

Edition | 13 November 2012



Constitutional Court Declares BP Migas Unconstitutional

1. Introduction

In a controversial decision (the “Decision”) handed down on 13 November 2012, the Constitutional Court reinforced its reputation for judicial activism in the economic sphere by declaring the Upstream Oil and Gas Regulator (BP Migas) unconstitutional. While the Applicants had only challenged Article 1 paragraph 23, Article 4 (3), and Article 44 of the Oil and Gas Act 2001 (No. 22 of 2001), the Court in the end excised all references to BP Migas from the legislation, meaning that the regulator has now effectively been abolished.

The Decision (Number 36/PUU-X/2012) was handed down in response to a constitutional challenge on various grounds brought by a large number of Islamic organizations and private individuals, led by the Muhammadiyah Central Executive Board.

2. Decision

In its judgment, the Court held, among other things, that the Oil and Gas Act contained a number of constitutional issues that needed to be addressed, particular as regards (a) the extent of state control over the resources sector (under Article 33 of the Constitution), and (b) the position and powers of BP Migas.

2.a. Extent of State Control over Resources:

Much of the economic issues dealt with by the Constitutional Court in recent years have revolved around Article 33(3) of the Constitution, which reads 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.” As in previous decisions on resources issues, the Court in this case once again adopted a very narrow interpretation of this provision, declaring that the State must have full control over natural resources so as to produce maximum benefit for the people. In this regard, it held, it is not enough for the State to merely regulate and supervise resource-based industries, but rather it must also be involved in (a) direct exploration and exploitation through state-owned enterprises (provided they have the necessary technology); and (b) policy making.

2.b. BP Migas

In line with its view of state control over resources (as described in 2.a. above), the Court ruled that BP Migas is unconstitutional for the following reasons, among others:

-
1. As BP Migas only has an upstream supervisory and regulatory role, the State is not directly involved in upstream exploration and exploitation, which are instead carried out by private companies based on production sharing contracts (PSCs). This, the Court reasoned, undermines the State's control of natural resources.
 2. The signing of PSCs by BP Migas prevents the State from issuing any new regulations or policies that would conflict with such contracts, thus undermining the State's sovereignty.
 3. The existence of BP Migas results in greater bureaucracy and the potential for inefficiency and corruption.

According to the Court, the State needs to be involved directly in exploration and exploitation. Thus, it reasoned, the State should retake full control of oil and gas, and assign exploitation rights to state-owned enterprises. Such state-owned enterprises would then be free to enter into PSCs with the private sector.

The Court acknowledged that one of its reasons for finding BP Migas unconstitutional is so as to encourage the framing of legislation that would streamline the government bureaucracy, improve efficiency and "reduce the proliferation of governmental bodies." Accordingly, it urged the Government to frame new oil and gas legislation as expeditiously as possible to reassert full State control with a view to maximizing public benefit based on bureaucratic efficiency.

3. Implications

The Court was at pains to recognize the serious implications of its decision, given the enormously important role played by BP Migas in the oil and gas industry. It stressed that as Constitutional Court decisions are of prospective rather than retroactive effect, all existing PSCs remain valid and binding. As regards the successor to BP Migas' rights and obligations under PSCs, the Court explained that this will be the Government or a state-owned enterprise, which in this case would in all probability mean Pertamina.

Meanwhile, to fill the legal vacuum left by the abolition of BP Migas, the Court expressly stated that BP Migas' powers will henceforth be vested in the ministry whose remit covers the oil and gas sector, i.e., the Ministry of Energy and Mineral Resources. Presumably, this means that BP Migas' employees and operating procedures can be taken over directly by the ministry so as to minimize disruption in the oil and gas sector.

However, on a more general note, as BP Migas is an organization established by law, it would be naïve to think that it will be more or less a case of "business as usual" in the oil and gas industry. The practical implications of the Court's decision are enormous, as every production-sharing contractor is required to have its budget approved by BP Migas. Given the legal uncertainty that now exists, it is difficult to see how any oil and gas operator would be courageous enough to take significant operational decisions given that its cost recovery entitlements will now be in jeopardy (BP Migas approval for an operator's budget is necessary to guarantee cost recovery). In addition, ongoing PSC tenders and negotiations could well be jeopardized.

4. Conclusion

While the Constitution Court's desire to force the Government and legislature's hand in streamlining the bureaucracy may be entirely laudable, as is its determination to force Parliament to improve its legislative drafting (as stressed in a number of judgments in recent years), wading into economic affairs without, perhaps, fully considering the consequences is a dangerous game to play, especially when the constitutional imperative of "maximum benefit to the people" is at stake. The fact that this decision will send further jitters through the natural resources sector at a time of economic uncertainty once again highlights the need for judicial restraint

AHP Client Alert is a publication of Assegaf Hamzah & Partners. It brings an overview of selected Indonesian laws and regulations to the attention of clients but is not intended to be viewed or relied upon as legal advice. Clients should seek advice of qualified Indonesian legal practitioners with respect to the precise effect of the laws and regulations referred to in AHP Client Alert. Whilst care has been taken in the preparation of AHP Client Alert, no warranty is given as to the accuracy of the information it contains and no liability is accepted for any statement, opinion, error or omission.

ASSEGAF | HAMZAH
& Partners

Menara Rajawali 16th Floor
Jalan Mega Kuningan Lot #5.1
Kawasan Mega Kuningan
Jakarta 12950 - INDONESIA
Telephone : (62-21) 25557800
Fax : (62-21) 25557899
E-mail : info@ahp.co.id
Web Site : www.ahp.co.id