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Sustainability based business contract reform for corporate environmental protection

Tsuroyyaa Maitsaa' Jaudah[1*], Basri Basri[1], Dakum Dakum[1], Fadil Muhammad[1], and Alika Mufida Qistina[1]

[1] Universitas Muhammadiyah Magelang, Magelang, Indonesia
*Corresponding author's email: tsuroyyaamaitsaa@unimma.ac.id

Abstract

The increase of high-risk industrial activities in Indonesia presents serious challenges for environmental protection. Pollution cases such as radioactive exposure in several areas demonstrate the weakness of contractual arrangements related to risk mitigation, waste management, and safety supervision. This situation underscores the need for business contract reform aligned with sustainability principles and environmental protection. This study aims to analyze the urgency of sustainability-based business contract reform and to formulate a contractual regulatory model capable of strengthening corporate responsibility in safeguarding the environment. The research employs a normative juridical method through the analysis of legislation, principles of contract law, and relevant academic articles. The findings show that current business contracts generally lack adequate sustainability clauses, such as mandatory environmental audits, operational safety standards, mechanisms for handling hazardous waste, and strict sanctions for violations. These gaps increase corporate vulnerability to environmental negligence and weaken accountability in risk management. The study emphasizes that business contracts can serve as an effective legal instrument to prevent pollution when designed with a sustainability orientation, including the integration of environmental performance clauses, risk allocation, and monitoring obligations. Sustainability-based contract reform carries important implications for enhancing corporate compliance and reducing environmental pollution risks. Moreover, this approach may strengthen Indonesia's business legal framework in alignment with global ESG standards.

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Keywords

Sustainable contract, Corporate liability, Environmental protection

Introduction

The growth of the industry in Indonesia not only impacts the advancement of the national economy, opens up job opportunities, and increases state revenue, but also contributes to enhancing Indonesia's competitiveness in the global economy [1]. However, behind these positive impacts lies a serious threat to the environment

surrounding the industrial area. Industrial activities often generate liquid waste, solid waste, hazardous air emissions, and most severely, high-risk waste such as chemicals and radioactive materials [2]. These wastes not only cause environmental damage but also endanger public health and future sustainability. The most current case of environmental pollution due to industrial waste in Indonesia is the radioactive contamination of cesium-137 that occurred in the Cikande Modern Industrial Area, Serang, Banten. The Nuclear Energy Regulatory Agency (Bapeten) found that the radioactive content of Cs-137 originated from the scrap metal collection site, specifically from metal powder or scrap metal [3]. In this case, the handling of radioactive waste exposure was not handled properly, leading to increased radiation in the community's residential areas. This shows how weak the supervision and management of industrial waste is, and how little awareness the company has of environmental safety standards, as industrial activities are solely focused on economic profit without considering environmental sustainability.

Regulations governing environmental protection and management are actually already in place, namely Law Number 32 of 2009 concerning Environmental Protection and Management. This regulation addresses crucial matters such as environmental impact analysis, environmental permits, pollution control and environmental damage, and also stipulates administrative and criminal sanctions for violators [4]. As modern corporate governance evolves, the Environmental, Social, and Governance (ESG) principle has also emerged as a sustainable approach to ensure that industrial activities not only pursue profit but also consider social responsibility and environmental sustainability [5]. However, the legal instrument that forms the basis for the company's operations, namely the company's founding contract, often does not include a clause regarding environmental responsibility.

The company establishment contract should be the primary legal source governing the internal relationships of the capital owners and the direction of company policy. However, when environmental liability clauses are not incorporated into the deed of establishment or the company's foundational agreements, sustainability is not internalized as a binding contractual norm but is instead treated merely as an external obligation dependent upon state regulation. From a theoretical perspective, sustainability governance requires environmental responsibility to be embedded within contractual mechanisms as a means of risk allocation and accountability among the parties, rather than being confined to a framework of mere regulatory compliance [6]. Nevertheless, empirical findings indicate that such practice has not yet become a standard in Indonesia. Dwitanto, Natsir, and Nasution [7] emphasize that although national law provides a legal basis for environmental liability within development contracts, the inclusion of such clauses has not been consistently institutionalized in contractual practice. Similarly, R. J. Gaghana [8] finds that environmental preservation clauses in investment agreements remain optional rather than standardized provisions, while M. P. Rokan et al. [9] demonstrate that the integration of green procurement

clauses in public procurement contracts remains sporadic. These conditions suggest that many companies continue to prioritize economic profit and assume that compliance with governmental regulations is sufficient, without reinforcing their environmental commitments through private contractual instruments. Additionally, the implementation of ESG is also not maximized, leading to minimal awareness of the Company's strategic sustainability. If the company's articles of association contain an environmental liability clause, it affirms the company's commitment to environmental sustainability and opens up civil legal enforcement mechanisms, allowing for the enforcement of environmental protection commitments based on contract.

This research emphasizes the urgency of including an environmental protection liability clause in the company's establishment contract, whereas previous research has focused more on the company's compliance with environmental laws from a public law perspective or on analyzing environmental management thru government licensing and supervision [10]. Previous research was also limited to the sanctions imposed on companies that pollute the environment, which were only based on administrative and criminal law. It did not discuss the sanctions suffered by companies that pollute the environment under civil law [11]. Additionally, research on ESG implementation is still limited to general company policy aspects and does not address contractual clauses in company establishment. Previous studies show that ESG implementation is not yet optimal, resulting in weak monitoring and compliance with regulations, despite the fact that ESG principles should be the main foundation for industry governance to balance economic, social, and environmental sustainability interests [12].

This research has some quite fundamental differences from previous studies. This research focuses on the importance of a company's environmental liability clause in the company's founding contract as a legally binding form of sustainability commitment from the company's inception. This research also aims to strengthen the implementation of sustainability principles in the fundamental legal aspects of the company and to synchronize contract law, company law, and environmental law. This research is expected to contribute to driving the transformation of the business world in Indonesia toward greater ecological awareness and responsibility, which aligns with the national development goals emphasizing a balance between economic interests, natural resource sustainability, and the well-being of future generations.

Method

This research is normative research that aims to analyze the urgency of implementing a company's environmental liability clause in the company's establishment contract. This research uses a legislative approach, a conceptual approach, and a case study approach. The data sources in this study are primary legal materials such as legislation, secondary legal materials such as books, journals, and related scientific articles, and tertiary legal materials such as encyclopedias. Legal materials were collected thru literature review with searches on credible digital sources. Data analysis was conducted qualitatively thru

the interpretation of legal norms, which were then linked to business practices to identify the significance and urgency of environmental protection clauses in company establishment contracts. This research employs a deductive reasoning pattern, drawing conclusions from general norms to formulate solutions to specific problems, as well as argumentative reasoning to strengthen the idea of sustainability-based business contract reform. The research findings are presented descriptively-analytically by outlining the relationship between theory and regulation and providing recommendations for contract law reform to support the implementation of sustainable development in business practice.

Results and discussion

The clause regarding the Company's environmental responsibility in the Company's establishment contract in Indonesia is still very weak and is not a primary focus in the preparation of the Company's founding documents. The company's establishment contract typically focuses only on capital, organizational structure, the authority of the company's organs, profit sharing, and decision-making mechanisms, while sustainability clauses are not explicitly formulated as binding contractual obligations. The absence of such provisions creates a legal gap, particularly with respect to civil liability in cases where environmental damage results from industrial activities. Empirically, the dominance of this pattern can be observed through governance and environmental compliance indicators in Indonesia. Reports issued by the Financial Services Authority (OJK) regarding the implementation of POJK No. 51/POJK.03/2017 indicate that the integration of Environmental, Social, and Governance (ESG) principles remains concentrated among publicly listed companies and financial service institutions, while non-listed companies have not systematically internalized sustainability considerations within their foundational documents or internal contractual arrangements [13]. Furthermore, the Ministry of Environment and Forestry's PROPER reports consistently demonstrate that the majority of companies are categorized as blue (minimum regulatory compliance), rather than green or gold, which reflect commitments beyond compliance. This indicates that environmental compliance remains predominantly administrative rather than contractual in nature. Academic literature reinforces these findings; M. Khan, G. Serafeim, and A. Yoon [14] show that only a limited number of companies internalize material environmental issues within their governance structures, while Fatemi, Glaum, and Kaiser [15] emphasize that substantive ESG integration has not yet become a universal practice. In the Indonesian context, Dwitanto, Natsir, and Nasution [7], as well as R. J. Gaghana [8], confirm that environmental clauses in development and investment contracts remain optional rather than standardized provisions. These conditions explain why many companies assume that compliance with administrative requirements and the acquisition of business permits suffice to fulfill their legal obligations, even when their operations cause environmental harm. Consequently, companies often perceive themselves as bearing no civil liability to undertake remedial or preventive measures, since environmental

commitments are not expressly embedded in contractual instruments enforceable through breach of contract mechanisms.

The company's responsibility toward the environment still refers to public legal regulations, particularly criminal sanctions and administrative oversight. This is evident when environmental violations occur, as the resolution is thru criminal channels that emphasize the element of fault or negligence. Meanwhile, civil law what should have been the basis for enforcing responsibility and awarding compensation is rarely utilized due to the lack of adequate regulatory basis in the company's establishment contract. This vacancy forced him to pursue a civil lawsuit based on unlawful acts, which requires complex proof and high litigation costs. In fact, if companies were required to include sustainability clauses in their contracts from the beginning, dispute resolution could proceed more effectively on the basis of breach of contract. Company establishment contracts are drafted solely to protect shareholders, while environmental and community protection has not yet been recognized as stakeholders with the right to ensure business sustainability. This contradicts ESG principles and sustainable development, which require companies to be responsible for their environmental impact from the very beginning of their establishment.

The absence of a sustainability clause means the Company has no sense of responsibility toward the environment, creating significant room for violations and neglect of environmental responsibilities. The company's establishment contract did not serve as a preventive instrument, even though they should have been an important control mechanism to ensure the company operates responsibly. The synchronization between the sustainability clauses in the Company's establishment contract is an effective step in strengthening the legal framework for environmental protection. With the inclusion of this clause, it can serve as the basis for effective civil sanctions such as compensation for losses, environmental restoration, and contractual penalties for companies that fail to meet their obligations. Therefore, the Company is not only obliged to comply with environmental law, namely the Environmental Protection and Management Law (UUPLH), but is also privately bound by commitments in the Company's agreement, which can be enforced by other interested parties.

The Company's establishment contract are an instrument of social control, not just a tool to legalize the Company's activities. Contract reforms that include environmental protection clauses will strengthen the position of the state and society in overseeing and encourage companies to operate ethically and sustainably. This allows the Company to increase accountability, reduce pollution risks, and expedite the environmental dispute resolution process in the event of a violation. Reforming the company's founding contract is necessary to complement existing laws and also provide more effective civil avenues for enforcing environmental responsibility. The inclusion of this clause will support the realization of responsible business practices, enhance the Company's competitiveness, and ensure long-term environmental protection as the foundation for national economic sustainability.

Business contract reform, in this case, sustainability-based company establishment contracts that include environmental protection clauses, is an urgent matter in the development of business law, especially in the industrial era. However, in practice, a company's deed of establishment in Indonesia does not explicitly stipulate environmental protection obligations, as the document continues to be primarily positioned as an instrument for the formation of a legal entity and the regulation of internal corporate relations. Consequently, environmental responsibility is generally perceived as an administrative obligation linked to licensing requirements rather than as a binding civil contractual commitment, resulting in the absence of clear internal provisions governing standards of prevention, remediation, and legal consequences in the event of non-compliance or environmental harm. This is not in line with the direction of national legal policy as stated in the Environmental Protection and Management Law (UUPLH), which requires every business actor to prevent pollution, carry out restoration, and apply the principle of sustainability in their business activities [16]. However, this principle of sustainability has not yet been internalized into the Company's articles of association, which refer to the provisions of Book III of the Civil Code regarding obligations, specifically the principle of freedom of contract.

Corporate compliance with environmental law only refers to public law, namely licensing, supervision, and enforcement by the government with administrative and criminal sanctions. Therefore, the role of the company's founding contract as an internal instrument for promoting environmental compliance is still inadequate. The company only considers environmental responsibility as a mere legal obligation, not because of the moral and legal obligations voluntarily agreed upon in the company's founding contract. Consequently, many cases of environmental pollution only end up in criminal or administrative channels [17]. Meanwhile, civil liability, such as compensation to the public and environmental restoration, is still very minimally applied because there is no clause in the company establishment contract that can serve as a basis for a lawsuit.

The company establishment contract, as a private instrument, cannot ignore the fact that the criminal aspect is also an important part of corporate responsibility for environmental damage. The Law on Environmental Protection and Management (UUPPLH) stipulates that companies can be penalized for environmental crimes, specifically in articles 98-115 of the UUPPLH, which impose criminal sanctions in the form of fines or imprisonment on offenders. It also clarifies that if the perpetrator is a business entity, the sanctions are imposed on the company or the person acting on behalf of the company. The application of criminal sanctions for companies has been recognized in Indonesia, although its implementation faces obstacles in proving guilt, the complexity of corporate structures, and economic pressures. This makes criminal law an important but insufficient repressive instrument to consistently ensure the rights of society and the environment [18].

Previously, the application of Environmental, Social, and Governance (ESG) was not a legal obligation inherent in the company's founding contract, but only focused on the

company's internal policies and sustainability reporting. ESG implementation in Indonesia is still weak, resulting in suboptimal monitoring and compliance of companies with environmental regulations. In fact, when ESG is used as the basis for drafting the company's founding contract, the principle of sustainability can become the foundation for business governance, ensuring a balance between economic, social, and environmental protection interests. Additionally, including sustainability clauses can serve as a private legal basis for environmental responsibility, such as waste management obligations, remediation obligations, environmental reporting, and contractual penalties, enabling civil actions like compensation, specific performance, or contractual penalties to be pursued independently of administrative or criminal processes. This aligns with the use of sustainability clauses in contracts as a tool to strengthen the Company's compliance, even tho their implementation and enforcement face challenges [19].

The Company's Articles of Association are the fundamental document that determines the Company's direction, objectives, and activities from the outset, as stipulated in Articles 1313 and 1338 of the Civil Code. The absence of an environmental protection clause indicates that the company's objectives are still dominated by a profit orientation and economic efficiency. In fact, there is a principle of good faith and compliance, which is a key component of contracts and should be the basis for affirming environmental sustainability obligations as part of the Company's responsibility to the environment and society. Based on this, reforming the company's establishment contract to integrate ESG principles will be a balancing tool between economic interests and public interests. Reforms to company establishment contracts will not replace existing regulations but will complement them with a faster private enforcement mechanism focused on environmental damage recovery [20].

The clause regarding the Company's responsibility for environmental protection in the Company's articles of association is actually supported by regulations concerning the Company's social and environmental responsibility, as stated in Article 74 of Law Number 40 of 2007 concerning Limited Liability Companies (UUPT). This is also emphasized in Government Regulation Number 47 of 2012 concerning Social and Environmental Responsibility of Limited Liability Companies, which requires an annual plan, a special budget, and responsibility in the annual report [21]. Although mentioned in the regulations, these normative provisions are not yet included in the Company's articles of association or deed of establishment. Therefore, environmental responsibility still refers to public regulation. However, public regulation has proven weak in guaranteeing recovery and compensation for environmental damage, especially thru civil mechanisms that are rarely used. The implementation of ESG in Indonesia is still understood as part of corporate reporting or moral responsibility, not as a contractual legal obligation. The company establishment contract should be an effective instrument for strengthening the company's commitment to environmental protection and providing a basis for private responsibility and law enforcement mechanisms. With this

environmental liability clause, the Company, investors, and other stakeholders can have specific environmental responsibility standards, such as regulating remediation obligations, periodic reporting, and contractual penalties in case of violations. Referring to the principle of freedom of contract, the Company's commitment to the environment can be designed flexibly according to needs while remaining in line with civil law. Therefore, the function of the company's establishment contract is not merely the regulation of ownership and profit sharing, but also serves as an instrument for social and environmental control.

Based on the above description, there are several recommendations for contract reform regarding the establishment of the Company thru the inclusion of sustainability clauses such as environmental and waste management clauses, environmental reporting (ESG Reporting Clause), remediation and compensation, contract penalties or financial sanctions, and environmental escrow or guaranty funds. With the inclusion of that clause in the company's founding contract, the company has been bound by environmental commitments since its inception. Therefore, the harmonization of regulations, contracts, and sustainable corporate governance practices is fundamental to effective environmental protection. The government, as the regulator, needs to encourage sustainability clauses to become a mandatory part of company establishment contracts, so that company establishment contracts not only serve as economic instruments but also as instruments for environmental protection and social justice, thereby concretely supporting the goals of sustainable development.

Conclusion

Company establishment contracts in Indonesia rarely include sustainability and environmental responsibility clauses, despite the mandate of Article 74 of the Limited Liability Company Law. As a result, environmental pollution is more often addressed through criminal and administrative sanctions, while civil mechanisms for restoring community and environmental rights remain limited. Sustainability clauses should function as binding legal instruments to implement ESG principles, prevent environmental damage, and establish corporate liability. Therefore, reforming company establishment contracts is urgent to align contract law, company law, and environmental law, while strengthening the roles of government, notaries, and business actors in promoting sustainable corporate governance and legal protection for society and the environment.

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