

110 *Ibid.*

111 *Ibid.*

112 *Ibid.*

113 *Ibid.*

114 Callahan, *supra*, n 106.

such as product quality, delivery, remittance or the late distribution of goods fell under the jurisdiction of the arbitration clause.¹¹⁵ This was totally at odds with the recently enacted A&ADR Act 1999 that governed arbitration, which stipulated that Indonesia's courts have no jurisdiction to adjudicate in disputes in which both parties are bound by an arbitration agreement.¹¹⁶ The case consequently made front-page headlines across the country, with one commentator noting:

The implication for the case is, if one can show a dispute does not involve technical business matters, companies can renege on their arbitration promises and instead pursue lawsuits in a system where judges are for sale.¹¹⁷

Secondly, whilst it was inappropriate for the distributor to go immediately to the district court, it was apparent that the company had no expectation that the distributor would behave in the way they did, nor did the company seem cognisant of the actual power imbalance that existed between the two companies in the context of the Indonesian business environment. Evidence from previous empirical studies of secondary stakeholder action shows how wealthy stakeholder groups often have the ability to be extremely influential, and that stakeholder groups with greater power relative to the targeted firm are generally going to be legitimate stakeholders.¹¹⁸ These points seemed to be either unidentified or ignored by the company in the development of its own business strategy. Equally, it is fair to say that the company failed to consider the emotions and interests of the distributor throughout the crisis, preferring instead to view the entire process through the lens of a quasi-legal-business model. When most diverse partnerships (such as the relationship delineated here between a producer and a distributor) consider options for the future, the three most basic responses to change are: (1) to seek middle ground; (2) to force action in retaliation; or (3) to adopt holistic responses to the management of the issue.¹¹⁹ The company's decision to attempt to immediately terminate

115 *Ibid.*

116 A&ADR Act 1999, arts 3, 11(1). Article 3 of the A&ADR Act 1999 states that the district court shall have no jurisdiction to try disputes between parties bound by an arbitration agreement, and art 11 stated that the existence of a written arbitration agreement shall eliminate the right of the parties to seek resolution of the dispute or difference of opinion contained in the agreement through the district court.

117 Callahan, *supra*, n 106.

118 Charles Eesley, 'Firm Responses to Secondary Stakeholder Action' (2005) 10 *Fuqua School of Business*, unpublished manuscript; A Hoffman, 'A Strategic Response to Investor Activism' (1996) 37 *Sloan Management Review* 61.

119 Chrissie Cochlan *et al*, *Accommodating Diverse Interests* (1999), Ecosystem Management Initiative Document, School of Natural Resources and Environment, University of Michigan, available online at <<http://www.snre.edu/ecomgt/pubs/crmp/interests.pdf>> (accessed 12 September 2007), p 9.

the contract meant that option (2) was always going to be the response by its distributor.

The crisis finally ended the following year, after much anger, animosity, expense and bitterness. The distributor, unsurprisingly, won the initial case at the district court level and the company appealed to the High Court with the distributor continuing to distribute all of the company's products in the interim. Before the case was heard, the issue was settled out of court with the OTC part of the contract taken away from the distributor and the RX contract retained with some, although not all, commissions increased.¹²⁰ Had this approach been considered at the beginning, considerable hardship and costs could have been avoided. Interestingly, the former President Director of the company was circumspect when he made himself available to be interviewed for this article, suggesting that the company could have been more respectful of the distributor and the importance of the long-term relationship, and could have approached the termination in a more informal manner at the beginning, engaging an important neutral person to sound out the distributor.¹²¹ The President Director suggested that a process of 'informal pre-arbitration would have been useful, because in an Indonesian case, you need to do what the Indonesians would do'.¹²² The President Director further noted that he 'followed the lawyers too much', and that he regretted 'putting the distributor in the corner, with the knife at his chest'.¹²³ Presumably, this point was made in regard to the aggressive manner in which the company had attempted to terminate the contract at the very first stage of proceedings. Five years after the crisis, the President Director's comments demonstrate how once an individual is removed from the emotion of a dispute situation, ADR processes can more ably be considered.¹²⁴

E. CONCLUSION

This article has provided insights into the realities and challenges surrounding arbitration law in Indonesia. It has suggested that given the parlous state of formal judicial dispute resolution in Indonesia, businesses would benefit from an appropriate use of SE as a pre-emptive strategy of dispute avoidance. Whilst the article has not focused a great deal on local cultural approaches

120 Personal communication and interview with the then President Director, 1 February 2006. The President Director noted that the media pressure brought to bear on the distributor may have been the tipping point in the negotiations.

121 *Ibid.*

122 *Ibid.*

123 *Ibid.*

124 *Ibid.*

to conflict resolution, there is little denying it remains an important element for multinationals when dealing with disputes internationally. Pyles, in particular, underlines the importance of local approaches in conflict resolution, and cautions against the knee-jerk use of litigation in overseas markets. He suggests that as courts are 'rooted in a national system of law, with a judge applying his own rules of court, laws and procedures, litigation is clearly parochial because the tribunal is localised, specialised and rooted in one particular legal system'.¹²⁵ He states:

[T]hus in an international dispute involving parties from different countries, and commonly, from different legal systems, one party will have the perceived advantage of familiarity with the court system. In addition, there may be an apprehension that the tribunal will be partial and will favour the local litigant. Further, the court may lack cross cultural and international expertise. It is here that arbitration may have tremendous advantages.¹²⁶

The article concludes that given the current realities of the Indonesian judicial system and its disheartening recent business history, failure to include SE processes as a part of a general dispute resolution strategy in Indonesia would suggest that protracted litigation in a corrupt and uncertain legal system will be a likely, if unwelcome, outcome.

125 M Pyles, 'The International Arbitration Regime in the Asia Pacific Region' (1995)

14 *The Arbitrator* 70.

126 *Ibid.*