

COAL EXPORTS AND DMO NON-COMPLIANCE – NEW RULES AND FUTURE PROBLEMS¹²³⁴⁵

INTRODUCTION

A new regulation on coal exports and non-compliance with Indonesia’s so-called “domestic market obligation” has resulted in 34 coal producers being temporarily banned from exporting coal.

The new regulation also provides much-needed detail about the sanctions that may be imposed on producers which export coal without having complied with the domestic market obligation.

The long run-up in international coal prices, and the consequent reluctance of Indonesian coal producers to sell their coal domestically, is almost certainly the catalyst for both the new regulation and the temporary ban imposed on 34 coal producers. It remains to be seen, however, if the new regulation will be effective in achieving its intended purpose of ensuring sufficient domestic supplies of coal without also a complete “re-think” of the domestic market obligation.

In this article, the writer will review the new regulation and its implications for coal producers before considering the bigger issue of whether or not the domestic market obligation, at least in its current form, is destined to fail in a time of fast-rising international coal prices.

BACKGROUND

Indonesia requires coal producers to prioritize the supply of coal to the domestic market (“**DM Obligation**”) by imposing (i) annual DM Obligation quotas on certain coal producers (“**DMO Quotas**”) and (ii) a ceiling price on the sale of coal to the state electricity company (“**PLN**”). The DMO Quota for 2021 is 25% while the ceiling price for coal, with certain specifications, sold to PLN is currently US\$70 per tonne (“**PLN Concessional Coal Price**”).

During the last days of 2020, the Minister of Energy & Mineral Resources (“**MoEMR**”) issued Decree No. 255 of 2020 re Fulfillment of Domestic Coal Needs in 2021 (“**MoEMR Decree 255/2020**”). Among other things, MoEMR Decree 255/2020 **appeared** to change the sanctions regime for coal producers which did not comply with the DM Obligation but,

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rather, exported coal that should have been supplied domestically. Prior to the issuance of MoEMR Decree 255/2020, coal producers (which exported coal in breach of the DM Obligation) were sanctioned by having their approved coal production quantities for the following year(s) reduced. MoEMR 255/2020, however, seemed to introduce a new sanctions approach whereby non-compliant coal producers simply had to pay financial compensation for their non-compliance with the DM Obligation and no longer had their approved coal production quantities for the following year(s) reduced.

In early April 2021, MoEMR issued Decree No. 66 of 2021 re Amendment to Decree 255/2020 re Fulfillment of Domestic Coal Needs in 2021 (“**MoEMR Decree 66/2021**”). MoEMR Decree 66/2021 (i) increased approved national coal production for 2021 by 75 million tonnes to become 625 million tonnes, (ii) specified that 100% of the 75 million tonnes of additional coal production in 2021 was to be for export and (iii) expressly exempted coal producers from compliance with the DM Obligation in respect of the 75 million tonnes of additional coal production.

The formula for calculating the MoEMR Decree 255/2020 financial compensation payable for non-compliance with the DM Obligation was to be set out in a subsequent decree or regulation.

Readers interested in knowing more about MoEMR Decree 255/2020 and MoEMR Decree 66/2021 are referred to the writer’s earlier article “*Relaxation of Mineral Export Requirements – Pragmatic Response to Economic Crisis*”, Coal Asia Magazine, June – July 2021, Petromindo.

MoEMR has now issued Decree No. 139 of 2021, dated 4 August 2021, re Fulfilment of Domestic Coal Needs (“**MoEMR Decree 139/2021**”).

Just 3 days after the issuance of MoEMR Decree 139/2021, the Director-General of Minerals & Coal (“**DGoMC**”) sent a letter to the Director-General of Foreign Trade, the Director-General of Customs & Excise and the Director-General of Sea Transportation (i) identifying 34 coal producers which had not fulfilled their DM Obligation during the period of January to July 2021 and (ii) requesting that no export documents be provided to the 34 coal producers until such time as they fulfilled their DM Obligation (“**7 August DGoMC Letter**”).

As reported by various media outlets, the 7 August DGoMC Letter both (i) highlights it was the failure to supply coal to PLN at the PLN Concessional Coal Price which was the aspect of the DM Obligation that the 34 coal producers had breached and (ii) cites MoEMR Decree 139/2021 as providing the legal basis for the temporary export ban being imposed on these coal producers.

Among the 34 coal producers temporarily banned from export activities was PT Arutmin Indonesia, part of the Bumi Resources Group which, traditionally, has been regarded as being very politically influential.

ANALYSIS AND DISCUSSION

1. Overview of MoEMR Decree 139/2021

MoEMR Decree 139/2021 restates and confirms, as well as expands in certain respects, the DM Obligation with particular attention being paid to the financial and other sanctions that may be imposed on parties not fulfilling the DM Obligation so that they can sell coal internationally.

MoEMR Decree 139/2021 incorporates some of the provisions of both MoEMR Decree 255/2020 and MoEMR Decree 66/2021.

2. MoEMR Decree 139/2021 in Detail

2.1 **DMO Quota for 2021:** The DMO Quota is 25% of the Government approved, planned annual coal production of holders of (i) mining business licenses (“**IUPs**”) for coal production operation (“**Coal IUPOPs**”), (ii) Special Coal IUPOPs (“**Coal IUPKOPs**”), (iii) Coal Contracts of Work (“**CCoWs**”) and (iv) so-called “Continuation Coal IUPKOPs” issued to former CCoW holders (together, “**Relevant Coal Producers**”).

The DMO Quota is to be used to satisfy domestic coal needs in respect of (i) the supply of electricity for public and private purposes and (ii) raw material/fuel required by industry (together, “**Domestic Coal Needs**”) (First Stipulation of MoEMR Decree 139/2021).

2.2 **DM Obligation:** Making coal available in accordance with the DMO Quota is an unconditional obligation of each Relevant Coal Producer (Second Stipulation of MoEMR Decree 139/2021).

2.3 **Possible Additional Coal Supply Obligation:** In the event that Domestic Coal Needs are not satisfied for whatever reason, the DGoMC may appoint/require one or more Relevant Coal Producers, as well as any holder of a coal sales and transportation permit (“**Coal S&T Permit**”), to meet/fulfil the unsatisfied Domestic Coal Needs (Third Stipulation of MoEMR Decree 139/2021).

2.4 **Sanctions and Penalties for Non-Fulfilment of DM Obligation:** Relevant Coal Producers, which export coal without fulfilling the DM Obligation, are subject to sanctions and penalties in the form of:

- (a) **prohibition** on making further coal export sales until such time as they fulfil their DM Obligation except in the case of Relevant Coal Producers which either (i) do not have any domestic sales contracts or (ii) produce coal with specifications for which there is no domestic market (“**Exempted Relevant Coal Producers**”);
- (b) in the case only of failure to fulfil the DM Obligation with respect to Domestic Coal Needs relating to the supply of electricity for **public** purposes (**i.e.**,

failure to supply coal to PLN at the PLN Concessional Coal Price), a **fine** calculated as:

(actual export selling price – PLN Concessional Coal Price) X export coal quantity sold equal to coal quantity not supplied to PLN;

- (c) in the case only of failure to fulfil the DM Obligation with respect to Domestic Coal Needs **other than** relating to the supply of electricity for public purposes, a **fine** calculated as:

(actual export selling price – Coal Benchmark Price) X export coal quantity sold equal to coal quantity not supplied to domestic users other than PLN; and

- (d) in the case only of Exempted Relevant Coal Producers, a **compensation payment** calculated as:

actual export selling price X export quantity sold equal to shortfall in coal amount supplied domestically X compensation percentage yet to be specified (Fourth Stipulation of MoEMR Decree 139/2021).

The “shortfall in coal amount supplied domestically” in 2.4(d) above is the amount that the Exempted Relevant Coal Producer would have been obliged to supply domestically if it had been subject to the DM Obligation and, therefore, had to supply the DMO Quota for the relevant year.

- 2.5 **Extension of Sanctions to Holders of Coal S&T Permits:** Holders of Coal S&T Permits, which are appointed by DGoMC to meet unsatisfied Domestic Coal Needs but fail to do so, are subject to the same sanctions, if they export coal, that apply to Relevant Coal Producers, which sanctions are summarized in 2.4 above (Fifth Stipulation of MoEMR Decree 139/2021).
- 2.6 **Guidelines for Imposition of Fines and Compensation Payments:** Guidelines for the imposition of fines and compensation payments are to be subsequently issued by DGoMC on behalf of MoEMR (**Sixth Stipulation of MoEMR Decree 139/2021**).
- 2.7 **Selling Price of Coal for Provision of Public Interest Electricity:** The FOB vessel selling price of coal supplied for the provision of public interest electricity (**i.e.**, the PLN Concessional Coal Price) is US\$70 per metric ton based on reference characteristics of (i) calorific value - 6,322 kcal/kg GAR, (ii) moisture content of 8%, (iii) sulfur content of 0.8% and (iii) ash content of 15%, with the FOB selling price to be adjusted in accordance with the Attachment to MoEMR Decree 139/2021 where the actual characteristics of coal supplied to PLN differ from the reference characteristics (**Seventh Stipulation of MoEMR Decree 139/2021**).
- 2.8 **Prioritization of Long-Term Coal Supply Contracts:** Business entities requiring coal for the provision of public interest electricity are required to ensure that they have adequate coal supplies by making annual business plans that prioritize long-term coal supply contracts with Relevant Coal Producers (**Eighth Stipulation of MoEMR Decree 139/2021**).

- 2.9 **Monthly Announcements of Non-Compliant Coal Producers:** DGoMC will, each month and with prior MoEMR approval, announce the details of Relevant Coal Producers and Coal S&T Permit holders which have not met their DM Obligation (**Ninth Stipulation of MoEMR Decree 139/2021**).
- 2.10 **2021 Coal Production Targets and 2020 Exemption:** Approved coal production for 2021 is 625 million tons including 75 million tons that may be exported entirely and is not otherwise subject to the DM Obligation.
- Relevant Coal Producers, which did not meet their 2020 DM Obligation, are expressly exempted from sanctions, in the form of fines or compensation payments only, in respect of such 2020 non-compliance (**Tenth Stipulation of MoEMR Decree 139/2021**).
- 2.11 **Revocation of MoEMR Decree 255/2020 and MoEMR Decree 66/2021:** MoEMR Decree 255/2020, as amended by MoEMR Decree 66/2021, is revoked (**Eleventh Stipulation of MoEMR Decree 139/2021**).
- 2.12 **Effective Date:** MoEMR Decree 139/2021 came into effect on 4 August 2021 (**Twelfth Stipulation of MoEMR Decree 139/2021**).

3. **Assessment & Evaluation of MoEMR Decree 139/2021**

- 3.1 **Preliminary Remarks:** Much of MoEMR Decree 139/2021 is not new at all but, rather, simply restates and confirms the continuation of the DM Obligation in general and, more particularly, the obligation of Relevant Coal Producers to continue subsidizing the operations of PLN by supplying coal to PLN at the PLN Concessional Coal Price which is now considerably less than 50% of the international market price.

What is new, however, about MoEMR Decree 139/2021 are (i) the details of the fines and compensation payments to be imposed on Relevant Coal Producers that export part or all of their DMO Quotas and (ii) the confirmation that fines and compensation payments are **not** substitute sanctions for reductions in production quotas or temporary export bans but, rather, are to be imposed **in addition** to temporary export bans which have, apparently, replaced the former practice of reducing future production quotas of Relevant Coal Producers which did not fulfil their DM Obligation.

- 3.2 **Catalyst for MoEMR Decree 139/2021:** The catalyst for the issuance of MoEMR Decree 139/2021 was almost certainly the Government's growing concern that, with international coal prices rising so rapidly during the first half of 2021, Relevant Coal Producers would increasingly choose to export their DMO Quotas, rather than use them to meet Domestic Coal Needs, in the expectation that any fines or compensation payments subsequently imposed on them (as clearly contemplated by MoEMR Decree 66/2021) would still leave them with net revenue in excess of what they would have generated if they had supplied 100% of their DMO Quotas to the local market. The threat to PLN's already perilous financial position, if it could no longer be assured of being able to acquire, at the PLN Concessional Coal Price and from Relevant Coal Producers, all the coal it needed must also have been obvious to the Government.

3.3 **Questionable Fairness of Temporary Export Ban:** The 34 coal producers, which were sanctioned with a temporary export ban on 7 August and in clear reliance upon the prohibition sanction provided for in the fourth stipulation of MoEMR Decree 139/2021 (see 2.4(a) above), would seem to have some genuine grounds to complain about their treatment.

The combined effect of MoEMR Decree 66/2021 and the earlier MoEMR Decree 255/2020 seemed to be that, during 2021, Indonesia's coal producers (i) could export 75 million tonnes of coal production without being subject to either the DM Obligation or having to pay compensation in lieu of compliance with the DM Obligation and also (ii) had the option of exporting part or all of their 25% DMO Quotas if the higher selling price available in the export market sufficiently exceeded the PLN Concessional Coal Price payable by PLN in the domestic market to make it worthwhile for them to pay any applicable fine or compensation for non-compliance with the DM Obligation. There was certainly nothing in MoEMR Decree 255/2020, as amended by MoEMR Decree 66/2021, to suggest that, if they elected to export part or all of their 25% DMO Quotas, they ran the risk of being sanctioned with a temporary export ban as well as with a fine or compensation payment.

The questionable fairness of the temporary export ban also derives support from the fact that MoEMR Decree 255/2020 and MoEMR Decree 66/2021 were generally understood by the market as being a pragmatic response, on the part of the Government, to the economic crisis engulfing Indonesia as a result of the Covid-19 pandemic and the consequent need to prioritize export earnings above all else. It is notable that, in amending MoEMR Decree 255/2020, MoEMR Decree 66/2021 makes specific reference to (i) the impact of the Covid-19 pandemic on the mining sector in 2020 and the resulting global decline in the "economy of mining activities" and (ii) the Covid-19 pandemic being a Government designated non-natural disaster that justifies the need for Government support in promoting overseas sales of coal. A cynical observer could be forgiven for thinking that the Government's promised support for promoting export sales of coal was a fleeting initiative at best and certainly not nearly as important to the Government as ensuring the continuation of indefinite private sector subsidies for PLN's loss-making operations, something that is actually the responsibility of the Government, rather than of the private sector, given PLN's status as a State-owned enterprise.

The 34 coal producers might well say, with some justification, that MoEMR Decree 255/2020 and MoEMR Decree 66/2021 were misleading and it was entirely reasonable for them to assume that, given there was no reference whatsoever to an export ban in these decrees, the only risk they ran, in exporting part of all of their 25% DMO Quotas, was the likelihood that they would have to eventually surrender, to the State Treasury, some part of the extra revenue they made from exporting their 25% DMO Quotas.

The unfairness of the temporary export ban has, however, been ameliorated somewhat by the fact that the Tenth Stipulation of MoEMR Decree 139/2021 (see 2.10 above) exempts Relevant Coal Producers (including the 34 coal producers recently the subject of the temporary export ban) from having to pay any fines or compensation in respect of 2020 non-compliance with the DM Obligation. It would be interesting to

know to what extent the cost, to the 34 coal producers, of the temporary export ban has been offset by avoiding any fines or compensation payments in respect of 2020 non-compliance with the DM Obligation.

It is important to note as well the 23 August 2021 item published by online news portal, Kontan.co.id, to the effect that the temporary export ban on 3 of the 34 coal producers has now been lifted. The 3 coal producers concerned are PT Arutmin Indonesia, PT Borneo Indobara and PT Bara Tabang which, apparently, have committed themselves to fulfilling the DM Obligation for the remainder of 2021. As the temporary export ban was only in place for 2 weeks for these 3 coal producers, one might reasonably question how serious the temporary export ban was in the first place. Interestingly, DGoMC seems to have accepted a “commitment to fulfil” the DM Obligation during the remainder of 2021 in place of the actual fulfilment of the outstanding DM Obligation which was what was originally reported as having been stated in the 7 August DGoMC Letter as the “price” for lifting the temporary export ban. One can only speculate as to what may have caused such a material shift in DGoMC’s position.

- 3.4 **Opportunistic Grab for Compensation Payments:** MoEMR Decree 139/2021’s imposition of a compensation payment sanction on Exempted Relevant Coal Producers seems particularly hard to justify. Given Exempted Relevant Coal Producers are Relevant Coal Producers which either (i) do **not** have any domestic sales contracts or (ii) produce coal with specifications for which there is **no** domestic market, it is difficult to understand why they should have to pay any compensation to the State Treasury if they export coal for which there is currently **no** Domestic Coal Need at all.

Enquiries with DGoMC, made by the writer’s staff, have met with the response that (i) the objective of imposing a compensation payment on Exempted Relevant Coal Producers, which export coal for which there is no current Domestic Coal Need, is to “*create a level playing field*” for all Relevant Coal Producers, (ii) DGoMC would have otherwise been entitled to strictly limit or even prohibit altogether the production of coal for which there is no current Domestic Coal Need and (iii) the Domestic Coal Need will keep growing in the future and, accordingly, at some unspecified time in the future, there may well be a Domestic Coal Need for the coal of Exempted Relevant Coal Producers.

None of the above-offered justifications for imposing a compensation payment on Exempted Relevant Coal Producers, which export coal for which there is **no** current Domestic Coal Need, seem particularly credible to the writer. An, arguably, altogether more plausible explanation is that the compensation payment imposed on Exempted Relevant Coal Producers is simply an overreaching and somewhat opportunistic “grab” by the Government aimed at enriching the State Treasury as much as possible and at the expense of Exempted Relevant Coal Producers.

- 3.5 **Still Some Uncertainty about Fines and Compensation Payments:** Although MoEMR Decree 139/2021 outlines how the fines and compensation payments, that will be imposed on Relevant Coal Producers which do not fulfil their DM Obligation, will be calculated, it seems we still do not know precisely when and how these sanctions will be imposed. In this regard, it is notable that the sixth stipulation of

MoEMR Decree 139/2021 makes clear that the coal industry must wait for “*guidelines for the imposition of fines and compensation payments to be subsequently issued by DGoMC on behalf of MoEMR*”.

It is hard to understand why the formulas for the calculation of fines and compensation payments, as well as the guidelines for the imposition of these fines and the compensation payments, were not dealt with in a single decree. Dealing with these matters in two separate instruments only prolongs the uncertainty for Relevant Coal Producers. Of course and to the extent that no fines or compensation payments will actually be imposed on Relevant Coal Producers until such time as the imposition guidelines are issued, the coal industry may actually welcome the fact that the guidelines have not yet been issued and hope that the eventual issuance of the guidelines is delayed indefinitely.

4. **Future of DM Obligation and Growing Risk of Illegal Coal Exports**

The issuance of MoEMR Decree 139/2021 and the imposition of temporary export bans, on Relevant Coal Producers which do not fulfil their DM Obligation, may **temporarily** ensure Domestic Coal Needs are met and PLN’s financial position is not further undermined in the short run. The problem for the Government, however, is that the DM Obligation in general and the PLN Concessional Coal Price, in particular, look increasingly unrealistic and unsustainable as international coal prices continue to rise.

The PLN Concessional Coal Price was already a significant financial burden on Relevant Coal Producers when the Newcastle ICE coal price was US\$90 per ton. With today’s Newcastle ICE coal price hovering around US\$165 per ton, however, the opportunity cost to Relevant Coal Producers, of having to supply all of PLN’s coal needs at US\$70 per ton, is huge. It would be entirely understandable if Relevant Coal Producers were increasingly of the view that the DM Obligation is denying them what could well be their very last chance to maximize the profitability of their coal operations. This is all the more likely given the uncertain long-term future of coal and the distinct possibility that the current record international prices for coal are being driven by short-term factors such as the ongoing trade dispute between Australia and China and extreme weather conditions which will not last indefinitely.

There must also be a real worry that, unless the DM Obligation is substantially revised and PLN is obliged to pay market prices for its coal needs, some Relevant Coal Producers will be increasingly tempted to export coal illegally. In the past, it has proven to be extremely difficult for the Government to prevent illegal exports of coal and other minerals from Indonesia. While the safeguards against illegal coal and other mineral exports have been significantly strengthened over time, these safeguards are only effective if the officials responsible for supervising the enforcement of those safeguards do not succumb to corruption and otherwise do their job properly. The immense disparity, which now exists between international coal prices and the PLN Concessional Coal Price, creates potentially very significant financial incentives for collusion between less law-abiding Relevant Coal Producers and officials responsible for supervising the enforcement of coal and other mineral export safeguards. Given Indonesia’s track record in this regard, no one could reasonably be surprised if such collusion once again becomes a reality.

Confounding the normal work of supply and demand, in determining the price of coal in the domestic market and by introducing the PLN Concessional Coal Price, was always going to be problematic for the Government in the long run. This is so even if, at the time it was introduced, the PLN Concessional Coal Price seemed like an easy solution to PLN's financial difficulties. The recent run-up in international coal prices has now almost certainly brought this problem to a head.

SUMMARY & CONCLUSIONS

MoEMR Decree 139/2021 and the resulting temporary export bans recently imposed on 34 Relevant Coal Producers have caused some consternation in the domestic market.

While it is understandable the Government sees the rapid rise in international coal prices as a threat to the satisfaction of Domestic Coal Needs and, therefore, necessitating strong action on its part, the way in which the temporary export bans have been imposed seems unfair in many respects and only serves to further highlight the unpredictability of policy and regulatory developments in the Indonesian mining sector.

Unless international coal prices quickly reverse their course and start to fall significantly, the Government may be forced to rethink the DM Obligation in general and the PLN Concessional Coal Price in particular. Otherwise, if international coal prices continue to rise and the PLN Concessional Price remains fixed at US\$70 per ton, it must be expected that illegal coal exports will, once again, become a major problem for Indonesia.

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