RECONCEPTUALISATION OF NOVATION IN CONTRACT LAW: A REVIEW OF THE PRACTICE OF CONVERTING LOCAL GOVERNMENT PROJECT AGREEMENTS INTO SHARES

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Abstract

Novation, as a form of contract termination, plays an important role in addressing obstacles to local government project development due to default or force majeure. Novation has legal consequences not only for the legal relationship between the parties but also for the subject matter of the contract that had previously been established. This study plays an important role in examining: (1) the reconceptualisation of novation through share conversion from a contract law perspective; and (2) the form of novation in the conversion of local government project agreements into shares. The approach used in this research is juridical, descriptive analytical research specification, and the types and sources of data consist of secondary data supported by primary legal materials, secondary legal materials, and tertiary legal materials. Data analysis is conducted qualitatively. The results of the study show that the concept of novation is no longer only interpreted as the replacement of debt with debt, but there is a transformation of the form of agreement into a different type of legal relationship through capital/share ownership in a company. The conversion of local government project agreements into shares falls under objective novation, as well as passive subjective novation and passive subjective novation.

Keywords*: Local Government Projects; Novation Reconceptualisation; Share Conversion.*

Abstrak

Novasi sebagai salah satu penghapusan perjanjian memiliki peran penting dalam menghadapi kendala pembangunan proyek pemerintah daerah karena wanprestasi maupun akibat overmacht. Novasi memiliki konsekuensi hukum selain terhadap hubungan hukum para pihak maupun objek perjanjian yang sebelumnya telah dibangun. Penelitian ini memililiki peran penting untuk mengkaji: (1) Rekonseptualisasi novasi melalui konversi saham dalam perspektif hukum perjanjian; dan (2) Bentuk novasi dalam konversi kesepakatan proyek pemerintah daerah menjadi saham. Metode pendekatan yang digunakan dalam penelitian yaitu yuridis normatif, spesifikasi penelitian deskriptif analisis, jenis dan sumber data terdiri dari data sekunder yang didukung oleh bahan hukum primer, bahan hukum sekunder, dan bahan hukum tersier. Adapun analisis data dilakukan secara kualitatif. Hasil penelitian bahwa konsep novasi tidak lagi hanya dimaknai sebagai penggantian utang dengan utang, tetapi terjadi transformasi bentuk perikatan menjadi jenis hubungan hukum yang berbeda melalui kepemilikan modal/saham dalam suatu perseroan. Konversi kesepakatan proyek pemerintah daerah menjadi saham termasuk ke dalam novasi objektif, serta novasi subjektif pasif maupun novasi subjektif pasif.

Kata Kunci*: Konversi Saham; Proyek Pemda; Rekonseptualisasi Novasi.*

INTRODUCTION

The development of civil law in Indonesia shows significant dynamics in various aspects of its rules and practices. Civil law, as a branch of law that regulates relationships between individuals, particularly in the realm of agreements, is the main foundation of social and economic order. Agreements play an important role in forming legal bonds that regulate the rights and obligations of the parties. Therefore, a deep understanding of the formation, implementation, and settlement of agreement disputes is fundamental to ensuring legal certainty and the smooth running of legal relations in society (Saskia et al., 2021) .

Along with economic development and advances in business transactions, the concept of novation has undergone an expansion in meaning and application. Novation is no longer understood narrowly as the replacement of debt with new debt, but has evolved into a more complex change in the form of legal relationships. One form of this is the conversion of a project agreement into share ownership in a business entity. This change has profound legal implications because it relates to ownership rights, responsibilities, and the capital structure of an entity, which were not originally regulated in a purely contractual relationship.

In local government practice, the implementation of development projects often faces legal and economic obstacles. These obstacles can take the form of default, contract non-compliance, or force majeure that disrupts project implementation. In such situations, novation can serve as an effective solution because it allows the old legal relationship to be transformed into a new, more adaptive one. With novation, the old agreement can be terminated and replaced with a new agreement that is tailored to the current conditions and needs of the parties.

The practice of converting local government project agreements into shares has emerged as a form of modern agreement restructuring that is increasingly being used. This conversion changes the position of the parties from mere creditors and debtors to shareholders and corporate entities. This shift not only brings about substantive legal changes, but also creates new legal consequences, such as voting rights, profit sharing, and capital liability. Therefore, it is important to examine the validity, mechanisms, and legal consequences of this transformation to ensure that it is in accordance with the principles of contract law and company law.

These developments indicate that the pattern of relations between local governments and business entities in development projects is becoming increasingly complex. *Public*-private partnerships (*PPPs*) have become the main forum for collaboration, often involving contractual restructuring, including the conversion of agreements into shares. This phenomenon reflects legal innovations that combine the principles of contract law with company law. In this context, a comprehensive legal approach is needed to understand all the legal, economic, and administrative aspects of the conversion process.

The urgency of research on this topic is also supported by the increasing use of the mechanism of converting projects into shares by local governments. This step is usually taken as a strategy to rescue failed projects, restructure financing, or maintain regional development sustainability. However, the application of this conversion often raises legal issues due to the lack of detailed regulations in national legislation. Therefore, a conceptual reconstruction of novation is needed to accommodate such conversion practices in a lawful and measurable manner within the Indonesian legal system.

In his article entitled "Novation and Advance Consent" (2022), K. H. Lau discusses in depth the validity of novation based on advance consent. He emphasises that novation is not merely a change in contract clauses, but the formation of a new agreement that replaces the old legal relationship. The validity of novation can only be recognised if all interested parties provide valid consent (C . In his follow-up article, "A *Call for Clarity in Contractual Accessions to Shareholder and Partnership* Agreements" (2024), Lau highlights the mechanism of accession or the addition of parties to shareholder agreements, which can have legal consequences similar to novation. Lau's study provides an important theoretical basis for understanding the transfer of rights and obligations in the context of project conversion to share ownership (Lau, 2025) .

Meanwhile, Zhang, Wang, and Chen (2023) in the journal Sustainability examine implicit debt risk in Public-Private Partnership (PPP) projects, particularly in the urban transport sector. They explain that changes in financing structures, such as converting project contracts into share ownership schemes, can create hidden fiscal burdens for governments (Zhang et al., 2023) . These findings are in line with Griffo et al. (2023) in Frontiers in Artificial Intelligence, which examined the dynamics of contractual relationships and distinguished between novation and amendment. Griffo emphasised that novation means the removal of the old contract and the formation of new obligations, unlike an amendment, which only changes part of the agreement without removing its legal basis (Gri et al., 2022) . Meanwhile, Demirel et al. (2022), through a study in ScienceDirect, examined the protection of private investment in PPP projects, highlighting the differences between debt-based and equity-based financing. They asserted that the conversion of contracts into shares must consider the balance between investor interests and the legal responsibilities of the government (Cigdem et al., 2022) .

The ideas from various international studies show that the reconceptualisation of novation is relevant in the context of modern contract law. Novation is no longer merely an instrument for the cancellation of obligations, but has evolved into a means of restructuring legal relationships in more complex forms, including the transfer of ownership and the formation of new entities. In the Indonesian context, this development provides an opportunity to renew the understanding and application of contract law in order to be able to respond to the legal and economic challenges arising from contractual innovations such as the conversion of local government projects into shares.

Thus, this study aims to examine the reconceptualisation of novation through the practice of converting local government project agreements into shares from a contract law perspective. This study is expected to identify new forms of novation that have emerged in practice, assess their validity based on the principles of Indonesian positive law, and contribute theoretically to the renewal of the concept of novation to make it more adaptive to modern legal and economic developments.

PROBLEM FORMULATION

1. How can the reconceptualisation of novation through share conversion be understood from a contract law perspective?

2. What are the forms of novation that occur in the conversion of local government project agreements into shares?

RESEARCH METHOD

The research method in this article uses a normative juridical approach that focuses on the study of theories, concepts, and laws related to novation in Indonesian contract law, particularly in relation to the practice of converting local government project agreements into shares. This method was carried out by examining secondary, primary, and tertiary legal materials through a literature study without conducting field research. This research has a descriptive analytical specification that aims to describe and analyse legal phenomena systematically and comprehensively.

The data used in this study is secondary data in the form of legislation, legal doctrines, journals, books, and other relevant legal materials. Data analysis was conducted qualitatively by interpreting applicable legal norms and examining the relationship between norms in the context of the reconceptualisation of novation. This normative approach involved various types of approaches such *as the statute approach*, *conceptual approach*, and *case approach.*

This normative juridical method is very suitable for examining the internal aspects of positive law regarding novation, which has undergone a transformation from debt replacement to capital/share ownership. Using this method, the study can explain the forms of novation that occur and the legal implications of converting local government project agreements into shares. In addition, the results of the research can also provide legal recommendations based on the existing normative framework, so that this research is both descriptive and prescriptive in addressing the legal issues raised.

Thus, the normative juridical research method used provides a strong scientific framework for examining the reconceptualisation of novation in Indonesian contract law through the practice of converting local government project agreements into shares in a thorough and systematic manner.

RESEARCH RESULTS AND DISCUSSION

A. Reconceptualisation of Novation Through Share Conversion in the Perspective of Contract Law

Etymologically, the term *novation* comes from the Latin *novatio*, which means "renewal" or "replacement of something old with something new." In the context of civil law, novation is defined as a legal act that causes the old contract to be extinguished and a new contract to be created in its place.This definition reflects a fundamental change in the basis of the legal relationship between the parties (Lau, 2022) .

According to Article 1413 *of* the Civil Code (KUHPerdata), novation can occur in three forms, namely:

1. Objective novation, where the old debt is replaced by a new debt with a different object or cause;
2. Active subjective novation, where the old creditor is replaced by a new creditor;

3. Passive subjective novation, where the old debtor is replaced by a new debtor with the creditor's consent.

The essential element of novation is the cancellation of the old obligation and the creation of a new obligation. This distinguishes it from a simple contract amendment, where the old legal relationship remains in existence and only its content is adjusted. Thus, novation is not merely an administrative renewal, but a *legal act* that substantively cancels the previous obligation (Grozavu Mircea, 2023) .

Conceptual Shift: From *Obligation Substitution* to *Legal Status Transformation.*

In classical contract law doctrine, novation is understood as a mechanism for obligation substitution. Its primary function is to replace the old legal relationship with a new one without altering the underlying type of obligation. For example, in passive subjective novation, a new debtor assumes the obligations of the old debtor with the creditor's consent. As a result, the old debtor is released, and a new legal relationship is formed between the creditor and the substitute debtor.

This understanding shows that the main focus of classical novation is on the replacement of the subject or obligation, not on the transformation of the substance of the legal relationship. In other words, traditional novation serves as an instrument for restructuring debt relationships without changing the basic legal character of the agreement (Olga, 2024) .

However, developments in modern economics and business law have expanded the meaning of novation to include *legal status transformation*. In this sense, novation no longer merely replaces old obligations with new ones, but fundamentally changes the nature and legal position of the parties. This shift is evident in modern financial practices, such as debt restructuring, financial derivatives, and share conversions, where old legal relationships are not only renewed but also transformed into new legal forms with different characteristics and consequences.

Novation in Share Conversion: A Form of Legal Status Transformation

One of the most obvious forms of *legal status transformation* is novation through share conversion *(debt-to-equity conversion*). In this mechanism, debt , which was originally a financial obligation of the debtor to the creditor, is converted into a form of ownership in the company. With this conversion, the creditor no longer has the right to claim debt repayment but instead obtains ownership rights (equity) in the form of shares.

This transformation brings about a significant change in legal status:

1. From a contractual relationship to an ownership relationship, where claim rights are converted into participatory rights in the company;
2. From a civil law regime to a corporate law regime, as creditors are now subject to the provisions of the Limited Liability Company Law and capital market regulations;
3. From a passive to an active position, as creditors who are now shareholders have voting rights, rights to dividends, and obligations attached to share ownership.

In the context of contract law, this marks a shift in the function of novation from merely a debt renewal mechanism to an instrument for transforming legal relationships and corporate financial structures.

Novation through share conversion allows for the reconstruction of legal relationships without going through the mechanism of dissolution or total elimination of the legal entities involved, but rather through the redefinition of the legal positions of the parties within the framework of a new agreement.

Contractual Legal Implications and the Reconceptualisation of Novation

The reconceptualisation of novation through share conversion affirms that modern contract law cannot be understood narrowly as merely a debt-credit relationship, but as a dynamic legal mechanism that is adaptive to economic needs. Novation has now become a means of legal and economic restructuring, which not only creates new obligations, but also builds a new legal order between the parties (Putri, 2023) .

From a contract law perspective, this raises several important implications:

1. The principle of consensuality is key, as changes in legal status are only valid if there is explicit agreement between the parties;
2. The principle of freedom of contract allows the parties to design a form of novation that suits their business needs, but this principle must still be limited by compliance with legislation, especially if it involves public entities such as local governments;
3. The principles of balance and good faith must be upheld so that the transformation of legal relationships does not disadvantage either party. Therefore, the reconceptualisation of novation requires objective valuation mechanisms and legal audits in the conversion process.
4. The principle of legal certainty requires that novation agreements be set out in writing and meet the formal requirements stipulated by law, especially in the case of share conversions in limited companies.

Thus, the reconceptualisation of novation through share conversion indicates a paradigm shift in contract law: from a traditional view that emphasises the replacement of obligations to a modern understanding that places novation as a tool for legal and economic transformation. Novation is no longer merely an administrative instrument, but a strategic mechanism in corporate legal engineering and the renewal of contractual structures (Budi, 2025) .

It can be concluded that novation has undergone a significant evolution in meaning and function in line with the complexity of modern legal relationships. In contemporary contract law, novation no longer serves only to replace old obligations with new ones, but also to substantively change the legal status of the parties through mechanisms such as share conversion.

Thus, the reconceptualisation of novation through share conversion is a form of conceptual renewal that broadens the horizon of contract law, making it more flexible, functional, and adaptive to the needs of the business world, without abandoning basic principles such as legal certainty, agreement, and balance between the parties.

Legal Analysis, Share Conversion as a Means of Extinguishing Old Obligations and Forming New Obligations in the Form of Capital Ownership

Share conversion in the perspective of contract law is not only a financial mechanism, but also a transformational legal action that directly changes the structure and status of the legal relationship between the parties. This process has two fundamental consequences, namely (1) the cancellation of old project contracts and (2) the creation of new obligations in the form of capital ownership or shares in the entity that takes over the project or runs the same business (Matytsin, 2024) .

1. Termination of the Old Contractual Obligations.

In principle, share conversion is commonly carried out in the context of debt restructuring or the settlement of contractual obligations arising from the implementation of a particular project. When a company is unable to fulfil its obligations to creditors, one of the legal solutions that can be pursued is to convert the debt-credit legal relationship into an ownership relationship through the issuance of new shares (Pradono & Cahyarini, 2022) .

In this process, the old agreement originating from the previous project contract is legally revoked. This revocation does not occur automatically but through a novation mechanism as stipulated in Article 1413 of the Civil Code, which states that the old agreement is revoked when the parties legally agree to a new agreement as a replacement. This novation agreement is constitutive in nature, meaning that the old obligations no longer have binding force once the conversion agreement is ratified.

Thus, all creditor claims and debtor payment obligations for the old project are legally terminated. Novation serves as a legal tool to sever the chain of old obligations and confirm that the debt no longer exists. The legal relationship, which was originally obligatory (based on payment obligations), is replaced by a corporate relationship. This marks the end of the old agreement's character as a contractual obligation and opens the way for the creation of a new, more permanent legal relationship within the company's capital structure.

2. Formation of New Agreements in the Form of Share Ownership.

After the old obligation is removed, a new obligation arises in the form of a capital or share ownership relationship. In this case, creditors who previously had claims against the company now become shareholders in the same entity or a new entity that takes over the project.

Legally, the creditor-debtor legal relationship, which was originally based on the principle of debt (based on *personal rights*), has now shifted to a corporate legal relationship based on *proprietary rights*. By acquiring shares, the legal position of creditors changes to owners of company capital, who have rights and responsibilities in accordance with the provisions of Law Number 40 of 2007 concerning Limited Liability Companies (UUPT) (Zulfikar, 2023) .

This change gives rise to new legal consequences, including:

a. Economic rights, in the form of rights to dividends and the remaining assets of the company;
b. Managerial rights, in the form of voting rights at the General Meeting of Shareholders (GMS);
c. Legal obligations, including liability for the company's losses limited to the paid-up capital.

This transition indicates that the conversion of shares is not merely the cancellation of debt, but also the establishment of a new legal framework that is structural and inherent to the corporate entity. In other words, the new agreement is institutional in nature, no longer a bilateral contractual relationship as in the previous project agreement (Zahra et al., 2024) .

3. Legal Aspects and Legal Procedures

For the share conversion to be legally valid, the process must comply with two main legal frameworks, namely contract law and corporate law.

a. From a contract law perspective, the conversion of shares must meet the requirements for a valid agreement as stipulated in Article 1320 of the Civil Code, namely: the agreement of the parties, legal competence, a specific object (namely the shares to be issued), and a lawful cause.
b. From a corporate law perspective, the issuance of new shares must follow the mechanism of the General Meeting of Shareholders (GMS), be set out in a notarial deed, and be recorded in the amendments to the company's articles of association (Mutiara & Fajri Mekka Putra, 2025) .

Compliance with these procedures is crucial because the conversion of debt into shares is not merely a change in the form of liability but also a legal action that alters the company's ownership structure. If not conducted in accordance with procedures, the status of share ownership and debt cancellation may be deemed invalid, potentially leading to legal disputes in the future.

4. Legal Implications and Transformation of Relationships Between Parties.

Share conversion has broad and transformational legal implications. Substantively, the relationship between the parties is no longer governed by the *debtor-creditor* principle, but by company law, which places them as corporate subjects with shared interests in the same entity.

These implications include:

1. A change in the nature of the legal relationship, from an obligatory relationship to a structural relationship subject to corporate provisions.
2. A transfer of legal risk, whereby creditors now bear business risks and profits in line with the company's performance, rather than being guaranteed fixed payments.
3. A change in legal status, whereby creditors who were previously in an external position to the company become an internal part of the corporate structure as shareholders.
4. The transformation of liability, which was originally based on personal obligations, changed to limited liability in accordance with the number of shares owned.

Thus, the conversion of shares results in a systemic change to the overall legal relationship between the parties. It not only removes the old contract, but also creates a new legal relationship governed by corporate law, which is sustainable and involves aspects of ownership, management, and joint responsibility in the company (Madi & Masn, 2024) .

Legally, share conversion is a form of substantive novation that completely changes the nature of the agreement between the parties. It not only cancels the old obligations in the project contract but also creates a new legal relationship in the form of share ownership. This shift brings profound changes to the structure of rights, obligations, and legal responsibilities attached to the parties.

Therefore, share conversion can be viewed as *a legal transformation mechanism* from contractual obligations to corporate obligations. This transformation demonstrates how modern contract law is able to adapt to the needs of the business world, providing legally valid restructuring solutions, while creating new forms of legal relationships that are more sustainable within the economic and corporate systems.

Analysis of the Elements of Novation in Debt-to-Equity Conversion

In the practice of converting debt into shares, the fulfilment of the elements of novation, namely consensus, the cancellation of the old obligation, and the formation of a new obligation, are essential requirements for the legal transformation to be valid and binding. These three elements not only represent administrative stages but also indicate the reconstruction of legal relationships from civil obligations into corporate relationships oriented towards capital ownership (.

1. The Will of the Parties (*Consensus*)

Will or *consensus* is a fundamental element in every novation as stipulated in Articles 1320 and 1413 of the Civil Code. In the context of converting debt into shares, this will is not merely an agreement to write off the debt, but also reflects *the legal intent* to change the nature of the relationship between the creditor and the debtor (Kautsar, 2022) .

In practice, the parties' intent is realised through a written agreement on the conversion of debt into shares, which must explicitly state:

a. the amount of debt converted,
b. the nominal value and type of shares issued,
c. the rights attached to the shares, and
d. the timing and mechanism for implementing the conversion.

Furthermore, in the corporate sphere, the will of the parties is not sufficient between the creditor and the debtor alone. The approval of the company's governing body is a legal requirement. Based on Article 41 paragraph (1) in conjunction with Article 42 of the UUPT, the issuance of new shares in the context of conversion must obtain the approval of the General Meeting of Shareholders (GMS), which reflects the collective will of the shareholders as owners of the legal entity (Leuciuc, 2023) .

If the conversion is carried out without the approval of the GMS, then the legal action is considered to not fulfil the element of valid intent and can be declared null and void. Similarly, if the conversion is intended for purposes that are contrary to the law, such as converting interest or penalties into shares, which is prohibited by Article 35 paragraph (2) of the UUPT, then the agreement loses the element of "lawful cause", rendering it legally invalid (*null and void)*.

Thus, the intent of the parties in the novation conversion is not only a matter of individual agreement, but also a manifestation of institutional legal consent that guarantees the legitimacy of the transformation of the legal status of debt into shares.

2. Extinction of the Old Obligation

The second element of novation is the extinguishment of the old obligation, namely the termination of the legal relationship between the creditor and the debtor who were previously bound by the debt agreement. In the context of conversion, the extinguishment of this obligation occurs because the substance of the performance that is the object of the obligation changes completely from the obligation to pay money to the issuance of shares as a form of compensation (Artika et al., 2024) .

Legally, this elimination has two dimensions:

1. The substantive dimension, namely the settlement of the debt payment obligation because it has been compensated with shares; and
2. The formal dimension, which is the explicit statement of the cancellation in the conversion agreement deed, which serves as the legal basis for the issuance of new shares and changes to the company's capital structure.

However, the cancellation of the old obligation is only valid if the conversion object meets the legal requirements. If the conversion is carried out on prohibited elements such as interest, penalties, or obligations that cannot be used as capital deposits, then the cancellation becomes legally flawed. This is in line with the principle that every novation must have a valid object and be legally accountable (Articles 1335 and 1337 of the Civil Code) (Fahrunnisa, 2022) .

Furthermore, from the perspective of contract law theory, the elimination of old obligations in share conversion has an existential function, namely to end creditor-debtor civil relations and replace them with corporate relations based on share ownership. Thus, this process is not merely the settlement of debt, but the formation of a new legal order in which claim rights are replaced by ownership rights.

3. Formation of New Obligations

After the old obligations are extinguished, the third element of novation is the creation of new obligations, namely the legal relationship between the company and the creditors who now have changed status to become shareholders. These new obligations carry substantially different legal implications:

a. The right to claim debt repayment is converted into *equity rights*.
b. Creditors acquire corporate rights such as voting rights at the AGM, rights to dividends, and rights to liquidation assets in proportion to their ownership.
c. The company's obligations to creditors are no longer in the form of debt repayment obligations, but rather corporate responsibilities in accordance with the principles *of fiduciary duty duty* and *good corporate governance.*

In order for the new agreement to be valid and binding, the share conversion must comply with the formal legal procedures as stipulated in the UUPT, including:

1. Approval by the General Meeting of Shareholders for the conversion and issuance of new shares;
2. *Fair valuation* of the converted debt;
3. Preparation of a notarial deed of amendment to the articles of association; and
4. Registration and approval of changes to company data by the Ministry of Law and Human Rights.

If any of these steps are omitted, the new agreement is considered legally incomplete, and the novation is not valid. In such cases, the relationship between the parties remains subject to the old agreement, and the conversion is deemed to have failed to create a transformation of legal status.

Theoretically, the formation of this new agreement indicates a shift in the meaning of novation from mere *obligation substitution* to *legal status transformation*, because there is a change in the legal identity of the legal relationship: from a debt-credit relationship to a capital ownership relationship within the framework of corporate law (Horianto, 2019) .

To reinforce this conceptual analysis, the following presents theoretical and empirical reinforcement showing how novation through share conversion has been applied in practice and recognised in legal doctrine.

The fulfilment of the elements of novation in share conversion indicates that this process is not merely administrative or financial in nature, but rather a legal act with a transformational dimension. Theoretically, this broadens the understanding of novation in modern contract law that the replacement of an obligation can mean a change in the form, nature, and legal status of the relationship between legal subjects, not merely a replacement of financial obligations.

In practical terms, share conversion is an important instrument in corporate restructuring because it can save business entities from default without violating the principle of legal certainty. However, the success of this transformation is highly dependent on compliance with the elements of valid novation, the cancellation of valid old obligations, and the formation of new obligations that meet the provisions of the UUPT.

Thus, novation through share conversion not only settles financial obligations but also creates a new legal framework that transforms contractual relationships into sustainable corporate relationships.

Theoretical and Empirical Strengthening of the Reconceptualisation of Novation through Share Conversion.

1. Theoretical Support from Doctrine and Expert Opinions

In Indonesian civil law literature, Subekti (1989) explains that *novation* is one way of extinguishing an obligation due to a new agreement replacing the old one. He emphasises that the essence of novation is not merely a change in the form of the obligation, but rather the creation of a new legal relationship that replaces all the legal consequences of the previous relationship. This shows that novation always contains the element *of intention to extinguish and replace*, not merely to renew the terms of the contract.

R. Setiawan's (2005) view reinforces this with " " stating that novation is a form of debt renewal that creates *discontinuity* between the old and new obligations. He emphasises the importance of *consensus novandi* — that is, an explicit agreement to extinguish the old obligation and replace it with a new obligation based on a different legal basis. In the context of share conversion, this means that the creditor-debtor relationship can no longer be recognised as an obligatory relationship after the new agreement (share ownership) is formed (I .

Meanwhile, in the common law system, Goode's (2011) view in *Commercial Law* explains that novation functions as *a legal instrument* that transfers all contractual rights and obligations from the old relationship to the new relationship, provided there is "clear and mutual assent" from the parties. Goode emphasises that novation differs from *assignment,* as *assignment* only transfers rights, whereas novation replaces the entire contract comprehensively. This view is in line with the principle in *debt-to-equity conversion* practice*,* where the old contract ends completely, and the new relationship (equity ownership) replaces it as the new legal basis.

Thus, both in Indonesian civil law doctrine and the *common law* system, novation is understood as a legal mechanism that does not merely replace obligations but also reorganises the legal status and relations of the parties. This is the theoretical foundation of the concept *of legal status transformation*, which is at the core of the reconceptualisation of novation through share conversion.

2. Empirical Case Examples of Debt Conversion into Shares

The application of the concept of novation in the form of share conversion has been widely used in Indonesia, particularly in the financial restructuring of corporations and state-owned enterprises.

One example is the restructuring of PT Garuda Indonesia (Persero) Tbk in 2022, where some of the obligations to creditors and lessors were converted into new shares through a *debt-to-equity swap* mechanism. This step was taken based on a settlement agreement (homologation) in the Debt Payment Obligation Deferral (PKPU) process. The conversion legally eliminated most of the old debt obligations and replaced them with share ownership relationships, whereby certain creditors became new shareholders in the same entity.

Another case can be found in the restructuring of companies in the energy and infrastructure sectors, where institutional creditors (including banks or investment institutions) agree to convert debt into shares so that projects can continue without burdening the company's cash flow. This practice is common in the context of strategic projects involving state-owned enterprises or subsidiaries of state-owned enterprises, as share conversion is considered a fair solution between the interests of debtors and creditors (As'ari, 2020) .

Internationally, a similar practice occurred in the restructuring of General Motors (US, 2009), where most of the debt to the government and private creditors was converted into shares in a new company (*New GM*). The conversion effectively terminated the old obligations and created a new legal relationship between investors, the government, and the new entity. This demonstrates that novation in the form of share conversion is universally recognised as a legitimate legal mechanism for transforming the legal relationship of debt into a corporate relationship ( ).

From a theoretical and practical perspective, it can be asserted that the reconceptualisation of novation through share conversion illustrates a fundamental shift from the concept *of renewal of obligation* to *transformation of legal relationship*.

In this new paradigm:

a. Novation no longer simply means replacing old financial obligations with new ones,
b. but also means changing the nature of the legal relationship itself, from a contractual relationship that is personal and obligatory to a corporate relationship based on ownership and capital participation.

This concept marks an expansion of the function of contract law in the modern legal system: the law not only regulates the settlement of obligations, but also becomes an instrument for engineering legal and economic structures that enable the sustainability of business entities.

Thus, novation through share conversion is a concrete form of the adaptation of contract law to economic dynamics, which makes legal relationships more functional, responsive, and in line with the principles of *good corporate governance* and the efficiency needs of modern corporations.

B. Forms of Novation in the Conversion of Local Government Project Agreements into Shares.

This section aims to analyse the forms of novation that arise in the practice of converting local government project agreements into shares and to assess the legal implications for obligations, legal subjects, and local government financial governance ( ). In civil law, novation is one of the ways of extinguishing obligations regulated in Articles 1413–1420 of the Civil Code (KUHPerdata), whereby an old obligation is extinguished and replaced with a new obligation that has different legal consequences. In the context of local government projects, the application of novation is interesting because it involves a shift in the legal regime from private contractual to public corporate, which includes elements of government administration, regional finance, and capital investment (Marsalina Susana & Urbanisasi Urbanisasi, 2025) .

The conversion of project agreements into shares is a modern manifestation of novation that implies a change in the object and/or subject of the agreement. This transformation is not only civil in nature but also intersects with public law norms, as it concerns the management of regional assets and the participation of local government capital in business entities.

In the context of contract law, novation functions as a legal instrument that causes the termination of an old agreement and at the same time gives birth to a new agreement, provided that there is a form of substitution (*substitution*) of either the subject, object, or both. Within the framework of local government project law, the conversion of project agreements into capital participation (shares) is a unique manifestation of novation, as it combines the principles of private law with public administration governance (Utomo et al., 2022) .

This transformation not only involves changes to the object of the performance but may also involve changes to the parties bound by it, resulting in both objective and subjective novation.

1. *Objective* Novation

Objective novation occurs when the object of the agreement changes. In the context of converting local government project agreements into shares, the initial object in the form of construction work, services, or payment obligations (project debt) is changed to capital ownership in the form of shares in a local business entity, such as a Regional Owned Enterprise (BUMD) or a joint venture company (Iin Selvina & Tjempaka, 2024) .

This change shifts the legal relationship between the parties from a contractual (*obligatory*) relationship to an ownership (*corporate*) relationship. The local government, which was originally in the position of employer or creditor, now becomes a shareholder with rights to dividends, voting rights, and responsibilities in proportion to its participation.

From a legal perspective, this transition is a form of requalification of the object of the agreement, from a debt-based obligation to a capital-based ownership right. This type of conversion marks a shift in the legal regime from public administration and procurement of goods/services law to corporate and regional investment law. Therefore, the implementation of this novation must not only comply with the provisions of Articles 1413–1420 of the Civil Code (KUHPerdata), but must also comply with regulations concerning regional government asset and investment management, including Law No. 23 of 2014 concerning Regional Government and Government Regulation No. 27 of 2014 concerning Management of State/Regional Property (Yoserizal et al., 2024) .

2. Subjective Novation: Pass*ive* and *Active*

Subjective novation occurs when there is a change in the parties to the agreement, while maintaining the object of the agreement. In the practice of converting local government projects, two forms of subjective novation can occur, namely passive subjective novation and active subjective novation.

a. Passive subjective novation occurs when the debtor is replaced by another entity that assumes the existing obligations. In the context of regional projects, this can occur when the initial contractor that originally had the obligation to complete the project is replaced by a new company, such as a regionally-owned enterprise or special purpose vehicle, which assumes these obligations in exchange for share ownership. Such a replacement requires the explicit consent of the creditor, namely the local government, as stipulated in Article 1415 of the Civil Code.

   This mechanism allows for the lawful transfer of responsibilities and obligations without severing the continuity of the agreement, provided that the transfer is based on a written agreement and the creditor receives administrative legitimacy .

b. Active Subjective Novation occurs when the creditor is replaced by another party. In a project conversion scheme, this can occur when the claim against the local government is transferred to a new entity, such as a joint venture or investment entity that receives the transfer of payment rights as a form of capital participation. Thus, the new entity becomes the legal recipient of the project value, replacing the position of the previous creditor (Novasi et al., 2024) .

   This transfer creates a new legal relationship between the local government and the new rights recipient entity, while the relationship with the old creditor ends.

3. Combination of Novation and Its Legal Implications

In practice, the conversion of project agreements into shares often involves a combination of objective novation and subjective novation. Changes occur not only in the object (from work to shares) but also in the parties involved (from contractors to new shareholders). This combination gives rise to complex legal consequences, including: the termination of the old project agreement and the creation of a new legal relationship in the form of capital ownership;

the transfer of responsibility from a debtor-creditor relationship to corporate responsi ; and a change in accountability governance from a contractual mechanism to a corporate governance mechanism (*corporate governance*) (Mamouri & Amini, 2024) .

Therefore, the novation process in converting local government projects into shares must have a valid legal basis, through the approval of the Regional Representative Council (DPRD), *a fair value assessment* of assets, and compliance with the principles of transparency and accountability in regional finances.

Without compliance with these legal provisions, novation may be declared null and void or result in administrative or even criminal liability for public officials involved, particularly in the context of regional financial and asset management.

The main legal implications of this combination include:

1. The termination of the old agreement and the creation of a new legal relationship in the form of capital ownership.
2. The transfer of legal responsibility from a debtor-creditor relationship to a corporate ownership relationship.
3. A change in accountability governance from a contractual mechanism to corporate governance principles.
4. The obligation to obtain DPRD approval and a fair asset valuation as a condition for the validity of the conversion.
5. Potential administrative or criminal liability for public officials if the conversion is carried out without a legal basis and proper procedures (Yusrizal et al., 2024) .

Table 1. Comparison of Novation Forms in the Conversion of Local Government Project Agreements

Type of Novation	**Elements That Change**	**Example in Conversion**	**Legal Impact**
Objective	Subject matter of the agreement	Project debt → shares	Transition from contractual to corporate legal regime
Subjective Passive	Debtor	Contractor → Regionally Owned Enterprise	Transfer of responsibility with creditor approval
Active Subject	Creditor	New investor → local government	Change of project claim recipient
Combination of novation	Both object and subject change simultaneously	Project debt converted into shares + change of contractor	Full transformation of legal relationships; new governance

The table above shows that each type of novation has different characteristics and legal consequences. In the practice of local government project conversion, these forms of novation often appear simultaneously and interact with each other, requiring an integrative regulatory framework capable of accommodating these cross-sectoral legal changes.

CONCLUSION

The reconceptualisation of novation in Indonesian contract law shows that the cancellation of obligations is no longer limited to the replacement of debts with new debts, but has developed into a legal instrument that allows for the transformation of legal relationships, including through the mechanism of converting project agreements into share ownership. In the context of local government projects, novation has become an adaptive legal means of adjusting old obligations to new legal and economic needs, without eliminating the basic principles of contract validity as stipulated in Articles 1320 and 1413–1420 of the Civil Code. The conversion of local government project agreements into shares reflects the simultaneous application of objective novation and subjective novation. Objective novation is evident through the change in the object of the agreement from the obligation to implement the project or pay debts to capital ownership (shares) in local business entities such as BUMDs or joint ventures. Meanwhile, both passive and active subjective novation occur when there is a replacement of parties in the agreement, both on the debtor side (contractor to BUMD/SPV) and on the creditor side (transfer of collection rights to new investors). The combination of these two forms of novation results in a shift in the legal regime from a public contractual relationship to a corporate relationship subject to regional company and investment law provisions.

Thus, the reconceptualisation of novation through the conversion of local government project agreements into shares expands the scope of application of contract law in Indonesia. This practice not only reflects the flexibility of private law in responding to public economic needs, but also requires compliance with the principles of transparency, accountability, and authoritative approval, such as from the Regional Representative Council (DPRD) and fair value assessment. These findings confirm that novation has *strategic* potential as a legal instrument for restructuring public agreements, as long as its implementation is based on the principles of legal certainty, contractual fairness, and good governance.

RECOMMENDATIONS

The reconceptualisation of novation through share conversion demonstrates the need for a paradigm shift in contract law. Civil law is no longer understood as a static and private system, but must be positioned as a dynamic instrument capable of regulating the transformation of economic relations in a fair, transparent and sustainable manner. Thus, the renewal of contract law in terms of novation must be directed towards realising contractual justice and protecting the public interest in accordance with equitable national development.

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