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Indonesia Energy, Utilities & Mining NewsFlash

Regulatory Round-up

Constitutional Court of Indonesia dissolves BP Migas; Temporary Working Unit established

Daniel Kohar

On 13 November 2012, the Constitutional Court of Indonesia issued a decision which cancelled certain articles within the Indonesian Oil & Gas Law No. 22/ 2001 on the basis that Badan Pelaksana ('BP Migas" or the executing agency) violated Article 33 of the 1945 Constitution of the Republic of Indonesia. The Constitutional Court's decision effectively dissolved BP Migas with immediate effect.

On the same day the President issued Presidential Regulation No. 95/ 2012 transferring the roles and responsibilities of BP Migas to the Ministry of Energy and Mineral Resources ("MoEMR") and MoEMR issued two decrees, MoEMR Decree No. 3135K/08/MEM/2012 and No. 3136 K/73/ MEM/2012, to establish Satuan Kerja Sementara (the "SKS" or a Temporary Working Unit) under the MoEMR.

The new regulations and decrees provide short-term clarity on the following:

1. That all duties, functions and responsibilities of BP Migas are assumed by the SKS;
2. That all employees and key management of BP Migas are transferred to the SKS with the exception that the SKS is headed by the Minister of Energy and Mineral Resources; and
3. That all PSCs awarded by BP Migas to oil and gas contractors remain in effect.

From our observations, PSC operators and the SKS are operating on a business as usual basis. This includes for the critical period of Annual Work Program & Budget ("WP&Bs") submissions and approvals between PSC operators and the SKS (replacing BP Migas).

We have seen no changes in the interactions between PSC contractors and the SKS regarding AFE approvals, government audits or procurement approvals.

It remains to be seen how the Government and MoEMR plan to regulate and manage the oil and gas industry over the longer term given the Constitutional Court's decision. Some of the issues are as follows:

- We believe the Government and MoEMR will need to reduce the administrative burden on oil and gas companies. Some of the existing guidelines, such as Pedoman Tata Kerja ("PTK" or work procedures guidelines) arguably create significant administrative burdens without materially improving the oil and gas operations themselves (e.g. the PTK on assets placed-into-service, the PTK on procurement, etc.).
- Oil and gas companies face a lengthy approval process from various government agencies (e.g. the Forestry Ministry for protected forest areas) and local governments, due to local government resistance and land clearance issues. There are also overlapping concessions with other natural resource-based industries such as the mining and plantation industries which have complicated approvals. We believe the Government and MoEMR should take a lead role in resolving issues relating to approval processes so that oil and gas companies can move from exploration to development and production stages more smoothly.
- MoEMR should extend its role in knowledge transfer and the promotion of new oil and gas field development to local companies to address claims that it currently favours international oil and gas players, while at the same time balancing the continuing and significant need for investment and technology from international oil and gas companies.
- BP Migas employees have gained knowledge and experience from working on advanced large oil and gas projects such as Tangguh, the Cepu development, the Duri Steam Flood, Masela and other deep water projects. The challenge is to transfer and integrate the knowledge and experience of BP Migas into the next state body tasked to oversee the oil and gas industry and manage PSC contractors.

Update on the taxing of PSC transfers

Tim Watson

The issuance of PMK 257 (see our NewsFlash of No.44/2012) continues to be a major consideration for anyone contemplating any type of PSC ownership restructuring. This is the case for outright PSC divestments, farm-outs, or as part of any group restructuring.

One ongoing and, as yet, unclarified concern has been the "range" at which PMK 257 could be applied to indirect transfers (i.e. PSC transfers by share sale). On this point PMK 257 provides no rules on the power of its "tracing" provisions. This theoretically means that (say), in every trade of shares in a major multi-national company on an overseas stock market, where the company holds an Indonesian PSC, a taxable transfer under PMK 257 arises.

This would clearly not have been the intent of PMK 257 but the level at which a taxpayer can safely complete a share transfer is still not clear. There has been some thinking that perhaps the taxation should be limited to scenarios involving a "change of control" in the underlying PSC although there is no formal confirmation on this at this time.
Some of the interim planning seems to be around simply ensuring that treaty protection is available for the vendor.

Further uncertainty arises on how branch profits tax ("BPT") is to be levied in these scenarios. This is particularly noting that, in the case of any indirect transfer, the vendor is very unlikely to have a branch in Indonesia against which BPT could be due. The attempt to override this with "a substance over form" proxy is also difficult to understand on a technical basis. Once again treaty protection may constitute the best interim planning.

Smelting and Downstream Processing Tax Issues

Ali Mardi & Felix MacDonogh

Following the issuance of government regulations restricting the export of ore and the concurrent promotion of in-country processing there has been a significant increase in investor interest in the construction of smelters and other downstream assets.

One of the immediate structuring issues to be determined is whether the downstream assets should be held in the same company as the relevant mining licence (ie. CoW/IUP), or in a separate legal entity.

In some circumstances holding downstream assets separately from the mine may be driven by commercial or financing requirements and tax planning becomes a secondary issue. However if some flexibility is available to investors, there are a number of points to consider from a tax perspective:

a) *Tax regime:* if a CoW is involved the tax regime for the mining activity may be "lex specialis" for the life of the CoW. This would mean that the tax rate, as well as many of the tax calculation rules, would apply for the life of the CoW. A view would need to be taken on whether this regime was an attractive framework for the downstream activities. Apart from fixing the tax rate (noting that Indonesia's long term trend is of lowered rates) there are a number of other important considerations. One which could be particularly important to large capex projects is the robustness of any "thin capitalization" or similar rules around the deductibility of interest according to project leverage. Many CoWs are quite prescriptive on these requirements and arguably less attractive than the current tax law. However, in the context of a long life project the stability may also be an advantage;

b) *Calculation of royalties:* royalties are generally only due on the value of the mineral produced by the miner. It is not entirely clear at this point however, if there are any circumstances where royalties could also be due on a processing activity;

c) *VAT outcome:* the supply of ore is generally not subject to VAT, while the supply of processed mining product generally is. It is more likely therefore that an integrated project will result in a VATable status for the entire value chain (assuming that this is considered to be attractive – which is generally the case).

   However processing on a tolling basis may enable retention of this VAT status even if asset separation is still required (but with a potential flow-on impact to import taxes);

d) *Income Tax Facilities:* CoWs generally include a limited range of tax incentives (e.g. accelerated depreciation, investment allowances, etc) whilst IUP based mining generally has no in-built incentives.

   In addition, mining activity often cannot access industry-driven tax incentives, such as the recently introduced 10 year tax holiday for "pioneer" industries. The pioneer incentive is in fact limited to only five "industries" which, while not covering mining, does extend to "base metals" which in practice is viewed as including smelting.

   Consequently entity structuring may need to be carefully planned at project inception in order to best capture the desired project incentives.

Update on export ban on raw minerals and ore

Rita Susanto

In May 2012, the Minister of Energy and Mineral Resources ("MoEMR") in Regulation No.7 ("Reg-7", amended by Regulation No.11), introduced an export ban for unprocessed ore. This was for the intended purpose of ensuring an adequate supply of minerals for the domestic market and encouraging the development of domestic processing facilities (see story above). Further implementing regulations were issued during the year to provide more guidance on the requirements on the export of minerals (please refer to our June 2012 NewsFlash No.45 for further details).

In mid 2012, the Indonesian Nickel Association filed a judicial review to the Supreme Court against the restrictions imposed in Reg-7. A decision was issued in September, where the Supreme Court revoked several Articles in Reg-7 (being Articles 8(3), 9(3), 10(1) and 21). The exact details of the relevant decision however have not been made publicly available by the Supreme Court to date.

The first three articles that were revoked (i.e. Articles 8(3), 9(3) and 10(1)) mainly dealt with the requirement for approval from the Director General of Minerals and Coal ("DGMC") in respect of "cooperation" for minerals processing and the need for consultation with the DGMC if the project is not economic or cooperation is not viable.

Article 21 dealt with the export ban on raw minerals and ore with effect from 6 May 2012. With the revocation of this article, the export ban is effectively lifted but it appears that the other requirements in relation to the export of raw minerals and ore are still in force (for example, the need for an export permit from the Ministry of Trade, an export "recommendation" from the DGMC and the payment of a 20% export duty).

In response to the above, the MoEMR is currently drafting a new regulation to govern this area. We will provide an update on the details of the Supreme Court decision, and the revised MoEMR regulation, in a future EU&M NewsFlash.

Constitutional Court decision may further delay the issuance of new mining business licences

Tjen She Siung

In November 2012 the Constitutional Court issued a decision on amendments to certain provisions under the Mining Law No. 4/2009 (the "Mining Law") regarding the determination of mining areas. The decision was issued in response to the judicial review request submitted by the East Kutai Bupati.

Prior to the Constitutional Court decision, the Mining Law required the Central Government to map mining areas (in terms of Mining Areas, Mining Business Areas, and Mining Business Licence Areas) after consultation with Regional Governments and the Parliament. Until the mapping of such areas is complete there were to be no new mining business licences (*Ijin Usaha Pertambangan* or IUP) issued.

The Court's decision means that determination of mining areas now has to be done in two steps, first by the Regional Government and then by the Central Government (after discussion with the Parliament). We understand that the Central Government had not completed the mine area mapping process prior to the decision. This new procedure may hold up the finalization of mining area mapping which will lead to further delays in the issuance of new IUPs.

One responsibility that has not been transferred to Regional Governments is the determination of State Reserve Areas, or areas where mining activities are prohibited for an unspecified period. Determining State Reserve Areas will remain the responsibility of the Central Government. This may result in conflicts and overlaps between State Reserve Areas and Mining Business Licence Areas where there is no coordination between the Central and Regional Governments. The Constitutional Court decision does not stipulate any means to resolve potential overlaps.


Upcoming tender – South Sumatra "Mine Mouth" Power Projects (Sumsel 9 & 10)

Agung Wiryawan

South Sumatra has substantial reserves of low rank coal with limited access to transportation. Mine mouth power generation is one of the Government's initiatives aimed at monetizing this potential in line with the need for adding generation capacity.

The tender of Sumsel 9 & 10 mine mouth coal-fired power projects in South Sumatra is the first major PPP project being made available in the power sector since the signing of the Central Java Coal-fired Power Plant PPA in October 2011. The tender will be conducted through a competitive process with the project profiles summarized in the following table:

Location	South Sumatra Province
Capacity	3 x 600 MW
Technology	Minimum specifications to be included in RFP
Project scheme	PPP procurement scheme
Terms	25- year term
Fuel Supply	• Low rank coal eligible for "cost plus" arrangement • Prescribed format of Coal Supply Agreement to be included in RFP
Guarantee	Eligible for guarantee through Indonesia Infrastructure Guarantee Fund (IIGF)
Estimated Project Cost	US$2.34 billion

Tariff

The tariff for this project will most likely follow the standard components A, B, C, D and E with certain indexation mechanism.

Coal supply

The Project Company will be responsible for securing the coal supply which must be available at production cost plus 25% margin in line with the Director General of Mineral and Coal Regulation No 1348.K/DJB/2011. The coal supplier must have a minimum equity ownership in the Project Company. A draft Coal Supply Agreement ("CSA") will be included in the Request for Proposal ("RFP") document. The CSA will include a Coal Base Price with a formula for annual adjustment based on pre-agreed indices to reflect changes in production costs.

Guarantee

A guarantee will be provided by the IIGF under the PPP framework detailed in Presidential Regulation 56/ 2011. The guarantee arrangement will be based on an assessment by IIGF.

Expected timeframe for tender process

The tender process was initiated by preliminary market soundings (also called "investor forums") conducted during October 2012. The pre-qualification ("PQ") was announced in November 2012. The RFP is expected to be issued in early 2013 with bids to be submitted in mid 2013. The result of the tender is expected to be announced sometime in August-September 2013 with the PPA expected to be signed in late 2013.

PLN issuance of second tranche of US$1 billion global bonds

Triadi Mukti

Following the success of its November 2011 bond issue of US$1 billion at a 5.5% coupon rate, in October 2012 PT PLN (Persero) issued a further US$1 billion in global bonds at a 5.25% coupon rate under its US$2 billion Global Medium Term Note ("GMTN") Program again, with a 30 year tenure.

Once again the GMTN was positively received by global investors as well as major international rating agencies. Fitch and S&P assigned BBB- and BB ratings to the bonds respectively. The first drawdown in 2011 was oversubscribed more than five times, while this drawdown was oversubscribed 11.5 times.

The allocation of the bond offering was 45% to investors in Asia, 31% to U.S. investors and 24% to European investors, with 73% for investment managers, 7% for insurance companies, 8% for banks, 9% for private banks and the remaining 3% for state property management and public institutions. PLN will use the proceeds to fund development of power plants, transmission networks, sub-stations and distribution networks.

For 2013 PLN is projected to require investment of US$6.69 billion, which is 7.1% higher than its 2012 investment plan. This will be funded by loans and State budget allocations.

New feed-in tariff for geothermal power plants

Triadi Mukti

The Indonesian Government has acted to strengthen investment in the geothermal energy sector with the issuance of the Ministry of Energy and Mineral Resources Regulation No. 22 of 2012 ("Reg-22") regarding new feed-in tariffs for geothermal power in August 2012. The regulation sets the new tariffs based on geographical areas as follows:

Location	Tariff (USD cents/ kwh)	
	High Voltage	Medium Voltage
Sumatra	10	11.5
Java, Madura, Bali	11	12.5
South Sulawesi, West Sulawesi and South East Sulawesi	12	13.5
North Sulawesi, Middle Sulawesi, Gorontalo	13	14.5
West Nusa Tenggara, East Nusa Tenggara	15	16.5
Maluku, Papua	17	18.5

These tariffs replace the US9.7 cents/kWh Indonesia-wide cap introduced in 2009 and serve as the minimum tariffs for PLN to purchase power supplied by geothermal power plants. Reg-22 also allows PLN to purchase power at a higher tariff through negotiation, subject to approval from the Minister of Energy and Mineral Resources. The approved tariff should be included in the relevant Power Purchase Agreement ("PPA").

Under Reg-22 PLN is obliged to purchase power based on the new tariffs from the following geothermal power plant projects:

1. a holder of a geothermal licence ("IUP") issued after the issuance of this regulation;
2. a holder of a geothermal licence or contract in existence prior to Geothermal Law No.27/ 2003 (e.g. a Joint Operation Contract) who have signed a PPA, and would like to expand the capacity of the project;
3. a holder of a geothermal licence or contract in existence prior to Geothermal Law No.27/ 2003 who would like to extend an expired PPA;
4. a holder of a geothermal licence or contract in existence prior to Geothermal Law No.27/ 2003 who have signed a PPA, regardless of whether or not the project has generated either power or steam, provided it is agreed by the contracting parties to amend the tariff; and
5. a holder of an IUP who holds a PPA which allows for a new tariff, provided it is agreed by the contracting parties

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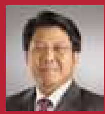
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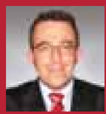
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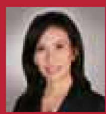
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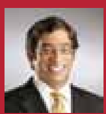
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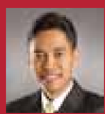
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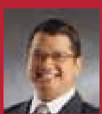
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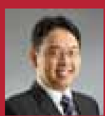
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