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New Regulation on Mandatory CSR for Resources Companies Adds Little New

Government Regulation No. 47 of 2012 (the "New Regulation") was issued recently to give effect to Article 74(4) of the Companies Act (No. 40 of 2007), which imposes a mandatory corporate social and environmental responsibility (CSR) regime on "natural resource-based" and "natural resource-related" companies. While the New Regulation puts some flesh on the bones of Article 74(4), it adds very little new that should be of concern to business.

Background

Now an established and widely accepted practice in the developed world, emerging nations differ in their approaches to CSR. While companies in some countries, such as Brazil, have been quick to embrace the concept, CSR remains underdeveloped (and unpopular) in other jurisdictions, particularly in the states that made up the former Soviet Union. However, whatever the approaches of individual countries, CSR continues to be voluntary in almost all jurisdictions.

By contrast, through the incorporation of Article 74(4) in the Companies Act, Indonesia has opted for the path of mandatory CSR, or what is sometimes pejoratively referred to as "coercive social responsibility." As such, this country has become one of the very few jurisdictions in the world to have established a mandatory CSR regime, albeit a limited and rather undemanding one – at least thus far.

Who is affected?

Article 2 of the New Regulation declares generally that every company, as a legal subject, has social and environmental responsibilities. This is fully in line with the international concept of corporate citizenship, as enshrined in the CSR documents produced by the United Nations, the ILO and other international organizations.

Article 3 of the New Regulation, which essentially rehashes Article 74(4) of the Companies Act, then moves on to the particular, providing that:
"Social and environmental responsibility … shall be mandatory for companies that carry on business in a natural resource-based or a natural resource-related field, as provided by law."

In the Elucidation on the New Regulation, it is explained that "companies that carry on business in a natural resource-based field" are those whose businesses involve the management and exploitation of natural resources, while companies that "carry on business in a natural resource-related field" are those whose businesses do not involve the exploitation of natural resources but have an impact on the

“capacity of natural-resource functions, including the sustainability of environmental functions.” Unfortunately, no explanation is given as to what this actually means in practical terms.

Regarding the meaning of “as provided by law,” the Elucidation states that this refers to specific legislation governing particular sectors that are related to natural resources (including industry, forestry, oil and gas, state enterprises, geothermal, water resources, coal and mineral resources, electricity, environmental protection and management), as well as legislation governing relevant ethical issues, such as fair competition, human rights, labor, and consumer protection. In the light of this, we may interpret Article 3 as follows:
CSR shall be mandatory for companies that carry on business in a natural resource-based or a natural resource-related field, where such CSR obligations are imposed by a specific sectoral statute.

Practical Implementation

Article 4 makes the Board of Directors responsible for implementing the nuts and bolts of CSR, and requires the preparing of an annual CSR operations plan, including an annual CSR budget, while Article 5 provides that such annual operations and budget plans must be prepared based on considerations of “appropriateness and reasonableness,” which the Elucidation describes as being “the financial capacity of the company having regard to the risks that give rise to the social and environmental responsibilities that must be borne by the company, subject to the obligations of the company as set out in the legislation governing the company’s business operations.” Thus, in theory at least, the higher a company’s profits and the greater its impact its operations have on the environment, the more it should allocate to CSR. However, nothing in the way of concrete guidance is provided by the New Regulation in this regard. [1]

As is now the practice in many countries (particularly in continental Europe), Article 7 of the New Regulation provides that CSR endeavors must be accounted for in a company’s annual report and to the shareholders’ general meeting.

What does it all mean?

In our opinion the New Regulation says no more than that if a particular statute imposes specific CSR obligations (such as the legislation governing the operation of mining companies or companies in the forestry sector), then those obligations must be implemented in accordance with the procedural scheme set out in the New Regulation. However, no new substantive CSR obligations are introduced by the New Regulation.

Sanctions

Article 7 of the New Regulation provides that if a company fails to fulfill its mandatory CSR obligations, then it will be liable to such sanctions as may be prescribed by the laws and regulations in effect. However, the New Regulation itself imposes no sanctions. Thus, in each case the existence or otherwise of concrete CSR obligations will depend on the relevant sectoral legislation, which may or may not, as the case may be, impose sanctions in respect of violations.

Fiscal Sweetener

Government Regulation No. 93 of 2010 provides for annual tax breaks of up to a maximum of 5 percent of net revenue earned during the previous fiscal year, deductible from gross revenue during the current fiscal year, in respect of expenditure on CSR activities.
Such tax breaks are available for CSR expenditure on the following:

a) Disaster relief efforts in Indonesia;
b) Research and development by R&D institutes in Indonesia, including accredited higher education institutes;
c) Educational facilities;
d) Sports facilities and development; and
e) Social infrastructure and facilities

Tax breaks are not available if the donations or contributions in question are extended to or channeled through an affiliate, as defined by the tax legislation.

CSR Controversy

During the debates on the Companies Act in the House of Representatives (DPR), the suggestion that CSR be made mandatory for all companies caused something of an outcry from business circles. By the time the bill had been passed into law, however, the proposal had been watered down to the extent that it only applied to resource-based and resource-related companies. Nevertheless, fears persisted that the ancillary/implementing regulations could yet establish an intrusive CSR regime, thereby contributing further to the high cost of doing business in Indonesia.

Those fears have not come to pass. Rather than requiring an across-the-board fixed percentage of corporate profits to be allocated to CSR efforts, the New Regulation leaves much of the substantive issues up to the specific sectoral legislation. Also, rather than introducing a formal monitoring mechanism (such as the establishment of a dedicated CSR agency), the New Regulation relies solely on public and shareholder pressure to encourage companies to fulfill their CSR obligations (through the public reporting and shareholder accountability requirements).

Companies are also completely at liberty to choose how they will spend their CSR funds. This clearly has the potential to give rise to controversy, particularly in a nation as ethnically, religiously, and socially diverse as Indonesia. The abuses associated with unregulated CSR are well-documented, including what critics refer to as “greenwashing,” i.e., the use by a company of phony CSR schemes so as to manipulate public opinion or indirectly bribe those in power. In fact, it was the potential for such abuses that persuaded India to drop a proposed mandatory CSR scheme last year.

There has also been little debate in Indonesia on the manifest inequity of imposing mandatory CSR on the resources sector alone. Why not also the booming financial services sector, for example?

By way of comparison …

An example of a robust CSR regime is to be found on the Indian Ocean island of Mauritius, the first country in the world to introduce mandatory CSR. Under the Mauritius Income Tax Act 1995, all

indigenous companies of a certain size are required to establish a CSR fund and allocate 2 percent of their annual profits to it (companies availing of Mauritius as a tax haven are exempt). The programs to be funded are subject to review and approval by a special CSR Committee established by the legislature, and reports on CSR implementation must be submitted to the Committee every six months.
Various forms of CSR investments are strictly prohibited, such as contributions for religious activities, for promoting discriminatory activities, to trade unions, to political parties, and for activities that are against the national and public interest. Also banned is sponsorship for marketing purposes and contributions to schemes that will benefit the staff or family members of staff or the shareholders of the contributing company.

Conclusion

Resource-based and –related companies that pay corporate taxes, land taxes, royalties, rehabilitation fund contributions, and a variety of other levies could be forgiven for believing they have already fulfilled their corporate social and environmental responsibilities. However, that is not the case as they are now required by law to apply CSR at the practical, hands-on level. Nevertheless, by comparison with the Mauritius CSR regime, the burden imposed by Indonesian law is relatively light. For example, there is no official list of approved CSR activities, nor any requirement to obtain approval from a governmental agency. Further, there is no oversight other than that provided by shareholders and the public at large. And, perhaps most importantly, there are no generally applicable sanctions, at least thus far. Consequently, as things stand at the moment, a company is free to choose whatever CSR activities suit it best, and to devote as much, or as little, of its profit as it considers “appropriate and reasonable.” Nevertheless, it should always be remembered that things could change in the future, especially given what appears to be growing nationalism in the resources sector.

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[1] It should be noted that state-owned enterprises (SOEs) are subject to specific CSR percentage expenditure targets under Minister of State Enterprises Regulation No. PER-05/MBU/2007, dated 27 April 2007

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