

Natural Resources Briefing

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Dissolution of BPMIGAS, Indonesia's upstream oil and gas regulatory body: legal and other forces at play

In a decision that has stunned both the Indonesian and foreign investment communities, Indonesia's Constitutional Court known as *Mahkamah Konstitusi* or (the "Court") ordered BPMIGAS, the upstream oil and gas regulatory body responsible for the administration of oil and gas exploration and exploitation activities in Indonesia, to be disbanded on 13 November 2012. The Court's ruling is final and has immediate legal effect.

On the same day, the President of Indonesia issued Presidential Regulation No. 95 Year 2012 ("PR 95/2012"), which provisionally transferred the powers and responsibilities of BPMIGAS to the Indonesian Ministry of Energy and Mineral Resources and declared that all production sharing contracts that had been entered into by BPMIGAS shall remain valid until their expiry.

The Minister of Energy and Mineral Resources has subsequently followed up on PR 95/2012 with the establishment of an Interim Working Unit for Upstream Oil and Gas Business Activities (SKSPMIGAS), which reports directly to the Minister of Energy and Mineral Resources, to take over the duties and functions of BPMIGAS.

The court case and decision

The constitutional challenge to BPMIGAS' authority and the practice of awarding production sharing contracts to private (in particular, foreign) parties was brought before the Court by a group of prominent Indonesian individuals and Islamic organisations with strong political and grassroots connections committed to their cause of maximising Indonesians' benefit from the country's rich resources as mandated by Article 33 of Indonesia's 1945 Constitution which provides that the "*land, waters and natural resources within shall be under the powers of the State and shall be used for the greatest benefit of the people.*"

“The Court held that BPMIGAS had acted unconstitutionally... thereby depriving the State from exercising its full constitutional authority over the country’s natural resources for the maximum benefit of the people.”

The Court reinforced State power over natural resources in accepting the petitioners’ argument that the Oil and Natural Gas Law No. 22 of 2001, from which BPMIGAS derived its authority, was in contradiction with Article 33 of the Constitution.

The Court held that BPMIGAS had acted unconstitutionally and usurped the State’s control, which included management, regulation, development and supervision of upstream oil and gas activities by, among others, entering into production sharing contracts with external parties, thereby depriving the State from exercising its full constitutional authority over the country’s natural resources for the maximum benefit of the people.

According to the Court, BPMIGAS, as an institution, did not only undermine State control over the valuable natural resource of oil and gas, but also had the potential to lead to inefficiencies and abuse of power. The Court opined that state-owned enterprises (“BUMNs”) are better placed to promote Indonesia’s constitutional objectives.

The Court expressed a preference for a concession regime where the Government awards a licence or concession to a BUMN, as opposed to the production sharing contract model where BPMIGAS, on behalf of the Government, entered into a production sharing contract with private entities as contractors. This seems to hark back to the pre-BPMIGAS days where Pertamina, a BUMN, entered into all the production sharing contracts. However, two Indonesian cabinet ministers have reportedly ruled out Pertamina taking on the dual roles of oil and gas operator and regulator.

The Court also clarified the scope of participation of private entities in the oil and gas sector, limiting the private sector’s role to circumstances in which the State lacks the ability to manage the country’s oil and gas resources, whether in terms of capital, technology, management or expertise.

The Court’s ruling takes prospective effect, so the validity of all previous production sharing contracts that had been entered into by BPMIGAS has been upheld.

What now?

Given the importance of this industry to Indonesia’s economy (in 2011, revenue from the oil and gas industry contributed approximately 20% of Indonesia’s domestic revenue), the Court’s unexpected ruling to disband BPMIGAS has set the Indonesian press, natural resources industry players and academic community abuzz. No consensus has yet emerged.

There is plenty at stake: at a more fundamental level, the expansion of the oil and gas industry and the need for foreign investment to fuel this growth, the regulatory architecture of the oil and gas industry, the role of BUMNs, the future of private sector and foreign participation in the oil and gas sector, the state of the 29 oil and gas concessions that are due to expire between 2013 and 2021 (including the highly-prized Mahakam block in East Kalimantan), the day-to-day administration of the existing production sharing contracts in areas such as cost recovery and workplan and budget approvals, the constitutional implications of this ruling to other natural resource sectors such as coal and precious metals, and the impact on other related industries such as shipping, to name but a few.

“The Court’s ruling takes prospective effect, so the validity of all previous production sharing contracts that had been entered into by BPMIGAS has been upheld.”

“The debate on the future course of Indonesia’s oil and gas industry is far from over; with the Court’s latest ruling, it has just begun.”

Of note, the Court’s ruling may portend an assertive and independent judiciary that upholds the law and safeguards its conception of national interest. The Government of Indonesia, to its credit, has responded swiftly to the Court’s ruling with PR 95/2012 and other administrative decisions and this swiftness of response has calmed an already jittery market further rattled by the Court’s ruling. But these measures are interim in nature and a permanent structure is in the works.

Conclusion

The Court’s ruling on the dissolution of BPMIGAS takes place against a backdrop of increasing resource nationalism in Indonesia.

There are complicated dynamics at play in Indonesia with the country experiencing surging national pride and confidence and economic prosperity, layered with early campaigning, political posturing and populist calls in anticipation of the 2014 presidential polls that promises to be very keenly contested.

The debate on the future course of Indonesia’s oil and gas industry is far from over; with the Court’s latest ruling, it has just begun.

Contacts

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