

IMPACT OF CONSTITUTIONAL COURT DISSOLUTION OF UPSTREAM OIL & GAS REGULATOR BPMIGAS

The impact of the dissolution of BPMIGAS on the oil & gas industry is manageable near-term, largely due to an exceptionally fast reaction by the Government providing near-term clarity & reassurance to stakeholders. The mid-term outlook is less clear, pending a new law and the separation of regulatory and commercial functions previously carried out by BPMIGAS.

WHAT'S HAPPENED?

- **Constitutional Court dissolves “unconstitutional” BPMIGAS:** On 13th November, Indonesia’s Constitutional Court annulled articles within Law 22/2001; The Oil & Gas Law, as unconstitutional, ruling that BPMIGAS’ existence as upstream oil & gas commercial counterparty to PSC’s and regulator should be dissolved with immediate effect. The legal action was brought by 42 applicants, primarily public interest and Non-Government Organizations. The Court’s decision is final and not subject to appeal.
- **Upstream Oil & Gas business activities reassigned to Energy Ministry:** In rejecting the ‘executive agency’ concept that gave birth to BPMIGAS, the Court stipulated that BPMIGAS’ rights, powers and functions should be carried out by the Government or a nominated State Owned Enterprise, It has now been determined that the functions previously carried out by BPMIGAS will be assigned to Ministry of Energy & Mineral Resources (termed ‘MEMR’ in English and ‘ESDM’ in Indonesian).
- **President SBY follows with regulation to provide near-term clarity:** On 13th November, with surprising speed, President SBY issued a regulation seeking to provide business continuity and reassurance. Specifically, this regulation with immediate effect: 1) confirmed that all duties, roles and functions of BPMIGAS would move to MEMR; 2) confirmed continuation in full force & effect of existing Production Sharing Contracts (PSC’s) and work & operational activities; 3) BPMIGAS employees and functions would continue under the auspices of MEMR.
- **MEMR issued two regulations on 15 November:** These establish a "Temporary Working Unit" (Satuan Kerja Sementara Pelaksana/"SKSP Migas") under the MEMR to assume BPMIGAS' functions, confirmed all staff below Deputies in their previous roles and named new Deputies and their roles, which were largely unchanged.

KEY TAKE-AWAYS:

- **Short-term clarity - Government serious in mitigating concerns:** The almost unprecedented speed of President SBY’s response to the Court’s decision highlights how seriously the Government takes investor concern on uncertainty. Furthermore, it is the government that has the most to lose (and gain) given hydrocarbons’ contribution to approx. 25% of 2011 total government revenues and up to 7% of GDP.

Indonesia: Oil & Gas Investment Note

- **Capability & existing agreements continue as before – for now:** The Presidential Regulation and MEMR regulations essentially keep BPMIGAS (and its capabilities) intact for now, albeit now under MEMR as a renamed transitional entity: UPK Migas (Upstream Oil and Gas Business Activities Implementation Unit) or SKSP Migas. Existing PSC contracts and previous BPMIGAS decisions have all been confirmed. The aim is to avoid near-term disruption and we believe this should be largely successful.
- **Some potential for operational & organizational delays:** Near-term operational delay potential exists. A key factor will be the ability of MEMR to get the new SKSP Migas working effectively as soon as possible. We expect the Deputy Minister of MEMR (an ex-BPMIGAS Deputy - Operations) to be a key interface. The Head of former BPMIGAS has been removed. However 6 Vice/Deputy Directors and all employees below Deputy level are confirmed in their roles at SKSP which should facilitate a smooth transition. We anticipate SKSP will return to decision making as usual during the course of next week. A further concern is the legality, in light of the Court's decision, for SKSP to mirror BPMigas's role of combining regulatory (the preserve of the State) and commercial (that of SOE) remits. The separation of these roles, not achieved in the transitional arrangements, but required by the Constitutional Court, will be addressed in the revised / new oil and gas law and implementing regulations. This will be a period of investor uncertainty.
- **Expect closer collaboration between ministry and regulator:** An interesting potential side-benefit of this affair could be closer collaboration between SKSP Migas (fulfilling the regulatory role) and Migas (the oil and gas directorate within MEMR) than occurred under BPMigas. This would have potential efficiency benefits for the industry.
- **Hint of resource nationalism:** The motivation of the 42 entities that brought the action to the Court is to redress a perceived imbalance between the State and foreign entities, whereby BPMIGAS did not adequately safeguard Indonesian resources. SBY's speech and regulation seeks to disabuse this, but longer-term the proof will be in the specifics of any new regulation.
- **Uncertainty on mid-term solution and new contracts:** While it is clear that existing PSC's continue to the end of their term there is now uncertainty for new contracts and further uncertainty for a long list of PSC's awaiting extension decisions. This will need to be resolved quickly if investment is to be maintained in these PSC's.
- **Mining industry example would offer little comfort:** One can only hope that the mining industry is not the benchmark to be followed. This sector has seen additional uncertainty for foreign investors and 3 years on from Mining Law changes there is still no system for granting new licenses.
- **Key is new regulatory regime and how fast government can provide long-term solution:** The next step will be changes to the 2001 law and implementing regulations. The President has already indicated that such redrafting is to begin immediately. This process will mean confronting the issues of 1) which body(s) take on the regulatory and commercial roles currently fulfilled by the transitional SKSP Migas; 2) whether these roles remain fused (counter to the Court's ruling) or are separated, with commercial issues administered by a SOE.

The government needs to continue with the speed and clarity it has offered near-term, in order to provide the reassurance, production and economics necessary in the longer-term for continued foreign investment.

IN MORE DETAIL:

- **Presidential Regulation No.95 of 2012, 13th November (English Translation):** <http://www.risco-energy.com/partition/PR-95-2012-14-Nov-12-v2.pdf>
- **President SBY speech, 14th November (English Translation):** <http://www.risco-energy.com/partition/BP-MIGAS-Dissolution-President-RI-Speech-14-Nov-12-v1.pdf>
- **Summary of ESDM Regulations 3135 and 3136** <http://www.risco-energy.com/partition/MEMR-Decrees-3135-and-3136-16-Nov-2012.docx>

ADDITIONAL SOURCES:

- **Baker McKenzie commentary on 13th November: “Turmoil...but no Oil”: Constitutional Court Decision No. 36/PUU-X/2012:** [http://f.datasrvr.com/fr1/612/51590/Finance_Projects_-_Turmoil_but_no_Oil_Constitutional_Court_Decision_No_36_\(November_2012\).pdf](http://f.datasrvr.com/fr1/612/51590/Finance_Projects_-_Turmoil_but_no_Oil_Constitutional_Court_Decision_No_36_(November_2012).pdf)
- **Baker McKenzie commentary on 16th November: “The Turmoil Ended, or the Calm Before the Storm”:** <http://bakerxchange.com/rv/ff000c66e17da8585e7b1768f1409da1fb269a78/p=5851396>
- **Herbert Smith commentary on 13th November Constitutional Court Decision No. 36/PUU-X/2012 and 14th November President SBY speech and regulation.**

RISCO ENERGY is an energy investment company. For more information on Risco Energy please go to www.riscoenergy.com

This report is prepared for general information purposes only. Any third party seeking to rely upon this report should seek separate professional advice in relation to any of the facts or opinions set out herein. Risco Energy Pte Ltd, its affiliates, its and their directors, officers and employees, and the consultants producing this report ("Risco") do not assume and hereby expressly disclaim any liability to any third party in respect of the contents of this report or any opinions or conclusions which might be drawn from it. Any third party using or otherwise relying upon the contents of this report does so entirely at its own risk, and any such reliance shall be construed as a waiver of any claim against any party comprising Risco in respect of the contents of this report.