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Indonesia

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## *Indonesia raises the minimum divestment requirements for foreign holders of mining licences*

In an announcement which has surprised some investors, the Government of Indonesia has raised the minimum divestment requirement for foreign holders of mining business licences (in Indonesian – *Izin Usaha Pertambangan* or "IUP") from 20% to 51%, by the end of the 10th year of production.

On 21 February 2012, Government Regulation No. 24 of 2012 ("GR 24") was issued, amending Government Regulation No. 23 of 2010 ("GR 23"). GR 23 was one of the key implementing regulations for Law No.4/2009 on Mineral and Coal Mining (the "Mining Law"). GR 23 required a minimum divestment of 20% of foreign capital in IUP holders after the 5th year of production, but under the Mining Law the determination of the requisite level of divestment is given to the Government, therefore the Government is within its power to revise this requirement. Pursuant to GR 24, the 51% divestment must be achieved after the 10th year of production, with minimum divestment milestones as follows:

| Number of years after production commences | Minimum divestment requirement of total shares (at the end of that year) |
|---|---|
| 6 | 20% |
| 7 | 30% |
| 8 | 37% |
| 9 | 44% |
| 10 | 51% |

The divestment of the requisite number of shares should be made to the following parties, in order of priority:

1. The Central Government
2. Provincial/Regional Governments
3. State-owned or Regionally owned enterprises
4. Indonesian owned companies.

An initial offer for divestment of shares must be made within 90 days of the end of the 5th year of production commencing, following which the milestone divestment requirements must have been actually achieved by the end of each of the relevant years (i.e. between the end of each of the years between year 6 and year 10). Each party to whom a divestment offer is made has 60 days to respond to the offer.

If the required level of divestment has not been achieved, the offer for the divestment shall occur in the following year, although non-adherence to the divestment requirements could also invoke administrative sanctions which include written warnings, suspension of production and/or revocation of the IUP.

The minimum divestment thresholds must subsequently be maintained, with GR 24 providing that any additional issue of shares must not dilute the Indonesian shareholders to below the minimum divestment amount.

GR 24 has been met with some concern from existing licence holders, industry groups and potential investors alike. The key criticism revolves around the requirement to relinquish control following only 10 years of production, which in many cases may be too short a period of time to realise a return on the investment. This is particularly the case for large, long-life mining projects that require significant upfront capital expenditure.

Many also fear that the divestment rules will discourage new foreign investors. Although the Government position appears to be that the Indonesian mining sector remains an attractive investment opportunity, and that rather than a decline in foreign investment there is more likely to be a shift from the traditional investment sources such as the USA and Europe to emerging economies such as China and India.

Most of the concerns appear to be from the mineral sector, given that Indonesia's largest coal mines are already predominantly controlled by Indonesian investors. Coal mining projects also tend to have lower upfront capital expenditures and shorter payback periods than large-scale mineral projects.

Other concerns which arise in respect of these divestment rules include:

- Under GR 24 although there is now clarity that the divestment percentage applies to the total issued shares rather than to the foreign owned proportion, GR 24 does not make it clear whether further divestment to Government entities would be required if the requisite percentage of shares was already held by private Indonesian investors before the deadline stipulated in GR 23. For instance, if from the date of incorporation 51% of the company was held by private Indonesian investors, would any further divestment to Government entities be required?
- The key issue of pricing the divested shares still remains uncertain. To date, the implementing regulations required under GR23 regarding pricing and divestment procedures have not been issued. As has been seen from previous divestment processes in Indonesia under the Contract of Work ("CoW") system, the pricing and terms of any divestment is not a straightforward matter.
- Despite the understanding that an existing CoW or Coal CoW ("CCoW") will be honored until its expiration date, recent media reports suggest that the Government may intend to pursue these divestment requirements in its CoW/CCoW re-negotiation discussions (as required by Law No.4/2009 and provided for in Presidential Decree No.3/2012 – see our EU&M NewsFlash No.42/2012). Such an approach appears to be undermining investor confidence in the contract sanctity of Indonesia's many mining agreements.
- What is the status of a company listed on the Indonesian Stock Exchange? Traditionally, Indonesian listed companies have been treated as Indonesian regardless of the nationality of the shareholders. This is supported by the Indonesian Investment Law. Will this principle continue to be applied?
- What is the position where no Indonesian party is willing to accept the divestment offer on the offered terms? Must a foreign shareholder accept divestment at any price?
- Will Indonesian parties be restricted from subsequently transferring part of the Indonesian ownership element to foreign parties if it would cause a breach of the divestment thresholds?
- Can divestment occur through an initial public offering ("IPO") on the Indonesian Stock Exchange, if Government or State-owned entities are not interested in pursuing an acquisition? Would an IPO in the earlier production years of the IUP satisfy the divestment requirements?

## *Application of GR 24 to a Contract of Work ("CoW") licence holder*

A key provision of the original GR 23 is that CoWs and CCoWs are to remain valid until their expiration. This provision has not been amended by GR 24, although the procedure for the extension of the contract and conversion into a mining licence (not a CoW/CCoW) has been addressed.

GR 24 continues to provide that extensions of CoWs and CCoWs will only be granted (if approved) in the form of IUPs (rather than a contract). In addition, applications for extension must be requested no more than 2 years and no less than 6 months prior to the expiration of the contract. The application must satisfy a number of administrative, technical, environmental and financial requirements, and can only be granted by the Minister. A rejection of the application must be granted prior to the expiration of the contract.

## *New mining licences and transfers of existing licences*

GR 24 provides that new mining licences issued to foreign held entities (i.e. PT PMAs) must only be granted by the Minister - presumably a measure intended to enable centralised monitoring of the new divestment requirements. However, GR 24 is not clear on whether existing IUPs issued by a Regional or Provincial Government to a PT PMA company must now be re-issued/approved/endorsed by the Minister.

GR 24 also provides that in certain circumstances a direct interest in a mining licence can be transferred (GR 23 previously prohibited direct transfers of mining licences, as opposed to sales of shares in companies holding the licences), provided that the transfer is to an entity which is at least 51% owned by an IUP holder. However, it is not clear whether the transfer can be to a different 51% Indonesian owned IUP company, or if it is intended that a transfer can only be made to a subsidiary of the existing IUP company for the purposes of intra-group restructuring, such as where one company holds several IUPs pursuant to the KP conversion transitional rules.

The intention behind this amendment is not clear and also appears to be in conflict with Article 93 of the Mining Law which states that holders of an IUP may not transfer an IUP (with the exception of certain approved stock exchange transactions) and the restriction in Article 9 of GR23 of one mining licence per entity.

Further clarification is required on the reasons for these amendments, and whether the relaxation of the IUP transfer rules indeed extends the exemption for multiple-holding of IUPs.

## *Outlook*

In common with many new regulations issued around the new mining law, or indeed many other new laws, the ultimate impact on investor sentiment is yet to be seen. We expect that this will be dependent on the Government's approach to:

- communicating that foreign investment in the Indonesian mining sector is required (and welcome) in order to ensure the industry's maximum contribution to the country's development goals;
- clearly regulating the terms and valuation method for the divestments, to reduce uncertainty in projecting future returns for mining projects, and to avoid disputes arising from divestment processes;
- providing more transparent guidance on any intention to renegotiate existing CoWs or CCoWs to include additional divestment requirements in line with GR 24 and so confirming contract sanctity as a priority feature of Indonesia's investment regime; and
- providing adequate tax or other incentives to investors such that appropriate investment returns can be generated prior to divestment deadlines – projects which are not economically feasible prior to the divestments, and for which local capital is not available, will not be developed.

We will continue to monitor the implementation process of this divestment regulation. Please contact your usual PwC mining contact with any queries on the commercial impacts of the regulation for your business.

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