Corporate

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PROPOSED JOINT VENTURES IN INDONESIA

A joint venture (JV) arrangement with an Indonesian partner is an effective and, from a regulatory perspective, often the most straightforward method of developing operations in Indonesia. In particular, a JV helps to restrict, as far as possible, the application of the Indonesian cabotage laws to a company's business.

Indonesian cabotage rules

The cabotage principle was enacted in Indonesia in 2008 and came into force on 7 May 2011. Under the cabotage principle, foreign flagged vessels are prohibited from operating in Indonesian waters. Foreign flagged vessels can continue to operate in Indonesia for further allowable time periods, with varied exemptions expiring between December 2012 and December 2015, depending on the type of activities and the type of vessels. The exempted vessels are primarily those engaged in offshore drilling activities.

After December 2015, all vessels operating in Indonesian waters need to be registered in Indonesia and be Indonesian flagged. This means they must be owned by an Indonesian company (which may be a joint venture). It is not permissible to operate such vessels in Indonesian waters under a foreign flag, even if those vessels are not engaging in domestic sea transportation.

It is reported that the Directorate General of Sea Communication at the Ministry of Communication (SEACOM) have imposed more strict policies in implementing the cabotage rules by requiring shipping companies to disclose their ultimate beneficial owners to Seacom.

Joint venture (JV) options

A JV with a foreign entity is permitted for Indonesian shipping companies engaging in domestic sea transportation, but they are subject to a maximum 49% foreign share ownership limitation. It is not possible under current practice to register vessels under the Indonesian flag without complying with the 49% foreign ownership requirement. Further, a JV company must own (not merely control through lease) at least one seaworthy Indonesian-flagged vessel of a minimum 5,000 GT, manned by Indonesian crew.

After December 2015, all vessels operating in Indonesian waters need to be registered in Indonesia and be Indonesian-flagged. This means they must be owned by an Indonesian company (which may be a joint venture). It will not be possible to operate such vessels in Indonesian waters under a foreign flag, even if those vessels are not engaging in domestic sea transportation.

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Three principal JV options, along with their advantages and disadvantages, are:

(i) A nominee structure in which a new company is established in Indonesia with an Indonesian legal entity holding 100% of the shares as nominee on behalf of the foreign partner.

- Nominee shareholder arrangements are not formally recognised in Indonesia. The law provides that domestic and foreign investors that undertake capital investment in the form of an Indonesian limited liability company are prohibited from entering into any agreement/arrangement and/or providing a statement which confirms that their share ownership is for and on behalf of another party. Any such agreement/arrangement/statement will be considered null and void.
- There are no real advantages to this structure. All the shares would be under the control of a local entity and a foreign partner would have to enforce its rights by relying on shareholders/side agreement, which is unlikely to be upheld by the courts in Indonesia.
- Even if management control could be exercised by the foreign partner, ownership of the vessels, assets and profits of the local company would rest with the local shareholder. This would be a considerable risk exposure to a foreign partner, and as such, is likely to be unacceptable.

(ii) A JV with a financial partner which would provide capital to the business, but have little involvement in the day to day business operations.This would be structured as a JV company in which the local partner would own 51% of the shares as required by Indonesian law, but management would be carried out by the foreign partner.

- The foreign partner benefits with operational control. There would also be separate management agreements for any vessels registered in the name of the JV company, which would allow most of the profits to be withdrawn and paid to the foreign partner, leaving only a minimal amount to cover taxes, local fees, and to pay a modest dividend or fee to the Indonesian partner.
- The main disadvantage is that the financial partner is likely to be keen to secure an exit strategy after a defined period. The foreign partner would then be left with the need to find an alternative partner to own the 51%.
- Even though there may be management agreements and shareholder agreements, control of the majority of the shares would still be with the financial partner, although as a financial partner they may have less interest in day to day involvement, provided they receive a satisfactory income, with a guaranteed exit strategy.
- The financial partner would be relatively silent on operational matters, but may not be able to offer much commercial assistance in relation to securing contracts.

- The foreign partner could take a pledge over the shares of the local partner, which is an effective form of security in Indonesia. However, in the event of having to enforce this security and take over the shares, an alternative local partner would have to be found. There is also a risk that this could be challenged as a nominee arrangement and declared null and void.

(iii) A JV with a shipping partner which would jointly operate the vessels, although primarily under the management of a foreign partner, which is the registered owner of the vessels.

- This would also be structured as a 49/51% JV company with the local partner as the majority shareholder. Again the foreign partner would exercise management control.
- Partnering with an Indonesian company in the shipping industry may be beneficial when bidding for contracts, and may also introduce additional commercial opportunities.
- The Indonesian partner would provide their equity share in the form of a support vessel, and possibly also a minor cash contribution. Their stake in the JV company could be diluted when additional vessels are introduced by the foreign partner. However this would still be subject to the 49% foreign ownership limitation.
- In addition, a foreign partner could take a pledge over the shares of the local partner, in security of its obligations.
- The main disadvantage to this structure is that ownership of the majority of the shares will be with the Indonesian partner, unless pledged. Also, if the partner has specific industry experience they may wish to have significant input on operational matters. A detailed JV agreement will be required to regulate how the joint venture will be operated.

Minimum investment and equity participation

For a foreign investment limited liability company the minimum paid-up share capital is Rp 2.5 billion, or US$260,000 (at the time of writing). It is an unwritten policy of the Indonesia Investment Coordinating Board (*Badan Koordinasi Penanaman Modal* or BKPM) to allow a 1:3 equity/paid-up capital to loan ratio of the total authorised capital of a PMA company.

The minimum total investment of a company must be US$1 million and this must be stated in its business plan, which must be submitted to the BKPM as part of the incorporation process. A company is also required to submit an Investment Activity Report to the BKPM every three or six months, depending on the stage of its operations. The level of investment will be assessed by the BKPM on an ongoing basis and it may require a company to increase its investment, or to justify why it does not need to.

A foreign partner which owns a vessel could therefore provide the vessel to the JV company as its 49% equity participation (in-kind capital). The vessel to be provided would require approval by an independent appraiser. The Indonesian partner could contribute its share either with its own equity or the foreign partner could provide financing to its JV partner.

Key issues to consider

1. Type of JV structure to be adopted and establishment process of Indonesian company.
2. Identity of partner – financial or industry.
3. Duration of JV and exit strategy.
4. Financial contributions of parties – cash/assets.
5. JV management.
6. Reflagging of the vessels – process and timescale.

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