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Digging Deeper? -New Indonesian Mining Law Finally Passes



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On 16 December 2008 the Indonesian Parliament passed Indonesia's new Law on Mineral and Coal Mining (the "Law"). This Law, which has been under deliberation for well in excess of three years, represents another major regulatory development in Indonesia's investment landscape (along with the 2007 Investment Law, and the 2007 and 2008 Tax Laws).

A key point to note is that, as expected, the well-regarded Contract of Work ("CoW") system will no longer be available under the new Law. This is a disappointment to many investors. Instead, both domestic and foreign investors will

be able to apply for a form of mining licence (referred to in Indonesian as an *Izin Usaha Pertambangan* or IUP).

The jury is still out on whether this Law will achieve the stated aims of increasing investment in the mining sector, which has suffered from numerous perceived regulatory weaknesses for a number of years. One of the great hopes for the new Law was that it would remove some of the uncertainty around the investment regime for the mining sector, which has prevailed for some time. Initial thoughts from Indonesian mining industry observers are that the Law may not

provide the level of certainty necessary to encourage the investment in large-scale mining projects, which is so vital to a strong mining sector. In particular, uncertainty around the transitional provisions for existing contracts of work, which are not available under the new system, is causing some concern.

It will take some time to fully digest the impact of the new Law, noting also that the Law will not formally become effective until the earlier of Presidential signature or 16 January 2009. The new Law will also rely heavily on many, still to be issued regulations for its implementation. Despite the fact that the new Law requires these implementing regulations to be issued within one year, the Government does not have a good track record of issuing such regulations on a timely basis. This may cause further uncertainty for investors.

However some initial highlights are as follows:

- a) legal framework:- the new law replaces the “original” Mining Law No.11/1967. The 1967 law had provided the framework for all of Indonesia’s existing mining concessions including all of the existing CoWs and Coal CoWs. Readers will be aware that the CoW/CCoW system represented the only formal avenue for foreign investment into the mining sector. On this point however it is worth noting that, apart from the single CoW issued approximately one month ago for an iron sands project, there have been no CoWs/CCoWs issued under the 1967 Law since the late 1990s.
- b) *Izin Usaha Pertambangan* (“IUP”) licences:- all investment (both foreign and Indonesian) must now be carried out pursuant to an “IUP” or IUP *Khusus* (“IUPK”). An IUP/IUPK is essentially a permit which is required for exploration, development and exploitation of mineral or coal resources. An IUP is applicable for general mining areas while an IUPK is applicable for State Reserve Areas (“SRA”). SRAs are to be determined by the Central Government with approval from parliament. State-owned companies are to be prioritised for the development of SRAs. The hope of many investors that a form of contract would remain available for SRAs or large projects above a certain investment threshold has not been realised in the Law.

Relevant features of an IUP/IUPK are as follows:

- i) IUPs/IUPKs are mineral/coal specific (Article 40 for IUP and article 74 for IUPK);
- ii) coal and metal IUPs/IUPKs are issued for two mining phases. Firstly for exploration up to a feasibility study with a period of 7-8 years and secondly for “construction, operation and production” with an initial period of 20 years but with possible extensions of two times 10 years (Articles 36, 42 for IUPs and Articles 76, 83 for IUPKs).
- iii) IUPs/IUPKs may be granted for a maximum of 100,000 ha for metals and 50,000 ha for coal during the exploration stage and 25,000 ha for metals and 15,000 ha for coal during the production stage (Articles 52, 53, 61, 62 for IUPs and Article 83 for IUPKs).
- iv) the relevant issuing authorities for IUPs are the Minister of Energy and Mineral Resources (after obtaining recommendation from the relevant Governor/Regent), or a Governor (after obtaining recommendation from the relevant Regent), or a Regent/Mayor. While IUPKs must be issued by the Minister (Articles 37, 48 for IUPs and Article 74 for IUPKs).
- v) in addition to the financial obligations for IUP holders (e.g. tax and non-tax state revenue), holders of IUPKs in the operation and production stage will also be subject to profit sharing at the rate of 10% of net profit once the production period commences. This payment will be allotted to the Central Government (4%), Provincial Government (1%), the Regency where the mining area is located (2.5%), and other Regencies within the same Province (2.5%) - Article 129.
- vi) exploration IUPs must be issued through a tender process, rather than direct appointment (Articles 51 and 60).

The IUP system appears to replace both the CoW/CCoW system, and the former Mining Right (or *Kuasa Pertambangan* – KP) system which was available only to Indonesian investors under the previous law. The new Law allows IUPs/IUPKs to be held by Indonesian legal entities, which would appear to include both Indonesian companies owned by Indonesian nationals, as well as foreign-owned Indonesian companies. This would seem to remove any distinction between Indonesian and foreign investors in the mining sector. This is consistent with the current “Negative List”, which allows for 100% foreign investment in the mining sector.

It should be noted however, that the new Law does require some form of divestment of foreign interests within five years of production commencing – details of this divestment process are expected to be set out in a separate regulation (Article 112).

c) transitional provisions:- Articles 169-171 set out transitional arrangements including specific language indicating that the rights and obligations under all existing CoWs/CCoWs will be honored until their expiration date. However, the very next clause of the Law indicates that the terms of these existing CoWs/CCoWs must be amended within one year to conform with the provisions of the new Law, other than terms related to State income (which is not defined but presumably includes royalties and taxes).

Further, the Law requires that holders of existing CoWs must, within five years of enactment of the Law, comply with the obligation under the Law to conduct onshore processing of their ore (Article 70).

In addition, CoW/CCoW holders which have already commenced some form of activity are required, within one year of enactment of the new Law, to submit a mining activity plan for the entire contract area. If this plan is not fulfilled, the contract area will be reduced to that allowed for IUPs under the new Law (Article 171)

The transitional provisions have probably been the most controversial aspects of the Law with debate in Parliament continuing on this point right up to the final passage of the Law. Unfortunately the outcome appears to be two possibly conflicting provisions meaning that, State income treatment aside, it is not clear how completely existing CoW/CCoW rights will be honored. Resolution of this will obviously be of major interest to those investors holding CoWs/CCoWs, and is likely to be a continuing detriment to additional investment by existing contractors, until the Government's interpretation of these transitional clauses is clearly understood.

d) Fiscal regime:- there are no specific articles outlining the details of tax or other fiscal provisions, however Article 168 provides that tax facilities should be provided in accordance with prevailing law except as otherwise stated in the IUP/IUPK.

This appears to indicate that the *lex specialis* concept embedded in some CoWs/CCoWs may not be completely dead, if certain enduring fiscal terms can be agreed in the IUP/IUPK. There are however no details on this at present, so implementation remains unclear. The ability of a term in an IUP/IUPK to override a Tax Law would also seem to be problematic in practice, and likely to result in further uncertainty.

e) There are no provisions dealing with conversion of Kuasa Pertambangan ("KP")

While there are transitional provisions in relation to CoWs/CCoWs, however uncertain they may be (see above), the status of current KPs is not mentioned at all in the new Law. It is not clear whether these KPs will be allowed to run until the end of their current terms, or whether they should be converted into IUPs. If they automatically become IUPs, then there may be an argument that foreign investors are able to take direct equity interests in these concessions. If this is the case, this could be a favourable outcome of the new Law, allowing immediate direct investment into Indonesia for existing KPs.

f) In-country processing:- the IUP holder is required to add value to resources through carrying out in-country refining and processing (Articles 102 and 103). Existing CoW holders, as noted above, must comply with this provision within five years of enactment of the Law.

The Law notes that implementing regulations are to be issued to regulate the in-country processing requirements. The Law itself only notes that these activities are designed to add value to mining products.

g) Mining support services :- Article 124 of the Law provides priority for local and/or national mining support services companies to provide services to IUP/IUPK holders. It appears to be very difficult for an IUP/IUPK holder to engage its subsidiary or affiliates to provide mining support services.

Article 124 provides guidance on the coverage of mining support services, however it appears not to include the performance of mining and processing/refining activities. Further details of these requirements will be included in a ministerial decree.

Outlook

As noted earlier, the above is a brief analysis of some of the key terms of the new Law likely to be of interest to investors. The Law however contains 175 articles, and requires numerous implementing regulations, so as usual the devil is in the detail. PricewaterhouseCoopers intends to issue a more detailed synopsis early in 2009 as more of this detail emerges.

In summary, the new Law may not have entirely eradicated the uncertainty that has been hanging over the mining industry in Indonesia. The terms of the Law may be adequate to encourage some investors, both foreign and domestic, to take direct equity stakes in IUPs for relatively small-scale projects. This will have a positive impact on investment in the sector. However, there is likely to be greater uncertainty around proposed large-scale projects as the new Law does not offer the long-term protections of the contract of work system for large, long-life projects which require significant investment. Investors will also be relying on the effective operation of the Indonesian legal system to protect their investments, without the specific terms provided in the contract of work.

Only time will tell whether investors will overcome these concerns and invest in these large projects, which are the lifeblood of a strong mining sector.

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