CHRISTIAN TEO & PARTNERS
(in association with Stephenson Harwood LLP)

# PYRRHIC VICTORY ONLY FOR FOREIGN CONSTRUCTION COMPANIES[1][2][3][4][5]

## INTRODUCTION

Intensive lobbying efforts, by various foreign chambers of commerce, resulted in the late 2019 revocation of a Ministry of Public Works regulation that was regarded as having the potential to cause serious problems for foreign-owned construction companies.

Unfortunately, however, the Ministry of Public Works subsequently issued a circular letter that, as currently interpreted and applied, seems to mean most of the previously identified problems have actually not gone away at all.

This likely pyrrhic victory only almost certainly means that foreign chambers of commerce will have to renew their lobbying efforts, in 2020, in an endeavor to obtain a satisfactory, long-term solution for foreign-owned construction companies.

The energy, infrastructure and mining industries should be watching very closely what happens next as foreign-owned construction companies have a major supporting role in each of these industries.

In this article, the writer will review the newly issued circular letter and explain why it is of little real assistance to foreign-owned construction companies in resolving the previously identified problems.

## BACKGROUND

In June 2019 the Minister of Public Works & Housing ("**MoPW&H**") issued Regulation No. 9 of 2019 re Licensing Services Guidelines for Foreign Construction Service Business Entities ("**MoPW&HR 9/2019**").

There were at least four major problems with MoPW&HR 9/2019 from the perspective of foreign-owned construction services companies ("**BUJKA PMAs**").

First, MoPW&HR 9/2019 obliged all BUJKA PMAs to comply with the current foreign ownership limitation for construction companies, being 67% where the shareholders are from non-ASEAN countries and 70% where the shareholders are from ASEAN countries ("**67%/70% Foreign Ownership Limitation**"), even though some BUJKA PMAs were established long before the 67%/70% Foreign Ownership Limitation was introduced in 2016

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[5] An earlier version of this article appeared in the January – February 2020 edition of Coal Asia Magazine.

("**Foreign Ownership Problem**").

Second, MoPW&HR 9/2019 obliged each BUJKA PMA to have a national construction company ("**BUJKN**") as its domestic shareholder ("**BUJKN Shareholder Requirement**"), thereby effectively meaning that Indonesian individuals could no longer be shareholders of BUJKA PMAs for the purpose of satisfying the 67%/70% Foreign Ownership Limitation ("**Shareholder Composition Problem**").

Third, MoPW&HR 9/2019 required BUJKA PMAs to obtain Business Entity Certificates ("**SBUs**") before their previously issued Construction Services Business Licenses ("**IUJKs**") became effective and they could actually start carrying out their approved construction business activities. Obtaining an SBU requires the relevant BUJKA PMA to join/become registered with a Construction Development Association recognized by the Construction Services Development Board ("**LPJK**") ("**Recognized CDA**") ("**Recognized CDA Membership Requirement**").

The Recognized CDA Membership Requirement has long been a problem for BUJKA PMAs due to the (i) very onerous conditions for Recognized CDA membership/registration, (ii) the overtly nationalistic and anti-foreign investor attitude of at least some Recognized CDAs and (iii) the fact that applications for SBUs are initially reviewed/vetted by Recognized CDAs on behalf of LPJK ("**Recognized CDA Membership Problem**").

Fourth, MoPW&HR 9/2019 made extensive provision for inclusion on a "blacklist" of BUJKA PMAs which committed various breaches of MoPW&HR 9/2019 ("**Blacklisting**"). The relevant breaches included failure to extend/renew IUJKs or SBUs not later than 30 days prior to the expiry of the relevant IUJK or SBU.

BUJKA PMAs included on the "blacklist" were to be prohibited, for 3 years, from carrying out/performing any construction activities/services. This would have effectively put the blacklisted BUJKA PMAs "out of business" altogether ("**Blacklisting Problem**").

Readers interested in knowing more about MoPW&HR 9/2019 are referred to the writer's earlier article on this subject, being "*New Licensing Requirements for Foreign Construction Entities – Ownership Challenges*" which appeared in the November – December 2019 issue of Coal Asia Magazine.

MoPW&HR 9/2019 was revoked in late 2019 by MoPW&H Regulation No. 17 of 2019 re Revocation of MoPW&HR 9/2019 ("**MoPW&HR 17/2019**").

Subsequent to the revocation of MoPW&HR 9/2019, MoPW&H issued Circular Letter No. 22/SE/M/2019 re Licensing Service Guidelines for Foreign Construction Service Business Entities ("**CL 22/2019**").

The licensing requirements for BUJKA PMAs are now to be determined by reference to (i) Law No. 2 of 2017 re Construction Services ("**Construction Law**"), (ii) Presidential Regulation No. 44 of 2016, dated 18 May 2016, re List of Business Fields Closed for Investment and List of Business Fields Open for Investment with Certain Conditions ("**PR 44/2016**"), (iii) LPJK Regulation No. 3 of 2017 re Certification and Registration of Construction Implementing Services ("**LPJKR 3/2017**"), (iv) MoPW&HR 17/2019 and (v) CL 22/2019.

## ANALYSIS AND DISCUSSION

### 1. Preliminary Remarks

Based on the outcome of enquiries recently made by the writer's staff at the Ministry of Public Works & Housing ("**Ministry**"), the revocation of MoPW&HR 9/2019 and the subsequent issuance of CL 22/2019 have **not** overcome **most** of the problems previously identified with MoPW&HR 9/2019.

Although the revocation of MoPW&HR 9/2019 and the subsequent issuance of CL 22/2019 have fallen far short of the expectations and needs of BUJKA PMAs, there is perhaps 1 modestly positive consequence of these developments for BUJKA PMAs that should not be overlooked.

### 2. Continuing Foreign Ownership Problem

CL 22/2019 is much less clear than was MoPW&HR 9/2019 with regard to the need or otherwise for BUJKA PMAs to comply with the 67%/70% Foreign Ownership Limitation.

Paragraph F5(a) of CL 22/2019 may, however, be interpreted as still requiring compliance with the 67%/70% Foreign Ownership Limitation and even in the case of BUJKA PMAs established before the 67%/70% Foreign Ownership Limitation came into effect. This is because Paragraph F5(a) of CL 22/2019 provides that in the case of BUJKA PMAs:

> *"… the amount of **equity** shall be **in accordance with the prevailing laws and regulations**."*

The "*prevailing laws and regulations*" almost certainly include PR 44/2016. PR44/2016 introduced the 2016 Negative Investment List which specifies the 67%/70% Foreign Ownership Limitation applicable to BUJKA PMAs. PR 44/2016 is still in force.

The Ministry has verbally confirmed to the writer's staff that BUJKA PMAs, which obtained IUJKs before the issuance of the 2016 Negative Investment List, are not required to immediately adjust their shareholding composition so as to comply with the 67%/70% Foreign Ownership Limitation. **The Ministry has, however, also verbally confirmed that, in the event of renewal of existing IUJKs or applications for new IUJKs, BUJKA PMAs must, first, strictly comply with the 67%/70% Foreign Ownership Limitation**. This is substantially identical to the position taken by the Ministry following the original issuance of the now revoked MoPW&HR 9/2019.

Having regard to the above, it must be concluded that **the revocation of MoPW&HR 9/2019 and the subsequent issuance of CL 22/2019 have made no difference whatsoever in terms of the existence of and the continuing, troublesome implications of the Foreign Ownership Problem for BUJKA PMAs**.

## 3. **Continuing Shareholder Composition Problem**

CL 22/2019 is also much less clear than was MoPW&HR 9/2019 as to whether or not Indonesian individuals can be shareholders of BUJKA PMAs for the purpose of satisfying the 67%/70% Foreign Ownership Limitation.

Paragraph B1 of CL 22/2019, however, specifically refers to the Construction Law as providing the legal basis for CL 22/2019.

Article 32 of the Construction Law provides that a foreign construction services company or "**BUJKA**" may only carry out construction services in Indonesia by way of establishing a Construction Services Representative Office ("**BUJKA RO**") **or a BUJKA PMA pursuant to**:

> *"**capital cooperation" with a BUJKN**"*

Although the Construction Law does not make clear what constitutes "capital cooperation with a BUJKN" for the purposes of establishing a BUJKA PMA, it is probably the case that the same refers to the establishment of an incorporated joint venture with a BUJKN. The Ministry has verbally confirmed to the writer's staff that this is, indeed, the interpretation currently adopted by the Ministry.

The Ministry's interpretation is supported by Article 30(2) of LPJKR 3/2017 which provides that the criteria for BUJKA PMAs include that **one of the shareholders must be a BUJKN with Large Business Qualification**.

Having regard to the above, it must be concluded that **the revocation of MoPW&HR 9/2019 and the subsequent issuance of CL 22/2019 have made no difference whatsoever in terms of the existence of and the continuing, troublesome implications of the Shareholder Composition Problem for BUJKA PMAs**.

## 4. **Continuing Recognized CDA Membership Problem**

CL 22/2019 does not make clear whether or not BUJKA PMAs still have to belong to a Recognized CDA as a pre-condition to obtaining SBUs.

Paragraph F7 of CL 22/2019, however, provides that an IUJK only becomes effective upon the relevant BUJKA PMA establishing it has fulfilled the commitment to obtain an SBU. Further, LPJKR 3/2017 requires BUJKA PMAs (as well as BUJKNs) to be members of Recognized CDAs in order to apply for SBUs. **Therefore, even though it is not referred to in CL 22/2019 itself, the better view is that Recognized CDA membership/registration is still necessary for BUJKA PMAs to be able to actually carry out construction business activities**. This has been confirmed by the writer's staff with the Ministry.

Having regard to the above, it must be concluded that **the revocation of MoPW&HR 9/2019 and the subsequent issuance of CL 22/2019 have made no difference whatsoever in terms of the existence of and the continuing, troublesome implications of the Recognized CDA Membership Problem for BUJKA PMAs**.

## 5. **Positive Consequence of Revocation of MoPW&HR 9/2019 and Issuance of CL 22/2019**

The most significant positive consequence of the revocation of MoPW&HR 9/2019 and the subsequent issuance of CL 22/2019 is that CL 22/2019 has **not** retained the additional administrative sanction introduced by MoPW&HR 9/2019 in the form of Blacklisting.

While the Construction Law continues to make reference to Blacklisting, as one of the possible sanctions for continuing to carry out construction activities without a valid SBU, the Construction Law does not provide any detail as to how the Blacklisting would work or what are the consequences of the Blacklisting of a BUJKA PMA. Accordingly, Blacklisting only became an effective, operating sanction with the issuance of MoPW&HR 9/2019. Following the revocation of MoPW&HR 9/2019 and given there is no provision for Blacklisting in CL 22/2019, the Blacklisting Problem seems to have gone away if only for the time being.

The fact that failure to extend/renew IUJKs or SBUs, not later than 30 days prior to the expiry of the relevant IUJK or SBU, no longer results in the Blacklisting of a BUJKA PMA means that the consequences of continuing delay in complying with the 67%/70% Foreign Ownership Limitation, the BUJKN Shareholder Requirement and/or the Recognized CDA Membership Requirement are not as serious for those BUJKA PMAs, without current IUJKs or SBUs, as they would otherwise have been.

BUJKA PMAs will, however, still face numerous difficulties once they no longer have current IUJKs or SBUs. First, such BUJKA PMAs are carrying on construction activities illegally and, therefore, will be subject to various already operating sanctions imposed by the Construction Law including (i) written warnings, (ii) administrative fines and (iii) temporary suspension of business activities, something that has many similarities to Blacklisting. Second, BUKJA PMAs carrying on construction activities without an IUJK or an SBU will almost certainly be in breach of the services agreements they have entered into in respect of existing projects and which services agreements typically include warranties and undertakings from the BUJKA PMAs that they have and will maintain all the approvals, licenses and permits required to legally perform the contracted for services – this includes IUJKs and SBUs. Third, BUJKA PMAs without current IUJKs or SBUs are not likely to be awarded new construction projects once their lack of current IUJKs or SBUs becomes apparent to project owners during the tender process. Fourth and most importantly, in the event of death, personal injury or serious property damage being caused by a BUJKA PMA, while carrying out its construction activities without a current IUJK or SBU, the relevant BUJKA PMA **and its management** will face a greatly increased risk of criminal prosecution and civil damages claims. Accordingly, it is questionable whether the removal of any immediate Blacklisting Problem materially improves the position of BUJKA PMAs without current IUJKs or SBUs. In a sense, Blacklisting was always the least of the risks faced by BUJKA PMAs unwilling or unable to comply with the 67%/70% Foreign Ownership Limitation, the BUJKN Shareholder Requirement and/or the Recognized CDA Membership Requirement.

## 6. Assessment of CL 22/2019

6.1 **Likely Reason for Unresolved Problems**: The fact that MoPW&HR 9/2019 has been revoked seems to indicate that the Ministry understood and accepted, at least in part, the legitimacy of the concerns expressed by foreign chambers of commerce regarding MoPW&HR 9/2019. Why then have the Foreign Ownership Problem, the Shareholder Composition Problem and the Recognized CDA Membership Problem **not** been resolved by the revocation of MoPW&HR 9/2019 and the issuance of CL 22/2019? The most likely reason is that the Ministry concluded MoPW&H only had limited authority to resolve the Foreign Ownership Problem, the Shareholder Composition Problem and the Recognized CDA Membership Problem even if the Ministry/MoPW&H otherwise wanted to do so.

As pointed out in 2 and 3 above, CL 22/2019 highlights (i) the existence of other relevant laws and regulations including PR 44/2016 (which introduced the 67%/70% Foreign Ownership Limitation) and (ii) its legal basis is to be found in the Construction Law which, very arguably, gives rise to the BUJKN Shareholder Requirement. Further, as pointed out in 4 above, it is LPJKR 3/2017 that imposes the Recognized CDA Membership Requirement. In other words, the actual source of the Foreign Ownership Problem, the Shareholder Composition Problem and the Recognized CDA Membership Problem was **not** MoPW&HR 9/2019 at all but, rather, PR 44/2016, the Construction Law and LPJKR 3/2017.

The Ministry/MoPW&H is **not** meant to act in a manner contrary to PR 44/2016 and the Construction Law. Likewise, ministerial regulations issued by MoPW&H are **not** meant to be inconsistent with higher ranking instruments such as a law or a presidential regulation. Further, it is the authority of LPJK, rather than the authority of the Ministry/MoPW&H, to specify the pre-conditions for obtaining an SBU. In these circumstances then, it may well be that the Ministry determined the best MoPW&H could do, in order to address the concerns of the foreign chambers of commerce, was to (i) revoke MoPW&HR 9/2019 and (ii) issue CL 22/2019 with its only very limited references to the actual sources of the Foreign Ownership Problem, the Shareholder Composition Problem and the Recognized CDA Membership Problem. At least the relative lack of clarity and lack of precision of wording in CL 22/2019 creates some potential opportunity for creative arguments by BUJKA PMAs and their professional advisers as to why the Ministry should not insist upon strict compliance with the 67%/70% Foreign Ownership Limitation, the BUJKN Shareholder Requirement and the Recognized CDA Membership Requirement.

6.2 **Unclear Way Forward**: The Ministry/MoPW&H apparently determined that it was still necessary to ensure the licensing process for BUJKA PMAs (and BUJKA ROs) is consistent with the on-line, single submission system for the establishment and licensing of business entities ("**OSS System**"). Rather, though, than issuing a new or amended regulation, in an endeavor to achieve consistency with the OSS System in the case of the licensing of BUJKA PMAs (and BUJKA ROs), the Ministry/MoPW&H has sought to achieve the required consistency through the issuance of CL 22/2019.

Amending or even revoking CL 22/2019 is within the authority of MoPW&H and, therefore, relatively easy to achieve with the Ministry/MoPW&H's co-operation.

As highlighted in 6.1 above, however, final resolution of the Foreign Ownership Problem, the Shareholder Composition Problem and the Recognized CDA Membership Problem will **not** be achieved by the amendment or revocation of CL 22/2019. Final resolution of the Foreign Ownership Problem, the Shareholder Composition Problem and the Recognized CDA Membership Problem actually requires one or more amendments to PR 44/2016, the Construction Law and LPJKR 3/2017. **This is an exponentially bigger and more time-consuming task. It is also something that is beyond the authority of the Ministry/MoPW&H to deliver by itself/himself**.

In the absence of the necessary amendments to PR 44/2016, the Construction Law and LPJKR 3/2017 becoming a reality any time soon, the fact that Blacklisting is no longer an immediate and material risk for non-compliant BUJKA PMAs is unlikely to make much difference.

Notwithstanding the foregoing, some interim relief from the Foreign Ownership Problem, the Shareholder Composition Problem and the Recognized CDA Membership Problem could still be achieved by MoPW&H ensuring that the Ministry staff do **not** automatically interpret and apply CL 22/2019 in a way that requires those BUJKA PMAs, which need/want to obtain or renew their IUJKs, to first comply with (i) the 67%/70% Foreign Ownership Limitation, (ii) the BUJKN Shareholder Requirement and (iii) the Recognized CDA Membership Requirement. The rationale for this practical approach could be that the issuance of CL 22/2019 is a temporary measure only that is merely intended to ensure interim consistency with the OSS System and pending a more thorough reconsideration of the foreign ownership, shareholding composition and licensing requirements applicable to BUJKA PMAs.

There must be some prospect that a more thorough reconsideration of the foreign ownership, shareholding composition and licensing requirements applicable to BUJKA PMAs will be part of the Government's ongoing endeavors to make Indonesia a more attractive destination for foreign investment. This could be in the context of the Omnibus Bills currently proposed by the Government, the issuance of a so-called "Positive Investment List" to replace the existing 2016 Negative Investment List and/or discrete changes to the Construction Law and and LPJKR 3/2017.

## SUMMARY AND CONCLUSIONS

The revocation of MoPW&HR 9/2019 seemed to be a very positive development for BUJKA PMAs in terms of resolving the Foreign Ownership Problem, the Shareholder Composition Problem, the Recognized CDA Membership Problem and the Blacklisting Problem. Careful analysis, however, of the subsequently issued CL 22/2019, as well as of other relevant laws and regulations, indicates that not much has changed in reality except, possibly, for the removal of the Blacklisting Problem.

It must be acknowledged that the Ministry/MoPW&H lacks the authority to finally resolve the Foreign Ownership Problem, the Shareholder Composition Problem and the Recognized CDA Membership Problem. However, the manner in which CL 22/2019 is presently being interpreted and applied by Ministry staff means that even interim relief from the Foreign

Ownership Problem, the Shareholder Composition Problem and the Recognized CDA Membership Problem is still not possible.

Unless and until such time as there is a fundamental change in the interpretation and application of CL 22/2019 by Ministry staff, BUJKA PMAs will remain materially disadvantaged pending a more thorough reconsideration of the foreign ownership, shareholding composition and licensing requirements applicable to BUJKA PMAs. It remains unclear, however, if and when such a thorough reconsideration will take place.

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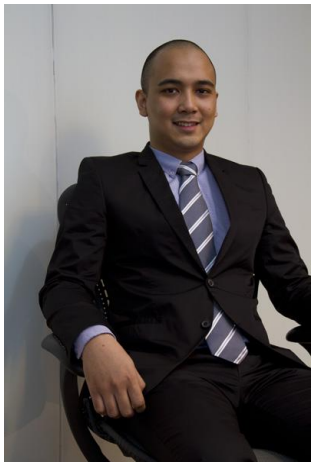

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