

UP IN SMOKE

Indonesia's upstream regulator dissolved by Constitutional Court



Recent events in Indonesia have the potential to impact not only the oil and gas sector but wider natural resources, including mining.

Earlier this month, the international oil and gas industry was shocked by a judgment on the legality of Indonesia's Oil and Gas Law No. 22/2001. The ruling effectively dissolved the current government administrator of the upstream industry, BPMigas, and furthermore branded the present system of Production Sharing Contracts (PSCs) as 'unconstitutional'. This unexpected move has shaken confidence in the prospects for current and future investment in the country.

Since the implementation of the Oil and Gas Law in 2002, enterprises wanting to invest upstream have been required to enter into joint co-operation contracts - principally PSCs - with the state acting through BPMigas as its executive agent. The role of BPMigas in these ventures, amongst other things, has been to monitor, regulate and approve conduct of upstream operations.

The judgment of 13 November 2012, given by Indonesia's Constitutional Court, states that the role of BPMigas is incompatible with the 1945 Indonesian Constitution, Article 33 of which in particular provides that the government should manage the natural resources of the country 'for the greatest benefit of the people'. Cited as evidence supporting this assertion was the fact that foreign investors could, through PSCs, gain control of Indonesian oil and gas supplies through (what was considered) insufficient regulatory scrutiny.

As a result, the Court ruled that the relevant articles in the Oil and Gas Law be deleted or amended so as to extinguish BPMigas. The Court's majority voiced their preference for a reinstatement of the pre-2001 concessions regime, which had been centred on the state monopoly, Pertamina. Early commentators have labelled the ruling as a prime example of rising resource nationalism - echoing the mining sector, where a national ban on the issue of new exploration and production licences prevails.



Regardless of the motivations behind the Court's decision, the forecast for what lies ahead in the coming weeks and months is unclear. President Yudhoyono moved swiftly to transfer the vacated powers and employees of BPMigas to the Ministry of Energy and Mineral Resources, widely regarded as a necessary stop-gap solution. In turn, it was confirmed that all current PSCs will remain valid until their expiry.

Nevertheless, there are pressing questions that the government has yet to address, such as how PSCs are to be renewed, and how entities will be able to invest in new PSCs - or whatever regime replaces them. The market is also anxious to see how other resource regulators fare under the Constitutional Court's microscope; foremost BPHMigas, the downstream equivalent to BPMigas. Answers are vital if investment is to continue in such an important sector in Indonesia.

What can you do?

- **Contact HFW.**
- **Monitor state developments.** Entities holding existing PSCs should continue the dialogue they had with BPMigas with the Ministry of Energy and Mineral Resources, which should be relatively straightforward.

- **Hope for the best and prepare for the worst.** It is possible this will not be the last challenge to foreign investment by resource nationalism, a rising trend in Asia. Holders of business interruption insurance should examine to what extent their policies will cover any disruption caused by cancellation or modification of their PSCs or licences. In addition, prospective investors should consider the termination provisions of any new contracts they sign.
- **Financial planning.** Consider whether you may be able to take advantage of dual investment treaties as a way of mitigating your loss.
- **It is important not to expect immediate results.** Indonesia's resources have become highly politicised and are likely to take centre-stage in the presidential elections in 2014. Aside from interim fixes, the long term view is therefore understandably hazy.

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