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Most Causes of Disputes in Indonesian Mining Sector

Overview

According to the data from the Ministry of Energy and Mineral Resources (hereinafter referred to as **"MoEMR"**), Indonesia has natural resources such as nickel, bauxite, tin, and coal reserves in 2020 amounted to 3,5 billion tonnes, 3,45 billion tonnes, 3,5 billion tonnes, and 558 billion tones, respectively. However, despite its land potential, Indonesia has yet to use it optimally. There are many challenges in implementing Law No.4 of 2009 regarding Mineral and Coal Mining (the Mining Law) and other regulations related to mining activities, particularly in disputes of ownership of shares in companies, overlaps of mining area, sale and purchase of mining commodities, mining service contracts, and investment failures. These problems cause uncertainty in the investment environment of the Indonesian mining industry. However, with its geological potential, Indonesia still has a good opportunity to attract more investment in the mining industry. This Legal Memo aims to outline most disputes in the Indonesian mining sector, which can hopefully be avoided in the future. We discuss below each of the disputes in more detail.

A. Legal Basis

1. Law No. 4 of 2009 regarding Mineral and Coal;
2. Law Number 32 of 2004 regarding Local Government
   Minister of Trade Regulation No. 102 of 2018 regarding Amendment of Minister of Trade Regulation Number 94 of 2018 concerning Provisions on Use of Letters of Credit for Export of Certain Goods;
   Government Regulation No. 77 of 2014 regarding to The Third Amendment to Government Regulation No.23 of 2010 regarding the Implementation of Mineral and Coal Mining Business Activities;
3. Government Regulation No. 1 of 2017, regarding The Fourth amendment to Government Regulation No 23 of 2010 regarding the Implementation of Mineral and Coal Mining Business Activities
4. Law No. 19 of 2004 on Stipulating Government Regulation of Substitute of Law No. 1/2004 on. Amendment of Law No. 41 of 1999 on Forestry.

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B. Ownership of Shares

In the case of sale and purchase of shares, there are following causes of disputes:

a. **Unclear sale and purchase**

Most mining shares sale and purchase agreements follow a basic template of general agreements. Typically, Sellers prefer to sell shares, and Buyers prefer to purchase assets in accordance with the due diligence result that causes trouble for the parties. For instance, unclear provisions in an agreement can lead to breach of contract. This kind of agreement must provide at least information about the identity of the Seller and Buyer, the number of shares being sold and their value, and about which laws govern the agreement. This agreement also includes payment details such as whether a deposit is required, when the full payment is due, and when the closing date of the agreement is.

b. **Insufficiently drafted post-closing adjustment**

Post-closing adjustment provisions focus on the liabilities and assets of the target company, which may fluctuate during business operations. Many post-closing misunderstandings arise simply because the parties to the agreement have different views about the purpose of the purchase price adjustment. For instance, the Seller tend to assume that the basic purpose of the purchase price adjustment is to compensate the Buyer or the Seller for changes in net assets resulting from the business operation between the date of the reference balance sheet that is used in setting the purchase price and the closing date. The Buyer often think the adjustment provision as a means of ensuring that net assets are delivered at the closing date. To avoid this misunderstanding, both Sellers and Buyers, when drafting purchase price adjustment provisions, should be clear and unambiguous on drafting the purchase price.

c. **Wrong representation and warranty by the seller**

Please note that representations and warranties, as well as Buyers's remedies for Seller's misrepresentation, in shares sale and purchase agreement must be freely agreed between the seller and the buyer. The representations and warranties must include:

a) The capacity and authority of Sellers and Buyers;
b) Assets;
c) Material Contracts;
d) Property;
e) Insolvency;
f) Environment;
g) Intellectual property; and
h) Debt.

However, representations and warranties that Buyers can obtain from Sellers are sometimes untrue. To anticipate this issue, the Buyer must ensure that the Contract gives the Buyer the right to seek compensation

if the Seller is later proven to have provided false information regarding their representations and warranties.

C. Overlaps of Mining Area

The most notable policy since the reformation era is the shift from a highly centralised system of administration to a decentralised system. In the decentralised system, a full autonomy is placed at the regency level with limited autonomy power at the provincial level. Under this regulation, the authority of the Central Government has also been reduced. Law Number 32 of 2004 regarding Local Government (Law 32/2004 or UU Pemda) has decentralized mining, energy and mineral resource affairs to the regions. Since the enactment of Law 32/2004, the Central Government has given the authority to local governments to make district expansions in order to equally improve the welfare of the community. However, this provision has provided significant changes resulting in ineffective mining licenses causing proliferation and overlaps of mining areas.

D. Mining Commodity

Contracts regarding the sale and purchase of mining commodities usually provide provisions related to the sale of product volumes, product prices, and commodity quantities. However, there are still issues that need considering, as follows:

a. Difference in quantity

Contracts regarding the sale and purchase of mining commodities require the Seller to provide the Buyer a certain quantity of mining commodities. However, there is a possibility that the Seller delivers a quantity of mining commodities that is not in accordance with the Contract. Not infrequently, the Seller delivers to the Buyer a quantity of mining commodities less than they contract to sell.

b. Difference in quality

Most mining commodities are exported on a free-on-board ("FOB") shipping basis, where the Buyer must make an upfront payment that includes costs and risks of loss of goods before shipping. By all means, the risk of goods is transferred from the Seller to the Buyer when they are loaded on the vessel at the port of departure. At that point, the Buyer is liable if the goods are damaged or destroyed during transportation.

c. Delay

Shippers can do their best to plan the loading/unloading of commodities and have all the necessary paperwork, but there are still other external factors that can affect deadlines and cause demurrage. Demurrage is a fee charged by the ship owner for storage of containers or rail cars that exceeds the free time offered for loading/unloading. The most common

reasons for demurrage are trigged by shipper's actions such as delays in payment and errors in paperworks.

a) Delays in payment
   If the shipper pays only for part of a shipment, the vessel can refuse to release the freight until fully paid. Any delays in payment will lead to cargo detentions at the port, which in turn result in demurrage charges.
b) Errors in paperworks
   The shipper may make a mistake in preparing all the initial documents for clearing customs process. The shipper needs at least four documents: commercial Invoice, Bill of Lading, Packing List, and Arrival Notice. Without these documents, demurrage charges will occur.

d. Payment discrepancy

Under Regulation of the Minister of Trade No. 102 of 2018 regarding Amendment of Regulation of the Minister of Trade Number 94 of 2018 concerning Provisions on the Use of Letters of Credit for Export of Certain Goods (PerMenDag 102/2018), the use of Letter of Credit ("L/C") is mandatory for the export of mineral products payment. With this payment, there is a takeover by the issuing bank to the beneficiary (the Seller) to make a payment within a specific time for the presentation of documents in accordance with the credit terms. Therefore, the risk to the beneficiary of nonpayment by the Buyer is transferred to the issuing bank as long as the exporter presents documents that comply with the credit terms. The following are possible causes of discrepancy:

a) Inconsistent data;
b) Lack of documents;
c) Unnamed carrier or when the document is not signed by the carrier; and
d) Incorrect goods description.

The causes of the above discrepancy need to be avoided because once a discrepancy happens, the issuing bank has the right not to make payments on documents presented by the beneficiary, or in other words, the payment obligations of the issuing bank no longer apply.

E. Mining Service Contract

Mining service contracts have an adverse effect on the Parties (Owners and Contractors). There are a few challenges in mining service contract as follows:

a. Coal loss

Occasionally, force majeure can lead to sudden losses due to flooding and accidents on the mine face or along the transportion infrastructure, but during normal operation, coal loss can happen due to:

a) Coal loss in storage and transit;
b) Blast damage; and

c) Coal loss from conveyors.

b. Change of order

In case the Seller make changes in the scope of work, the cost invariably inceases, and, before work is completed, the project runs out of approved money. This means that the Contractors have to overspend and finish the job only with the money that has been paid. The implications of change of order can cause the Contractor to refuse to do their work since the scope of work has expanded.

c. Delay

Delay in mining service contracts has become a major concern and can lead to disputes amongst the Parties because it impacts mining activities such as loss of productivity. The main causes of delay include:

a) Changes in scope of work;
b) Financial difficulties faced by the Contractor;
c) Bad planning by the Contractor;
d) Delay in purchasing Materials; and
e) Improper storage of materials.

d. Underperformance

Both Parties must be prepared to deal with problems regarding the Contractor's underperformance. Disputes may arise and result in the contract termination by the Owners, with the following conditions:

a) If the Contractor is unable to provide all services required to perform mining operation activities;
b) If the Contractor fails to implement mining regulations;
c) If the Contractor becomes insolvent or bankrupt;
d) If the Contractor cancels or suspends their work without justifiablereasons; and
e) If the Contractor refuses to carry out their work directly.

F. Investment failure

Indonesia is a country blessed with abundant mineral resources, including tin, gold, natural gas, coal, nickel and copper. With the potential of its mining industry, Indonesia aims to increase the attractiveness of the mining industry for potential investors. However, investors still need to do further research and follow up on the latest information about investments and operational requirements. Since the Mining Law was introduced, there have been a number of problems. Most common problems include but are not limited to:

a. Divestment requirements

Previously, under Government Regulation No. 77 of 2014 (GR 77/2014) regarding The Third Amendment to Government Regulation No.23 of 2010 (GR 23/2010) regarding the Implementation of Mineral and Coal Mining Business Activities, Production Mining Licenses (Izin Usaha Pertambangan

Operasi Produksi, "IUP-OP") and Special Production Mining Licenses (Izin Usaha Pertambangan Khusus Operasi Produksi, "IUPK-OP") holders that conduct underground mining can, after the fifth year of production, have a maximum of 70% foreign shareholding. Whereas IUP-OP and IUPK-OP holders that carry out processing and/or refining activities can, after the fifth year of production, have a maximum of 60% foreign shareholding.

However, since the issuance of Government Regulation No. 1 of 2017, the fourth amendment to GR 23/2010, the above provisions are no longer valid, and the divestment must follow the requirements under GR 1/2017 stating that foreign shareholders must, after five years of production, divest their shares in stages: by the tenth year of production, foreign shareholders shall have a maximum of 49% shareholding. This GR causes foreign investors to lose the majority stake in the mines in which they have invested, regardless of whether they are carrying out underground mining or smelting activities.

b. Conflicts between mining regulations and forestry regulations

Under the Mining Law, the Central Government (The Ministry of Energy and Mineral Resources) determines the areas that can be mined and, except in certain exceptional circumstances, regional governments that have the authority to grant mining business licences within these pre-determined areas. However, the Central Government has more control over the determination of the areas open to mining, which has reduced the impact of the historical issue of mining concessions overlapping with each other and with areas that have been reserved for other purposes, such as forestry.

Based on Law No. 19 of 2004 on Establishment of Government Regulation on Substitute of Law No. 1/2004 on Amendments to Law No. 41/1999 on Forestry (Law 9/2004), the use of forest resources is therefore regulated by the Central Government (The Ministry of Environment and Forestry), especially resources of protected forests, which causes mining concession areas overlap with forestry areas (such as protected areas dan production forest). This means that mining activities will be affected by rules that apply to such forests.

As of today, legal uncertainty in the mining industry still continue to challenge and worry investors.

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By combining commercial sensibilities and legal expertise, ADCO Law assists the clients to structure, organize and implement their business ventures and investments, including structuring, financing and securing investments as well as establishing new foreign companies in Indonesia. Should you have more queries regarding this matter, please do not hesitate to contact us.

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