

Client Alert

September 2019

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Indonesia Issues New Guideline on Sanctions for Delay in Smelter Construction and Accelerates the Ban on Nickel Ore Export

The Minister of Energy and Mineral Resources (**MEMR**) recently issued Regulation No. 11 of 2019 (**Regulation 11**), which accelerates the ban on export of nickel ore with content below 1.7% to 31 December 2019. If a mining company has previously obtained an export recommendation for the period beyond 31 December 2019, the recommendation will only be valid until 31 December 2019. Under the previous regulation, mining companies were allowed to export nickel ore with content below 1.7% until 11 January 2022, subject to the progress of the company's smelter construction in Indonesia. Regulation 11 still allows mining companies to export washed bauxite with a minimum Al_2O_3 content of 42% until 11 January 2022, subject to the progress of the company's smelter construction.

At around the same time, the MEMR also issued Decree No. 154 K/30/MEM/2019 (**Decree 154**), which sets out further details of how the Government of Indonesia (**GOI**) will seek to sanction companies that fail to construct, or procure the construction of, smelters in Indonesia within the approved timeline. In addition, Decree 154 also requires the same mining companies to provide an additional surety bond, which can only be withdrawn by the companies after the progress of the smelter construction has reached 75%. The amount of the additional bond is equal to 5% of the export volume being shipped multiplied by the export benchmark price (HPE).

Smelter Construction Obligation

In January 2017, through MEMR Regulation No. 6 of 2017 on Procedure and Requirements for the Granting of Recommendations for Export of Processed and Refined Minerals, as amended by Regulation No. 35 of 2017, the GOI introduced a requirement for a permit to export mineral concentrates and anode slimes for mining companies, and tied this in to the progress of physical construction of processing and refining facilities (smelters) in Indonesia for those companies' products.

In May 2018, the GOI introduced MEMR Regulation No. 25 of 2018 on the Management of Mineral and Coal Mining Activities, as lastly amended by Regulation 11 ("**Regulation 25/2018**"), which set out more detail on the export permit enforcement regime. Under this regulation, if a mining company wants to obtain an export recommendation from the MEMR, it must first submit a



smelter construction plan. The MEMR will supervise the progress of the smelter construction against this plan every six months, or more frequently. The mining company must submit evidence to the MEMR that it has achieved at least 90% of the progress planned for each six-month period. This is to be determined by an independent verifier reviewing the aggregate progress reached in month five of the relevant six-month period.

Regulation 25/2018 stipulates the following consequences if a mining company fails to achieve this rate of progress:

- (a) The MEMR will issue a recommendation to the Ministry of Trade to revoke the company's export approval.
- (b) The company will be subject to administrative penalties, equal to 20% of its cumulative mineral sales revenue offshore.

Regulation 25/2018 does not specify how this 20% penalty on sales revenue would be calculated (e.g., is it 20% of total revenue since the issuance of Regulation 25/2018, since the start of the construction of the smelter, or for the past six months only?)

Under Regulation 25/2018, if a company fails to pay the penalties within one month after the imposition of the sanction, the MEMR or Governor (depending on who issued the company's mining license) may suspend the company's activities for up to 60 days. If the company has still not paid the penalties within this period, its mining permit will be revoked.

Who is affected by Decree 154?

Holders of the following mining permits that export certain metal ores are affected by the new Decree:

- Special Mining Business License for Operation Production of Mineral Metal (IUPK-OP of mineral metal)
- Mining Business License for Operation Production of Mineral Metal (IUP-OP of mineral metal)
- Mining Business License for Operation Production specifically for processing and refining (IUP-OP for processing and refining)

What is in Decree 154?

Decree 154 sets out more detail on how the sanctions will be imposed for delays in construction of smelters. It also clarifies that the amount of the penalties payable by the relevant mining company will be 20% of the company's cumulative export mineral sales revenue during the last six months.

Under Decree 154, if a company fails to meet the 90% milestone, the MEMR (through the Director General of Mineral and Coal) will issue a recommendation for suspension of export approval to the director general in charge of foreign trade affairs.



The company must pay the penalties within one month through a bank, and submit evidence of payment to the MEMR within three days after the payment is made. If the company fails to pay the penalties by the one-month deadline, the MEMR will issue a recommendation to revoke the company's export approval.

Decree 154 further stipulates that the payment of penalties alone is not enough to allow the company to resume its exports. The MEMR will only issue a recommendation to revoke the export suspension once there is a report from an independent verifier confirming that the company has met the 90% milestone within the past six months. In other words, mining companies are also required to "make up" the delay in construction if they want to resume exports. Decree 154 is not very clear on how to calculate this. But it appears that the intention is the company must provide another independent verifier report confirming that the company has met the 90% milestone by the end of the six-month period. So if the company misses this deadline, there is a possibility that it will not be able to resume its export until the end of the *next* six-month period.

Under Regulation 25/2018, if there is an event of force majeure that directly causes any delay in achieving 90% of the targeted milestone, the MEMR can issue a written approval confirming that an event of force majeure has occurred, and this approval will become the basis for evaluating the company's request for an export recommendation. Note that events of force majeure under the Mining Law are limited to wars, civil commotion, rebellions, epidemics, earthquakes, floods, fire, and other acts of God beyond the control of human beings.

Additional surety bond

In 2016, the MEMR issued Regulation No. 5 of 2016 on Procedures and Requirements for the Issuance of a Mineral Export Recommendation. This regulation has been replaced by Regulation 25/2018. One of the requirements introduced in 2016 was that mining companies that seek to obtain an export recommendation must deposit a surety bond in an escrow account held in a state-owned bank.



The amount of the surety bond required under the 2016 regulation was equivalent to 5% of the new investment value for the smelter construction, or 5% of the remaining investment value not yet realized (if the construction of the smelter has already started). Regulation 25/2018 also stipulated that the mining company can withdraw this surety bond once 35% of the total construction of the smelter is achieved. If the mining company fails to achieve this target within three months after 12 January 2022, the surety bond will be forfeited to the state.

Decree 154 now introduces an additional surety bond for companies that fail to meet the 90% progress target during a six-month period. These mining companies will need to provide a surety bond, the amount of which is equal to 5% of the export volume being shipped multiplied by the export benchmark price (HPE). It is not very clear which shipping volume will be used by the Government to calculate this additional surety bond, e.g., would it be the volume of the last shipment before the company's export recommendation is suspended?

Decree 154 states that the mining company can withdraw the bond once 75% of the total construction of the smelter is achieved, as verified by an independent verifier. But the Government can only draw down the bond if the mining company's mining license is revoked as a result of its failure to pay the administrative penalties discussed above.

Closing

With the issuance of Regulation 11 and Decree 154, the Government is seeking to put more pressure on mining companies to accelerate smelter construction. The Government has signaled its willingness to 'stand strong' on this issue; earlier this year, it revoked the export recommendation of one mining company, and suspended the export recommendation of five others.¹

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¹ <https://industri.kontan.co.id/news/progres-smelter-tak-sesuai-target-esdm-sanksi-enam-perusahaan-mineral>