CLIENT ALERT
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Constitutional Court leaves Water Sector High and Dry

1. Introduction

In what will be seen by many as yet another controversial decision in the economic sphere, the Constitutional Court has unanimously decided that the 2004 Water Resources Law[i] is non-binding as being contrary to the 1945 Constitution, and in doing so reinstated its predecessor, the 1974 Water Law.[ii] This latest decision[iii] (the "**Decision**"), handed down on 18 February 2015, reaffirms the Court's literal interpretation of the constitutional provisions on state ownership of natural resources, and in doing so thwarts the nation's efforts to modernize the management of water resources, including public access to piped water and sanitation services. At the same time, it throws the entire water sector into chaos at a time when Indonesia urgently needs to maintain, or increase, current foreign direct investment (FDI) flows. Several planned projects are reported to have been postponed and the rights of existing water-utilization license holders are now in limbo.

2. Background

2.1. Urban Water Supply & Sanitation Schemes

Indonesia has one of the least developed urban water supply and sanitation systems in Asia. Even in the capital and its satellite cities, the vast majority of residents lack access to public sewage systems, and instead are forced to rely on (often leaky) septic tanks. Since independence, the public sector has proven itself unable to serve the water and sanitation needs of the country's burgeoning population.

Given the financial, technical and other constraints (including corruption) facing the public sector, the Water Resources Law envisaged the involvement of the private sector in the provision of public water and sanitation schemes based on the principle of full-cost recovery for those who can afford to pay. The Petitioners argued that this was contrary to the principle of state control over natural resources, as enshrined in the Constitution.

2.2. Packaged Water Companies

Another source of controversy in recent years has been allegations of abuses and over-exploitation of water resources by packaged water companies, who are often accused of monopolizing such resources in rural areas. As is often the case in developing countries, where resource nationalism has in general been on the rise, the bulk of the scrutiny in Indonesia has been directed at the foreign-owned sector. Once again, the Petitioners argued that the activities of packaged water producers violated the spirit of state control over natural resources.

While much of the public controversy over water in recent years has focused on corporatization and the operations of packaged water producers, the reality is that the impact of the judgment will affect all sectors that require large volumes of water in their production cycles, including the food & beverage, textile and hospitality industries, to name a few.

3. The Decision

The Court based its reasoning on Article 33(3) of the Indonesian Constitution, which may be freely translated as follows:

> *The land and the waters and all the natural resources contained therein shall be controlled by the State and employed so as to provide maximum benefit to the people.*[iv]

In doing so, it relied on two of its previous decisions on the Water Resources Law, one in 2004 and one in 2005,[v] when it held that the legislation would only be constitutional if six conditions prescribed by the Court were fulfilled by the government. In other words, if these conditions were not fulfilled, the legislation would be open to further challenge.

The said conditions are as follows:

1. Every measure related to water utilization must have regard to the public's rights to water, as the resource is to be utilized for the greater good of the people;
2. The state must ensure the fulfillment of the public's rights to water;

3. The utilization of water must take into account environmental conservation;
4. The state must possess the authority to oversee and control water;
5. The state must grant priority to state or local government enterprises in the utilization of water; and
6. If conditions 1 – 5 are satisfied and water is still available, the private sector may be granted rights to utilize water, but only subject to strict conditions.

The Court found that a series of regulations issued by the government since the handing down of the 2004 and 2005 decisions failed to satisfy the above conditions and that accordingly the Water Resources Law must be found unconstitutional.

As regards the scope of "state control" under Article 33(3) of the Constitution, the Court has consistently interpreted the term as signifying nothing less than direct control. It has used this interpretation to strike down a raft of laws in recent years, such as the 2002 Electricity Law and the legislation establishing the former upstream oil and gas regulator BP Migas, insisting that natural resources must continue to be controlled directly by the state or state/local government companies.

5. Implications

The Constitutional Court's decision on the Water Resources Law strikes at the heart of the government's efforts to modernize the water sector. It means that the public-private partnership (PPP) approach that has been pursued by the government so as to expand mains water and sanitation networks is now in peril. The Court appears to essentially dislike the concept of cost recovery and wishes to see water and sanitation services provided by state/local government bodies on a non-profit basis, something that would make existing PPP initiatives unsustainable. Unfortunately, the Court offered no alternative to the current to the PPP approach, and it appears to be unconcerned about the poor record of state/local government bodies in providing such services in the past. Indonesia needs enormous investment in the water and sanitation sectors in order to even begin to address current deficiencies. The government simply does not have the money, so where is it to come from? No answers were forthcoming from the Court.

It has been argued that the Decision can be used to overturn existing water-utilization licenses of private sector firms. However, we do not believe that this argument is well-founded. The reality is that the Constitutional Court Law provides that decisions of the Court on the constitutionality of legislation are not of retroactive effect. Therefore, all decisions or determinations made on the basis of a statute prior to its annulment for unconstitutionality remain in effect. Accordingly, all licenses issued based on the Water Resources Law should also remain in effect. However, the situation as regards renewals of existing licenses remains unclear. Disgruntled members of the public could also use the Decision as a tool to challenge licenses. While we believe that such challenges should not succeed, it will ultimately be for the courts to decide. It is also a cause of concern that the Investment Coordinating Board (BKPM) quickly put on hold all applications for new FDI licenses in the water sector and also the processing of approvals for commercial actions by companies that rely on water as part of their business cycles.

The Ministry of Public Works and Public Housing announced late last Thursday (Mar 19) that it would send out a circular letter to interested parties stating that all existing joint venture / collaboration agreements and licenses with the private sector (issued under the Water Resources Law) will continue in effect until such time as their expiry. The ministry said that in making this decision, it had taken into account the advice of the Ministry of Law and Human Rights. However, there has been no guidance forthcoming on what steps will be taken by Government to provide a permanent solution to the problems caused by the Decision.

Meanwhile, it has been reported in the media that the Central Jakarta District Court ruled on Tuesday (March 26) that the partial privatization of water services in Jakarta is illegal. However, no further details of the precise scope and grounds of the judgment have been forthcoming, including as regards the crucial question of whether it was influenced by the Decision..

6. What Now?

The answer to the "what now?" question is unclear. The 1974 legislation is clearly unsatisfactory as it fails to expressly regulate many important aspects of the water and sanitation sectors. It was also enacted prior to the era of regional autonomy. Consequently, new legislation will ultimately be required. To go through the normal legislative process would take a considerable period of time and leave something of a legal vacuum until enacted. Accordingly, the best solution would seem to be for the Government to issue an Emergency Regulation,[vi] which would enjoy the force of law until such time as it is approved or rejected by the House

of Representatives (DPR), as the case may be. This would allow the Government some breathing space to draft comprehensive new legislation, hopefully having first carefully scrutinized the provisions of the Water Resources Law that the Constitutional Court found objectionable, and replacing them with something more amenable to the Court's way of thinking, while at the same time maintaining the spirit and ethos of the original legislation.

Another alternative would be for the Government to issue a Government Regulation or a Presidential Decree to maintain the status quo until such time as new legislation can be enacted by the House of Representatives (DPR) However, as things stand at the moment, there has been a singular lack of guidance from the executive, which has led to significant legal uncertainty in the water and sanitation sectors.

7. Conclusion

The Water Resources Law, while far from being perfect, represents a progressive piece of legislation that provided guarantees of access to water for all, protected ground water resources, addressed water conservation issues and allowed private sector involvement in the provision of piped water and sanitation services to those Indonesians who have long been deprived of such access (the vast majority of the population). With its 200 articles, It attempts to comprehensively address the water and sanitation issues facing Indonesia by encouraging private investment in a sector that had been starved of funding for decades. By contrast, the Soeharto-era 1974 Water Law, which has now been reinstated by the Constitutional Court, consists of a mere 17 articles and is very vague.

Whether we like it or not, the state simply does not have the money to finance the massive investment necessary to modernize the water and sanitation sector, or, indeed, to sustainably exploit the country's natural resources. So, until the nation can reach a consensus on the way forward in the natural resources arena, the type of confusion and lack of legal certainty that this decision has given rise to are likely to keep cropping up with regrettable regularity.

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