

ClientAlert

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MEMR Issues New Regulation on Procedures for Divestment, Share Pricing and Changes to Investment in Mineral and Coal Mining Businesses

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Introduction

On 13 September 2013, the Indonesian government (through the Minister of Energy and Mineral Resources (the “MEMR”)) demonstrated its ongoing determination to implement the divestment requirement of the 2009 Mining Law by issuing Regulation No. 27 of 2013 on Procedures for Divestment and Share Pricing and Changes to Investment in Mineral and Coal Mining Businesses (“Reg 27/2013”).

Reg 27/2013 implements Government Regulation No. 23 of 2010 (as amended) (“GR 23/2010”). GR 23/2010 provides that foreign participation in a mining company holding a mining licence (“IUP”) must be divested through several domestic ownership levels following the end of the fifth year after production until the tenth year after production, so that by the end of year 10 at least 51% of the shares are owned domestically.

Reg 27/2013 clarifies GR 23/2010 and provides further guidelines on how the divestment requirement is to be carried out. In addition, Reg 27/2013 causes additional negative impacts on foreign investment in mining, such as a less favourable pricing formula for the divested shares and further restrictions on foreign ownership.

Interestingly, in a recent publication by the Indonesian Mining Association, the Directorate General of Mineral and Coal has suggested that the Indonesian government might apply a lower divestment requirement (i.e. 40% instead of 51%) in certain circumstances. Although the requirement will need to be further regulated before its benefit can be assessed, the Directorate General hinted that the exemption might apply to mining companies with integrated downstream and upstream activities.

Key Principles of Reg 27/2013

1. Clarification of Scope of Application of GR 23/2010

Reg 27/2013 clearly provides that the divestment requirement only applies to companies holding IUPs and special IUPs for mining and, therefore, companies holding special IUPs for transportation and trading or special IUPs for processing and refinery are not subject to such divestment.



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2. Divestment Process

A) Parties

Under Reg 27/2013, the shares to be divested must be offered, in sequential order, as follows:

1. The offer must first be made to the **Indonesian government, the provincial government and the regency/municipality**. The Indonesian government will be given priority.
2. If the first offer is not accepted, an offer must be made, through auction, to **state-owned companies and regional-owned companies**.
3. If the second offer is not accepted, an offer must be made to **national private companies** through auction.

B) Timeframe

Reg 27/2013 provides the timeframe within which the offer must be made and the period in which the transaction must be closed. The whole process must be completed within a year.

If, within a year during the divestment period, no one is interested in buying the offered shares, the relevant shares are to be aggregated with the shares which are required to be offered during the next year.

C) Price

Reg 27/2013 provides that the price for the divested shares will be determined on the following basis:

- the **replacement cost** of the accumulated investment costs spent from the exploration stage up to the year in which the divestment obligation is due, less:
 - i. **accumulated depreciation and amortization costs** (based on the economic or benefit age of the relevant assets as adjusted by the inflation rates); and
 - ii. **financial obligations** up to the end of the year in which the divestment obligation is due;

and the replacement cost can be calculated by an independent appraiser.

The price based on the above formula must be:

- i. the highest price to be offered to the Indonesian government and the provincial and regency government; and
- ii. the base price for the offer to state-owned companies, regional-owned companies, and national private companies.

In many instances this will be a variation of the pricing formula used in certain Coal Contracts of Work ("**CCOWs**") or Contracts of Work ("**COWs**") as some of them provide market-based pricing mechanism.

Alternatively, to avoid the rigid offering process and pricing method mentioned above, a foreign shareholder in an IUP company can start selling shares prior to the divestment obligation arising. However, such sale is subject to the approval of the issuer of the IUP.

D) Other Matters

Reg 27/2013 clarifies the following issues:

- i. After divestment has been undertaken, the shareholding of the Indonesian participant cannot be diluted below the percentage target for each domestic ownership level during the divestment process.
- ii. Shares to be divested cannot be pledged. This new requirement, ensuring that divested shares are transferred free from encumbrance, presents significant issues for projects with existing financing facilities. Lenders may have to release some of the divested shares given as collateral and consider alternative security packages to secure the financing.
- iii. The company holding a Production IUP and its affiliates are not permitted to lend funds to purchase the divested shares. The restriction seems a reasonable protection for existing creditors of the IUP company.

Reg 27/2013 also introduces the following provision:

- i. A public offering does not release foreign investors from the divestment requirement.

However, we have yet to see how this provision will be implemented and whether the Indonesian government will take a nationalistic approach by considering shares held by the public as "foreign" and, therefore, not counted in determining the shareholding of the Indonesian participant (and compliance with the divestment obligation).

3. Further Restriction on Foreign Investment

While Reg 27/2013 clarifies the divestment process, it also adds to the GR 23/2010 restrictions on foreign ownership in IUP companies.

The new restrictions will be triggered when:

- the status of a company holding an IUP for mining is converted from a non-foreign investment ("**non-PMA**") company to a foreign investment ("**PMA**") company, i.e. the first time a foreign investor acquires shares in an IUP company, and the following restrictions apply:
 - for a company holding an Exploration IUP, foreign ownership in the PMA company must not exceed 75%; and
 - for a company holding a Production IUP, foreign ownership in the PMA company must not exceed 49%.

- there is a change in the shareholding in an existing PMA IUP company, and the following restrictions apply:
 - for a company holding an Exploration IUP, foreign ownership as a result of such change must not exceed 75%; and
 - for a company holding a Production IUP, foreign ownership as a result of such change must not exceed 49%.

Moreover, the conversion of status from a non-PMA company to a PMA company can be done after the MEMR issues its approval with a recommendation from the issuer of the IUP held by the relevant mining company. Following the conversion, the IUP of the PMA company will be renewed by the MEMR. This clarifies GR 23/2010.

This will likely ensure that all PMA IUP companies are both supervised and directed by the same authority and that the Indonesian government has control over the implementation of any bilateral investment treaty in relation to foreign investment in mining.

It will also result in more consistent regulation of foreign investment and enable central government to action policy responses at different points in the economic cycle in the interest of Indonesia.

Under Reg 27/2013, if an IUP company has been converted to PMA before 13 September 2013 and the foreign shareholder holds more than 49%, the IUP company remains subject to the divestment requirement and is not allowed to increase its foreign shareholding.

It is not clear how to treat a domestic investment (PMDN) mining company which, based on Government Regulation No. 20 of 1994 on Share Ownership in the PMA Company, has, directly or indirectly, a foreign shareholder. It is unclear whether any change of foreign shareholder in that company would result in the MEMR requiring such change to be subject to the above requirements.

4. Effect on COWs and CCOWs

Reg 27/2013 provides that COW/CCOW companies are also subject to the divestment process and pricing formula provisions (see paragraph 2 above).

This will disadvantage foreign shareholders of COW/CCOW companies.

The 2009 Mining Law requires COWs or CCOWs to be adjusted but this has yet to be finalised. It remains unclear whether the Government will unilaterally impose Reg 27/2013 without adjusting the terms of COWs or CCOWs.

If unilaterally imposed, COW/CCOW companies will likely argue that the Government is in breach of contract. Any unilateral enforcement of this obligation will create negative sovereign risk perception in Indonesia at a time when foreign investment is crucial to the economy.

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