Client Update

Indonesia Mining Update

18 September 2014

It has been a torrid few years for investors in the Indonesian mining sector. The mining sector was one of the key sectors bearing the brunt of the nationalistic sentiment that became a focal point of the political discourse during the recent parliamentary and presidential election campaigns. With these elections now out of the way, and the Jokowi-Kalla team emerging as victors in the presidential campaign, there is some cause for optimism going forward. However, much will depend on the machinations of the coalitions and allegiances that crystallise during the new parliament, including the extent to which the so-called permanent coalition formed by the losing presidential candidate Prabowo Subianto remains intact, and the consequent pressures that these parliamentary forces exert on government officials and policy formation in the Indonesian mining sector.

In-country proceeding requirements

The most controversial of the recent regulatory challenges has been the implementation of the in-country processing requirements in January this year. Under the Mining Law and its implementing regulations, holders of mining concessions are required to add value for Indonesia by conducting in-country processing and refining, and, in particular are required in-country processing and/or refining of minerals within five years of the law taking effect (ie by the 12 January 2014). The law therefore effectively imposed a ban on the export of ore after that date. See our Client Update: Indonesia implements export ban on ore, 21 January 2014.

The Government has enacted a range of regulations during 2014 designed to implement the in-country processing requirements following the expiry of this five-year transition period. Key features of the new regulations include:

- All mineral commodities (including metal minerals, non-metal minerals and rock/stone, but excluding coal) must be processed and/or refined in-country in accordance with the minimum processing and/or refining limits set out in the regulation, prior to export.
- Nickel, bauxite, tin, gold, silver and chromium must be fully refined in-country in accordance with the minimum refining limits set out in the regulation, prior to export.

- The mining concession holders may, for a period of not more than three years from 12 January 2014, continue to export:
  - semi-processed metal minerals in the form of: copper, iron, ilmenite, titanium, lead, zinc and manganese concentrates (provided the relevant minimum limits for the processing of such concentrates set out in the regulation are satisfied); and
  - copper by-products in the form of: anode sludge and copper telluride, provided that further refinement of such products in-country cannot yet be undertaken.
- The right to export such semi-processed minerals and copper by-products is dependent upon the mining concession holder obtaining a recommendation from the Director General in the name of the MEMR. Each recommendation is valid for a period of six months. In order to obtain such recommendation, the mining concession holder, in the case of export of semi-processed minerals, must demonstrate, among other things, its seriousness to develop refining facilities directly or in cooperation with another party with a plan for the development of such facilities. In April of this year, this requirement was further elaborated as requiring, among other things, a construction plan for a domestic processing facility that has been approved by the Director General, as well as a seriousness deposit in the amount of 5 per cent of the construction costs to be deposited in an escrow account with a state-owned bank.

Export tax regime

The Ministry of Finance has also imposed an export tax regime which imposes export taxes on the export of copper, iron, ilmenite, titanium, manganese, lead and zinc concentrates. This regulation was initially designed to increasingly ‘disincentivise’ concession holders from exporting semi-processed products. Export taxes were to be imposed progressively, commencing at a rate of 20 per cent (25 per cent for copper concentrate) in 2014 and increasing to 60 per cent by 2016. Following intensive negotiations with Freeport in relation to the massive Grasberg copper mine in Papua, the Ministry of Finance subsequently amended the regime to instead increasingly ‘incentivise’ concession holders to progress its smelter construction activities. The amended regime contemplates three stages for construction linked to specific percentages of completion of the smelter (0–7.5 per cent, 7.5-30 per cent and above 30 per cent), with the export tax starting at 7.5 per cent during the first stage, and then dropping to 5 per cent and, ultimately, 0 per cent during the subsequent stages. Much interest will continue to centre around the ongoing negotiations between the Government and Newmont following the announcement from Newmont that it would withdraw its request for arbitration in order to continue its negotiations with the Government.

Divestment requirement

The other controversial policy area that has been further implemented in the past 12 months is the divestment requirement. Readers would no doubt recall that 2012 amendments to the relevant government regulation requires that a minimum 51 per cent shareholding be progressively divested to Indonesian Participants after five years of production. Late last year, the Ministry introduced mechanisms for the priority divestment procedure and for determining the share prices for divestment. It also imposes new restrictions on foreign investment through the issuance of procedures for changing the investment structures of mineral and coal mining companies.

Notably, the divestment price offered for the shares should be calculated based on an independent evaluation, taking into account the investment costs incurred by the concession holder during the exploration phase and up to year of divestment, less depreciation of facilities and assets and financial obligations, such as debts and taxes.

The regulation also clarified the following:

- Shares in a concession holder that are sold on the stock exchange will not satisfy the divestment obligation.
- If a local Indonesian company already holds not less than 51 per cent of the shares in a concession holder, the concession holder is not required to implement the priority divestment procedure.
- Concession holders and their affiliates are not permitted to lend funds to the Indonesian Participant for the purchase of the divested shares.
- Foreign investors looking to acquire a shareholding or change share ownership in a concession holder which holds an exploration concession are limited to 75% of the total issued shares.
- Foreign investors looking to acquire a shareholding or change share ownership in a concession holder that holds a production operation concession are limited to 49 per cent of the total issued shares.
- In addition to the above, the regulation also requires that all applications for changes of investment structure must be accompanied by evidence that the relevant concession has 'clean and clear' status. This simply reinforces the trend that it is increasingly difficult for any concession holders that do not have 'clean and clear' status to implement their investment activities.

Looking forward

While the Government, as well as the president-elect and his transitional team, have displayed limited willingness to significantly re-visit the in-country processing requirements, they have foreshadowed a potentially broader relaxation of the divestment requirements for integrated upstream and downstream companies off the back of the Government's negotiations with Contract of Work companies, particularly Vale Indonesia and Freeport, on the renegotiation of their concessions to align them with the 2009 Mining Law (as contemplated under that law). The Government has publicly confirmed that the divestment requirement is, in principle, only applicable to the upstream 'mining' activities, and that therefore a reduced divestment requirement should be appropriate for companies with capital intensive integrated operations.

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