LOCAL CONTENT

Indonesia – Mining

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Columbia Center on Sustainable Investment

A JOINT CENTER OF COLUMBIA LAW SCHOOL AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

Synopsis

Highlights

- Indonesia implemented a controversial divestment program where foreign owners of mining permits are required to divest their ownership shares according to a proportional plan after five years.
- Holders of mining permits are required to use national or local companies established under Indonesian law and domiciled in the country.
- Mining companies are required to process and refine mining products domestically.
- Local content requirements are spread across various laws, regulations, and decrees that have frequently been subject to amendment.

✓	Employment Requirements
✓	Procurement Requirements
✓	Training Requirements
✗	Technology Transfer Requirements
✓	Monitoring and Enforcement Mechanisms
✗	Government Obligations in Support of the Companies' Program

The project[1] - background

Resource-rich countries are increasingly inserting requirements for local content ("local content provisions") into their legal framework, through legislation, regulations, contracts, and bidding practices. If successful, a policy to increase local content can lead to job creation, boost the domestic private sector, facilitate technology transfer and build a competitive local workforce. However, local content goals are often unfulfilled and the opportunities are not captured. For example, local content provisions typically require investors to meet targets measured as a percentage of investment, hours worked, equipment supplied, or jobs created. If targets are too high, they may either scare away investment or remain unmet as investors accept the fines or find loopholes. If they are too low, the country will not maximize potential linkages. This shows the importance of the framing of local content provisions. Targets, and other local content objectives, need to be carefully quantified, adapted to the local context and collaborative. Because local content provisions can be key to translating resource investments into sustainable benefits for the local population, this project examines the detail of the existing legal frameworks for local content in a number of countries.

CCSI has conducted a survey of the local content frameworks of a number of countries – identifying the key legislation, regulations, contracts and non-binding policies and frameworks dealing with local content issues in the mining and petroleum sectors[2]. A profile was created for each country, summarizing the provisions in the legal instruments dealing with local content and highlighting examples of high impact clauses[3] – those containing precise language which might be useful as an example to those looking to draft policies to enhance a country's local content[4]. The profiles examine provisions dealing with local employment, training, procurement, technology transfer, local content plans as well as local ownership, depending on the country's approach to and definition of local content. In addition, as key to translating provisions into action, the profiles look at implementation, monitoring and enforcement provisions as well as the government's role in expanding local involvement. Aside from emphasizing the strong clauses, which may be adaptable across countries, the profiles summarize the provisions but do not provide commentary, because local content is so context specific. The profiles are intended as a tool for policy makers, researchers and citizens seeking to understand and compare how local content is dealt with in other countries, and to provide some examples of language that might be adopted in a framework to achieve local content goals. Hyperlinks are provided to the source legislation, regulations, policies and contracts where available.

[1] The project was managed by Perrine Toledano and Sophie Thomashausen. Research was conducted by Sasha Zheng, and David Kienzler.

[2] General legislation with provisions that relate to local content (for example, tax laws with incentives for local procurement or employment in any industry), was not included in the review. The review included dedicated mining or petroleum sector or specific local content legislation, regulations, policy and contracts.

[3]Those clauses are framed and singled out by a "thumb up".

[4] Our criteria for assessment of the quality of the provisions were language that is less likely to present a loophole, i.e. less likely to be subject to interpretation due to vagueness and more likely to lead to enforcement because of its clarity in terms of rights and obligations of both parties (state and investor), and reasonable in its obligations on the company. In addition, as mentioned above, we looked for clauses that encourage collaboration between the company and the government in defining local content targets and goals, and those where the government has a role, as well as clauses enabling implementation and monitoring of the requirements and those giving the government strong remedies to enforce companies' compliance.

The project - background

<u>The impact of international law</u>

The World Trade Organization (WTO)'s agreements and investment treaties can present an obstacle to the realization of local content goals by prohibiting some types of local content requirements (a sub-category of “performance requirements”[1]). CCSI therefore surveyed the relevant WTO agreements and investment treaties in each country profiled to identify the provisions that may prevent, counsel against and/or shield local content standards. These provisions are quoted in the profile in order to show the potential barriers to implementation of local content so that they can be kept in mind when countries enter into these international investment treaties[2]. Free Trade Agreements other than the WTO agreements, some of which may contain investment chapters, are not included in the scope of the review, but may also be relevant and should be similarly kept in mind.

[1]Performance requirements are measures in law, regulation or contract that require investors to meet specified goals when entering, operating or expanding in, or leaving a host country. Some are strictly mandatory; others are imposed as a condition for receiving some sort of added benefit or advantage.

[2]Countries implementing local content requirements should be aware of the possibility of a challenge to those provisions either through the WTO (state-to-state dispute settlement) or arbitration under the bilateral investment treaties (which is investor-state dispute settlement). While the potential for such actions may be low, they remain a risk depending on the circumstances, and particularly should relations between the state and the investor sour over the course of the investment.

Synopsis

International Law

Legislation

Law No. 4/2009 on Minerals and Coal Mining ("Mining Law") – covers mineral and coal mining generally but also has provisions on specific local content requirements.

Regulation

Government Regulation Number 24 of 2012 ("Reg. 24/2012") – Includes provisions for divestment of foreign ownership of mining companies.

Regulation No. 77 of 2014 ("Reg. 77/2014") – Provisions for local ownership.

Regulation No. 1 of 2014 ("Reg. 1/2014") and Regulation No. 6 of 2014 ("Reg. 6/2014") – Set requirements for domestic mineral processing and beneficiation.

Policy

There is no available policy framework

Contract

Previous contracts are required to be brought into compliance with the Law by 2010. No model mining contract is currently available

Key definitions

- **Indonesian company**: a legal entity where all shares are owned by Indonesian nationals and operates in Indonesia or offshore (PerMen 28/24)[1].
- **Empowerment of the community**: "an effort to improve the capacity of the community, either individually or collectively, to improve their living standards" (Mining Law, Art. 1.28).

[1] PricewaterhouseCoopers, *Oil and Gas in Indonesia: Investment and Taxation Guide 6th Edition*, May 2014, p.30.

Overview

Rights Application

- Applications for mining business permits for production must include information on its use of domestic goods and services.
- After five years of production, foreign-owned companies holding mining permits are required to begin divesting a percentage of their shares to the Indonesian government or Indonesian companies.
- Mining companies are required to process and refine mining products domestically.

Training and Employment

- Mining permit holders are required to use Indonesian mining service companies and those service companies are required to prioritize local contractors and workers.

Procuring goods and services

- Mining permit holders are required to prioritize local goods and services, though “local” is not defined in the laws or regulations.

Monitoring and Enforcement

- The Minister of Energy and Mineral Resources has authority to supervise use of local goods and services.
- Enforcement mechanisms and penalties for non-compliance are not specified.

Applications for rights

- Applications for mining business permits for production must include information on its use of domestic goods, services and technology (Mining Law, Art. 39(2)).
- Only companies listed on the Indonesian stock exchange may own more than one mining permit.[1]
- Regency/municipal government must give preference to locals when issuing smallholder mining permits (Mining Law, Art. 67).
- After five years of production, foreign-owned companies holding mining permits are required to begin divesting their shares to the Indonesian government, regional government, state or regional government-owned company, or an Indonesian private company (Mining Law, Art. 112; Reg. 24/2012).
- In the sixth year of production local ownership must be no less than 20% and no less than 30% in the fifteenth year (Reg. 77/2014, Art. 97).
- Mining companies are required to process and refine mining products domestically. They can only export products refined or processed in Indonesia. As a result of insufficient smelting and processing facilities in Indonesia, the export of certain unrefined but processed products is still permitted until 2017 (Reg. 1/2014; Reg 6/2014).[2]

[1] "Mining in Indonesia Investment and Taxation Guide," PricewaterhouseCoopers, May 2010.

[2] John Tivey, "Domestic Mineral Processing and Beneficiation in Indonesian Mining Sector," Mondaq, 12 August 2014.

Training and Employment

- Mining permit holders are required to use Indonesian mining service companies and those service companies are required to prioritize local contractors and workers, with consideration to their competency. Permit holders can only engage foreign services providers if local companies are unavailable (Mining Law, Art. 124-125).

Procuring Goods and Services

- Mining permit holders are required to give priority to local goods and services and involve local businesses (Mining Law, Art. 106-107).

Monitoring and enforcement

- The Minister of Energy and Mineral Resources has the authority to supervise the use of local goods, services and technology, as well as the development of mining technical workers (Mining Law, Art. 140).

- There is no mention of an enforcement mechanism specifically regarding local content requirements, and there are no stated penalties or consequences a failure to comply.

Agreement on Trade-Related Investment Measures (TRIMs)[1]

- Indonesia has been a member of the WTO since January 1, 1995.

- All World Trade Organization (WTO) Members must adopt and abide by the obligations of TRIMs. This can impact a country's ability to impose certain local content requirements (referred to as "investment measures"), to the extent they affect trade in *goods.*

- The following types of local content requirements are covered by TRIMS[2]:
  - requiring a company to purchase or use products of domestic origin – TRIMs prohibits discrimination between goods of domestic and imported origin;
  - limiting the amount of imported products that an enterprise may purchase or use depending on the volume or value of local products that the enterprise exports;
  - restricting foreign exchange necessary to import (e.g., restricting the importation by an enterprise of products used in local production by restricting its access to foreign exchange); and
  - restricting exports.

[1] The TRIMs Agreement clarifies existing rules contained in Articles III (National Treatment Obligation (NTO)) and XI (Prohibition on Quantitative Restrictions) of the General Agreement on Tariffs and Trade (GATT), 1994.

[2] It is important to be aware of the types of measures prohibited under the TRIMs Agreement, in order to avoid the potential for dispute settlement under the WTO - a state can bring an action against another state for an alleged violation of the TRIMs Agreement (i.e. "state-to-state action").

International law – WTO agreements

General Agreement on Trade in Services (GATS)

- A separate WTO agreement, the General Agreement on Trade in Services (“GATS”), covers investment measures related to services (in Article XVI), including the following which are relevant to local content:
  - Requirements to use domestic service suppliers
  - Limits on the number of service suppliers
  - Limits on the total value of service transactions or assets
  - Limits on the total number of service operations or quantity of service output
  - Limits on the total number of natural persons permitted
  - Restrictions on or requirements for certain types of legal entities (e.g., joint venture requirements)
  - Imposition of domestic equity

- GATS only applies to those service sectors that the country chooses to include in its Schedule of Commitments. Indonesia’s commitments relating to business services, construction and related engineering services, financial services and telecommunication services may affect the implementation of Mining Law, Art. 106-107, 124-125.

International law – bilateral investment treaties

- As at 11 February 2015, Indonesia had entered into 64 bilateral investment treaties (BITs) of which 47 were in force[1].

- Indonesia reportedly informed the Netherlands it will be terminating their BiT on 1 July 2015 and that the country intends to terminate all of its BiTs[2].

- Investment treaties are international agreements between two or more countries which establish the terms and conditions of foreign investment within each country and provide rights directly to the investors of each country which is party to the treaty. The treaties can contain restrictions on local content requirements.[3]

- Investment treaties can contain the following types of provisions, each of which affects a country's ability to impose local content requirements:
  - non-discrimination provisions ("national treatment" and "most-favored nation" obligations), which are relevant in the context of local content when:
    1. host countries require some foreign investors to source from certain goods and service providers but don't impose similar requirements on other investors; and
    2. host countries give an advantage to some domestic or foreign goods and services providers, but not to a foreign provider whose state has a relevant treaty with the host country. (Note that this is relevant only where the foreign provider of goods or services has or, intends to have[4], a presence in the host country);
  - restrictions on capital transfers;
  - "pre-establishment" protections, which prevent a state from imposing conditions on foreign investors that are not imposed on domestic investors, such as requirements to transfer technology to local firms, to establish the firm through a joint venture, or to reinvest a certain amount of capital in the host country;
  - incorporation of the TRIMs agreement; and
  - explicit prohibition of performance requirements that go beyond what is restricted by the TRIMs Agreement.

[1] According to UNCTAD's country specific list of bilateral investment treaties

[2] "Indonesia indicates intention to terminate all of its Bilateral Investment Treaties," *Herbert Smith Freehills Arbitration Notes*, 20 March 2014.

[3] It is important to be aware of the BITs a country has signed and the types of requirements prohibited under it, in order to avoid the potential for arbitration against the country - the majority of investment treaties allow investors to bring arbitration claims directly against the country in which they have invested ("investor-state arbitration).

[4] I.e., the conditions under which an investor may enter into the territory of a party, not only the conditions once the investment is made.

International law – bilateral investment treaties

- Of the 64 BITS signed by Indonesia, 44 were reviewed (and are available on UNCTAD's database).

- Aside from the inclusion of National Treatment Obligations and Most Favored Nation clauses, performance requirements are limited or prohibited in the BITs with 2 countries (Croatia and Turkey). Clauses are quoted below.

Indonesia – Croatia

Article 2 – Promotion and Admission of Investments

"2.3 Each Contracting Party shall grant, whenever necessary, within the framework of its legislation, permits in connection with the investment in its territory, including authorizations for engaging top managerial and technical personnel of their choice, regardless of nationality.

2.4 Each Contracting Party shall permit, subject to its laws, regulations and procedures affecting the entry, stay and work of natural persons, regardless of nationality, key personnel including top managerial and technical persons who are employed for the purposes of investments by an investor of the other Contracting Party, to enter, stay and work in its territory(…)

3.3 Each Contracting Party shall not impose in its territory mandatory measures on investments by investors of the other Contracting Party concerning purchase of materials, mean of production, operation, transport, marketing of its products or similar orders having discriminatory effects."

Indonesia – Turkey

Article 2 – Promotion and Admission of Investments

"(…) Companies which are legally constituted under the applicable laws and regulations of one Party, and which are investments of investors of other Party, shall be permitted to engage managerial and technical personnel of their choice, regardless of nationality."