

**NEW CONTRACT RESTRICTIONS FOR PMA IUJK COMPANIES – FOREIGN
INVESTMENT DISCONNECT ¹²³⁴⁵**

INTRODUCTION

A 2016 Minister of Public Works & Housing regulation restricts the right of PMA Companies to carry out construction work and construction related consultancy services.

The new contract restrictions have the potential to greatly limit the choices of energy, infrastructure, mining and O&G companies in developing new projects and in carrying out work in respect of existing projects. At a time when mining and O&G companies, in particular, are experiencing very challenging business conditions, any initiative that prevents them from letting contracts, for construction work and construction related consultancy services, to the service provider offering the best combination of technical expertise, practical experience and cost effectiveness is to be very much regretted.

There is clearly a growing disconnect between what Indonesia says is its new found openness to foreign investment and the reality of increasing, preferential treatment for domestic investors in some parts of the Indonesian economy.

The problems created by this foreign investment disconnect, in the case of PMA Companies carrying out construction work and construction related consultancy services, have been exacerbated by the conflicting wording of the more recent 2016 Negative Investment List which imposes different restrictions on these PMA Companies.

In this article, the writer will examine the new contract restrictions and why the same are such a bad idea at this stage of Indonesia's economic development.

BACKGROUND

For regulatory purposes, there are three different categories of construction activities in Indonesia being (i) Construction Planning, (ii) Construction Work Implementation and (iii) Construction Supervision.

Construction Planning includes:

1. Architecture Planning:

¹ Bill Sullivan, Senior Foreign Counsel with Christian Teo & Partners (in association with Stephenson Harwood LLP).

² Bill Sullivan is the author of "*Mining Law & Regulatory Practice in Indonesia – A Primary Reference Source*" (Wiley, New York & Singapore 2013), the first internationally published, comprehensive book on Indonesia's 2009 Mining Law and its implementing regulations.

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⁵ This article first appeared in the June - July 2016 edition of Coal Asia Magazine.

- (a) architectural pre-design and consultancy services;
- (b) architectural design services;
- (c) building maintenance assessment services;
- (d) interior design services; and
- (e) other architecture services.

2. Engineering Planning:

- (a) technical engineering consultancy and advisory services;
- (b) engineering design for building foundations and building construction;
- (c) engineering design for water civil technical work;
- (d) engineering design for transportation civil technical work;
- (e) engineering design for mechanical and electrical work inside buildings;
- (f) engineering design for industrial and production processes;
- (g) construction engineering consultancy and advisory services; and
- (h) other engineering design services.

3. Spatial Planning:

- (a) city planning and design services;
- (b) area planning services;
- (c) landscape and building environmental planning and design services; and
- (d) space utilization development services.

Construction Implementation includes:

1. Building:

- (a) residency construction implementation services;
- (b) warehouse and manufacturing facility construction implementation services; and
- (c) commercial building construction implementation services.

2. Civil Building:

- (a) road construction implementation services;
- (b) bridge, fly-over, tunnel and subway construction implementation services; and
- (c) local oil and gas pipeline construction implementation services.

3. Electrical and Mechanical Installation:

- (a) heater and air conditioning installation construction implementation services;
- (b) elevator and escalator installation construction implementation services;
- (c) mining and manufacturing facility construction implementation services;
- (d) production facility, O&G storage facility construction implementation services; and
- (e) power plant installation construction implementation services.

4. Other Implementation Services:
 - (a) equipment leasing services for building construction and demolition;
 - (b) demolition work;
 - (c) land/location preparation work; and
 - (d) area preparation for mining work.

5. Specialist Implementation Services:
 - (a) other special construction services;
 - (b) landscape/gardening work; and
 - (c) building maintenance work.

6. Skills Implementation Services:
 - (a) painting work;
 - (b) decoration and interior application work; and
 - (c) plastering work.

7. Integrated Construction Services:
 - (a) transportation infrastructure integrated services;
 - (b) water distribution and sanitation work construction integrated services;
 - (c) manufacturing construction integrated services; and
 - (d) O&G facilities construction integrated services.

Construction Supervision includes:

1. Architecture Supervision:
 - (a) contract administration supervision services.

2. Engineering Supervision:
 - (a) building construction work supervision services;
 - (b) transportation civil engineering construction work supervision services;
 - (c) water civil engineering construction work supervision services; and
 - (d) manufacturing facility and process construction work and installation supervision services.

3. Spatial Planning Supervision:
 - (a) spatial planning control and supervision services.

4. Specialist Consultancy:
 - (a) geophysical and geological prospectus preparation services;
 - (b) underground survey services;

- (c) land surface survey services;
- (d) map making services;
- (e) refinement level and composition analysis and testing services; and
- (f) technical inspection services.

5. Other Consultancy:

- (a) environmental consultancy services;
- (b) building and land price estimation consultancy services; and
- (c) building construction related project management services.

The Indonesian regulatory regime also recognizes the activity of Integrated Construction Services which covers all of Construction Planning, Construction Implementation and Construction Supervision.

It should be readily apparent to readers that the scope of Construction Planning, Construction Implementation and Construction Supervision is so broad that, together, they cover substantially all the activities of both mainstream engineering, procurement and construction contractors (“**EPC Contractors**”) and a wide variety of consultants and miscellaneous services providers to the construction industry (“**Consultants**”).

Foreign investors, wanting to be directly involved in carrying out construction activities in Indonesia, essentially have two choices from a legal structure perspective. First, subject to compliance with the applicable foreign ownership limitations in respect of certain industry sectors and certain construction activities, foreign investors may set up a PMA Company to carry out the proposed construction activities. Second, the foreign investors may set up a Construction Representative Office which then enters into an unincorporated joint venture with a local construction company.

The practical limitations, of operating as a Construction Representative Office in Indonesia, often mean that, depending upon the industry sectors and the construction activities of interest to particular foreign investors, the PMA Company alternative is preferable although this is not always the case.

PMA Companies and Construction Representative Offices, directly involved in carrying out construction activities in Indonesia, are required to hold (i) Construction Services Business Licenses (“**IUJKs**”) in the case of PMA Companies and (ii) Construction Office Representative Licenses in the case of Construction Representative Offices.

COMMENTARY

1. OVERVIEW

- 1.1 **MoPWHR 3/2016:** The Minister of Public Works and Housing (“**MoPWH**”) has issued Regulation No. 3 of 2016, dated 4 February 2016, re Technical Guidelines for Issuance of IUJKs to PMA Companies (“**PMA IUJK Companies**”) (“**MoPWHR 3/2016**”).

MoPWHR 3/2016 was issued by way of the implementation of Article 4b of MoPWH Regulation No. 22 of 2014, dated 29 December 2014, re Delegation of Authority for Issuance

of Business Licenses for the Public Works and Housing Sectors in the Framework of One Stop Integrated Services at the Indonesian Investment Coordinating Board (“BKPM”).

MoPWHR 3/2016 sets out the technical guidelines for the issuance, by BKPM, of IUJKs to PMA Companies.

According to MoPWHR 3/2016, PMA IUJK Companies may only carry out construction work which fulfills the **cumulative criteria** of (i) “Advanced Technology”, (ii) “High Risk” **and** (iii) “High Value”.

MoPWHR 3/2016 defines each of the abovementioned criteria as follows:

- (a) **Advanced Technology**: Construction work that, in its implementation, uses special construction implementation methods, highly advanced technological equipment, special construction equipment and involves many experts.
- (b) **High Risk**: Construction work that, in its implementation, endangers the safety of the public, property, human life and/or the environment.
- (c) **High Value**: Construction work with the following minimum values:
 - (i) in the case of Construction Implementation, a value of **not less than Rp100,000,000,000**; and
 - (ii) in the case of Construction Planning or Construction Supervision, a value of **not less than Rp10,000,000,000**.

1.2 **2016 Negative Investment List**: Presidential Regulation No. 44 of 2016 re List of Business Fields that are Closed and Business Fields that are Open with Restrictions in the Field of Capital Investment was issued in May and sets out the latest version of the so-called “Negative Investment List” (“**New NI List**”) (“**PR 44/2016**”).

PR 44/2016 provides for maximum PMA Company foreign ownership of 67% (70% in the case of investors from other ASEAN countries):

- (a) in the case of Construction Implementation (i) with a value of **not less than Rp50,000,000,000**, (ii) that involves “Advanced Technology” **or** (iii) is “High Risk”; and
- (b) in the case of Construction Planning or Construction Supervision (i) with a value of **not less than Rp10,000,000,000**, (ii) that involves “Advanced Technology” **or** (iii) is “High Risk”.

PR 44/2016 does not provide any definitions of or guidance as to what constitutes “Advanced Technology” or “High Risk”.

1.3 **Inconsistency**: MoPWHR 3/2016 and PR 44/2016 are actually concerned with quite different things - the issuance of IUJKs in the case of MoPWHR 3/2016 and the limitations on foreign

ownership in the case of PR 44/2016. Nevertheless, there is a glaring inconsistency between MoPWHR 3/2016 and PR 44/2016 to the extent that PR 44/2016 is to be properly interpreted as meaning that PMA Companies may carry out construction work activities so long as **any one of three** criteria are satisfied; namely, (i) a minimum contract value of Rp50,000,000,000/ Rp10,000,000,000 **or** (ii) Advanced Technology is involved **or** (iii) the work is High Risk whereas MoPWHR 3/2016 requires a PMA IUJK Company to fulfil **all** three criteria of Advanced Technology, High Risk **and** High Value.

There are, of course, actually two inconsistencies between MoPWHR 3/2016 and PR 44/2016; namely (i) the relevant minimum contract value amount (**i.e.**, Rp100,000,000,000 vs Rp50,000,000,000 in the case of Construction Implementation) and (ii) the relevance of Advanced Technology and High Risk (**i.e.**, **cumulative** criteria vs **alternative** criteria in the case of both Construction Implementation and Construction Planning/Construction Supervision).

PR 44/2016 is considerably less onerous than MoPWHR 3/2016 and, therefore, PMA IUJK Companies would, understandably, very much like to only have to comply with PR 44/2016 rather than with MoPWHR 3/2016. At a minimum, only having to comply with PR 44/2016 would enable PMA IUJK Companies to avoid the minimum contract value restriction altogether so long as Advanced Technology is being used or the subject work is High Risk. As neither “Advanced Technology” nor “High Risk” are defined in PR 44/2016, these alternative qualification criteria, arguably, become a matter of subjective, case by case interpretation that are likely to be readily deemed satisfied in many if not most instances where PMA IUJK Companies are credible contenders for the subject construction work.

- 1.4 **BKPM Position:** BKPM is the authority charged with responsibility for both implementing PR 44/2016 and issuing IUJKs to PMA Companies for the purposes of MoPWHR 3/2016. Accordingly, BKPM’s view on the proper application of PR 44/2016 and MoPWHR 3/2016, in the case of PMA IUJK Companies, is of paramount importance for foreign investors.

BKPM is taking the position that the inconsistencies between MoPWHR 3/2016 and PR 44/2016, as highlighted in 1.3 above, are actually dealt with by Article 11 of PR 44/2016 which provides that, notwithstanding the other provisions of PR 44/2016, foreign investors must also comply with any “applicable industry regulations”. According to BKPM, MoPWHR 3/2016 is an “applicable industry regulation” which PMA IUJK Companies must comply with to the extent that MoPWHR 3/2016 imposes more onerous conditions on the use of IUJKs by PMA Companies than does PR 44/2016. In other words, BKPM’s position is that, notwithstanding the clear wording of PR 44/2016 to the contrary:

- (a) PMA IUJK Companies should only carry out construction work with a minimum contract value of Rp100,000,000,000 in the case of Construction Implementation or Rp10,000,000,000 in the case of Construction Planning or Construction Supervision; **and**
- (b) which construction work **both** uses Advanced Technology **and** is High Risk in the case of Construction Implementation, Construction Planning or Construction Supervision (together, “**New Contract Restrictions**”).

By implication, BKPM's position is also that the definitions of "Advanced Technology" and "High Risk" in MoPWHR 3/2016 apply.

Regrettably, this already confusing situation regarding the New Contract Restrictions has, undoubtedly, become considerably more confusing due to what the writer understands were somewhat unclear remarks made by a BKPM official speaking, on 2 June, at an event organized by the Japan External Trade Organization to discuss the New NI List. Apparently, the subject BKPM official's remarks were interpreted, by those present, as meaning that, in the event of any inconsistency, PR 44/2016 prevails over MoPWHR 3/2016. This clearly wrong interpretation was, so the writer is told, subsequently reported in the Japanese media. The correct relationship between PR 44/2016 and MoPWHR 3/2016 has, in fact, now been clarified by the writer's staff with BKPM and is as set out above.

2. PRACTICAL CONSIDERATIONS

2.1 **Effective Date:** The New Contract Restrictions are already in effect.

2.2 **Scope:** The New Contract Restrictions are applicable to **all** PMA IUJK Companies, whether EPC Contractors or Consultants.

The New Contract Restrictions are **not** confined just to (i) government projects or (ii) particular industries but, rather, apply to **all** construction projects, in **all** industries in which PMA IUJK Companies wish to participate, whether as EPC Contractors or as Consultants.

2.3 **Grandfather Protection:** There is **no** "grandfather protection" from the New Contract Restrictions in the case of (i) existing PMA IUJK Companies or (ii) until such time as it becomes necessary for individual PMA IUJK Companies to renew their IUJKs.

2.4 **Compliance:** Compliance with the New Contract Restrictions is the responsibility of every PMA IUJK Company and regardless of whether it is an EPC Contractor or a Consultant.

Compliance is **not** the responsibility of construction project companies conducting tenders.

Failure to comply with the New Contract Restrictions may expose PMA IUJK Companies to administrative sanctions in the form of (i) written warnings, (ii) suspension of business activities and, ultimately, (iii) cancellation or revocation of their IUJKs.

PMA IUJK Companies, which do not comply with the New Contract Restrictions, may also (at least in theory) risk losing the protection of the guarantees that Indonesia makes to all foreign investors in respect of no expropriation without just compensation and no restrictions on repatriation of capital and earnings. These guarantees are commonly understood as only applying to foreign investors carrying on their activities, in Indonesia, in accordance with the applicable laws and regulations of Indonesia which include, in the instant case, MoPWHR 3/2016 and PR 44/2016.

3. IMPLICATIONS

As Construction Planning, Construction Implementation and Construction Supervision substantially cover the entirety of the construction industry activities of EPC Providers and Consultants, the New Contract Restrictions effectively preclude PMA IUJK Companies from undertaking (i) small and medium size contracts by value, (ii) contracts that do **not** involve Advanced Technology **and** (iii) contracts that do **not** involve High Risk.

The New Contract Restrictions have serious implications for **both** those (i) PMA IUJK Companies that focus on small and medium size assignments to generate a significant part of their revenues **and** (ii) industrial, infrastructure, manufacturing, mining and O&G companies that rely, directly or indirectly, on PMA IUJK Companies to carry out discrete parts of larger construction projects.

Large construction projects are commonly awarded to a project developer or head contractor which then parcels out discrete parts of the project to multiple subcontractors. Accordingly, large construction projects may be just as much affected, if not more so, than small and medium size construction projects by the New Contract Restrictions. This is all the more likely where the subcontracted work is for highly specialized and technically complex tasks which, while essential for the overall success of the large construction project, are only small or medium size contracts in their own right or not High Risk.

4. ASSESSMENT AND EVALUATION

The presumed reason, for the New Contract Restrictions, is to protect local construction companies, during difficult economic times and a shortage of large construction contracts especially in the mining and O&G sectors, by giving them a monopoly over small and medium size construction contracts as well as a monopoly over construction contracts of any size that do not also involve both Advanced Technology and High Risk. This, however, seems inherently unfair to PMA IUJK Companies which, in many instances, have made large investments in Indonesia and on the basis of a reasonable expectation that they would be able to operate during both good economic times and bad economic times.

At a time when large construction projects are few and far between, especially in the Indonesian mining and O&G industries, PMA IUJK Companies focusing on these industries are likely to be particularly severely affected by the New Contract Restrictions. These PMA IUJK Companies will no longer be able to rely on a steady stream of small and medium size assignments to make up, at least in part, for the absence of large projects and, thereby, carry them through the current difficult period for the local mining and O&G industries.

Given the Government is currently focusing a lot of attention on infrastructure development and increasing O&G production, it seems somewhat inconsistent with these objectives to be taking steps which could effectively prevent high caliber PMA IUJK Companies, with important technical knowhow and specialist skills not otherwise readily available in Indonesia, from participating in construction projects unless the available subcontracts happen to (i) exceed the specified minimum values, (ii) involve Advanced Technology **and** (iii) be High Risk.

To the extent that PMA IUJK Companies are an important repository of the technical knowhow and specialist skills required for complex and large scale construction projects, industrial, infrastructure, manufacturing, mining and O&G companies, undertaking such construction projects, may well find that they or, at least, their head contractors are prevented from awarding (i) small and medium size contracts/subcontracts and (ii) contracts/subcontracts of any size that do not involve both Advanced Technology and High Risk to these specialist PMA IUJK Companies. This, potentially, represents a significant loss of expertise and technical skills for Indonesia.

SUMMARY AND CONCLUSIONS

The New Contract Restrictions are inconsistent with the multiple reform packages recently announced by the Government and which reform packages are said to be intended to ease investment restrictions for foreign companies, as well as local companies, as part of the Government's endeavor to encourage more business activity at a time when the Indonesian economy is not performing as well as it should.

It is hard to escape the overall impression of a fundamental lack of co-ordination among Indonesian government ministries, with each ministry doing "its own thing" and pursuing its own agenda in complete disregard for the pro-foreign investment message the President has been trying to send.

The Ministry of Public Works & Housing is, apparently, more concerned with addressing short term problems facing the local construction industry than with focusing on the "bigger picture" of what is good for the Indonesian economy as a whole, such as realization of the Government's ambitious infrastructure program.

There is clearly a pressing need to better align MoPWHR 3/2016 with the Government's macro objectives by rolling back the New Contract Restrictions altogether or, at a minimum, amending MoPWHR 3/2016 so that it is consistent with PR 44/2016. Inevitably, however, there will be opposition, from the local construction industry, to any rollback of the New Contract Restrictions and, once again, the Government will be faced with the difficulty of trying to decide between short term, domestic, political interests and the medium to long term economic interests of Indonesia as a whole.

The prospects for the Government making the "right" decision in the case of the New Contract Restrictions are not necessarily encouraging given its recent ruling on the BP-INPEX Masela onshore/offshore O&G Project where short term, domestic, political interests were clearly allowed to dominate and "crowd out" the medium to long term economic interests of Indonesia as a whole.

[This article has been contributed by Bill Sullivan, Senior Foreign Counsel with [Christian Teo & Partners](#). [Christian Teo & Partners](#) is a Jakarta based, Indonesian law firm and a leader in Indonesian mining law and regulatory practice. [Christian Teo & Partners](#) operates in association with international law firm [Stephenson Harwood LLP](#) which has nine offices across Asia, Europe and the Middle East: Beijing, Dubai, Hong Kong, London, Paris, Piraeus, Seoul, Shanghai and Singapore. Readers may contact the author at email: bsullivan@cteolaw.com; office: 62 21 5150280; mobile: 62 815 85060978]