Indonesia’s oil and gas laws

A legal introduction
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THE MAIN OIL AND GAS LAW

Oil and gas has been specifically regulated in Indonesia since 1960.

Today, Indonesia’s principal oil and gas law is Law No. 22 of 2001 dated 23 November 2001 (Oil and Gas Law). The Government has issued a number of implementing regulations for the Oil and Gas Law.

UNDERSTANDING THE OBJECTIVES OF THE LAW

The Oil and Gas Law was introduced to:

• open up competition in the oil and gas industry:
  – The law ends Pertamina’s monopoly over upstream and downstream activities. It provides that Pertamina can no longer be both a regulator and an industry participant. Pertamina no longer plays a regulatory role and is simply a commercial participant which is also State-owned and benefits from privileges such as a limited exclusivity in certain areas.

• improve administration and supervision of the industry:
  – Under the old system, Pertamina was responsible for supervising the whole industry. Now, BP Migas is appointed to supervise upstream activities. BPH Migas is appointed to supervise downstream activities.

• give the Government the power to grant “rights to mine”:
  – The law gives the Government the power to grant “rights to mine” (known as cooperation contracts). Pertamina previously had this power.

An investor should understand the general objectives of Indonesia’s oil and gas law. This is because the Oil and Gas Law and its implementing regulations will be interpreted and implemented using these as guidelines. These are to:

• guarantee effective, efficient highly competitive and sustainable exploration and exploitation;
• assure accountable processing, transport, storage and trading through fair and transparent business competition;
• guarantee efficient and effective supply of oil and gas as a source of energy and for domestic needs;
• support and promote national capacity so as to be more capable of competing nationally, regionally and internationally;
• increase state income to develop national economy and strengthen Indonesian industry; and
• create job opportunities and enhance public welfare and prosperity, as well as conserving the environment.

Because of decreasing oil and natural gas production, in 2010 the Government introduced policy guidelines to stimulate the expansion and optimisation of oil and gas production. In the Exploration and Exploitation section of this document, we discuss how these guidelines affect contractors.
SEPARATION OF UPSTREAM AND DOWNSTREAM BUSINESS ACTIVITIES

The Oil and Gas Law deals separately with upstream and downstream business activities.

UPSTREAM BUSINESS ACTIVITIES

Upstream business activities include exploration and exploitation. These activities are controlled by the Government through a non-profit, state-owned legal entity called BP Migas. BP Migas’s primary roles include:

- making recommendations to the Minister of Energy and Mineral Resources (MoEMR)\(^1\) about the issuance of working areas;
- assessing plans for the development of fields;
- signing joint cooperation contracts;
- approving work programs and budgets; and
- supervising joint cooperation contracts with contractors on behalf of the Government.

The Director General of Oil and Gas (Director General) is responsible for ensuring that contractors comply with the relevant oil and gas laws and regulations, including in relation to:

- environment management;
- work safety and security;
- conservation of resources;
- utilisation of domestic manpower, goods and services; and
- development of local communities.

DOWNSTREAM BUSINESS ACTIVITIES

Downstream business activities include:

- processing;
- storage;
- transportation; and
- trading.

The Government controls these activities through the issuance of licences by the MoEMR and BPH Migas, the downstream oil and gas regulator and supervisor. BPH Migas’s role includes supervising and regulating the supply and distribution of fuel oil and transport of natural gas through pipelines.

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\(^1\) All references to MoEMR in this document include the Director General of Oil and Gas as the Director General has been delegated to oversee the oil and gas sector in Indonesia on behalf of the MoEMR.
What type of company should you use?

UPSTREAM BUSINESS ACTIVITIES
The Indonesian model of production sharing has been adopted in many other jurisdictions around the world. Under the model, Government partners with companies that have experience in the industry and are willing to fund projects that are both capital intensive and risky in nature. Foreign companies are often suitable partners as they have the desired expertise and resources.

As a result, the Government has allowed foreigners to invest through a local branch of a company that is incorporated outside of Indonesia (called a Permanent Establishment or PE). It is theoretically possible to invest through a locally domiciled incorporated company called a PMA Company (or Perusahaan Penanaman Modal Asing) but the regulator of these companies has never granted permission for one to operate in the oil and gas industry, so it is not a practical option for foreigners.

By investing through a PE, not a PMA Company, foreign investors can avoid certain restrictions placed on locally incorporated companies under the Indonesian Company Law, including:

• capital requirements; and
• the requirement to have two shareholders.

A PE or PMA Company is only allowed one working area. An investor must establish multiple subsidiaries to invest in multiple working areas – one subsidiary per working area.

Entities involved in upstream business activities are not allowed to participate in downstream business activities (except where the upstream entity conducts downstream activities to support its exploitation activities). Entities involved in downstream business activities are not allowed to participate in upstream business activities.

DOWNSTREAM BUSINESS ACTIVITIES
Only Indonesian entities can perform downstream business activities. These include State and regional owned companies, cooperatives and private companies.

PEs cannot invest in downstream activities.
JOINT COOPERATION CONTRACTS – A MEANS OF CONTROLLING UPSTREAM ACTIVITIES

Upstream business activities are controlled by the Government through joint cooperation contracts. Joint cooperation contracts may be written in Indonesian and/or English. Government Regulation No. 35 of 2004 recognises certain forms of joint cooperation contract, namely:

• Production Sharing Contracts (PSCs); and
• Services Contracts.

Up until August 2011 when this publication was prepared, the Government of Indonesia has not yet entered into any Services Contracts as a mean to control its upstream activities.

All PSCs incorporate the following key concepts:

• the Government retains ownership of the oil and gas until the delivery point (the point of sale of oil and gas);
• BP Migas retains operational control of the project, including the power to approve work plans and budgets and field development plans;
• the contractor bears all capital costs and associated financial risks; and
• any oil and gas produced is shared between the contractor and the Government in proportions specified in the joint cooperation agreement.
NEW FORM OF PRODUCTION SHARING CONTRACT

In 2008 the Government introduced a new form of PSC. Some of the more important provisions include:

<table>
<thead>
<tr>
<th>TERM</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract period</td>
<td>• Maximum term of 30 years – can apply to BP Migas to extend for a further 20 years.</td>
</tr>
<tr>
<td>Operator</td>
<td>• Subject to the prior written approval of BP Migas, in the event that a oil and gas working area comprises of more than one participating interest holder, then it must appoint one of the participating interest holders as an Operator which is authorised to execute petroleum activities.</td>
</tr>
</tbody>
</table>
| Transfer                    | • Must obtain BP Migas and MoEMR approval. Extra restrictions on transfers to non-affiliates, including requiring an offer to Indians and a transfer ban during early exploration.  
|                             | • Once the plan of development is approved, the contractor must offer a 10% participating interest to a regional enterprise. |
| Activity                    | • Operations must commence within 6 months of the commencement date of the PSC. |
| Relinquishment of working areas | • Contractor must gradually relinquish part or all of its working area to BP Migas. |
| Expenditure requirements    | • Contractor must finance the project and bear all costs and risks of financing.  
|                             | • Annual exploration expenditure and performance bond requirements. |
| Costs and cost recovery     | • Contractor must obtain approval from BP Migas before incurring investment and operational costs.  
|                             | • A contractor can recover relevant, budgeted operating costs authorised by BP Migas, after commercial production has started.  
<p>|                             | • Non-recoverable costs are listed in Regulation of the MoEMR No. 22 of 2008 dated 30 June 2008 (Regulation No. 22 of 2008) as well as the newly issued Government Regulation No. 79 of 2010. |
| Bonuses                     | • The MoEMR is usually awarded a signature bonus and production bonuses, and there may also be bonuses for special purposes. |
| State revenue               | • Tax revenues (VAT, import duties and tariffs, and regional taxes and levies) and non-tax revenues (State’s portion of revenue from production, exploration and exploitation fees, and bonuses). |
| Ownership of data           | • As a general rule, the Government owns and controls data obtained from project activities. |</p>
<table>
<thead>
<tr>
<th>Distribution of oil and/or gas between contractor and Government</th>
<th>• Specified order of distribution of volumes – “First Tranche Petroleum” to Government (agreed in PSC), then cost recovery, then balance is split in accordance with the terms of the PSC, followed by deduction from contractor’s portion of domestic market obligation.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial production</td>
<td>• Upon discovery of petroleum, the Contractor must submit a proposed plan of development for the field in which petroleum is discovered. Once the MoEMR approves the Contractor’s plan of development for the first field in the contract area, this plan of development approval shall constitute the declaration of commerciality of the entire contract area and the Contractor shall commence developing the field in which petroleum is discovered.</td>
</tr>
<tr>
<td>Domestic market obligations</td>
<td>• Contractors must provide 25% of their share of production of crude oil or natural gas (excluding cost recovery volumes) for domestic needs, in accordance with the provisions in the PSC as well as annual MoEMR policy.</td>
</tr>
<tr>
<td>Occupational health and safety</td>
<td>• Contractors must comply with occupational health and safety laws and regulations.</td>
</tr>
<tr>
<td>Environmental management</td>
<td>• Contractors must prevent pollution and rectify damage to the environment resulting from operations, plus post-exploitation rectification work.</td>
</tr>
<tr>
<td>Community and environment development</td>
<td>• General obligation includes prioritising local employment and improving infrastructure. Funds included in work program and budget. Contractors will need to coordinate these initiatives with the Regional Government.</td>
</tr>
<tr>
<td>Prioritisation of use of Indonesian manpower</td>
<td>• Contractors must prioritise the use of local manpower, goods and services, and develop and train Indonesian workers.</td>
</tr>
<tr>
<td>Use of domestic goods and services</td>
<td>• Restrictions on use of imported goods and equipments (including approval from MoEMR, the MOF and the Minister of Trade and submission of demand plan to BP Migas). • All goods bought (imported or not) will be owned by the State.</td>
</tr>
<tr>
<td>Reporting requirements</td>
<td>• Contractors must report oil and gas deposits and intrusions of excess oil and gas into other areas.</td>
</tr>
<tr>
<td>Post-exploitation obligations</td>
<td>• Contractors must return work areas and carry out rectification work (allocating funds in the work program and budget from the start).</td>
</tr>
</tbody>
</table>
TIMING AND POLICY GUIDELINES ON INCREASING PRODUCTION

To support the Government’s objectives of increasing and optimising production of oil and natural gas, the MoEMR passed MoEMR Regulation No 6 of 2010 requiring contractors to, in summary, accelerate exploration and the development of new fields, and maximise production possibilities in potential fields and wells.

MoEMR Regulation No 6 of 2010 accordingly imposes several specific timing requirements on contractors, for example to commence field development activities within 180 days of obtaining approval for the field development plan.

The regulation also stipulates strict time periods for BP Migas to issue its approvals for activities, for example:

- approval of a contractor’s plan of development for a field must be issued no later than 40 calendar days from the date the contractor submits its complete receipt of the contractor’s proposal; and
- approval of a contractor’s work program and budget and/or authorisation of financial expenditures no later than 40 calendar days from the date the contractor submits its work program and budget proposal.

OWNERSHIP OF AND ACCESS TO LAND FOR UPSTREAM ACTIVITIES

As a contractor you will not be able to conduct upstream activities without reaching a settlement with the landowner(s) of any land in question, which must reasonably compensate the landowner for use of the land. A settlement could involve sale and purchase of land, exchange of goods or other forms of compensation (for example, fees). Once the land is settled it becomes property of the State, to be managed by BP Migas (except land rented from landowners).

Carrying out activities in certain specified areas (eg cemeteries, state defence fields, historic sites and buildings, residences or factories) is prohibited without formal permission.

UNITISATION

Contractors must unitise, with approval of the MoEMR, if there is evidence of excess oil and/or gas entering the work area of another contractor. The MoEMR will assign the operatorship of the area to a party based on agreement between the parties, and in consultation with BP Migas.

PROCESSING, TRANSPORTATION, STORAGE AND TRADING, AND THE FACILITIES REQUIRED

Upstream business activities include processing, transportation, storage and sale by a contractor of its own products. Facilities for processing, transportation, storage or sale of its products can be built and operated by an upstream contractor, however, the contractor must not gain or profit from the facilities. If a profit is obtained, the contractor must establish an independent downstream business entity and obtain the required business licence.

If, however, there is excess capacity in the facilities, the contractor may invite a third party, with the approval of BP Migas, to use the facilities. The third party must cover the cost of operation of the facility in proportion to its use of the facility.

MARGINAL FIELD INCENTIVES

The MoEMR introduced a Marginal Oil Field Incentive Program in 2005, under Regulation No 08 of 2005, which enables contractors to recover an additional 20% of costs from oil fields in production and meeting marginal field criteria (eg an estimated rate of return of less than 15%).
Tendering for work areas

TYPES OF TENDERS

Works areas (or territories) are offered and designated by the MoEMR through consultation with BP Migas and local Government authorities. For new acreage, the MoEMR may either offer the work area directly or through a tendering process.

DIRECT OFFER

Preparation of a new work area is conducted by the Director General based on a proposal made by a prospective contractor. Proposals must meet detailed requirements.

- A prospective contractor can only propose an open area that has not been reserved as an open area to be offered via a tendering process.
- If the Director General approves the proposal, the Director General and the prospective contractor must conduct a joint study over a period of 8–12 months, at the expense and risk of the prospective contractor. If the Director General evaluates the results of the joint study as acceptable, the MoEMR will allocate the proposed area as a working area.
- After the working area has been allocated, the Director General can conduct a tender over the working area. The prospective contractor who was involved in the joint study will receive the right to match the highest bidder of the tender round – if it cannot it surrenders all data to the Director General.

TENDER PROCESS

- The tender process is more common and requires the tendering company to comply with a number of bid requirements, including submitting work programs and budgets, technical reports, financial reports and a draft of the PSC agreement. Tenders are evaluated by the MoEMR and awarded by the Directorate General (upon recommendation from the MoEMR).
- Successful tenders will be judged to be in Indonesia’s national interests.

SURVEY

- To support the preparation of a new work area, the MoEMR will perform a general survey (which includes geological, geophysical and geochemical surveys). The MoEMR can grant a licence to an Indonesian entity to carry out the general survey work (which will be at the licensee’s own risk and cost). Any data obtained from the general survey work remains property of the state and must be delivered to the MoEMR upon expiration of the licence.
Downstream business activities

TYPES OF ACTIVITIES AND LICENCES REQUIRED

Only Indonesian registered companies can perform downstream oil and gas activities. PEs are not permitted to operate in this sector. Foreign companies wishing to conduct downstream oil and gas activities must do so through a locally domiciled incorporated company (PMA Company or Perusahaan Penanaman Modal Asing).

Downstream business activities include the following activities (controlled by the Government though the issuance of licences by MoEMR in consultation with BPH Migas):

<table>
<thead>
<tr>
<th>LICENCE</th>
<th>ACTIVITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Processing business licence</td>
<td>Adding value to extracted product (for example by purification), including the production of petroleum fuel, gas fuel, processed product, LPG and LNG.</td>
</tr>
<tr>
<td>Transportation business licence</td>
<td>Transporting crude oil, petroleum fuel, gas fuel, and/or processed product by land, water and air including transportation of natural gas through pipelines.</td>
</tr>
<tr>
<td>Storage business licence</td>
<td>Receiving, collecting, storing and releasing of crude oil, petroleum fuel, gas fuel, LNG and/or processed products.</td>
</tr>
<tr>
<td>Trading business licence and wholesale business licence</td>
<td>Purchasing, selling, exporting and importing crude oil, natural gas, petroleum fuel, and/or processed products, including trading natural gas through pipelines.</td>
</tr>
</tbody>
</table>
CARRYING OUT MULTIPLE ACTIVITIES
A company may hold multiple licences. However, if a company participates in more than one activity, it must obtain a separate licence for any activity that generates a profit. There are certain exceptions, for example a company only needs a trading licence to engage in storage or transportation activities to support its trading activities.

 LICENSING PROCESS
Business licences are issued in two stages:

• a temporary licence for a maximum period of 5 years whilst the applicant prepares the facilities and infrastructure of the business; and
• a permanent operating licence once the applicant is ready for operation.

Companies engaging in any of the above activities must comply with OHS, environmental management, community development and quality standards.

 PROCESSING
The processing of natural gas to produce LNG, LPG or GTL is a downstream activity, provided it is aimed at obtaining profits and does not form part of an upstream business activity.

An entity with a processing business licence must have an approved plan of development and must report to the MoEMR on several fronts on either a monthly or an annual basis.

 TRANSPORTATION
An entity with a transportation business licence also needs a separate transportation licence to transport the specific product, from the relevant authority.

A company transporting natural gas by distribution or transmission pipeline needs a special right from BPH Migas to operate a distribution or transmission pipeline. This is granted through a tender mechanism. The pipeline must conform to a national Master Plan. Natural gas pipeline operators must give other parties an opportunity to use their facilities and can only increase capacity with approval from the MoEMR through the Director General.

 STORAGE
An entity holding a storage business licence must also obtain a location permit from the competent authority. A separate licence is required to conduct LNG storage business activities.

In remote areas and areas where petroleum fuel is scarce, companies are required to give other parties an opportunity to utilise their storage facilities.

 A storage entity may increase its storage capacity and facilities pursuant to a recommendation from BPH Migas to the MoEMR for its approval.

Entities holding a storage business licence that perform blending activities must comply with testing and quality standards and procedures.

 TRADING
A company with a trading business licence has general obligations relating to continuous supply, maintaining normal pricing, providing adequate facilities to support trading, meeting quality standards and reporting.

Entities carrying out petroleum fuel, gas fuel, other types of fuel and/or processed products businesses may be granted a wholesale business licence or a trading business licence.

Some trading activities can be covered by a wholesale business licence and not a trading licence. An entity holding a wholesale business licence must own and/or have all necessary facilities and infrastructure to support its wholesale activities. The law sets out a framework for the entity’s rights to distribute oil and gas products, together with a series of limitations on those rights.

An entity operating a LPG business licence must control facilities for storage and bottling, have a registered trademark and comply with quality standards.

Entities carrying out natural gas trading activities are classified into:

• Entities that have a natural gas distribution network facility:
  – Entities that own a natural gas distribution network facility may only carry out natural gas trading activities after obtaining a natural gas trading business licence and a special right for a distribution network area.
• Entities that do not have natural gas distribution network facilities:
  – Entities that conduct natural gas trading business activities, but do not own a natural gas distribution network facility, may only carry out distribution through natural gas distribution network facilities owned by other entities who have obtained a special right from BPH Migas.

Entities holding a business licence, or end-users, who want to conduct export and import of oil and/or natural gas, petroleum fuel, gas fuel, LNG, LPG, other types of petroleum and/or processed products require a recommendation from the MoEMR.
Supporting businesses

**TYPES OF SUPPORTING BUSINESS**

The Oil and Gas Law allows:

- Supporting Services Businesses; and
- Supporting Industry Businesses.

**SUPPORTING SERVICES BUSINESSES**

A Supporting Services Business provides services (Supporting Services) to:

- upstream business entities (conducting exploration / exploitation / production); or
- downstream business entities (conducting processing / transportation / storage / trading).

Supporting Services are split into construction and non-construction services.

**SUPPORTING INDUSTRY BUSINESSES**

Supporting Industry Businesses produce and supply goods, materials and/or equipment that are used by companies in conducting upstream and downstream business activities.

Supporting businesses are governed by Regulation of the Minister of Energy and Mineral Resources No. 27/2008 dated 22 August 2008. The different types of supporting businesses are set out in the diagram below.

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**Supporting Business**

- **Supporting Services**
  - Construction Services
    - Planning and design engineering
    - Construction engineering services, including engineering, procurement and construction
    - Installation business and commissioning
    - Construction supervision
    - Supporting Services.
  - Non-Construction Services
    - Seismic surveying and non-seismic surveying
    - Geological and geophysical surveying
    - Drilling
    - Drilling well-operation
    - Underwater work
    - Management of explosive, radioactive and dangerous materials
    - Shore/offshore base
    - Operation and maintenance, etc
    - Technical inspection and testing
    - Decommissioning
    - Research and development
    - Education and training
    - Drilling and production waster treatment
    - Other services.

- **Supporting Industry**
  - Materials
  - Equipment
  - Industry Users
INVESTMENT BY FOREIGN COMPANIES IN SUPPORTING BUSINESSES

CONTRACTING FOR SERVICES
Foreign incorporated companies cannot contract directly with joint cooperation contractors for the provision of supporting services but must do so through a PMA Company.

SUPPLYING GOODS
Foreign incorporated companies may directly supply goods, materials and equipment to contractors, as long as these goods, materials and equipment are not available domestically or that the price domestically is more expensive than abroad and approval is granted by BPMigas, the MoEMR, the MOF and the relevant Minister for trading affairs.

EXCEPTIONS – ACTIVITIES OPEN FOR INVESTMENT BY FOREIGN INCORPORATED COMPANIES
In the upstream sector, foreign incorporated companies may, as an exception to the principle referred to above in relation to contracting for services and supplying goods, directly participate in tenders relating to procurement, construction or consultancy. Depending on the sector, they need to meet one, two or three tests, which relate to the value of the activities, partnering with a national company, and/or serving as a subcontractor to the national company.

FOREIGN CAPITAL LIMITATIONS
The Negative List (Presidential Regulation No. 36 of 2010) contains a list of business fields which are open to foreign investment, but which are subject to conditions, including foreign ownership restrictions including, for the oil and gas sector:

<table>
<thead>
<tr>
<th>BUSINESS FIELD</th>
<th>FOREIGN OWNERSHIP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operation and maintenance of geothermal facility</td>
<td>90%</td>
</tr>
<tr>
<td>Geothermal drilling service</td>
<td>95%</td>
</tr>
<tr>
<td>Oil and gas drilling service – offshore outside of Eastern Indonesian Territory</td>
<td>95%</td>
</tr>
<tr>
<td>Oil and gas drilling service on land</td>
<td>95%</td>
</tr>
<tr>
<td>Operating and maintenance service of oil and gas facility</td>
<td>95%</td>
</tr>
<tr>
<td>Engineering procurement construction service</td>
<td>95%</td>
</tr>
</tbody>
</table>

REGISTRATION OF A SUPPORTING BUSINESS
Companies wishing to undertake supporting business activities (including both Supporting Service activities and Supporting Industry activities) must obtain a certificate of registration, by applying to the Director General. A certificate of registration is valid for 3 years and allows a company to, for example, participate in tenders or enter into contracts with PSC holders.

Supporting Service companies must meet a number of requirements including local content (upstream sector), best practice on technical norms, OHS management, environmental management and development of Indonesian manpower.

The Director General may impose administrative sanctions if the above requirements are not complied with, including providing written warnings and/or revoking the certificate of registration.

The Director General is responsible for fostering the development of and supervision of Supporting Service and Industry Businesses and uses a rating system as one of the tools to do this.
A STRATEGIC RESOURCE
Under new laws passed in 2008, the development of coal bed methane (CBM) resources is part of the Government’s energy diversification strategy.

CBM projects, like other oil and gas projects, are controlled by the Government through joint cooperation contracts (the most common of which is a PSC). BP Migas is responsible for supervising the execution and implementation of joint cooperation contracts.

INVESTING IN THE CBM INDUSTRY
The industry is open for investment by PEs and (theoretically) PMA companies. An investor in a PSC or mining tenement is not allowed to participate in a CBM joint cooperation contract as well, and must incorporate a separate entity to enter into the CBM joint cooperation contract.

CONDUCTING CBM OPERATIONS
CBM operations can be conducted anywhere in Indonesia, including in areas already designated for the exploration and/or exploitation of oil and natural gas and coal (pursuant to both a CCOW and an IUP). However, a CBM work area must not exceed 3,000 square kilometres.

TENDERING PROCESS
CBM work areas are designated and offered by the Director General in consultation with committees established by the Director General. The Minister will designate an area as a CBM working area and the Director General will offer the CBM working area through a tender process or direct offer (in the same way as other oil and gas working areas are offered).

Companies (including PMAs and PEs) may, for areas that are not already designated for the exploration and/or exploitation of other products, submit to the Director General a proposal for a direct offer.

PRIORITY RIGHTS
A contractor has a priority right to submit a direct offer in relation to any CBM situated in its oil and gas working area, if it has completed 3 years of exploration and fulfilled all firm commitments.

Holders of Coal Contracts of Work (CCOWs) and holders of coal IUPs, the other form of coal tenement in Indonesia, have a priority right to submit direct offers for any CBM in their coal permit area, if the holder has completed 3 years of exploitation/production.

If CBM is found in an area that is subject to both a joint cooperation agreement for oil and gas and a CCOW or IUP in relation to coal, then the oil and gas contractor has a right of first refusal to submit a proposal for a direct offer to the Director General.

If the CCOW contractor or IUP holder submits a proposal for the exploitation of CBM before the oil and gas contractor, then the Director General must notify the oil and gas contractor of the proposal and give it the first opportunity to submit a direct offer. If, within 6 months, it does not submit a proposal, only then can the CCOW contractor or IUP holder proceed with its proposal.

If a priority right is exercised, the request for a direct offer must be made through a joint evaluation mechanism between the relevant contractor and the Director General. This evaluation consists of taking inventory, processing and interpreting all data relating to the proposed area for the purposes of discovering the potential and commerciality of coal bed methane in the proposed area.
Floating storage and re-gasification units and floating production storage and offloading facilities

FLAG REQUIREMENTS

The definition of “ship” under Law No. 17 of 2008 (Shipping Law) includes various forms of water vehicle, including non-removable floating buildings (eg an offshore platform). FSRUs, FPSOs and similar units fall within this definition. If these facilities are operated in Indonesian waters, the Shipping Law (and the related cabotage rules) will apply.

The Shipping Law provides that in order for a vessel to operate in Indonesian waters, it must be:

• flagged Indonesian; and
• be operated by an Indonesian company (holding a shipping licence (SIUPAL)).

Indonesia’s cabotage rules, which were updated in November 2005, specify that by 1 January 2010, transportation of natural gas must be carried out by a majority Indonesian-owned shipping company using Indonesian flagged ships.

Under Regulation No. 73 of 2010, support services for both upstream and downstream oil and gas businesses have until 7 May 2011 to convert existing ships to Indonesian flagged and operated vessels. After intensive lobbying by the oil and gas industry, the government has agreed to exempt specific types of vessels which will be allowed to operate within Indonesian waters using a foreign flag to support offshore oil and gas industries. This is a major step forward for the oil and gas industry in this area although the exemptions are not as comprehensive as hoped and are for a limited period of a few years only.

INVESTMENT REQUIREMENTS

To operate an Indonesian flagged ship, the ship must be owned by a company which is majority (at least 51%) owned by an Indonesian company or individual.

There are structures that may be put into place to protect the interest of the foreign minority shareholder, however, such structures must not be contrary to Indonesian investment laws (eg nominee shareholder arrangements are not formally recognised in Indonesia and may contravene the Investment Law).
COMPLIANCE PROCESS
Once a joint venture shipping company (51% owned by an Indonesian entity, 49% owned by a foreign entity) is established, the shipping company will need to re-flag any existing foreign ships and apply for a SIUPAL from the Ministry of Transportation.

RE-FLAGGING
To re-flag a foreign ship, the following is generally required:
- re-flagging application;
- bill of sale (legalised before a notary upon execution of bill of sale or authorised Government agencies of the origin country);
- protocol for delivery and acceptance;
- deletion certificate from the original flag;
- builder’s certificate; and
- vessel documentation.

The re-flagging process generally takes approximately one month.

SIUPAL
Approval for a SIUPAL generally takes one month from the date of application. The application usually requires the following:
- articles of association of the shipping company which state that the purpose and objective of the company is shipping;
- at least one seaworthy Indonesian flagged vessel with minimum gross tonnage of 5,000;
- proof of ownership of the vessel (vessel ownership certificate, measurement letter, and valid vessel security certificates) will be required. A leased vessel may be registered with the consent of the owner of the vessel;
- appropriate staff with expertise in procedures, nautical matters and commercial shipping techniques;
- the shipping company’s letter of domicile;
- an authorised individual to represent the company (eg Director); and
- a tax registration number (NPWP).

OPERATING LICENCE
A separate application must be made to the Director General for a licence and various certificates to operate the FSRU/ FPSO (as described in the Downstream section on page 16 of this publication).

MANPOWER REQUIREMENTS
The Shipping Law requires Indonesian flagged ships to be operated by Indonesian crew members. While no ratio of Indonesian crew members to foreign crew members is specified in the Shipping Law or any regulations, the purpose of the Shipping Law requires a clear majority of crew members to be Indonesian.

However, in practice, the Ministry of Manpower will accept applications for foreign crew members where it can be demonstrated that the company will be unable to fill technical positions with Indonesian crew members.
Key Contacts

Greg Terry
International Partner, Blake Dawson Asia Business Services Ltd
Senior Foreign Consultant, Oentoeng Suria & Partners
greg.terry@blakedawson.com

Greg specialises in M&A and capital market transactions with a strong focus on energy & resources. Immediately prior to joining the firm in 2009, Greg was Chairman of Morgan Stanley, South East Asia. He has previously held the positions of Vice Chairman Asia Pacific, CSFB, and General Counsel of the Jardine Matheson Group. Greg has been involved in a number of major projects in Australia and Asia, both as a lawyer and as an investment banker.

Sean Prior
Partner, Blake Dawson
(Solicitor of the Senior Courts of England and Wales)
sean.prior@blakedawson.com

Sean is a highly experienced lawyer in the areas of resources and energy law, project finance and large infrastructure. He spent seven years doing international energy and resources projects at a Magic Circle firm in London. He has acted for some of the largest energy and resources companies in the world on their biggest transactions. He has significant Indonesian oil and gas experience, is based in South East Asia and has acted on a number of keynote Indonesian oil and gas deals over the last two years.
Febby Sagita
Senior Associate, Oentoeng Suria & Partners
febby.sagita@oentoengsuria.com
Febby is an expert on shipping and related infrastructure in Indonesia and specialises in non-contentious shipping and trade-related advice. Febby regularly acts for a wide variety of financiers active in the shipping industry and on behalf of various organisations with transport-related infrastructure interests.

Mitch Ainsworth
Senior Associate, Blake Dawson
mitch.ainsworth@blakedawson.com
Currently based in Singapore, Mitch is an Australian and Indonesian mining and oil and gas specialist who has lived and practised in Jakarta during 2010 and has been involved in several significant high value mining deals in Indonesia. He has provided advice on acquisitions, structuring and services to foreign investors on oil and gas due diligence.

Pramu Priyandono
Senior Associate, Oentoeng Suria & Partners
pramu.priyandono@oentoengsuria.com
Pramu is an expert on Indonesian oil and gas law. He has worked for the in-house legal team of BP Migas for the last two years, and left to join OSP in April 2011. He has dealt with all the key aspects of Indonesian oil and gas law from the regulator’s perspective in a number of different contexts and is deeply familiar with the subtleties of the industry and how it is regulated.
Indonesian laws and regulations are constantly changing. This publication is up to date to August 2011, unless otherwise stated. This publication is intended only to provide a high level summary of the subject matter covered. It does not purport to be comprehensive or to provide legal advice. Actual implementation of laws and regulations may differ and relevant authorities may have different interpretations. No reader should act on the basis of any matter contained in this publication without first obtaining specific professional advice. Please contact us for further information or assistance.

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