May 2014

Oentoeng Suria & Partners
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Client Update - Indonesia revises its negative list for foreign investment

Introduction

On 24 April 2014, the President of the Republic of Indonesia signed Presidential Regulation No. 39 of 2014 (the "**New Negative List**") revoking and replacing Presidential Regulation No. 36 of 2010 (the "**Old Negative List**"). The "negative list" is the mechanism pursuant to which Indonesia regulates those business sectors that are closed, or open with conditions, to direct foreign investment. The negative list does not apply to indirect or portfolio investments made through the domestic capital market. In this note, we highlight several of the most significant changes made by the New Negative List.

Non-listed business sectors now open to foreign investment?

Similar to the Old Negative List, the New Negative List identifies (in two attachments) the list of businesses that are closed and the list of businesses that are open with conditions to foreign investment (the "**Lists**").

The New Negative List, unlike the Old Negative List, now expressly states that business sectors not specified in either of the Lists are open, without conditions, to foreign investment. This eliminates the previous uncertainty under the Old Negative List regarding the status of business sectors not identified in the Lists. In the past, business sectors not identified in the Lists were considered (theoretically at least) to be completely open to investment, but at a practical level it remained subject to prevailing policy to determine at any one time if the business was closed or open to foreign investment and, what conditions, if any, applied. This development would offer greater certainty to investors assuming it is implemented in practice.

Businesses subject to stricter regulations

The manufacturing of (i) active pesticides, (ii) the industrial chemicals Polychlorinated Biphenyl (PCB) and Hexachlorobenzene, and (iii) ozone depleting materials, have all now been expressly closed to foreign investment.

Several business sectors which previously were not mentioned in the Old Negative List (and were generally considered open up to 100% foreign investment), are now subject to restrictions, namely:

- distribution and warehousing are now restricted to a maximum of 33% foreign ownership;
- cold storage, is now restricted to a maximum of 33% foreign ownership (if located in Java, Sumatera and Bali), or a maximum of 67% foreign ownership (if located in Kalimantan, Sulawesi, Nusa Tenggara, Maluku, and Papua);
- treatment and disposal of non-hazardous waste, is now restricted to a maximum of 95% foreign ownership; and
- public opinion polling and market research, is now restricted to a maximum of 51% foreign ownership.

Certain businesses which were open to foreign investment on a restricted basis, have come under further restrictions, including:

- oil and gas construction services, which were previously open to a maximum of 95% foreign ownership, have now been divided into several separate business lines with separate foreign ownership limitations, namely: (i) construction of platforms - maximum foreign ownership of 75%, (ii) construction spherical tanks – maximum foreign ownership of 49%, and (iii) offshore pipeline installation - maximum foreign ownership of 49%, whilst certain other oil and gas construction services are restricted to domestic ownership;
- survey service activities, which were previously categorized under non-construction oil and gas supporting services and open (under BKPM policy) up to a maximum of 95% foreign ownership, are now specifically mentioned and split into survey activities for (i) oil and gas, (ii) geology and geophysics, and (iii) geothermal, each of which is restricted to 49% foreign ownership, except for geothermal survey (which remains at 95%);
- onshore oil and gas drilling, well operation and maintenance services, oil and gas design and engineering services which were previously open to a maximum of 95% foreign investment, are now reserved for domestic investment only; and

- offshore oil and gas drilling, which was previously open to a maximum of 95% foreign ownership, is now restricted to a maximum of 75% foreign ownership.

The retail industry continues to be closed to foreign investment. An important inclusion in the New Negative List is the express mention of e-commerce business being reserved for domestic investment only. Prior to the issuance of the New Negative List the position regarding e-commerce business was unclear.

The crumb rubber industry is open only to domestic investment and transfer of shares to a foreign entity is prohibited.

Restrictions on foreign investment in certain businesses have also been imposed under the New Negative List in order to synchronize the New Negative List with existing regulations in respect of the relevant sectors. Below is a list of several business sectors where foreign investment limits have been harmonised to align with sector-specific regulations:

- certain agricultural business lines, previously open to a maximum of 95% foreign ownership are now restricted to a maximum of 30% foreign ownership to conform with Law No. 13 of 2010 on Horticulture (e.g. horticulture breeding (*perbenihan hortikultura*), horticulture crops (*budidaya hortikultura*), horticulture processing industry (*industri pengolahan hortikultura*), horticultural research and quality test laboratories (*usaha penelitian hortikultura dan usaha laboratorium uji mutu hortikultura*), horticultural agro tourism (*pengusahaan wisata agro hortikultura*) and other horticultural business service (*usaha jasa hortikultura lainnya*));
- certain telecommunication sector businesses, which were previously subject to a partnership arrangement and open up to a maximum 65% of foreign ownership are now restricted to a maximum of 49% foreign ownership to conform with telecommunication regulations (e.g. content services, call centre and other value added telephony services, data communication services, internet interconnection services and wired/wireless/satellite telecommunications services integrating with telecommunications services); and
- alternative trading, which was previously open with conditions, to foreign investment is now reserved only for domestic investment to conform with the Head of Indonesian Commodities Exchange Agency Regulation No. 103/BAPPEBTI/PER/03/2013 on Prohibition of Foreign Investment Participation for Future Trader and Future Trading System Organizer.

Businesses with restrictions lifted or reduced

Whilst a not insignificant number of business sectors continue to face restrictions, several business sectors which were previously closed for foreign investment, have now been opened up, namely:

- construction of terminals (land transport and cargo), which was previously closed to foreign investment is now open to foreign investment up to a maximum of 49%; and
- performance of periodical testing of motor vehicles, which was previously closed to foreign investment is now open up to a maximum of 49%.

The public-private partnership (PPP) model is a major benefactor under the New Negative List. The foreign investment limit for several businesses within the PPP model have been raised, namely:

- the foreign investment limit for port facilities (jetties, buildings, tugs at cargo container terminals, liquid-bulk terminal, dry-bulk terminal and ro-ro terminal) has been raised to a maximum of 95% during the concession period (foreign investment limits for investments outside the PPP model continue to be restricted at 49%);
- the foreign investment limit for power plants with a capacity more than 10 MW has been raised to a maximum of 100% during the concession period (foreign investment limits for investments outside the PPP model continue to be restricted at 95%);
- the foreign investment for electric power transmission has been raised to a maximum of 100% during the concession period (foreign investment limits for investments outside the PPP model continue to be restricted at 95%); and
- the foreign investment for electric power distribution has been raised to a maximum of 100% during the concession period (foreign investment limits for investments outside the PPP model continue to be restricted at 95%).

The foreign investment limit for the manufacture of pharmaceuticals (including manufacture of drug raw materials and medical products) has been increased from 75% to 85%.

The foreign investment limit for venture capital companies has also been increased from 80% to 85%.

ASEAN commitments

Indonesia's various commitments to the ASEAN Economic Community (AEC), amongst other things, require member states to provide preferential treatment to ASEAN member nations. The treatment of ASEAN members is set out in the Lists and we set out several of the preferential opportunities for ASEAN members below:

- motion picture advertising, advertisements, posters, stills, photographs, slides, negatives, banners, pamphlets, folders, which was previously closed to foreign investment is now open up to 51%;

- other accommodation: motels are open up to a maximum of 70% foreign investment, to the extent that it is not contrary to local regulations; and
- golf courses located in Java and Bali are open to a maximum of 70% foreign investment, to the extent that it is not contrary to local regulations. Courses located other than in Java and Bali are open to 100% foreign investment.

Implementation

The New Negative List, in Article 9, specifically grandfathers investments approved prior to its issuance. There will accordingly be no retroactive application of restrictions identified in the Lists.

Article 5 of the New Negative List specifies that the restrictions do not apply to indirect or portfolio investments made through the domestic capital market (confirming the position that the restrictions do not apply to Indonesian public companies).

Article 7 notably permits a foreign investor to inject capital beyond the permissible foreign equity limit where the domestic investors cannot participate in the capital increase, subject to dilution back to the maximum equity limit within two years, either by way of sale to domestic investors, sale through a public offer on the domestic capital market, or re-purchase of its stock by the company.

Going-forward

The New Negative List indicates Indonesia's intention to channel investment into sectors of the economy which it considers in need of additional investment, whilst reducing investment opportunities in areas that no longer justify high (or any) foreign investment, or should remain protected. ASEAN investors will continue to benefit as the AEC heads towards greater implementation.

As always, we recommend consultation with the Indonesia Investment Coordinating Board (*Badan Koordinasi Penanaman Modal (BKPM)*) in areas of uncertainty and to confirm practical implementation.

Key contacts

If you have any questions on the matters discussed in this Client Alert or wish to discuss anything contained in this Client Alert in further detail, please feel free to get in touch with:

Atik Susanto
Partner, OSP

T: +62 21 2996 9200
E: atik.susanto@oentoengsuria.com

Toby Grainger
Senior Foreign Legal Consultant, OSP

T: +62 21 2996 9200
E: toby.grainger@oentoengsuria.com

Noor Meurling
Senior Foreign Legal Consultant, OSP

T: +62 21 2996 9200
E: noor.meurling@oentoengsuria.com

Alwin Redfordi
Senior Associate, OSP

T: +62 21 2996 9200
E: alwin.redfordi@oentoengsuria.com