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SHIPPING COAL FROM INDONESIA – PENNY FINALLY DROPS[1][2][3][4][5]

INTRODUCTION

For nearly 10 years, the Government has sought to make it compulsory for Indonesia's coal exports to be shipped in Indonesian-owned ships and insured with Indonesian-owned insurance companies.

The Government has now "backtracked" to a very significant degree, with the Indonesian shipping requirement and the Indonesian insurance requirement being ultimately confined to ships with a capacity of 10,000 DWT or less.

It seems tolerably clear that the immediate catalyst for the Government's change of position is the ongoing economic crisis in Indonesia, brought about by the Covid-19 pandemic, and the consequently deteriorating financial situation of many of the country's largest coal producers. In the face of falling demand for and falling prices of Indonesian coal, the Government simply could not risk imposing additional requirements on coal exporters that would only serve to further reduce the competitiveness of Indonesian coal.

The surprising thing, however, is that it took so long for "the penny to finally drop" and required a major economic crisis before the Government would effectively acknowledge, albeit still very reluctantly, that Indonesia's market position is just not strong enough to impose requirements that are seriously inconsistent with the limited available capacity of the local shipping industry as well as with the well-established norms of international trade and with economic reality.

In this article, the writer will review the latest form of the national shipping requirement and the national insurance requirement as well as the factors that ultimately made the recent "backtracking" inevitable.

BACKGROUND

Indonesia is the world's largest exporter of crude palm oil ("**CPO**") and one of the world's largest exporters of coal. Indonesia is also a major importer of rice as well as of other commodities and products.

The Government has long sought to "leverage" the country's undeniable importance as an exporter and importer of certain commodities and products in order to promote other domestic

[1] Bill Sullivan, Senior Foreign Counsel with Christian Teo & Partners and Senior Adviser to 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.

[5] An earlier version of this article appeared in the September - October 2020 edition of Coal Asia Magazine.

industries. This nationalist agenda has, however, often been unfortunately pursued with substantial disregard for (i) practical considerations, (ii) international trade norms and (iii) economics.

The requirement that Indonesian coal producers export their production using Indonesian-owned ships ("**National Shipping Requirement**") and with cargo insurance provided by Indonesian insurance companies ("**National Insurance Requirement**") has a convoluted, long and unfortunate history.

The National Shipping Requirement and the National Insurance Requirement were first introduced, for coal only, by Minister of Energy & Mineral Resources ("**MoEMR**") Regulation No. 17 of 2010 re Procedures for Minerals & Coal Benchmark Price Determination ("**MoEMRR 17/2010**"). As introduced by MoEMRR 17/2010, the National Shipping Requirement and the National Insurance Requirement were never actually enforced in respect of coal.

MoEMRR 17/2010 was, later, partially revoked by MoEMRR 7 of 2017 re Procedures for Metal Minerals & Coal Benchmark Price Determination ("**MoEMRR 7/2017**") but only with regard to those provisions of MoEMRR 17/2010 dealing with coal benchmark price determination. MoEMRR 7/2017 did not specifically relieve Indonesia's coal producers of the obligation to comply with the National Shipping Requirement and the National Insurance Requirement.

The National Shipping Requirement and the National Insurance Requirement were subsequently restated and greatly extended by Minister of Trade ("**MoT**") Regulation No. 82 of 2017 re Provisions for the Utilization of National Maritime Transportation for Export and Import of Certain Goods ("**MoTR 82/2017**"). Pursuant to MoTR 82/2017, the scope of the National Shipping Requirement and the National Insurance Requirement came to also include (i) exports of CPO as well as of coal and (ii) import of rice and "government procurement goods".

<u>**As envisaged by MoTR 82/2017**</u>, the National Shipping Requirement and the National Insurance Requirement applied to (i) <u>**all**</u> exports of coal and CPO and (ii) <u>**all**</u> imports of rice and government procurement goods, in each case without regard to either the volume of any particular export/import quantity or the size of the ship carrying the relevant exported/imported commodity/good.

Between 2017 and 2019 there were numerous and, invariably, last-minute extensions of the deadline for compliance with the National Shipping Requirement and the National Insurance Requirement.

The National Insurance Requirement finally came into operation on 1 February 2019 while the start date for the National Shipping Requirement was postponed until 1 May 2020.

In April 2020 and <u>**less than one month before**</u> the National Shipping Requirement was due to come into force, MoTR 82/2017 was revoked by MoT Regulation No. 40 of 2020 re Provisions for the Utilization of National Maritime Transportation for Export and Import of Certain Goods ("**MoTR 40/2020**"). MoTR 40/2020 greatly reduced the scope of <u>**both**</u> the National Shipping Requirement <u>**and**</u> the National Insurance Requirement by restricting its application to relevant exports and imports transported in ships with a capacity of **15,000** deadweight tons ("**DWT**") or less.

In July 2020 and **less than two months after** the National Shipping Requirement had finally come into force, the Ministry of Trade moved to amend MoTR 40/2020 with the issuance of MoT Regulation No. 65 of 2020 re Amendment of MoTR 40/2020 ("**MoTR 65/2020**"). MoTR 65/2020 reduces, **still further**, the scope of **both** the National Shipping Requirement **and** the National Insurance Requirement by restricting its application to relevant exports and imports transported in ships with a capacity of **10,000** DWT or less.

Readers interested in knowing more about the history of the National Shipping Requirement and the National Insurance Requirement are referred to the writer's earlier article "*New Commodity Export & Import Restrictions – Favouring National Shipping & Insurance Companies*", Coal Asia Magazine, January – February 2018, Petromindo.

ANALYSIS AND DISCUSSION

1. Market Confusion

As highlighted in the Background section above, there have been an extraordinary number of "twists and turns" in the history of the National Shipping Requirement and the National Insurance Requirement. It would not be surprising therefore if there is considerable confusion in the market as to just what obligations are imposed by the National Shipping Requirement and the National Insurance Requirement as well as to on which parties these obligations are imposed.

Having regard to the above, it is appropriate to set out with some precision the **current** scope of the National Shipping Requirement and the National Insurance Requirement.

2. Current Scope of National Shipping Requirement

2.1 **Relevant Exports and Imports:** The National Shipping Requirement applies to:

(a) exports of coal and CPO:

(i) from Indonesia; and

(ii) carried in ships with a capacity of 10,000 DWT or less ("**Relevant Exports**"); and

(b) imports of rice and government procurement goods:

(i) into Indonesia; and

(ii) carried in ships with a capacity of 10,000 DWT or less ("**Relevant Imports**") (Articles 3(1) and 3(2) of MoTR 65/2020).

Coal and CPO exported from Indonesia in ships with a capacity of more than 10,000 DWT are **not** Relevant Exports and, therefore, are **not** subject to the National Shipping Requirement. Likewise, rice and government procurement goods imported into Indonesia in ships with a capacity of more than 10,000 DWT are **not** Relevant Imports and, therefore, are **not** subject to the National Shipping Requirement.

2.2 **Use of National Maritime Transportation**: Relevant Exports may only leave Indonesia and Relevant Imports may only enter Indonesia if they are transported in ships that qualify as "National Maritime Transportation", being ships:

(a) owned by National Maritime Transportation Companies; or

(b) leased by National Maritime Transportation Companies under:

(i) bareboat arrangements;

(ii) time charters;

(iii) voyage charters;

(iv) contracts of affreightment; or

(v) other ship lease agreements (Article 1.5 of MoTR 40/2020).

2.2 **National Maritime Transportation Company**: A "National Maritime Transportation Company" is (i) an Indonesia incorporated company, (ii) majority owned by Indonesian nationals and (iii) licensed to carry out maritime transportation activities in the territorial waters of Indonesia and/or from/to foreign seaports (Article 1.7 of MoTR 40/2020).

2.3 **Verification and Reporting**: Exporters of Relevant Exports/importers of Relevant Imports ("**Relevant Exporters/Relevant Importers**") must:

(a) have verification/technical surveys carried out:

(i) of the Relevant Exports/Relevant Imports **in the case of coal and rice only**;

(ii) before loading; and

(iii) by a Surveyor approved by/registered with the Ministry of Trade (Article 14 of MoTR 40/2020);

(b) prepare/submit Export Goods Notifications/Import Goods Notifications, including details of cost and freight, to the Director General of Foreign Trade at the Ministry of Trade ("**Director General**") via Inatrade (Article 10 of MoTR 40/2020); and

(c) submit National Maritime Utilization Reports to the Director General via Inatrade (Article 4(2) of MoTR 40/2020).

National Maritime Transportation Companies, with ships used to carry Relevant Exports/Relevant Imports, must also submit National Maritime Transportation utilization data to the Director General via Inatrade, which data includes (i) the name of the ship used to carry Relevant Exports/Relevant Imports, (ii) number of relevant international maritime organization and (iii) contract/lease/charter period of the ship used to carry Relevant Exports/Relevant Imports (Article 4(4) of MoTR 40/2020).

2.4 **Sanctions**: Relevant Exporters/Relevant Importers, which fail to comply with the National Shipping Requirement, may be the subject of sanctions in the form of:

(a) recommendation for suspension of Business Identification Number; and/or

(b) postponement of future Relevant Exports/Relevant Imports (Article 17 of MoTR 40/2020).

National Maritime Transportation Companies, which fail to comply with their reporting requirements, may also be subject to sanctions in the form of recommendation for suspension of Business Identification Number (Article 18(1) of MoTR 40/2020).

Suspension of a company’s Business Identification Number effectively amounts to suspending the right of the relevant company to carry on its normal business activities.

3. Current Scope of National Insurance Requirement

3.1 **Relevant Exports and Imports**: The National Insurance Requirement applies to Relevant Exports and Relevant Imports (Articles 3(1) and 3(2) of MoTR 65/2020).

Coal and CPO exported from Indonesia in ships with a capacity of more than 10,000 DWT are **not** Relevant Exports and, therefore, are **not** subject to the National Insurance Requirement. Likewise, rice and government procurement goods imported into Indonesia in ships with a capacity of more than 10,000 DWT are **not** Relevant Imports and, therefore, are **not** subject to the National Insurance Requirement.

3.2 **Use of National Insurance Companies**: Relevant Exporters/Relevant Importers must obtain cargo insurance for the Relevant Exports/Relevant Imports from National Insurance Companies (Article 2 of MoTR 40/2020).

3.3 **National Insurance Companies**: A “National Insurance Company” is (i) an Indonesia incorporated company, (ii) majority owned by Indonesian nationals, (iii) licensed by the Financial Services Authority to market marine cargo insurance, (iv) registered with the Ministry of Trade and (v) fulfilling certain minimum paid-up capital and equity requirements (Article 6(1) of MoTR 40/2020).

Obtaining a registration certificate from the Ministry of Trade requires the relevant National Insurance Company to fulfil extensive documentation and other requirements (Article 6(3) of MoTR 40/2020).

3.4 **Reporting**: Relevant Exporters and Relevant Importers must submit National Insurance Utilization Reports to the Director General via Inatrade (Article 15(3) of MoTR 40/2020).

National Insurance Companies, which provide cargo insurance in respect of Relevant Exports/Relevant Imports, must also submit policy data or insurance certificates to the Director General via Inatrade, which data includes (i) number and date of relevant policy/insurance certificate, (ii) insurance premium, (iii) identity of insurer, (iv) identity of insured, (v) identity of ship used to carry insured cargo, (vi) loading port and Relevant Export destination, (vii) destination port and Relevant Import origin and (viii) type of Relevant Export/Relevant Import covered by cargo insurance (Article 15(4) of MoTR 40/2020).

3.5 **Sanctions**: Relevant Exporters/Relevant Importers, which fail to comply with the National Insurance Requirement, may be the subject of sanctions in the form of:

(a) recommendation for suspension of Business Identification Number; and/or

(b) postponement of future Relevant Exports/Relevant Imports (Article 18(2) of MoTR 40/2020).

National Insurance Companies, which fail to comply with their registration or reporting requirements, may also be subject to sanctions in the form of suspension of registration certificate (Article 18(2) of MoTR 40/2020).

4. **Practical Problems for National Shipping Requirement**

It really should have come as little surprise to anyone, including the Government, that the National Shipping Requirement, **as originally envisaged**, was patently unworkable from the very beginning. Requiring (i) **all** exports of coal and CPO and (ii) **all** imports of rice and government procurement goods, to be carried in ships qualifying as National Maritime Transportation and without regard to either the volume of any particular export/import quantity or the size of the ship carrying the relevant exported/imported commodity/good, was always going to be logistically impossible, at least in the case of coal, given Indonesian coal export volumes and the small size of Indonesia's existing maritime fleet.

According to data compiled by the Indonesian Coal Mining Association ("**APBI**") and published in The Jakarta Post on 20 February 2020, Indonesia exports 35 to 38 million tons of coal per month but only has National Maritime Transportation with a combined capacity of 3.5 million DWT. Assuming every ship (qualifying as National Maritime Transportation) made 2 to 3 round trips per month, this would still leave a huge shortfall in available coal export shipping capacity of 20 to 25 million tons per month.

APBI has also pointed out that Indonesia's National Maritime Transportation, in the form of bulk carriers, comprises approximately 109 ships but includes only 18 Panamax bulk carriers with an average capacity of 65,000 DWT. Panamax bulk carriers are the preferred ship type for long distance and large volume coal exports.

Finally, APBI has highlighted that 78 of Indonesia's 109 bulk carriers are more than 15 years old and, as such, are not welcome in important coal export destinations, such as Japan, because they are considered to be too old and, therefore, unsafe.

The most that can "charitably" be said, in respect of the original announcement of the National Shipping Requirement nearly 10 years ago, is that the Government may have expected or, at least, hoped this would spur huge investment in additional National Maritime Transportation by National Marine Transportation Companies eager to take advantage of the market opportunity the Government was seeking to create for them. If this is, indeed, the case then the Government can only have been greatly disappointed by the lack of sufficient new investment in National Maritime Transportation over the ensuing 10 years.

5. **Implications for International Trade**

Even leaving aside the practical problems highlighted in Part 4 above, the National Shipping Requirement and the National Insurance Requirement were always and continue to be of highly questionable value given the negative implications of the same for international trade.

The National Shipping Requirement and the National Insurance Requirement are wholly inconsistent with the long established norms of international trade which traditionally allow the buyer and the seller to decide (i) which of them will be responsible for organizing and paying for the transportation and insurance costs of delivery of the bought/sold commodities/products to the buyer, (ii) what shipping company (domestic or foreign) will be engaged to provide the required transportation services for delivery of the bought/sold commodities/products to the buyer and (iii) what insurance company (domestic or foreign) will be engaged to provide the required insurance services for the bought/sold commodities/products to be delivered to the buyer.

The writer understands that the majority of Indonesian coal has, for a long time, been sold for export on "free on board" or FOB terms pursuant to which the buyer is responsible for organizing and paying for the transportation and insurance costs once the coal is delivered on board the relevant ship. Other commodities/products may, though, be routinely sold on "commission, insurance and freight" or "CIF" terms pursuant to which the seller is responsible for organizing and paying for the associated transportation and insurance costs of delivery.

The National Shipping Requirement and the National Insurance Requirement, however, effectively compel (i) Relevant Exporters to accept CIF terms for Relevant Exports and (ii) Relevant Importers to accept FOB terms for Relevant Imports. This is because foreign buyers of Relevant Exports and foreign sellers of Relevant Imports cannot reasonably be expected to assume responsibility for identifying, negotiating with and paying the likely higher costs of using National Maritime Transportation Companies and National Insurance Companies, as part of compliance with the National Shipping Requirement and the National Insurance Requirement, when similar restrictions do not apply in other countries with (i) equivalent commodities available for export in the case of Relevant Exports and (ii) available buyers in the case of Relevant Imports.

Under weak market conditions (**i.e.**, low demand and excess supply), Indonesia's Relevant Exporters are at a distinct competitive disadvantage as the National Shipping Requirement and the National Insurance Requirement make Indonesia/Indonesian producers of coal and CPO less attractive to foreign buyers as a source of Relevant Exports. Likewise, strong market conditions (**i.e.**, high demand and inadequate supply) mean that Indonesia's Relevant Importers are at a distinct competitive disadvantage as the National Shipping Requirement and the National Insurance Requirement make Indonesia/Indonesian buyers of rice and government procurement goods less attractive to foreign sellers as a destination for Relevant Imports.

It should also go without saying that the National Shipping Requirement and the National Insurance Requirement overtly discriminate against foreign shipping companies and foreign insurance companies in favour of National Maritime Transportation Companies and National Insurance Companies when it comes to transporting and insuring Relevant Exports and Relevant Imports. This overt discrimination is, self-evidently, always going to be a seriously negative factor in promoting the international trade of goods and services between Indonesia and the rest of the world .

6. Economic Crisis forces a Rethink

Coal is Indonesia's most important mineral export and the Government relies heavily on revenue from the coal industry. The percentage contribution that the coal industry makes to Government revenue varies from year to year and is a matter of some debate. However, a April 2019 study by the Institute for Essential Services Reform ("**IESR**") indicates that, in recent years, coal production royalties may, on average, have been as much as 80% of the Government's total non-oil & gas revenue.

IESR also reported, in the same 2019 study, that (i) Indonesia's coal exports increased more than 250% in the 10 year period from 2006 to 2016 and (ii) the Government increasingly relies upon ever greater coal exports to help keep the country's current account deficit within sustainable limits.

Given the importance of coal production royalties and coal exports to the Government, the negative impact of the current economic crisis on coal demand and coal prices has serious implications for the Government.

Covid-19 has reduced economic activity throughout the world and, hence, demand for Indonesian coal along with demand for various other Indonesian commodities. At the same time, restrictions imposed by various traditional export destinations for Indonesian coal, including China, India and The Philippines, on the importation of coal and other commodities have further exacerbated the drop off in demand for Indonesian coal.

According to APBI, (i) Indonesian coal exports dropped to a three year low in May 2020 and (ii) Indonesian coal prices dropped to a four year low in August 2020.

The above harsh economic and market realities are clearly at odds with the fundamental premise on which the National Shipping Requirement and the National Insurance Requirement are based; namely, that Indonesia's market position is so strong, in the case of coal (and other Relevant Exports/Relevant Imports), that Indonesia can interfere with the norms of and impose additional costs on international trade in the Relevant Exports and Relevant Imports without Relevant Exporters and Relevant Importers suffering any material disadvantage.

Covid-19 and the resulting economic crisis for Indonesia (as well as for the rest of the world) have conclusively shown that, at least for the time being, Indonesia's traditional leading market role in the export of coal, CPO and other commodities counts for much less than was previously thought to be the case. More particularly, Indonesia cannot interfere, in a time of serious economic crisis, with the norms of and impose additional costs on international trade in the Relevant Exports and Relevant Imports without Relevant Exporters and Relevant Importers suffering very material financial disadvantage as a consequence.

Having regard to the above, it is hardly surprising that Indonesia was forced to (i) dramatically scale back the scope of the National Shipping Requirement/the National Insurance Requirement in April 2020 being two months into the Covid-19 economic crisis and (ii) further scale back the scope of the National Shipping Requirement/the National Insurance Requirement in July 2020 being five months into the Covid-19 economic crisis.

SUMMARY AND CONCLUSIONS

Limited to the transportation of certain exports and imports in ships with a capacity of 10,000 DWT or less, the National Shipping Requirement and the National Insurance Requirement are now mere "shadows" of what the Government originally envisaged, especially in the case of exports of coal.

The preference for using Panamax bulk carriers (with an average capacity of **65,000 DWT)**, in the case of long distance and large volume coal exports, makes all too apparent that the latest and much reduced scope of the National Shipping Requirement (and the National Insurance Requirement), with its focus on ships of **10,000 DWT or less**, means that the National Shipping Requirement and the National Insurance Requirement are now almost meaningless, at least in the case of coal exports for delivery to distant ports.

The fact that the Government has been forced to "backtrack" so far on the National Shipping Requirement and the National Insurance Requirement shows all too clearly what often happens when nationalism "collides" with economics under weak market conditions.

There is nothing wrong, as such, in the Government seeking to promote opportunities for National Maritime Transportation Companies and National Insurance Companies. The problem arises, however, when the Government seeks to promote opportunities for National Maritime Transportation Companies and National Insurance Companies without regard to (i) practical considerations, (ii) international trade norms and (iii) economics.

Indonesia's first president, Sukarno, was a notable supporter of the Indonesian economist, Muhammad Fadhli, who was supposedly fond of saying:

> "*You should never miss a good economic crisis and the opportunities it presents for reform*"

What Muhammad Fadhli was getting at of course was that, in good economic times, Governments have the financial leeway to introduce very bad policies but, in bad economic times, that financial leeway disappears and Governments are, consequently, forced to re-think those policies as they become unsustainable.

The current Covid-19 driven economic crisis in Indonesia and what it has forced the Government to do in terms of dramatically scaling back the scope of the National Shipping Requirement and the National Insurance Requirement is a very good example of Muhammad Fadhli's supposedly clever saying at work.

It is, needless to say, a positive development for international trade that the National Shipping Requirement and the National Insurance Requirement have, at least for the time being, been substantially "neutered". It must be regretted, however, that it has taken nearly ten years for "the penny to finally drop" and economic reality make itself felt in the case of the National Shipping Requirement and the National Insurance Requirement.

It also remains to be seen whether or not the original versions of the National Shipping Requirement and the National Insurance Requirement are reintroduced once the current Covid-19 driven economic crisis is behind us. The unthinking pursuit of aggressively nationalist agendas is a perennial problem in Indonesia and one that has survived many previous economic crises. The writer can only hope (albeit with not a lot of conviction this hope will actually be realized) that, somehow, this time it will be different.

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This article was written by Bill Sullivan, Senior Foreign Counsel with Christian Teo & Partners and Senior Adviser to Stephenson Harwood LLP. Christian Teo & Partners is a Jakarta based, Indonesian law firm and a leader in Indonesian energy, infrastructure and mining law and regulatory practice. Christian Teo & Partners operates in close association with international law firm Stephenson Harwood LLP which has ten offices across Asia, Europe and the Middle East: Beijing, Dubai, Hong Kong, London, Paris, Piraeus, Seoul, Shanghai, Singapore and Yangon.

Get in touch

Bill Sullivan

T: +62 21 5020 2789
M: +62 815 8506 0978
E: bsullivan@cteolaw.com

Christian Teo

T: +62 21 5020 2789
M: +62 818 124 747
E: cteo@cteolaw.com

Claudius Novabianto

T: +62 21 5020 2789
M: +62 818 0858 9235
E: cnbianto@cteolaw.com