



INDONESIA OIL AND GAS – TIME FOR (ANOTHER) REFORMATION?

Background

Another corruption scandal in Indonesia has shocked the international oil and gas industry. On 13 August 2013, the head of Indonesia's upstream oil and gas regulator (or the Special Task Force for Upstream Oil and Gas Business Activities (SKKMigas)), Rudi Rubiandini, was arrested by the Corruption Eradication Commission (or the KPK) for allegedly accepting a bribe worth more than US\$700,000 from Kernel Oil, a Singapore-based oil trading company. SKKMigas was established by the Indonesian government to replace the function of BPMigas, the previous upstream oil and gas regulator, following its disbandment by the Constitutional Court on 13 November 2012. Rubiandini was appointed as the head of SKKMigas in January this year immediately after BPMigas' dissolution. As a result of the alleged corruption, Kernel Oil was disqualified from a lucrative tender process to be appointed as SKKMigas' crude oil marketing agent. The contract was subsequently granted to Trafigura Pte Ltd as the other tender participant.

KPK has reported that Rubiandini will be charged with bribery and corruption¹. He may also be charged with violating Indonesia's money laundering act. In addition, the representatives of Kernel Oil have been similarly detained for allegedly offering the bribe.

The effect of the case

Indonesia's President, Susilo Bambang Yudhoyono, reacted promptly to restore confidence in SKKMigas by immediately replacing Rubiandini with his deputy, whilst providing guarantees that the arrest will not affect SKKMigas' performance. Regardless, many expect that the events will, at least, delay the granting of permits and licences and negotiation of production sharing contracts (PSCs) and other oil and gas concession contracts. This scandal will also cast a shadow of doubt over the nation's regulatory environment and potentially harm foreign investment in general.

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1. Article 12a and b or article 11 of Law 31 of 1999 as amended by Law No 20 of 2001 concerning Eradication of Criminal Act of Corruption and paragraph 1 of article 55 of the Criminal Code.



After the dissolution of BPMigas in November 2012, Indonesia's House of Representatives has come under increased public pressure to enact new oil and gas legislation as certain provisions of the current oil and gas law (pursuant to which BPMigas was established) were annulled by the Constitutional Court. After Rubiandini's arrest, the need for reform or amendment of the oil and gas law has become even more pressing. It is widely understood that Indonesia needs to allow increased protection over the nation's hydrocarbon resources, whilst eliminating opportunities for bribery and corrupt practices and, at the same time, providing more legal certainty to protect foreign investors' interests in the industry.

What has the Indonesian government done?

As an immediate attempt to eradicate bribery and corrupt practices in the procurement of oil sale contracts within SKKMigas, SKKMigas decided to eliminate the tender requirement from the procurement process of the state's oil sale contracts. The new policy was made effective on 6

September 2013. As a result of the new policy, the government's portion of crude oil or condensate will no longer be sold by private oil trading companies. Rather, it will be sold by Pertamina, Indonesia's state owned oil company (NOC). To implement the new policy, SKKMigas will enter into a memorandum of understanding with Pertamina to firm up the terms of sale of the government's stake.

Bribery and corruption

Experts are of the view that bribery and corrupt practices are still the major obstacles for foreign investment in developing or rapidly growing economies. In light of this, foreign companies having business in such places should be aware not only of the local bribery and corruption legislation, but also of the wider extra-territorial legislation of most developed economies, such as those which are members of the OECD, which target bribery and corrupt payments. The UK Bribery Act is one example of this type of legislation, which is inspired by the OECD. The US Foreign Corrupt Practices Act (FCPA) is another, more long-standing example. This legislation applies to

UK and US citizens overseas. The FCPA also has wider application than the UK Bribery Act to overseas companies.

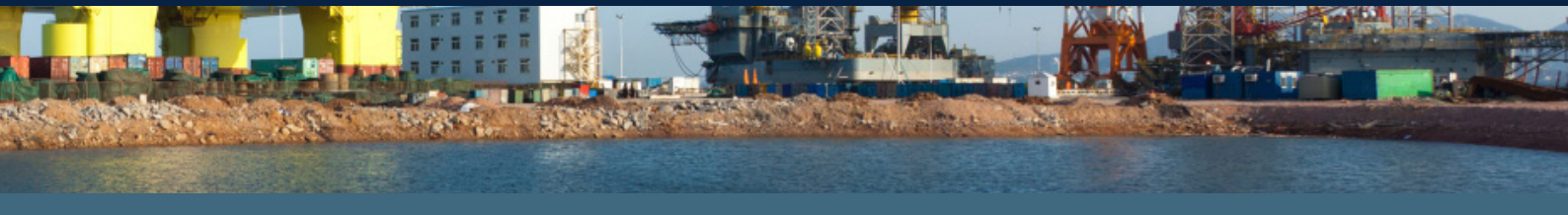
What should you do?

Risk factor analysis

Before investing in Indonesia, foreign investors should carefully assess the local risk factors associated with Indonesia. This may include the unstable political situation, legal uncertainty and widespread bribery and corruption. Foreign investors should also note that they will be subject to Indonesian law and its regulatory system in terms of obtaining operating permits and licences. Oil and gas concessions, such as PSCs and cooperation contracts (or known as *Kontrak Kerjasama Operasi (KSO)*) have to be governed by Indonesian law, which means that foreign investors should be aware of the associated risk factors. This is a non-negotiable provision under those oil and gas concession contracts.



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Robust corporate governance

Oil and gas companies in Indonesia should implement robust corporate governance procedures within their organisation. They need to ensure that their employees are aware of and familiar with what is prohibited by law (either under local law or the law of their parent companies). This can be achieved through employee training and producing a comprehensive code of conduct. The provisions of bribery and corruption legalisation under the laws of the parent companies, such as the UK Bribery Act and the FCPA (if applicable) must also be incorporated into the code of conduct.

How can HFW help?

HFW is a leading energy, resources and commodities law firm and has been involved in the negotiation of international oil and gas arrangements throughout the world's energy regions. We have been operating in South East Asia for over 20 years and, in that time, have developed a good understanding of the regulatory environment. We have been actively involved in advising on Indonesia's oil and gas regulatory framework and the typical structure of investment in Indonesia's upstream and downstream oil and gas industry. We have also regularly advised on upstream oil and gas contracts and associated operational issues in Indonesia.

We are able to advise you on all the issues raised in this briefing, including the preparation of a code of conduct that deals with the relevant bribery and corruption legislation and can conduct training for your employees on what is prohibited under Indonesia's bribery and corruption law and the criminal code, the UK Bribery Act and the FCPA.

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