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### COAL PORTS – DIFFICULT LEGAL STRUCTURE CHOICES WITH MULTIPLE REGULATORY HURDLES TO OVERCOME<sup>1234</sup>

#### INTRODUCTION

Indonesia's huge coal exports, as well as the myriad infrastructure problems which can delay and impede the efficient handling of those exports at the point of shipment and delivery, have created much interest in developing new specialized loading ports and terminals dedicated to coal only (“**Coal Terminals**”).

Indonesia unquestionably needs multiple new Coal Terminals if it is to become a more efficient exporter of coal and, therefore, strong demand for the services of new Coal Terminals is almost a given. This implies potentially high profits for the developers and operators of Coal Terminals.

Realizing the potential for new Coal Terminals in Indonesia has, however, proved difficult owing to the multiple regulatory hurdles to be overcome in arriving at a legal structure for Coal Terminal projects which can withstand the rigorous legal due diligence scrutiny of potential financiers of and investors in such projects.

#### BACKGROUND

The main commercial objectives of the promoters and developers of Coal Terminals are, self-evidently, to:

- (a) to own and control the operation of a Coal Terminal;
- (b) use the Coal Terminal to carry on a business of loading and exporting coal for all producers and traders of coal interested in availing themselves of the services of the Coal Terminal; and
- (c) generate income from charges or tariffs payable by producers and traders of coal availing themselves of the services of the Coal Terminal.

The question is whether or not these unremarkable commercial objectives of the promoters and developers of Coal Terminal projects can be realized using available legal structures which also meet the needs of potential third party financiers of and investors in Coal Terminal projects with their usual focus on certainty and security.

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Unfortunately, the certainty and security of the currently available legal structures for Coal Terminal projects is not beyond doubt due to the existence of a number of challenging regulatory hurdles.

A big part of the regulatory hurdles to be overcome in arriving at a bankable legal structure for Coal Terminal projects is the result of the number of laws and regulations that have to be addressed in structuring a Coal Terminal project as well as the overlapping and conflicting positions of various government agencies which claim some authority to regulate Coal Terminals.

Some only of the laws and regulations relevant to Coal Terminals are:

1. Law No. 17 of 2008 on Shipping, dated 7 May 2008 (“**Shipping Law**”);
2. Law No. 4 of 2009 on Mineral and Coal Mining, dated 12 January 2009 (“**Mining Law**”);
3. Government Regulation No. 61 of 2009 on Ports, dated 20 October 2009 (“**GR 61**”);
4. Government Regulation No. 23 of 2010 on Implementation of Mineral and Coal Mining Business Activities, dated 1 February 2010 (“**GR 23**”);
5. Minister of Energy and Mineral Resources Regulation No. 28 of 2009 on Mineral and Coal Mining Services Business, dated 30 September 2009 (“**MoEMR 28**”); and
6. Minister of Transportation Regulation No. 51 of 2011 on Special Terminals and Terminals for Own Interest, dated 18 May 2011 (“**MoT 51**”).

Both the Directorate General of Sea Transportation (“**DGoST**”) and the Directorate General of Minerals and Coal (“**DGoMC**”) have various levels of authority to regulate Coal Terminals.

## COMMENTARY

### 1. General Overview of Terminals

**1.1 Terminals:** “Terminals” are broadly defined to mean a port facility consisting of a dock, place for ships to anchor, storage area, waiting area, embarkation and disembarkation of passengers area and/or loading and unloading of goods area (Article 1 Paragraph 19 of GR 61).

In principle, it is possible for private companies, engaged in certain specific business activities, to obtain the various licenses needed to develop and operate a Terminal.

**1.2 Terminal Owners:** The types of main or principal business activities which a company (“**Terminal Owner**”) must carry on in order to be able to legally own and operate a Terminal are as follows:

- (a) Mining;
- (b) Energy;
- (c) Forestry;
- (d) Agriculture;
- (e) Fisheries;
- (f) Industrial;
- (g) Tourism;
- (h) Shipyards; or
- (i) Other business activities that require jetty facilities (“**Main Business Activity**”).

**1.3 Types of Terminal:** The Shipping Law and its implementing regulations recognize two distinct categories of Terminals, being:

- (a) Special Terminals (*Terminal Khusus*); and
- (b) Terminals for Own Interest (*Terminal Untuk Kepentingan Sendiri*).

**1.3.1. Special Terminals:** A Special Terminal is a Terminal, located **outside** of the Working Environment Area (*Daerah Lingkungan Kerja* or “**DLKr**”) and Interest Environment Area (*Daerah Lingkungan Kepentingan* or “**DLKp**”) of, but still considered to be part of, the nearest public port, and utilized **solely** for the exclusive purpose of supporting the Main Business Activity of the Terminal Owner.

A Special Terminal may be solely used for the following purposes:

- (a) support the Terminal Owner and the subsidiary companies of the Terminal Owner, with the same business activities;
- (b) handle ship traffic, embarkation and disembarkation of passengers, loading and unloading of goods (**e.g.**, raw materials, products and supporting equipment which are relevant to the Main Business Activities) which must be evidenced by passenger documents and/or goods loading documents; and
- (c) government activities, research, study, training and social activities.

The construction and development of the Special Terminal is carried out by the Terminal Owner after obtaining a “**Special Terminal Construction License**” issued by DGoST and must be completed within one year from the date of the Special Terminal Construction License.

Once the Special Terminal has been constructed, the operation of the Special Terminal requires the Terminal Owner to (i) obtain a “**Special Terminal Operating License**” from DGoST and (ii) enter into a co-operation arrangement with the nearest public port administrator (*penyelenggara pelabuhan* or “**Port Administrator**”).

The Special Terminal Operating License is valid for a period of five years and is renewable.

A Special Terminal Operating License is transferable **only if** the Main Business Activities of the Terminal Owner are also being transferred.

A Special Terminal is only open for public use in certain very specific situations as follows:

- (a) there are no public ports near the relevant area and neither the available transportation facilities nor the nearest public port can provide adequate services, thereby resulting in limitations on the transportation of goods or
- (b) the occurrence of a natural disaster or other events that prevent the public ports from functioning.

Approval to operate a Special Terminal for the above limited public purposes is only granted subject to the fulfillment of the following requirements by the Terminal Owner:

- (a) the Special Terminal must have adequate facilities to ensure (a) the safety of shipping activity and (b) the carrying out of port services;
- (b) co-operation with the nearest Port Administrator; and
- (c) the obtaining of a license for the utilization of the Special Terminal for public purposes from the Ministry of Transportation (“**MoT**”) (“**Public Purposes ST License**”).

The critical limitation on the utilization of a Special Terminal, for public purposes as a Coal Terminal, is that a Public Purposes ST License is meant to be only temporary in nature and, accordingly, once the nearest public port is able to provide the required services, MoT has the right to (and, indeed, is meant to) revoke the Public Purposes ST License.

**1.3.2. Terminal for Own Interest:** A Terminal for Own Interest is a Terminal located **within** DLK<sub>r</sub> and DLK<sub>p</sub> of a public port and may be either a **private** Terminal for Own Interest or a **public** Terminal for Own Interest.

A **private** Terminal for Own Interest must be utilized **solely** for the exclusive purpose of supporting the Main Business Activities of the Terminal Owner. A **public** Terminal for Own Interest, on the other hand, may be used for the benefit of third parties not being the Terminal Owner.

A Terminal for Own Interest is established on the basis of:

- (a) a co-operation agreement between the Terminal Owner and the Port Administrator; and

- (b) written approval from MoT, the Governor or Regent/Mayor, based on their relevant authority.

The **basic** approval requirements in respect of the operation of a **private** Terminal for Own Interest are extensive but still manageable. These requirements are as follows:

- (a) evidence of co-operation agreement between Terminal Owner and Port Administrator;
- (b) complete corporate documentation of the Terminal Owner (**e.g.**, Deed of Establishment, Articles of Association and its amendments, Tax Payer Registration Number and Main Business Activity License (**e.g.**, Mining Business License (*Ijin Usaha Pertambangan* “**IUP**”));
- (c) drawings of Terminal for Own Interest spatial layout, drawings of jetty construction, geographical coordinates of the location of Terminal for Own Interest;
- (d) document evidencing land control and possession issued by the National Land Agency (BPN);
- (e) business proposal for Terminal for Own Interest;
- (f) recommendation from the harbormaster (*Syahbandar*) of the nearest public port;
- (g) minutes of site visit carried out by the MoT technical team; and
- (h) environmental feasibility study as approved by the relevant authority.

The activities that are allowed to be carried out within a **private** Terminal for Own Interest are limited to the following:

- (a) ship traffic, embarkation and disembarkation of passengers, loading and unloading of goods (**e.g.**, raw materials, products and supporting equipment) which are relevant to the Main Business Activities of the Terminal Owner and which must be evidenced by passenger documents and/or goods loading documents; and
- (b) government activities, research, study, training and social activities.

Where, however, a Terminal for Own Interest is to be utilized for the benefit of any third party (**i.e.**, a **public** Terminal for Own Interest) the Terminal Owner must also obtain a “**concession**” from the Port Administrator (“**Concession**”).

A Concession is the right to operate a Terminal for Own Interest for public use/commercial purposes granted by the Port Administrator to the Terminal Owner in co-operation with a Port Business Entity (*Badan Usaha Pelabuhan*

or “BUP”) and on the basis of a co-operation agreement between the Terminal Owner and the BUP.

The BUP is meant to act as the operator of the Terminal for Own Interest and on behalf of the Terminal Owner.

A Concession may be granted upon the fulfillment of the following requirements by the Terminal Owner:

- (a) establish capability of the jetty and other existing facilities to fulfill the demand for port services;
- (b) preparation of an activities plan, to be evaluated from the perspective of shipping security, good order and safety, based on a recommendation from the harbormaster of the nearest public port;
- (c) carrying out of efforts to increase the quality and quantity of services rendered to port service consumers, in co-operation with BUP;
- (d) collection of port service tariffs carried out by the relevant Port Administer, in co-operation with BUP; and
- (e) application of port services systems and procedures at the relevant port, in co-operation with BUP.

To date, however, no implementing regulations, which set out the detailed procedures for obtaining a Concession, have been issued. The implementing regulations on Concessions are still being discussed but **may** be issued before the end of this year. Due to the absence of any implementing regulations, the procedures for obtaining a Concession remain unclear as does the legal status of any Concession issued prior to the implementing regulations being issued.

## 2. General Overview of BUP

**2.1 BUP:** BUP is a business entity (**e.g.**, a limited liability company (*perseoran terbatas* or PT) which **solely** engages in the operation of Terminals and other port facilities.

A BUP must be established in the form of a **special purpose company** and must not engage in any business activities other than the operation of Terminals and other port facilities. The Articles of Association of a BUP must specifically state “**port services**” (*jasa kepelabunan*) as its sole business activity.

A BUP is not allowed to construct and/or own a Terminal.

**2.2 Activities of BUP:** A BUP is allowed to provide the following terminal operation services from one or more Terminals located within one port:

- (a) procurement and/or services of jetties for anchoring;

- (b) procurement and/or fuel and clean water services;
- (c) procurement and/or embarkation and disembarkation of passengers and vehicle services;
- (d) procurement and/or dock for loading and unloading of goods and containers;
- (e) procurement and/or services of warehouse and storage for goods, loading of equipment services;
- (f) procurement and/or services of terminal for containers, liquid bulk, dry bulk and roll-in roll-out (ro-ro);
- (g) procurement and/or services of distribution and goods consolidation center; and/or
- (h) procurement and/or services of ship delay (together, “**Terminal Operating Services**”).

**2.3 BUP Licensing Requirements:** Before it may carry out Terminal Operating Services, a BUP is obliged to obtain a Business License issued by the Minister of Transportation, relevant Governor or relevant Regent/Mayor, depending on the type of port.

GR 51 only provides limited guidance on the requirements for obtaining the BUP Business License; namely, the applicant must be established as a limited liability company (*Perseroan Terbatas*) which solely engages in port services business and holds the general, mandatory corporate licenses (i.e., Certificate of Domicile and NPWP).

Again, there are no implementing regulations which set out the detailed procedure for obtaining a BUP Business License. The implementing regulations on BUP Business Licenses are still being discussed but may be issued before the end of this year. Due to the absence of the implementing regulations, the procedures for obtaining a BUP Business License remain unclear.

### **3. Assessment and Evaluation of Available Alternatives for Coal Terminals**

**3.1 Special Terminals:** Using a Special Terminal for public purposes as a Coal Terminal is inherently risky given that a Public Purposes ST License is meant to be only temporary in nature and, accordingly, once the nearest public port is able to provide the required services, MoT has the right to (and, indeed, is meant to) revoke the Public Purposes ST License. Unless the promoter and developer of the Coal Terminal project are very certain that the nearest public port is never going to be able to provide the services required by users of Coal Terminals or that, at least, this is not likely to happen until the promoter and developer have fully recovered their respective investments in the Coal Terminal project, together with a reasonable return on such investments, a Public Purposes ST License is not going to provide a satisfactory legal basis for a Coal Terminal project. Third party financiers approached by the promoter of the Coal Terminal project are, understandably, going to be particularly concerned about the risk of the temporary Public Purposes ST License being revoked, thereby bringing to an end the cash flow from the Coal Terminal’s commercial operations, which cash flow is, in most cases,

being relied upon to service and, ultimately, repay all third party development financing.

**3.2 Public Terminal for Own Interests:** A **public** Terminal for Own Interests would seem, on its face, to be far superior to a Special Terminal in terms of providing a defensible and secure legal basis for a commercial Coal Terminal project given that the permitted public use of a Terminal for Own Interests is (i) not temporary in nature and (ii) not dependent upon the continuing limited capacity of the nearest public port. The problem, however, with a Terminal for Own Interests is that it can only be used as the legal basis for a **public** Coal terminal operation if (i) a Concession is obtained and (ii) a BUP is established, licensed and appointed to operate the Terminal for Own Interests as a public Coal Terminal. The current absence of any implementing regulations for Concessions and the licensing of BUPs makes it doubtful whether either of these requirements can be met at this time. Although implementing regulations for both Concessions and the licensing of BUPs may be available in the near future, unless and until this happens and the implementing regulations are shown to be workable, potential third party financiers and investors are, understandably, going to be very reluctant to commit to financing or investing a commercial Coal Terminal project based on a public Terminal for Own Interests legal structure. Even if a Concession has been obtained in the absence of implementing regulations, potential third party financiers and investors are likely to question and have reservations about the legal status of that Concession. As the validity and security of the Concession underlie the viability of the entire Coal Terminal project, these reservations can be fatal to the necessary financing and investment being forthcoming from third parties.

**3.3 Private Terminal for Own Interests:** In the absence of implementing regulations on Concessions and licensing of BUPs, one needs to consider whether a non-public or **private** Terminal for Own Interests can be used as the defensible and secure legal basis for a Coal Terminal project which meets the promoter and developer's commercial objectives.

Without a Concession and a duly licensed BUP, a Terminal for Own Interests must be used exclusively to support the Main Business Activity of the Terminal Owner. In the case of a Coal Terminal, this implies that the Main Business Activity of the Terminal Owner should be coal mining, something which requires the Terminal Owner to both (i) have coal mining or coal transportation and sales as one of the stated purposes in the Terminal Owner's Deed of Establishment and (ii) hold either an Operation Production IUP for Coal or (ii) a Special IUP for Transportation & Sales.

More importantly, DGoST takes the position that a coal mining company having a private Terminal for Own Interests may only use the Terminal for Own Interests to load its "own" coal. Whether "own" coal is confined to coal which the Terminal Owner produces itself or includes coal the Terminal Owner buys in from third parties is unclear. DGoMC, however, appears to take a more flexible stance and accept that the holder of a Operation Production IUP for Coal can always appoint the holder of a Special IUP for Transportation & Sales to handle the transportation, loading and export of its

coal production, something which suggests that a Terminal Owner with a Special IUP for Transportation & Sales should be able to load and export the coal production of third party coal producers. It is, however, unclear whether DGoST is willing to accept that a Terminal Owner with a Special IUP for Transportation & Sales only can load and export the coal production of third party coal producers. As Terminals fall within the immediate authority of DGoST, rather than DGoMC, it is really DGoST that has the final say on what a private Terminal for Own Interests may be used for.

Having regard to the foregoing, it must be questioned whether the restrictions on **private** Terminals for Own Interest make **private** Terminals for Own Interest a viable legal structure for commercial Coal Terminal projects.

#### **4. Unauthorized Public Use of Special Terminals and Terminal for Own Interests**

It is not uncommon to find Special Terminals and Terminals for Own Interest being used for long term, public purposes despite the fact that (i) Special Terminals are only meant to be used for public purposes on a temporary basis and (ii) Terminals for Own Interests are only meant to be used for public purposes after having, first, obtained a Concession and appointed a licensed BUP as operator, both things which, arguably, are not legally possible given the absence, as yet, of the necessary implementing regulations. This current use of Special Terminals and Terminals for Own Interest for what are, essentially, commercial Coal Terminal operations and despite the absence of the necessary implementing regulations may be due to various reasons including a current lack of close supervision by the relevant Government Authorities of the actual use being made of Special Terminals and Terminals for Own Interest. It is also possible that, in the case of privately financed and owned Coal Terminals, with no third party financiers and investors involved, the importance of a legally certain and secure structure for the Coal Terminal project is deemed to be less important.

Such long term public use, however, of Coal Terminals may well amount to a violation of the law given that Special Terminals and **private** Terminals for Own Interest may only be utilized to support the Terminal Owner's Main Business Activities and not for general commercial purposes.

In the event that a Terminal Owner allows the unauthorized use of its Special Terminal or **private** Terminal for Own Interest for public/commercial purposes, the Terminal Owner may be the subject of administrative sanctions including (i) written warnings; (ii) fines; and/or (iii) revocation of Special Terminal Operating License or Operation of Terminal for Own Interest License.

## **SUMMARY AND CONCLUSIONS**

As with so many other things in the Indonesian coal industry, the development and financing of Coal Terminals is no easy matter despite the fact that Indonesia's need for Coal Terminals is very considerable. The problems with developing and

financing Coal Terminals are due, at least in part, to the multiple regulatory hurdles which currently face potential investors and financiers in Coal Terminal projects trying to find a certain and secure legal structure for Coal Terminal project which also enables the promoter and developer of the Coal Terminal project to realize their commercial objectives.

**Public** Terminals for Own Interest unquestionably represent the ideal structure for Coal Terminals in that they offer promoters and developers of Coal Terminal projects the right to load coal, on a long term basis, for all interested coal producers and traders rather than just for the purpose of supporting the Main Business Activity of the Terminal Owner and without third party coal producers and traders being able to use the services of the Coal Terminal.

The absence, at this time, of implementing regulations on Concessions and BUP business licenses, however, makes **public** Terminals for Own Interest problematic from a legal certainty and security perspective. Meanwhile, the restrictions on the use which may be legally made of **private** Terminals for Own Interest are likely to pose very challenging commercial obstacles for promoters and developers of Coal Terminal projects using this legal structure as well as for potential third party financiers of and investors in such Coal Terminal projects.

If the promised implementing regulations on Concessions and BUP business licenses are forthcoming in a timely fashion and in a workable form, **public** Terminals for Own Interest will surely be readily adopted as the preferred legal structure for Coal Terminal projects from the perspective of third party financiers and investors given their emphasis on the importance of legal certainty and security.

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