LOCAL CONTENT

Indonesia – Petroleum

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Columbia Center on Sustainable Investment

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

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 – those containing precise language which might be useful as an example to those looking to draft policies to enhance a country's local content.[3] 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 Solina Kennedy.

[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] 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

The impact of international law

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

Highlights*

- Local content requirements are spread across various laws, regulations, and decrees that have frequently been subject to amendment.
- Oil and gas companies are required to give preference to Indonesian workers and engineering and design capabilities if at all possible, as well as implement training programs.
- Oil and gas companies are required to prioritize Indonesian goods and services and they are given price preferences.
- Enforcement and sanctions are imposed through both industry self-regulation as well as Indonesian government agencies.
- Local content of goods, services and combinations of goods and services are calculated based on particular ratios (of domestic components in goods and costs) and the status of the goods and/or services' provider (domestic, national or foreign) as well as the level of demand and supply determine the local content value.
- The gross split PSC incentivizes procurement of local goods and services.
- The procurement of Local content requirements are regulated under SKK Migas Work Guidelines No PTK 007 which was last amended in 2017 and so far monitored by SKK Migas.
- The role of SKK Migas is now put into question by both the Gross Split PSC and a 2020 bill.
- On November 13, 2012, the Indonesia's Constitutional Court ruled parts of the Law 22, regulating the oil and gas sector, unconstitutional. A draft amendment of Law 22 was made public for comments in 2018 and a new law might come out provoking further changes in local content obligations.

* CCSI analysis is based on translations of the laws and regulations and on secondary sources. We therefore do not guarantee the accuracy of the texts.

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

Synopsis

International Law

Legislation

Law No. 22/2001 on Petroleum and Natural Gas ("Law 22") – The primary oil law but suspected to be amended. A draft amendment to this law was made publicly available in 2018 for comments from stakeholders following a 2012 Constitutional Court ruling that found parts of it unconstitutional and decided to disband the upstream regulator BP Migas.

Regulation No. 35/2004 on Upstream Oil and Gas Business Activities ("Reg. 35") – The implementing regulation of Law 22. Last amended by Reg. No. 55 of 2009. Supervised and managed by SKK Migas.

Regulation

SKK Migas Work Guidelines PTK No. 007 Revision 4/PTK/2017 ("PTK 007") concerning Procurement Guidelines for Goods or Services, last amended 2017 ("2017 PTK 007 update"), effective July 28, 2017). Limits permitted contractors to bid for work and requires SKK Migas to approve procurement tenders over a certain amount

Regulations No. 15/2013 ("Reg. 15") on the Use of Domestic Products for Upstream business of Oil and Natural Gas – Issued by the Ministry of Energy and Mineral Resources (MEMR), generally codifies PTK 007 and sets out local content requirements

MEMR Regulation No. 14 of 2018 (" MEMR Regulation 14/2008") revoked MEMR Regulation 27/2008 concerning Oil and Gas Supporting Business

Presidential Regulation No. 9 of 2013 (Reg. 9) – Temporary measure until Law 22 is amended. Created provisions for governing bodies to supervise upstream and downstream sector. Delegated SKK Migas as regulator.

Contract

Regulation No. 8 of 2017 Gross-Split PSC Regulation ("Reg. 8") as amended by Regulation No. 52 of 2017 states that new PSCs must comply with the new gross-split model PSC (a 'Gross-Split PSC') which replaces the previous cost recovery system. [1]

Key definitions

- **BP Migas** was the Executive Agency for Upstream Oil and Gas Business Activities. It was disbanded by the Constitutional Court in 2012.
- **Business entities** means "companies in the form of statutory body which undertake business permanently, continuously and are established in accordance with laws in force as well as operate and are domiciled in the territory of the Unitary State of the Republic of Indonesia" (Law 22, Art. 1).
- **Domestic company** means owned by at least 50% Indonesian entity(s) (MEMR).
- **Indonesian company** means companies with 51% of voting shares and two-thirds of board of director seats held by Indonesian citizens (GBG).
- **National company** means owned 50% or more by foreign entities (PWC).
- **PTK** – *Pedoman Tata Kerja* – means work procedure guidelines (PWC).
- **SKK Migas** is the Executive Task Force for Upstream Oil and Natural Gas Business Activities (the upstream oil & gas regulator).
- **TKDN** – *Tingkat Komponen Dalam Negeri* – means local content (PWC).

[1]See Brad Roach and Alistair Dunstan, "The Indonesian PSC: the end of an era," Journal of World Energy Law and Business, (2018), doi: 10.1093/jwelb/jwy001

Overview

Rights application

- Indonesia's oil and gas law was ruled unconstitutional in 2012 for failing to maintain sufficient ownership of oil and gas production.
- Oil and gas production is still conducted by foreign companies through PSCs and the model PSC is now gross split which has implications for local content too.

Training and Employment

- Oil and gas companies are required to prioritize the use of Indonesian personnel, included at the community level. When certain expertise is not available in Indonesia, companies can bring in expatriates.
- Companies are required to conduct education and training programs for Indonesian personnel, including for management positions.

Procuring goods and services

- Business entities are required to prioritize local goods, services, and technology, as well as Indonesian design and engineering capabilities.
- Price preferences are given for domestic content that is certified
- A basic formula is given to calculate domestic content
- Targets are established by the government according to level of demand and supply of a good/ service and the status of the provider.
- The gross split PSC provides incentives for the procurement of local content
- Import Duty exemption is only granted to goods that are not produced locally, or cannot be produced locally in the quantity or quality required

Implementation

- Implementation of local content was delegated by the Ministry of Energy and Mineral Resources to SKK Migas after BP Migas was disbanded.
- A new bill proposes to disband SKK Migas too.

Monitoring and enforcement

- Monitoring and compliance is carried out through a mixture of self-regulation and government regulatory agencies.
- The monitoring role of SKK Migas on expenditures might be put into question in the implementation of the gross split PSC.
- Companies can be sanctioned for non-compliance.

Applications for rights

- The Constitution places natural resources under the powers of the State to be used to the greatest benefit of the people (Constitution, Art. 33(3)). As a state asset, the government must be the holder of the mineral concession. Under Law 22, private companies could conduct exploration, development and production as contractors to the government under cooperation (PSC) contracts (Law 22, Art. 4, 6).

- Law 22 was ruled unconstitutional in 2012 by the Constitutional Court as, in the opinion of the Court, it failed to maintain the state's possession of oil and gas production which was found to require not just ownership but also management and direct control by the government. The Court disbanded BP Migas and further changes that could impact local content provisions are possible when an amended law is passed[1].

[1] Satya Widya Yudha, "A House priority: Revising the oil and gas law," *The Jakarta Post*, 3 November 2014.

Training and employment

- Companies must give preference to Indonesian manpower in accordance with competency standards. In line with the competence required, companies can use foreign manpower for certain positions that cannot be fulfilled by Indonesian personnel. (Reg. 35, Art. 82).

- Companies must conduct guidance, education, and training programs for Indonesian personnel to enable them to meet the standards of their positions, according to the applicable laws and regulations (Reg. 35, Arts. 84, 85).

- All PSCs must contain provisions prioritizing the recruitment of Indonesian personnel (Law 22, Art. 11(2)(q)).

- MEMR Decree No. 6/2018 revoked Decree 31/2013 on Expatriate Utilisation and the Development of Indonesian Employees in the Oil and Gas Business, opening up more positions to expatriates that were previously closed (unless restricted under the general manpower regulations).

- Companies are responsible for developing local communities (Law 22, Art. 40(5)), by improving infrastructures and facilities as well as empowering and employing local citizens (Reg. 35, Arts. 74, 77).

Procuring goods and services

- Business entities are required to prioritize local goods, services, and technology, as well as Indonesian design and engineering capabilities so long as they are of comparable quality, price and availability (Law 22, Art. 40(4); Reg. 35, Art. 79(2)).

- Regulation No. 15/2013 stipulates that procurement activities must be in accordance with MEMR's Domestic Product Appreciation Book (APDN Book) which categorizes goods and services according to: "mandatory, maximized or empowered".[1]

- This categorization generates different targets and timeframes for different goods and services in oil and gas to advance local content taking into account where the demand for goods and services are expected to be the greatest and the amount of time necessary for local providers to develop the capacity to meet expected new demand.

- Local content for goods, services and a combination of goods and services is calculated differently for each based on ratios between the domestic components/service cost of the domestic components and the total cost of finished goods/services. The status of providers of goods/services as defined by MEMR (Domestic, National or Foreign Company) also determines the local content value. The status can be: (i) Domestic Company (owned at least 50% by Indonesian entity(s)); (ii) National Company (owned 50% or more by foreign entities); and (iii) Foreign Company.

- Indonesian-made equipment must be purchased if it meets the requirements, even if the cost of the equipment is higher than foreign-made equipment.
  - Goods must have a TKDN certificate to be procured as local goods and they will benefit from price preference if their TKDN is 25% or more.
  - Services benefit from price preference if their TKDN is 30% or more.
  - Price preference are for local goods within 15% of the lowest tender, within 7.5% for local services (2017 PTK 007 Update).
  - The price preference calculation will vary according to the status of the company. (2017 PTK 007 Update).
  - Goods, services, technology, and design and engineering capabilities can be imported if they are not produced domestically (Reg. 35, Art. 80).

[1] PWC, "Oil and Gas In Indonesia: Investment and Taxation Guide," (September 2019), 10th Edition, page 29.

[2] KS law, Indonesia Law and Practice, Energy: Oil and Gas, 2019.

Procuring goods and services

- 2017 PTK 007 Update establishes a 2.5% pricing preference for Indonesian companies, defined as companies with 51% of voting shares and two-thirds of board of director seats held by Indonesian citizens.
- The gross split PSC grants financial incentives for the procurement of domestic goods or services with "a variable component adjustment ranging from 0 – 4% depending on the level of local content." [1]
- Guidelines and decisions regarding large purchases of most equipment or services provided to the upstream sector are made by the Government and SKK Migas. Purchases made by Joint Cooperation Contracts (JCC) are considered Government expenditure, excluding under gross split PSCs, and must be provided by a local limited liability company.[2]
- PTK 007 mandates, in respect to payments for goods and services, that PSC Contractors must use a state-owned bank for vendor and payer's accounts.
- On 2 April 2013, MoF instated Regulation No.70/PMK.011/2013 ("PMK 70") exempting imports of goods (during exploration and exploitation phases) for the upstream sector from VATs. PMK 177 restricts the Import Duty exemption to goods that are not produced locally, or cannot be produced locally in the quantity or quality required.

[1] KS law, Indonesia Law and Practice, Energy: Oil and Gas, 2019.
[2] PWC, "Oil and Gas In Indonesia: Investment and Taxation Guide," (September 2019), 10th Edition, page 136

Procuring goods and services

- The [2017 SKK Migas Tender Implementation Instructions (Number: EDR-0167 / SKKMH0000/2017/S7)](#) provides an example of bidding evaluation price for tender participants:*

	Component	Currency	Bid	TKDN Service Target Achievement	TKDN Commitment	Preference	Evaluation Price Offers (HEP)	Rating
Tender Participants				Consortium of PT Successfully Independently and PT Gas Asia				
Company Category Status in APDN Services				Important (or 'takes precedence')				
Commitment of Implementing Work by Domestic Companies %				51.00%				
Commitment of Implementing Work in the Territory of Indonesia %				65.00%				
	a	**b**	**c**	**d**	**e**	**f**	**g**	**h**
a	**Components of the Costs of Goods and Services**							
	1. Goods	US $	$ 127,000,000.00	70.00%	60.00%	12.86%	$ 112,531,645.57	
	2. Services	US $	$ 24,000,000.00	70.00%	100.00%	7.50%	$ 22,325,581.40	
	Total Cost of the Components of Goods and Services	US $	$ 151,000,000.00		66.36%		$ 134,857,226.96	
	Tender Participant Company Status	US $	$ 151,000,000.00	Consortium of Domestic Companies as lead firm with National Companies and Foreign Companies (LPDN-PN-PA)			$ 128,435,454.25	||
	Company Category in APDN Services	US $		Important (or 'takes precedence')				
b	**Non-Cost Components**	US $	$ 11,000,000.00				$ 11,000,000.00	
	Total Quote Price	US $	**$ 162,000,000.00**				**$ 139,435,454.25**	

* This chart has been translated and reconstructed from the original Indonesian version

Implementation

- Until 2012 the Executive Agency for Upstream Oil and Gas Business Activities (BP Migas) supervised the upstream oil and gas industry including local content compliance. Following the Constitutional Court ruling disbanding it, oversight was delegated by the Ministry of Energy and Mineral Resources to the Executive Task Force for Upstream Oil and Natural Gas Business Activities (SKK Migas) (Reg. 9).[1]

- The role of SKK Migas as a regulator might disappear: As of February 2020, a new bill was made public and submitted to parliament that would create a new state firm to attract foreign investment by reducing red tape. Under the law, private companies would work with the new firm through a PSC and the requirement for an upstream oil and gas regulator (currently performed by SKK Migas) would be dropped. Responsibilities held by SKK Migas under existing PSCs will be taken over by the new firm.[2]

[1] PricewaterhouseCoopers, *Oil and Gas in Indonesia: Investment and Taxation Guide 6th Edition*, May 2014, p.17.
[2] Reuters, "Indonesia aims for state firm to handle upstream oil and gas business," February 13, 2020.

Monitoring and enforcement

- Reg. 15 sets out the government's monitoring and enforcement authority including the ability to witness production processes, making verification of local content levels compulsory and giving SKK Migas the ability to set the local content level a company needs to achieve in its work programs and procurement plans (Reg. 15)[1].

- SKK Migas annually reviews PSC work plans for training program costs, employee organization charts, and plans for the indonesianisation of expatriate positions[2].

- Regulation 8 (as amended by Regulation 52), Arts (18 (2) and 23 (1)) may now weaken the power of government procurement regulations such as PTK 007 (especially pertaining to the role of SKK Migas in monitoring the contractor's work program and budget), by mandating that contractors may independently procure goods and services.

- Failure to comply with the local content commitments can result in administrative and/or financial sanctions (PTK 007). Reg. 15 further expanded the government's sanction options[3].

[1] "Oil and Gas New Rules on Domestic Content: Hard Headed Pragmatism or Impossible Dream," Hadiputranto, Hadinoto & Partners, April 2013.
[2] PricewaterhouseCoopers, *Oil and Gas in Indonesia: Investment and Taxation Guide 6th Edition*, May 2014, p.45.
[3] "Oil and Gas New Rules on Domestic Content: Hard Headed Pragmatism or Impossible Dream," Hadiputranto, Hadinoto & Partners, April 2013.

International law – WTO agreements

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 Law 22, Art. 40(4); Reg. 35, Art. 79(2); Model PSC, Art. 5.2.16

International law – bilateral investment treaties

- As at 31 August 2020, Indonesia had entered into 72 bilateral investment treaties (BITs) of which 26 were in force.[1]

- Indonesia informed the Netherlands it would be terminating their BIT on 1 July 2015 and that the country intends to terminate all of its BITs.[2] As of 31 August 2020, 30 BITs have been terminated.

- 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,[3] 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 72 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."