Indonesian Journal of International Law

Volume 10 | Number 4 Article 1

7-1-2013

INDONESIA'S NATIONAL POLICY ON OFFSHORE MINERAL RESOURCES: SOME LEGAL ISSUES

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INDONESIA'S NATIONAL POLICY ON OFFSHORE MINERAL RESOURCES: SOME LEGAL ISSUES *

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Abstract

There are many legal issues arising from the field offshore mineral resources activities, one of them is about the ownership of the resources and the right to explore and exploit. This article discusses the historical background of the law governing offshore resources in Indonesia and then completed by the current development of this field.

Banyak permasalahan hukum yang menyangkut kegiatan pemanfaatan sumber daya alam lepas pantai, salah satunya adalah masalah kepemilikan dari sumber daya tersebut. Tulisan ini menyoroti sejarah perkembangan dari hukum yang mengatur sumber daya lepas pantai dan kemudian dilengkapi dengan perkembangan terbarunya.

Keywords: *offshore resources, production sharing contract*

I. INTRODUCTION

The Indonesian national policy on the exploration and exploitation of mineral resources (including hydrocarbons) in the archipelagic waters constitutes a system of mineral and hydrocarbon production development as part of national energy and mineral resources development policy. This approach is made possible by Indonesian law, which vests the right to minerals (including oil and gas) in the state, unlike U.S law, for example where the right or title to the land includes the right and title to the minerals (including hydrocarbons) found underneath the surface of the land (right of capture).

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* Developed from a paper presented at the Penataran Hukum International (International Law Upgrading Courses), 8-20 January 1990, conducted jointly by the Netherlands Institute for the Law of the Sea (NILOS), the University of Utrecht, the Netherlands and by the Indonesian Center on the Law of the Sea (ICLOS), a project of the Konsorsium Ilmu Hukum Indonesia (Indonesian Law Consortium) entrusted to the Padjadjaran University Law School, Bandung, Indonesia. This paper has been updated by the editorial staff of IJIL for having a fine paper containing the historical background and the current development of the topic.

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The Indonesian concept of a right to mineral resources separate from the rights to the land is a continuation of a legal tradition introduced by the Dutch in 1899. [2] Indonesia replaced the colonial law on mining with two national laws, one dealing with hard minerals (Undang-undang Pertambangan, 1960, amended 1967[3]) and one with oil and gas (Undang-undang Minyak dan Gas Bumi, 1960[4]). Both laws retained the basic principle that the right to the minerals remained vested in the state rather than in the holder or owner of the land. This is the first factor in Indonesia's national policy in mineral resources (hard minerals) and energy (oil and gas) development.

As Indonesia views its marine space in the same way as its land space, both being integral parts of the nation's territory, the laws on mining both hard minerals and hydrocarbons (oil and gas) are equally to the operations on land and offshore.

The second factor of the system concerns the method of extraction. The Dutch licensing system (*concessie*) was replaced by the 1960 Mining and Oil and Gas Law. This uses a completely different system, based on native Indonesian legal thinking and taking into account the realities the nation faced in the early 60's, when it aspired to explore and exploit its mineral resources and hydrocarbons without possessing the financial resources and technology for that purpose.

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[2] Indische Mijnwet (Mining Act of the Indies), 23 May 1899 State Gazette no.214 (1899), last amended on August 1938, State Gazette no, S 618 and 652 (1938). See Articles 1,4,7,13, and 35.

[3] The latest law regarding hard mineral is Law No. 4 of 2009 Concerning Mineral and Coal Mining (Undang-Undang Nomor 4 Tahun 2009 Tentang Pertambangan Mineral dan Batu Bara)

[4] The latest law regarding oil and gas is Law No. 22 of 2001 Concerning Oil and Gas (Undang-Undang Nomor 22 Tahun 2001 Tentang Minyak dan Gas Bumi).

on native Indonesian legal thinking and taking into account the realities the nation faced in the early 60's, when it aspired to explore and exploit its mineral resources and hydrocarbons without possessing the financial resources and technology for that purpose.

The *kontrak karya* (for hard minerals)[5] and the production-sharing contract (for oil and gas; PSC) are essentially based on the concept of the owner of the resources (the state) engaging a third party (a mining company in the case of hard minerals and an oil company in the case of hydrocarbons) as contractors. The proceeds of the contractor's work or activity (i.e., the production) are shared between the state and the contractor on the basis of a previously agreed formula, after the subtraction of costs. In assessing the nature of the *kontrak karya* and PSC, production sharing should not be confused with the profit sharing. Profit sharing is often not advantageous to owners of the resource, as they have no control at all over cost. To simplify the discussion in the following pages, I will concentrate on describing the PSC used in the development of hydrocarbon resources.

The regulatory agency at the Ministry of Mines in charge of supervising oil and gas production is the Directorate General Migas (Minyak dan Gas Bumi).[6] This agency ensures that hydrocarbon production and development are in line with the government's program and policy. The operational agency in charge of hydrocarbon production and development is the state oil company, Pertamina. It is Petamina, on behalf of the state that holds the right to mine. Consequently, by law it is also

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[5] See Infra, " basic Feature of the Production – Sharing contract". Later on its further development, the latest Law concerning Mineral and Mining is no longer use Kontrak Karya as its basic principle, and mining permit system (Sistem Izin Tambang) is introduced and still in use until now. See H. Salim HS in Hukum Pertambangan Indonesia.

[6] According to the Law No. 21 of 2001, the regulatory body acting independently and completely separated from mining activities, e.g. Pertamina was mandated by Law No. 8 of 1971 Concerning Pertamina (Undang-Undang Nomor 8 Tahun 1971 Tentang Pertamina), amended with Law No. 10 of 1974 Concerning the Amendment of Law No. 8 of 1971 Concerning Pertamina (Undang-Undang Nomor 10 Tahun 1974 Tentang Perubahan Undang-Undang Nomor 8 Tahun 1971 Tentang Pertamina), to act both as regulator and operator in oil and gas sector until the Law Concerning Pertamina is revoked by Law No. 21 of 2001. In return, the Law established new independent regulatory body, namely BP MIGAS (Badan Pengawas Minyak dan Gas Bumi).

Pertamina that holds the oil-and-gas work area (*wilayah kerja pertambangan migas*). The work are is offered to prospective contractor through a bidding system, the successful bidder obtaining a contract area (*wilayah kontrak kerja*). Usually a signature fee is paid by the contractor at the signing of PSC.

Up to this point there appears to be no big difference between a production-sharing system of oil-and-gas production and a concession system. The difference is appears in the structure and content of a PSC.

II. BASIC FEATURES OF THE PRODUCTION-SHARING CONTRACT[7]

As already stated, a PSC is a contract between the owner of the resources, that is, the Indonesian state represented by the state oil company, Pertamina, and the contractor, that is, the oil company assigned a certain contract area. The production-sharing concept has been developed since 1966, initially comprising the following principles:

1. The state oil company has control over management.
2. The contract is to be based on the sharing production rather than profit.
3. The foreign company –as contractor to the state oil company- is to bear pre-production risks, cost recovery to be limited to 40% of the oil produced annually if oil is discovered and produced.[8]
4. The remaining 60% of production (or more when cost amortization) is below the 40% maximum) is to be split, with 65% going to the state oil company and 35% to the contractor.

[7] This Section is largely based on my Mining Law (Bandung, Indonesia; Padjadjaran University Law School, 1974). For a detailed comparison of terms and conditions of PSCs of the first (1965-75), second (1976-88), and third (since 1988) generations, see A.S. Moch Anwar, F.X Sujanto, and D.Zahar, Pertamina: Indonesia Production Sharing Contract; Its Development and Current Status (Jakarta, Indonesia: Pertamina, 1989)

[8] This ceiling was lifted when oil prices were low in early 1989 and replaced by a 20% government share taken from the first tranche (phase) of production. The split between Pertamina and the contractor now is usually 85 : 15, and in some cases 80 : 20. A higher percentage in the production split and other incentives are provided in marginal cases and in remote areas, considered "frontier areas".

5. Title to all project-related equipment bought by the contractors is to pass to the state oil company upon entry into Indonesia, the cost to be recovered from the 40% of the oil produced and set aside for recovery cost.

These five principles, reflecting some basic ideas on petroleum resources development, are not embodied in the *kontrak karya* on oil signed in 1963 between the Government of Indonesia and Caltex and Stanvac Oil Companies.[9] Management of the operation should be controlled by the owner of the resource, that is, the state or state enterprise, rather than by the contractor. As it is the contractor who bear the risks, this means in practice that the relationship between Pertamina and the contractor is one of joint management. Second, to ensure a role for the state enterprise in marketing and to eliminate disputes over prices, the product is to be shared, rather than the profits. The limitation of cost recovery is a logical corollary of the two basic principles.

It should be noted here that, although Pertamina is given the prower of management, in the early years it used this power only to keep tight control over costs. There are several reasons for this: (1) Pertamina felt that cost is the most important aspect of management from their point of view, because the incentives (especially the 40% of output allowed for cost recovery) are such that the contractor's interest in keeping costs down may not be as great as Pertamina's; (2) Pertamina had to economize on the use of its trainee personnel, for it did not have an unlimited number; (3) Pertamina management felt that foreign investors, who are risking their capital, must in fairness have an important say in management matters, especially those in which the interest of the foreign investor and of Pertamina are similar or do not conflict.

At least 3 months prior to each contract year the contractor must submit to Pertamina a work program and budget. From the point of view of Pertamina, the work program is a basic management tool, containing the essential elements for an exploration program. It defines the proposed types of exploration activities, the duration of the program, disposal of data and information, estimated expenses and costs, plans for the relinquishment of the area, and so forth.

[9] These were the first and last kontrak karya on oil and gas. This type of agreement was later used exclusively for hard minerals.

Pertamina obtains all the data gathered by the contractor during the exploration stage. If the contractor finds a promising location or structure, the matter is discussed with Pertamina after test drilling has ascertained the viability of production.

It is at this stage that the difference between the production-sharing system and the concession system becomes apparent. Under the concession system, the decision is entirely up to the oil company. They usually base their decision on the company's production policy and program, which in the case of the big oil companies are integrated into their worldwide production program. They may proceed with actual production or cap the well. As an oil company's decision may not be always be good one from the point of view of Indonesia's energy development program, the pre-production consultation between Pertamina and contractor are very useful. If the size of the deposit and the nature of composition of the hydrocarbons are attractive, a decision may be made to enter the next stage of development, which is the actual production of oil and gas.

Recently, incentives have been given to oil companies concluding explorations contracts with Pertamina in areas that are marginal both in the sense of productivity potential and/or accessibility and convenience (remoteness)

The original PSC stipulated that *all equipment* purchased by the contractor and brought into Indonesia for purposes of exploration and production becomes the property of Pertamina. As a cost element it is written off according to a formula agreed upon between Pertamina and the contractor. Experience has shown, however, that even at the exploration stage the contractor very often subcontracts the drilling to other companies, so that this provision is no longer considered advantageous to Pertamina. One other consideration making the equipment provision of dubious advantage to Pertamina is the cost of removal after a work area or contract area has been abandoned.

Other provisions in the contract contain stipulation on the transfer of technology, the Indonesianization of staff , and other ways to ensure that Indonesia will be able in a reasonably short time to run its own oil industries. The contracts also contain provisions on marketing and on fulfilling the need of the domestic oil market.

To a large extent the objectives set out by the designers of the PSC had been achieved. Not only Pertamina is doing its job as a manager of Indonesia oil-and-gas development program, but many service companies supporting or supplying Pertamina and the oil contractors are now run or owned by Indonesians, including drilling contractors. Work or services requiring high technology or large capitals input, however, are still provided by foreign firm or operate as joint venture. At present there are no private Indonesian companies working as independent contractors.

With the introduction of the new tax law some years ago, the tax provisions in the PSC have been largely rewritten. In the original PSC no tax was paid: tax payment were included in the cost component deducted from gross revenue to arrive at net production (revenue) to be shared between Pertamina and the contractor. This was gradually changed over the years, and at present the picture is much clearer. The oil industry is one of the big tax contributors to the Indonesian Treasury, in all stages of operations up to and including the gas pump. At the production stage, no consolidation of taxes is allowed as a matter of a general principle, as indeed no consolidation of cost is allowed even between different contract areas worked by one company operating within Indonesia.

One PSC provision that merits special attention is the clause on mutuality, which states that "Pertamina and Contractor undertake to carry out the terms and provisions of this contract in accordance with the principles of mutual good will and good faith and to respect the spirit as well as the letter or said terms and provisions". One can read this mutually clause in a number of different ways. It is certainly unusual, especially when thought of in the context of transaction involving millions of U.S. dollars. Nevertheless, the clause reflects the atmosphere surrounding the PSCs in 1960s, which should be viewed as laying down the rules for a partnership in search of oil and gas, with one player, Pertamina, as the custodian of the resources providing the opportunity and facilities and taking the responsibility for all burdens involving administrative, fiscal and government-related matters, and with the foreign partner, i.e., the contractor, concentrating on the financial, technical, and commercial aspects of oil exploration and production.

One area in which this mutually clause could become very important is the decision whether to exploit a marginally economic oil deposit. Here the interests of the partners may be different: the contractor's interest is in recovering costs plus a good return, whereas Pertamina's interest is in getting its fair share. This conflict has not yet given rise to disputes, however, because so far all of the deposits found have been fairly substantial.

There is certainly room for improvement in the PSC, especially for a more precise formulation of some of the rights and duties of both parties. However, improvements should not disturb the mutuality of trust and good will that so far have characterized these contracts in actual performance.

Having given a brief sketch of the PSC, I next present some legal issues pertaining to mineral (oil and gas) resources development in the Indonesia marine space.

III.SOME LEGAL ISSUES IN MINERAL RESOURCES DEVELOPMENT IN INDONESIA

The Form of Contracts Employed

A. KONTRAK KARYA COMPARED TO CONCESSION CONTRACT

From a practical point of view the *kontrak karya* gives the contractor rights and obligations similar to the concession holder. As far as the implementation of the safety regulations contained in Mijn Politie Reglement is concerned, for example, all the provisions are considered applicable to the contract simply by substituting mining-rights holder, and on the holder's behalf the contractors, for concession holder. In other aspects of the *kontrak karya,* for example, the payment of land rent, royalties, and other taxes and levies, and the relationship between contractor and the holder of surface land rights, the similarity is indeed striking. The work contract further gives the contractor actual control over the minerals found and produced.

These facts have led people to state that a *kontrak karya* is nothing but a concession in disguise, and that the rights of the contractor,

although derivative in character, are in fact similar to those of a mining-rights holder (concession or license). As one supporter of this view has written,

> Although the agreement entered into the field of mining are identified as work contracts, *kontrak karya*, it appears to the writer that there is little difference between the substance of these agreements and the more traditional mineral concession agreements: the only difference being that in the traditional concession agreements the concessionaire obtains title to the minerals in the concession area at the time the concession is granted, while in Indonesia work contract agreements the "contractor" apparently obtains title only upon exploitation. The importance of this distinction appears to be minimal. What is of far greater importance is that under the Indonesian agreements the "contractor" maintains the authority over virtually all management, production, and marketing decisions, at least within the very liberal time limits imposed by the agreements.[10]

The writer cannot agree with such view, however persuasive it may seem for two reasons. The conditions for tenure in a *kontrak karya* are more restrictive than those usually found in concession agreements. And legally more important, the juridical nature of the contractor's right under a *kontrak karya* is radically different from rights under a concession.

At least under the Netherlands Indies legislation that is the Indische Mijnwet, the concession right was a "zakelijk recht" (right in rem), which could be mortgaged. Related to this was the obligation of the concession holder to have the concession right made public by registering it on the same manner as land rights. The rights of a contractor under a *kontrak karya,* on the other hand, are contractual rights that cannot be subject to mortgage under Indonesia Law, nor are they freely assignable like concession rights under the Indische Mijnwet. This legal difference between rights of the contractor under a *kontrak karya* and holder of concession rights is not inconsiderable, especially with respect to possibilities of acquiring third-party financing for the mining undertaking in question.

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[10] Timothy Manring, "Comments on Agreements in the Fields of Mining and Timber", cited in Mochtar (n.4 above), p.58.

B. PSC COMPARED TO CONCESSION CONTRACT

What has been said so far applies to *kontrak karya* related to minerals other than petroleum, that is, mining as regulated by the Basic Mining Law of 1967 and related government regulations. With regard to petroleum, the development of the *kontrak karya* concept has –as has already shown- followed a different road, ultimately leading to the PSC.

Like rights under *kontrak karya* (for hard minerals), rights under a PSC are personal rights (rights in personam) and as such are distinguished from rights under a concession. Moreover, there are other important legal differences between a PSC and the Former concession contracts. Whereas under a concession contract the concessionaire (i.e, the license holder or licensee) had the exclusive right to manage the enterprise, under a PSC the right of management belongs to Pertamina. The PSC is no longer based on profit-sharing (like the concession contract) but on a production-sharing scheme, thus minimizing the occurrence of conflicts over price-setting and accounting procedures. Unlike the concession contract, which granted the concessionaire title oil and at the wellhead, the PSC grants title to the contractor only at the point of export. Other point of difference, intended to increase the benefits to Indonesia, obligate the contractor to contribute some of the oil produced to the domestic market, to submit its geological and other data to Pertamina, to offer participation in the enterprise to an Indonesian national, to relinquish a certain portion of the contract area at specified intervals, to give title to its imported equipment to Pertamina, to consider local processing and to employ and train Indonesian personnel.

C. WORK CONTRACT (KONTRAK KARYA) COMPARED TO PSC

As has been shown, rights under work contracts as well as rights under PSC are personal rights. Yet, it is important to bear in mind the major difference between work contracts and PSCs.

1. Under the PSC the government, through Pertamina, retains the management of the operations and control over the resources; under the work contract, management of the operations and control over the resources is the hands of the contractor, with the government (i.e. the Department Mines) only supervising

2. Under the PSC the work program and budget are annually submitted for approval by Pertamina, and Pertamina may propose revisions; most work contracts concerning minerals do not contain such provisions. Where such provisions do exist their function is not to give the government management rights, as it is in the PSCs, but merely to indicate whether the contractor adhering to mining laws, regulations, and guidelines of the department.
3. Responsibility for taxes and other government levies under the PSCs is Pertamina's, since Pertamina is the holder of the authority to mine; under the work contract, however, it is the contractor who must pay land rent royalties, taxes, and other levies.
4. The PSC explicitly states that "title to the [contractor's share of] crude oil passes at the point of export"; no such provision exists in the work contracts in which title to oil presumably passes at the wellhead

Paradoxical as it may seem, it could be argued from the above differences that the PSC is more truly a "contract work" (*kontrak karya*), with the foreign company acting as a contractor, than is the *kontrak karya*, where the contractor although indirectly, does have actual mining rights.

One legal issue that could be important for purposes of liability (general) risk (insurance), and computation of damages to third parties is the question. At what point does title to the oil lifted pass to the contractor (oil company). In the concession system, title passes at the well head, as opposed to the PSC where title passes at the point of export.

D. REMOVAL OF EQUIPMENT

Ownership of oil and gas production equipment, especially drilling platforms, has recently given rise to problems for Pertamina.[11] After the expiration of the contract, the contractor is freely to leave, abandoning the equipment, including that to which Pertamina has title, This may cause problems, as removal of drilling platforms is quite costly. The alternative would be to leave the platform intact for other purposes or

[11] At present there are approximately 200 offshore wells temporarily abandoned, and some 130 wells permanently abandoned in the Indonesian offshore areas.

for use if resumption of production at the same well becomes commercially feasible.

In the meantime, however, Pertamina is responsible for the maintenance of these platforms and for the damage or mishaps they can cause to passing vessels. At least Pertamina has to bear the cost not only for maintaining the drilling platforms but also for providing them with warning lights in accordance with safety and navigation requirements. The cost to Pertamina is considerable, since in the Java Sea alone there about 100 drilling platforms, many no longer activities. In negotiations an attempt is made to build these cost into actives. In negotiations an attempt is made to build these cost into the PSC by including maintenance and lighting cost for abandoned platforms in the cost component of the contract. A more radical solution would be to revise the PSC provision relating to passage of title to all equipment purchased and brought into Indonesia by the contractor. In negotiating new PSCs, this particular provision could be rewritten to solve the problem.

Another alternative would be to sell the platforms to third parties, which may or may not be feasible as drilling technology keeps advancing. Unusable platforms can always be sold for scrap. On the other hand, experience has proven that the presence of drilling platforms in shallow seas like the Java Sea is conducive to creation of a favorable marine environment for the sea's living resources. In particular, the oil/gas rigs may be used wholly or partially as artificial reefs for fish aggregation.

E. PROTECTION OF THE MARINE ENVIRONMENT

The production of hydrocarbon offshore naturally entails the risk of marine pollution. The oil industry's record on this matter in Indonesia, however, is good, thanks to the offshore production safety measures prescribed by the Directorate General Migas, which has issued offshore regulations dealing with the matter, including provisions to protect the marine environment.[12] Oil companies operating in Indonesian offshore

[12] The two main regulations are Peraturan Menteri Pertambangan (Minister of Mines Regulation) no. 04/P/M/Pertamb./1973, 22 March 1973; Surat Keputusan Bersama Dirjen Perhubungan Laut dan Dirjen Migas (Joint Decision [Regulation] Director-General of Sea Communication, and Director-General of Oil and Gas) no. DKP/49/1/1- no. 01/KPTS/DM/MIGAS, 1981 Tentang Prosedur Tetap (Protap)

areas have an excellence record of adherence to regulations related to protection of the marine environment.

F. BOUNDARY DELIMITATION

Boundary delimitation gives rise to dispute between oil companies and between countries.

Boundary disputes that arise between two oil companies assigned adjoining contract areas may have their source in the delimitation or demarcation of the contract area originally negotiated between the contractors and Pertamina. The natural way to resolve the problem would be to appeal to Pertamina for a settlement. This is, of course, easier said than done, especially when the disputed area holds great promise of oil or gas deposits. At least one such case occurs in the early years of the PSC,[13] but the situation has improved over the years, and hardly any disputes are occurring at present over faulty delimitation of boundaries of contract areas.

Delimiting boundaries between two countries creates another set of problems. It is because of this potential for conflict that Indonesia has paid great attention to negotiating its continental shelf boundary with its neighbours, starting with Malaysia in 1969, when the first Continental-Shelf Agreements was signed. At present, a total of 15 boundary delimitation agreements between Indonesia and other countries have been signed.[14] Most of the relate to Continental Shelf or seabed boundaries, with a few Territorial Sea boundaries included, one with Malaysia in 1970 and one with Singapore in 1972. The Indonesia-Australia Boundary Treaty of 1974 also involves a territorial Sea delimitation.

The principle followed in relation to areas held by oil companies

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Pencegahan dan Penanggulangan Pencemaran Laut oleh Minyak Bumi di Selat Malaka dan Selat Singapura (Permanent Procedure concerning Protection of the Straits of Malacca and Singapore against Pollution).

[13] A dispute between Union Oil Co. (Indonesia) and Shell (Indonesia) (1971-73) over the Sangkulirang (Bay), situated on the east cost of Kalimantan.

[14] For a detailed examination see regional overviews by Choon-ho Park (on central Pacific/east Asia) and J.R.V. Prescott (on Indian Ocean), in Jonathan I.Charney and Lewis M. Alexander, eds., International Maritime Boundaries (Dordrecht, Netherlands: Martinus Nijhoff Publishres, forthcoming).

under contract to Pertamina is that, in cases of a boundary agreement concluded between Indonesia and a foreign country, the contract area boundary is in consequence corrected as a matter of law. Usually there is a provision in the PSC related to this matter, to prevent legal issue or dispute arising between Pertamina and the contractor.

Not all boundary questions that Indonesia has with its neighbours have been solven. However, two exceptions are the Continental Shelf boundary with Vietnam, which is still under negotiation, and the Continental Shelf or seabed boundary between Indonesia and Australia in the area that was previously Portuguese East Timor, popularly called the "Timor Gap".

With regard to the latter case, the solution has drawn much attention because of the new ideas and concepts it has created. It is a very interesting example of seeking a temporary solution for an intractable boundary question, through the establishment of a joint development zone. Because of its importance as a novel legal concept, it will be dealt within come detail.

THE INDONESIA – AUSTRALIA JOINT COOPERATION ZONE

The joint development zone has frequently been employed in cases where countries were unable to solve boundary disputes, in order that the development of resources could be undertaken pending the final settlement of the boundary question. The most well-known are (1) the Japan-Korea Joint Development Zone, (2) the Saudi-United Arab Emirates Joint Development Zone in the Persian Gulf, (3) the UK-Norwegian Joint Development Zone in the North Sea, and (4) the Thai-Malaysia Joint Development Zone in the Gulf of Thailand.

The Indonesia-Australia case is unique, however, because it involves the creation of new institutions and new law, thereby setting a precedent of sorts. The basic principles for the treaty were contained in a joint statement signed by the Foreign Minister of Indonesia and the Secretary of External Affairs and Trade of Australia on 25 October 1988 in Jakarta. The operative paragraphs state:

a. The Zone of Cooperation will be delineated in the northern side

by a simplified bathymetric axis line, in the southern side by the 200 nautical miles line measured from the Indonesian archipelagic baseline, and in the easterns side and western side by the equidistance lines. The establishment of the zone and its delincation will not prejudice the respective positions of the two Governments on a permanent continental shelf delimitation in the area and will not in any way be construed as affecting the respective sovereign rights claimed by each side in the zone of cooperation.

b. The Zone of Cooperation will comprise three component areas, namely Areas A, B, C as in the attached sketch map. A joint development regime will apply in Area A, and there will be established a Ministerial Council and a Joint Authority. In Area B the relevant Australian legal regime will apply, and in Area C the relevant Indonesian legal regime will apply, subject to a regime of sharing in tax returns applicable in each of the two areas and a process of notification and consultation between the two governments through the Joint Authority on petroleum exploration and development activities.[15]

On 11 December 1989, Indonesia and Australia signed the Treaty on the Zone of Cooperation in an Area between the Indonesian Province of East Timor and Northern Australia (the so-called Timor Gap), embodying the principles contained in the joint statement referred to above. The treaty, which was signed by the foreign ministers of Indonesia and Australia in an aircraft circling the area, has three annexes: Annex I delimiting the zone of cooperation, consisting of Area A (joint development zone), Area B, and Area C; Annex II, a mining code especially designed for the joint development zone (Area A); and Annex III, a model PSC, applicable exclusively to the joint development zone (Area A). In other words, oil and gas companies holding rights under Australian law in Australia cannot use or claim rights based on the provisions contained in this special PSC.

A through discussion of the provisions of the treaty, the mining code

[15] Joint Statement of Jakarta, 25 October 1988, Parts 2 and 3; see also Mochtar Kusumaatmadja, "Indonesian-Australian Joint Cooperation Zone of South of East Timor (the 'Timor Gap')", paper presented at the IRR Conference, Singapore, 30-31 May 1989.

and the model PSC is clearly beyond the scope of this article.[16] Suffice it to say that the system employed in the exploration and production of oil and gas in the Timor Gap area of the seabed between Indonesia and Australia is closely following the production-sharing system pioneered by Indonesian and now widely used throughout the world.

G. THE PSC AS A SYSTEM OF OIL-AND GAS RESOURCES DEVELOPMENT

As described in this article, the PSC system is truly a system of oil and gas *resources development* as opposed to a system of *mineral resources extraction* followed under the concession or licensing system, the difference being that management of and title to the oil and gas in the PSC system are both held by the state company (Pertamina) on behalf of the state as the custodian of the nation's resources (Article 33 of the Indonesian Constitution). This system, which is a manifestation of the principle of sovereignty over national resources if properly handled and implemented, provides a balance between the public interests represented by Pertamina and the private-enterprise interests represented by the oil company (contractor).

The system has worked well in Indonesia, because Pertamina has since its inception handled its mandate with good sense, adhering to generally accepted good oil practices. The same can be said of the foreign oil companies, which have learned to behave like partners in development rather than like profiteers. The mutuality clause expresses the spirit of cooperation and partnership for mutual benefit.

The PSC system of oil-and-gas resources development, now nearly 30 years old and widely adopted around the world, benefits developing countries because it provides the basis for sound mineral resources development as opposed to mineral resources extraction. On the other hand the PSC system for oil and gas and the *kontrak karya* system for hard minerals have provided a stable environment for investment and

[16] Mochtar Kusumaatmadja, "Perjanjian Indonesia-Australia di Celah Timor" (The Indonesia-Australia Treaty on the Timor Gap), paper read at the University of Gajah Mada, Yogyakarta, 9 February 1990, p.32: Prescott (n.11 above), report no.6-2(5); J.R.V. Prescott, "Maritime Boundary Agreements: Australia-Indonesia and Australia-Solomon Islands," Marine Policy Reports 1 (1989): 37-45.

production for foreign companies. These companies are treated as partners in developing Indonesia;s resources, not only by the government but also by the communities in which they operate. In remote areas this can be very important for the successful operation of a mining venture.

The various provisions on personnel development and the transfer of skills, know-how, and the experience gained in management and environmental protection are useful from a developing country's point of view. The opportunity the PSC system gives to Indonesia to husband its scarce mineral resources is perhaps the most important advantage from a resource-development point of view.

The difficulties experienced by the mining companies at the Ok Tedi and Bougainville copper mines in Papua New Guinea are a telling example of troubles arising from a mineral resources extraction system, which can perhaps be explained to a large extent by the different system employed and different philosophy underlying it.

It may be said with some justification that the PSC system for oil and gas and the *kontrak karya* system for hard minerals are important contributions made by Indonesia to the concept of mineral resources development. It is a system in keeping with finite mineral resources and with concerns for the environment in a rapidly shrinking world.

IV. CURRENT DEVELOPMENT OF OIL AND GAS CASE

Oil and gas industry is basically an industrial activity that has 3 (three) main characteristic such are: expensive (high cost), requires advanced technology (high tech), and high risks (high risk). This becomes the main reason of why it is not an easy matter for national companies to invest in oil and gas industry. The fact that Indonesia is a developing country and still lack of capability in those all three sectors mentioned above to run its operation independently. Therefore, the involvement of foreign parties in the oil and gas industry in Indonesia plays an important role.

Given that the oil and gas industry is a high-risk activity (high risk), it doesn't mean there is no possibility of disputes arise during the activity. As for foreign investors contributed in this industry, arbitration

is deemed as the most preferred mean of dispute settlement chosen by those foreign investors. This is primarily because arbitration is a dispute settlement mechanism seen as a more "neutral" compared to national courts. Even so, the role of the national court is still required in order to enforce the awards issued by arbitrators to be implemented or executed under national law. One of the advancement that has been achieved in Indonesia in the field of investment is the establishment the Law No. 30 of 1999 concerning Arbitration and Alternative Dispute.

However, Indonesia's credibility as a member of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (New York Convention) had been in doubt. It is seen by the annulment of a foreign arbitral award in a dispute between Karaha Bodas Company, LLC with PT Pertamina and PT PLN (Persero) by the Central Jakarta District Court in 2002. Further, it has a widespread implication in oil and gas industry in Indonesia today. More detailed discussion on the case is given below:

1. Indonesia as A Member of New York Convention

New York Convention of 1958[17] is the United Nations Convention held in the framework of the recognition and enforcement of foreign arbitral awards inside its member States. The presence of the New York Convention is to present a common perception, the universality of the recognition and implementation of arbitral awards to its member States[18]. Even so, the universality of perceptions and regulations sets by the New York Convention of 1958 in fact, is still difficult to be imple-

[17] New York Convention of 1958 is well-known by Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The Convention has been ratified by more than 145 (one hundred and forty five) State Parties, including Indonesia. The Government of Indonesia has ratified New York Convention by Presidential Decree No. 34 of 1981 on August 5, 1981. The Supreme Court later issued Regulation No. 1 of 1990 on Procedures for Arbitration Award as the basic implementation of foreign arbitral awards in Indonesia.

[18] Albert Jan Van Den Berg, Chair of the Netherlands Arbitration Institute, Rotterdam stipulates that, "two basic actions contemplated by the New York Convention: (1) the first action is the recognition and enforcement of foreign arbitral awards, i.e., arbitral awards; and (2) the second action contemplated by the New York Convention is the referral by a court to arbitration." in Albert Jan Van Den Berg, "The New York Convention of 1958: An Overview", Commercial Arbitration Yearbook, Vol. XXVII, 2009, p. 1

mented under a territory of a State Party. It is because of there are lots of differentiations and procedures in enforcing foreign arbitral awards in various States due to the freedom to determine their national law in respect to the recognition and enforcement of foreign arbitral awards, especially foreign arbitral award[19].

One example of the difference on perceptions and implementation can be seen in the provisions regarding annulment and refusal of a foreign arbitral award between Law No. 30 of 1999 concerning Arbitration and Alternative Dispute Resolution (Arbitration Act) and New York Convention. In Indonesia's Arbitration Act, annulment of foreign arbitral award is under the provision of Article 70 of the Act[20].

Annulment of foreign arbitral awards is basically different from the refusal of the enforcement of the award. The difference between the two terms could be seen from 2 (two) perspectives, such are: (1) based on the legal consequences arise from annulment and refusal of a foreign award, and (2) based on the authority of the annulment and refusal of a foreign arbitral award.

In regards to its legal consequences, if an arbitration award is annulled, the implication of such act is that the award no longer has the power of execution (as if it was never made). Therefore, the court may request that the parties to resettle their disputes (re-arbitrate). In the

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[19] Jan Paulsson, Vice Presiden of London Court of International Arbitration challenges the argument. It is stated, "broadly speaking, the New York Convention was intended to make it easier to enforce an arbitral award rendered in one country in the courts of other countries. Therefore, the Convention focuses squarely on imposing certain obligations on the judge at the place of enforcement. It does not create obligations for the courts at the place of arbitration – that would have been beyond the scope of the Convention. So each country remains free to make whatever rules it wishes with respect to the grounds on which thet might invalidate an award rendered in their territory." in "Enforcing Arbitration Awards under the New York Convention", (New York: United Nations Publications, 1999), p. 2.

[20] The provisions under Article 70 of the Arbitration Act states that: "The Parties may apply for annulment of the award if the award contains the following elements: (a) Letters or documents submitted during the examination, after adjudication, recognized or otherwise false; (b) After the decision was taken, it was discovered that a decisive document, which was hidden by the opposing party, and/or (c) the decision was taken based on the deceitful act done by one party during the examination of the dispute."

case of refusal of an arbitration award, the award doesn't mean denied by the court. The legal consequences arising from the refusal of an arbitration award cannot be implemented under the jurisdiction of the court which refuses to implement the award[21], but the award will still has its power to execute.

Pursuant to the authority given to annul and refuse an arbitration award, there are 2 (two) types of authority given. These two kinds of authorities will also have two different legal consequences. Those two authorities are well-known as:

1. Primary Jurisdiction; and
2. Secondary Jurisdiction.

The annulment of foreign arbitral award can be conducted by the primary forum which holds the primary jurisdiction over the award (in this case, such forum is the arbitration body which issued the award), while the refusal of arbitral award is conducted by the secondary forum which holds the secondary jurisdiction (in this case, such forum is judiciary body of a member State where the registration of the award is filed)[22].

Furthermore, it raises a big question, whether domestic courts have such authority to annul a foreign arbitral award or not. This question arises because there is no definitive explanation under Article 70 and 72 of the Arbitration Act in regards to the annulment of the arbitral award shall also be applicable to foreign arbitral award or limited to the extent of the issuance from local arbitration body.

2. Dispute Between Karaha Bodas Company, L.L.C. Against PT. Pertamina and PT. PLN (Persero)

The dispute between Karaha Bodas Company, L.L.C. (KBC) against PT. Pertamina and PT. PLN (Persero) started in 1994. The dispute was

[21] Hikmahanto Juwana, "Pembatalan Putusan Arbitrase Internasional oleh Pengadilan Nasional" [The Annulment of Foreign Arbitral Award by the Local Court], Jurnal Hukum Bisnis [Business Law Journal] Vol.21, (2002), p. 67.

[22] Sudargo Gautama, Arbitrase Luar Negeri dan Pemakaian Hukum Indonesia [Foreign Arbitration and the Usage of Indonesian Law], (Bandung: PT Citra Aditya Bakti, 2004), p. 73.

about the geothermal power plant contract dispute which was brought before the Switzerland International Arbitration Body on the ground of Pertamina and PLN default.[23]

In 1994, there was a Joint Operation Contract ("JOC"), of which KBC, a Cayman Island registered company, was given a right to build the Karaha Bodas geothermal project for 400 MW in capacity in Karaha and Telaga Bodas, West Java, Indonesia. The second contract disputed was the Energy Sales Contract ("ESC") between KBC and Pertamina in collaboration with PLN on behalf of Pertamina. In the period of the implementation of the contract, because of the monetary crisis and International Monetary Fund (IMF) recommendation by its issuance of Letter of Intent in 20 September 1997, President of Indonesia issued the President Decree Number 39 Year 1997 Concerning the Suspension/ Re-evaluation of the Government Project and the State-Owned Enterprises, which suspended the implementation of the project based on those JOC and ESC until unknown estimated time.[24]

KBC brought the dispute further before the Switzerland Arbitration Body to be examined on the ground of default against Pertamina and PLN. In 18 December 2000, the Switzerland Arbitration Body, referring The United Nations Commission on International Trade Law ("UNCITRAL") Rules, charged the Plaintiff to pay the Defendants a remedy worth US$ 266.166.654 with 4% interest a year. The payment of the remedies would be done by plaintiff's assets and property seizure situated in USA. Pertamina then lodged an exequatur petition to Central Jakarta District Court, which[25] then granted the request.

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[23] The Supreme Court of Republic of Indonesia, Judgment Number 444 PK/Pdt/2007 of Judgment

[24] On 1 November 1997, the project was able to be carried out de novo by the issuance of President Decree Number 47 Year 1997. but, in 10 January 1998, there was another issuance of President Decree Number 5 Year 1998 stated the suspension of those ESC and JOC reverted.

[25] Central Jakarta District Court then affirmed Judgment Number 86/Pdt.G/2002/ PN.JKT.PST regarding the Foreign Arbitral Award Annulment by Switzerland Arbitration Association. For the latter judgment, KBC filed a cassation to the Supreme Court of Republic of Indonesia with file number 01/Banding/Wasit.Int/2002, which annulled the earlier Judgment of Central Jakarta District Court. Pertamina further filed a petition of Case Review (Peninjauan Kembali/PK) for the latest judgment affirmed by the Supreme Court.

3. The Implication to Oil and Gas Industry in Indonesia after Karaha Bodas Company, L.L.C. Against PT Pertamina and PT PLN (Persero) Dispute

From the aforementioned of the explanation about primary jurisdiction and secondary jurisdiction, as a result, the regulations relating to the recognition and implementation of foreign arbitral award has not been set out comprehensively in Indonesia. The arbitration matters is only set out in Arbitration law. Furthermore, neither New York Convention, President Decree Number 34 Year 1981, nor Perma Number 1 Year 1990, has the consideration for Indonesian Arbitration Law. It then causes the multiple interpretations among the judges to decide the requests of annulment or refusal of a foreign arbitral award.

It is said so, the judges should refer to the prevailed positive law in deciding the requests of annulment or refusal of foreign arbitral award, in this case the Indonesian Arbitration Law. But, the judges should also have the competence required of understanding the Private International Law to apply it further in deciding foreign arbitral award related matters. Its objective is to avoid the *chauvinism jurisdich*[26] stand by the Indonesian court and also to escalate its credibility in international level.

V. CONCLUSION

The development of law concerning offshore mineral are rapidly changed not only in Indonesia but also in the world. Historical background of this law in Indonesia has shown that Indonesia has played significant role in shaping this law to be mimicked by other states in the world. But the recent development of this law has taken a high attention of the Indonesian Government especially those relating to right of foreign investor.

[26] Sudargo Gautama used the term "chauvinism juridisch" to state the waiver in using foreign law which oppose the national law core value. This principle is also known as public order in Private International Law field. However, the public order concept in each country is different and there is no exact indicator to define the lines in violating the public order. Thus, it depends on judge's interpretation. It often happens in Indonesia that a judge decides there is a violation of public order based on no grounds and limitations in his merits.

At least there are two things for Indonesian government to consider about relating to the dispute between KBC against Pertamina and PLN. Firstly, the development of oil and gas industry in Indonesia shall be supported by credible local courts which do not take side in examining a case. Secondly, an independent[27] implementing agency status is urgently needed to avoid another huge loss suffered as been the example of KBC v. Pertamina and PLN dispute.[28]

State total loss worth US$ 275 million was a result of PT Pertamina status as State Enterprise at that time.[29] It resulted to the seizure of PT Pertamina assets, of which indirectly resulted to the seizure of state assets.[30] A new Law Number 22 Year 2001 concerning Oil and Geothermal was enacted consequently. The law established an independent agency and PT Pertamina status became the regular State-Owned Enterprise and conducts the activity in oil and gas.[31]

However, the decision of Constitutional Court of Republic of Indonesia disbanding the Upstream Oil and Gas Agency (Indonesian upstream oil and gas regulator) brought back the international concern about the legal certainty of oil and gas regime in Indonesia. The government then enacted a Presidential Decree Number 9 Year 2013 concerning the Management of Upstream Oil and Gas Activity dated 10 January 2013 (Perpres 9/2013). Shortly, this regulation established the Special Tasks Force For Upstream Oil and Gas Business Activities ("SKK Migas") and mandated Minister of Energy and Mineral Resources as its

[27] Independent agency means a legal entity which has separate wealth and the state budget.

[28] The Court of Appeals for the Second Circuit decided to freeze Pertamina bank account worth US $275 million of total US$ 520 juta which was being frozen by one of New York Bank even though there had been the foreign arbitral award annulment by the Central Jakarta District Court.

[29] As stipulated in Article 1(1) jo. Article 6(1) Law Number 8 Year 1971 concerning Oil and Gas Mining Corporation (Pertamina Law), which then was invoked by Law Number 22 Year 2001 concerning Oil and Gas. PT Pertamina monitors the oil and gas business activities and also conduct the activity in exploration, exploitation, purification, processing, transportation, and sale.

[30] As stipulated in article 7(1) Pertamina Law, PT Pertamina's capital is state assets which are separated from the State Budget.

[31] PT Pertamina (persero) is registered in Indonesia State Owned Enterprise list conduct it activity in Mining sector with other 4 companies. (http://www.bumn.go.id/daftar-bumn/ accessed in 19/07/2013)

coordinator and supervisor.[32]

The establishment of SKK Migas under supervision of Minister of Energy and Mineral Resources does not grant the Indonesian Government itself to ensure there will be no dispute between the foreign investor and Government of Indonesia which able to cause another huge loss like it was happened in KBC v. Pertamina and PLN dispute.[33] What is all Indonesia need is excellent contract drafter and negotiator in oil and gas field and the judges who master the matter in Private International Law.

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[32] SKK Migas has few functions, such as to give consideration to the Minister of Energy and Mineral Resources while preparing and bidding offer the Area of Work and Joint Contract and also in signing the Production Sharing Contract.

[33] In response to the option of establishing a new State owned Enterprise replacing BP Migas, Hikmahanto Juwana (International Law Expertise, Universitas Indonesia) suggested that an agency replacing BP Migas should be formed as State Owned Enterprise to avoid a suit against the state. Realizing that oil and gas regime uses contract as its basis to conduct its activity, it will be wiser if state opt out to be a party of these contracts and represented by a legal entity solely. It is related to state avoidance of experiencing another huge loss and the possibility to be put under insolvency.

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