State Control over Natural Resources in Indonesia: Implications of the *Oil and Natural Gas Law* Case of 2012

Simon Butt and Fritz Edward Siregar*

In late 2012, the Indonesian Constitutional Court disbanded BP Migas – the institution the Indonesian Government had established to regulate and monitor the oil and gas sector. A majority of the Court decided that BP Migas exerted insufficient control over the sector, thereby violating Article 33 of Indonesia's Constitution. In particular, the majority held that Article 33 required that the state maintain virtually unbridled control over the sector, including by directly managing upstream activities. This article sets out the Court's reasoning in this case and critiques it. It also speculates on the likely implications of the decision, particularly for other natural resource sectors, in which many foreign investors are involved.

On 13 November 2012, the Indonesian Constitutional Court (Mahkamah Konstitusi) handed down its decision in the *Oil and Natural Gas Law* case (2012).[1] An eight-to-one majority decided that BP Migas, a state agency that the government had established to regulate and monitor the oil and gas sector, was unconstitutional and therefore ordered the agency's disbandment. The majority decision was based on Article 33, paragraph 3 of the Indonesian Constitution,

* Simon Butt is Associate Professor, Sydney Law School, where he teaches and researches Indonesian law. Fritz Edward Siregar is a SJD Candidate, University of New South Wales and Researcher, Sydney Law School. Mr Siregar previously worked at the Indonesian Constitutional Court as a judge's associate. The authors can be reached at, respectively, simon.butt@sydney.edu.au and fritz.siregar@sydney.edu.au.

1 Constitutional Court Decision 36/PUU-X/2012 (the '*Oil and Natural Gas Law* case (2012)').

which requires 'state control' over natural resources to ensure the greatest possible prosperity of the people. According to the Court, BP Migas' statutory functions were insufficient to constitute 'control' of the sector.

This is the third case in which the Court has reviewed the constitutionality of Law No 22 of 2001 on Oil and Natural Gas (the '2001 Oil and Natural Gas Law').[2] It is one of many cases in which the Court has reviewed statutes dealing with Indonesia's natural resources, including land, forests and water, and important public utilities, such as electricity.[3] In some of these other cases the Court has struck down legislation and legislative provisions for non-compliance with Article 33. In its very first case, decided in 2003, for example, the Court invalidated an entire statute that sought to regulate and privatise aspects of the electricity industry.[4]

The majority's decision in the *Oil and Natural Gas Law* case (2012) was nevertheless highly controversial, attracting significant domestic and international press coverage and drawing concern about its impact on foreign and domestic investment in the oil and natural gas (*minyak* and *gas bumi*, often shortened to 'Migas') and other natural resource sectors. In particular, investors were concerned that contracts that they had entered into with BP Migas to engage in upstream oil and gas activities might be invalid. At the time of the decision, there were more than 350 such production-sharing and sale contracts valued at approximately US$70bn per year, contributing more than Rp360tn to Indonesia's state revenue.[5]

The Court's decision has also heightened widespread anxiety about the perceived increase in so-called resource nationalism in Indonesia. For example, in February 2012, the Indonesian Government issued a regulation requiring majority or wholly foreign-owned companies holding mining licences in Indonesia to divest a majority share of the company to an 'Indonesian participant' after ten years of production.[6]

This article critiques the legal reasoning employed in the case and speculates about the potential ramifications of the decision for the management of other natural resource sectors in Indonesia. The article begins by introducing the Constitutional Court before discussing the rationales for its establishment

2 Constitutional Court Decision 02/PUU-I/2003; Constitutional Court Decision 20/PUU-V/2007.

3 Simon Butt and Tim Lindsey, *The Constitution of Indonesia: a Contextual Analysis* (Hart Publishing 2012).

4 Simon Butt and Tim Lindsey, 'Economic Reform When the Constitution Matters: Indonesia's Constitutional Court and Article 33' (2008) 44 Bulletin of Indonesian Economic Studies 239–262.

5 'Membaca Tiga Regulasi Pasca Pembubaran BP Migas' *Hukumonline* (Jakarta, 27 November 2012).

6 Simon Butt and Luke Nottage, 'Divestment of Foreign Mining Interests Set to Hurt Indonesia' *Jakarta Globe* (15 May 2012).

and the functions it held during its more than ten years of existence. Next, the article sets out the Constitutional Court's decision in the *Oil and Natural Gas Law* case (2012), highlighting its contribution to the Court's Article 33 jurisprudence. The Court's decision is critiqued and the government's response to the decision is described. The article concludes by considering some of the implications of the decision.

Indonesian Constitutional Court

The Indonesian Constitutional Court is one of the most successful results of the reformation (*Reformasi*) movement that emerged in Indonesia when President Suharto fell in 1998 after 33 years in power. Under his authoritarian regime, the judiciary, dependent on government and lacking judicial review powers, had been largely reduced to a rubber stamp for government action, and standards of competence and integrity had plummeted. Defying the expectations of many, the Constitutional Court emerged as a professional and highly respected judicial institution. Much of the success of the Court is attributable to its founding Chief Justice Jimly Asshiddiqie, a formidable professor of Indonesian constitutional law, dedicated to building an impartial court and developing Indonesia's first body of constitutional jurisprudence.

In the decade since its establishment, the Constitutional Court has drawn much praise for striking down many statutory provisions that it has found to breach Indonesia's Bill of Rights, inserted into the Indonesian Constitution as part of the post-Suharto reforms. However, the Court's decisions have certainly not been immune from criticism. In particular, its interpretation of the requirements of Article 33 has been criticised for significantly hampering or even blocking government efforts to increase competition in important sectors and to attract more foreign investment.

BP Migas

The Indonesian oil and gas sector has, since the 1960s, functioned largely by way of production-sharing contracts. Before 2001, the parties to these contracts were investors, many of whom were foreign, and the state-owned oil company, Pertamina, which operated as both regulator and industry participant. Pertamina, holding a monopoly and run primarily by military figures, was widely considered to be rife with corruption and a lucrative cash resource for the Suharto regime.[7]

7 Donald Hertzmark, *Pertamina: Indonesia's State-Owned Oil Company* (Rice University 2007).

The Asian economic crisis of 1997 decimated Indonesia's economy, leading to Suharto's resignation. International donors, particularly the International Monetary Fund, pushed the Indonesian Government to break down state monopolies over natural resources and public utilities, hoping that increased competition would resurrect the economy by increasing efficiency, reducing corruption and boosting investment. One of the government's responses was to enact a new Oil and Natural Gas Law in 2001. This Law established BP Migas as the state Implementing Agency (*Badan Pelaksana*, or BP) to manage and supervise the upstream activities of exploration and exploitation and to take over Pertamina's regulatory and administrative functions.[8] BP Migas did not directly participate in the oil and gas sector itself,[9] but the Law permitted other state-owned enterprises and the private sector, both domestic and foreign, to enter the downstream market, thereby forcing Pertamina to compete as an operator.

Oil and Natural Gas Law case

Applicants' arguments

The 2012 case was brought by ten Islamic organisations and 32 individual applicants led by Professor Dr HM Din Syamsudin MA, general chairperson of Muhammadiyah, Indonesia's second-largest Islamic organisation, boasting almost 30 million members.

The applicants claimed that by establishing BP Migas the 2001 Oil and Natural Gas Law reduced state control over natural resources, thereby violating Article 33 of the Indonesian Constitution. They argued that the contracts BP Migas had entered into with foreign-owned companies bound the state, thus restricting its ability freely to regulate and control oil and gas resources. The applicants also objected to the arbitration clauses in many of these contracts, which exposed the state to binding international arbitration.[10] Not only did this impose a financial burden on the state, it also undermined both the national parliament's authority as the people's representative and participation by the people as the owners of natural resources.

Finally, the applicants complained that by allowing commercial enterprises to operate in the oil and gas sector[11] the law undermined state control because it required state-owned enterprises to compete with other operators.

8 Constitutional Court Decision 002/PUU-I/2003, p 217.

9 *Oil and Natural Gas Law* case (2012) at [3.13.2].

10 As required by Arts 1, para 23, 4, para 3 and 44 of the 2001 Oil and Natural Gas Law.

11 Such as Arts 3(b) and 9 of the 2001 Oil and Natural Gas Law.

Controlled by the state

The majority began by referring to the Court's decision in the *Electricity Law* case,[12] in which the Court first considered the meaning and requirements of 'state control' in Article 33. In the *Electricity Law* case, the Court established the following principles. The state's power to regulate natural resources did not of itself constitute state control because the state already had inherent power to regulate irrespective of Article 33. Also, mere civil ownership by the state was not 'control by the state' because natural resources were public assets collectively owned by all Indonesians and the state was required to control those assets for the greatest possible collective prosperity.[13] Rather, 'state control' comprised five activities: making policies; administering; regulating; managing; and supervising.[14] And, at least for natural resources, these five activities needed to be performed for one purpose: the greatest prosperity of the people.[15]

In the *Oil and Natural Gas Law* case (2012), the Court extended this *Electricity Law* case jurisprudence. The majority categorised each of these five activities that comprise 'state control' into one of three 'tiers' or levels of importance depending on the extent to which the majority thought the activity achieved the greatest possible prosperity of the people. Direct management over the natural resource was 'the most important first order form of state control'.[16] Of secondary importance were, equally, policy-making and administration. Both regulation and monitoring fell within the third tier.

Direct management and BP Migas

According to the majority, direct state management of natural resources, through state-owned enterprises, ensured that all profits would flow to the state, thereby indirectly bringing greater benefits to the people. By contrast, handing over natural resource management to the private sector meant sharing profits between the state and private entities, thereby reducing the benefits flowing to the people. The majority decided that the state needed to manage natural resources fully unless it was unable to do so, in

12 Constitutional Court Decision 001-021-022/PUU-I/2003.

13 *Oil and Natural Gas Law* case (2012) at [3.11].

14 The Court specified that a small number of activities would constitute elements of state control. The government could exercise its power to administer by issuing and revoking licences and concessions. And it could manage through share ownership or by running the enterprise as a state institution (*Oil and Natural Gas Law* case (2012) at [3.11]). Presumably, the Court did not intend that this list be exhaustive.

15 *Ibid* [3.11], citing Constitutional Court Decision 3/PUU-VIII/2010 at [3.15.4].

16 *Ibid* [3.12].

which case opportunities could be given to foreigners. If the state did have sufficient capital, technology and capacity to manage the natural resource, then, according to the Court, the state was required to manage that natural resource directly.

In support of these claims, the majority referred to the writings of Mohammad Hatta, one of the founding fathers of the Indonesian nation and its first Vice-President. Hatta wrote the following about the intent behind Article 33:

> 'the ideals planted in Article 33 of the Constitution are the greatest possible production to be performed by the government with borrowed capital from overseas. If this strategy is unsuccessful, an opportunity must be given to foreign businesses to invest their capital in Indonesia based on requirements stipulated by the government... If national workforce and capital is insufficient, we borrow foreign workers and capital to smooth production. If a foreign country it is not prepared to lend capital, then opportunities are given to them to invest their capital in Indonesia with conditions determined by the government of Indonesia itself. These conditions are primarily to guarantee that our natural resources, such as forests and land fertility, are looked after. In developing the state and the community, workers and national capacity will improve over time, and foreign workers and capital will reduce over time.'[17]

The majority found that BP Migas did not directly manage oil and gas resources. Under the 2001 Oil and Natural Gas Law, BP Migas' main functions were to enter into cooperation contracts with industry participants and then to monitor the implementation of those contracts to ensure that oil and gas resources generated the maximum benefit for the greatest prosperity of the people.[18] BP Migas also advised the Energy and Mineral Resources Minister on cooperation contracts, production plans, budgets and the appointment of oil and gas sellers, again in the interests of securing the largest possible profit for the state.[19] According to the majority, these functions did not constitute 'control' within the meaning of Article 33. Upstream oil and gas activities were managed by the commercial entities with which BP Migas contracted – whether state-owned enterprises (BUMN, *Badan Usaha Milik Negara*), regional state-owned enterprises (BUMD, *Badan Usaha Milik Daerah*), cooperatives or private enterprises – not BP Migas itself. The Court also decided that when BP Migas entered into a contract with a private enterprise, the prosperity of the people was not 'maximised' because the private enterprise would share in any profits.

17 Mohammad Hatta, *Bung Hatta Menjawab* (PT Toko Gunung Agung Tbk 2002), 202–203, cited in the *Oil and Natural Gas Law* case (2012) at [3.13].

18 Article 44, paras 1 and 2 of the 2001 Oil and Natural Gas Law.

19 Article 44, para 3 of the 2001 Oil and Natural Gas Law.

The finding that the 2001 Oil and Natural Gas Law violated Article 33 because it did not require the state to manage upstream activities directly was arguably sufficient to resolve the case. However, the majority provided three additional reasons for declaring parts of the law unconstitutional. As the article argues below, these additional reasons will probably have significant ramifications for the way in which natural resources are exploited and managed in Indonesia.

Two of these additional reasons added weight to the majority's finding that the 2001 Oil and Natural Gas Law did not give BP Migas adequate control over oil and gas resources. The first was that the Law took away from the state 'the authority to directly appoint state agencies or corporations in exploiting oil and gas resources'.[20] The Law required them to 'go through the proper competition and market mechanism'.[21] This undermined the state control required by Article 33. The second reason was that the contracts BP Migas made with commercial entities to engage in upstream activities undermined state control. According to the majority:

> 'Once the contract is signed, the government is bound by the contract. The government loses sovereignty and control over natural resources so that exercising that control might breach the contract. However, as representatives of the people and the controller of natural resources, the state needs freedom to make regulations that bring the greatest possible prosperity to the people... According to the Court, the relationship between the state and the private sector in the management of natural resources cannot be established through civil law. It is a public relationship... [because it involves] providing concessions or licences that are under the complete control and power of the state. Civil contracts degrade the sovereignty of the nation over natural resources – in this case Migas... To avoid this problem, the government can establish or appoint a state-owned enterprise and give it a concession to manage Migas in... a Working Area so that that state-owned enterprise is the one entering into contracts with commercial enterprises. In this way, there is no longer a connection between the state and the commercial enterprise.'[22]

Finally, the majority was concerned that BP Migas had engaged in misuse of power and inefficient practices. BP Migas had thereby 'contradicted the purposes of the state in the management of natural resources and in the

20 Mohamad Mova Al Afghani, 'The Elements of "State Control"' *Jakarta Post* (14 January 2013).

21 *Ibid.*

22 *Oil and Natural Gas Law* case (2012) at [3.13.3].

organisation of government'.[23] This, the Court found, was unconstitutional,[24] though it pointed neither to any constitutional provision or principle that BP Migas had breached, nor to any specific evidence indicating BP Migas' inefficiencies or breaches.

In the result, the majority decided to excise from the 2001 Oil and Natural Gas Law all references to BP Migas, including the provisions granting it powers and functions.[25] BP Migas was thereby disbanded, effective from the time the judges had finished reading the decision. Until the government could issue new legislation in response to its decision, the Court declared that BP Migas' functions were to be performed by the Energy and Mineral Resources Ministry.[26] The decision did not mean, however, that the contracts that BP Migas had entered into before its disbandment were invalid. The Court declared that, in the interests of legal certainty, all working contracts made between BP Migas and commercial enterprises would continue in force until their expiry or a date on which the parties agreed.[27]

Critique

The Court's decision in the *Oil and Natural Gas Law* case (2012) has little to commend it, for several reasons. This article briefly outlines some of them, broadly categorised under three headings and incorporating some of the arguments Justice Harjono made in dissent.

Elements of state control

The first criticism relates to the Court's very first decided case – the *Electricity Law* case. As mentioned above, in that case, the Court held that 'state control' is made up of five activities. However, in the *Electricity Law* case, and in the several subsequent cases in which it has been asked to assess whether particular statutes maintain the state control required by Article 33, the Court has not explained from where it derived the five activities. The Court has not, for example, declared that it devised these five activities itself, or that it lifted or adapted them from elsewhere. It has not explained why these five elements, and not others, constitute 'state control'.

One Indonesian academic, Afghani, has suggested that the Court may have been influenced by the writings of German jurist Wolfgang Friedmann.[28]

23 *Ibid.*
24 *Ibid* at [3.13.4].
25 *Ibid* at [3.13.5].
26 *Ibid* at [3.22].
27 *Ibid* at [3.21].
28 Mohamad Mova Al Afghani, n 20 above.

In Friedmann's writings about the welfare state and mixed economies, he argued that the state had four primary functions: as provider, umpire, entrepreneur and regulator. According to Afghani:

> 'One could easily see the link between Friedmann's idea of the welfare state and the five-element construction developed by the court. If these assumptions are correct, the question then becomes, whether Friedmann's construction of the welfare state, which was written in the 1970s and now practiced by Indonesian jurists, is still relevant to the present-day situation?'[29]

The *Oil and Natural Gas Law* case (2012) brings the derivation of the five elements into sharp relief because, as mentioned above, the Court sought to rank them in order of importance. Again, the Court did not explain why it decided to rank the activities and how it devised the ranking. And yet the ranking attributed to each activity is far from self-explanatory. In particular, the Court's ranking of direct management as the most important aspect of state control and regulation as the equal least important is particularly problematic. This is because regulation appears to encompass some of the other elements of state control. Afghani argues that the Court's view of regulation is narrow, with 'contemporary mainstream academic understanding of regulation also [including] supervisory activities, as well as license-granting, standard-setting, in addition to the traditional understanding of enacting rules'.[30]

Indeed, it is arguable even that, using its regulatory power, the state could effectively directly manage by comprehensively regulating the sector, and strictly monitoring compliance, so that industry participants function just as the state would have sought to do if it participated directly.

The Court also appears to have ignored important passages in the same chapter of Hatta's book from which the Court cited. One such passage emphasises the importance of regulation to state control and downplays the need for the state to manage: 'State control [within the meaning of Article 33, paragraphs 2 and 3] does not mean that the state functions as entrepreneur. It is more accurate to say that state control is in making regulations to make the economy run smoothly, regulations that prohibit people with capital "sucking dry" the weak.'[31]

Also significant is that the majority did not appear to seek out any alternative views about Article 33, of which there are many. Although Hatta's opinions may well be highly revered in Indonesia today, they are certainly not the only views that were influential at the time Article 33 was drafted.

29 *Ibid.*

30 *Ibid.*

31 Mohammad Hatta, n 17 above, 210.

This is clear from Yamin's records of the debates that took place between 29 May and 1 June 1945.[32] Transcripts of recent constitutional debates about (unsuccessful) attempts to amend Article 33 in 2001 reveal a more contemporary diversity of opinion.[33])

Finally, the Court said that if the government was unable to perform all five roles as one action, then 'they must be prioritised based on their effectiveness to achieve the greatest possible prosperity of the people'.[34] From this quote, it seems clear that the Court will be willing to accept that state control might be maintained even if one of the five elements, apart from direct management, is missing. However, the Court did not state this explicitly, and it did not specify whether state control could be maintained in the absence of a second-, or only a third-tier, element.

Capacity and prosperity

In his dissent, Harjono agreed that the most important form of state control was management and that the state should, if able, directly manage natural resources. However, he refused to require the state to manage the oil and gas sector directly. Whether the state has the capacity and capital to manage the sector directly, he decided, was a matter for the president and the national parliament, who know more about these matters than the Court.

Harjono's argument exposes a significant flaw in the majority's reasoning. Inherent in the Court's finding – that the state must directly manage the oil and gas sector – is a presumption that the state is capable of doing so. Yet in its decision the majority neither assessed whether the state was, in fact, capable of managing the sector, nor explicitly declared that it was. To the contrary, the Court accepted evidence that appeared to point to the state's lack of capability. As mentioned above, the Court emphasised BP Migas' alleged inefficiencies and abuses of power to support its decision to disband the agency. Given the notorious corruption and mismanagement of its predecessor – Pertamina, a state-owned enterprise – there is little to suggest that the state is capable of managing the sector directly, at least in a way that achieves the greatest prosperity of the people. At a public discussion held

32 Muhammad Yamin, *Naskah-Persiapan Undang-Undang Dasar 1945: Disiarkan Dengan Dibubuhi Tjatatan* (Jajasan Prapantja 1959–60). See also PJ Suwarno, *Pancasila Budaya Banga Indonesia* (Kanisius 1993), 44; RMAB Kusuma, *Lahirnya Undang-Undang Dasar 1945* (Badan Penerbit Fakultas Hukum Universitas Indonesia 2004).

33 Simon Butt and Tim Lindsey, 'The People's Prosperity? Indonesian Constitutional Interpretation, Economic Reform and Globalisation' in John Gillespie and Randall Perrenboom (eds), *Pushing Back On Globalization: Asian Regulatory Perspectives* (RoutledgeCurzon 2009).

34 *Oil and Natural Gas Law* case (2012) at [3.13.4].

at the Indonesian Consulate in Sydney, Australia, on 24 November 2012, Chief Justice Mahfud admitted that disbanding BP Migas would not guarantee an end to corruption and inefficiencies, although it would push the government to restructure the sector to minimise them. With respect, it is difficult to see how requiring an extra layer of 'the state' in the form of a state-owned enterprise will reduce corruption and inefficiencies in the management of the sector. Given the perceived prevalence of corruption in government, one might even argue that the greater the involvement of the state, the more likely an increase in the prosperity of well-placed government officials would be.

The Court also did not consider any positive effects of non-government involvement on the oil and gas industry and, in particular, whether such involvement might create greater prosperity for the people than if the government directly managed it. As Harjono pointed out, the oil and gas sector is high risk, requiring significant capital and capacity. Opening up competition and allowing private-sector involvement in upstream activities might therefore allow more exploration and exploitation to take place than the state could achieve, resulting in profits or other benefits that, even if split between the industry participant and the state, might be significantly more than if the state had directly managed the activities itself. This view appears to be consistent with the writings of Hatta, who seemed to endorse private-sector involvement provided that Indonesian workers were employed: 'What is important is that foreign capital operating in Indonesia provides opportunity to work for Indonesian workers. It is better for them to work with a sufficient livelihood than them being unemployed.'[35]

Legal relationship between investors and the state

As mentioned above, the majority decided that contracts between the state and third parties degraded state control over natural resources because those contracts bound the state. While Harjono agreed that those contracts bound the state, he disagreed with the majority that any ensuing constraints on the state breached Article 33 for interfering with the state's 'control' of the natural resources to which the contract applied. Harjono emphasised that Indonesia is a 'law state' (*negara hukum*) and that the state could not simply use its power over national resources as it deemed fit once it had entered into such a contract. Rather, for Harjono, the 'state control' requirement was met because the state controlled BP Migas. Its chairperson was appointed and dismissed by the president, after consultation with the national parliament.

35 Mohammad Hatta, n 17 above, 212.

According to Harjono, the state, through BP Migas, exercised control over the sector when it negotiated contracts and awarded concessions. After agreements had been made and contracts signed, the control had already been exercised and the Indonesian Government was bound by the contract.

The majority's insistence that the state not be bound by contracts with third parties over natural resources is highly problematic. The government commonly signs contracts with non-government parties and, indeed, it has done so with many foreign-owned companies covering oil and gas and non-oil and gas resources alike.[36] Of course, the very fact that the state is party to a contract does not undermine the state's sovereignty to regulate.[37] However, as Harjono also pointed out, regulation adversely affecting the sector, or that purports to breach the contract or allow the government to do so, has led investors to initiate overseas arbitration proceedings against the Indonesian Government as 'just a normal party'.

Moreover, the Court's proposed longer-term solution does not appear to solve the problems the Court identified. As mentioned above, the Court suggested that the government appoint a state-owned enterprise and give it a concession to manage oil and gas reserves so that the enterprise, rather than the government itself, entered into contracts with commercial enterprises. State-owned enterprises are wholly owned by the state and the Minister for State-Owned Enterprises has ultimate control over their management, acting as the general meeting of shareholders and able to appoint and dismiss directors.[38] It is difficult to see, then, how state-owned enterprises are not 'the state' in the same way as was BP Migas or its replacement.

Political response

Within only a few hours of the Court issuing its decision in the *Oil and Natural Gas Law* case (2012), President Susilo Bambang Yudhoyono had issued Presidential Regulation No 95 of 2012 on the Transfer of Tasks and Functions of Upstream Oil and Gas Activities. This Regulation appeared to follow the Court's suggested solution to fill the gap left by BP Migas, allocating the agency's responsibilities to the Energy and Mineral Resources Ministry (Article 3) until the national parliament was able to amend the 2001 Oil and Natural Gas Law to accommodate the Constitutional Court's decision. The Regulation also reaffirmed that all cooperation contracts remained in force (Article 2), a pledge restated by President Yudhoyono in formal announcements soon thereafter.

36 A Zen Umar Purba, 'Negara dan Kontrak Privat' *Kompas* (3 January 2013).

37 *Ibid.*

38 By virtue of Law No 19 of 2003 on State-Owned Enterprises.

On the same day, Energy and Mineral Resources Minister Jero Wacik issued two regulations. The first, Regulation SK 3135K/08/MEM/2012 on the Transfer of Tasks, Functions and Organisation for the Implementation of Upstream Oil and Gas Activities, established a Temporary Implementation Working Unit for Upstream Oil and Gas Activities (SKSP Migas, or Satuan Kerja Sementara Pelaksana Kegiatan Hulu Minyak dan Gas Bumi) within the Energy and Mineral Resources Ministry. This Regulation transferred BP Migas' functions to SKSP, along with its personnel, assets and resource allocations.[39] The second, Regulation SK No 3136K/73/MEM/2012, transferred the officials from BP Migas to SKSP with their original office titles, salaries, benefits and work facilities.

The net result of these Regulations is that BP Migas has been replaced by an almost identically constituted body – SKSP. The Court's decision appears to have not perceptibly increased the state's control over the oil and gas sector and is unlikely to do so until the legislature amends the 2001 Oil and Natural Gas Law, a process that might take months or even years. The primary change is that now the head of the unit is appointed directly by the president – initially Energy and Mineral Resources Minister Jero Wacik, but since mid-January 2013, former Deputy Energy and Mineral Resources Minister Rudi Rubiandini. As mentioned above, the head of BP Migas was previously appointed by the president after consultation with the national parliament.[40]

Concerns have been raised about the government's response, which followed the majority's suggestion, particularly given that Indonesia is preparing for 2014 presidential and legislative elections that will require significant funds for successful campaigns. For example, *Kompas* newspaper reported Indonesia's Regional Representative Council Vice-Chairperson Laode Ida as stating:

> 'It needs to be noted that the Migas sector is thought to be the biggest cash cow for the ruler and his party. The result is that the transfer of authority from BP Migas to the Energy and Mineral Resources Ministry, the Minister from which is also from the ruler's party, even though it is only temporary... It will make access easier for those who want to take advantage of it to further their personal interests or the group in power, particularly in the lead-up to the upcoming 2014 elections.'[41]

39 'Membaca Tiga Regulasi Pasca Pembubaran BP Migas' *Hukumonline* (Jakarta, 27 November 2012).

40 Article 45 of the 2001 Oil and Natural Gas Law.

41 Suhartono, 'Pengalihan BP Migas Ibarat Durian Matang Jatuh' *Kompas* (Jakarta, 17 November 2012).

Ramifications for future natural resource management in Indonesia

Despite the problematic aspects of the decision, the Court's reasoning in the *Oil and Natural Gas Law* case (2012) is likely to have significant ramifications for the administration and management of other natural resources. Article 33, paragraphs 2 and 3 of the Constitution refer not only to the oil and gas sector but also to land, water and other natural resources, and to public utilities, such as electricity. Indonesia has no formal system of precedent and Constitutional Court decisions apply only as against the statute under review. However, it is likely that constitutional challenges will be brought against the statutes that govern these other resources on the same grounds used in the *Oil and Natural Gas Law* case (2012). It is likely that the Court will uphold challenges based on the same or similar grounds. The result, this article argues, will reduce the attractiveness of Indonesia as a site for direct foreign investment in two primary ways. This is unfortunate because Indonesia itself accepts that it needs foreign investment to maintain and further increase its economic growth.

The first way is that the government will probably be required to alter the way that those sectors are structured. As mentioned above, the Court suggested that, to maintain the state control required by Article 33, the oil and gas industry could be structured by delegating, through issuance of licences or concessions, to a state-owned enterprise the authority to directly manage the industry. If this state-owned enterprise lacks the necessary capital or expertise to engage in the upstream activities itself, the enterprise can contract with others, including the private sector, to provide the necessary capital and expertise. Presumably, though, non-state involvement in natural resource exploitation will be limited to making up any shortfall of capital or expertise that the state is unable to provide, even if the private sector can promise better efficiencies than the government.[42]

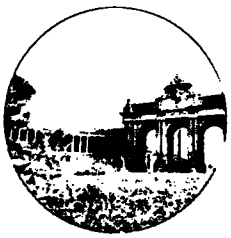
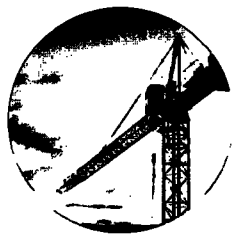
The second way in which the decision is likely to reduce the desirability of Indonesia as a site for foreign investment is that, in future cases, the Court will probably maintain its stance that the government must retain overarching and unrestrained authority to ensure that the people obtain the greatest possible benefit from the exploitation of natural resources. This has important ramifications for contracts between state-owned enterprises and private parties. It appears that the Court does not want the state itself to be bound by contracts entered into by state-owned enterprises; rather the Court appears to want to insulate the state from civil claims that might deter it from exercising its regulatory control.

42 'Cadangan Minyak Menyusut: Investor Enggan Menanamkan Uanganya di Indonesia' *Tempo* (Jakarta, 31 January 2013).

This is likely to result in more domestic legal action against the government. It is also likely to lead to more international arbitration, to which the Indonesian Government has often been subjected in recent years. In some of these cases, such as the notorious *Karaha Bodas* case, the Indonesian Government has lost and been ordered to pay large compensation payouts.[43] If the state takes the *Oil and Natural Gas Law* case (2012) as carte blanche to exert control by issuing regulations that affect contracts relating to natural resources, one might expect more arbitration and, ultimately, more losses to the state as the Indonesian Government defends those cases and, if it loses, pays out large compensation claims to investors.

43 In this case, Karaha Bodas, a largely foreign-owned entity, was awarded US$260m against the Indonesian Government in arbitration held in Switzerland. Karaha Bodas had entered into an agreement with Indonesia's state-owned oil and electricity companies for the production and distribution of thermal energy, but the contract was suspended by Presidential Decree when the 1997 economic crisis made the project unviable for the government. Though this award was enforced against the Indonesian Government's assets overseas, the Indonesian lower courts refused to enforce the award in Indonesia on public policy grounds. Ultimately, however, the Supreme Court upheld the award on appeal. See LT Wells and R Ahmed, *Making Foreign Investment Safe: Property Rights and National Sovereignty* (Oxford University Press 2007).

INTERNATIONAL BAR ASSOCIATION CONFERENC


UP TO 9 CPD HOURS AVAILABLE

5th Biennial Construction Projects from Conception to Completion Conference

6–7 September 2013 **Brussels Marriott Hotel, Brussels, Belgiu**

A conference presented by the IBA International Construction Projects Committee, supported by the IBA European Regional Forum

Topics include:

- The New Engineering Contract – its use outside the UK
- The top five most negotiated clauses in construction contracts – the devil is in the detail
- Drafting dispute escalation/resolution provisions
- Force majeure – in light of recent history, such as the Arab spring
- Time bar provisions – the devil in the contract?
- Expert witnesses in arbitration

Who should attend?

Private practitioners, in-house lawyers, contract managers and claims consultants should attend this conference. This conference will have particular appeal to younger project lawyers, and, as in previous years, will cover topics in a manner accessible to lawyers near the beginning of their careers while also appealing to lawyers with many years' project experience.

Headline sponsors

Secretari INTERNA

the global voice of the legal profession

London São Paulo Seoul Washington DC

4th Floor, 10 St Bride Street, London EC4A 4AD United Kingdom
Tel: +44 (0)20 7842 0090 Fax: +44 (0)20 7842 0091 www.ibanet.org