

**WIUP/WIUPK TENDER GUIDELINES – GOOD INTENTIONS  
FRUSTRATED BY LEGAL AND PRACTICAL PROBLEMS<sup>12</sup>**

**INTRODUCTION**

The Minister of Energy & Mineral Resources (“**MoEMR**”) has released draft Guidelines for Licensing of Mining Business Activities in respect of Metal Minerals & Coal (“**Draft Guidelines**”). The Draft Guidelines cover a variety of matters including, most importantly, the proposed auction or tender procedures for mining business license areas (“**WIUPs**”) and special mining business license areas (“**WIUPKs**”) (“**Tender Guidelines**”).

Rather than reviewing the Tender Guidelines in detail, this article will confine itself to highlighting and commenting on 6 very material legal issues and 6 very material practical issues to which the Tender Guidelines seem to give rise.

**BACKGROUND**

The Tender Guidelines have been a long time coming and have been anxiously awaited by exploration companies active in the Indonesian mining sector.

The 2009 Minerals & Coal Mining Law mandates that all WIUPs/WIUPKs for metal minerals and coal should be awarded on the basis of public auction or tender, rather than by way of private application as was the case previously with mining licenses under the 1967 Mining Law (*i.e.*, KPs.). Accordingly, the Tender Guidelines have to be finalized and issued before any new WIUPs/WIUPKs can be awarded. As such, the future of exploration activity in respect of metal minerals and coal is very much dependent upon the Tender Guidelines being workable and otherwise adequately addressing the problems previously encountered with the old private application procedure for KPs.

The Tender Guidelines (which are still a draft only) provide a most comprehensive and detailed “road map” for the conduct of WIUP/WIUPK tenders. Further, the Tender Guidelines clearly represent a good faith and serious effort by MoEMR to overcome many of the problems previously encountered with the old private application procedure for KPs. Accordingly, the Tender Guidelines are to be welcomed.

The problems previously encountered with the old private application procedure for KPs are well known. These problems included, among others, (i) excessive rent seeking on the part of Governors and Regents as the “unofficial” price of obtaining a KP, (ii) awarding of KPs to business associates, friends, and relatives of Governors and Regents, (iii) awarding of KPs to parties clearly lacking the financial, human and

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technical resources to properly explore and, if appropriate, develop the mining concessions covered by their KPs, (iv) a general lack of transparency in the process of awarding KPs and (v) no effective avenues for challenging the award of KPs.

## COMMENTARY

### 1. Legal Issues

**1.1 Are the Tender Guidelines Legally Enforceable?:** Many readers of the Tender Guidelines will, no doubt, assume that, because the Tender Guidelines, when finalized, will be issued in the form of a MoEMR regulation, this must mean that the Tender Guidelines will be legally binding on Indonesia's Governors and Regents in the sense that the Governors and Regents will be legally obliged to conduct future WIUP/WIUPK tenders on the basis of the strict application of the Tender Guidelines. Sadly, however, this may well not be the case. With regional autonomy, the Central Government in Jakarta simply lacks the authority to dictate to Provincial and Regency Governments how they will administer matters taking place exclusively within their Provinces or Regencies – this includes tenders for WIUPs/WIUPKs wholly located within a particular Regency or Province.

That MoEMR understands and reluctantly accepts the legal reality of Governors and Regents not being legally obliged to conduct future WIUP/WIUPK tenders on the basis of the strict application of the Tender Guidelines is evident from two things. First, although the Tender Guidelines will be eventually be issued in the form of a MoEMR regulation, the Tender Guidelines are expressed to be and carefully styled as “guidelines” rather than “rules”. The term “guidelines” normally implies something less than a legally enforceable rule that parties are obliged to follow but, rather, something more in the nature of a recommendation or an advisory statement of good and prudent practice. Second, a careful reading of the Tender Guidelines reveals that no penalties are imposed on Governors or Regents that do not follow the Tender Guidelines in conducting future WIUP/WIUPK tenders. If the Tender Guidelines were really intended to be and capable of being legal binding on and enforceable against Governors and Regents, one would, logically, expect that some penalty or sanction would be imposed for violations of the Tender Guidelines. This, however, is not the case. It is particularly noteworthy that the Tender Guidelines nowhere provide that WIUP/WIUPK tenders, conducted in a manner contrary to the Tender Guidelines, are invalid and/or that IUPs/IUPKs issued by a Governor or Regent on the basis of WIUP/WIUPK tenders, conducted in a manner contrary to the Tender Guidelines, are invalid. If MoEMR truly believed that the Tender Guidelines were legally binding on and enforceable against Governors and Regents, then the Tender Guidelines would reasonably be expected to provide that WIUP/WIUPK tenders, conducted in a manner contrary to the Tender Guidelines, are invalid and/or that IUPs/IUPKs issued by a Governor or Regent on the basis of WIUP/WIUPK tenders, conducted in a manner contrary to the Tender Guidelines, are invalid.

MoEMR is surely as much aware as anyone of the limitations imposed on its authority by regional autonomy. Accordingly, in drafting the Tender Guidelines, MoEMR has carefully avoided placing itself in a position where it would only likely to be seriously embarrassed by a subsequently successful legal challenge to any Tender Guideline provision mandating the invalidity of (i) WIUP/WIUPK tenders conducted in a manner contrary to the Tender Guidelines or (ii) IUPs/IUPKs issued by a Governor or Regent on the basis of WIUP/WIUPK tenders, conducted in a manner contrary to the Tender Guidelines.

There is an instructive parallel with the Clean & Clear List recently issued by MoEMR. MoEMR is always very careful to emphasize that it is not taking the position that IUPs which are not on the Clean & Clear List, are necessarily invalid despite MoEMR's determination that such IUPs are characterized by unspecified "problems". The reason for this ambiguous stance is surely that MoEMR is only too painfully aware that it may well lack the legal authority to invalidate IUPs with MoEMR identified but unspecified "problems". Accordingly, MoEMR has taken the alternative approach of simply confirming the "clear and clear" status of those IUPs on the Clean & Clear List without saying anything definitive about the status of those IUPs not on the Clean & Clear List. So to, with WIUP/WIUPK tenders not conducted by Governors and Regents in accordance with the Tender Guidelines and IUPs/IUPKs issued by a Governor or Regent on the basis of WIUP/WIUPK tenders, conducted in a manner contrary to the Tender Guidelines.

It is, most likely, the case that only Governors or Regents can revoke IUPs/IUPKs issued on the basis of tenders for WIUPs/WIUPKs which do not comply with the Tender Guidelines and where the WIUPs/WIUPKs concerned are located wholly within a particular Province or Regency. As, however, any deviation from the Tender Guidelines, in a particular Province or Regency, will often if not always involve complicity on the part of the relevant Governor or Regent, it seems most improbable that the relevant Governor or Regent will have any incentive to revoke IUPs/IUPKs issued on the basis of tenders for WIUPs/WIUPKs which do not comply with the Tender Guidelines and where the WIUPs/WIUPKs concerned are located wholly within a particular Province or Regency.

The reality then is that, most probably, the Tender "Guidelines" are just that (i.e., "guidelines" or advisory recommendations and statements of desirable and good practice rather than legally binding and enforceable rules). The one exception is where the WIUP/WIUPK falls within two or more Provinces and, so, the relevant authority for issuing the IUP/IUPK is MoEMR. This, however, will only be the case in a tiny minority of situations.

- 1.2 If the Tender Guidelines are not Legally Enforceable, what are the Implications?:** Accepting that the Tender Guidelines are, most probably, only legally binding and enforceable (i.e., mandatory and obligatory as opposed to advisory guidelines or recommendations) where the WIUP/WIUPK falls within two or more Provinces and, so, the relevant

authority for issuing the IUP/IUPK is MoEMR, this has worrying implications for the practical significance of the Tender Guidelines.

Indonesia's responsible Governors and Regents (of whom there are, no doubt, many) will, of course, adopt and apply the Tender Guidelines. However, this will, effectively, be on a voluntary basis rather than because the Tender Guidelines are legally binding and enforceable.

Irresponsible Governors and Regents (who are, hopefully, only in a minority) are not going to adopt and apply the Tender Guidelines in good faith. Rather, such Governors and Regents will surely (i) ignore the Tender Guidelines, (ii) "cherry pick" those parts of the Tender Guidelines that suit their purposes or (iii) make up their own local tender procedures which, to a greater or lesser extent, differ from the Tender Guidelines.

The practical ability of Governors and Regents to make what they want of the Tender Guidelines means it is highly unlikely there will be any uniformity of WIUP/WIUPK tender procedures throughout Indonesia. As a result, participants in WIUP/WIUPK tenders will have to follow whatever tender procedures happen to apply in the particular Province or Regency where they are interested in carrying on exploration activities for metal minerals or coal.

- 1.3 What are the Implications of Governors/Regents not Following the Tender Guidelines?:** As was pointed out in Part 1.1 above, it is probably the case that MoEMR simply lacks the legal authority to cancel IUPs/IUPKs issued by Governors and Regents on the basis of WIUP/WIUPK tenders that do not comply with the Tender Guidelines. If MoEMR was to announce the cancellation or revocation of such IUPs/IUPKs, Administrative Court and/or Constitutional Court legal challenges, from the relevant Governors and Regents, as well as from the adversely affected IUP/IUPK holders, would almost certainly follow. As with all legal proceedings in Indonesia, such challenges would, inevitably, be time consuming and expensive to resolve, with MoEMR's chances of ultimately prevailing, based on the strength of its legal position only, being highly problematic and uncertain.

Given the risks for MoEMR in formally cancelling or revoking IUPs/IUPKs issued by Governors and Regents on the basis of WIUP/WIUPK tenders that do not comply with the Tender Guidelines, MoEMR may well try to bring the Governors and Regents into line by expanding the use of the Clean & Clear List to only include new IUPs/IUPKs, for metal minerals and coal, which have been issued on the basis of tenders carried out in strict compliance with the Tender Guidelines. This strategy would avoid the need for MoEMR to take any official stand on the validity of IUPs/IUPKs not included on the expanded Clean & Clear List and may well enable MoEMR to escape bruising legal challenges. However, as is currently the case with IUPs not included by MoEMR on the Clean & Clear List due to identified but unspecified "problems", there is then likely to be an ever greater number of IUPs/IUPKs, for metal minerals and coal, of uncertain legal status and which are, for all intents and purposes, in "limbo" because they are not on the Clean & Clear List but have not been cancelled or revoked.

This, likely, ever greater number of IUPs/IUPKs, for metal minerals and coal, of uncertain legal status, can only be bad news for potential investors and financiers of metal mineral and coal mining projects. Legal due diligence exercises in respect of Indonesian mining projects are already hugely challenging and difficult exercises owing to the large number of issues to be addressed in assessing the legal viability of a mining project. Anything that makes the true legal status of IUPs/IUPKs, for coal and metal mineral mining projects, even more uncertain has the potential to raise the challenging and difficult nature of mining project legal due diligence exercises to nightmare proportions. Potential mining project investors and financiers will be forced to make decisions, whether or not to proceed with the investment in or financing of many mining projects, on the basis of doubtful assessments as to whether or not IUPs/IUPKS issued by Governors and Regents, on the basis of non-compliant WIUP/WIUPK tenders, are valid or invalid and without the benefit of any definitive and well accepted legal position re the true status of such IUPs/IUPKs. This cannot be good for the future of the Indonesian mining industry because, in the presence of any material doubt as to the validity of the underlying IUP/IUPK, cautious, prudent and well advised, potential investors and financiers will simply choose not to proceed. As it will be individual Governors and Regents, rather than tender participants, who decide whether or not to strictly implement the Tender Guidelines, IUP/IUPK holders who participated, in good faith, in WIUP/WIUPK tenders, where the Tender Guidelines have not been strictly implemented, will be quite unfairly prejudiced as a result of the much greater resulting difficulty they will face in securing new investors and financiers for their mining projects.

- 1.4 Is there a Right to Challenge the Pre-Qualification Process?:** As presently drafted, the Tender Guidelines do not provide any clear right to challenge exclusion from WIUP/WIUPK tender participation as part of the pre-qualification process. Although Article 24 of the Tender Guidelines provides a right to challenge the outcome of the tender (i.e., the winner) and the tender process itself, it is only “bidders” which are authorized to submit a so-called “rebuttal letter” under Article 24. As “bidders” are parties that pre-qualified to participate in the tender, the Article 24 right does not seem to extend to parties that sought to participate in the tender but were excluded as part of the pre-qualification process.

The absence of any clear right to challenge exclusion, from WIUP/WIUPK tender participation as part of the pre-qualification process, is worrying because the satisfaction or otherwise of the technical requirements for pre-qualification (i.e., mining experience, availability of suitably qualified and experienced human resources and work plans) are open to subjective assessment and evaluation. This would seem to create an opportunity for tender committees, with bad intentions, to pre-qualify “co-operative” or “friendly” bidders only and thereby ensure the exclusion from the tender of potential bidders which are not willing to work with the tender committee to achieve a particular outcome.

Article 24 of the Tender Guidelines should be expanded to make it clear that parties excluded as part of the pre-qualification process, as well as “bidders”,

have the right to challenge all aspects of the entire tender process including the conduct of the pre-qualification stage.

- 1.5 Is it Possible for Foreign Companies and Newly Established Companies to Pre Qualify?:** Although not entirely clear, it is probably the case that foreign companies are not eligible to pre-qualify for tenders but, rather, must set up PMA Companies in order to be able to pre-qualify. This is due to the requirement that parties wanting to pre-qualify must submit details of their NPWPs and VAT Collector numbers, things which are only applicable to Indonesian incorporated companies.

It also seems to be very difficult for newly established Indonesian companies (both PMA Companies and Non-PMA Companies) to pre-qualify for pre-tender participation due to the pre-qualification requirements which include (i) four years of exploration or production operations, (ii) audited financial statements and (iii) taxpayer receipts for previous years. Newly established Indonesian companies will, self-evidently, not be able to meet any of these requirements.

It appropriate to ask whether or not the Tender Guidelines' apparent bias in favor of well established, Indonesian companies is necessarily in the best interests of the local mining industry. Surely, it is desirable that newly established Indonesian companies also be able to pre-qualify to participate in tenders so long as they can establish access to the necessary human and financial resources to carry out their obligations if they are tender winners. If nothing else, this will ensure greater competition in tenders and make possible a greater diversity of participants in the Indonesian mining industry.

- 1.6 Does the Successful Tenderer have a Legal Right to an IUP/IUPK?:** It is important to note that tenders are for WIUPs/WIUPKs rather than for IUPs/IUPKs. In other words, a successful tenderer receives a mining business license area rather than the mining business license itself. The successful tenderer then has to apply for the IUP/IUPK. Although Article 35 of the Tender Guidelines provides that MoEMR, the Governor or the Regent, as the case may be, will issue the IUP/IUPK not later than 14 days after the application is submitted in good order, there is no provision made for what should happen if, for whatever reason, MoEMR, the Governor or the Regent, as the case may be, does not issue the IUP/IUPK within the prescribed 14 day period. This is in curious contrast to the situation where a Governor or Regent fails to issue the Recommendation/Approval required for the WIUP/WIUPK tender to take place. Article 6 of the Tender Guidelines provides that, in this situation, the Governor or Regent is deemed to have given the necessary Recommendation/Approval. One may reasonably ask why is there no equivalent deeming procedure where the Governor or Regent fails, for whatever reason, to issue the IUP/IUPK within the prescribed 14 day period.

The absence of a deeming procedure, where the Governor or Regent fails to issue the IUP/IUPK within the prescribed 14 day period, leaves it open for unscrupulous Governors and Regents to engage in rent seeking behavior as the price of issuing, on a timely basis, the IUP/IUPK to the successful

WIUP/WIUPK tenderer which has otherwise met all the application requirements. It is no answer to say that the successful WIUP/WIUPK tenderer, which has otherwise met all the application requirements, may commence Administrative Court proceedings against the recalcitrant Governor or Regent in order to compel the issuance of the IUP/IUPK. Given the high costs and long delays associated with Indonesian legal proceedings, the successful WIUP/WIUPK tenderer will be severely prejudiced if it has to undertake legal proceedings to compel the issuance of the IUP/IUPK. This is all the more so given that, before the successful WIUP/WIUPK tenderer is entitled to receive its IUP/IUPK, Articles 33(5) and 36 require the successful WIUP/WIUPK tenderer to have already provided its Guarantee of Seriousness Deposit. This is on top of the substantial monies the successful WIUP/WIUPK tenderer will surely have already spent in pre-qualifying for and participating in the tender, not to mention paying the winning bid.

In order to adequately protect their legitimate interests, the Tender Guidelines should be amended to provide that MoEMR, the Governor or the Regent, as the case may be, is deemed to have issued the IUP/IUPK to the successful tenderer if the IUP/IUPK is not otherwise forthcoming within 14 days of the complete application being submitted. Anything less than this just leaves successful tenderers at the none too tender mercy of rapacious Governors and Regents intent on doing the wrong thing.

## **2. Practical Issues**

**2.1 Are Tenders and Tender Committees an Effective and Realistic Solution to Past Problems?** The Tender Guidelines go to considerable lengths to try to ensure greater transparency and independence/objectivity in the process of awarding WIUPs/WIUPKs and IUPs/IUPKs for metal minerals and coal. As such, the Tender Guidelines unquestionably represent an improvement on the previous practice of awarding KPs by private application. However, this improvement is, to a substantial degree, likely to be an improvement in theory more than it is an improvement in practice. This is because much of the potential improvement in transparency and independence/objectivity, which the Tender Guidelines offer, will only be realized if the Tender Guidelines are adopted and implemented honestly and in good faith by the various Provinces and Regencies of Indonesia. As the Governors and Regents are, very arguably, not legally bound and compelled to adopt the Tender Guidelines as is (see Parts 1.1 and 1.2 above), much depends on voluntary compliance with the Tender Guidelines. Further, as previously pointed out (see Parts 1.1 and 1.2 above), there is not much MoEMR can legally do if Governors and Regents do not voluntarily adopt the Tender Guidelines as is. Accordingly, the question really becomes how likely is that the Governors and Regents will voluntarily adopt the Tender Guidelines as is and then proceed to implement the Tender Guidelines honestly and in good faith?

Based on the past record of at least some of the Governors and Regents in handling KP applications, it is not easy to be confident that those same Governors and Regents or their successors) will willingly abstain from their past rent seeking behavior and otherwise voluntarily adopt and implement,

honestly and in good faith, the Tender Guidelines. Such easy confidence would only be possible (not to say realistic) if (i) there were severe penalties imposed on Governors and Regents who did not implement the Tender Guidelines properly and/or (ii) IUPs/IUPKs issued on the basis of non-complaint WIUP/WIUPK tenders were to be cancelled or revoked. As should be apparent from Parts 1.1 and 1.2 above, neither of these pre-conditions is met by the Tender Guidelines. With no meaningful “carrots” to encourage Governors and Regents to do the right thing and no meaningful “sticks” to punish Governors and Regents, for failing to properly adopt and implement the Tender Guidelines, MoEMR is essentially relying on the goodwill and voluntary co-operation of the Governors and Regents to make sure the Tender Guidelines deliver their promised benefits. As old habits are hard to change and as goodwill and co-operation seem to be in very short supply when it comes to MoEMR/Governor/Regent relations, one cannot be overly sanguine about the chances of the Tender Guidelines producing, in practice as opposed to in theory, a much fairer and much more transparent process for issuing mining licenses. This unhappy situation is, of course, not the fault of MoEMR but, rather, of regional autonomy which gives MoEMR so little effective authority and control over the Governors and Regents when it comes to mining related matters.

- 2.2 Do the Provinces/Regencies have Sufficient Human Resources/Technical Expertise to Properly Implement the Tender Guidelines?:** Preparing the exploration and geological data packages contemplated by the Tender Guidelines needs to be carried out carefully as Tender bids will be based, at least in part, on this data and what it purports to reveal about the mineral reserve potential of the WIUPs/WIUPKs. This is likely to be all the more the case given the limited opportunity for would be tender participants to carry out any meaningful technical due diligence enquiries as a part of the site visits contemplated by the Tender Guidelines or otherwise.

At the same time, the procedures specified in the Tender Guidelines for the conduct of tenders are quite complex and detailed. As such, considerable administrative and management expertise will surely be required to ensure that the Tender Guidelines are properly implemented, especially where there are multiple tenders taking place simultaneously in particular Provinces and Regencies.

There are, of course, competent, experienced and professional officials working in mining related activities in the Provinces and Regencies. However, it seems only realistic to question whether or not there are really enough of these competent, experienced and professional officials to handle multiple tenders taking place simultaneously in particular Provinces and Regencies. This seems to be especially problematic given provincial and regional mining officials have many other responsibilities to discharge apart from serving on tender committees.

- 2.3 Is the Mechanism for Challenging Tender Outcomes Adequate?:** Serious reservations must be expressed about the practicality of the procedures provided in the Tender Guidelines for challenging tender outcomes and the overall conduct of tenders.

First, Article 24(1) of the Tender Guidelines provides that aggrieved bidders have to submit their rebuttal letters or challenges to the Governor or Regent, as the case may be, where the tender was in respect of a WIUP/WIUPK that does not cross the boundaries of two Provinces and it is then up to the Governor or Regent to decide on the merits of the rebuttal/challenge. The problem with this is that the Governor or Regent is not independent of the tender in respect of which the rebuttal or challenge is being made and on the merits of which he is being asked to rule. This is because the tender committees, charged with the responsibility of carrying out the tenders in accordance with the Tender Guidelines, will in most cases be established by the Governor or Regent himself albeit in accordance with the composition requirements set out in Article 7 of the Tender Guidelines. In other words, any unfairness or wrongdoing in carrying out the tender will be unfairness or wrongdoing on the part of tender committee members appointed by the Governor or Regent. Effectively, then, the Governors and Regents are being asked to rule on the conduct of their own tender committee appointees. At the risk of stating the obvious, this is not conducive to an impartial and independent review of the tender committee's performance in conducting the tender.

Second, Article 24(1) of the Tender Guidelines requires that rebuttals/challenges, together (presumably) with all supporting evidence and materials, be submitted not later than three working days after the announcement of the tender winner. Aggrieved bidders are surely going to find it extremely challenging to meet this very short time limit given the need to prepare detailed grounds of rebuttal/challenge and collect supporting evidence/materials. The impossibly short rebuttal/challenge period seems deliberately designed to discourage, if not make impossible, effective rebuttals/challenges to tender outcomes, something which is to be regretted if greater transparency and accountability is meant to be one of the principal objectives of the Tender Guidelines.

Third, Article 24(3) requires the Governor or Regent to rule on the rebuttal/challenge within five working days of the rebuttal/challenge being received. Again, this time frame seems quite unrealistic given the numerous other responsibilities which Governors and Regents have. Even assuming absolute good faith on the part of Governors and Regents, it is surely impossible to expect that Governors and Regents are going to be able to, at short notice, devote large amounts of time to independently investigating and reviewing the rebuttal/challenge and the supporting evidence. Once more, one is left to wonder whether the rebuttal/challenge process is meant to be a mere formality designed to ensure the confirmation of all tender outcomes as opposed to a serious and searching review of what actually happened in the course of the tender.

Fourth, Article 24(5) leaves quite unclear what is the outcome if a rebuttal/challenge is submitted within the mandated three day period but the Governor or Regent does not rule on the rebuttal/challenge by the end of the immediately following five day period. In these circumstances, is the rebuttal/challenge deemed to be rejected? This uncertainty is most unhelpful.

**2.4 Why should Holders of Expired IUPs/IUPKs have Right to Match Winning Bids?:** Article 27 of the Tender Guidelines gives the holder of an expired Production Operation IUP/IUPK, covering a WIUP/WIUPK being offered for tender, the right to match the winning bid if the holder of the expired Production Operation IUP participated in the tender but submitted a lower bid than that of the winning bidder. This right to match seems very undesirable from a fair competition and transparency perspective. Having already carried out production operation activities on the WIUP/WIUPK, the holder of the expired Production Operation IUP/IUPK will surely have the best knowledge of the mining reserves potential of the WIUP/WIUPK and, therefore, be best placed to make the most accurate assessment of the value of the residual value of the WIUP/WIUPK. As currently drafted, however, Article 25 encourages the holders of expired Production Operation IUPs/IUPKs to not reveal their inside knowledge of the residual value of the WIUP/WIUPK by submitting a realistic bid reflecting that inside knowledge but, rather, to deliberately submit a nominal bid only and wait to see what the other bidders, which don't have the benefit of its inside knowledge, do in terms of setting their bid amounts. Other bidders, having less information, will invariably submit lower bids than they would if they had accurate information (as does the holder of the expired IUP/IUPK) regarding the residual value of the WIUP/WIUPK. This then allows the holder of the expired IUP/IUPK to acquire the WIUP/WIUPK by matching the lower bid of the winning bidder and without having to pay what it knows to be the higher residual value of the WIUP/WIUPK. In other words, the holder of the expired IUP/IUPK is given a hugely unfair competitive advantage over other bidders by virtue of being encouraged not to disclose what it knows about the residual value of the WIUP/WIUPK before the other bidders have committed themselves by submitting their much less well informed bids.

The end result of the right to match must be that the holder of the expired IUP/IUPK will always end up getting the WIUP/WIUPK except where the other less well-informed bidders recklessly overbid for the WIUP/WIUPK, exceeding what the holder of the expired IUP/IUPK knows to be the real residual value of the WIUP/WIUPK. This is a classic illustration of what, in the finance literature, is called the “winner’s curse”. It is a “winner’s curse” because the uninformed bidder will ever only succeed in getting the WIUP/WIUPK where he pays more than what the much better informed holder of the expired IUP/IUPK knows to be the residual value of the WIUP/WIUPK. In all other situations, the holder of the expired IUP/IUPK will exercise its right to match and acquire the WIUP/WIUPK for what it knows to be less than the residual value of the WIUP/WIUPK.

**2.5 Why Should SOE’s have Priority Right to WIUPKs?:** Perhaps even more perplexing than the right to match discussed in Part 2.4 above, is the priority right given by Article 28 of the Tender Guidelines to State Owned Enterprises and local enterprises (“SoEs”) to obtain WIUPKs; that is, mining business license areas of national strategic importance. By definition, WIUPKs are areas that have been identified as likely having mineral reserves of particularly high importance and significance, economic, strategic or otherwise, to Indonesia’s future. This being the case, it is surely in the best

interests of Indonesia and Indonesians that WIUPKs be given to those entities that, because of their proven expertise and available resources, are best able to apply best practices, cutting edge technology and professional management to efficiently and thoroughly explore the WIUPKs and confirm the true potential of the mining reserves located there. In these circumstances, to allow SoEs to take the WIUPKs on a priority basis makes no sense at all from a rational economic perspective.

Although there are undoubtedly competent SoEs in Indonesia, the overall reputation and track record of Indonesia's SoEs is not encouraging. It seems that, in giving a priority right to SoEs, MoEMR is putting nationalistic and political considerations ahead of rational economic considerations. This cannot be desirable, in the long run, for the future advancement and development of Indonesia and Indonesians.

- 2.6 Are Smaller Exploration Companies Disadvantaged?:** The cost of meeting pre-qualification administrative and technical requirements may well be prohibitive for small exploration companies which will be obliged to incur these costs merely for the privilege of participating in a tender and without any certainty of being the winning bidder. This burden is likely to increase exponentially as the result of the need to participate in multiple tenders in multiple Provinces and Regencies in order to increase the chance of being the winning bidder in at least one tender. This effectively places smaller and less well established and well resourced mining companies at a competitive disadvantage in obtaining WIUPs/WIUPKs for metal minerals and coal.

The Indonesian government may well prefer to deal with a few large and well established mining companies, rather than a large number of smaller and less well established mining companies, as this is more administratively efficient from the government's perspective. In drafting the Tender Guidelines so that they, arguably, favor large mining companies over small mining companies, however, MoEMR seems to have overlooked or chosen to ignore at least two things. First, small mining companies have a well established and international track record of making many of the most promising exploration discoveries due to their greater risk appetite and more flexible operating procedures compared to large mining companies. Second, the type of mining company (i.e., small mining company versus big mining company) best suited to successful exploration activity is not the same as the type of mining company (i.e., small mining company versus big mining company) best suited to successful production operation activity. As the Tender Guidelines are solely concerned with the award of WIUPs/WIUPKs for exploration activities, as opposed to for production operation activities, the fact that big mining companies may be more technically capable and much better resourced, than small mining companies, to carry out production operation activities is irrelevant in awarding WIUPs/WIUPKs for exploration activities. There is a well established and internationally recognized tradition of small mining companies carrying out highly successful exploration activities and otherwise making important exploration discoveries before selling out to or bringing in, as partners, big mining companies to carry out the much more capital intensive and technically challenging production operation activities. By failing to adequately distinguish between the areas of activity best suited

to the risk appetite and resources profiles of small mining companies versus big mining companies, the Tender Guidelines give rise to the prospect of creating a more orderly and administratively efficient mining environment in Indonesia but at the great expense of not maximizing the ultimate return Indonesia and Indonesians derive from this country's mineral assets.

## **SUMMARY AND CONCLUSIONS**

The Tender Guidelines unquestionably will promote greater transparency, to a some degree, in the licensing process for WIUPs/WIUPKs and make it more likely that well experienced, qualified and resourced parties will obtain IUPs/IPUKs going forward. This must be seen as very positive.

MoEMR has also clearly put much effort into the formulation of the Tender Guidelines.

Nevertheless, there are a number of legal and practical issues raised by the Tender Guidelines, in their current form, which must give rise to serious reservations whether, if implemented in their current form, the Tender Guidelines will really overcome all or even most of the problems previously encountered with the private application procedure for KPs.

Unfortunately, the most serious legal problem with the Tender Guidelines; namely, their highly questionable enforceability, is a function of Indonesia's adoption of regional autonomy in 1998 and the consequent great authority of Governors and Regents in dealing with licensing matters within their own Provinces and Regencies. For better or worse, regional autonomy is clearly here to stay and, so, the probable lack of legal enforceability of the Tender Guidelines is likely unavoidable.

Improvements could, however, be made in terms of those identified practical problems identified in respect of the Tender Guidelines with regard to (i) the right to match of expired IUP/IUPK holders, (ii) the WIUPK priority right of SOEs and (iii) the competitive disadvantage which the Tender Guidelines impose on small exploration companies. Indonesia would, almost certainly, be better off if the Tender Guidelines were revised to address these practical issues.

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