Indonesia in focus

Indonesian Oil & Gas Sector - Recent Developments and Updates

October 2015

In September 2015, in an attempt to increase the country's oil and gas reserves and boost upstream investments, the Indonesian Government (the "**Government**") announced the commencement of a tender round for eight conventional oil and gas fields (the "**September 2015 Tender**") . Prior to that, the Government had disclosed its plan to offer 13 conventional and eight non-conventional oil and gas fields to the public in 2016.

Despite the turmoil in the global energy markets, the Government is determined to attract investment and has been trying to fix various long standing issues in the country's oil and gas sector. Regulatory uncertainty, land acquisition issues, ageing fields, bureaucracy, and problems with regional governments are just some of the difficulties continuously faced by investors which ultimately contribute to the slowing development of the fields and declining production outputs. Consequently, Indonesia has seen several major oil and gas players reviewing their investment portfolios in Indonesia and some of them even have handed their fields back to Indonesia. The below are some recent steps taken by the Government to improve the business conditions in Indonesia's oil and gas sector.

(i) Streamlining the Tender Process

The September 2015 Tender is the first to see the implementation of an online tender process. The new system is designed to reduce the direct interface between government officials and bidders and ultimately, cutting down bureaucratic red tape. Importantly, it is hoped that the programme will also minimise corruption, speed up the tender process, and increase transparency and fairness.

The electronic system allows interested bidders to register as tender participants, obtain the bid information package, and ask for clarifications online. Nevertheless, submission of the bid and supporting documentation has to be physically done by delivering the documents to the office of the Directorate General. If a participant prefers to obtain the bid information in printed form, this can be requested from the Directorate General. However, should there be any discrepancy between the information presented in the electronic form and the hard copy, the printed version of the bid information will prevail.

(ii) New Profit Sharing Split

In addition to the online tender process, the September 2015 Tender also offers a different profit sharing split from the traditional government-contractor sharing ratio. It is hoped that investors' appetite would go up as their share portion increases. Usually, the government-contractor profit sharing split (after tax) in oil production is 85%:15% and for oil, 65-60%:35-40%. The new profit sharing ratios applicable for this year's tender are set out in the table below.

No.	Work Area	Oil Govt. : Contractor	Gas Govt. : Contractor
1	Southwest Bengara, East Kalimantan (onshore)	70:30	65:35
2	West Berau, West Papua (offshore)	65:35	60:40
3	Rupat Labuhan, Riau/North Sumatera (offshore)	70:30	60:40

4	Nibung, Riau/Jambi (onshore)	70:30	60:40
5	West Asri, Lampung (offshore)	65:35	60:40
6	Oti, East Kalimantan (offshore)	65:35	60:40
7	Manakarra Mamuju, West Sulawesi (offshore)	65:35	60:40
8	Kasuri II, West Papua (onshore)	65:35	60:40

(iii) New Scheme of Joint Cooperation Agreement

The Government is planning to introduce a new feature in the joint cooperation arrangement between the Government and the contractor in the form of a revenue/ gross split or sliding scale mechanism. Currently, most joint cooperation contracts are executed in the form of production sharing contracts or PSCs. It is expected that the new scheme will be ready for use on the upcoming tender of the three non-conventional oil and gas fields this year.

The distinctive feature of current PSCs involves the recovery of operational costs incurred by the contractors. In principle, the Government will reimburse the contractors' expenses after oil or gas is commercially produced, subject to certain exclusions. If no oil or gas is produced commercially from the field, all costs and expenses previously incurred by the contractors will become the contractors' responsibility.

Implementation of the cost recovery process can be strenuous and time-consuming as each expense of the contractor requires the Government's approval. From the Government's perspective, the common complaint is that escalation of the cost recovery amount is not necessarily followed by the increase in the oil or gas production.

The new gross split mechanism is designed to remove the cost recovery aspect of the PSC and is hoped to offer larger output proceeds during the earlier years of production so that contractors can recover their costs. Details of this new arrangement still await a ministerial regulation which is scheduled to be issued shortly. Once published, investors will have the options to decide which contract type works best for them. It is expected that the new oil and gas law will also be passed this year.

(iv) One-Stop Licensing Service

In an effort to simplify and expedite the issuance of oil and gas licenses, the Indonesian Government created a one-stop licensing service located at the Investment Coordinating Board ("**BKPM**"). The Minister of Energy and Mineral Resources ("**MEMR**") has delegated his power to issue various permits and licenses in the oil and gas sector to the BKPM. There are 42 oil and gas recommendations, licenses, and permits in total; 10 of which have been delegated to the BKPM since 1 August 2015 and 20 on 1 September 2015. The remainder of the licenses will be delegated on 1 October 2015. Details of the delegated licenses are set out in the MEMR Regulation No. 23 of 2015 dated 31 July 2015 ("**Regulation 23**"). In addition to the delegation, MEMR has also reduced the number of permits and licenses. Prior to the issuance of the Regulation 23, there were 52 oil and gas licenses issued by MEMR; and currently there is a discussion to further reduce the number to 28.

(v) Extension of Production Sharing Contracts

Generally, upon the expiry of the joint cooperation contract, a contractor is obliged to return the oil/gas field back to the Government, unless the term of the contract is extended. However, contractors are often left in doubt whether or not the term of their contracts will be extended. As a response, MEMR has recently issued MEMR Regulation No. 15 of 2015 dated 8 May 2015. Under this regulation, a contractor may submit a request to MEMR for an extension of the joint cooperation contract at the earliest 10 years and at the latest two years prior to the contract expiry date. MEMR then will issue the decision at the latest one year before the expiry date. Alternatively, MEMR may determine that the field will be managed by the state-owned company Pertamina alone or by Pertamina together with existing the contractor. This change is meant to give greater certainty for contractors.

The oil and gas sector plays a major role in the Indonesian economy. However, underinvestment has arguably hampered progress in Indonesia's oil and gas industries since the late 1990s. Domestic consumption has continued to rise while production has been falling, so in recent years Indonesia has become a net oil importer. Persistent issues on energy security and state revenue have made government officials repeatedly emphasise the need to boost upstream production. Regardless of the challenges in the global and domestic energy markets, the Indonesian Government is actively finding solutions to tackle problems that it sees are hindering investment. Especially in the current volatile energy environment, all this is necessary for investors to feel confident in the long-term prospects of the country's oil and gas sector.

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