WATSON FARLEY
&
WILLIAMS

BRIEFING

FURTHER HURDLES RELATING TO THE OWNERSHIP/OPERATION OF INDONESIAN MARITIME ASSETS (PART II)

NOVEMBER 2016

- HAVING THE RIGHT STRUCTURE AND LOCAL PARTNER IS THE KEY TO ANY SUCCESSFUL SHIPPING BUSINESS IN INDONESIA
- ROBUST TAX ADVICE BEFORE IMPORTING ANY NEW MARITIME ASSETS INTO INDONESIA AND, IF RELEVANT, SET ASIDE ADEQUATE ALLOWANCES FOR SUCH TAXES
- BE AWARE OF THE OBLIGATION TO USE RUPIAH FOR CASH AND NON-CASH PAYMENTS

The first Briefing of our series on Indonesian maritime asset issues reviewed the first hurdles that prospective maritime asset owners are likely to encounter in Indonesia, namely: ownership, cabotage and flag. However, what additional hurdles might they have to overcome? This Briefing seeks to address further practical issues that Watson Farley & Williams has encountered while advising on Indonesian maritime projects and transactions.

Ownership, cabotage and flag issues are, of course, merely the first hurdle to owning and/or operating Indonesian maritime assets. Owners/operators of Indonesian maritime assets also should be mindful of the following additional practical and commercial issues.

Use of Bahasa Indonesia language for documentation

Pursuant to Law 24 of 2009 on the National Flag, Language, Emblem and Anthem ("Law 24"), which was enacted in July 2009, all documents signed by an Indonesian entity have to be in Bahasa Indonesia. Law 24 does not expressly differentiate between Indonesian law governed documents and non-Indonesian law governed documents. In contracts with a non-Indonesian counterparty, it is relatively common for parties to seek to comply with the above requirement by documenting contracts in dual language (ie. Bahasa Indonesia and English).

Law 24 is silent on the consequences of the non-compliance with such requirements and the implementing legislation for Law 24 has yet to be enacted. However the Jakarta High Court and the Indonesian Supreme Court recently upheld a first-

instance decision of the West Jakarta District Court[1] that an Indonesian law document that is not documented in Bahasa Indonesia is void and unenforceable. Further, the Indonesian Supreme Court considered that an earlier ministerial statement issued by the Indonesian Minister of Law and Human Rights confirming that the English language-only documents entered into between private parties will not violate Law 24 was "non-binding". While the decisions of the Indonesian courts are not strictly binding on other cases before the Indonesian courts, the above decisions do make it difficult for parties not to take the view that documents executed by an Indonesian entity should be documented in Bahasa Indonesia as well.

"VARIOUS OPTIONS HAVE DEVELOPED IN PRACTICE TO MITIGATE THE POTENTIAL DELAYS TO DOCUMENT EXECUTION THAT THE ABOVE REQUIREMENT COULD CAUSE "

Various options have developed in practice to mitigate the potential delays to document execution that the above requirement could cause.

The issues raised by Law 24 are particularly acute for the shipping industry which commonly contracts on industry standard form documents (such as standard form charters and bills of lading). These documents are rarely translated into Bahasa Indonesia. In particular, bills of lading are generally transferable and can be subsequently endorsed to an Indonesian entity.

Taxation

The tax treatment afforded to Indonesian maritime assets and asset owners are complex and beyond the scope of this Briefing. This is a constantly evolving issue and, for the above reasons, the import and income tax treatment for Indonesian maritime assets could vary. Owners of new Indonesian maritime assets would therefore be prudent to seek robust tax advice before importing any new maritime assets into Indonesia and, if relevant, set aside adequate allowances for such taxes.

It is worth noting that, historically, all vessels imported into Indonesian waters by a holder of a Marine Transport Business Service Permit (known as SIUPAL) were granted an exemption on VAT import taxes and such owners could elect to pay at a reduced income tax rate based on the gross charter income of the relevant vessel. However, Indonesian tax officials have taken the view that the above VAT exemptions should apply only to vessels engaged in transportation services (and not, for example, drilling rigs or floating production units unless certain additional exceptions or conditions apply) and that the reduced income tax rate should apply only to income obtained solely from the provision of transportation services. The matter is sometimes further complicated by inconsistent tax treatment by different local Indonesian tax offices.

If no tax exemptions apply, importing a vessel into Indonesia would be subject to import duties and taxes, although a rebate on these taxes may be obtained subsequently.

In addition to the SIUPAL exemptions mentioned above, some other tax exemptions also apply for certain offshore oil & gas assets. If such tax exemptions are relevant, it would be advisable for owners/operators of Indonesian maritime assets to explore the use of such exemptions as well, rather than rely solely on the SIUPAL tax exemption.

[1] In *PT Bangun Karya Pratama Lestari v. Nine AM Ltd.*

"THE RUPIAH REGULATION ALSO CONTAINS AN EXPRESS REQUIREMENT TO STATE THE PRICE OF GOODS AND SERVICES IN INDONESIAN RUPIAH ONLY "

Rupiah Regulation and Offshore Debt Regulation

On 31 March 2015, Bank Indonesia ("BI") issued regulation no. 17/3/PBI/2015 on the obligation to use Indonesian Rupiah in Indonesia (the "Rupiah Regulation"). The Rupiah Regulation, which came into force fully on 1 July 2015, will generally impose a mandatory requirement for all cash and non-cash payments and settlement of financial obligations in Indonesia to be made in Indonesian Rupiah unless an exemption applies. The Rupiah Regulation also contains an express requirement to state the price of goods and services in Indonesian Rupiah only.

The requirements of the Rupiah Regulation were further clarified in the BI circular letter No. 17/11/DKSP dated 1 June 2015 ("SE 17"). SE 17provided a non-exhaustive list of infrastructure projects that could be exempt from the mandatory use of the Rupiah provided that the relevant project owner obtains: (i) a confirmation from the related Indonesian government ministry that the work is for a strategic infrastructure project; and (ii) a relevant waiver letter from BI containing an applicable exemption for the mandatory use of Rupiah. These infrastructure projects include those related to transportation (e.g. airports), oil & gas projects, power utilities, water infrastructure and road construction and irrigation.

The Indonesian Minister of Energy and Mineral Resources, perhaps recognising the difficulty that the mandatory use of the Indonesian Rupiah would have on certain transactions in the energy sector, also issued a press release on 1 July 2015 (No. 40/SJI/2015) setting out the transition arrangements for that sector.

Essentially, the press release classified transactions in the energy sector into the following three categories:

- Category 1: transactions for which the mandatory requirement to use the Indonesian Rupiah will apply. These include leases for offices/houses/vehicles, salary payments to local Indonesian employees and various support services. A six-month transition period will apply to transactions in this category.
- Category 2: transactions that will require time to switch to the mandatory use of the Indonesian Rupiah. Transactions that fall into this category include long-term contracts and multi-currency contracts. These transactions can continue to be conducted in a currency other than the Indonesian Rupiah subject to further amendments to the contract; and
- Category 3: transactions that are fundamentally difficult to fulfil in the Indonesian Rupiah. Transactions in this category include salary payments to expatriates, drilling services and ship leases. Transactions in this category may continue to be conducted in a currency other than the Indonesian Rupiah.

It is, however, important to note that the above announcement applies only to some elements of the energy sector and does not strictly have the force of law.

On 29 December 2014 and 30 December 2014 respectively, the BI also issued: (i) regulation no. 16/21/PBI/2014; and (ii) Circular no. 16/214/DKEM (the "Offshore Debt Regulation") on the Application of Prudential Principles in Management of Offshore Debt of Non-Bank Corporations. The Offshore Debt Regulation took effect on 1 January 2015 and currently imposes the following requirements on Indonesian non-bank corporations (each an "Indonesian NBC"). They have to:

- Hedge no less than 25% of the amount by which that Indonesian NBC's Foreign Currency Assets are less than its Foreign Currency Liabilities that fall due in the following two consecutive three-month periods (the "Hedging Ratio Requirement").
- Have Foreign Currency Assets that are at least 70% of its Foreign Currency Liabilities that fall due in the following three-month period (the "Liquidity Requirement").
- Obtain and maintain a minimum credit rating of BB- (Standard &Poor's) (or equivalent with other credit rating agencies recognised by the BI) if it has incurred external foreign currency indebtedness (the "Credit Rating Requirement").

Rupiah Regulation

The Rupiah Regulation creates a particular issue for owners of Indonesian maritime assets that are financed by non-Indonesian Rupiah (often US dollars) denominated debt facilities but are looking to fund the repayment of such facilities through charter payments from Indonesian charterers.

"INTERNATIONAL FINANCING TRANSACTIONS… ARE GENERALLY EXEMPT FROM THE RUPIAH REGULATION, AND AN INDONESIAN MARITIME ASSET OWNER CAN THEREFORE BORROW IN A CURRENCY OTHER THAN THE INDONESIAN RUPIAH."

International financing transactions (i.e. a transaction where either the provider or the receiver of the financing is domiciled outside of Indonesia) are generally exempt from the Rupiah Regulation, and an Indonesian maritime asset owner can therefore borrow in a currency other than the Indonesian Rupiah. However, unless an exemption to the Rupiah Regulation also applies to the relevant charter payments, all charter payments must be quoted and paid to the Indonesian asset owner in Indonesian Rupiahs. This currency mismatch creates a foreign exchange risk for the relevant Indonesian maritime asset owner unless steps are taken to mitigate this foreign exchange risk, such as entering into a currency hedge.

Offshore Debt Regulations

The requirements of the Offshore Debt Regulation present another tricky issue for Indonesian maritime asset owners funded by non-Indonesian Rupiah financing. The obligation to pay principal and interest (or equivalent) in respect of non-Indonesian Rupiah loans are likely to create "Foreign Currency Liabilities" under the Offshore Debt Regulation. Unless an exemption applies, an Indonesian asset owner with non-Indonesian Rupiah financing will need to comply with (and monitor its ongoing compliance with) the Hedging Ratio Requirement and Liquidity Requirement. The forward-looking nature of these requirements are also likely to create compliance issues in relation to 'balloon' loan repayments of non-Indonesian Rupiah denominated debt.

Compliance with the Credit Rating Requirement could also present another problematic issue for Indonesian asset owners that are newly formed special purpose vehicles ("SPVs") which may not be able to meet the Credit Rating Requirement by themselves. Under the Offshore Debt Regulation, SPVs are allowed to use their parent company's credit rating, but it is not clear whether the identity of an SPV's parent company is determined solely by reference to shareholding or if other factors (such as management control) will be taken into account. In any event, unless the parent company is guaranteeing the foreign currency liability, such SPVs are allowed to rely on their parent company's credit rating only for three years from the start of their commercial operations. The requisite credit ratings must also be valid at the time of "signing and/or issuance of" the relevant loan and must be valid for these purposes for up to two years from the date on which it is issued.

The Offshore Debt Regulation also requires that all foreign exchange hedging has to be placed with a licensed bank in Indonesia from 1 January 2017. This would further limit the hedging options available to Indonesian maritime asset owners.

"AS A GENERAL REQUIREMENT OF INDONESIAN LAW, MARITIME ASSETS LOCATED IN INDONESIA HAVE TO BE PRIMARILY INSURED WITH LICENSED INDONESIAN INSURERS."

Insurance requirements

As a general requirement of Indonesian law, maritime assets located in Indonesia have to be primarily insured with licensed Indonesian insurers unless it can be established that Indonesian insurers are not able to or do not have the capacity to insure the relevant risk. Owners/operators of Indonesian maritime assets will therefore have to either insure those assets with Indonesian insurers (possibly reinsuring such risk into the international market) or be prepared to prove that Indonesian insurers do not have the capacity or are not able to provide the insurance coverage required.

If the relevant Indonesian maritime asset is financed by a secured loan facility, the relevant financiers may require insurances placed with Indonesian insurers to be reinsured into the international market and for reinsurance security to be provided and/or 'cut through' clauses to be endorsed on the relevant reinsurance policies.

Upstream oil & gas assets

Owners/operators of Indonesian upstream offshore oil & gas assets should also be mindful of the SKK Migas Standard Operating Procedure for Supply Chain Management of Production Sharing Contract Contractor number PTK-007/SKKO0000/2015/S0 (PTK 007/2015) ("PTK 007"). The requirements of PTK 007 are complex and beyond the scope of this Briefing.
Owners/operators/contractors of such maritime oil & gas assets should be alive to these requirements as they could allow owners/operators to obtain a price preference that (if applicable) could have substantial consequences on the economic viability of a project.

Closing observations

The issues mentioned above are only some of the key issues that owners/operators of Indonesian maritime assets may encounter. Watson Farley & Williams has advised numerous owners/operators and contractors of Indonesian maritime assets and has developed practical solutions to each of these issues.

In the first Briefing of this series we asked how far is Indonesia from fulfilling the wish that President Jokowi expressed in his inaugural speech two years ago to see the country become a global maritime Axis. As can be seen from the above list of issues, numerous hurdles still remain.

Ultimately, having the right structure and local partner is the key to any successful shipping business in Indonesia. Any entrants to the Indonesian market would be well advised to consider the above before taking that first leap.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with the author below or your regular contact at Watson Farley & Williams.

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