

## Client Alert

August 2017

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## MEMR Imposes Stricter Requirements for Changing Shareholders and Board Members for some Mining Companies

When the Minister of Energy and Mineral Resources ("**MEMR**") issued Regulation No. 42 of 2017 on the Supervision of Business Activities in the Energy and Mineral Resources Sector ("**Reg. 42**") on 17 July 2017, there were strong reactions in the market.

As a result, on 3 August 2017, the MEMR issued Regulation No. 48 of 2017 on Supervision in the Energy and Mineral Resources Sector ("**Reg. 48**"), which governs the same matters as Reg. 42 ie, procedures for changes of shareholdings and board of directors ("**BOD**") and board of commissioners members ("**BOC**") in power, geothermal, oil and gas, and mining companies. Reg. 48 revoked all provisions in Reg. 42.

This alert discusses the impact of Reg. 48 on mining companies.

For mining companies, approvals for changing shareholders and board members are not very recent requirements, as these approvals have been adopted since 2013 for IUP holders and 2009 for contract of work and coal contract of work holders (collectively referred to as "**COW**").

For the mining sector, there is no significant change from Reg. 42 to Reg. 48. Reg. 42 revoked certain provisions in MEMR Regulation No. 34 of 2017 on Licensing in the Mineral and Coal Mining Sector ("**Reg. 34**"), particularly the provisions on changes of shareholders and members of the BOD and BOC of mining companies that fall within the authority of the MEMR. However, Reg. 48 does appear to impose stricter requirements than Reg. 34 for changing shareholders and board members for mining companies under the authority of the MEMR.

### Historical background

Since the enactment of Law No. 4 of 2009 on Mineral and Coal Mining ("**Mining Law**"), the Government of Indonesia has issued several regulations that require approval from central or regional government for changing shareholders and board members in mining companies.

MEMR Regulation No. 18 of 2009 on the Procedures for Change of Investments in Contracts of Work and Coal Contracts of Work ("**Reg. 18**") was the regulation that required prior approval from the MEMR for, among other things, changing shareholders and board members in COW holders.

MEMR Regulation No. 27 of 2013 on Procedures and Determination of Share Divestment Pricing and Changes of Capital Investment in Coal and Mining Sectors ("**Reg. 27**") was the first regulation to introduce approval requirements



for changing shareholders and board members for IUP holders. Essentially, this regulation required approval from the MEMR or the heads of regional governments (depending on their respective authority) for changing shareholders and board members in IUP holding mining companies.

In May 2017, the above regulations were revoked and replaced by Reg. 34. Under Reg. 34, the concept of prior approval from the MEMR or the head of regional government was replaced by a prior recommendation from the Director General of Mineral and Coal ("**DGMC**") or governor for changes of shares and board members in all mining companies. However, the standard application form attached to Reg. 34 stipulates an application for an approval instead of a recommendation.

Given the lack of definition of "change of shares" under Reg. 34, there was confusion as to whether a share issuance for a capital increase was a change of shares that required a recommendation, or that required prior approval from the MEMR as part of the amendment of the work plan and budget of the relevant mining company. Having said that, Reg. 34 was broadly construed such that any kind of corporate action that would result in a change of shares of mining companies was subject to prior recommendation from DGMC.

Reg. 34 was partially revoked by Reg. 42. The closing provision of Reg. 42 provides that Reg. 34, to the extent it regulates matters relating to share transfers or change of directors and/or commissioners that fall under the authority of the MEMR, is revoked and declared void.

Reg. 48 then revoked Reg. 42 in its entirety.

## What's new?

### 1. **Still the same (stricter) requirements?**

#### (a) Shares transfer

Under Reg. 34, an application for a 'change of shares' had to include certain administrative and financial requirements such as an application letter, shareholders resolutions, financial statements and income tax returns of the IUP/COW holders. All these requirements were straightforward and related to IUP/COW holders.

Reg. 42, however, imposed stricter requirements than Reg. 34 to include the following additional administrative and financial requirements, including information relating to the entity that will be the transferee of the shares ("**Transferee**"):

- (i) an application letter signed by a director whose name is registered at the DGMC
- (ii) shares sale and purchase plan



- (iii) identity/profile of the Transferee, in the form of:
  - (A) deed of establishment and/or latest articles of association as approved by the ministry of law and human rights, company registration certificate
  - (B) copy of identity card (for Indonesian citizen) or passport (for foreign citizen)
- (iv) a copy of the annual income tax return of the Transferee for the last two years
- (v) a copy of the Transferee's taxpayer's registration number (NPWP)
- (vi) a copy of the Transferee's audited financial statements for the last two years.

The change that Reg. 48 provides is with respect to the requirements set out in items (iv), (v) and (vi); these requirements do not apply if the Transferee is a newly established business entity.

(b) Change of board members

Reg. 42 imposed the following additional requirements from those under Reg. 34 for changing a board member:

- (i) an application letter signed by a director whose name is registered at the DGMC
- (ii) identity/profile of the new candidate of director/commissioner, including his/her identity card (for Indonesian citizen) or passport (for foreign citizen)
- (iii) a copy of NPWP of the new candidate of directors/commissioners
- (iv) a copy of income tax return of the new candidate directors/commissioners for the last two years

The only change that Reg. 48 provides from Reg. 42 is that the requirements in items (iii) and (iv) above do not apply to candidate directors/commissioners who are foreign citizens and previously have not obtained an NPWP.

Based on the above, it does not appear that Reg. 48 introduces a significant change compared to Reg. 42, although these provisions are still stricter than Reg. 34.



## 2. **Reg. 48 applies to certain mining companies (and so did Reg. 42)**

Like Reg. 42, Reg. 48 clearly stipulates that it only applies to IUP holders whose IUP was issued by the MEMR and COW holders.

Under the Mining Law and Reg. 34, the MEMR has authority over COWs and these types of IUPs:

- (a) Exploration IUPs and IUPKs with a mining area located:
  - (i) across provinces
  - (ii) within sea territory exceeding twelve nautical miles from the shoreline to high seas or archipelagic waters
  - (iii) with a direct border with another country's territory
- (b) Production Operation IUPs and IUPKs, whose mining area, processing and/or refining facility, or special port is located:
  - (i) across provinces
  - (ii) with a direct border with another country's territory
- (c) Special IUP Production Operation for Processing and/or refining if:
  - (i) the mining commodity that will be processed comes from other province outside the location of processing and/or refining facility
  - (ii) the mining commodity that will be processed comes from abroad
  - (iii) the processing and/or refining facility is located across provinces
- (d) IUPs, including the Special IUP Production and Operation for Processing and/or Refining, issued by the MEMR within the framework of foreign direct investment (PMA).

Consequently, all transfers of shares and changes of board members in the above mining companies are subject to prior approval from the MEMR. In this respect, there is no change from Reg. 42 to Reg. 48.



## Impact of Reg. 48

### 1. **Was there any registration requirement under the previous regulations?**

Similar to Reg. 42, all applications for approval of a transfer of shares or change of board members under Reg. 48 must be signed by a director whose name is registered at the DGMC. If the requirement is not met, the application could be rejected by the MEMR.

There is no clarity in Reg. 48 as to how and when a mining company must have its directors registered at the DGMC, and the evidence of such registration. Additionally, there is no transitional provision in Reg. 48 that provides opportunities for mining companies who have not yet registered their directors to register their directors.

Importantly, MEMR has never issued any regulation that requires registration of directors (and/or commissioners) of mining companies, nor has it issued any regulation that establishes the procedures and requirements for such registration. Also, the previous regulations (ie, Reg. 18, Reg. 27 and Reg. 34) applied an approval or a recommendation approach, but they did not set up any registration framework whatsoever. Presumably, any registration requirements provided in Reg. 48 will be similar with the approval or recommendations processes provided in the previous regulations.

Consequently, all mining companies under the authority of the MEMR will be affected by Reg. 48 in the same manner as they were affected by Reg. 42 so long as they have not obtained an MEMR approval for the current or existing directors composition.

This raises the question as to what would be the treatment of existing members of the BOD and BOC of a mining company who have assumed their positions prior to Reg. 18 (for COW companies) and Reg. 27 (for IUP companies) and who is still continue to hold their positions. Our view is that these directors/commissioners should technically, be exempted from such registration requirements.

### 2. **Overlaps with the Company Law**

The Company Law provides that the articles of association may provide procedures for resignation, for filling in vacant positions and for representing the company if all of the members of the board of directors are absent or temporarily suspended. Articles of association of limited liability companies generally detail the procedures and authority for the commissioners to represent the company in case all members of the board of directors are absent or suspended or a position is vacant.

Unfortunately, in respect of this matter, Reg. 48 is the same as Reg. 42. It does not provide any room for flexibility to mining companies if any of



the following circumstances occur, especially mining companies that only have a sole director:

- a. vacant position or unavailability of a director
- b. suspension of a director by the board of commissioners
- c. resignation, demise or incapacitation of a director
- d. dispute between the shareholders and a director

In such circumstances, the shareholders of the affected mining companies may not be able to proceed with any share transfer or change of the members of the BOD, and this will have a great impact on the operations or activities of the mining companies.

**3. Change of all the members of the BOD may not be able to be made effective immediately on the date of the shareholders resolutions**

Assuming that a regulation on directors registration does exist, the requirement to have an application signed by a registered director such as in Reg. 48 will likely affect a mining company if it wishes to replace its entire BOD members with new directors.

If not provided otherwise in the articles of association, the effectiveness of an appointment of new directors is generally on the date the resolutions are passed by the shareholders.

Although one of the requirements to submit an application to change the board members is a copy of a shareholders resolution, due to the requirement in Reg. 48, a change of all BOD members can only be made effective once the approval from the MEMR has been obtained such that an existing director (who is supposed to be a registered director) can sign and submit an application to the MEMR for an approval.

Clearly, this may not necessarily be the case if the MEMR acknowledges an existing director who has assumed his/her position prior to Reg. 18 (for COW companies) and Reg. 27 (for IUP companies) and who still continues to hold such position.

**4. Enforcement of pledge of shares**

A share pledge is one of the most common securities provided to lenders/banks in financing transactions, and are commonly used by mining businesses in Indonesia.

Security enforcement is usually the last resort when a default has occurred and the borrower is not able to repay the lender/bank the outstanding loan principal and interest.



In such a circumstance, the lender/bank will need to enforce the security by selling the secured assets to third parties in order to obtain proceeds to repay the outstanding loan principal and interest.

It is often the case that enforcement of security ends up in long disputes and litigation proceedings between the borrower and the lender/bank, and in such an event, it may be difficult for the lender/bank to get the borrower's director to sign any document such as an application for MEMR approval of a share transfer for security enforcement purposes.

As with the previous regulations, Reg. 48, unfortunately, does not provide any exclusion for enforcement of a pledge of shares and this consequently may affect lenders'/banks' appetite for providing financing to mining companies given such risks.

Also, given the wording in Article 14(2) of Reg. 48, it remains unclear whether a power of attorney would be acceptable to the MEMR if an application was submitted by the lender/bank based on a power of attorney signed by the board of directors of the borrower.

The next question that should be considered by the MEMR is whether the MEMR should set up a registration system to register POAs for the purpose of enforcement of pledges of shares as well.

#### **5. Mining companies are mining companies - what's the difference?**

Like Reg. 42, the scope of Reg. 48 is very limited. It only applies to COW holders and IUP holders whose IUP was issued by the MEMR.

Like Reg. 42, there is no reasoning as to why Reg. 48 applies only to certain mining companies, and not to IUPs issued by the regional governments.

#### **6. IUPs that have not been renewed/reissued by the MEMR**

For a change of status from non-PMA to PMA status, Reg. 34 requires the governors to transfer to the MEMR all IUPs whose holders have been converted to PMA, for the MEMR to renew them. In practice, the MEMR renews the IUP by issuing a new IUP.

However, while this is not a new requirement and it was first introduced for regional governments when Reg. 27 was issued, some regional governments may not have fully implemented this requirement, which in turn causes delay for the relevant IUPs to be renewed/re-issued. In practice, many PMA mining companies hold IUPs but these have not been renewed/re-issued by the MEMR.

Reg. 48 only applies to IUPs issued by the MEMR. Arguably, PMA mining companies whose IUPs have not been renewed/re-issued by MEMR may not be caught by the prior approval requirement under Reg. 48. However, it also remains unclear whether such IUPs are recognized



by the MEMR and if not, whether the governors still have authority over such PMA mining companies.

## Conclusion

For the mining sector, Reg. 48 does not provide a significant change from Reg. 42. The same material concerns raised under Reg. 42 as explained in the preceding paragraphs still exist under Reg 48.

In order for Reg. 48 to work for the affected mining companies, the government first needs to set up a regulatory framework for registration of directors and evidence of such registration, and to set out provisions that cover the existing mining companies that have not yet registered their directors (including the treatment for directors/commissioners who have assumed their positions prior to issuance of Reg. 18 and Reg. 27 and still continue to hold their positions).

Also, it is crucial for the market to understand why there is different treatment between mining companies under the authority of the MEMR (which are now subject to stricter requirements) and mining companies under the authority of the governors (which are not affected by Reg. 48 but are affected by Reg. 34).

Hopefully, some of the gaps identified here, such as the need to establish a registration system and provide opportunities for directors who have not been registered to be registered and to address concerns relating to enforcement of pledge of shares, will be quickly addressed through further regulation.