THE LEGAL POSSIBILITIES OF IMPLEMENTATION OF 10 % PARTICIPATING INTEREST FROM OIL AND GAS TOWARD MINERAL AND COAL MINING ACTIVITIES

A BACHELOR DEGREE THESIS

By:

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Student ID Number : 13410619

INTERNATIONAL PROGRAM

FACULTY OF LAW

UNIVERSITAS ISLAM INDONESIA

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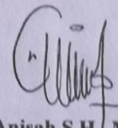

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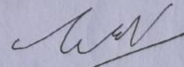

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Selanjutnya, berkaitan dengan hal di atas terutama pernyataan pada butir no. 1 dan 2, saya sanggup menerima sanksi baik sanksi administrasi, akademik, bahkan sanksi pidana jika saya terbukti secara kuat dan menyakinkan telah melakukan perbuatan yang menyimpang dari pernyataan tersebut. Saya juga akan bersifat kooperatif untuk hadir menjawab, membuktikan, melakukan pembelaan terhadap hak-hak saya. Tim Fakultas Hukum Universitas Islam Indonesia yang ditunjuk oleh pimpinan Fakultas apabila ada tanda-tanda plagiat yang disinyalir terjadi pada karya tulis ilmiah saya ini oleh pihak Fakultas Hukum Universitas Islam Indonesia.

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I, from the deepest part of my heart, would like to dedicate this thesis to:

The greatest man in the world, Mr. Andriansito;

My dearest Mother, Mrs. Eny Rahmawati;

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(Hanif Abdul Halim)

MOTTOS

"The greatest Jihad is to battle your own soul and to fight the evil within yourself."

(Prophet Muhammad SAW)

"Education is the most powerful weapon, which we can use to change the world."

(Nelson Mandela)

"Fiat Justitia Ruat Caelum."

(Latin Legal Phrase)

"Fiat Justitia et Pereat Mundus."

(Roman Emperor, Ferdinand I)

"Kesempatan tidak hanya dicari, tapi juga diciptakan. Rasa galau dan stres harus dijadikan teman hidup sehari-hari dan menjalaninya dengan tenang dan ringan."

(Chairul Tanjung)

"There are two ways to be remembered : be the first or be different."

(Hanif Abdul Halim)

TABLE OF CONTENTS

Contents

PAGE OF TITLE i
PAGE OF APPROVAL ....Error! Bookmark not defined.
SURAT PERNYATAAN v
CURRICULUM VITAE viii
ACKOWLEDGEMENTS xii
MOTTOS xv
TABLE OF CONTENTS xvi
LIST OF TABLE xvii
ABSTRACT xviii
CHAPTER I 1
INTRODUCTION 1
A. Context of Study 1
B. Problem Formulation 9
C. Research Objectives 9
D. Definition of Terms 9
E. Theoretical Review 12
F. Research Method 16
CHAPTER II 21
A. GENERAL OVERVIEW ON OIL AND GAS GOVERNANCE IN INDONESIA 21
1. The History and Development of Oil and Gas Governance in Indonesia 21
2. Upstream Oil and Gas Activities 27
a. General Overview on Upstream Oil and Gas Activities 27
b. The Authority of Executing Body *(BP Migas)* in Upstream Oil and Gas Activities 31

c. The Dissolution of the Oil and Gas Executing Body through a Decision of Constitutional Court 34

3. Contract Regime in Oil and Gas Law 37

a. Concession Contract 38

b. Production Sharing Contract 42

B. GENERAL OVERVIEW ON MINERAL AND COAL GOVERNANCE IN INDONESIA 53

1. The Exploitation of Mineral and Coal Mining based on Act Number 11 of 1967 about Basic Provisions of Mining 53

2. The Exploitation of Mineral and Coal Mining based on Act Number 4 of 2009 about Mineral and Coal Mining 58

C. THE DIFFERENCES AND SIMILARITIES OF OIL AND GAS AND MINERAL AND COAL INDUSTRIES 66

D. STATE'S POWER OVER NATURAL RESOURCES IN ISLAMIC PERSPECTIVE 70

CHAPTER III 77

ANALYZING THE LEGAL POSSIBILITIES OF IMPLEMENTATION OF 10 % PARTICIPATING INTEREST FROM OIL AND GAS TOWARD MINERAL AND COAL MINING ACTIVITIES 77

A. The Implementation of the 10% Participating Interest (PI) Offer Provision in Upstream Oil and Gas Activities 77

B. The Legal Challenges if the Provision of 10% Participating Interest (PI) Offer Implemented in The Mineral and Coal Mining Activities 96

CHAPTER IV 104

CONCLUSION AND RECOMMENDATION 104

A. Conclusion 104

B. Recommendation 105

BIBLIOGRAPHY 107

LIST OF TABLE

Table 2. 1 Oil and Gas Contract in Various Countries 49

ABSTRACT

This study focuses on analyzing the provision of 10% Participating Interest (10% PI) in the oil and gas law. This provision has been comes into existence since the Government Regulation Number 35 of 2004 on Oil and Gas Upstream Business Activity issued. On the other side, the instrument governing the procedures for bidding and the condition of BUMDs that may participate in this 10% PI is newly regulated by Regulation of The Minister of Energy and Mineral Resources Number 36 of 2017 regarding Provisions for the Offer of 10% PI in Oil and Gas Working Areas. The problem formulation of this research how is the implementation of the 10% PI offer provision in upstream oil and gas activities and what are the legal challenges if the provision of 10% PI offer implemented in the mineral and coal mining activities. This is a normative research with three sources of data namely primary legal materials such as the positive laws, secondary legal materials (books, journals, and other literatures), and tertiary legal material. The data are all collected by intensive library studies and approached by using a normative juridical approach. This paper find out that although there are weaknesses, this concept (10% PI offering) is in fact able to guarantee and increase the participation of oil and gas producing regions to directly manage the natural resources contained in their territory. Finally, it concludes that any legal possibilities (chances and obstacles) if such 10% PI can be transformed to other mineral and coal mining industries are differences in regime used, the characteristic of the two industries that are different, and that both mining products need different treatment. However, the core value of 10% PI is arguably can be transformed.

Keywords : Participating Interest, Oil and Gas, Mineral and Coal

THE LEGAL POSSIBILITIES OF IMPLEMENTATION OF 10 % PARTICIPATING INTEREST FROM OIL AND GAS TOWARD MINERAL AND COAL MINING ACTIVITIES

CHAPTER I

INTRODUCTION

A. Context of Study

In the history of Republic of Indonesia, there were at least two Acts have been issued regarding the Oil and Gas mining. On the year of 1960, there was Act number 44 Prp of 1960 about Oil and Gas Mining (The Old Law), which was then completed by the Act number 8 of 1971 about Oil and Gas Mining Enterprise. Subsequently, the Act number 22 of 2001 about Oil and Gas (The New Law) has been passed by the legislative body as the substitute of the old law and is applied until nowadays.[1] In the old law, there are two functions, namely the government as a regulator as well as a supervisor and State Enterprise (Perusahaan Negara) in this case Pertamina, as a business actor or operator. Meanwhile, the business entity and permanent business entity from national or foreign private is a contractor of Pertamina.[2]

Unlike the old law, the new law embraces the separation of functions between regulatory functions, supervision, and operators. Pertamina's position was changed from the previous holder of oil and gas mining (monopoly) to a limited liability company and positioned the same as regular contractors in

[1]Jawahir Thontowi, *Negara Hukum Kontemporer* : *Eksploitasi Tambang untuk Kesejahteraan Rakyat Indonesia*, Jakarta, Madyan – Ind Press, 2016, p. 79.

[2]*Ibid.*

general. Instead, the government established the Oil and Gas Executing Agency (BP Migas) in the upstream oil and gas sector management and Oil and Gas Regulatory Body Migas) in the downstream sector of oil and gas.[3] Oil and Gas Executing Agency (BP Migas) then dissolved by a decision of the Constitutional Court.[4] For the sake of investors and contracts holders protection[5] and certainty of law, Indonesia government established Special Unit for Upstream Oil and Gas Business Activities (SKK Migas) based on the Presidential Regulation (Perpres) Number 9 of 2013 on the Implementation of Upstream Oil and Gas Business Management.[6]

Oil and gas business activities are generally divided into two, namely upstream business activities and downstream business activities.[7] The upstream activities are connected with the activities of exploration and exploitation. The upstream ones are regulated in the article 1 section (7), article 5 until article 6, and article 9 until article 22 of the Act number 22 of 2001.[8] The upstream business activities are implemented and controlled through a certain type of contract known as a Cooperation Contract (*Kontrak Kerja Sama*). This contract is a profit sharing contract or another form of contract in which may give more income for

[3]*Ibid,* p. 80.
[4] Constitutional Court Decision, *Putusan MK Nomor 36/PUU-X/2012*.
[5] Junaidi Albab Setiawan,*Op. cit,* p. 24.
[6]http://skkmigas.go.id/tentang-kami/profil, accessed on July 1st, 2017.
[7] Article 5, Act number 22 of 2001 about Natural Oil and Gas.
[8] H. Salim HS,*Op. cit*, p. 237.

the State and utilized for the people welfare.[9] The minimum requirements in this cooperation contract are :

1. The ownership of natural resources remains in the hands of the government to the point of submission,
2. Management control and operational issues borne by the Implementing Body (*Badan Pelaksana*),
3. While the capital and the risk of the business activities shall be borne entirely by business entities and permanent enterprises engaged in upstream oil activities (exploration and exploitation).[10]

The upstream activities can be conducted by :

a. State Owned Enterprises
b. Local Government Owned Enterprises
c. Cooperation (*Koperasi*),
d. Private Enterprises.[11]

On the other hand, the downstream activities are regulated on article 1 section (10), article 5, article 7, article 23 until article 25 the law number 22 of 2001.[12] The downstream activities include processing, transportation, storage and commerce. Those downstream activities held through a fair, health, and transparent business competition mechanism. All of those mentioned activities

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[9] *Ibid*, p. 238.

[10] Syaiful Bakhri, *Hukum Migas : Telaah penggunaan Hukum Pidana dalam Perundang-undangan,* Jakarta, Total Media, 2012, p. 96.

[11] *Op. cit*, p. 239.

[12] *Ibid*, p. 241.

can only be done after the issuance of Government Permits such as processing business permits, transportation business licenses, storage business licenses, and commercial operations licenses.[13] The licenses are a proof of government's role in maintaining the fairness within the downstream activities.

Oil and natural gas is controlled by the state and utilized to the greatest prosperity of the people. Therefore, even if individuals and business actors own the land rights, they have no right to mine and control the oil and natural gas contained therein.[14] The concept of the State's control over the oil and gas reserves is also affected by the law of local government's autonomy which is brought by the reform movement.[15] Subsequently, the influence of the local autonomy has given birth to a concept of local government participation in the "participating interest". This concept is also related to the fact that the area where an oil and gas excavation work area is located, gets little benefit. Whereas in fact, these areas are most affected by oil and gas exploration and exploitation activities both positively and negatively.[16]

There is no single definition of participating interest be found anywhere. But, the government regulation has at least explained it as follows[17] :

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[13] Syaiful Bakhri,*Op. cit*, p. 97.

[14]*Op. cit*, H. Salim HS, p. 236.

[15]Junaidi Albab Setiawan, *Partisipasi Daerah Penghasil (Participating Interest) di Wilayah Kerja (Blok) Masela*, Jurnal Komunikasi Hukum, Universitas Pendidikan Ganesha Singaraja, 2016, p. 190.

[16]*Ibid,* p. 190.

[17] Article 34 jo. Article 35 of Government Regulation Number 35 of 2004.

1. Since the approval of the first field development plan will be produced from a Work Area, the Contractor shall offer a 10% participating interest (ten percent) to the Regional Owned Enterprises.
2. Statement of interest and ability to take participating interest as referred to in Article 34 shall be submitted by Regional Government Enterprises within a period of no more than 60 (sixty) Days from the offer date of the Contractor.
3. In the case of a Local Enterprise does not provide a statement of ability within a period of time As referred to in paragraph (1), the Contractor shall offer to the national enterprise.
4. In the case of a national company does not provide a statement of interest and ability maximum of 60 (sixty) days since the offer date of the Contractor to the National Company, then the offer is declared closed.

In addition to the fact that there is no single definition of the term participating interest, participating interest itself is interpreted differently by several sources. Participating interest may be defined as a right which is a limited right to exercise, in particular over a period of 60 days from being offered by an oil and gas contractor.[18] It is a proportion of exploration and production costs of each party will bear and the proportion of production each party will receive, as set out in an operating agreement.[19] Participating interest is rights and obligations

[18] Muhammad Yusuf Sihite, *Kaji Ulang Participating Interest Bagi Badan Usaha Milik Daerah (BUMD) Dalam Industri Hulu Minyak dan Gas Bumi (Migas)*, Rechtsvinding, 2016, p. 3.
[19] http://www.glossary.oilfield.slb.com/Terms/p/participating_interest.aspx (accessed on July 9th, 2017)

as a contractor of Contract of Cooperation (KKS), by direct or indirect means, on a work area.[20]

Participating interest can be viewed as a proportion of ownership of production and exploration ownership of one certain working area of oil and gas. Participating interest (PI) in another perspective is also the participation of business entity including BUMD (Regional Owned Enterprise) and permanent establishment in upstream oil and gas management through transfer of participating interest.[21] The participating interest has been an obligation of any contractor to offer to Regional Owned Enterprises since the Government Regulation number 35 of 2004 issued. Furthermore, Ministerial of Energy and Mineral Resources Regulation number 37 of 2016 has also regulated further on the provisions of the offerings of 10% and other procedural matters. This regulation provides clarity on the implementation of the 10% PI offer to the regions (through Regional Owned Enterprises) and provides clear restrictions that must be followed by all parties. This regulation also explains the requirements to be met by the enterprises, the terms of the offer, the procedure of the offer, and also the procedure of transfer of PI 10%.[22]

The development of this concept (PI 10%) within the oil and gas industry has been well developed over the past decade. With the issuance of the above

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[20]Article 1, section (14), Government Regulation number 79 of 2010 about Operating Cost Of Re-Refundable And Tax Revenue In The Field Of Oil And Gas Business and Article 1, Ministerial Regulation number 257/PMK.011/2011.

[21]Ahita Nur Aisyah Zen and Nurkholis, *Analisis Participating Interest (Pi) Dalam Kontrak Kerja Sama(Kks) Pemerintah Daerah Dan Swasta (Studi Kasus Pada Sektor Migas Blok Cepu Di Kabupaten Bojonegoro)*, Universitas Brawijaya, Malang, p. 7.

[22]http://skkmigas.go.id/detail/2031/skk-migas-sosialisasikan-permen-participating-interest (accessed on July 9th, 2017)

Ministerial Regulation, many regional heads are hoping that the 10% PI offer provision can be implemented steadily and accompanied by legal certainty. Thus, ultimately the dividends that come from the 10% PI mechanism can be utilized for the welfare of the people.[23] With all the risks of participation that may be faced by oil and gas producing regions through 10% of PI, the producing regions should be the first to enjoy the blessings of progress and prosperity, especially economic welfare, due to the exploitation of energy resources (oil and gas) in the region.[24]

However, the issue between the welfare of the people in extractive products producing areas is not only happen in the oil and gas sector but also in the minerals and coal sectors. People living in the vicinity of mineral and coal mining products also often experience welfare dilemmas. Where the natural product (mining products) that exist in their area are dredged out, but welfare does not yet to come to them. In addition, the environmental impacts caused by the mines are continuously suffered by them.[25]

In addition, exploration and exploitation activities in the oil and gas sector require substantial investment funds. Generally required investment funds can come from two sources, namely local investors through domestic investment and foreign investors through foreign direct investment. In association with foreign direct investment (FDI), Indonesia as a sovereign country certainly has its own provisions in regulating the lane. National and international law become very

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[23]https://nusantara.news/gebrakan-regulasi-jonan-candra-participating-interest-10-saham-daerah/ (accessed on July 9th, 2017)

[24]Junaidi Albab Setiawan,*Op. cit*,*Partisipasi Daerah Penghasil (Participating Interest) di Wilayah Kerja (Blok) Masela*, p. 190.

[25]*Ibid*.

dynamic when regulating the matter of FDI, this is influenced by the rapid development of foreign investment.[26]

In regulating the rate of foreign investment, there is term of negative investment list or closed and open business fields. The open business field is the business field undertaken without requirement in the framework of investment.[27] While a closed business field is a certain business field which is prohibited to be cultivated as an investment activity.[28] The regulation on this closed and open business field should be highly considered in determining whether or not participating interest in upstream oil and gas activities can be implemented in mineral and coal mining activities.

From the explanation above, this study aims to analyze whether the offering mechanism of 10% PI from contractors of Cooperation Contract (KKS) to regional owned enterprise where there is a work area of upstream oil and gas activities, can be applied to the mining sector of mineral and coal. Whether or not the Regional Owned Enterprises can get 10% of total cost needed by the mining activities. This paper will also look for whether the 10% PI concept has its own legal challenges if applied in mineral and coal mining law. This will encompass the legal challenge by looking at the characteristics and similarities of both fields as well as the differences between them.

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[26] http://business-law.binus.ac.id/2017/02/19/investasi-dan-sejarah-perkembangan-investasi-asing-di-indonesia/ (accessed on July 27th, 2017)

[27] Article 1 section (2), Presidential Decree number 44 of 2016 about List of Closed Business Fields and Opened Business Fields With Requirements In The Field Of Investment.

[28] *Ibid,* article 1 section (2).

B. Problem Formulation

1. How is the implementation of the 10% Participating Interest (PI) offer provision in upstream oil and gas activities?
2. What are the legal challenges if the provision of 10% Participating Interest (PI) offer implemented in the mineral and coal mining activities ?

C. Research Objectives

1. The research objective is to analyze the implementation of the 10% Participating Interest (PI) offer provision in upstream oil and gas activities.
2. The research objective is to find out the legal challenges if 10% Participating Interest (PI) offer provision implemented in the law of mineral and coal mining activities.

D. Definition of Terms

Natural Oil : is the result of a natural process of hydrocarbons under conditions of atmospheric pressure or temperature in the form of a liquid or solid phase, including asphalt, mineral wax or ozokerite and bitumen obtained from the

mining process, but excluding coal or other hydrocarbon deposits in the form of solid obtained From activities not related to Oil and Gas business activities.[29]

Natural Gas : is the result of a natural process of hydrocarbons under pressure conditions and the atmospheric temperature in the form of a gas phase obtained from the mining process.[30]

Upstream Business Activities : are business activities that are core or based on Exploration and Exploitation business activities.[31]

Downstream Business Activities : are business activities that are core or based on business activities of Processing, Transportation, Storage, and / or Commerce.[32]

Cooperation contract : A Cooperation Contract is a Production Sharing Contract or other form of cooperation in an Exploration and Exploitation activity that is more favorable to the State and the results are used extensively for the welfare of the people. The Cooperation Contract shall at least contain a requirement stating that the ownership of Oil and Gas resources shall remain in the hands of the Government up to the point of delivery, the management of the

[29] Article 1, section (1), Law of Republic of Indonesia number 22 of 2001 about Oil and Gas.

[30] *Ibid,* Article 1, section (2).

[31] *Ibid,* Article 1, section (7).

[32] *Ibid,* Article 1, section (10).

operations carried out by the contractor shall be with the Implementing Body, and the capital and risk shall be borne entirely by the Contractor.[33]

Participating Interest : Based on Government Regulation No. 79 of 2010 Article 1 and Regulations Minister Number 257 / PMK.011 / 2011 article 1 mentioned that Participating Interest (PI) is the right and obligation as Contractor of Cooperation Contract, directly or indirectly, on a work area. Participating Interest (PI) is the proportion of production and exploration ownership of a work area of oil and gas. Participating interest is a business entity participation including Regional Owned Enterprises and permanent business entity in upstream oil and gas management through transfer of participating interests.[34]

10% Participating Interest : is the maximum amount of 10% (ten percent) participating interest on Cooperation Contract which must be offered by the Contractor to Regional – Owned Enterprises or State – Owned Enterprises.[35]

Mineral mining : is mining of minerals in the form of ores or rocks, outside geothermal, oil and gas, and groundwater.[36]

Coal mining : is mining of carbon deposits contained in the earth, including bitumen solid, peat, and asphalt rocks.[37]

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[33] http://www.gultomlawconsultants.com/bentuk-bentuk-kontrak-pengelolaan-minyak-dan-gas-di-indonesia/ (accessed on July 11th, 2017)

[34] *Op. cit,* Ahita Nur Aisyah Zen and Nurkholis, p. 7.

[35] Article 1, section (4), Minister of Energy and Natural Resources Regulation of Republic of Indonesia Number 37 of 2016 about The provision of participating interest 10% (ten percent) offer in oil and gas work area.

[36] Article 1, section (4), Law of Republic of Indonesia number 4 of 2009 about Mineral and Coal Mining.

[37] *Ibid,* Article 1, section (5).

E. Theoretical Review

The theoretical discussion in this chapter aims to build a systematic, comprehensive, and consistent framework of thinking, in relation to the theme being promoted. The theories contained in this chapter are also selected from relevant theories and highly correlated with existing problems. So hopefully the problem will not only be solved, but also be solved in accordance with the appropriate theories and normative values.

1. Theory of State Power over Natural Resources

Basically the right of the state to control the natural resources contained in its territory is a conception that is part of the derivation of the theory of state control. In connection with the theory of state control, there are two most famous theories coming from Van Vollenhoven and J. J. Rousseau. Van Vollenhoven stated that the state as the highest organization of the nation given the power to regulate everything and the state based on its position has the authority for the rule of law. In this case state power is always associated with the theory of sovereignty (*souverenitet*). While on the other hand, Rousseau argues that the power of the state as a body or people's organization comes from a contract social whose essence is a form of unity that defends and protects the common power, personal power and property of each individual. In this case the essence of power is not sovereignty, but the power of the state is also not unlimited power, because there

are some legal provisions that bind themselves like the laws of nature and the law of God and the law common to all nations called *leges imperii.*[38]

The relationship with the right of state control with the greatest prosperity of the people will realize the obligations of the state as follows :

a) All forms of utilization (earth and water) as well as the results obtained (natural wealth), should significantly increase the prosperity and welfare of the people.
b) Protect and guarantee all the rights of the people contained in or on earth, water and certain natural resources that can be produced directly or enjoyed directly by the people.
c) Prevent any action from any party that will cause the people not to have a chance or will lose their rights in enjoying the natural wealth.

Those three obligations above explain all guarantees for the purpose of state control over natural resources which also gives an understanding that in the right of control, the state only performs the *bestuursdaad* and the processing *(beheersdaad)*, not to do (*eigensdaad).*[39]

Mohammad Hatta formulates the notion of being controlled by the state is controlled by the state does not mean the state itself becomes entrepreneur, businessman or ordernemer. It is more appropriate to say that the power of the

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[38] J. Ronald Mawuntu, *Konsep Penguasaan Negara berdasarkan Pasal 33 UUD 1945 dan Putusan Mahkamah Konstitusi*, Jurnal Univesitas Sam Ratulangi, Manado, 2012, p. 15.

[39]*Ibid*, p. 16.

state lies in the making of rules for the smoothness of economic roads, the rules which prohibit the exploitation of the weak by the capital.[40]

2. The Regional Autonomy Theory

In relation with the authority at the regional level, the 1945 Constitution becomes the very fundamental law we have to consider at. The regional government authority derives from the article 18 of the Constitution which stated that the division of the Indonesian territory over large and small areas, in the form of their government, shall be established by law, with due regard to and remembrance of the basis of deliberations in the system of state governance, and the rights of origins in the regions with a special characteristic. This article emphasized that Indonesia as a unitary state will never have regions within its territory in the form of states.[41] Furthermore, Indonesia is divided into large and small areas that are autonomous, namely areas that may manage their own household and administrative areas, namely areas that can not stand alone. The aforementioned explanation are having decentralization principle as its ground. The principle which shift some of governmental affairs from the authority of central government to be under the authority of the local or regional government.[42]

According to the law number 32 of 2004 on Regional Government, regional autonomy is the right, authority, and obligation of autonomous regions to

[40] *Ibid,* quoted from Mohammad Hatta, *Penjabaran Pasal 33 Undang-Undang Dasar 1945,* Mutiara, Jakarta, 1977, p. 28.

[41] CST Kansil and Christine Kansil, *Pemerintahan Daerah Indonesia*, Jakarta, SInar Grafika, 2002, p.3.

[42] *Ibid.*

regulate and manage their own governmental affairs and the interests of local communities in accordance with legislation. From this understanding it can be interpreted that the regional autonomy is the freedom to determine their own rules based on legislation, in meeting regional needs in accordance with the potential and ability possessed by the region. The granting of wider authority in the area of administration and local governance has been elaborated in the mentioned legislation.[43]

3. National Treatment Theory and State Welfare

One of the principles contained in GATT is the principle of National Treatment (national treatment), this principle provided in Article III of GATT 1994 which requires that a country is not permissible to treat discriminatively between imported products with domestic products (same product) with the intention to do protection.[44]In this principle there are two direct-front interests: the national interest for protecting domestic products from competition with foreign products and international interests that require free competition with equal opportunity.

In other words the principle of National Treatment prohibits discriminatory regulations as a means to provide protection against domestic products. This includes taxation and other levies. This principle also applies to Legislation, regulation and legal requirements that may affect the sale, purchase,

[43]http://eprints.uny.ac.id/18104/3/BAB%20II%2008.01.007%20And%20p.pdf (accessed on July 27th, 2017)

[44] Budi Artanto, *Implikasi Yuridis National Treatment Dalam TRIPS – WTO Terhadap Pengaturan Perlindungan Hak Cipta di Indonesia*, Universitas Jambi, Jambi, p. 96.

distribution or use of products in the domestic market and the protection of protectionism as administrative or legislative measures or policies.[45]

National treatment, in its implementation has some exceptions, which one of them is the national interest of the state. A state might limit the implementation of national treatment principle due to a national interest. In its development, the national interest can be seen as an effort of a state of improving the level of welfare of its people. In the dynamics of economic development, changes in the welfare of the community are important things that can not be separated. This is because the critical determinant of the success of economic development is the increase of people's welfare.[46] According to Todaro and Stephen C. Smith, the welfare of the community shows the measure of development outcomes in achieving a better life which consists of: first, capacity building and equitable distribution of basic needs such as food, housing, and health. Secondly, increased levels of living, income levels, better education, and increased attention to humanitarian values. Third, expand the scale of economics and the availability of social choice of individuals and nations.[47]

F. Research Method

I. Source of Data

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[45] Mahmul Siregar, 2008, p. 68. (quoted and accessed from http://dwimaret.blogspot.co.id/2012/12/prinsip-national-treatment-dalam.html on July 27th, 2017)

[46] http://erepo.unud.ac.id/17791/3/1190671012-3-BAB%20%20II.pdf (accessed on July 27th, 2017)

[47] *Ibid.*

Within this research, the sources of data which use are Primary Legal Materials, Secondary Legal Materials, and Tertiary Legal Materials.

a) Primary legal materials:

Primary Legal Materials means that legally binding in juridical manners[48] that relate to the object of research, including

i. The 1945 Constitution of Republic of Indonesia
ii. General Agreement on Tariffs and Trade 1986
iii. Law No. 22 of 2001 about Oil and Gas
iv. Law No. 4 of 2009 about Mineral and Coal Mining
v. Law No. 25 of 2007 on Investment
vi. Government Regulation No. 35 of 2004 about Upstream Oil and Gas Mining Activities
vii. Presidential Decree No. 44 of 2016 on List of Closed Business Fields and Opened Business Fields With Requirements In The Field Of Investment
viii. Ministerial of Energy and Mineral Resources Regulation No. 37 of 2016 on the Provision of 10% (Ten Percent) Participating Interest Offer in the Oil and Gas Work Area.
ix. Related Qur'an and Hadith

b) Secondary Legal Materials

[48]Soerjono Soekanto, *Penelitian Hukum Normatif : Suatu Tinjauan Singkat,* Rajawali, Jakarta, 1998, p. 10.

Secondary Legal Materials means that the legal materials which using the rules used to support and provide an explanation for the primary legal materials.[49] Within this research the secondary legal materials which use are:

i. Books and Literature which comprises of the perspective from a legal expert which dealing with the research.
ii. Journal, Article and the previous research which dealing with this research.
iii. Internet Sites in domestic or international scope whereby the sources are valid and dealing with this research.

c) Tertiary Legal Materials

Tertiary legal materials in this research are using a material that can support the primary legal materials and secondary legal materials,[50] within this research the tertiary legal materials used are:

i. Oxford Dictionary.
ii. Black Law Dictionary.
iii. Business Law Dictionary.
iv. Encyclopedias that can help understand and analyze the issues examined in this study.

II. Data Collecting

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[49] *Ibid.*
[50] *Ibid*, p.16.

The process of collecting data in the making of this research is done by library studies as many as possible it can be books, articles, and or documents.

III. Data Approach

The process of data approach in the research is using a normative juridical approach based on the main legal material by examining theories, concepts, legal principles, and law relating to this research.

IV. Data Analysis

In the process of analyzing data during the process of this research, it is applied the normative legal method of analysis. Which is done by analyzing the document study, it means using a variety of secondary data such as regulations, legal theory, and scholar’s opinion. This research is using qualitative analysis that relies, justifying, interpreting the data, and drawing the conclusion of the data.

V. Structure of Writing

Chapter I contains an introduction which comprises of these following parts : Context of Study, Problem Formulation, Research Objectives, Theoretical Review, Research Method, and Structure of Writing.

Chapter II contains theoretical review which discussed about the similar characteristics and differences of oil and gas industry and mineral and coal mining industry.

Chapter III contains of two discussion regarding : The implementation of the 10% Participating Interest (PI) offer provision in upstream oil and gas activities and the legal challenges if 10% Participating Interest (PI) offer provision implemented in the mineral and coal mining activities.

Chapter IV contains the conclusion and recommendation which is obtained by the previous analysis which has been done within the previous chapters.

CHAPTER II

THEORITICAL FRAMEWORK

THE GENERAL OVERVIEW ON OIL AND GAS GOVERNANCE AND MINERAL AND COAL GOVERNANCE IN INDONESIA

A. GENERAL OVERVIEW ON OIL AND GAS GOVERNANCE IN INDONESIA

1. The History and Development of Oil and Gas Governance in Indonesia

The struggle of Indonesia in obtaining the full power to control and manage oil and gas has been identified to be started from the pre independence era. *Vereenigde Oost Indedische Company* (VOC) under Jan Pieterzoen Coen is a Dutch trading company who begun the colonization over some Indonesia islands in 1816. On this era there were no significant development both on exploration and exploitation of oil and gas nationwide. The exploration then begun to happened after a discovery by a Dutch engineer, P. Vandijk in the area of Purwodadi, Central Java. He drilled on at least 4 wells but none of them provide a commercial-oriented outcome.

Year after year, some of areas are found to be having oil and gas reserves such as Langkat North Sumatera in 1885 operated by Royal Dutch Shell (Bataffsche Petroleum Matschappij) by a concession lead by

Aeilko Jans Zijlker, and Kruku East Java in 1887 as well as Cepu Central Javai 1901 which both of them are also operated by Bataffsche Petroleum Matschappij (BPM). Having information regarding oil reserves on those areas, Zijlker started to built an oil and gas industries along with his colleagues in Den Haag, the company they built was named Koninklijke Nederlandsche Petroleum or what was known as Royal Dutch Petroleum.[51]

At that time, there was another big oil company called Shell Transport and Trading Co. led by Marcus Samuel, a British national which operated in East Kalimantan. Shell Transport and Trading Co.'s strength was in the transport and its market share of oil products, while Royal Dutch Company excess was in the production and processing. Both of them were agreed to merge into one big oil company in the beginning of 20th century and changed their name into The Royal Dutch Shell Group (Shell). They begun to dominate the oil industries in Indonesia although another big oil company, Standard Oil got their own domination in the eastern part of Indonesia market.

Entering the era of second world war, after Japan successfully destroyed Pearl Harbor, the Dutch East Indies government realized that Japan will come to Indonesia to take control of Asia including the oil industries as an important element for them to win the world war. The Dutch government knew its inability to stop Japan and were deciding a tactic to burning down all the installation and facilities of oil industries. In

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[51] Syaiful Bakhri, *Op.cit*, p. 16.

such conditions, Japan have only few choices but to maximize all of the facilities left and to empowering the natives worker from Indonesia through some training they provided.[52]

Japanese surrender to America and its allies in August 15th 1945 left Indonesia abandoned. This condition was used by the founding father of Indonesia, Soekarno and Hatta to proclaiming Indonesia's indepence in 17th August 1945. As fast as Indonesia were free from colonization, the control over oil and gas as a natural resources shifted to the Indonesia's sovereign government.[53] It was promulgated in the article 33 of Indonesia 1945 Constitution that earth and water and the wealth contained therein is controlled by the State and used for the greatest prosperity of the people.[54]

The struggle to take control over oil and gas industries after the independence were organized by what so called as *Laskar Minyak*. It was an organization comprises of the former worker of oil and gas sector since the era of Dutch until Japan colonization. Their struggle was successfully seized the whole refineries around North Sumatera and established PT. *Tambang Minyak Sumatera Utara*. Meanwhile in the South Sumatera and Jambi areas, the seizure of oil and gas production area was done amicably. It was lead by M. Isa without any armed conflict and also by establishing *Perusahaan Minyak Republik Indonesia (PERMIRI).* At the same time, in Central Java, Indonesia government established *Perusahaan Tambang*

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[52]*Ibid*, p. 23.
[53]*Ibid*, p. 25.
[54] Rudi M. Simamora, *Minyak Bumi dan Gas Bumi*, Jakarta, Djambatan, 2000, p. 11.

Minyak Nasional (PTMN). This company was assigned to take over the former working areas of Shell which was located in some areas such as Semanggi, Ledok, Cepu refineries, up to the West Java areas.[55]

On December 13th 1960, based on Act Number 19 Prp of 1960 about Oil and Gas Mining, the government established *Perusahaan Pertambangan Minyak Indonesia* (*PT Pertamin)*. Meanwhile in North Sumatera, on December 10th 1957 PT. TMSU was changed into *PT Perusahaan Minyak Nasional* (*PT Permina)*. In order to improve the efficiency of these two State Owned Enterprises (SOE), there was a Minister of Mining and Oil and Gas decision No.123/M/Migas/66 issued on March 24th 1966 to divide the job descriptions to each of PT. Pertamin and PT. Permina. PT Pertamin was assigned to distribute the oil product nationwide, while PT. Perminat was designated to handle the production aspects. The peak of the consolidation of some SOEs at that era was the merger between PT. Pertamin and PT. Permina based on Government Regulation No. 27 of 1968. This decision was taken based on the five year term plan of development (REPELITA) under the new order regime led by President Soeharto.[56]

Another great progress in terms of oil and gas industries at the new order era was on 1966 when Ibnu Soetowo and Independent Indonesia American Petroleum Company (IIAPCO) used a new model of contract called as Production Sharing Contract. This contract was recognized as the

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[55] *Ibid,* p. 27.
[56] *Ibid,* p. 33.

best synthesis of how Indonesia compromise with the west capitalism and the sense of nationalism. This model successfully accommodate the economic interest of the nation which contain some principles of cooperation within, such as :

1) Production sharing contract has eliminate the concession model in Indonesia.
2) There will be more involvement of the government in the mining process which will be depends on the mined materials.
3) The authority of cultivation and control are under Pertamina who will be then responsible to the government.
4) Basically, this contract was an adjustment of cooperation between Pertamina and foreign company
5) Foreign company shall provide fund and technical assessment for the oil and gas mining.
6) Foreign contract shall bear the funding risk and is return shall be based on the production result.[57]

The establishment of PT. Pertamina brought some improvements to the industries of oil and gas. In terms of business effectivity and efficiency PT. Pertamina has boosted it to the next level where the government has made the company to be an integrated oil company. On the other hand, in terms of production, the company has been successfully

[57] Abrar Saleng, *Hukum Pertambangan*, Yogyakarta, UII press, 2004, p. 61.

advanced the use of natural gas to be Liquified Natural Gas (LNG) and Liquified Petroleum Gas (LPG). Nowadays, LPG have been consumed by almost all of the population nationwide and even exported to some other countries like Japan. The company also has felt what so called as "golden decade" by some Countries of oil producer when the oil price reached 30 USD per barrel in 1970's.[58]

Up until the 1990's PT. Pertamina has been an overrated company of the nation. No longer from that time, it was in 1998 where the New Order regime has fallen and changed into the era of reform. The 1945 constitution also got amended at least four times until 2002. The result of the amendment was the system of constitutional State's organs. The face of the constitutional system at that time was the birth of "independent regulatory agencies" non structural or other similar executive branch agencies. Oil and gas governance has received its effect when the Act Number 22 of 2001 issued. The integral part of the idea of this law was to build an independent executive body who will supervise, control, and manage the industry of oil and gas.

The idea of establishing an independent body came out in the form of Government Regulation Number 42 of 2002 about *Badan Pelaksana Kegiatan Usaha Hulu Minyak dan Gas* (BP MIGAS) whose its authorities are derived from article 44 of the Act Number 22 of 2001 juncto article 10 of the government regulation. Subsequently, there was Government

[58]*Ibid,* p. 36.

Regulation Number 35 of 2004 which was then amended to the Government Regulation Number 34 of 2005 about Upstream Oil and Gas Activities. Meanwhile in the downstream sector, there was Government Regulation Number 67 of 2002 which was amended to be Government Regulation Number 36 of 2004 and to be Government Regulation Number 30 of 2009 about Downstream Oil and Gas Activities.

2. Upstream Oil and Gas Activities

a. General Overview on Upstream Oil and Gas Activities

The oil and gas industry is generally divided into two big sectors, namely upstream business activities and downstream business activities. The upstream one also consist of two big stages that are exploration and exploitation of oil and gas reserves beneath the earth surfaces.[59] The upstream activities are regulated by the Act Number 22 of 2001 as its highest legislation. It is also accompanied by some other integral legal instruments such as Government Regulation Number 35 of 2004 which is lately amended become Government Regulation Number 34 of 2005 regarding the Upstream Business Activities. There are also some other regulations related with the upstream activities, Government Regulation Number 79 of 2010 about Cost Recovery and Income Tax in Upstream

[59] Oentoeng Suria and Partners, *Indonesia's Oil and Gas Laws : A Legal Introduction,* Jakarta, Oentoeng Suria and Partners in Association with Blake Dawson, 2011, p.

Industry, Ministry of Energy and Mineral Resources Regulation (MoEMR Regulation) Number 35 of 2008 about Public Procurement Procedure of Working Areas, and the latest one is MoEMR Regulation Number 37 of 2016 about 10% participating interest offering provision in the oil and gas working area.

The upstream business activities which conducted in Indonesia territory will be called as "working area". An area which will be granted by the authority of Directorate General of Oil and Gas (*Dirjen Migas*), Minister of Energy and Mineral Resources (MoEMR), and the local government where the oil and gas will be explored and exploited. A working area can be granted to a business entity or permanent enterprises through a fair public procurement and or direct offers. Every business entity or permanent enterprises who desire to obtain the official bid information shall register itself by completing bid document which consist of[60]:

1) Application form,
2) Work program & budget,
3) Technical report & montage,
4) Financial report,
5) A Statement regarding bonuses,
6) All consortium agreement (if any),

[60] Asvira Rahmadani, *Change of Control in Indonesian Production Sharing Contract,* Tilburg, Tilburg Law School, 2014, p. 15.

7) Production sharing contract draft,

8) A Statement agreeing to the PSC draft,

9) Copy of notarized deed/articles of establishment,

10) A compliance Statement and etc.

Meanwhile on the other way, business entity or permanent enterprises who wants to obtain a working area through a direct offer could propose a joint study. The company shall submit a different document which at least consist of[61] :

1) The boundary of proposed Area;

2) Geology overview of proposed Area;

3) A Company profile including financial report, letter of covert from a Indonesian prime bank, and list of Oil and Gas expertise;

4) A Statement regarding collateral of joint study;

5) Joint Study Planning and Schedule.

When the entity got its Joint Study approved, the entity shall conduct the joint study through some phases which are geological survey, geophysical survey or geochemistry survey during 8 months and it is extendable for maximum 4 months.

The upstream business activities are fundamentally connected with the exploration and exploitation. Upstream business activities of oil at the stage of production aimed at lifting oil and gas located underground to the

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[61] *Ibid.*

surface. This upstream oil activity is the most important part because it is the forerunner of the oil business.[62] After obtaining a working area, a business entity will try to explore the economic potential values within the area. This exploration phase is aiming to[63]:

a. Obtaining information on geological conditions;
b. Find and estimate oil and gas reserves; and
c. Determine the location of the working area.

Meanwhile, the exploitation activities are aimed to[64]:

1. Produce oil and gas;
2. Determine where the working area is, which consists of:
   1) Drilling and well completion;
   2) Development of transportation, storage and processing facilities;
   3) Separation and purification of oil and gas;
   4) Other supporting activities.

Based on the old law, in the upstream business activities, PT. Pertamina had an exclusive authority to mine, own the operational authority, and also as the upstream regulator. At that time, Pertamina had a special directorate who manage the production sharing contract, risk and financing, economic return (profit) with the contractor in any working

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[62] http://www.prosesindustri.com/2016/08/alur-kegiatan-hulu-migas-di-indonesia.html (accessed on July 4th 2017)
[63] H. Salim HS, *Op. cit,* p. 237.
[64] *Ibid*, p. 237.

areas in the country. But nowadays, by issuing the law of 2001, those authorities are shifted to the *BP Migas* as a State Owned Legal Body.[65]

b. The Authority of Executing Body *(BP Migas)* in Upstream Oil and Gas Activities

Before the current Act Number 22 of 2001 about Oil and Gas, there was an Act Number 44 Prp of 1960 that regulates about oil and gas. The old law only recognized two actors namely the Government and PT. Pertamina. At that time, the function as regulator and supervisor were in the hand of the government. Meanwhile the function of business operator and technical issues were run by Pertamina as a State Owned Enterprises (SOE). The old law limits the role of foreign contractors only as the contractor of Pertamina and were designated to do the task that Pertamina could not complete yet.[66]

The old law gave very broad authorities to Pertamina in the governance and management of oil and gas industry in Indonesia. This got even broader because of the fact that Pertamina as a State Company was established based on an Act Number 8 of 1971. This issue was different to the nowadays concept in which an SOE is established only based on a Government Regulation (*PP).* Those authorities of Pertamina were

[65] Adrian Sutedi, *Hukum Pertambangan*, Jakarta, Sinar Grafika, 2011, p. 65.
[66] Jawahir Thontowi, *Loc. Cit*, p. 79.

inseparable to the oil and gas itself as a strategic commodity to the nation.[67]

The new law, Act Number 22 of 2001 consider a lot about the separation of functions that consist of regulating function, supervising function, and operating function. This issue means changing the position of Pertamina as the only mining authority holder (monopoly) at the previous time, to be an ordinary contractor in the form of Limited Liability Company (*PT*). The control of oil and gas was given back to the government based on the article 4 section (2). On the ground of this virtue of law, the government then established the so called Executing Body of oil and gas or *Badan Pelaksana Minyak dan Gas (BP Migas)*.[68]

BP Migas was established based on the Government Regulation Number 42 of 2002. This body was designed to carry out the whole aspects of upstream oil and gas activities covering exploration and exploitation. The body has a function of supervising all the upstream activities for the greatest purpose of people welfare and shall be in line with the thoughts of founding father of the nation as stipulated in the article 33 section (3) of the 1945 Constitution.[69] To perform those functions, the Executing Body has the tasks to[70] :

a. giving consideration to the Minister for his discretion in matters of preparation and supply of Work Areas and Cooperation Contracts;

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[67] *Ibid,* p. *80.*

[68] *Ibid.*

[69] Dyah Silvana Amalia, *Tanggung Jawab Negara dalam Pengelolaan Minyak dan Gas Bumi*, Jakarta, Jurnal Ilmiah FENOMENA, Volume XII, 2014, p. 1.

[70] Article 11 of Government Regulation Number 42 of 2002.

b. carrying out the signing of Cooperation Contracts;
c. review and submit the first field development plan that will be produced within a Work Area to the Minister to obtain approval;
d. provide approval of field development plan other than as referred to in letter c;
e. grant approval of work plans and budgets;
f. carry out monitoring and report to the Minister on implementation Cooperation Contract;
g. appoint sellers of the Petroleum and / or Natural Gas owned by the State which may provide the greatest advantage to the State.

In carrying out its duties, the Implementing Body has the authority[71] :

a. foster cooperation in the framework of integration and synchronization of the operational activities of Contractor of Cooperation Contract;
b. formulating policy on the contractor's budget and the work program of Contractor of Cooperation Contract;
c. oversee the main operational activities of Contractor of Cooperation Contract operators;
d. fostering all assets of the Contractor of Cooperation Contract that belongs to the State;

[71] *Ibid,* Article 12.

e. coordinating with the related parties and / or agencies in the implementation of Upstream Business Activities.

c. The Dissolution of the Oil and Gas Executing Body through a Decision of Constitutional Court

The establishment of *BP Migas* as an executing body was considered in line by the government with the Act Number 22 of 2001 about oil and gas. It was also considered suitable with the spirit of the article 33 section (3) of the 1945 constitution in which "earth and water and the natural resources contained therein are controlled by the State and utilized as much as possible for the welfare of the people. The Constitutional Court has defined the phrase "utilized as much as possible for the welfare of the people.." as the guidance for the government to manage, govern, and control the earth, water, and natural resources within the territory of Indonesia.[72] Therefore, if the control of the State is not directly linked with the greatest prosperity of the people it can be interpreted that the control is unconstitutional.[73]

Unfortunately, the Constitutional Court had a different idea of the *BP Migas*'s existence. The court by means of a Decision Number 36/PUU-X/2012 has Stated the existence of *BP Migas* as

[72] The Constitutional Court Decision Number 3/PUU-VIII/2010, 2010, p.*158*

[73] M. Ilham F Putuhena, *Politik Hukum Pengelolaan Hulu Migas Pasca Putusan Mahkamah Konstitusi*, Jakarta, Rechtsvinding, Volume 4 Number 2, 2015, p. 238.

unconstitutional and was contradicted with the 1945 Constitution. The court granted the decision for the judicial review over the Law Number 22 of 2001. The judicial review was represented by at least 30 intellectuals and 12 Mass Organization such as PP Muhammadiyah, Hizbut Tahrir Indonesia, PP Persatuan Umat Islam, PP Lajnah Tanfidziyah Syarikat Islam, PP Al-Irsyad Al-Islamiyah, PP Persaudaraan Muslim Indonesia, Pimpinan Besar Pemuda Muslimin Indonesia, Al Jami'yatul Washliyah, Solidaritas Juru Parkir, Pedagang Kaki Lima, Pengusaha dan Karyawan (SOJUPEK), Kesatuan Aksi Mahasiswa Muslim Indonesia dan Ikatan Advokat Indonesia. Within their petition, there are at least 6 main points namely[74] :

1) the position and authority of the oil and gas executing body, hereinafter referred to as BP Migas;
2) oil and gas cooperation contracts;
3) the phrase "organized through fair, healthy, and transparent business competition mechanism";
4) SOE position that can no longer do monopoly;
5) A ban on the unification of upstream and downstream businesses
6) PSC notification to the House of Representatives (*Dewan Permusyawaratan Rakyat*)

[74] Jawahir Thontowi, *Loc. Cit*, p. 85.

The court's decision mentioned at least 3 main argumentations that are as follow :

1) the government can not directly manage or directly appoint State Owned Enterprises (*SOE)* to manage all oil and gas working areas in upstream business activities;
2) after *BP Migas* signed the Production Sharing Contract (PSC), the State will be immediately bound to the agreement or the clauses therein, which resulted in the State losing its independency in issuing policies contrary to the content of PSC;
3) the maximum benefit of the State for the greatest prosperity of the people decrease, because there is potential for control of oil and gas and the profits of them are done by the permanent legal entity and / or private legal entity conducted on the principle of fair and transparent business competition.

This model of mastery has removed the State's direct control over natural resources in the form of oil and gas. The State loses its authority to directly appoint SOEs to manage their natural resources. Whereas the function of management and control itself is the most fundamental form of State control to achieve the greatest welfare of the people.[75]

[75]*Ibid,* p. 240.

The court decision emphasized on the unconstitutionality of *BP Migas* and the urgency of a new relationship model in the management of oil and gas. Ever since the court decision issued, there has not been any single Act that change the current regulation substantially. The only short term solution made by the Government is by issuing a new Government Regulation Number 9 of 2013 which established Special Work Unit or *Satuan Kerja Khusus MIigas (SKK Migas)*. This regulation was meant to fill the absence of a certain body who supervise the upstream businesses after the Constitutional Court decision. However, this regulation was a lot criticized and was called as a "temporary medicine" to answer the legal problems that come out from the court decision.[76]

3. Contract Regime in Oil and Gas Law

The Act Number 22 of 2001 is a perfect reflection of Article 33 of 1945 Constitution which emphasized that oil and gas is one strategic natural resources controlled by State and used for the greatest purpose of people welfare. The authority as an operator, regulator, and supervisor at the upstream oil and gas mining is shifted from PT. Pertamina based on previous regulation, to be under the authority of Operating Body (*Badan Pelaksana)*. There are *BP Migas* who control the upstream activities, and *BPH Migas* for the downstream activities. The process of the issuance of this act has been a complicated long road along with the involvement of *International Monetary*

[76] M. Ilham F Putuhena, *Op. Cit,* p. 247.

Fund who promised to grant more financial assistance if Indonesia could reform its oil and gas governance.[77]

Unfortunately, *BP Migas* was Stated unconstitutional and dismissed by the Constitutional Court by a decision Number 36/PUU-X/2012 because of 3 reasoning. The first one is because the court agrees that the Government had some difficulties in directly control the natural resources. Secondly, the *BP Migas* wholly bound by contractual obligation under Production Sharing Contract (PSC) which causes Government has no flexibility in issuing new regulation outside the signed contract. Meanwhile the last one is that the Government has failed in resulting profits for the greatest purpose of the people welfare by let the control over the oil and gas industry fell under the market mechanism. The court argue that the Government shall actively involve not only as a regulator but also until the operational issue. The form of contract under this law that become the ground for the government to regulate the industry comprises of two kind, they are Production Sharing Contract (PSC) and Cooperation Contract.[78]

a. Concession Contract

Black's Law Dictionary give the definition of concession as follows :

> "A contract in which a country transfers some rights to a foreign enterprise which then engages in an activity (such as mining)

[77] Extractive Industry Transparency Initiative (EITI) Indonesia, *Laporan EITI Indonesia 2014; Laporan Kontekstual*, Jakarta, EITI Indonesia, 2014, p. 10.
[78] *Ibid,* p. 11.

> contingent on State approval and subject to the terms of the contract".[79]

Meanwhile investopedia defined concession as :

> "A concession agreement is a negotiated contract between a company and a government that gives the company the right to operate a specific business within the government's jurisdiction, subject to certain conditions. Concession agreements may also refer to agreements between the owner of a facility and the concession owners or concessionaires that grant the latter exclusive rights to operate a specified business in the facility under specified conditions".[80]

Concession is an agreement made by the State as the owner of the natural resources with the business entity or called as investor. Upon the agreement made between them, the investor will get the right to explore and conduct oil and gas production as well as to sell it without any government involvement in the operational and managerial issues.[81] In Indonesia alone, this model of contract has been used since the Dutch colonial era. At that time, the concession contract often used by the government in cooperating with the company to lift and develop oil and gas reserves. The contract has a certain royalty that must be paid to the

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[79] Bryan A. Garner, *Black's Law Dictionary*, Texas, La*W*Prose,Inc., 2009, p. 328.
[80]http://www.investopedia.com/terms/c/concessionagreement.asp, accessed on October 29th, 2017.
[81] Rudi M. Simamora, *Op. cit,* p. 55.

government and a defined period of time (usually 75 years or more) in which the company may utilize the agreed areas.[82]

With this concession system, hydrocarbons are belongs to the contractors and they have the obligation to pay some physical royalties in the form of money up to the oil and gas put in a well. On the other hand, the contractors are posses the installation until the contract is out of date. Alternatively, for some of the installations that are no longer in use, can be thrown away by the contractors with their own fund. The contractor may reuse the installation for the discovery of the same oil and gas reserves in the territory of Indonesia the State shall obtain the following[83] :

1. Bonus of signing or production;
2. surface fee ;
3. royalties or production;
4. tax or income;
5. in some cases the State may obtain an excess profit tax.

Other arrangements can be seen from the fact that oil and gas companies obtain the management rights to oil and gas reserves they find and can be developed commercially. In fact, the company can also do the same activities of processing, storage, distribution, and marketing of oil

[82] Zhigou Gaw, *International Offshore Petroleum Contract : Towards Compatibility of Energy Need and Sustainable Development"*, Dalhousie University, Halifax, Canada, p. 27. As quoted from Muhammad Syahrir, *Studi Komparatif antara Sistem Kontrak Bagi Hasil Minyak dan Gas Bumi di Indonesia dengan Sistem Konsesi,* Depok, Fakultas Hukum Universitas Indonesia, 2011, p. 26.

[83] Majdedi Hasan, *Kontrak Minyak dan Gas Bumi Berasas Keadilan dan Kepastian Hukum,* Jakarta, PT. Fikahati Aneska , 2009, p. 17.

and gas products they produce. The conditions of oil and gas industry with concession system can be briefly explained by the following points :

1. Oil and gas companies with risk and own funding may conduct exploration and exploitation activities.
2. The Company has ownership rights over oil and gas production from the concession area and is obliged to submit some of its oil to Domestic Marketing Obligaiton (DMO).
3. The company must pay the rental fee during the exploration in the designated area.
4. Royalties are paid by cash and / or with the resulting oil and gas products.
5. The Company shall pay taxes on its profits.
6. Company assets belong to oil companies at the end of their business activities.

The weakness of this concession contract system is the absence of government in the operational aspects of the oil and gas company. The government cannot regulate the guidance policy, the lack of efforts to improve human resources from Indonesia, and no transfer of technology.[84]

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[84] Keith W. Blinn, et. Al, *International Petroleum Exploration and Exploitation : Legal, Economic, and Policy Aspects,* New York, Barrows Company Inc., 1986, p. 61. As quoted from Muhammad Syahrir, *Op. Cit,* p. 27.

b. Production Sharing Contract

This particular model of contract has been recognized and used in Indonesia from such a long time. The definition of Production Sharing Contract (PSC) itself can be found in the Act Number 12 section (2) of 1971 about Pertamina. At that time, Pertamina was the only holder of mining authority in Indonesia for oil and gas sector. In the implementation, lack of budgets owned by Pertamina, made them possible to do the mining through a PSC with any contractor desired. Meanwhile in the current Act Number 22 of 2001 about oil and gas, article 1 section (19) the term used is Cooperation Contract (*Kontrak Kerjasama)*. This kind of contract can be implemented in the two forms, namely PSC and other kind of cooperation contract.[85]

Soedjono Dirdjosisworo defined PSC as :

"Cooperation with the profit-sharing system between state enterprises and foreign companies that is contractual. If the contract is exhausted then the machines brought by foreign parties remain in Indonesia. This form of cooperation is a foreign credit in which the payment is made by means of profit sharing to the production that has been produced by the company".[86]

[85] Haris Retno Susmiyati, *Legal Aspect of Production Sharing Contract on Oil and Gas Mining in Indonesia*, Samarinda, Risalah Hukum Fakultas Hukum Universitas Mulawarman, 2006, p. 98.

[86] H. Salim HS, *Loc. Cit*, p.38.

In a standard draft of a PSC, *BP Migas* or any ruling Executing Body is responsible over operational management and the contractor is responsible for the operational execution based on the clauses in the contract. Therefore, there is only one appointed contractor who will operating an agreed work area. The contractor shall also be responsible for the agreed Work Plan and execute it scientifically proper. On the other side, the Executing Body (currently *SKK Migas*) shall give any necessary assistance, give consultation, and swipe away any possible barriers.[87]

The shared profit came out from this contract will be estimated based on the production result not from the profit / sales result. That is why this contract called as “production sharing” rather than “profit sharing” instead. Basically, PSC cannot deliver the profits proportionally to the parties of the contract. This is happen because the government has its own authority to issue any regulations in order to get a maximum profits from the contract and minimize the possible risks.[88]

Production shares are calculated on the basis of production rather than profit in the sense of production sharing is not profit sharing. So the calculation will be in contrast to production sharing as well as to be understood that production is the amount of volume of oil produced from the well in the unit barrel. For example, on the State work contract will get

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[87] Muhamamd Syahrir, *Loc. Cit,* p. 32.

[88] Sang Ayu Putu Rahayu, *Prinsip Hukum dalam Kontrak Kerjasama Kegiatan Usaha Hulu Minyak dan Gas Bumi*, Surabaya, Jurnal Hukum Yuridika Fakultas Hukum Universitas Airlangga, Volume 32, 2017, p. 349.

a profit share on profit (profit sharing), but there is also royalty system where the State will earn royalty of a certain percentage of the production with all costs are borne by the contractor. On the profit sharing contracts the result of operating activities will be shared between the State and the contractor after decreased by the production costs. Basically, the division of production in the PSC is done by “inkind”, which means the divided profit is in the form of oil and gas production itself not the result of the sale. The profit that will be achieved later in the cooperation contract is in the form of oil and gas that will be firstly divided proportionally and then will be calculated by its commercial values and not *vice versa*. So the division is in the form of oil and gas under the terms of the PSC itself. The principle of proportional sharing is the main principles in the implementation of PSC especially PSC, because the principle of profit sharing proportional is an important principle for the fulfillment of a sense of justice related to the proportion of production shares to be received by the State.[89]

The concept of PSC in the Act Number 22 of 2001 about Oil and Gas is as follow[90] :

1) Ownership of natural resources remains in the hands of the Indonesian government;

[89]*Ibid*, p. 350 – 351.
[90] Article 6 section (2), Act Number 22 of 2001 about Oil and Gas.

2) Control of operations management is basically kept under the control of the government;
3) Capital and risk are borne by investors acting as contractors from the government.

The characteristic of PSC as defined by the law above is firstly, the investor is responsible to any possible risks occur in the exploration. If in the exploration period of time, the oil and gas reserves are not found than there will be no compensation. Second of all, all of the oil and gas reserves discovered and all of the installations used are all belong to the State. The basic provisions of the PSC were firstly defined by the Government Regulation Number 35 of 1994 about Terms and Guidance for the Profit Sharing Contract of Oil and Gas which now become Government Regulation Number 35 of 2004 about Upstream Oil and Gas Activities. Under the current regulation, PSC at least contains basic provisions namely[91] :

a. State revenue;
b. Work Area and its return;
c. the obligation to disburse funds;
d. transfer of ownership of production of Oil and Gas;
e. duration and conditions of contract extension;
f. dispute resolution;
g. the obligation to supply petroleum and / or natural gas for domestic needs;

[91] Article 26, Government Regulation Number 35 of 2004.

h. termination of contract;
i. mining operation paste obligations;
j. occupational Health and Safety;
k. management of the environment;
l. transfer of rights and obligations;
m. reporting required;
n. field development plan;
o. prioritization of the utilization of domestic goods and services;
p. the development of the surrounding community and the guarantee of the rights of indigenous peoples;
q. prioritizing the use of Indonesian labor.

Meanwhile, the Law Number 22 of 2001 explain about the basic principle of PSC as follows[92] :

1. Supervision of management of mining operations shall be done by the Executing Body;
2. There shall be a contract signature bonus payment whose value is stipulated by the government in addition to other bonuses that when the commercialization stage is reached a certain production level;
3. The term of the contract for the exploration period shall be considered, ie for 4 years and may be extended for 6 years;

[92] Alan Frederik, *Prinsip Dasar Kontrak Kerja Sama*, Paper on Loka Karya Litigasi, Denpasar, 2004, p. 47. As quoted from Muhammad Syahrir, *Loc. Cit*, p. 37.

4. The Contractor is required to provide a fee to perform activities based on a definite commitment within a certain period of time since the contract is signed;
5. All production costs shall be borne by the contractor and the contractor shall be liable for any costs incurred if no suitable oil and gas reserves are found to be commercially produced;
6. All production costs can be 100% to cost recovery by contractor from production if oil and gas is found;
7. The government sets the amount of First Tranche Petroleum (FTP);
8. The sharing of production between the Executing Body and the contractor shall be stipulated by the government in a certain percentage. The share of the share of each party's share depends on the risks and difficulties in the region;
9. The Contractor shall periodically re-allocate part of its work area during the exploration period, the working area during production shall not exceed a certain percentage specified in the agreement of the previous area;
10. All equipment purchased by the contractor for its operations becomes State property managed by the Implementing Body after entering the Indonesian port;
11. The Contractor shall meet the needs of domestic market or Domestic Market Obligation (DMO) after its production reaches commercial production level;

12. The Contractor is obliged to market State-owned crude oil from production in its working territory if the government does not specify another will;
13. The Contractor shall directly pay the company's tax to the government, the interest on the royalty dividend in accordance with the provisions in the taxation field;
14. Contractors are obliged to employ national labor in operational activities taking place in their working areas and have an obligation to use national procurement to meet the needs of goods and services;
15. Contractors may obtain intensive *pro rate* prices for the first 5 years of production equal to market prices, credit investments in certain percentage amounts for development facilities built by contractors, intensive sea for offshore operations at a certain depth, intense marginal field for the purpose tackling the decline in national production in a scientific way by developing fields with small reserves that have been difficult to disintegrate.

The goals of PSC itself are to overcoming the limitations and lack of capital, technologies, and the human resources faced by Pertamina as a State Owned Enterprises especially on running the exploration and exploitation of oil and gas.[93]

[93] Rudi M. Simamora, *Loc. Cit*, p. 93.

Every State has a full sovereignty to decide what kind of contract they would like to use for the oil and gas governance. They can choose freely with considering the situation and condition within their own territories. Here is a table of types of oil and gas contracts around the globe:

Table 2. 1 Oil and Gas Contract in Various Countries[94]

No	Regions	Concession Contract	Productions Sharing Contract (PSC)	Risk Service Contract
1	**Middle East**	Ajman Dubai Fujairah Abu Dhabi Neutral Zone Sharjah	Bahrain Iraq Jordan Oman Qatar Syria Yemen	Iran Kuwait Saudi Arabia
2	**Asia & Oceania**	Australia Brunei Darussalam South Korea Pakistan Ons ONG New Zealand Thailand	Bangladesh China Indonesia India Lao Cambodia Malaysia	Filipina

[94] Barrow Company, as quoted from Majdedi Hasan, *Loc. Cit*, p. 53.

<table>
<tr><td></td><td></td><td>Timor Gap B</td><td>Myanmar
Mongolia
Nepal
Pakistan Offs
Sri Lanka
Timor Gap A
Vietnam</td><td></td></tr>
<tr><td>3</td><td>Former of Union of Soviet Socialist Republics (USSR)</td><td></td><td>Azerbaijan
Georgia
Kazakhstan
Kyrgyzstan
Russia
Turkmenistan
Uzbekistan</td><td></td></tr>
<tr><td>4</td><td>Latin America</td><td>Argentina
Bolivia
Brazil (new)
Columbia
Costa Rica
Fakland
Paraguay
Peru
Trinidad</td><td>Belize
Cuba
Guatemala
Guyana
Jamaica
Nicaragua
Panama
Trinidad
Uruguay</td><td>Brazil (old)
Chile
Grenada
Venezuela (old)
Haiti
Honduras
Panama
Peru</td></tr>
</table>

5	**Africa**	Central Africa South Africa Chad Ghana Congo Madagascar Malawi Mali Morocco Namibia Niger Nigeria Senegal Seychelles Somalia Tunisia (old)	Aljazeera Angola Benin Congo Ethiopia Gabon Gambia Guinea Cameroon Kenya Liberia Libya Madagascar Egypt Mozambique Nigeria Côte d'Ivoire Sudan Tanzania Togo Tunisia (new) Uganda Zambia	Nigeria

6	**North America**	Canada USA		
7	**Europe**	Netherland Bulgaria Czech Republic Denmark Hungary England Ireland Italy Norway France Portugal Rumania Spain Turkey Yunani	Albania Malta Poland Turkey	

B. GENERAL OVERVIEW ON MINERAL AND COAL GOVERNANCE IN INDONESIA

1. The Exploitation of Mineral and Coal Mining based on Act Number 11 of 1967 about Basic Provisions of Mining

There are some factors that influence the business of mineral and coal mining. Economic development, social equity, and environmental protection become a single converged factors that predispose the policies and implementation of mineral and coal governance. This issue is correlated with the fact that mineral and coal is a non-renewable natural resources. Thus the concept of sustainable development goal try to collaborate those three factors in order to maintain the reserves of mineral and coal.[95]

In Indonesia, the management of mineral and coal as one of extractive industry product is oriented to the manifestation of Article 33 section (3) of 1945 Constitution. State shall be the one and only holder of control right.[96] This right gives the government of Indonesia the right to control or manage the natural resources by any means such as issuing permission, licenses,

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[95] Ahmad Redi, *Dilema Penegakan Hukum Penambangan Mineral dan Barubara Tanpa Izin Pada Pertambangan Skala Kecil*, Jakarta, Rechtsvinding, Volume 5 Number 3, 2016, p. 400.

[96] Constitutional Court gave a commentary on the meaning of control right of the State in the decision Number 001-021-022/PUU-I/2003. The people collectively give the mandate to the State to make policy *(beleid)*, management action (*bestuursdaad*), arrangement (*regelendaad*), management (*behersdaad*), and supervision (*toezichthoundaad*), for the greatest purpose of people welfare.

concession, or signing any necessary contract in order to utilize the natural resources for the greatest purpose of people welfare.[97]

Mineral and coal mining activities were once regulated by the Act Number 11 of 1967 about basic provisions of mining. At that time there were 3 (three) types of mining business in Indonesia, they were :

a. Mining Power (*Kuasa Pertambangan*)

Mining power is one type of legal instrument that can be granted to any parties who want to do a mining activity. The Law Number 11 of 1967 defined the mining power as an authority given to a legal body or individuals to run a mining activities. Mining power itself consists of 3 (three) forms that are:

1) Mining Assignment Decree (*Surat Keputusan Penugasan Pertambangan*)

   This kind of decree is an authority to mine which the related Minister, Governor, or Regent/Mayor grants. It can be given to a governmental institution and only include a general investigation and exploration stage.[98]

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[97] *Ibid,* p. 401.

[98] Article 2, section (2), Government Regulation Number 75 of 2011 about The Second Amendment of Government Regulation 32 of 1969 about The Implementation of Law Number 11 of 1967 about Basic Provisions of Mining. As quoted from Nisran Simamora, *Analisis Yuridis Terhadap Ketentuan-ketentuan Izin Usaha Pertambangan Eksplorasi dan Izin Usaha Pertambangan Operasi Produksi Berdasarkan Undang-undang Nomor 4 Tahun 2009 Tentang Pertambangan Mineral dan Batubara* (*Studi Kasus Terhadap IUP Eksplorasi Timah PT. Bumi Palong dan IUP Operasi Produksi Batubara PT. Mitra Tambang Barito*), Depok, Fakultas Hukum Universitas Indonesia, 2012, p.16.

2) People's Mining Permit Decree (*Surat Keputusan Izin Usaha Rakyat*)

   This decree is come from Regent/Mayor who grants a mining authority to the local people to conduct a mining activity in a small scale with a very limited area. It is including some stages such as general investigation, exploration, exploitation, processing, purification, transportation and also sales.[99]

3) Mining Authorization Decree (*Surat Keputusan Pemberian Kuasa Pertambangan*)

   This form is a mining authority which is given by the related Minister, Governor, or Regent/Mayor. It can be given to a governmental institution and including the whole stages of activities namely general investigation, exploration, exploitation, processing, purification, transportation and also sales.[100]

Meanwhile, from the business aspects, mining authority is divided into 5 (five) types namely :

i. General Investigation Mining Authority
ii. Exploration Mining Authority
iii. Exploitation Mining Authority

[99] *Ibid*, article 2, section (3).
[100] *Ibid,* article 2, section (4).

iv. Processing and Purification Mining Authority

v. Transportation and Sales Mining Authority

b. Contract of Work (*Kontrak Karya*)

The definition of contract of work was found in the Minister of Energy and Mineral Resources Decree Number 1614 of 2004 about Guidance on Process of Contract of Work Application and Agreement of Work of Coal Mining Activities as follow[101]:

> "An agreement between Indonesia Government with a national legal enterprises in order for foreign direct investment to conduct a mining business of minerals excluding oil, gas, geothermal, radioactive, and coal".

There are two objects of this contract namely Indonesian government and the national legal enterprises. The major capital of the enterprises are come from foreign capital. The amount of the capital is 95% maximum from foreign capital and 5% minimum from the national partner. The objects of the contracts can be any extractive products except oil, gas, geothermal, radioactive, and coal. The minerals that can be mined are such as gold, silver, and *copper*.[102]

c. Agreement of Work on Coal Mining Activities (*PKP2B*)

[101]Article 1, section (1), Minister of Energy and Mineral Resources Decree Number 1614 of 2004 about Guidance on Process of Contract of Work Application and Agreement of Work of Coal Mining Activities

[102] H. Salim HS, *Loc. Cit*, p. 129.

Presidential Decree Number 74 of 1996 about Basic Provisions of Mining defined *PKP2B* as[103]:

> "agreement of work that is made between Indonesian government and private contractor company to conduct coal mining activities."

Another definition also given by a Decision of Minister of Mining and Energy Number 1409.K/201/M.PE/1996 about The Procedures on Application of Mining Authority, Principal Permit, Contract of Work, and *PKP2B*. It defined *PKP2B* as follows[104]:

> "*PKP2B* is an agreement made between Indonesian government and foreign private company or a joint venture company (in order for foreign investment) aiming for coal business guided by Act Number 1 of 1967 about Foreign Investment and Act Number 11 of 1967 about Basic Provisions of Mining."

Those two definitions have some differences in defining *PKP2B.* In the Presidential Decree Number 75 of 1996, it was not clear about what kind of private company that may run coal business. Meanwhile in the Decision of Minister of Mining and Energy Number 1409.K/201/M.PE/1996 mentioned that all of the national private

[103] Article 1, Presidential Decree Number 75 of 1966 about Basic Provisions of Mining.
[104]Article 1, Decision of Minister of Mining and Energy Number 1409.K/201/M.PE/1996 about The Procedures on Application of Mining Authority, Principal Permit, Contract of Work, and *PKP2B.*

company, foreign private company, or joint venture company have the access and right to apply *PKP2B* and run a coal mining businesses.[105]

2. The Exploitation of Mineral and Coal Mining based on Act Number 4 of 2009 about Mineral and Coal Mining

The issuance of the Act Number 4 of 2009 about Mineral and Coal Mining has replace the existence of Act Number 11 of 1967 about Basic Provisions of Mining and also changes some of mineral and coal governance in Indonesia. One of the biggest impact of the current act is the elimination of mining authority and contract of work to be the regime of licensing regime. Another significant changes of mineral and coal governance include the regulation regarding working areas of mining, business form of mining, and the abolition of different treatments to the national and foreign companies.

In the context of mastery of mineral and coal, the current law brought a significant change. Although the control over the natural resources is still based on the article 33 section (3) of 1945 Constitution, but there is a new element added namely local autonomy. The control over natural resources is not only done by the central government but also by local government. This concept is an integral part and is inseparable by the spirit of reformation.

a. Mining Areas

[105] Nisran Simamora, *Loc. Cit*, p. 18.

In Law Number 4 of 2009 on Mineral and Coal Mining, there is a regulation concerning mining areas in which it is not found in the Law Number 11 of 1967. Mining area is defined as follows:[106]

> "Mining areas (*WP*), are areas that have mineral and / or coal potential and are not bound by government administrative boundaries that are part of the national spatial plan."

Based on Article 9 paragraph (1) of Law Number 4 of 2009 concerning Mining of Minerals and Coal is regulated on Mining Areas (*WP*) which is Stated as the basis for the determination of mining activities. Determination of this area is carried out by the government after coordinating with the local government and in consultation with the House of Representatives (*DPR*). Determination of the territory should be implemented through the following process:[107]

1) Transparently, participative, and responsibly;
2) in an integrated manner by taking into account the opinions of relevant government agencies, the public, and by considering the ecological, economic, and socio-cultural aspects as well as being environmentally sound; and
3) taking into account any of regional aspirations.

[106] Article 1, number 29, Act number 4 of 2009.
[107] *Ibid,* article 10.

Mining Area (*WP*) itself is divided into 3 (three) types as follows:[108]

1) Mining Business Area, hereinafter referred to as WUP, is part of Mining Area (*WP*) which already has data availability, potential, and / or geological information.
2) The People's Mining Area (*WP*R) is a part of the Mining Area (*WP*), which is the place where the people's mining business is conducted.
3) State Reserves Areas (*WP*N) are part of Mining Areas (*WP*) reserved for national strategic interests. *WP*N can be cultivated in part of its territory with the approval of DPR RI and the area that will be cultivated will change the status to become a Special Mining Business Region (WUPK).

b. Forms of Mining Operations

In contrast to Law Number 11 of 1967 concerning Basic Provisions on Mining which divides mining business based on strategic excavation, vital excavation and non-vital non-strategic mining, Law Number 4 Year 2009 classifies into two types, namely minerals mining and coal mining. Mineral mining itself classified into some types as follows:[109]

1) Mining of radioactive minerals;
2) metal mineral mining;

[108] *Ibid,* article 1, number 30 – 32.
[109] *Ibid,* article 34, section (2).

3) non-metallic mineral deposits; and
4) rock mining.

The above mining business can be implemented through several forms of mining business, including:[110]

1) Mining Business License (*IUP*)

The definition of Mining Business License (*IUP*) is described in Article 1 Number (7) of Law No. 4 of 2009, which is a license to carry out mining business. Implementation of *IUP* consists of two short stages compared to what has been regulated by law Number 11 of 1967. The two stages are:[111]

i. Exploration *IUP* covering general investigation, exploration and feasibility studies; and
ii. Production Operation *IUP* includes construction, mining, processing and refining activities, as well as transportation and sales.

2) Mining Permit for the People (IPR)

The definition of the People's Mining Permit (IPR) is described in Article 1 Number (10) of Law No. 4 of 2009, which is a license to carry out mining business within a community mining area with

[110] *Ibid*, article 35.
[111] *Ibid*, article 36.

limited area and investment. People's mining activities can only be conducted on the following mines:[112]

a) Metal mineral mining;
b) non-metallic mineral mining;
c) rock mining; and / or
d) coal mining.

The area and period of time for its own IPR in article 68 is explained that for one IPR can be given to individuals of at most one hectare, community group of five hectares, and cooperative at most ten hectares. For the duration of IPR, the maximum period of five years and can be extended.

3) Special Mining Business License (*IUPK*)

Understanding of a Special Mining Business License (*IUPK*) is a license to carry out mining business in a special mining business permit area.[113] Implementation of *IUPK* itself consists of two stages, namely:[114]

a) *IUPK* Exploration, covering general investigation, exploration, and feasibility study;

[112] *Ibid*, article 66.
[113] *Ibid,* article 1, number (11).
[114] *Ibid*, article 76.

b) *IUPK* Production Operation includes construction, mining, processing and refining activities, as well as transportation and sales.

IUPK holders who find other minerals within the Special Mining Permit Operations Area (W*IUPK*) managed are given priority to work on them. If the holder of this Mining Business License intends to seek other minerals to be found, it shall apply for a new *IUP*. If the holder of *IUP* is not interested in obtaining the found mineral, the holder of the *IUP* is obliged to preserve the other minerals because the minerals may be given to other parties by the relevant Minister.

The grant of *IUPK* shall be based on the considerations as described in Article 28 of Law Number 4 Year 2009 as follows:

a) Fulfillment of domestic industrial and energy raw materials;
b) source of foreign exchange;
c) the condition of the region is based on the limited facilities and infrastructure;
d) potentially to be developed as a center of economic growth;
e) environmental carrying capacity; and / or
f) use of high technology and large investment capital.

c. Foreign Investment

Foreign investment in mining is stipulated in Law Number 4 of 2009 and refers to the law number 25 of 2007 on Investment.

1) Form of Foreign Investment

In the law number 4 of 2009 there is no distinction in the form of mining concessions for business entities with foreign capital. Post 38 States that the Mining Business License (*IUP*) may be granted to:

a. Business entity;
b. cooperative;
c. individual.

Among those under Article 75 paragraph (2), *IUPK* may be granted to a legal entity of Indonesia, whether State-owned enterprises (*BUMN*), regional-owned enterprises or private business entities. Business entities are defined as any legal entity engaged in mining established under Indonesian law and domiciled within the territory of the Unitary State of the Republic of Indonesia.

However, on investment, it is stipulated that foreign investment shall be in the form of a Limited Liability Company (*PT*) under Indonesian law and domiciled within the territory of the

Republic of Indonesia, unless otherwise provided by law.[115] Therefore, the form of business of foreign investment in the mining sector is not only in the form of a Limited Liability Company, but may be any other business entity determined by Law number 4 of 2009.

2) Divestment

Foreign investment has a divestment obligation in every business entity whose shares are owned by a foreigner as Stated in law number 4 of 2009[116], that after 5 years of production, *IUP* and *IUPK* business entities whose shares are owned by foreigners are required to divest the shares to Government, Regional Government, State-Owned Enterprises, Regional-Owned Enterprises or private national business entities. Further provisions concerning this divestment are further stipulated in Government Regulation No. 23 of 2010 concerning the Implementation of Mining and Coal Mining Business Activities as amended by Government Regulation No. 24/2012.

[115] Article 5, section (2), Act number 25 of 2007.

[116] Act number 4 of 2009, *Op. Cit*, article 112.

C. THE DIFFERENCES AND SIMILARITIES OF OIL AND GAS AND MINERAL AND COAL INDUSTRIES

The changing environmental dynamics, including the implementation of regional autonomy, is the context behind the birth of a number of changes in the new Mining Act Number 4 of 2009. The most important of these is the abolition of the contract of work (*KK*) system for mining companies and replaced by the mining business license system (*IUP*). Reinforcing the State Ownership Rights (*HPN*), including the control of common assets, the Government should arrange such an arrangement through the expert to direct, oversee and administer the administration of mining business. Therefore it will be starting from the difference in contract system or regime into permit system or regime.[117]

In the contract system or regime as applied so far based on Law Number 11 of 1967, the government's position is not only ambiguous as regulator and contracting party, but also fundamentally lowering the position of the State to be equivalent as contractor. Therefore the legal implications of system or regime change in the new law is to restore the principle of State's control in a statutory position. Here is the comparison between the licensing regime and the contract regime of both extractive industries.

The comparison of permit system or regime and contract system or regime:[118]

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[117] H. Salim HS, *Loc.* Cit. As quoted by Syaepudin, *Analisis Perbandingan Migas dan Minerba*, Fakultas Hukum Universitas Gadjah Mada, Yogyakarta, 2012, p. 4.

[118] *Ibid*, p. 5.

No	Subjects	Permit System/Regime	Contract System/Regime
1	Legal Relation	Has a public characteristic and is a part of administrative law	Has a private characteristic and is subject to private law
2	Legal Application	Only by Government	by both parties
3	Legal Choice	There is no legal choice	There is legal choice which is up to the parties intention
4	Legal Implication	Unilaterally	Based on consensus
5	Dispute Settlement	Administrative Court (*PTUN*)	Arbitration
6	Legal Certainty	More secure	Flexible, based on the consent of both contracting parties
7	Rights and Obligation	Rights and obligations of the government are bigger	Rights and obligations are relatively equal
8	Legal Sources	Applicable regulations (Acts, Government Regulations, Ministerial Regulations, etc)	The clauses of the contract itself

In mineral mining, there is a term of Contract of Work (*KK*). While in the coal mining industry there is the term Working Agreement of Coal Mining Entrepreneurs (*PKP2B*) and Mining Authority (*KP*). This contract system put the State and mining corporation equally. In the contract regime, the State is seen as a mining company's business partner who has no superior positions. This causes the State to remain weak when dealing with corporations in the formulation of contract renewal, royalty and tax withdrawals, as well as environmental and social cases emerging.

The weak position of the State in Law Number 11 of 1967 is what is trying to be changed by the government and the House of Representatives through Law Number 4 of 2009 on Mineral and Coal Mining. There is a fundamental change of regime in the newest act in the governance of the national mining industry. Therefore some terms such as *KK*, *PKP2B* and *KP* were changed to Mining Business License (*IUP*). In this licensing or IUP regime, the State is in a superior position compared to the mining company.[119] The State has the authority to impose administrative sanctions ranging from the temporary suspension of mining activities to the revocation of IUP.[120]

Meanwhile, in the implementation of oil and gas business is currently emphasized in Production Sharing Center (PSC) system because royalties received by the government in this case through the Minister of Energy and

[119] http://www.berdikarionline.com/kontradiksi-dalam-uu-mineral-dan-batubara/ (accessed on November 6th, 2017)

[120] Article 151, section (2), Act Number 4 of 2009.

Mineral Resources is greater. In addition to government acceptable royalties, the PSC system has several other advantages, including:[121]

1. In this system the contractor is only given the economic right to the mining rights controlled by the State Company through the pattern of production sharing, not profit in the form of money (profit sharing)
2. The system also has control mechanisms for contractors
3. All risks borne by the contractor, if it fails then all costs will be borne by the oil and gas entrepreneurs, while the land owner / country will not be asked for compensation.
4. All facilities built by contractors remain government property. In PSC all equipment or installations of oil and gas become State property.
5. Within the PSC, the State remains in control of oil and gas management. The Contractor shall file the program and budget annually to the government for approval.
6. In the standard PSC, the State and contractor sections are 85% and 15%, respectively.

[121] Rudi M. Simamora, *Loc. Cit*, p. 30.

D. STATE’S POWER OVER NATURAL RESOURCES IN ISLAMIC PERSPECTIVE

In the context of Islamic law, the responsibility of the state in the management of oil and gas will bring *maslahah* to the community. In terminological terms, *maslahah* has been given a load of meaning by some scholars of *usûl al-fiqh*. For example, the genuine meaning of *maslahah* is to attract or realize the benefit or to remove or avoid *mudharat* (*jalb al-manfa'ah* or *daf 'al-madarrah*). According to Al-Gazali, what is meant by *maslahah*, in the terminological sense, is to preserve and realize the objectives of Islamic law (*Shariah*) in the form of maintaining religion, soul, mind, descent, and wealth. Thus, the responsibility of the state in oil and gas management according to Islamic law is the benefit for the community.[122] The Qur'an declares that the existing natural resources on earth are aimed at human prosperity, human beings who become *khalifah* to take care of and utilize it without destroying the existing order.[123] As mentioned by the Qur’an Surah Al-An’am, verse 165:

وَهُوَ ٱلَّذِى جَعَلَكُمْ خَلَٰٓئِفَ ٱلْأَرْضِ وَرَفَعَ بَعْضَكُمْ فَوْقَ بَعْضٍ دَرَجَٰتٍ
لِّيَبْلُوَكُمْ فِى مَآ ءَاتَىٰكُمْ ۗ إِنَّ رَبَّكَ سَرِيعُ ٱلْعِقَابِ وَإِنَّهُۥ لَغَفُورٌ رَّحِيمٌۢ ١٦٥

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[122] Asmawi, *Memahami Konsep Maslahah sebagai Inti Maqasid al-Syariah*, Institut Manajemen Zakat, Jakarta, 2012, p.1. As quoted from Dyah Silvana Amalia, *Loc.* Cit, p. 4

[123] Erikh Muhartono, *Pemanfaatan dan Konservasi Sumber Daya Alam,* UIN Syarif Hidayatullah, Jakarta, 2015, p. 2.

"And it is He who has made you successors of the degrees [of rank] that He may try you through what He has given you. Indeed, your Lord is swift in penalty; but indeed, He is Forgiving and Merciful."

In view of the Islamic economic system, the treasures that exist on this earth are not belong to the individual, as in the understanding of the economic system of capitalism. On the contrary, it is not like in the view of the economic system of socialism, which sees that the treasures on earth must be fully controlled by the State. In the Islamic economic system, the ownership of all the assets on earth can be categorized into three groups:

1. Individual ownership, (*syara'* law) which applies to certain substances or benefits, which makes it possible for those who acquire it to use it directly or take compensation (*iwadh*) of the goods.
2. Public ownership, (*Ash-Shari'ah* permit) to a community to jointly utilize the object.
3. State ownership, is a property that does not belong to the category of public property but belongs to the individual, but the goods are related to the rights of the Muslims in general.

From the aforementioned distribution of ownership in the Islamic economy, then where the position of natural resources such as mining products, energy, forest, water is in the second category, that is, public ownership.[124] This opinion can be understood based on the argument of the *Hadith* which comes

[124] Muhamamd Nizar, *Sumberdana dalam Kepemilikan Islam* (*Kepemilikan Harta dalam Perspektif Islam)*, Jurnal Al-Murabbi, Volume 1, Number 2, 2016, p. 389.

from Imam At-Tirmidhi who narrated the *Hadith* from Abyadh bin Hamal, that he has asked the Messenger, Muhammad SAW to administer his salt mines, then the Prophet gave it. After he left, there was a man from the *majlis* asking:

> "O Messenger of Allah, do you know what you give to him? Surely you have given something like flowing water (ma'u al-iddu). Rasulullah then said: "Draw the mine from him". (From Abu Dawud, atTirmidzi, Ibn Majah, Ibn Hibban, and others)."

Ma'u al-iddu is an infinite amount of water. The *Hadith* is a salt-salt mine with flowing water, because the number is infinite. This *Hadith* explains that Rasullah SAW provided a salt mine to Abyadh. It shows the ability to give the salt mines to an individual if the mines are small. However, when he knew that the mine was a large mine (like running water), then he revoking its granting and prohibiting private ownership, means the mine became a public property.

In the *Hadith*, the things which is intended is not only the salt itself, but the mine. It is based on the evidence that when the Prophet Muhammad knew that the mine was infinite in number, he prevented it, meanwhile he knew from the beginning that it was the salt given to Abyadh. Thus, the retraction is not due to the salt alone, but because of an unlimited number of mines. Abu Ubaid commented on this *Hadith* with the following explanation:[125]

[125] Fahrul Ulum, *Sistem Ekonomi Islam: Menumbuhkan dan Mensejahterakan*, UIN Sunan Ampel, Surabaya, 2015, p. 44.

> "As for the gift by the Prophet SAW to Abyadh bin Hambal over a salt mine located in Ma'rab area, then he took it back from the hands of Abyadh, actually he pulled it out solely because according to him the mine is a dead land that was turned on by Abyadh. When the Prophet SAW knew that the mine was as much as flowing water, which water was an inexhaustible object, like a spring and a drill, he retracted it".

If the salt is included in the category of mine, then the revocation of the Prophet to his gift to Abyadh is considered to be an *illat* of a prohibition of individual ownership. From the above *Hadith* it seems clear that the *illat* of the ban to not provide the salt mine is because the mine is flowing and unlimited, not because the uncountable amount of the salt itself. A more clearly explanation, based on the history of Amru bin Qais, the meaning of salt here is a salt mine, where he says: "*ma'danul milhi*" (salt mine). So by examining the Statements of *fiqh* scholars, it becomes clear that they have made salt included in the category of mine, so this *Hadith* is clearly related to the mine, not with the salt itself specifically.

As for the *Hadith* narrated by Abu Daud, that the Messenger of Allah had given the mine to Bilal ibn Harits Al Muzni from his tribe, and the *Hadith* narrated by Abu Ubaid in the book of *Al Amwal from Abi Ikrimah* which says:

> "Allah's Messenger (may peace be upon him) gave this plot of land to Bilal from this place until so much, along with the content of his earth, whether in the form of a mountain or a mine"

In fact, it does not contradict the *Hadith* on Abyadh, but it implies that the mine given by the Prophet to Bilal is limited, so it may be given. As the Messenger of Allah first gave the salt mine to Abyadh and should not be interpreted as an absolute gift of mine, for if it is defined it would be contrary to the Prophet's removal of the mine he had known that the mine was flowing and large in number. So it is clear that the content of the mines given by the Prophet is limited.

The unlimited mine is a public property, it also covers all the mines, both visible mines that can be obtained without much effort, which can be obtained by humans, and can be utilized, such as salt, antimony, precious stones and so on. Also for the mine in the bowels of the earth that could not be obtained other than by labor and hard work such as gold, silver, iron, copper, tin and the like. Whether in solid form, such as crystals or liquid, such as kerosene, then everything is a mine which is included in the sense of *Hadith* above.[126]

Islam considers natural resources including public goods such as water, fire, grasslands, forests and minerals to be managed only by the State whose products should be returned to the people in the form of cheap goods or subsidies for primary needs such as food, education, health, and public facilities. The above view is based on a *Hadith* of the Prophet Muhammad:[127]

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[126]http://jurnal-ekonomi.org/peran-negara-dalam-pengelolaan-sumber-daya-alam/ (accessed on November 6th, 2017)

[127] This Hadist is shahih (see: Ibn Abdil Bar, al-Isti'âb, IV/1635; Ibn Hajar alAshqalani, Talkhîsh al-Habîr, iii/65, Madinah al-Munawarah. 1964; al-Albani, Irwâ' al-Ghalîl, vi/6-9, Maktab al-Islami, Beirut, cet. ii. 1405/1985). As quoted from Fahrul Ulum, *Op. Cit*, p. 41.

الْمُسْلِمُونَ شُرَكَاءُ فِي ثَلَاثٍ فِي الْمَاءِ الْكَلَإِوَ وَ النَّارِ

"Muslims are associated in three ways: water, pasture, and fire." (Ibnu Majjah No. 2463).

The community of association (the share) is that the community can directly utilize and manage the public goods, if the goods can be obtained easily without having to spend large funds such as, utilization of river water or wells, returning livestock to the pasture. While utilization that requires difficult exploration and exploitation, this general management is carried out only by the State for all people by means of free or low cost. [128]

The question upon who should manage natural resources if natural resources include public ownership. The answer according to the political perspective of Islamic economics is the State. However, what remains to be remembered is that the task of the State is merely to manage, not to own. The responsibility of the State is to manage all the resources to be used fully for the prosperity of its people. In regards with means by the State to sell the commodity to its people, the answer can be seen from the continuation of the above *Hadith*. From the above *Hadith* there is an additional sentence as narrated by Imam Anas from Ibn Abbas, which sounds:

"*wa tsamanuhu haromun* (and the price is *haram*)".

[128] Rivai, Feitzhal, *et. al, Islamic Economics : Ekonomi Syariah bukan Opsi tetapi Solusi*, Bumi Aksara, Jakarta, 2009, p.15.

Its meaning is, taking a *tsaman* (the profit from price taken by selling those three commodity) is *haram* (prohibited). The provision is still with an important note, if in the management of those natural resources the State bears the cost of production, then the State can sell these commodities to the people at a price limited to the burden of the production costs.

For example, as has been calculated by Kwik Kian Gie (Former Coordinating Minister for Economy) on the price of fuel production costs in Indonesia. According to Kwik (at the time he served) the cost of pumping or lifting, refining and transportation, from crude oil to fuel ready for sale at gas stations, was only 10 US dollars per barrel. If the rupiah exchange rate is assumed to be 10,000 Rupiahs per US dollar, then the production cost is only 630 Rupiahs per liter (1 barrel equals 150 liters). Thus, if the provisions of Islamic economy is applied, then the people of Indonesia can enjoy the price of gasoline amounting to only 630 Rupiahs per liter. If for the consumption needs of the people there is still a residue, then the State can export it with the price as world oil prices, then the profits must be given back to its people, as the true owner of the commodity. Such returns can be given in an indirect form, such as in the form of education and free health services. Likewise, the return can also be given in direct form, such as to meet the basic needs of some of its people, if there are still the poor.[129]

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[129]http://jurnal-ekonomi.org/peran-negara-dalam-pengelolaan-sumber-daya-alam/, *Op. Cit,* (accessed on November 6th, 2017)

CHAPTER III

ANALYZING THE LEGAL POSSIBILITIES OF IMPLEMENTATION OF 10 % PARTICIPATING INTEREST FROM OIL AND GAS TOWARD MINERAL AND COAL MINING ACTIVITIES

A. The Implementation of the 10% Participating Interest (PI) Offer Provision in Upstream Oil and Gas Activities

Petroleum and other mineral resources have been a strategic significance in the countries in which they are found abundance.[130] It is not surprising that any State posses a lot reserves of them are willing to participate and control them. The state participation in the natural resources governance are coming in varied of ways. A state might going ahead with investment on its own through a State Owned Enterprises (SME) or National Resources Companies (NSC), and or investing to the private companies through the start of their operations.[131]

Indonesia, since the enactment of the era of regional autonomy by the issuance of Law Number 22 Year 1999 about Local Government

[130] Charles McPherson, *State Participation in the Natural Resource Sectors: Evolution, Issues, and Outlook*, (the paper was presented in the IMF conference on *Taxing Natural Resources* : *New Challenges, New Perspectives*, September 25-27th 2008) p. 2. obtained from http://www.imf.org/external/np/seminars/eng/2008/taxnatural/pdf/mcpherson.pdf (accessed on November 8th, 2017)

[131] *Ibid*, p.6.

and Law Number 25 Year 1999about Financial Balance between Central Government and Local Government provide flexibility and opportunity for regions to manage the potential of natural resources owned, one of which is the opportunity of oil and gas business. One of the opportunity is the oil and gas governance business by region based on Law Number 22 Year 2001 concerning Oil and Gas.Along with Government Regulation Number 35 Year 2004 concerning Upstream Oil and Gas Business Activities and Government Regulation Number 34 Year 2005 regarding the amendment to the previous Regulation, local government have a chance to participate in the business.[132]

There is no single terminology in Indonesia language stated in the legislations that could describe Participating Interest. The best definition that could be found is as follow:[133]

> “The proportion of exploration and production cost each party will bear and the proportion of production each party will receive, as set out in operating agreement”.

Since definitions about PI are not found in legislation, but in comparison we can see in the Code of Federal Regulations of the

[132] http://www.digilib.itb.ac.id/files/disk1/620/jbptitbpp-gdl-teguhwiyon-30963-2-2008ts-1.pdf (accessed on November 7th, 2017)

[133] http://www.glossary.oilfield.slb.com/Terms/p/participating_interest.aspx (accessed on November 7th, 2017)

United States of America on Commodity and Securities Exchange, mentioning that Participating Interest is:[134]

> "The right of participation in the oil or gas, produced from a specified track or tracts, or well (s), which right is limitedin duration to the terms of an existing lease and is subject to any portion of expense or development, operation, or maintenance (Code of Federal Regulations of the United States of America)".

This definition is collaborated in a more dense description by Charlote J. Wright and Rebecca A. Gallun, that:[135]

> "Participating Interest means the parties agree, or is otherwise oblivious to pay and bear".

From those definitions it can be drawn to the thread that the PI is basically the right to take precedence or the main opportunity to participate in a production of oil and gas. But the Participating Interest is not an unconditional participation rights, a kind of golden right or share that is usually given by the company to people who are prioritizedwithout paying capital.[136] In the PI, owners remain burdened with an obligation to pay a quantity of

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[134]The Code of Federal Regulations of the United States of America, Title 17, Commodity and Securities Exchange. As quoted from Junaidi Albab Setiawan, *Loc. Cit*, p. 5.

[135]*Ibid*.

[136] Indra Bastian, *Privatisasi di Indonesia: Teori dan Implementasi*, Salemba Empat, Jakarta, 2002, p.31.

participation value agreed upon and in due time entitled to a share of profits according to the percentage of participation.

From the above discussion, several important points of the PI are:[137]

(1) the existence of a grant of priority in the form of the opportunity to participate which is given by the time limit;

(2) shall be accompanied by an obligation to pay for capital participation (*inbreng*) with an agreed amount;

(3) subject to the master contract;

(4) and continue to assume the risk of loss;

(5) but is entitled to a portion of the profits of participation.

Literally it can be interpreted that the participating interest (PI) is the right and obligation in the upstream oil and gas business which in the Law Number 22 of 2001 is offered by the contractor to the Regional Owned Enterprise (BUMD). Upstream oil and gas business is undertaken in a working area to obtain results. From the whole 100% of PI in a working area, the contractor shall bear all rights and obligations. But sometimes in a profit-sharing contract, the contractor is more than one. As an illustration, for Block A, there are three contractors involved with their respective sections of 100% PI, namely

[137] Junaidi Albab Setiawan, *Op. Cit*, p.6.

Medco (41.67%), Premier Oil (41.66%), and Japex / Japan Petroleum Exploration (16.67%). According to Article 34 above, the Government of Aceh and the Government of East Aceh Regency can still get a PI of 10% of the 100% composition and act as contractor through BUMD. To manage the duties and responsibilities of contractors, contractors will make further arrangements as set forth in the joint operating agreement (JOA).[138]

According to Government Regulation Number 35 Year 2004 since the approval of the first field development plan will be produced from a working area, the contractor shall offer a Participating Interest of 10% (PI 10%) to the region to a Regional Owned Enterprise (*BUMD*).[139] This offer is a very limited in terms of time. The time limitation for a *BUMD* to show its interest to take participating interest is only 60 days after the offer from the contractor. If there is no *BUMD* who willing to take a part, then the contractor has to send the offer to a national company. The national companies are also having the same time limitation as much as 60 days to take a part.[140]

There are some criteria for a *BUMD*wishing to take a 10% PI. Based on the latest regulation issued by Minister of Energy and

[138]https://www.kompasiana.com/khairulrijal.blogspot.com/participating-interest-untuk-public-interest-solusi-polemik-gubernur-dan-bupati_5500e607a333115973512390 (accessed on November 8th, 2017)

[139] Article 34, Government Regulation Number 35 of 2004 about Upstream Oil and Gas Activities.

[140]*Ibid*.

Mineral Resources (MoEMR) Number 37 of 2016, the said *BUMD* must meet the requirements:[141]

a. the Regional Owned Enterprise shall be in the form of:
    1. a regional company with shares wholly owned by theregional government; or
    2. a limited liability company with at least 99% (ninety-ninepercent) of its shares owned by the regional governmentand the ownership of the shares all affiliatedwith the regional government;
b. its status is sanctioned by regional regulations; and
c. with no business activities other than the management of theparticipating interest.

The 10% PI offer to the Regional Owned Enterprise shall be conducted by the following provisions:[142]

1. for a field located onshore within 1 (one) province or offshoreat a distance of up to 4 (four) nautical miles, the 10% PI shallbe offered to 1 (one) Regional Owned Enterprise whoseformation is coordinated by the Governor with theinvolvement of the Regent / mayor in his

[141]Article 3, Minister of Energy and Mineral Resources Number 37 of 2016 about Provisions for the Offer of 10% (Ten Percent)Participating Interest in Oil and Gas Working Areas.
[142] Article 4, *Ibid*.

administrativearea of the field with the approved plan of development islocated.

2. for a field located offshore at a distance of more than 4 (four)nautical miles and up to 12 (twelve) nautical miles asmeasured from the shoreline to the open sea the 10% PI shallbe offered to the Provincial Owned Enterprise with theimplementation coordinated by the Governor;
3. for a field located onshore and / or offshore within theadministrative area of more than 1 (one) province theimplementation of the 10% PI offer shall be carried withthe following provisions:

    a. based on a consensus among the relevant governorsand coordinated by the governor in whose areagreater part of the field to be developed is located; or
    b. in the event the consensus among the governors as referred to in number 1 cannot be achieved at the latest 3(three) months after the date of the request for theappointment of a Regional Owned Enterprise, theMinister shall determine the amount of participatinginterest to be offered to each province.

The producing region is an area whose territory covers the working area of the upstream contractors. The boundaries are areas that are not location proximity, such as the Natuna D-Alpha working area is geographically closer to Pontianak of West Kalimantan compared to the Riau Archipelago. Masela's working area is closer to Kupang NTT than to Ambon's territory. Cepu working area there are 4 regions that include the region of Bojonegoro and East Java Province and Blora Regency and Central Java Province, Madura Strait working area that occupies the Sampang and Sumenep regencies, Kangean working areas that occupy Sampang Regency and East Java Province. So in order to divide the PI the approach is the administrative approach of government rather than geographical approach. If in the field it turns out that the working area is located in an area consisting of one or more local governments, then the agreement of division among regions shall be done fairly and proportionally.[143]

The provisions concerning the profit sharing and the financial balance were came from the Law Number 33 of 2004 regarding Financial Balance of Central and Local Government. It is limited to the amount of funds obtained from the State of the production sharing contract that has been deposited into the state treasury, while the PI is outside of the framework of that

[143] Junaidi Albab Setiawan, *Op. Cit*, p. 10.

understanding. One of the sources of balance between the central government and regional government is profit sharing fund originating from oil and gas as stipulated in Article 11 paragraph (3) of Law Number 33 Year 2004. In the said law, set in Article 19, that the income of oil and gas mining which is distributed to the regions is the income of natural resources of oil and gas in the area concerned after deducted by taxes and other levies.[144]

The norms contained in the laws above imply a form of:

(1) A respect for a region;

(2) justice and proportional and demand in order to;

(3) the region becomes more independent in the framework of regional autonomy, by keep on seeking opportunities from potential and regional;

(4) a proportionate share of central and regional financial schemes.

The norms that elevate the producing region have inspired to further strengthen the PI. PI is very important, because it is appropriate that the producer region could obtainan adequate compensation by considering various aspects. The share of the region should take into account the costs of social and

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[144] *Ibid*, p. 11.

environmental restoration as a result of exploration and exploitation of oil and gas.[145]

One might took an example of participating interest in Masela Block. It is located near to the Regency of West Southeast Maluku, Maluku Province. Contract of cooperation upon the working area of Masela was signed on November 16th 1998, when there was no such obligation to offer 10% PI. This working area was approved by Plan of Development (POD) I on December 6th, 2010. So in the case of the PI, the present phase represents a valuable opportunity for the Provincial Government of Maluku, especially West Southeast Maluku Regency to actively convey their aspirations. That is because there are still some obstacles related to the provision that the PI is limited by the distance between the location and the nearest coastline. A working area located 0-4 miles from the coastline is belong to Regency's authority, provincial authority up to 12 miles and above 12 miles became the authority of the central government, while the Masela working area is about 150 km from the Maluku coastline.[146]

Masela working area with PT. Inpex Masela Limited as the contractor has an area of approximately 4,291.35 km². This oil and

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[145] Agoes Soegianto, *Eksplorasi dan Produksi Migas Lepas Pantai: Dampak Ekologis dan Penangananannya*, Airlangga Press, Surabay, 2005, p. 64.

[146] http://www.migas.esdm.go.id/post/read/pemerintah-cari-pembeli-gas-masela (accessed on November 10th, 2017)

gas working area is located in Arafura Sea, about 800 km east of Kupang, East Nusa Tenggara or approximately 400 km north of Darwin city, Australia, with sea depth 300-1000 meters. Inpex Masela will soon develop an Eternal Gas Field (*Lapangan Gas* Abadi) located off the coast of Arafura Sea, with an ocean depth of between 400-800 meters, approximately 150 km southwest of Saumlaki, the capital of West Southeast Maluku Regency, Maluku Province.[147] Masela working area located in the Arafura Sea, Maluku is based on the survey has a potential gas reserves proved very large. Based on data from the Office of Presidential staff and the data of Lemigas 2015, proven reserves Masela's working area reached 10.73trillion cubic feet (tcf).[148]

According to a geological study conducted by LEMIGAS, the working area of Masela will be developed into a gas production area through the Abadi Field on Jurassic rock as a target lead containing hydrocarbons. Currently some preparations have been made to encourage production, such as Feasability Study for piping systems to shelters in Yamdena Island, Tanimbar Islands. Development of Masela's working area, will be continued with the

[147] *Ibid*.

[148] http://www.migas.esdm.go.id/post/read/kajian-kilang--blok-masela-dilakukan-dalam-dua-fase (accessed on November 10th, 2017)

development of West Masela working area and Babar working area.[149]

BUMD of West Southeast Maluku and Maluku Province have the opportunity to utilize 10% PI in the management of Masela block working area where their rights are guaranteed by oil and gas regulation. The next thing to be aware of and to be noted is that the right of participation is not misplaced and is benefiting the private sector only. This situation should be of particular concern, because the Province of Maluku and Regency of West Southeast Maluku is a lagging region with limited funding capability in order to take such PI. Asking both of these producing regions to prepare capital for participation in the PI is certainly very heavy task to do. While this whole time the private sector has started to play its influence to take PI Masela's working area.[150]

In terms of upstream oil and gas industry, participating interest is the right of the Region that shall be ensured full utilization by the Region through a fully owned Regional Government Enterprise. With the provision of PI to the region also provides impact and opportunities for the region to move forward. In order for PIs to be targeted, the PI arrangements should also be accompanied by provisions on the utilization of local potentials to

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[149] *Ibid.*

[150] Junaidi Albab Setiawan, *Loc. Cit*, p. 17.

support local entrepreneurs, training opportunities, skills development, and financial support that may be available to enable them to participate in each value chain of the oil and gas industry. The regions are entitled to the optimum benefits from the exploitation of natural oil and gas resources in their areas.[151] The operation of upstream oil and gas sector provides benefits to the region through direct BUMD involvement.

Government through the Ministry of EMR as well need to ensure the Provincial Government of Maluku get management rights or participating interest in the Working Area of Masela by any necessary means. The Maluku Province is ideally does not need to pay with market price to obtain such management rights,but as the initial value of investment as a privilege formgiven to the local government. Byterritory, giving 10% PI indeed the authority of the central governmentbecause the location of the Working Area of Masela is located from 12 miles of Maluku's coastline and is categorized under Central Government authority. Nevertheless,Minister of EMR needs to commit to give10 per cent of the management rights of the working areaMasela to the Maluku Provincial Government.[152]

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[151]*Ibid.*

[152] Yusa' Farchan, *Reformasi Pengelolaan Minyak dan Gas Bumi Berdasarkan Konstitusi; Studi Kasus Wilayah Kerja Masela Maluku*, Jurnal Renaissance, Volume 1 No.02, 2016, p. 112.

It is different to what happened in the Cepu Block. Working area of Cepu is geographically located in the border of two big Provinces namely Central Java and East Java. Administratively the area is between Bojonegoro Regency (East Java), Blora Regency (Central Java), and Tuban Regency (East Java). The cooperation contract of Cepu Block was signed on September 17th 2005 with Mobil Ceput Ltd (MCL) as the operator. MCL, a subsidiary of Exxon Mobil Corporation, holds a 45% interest in participating interest, together with PT. Pertamina EP Cepu which holds 45% shares and the Cooperation Agency of Cepu Block (BKS) with 10% shares. The field development plan was approved by the Minister of Energy and Mineral Resources on July 15, 2006. Oil reserves in Banyu Urip Field are estimated at 450 million barrels.[153]

In this Cooperation Contract (*KKS*), local governments takeParticipating Interest (PI) of 10% offered by PT. Pertamina EP Cepu (PEPC) and ExxonMobil as the contractor of the government. Participating Interest (PI) is derived from a 5% reduction from the part of PT. Pertamina EP Cepu and 5% from Mobil Cepu Ltd and AmpolexPte. Ltd. This participating interest is then managed by a regional enterprises (*BUMD*) appointed by the central government, namely PT. Asri DharmaSejahtera

[153]http://www.migas.esdm.go.id/post/read/Pengembangan-Proyek-Cepu-Lebih-Dari-90-Persen (accessed on November 10th, 2017)

(Bojonegoro Regency), PT. Blora Patragas Hulu (Blora Regency), PT.Sarana Patra Hulu Cepu (Central Java Province), and PT. Petrogas Jatim UtamaCendana (East Java Province). Later on, every BUMD as the representatives of local governments, will get dividend, as much as amount of PI they posses. The local government will also get a Profit Sharing Fund(*DBH*) for producing regions and other regions included in one province where the well is located.[154]

In the management of Cepu block, PEPC, MCL, Ampolex, and BUMD entered into a cooperation contract (KKS) with the government which at that time was represented by BP Migas. in the management of Cepu Blocks, contractors entered into agreements to operate the implementation of the Cepu Block development contained in the Joint Operation Agreement (JOA).[155] Negotiation process between PT. Pertamina and PT. Exxonmobil as party in fighting over the position of main operator of Cepu block was very tough. On the basis of nationalism, the Pertamina as a SOE insisted to become the main operator of Cepu Block. However, having some limitation in exploring oil and gas (Pertamina takes time in improving its technology), while Indonesia must immediately find new oil wells source considering Indonesia's oil supply is increasingly depleted by the issuance of

[154]Ahita Nur Aisyah Zen and Nurkholis, *Loc. Cit*, p. 3.
[155] PT. Pertamina EP Cepu, *Laporan Tahunan PT. Pertamina EP Cepu*, 2013, p. 2.

Indonesia from OPEC in 2004.[156] On the ground to accelerate the production of the block, under the agreement, the contractors agreed to appoint MCL (which is a subsidiary of ExxonMobil) as operator in the management of Cepu Block.[157]

Since the approval of Plan of Development (POD) I Banyu Urip field on June 15th, 2007 by the MoEMR, the regions (Central Java Province, East Java Province, Bojonegoro Regency and Blora Regency) are entitled to engage in oil and gas exploitation in the form of Participating Interest (PI) on the first stage development project of Banyu Urip oil field.[158]The detail composition of Cepu Block's investment (participating interest) is 45% for ExxonMobilconsisting of 20.50% Mobil Cepu Ltd (MCL) and 24,50% Ampolex Cepu Pte Ltd(Ampolex), 45% for PT. Pertamina EP Cepu (PEPC), and 10% for the local government where the working area is located. Participating Interest (PI) for local government is asthe following: East Java Provincial Government (2.2423%), Government of Central Java Province(1.0910%), Bojonegoro Regency Government (4.4847%), and Blora Regency Government(2.1820%), each managed by the *BUMD* that has beenappointed by the Central Government. After that, those PI

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[156] https://www.merdeka.com/uang/5-perusahaan-asing-yang-kuasai-migas-indonesia.html (accessed on November 10th, 2017)

[157] Marwan Batubara, *Proses Panjang Negoisasi Blok Cepu,* Bening Citra Publishing, Jakarta, 2006, p. 55.

[158] http://www.digilib.itb.ac.id/files/disk1/620/jbptitbpp-gdl-teguhwiyon-30963-2-2008ts-1.pdf, *Op. Cit*, (accessed on November 10th, 2017).

holders (Local Government) establish a Cooperation Body (Badan Kerja Sama) with official members are PT. Petrogas Jatim Utama Cendana(PJUC) East Java *BUMD*, PT. Sarana Patra Hulu Cepu (SPHC) Central Java's *BUMD*, PT. Asri Dharma Sejahtera (ADS) Bojonegoro Regency's *BUMD*, and PT.Blora Patragas Hulu (BPH) Blora Regency's *BUMD*.[159]

By the founding and ready in-production of several wells in the Cepu Block,especially in Banyurip field, Bojonegoro, is likely to boostthe daily production of Indonesia's crude oil. The Central Government once assumed, if the production process of Banyu Urip fieldalready running, expected daily production of Indonesia crude oil to reachback the limit allowed to enter as a member of OPEC, which is 1.4 millionbopd, of which 150,000 up to 170,000 bopd are from Cepu Blocks.[160]

From the aforementioned elaboration, it might be concluded that cooperative contract on upstream oil and gas industries is a very long term contract along with high risks and big amount of funds needed. This issues makes no company can take control to explore and exploit a working area alone. This problem opens up a chance for local government to take a part on the

[159]*Ibid*, p. 13.

[160] Makky S. Jaya, *Beberapa Pokok Pikiran Pengelolaan Blok Cepu: Peran Pemda dan DPRD Jatim*, Pusat Penelitian Kebumian dan Eksplorasi Sumber Daya Alam, ITS Surabaya, Surabaya, 2006, p. 2.

industry through the 10% PI. The concept of offer of participating interest to *BUMD* then came up on 2004 by a government regulation, 3 years after the issuance of oil and gas law of 2001.

Unfortunately, the very technical aspects of the offer only got settled by 2016 by the aforementioned MoEMR Regulation Number 37 of 2016. It turns out that, the obligation of contractor to offer 10% of participating interest still have some weaknesses, obstacles, as well as conflict of interest in its implementation. Those things pointed out as follows:

1. Oil and gas industry both upstream and downstream is an industry that classified as an industry capital-intensive. The Capital set at 10% as a number of capital that must be offered by the contractor of oil and gas to the *BUMD* was not a small number. The amount of the funds needed for a working area will be depend on the scale of the area itself. It has to be noted that the financial condition of a *BUMD* is not as strong as the multinational oil companies.[161] The evident is from the difficulties experienced by the provincial government of Maluku and western districts of Maluku district to take 10% PI from the Masela block.
2. As an industry which is classified as a labor-intensive industry, upstream oil and gas sectordemanding availability

[161] Muhammad Yusuf Sihite, *Loc. Cit*, p. 4.

of facilities,infrastructure and source of adequate human resources. Those are the things needed as a fundamental requirement that currently still cannot fulfilled by*BUMD* of producers regions.[162]

3. In light of the lack of understanding, capital and corruption, the 10% PI for producing regions will be facing a though conflict of interest between stakeholders. Central Government PI run and managed by PT. Pertamina as an SOE. Because in order to ensure the realization of the provisions of the constitution, the government need to encourage both *BUMD* and PT. Pertamina to acquire a participating interest (PI) within the working area of oil and gas. By having a PI, Pertamina can be directly involved in the management of working areas of oil and gas which are currently, most of them held by foreign oil and gas companies. Thus, Pertamina is expected to obtain technology and knowledge transfer from international oil and gas companies.
4. PI for producing regions will also be facing Contractors of Cooperation Contract (*KKKS*) efforts to obtain as much profits as possible. This *KKKS* effort is of course contrary to the mission of the producing regions to participate in the

[162]*Ibid*.

oil and gas business with PI's maximum allocation. Thus *KKKS* as far as possible will try not to involve the producing regions to take the participating interest, because in the eyes *KKKS* the involvement of producing regions will only minimize its share and its profits. On the other hand, the producing region will seek to obtain a 10% PI for them. Inevitably, both interests will always be against each other.[163]

B. The Legal Challenges if the Provision of 10% Participating Interest (PI) Offer Implemented in The Mineral and Coal Mining Activities

During the recent 30 years the portion of oil has been exceptionally predominant in the Indonesian economy, representing near 90% of essential vitality supply in the year of 1970's. From that point forward it has diminished to the present level of 57% , being supplanted to a great extent by natural gas, whose contribution has developed from 6% to 27% amid this time. However this enhancement has to a great extent occurred in the export market not in the domestic market. As just said oil still stays especially the prevailing vitality source to take care of local demand, providing 75% of Indonesia's needs and there keeps on being worry about the fast exhaustion of oil reserves. Therefore,

[163] Junaidi Albab Setiawan, *Loc. Cit*, p. 19.

Indonesia keeps on looking for approaches to diminish its reliance on oil. The new national oil and gas law that has been issued as of late, should empower the administration to complete a more practical and economical improvement of the national oil and gas assets.[164]

The Indonesian mining sector performance has been promisingly increasing, particularly since the early 70's. The Indonesian mineral and coal sectors constitutes another potential supporter of the national economy. This segment includes copious products, for example, metallic minerals, various mechanical minerals and rocks. Among these different minerals, tin, nickel, copper, gold, and coal, have been created from world class deposits. They frame critical national products, either for send out or in local markets.[165]

This research is somehow influenced by the aforementioned thought. While the idea is to improve the participation of local government through their respective local enterprises (*BUMD*) on the basis of 10% Participating Interest (10% PI) policy. Although the 10% PI policy based on Minister of Energy and Mineral Resources still have some shortages in its implementation, but this policy has been proven able to increase the participation of oil and gas producing regions in managing their own resources. Furthermore, it is expected to

[164] S. Suryantoro and M. H. Manaf, *The Indonesian Energy and Mineral Resources Development and Its Environmental Management to Support Sustainable National Economic Development*, Organization for Economic Co-operation and Development (OECD), Paris, available on https://www.oecd.org/env/2075532.pdf, 2002, p. 4.

[165] *Ibid*, p. 5.

be not only applied within the oil and gas industry, but also can be implemented towards the other extractive industry namely mineral and coal mining.

There are some legal challenges to be aware of, if such 10% PI will be implemented in the mineral and coal mining. First of all, different characters from oil and gas and minerals and coal as a mining product lead to different treatments given to them. As a fossil fuel, oil and gas characters are hard to find, located offshore, and in difficult-to-reach sea depths that requires considerable exploration costs. And often, these high cost explorations do not find the desired oil and gas reserves. So in its implementation, typically one working area of oil and gas is managed based on the joint venture agreement and consists of several contractors.

In addition, oil and gas processing from crude oil to ready-to-use fuel is also more complicated than minerals such as radioactive minerals, metal minerals, and or rocks. Because the stages of processing crude oil and natural gas is way longer, then the industry is divided into two major stages of upstream oil and gas activities and downstream activities of oil and gas. Upstream activities include exploration and exploitation. While downstream activities include processing, storage, transportation, and sales.[166]

[166] Interview Results with Irwan Ratman, conducted on November 11th, 2017.

Second of all, the existing regime in the oil and gas industry is different from the existing regime in the mineral and coal industry. The regime used in oil and gas (upstream activities) is a contractual regime, while mineral and coal only use licensing regimes. The licensing regimes used in mineral and coal mining are Mining Business License (*IUP*), Mining Permit for the People (*IPR*), and Special Mining Business License (*IUPK*). The use of contract regime in upstream oil and gas activities cannot be separated from the character of the upstream industry itself, which is a capital intensive industry. Exploration activities that have high risk and may not necessarily produce oil and gas make this activity requires a lot of funds and the involvement of many business actors.

The use of cooperative contracts that normally take the form of Production Sharing Contract (PSC) allows the involvement of many Contractors of Cooperation Contracts (KKKS) to participate. This allows the oil and gas producing regions to participate in this joint venture operation to put 10% of the total funds needed in an upstream oil and gas activity. Because in general, a working area where upstream oil and gas activities take place, is impossible to be held by one contractor only.

Meanwhile in mineral and coal mining activities, one mining area (*WP*), can be held by one company only. Viewed from the characteristics of mineral and coal mining products that are mostly

located on the land (onshore) relatively require lower exploration and exploitation costs than oil and gas products. In addition, mining concession permits are granted only to one business entity, whether corporate, cooperative, or individual. This makes the involvement of other parties including local government has no place at all.[167]

Nevertheless, the local government participation in mineral and coal mining in its administrative territory is still possible through the divestment scheme. However, the divestment itself can only be applied to *IUP* or *IUPK* holderswho are resulted from foreign investment with the following provisions:[168]

1. Holders of *IUP* and *IUPK* in the framework of foreign investment, after 5 (five) years since produces the obligation to divest its shares gradually, so in the tenth year the sharesat least become 51% (fifty one percent) owned by Indonesian participants.
2. Ownership of Indonesian participants as referred to in paragraph (1), in each year after the end of the fifth year since production shall not be less than the following percentage:
   a) sixth year 20% (twenty percent);
   b) seventh year 30% (thirty percent);

[167] *Ibid*.

[168] Article 97, Government Regulation Number 1 of 2017 about The Fourth Amendment of Government Regulation Number 23 of 2010 about The Implementation of Mineral and Coal Mining Business Activities.

c) eighth year of 37% (thirty seven percent);

d) the ninth year 44% (forty four percent);

e) the tenth year 51% (fifty one percent),of the total number of shares.

3. The divestment of shares as referred to in paragraph (1) shall be made to Indonesian participants consisting of the Government, the Provincial government, or the Local government of the Regency / City, *BUMN*, *BUMD*, or national private enterprise.
4. In the event that the Government is unwilling to purchase shares as referred to in paragraph (3), offered to the provincial or local government of the district / city.
5. If the provincial or local government of a regency / city as such referred to in paragraph (4) are not willing to buy shares, offered to *BUMN* or *BUMD*.
6. If *BUMN* and *BUMD* as referred to in paragraph (5) are not willing to buy shares,offered to private national entities.
7. The offering of shares as referred to in paragraph (1) shall be made within the maximum period of 90 (ninety) calendar days after 5 (five) years issuance of production operation license mining stage.

The local government participation in managing its own natural resources through the divestment mechanism is very limited. First, the

local government can only take over the shares of mining companies that are the result of foreign investment and are holders of *IUP* and *IUPK*, while it cannot be applied to local companies or national holders of *IUP* and *IUPK*. Secondly, local government can take over the shares after the mining company operates for 5 years. It is even with a note, the central government does not buy the shares of the mining company.

This is in contrast to what happens in the upstream oil and gas industry with its 10% PI provision. Local governments have been able to participate since the very first Plan of Development (PoD) was approved by the Minister of Energy and Mineral Resources (MoEMR). In addition, the obligation to offer 10% PI applies not only to foreign *KKKS*, but also to national contractors such as PT. Pertamina. Thus, it might be concluded that the chance for local government to participate is more guaranteed by the 10% PI provision.

However, the 10% PI provision has been recognized as an efficient policy for the State, especially for local government. Through this policy, cost and benefit obtained by the State (both central and local government) is not only in financial terms but also in terms of control and management

of the mined resources.[169] This provision has made cross control among the PI holder (*KKKS*) on the cost recovery possible.[170]

Government involvements are needed to correct the pollution from the mining industry, by taking into account the cost of pollution in mining costs.[171] Thus, in addition to supporting the sustainability of development, government participation in mining activities is also necessary to reduce the possibility of occurring pollution. Therefore, it is fair that the government should involve in mining activities not as only as a regulator but as an business actor through their own respective enterprises. Even more so, in order to carry out the mandate of the 1945 Constitution, so that the state can really become the ruler of natural resources contained in the earth of Indonesia and can be used for the greatest purpose of the prosperity of the people.

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[169]Tri Budi Santoso, *Efisienkah Kewajiban KKKS Menawarkan Participating Interest 10% kepada BUMD?*, www.tbs-plus.com, Jakarta, 2017, p. 8.

[170] Benny Lubiantara, *Ekonomi Migas, Tinjauan Aspek Komersial Kontrak Migas*, Gramedia, Jakarta, 2015, p. 122.

[171] Hartati, *Kewenangan Pemerintah Daerah Dalam Pengelolaan Pertambangan Mineral dan Batubara*, Jurnal MMH Fakultas Hukum, Universitas Jambi, Volume 41 No. 4, Jambi, 2012, p. 6.

CHAPTER IV

CONCLUSION AND RECOMMENDATION

A. Conclusion

1. The Provisions for The Offer of 10% Participating Interest in Oil and Gas Working Areas has been developed from the year of 2004. The latest improvement of the provision is by the issuance of Minister of Energy and Mineral Resources Regulation Number 36 of 2017 where it regulates both technical and procedural aspects of the 10% PI offer. Through twelve years of development, this kind of concept still have some shortages and obstacles to overcome. The financial strength of local enterprises (*BUMD*) to acquire 10% of PI in a oil and gas working area is predominant obstacle of all. The human resources quality and quantity issues are also come along with the previous issue. However, the provision on the offer of 10% PI still recognized as a effective and efficient policy. It is able to improve and guarantee the participation of the local government through its local enterprises, over the existing natural resources on their administrative territory.
2. It is to be expected that such 10% PI provision can be implemented in another extractive industry namely mineral and coal mining. Since both of extractive industries posses not only differences but

also similarities. In mineral and coal mining industry, there is lack of participation of local government. The very fundamental legal challenges is the different regime used for both businesses. Oil and gas use contract regime, mineral and coal use licensing regime on the other hand. The use of licensing regime limits the role of the local government to be only as the regulator rather than operator on the mining itself. Although there is a divestment scheme on the industry, but it gives so many limitations for the local government to participate and own the natural resources even the ones that exist in their territory.

B. Recommendation

In order to enhance the participation of local government over their own existing mineral and coal reserves, such 10% PI provisions can be transformed from oil and gas law. Although there are some challenges in terms of legal, but the government can try to figure out the most suitable provision which can be implemented on the mineral and coal mining. The government or another stake holders do not need to wholly implement the 10% PI provision towards the mineral and coal industry, but they can take the very essential values of the provision which arguably to improve the local government participation. The 10% PI provision can be firstly adjusted before it will be implemented in the mineral and coal mining. The

aforementioned challenges shall also be overcome prior to the transformation. After all, oil and gas as well as mineral and coal mining are both extractive industries with a lot of similar characteristics. In the end, the main idea of the transformation of 10% PI provision from oil and gas towards mineral and coal mining, is to actualize the mandate of 1945 Constitution; earth and water and the wealth contained therein is controlled by the State and used for the greatest prosperity of the people.

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