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Client Alert

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Indonesia: The Constitutional Court's Statutory Interpretation of Article 251 of The Commercial Code

In brief

On 3 January 2025, Indonesia's Constitutional Court issued a decision that provides a statutory interpretation of Article 251 of the Indonesian Commercial Code, concerning the cancellation of insurance policies.

The court ruled that Article 251 of the Commercial Code is conditionally unconstitutional unless it is interpreted to mean that the cancellation of insurance policies due to material non-disclosure must be based on mutual agreement between the insurer and the insured, or based on a court decision. While Article 251 of the Commercial Code remains in effect, it must now be understood and enforced according to this statutory interpretation. The decision applies as of 3 January 2025, and is final, with no avenue for appeal.

The court did not diminish the insured's obligation to disclose information with utmost good faith, but now the cancellation of insurance policy on the basis of material non-disclosure can no longer be unilateral. Arguably, withholding claim payment subject to the resolution of a dispute is acceptable, but there may be certain risk worth considering as we elaborate below. Noting this development, there appears to be a need for quick and efficient resolution of disputes with insureds to manage potential financial impact due to a lengthy settlement of disputes about the validity of policies and insurance claims.

In this issue

Key legal considerations of the decision

The following are two key considerations of the decision:

1. The court emphasized the principle of utmost good faith when entering into an insurance agreement, reinforcing that insureds remain legally obligated to provide accurate underwriting data to insurers under Article 251 of the Commercial Code. The court's decision does not alter the standard of good faith required of insureds under Article 251 of the Commercial Code. The court specifically reasoned as follows [the bold is our emphasis]:

   > *"Therefore, the affirmation of the principle of utmost good faith in insurance agreements is a logical consequence of the special nature of such agreements. Thus, in an insurance agreement, both parties are obligated to provide everything, including information about the risks covered by the agreement. Furthermore, insurance agreements are based on the assumption that the prospective insured, when applying for insurance, is aware of all the risks and conditions to be insured, while the insurer does not know them.* ***The insurer, in analyzing the risk to be insured, relies more on the information provided by the prospective insured, which must be complete and given in utmost good faith[...]"***
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   > *[page 456, paragraph 3.18.2 of the Constitutional Court decision]*

2. The court did not change the rule that insurers have a legal right to cancel an insurance policy if the insured fails to disclose any material underwriting data or provides inaccurate underwriting data. However, the court stated that cancellation of an insurance policy under Article 251 of the Commercial Code must be based on a court decision (if the parties cannot agree on a mutual cancellation), rather than being a decision unilaterally made by the insurer. Essentially, it means that for the insurer to cancel the policy, the insurer will need to commence a civil court case to obtain a court decision declaring a cancellation of the policy.

The court explained the key issue of the case as follows:

> *"[…] however, the fundamental issue that must be addressed in the petition at hand, particularly in an insurance agreement, is whether the condition for the invalidity or cancellation of an agreement, whether automatically void by law or subject to cancellation, can be carried out by one party unilaterally (automatically), or whether it must first be annulled by a court."*
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> *[page 458, paragraph 3.18.4 of the Constitutional Court decision]*

Responding to that crux of the issue, the Constitutional Court concluded:

> *"Therefore, according to the Court, in order to provide fair protection and legal certainty, the norms of Article 251 of the Commercial Code must be declared to be inconsistent with the 1945 Constitution and to not have binding legal force unless it is interpreted to mean that the cancellation of the insurance policy must be based on the agreement of both the insurer and the insured or based on a court decision."*
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> *[page 462, paragraph 3.20 of the Constitutional Court decision]*

Can insurers still cancel a policy unilaterally even if the policy allows it?

It may be common for parties to agree that the insurer is entitled to unilaterally cancel a policy if the insured fails to provide full disclosure, i.e., the unilateral cancellation is agreed upfront. The question is, does the Constitutional Court decision affect this type of arrangement?

The court decision does not provide an explicit answer to this question. It mentions 'mutual agreement between the parties' in terms of policy cancellation in a general sense and it does not specify if it can be made upfront. However, the court's reasoning suggests that insurers cannot unilaterally cancel a policy, even if the agreement contains a unilateral cancellation clause (i.e., agreed upfront). The court highlighted [the bold is our emphasis]:

> *"If there is a dispute between the parties in the agreement, the dispute must first be resolved through mutual agreement or mediation.* ***If such a resolution is not achieved, to make a determination on whether there has been any misleading or concealed information, even in good faith, in relation to the insured, such a decision must be made by the courts,*** *which constitutionally hold the judicial authority to resolve all civil matters as a last resort."*
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> *[page 461, paragraph 3.19 of the decision of the Constitutional Court]*

It is interesting to note from the passage above that the court's reason for requiring a judicial intervention is to determine "*whether there has been any misleading or concealed information if such a resolution [amicable settlement] is not achieved*." Arguably the court's reasoning may effectively diminish the meaning of a unilateral termination clause, as the insurer's ability to enforce this clause is premised on a notion that the insured fails to provide full disclosure, while based on the court's reasoning, this determination falls within civil courts' domain.

It remains to be seen if the court's reason for requiring a judicial intervention is confined to Article 251 of the Commercial Code or whether there is room to reasonably interpret that the court's reasoning also prohibits a unilateral cancellation (or termination as the case may be) of a policy in all circumstances beyond Article 251 of the Commercial Code.

Does it mean that insurers should raise their standards in underwriting?

Although the court in its legal considerations commented that insurers should not take the insureds' disclosures at face value, there is the lingering question of whether that can be interpreted to mean that the court imposes higher standards for the underwriting process on insurers, and whether this issue can moderate the insurers' legal right to enforce Article 251 of the Commercial Code. The court reasoned as follows [the bold is our emphasis]:

> *"[…] insurance agreements are based on the assumption that the insured is fully aware of all risks and conditions related to the insurance at the time of application, while the insurer does not have such knowledge. Consequently, the insurer relies heavily on the information provided by the prospective insured when assessing the risk,* ***although the insurer should not blindly trust the insured's statements****, the information provided by the insured should be supported by other evidence to ensure its accuracy and reliability."*
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> *[page 456, paragraph 3.18.2 of the decision of the Constitutional Court]*

Settlement of insurance claims pending the resolution of the dispute

One of the central concerns is whether an insurer should be required to settle an insurance claim while the validity of the policy is still in dispute. Nothing in the court's decision requires an insurer to pay a claim while a dispute is pending. Arguably, the act of withholding payment pending resolution of a dispute on the basis of Article 251 of the Commercial Code is not contradictory with the legal considerations of the decision.

Since the court already ruled that the cancellation of a policy requires judicial intervention, it follows logically that the payment of a claim, which is also tied to the validity of the policy, should similarly await a judicial resolution. However, this approach may not be risk-free. For example, it is common for claimants to claim statutory interest of 6% annually for outstanding monetary obligations against defendants. It is likely that some (if not all) insureds will take this approach when formulating their claims against insurers in civil courts. While limitation of liability clauses are generally recognized and are common in Indonesia, it remains to be seen if public courts will uphold such clauses when they are used to pre-empt risks associated with withholding claim payments.

Dispute Resolution

One of the practical implications of the court's decision for insurers is the need to revisit dispute resolution mechanisms to avoid prolonged disputes on policies validity and claim payments (noting the court requires a judicial intervention to cancel a policy). One potential issue would be a clause in an insurance policy that provides the right to elect the dispute resolution forum only to the insureds. When such a clause exists, insurers may have to wait for the insureds to exercise that right, and delay by insureds in electing the dispute resolution forum means delay in the whole process. Overall, the longer disputes go unresolved, the higher the risk for insurers, as their reserves could potentially be tied up in pending claims.

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