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Principles of Good Faith in the Reimbursement of Expenses within Oil and Gas Revenue Sharing Agreements in Indonesia

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Abstract: This study seeks to examine and elucidate the significance of the principle of good faith within the national legal framework, as well as to develop norms pertaining to good faith in the context of operational cost recovery for production sharing contracts in Indonesia's oil and gas industry. This study utilizes a normative legal methodology alongside a legislative framework. The sources of data encompass essential legal materials, including legislation, journal articles, books, and pertinent research reports that contribute to the discourse. The analysis of the data is performed qualitatively through a juridical-philosophical lens, developing arguments rooted in legal philosophy, legal theory, and various legal principles. The findings reveal that the principle of good faith in the operational cost recovery of production sharing contracts in Indonesia is governed at each stage of the contract to safeguard the interests of disadvantaged parties. This regulation addresses the essential principle of good faith that all parties must adhere to in order to guarantee the equitable execution of rights and obligations. In the context of operational cost recovery for production sharing contracts in Indonesia, good faith is characterized by adherence to and compliance with audit results, reflecting a commitment to the proper execution of the business contract's terms. The operational cost recovery system is anticipated to serve as a reimbursement mechanism for expenses associated with oil and gas production.

Keywords: Good Faith, Operational Cost, Product Cost Sharing, Oil and Gas, Legal Justice

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Abstrak: Penelitian ini bertujuan untuk menganalisis dan menjelaskan makna prinsip itikad baik dalam sistem hukum nasional. Merumuskan norma itikad baik pengembalian biaya operasional pada kontrak bagi hasil produksi migas di Indonesia. menggunakan metode penelitian yuridis normatif dengan pendekatan perundang-undangan. Sumber data berasal dari data data utama, yaitu berupa aturan perundang-undangan, artikel jurnal, buku dan laporan penelitian yang terkait dengan pembahasan. Analisis data dilakukan secara kualitatif, dengan menggunakan analisis filosofis yuridis. Analisis data dilakukan secara kualitatif. Dengan membangun argumen berdasarkan filsafat hukum dan teori hukum, serta prinsip-prinsip hukum lainnya. Hal ini dilakukan untuk menjawab permasalahan yang telah dirumuskan dalam penelitian, yang hasilnya dinyatakan dalam perspektif. Hasil penelitian menunjukkan bahwa norma prinsip itikad baik pengembalian biaya operasional atas kontrak bagi hasil produksi migas di Indonesia dilakukan dengan cara pengaturan pada setiap tahapan kontrak dan sebagai upaya perlindungan pihak yang dirugikan, pengaturan tersebut menyangkut prinsip itikad baik yang harus dilakukan oleh para pihak untuk mencapai pelaksanaan hak dan kewajiban yang adil. Terkait dengan transparansi pengembalian biaya operasional atas kontrak bagi hasil produksi minyak di Indonesia, prinsip itikad baik didefinisikan sebagai pelaksanaan dan kepatuhan terhadap ketentuan hasil audit sebagai bentuk pelaksanaan itikad baik sesuai dengan pembukaan kontrak usaha yang telah dibuat, pengembalian biaya operasional diharapkan dapat menjadi sistem penggantian biaya produksi migas.

Katakunci: Prinsip itikad baik, biaya operasional, bagi hasil produksi, minyak dan gas bumi, keadilan hukum

Introduction

The principle of good faith has historically served as a cornerstone in civil law within numerous jurisdictions, such as Europe, Canada, and Latin America. Historically, the 1804 French Civil Code acted as a significant reference point in Europe and Latin America, establishing a robust model of civil good faith in these regions for the interpretation, supplementation, and correction of contractual provisions. Peru, however, implemented a more constrained good faith model akin to English law, which upholds a formalistic and objective perspective.¹ This demonstrates that the principle of good faith is essential in legal implementation.

In Indonesia, the principle of good faith is essential in contractual relationships, particularly in the realm of commercial contracts. The implementation of this principle is crucial for promoting a supportive, equitable,

¹ Chris D.L. Hunt, "Good Faith Performance in Canadian Contract Law," *The Cambridge Law Journal* 74, No. 01 (2015), p. 4-7. Sergio Garcia Long, "Towards a Formalistic Approach of Good Faith in Comparative Contract Law," *European Business Law Review* 35, Issue 7 (2024), p. 947-976. Alberto Tassoni, "Good Faith in English Contract Law: Should the Law Retreat?" *Business Law Review* 44, Issue 5(2023), p. 160-171.

and transparent business environment. Indonesian law requires the principle of good faith to be upheld not just during the execution of contracts, but also throughout the pre-contractual negotiation process. This protects the parties engaged in transactions from possible losses. The principle has been consistently affirmed in numerous judicial cases, including those involving life insurance contracts, where courts have prioritized good faith to safeguard the rights of all parties involved.²

The implementation of good faith holds significant importance for all entities involved in agreements, encompassing both business operators and consumers. This principle guarantees that agreements are executed based on a solid foundation of mutual trust and integrity. Maintaining good faith can significantly reduce the likelihood of contractual breaches, as the established contracts foster a foundation of trust and fairness among the parties involved.³

Production sharing contracts play a crucial role in the exploitation and management of Indonesia's natural oil and gas resources. The recovery of operational costs is an essential aspect of these agreements, (henceforth abbreviated to MIGAS) as the state maintains ownership of resources while allowing contractors the rights to explore and produce (henceforth abbreviated to KKKS). Cost recovery mechanisms ensure that oil and gas companies cannot regard production areas as private property, as the bailout costs associated with oil and gas production are compensated through the recovery system.⁴

The Indonesian government engages in cooperation contracts with contractors, which may encompass foreign legal entities, thus classifying these agreements as international business contracts. Within the context of an international contract framework, the recovery of operational costs represents a crucial right and duty for the parties involved in the agreement.⁵ The extent of cost recovery plays a crucial role in shaping state revenue derived from the oil and gas sector.⁶

Numerous studies have been conducted regarding good faith in various contexts. For instance, Sudrajat and Lestari examined the conduct of insurance companies. Their findings indicated that the rejection of a life insurance claim by

² Alpan Mega Nugraha, et.al., "Implementation of Good Faith Principles in Trade Contracts in Indonesia," *Journal of Social Research* 3, No. 9 (2024). Szyva Silviana Putri, et.al., "The Urgency of Good Faith Principles in Production Sharing Cooperation Contracts with the Gross Split System," *Qistina: Jurnal Multidisiplin Indonesia* 2, No. 1 (2023), p. 462-466.

³ Dora Kusumastuti and Sutoyo Sutoyo, "The Principles of Good Faith in E-Contract Financial Technology," *Jurnal Akta* 11, No. 4 (2024), p. 1282.

⁴Widjajono Partowidagdo, *Migas dan Energi di Indonesia: Masalah dan Analisis Kebijakan*, Bandung: Development Studies Foundation, 2009, p. 193.

⁵Afifah Kusumadara, *Kontrak Bisnis Internasional*, Jakarta: Sinar Grafika, 2013, p 20.

⁶Shofiah Shobah dan Hanif Nur Widhianti, *Cost Recovery dalam Kontrak Kerja Sama Minyak dan Gas Bumi di Indonesia Dalam Kontrak Internasional*, Penelitian dari Universitas Brawijaya, Malang, 2015.

a customer was consistent with the principle of good faith, and the resolution process was aligned with the District Court Decision, which awarded insurance benefits to the heirs based on that ruling. This was further supported by the High Court decision, while the cassation decision was entirely dismissed. Additionally, the legal implications of the insured violating the principle of good faith resulted in the insurance agreement being rendered void, meaning the insurer had no obligation to provide benefits in the event of the insured's death.⁷

Cindawati asserts that the principle of good faith fundamentally embodies "honesty" in conduct or in commercial exchanges, which encompasses truthfulness in facts and adherence to equitable trade norms and sincere trading practices. Relationships necessitate a commitment to good faith not just at the moment the contract is executed, but also prior to the finalization of the agreement.⁸ Harisa acknowledges that the regulation of good faith as outlined in the Arbitration and Alternative Dispute Resolution Law (1999) lacks clarity regarding its meaning and limitations. Consequently, the regulation of good faith ought to be defined as "a disposition or conduct of honoring an agreement by providing the other party with their rightful entitlements, rather than seeking loopholes to evade the commitments made, grounded in propriety and rationality."⁹

Nova examines the application of the principle of good faith within the management cooperation agreement between Garuda Group and Sriwijaya Group. The findings indicate a propensity to overlook the Business Judgment Rule (BJR) in the application of good faith, potentially obstructing the effectiveness of the Management Cooperation (KSM). An example of this is the alteration of the KSM agreement (Amendments II and III) by the Directors of Sriwijaya Group who have connections to Garuda Group—without prior approval from the Shareholders of Sriwijaya Group, demonstrating a breach of good faith principles. To promote fairness and transparency in the development and implementation of the KSM agreement, it is essential to establish well-defined regulations that govern its clauses. Furthermore, clear guidelines delineating the roles and responsibilities of the company's governing bodies are essential to avert business decisions that could diverge from the best interests of Sriwijaya Group.¹⁰

⁷ Muhammad Maliki Sudrajat and Suci Lestari, "Pelanggaran Prinsip Itikad Baik oleh Tertanggung di Asuransi Jiwa P.T. AJMLI," *Trijurnal* (2019).

⁸Cindawati, "Prinsip Good Faith (Itikad Baik) Dalam Hukum Kontrak Bisnis Internasional," *Mimbar Hukum: Fakultas Hukum Universitas Gadjah Mada* 26 (2) (2014), p. 181.

⁹Novran Harisa, "Asas Itikad Baik Dalam Perjanjian Arbitrase Sebagai Metode Penyelesaian Sengketa," *Aktualita (Jurnal Hukum)* 1, No. 1 (2018), p. 261-279.

¹⁰Nova, "Penerapan Asas Itikad Baik Dalam Perjanjian Kerja Sama Pengelolaan Management Antara PT Citilink Indonesia (Garuda Group) Dengan PT Sriwijaya Air dan PT Nam Air (Sriwijaya Group)," *Otentik's: Jurnal Hukum Kenotariatan* 3, No. 2 (2021).

Sibarani examines the significance of the good faith principle in the establishment of business contracts through the lens of civil law. The principle of *uberrimae fidei* plays a crucial role in promoting trust and equity among parties, minimizing the likelihood of conflicts during the contract's term, and enhancing legal clarity. The principle of good faith is essential in the formation and implementation of business contracts, serving as a crucial benchmark for assessing the feasibility of contract enforcement.¹¹

Atmoko and Noviriska highlight that practical applications frequently uncover difficulties in ensuring that business entities adhere to the principle of good faith, especially when it comes to delivering precise and transparent product information. Maintaining this principle in online sales and purchase agreements is essential for safeguarding consumers from potential harm. Consequently, it is crucial to enhance regulations that protect consumer rights and promote transparency and integrity in online transactions.¹²

Current literature has not yet delivered an in-depth examination of the principle of good faith concerning cost reimbursement within oil and gas profit-sharing agreements. It is widely acknowledged that the principle of good faith plays a vital role in the framework of contract law in Indonesia. In certain instances, the recuperation of operational expenses can serve not just the interests of contractors but also pose potential risks for the state, given that evaluations of production costs are particularly vulnerable to manipulation.

This research uses normative legal research methodology, leveraging a statutory framework.¹³ Key sources of primary data encompass legal frameworks, scholarly articles, literature, and investigative reports pertinent to the subject matter. The data was analyzed through qualitative data analysis procedure from a legal philosophical standpoint, formulating arguments rooted in legal philosophy, legal theory, and various legal principles. The study seeks to investigate matters concerning good faith in cost reimbursement within oil and gas profit-sharing agreements in Indonesia.

Good Faith as a Legal Principle

The principle of good faith holds a fundamental position in contemporary law, philosophy, and business, serving as the cornerstone of contractual

¹¹ Asiroht Can Sauli Sibarani, "The Application of the Principle of Good Faith in Business Contracts: A Civil Law Perspective," *Edusoshum: Journal of Islamic Education and Social Humanities* 4, No. 3 (2024), p. 305-313.

¹² Dwi Atmoko and Noviriska Noviriska, "Kepastian Hukum dalam Transaksi Online: Peran Asas Itikad Baik Berdasarkan Hukum Perdata Indonesia," *Binamulia Hukum* 13, 2 (2024), p. 421-428.

¹³ I Made Pasek Diantha, *Metode Penelitian Hukum Normatif: Dalam Justifikasi Teori Hukum*, Jakarta: Kencana, 2016. Peter Mahmud Marzuki, *Metode Penelitian Hukum*, Jakarta: Kencana, 2010.

relationships in various legal systems across Europe. Over time, its influence has extended to numerous other nations, including Indonesia. The introduction of a new conceptual approach to the principle of good faith provides a coherent and systematic framework for understanding and interpreting this concept.¹⁴

Legal principles constitute fundamental tenets inherent in every legal system, expressed through statutes, regulations, and judicial decisions. These individual provisions and rulings can be regarded as detailed manifestations of these core principles. Bruggink posits that legal principles function as meta-rules governing rules of conduct while also possessing the capacity to operate as rules of conduct themselves. This dual function arises from the nature of meta-rules, which incorporate evaluative criteria (*waarderingnormen*). The role of legal principles, therefore, is to ensure the optimal application of evaluative measures within the framework of positive law and its implementation.¹⁵

One of the key principles in contract law is the principle of good faith, as enshrined in Article 1338(3) of the Civil Code, which mandates that contractual agreements be executed in good faith. In response to evolving legal interpretations, this provision is now understood in a broader sense, recognizing that good faith extends beyond the performance of the contract to include the negotiation and pre-contractual stages leading up to its finalization. As a result, the contract functions as a legal mechanism that facilitates the fulfillment of the rights and obligations of the parties involved, with each stage of the contractual process requiring strict adherence to the principle of good faith.¹⁶

The principle of good faith is acknowledged as a core element within the Civil Law framework, covering the comprehensive scope of the Law of Obligations.¹⁷ Article 1338(3) of the Civil Code highlights the importance of parties to a contract executing their obligations in good faith, reflecting the changing dynamics of the legal framework. This provision is understood in a broad context, indicating that good faith encompasses not only the execution of the contract but also the negotiation, signing, and pre-contractual stages that occur before the agreement is finalized. As a result, a contract embodies a systematic approach to actualizing the rights and responsibilities of the involved parties, with every phase necessitating compliance with the principle of good faith.¹⁸

¹⁴Tamar Mepharishvili, "The Principle of Good Faith in Contractual Relations," *European Scientific Journal* 21, 39 (2025), p. 162.

¹⁵ Sudikno Mertokusumo, *Mengenal Hukum*, Yogyakarta: Kebebasan, 1996. p. 119-120

¹⁶ Yohannes Sogar Simamora, "Fungsi Itikad Baik dalam Kontrak (Orientasi dengan Metode Pendekatan Sistem)," *Jurnal Perspektif* 4, No. 3 (2001) p. 200.

¹⁷ Jack Beatson and Daniel Friedmann, *Good Faith and Fault in Contract Law*, Oxford: Clarendon Press, 1995.

The principle of good faith underpins contractual performance, requiring the parties to adhere to this standard during both the creation and implementation of the contract. In this context, contractual obligations should be fulfilled in alignment with the established standards of propriety and ethics. The principle of good faith, closely associated with fairness, is further detailed in Article 1339 of the Civil Code. This provision indicates that a contract is not only binding concerning its explicitly stated terms but also encompasses all obligations that, by the nature of the agreement, are required by propriety, custom, and legal principles.¹⁹

The notion of good faith requires individuals to fulfill their obligations and behave in alignment with established standards of justice and societal expectations, thus maintaining the core principles of the law. The concept extends beyond the mere good intentions of the parties involved; it must also embody the ethical and moral values that are ingrained in the society, as good faith is fundamentally a construct of that society.²⁰

The principle of good faith is essential in oil and gas production sharing contracts in Indonesia, especially in protecting state interests in the management of natural resources for the maximum benefit of the public. In its capacity as the authority overseeing mining authorizations, SKK *Migas* has a duty to safeguard and maintain oil and gas resources as valuable state assets. The practical application of the good faith principle in contractual agreements is intricate, yet it is essential throughout the entire contractual lifecycle—from drafting and executing the contract to its eventual termination. Considering the long-term nature of oil and gas production sharing contracts, they are susceptible to fluctuations that can have both direct and indirect effects, potentially resulting in significant financial losses. An illustrative case is the fluctuation of global oil prices, which can profoundly influence contractual commitments and economic results.

Three key factors influence the development of contract law, shaping its forms and principles. Three key factors influence the development of contract law, shaping its forms and principles:²¹

1. Internal Factors – These include government policies aimed at fostering national prosperity and improving public well-being, necessitating state intervention in the economic sector. In Indonesia, various deregulation measures have been implemented to facilitate business establishment and expansion for both domestic and foreign entities;

¹⁹ Abdulkadir Muhammad, *Hukum Perikatan*, Bandung: Citra Aditya Bhakti, 2000.

²⁰ Ayu Sundari and Yudho Taruno Muryanto, “Penerapan Prinsip Itikad Baik dalam Kontrak Bagi Hasil dengan Sistem Cost Recovery dan Gross Split,” *Jurnal Privat Law* 8, No. 1 (2020).

²¹ Endang Suprpti and Arihta Esther Tarigan, “Itikad Baik Dalam Perjanjian Suatu Perspektif Hukum dan Keadilan,” *Salam: Jurnal Sosial dan Budaya Syar’i* 8, No. 1 (2021).

2. External Factors – These refer to international influences that drive economic openness due to the pressures of global integration. Consequently, foreign elements are increasingly shaping Indonesia's legal framework. This trend has been evident since the introduction of foreign investment opportunities and the establishment of a free market, which have removed barriers to international business transactions. As a result, contractual engagements between the government and private sector entities have increased, fostering the development of new contractual principles and frameworks;
3. The Expanding Scope and Frequency of Business Operations – The growing complexity and volume of business transactions have heightened the need for formalized contractual agreements.

In response, the Indonesian government introduced the Gross Split Production Sharing Contract scheme under Ministerial Regulation No. 8 of 2017 for new contracts in the oil and gas sector. However, this regulation does not apply to existing contracts. During contract renewal, oil and gas contractors may either retain the operational cost recovery scheme or transition to the gross split scheme.

Given the high-risk nature, substantial costs, and technological demands of oil and gas production sharing contracts, a well-defined contractual framework is essential to achieving contractual objectives. This framework incorporates the principle of good faith, ensuring fairness in contractual agreements while optimizing natural resource utilization for the broader public good.

The Critical Role of Legal Ethics in Indonesia's Legal System

The relationship between ethics and law can be analyzed from three key perspectives: (1) the interaction between substantive principles and legal structures, (2) the breadth of their respective applications, and (3) the underlying motivations that influence individuals to comply with or violate these norms. Various legal scholars who have explored the significance of ethics in law can be categorized within these dimensions. Jimly Asshiddiqie illustrates the interplay between law and ethics through an analogy in which religion serves as the fundamental essence of both. He compares this relationship to a wrapped meal, where law functions as the outer layer, ethics constitutes the main components such as rice and side dishes, and religion symbolizes the essential nutrients, including proteins and vitamins, which underpin both legal and ethical principles. From a scope perspective, ethics encompasses a broader range of conduct than law. Consequently, every legal transgression inherently constitutes an ethical breach. However, it is important to recognize that not all unethical actions necessarily amount to legal violations.²²

²²Jimly Asshiddiqie, *Peradilan Etik dan Etika Konstitusi*, Jakarta: Sinar Grafika, 2016.

The third dimension pertains to the motivational factors driving adherence to legal standards. Ethical principles encourage individuals to comply with laws and regulations not solely due to the fear of sanctions but also because of an intrinsic understanding that these rules are just and necessary. Ethics serves as a preventive mechanism in regulating human behavior, delineating boundaries between acceptable and unacceptable conduct before legal intervention becomes necessary. In this regard, ethical frameworks function as corrective tools, ideally addressing behavioral discrepancies before resorting to legal enforcement.²³

The ethical behavior of public officials and professionals, whose roles are fundamentally anchored in public trust, necessitates the establishment of a robust ethical regulatory framework. When misconduct among public officials is managed exclusively through legal proceedings, there is a substantial risk that the prolonged nature of legal processes may undermine public confidence in governmental institutions. Thus, the implementation of ethical governance mechanisms is strongly recommended as a foundational approach.

In the context of good faith in the reimbursement of operational expenses in Indonesia's oil and gas profit-sharing agreements, contractual provisions are carefully structured at each stage to safeguard the interests of potentially disadvantaged parties. The principle of good faith mandates that all contractual parties ensure the equitable execution of rights and obligations. Transparency in cost recovery within oil production-sharing contracts is demonstrated through adherence to audit findings, reflecting the commitments established in the initial agreements. Consequently, the reimbursement of operational expenditures is expected to function as a fair and transparent mechanism for compensating the costs associated with oil and natural gas production.

The principle of good faith in Islamic law is deeply interwoven with fundamental legal and ethical tenets, particularly in the formation and execution of contracts as prescribed by Islamic teachings.²⁴ This principle plays a pivotal role in the contract law, encompassing all stages from pre-contractual negotiations to the fulfillment of contractual obligations. Contracting parties are expected to adhere to the obligations of good faith, which include the duty to disclose essential information, maintain transparency in negotiations, foster mutual cooperation, and remain committed to their contractual responsibilities. Failure to uphold these obligations may necessitate assurances of performance, which could involve a commitment to engage in negotiations, the obligation to disclose relevant

²³Sri Pujiningsih, "Hubungan Antara Hukum dan Etika dalam Politik Hukum di Indonesia (Membaca Pancasila sebagai Sumber Nilai dan Sumber Etik)," *Pena Justisia*17, No. 1 (2017).

²⁴ Anowar Zahid, et.al., "Good Faith in International Commercial Contracts Under UN Sale Convention and Islamic Law: A Brief Comparison," *International Journal of Applied Business and Economic Research* 14, No. 13 (2016).

information, or compensation for any damages incurred due to breaches of contractual terms and benefits.²⁵

In the Islamic law, the concept of good faith is understood as conduct that aligns with *'urf* (custom) and does not contradict the Qur'an or Hadith. In civil law, Article 1338 of the Civil Code defines good faith as a principle grounded in justice, whereas in customary law, it derives from long-standing societal traditions and values. Based on these interpretations, the reimbursement of operational costs in Indonesia's oil and gas profit-sharing contracts should be carried out in good faith, in accordance with legal regulations, prevailing customs, the Islamic law, and customary law as a moral benchmark. In this context, good faith is synonymous with honesty, requiring each party to consider the interests of the other. Furthermore, it functions as both a legal and ethical framework, embedding moral principles within contractual obligations.

Good Faith and the Principle of Legal Justice

The concept of good faith originates from natural law principles, which assert that individuals should fundamentally act with sincerity and integrity. Actions undertaken in good faith are considered a directive from the Creator. As natural law theory evolved, Enlightenment-era thinkers posited that individuals are inherently obligated to engage in virtuous actions, as reason dictates that human behavior should align with ethical standards. This expectation of ethical conduct is reciprocal; individuals anticipate similar integrity from others in their interactions.²⁶

Roscoe Pound emphasizes that the principle of good faith is an essential legal requirement. As social relations become increasingly complex, legal frameworks evolve to incorporate ethical principles, embedding values such as good faith and good conscience into societal relationships. Pound highlighted that, under the guidance of philosophical legal scholars, individuals began to focus on the logical development of legal norms, considering both the optimal form of legal circumstances and ethical principles such as good faith and good conscience in specific transactions and relationships.

The principle of good faith is closely intertwined with the concept of legal justice. According to Hernoko, justice requires that all parties clearly recognize their rights and the corresponding entitlements due to them. Justice entails treating equals equally and addressing inequalities proportionally. However, justice does not necessarily mandate equal distribution of essential resources; rather, it necessitates an awareness of existing disparities and strives for fairness in addressing them. In this context, it is crucial to understand justice not only as a

²⁵ Choi Seok Beom, et.al., "Towards A Better Understanding of Good Faith Concept in Islamic Contract Law," *International Journal of Engineering & Technology* (2018).

²⁶Huala Adolf, "Prinsip Itikad Baik (Good Faith) dalam Hukum Kontrak," *Bani: Arbitration and Law Journal* 1, No. 1 (2024).

structural principle but also as a substantive standard for evaluating fairness. Boatright and Velasquez classify justice into three primary categories: distributive justice, which ensures the fair allocation of rights and obligations; retributive justice, which concerns the equitable imposition of penalties or legal consequences for wrongdoing; and compensatory justice, which focuses on rectifying harm through restitution or compensation for those adversely affected.²⁷

John Rawls further argues that justice serves as the foundational principle guiding social institutions. He asserts that theories, regardless of their intellectual refinement, must be revised or discarded if they prove to be flawed. Similarly, laws and institutions, no matter how effective or structurally sound, must be reformed or abolished if they are unjust. Rawls maintains that every individual possesses inherent dignity grounded in justice, which cannot be overridden by the collective will of society. Consequently, he contends that the deprivation of freedom for a minority cannot be justified by benefits conferred upon the majority. A just society does not permit the burdens imposed on a minority to be exacerbated by the advantages enjoyed by the majority. Within a fair legal system, individual freedoms are firmly upheld, and the rights safeguarded by justice remain impervious to political bargaining or considerations of societal utility.²⁸

The central focus of justice lies in the fundamental structure of society, particularly in the manner by which core social institutions allocate rights and responsibilities and regulate the distribution of benefits derived from social cooperation. The concept of social justice should be regarded as a benchmark for evaluating the foundational framework of society. However, this standard should not be conflated with the principles defining other virtues, as the fundamental structure—and the broader social order—may be efficient or inefficient, liberal or illiberal, and, most importantly, either just or unjust. The comprehensive framework that establishes principles for all essential structural virtues, along with their associated obligations and conflicts, extends beyond the mere concept of justice.²⁹

The principle of good faith stipulates that any confidential professional information disclosed by one party must remain undisclosed and should not be exploited for personal gain by the receiving party. If the disclosure of such information constitutes a violation of the duty to uphold pre-contractual confidentiality, two potential legal remedies may be pursued. First, the aggrieved party may seek compensation for any damages incurred as a result of the unauthorized disclosure or personal misuse of the information. Second, the injured party is entitled to claim any benefits gained by the recipient of the

²⁷Agus Yudha Hernoko, *Hukum Kontrak tentang Prinsip Proporsionalitas dalam Kontrak Komersial*, Jakarta: Kencana Prenada Media Group, 2010, p. 50.

²⁸John Rawls, *Teori Keadilan*, Terjemahan, Jakarta: Pustaka Pelajar, 2006.

²⁹John Rawls, *Teori Keadilan*, Terjemahan, Jakarta: Pustaka Pelajar, 2006.

information due to its improper use, regardless of whether the disclosing party has acquiesced to the loss. Engaging in simultaneous negotiations during preliminary discussions, if conducted in bad faith, constitutes a violation of this principle and should impose legal obligations on the parties involved.

As long as parallel negotiations are conducted in good faith, with all parties genuinely seeking the most advantageous resolution for the same issue, no binding obligation is imposed on them. However, if a party has already selected a contractual partner yet continues negotiations with other parties without a genuine intent to formalize a new contract, it may be held liable to those affected.

These legal provisions represent an extension of Article 33 of the 1945 Constitution, which mandates that the management of natural resources must prioritize the public interest. Consequently, the governance of oil and gas resources falls exclusively under the jurisdiction of the state, administered through Indonesian State-Owned Enterprises (BUMN). In cases where a BUMN lacks the necessary capital or technological expertise for oil and gas exploration and extraction, it may collaborate with external parties, including foreign private corporations, through a Production Sharing Contract (PSC).³⁰

Good Faith in Oil and Gas Production Sharing Contracts

The 2001 Oil and Gas Law highlights that the Government, as the holder of the Mining Authority, exercises state control and establishes an Implementing Agency known as BPMIGAS, which is responsible for overseeing upstream business activities in the oil and gas mining sector.³¹ This agency assumes the responsibilities and duties previously held by PERTAMINA in executing mining authorizations and managing the signing or execution of contracts with investors, including those from abroad, within the oil and gas sector. The government's role in this production sharing contract is that of the holder of mining rights, which are granted by the state. It acts as the mineral rights authority, responsible for supervising and regulating the implementation of production sharing contracts within the oil and gas mining sector.

Conventional Production Sharing Contracts (PSCs) allocate a limited timeframe for developers, referred to as "contractors," to achieve commercial discoveries, succeeded by an extended phase for development and production. In contrast, shale development generally evaluates recognized resources concerning their quality, geographical focus, and economic development methodologies. Although the initial pilot or appraisal phase might be brief, it is possible that an extended duration, potentially reaching up to 50 years in certain instances, will be

³⁰Rudi M Simamora, Pembaharuan UU Migas Khususnya di Sektor Hulu dan Perlindungan Kepentingan Nasional, Makalah yang Dipresentasikan pada Seminar Nasional Pembaharuan UU Migas dan Perlindungan Kepentingan Nasional, SEMA FH UNPAD, Bandung, 31 Maret 2004, hlm. 3

³¹Pasal 4 Undang-Undang No. 22 Tahun 2001 tentang Minyak dan Gas Bumi.

necessary to complete the requisite number of wells. Consequently, the standard traditional notion of relinquishing unutilized areas during the exploration phase is not applicable in an unconventional setting. Consequently, the distribution might require restrictions, or it could be paused or made optional.³²

The transition of the management and implementation of the production sharing contract from PERTAMINA to BPMIGAS has emerged as a significant vulnerability in the national oil and gas management framework in Indonesia. This concern arises from the legal status of BPMIGAS as a State-Owned Legal Entity (BHMN), which does not function as a profit-driven business entity and lacks its own assets. Consequently, there are apprehensions regarding potential state losses should disputes arise between the contractor and the government during the execution of the cooperation contract, as all government assets could be jeopardized in the resolution process. Consider the instance of the Karaha Bodas Company (KBC).³³

Furthermore, BPMIGAS lacks mining rights. Currently, the specific institution housing the mining authority remains unidentified. Following the enactment of the Oil and Gas Law, the matter of the Mining Authority (KP) as a manifestation of state sovereignty over natural oil and gas resources is not clearly delineated as it was in Law No. 8 of 1971. There appears to be a trend in the 2001 Oil and Gas Law, where KP, after being acquired by the government from the state according to Article 4 paragraphs 1 and 2, is subsequently transferred to business entities by the minister as outlined in Article 1 paragraph 5 and Article 12 paragraph (3). The stipulations outlined in Article 12 paragraph (3) of the Oil and Gas Law were included in the Judicial Review submitted to the Constitutional Court. The outcome of the Court's decision was to amend and annul these provisions, deeming them inconsistent with the 1945 Constitution. However, as of now, the provisions of the Article remain unchanged. Consequently, it is the business entities that possess the key positions, leading to a potential erosion of state authority over oil and gas extraction. As a result, the legal mandate asserting state control over natural resources may remain unfulfilled.

The notion of "controlled by the state" as articulated in Article 33 of the 1945 Constitution is exemplified through Decision Number 002/PUU-I/2003, which pertains to the examination of Law Number 22 of 2001 regarding Oil and Natural Gas, commonly referred to as the 2003 Oil and Gas Case, and was adjudicated on December 21, 2004. In the 2003 Oil and Gas Case, the Constitutional Court articulated that: "... state control in Article 33 of the 1945 Constitution encompasses a more expansive meaning than ownership as defined

³²Humphrey Douglas, Shale: Panduan untuk Menyesuaikan Undang-undang, SPA, Perjanjian Farm-in dan JOA dalam Mengembangkan Cekungan Tidak Konvensional, Tinjauan hukum energi internasional, 2014, Vol 32. Edisi 6, hlm 201-203

³³Ida Bagus Rahmadi Supancana, *Kerangka Hukum dan Kebijakan Investasi Langsung di Indonesia*, Jakarta: Ghalia Indonesia, 2006, p. 134.

in civil law. The notion of state control is rooted in public law and is intrinsically linked to the principle of people's sovereignty as enshrined in the 1945 Constitution, applicable to both political (political democracy) and economic (economic democracy) domains.

The term "controlled by the state" should be understood in a broad context, rooted in the sovereignty of the Indonesian people over all wealth sources, including land, water, and natural resources. This encompasses the idea of public ownership by the collective populace regarding these resources. The collective identity of the people is established by the 1945 Constitution, which directs the state to carry out policies, management actions, regulations, management, and supervision aimed at achieving the greatest prosperity for the populace.³⁴

The activities involved in oil and gas exploration and exploitation are characterized by significant capital investment, advanced technology requirements, and inherent risks accompanied by uncertainty. This context highlights that, since the inception of the modern oil and gas sector in the early twentieth century, the exploration and exploitation endeavors in developing nations, such as Indonesia, have predominantly been managed by international oil and gas corporations. These companies, equipped with the necessary capital and technological resources, are positioned to navigate the associated risks effectively, allowing them to operate across multiple countries. Production Sharing Contract or profit sharing contract is carried out by dividing oil and gas production between the government and contractors (in this case national and international oil and gas investors/companies). The selection of the oil and gas profit sharing system is actually a consequence of the limited conditions of the country (at that time, and apparently until now) both in financial capacity and technological capabilities in managing and developing oil and gas resources.³⁵

The consequence of this cooperation contract is the implementation of a mechanism regarding cost recovery in oil and gas management which still requires management control in the hands of the state. However, before the oil and gas is divided, it must first be reduced by the costs incurred by the contractor to produce oil and gas, known as cost recovery.³⁶ Operational costs or Cost Recovery are the return of costs that have been incurred in the context of oil operations by the Cooperation Contract Contractor (KKKS) using oil and/or

³⁴Putusan Mahkamah Konstitusi Nomor 002/PUU-I/2003 tentang Peninjauan Kembali Undang-Undang Republik Indonesia Nomor 22 Tahun 2001 tentang Minyak dan Gas Bumi.

³⁵Andrey Hernandoko and Mochammad Najib Imanullah, "Implikasi Berubahnya Kontrak Bagi Hasil (Product Sharing Contract) Ke Kontrak Bagi Hasil Gross Split Terhadap Investasi Minyak Dan Gas Bumi Di Indonesia," *Jurnal Privat Law* 6, No. 2 (2018), p. 160.

³⁶Anton Dedi Hermanto, "Studi Yuridis Penerapan Cost Recovery dalam Sistem Kontrak Bagi Hasil sesuai ketentuan Undang-Undang Nomor 22 Tahun 2001 tentang Minyak dan Gas Bumi Terkait Peraturan Pemerintah, Tesis, Universitas Gajah Mada, Yogyakarta, 2014, p. 138.

natural gas (oil and gas) production as referred to in (Article 1 Number 1 to 6 of Law Number 2 of 2010 concerning Amendments to Law Number 47 of 2009 concerning the 2010 State Budget.

Cost recovery is a concept of reimbursement of operational costs by the government which was first implemented by Indonesia. Cost recovery is a constitutive right for contractors as stated in the contract. In Part VI Recovery of Operational Costs and Production Handling Sub-section 6.1. In the Production Sharing Contract between the Upstream Oil and Gas Executive Agency (BPMigas) and the Contractor, it is formulated that to recover operational costs it is stated that the contractor "will" but not "must" get it back. With the connotation that there is still a risk of not getting it back. The risks are, first, on the production capacity of the entire work area, and second on the contract term limit. The government in this case has issued regulations regarding cost recovery, this action is a government strategy so that foreign oil and gas investors or companies are more interested in investing in Indonesia.

Refund of operational costs is the right of the contractor or investor as agreed as one of the provisions of the contract by the contracting parties. However, slightly different from normal business, the amount of annual operational cost recovery in the KBH converted into production is limited to no more than 80% (90% in contracts for difficult areas), so there is always the possibility that not all costs can be recovered within one year. ongoing and must be postponed to the following year (especially in a low oil price situation).

The procedure for claiming reimbursement of operating costs is set out in sufficient detail in the contract (Appendix c in the KBH), including the classification of costs and the types of costs that can be claimed. Not all costs incurred can be claimed as reimbursable operating costs. For example, bonus payments (at the time of signing the contract and production) cannot be claimed as operating costs, but can be counted as deductions from corporate tax that must be paid.

The main problem associated with operating costs is the imposition of overhead costs, which some observers see as a cost markup. The response to this can refer to the provisions in the KBH, especially Article 3.2 in Appendix c which states that general and administrative costs other than direct costs that can be calculated in operating costs are determined based on studies and study methods are used consistently. Since the implementation of the KBH 40 years ago, the costs of the contractor's overseas head office that can be charged for cost recovery do not exceed 2% of the total annual budget. The percentage of 2% is not determined by the contract, but rather Pertamina's policy which is then continued by SKK Migas. However, the actual costs that can be claimed can still be corrected based on the results of the review.³⁷ Thus, the main objective of Cost

³⁷Anton Dedi Hermanto, *Studi Yuridis Penerapan Cost Recovery*.

Recovery is for the state to reimburse all production costs of oil and gas exploration and exploitation on its land, where mining rights are transferred to KKKS. Cost Recovery also prevents oil and gas companies from being encouraged to acquire oil and gas production areas as if they had ownership rights to the area, because the bailout costs for oil and gas production have been reimbursed through Cost Recovery.

In examining the position and mechanism of cost recovery, it is essential to consider several fundamental aspects, as the return on cost recovery will significantly influence the overall state revenue. Furthermore, the concept of cost recovery carries a dual significance. On one side, a higher cost recovery may suggest an increase in the value of oil and gas investments, which is a favorable outcome. However, it also leaves room for the potential inefficiencies associated with elevated economic operating costs in the oil sector. and natural gas, indicating a negative outcome

When signing the international business contracts, it is essential to meticulously examine and contemplate every aspect of the agreement, particularly the rights and obligations, to ensure the contract's intended purpose is achieved. Ensuring precision in articulating rights and obligations will reduce discrepancies in practice, thereby safeguarding all parties from potential harm due to the improper fulfillment of their rights. The Production Sharing Contract does not explicitly regulate the classification of costs that may or may not be recovered through Cost Recovery. Prior to the release of the Regulation of the Minister of Energy and Mineral Resources Number 22 of 2008, which addresses Types of Upstream Oil and Gas Business Activity Costs that are non-recoverable by the Cooperation Contract Contractor, there existed 17 categories of negative lists regarding cost recovery costs. The provisions concerning the recovery of negative list costs were subsequently reorganized in Government Regulation Number 79 of 2010, articulated in 24 points as outlined in Article 13.³⁸

Regrettably, the oversight concerning the execution of Cost Recovery payments remains inadequate. SKK Migas, designated to succeed BP Migas following its unconstitutional ruling by the Constitutional Court in 2013, has not effectively executed its supervisory responsibilities.³⁹ Excessive Cost Recovery funds are frequently observed by KKKS due to adherence to the negative cost recovery list. To address differing viewpoints, the KBH contract text includes a specified mechanism or process. This involves the submission of the Government's financial audit results to SKK Migas, which will subsequently relay this information to the contractor for their response and clarification concerning the findings. The contractor's claims will undergo revision based on the outcomes

³⁸ Peraturan Menteri ESDM Nomor 22 Tahun 2008 tentang Jenis Biaya Kegiatan Usaha Hulu Migas.

³⁹ Dian Aries Mujiburohman, "Akibat Hukum Pembubaran BP Migas," *Mimbar Hukum: Fakultas Hukum Universitas Gadjah Mada* 25, No. 3 (2014).

of discussions held between the involved parties. In the event that an agreement cannot be achieved and attempts at consultation and mediation fail, the parties are entitled to present this disagreement to the arbitration forum for resolution. This arbitration decision is conclusive and obligatory (final and binding).

Referring to the Supreme Court decision Number wkma/Yud/20/VIH/2006, dated August 16, 2006, which delineates the distinction between BUMN assets and state-owned assets, it is established that losses arising from increased cost recovery are categorized as business losses, or more commonly, business risks, rather than state financial losses. The existing legal framework lacks a uniform understanding of the concept of state finances. Furthermore, Law No. 17 of 2003 concerning State Finance (UUKN) defines state finances as encompassing all state rights and obligations that can be quantified in monetary terms, along with all forms of money or goods that can be utilized as state property in relation to the execution of these rights and obligations. This UUKN effectively positions BUMN Persero within the realm of public law.

Disobedience (non-compliance) in the form of implementing a negative list of recovery costs, thereby harming the state. What can be applied if there is a difference in cost recovery components is the termination of operational costs through the PTK Termination of Operational Costs. The suspension period is 90 days and a maximum of 3 negotiations, which will provide a final decision on whether or not there is a reduction in the cost recovery value. Indications of fraud in the implementation of cost recovery always occur in oil and gas cooperation contracts in Indonesia. In accordance with the systematic management in PSC, an audit system is very necessary to be implemented considering that the management of the implementation of oil and gas production is in the hands of the Government. Audits are carried out once a year after coordination between SKK Migas and KKKS in a coordination meeting (rakor).⁴⁰ Complying with audit provisions is also a form of implementing good faith in accordance with the considerations of the business contract that has been made.

Conclusion

The principle of good faith is a fundamental basis in establishing contractual relations between parties, including in Indonesia. Non-compliance in the implementation of the contract can result in losses for other parties, so it is very important to emphasize good faith in the contract clause so that the objectives of implementing the contract are achieved. The problem of cost recovery occurs due to the supervision mechanism of oil and gas production sharing contracts, lack of coordination and overlapping. overlapping authority of institutions related

⁴⁰ Departemen Keuangan, Kangean Energy Indonesia Ltd. Mekanisme Pasca Audit dalam Kontrak Kerjasama, Jakarta, 10 Maret 2015.

to each other. There needs to be strict regulation that can provide legal certainty in the oil and gas mining sector in Indonesia. The principle of good faith in the return of operational costs on oil and gas production sharing contracts in Indonesia is carried out by means of arrangements at each stage of the contract and as an effort to protect the injured party, these arrangements concern the principle of good faith that must be carried out by the parties to achieve fair implementation of rights and obligations. Related to the transparency of the return of operational costs on oil production sharing contracts in Indonesia, the principle of good faith is defined as the implementation and compliance with the provisions of the audit results as a form of implementation of good faith in accordance with the opening of the business contract that has been made, the return of operational costs is expected to be a system for replacing oil and gas production costs.

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