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EXPORT BAN TO STAY – STRATEGIES VS OBJECTIVES¹²³⁴⁵

INTRODUCTION

On 7 September, the Minister of Energy & Mineral Resources (“**MoEMR**”) announced that, contrary to widespread rumors, the Government of Indonesia (“**GoI**”) would not be easing the 2014 export ban on unprocessed metal minerals (“**Export Ban**”) as part of GoI’s efforts to stimulate the flagging Indonesian economy (“**7 September Announcement**”).

The 7 September Announcement has, of course, been warmly welcomed by promoters and developers of domestic, metal mineral smelter projects and, in particular, by promoters and developers of nickel smelter projects.

GoI has been keen to create the impression that the merits of the Export Ban will not be revisited in the future and, accordingly, any further speculation about the continuation of the Export Ban is counterproductive.

It may well be the case that, at least with regard to nickel, sufficient progress has now been made, on domestic smelter construction, to justify continuing with the Export Ban on unprocessed nickel ore. This, however, is not so with regard to at least some of the other metal minerals affected by the Export Ban where very little progress has been made, to date, in domestic smelter construction and the realistic timetable for completing the construction of smelters for these other metal minerals grows ever more distant.

GoI’s continuing insistence on full domestic processing and refining for **all** metal minerals (“**DP&R Obligation**”) and its consequent refusal to revisit the Export Ban and the DP&R Obligation **in the case of individual metal minerals** suggest that GoI has lost sight of the fact that the Export Ban and the DP&R Obligation are not actually objectives in and of themselves but, rather, just 2 of the strategies, decided upon by the previous GoI, for realizing the actual objective of Indonesia’s Energy Security Policy which is to ensure that, going forward, Indonesia and Indonesians as a whole derive more benefit from the local mining industry than they, arguably, have in the past. This confusion of strategies with the objective may have painful economic and political consequences for the current GoI.

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⁵ This article appeared in the October-November 2015 issue of Coal Asia Magazine.

In this article, the writer will look at why the Export Ban continues to be such a difficult and challenging issue for GoI at least in the case of those metal minerals, other than nickel, that are not already routinely fully processed and refined in Indonesia. The writer will then consider how more carefully distinguishing between strategies and the underlying objective may help GoI find a more credible way forward.

BACKGROUND

Readers interested in knowing more about the history of DP&R and the Export Ban are referred to the writer's earlier articles (i) *"Is the Export Ban Really Going to be Enforced in January 2014 After All?"*, December 2013 – January 2014 issue of Coal Asia Magazine, (ii) *"The Export Ban as Finally Introduced – A Grand Compromise with Much Residual Uncertainty"*, January – February 2014 issue of Coal Asia Magazine, (iii) *"The Unfinished Business of the Export Ban – Old and New Issues Frustrate the Grand Compromise"*, February - March 2014 issue of Coal Asia Magazine and (iv) *"Export Ban Upheld by Constitutional Court"*, January – February 2015 issue of Coal Asia Magazine.

GoI's decision not to relax the Export Ban, for any metal minerals, was clearly a very "close run thing" given that, only the week before, GoI had indicated, according to Thomson Reuters, it was considering allowing metal mineral producers, with smelter projects that were at least 30 percent complete, to export unprocessed ore for 12 months and as part of a package of policies intended to improve investor sentiment. That same week, Thomson Reuters reported that GoI was looking to push back the 2017 deadline for an end to copper concentrate exports and was considering easing its ban on bauxite exports.

Indonesia's new Coordinating Minister of Maritime Affairs & Resources ("CMoMA&R"), Rizal Ramli, also seemed to be having second thoughts about the wisdom of the Export Ban and the DP&R Obligation when, according to a Thomson Reuters 2 September news release, he said in an interview that only about 10 companies could afford to build smelters on a scale that would be economically viable. As quoted by Thomson Reuters, CMoMA&R remarked:

"The law itself has problems because not everybody can build smelters in Indonesia. The investment is huge....Freeport can afford that. Newmont can afford that... The rest cant."

There was surely a certain, no doubt wholly unintended, irony in the explanation given by Mr. Susantyo, the chairman of the Indonesian Nickel Association, as to why GoI should not relax the Export Ban when, as quoted by Thomson Reuters in a 2 September news release, he said:

"Rumors of easing bans often come up but, if there is a relaxation, it would mean the Government is not consistent."

Inadvertently perhaps, the chairman of the Indonesian Nickel Association has surely "put his finger" on the very issue of greatest concern to promoters and developers of smelter projects in Indonesia; namely, GoI's well established proclivity to not carefully research and think through all the economic, political and social implications of particular policy positions before publicly announcing the same, only to be then forced into an embarrassing "about face" when the previously overlooked economic,

political and social implications become apparent. These all too common GoI policy “flip flops” resulted in a stern rebuke, by the President, of State Ministers in July and were extensively discussed in the writer’s earlier article “*Rethinking the IDR Requirement as it Relates to Energy, Mining and O&G Companies – Just Another Policy “Flip Flop”*” August - September 2015 issue of Coal Asia Magazine.

COMMENTARY

1. Overview

It is, of course, easy to understand why GoI wants/hopes the 7 September Announcement will foreclose any further discussion of a possible relaxation of the Export Ban as such discussion is only likely to discourage or delay investment in domestic smelters.

The problem, however, with the 7 September Announcement and why it may well not achieve its intended purpose is that it is too broad and too unqualified to be really credible in respect of **all** metal minerals and having regard to the current economic and political realities facing GoI. The reality is that no government policy, in Indonesia or elsewhere for that matter, is fixed for ever and otherwise not liable to be revisited and changed to meet the needs of changing economic, political and social conditions. The truth of the continuity of any government policy is, as the market knows only too well, “it depends”!!

The 7 September Announcement would actually have had much more credibility if it had (i) confirmed the Export Ban in respect of nickel only and (ii) acknowledged that, at least in respect of some other metal minerals that are not already fully processed and refined in Indonesia as a matter of course, GoI would be rethinking the Export Ban and, hence, indirectly the DP&R Obligation with regard to those other metal minerals.

At a time when dealing effectively with Indonesia’s mounting economic challenges requires GoI to show considerable flexibility and sophistication in developing and implementing policy, GoI has instead opted to “officially” continue with the “one size fits all” approach to the Export Ban and the DP&R Obligation although this is hardly realistic. In other words, the 7 September Announcement is simply too good to be readily accepted as true in respect of many metal minerals other than nickel. The danger is that, in casting the 7 September Announcement in such broad and unqualified terms, GoI risks undermining market confidence in its long lasting truth even with regard to nickel. A more nuanced and qualified restatement of the Export Ban and, by implication, of the DP&R Obligation would be likely to have much better served the interests of Indonesia and its investors.

2. In the Medium Term, It Depends

2.1 **Relevant Considerations:** While readily acknowledging the unqualified nature of the 7 September Announcement and MoEMR’s undoubtedly good intentions in making the 7 September Announcement, it would seem more realistic to recognize that GoI’s **medium term** commitment to the Export Ban in respect of **all** metal minerals actually depends upon a host of economic, political and social considerations including:

- (a) how serious and protracted is the current downturn in the Indonesian economy;
- (b) the success or otherwise GoI has in finding alternatives to the mining industry as a source of additional revenue to overcome the shortfall in oil & gas revenue and fund its infrastructure development program;
- (c) GoI's private assessment of if and when **large scale** smelter development will be sufficiently advanced to make a **meaningful** contribution to government revenue;
- (d) the extent to which the President becomes concerned about the deterioration in his voter support base as 2019 approaches; and
- (e) the President's ongoing assessment of the employment creation potential of the Export Ban and the DP&R Obligation.

The considerations outlined above highlight the multiple dilemmas the Export Ban and the DP&R Obligation represent for the unfortunate current GoI which has had to live with the mining industry policies, including the Export Ban and the DP&R Obligation, introduced by the previous GoI without adequate planning and research. There is surely both an economic dilemma and a political dilemma for the current GoI, together with the President, as they try to make the best of the Export Ban and the DP&R Obligation.

2.2 **Economic Dilemma:** The DP&R Obligation was introduced as part of the 2009 Minerals & Coal Mining Law ("**2009 Mining Law**") and at a time when Indonesia was in a very strong economic position as a result of the long running mineral commodities boom. The previous GoI surely understood the Export Ban and the DP&R Obligation would entail some initial cost to the Indonesian economy as a whole. However, it clearly failed to understand and internalize the assessment of the World Bank that the Export Ban would actually have 3 very significant economic impacts for Indonesia – 2 negative economic impacts and 1 positive economic impact. The economic impacts are (i) an immediate decline in Indonesia's balance of trade as unprocessed metal mineral exports are halted, (ii) a further decline in Indonesia's balance of trade as equipment and machinery are imported into Indonesia for the purposes of building domestic smelters and (iii) an eventual improvement in Indonesia's balance of trade **if and when only** Indonesia starts to export material quantities of processed and refined metal mineral products.

The previous GoI assumed the costs and identified negative economic impacts would be experienced in the short to medium term only and be entirely bearable given the 5 year time horizon for domestic smelter construction envisaged by the 2009 Mining Law and its implementing regulations as well as the then robust projections for the future performance of the Indonesian economy. Unfortunately for the current GoI, realization of the DP&R Obligation has taken far longer to achieve than was originally envisaged and, at the same time, the ability of the Indonesian economy to easily absorb the associated costs and negative economic impacts has been materially and very adversely impacted by the end of the commodities boom. What was meant to be a 5 year implementation period has, in reality,

become a 7 to 10+ year implementation period at best and then for some metal minerals only. At the same time, the projected, short term negative economic impacts of the Export Ban have morphed into medium to long term negative economic impacts of the Export Ban.

Indonesia is still working its way through the 2 negative economic impacts of the Export Ban identified by the World Bank while the hoped for 1 positive economic impact of the Export Ban remains a tantalizing future prospect only.

- 2.3 **Political Dilemma:** The political dilemma has 2 aspects to it – the risk of alienating part of the President’s voter support base in the run up to the 2019 Presidential Elections (“**PD 1**”) and the risk of alienating the resource nationalists in the Indonesian Parliament (“**DPR**”) and in his own Great Indonesia Coalition (“**GIC**”) whose continuing support the President and GoI need or would at least like in order to ensure their ability to bring about meaningful change, in multiple areas including both mining and areas quite unrelated to mining, is not derailed (“**PD 2**”).

PD 1 turns on the fact that Indonesia’s current President is widely accepted (even by his political adversaries) as being a committed and genuine populist who sees himself as having a special connection with and obligation to promote the economic well being of the “average Indonesian” (i.e., Indonesians with limited education and few technical skills who essentially rely on manual labor to survive). This is something which, arguably, distinguishes the current President from most of his predecessors and is, of course, a very good thing. It is also average Indonesians who overwhelmingly elected the current President in 2014 and, hence, constitute his voter support base.

As a populist, however, the current President is likely to measure the success or otherwise of his presidency in terms of the employment opportunities created for average Indonesians. This is because, for the average Indonesian, the fundamental attribute of economic well being is to be employed in a job that pays a living wage. For the average Indonesian, it is simply irrelevant and meaningless that the Export Ban and the DP&R Obligation will, if successful, eventually result in greater local value added activity and thereby improve Indonesia’s balance of payments unless these policies/strategies also improve the average Indonesian’s long term employment opportunities. To date, the Export Ban has not only **not** resulted in any increase in employment opportunities for average Indonesians but has actually resulted in a significant reduction in employment opportunities for average Indonesians as small and medium sized metal mineral producers (traditionally significant employers of unskilled and semi-skilled manual workers) reduce or cease production altogether as a result of their inability to export unprocessed metal minerals. The increasing unemployment in the local metal minerals mining industry therefore risks alienating the President’s voter support base.

GoI and the President’s PD 1 is compounded by the fact that, while the construction of domestic smelters will certainly generate some short term, job opportunities for average Indonesians, once the smelters are built and become operational, they will be essentially capital intensive, not labor intensive, projects which need skilled engineers and technicians to run the same but employ relatively few unskilled and semi-skilled manual workers. Accordingly, even if the Export Ban is ultimately successful in forcing the implementation of the DP&R Obligation (a dubious prospect at best in the case of many metal minerals other than nickel),

the Export Ban will do little if anything to benefit the President's voter support base by way of the creation of improved, long term, employment opportunities for average Indonesians.

PD 2, on the other hand, arises because the Export Ban and the DP&R Obligation are at the centre of resource nationalism in Indonesia and, as a consequence, a great deal of political capital has been invested by the resource nationalists in promoting the DP&R Obligation, in respect of **all** metal minerals, regardless of its lack of any substantial economic merit in the case of many **individual** metal minerals. If GoI was to dilute the Export Ban, this would surely antagonize the DPR resource nationalists and weaken DPR support for the President generally. Until recently, the President's GIC has been in a minority in the DPR and, therefore, GIC has had to find a way to work with and secure the support of the majority Red & White Coalition in order to achieve its legislative objectives. Although GIC now seems to be on the verge of gaining the upper hand in the DPR, as a result of the recent defection of PAN from the Red & White Coalition and the ongoing disunity within Golkar, it is understandable that, unless and until such time as GIC is able to solidify its position in the DPR, the President would very much like to avoid a major confrontation with the DPR over something as emotionally and politically charged as the Export Ban and the DP&R Obligation. At the same time, there are, undoubtedly, many DPR members who are part of the President's own GIC as well as being strong resource nationalists and, therefore, would be opposed to any overt dismantling of the Export Ban.

Given the existence of PD 2, the President may well feel compelled, in the short run, to put up with PD 1 and accept some temporary or even permanent loss in his voter support base as the price for keeping the DPR/GIC resource nationalists on side. This is because PD 2 is a very real problem now, in terms of the ongoing effectiveness of GoI, whereas PD 1 actually only becomes a very real problem in 2019 when the President has to seek a second term.

- 2.4 **2019 Presidential Elections:** To the extent it becomes apparent that domestic smelter development can only be realized **on a large scale basis**, if at all, **after** 2019, it must be expected that the President will face a growing political problem as the 2019 Presidential Elections draw closer and Indonesia has very little, if anything, to show, in terms of tangible economic benefit, for having endured the medium term, negative economic consequences of the Export Ban. Put simply, even if GoI believes the promised benefits to Indonesia, of the Export Ban and the DP&R Obligation, will be eventually realized after 2019, this is probably not going to be nearly good enough, in a political sense, as the President risks losing much of his voter support base and, therefore, not being reelected in 2019 for another 5 year term. GoI and the President need to be absolutely convinced that the promised benefits to Indonesia, of the Export Ban and the DP&R Obligation will be largely realized **before 2019**. This is looking increasingly unlikely to many observers except in the case of nickel. Accordingly, as 2019 gets closer, PD 1, rather than PD 2, is likely to start dominating the President's thinking and the President will be forced to consider risking the opposition of the DPR/GIC resource nationalists, notwithstanding PD 2, in order to address PD 1 and, thereby, shore up his voter support base in time for the 2019 Presidential Elections.

Having regard to the foregoing, the **medium term** commitment of GoI and the President to the Export Ban in respect of **all** metal minerals may fade as 2019 gets closer unless it is clear the promised benefits to Indonesia, of the Export Ban and the DP&R Obligation, will be largely realized before 2019. In this regard, it is important to understand how the relative importance of PD 1 and PD 2, in influencing GoI and the President's thinking regarding the Export Ban, is likely to change over time. Rizal Ramli's recent highlighting of the practical impossibility of all but a handful of companies being able to build smelters may indicate that the President is already allowing, if not encouraging, CMO&R to position himself to eventually "call time", if necessary, on the Export Ban and the DP&R Obligation, as it relates to **certain metal minerals only**, just as CMO&R has recently sought to do in respect of the 35,000 MW electricity generation capacity project. In this regard, GoI and the President can hardly have been overly encouraged by the assessment of the pace of smelter development delivered by a Macquarie Bank senior consultant at a smelter conference in London earlier this year that, as reported by Thomson Reuters on 29 April:

*"The future is Indonesia...but I think that industry will develop **over the next decade rather than over the next few years.**"*

3. **Why Nickel is Probably a Special Case**

Nickel may well be the 1 metal mineral where the medium term negative economic consequences of the Export Ban can be justified. The economics of DP&R of nickel have always looked considerably more promising than that of other metal minerals not already fully processed and refined in Indonesia as a matter of routine. This is clearly reflected in the much greater progress that has been made, to date, in building domestic nickel smelters compared to, say, domestic bauxite or copper smelters. According to a presentation made by the chairman of the Indonesia Smelter & Mineral Processing Association ("ISPA"), at the recent 3rd Asia Nickel Conference in Jakarta, there are (i) 5 to 9 companies already producing or almost ready to start producing refined nickel in Indonesia and (ii) some 17 other nickel smelting projects which are already at least 30% completed. This compares with only 1 bauxite smelting project which ISPA recognizes as being at least 30% completed. In the case of other metal minerals, not traditionally processed and refined in Indonesia, such as copper, lead, iron ore, zinc, manganese and zircon, the ISPA recognized smelter completion levels trail away to relative insignificance in most cases although it appears, from other sources, that the proposed joint Freeport-Newmont copper smelter project may have reached a notional completion level of greater than 10%.

Assuming ISPA's figures are correct, it may well be that GoI can see sufficient prospect of **substantial** economic benefit being derived by Indonesia before 2019, in terms of DP&R of nickel, to justify the continuation of the Export Ban **in respect of nickel**. On the basis of ISPA's figures, however, it is hard to see any **substantial** economic benefit being derived by Indonesia, before 2019, in terms of DP&R of metal minerals **other than nickel**. Accordingly, while the 7 September Announcement would probably make economic and political sense if it was confined to continuation of the Export Ban in respect of nickel only, it is much harder to see any justification for the 7 September Announcement also continuing the Export Ban in respect of at least some of the other metal minerals apart from nickel and those metal minerals that have been traditional fully processed and refined in Indonesia unless one factors in the interplay of GoI and the President's economic and political dilemmas as explained in 2.2

to 2.4 above.

The only possible residual risk, in terms of the continuation of the Export Ban with regard to nickel, seems to be if (i) the multiple ongoing nickel smelting projects are not substantially completed in 2016-2017, (ii) the multiple ongoing nickel smelting projects are substantially completed in 2016-2017 but cannot commence full operations because of ongoing infrastructure constraints such as inadequate electricity supply or (iii) the multiple ongoing nickel smelting projects are substantially completed in 2016-2017 but the international market price of refined nickel products falls to such a level that it is not economic to produce and export refined nickel products in and from Indonesia at that time.

4. Distinguishing between Strategy and Objective

On the premise that there is now a strong economic case to maintain the Export Ban in respect of nickel but much less of an economic case to maintain the Export Ban in respect of at least some of the other metal minerals which not already routinely processed and refined in Indonesia, the question arises as to how GoI can best reconcile these different positions and thereby, hopefully, resolve its economic and political dilemmas.

The writer would suggest that the answer may be found in distinguishing between “strategy” and “objective”. The discussion of the Export Ban and the DP&R Obligation has become so emotionally and politically charged that most people, including current GoI itself, seem to have largely lost sight of the fact that the Export Ban and the DP&R Obligation are **not** inviolable objectives, “cast in stone”, that Indonesia must absolutely commit itself to and regardless of the associated cost. In fact, the Export Ban and the DP&R Obligation are **not** objectives at all. The objective, as outlined in the last GoI’s 2011 Energy Security Policy, is actually to ensure that, going forward, Indonesia and Indonesians as a whole derive more benefit from the local mining industry than they, arguably, have in the past. The Export Ban and DP&R Obligation are just 2 of the many strategies the last GoI chose to adopt and pursue in trying to realize this overriding objective of the Energy Security Policy. The only thing then that is truly inviolable and that current GoI must absolutely commit itself to, regardless of the associated cost, is ensuring Indonesia and Indonesians as a whole derive more benefit from the local mining industry than they have in the past. As the inheritor only and not the originator of the Export Ban and the DP&R Obligation strategies, current GoI can be absolutely committed to delivering on the true underlying objective of these strategies while still regarding itself as having some considerable freedom to “fine tune” these strategies if it is apparent that they are not, in all respects, delivering on the underlying objective in an effective and efficient manner.

Having regard to the foregoing, current GoI needs to (i) carefully distinguish between “strategy” and “objective”, (ii) reconfirm its absolute commitment to the underlying “objective” of ensuring Indonesia and Indonesians as a whole derive more benefit from the local mining industry than they have in the past, (iii) leave in place what seems to be working with regard to the Export Ban and DP&R Obligation **strategies** (eg, the Export Ban **as it relates to nickel** and the building of **nickel** smelters) and (iv) and then quickly move forward with considering what changes may be appropriate in respect of the Export Ban and the DP&R Obligation **strategies** as they relate to those other metal minerals (apart from nickel) which are not presently processed and refined in Indonesia as a matter of course. This multi-step approach will help to ensure that, in respect of the exploitation of those other metal

minerals, the underlying objective is being better realized than it is at the moment as evidenced by the very slow progress being made in the building of domestic smelters for metal minerals other than nickel.

With regard to metal minerals, **apart from nickel and those other metal minerals that already fully processed and refined in Indonesia**, GoI might legitimately decide that Indonesia and Indonesians as whole would actually derive considerably more benefit, than they are at the moment, from the exploitation of bauxite, copper, iron ore, lead, manganese, zinc and zircon by, in respect of some or all of these metal minerals:

- (a) leaving in place but suspending the immediate operation of the Export Ban and the DP&R Obligation;
- (b) allowing the immediate resumption of unprocessed metal mineral exports or the continuation, beyond 2017, of metal concentrate exports;
- (c) imposing a tax on unprocessed metal mineral exports or continuing to collect, beyond 2017, the existing tax on metal concentrate exports;
- (d) carrying out an annual or bi-annual study of the changing economics of DP&R; and
- (e) if an when (i) the annual or bi-annual study of the changing economics of DP&R shows that 1 or more of these metal minerals can now be economically processed and refined in Indonesia and (ii) credible and firm commitments can be obtained to build and finance the building of domestic smelters, reactivate the previously suspended Export Ban and the DP&R Obligation according to a timetable that reflects the realistic completion date and capacity constraints of these proposed domestic smelters.

SUMMARY AND CONCLUSIONS

The Export Ban and the DP&R Obligation seem to be having the desired outcome for nickel given the large number of domestic nickel smelters already operational or at an advanced stage of construction. It is much less clear, however, that the Export Ban and the DP&R Obligation are having the desired outcome in respect of at least some of the other metal minerals that are not fully processed and refined in Indonesia as a matter of course.

GoI's continuing refusal, to look at the different metal minerals on an individual basis and to recognize the unique economic and technical issues which domestic smelter development gives rise to in respect of each metal mineral, is perplexing unless the conflicting economic and political dilemmas that GoI and the President currently face are explicitly recognized. Even recognizing and being very understanding of the predicament facing GoI and the President, as they try to deal with these conflicting economic and political dilemmas, it must be said GoI risks undermining its credibility given the unconditional nature of the 7 September Announcement that the Export Ban will not be revisited and the necessary implication that this is the case in respect of **all** metal minerals. A much more nuanced and metal mineral specific approach to the continuation of the Export Ban and the

DP&R Obligation would be (i) more consistent with economic and political reality and (ii) therefore, more credible.

GoI, the DPR and the Indonesian public at large have, arguably, temporarily lost sight of the fact that the Export Ban and the DP&R Obligation are **not** objectives in and of themselves but, rather, only strategies for realizing the objective which is actually to ensure that Indonesia and Indonesians as a whole benefit more from the mining industry than they have in the past. Accordingly, in trying to achieve, on a timely basis, the underlying objective in respect of all metal minerals, GoI should regard itself as having some latitude to “fine tune” the Export Ban and the DP&R Obligation strategies as they apply to **certain** metal minerals. Unfortunately, this is not at all evident from the 7 September Announcement.

Focusing everyone’s attention on the critical difference between “objective” and “strategy” would also assist GoI in managing the complex economic and political dilemmas that the present obsession with unconditional enforcement of the Export Ban and the DP&R Obligation is creating for GoI and the President. As the 2019 Presidential Elections draw closer, the importance of resolving these economic and political dilemmas is likely to become ever more critical.

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