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NEW IDR REQUIREMENT – IMPLICATIONS FOR ENERGY, MINING AND O&G INDUSTRIES [1][2][3][4][5]

INTRODUCTION

The Indonesian Central Bank has issued a new regulation which requires the use of the Indonesian Rupiah ("**IDR**") for all domestic transactions ("**IDR Requirement**") – Bank Indonesia Regulation No. 17 of 2015 re Obligation to Use Rupiah in the Territory of the Republic of Indonesia ("**BIR 17/2015**").

Although "dressed up" in terms of acknowledging and respecting Indonesian sovereignty, BIR 17/2015 is really all about trying to stem the current IDR volatility by creating greater IDR demand through eliminating the right of parties to choose the currency in which they will carry out their transactions within Indonesia.

BIR 17/2015 has many potential implications for the energy, mining and oil & gas ("**O&G**") industries where the United States Dollar ("**USD**") has long been the preferred medium of exchange and most transactions are denominated in USD rather than in IDR.

In this article, the writer will review the principal provisions of BIR 17/2015 before providing some assessment of the merits or otherwise of the IDR Requirement and then addressing the potential implications of the IDR Requirement for the energy, mining and O&G industries.

BACKGROUND

The IDR is currently trading at about 13,000 IDR to 1 USD and has been depreciating steadily over the last 12 months as a combination of growing concern about the outlook for economic growth in Indonesia and the inevitability of a sooner rather than later rise in interest rates, in the United States, has led to international investors increasingly preferring to hold USD denominated assets rather than IDR denominated assets.

Indonesia is not alone in experiencing the adverse effects of a strengthening USD as this phenomenon has impacted, to a greater or lesser extent, most currencies in South East Asia including those of Malaysia and Thailand as well as Indonesia.

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In Indonesia's case, the decline in the IDR:USD exchange rate has been exacerbated by a dawning realization, on the part of investors (both domestic and foreign), that Indonesia's President may not be willing or able to make the tough policy decisions required to move the country forward in a meaningful economic sense. Perhaps people's expectations of Joko Widodo, as a progressive thinker and committed reformer who would overcome vested interests and the entrenched political elite, were just unrealistically high from the very beginning. Certainly, a series of early policy missteps regarding the handling of the confrontation between the KPK and the police over the direction of the fight against corruption and the apparent domination of the President by the chairwoman of the PDIP, Megawati Sukarnoputri, have resulted in an increasingly negative reassessment, among both Indonesians and foreigners, of what can be expected of the current government in terms of economic performance. Whether fair or not, this negative reassessment has, unquestionably, exacerbated investors' worries about the economic outlook for Indonesia.

The Government has responded with various measures which, unfortunately, are aimed more at addressing the symptoms of the ongoing re-evaluation of the relative attractiveness of IDR and USD denominated assets than they are at addressing the local reasons for that ongoing re-evaluation. One such measure was the January 2015 requirement to have the proceeds of letters of credit, in respect of the export sale of Indonesian minerals, oil & gas and palm oil, collected through Indonesian banks ("**LoC Requirement**"). Readers interested in knowing more about the LoC Requirement are referred to the writer's earlier article "***New Letter of Credit Requirements for Mineral, Coal and Oil & Gas Exports***"*,* Petromindo, Coal Asia Magazine, February – March 2015. The IDR Requirement is just the latest such measure and more of the same can and should be expected.

COMMENTARY

1. Main Features of BIR 17/2015 and the IDR Requirement

1.1 **Objective**: The opening paragraph of the preamble to BIR 17/2015 couches the IDR Requirement in rousing nationalist terms as follows:

"[*The] Rupiah is a legitimate payment instrument in the territory of the Republic of Indonesia and a symbol of sovereignty of the Republic of Indonesia.*"

The far more mundane reality of the IDR Requirement becomes apparent in the immediately following paragraph of the preamble to BIR 17/2015 which reads:

"*Utilization of [the] Rupiah for every transaction in the Republic of Indonesia is required in order to achieve the stability of the Rupiah exchange rate*."

1.2 **Payments and Transactions Subject to IDR Requirement**: Subject to various exemptions, **t**he IDR Requirement applies to all "transactions" carried out in Indonesia (BIR 17/2015 Article 10).

"Transactions", for the purposes of the IDR Requirement, include:

(a) every transaction for the purpose of payment;

(b) settlement of other obligations which must be fulfilled with money; and

(c) other financial transactions (BIR 17/2015 Article 2(2)).

Both cash and non-cash transactions are covered by the IDR Requirement (BIR 17/2015 Article 3(1)).

1.3 **General Exemptions to IDR Requirement**: The currently specified, general exemptions to the IDR Requirement are:

(a) certain transactions within the framework of the implementation of state revenue and the state expenditure budget;

(b) transactions involving the making or receiving of grants from offshore;

(c) **international trade transactions**;

(d) bank deposits/savings in foreign currencies; and

(e) **international financing transactions** ("**IDR General Exemptions**") (BIR 17/2015 Article 4).

The IDR General Exemption, referred to in 1.3(a) above, for "**state revenue and expenditure transactions**", is explained in terms that cover:

(a) foreign debt payments;

(b) domestic debt payments in foreign currency;

(c) goods expenditure from abroad;

(d) capital expenditure from abroad;

(e) state revenues derived from the sale of state bonds in foreign currencies; and

(f) other transactions within the framework of the implementation of state revenue and expenditure budget (BIR 17/2015 Article 6).

The IDR General Exemption, referred to in 1.3(c) above, for "**international trade transactions**" ("**International Trade Exemption**"), is explained in terms that cover:

(a) export and/or import of goods to or from the customs territory of Indonesia; and

(b) services trade beyond state borders carried out by way of

(i) cross border supply; and

(ii) consumption abroad (BIR 17/2015 Article 8(1)).

The International Trade Exemption does **not**, however, extend to "additional" (**i.e.**, ancillary) activities in respect of the export or import of goods from or to Indonesia (BIR 17/2015 Article 8(2)).

The IDR General Exemption, as referred to in 1.3(e) above, for "**international finance transactions**" ("**International Finance Exemption**"), only applies when either the grantor or the recipient of the financing (**i.e.**, the lender or the borrower) is domiciled outside of Indonesia (BIR 17/2015 Article 9(1)).

There is also an exemption to the IDR Requirement in the case of foreign currency transactions carried out in accordance with the provisions of specific laws of Indonesia including:

(a) foreign currency transactions carried out through a bank and governed by those Indonesian laws relating to banking and syariah banking;

(b) foreign currency transactions involving Indonesian government bonds and securities and governed by those Indonesian laws relating to state bonds and state syariah securities; and

(c) other foreign currency transactions carried out "based on the law" (BIR 17/2015 Article 5).

There is a further exemption to the IDR Requirement in the case of the payment or settlement of obligations in foreign currencies, which payment or settlement is governed by a written agreement entered into before 1 July 2015 ("**Existing Contract Exemption**") (BIR 17/2015 Article 21(1)). The Existing Contract Exemption, however, (i) only applies to **non-cash** transactions (BIR 17/2015 Article 21(1)) and (ii) is lost once the relevant pre 1 July 2015 agreement is amended or extended (BIR 17/2015 Article 21(3)).

1.4 **Future Additional Exemptions to IDR Requirement**: Owing, no doubt, to widespread industry "pushback" to the IDR Requirement, Bank Indonesia is currently preparing a circular letter which, apparently, will allow individual companies to apply for case by case exemptions to the IDR Requirement on a "special needs" or "special circumstances" basis. The possibility of Bank Indonesia granting case by case exemptions is specifically contemplated in Article 16 of BIR 17/2015 ("**Case by Case Exemptions**").

1.5 **Specification of IDR Prices**: In order to facilitate compliance with the IDR Requirement, business actors are obliged to specify the prices of goods and services in IDR only ("**Price Specification Requirement**") (BIR 17/2015 Article 11).

1.6 **Prohibition on Rejecting IDR**: There is an express prohibition on parties refusing to accept (**i.e.**, rejecting) IDR as the medium for payment or settlement of obligations which are subject to the IDR Requirement (BIR 17/2015 Article 10(1)).

The prohibition on rejecting IDR, as a medium for the payment or settlement of obligations, does not apply in the case of:

(a) **cash** transactions where there is doubt about IDR authenticity; and

(b) **non-cash** transactions (i) which are otherwise exempt from the IDR Requirement **or relate to strategic infrastructure projects approved by Bank Indonesia** ("**Strategic Infrastructure Exemption**") and (ii) where the payment or settlement of obligations in a foreign currency is provided for in a written agreement (BIR 17/2015 Articles 10(2) and 10(3)(b)).

1.7 **Consequences of Non Compliance with IDR Requirement**: Violation of the IDR Requirement, in the case of **cash** transactions, is a criminal offence punishable in accordance with Article 3.3 of Law No. 7 of 2011 re Currency (BIR 17/2015 Article 17).

Violation of the IDR Requirement, in the case of **non-cash** transactions, is apparently not a criminal offence but, rather, is an administrative violation only and subject to administrative sanctions in the form of (i) written warnings, (ii) fines up to a maximum of 1% of the value of the offending transaction and (iii) exclusion from "participation in the payment transactions flow" (BIR 17/2015 Article18).

1.8 **Administration of IDR Requirement**: Bank Indonesia is responsible for monitoring, supervising and otherwise ensuring compliance with the IDR Requirement (BIR 17/2015 Article 13(1)).

In carrying out its monitoring and supervision role, Bank Indonesia has the authority to:

(a) request reports, information and data from parties subject to the IDR Requirement;

(b) carry out direct supervision of individual parties;

(c) appoint other parties to carry out research and otherwise assist with compliance monitoring and supervision (BIR 17/2015 Articles 12(1) and 13(2)).

There is an express obligation imposed on parties, which are subject to the IDR Requirement, to submit the reports, data and other information requested by Bank Indonesia (BIR 17/2015 Article 12(2)).

2. Assessment and Evaluation of IDR Requirement

2.1 **General**: It is, of course, entirely understandable that the Government is concerned about the current volatility of the IDR and is looking for ways to reduce that volatility. Nevertheless, the IDR Requirement, as the Government's preferred approach to controlling IDR volatility, is open to serious criticism on several grounds.

First, the Government has simply transferred to the private sector all the risk of IDR volatility and, at the same time, denied the private sector the most obvious strategy for dealing with IDR volatility; namely, using a currency other than the IDR for domestic transactions. Given the high cost and relative difficulty of hedging effectively against IDR volatility, the IDR Requirement is, unquestionably, going to make doing business in Indonesia more problematic and less attractive for many foreign companies and their Indonesian subsidiaries, the performance of which Indonesian subsidiaries and their managements is, invariably, measured in USD equivalent revenue generated and **not** in IDR revenue generated.

Second, the Government is, once again, interfering with the freedom of private sector parties to structure commercial transactions in the way that makes the most sense for them having regard to the particular constraints they are operating under. As such and like the LoC Requirement, the IDR Requirement may be seen as a continuation of the Government's preference for a command and control style economy where the role of the private sector is, increasingly, just to carry out the policies laid down by the Government.

Third, to the extent that the current IDR volatility is, at least in part, due to growing market disenchantment with the economic policies of the Government, the IDR Requirement does nothing to address the deficiencies of those economic policies. Rather, the IDR Requirement is simply a way to avoid the need to address problems with the economic policies being pursued by the Government.

2.2 **Uncertainty and Limitations of International Trade Exemption**: It is, apparently, intended that the International Trade Exemption covers **all** exports from Indonesia including exports of natural resource products. However, it should be pointed out that the wording of the International Trade Exemption leaves a lot to be desired in terms of clarity. More particularly, the International Trade Exemption refers to the export or import of "goods". "Goods" could be restrictively interpreted as a reference to manufactured items, an interpretation which would, arguably, not include unprocessed, semi-processed or semi-refined natural resource products. Bank Indonesia is, however, currently giving "goods" an expansive and all inclusive interpretation.

The International Trade Exemption is also rather more limited in its scope than might otherwise be thought to be the case. This is because of the exclusion of additional or ancillary activities, in export and import transactions, from the International Trade Exemption. Just what constitutes "additional or ancillary" activities is presently far from clear although it is, likely, intended to include shipping and cargo handling as a minimum.

2.3 **Limitations of Existing Contract Exemption**: On its face, the Existing Contract Exemption seems to be a "blanket" exemption for all contracts entered into prior to 1 July 2015 such that any pre 1 July 2015 contract will be exempt, for the life of the pre 1 July 2015 contract, from compliance with the IDR Requirement. A closer reading of BIR 17/2015, however, reveals that the Existing Contract Exemption is actually much more limited and will be automatically lost in the event of **any** subsequent amendment or variation of a pre 1 July 2015 contract.

2.4 **Misconceived Nature of Strategic Infrastructure Exemption**: Does it really make any sense to give Bank Indonesia the right to determine which infrastructure projects are sufficiently "strategic" to warrant the associated foreign exchange transactions being exempted from the IDR Requirement? The writer questions whether Bank Indonesia has the relevant expertise and experience required to make such a determination on an informed basis. While there may well be good practical grounds for a Strategic Infrastructure Exception, given the importance the Government is currently placing on fast tracking Indonesia's infrastructure development, Bank Indonesia seems an unlikely and, indeed, inappropriate "gatekeeper" for determining the availability or otherwise of the Strategic Infrastructure Exception.

It is also quite unclear what are the applicable criteria for determining whether or not a particular project qualifies as a "strategic" infrastructure project.

2.5 **Inadequacy of Case by Case Exemptions**: The provision for Case by Case Exemptions is obviously intended to introduce some potential flexibility into the application and enforcement of the IDR Requirement. Although flexibility is generally a good thing, BIR 17/2015 does not provide any guidance as to in what circumstances the Case by Case Exemption will be granted or the process of applying for a Case by Case exemption. The writer is left with the uncomfortable impression that the availability of Case by Case Exemptions is really just intended to provide an "escape hatch" if it becomes apparent the IDR Requirement is impractical and unworkable in various situations. As such, the availability of Case by Case Exemptions can be seen as providing an excuse for not carrying out a more detailed and thoughtful review, including industry consultation, of the likely implications of the IDR Requirement **before** the issuance of BIR 17/2015. Regrettably, making policy "on the run" and then relying on the availability of case by case exemptions to deal with situations that should have been carefully considered before issuing the policy in the first place, seems to have become the preferred approach in Indonesia as evidenced by the LoC Requirement which is also meant to provide for case by case exemptions.

3. Implications for Energy, Mining and O&G Industries

3.1 **Domestic Power, Mineral and O&G Sales**: Except in the event of the availability of the Existing Contract Exemption or the Case by Case Exemption, after 1 July 2015 (i) power, coal, minerals and O&G may only be offered for domestic sale in IDR and (ii) all domestic sales of power, coal, minerals and O&G will have to be made and settled in IDR.

The non-availability of the Existing Contract Exemption, in the case of pre 1 July 2015 contracts that are subsequently amended or varied after 1 July 2015, is likely to be particularly

significant in the case of domestic coal and mineral offtake agreements where the price can only be set for a maximum of 12 months and must, thereafter, be reset on each anniversary of the offtake agreement and at the then prevailing benchmark price. The need to reset, on an annual basis, the applicable price for **domestic** coal and mineral offtake agreements (which are not eligible for the International Trade Exemption) will, almost certainly, constitute an amendment or variation such as to result in the loss of the Existing Contract Exemption come the first anniversary of the pre 1 July 2015 offtake agreement.

It is also unclear whether the Existing Contract Exemption will extend to individual domestic sale and purchase transactions in respect of coal, minerals and O&G which are made pursuant to a long term offtake or supply contract executed prior to 1 July 2015. This is because such individual sale and purchase transactions are, usually, separately documented by an exchange of purchase orders and acceptance notifications issued and dated when the individual sale and purchase transactions are made. In these circumstances, is it sufficient, for the purposes of having the benefit of the Existing Contract Exemption, that an underlying long term offtake or supply contract was executed prior to 1 July 2015 even though the purchase order and acceptance notification, for an individual sale and purchase transaction, is dated sometime after 1 July 2015? Until this is clarified, producers and buyers of coal, minerals and O&G, pursuant to long term offtake or supply contracts predating 1 July 2015, should not assume that it is, necessarily, the case that each and every sale and purchase transaction, made pursuant to such long term offtake or supply contracts but entered into on or after 1 July 2015, will have the benefit of the Existing Contract Exemption.

International Mineral and O&G Sales: Export sales of coal, minerals and O&G (whether, unprocessed, processed only, semi-refined or fully refined) are not going to be affected by the IDR Requirement after 1 July 2015 because such export sales will fall within the International Trade Exemption as currently interpreted by Bank Indonesia. However, additional or ancillary activities, in the case of exports of coal, minerals and O&G, will not be covered by the International Trade Exemption, This probably means that content & quality surveys, insurance, transportation, stockpiling, barging, shipping and cargo handling, for coal, mineral and O&G export sales, will have to be quoted and paid for in IDR.

3.2 **Domestic Generating, Mining and O&G Equipment Sales**: Except in the event of the availability of the Existing Contract Exemption, the Case by Case Exemption or the Strategic Infrastructure Exemption, after 1 July 2015 (i) equipment for the generation of power, equipment for the production, processing and refining of coal and minerals and equipment for the production, delivery and storage of O&G may only be offered for domestic sale in IDR and (ii) all domestic sales of equipment for the generation of power, equipment for the production, processing and refining of coal and minerals and equipment for the production, delivery and storage of O&G will have to be made and settled in IDR.

Given the obligation of mining companies to source their equipment needs locally, virtually all mining equipment and spare parts sold in Indonesia is a domestic transaction routed through a local agent or foreign manufacturer's PMA company. As such, it is most unlikely that sellers of mining equipment will be able to take advantage of the International Trade Exemption even though the equipment is manufactured outside of Indonesia.

Likewise, the increasingly onerous local content requirements facing O&G explorers and producers means that the International Trade Exemption is going to be less and less relevant to foreign manufacturers and local buyers of equipment used in the domestic O&G industry.

Most power generation, mining and O&G production projects have a significant infrastructure element to them but are they "strategic" infrastructure projects? This seems unlikely except in the case of the very largest and most high profile power generation, mining and O&G production projects, thereby putting the Strategic Infrastructure Exemption beyond reach in most domestic sales of equipment for the generation of power, equipment for the production, processing and refining of coal and minerals and equipment for the production, delivery and storage of O&G.

3.3 **Domestic Power Generation, Mining and O&G Services Provision**: Except in the event of the availability of the Existing Contract Exemption, the Case by Case Exemption or the Strategic Infrastructure Exemption, after 1 July 2015 (i) all offers of consultancy and contractor services in respect of domestic power generation, mining and O&G exploration and production will have to be priced in IDR and (ii) all invoices for consultancy and contractor services in respect of domestic power generation, mining and O&G exploration and production will have to be settled in IDR.

Given that (i) foreign mining services providers can only operate in Indonesia through a local PMA company and (ii) the substantial exclusion altogether of foreign services providers from participating in upstream oil and gas activities, whether through a local PMA company or otherwise, it is unlikely the International Trade Exemption will be relevant at all in the case of mining services and O&G services.

3.4 **Employment Contracts for Energy, Mining and O&G Professionals**: Except in the event of the availability of the Existing Contract Exemption, all staff, including expatriate staff, employed by Indonesia incorporated PMA companies and non-PMA companies operating in the energy, mining and O&G industries will have to be (i) given contracts with their salaries and benefits stated in IDR and (ii) paid in IDR. Inevitably, this is going to result in energy, mining and O&G industry expatriates, with particular experience and skills in high demand, insisting upon their local IDR denominated employment contracts and salaries being supplemented by offshore adjustment, compensating, equalization and top-up arrangements for the purpose of ensuring that they do not suffer any actual loss in total equivalent USD compensation as a result of declines in the IDR:USD exchange rate. The associated administrative complexity of and tax issues raised by such offshore-onshore total compensation arrangements is to be very much regretted.

SUMMARY AND CONCLUSIONS

BIR 17/2015 is another attempt at a "quick fix" and a "band aid solution" to a problem facing Indonesia.

The IDR Requirement does not, in any way, address the reasons for market dissatisfaction with the Government's economic policies which are, at least in part, a contributing cause of the current IDR volatility. As such, an opportunity has been lost to introduce better economic policies.

BIR 17/2015 leaves the private sector very much exposed to the risks of IDR volatility by interfering with the ability of private sector parties to structure their commercial transactions in the manner they determine to be most appropriate.

Within the overall deficiencies and limitations of the IDR Requirement, the International Trade Exemption, the International Finance Exemption and the Existing Contract Exemption are appropriate and reasonable. Unfortunately, however, there is a lack of clarity as to the ambit of the International Trade Exemption and the Existing Contract Exemption. At the same time, the Strategic Infrastructure Exception and the Case by Case Exemption seem to be somewhat misconceived.

BIR 17/2015 will surely make life more difficult for many participants in the energy, mining and O&G industries as the IDR Requirement runs counter to how transactions in these industries have been structured for a long time and for good reason.

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