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Indonesia and OPEC

Mirza Karim, Karen Mills and Intan Ajrina Qadrya*

ABSTRACT

The Organization of Petroleum Exporting Countries (OPEC) was established in 1960, and Indonesia became the seventh country to join in 1962. However, Indonesia suspended her membership for seven years from January 2009, and has just rejoined in January of this year. During her initial 27-year tenure, Indonesia's representatives held the position of Secretary General four times, for a total of 10 years. This article will give a brief historical overview of OPEC, as well as that of Indonesia's oil and gas sector and her relationship with OPEC.

1. OPEC

Although not fully established until 1960, the roots of the Organization of Petroleum Exporting Countries (OPEC) date back to 1949, when Venezuela invited several fellow oil-producing nations (namely Kuwait, Iran, Iraq and Saudi Arabia) to meet to seek a means to communicate and work more closely together in the interests of regularizing the industry.

It became clear that such a cooperation was in fact badly needed, when, 10 years later, the major multinational oil companies took it upon themselves to cooperate in the control of pricing by reducing the prices they would pay for crude oil in Venezuela and in the Middle East by up to US 25 cents per barrel. In response, the governments of the Middle Eastern oil-producing nations called for the establishment of the 1959 first Arab Petroleum Congress in Cairo, which in turn established the Oil Consultation Commission and passed a resolution requiring the governments of producing countries to submit any proposed action on oil prices to that commission before any such action could be implemented.

But, as the oil companies were not complying (having yet again reduced prices less than a year later), in September 1960 a conference held in Baghdad and attended by representatives of the governments of Kuwait, Iran, Iraq, Saudi Arabia and Venezuela established the intergovernmental organization known as the Organization of Petroleum Exporting Countries, or 'OPEC', with the intention of positioning this essential world economic factor out of the private sector and bringing it back under government control. The group met again in Caracas in January 1961, at which time the original text of OPEC's Statute was approved. Article 2 of the Statute sets out the principal purposes of the organization:

- A. The principal aim of the Organization shall be the coordination and unification of the petroleum policies of Member Countries and the determination of the best means for safeguarding their interests, individually and collectively.
- B. The Organization shall devise ways and means of ensuring the stabilization of prices in international oil markets with a view to eliminating harmful and unnecessary fluctuations.

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C. Due regard shall be given at all times to the interests of the producing nations and to the necessity of securing a steady income to the producing countries; an efficient, economic and regular supply of petroleum to consuming nations; and a fair return on their capital to those investing in the petroleum industry.¹

The 1960s was an important era in terms of international economic and political identities, marking the beginning of the end of the colonial empires, with many new independent states emerging in the developing world. But the international oil market was still largely dominated by seven major western multinationals: Esso (Standard Oil of Ohio), Shell (Royal Dutch Shell), BP (British Petroleum), Mobil Oil, Chevron, Gulf Oil and Texaco; known collectively as the 'Seven Sisters', which were increasingly operating outside of any national control. OPEC was established by the governments of the oil-producing nations in an effort to bring the industry under state control. It set up a Secretariat in Geneva, which was moved to Vienna in 1965, and adopted its 'Declaratory Statement of Petroleum Policy in Member Countries'² setting out the right of all countries to exercise permanent sovereignty over their own natural resources in the interests of their respective national development.

By 1962 Indonesia had already joined OPEC, as had Qatar and Libya. After the Secretariat was moved to Vienna in 1965, these countries were joined by the United Arab Emirates in 1967, Algeria in 1969, Nigeria in 1971, Ecuador in 1973, Gabon in 1975 (although its membership was terminated in 1995) and Angola in 2007. Ecuador suspended her membership between 1992 and 2007, as did Indonesia from 2009 until January of this year. Today, the membership of OPEC stands at 13 countries.

By the 1970s OPEC had risen to international prominence as its sovereign members took over control of their domestic petroleum industries and were able to exercise greater control over the pricing of crude oil on the world markets. Twice it took advantage of international conditions to effect steep price increases. In October 1973, reacting to the 'Yom Kippur War' between Israel and a coalition of Arab states led by Egypt and Syria, OPEC raised oil prices by 70 per cent, and only two months later raised them again by an additional 130 per cent, as the organization's Arab members (who had formed Organization of Arab Petroleum Exporting Countries³ (OAPEC) in 1968) curtailed production and placed an embargo on oil shipments to the USA and the Netherlands, the main supporters of Israel during that war. This resulted in severe oil shortages throughout the West with attendant spiraling inflation. Prices were raised again at the outbreak of the Iranian Revolution of 1979 and, as OPEC continued to raise prices (with prices increasing 10-fold between 1973 and 1980), its political and economic power grew. Flush with petrodollars, many OPEC members began large-scale domestic economic and social development programmes and invested heavily overseas, particularly in the USA and Europe. In 1975, OPEC held its first Summit of Heads of State and Government in Algiers to address the plight of the poorer nations, calling for a new era of cooperation in international relations in the interests of world economic development and stability. In 1976, the OPEC Fund for International Development was established for this purpose.⁴

By the early 1980s prices had risen beyond reasonable expectations, creating efforts across the globe to reduce oil dependency. This trend, set against the oil producers' eagerness to extract as much as possible to take advantage of the prices at that time, resulted in a glut of available oil and a consequent reduction of prices, culminating in a crash in 1986 with attendant detriment to the OPEC members' economic health. By the end of the decade prices had leveled off to around half what they had been less than 10 years earlier. As a result, and in an effort to prevent a recurrence, OPEC instituted group production quotas with a ceiling for each

1 The current (2012) version of the full Statute can be found at <http://www.opec.org/opec_web/static_files_project/media/downloads/publications/OPEC_Statute.pdf> accessed 16 May 2016.

2 See <<https://www.ogel.org/legal-and-regulatory-detail.asp?key=86>> accessed 16 May 2016.

3 See <<http://www.oapec.org/Home>> accessed 16 May 2016.

4 See <<http://www.ofid.org/>> accessed 16 May 2016.

member country, as well as a Reference Basket for pricing. Unsurprisingly, by this time the world had started to awaken to environmental issues, including, in particular, the effects of hydrocarbon operations and usage.

Since the 1990s we have seen all nature of price movements, despite OPEC's continued emphasis on production quotas. OPEC was able to reduce the market impact of the Middle Eastern hostilities of 1990–1991, but by the end of that decade the South East Asian economic crisis, coupled with a very mild winter in northern countries, brought prices back down to mid-1980s levels. It was during this time that Ecuador suspended her membership (which she took up again 15 years later), and Gabon resigned.

By the turn of the 21st century, owing to greater unity among OPEC members and better cooperation with non-members (such as Mexico, Norway, Oman and Russia), OPEC's mechanism for the establishment of pricing did initially bring an element of stabilization, despite increased tensions in the Middle East and a political crisis in Venezuela. This was the era of international recognition of the need to reduce the burning of fossil fuels, which had contributed and continues to contribute significantly to global warming, indicating the likelihood that world demand for oil would inevitably decline. In response, OPEC attempted to develop a coherent environmental policy to keep prices stable, as OPEC was by then becoming a stabilizing force of global economic trends. OPEC held its second and third summits in Caracas and Riyadh in 2000 and 2007, respectively, with the purpose of setting a long-term strategy for stabilizing energy prices, while simultaneously seeking to achieve sustainable development and the preservation of the environment.

However, world economic factors began again to increase both prices and volatility by 2004, and creative financing mechanisms using hydrocarbons as a tradable asset, (somewhat similar to the sub-prime mortgage debacle) caused prices to hit record levels in 2008 and then to collapse in the midst of the world economic crisis of that year. Indonesia, having become a net oil importer, suspended her membership of OPEC in 2009, although Angola had joined, and Ecuador had rejoined, in 2007.

The current decade has so far seen more volatility in all areas of economic development, including the oil market, greatly exacerbated by political, social and religious tensions and clashes in many parts of the globe. OPEC's policies were successful in keeping prices relatively stable until about mid-2014, after which they began a new freefall from which the market has not recovered as at the date of this article. Nonetheless, OPEC continues its efforts to stabilize the market, and increased confidence can be seen in moves such as Indonesia's return to the organization at the beginning of 2016.

Clearly, the power of OPEC has waxed and waned since its creation in 1960, and is likely to continue to do so for as long as oil remains a viable energy resource. Where things will go is anyone's guess, but OPEC, and Indonesia, continue to maintain cautious optimism.⁵

2. INDONESIA

The first record of Indonesian culture can be found in India's Ramayana epic dating back to at least 200 BC, where there is mention of her Hindu kingdoms.

Indonesia's oil reserves were first recorded by Ptolemy in his 954 (AD) 'Geography of Eastern Asia', which incited world interest in the wealth of natural resources that abound in this archipelago. In 1295, Marco Polo brought back with him to Venice samples of Indonesian crude oil which he had found in Aceh, at the northern tip of Sumatra, and he recounted tales of the fabulous wealth to be found there. Since that time Indonesia has continued to be sought after by those looking to benefit from her plenitude of oil, gas and hard minerals. The Portugese, British and Dutch, and to an extent the Spanish and French, vied for control during the 16th and 17th centuries, until finally the Dutch took over much of the country and her reserves in the late 19th century, only to be finally and fully ousted after the Second World War. Indonesia's wealth of natural resources has always been a significant part of her history and even today, more than 70 years after

5 See also <http://www.opec.org/opec_web/en/about_us/24.htm> accessed 16 May 2016 on OPEC's website for more detailed historical summary.

Indonesia's recognition as an independent sovereign nation, we continue to see local and foreign interests competing to exploit her natural resources, each for its own maximum benefit.

'Modern' petroleum operations commenced in Indonesia in 1871, only 12 years after the very first oil well was drilled in Pennsylvania. In 1883, a Dutch planter came upon a Sumatran local using local oil to start a fire during a tropical storm, and was shown the source: a black pond of oil. The planter began drilling operations in what is now known as the Telega Tila field in 1885.⁶ His company eventually merged with a British company to form Royal Dutch Shell, which, with later concessions not only in Sumatra but also in Java and Kalimantan (Indonesian Borneo), dominated Indonesian oil production until 1912 when Standard Oil of New Jersey (later to become known as Stanvac), also began exploration and extraction in Indonesia. Stanvac was followed not long thereafter, in 1930, by Standard Oil of California, which in 1936 created a joint venture with Texaco, which became known as Caltex. By 1940, Indonesia was in the fifth rank of oil producers in the world and the largest oil producer in Asia, clearly making this nation an imperative strategic target for the Japanese invasion of South East Asia to provide fuel to its armies of occupation and further invasion plans. Control of all mining activities in Indonesia was taken over by the Japanese Occupation Forces for a period of almost three and a half years, although many of the oilfield installations throughout Indonesia had been destroyed by the fleeing Dutch operators ahead of the Japanese invasion.

At the end of the Second World War, the 'Big Three' oil companies (Shell, Stanvac and Caltex) were keen to return to Indonesia, and entered into agreements with the newly formed government of the Republic of Indonesia.

After independence, the Government of Indonesia was given the mandate by the 1945 Constitution to control land, water and natural resources found therein, and any branches of production deemed important for the State and affecting the lives of most of the Indonesian people, for the benefit of the people. Article 33 of the 1945 Constitution states:

1. The economy shall be organized as cooperative based on the concept of family.
2. Branches of production which are of importance to the State and which affect the majority of the people shall be controlled by the State.
3. Earth, water and natural resources contained within the earth shall be under the control of the State and shall be used for the maximum welfare of the people.

In 1960, Indonesia promulgated its first Oil and Gas Mining law, Law No 44 of 1960. In 1971, Law No 8 of 1971 (generally known as the 'Pertamina Law') was promulgated which allowed exploration and exploitation of upstream activities in the oil and gas sector through the system of Production Sharing Contracts (PSCs) to be entered into between foreign contractors and Indonesia's (by then) sole State-owned oil and gas company, Pertamina, which company had also been entrusted with the authority to administer the whole sector. Under the PSC system, the majority of the oil extracted belongs to the State while the contractor takes a minority share, but the contractor is also entitled to recover its reasonable exploration and development costs. As the majority of the uplift belongs to the State it can be utilized for the greater benefit of the people and thus is considered consistent with the Constitution. The current law, Law No 22 of 2001 on Oil and Gas Mining, was passed in 2001, retaining the PSC system but designating new government bodies as the administering Authority. For upstream activities, this new Authority is now SKK Migas.

3. INDONESIA IN OPEC

As mentioned above, Indonesia joined OPEC in 1962. By 1969 her chief representative, Dr Elrich Sanger, had been elected as the Secretary General, OPEC's Chief Executive Officer. Indonesians were to hold that

⁶ See <https://en.wikipedia.org/wiki/Oil_reserves_in_Southeast_Asia> accessed 16 May 2016.

post for an additional eight years, with the two others also serving as President of OPEC Conferences, as mentioned below.

The growth of OPEC's power and influence in the energy sector should be clear from above summary. As a member country of OPEC, Indonesia has reaped both economic and political benefits. During the 1970s when OPEC raised oil prices, Indonesia's economic benefits were used for development. Pertamina, by then the only State-owned enterprise dealing with petroleum operations, became the major financier needed for the nation's development. The 1973 oil price increases provided an export revenue windfall that was able to contribute greatly to sustained high economic growth rates, averaging over 7% annually, from 1968 to 1981. The second oil boom, which took place in 1978/1979, when the Iranian revolution disrupted oil production, resulted in yet another massive price increase. Due to these oil booms, Indonesia's export earnings, and attendant government revenues, rose steeply.

Prof Dr Subroto

It was during this period that Indonesia's former Minister of Mines and Energy (following two other Ministerial posts), Prof Dr Subroto, held the position of Executive Director of OPEC twice; once from 1984 to 1985, during which time he also served as President of the OPEC Conference, and a second time for a record six years, from 1988 through 1994. Prof Subroto's role gave Indonesia an additional special strength in the political field, as he was able successfully to serve as a mediator to bridge the gap between the Arab countries and Latin America and Africa. Prof Subroto was also the key player in establishing cooperation and better understanding between OPEC and the International Energy Agency (IEA). For many years prior to 1988 the relationship between OPEC and IEA was one of 'cat and mouse'. Gradually, with Prof Subroto's guidance, a workable relationship developed which encouraged the establishment of the International Energy Forum (IEF),⁷ a forum that allows all stakeholders to discuss and deliberate the oil industry's challenges and opportunities. The IEF has had very important implications for the global oil industry. The slogan at that time was: 'From confrontation to cooperation'.

Prof Subroto is still recognized as OPEC's most prominent and popular Secretary General, in which role he used his considerable knowledge and charisma to put OPEC on the global map. Likewise, Indonesia recognizes him as his country's most effective Minister of Mines and Energy, and he remains active as a highly revered oil and gas 'guru' as well as the founder and CEO of 'Bimasena', Indonesia's Mines and Energy Society, to this day.

Subsequently, another former Minister of Mines and Energy, Dr Purnomo Yusgiantoro, also served as Secretary General, as well as Chair of the OPEC Conference, in 2004.

Indonesia's suspension of OPEC membership

Indonesia's oil production peaked in 1991 at 1.67 million barrels per day, but it has declined steadily since then. Meanwhile, domestic consumption reached a high of 1.64 million barrels per day in 2014. The year 2003 was the inflection point, when consumption began to outstrip production, and by 2009, as Indonesia had become a net oil importer, the government decided to leave OPEC. Indonesia's decision to suspend its OPEC membership was prompted by growing internal demand for energy, declining crude oil and condensate production in mature fields and limited investment to increase production capacity. Indonesia's production of petroleum and other liquids had been on a general decline since the mid-1990s. From 2004 to 2014, the average fuel deficit—the difference between production and consumption—had been 438,000 barrels per day. This is a deficit that Indonesia had to make up by importing oil. Indonesia produced around 794,000 barrels per day of crude oil and condensates in 2014, equivalent to the third lowest level among OPEC countries.

7 See <<https://www.ief.org/>> accessed 16 May 2016.

Indonesia rejoins OPEC

Indonesia is no longer an influential player in the energy market. Not much has changed since Indonesia renounced her membership in 2009 because she had become a net energy importer rather than a net producer. Nonetheless, in September 2015 Indonesia submitted an official request to OPEC to reactive her full membership, reversing her suspended membership from 1 January 2009, primarily due to declining domestic oil production and rising domestic demand. Indonesia's reintegration will add roughly 825,000 barrels per day to OPEC's total output—around one per cent of total global production. This meagre contribution will place the country alongside OPEC's least significant producers such as Libya and Ecuador.⁸

OPEC's website records that Indonesia was invited to attend an OPEC meeting on 4 December 2015 and, as a result, reactivated her membership at the 168th Meeting of the OPEC Conference, effective 1 January 2016.⁹

Indonesia's current Minister of Energy and Mineral Resources, Sudirman Said, said that the country was still exporting gas and that it was, therefore, not problematic for the country to be an OPEC member again. Indonesia still exports some crude oil, although her imports of refined products still make her a net importer.¹⁰ However, the country is a major exporter of liquefied natural gas, and it is anticipated that renewed OPEC membership will strengthen her ability to secure oil supplies and attract investment to her domestic energy industry.

The move was not, however, without controversy.

Critics have pointed out the obvious oddity of a net oil importer joining a cartel of oil producers. The interests of a buyer are opposite to those of a seller. How would Indonesia, as an importer who benefits from low prices, play her role amid exporting countries interested in keeping the prices high? OPEC's decision to welcome Indonesia back has also been viewed with some dismay, with many questioning how one can interpret the move as complying with OPEC's Statute, which provides that: "No country may be admitted to Associate Membership which does not fundamentally have interests and aims similar to those of Member Countries."

The supporters of the move cite that one of the benefits for Indonesia in rejoining OPEC is to ensure the supply of oil to Indonesia from fellow members. But this argument has been rebutted by argument that the purpose of ensuring supply would be better achieved by establishing good bilateral relations with the most feasible oil exporters (whether or not these are OPEC members), making it unnecessary to join OPEC just to ensure supply. Furthermore, Indonesia surely does not require supply from all 12 members of OPEC.

In addition, joining OPEC comes with an annual cost of a staggering US \$3.1 million, adding fuel to the position of the critics who doubt that the benefit to Indonesia in rejoining OPEC outweighs the costs or equals the benefit she brings to OPEC.

On the other hand, some analysts see the reactivation of Indonesia's membership in OPEC as a sensible strategy of the Indonesian government to secure her economic development programme for the future, especially since Indonesia's GDP growth rate has been increasing and is projected to accelerate in the next few years.

Indonesia also anticipates that a greater volume of crude oil imports will be needed to meet domestic demand due to increased refining capacity. Indonesia is planning a number of upgrades and expansions to existing refineries, slated to become operational within the next decade, and has also proposed the building of four new refineries, each having a capacity of 300,000 barrels per day. Because Indonesia struggles with the level of investment needed to offset oil and natural gas production declines and a lack of adequate infrastructure, she hopes to attract investment in both upstream and downstream sectors from OPEC members.

8 Kristin Berndt, 'And Then There Were 13: Indonesia Rejoins OPEC' *The Diplomat* (Tokyo, Japan, 2 December 2015) <<http://thediplomat.com/2015/12/and-then-there-were-13-indonesia-rejoins-opec/>> accessed 16 May 2016.

9 See <www.opec.org/opec_web/en/press_room/3193.htm> accessed 16 May 2016.

10 *OPEC Bulletin* (September 2015) <www.opec.org> accessed 16 May 2016.

Indonesia is currently in discussions with several OPEC countries (such as Iran, Kuwait and Saudi Arabia, among others) about crude oil supply deals and investments in refinery projects.

Indonesia is still the largest South East Asian oil producer, but this nation of over 250 million people has imported petroleum for years because of aging wells and exploration limitations. However, figures show that the nation's oil consumption is still continuing to rise. Indonesia's 2015 target was to produce an average of 825,000 barrels per day of crude oil, which would still make her the fourth smallest producer in the now 13-member OPEC, behind Libya, Ecuador and Qatar. Figures show that, in 2014, Indonesia's average crude oil production of 794,000 barrels per day was just below her target of 818,000 barrels per day. Current output is around 800,000 barrels per day.¹¹ Therefore, OPEC expects that Indonesia's membership reactivation will add almost three per cent to the organization's petroleum production, which was already close to its peak.

Despite the fact that Indonesia's oil production is not as great as that of most of the other OPEC-Member States, Indonesia has been playing an important role in the global petroleum market. Indonesia could also position herself as a country which could fill in the 'blank spot' of 'global representativeness' of OPEC. As the only Asian country involved in the oil exporter group, Indonesia could symbolize a more global aspect of OPEC's representation amid Middle Eastern dominance. Global representativeness is important for OPEC if it wishes to secure recognition as a truly international organization.¹²

Moreover, with the shifting of the global economic epicentre from the western countries towards Asia, global oil market players have been paying more attention to the region. This phenomenon is growing alongside the rising economic power of the Asian countries. OPEC countries need to maintain their links to the Asian petroleum market, which has been the fastest growing oil market compared to that of other regions. Therefore, the involvement of a country which has a significant political and economic position in the region is very important.

Indonesia is currently recognized as the third largest democracy in the world, and has also been in the process of liberalizing her economy. According to the World Bank (2014), Indonesia is positioned as the 10th largest economy in the world. This set of political and economic status markers gives Indonesia a more representative identity and makes OPEC seem friendlier to the global market of non-OPEC members, most of which are grouped as members of the Organization of Economic Cooperation and Development (OECD).¹³ Indonesia's global status can also favourably be compared to the other OPEC member countries that have not embraced democracy and market economy as practiced by Indonesia.

Despite all the controversy, the government and OPEC finally determined that Indonesia's rejoining the organization would have advantages to both Indonesia and OPEC. Thus, the decision was finally made to re-join, and rejoin Indonesia has, now becoming the 13th member of OPEC. Whether it was a mistake or the right decision, only time will tell.

11 See also: 'Indonesia Set to Reactive OPEC Membership' *OPEC Bulletin* (September 2015) <http://www.opec.org/opec_web/static_files_project/media/downloads/publications/OB092015.pdf> accessed 16 May 2016.

12 Muhammad Badaruddin, 'Indonesia Rejoining OPEC: Dynamics of the Oil Importer and Exporter Countries' (Jakarta, 2015) 3 *Journal of Asean Studies* 125 <<http://scholar.google.co.id/citations?user=Jc2u3JAAAAAJ&hl=en>> accessed 16 May 2016.

13 *ibid* 126.