

Government and Multinationals: Conflict over Economic Resources in East Kalimantan, 1998–2003

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Abstract

The present study focuses on the changes in Indonesia after the fall of Soeharto in 1998. The dispute involving the central government and the provincial government and Kaltim Prima Coal (KPC), a multinational company, based in East Kalimantan, over the process of divestment of KPC will exemplify that after the democratization and decentralization, a new pattern of politics has been in the making in Indonesia. The governor of East Kalimantan Suwarna has managed to set up political alliances with powerful local and national politicians. Such a political network initiated from the provincial level was a novelty that did not exist within the New Order state. Eventually Suwarna was challenging the policy decided by the central government, and directly created a climate inhospitable to foreign investors.

Keywords: Indonesian political economy, institutions, local politics, multinational corporations, political network, political bargaining, East Kalimantan

I Introduction

The purpose of this paper is to analyze the political and economic situation after the democratization and decentralization of Indonesia. The paper shows the dysfunction of the bureaucratic rule as exemplified in East Kalimantan province. It should be made clear that such dysfunction was an outcome of the long and deep conflict concerning the central government, provincial government, and the Kaltim Prima Coal (KPC), a multinational company owned by British and Australian investors.

East Kalimantan under Soeharto

East Kalimantan, with size of 211,440 square kilometer or one and half bigger than Java Island, is a home for around 2.5 million people. The 44.51% of its population are composed mainly of migrants from various provinces of East Java, South Sulawesi, South Kalimantan, and Central Java. The Javanese, who came from both East and Central Java, are the largest ethnic group with 29.55%.

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Next are the Buginese of South Sulawesi (18.26%), Banjarese of South Kalimantan (13.94%), the indigenous Dayak (9.91%), the Kutai people (9.21%), and the rest come from different ethnic groups (19.13%) [East Kalimantan Statistical Bureau 2001: 5]. Javanese are concentrated in the three regencies and cities of Samarinda, Balikpapan and Kutai. They came to this province due to two reasons: transmigration and employment provided by both the timber and mining boom in 1970s. Other regencies such as Pasir are home to the Buginese and Banjarese. The Dayak group is domiciled in the interior such as Kutai.

In his long reign, from 1966–98, Soeharto established institutions for controlling the political and economic process for his benefit. In this paper institution is defined as “the formal rules [that] are created to serve the interest of those with bargaining power to create new rules” [North 1995]. Soeharto controlled the political process ranging from the center down to the entire region in the country through two means: establishing institutional arrangements and creating political alliance. These institutional arrangements were deeply associated with the military and with the dominant political party, Golkar (Functional Group) [Robison 1993]. In addition to his ability to control the military, Soeharto also secured effective authority within Golkar as head of its Supervisory Council (Dewan Pembina), a position that enabled him to determine the selection of Golkar office-holders and to control politics down to the village level [Shiraishi 1994].

Through his rule over the military and Golkar, Soeharto controlled the appointment of provincial governors and district chiefs and mayors. He instituted the law 5/1974 on Local Administration for this purpose. In this law, although the candidates for governors, mayors or district chiefs were elected by the regional parliaments (DPRD), at the final stage of decision making, they were appointed by and responsible to President Soeharto.¹⁾ With this control of the election process, Soeharto made the regional government leaders depend on him politically.

In addition to that Soeharto also controlled the flow of funds for the region by means of allocating lucrative taxes to the central government and then channeling some of the funds to the region. The regional income (PAD) was far from sufficient to run the government. All the provinces had to rely on subsidy from the central government for about 60% for their operating expenses [Kuntjoro 1995].

These political and fiscal arrangements then gave an impetus for a foundation of political alliance between Soeharto and the governors. It would be safe to claim that all the governors were political allies of Soeharto, and they depended on him for their political careers. The governors then

1) The article 15 of Law 5/1974 on Local Administration

responded to the wishes of Soeharto instead of the local population, and they were also politically accountable to Soeharto.

The combination of such institutional arrangements and political alliances created a political economy revolving around Soeharto as the center. Soeharto then was able to determine the fate and political careers of regional politicians and to intervene decisively in the economic affairs of the region.

This political structure of the economy in East Kalimantan was apparent. It was borne out by the defeat of Wahab Sjahranie,²⁾ one of prominent local elites,³⁾ in 1978 to maintain his governorship. Wahab was unable to compete with Ery Supardjan who was appointed by Soeharto in 1978, commander in chief for Kalimantan territory and a Javanese, as governor [Magenda 1991: 91]. With the appointment of Ery Supardjan the role of the local elites started to decline politically. Since then Golkar dominated the political scene with an average vote of 55% in the elections from 1982 up to 1997. It was in this context that Soeharto granted a concession to Kaltim Prima Coal (KPC) to mine in the province in the early 1980s. Soeharto's rule defined the Coal Contract between KPC and the government in that the central government received the entire royalty of 13.5% from KPC sales, plus corporate tax. The East Kalimantan province only received a small portion of revenue in the form of a regional development tax and land rent.

East Kalimantan in Post-Soeharto

The structure of the political economy established by Soeharto was broken up alongside his downfall in 1998. None of the political forces was able to inherit all his power due to serious rifts within the military and Golkar, the backbone of Soeharto government. The military, as far as 1998, experienced a serious divide between Wiranto, top commander of armed forces, and Prabowo, Soeharto's son-in-law who was the Commander of Army Strategic Reserve, when the two competed for command of the military [Shiraishi 1999]. Golkar also experienced a similar fate to that of the military. It was broken up into various camps from 1998 to 2000. The first divide was between Akbar Tanjung, the secretary of Supervisory Council of Golkar, and Edi Soedrajat, retired general, when they competed

2) Wahab Sjahranie was born into a Banjarese aristocratic family in Rantau, South Kalimantan. He graduated from HIS (Hollandsche Inlandsche School, primary school for the native) in 1937 and went to Opleiding Bestuur (Ministry of Education under Dutch Administration) in 1941. From 1947–50 he worked with a unit of Division I of the Indonesian Navy. Between 1950–60 he held various jobs in the army. One of them was Commander of a battalion in Kandangan. He was deputy to the sixth Assistant of the Army Chief of Staff. He was governor of East Kalimantan from 1967–78.

3) The local elites here meant those who were derived from aristocratic families of both East Kalimantan and South Kalimantan.

for chairmanship in the party. Then there was also the divide between Akbar Tanjung and Habibie supporters who mainly came from Sulawesi, Papua and Kalimantan [Nugroho and Stanley 1999].

Introduction of new institutions such as the laws on regional autonomy and political parties created new arrangements in politics and fiscal relations. With law 25/1999 the privilege of the President to appoint governors was abolished. This law also made the provincial assembly powerful due to its authority to elect the governor. With this new rule the governor is made responsible and accountable to the provincial assembly because of the position of the governor as the head of the regional government. In addition the governor is also responsible to the president because the governor represents the central government in the region.

The new rule on political parties of law 2/1999 offered an opportunity to set up new political parties other than those that already existed during the Soeharto period such as Golkar (Functional



Map 1 East Kalimantan

Group), PPP (United Development Party), and PDI (Indonesian Democratic Party). These parties old and new competed in the 1999 election, and the result of the elections in 1999 showed that five political parties dominated the political scene both in the central and regional levels: PDI-P (Indonesian Democratic Party for Struggle), Golkar, PPP, PKB (National Awakening Party), and PAN (National Mandate Party). The parliament and political parties began gaining strength against the executive.

The political landscape at the national level was reflected down to the region. In 1999 PDI-P outperformed Golkar by garnering 33.8% of the vote.⁴⁾ PDI-P has 17 seats out of 45 seats in the provincial legislative body. The secretary of the PDI-P's branch in East Kalimantan, Soekardi Jarwo Putro, has been chairing the provincial legislative body. It seemed that PDI-P garnered votes from Javanese migrants mainly residing in Samarinda (33.2% of its total votes in East Kalimantan) and Balikpapan (37.3% of its total votes in East Kalimantan). Other than that PDI-P garnered votes from the Dayaks group in Kutai (38.6% of its total votes in East Kalimantan). Furthermore, the Javanese who reside in East Kalimantan are mainly from East Java, one of the strongholds of PDI-P. In Samarinda, Balikpapan and Kutai the voters shared urban characteristics and they were aware of the politics of Jakarta and Golkar was being discredited. The Dayaks, who are mostly Christians [Nanang 1998: 2], supported PDI-P due to their religious affiliation. The religious leaders in the Dayak communities mobilized their members to vote for the PDI-P through various churches and the association of Dayak communities.

The combination of massive changes in many fronts broke the political and economic structure established by Soeharto government. The relationship between the center and the region, as indicated by the relationship among various offices of central governments and the governors, had also altered. As mentioned earlier, the governors were no longer only accountable and responsible to the President, but also mainly to the provincial parliament, the political body that elected him. The political alliances created by Soeharto also disappeared and have been replaced by more diverse political networks based on political parties.

It was at the periphery that the central government authority was weakest and had to face up to the rise of local elite politicians, such as governor of East Kalimantan Suwarna Abdul Fatah.⁵⁾ With the rise of the governor, the central government agency, in this case the Ministry of Energy, had to negotiate and bargain with or even accommodate to some extent the interests of the local elite. Such a situation is labeled as having a weak state [Migdal 1987; 1988; Abinales 2001].⁶⁾

4) "Sebuah Pelajaran yang Sangat Pahit" [*Kompas*, 3 February 2004]

5) He was born into a Sundanese family on 1 January 1944, graduated from military academy in 1966.

The dispute over the divestment of KPC is located in a wider context of the break up of the old structure of the political economy. In this context scholars argue that the fall of Soeharto “merely opens the door to a fresh round of struggles to reshape and to redefine economics and politics” [Robison and Hadiz 2004: 27]. It does open the door for a fresh round of struggle that mainly involved the players incubated in the New Order days, who are oligarchs [*ibid.*: 40–66, 187–217]. They, furthermore, admit that such struggle took place at the regency level in which local politicians have come to develop political capability and were trying to shape politics and economics in their locality [*ibid.*: 245–247]. These scholars discuss those political players operating in the regional context and their ability to control the local economy, such as protection racket, illegal gambling, and prostitution. In controlling those economic activities, these scholars continue, the local politicians hardly needed support from Jakarta. These scholars pay less attention to the interconnection of politics at the local level with those of Jakarta to understand the local politicians’ behavior. This paper expands the scope of analysis by discussing the provincial politicians who were able to develop networks⁷⁾ with those wielding power in Jakarta. As this case points out, there were new players from the province and were in the process of emerging. More importantly the new players were able to secure political support from powerful politicians in Jakarta through networks.

This case sheds light on the current development of Indonesian politics and economy by looking at the provincial politicians who managed to create networks. Even though the governor of East Kalimantan Suwarna Abdul Fatah met with little success in achieving his goal to control KPC, he was capable of creating networks to strengthen his political bargain in the situation of conflict over the KPC divestment process. Since the beginning of the conflict, Suwarna needed to forge a network because he was well aware that he would deal with coal mining legally under control of the central government. Other than that, Suwarna should consider the behavior of the multinationals that wanted to protect their source of income and benefit. Confronted with this context, Suwarna was left with little choice if he wanted to control the coal mining except to strengthen his political standing by linking with those powerful politicians in Jakarta who shared an interest in controlling KPC.

Suwarna’s initiatives and capability to establish networks is a new development within the context of Indonesian politics and economy in the post-Soeharto period. Equally important

6) Migdal argued that the weak state happened when the local strongmen were able to capture the state agencies and resources. They limit state autonomy and capacity, causing state weakness [Migdal 1988: 9].

7) Network is defined as a closely connected group of people through various means such as education, working experience, political parties or even interests. See Barabasi [2003: 41–54] and Watts [2001: 11–40].

shall be Suwarna's readiness to take advantages from the process of political opening and of decentralization. Therefore, Suwarna's effort to connect politics in the province with that of Jakarta's offers up material for discussion concerning the new patterns for Indonesian politics and economy.

Calibrating the Relative Strength of KPC

In 1982 the country experienced a decline in oil production and in its price. This had major consequences for foreign exchange receipts and government revenues. This was because oil revenues constituted the greater part — around 70% — of the foreign exchange inflow and government revenues.⁸⁾ In order to respond to the situation, the technocrats, one of them M. Sadli,⁹⁾ the Minister of Mines at the time, adopted a market-friendly approach¹⁰⁾ to the mining industry. Before the introduction of such a policy, the coalmine sector was operated mainly by the state-owned company, small domestic operators, and cooperatives, with production of only between 1 million to 4 million tons per year [Priyono 1990: 519]. Substitution of coal for oil was part of a bigger strategy of diversification for domestic energy usage in order to enable more oil to be preserved for export.

Two multinational corporations Rio Tinto of Australia¹¹⁾ and BP International of the UK¹²⁾ owned KPC. Rio Tinto of Australia had been exploring for mineral in Indonesia since 1970 and in 1976 it had made an agreement with BP of Britain for a joint exploration for coal throughout the country. As a result of this exploration carried out from 1976 to 1978, the two multinational companies responded to the government's invitation and submitted a tender for an area centered on the small town of Sangatta in Kutai [Dolinschek 1990: 530]. Then, Rio Tinto and BP International in December 1978 entered into a Coal Contract in the Sangatta area with Perum Tambang Batubara (Batubara), the state coal company. The Coal Agreement was signed on the 8th April 1982. In 1996 Batubara was

8) Government Statement on the Draft State Budget for 1983–84 to the House of People's Representative, delivered by President Soeharto.

9) Sadli was part of a group of technocrats who were educated in the USA, mainly University of California at Berkeley. See Shiraishi [2002: 1–3].

10) This market-friendly approach is a legacy of the neoclassical economic period of the 1970s, and in the 1980s three important nations — USA (Reagan), UK (Thatcher) and West Germany (Kohl) — embraced this policy. The OECD, World Bank and the IMF also supported the neoclassical approach. The World Bank and the IMF further imposed policies on Indonesia based on the tenets of neoclassical economics in the 1980s.

11) Rio Tinto had invested US\$1.2 billion in 2003 (email correspondence with Anang Rizkani Noor, vice director for external relation, on 12 February 2004). Rio Tinto's operation in Indonesia accounted for 4% of its net earning, approximately US\$60 million. See Rio Tinto [2000: 4].

12) BP controls interest in Indonesia for about US\$6 billion in various companies. "Investasi BP di Indonesia Mencapai US\$6 miliar" [*Bisnis Indonesia*, 26 January 2004]. BP is Indonesia's largest offshore oil and gas operator and the main natural gas supplier to its largest domestic market. BP conducted a project of gas plant amounted to US\$2 billion. See "BP in Indonesia — Sociologist Before Geologist?" [*Economist*, 29 June 2002].

replaced by the Ministry of Energy.

KPC is a company incorporated in Indonesia. Rio Tinto and BP International owned its shares in equal proportions of 50% each. KPC initially invested about US\$570 million in operations, covering 790,000 hectares.¹³⁾ Construction started in January 1989 and finished on 1 September 1991. KPC's main asset has been its mining concession right for an area of 90,000 hectares that lasts for 30 years. Up to 2001 KPC opened about 30,000 hectares for its coal production with an average annual production of 15 million tons. In short, the power of KPC is its capital invested in the Indonesian economy.

The agreement with the Ministry of Energy forms the legal framework in which KPC operates. It also defines a package of tax and other conditions including divestment. KPC obligations, as stated in the Coal Contract, are as follows:

1. The operating period shall continue for 30 years (article 10).
2. The application of income tax at 35% during the first 10 years of operation and 45% thereafter (article 11).
3. The obligation to provide 13.5% of coal to the government of Indonesia free of charge (article 11).
4. The obligation to progressively offer for sale at market value, a total of 51% of share to the Indonesian participant(s) (article 26).

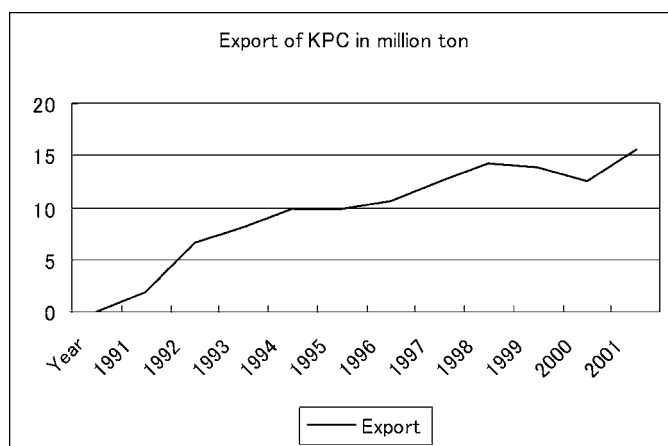


Fig. 1 Export of KPC in Million Ton

Source: KPC presentation in DPRD (The Provincial House of Representatives) on 5 July 2001

13) Interview with Anang Rizkani Noor, Deputy Director for Communication of PT Rio Tinto Indonesia, on 14 August 2003

In period 1991–2001 KPC exported 116.7 million tons of coal with Europe taking 28%, Japan 25%, Taiwan 16%, other Asian countries 21%, USA 6%, and the domestic market 4%. These data reveal not only KPC's strength in producing coal but also its marketing network worldwide.

The significance of KPC in the Indonesian economy is evident in the form of its fiscal obligation to the government in payment of royalty and dividend. As governed in the Coal Contract article 11, KPC has to pay a royalty of 13.5% from its net sales per year and to pay for dividend from its annual net profit amounted to 35% up to 45%. Total royalty payment of KPC to the government for the period 1991 to 2001 amounted to US\$499,287,040 with average annual payment of US\$45,389,730. From 1995 to 2000 KPC in average paid royalty and dividend amounting to US\$80.8 million annually. This figure was larger than that of other contractors such as Arutmin, a coal company operating in South Kalimantan, which paid royalties amounting to US\$35.2 million in 2002.¹⁴⁾

II The Rise of Governor Suwarna

The governor of East Kalimantan Suwarna Abdul Fatah spent his career mainly within the military and he had served in various posts until 1994. In 1994 he entered political life as the deputy governor for East Kalimantan. In 1998 he was appointed as governor¹⁵⁾ with political support mainly from the former commanders of Military Area Command (Kodam) Tanjungpura. Later on Golkar and PDI-P also supported him. The decentralization and other political policies had provided an impetus for Suwarna to voice his concern on the divestment of KPC even at the national scene, yet he did not have any particular legal standing, as far as the new regulations were concerned, for claiming his interest. The space to maneuver for Suwarna was opened when he received information of the divestment process¹⁶⁾ around 1999. Up to November 1999 the provincial government had been short-listed by KPC as one of the parties who would be given the opportunity to buy the equity of the company.¹⁷⁾

14) Data for net sales of PT Arutmin is obtained from www.miningindo.com [downloaded on 25 October 2004].

15) He became governor with support from Military Area Command (Kodam) Tanjungpura in 1998, after serving as the vice governor up to 1998. With the installment of a new parliament in 1999 he cultivated political support from important political parties in the region like PDI-P and Golkar, both of which were instrumental to his reappointment as governor in 2003. Golkar local leader Syaokani and PDI-P local secretary Soekardi Jarwo Putro have been his close allies. Chief Kodam of Tanjungpura was mainly from Java like Moetojib, Namuri Anoem, Muchi PR, and Zainuri Hasyim.

16) Interview with Syaiful Teteng, secretary of East Kalimantan Government and he was involved deeply in the dispute regarding the divestment of KPC shares. The interview was conducted in Samarinda on 9 September 2003. Gatra also revealed that it was David Salim who provided the information in 1996 to the provincial government. See "Baku Sikut Juragan Tambang" [*Gatra*, 2 April 2002].

The invitation from the central government stated clearly that it was the province that was short-listed, not Suwarna himself, for the opportunity to purchase KPC. Therefore, as will be discussed later, Suwarna could only use his office to go against the central government. This was clear when Suwarna had to use the provincial government enterprise, the Perusda, to set a joint venture company. Yet, the possibility for Suwarna to gain benefit from his effort on behalf of the province to purchase the equity of KPC might open. Such benefit would have been in form of commission fee had the province successfully purchased the equity of KPC.

The source of Suwarna's power for bargaining is the site of coal mining. This site is immobile and cannot be transferred to other places. The source of power for Suwarna then resides in the immobility of extractive resources [Moran 1974]. This immobility is directly translated into power for Suwarna because KPC has already been in operation for some time in East Kalimantan. The possibility of a KPC withdrawal is nil due to its massive investment in the country.

Another source of Suwarna's power was his ability to seek political support by establishing political alliances at the national level. In November 2000 he entered into an agreement with Moetojib, former commander of Tanjungpura territory of Kalimantan, an agreement which later on cemented his efforts at acquiring the equities of KPC. Moetojib graduated from the National Military Academy in 1962, and served as the chief of intelligence service BAKIN under Soeharto. He previously held various positions as chief commander of Kodam Tanjungpura in Kalimantan, governor of a government security think tank, the Lemhanas. He met with Suwarna in the Lemhanas, and since then they maintained the relationship closely. Suwarna and Moetojib established a joint venture company called PT Melati Intan Bhakti Satya (MIBS), which was a joint venture between PT Intan Bumi Inti Prasada (PT Intan), where Moetojib was acting as commissioner, and East Kalimantan province-owned enterprise PD Melati Bhakti Satya (PD Melati).¹⁸⁾ Moetojib connected Suwarna to David Salim,¹⁹⁾ nephew of prominent Indonesian tycoon Sudono Salim, who would provide substantial capital for the purchase of shares of KPC. This joint venture not only provided Suwarna with political standing but also financial backing. In particular MIBS was intended to purchase all 51% of KPC's equity.²⁰⁾

17) Letter from KPC to Minister of Energy Susilo Bambang Yudhoyono dated 16 November 1999, signed by Philip Strachan (of Sangatta Holding Ltd) and Peter Vider (BP International)

18) Deed of Agreement before Notary Esther Mercia Sulaiman, means it has a legal basis.

19) He perhaps acted as a broker who was mediating governor with international capital such as Batavia Investment Management. See "Berebut Batubara di Kalimantan" [*Tempo*, 16 June 2002: 72]. However, only limited information related to him, until the dispute was over his figure remained in the dark.

20) Deeds of Agreement on clause of Policy over Dividend, p. 10

Suwarna and Moetojib, with financial backing from David Salim, entered an agreement that put PT Intan with 45.9% shares, and the province 5.1%.²¹⁾ But later Suwarna demanded more shares for the province, as he had to convince other chiefs of districts in the province to support his proposal. Then the shares composition changed in July 2002 and the province received 10.2%. Since then the governor has acted as representative of MIBS on behalf of this joint venture.

Suwarna approached the Minister of State Owned Enterprises (SOE) Laksamana Soekardi who was already involved in the process of divestment of KPC through PT Tambang Batubara Bukit Asam (PTBA),²²⁾ a state owned enterprise specializing in the coal mining industry, which was under his supervision. In July 2002 the central government divided 51% of the equity of KPC into two main parts: 20% for PTBA; and 31% for the local government of East Kalimantan. The involvement of PTBA provided a way for Laksamana to take part in the process of divestment. In mid September 2002 Suwarna saw his efforts bear initial fruit as Laksamana stated that he was ready to involve himself in the proposed consortium, which comprised of PT Intan, PTBA, PD Melati and a company belonged to East Kutai regency by the name of Perusda on mining and energy (PEKT), to buy 51% of the equity of KPC.²³⁾ The name of consortium was MIBS and it was formed on 8 November 2002 in order to pursue benefits for Suwarna and Laksamana. With this consortium Suwarna was aiming at controlling KPC, while Laksamana could solve his problem by buying only for about 4% of the shares of KPC because he learned that PTBA did not have enough funds to purchase the entire 20% shares. Suwarna and Laksamana agreed that 10.2% shares, which was already allocated for East Kalimantan, would be divided into two parts, in which the central government (PTBA) would receive 3.98% shares, and East Kalimantan province (PD Melati) and PEKT 6.22%.²⁴⁾ In this consortium of MIBS, PT Intan would receive 40.80% shares.²⁵⁾ They agreed that PT Intan would be involved in the

21) See also confirmation from Said Safran, former secretary of East Kalimantan government to *Gatra*, "Baku Sikut Juragan Tambang" [2 April 2002].

22) PT Tambang Batubara Bukit Asam (PTBA) is a state owned enterprise specializing in coal mining operations. It was established in 1981 and publicly listed on the Jakarta Stock Exchange in 2002. PTBA is the country's 5th largest coal producer. In 1990 PTBA merged with Perum Tambang Batubara. It possesses about 17% of Indonesia's coal reserves. PTBA is currently exploiting two mines areas located in Tanjung Enim (South Sumatra) and in Ombilin (West Sumatra). PTBA is under supervision of the Ministry of SOE.

23) "Pemerintah Optimis Divestasi Akan Tuntas" [*Bisnis Indonesia*, 11 September 2002]

24) The calculation was based on a ratio of 20:31; therefore PTBA would receive $(20/51 \times 10.2\%)$ 3.98%, and PD Melati and PEKT $(31/51 \times 10.2\%)$ 6.22%. The 6.22% portion for PD Melati and PEKT was divided based on a ratio of 40:60; therefore PD Melati would receive $(6.22 \times 40\%)$ 2.49% and PEKT would receive $(6.22 \times 60\%)$ 3.73%.

25) The article 1 of Memorandum of Understanding among PTBA, Perusda Melati and Perusda East Kutai signed by Ismet Harmaini (PTBA), Mandurdi (Perusda Melati), Wahyu Setiaji (Perusda East Kutai), Moetojib (PT Intan) dated 8 November 2002. This agreement was approved by Minister Laksamana Soekardi by ↗

partnership and could join the negotiator team;²⁶⁾ and that the negotiator team would scrutinize KPC with due diligence.²⁷⁾

Laksamana's decision to support governor Suwarna's proposal to purchase the equity of KPC might be related to the bigger political effort of PDI-P to approach the governor and to the financial constraint he had to confront. In the late July 2002 Megawati, after listening a suggestion from Minister of Energy Purnomo Yusgiantoro who was in charge for the divestment of KPC and wanted to block Suwarna's intention to control the multinational, ordered PTBA to purchase 20% of KPC equity. Minister of SOE Laksamana Soekardi was fully aware that the government lacked fresh funds to acquire KPC equity amounting to US\$164.4 million for 20%, and it would be difficult to find people who could or wanted to finance the purchase.²⁸⁾ Only by establishing an alliance with governor Suwarna, Laksamana found a way to resolve his problem of providing a significant amount of fresh funds.

Governor Suwarna was important enough for national PDI-P strategy of maintaining an alliance with the military. Megawati and PDI-P secretary general Soetjipto decided on 22 May 2003 to throw their support behind Suwarna's candidacy as governor for the second term, at the expense of PDI-P East Kalimantan chairperson Imam Mundjiat. Megawati intended to send a clear message that her party was ready to cooperate with the military. Megawati sent her aides Theo Syafii and Agnita Singedekane to discuss the matter with the provincial chapter of the party and concluded that PDI-P would support Suwarna with 12 votes²⁹⁾ out of 17 total votes that the party held. In June Suwarna was reelected as the governor with a majority of 24 votes (53%) out of 45 total votes.³⁰⁾

In addition to that of alliance with national figures, Suwarna also entered into a political alliance with the chief official of the district of East Kutai, where the mine site of KPC is located. In late April 2001 governor Suwarna managed to gain initial support from regent Awang Faroek Ishak. They entered an agreement after settling their dispute over who has the right to represent East Kalimantan vis-à-vis the central government by July 2002. After disputing representation for about

↘ his letter to the board directors of PTBA, letter number: S-300/M-MBU/2002, dated 12 December 2002 and signed by Laksamana Soekardi. PT Intan would receive the large amount of shares because it would provide the funds.

26) The team was comprised of Roes Aryawijaya from Minister Laksamana's office, Syaiful Teteng from East Kalimantan provincial government and Wahyu Setiaji from East Kutai regency government.

27) Memorandum of Understanding among Minister of SOE, Government of East Kalimantan and Government of East Kutai, article 3

28) Minister Laksamana statement as quoted by "Bumi Sudah Setor Dana Akuisisi KPC" [*Koran Tempo*, 2 August 2003]

29) "Mega Restui Suwarna?" [*Kaltim Post*, 28 May 2003]

30) "Suwarna Jadi Gubernur Lagi" [*Kaltim Post*, 3 June 2003]

one year, they finally agreed to increase equity allocation of the province from 10% out of 51% (5.1%) to 20% (10.2%) in MIBS. The regent would receive 60% out of 10.2%, and the province 40%.³¹⁾ As a result of this agreement then Faroeek wrote a letter of support on behalf of governor Suwarna to Minister Purnomo.³²⁾ Regent Faroeek was very crucial for governor Suwarna because he had the choice of whether to join the governor or not. The governor knew that the regent could move on his own to fight against the central government instead of siding with him. The only incentive that could be offered by the governor to the regent was to raise the shares composition and increase the community development fund. Both of them were aware that they would face difficulties if they moved on their own. They agreed that PT Intan must give community development funding of US\$7 million if MIBS purchased all 51% of KPC's equity.³³⁾

Suwarna received political support from Syaukani,³⁴⁾ district chief of Kutai Kartanegara. Even though Syaukani's political influence was probably important and went beyond the scope of his district, due to his strong connection to Golkar where he had been a member since 1978, he had no claim on the mining because it is located in East Kutai. His reason for supporting Suwarna was that it was the only chance for him if he wanted to have shares in KPC. After considering that Suwarna received political support from Moetojib, Laksamana and Awang Faroeek, Syaukani had little chance to wage his own battle.

III Dispute between the Ministry of Energy and the Governor

Minister of Energy Purnomo was assigned to perform the process of divestment of KPC as mentioned in the Coal Contract. According to the article 26 of the Contract, KPC had to divest its equity to Indonesian participants. This regulation was formulated with the intention of offering the Indonesian businesspersons a chance to operate a large coal mining operation through a partnership

31) Memorandum of Understanding between Governor East Kalimantan and Regent East Kutai dated 25 March 2002, signed by governor Suwarna and regent Awang Faroeek Ishak Firmansyah, Agung. See "Divestasi Saham KPC: Memperjuangkan Hak Rakyat Kalimantan Timur" [*Forum Indonesia Tumbuh*, 2003: 56].

32) Letter of Regent of East Kutai number 236/541/BUP-KUTIM/3/V/2001 dated 27 April 2001 signed by Awang Faroeek Ishak

33) There were several companies approached by the provincial government, including Prabowo Subianto's company and Bumi Resources, yet they have been defeated by PT Intan that increased its shares to the province from 10% to 20%. PT Bumi Resources offered only 5% to the province.

34) He was born in Tenggarong on 11 November 1948. He graduated from Jember University, a local university in East Java, in 1978. Since then he begun his political career in Golkar and served as the chief of Golkar youth organization (AMPI) in 1978. Chief of Golkar in Kutai in 1993-2001. Chief of local parliament in Kutai for two periods before serving as the chief district. For further information, see Ali [2003].

with large multinationals. The Indonesian government in the beginning of the 1980s was aware that the Indonesian company had very limited access to technology, capital and the international market. Such a partnership would provide Indonesian companies access to the international market, capital and technology.

Even though Purnomo received the task to divest the equities of KPC, he along with KPC, doubted that Suwarna met the qualifications of a potential majority shareholder. He and KPC shared similar belief that Suwarna did not have enough funds to purchase 51% of KPC shares worth US\$419 million, which was far bigger than the entire provincial budget of IDR517.83 billion (or US\$5.17 million).³⁵⁾ Even with the involvement of David Salim, Purnomo and KPC believed that Suwarna still lacked fresh funds to finance the purchase. They acquired relevant information mentioning that either David Salim or Suwarna did not have any substantial experiences in the coal industry. This was the most relevant reason for Purnomo and KPC to impede Suwarna. While David Salim has been doing business in the property sector, Suwarna has been a politician with military background. Considering these facts, Purnomo and KPC concluded that the future of KPC, if it went to both Suwarna and David Salim, would not be very impressive. Finally, they considered the trust and relationship that they had built for the last three decades. Through the operation of KPC, under the management of Rio Tinto and BP, the central government regularly received funds. Purnomo thought that KPC would be the best partner for the central government in providing continuous flow of income to its coffer in terms of royalty and taxes.

The dispute was characterized by Suwarna's effort to control KPC by gaining majority ownership. For Governor Suwarna controlling KPC meant gaining profit. He saw that KPC has been profitable, as shown from the Fig. 2 below with average net profit margin (NPM) of 20% after 2001, which was far better than overall NPM of the mining industry for the period 1996–2002, which was a rate less than 15%. He might even have known that in the past 10 years KPC had been generating profits. On the average from 1995 to 2000 KPC would have generated dividends for the province of about US\$3 million/year, if the province had purchased 2.49% shares of KPC.³⁶⁾ Even though PT Intan would benefit the most if the consortium had purchased the entire 51% equity, Suwarna seemed quite happy with the allotment of the shares. He knew that PT Intan provided all the necessary funds by borrowing from international lenders.

35) See East Kalimantan Government [2000].

36) This number is calculated based on an agreement of the East Kalimantan government, PTBA, and the East Kutai regency on shares proportion if they could purchase 51% of KPC shares. In this proportion the province would have gotten 6.2% ($31/51 \times 10.2\%$). The percent 10.2 would have been the portion for three of them. The percent 6.2 multiplied by net profit and it was the dividend.

Fig. 3 indicates that if the rate of profit were stable for the next 10 years, the governor by holding 2.49% of KPC equity would have hoped to acquire nominal profit amounting to an average of US\$3 million per year for the duration of the Coal Contract.

The real conflict between Suwarna and Purnomo began in November 2001 when the governor lodged an administrative lawsuit in the Jakarta State Administrative Court. Suwarna had challenged the validity of several decisions of Purnomo to defer the divestment of equity of KPC. He argued that the Minister was blocking the process,³⁷⁾ because until the late 2001 there were no signs of a permanent solution as to how to proceed with the process. The governor was also questioning

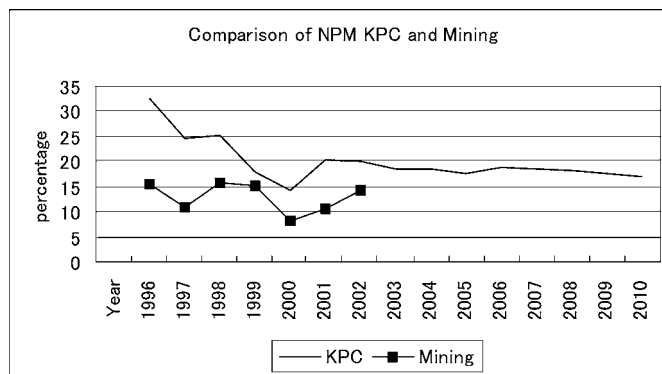


Fig. 2 Comparison of Net Profit Margin between KPC and Mining

Sources: Confidential reports of Bahana Securities to Ministry of Energy and KKEDS (Working group on divestment shares for KPC) to Minister of Energy 2002 and Price Water House Cooper survey on Indonesian Mining Industry 2002 and 2003.

Notes: for KPC 1996–2000 is actual, the rest is projection; for mining is actual.

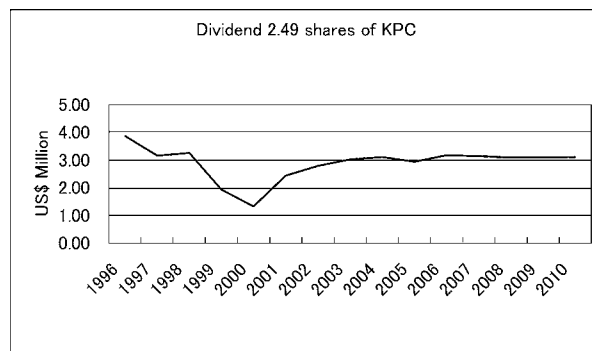


Fig. 3 Dividend for 2.49% Shares for the Province

Sources: Confidential reports of Bahana Securities to Ministry of Energy and KKEDS to Minister of Energy 2002

the ministerial action of not taking decisive political measures to solve the chaotic divestment regulation.³⁸⁾ The governor asked that the Court direct the Minister to instruct KPC to sell 51% of its equity to the provincial government at US\$419 million. Because of that legal suit, Purnomo had to continue the divestment process. Such continuation gave more room for Suwarna to be involved in the process of divestment.

Even though Suwarna maneuvered to find room over the divestment, Purnomo in fact remained influential within the context of the dispute. By making use of his authority as the minister in charge of this divestment, Purnomo carefully limited the choices for Suwarna. Purnomo was aware of the necessity of accommodating the demands of the province, therefore he sent a clear signal to fit in with Suwarna's wish. Nevertheless, Purnomo had systematically intended to place Suwarna only as one of the shareholders, while he carefully engineered KPC staying on as the majority shareholders. There were three political measures adopted by Purnomo.

First, in responding to Suwarna's legal suit, mentioned above, Purnomo decided to continue the divestment process. Having done so, however, Purnomo preferred to make huge concession to KPC, instead of Suwarna, by agreeing on the price of US\$8.22 million for every 1% equity or US\$822 million for 100% of KPC equity.³⁹⁾ The price was very close to the one proposed by KPC since the initial process of divestment. Since the beginning of the divestment process the Ministry of Energy and KPC had never settled the price. In 1999 the Ministry of Energy had considered that the price for 30% shares of US\$200 million offered by KPC was very expensive. The Minister proposed a price of US\$145 million.⁴⁰⁾ In 2001, when KPC had to divest its 51% equity, a multinational proposed the price for 100% share worth for US\$889 million (or US\$453.39 million for 51% shares), while⁴¹⁾ Purnomo proposed US\$320.2 million for 51% shares.⁴²⁾ The price of the shares fluctuated as the

37) As said in press release obtained by "Pemda Kaltim Gugat Menteri ESDM" [*Bisnis Indonesia*, 21 November 2001].

38) "Gugatan Hukum Kaltim Tak Berdasar" [*Bisnis Indonesia*, 26 December 2001].

39) "Kepercayaan Investor Tambang Kembali Pulih" [*Bisnis Indonesia*, 13 March 2002].

40) As mentioned by president director PT Timah, Erry Riyana Hardjapamekas in "Timah Batal Beli 30% Saham KPC" [*Bisnis Indonesia*, 24 November 1999].

41) This price was offered by Lex Graefe in "KPC Ajukan Nilai Kapitalisasi US\$889 juta" [*Bisnis Indonesia*, 4 October 2001].

42) "Pemerintah Hargai 51% Saham KPC US\$320 juta" [*Bisnis Indonesia*, 6 October 2001]. In fact the Ministry had three scenarios on how to determine shares prices: first, 44% plus 7% model. This decision based on agreement on 26 October 2000 where value for 44% shares KPC was US\$257 and 7% was calculated from 7% out of 100% (US\$889) of KPC shares worth US\$62 million. With this first option 51% of KPC shares worth US\$319 million. Second, 37% plus 14% model in which calculation was based on the price agreed for 37% shares on 26 October 2000 worth US\$216 million, and the rest 14% was calculated on the basis of median price 100% of US\$889 million.

negotiation experienced a deadlock for almost a year. In the end Purnomo had to agree with the price offered by KPC, which had been considered by the minister as expensive, in order to block Suwarna.

Second, Purnomo demanded Suwarna to “fully, finally and unconditionally withdraw, remove or cease”⁴³⁾ all legal claim as a requirement for the continuation of the shares offer. By doing this Purnomo left the choice upon Suwarna, if the governor would continue the process of divestment, he had to withdraw all legal charges, if not the divestment would stop. This situation was a dilemma for Suwarna. He had the intention of using the legal charges to weaken Purnomo’s political standing. He however had no choice except to withdraw his charge against KPC.

Third, one month after Purnomo made the decision to split the shares of KPC into two parts, he exerted another form of pressure on Suwarna. Purnomo and KPC entered into an agreement under which the 2001 offer of divestment of 51% equity in KPC was to be implemented. This agreement was an attempt to influence the divestment process for protecting the interest of KPC by stating several conditions that would be very difficult to accomplish by Suwarna in his position as the buyer of the equity. The framework defined the criteria of the buyers, such as Indonesian participants, and sought proof to demonstrate that the buyers can provide the necessary funds to buy the shares.⁴⁴⁾

IV Dispute between Governor and KPC

A scholar said, “there is one and only one social responsibility of business — to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of game” [Friedman 1982: 133]. This position reflected the main objective of KPC for gaining profit from coal operation, while the multinational stayed within the rule of the game. Even in attempting to justify its interest, KPC preferred to stay within the rules of the game, which meant the various regulations that defined the coal operation. When Suwarna disputed that the province had the exclusive right to become the shareholder, KPC preferred to the legal road in protecting its position. The section analyses the dispute between Suwarna and KPC, the large part of this conflict centered on the interpretation of the contract, and the other part on the legal steps adopted by KPC.

With no substantial legal standing to be involved in the process of divestment, Suwarna initially offered a controversial interpretation of the regulation, which is the Coal Contract, mentioning that the province had priority as the first buyer of KPC equity. Suwarna went on to explain that his

43) Framework Agreement between Government of Indonesia and KPC dated 5 August 2002, clause 5.1, p. 10

44) Framework Agreement between Government of Indonesia and KPC dated 5 August 2002, clause 3, pp. 7–8

interpretation should be considered by KPC. When KPC denied strongly that the province must be granted with the majority shareholding, it led to a dispute, which can be grouped into three clusters: legal dispute, framework agreement, and due diligence process.

Legal Disputes

On 17 July 2001 Suwarna lodged a lawsuit against KPC⁴⁵⁾ over the alleged failure of the multinational company to carry out its divestment obligations under the Coal Contract.⁴⁶⁾ With this charge Suwarna systematically sought damages worth US\$776 million for past and future dividends that the province would have received from KPC, if the divestment had occurred according to the original Coal Contract and the province had held 51% shares. In addition he sought exclusive right to buy the entire 51% of the shares of KPC.

On seeking the damages of US\$776 million,⁴⁷⁾ the governor argued that the province had a right to the natural resources located in its region. To strengthen his claim, he stated that KPC's operation was designed only for the benefit of its shareholders.⁴⁸⁾

In seeking exclusive rights Suwarna expressed the opinion that the government owns the mineral resources. He referred to the Presidential Decree number 49/1981 and article 26 of the Coal Contract and the provision of mining law number 11/1967 stating that the government holds the authority over and ownership of mineral resources.⁴⁹⁾ Suwarna based his argument on the article 10 Law 11/1967 stating that the Minister could appoint another party as contractor. Suwarna argued that KPC was a contractor to the government of Indonesia. Then he claimed that "a contractor had no right to determine or even to select the Indonesian participant"⁵⁰⁾ in the divestment process.

Having established the arguments that KPC, as the contractor, had no right to select the Indonesian participant in the divestment process, Suwarna tried to argue that the province is also a part of the government. Suwarna adopted the definition of government that includes the province in the Coal Contract.⁵¹⁾

45) The lawsuit was registered in the District of South Jakarta court number 350/Pdt.G/2001/PN Jaksel dated 17 July 2001

46) KPC, Overview of the Case, downloaded from http://www.kaltimprimacoal.co.id/legal_overview.cfm on 4 February 2004

47) Lawsuit of East Kalimantan province as represented by its law firm Dermawan Nugroho & Co Ref. DN/tb-mp-is/079/III/02, dated 12 March 2002

48) Lawsuit, 12 March 2002, p. 27

49) Lawsuit, 17 July 2001, p. 6

50) Lawsuit, 17 July 2001, p. 7

51) Coal Contract mentioned that "government means government of the Republic Indonesia, its Ministries, Departments, Agencies, Instrumentalities, Regional, Provincial or Districts Authorities. See also Reply ↗

To this particular pressure, KPC prepared careful responses by way of deploying counter interpretations to the one proposed by Suwana. KPC denied the accusation of the governor on these two points of the divestment and exclusive right of the government as Indonesian participant. As for the divestment, KPC and its shareholders were of the opinion that KPC “has no obligation to sell, transfer, or divest shares.”⁵²⁾ KPC maintained that it has an obligation to offer its shares to the Indonesian participants. KPC made its position on the matter clear by trying to distinguish between the obligation to sell, transfer or divest and the obligation to offer the shares. KPC also referred to the article 26 of the Coal Contract, yet it stressed that KPC has the obligation to ensure that shares “are offered . . . to the government or Indonesian nationals or Indonesian companies controlled by Indonesian nationals.”⁵³⁾ Contrary to the governor’s position of seeking a complete process of divestment until all the shares are sold, KPC was of the opinion that its obligation was only to ensure the offering of shares.

As for Indonesian participants, KPC maintained the argument that there was no exclusive right for the government, including the province of East Kalimantan. The province was not the only prospective purchaser but merely had the status of one interested purchaser.⁵⁴⁾ In order to support its position KPC claimed it had already fulfilled its obligation to offer shares to Indonesian participants in each year of 1998, 1999 and 2000 in full consultation and agreement with the Ministry of Energy. While offering the shares, KPC also was of the opinion that it was waiting for the government to agree on the shares price.

The dispute ended on 29 July 2003 after the central government made a decision to split 51% of KPC shares into 20% for the central government and 31% for the local government. As condition for the divestment, KPC demanded that the provincial government withdraw its legal suit. KPC argued that it could not conduct the divestment process, because the law did not allow the company to do so, particularly when the asset was placed under an order of seizure.⁵⁵⁾ Then governor Suwana wrote a letter to the panel of South Jakarta District Court for revocation of the lawsuit against KPC and the court granted the petition of Governor Suwana.⁵⁶⁾

↘ of Lawsuit number 350/Pdt.G/PN Jaksel, dated 12 March 2002 signed by East Kalimantan provincial’s lawyer Ibrahim Senen, p. 6.

52) Response from KPC as put by its lawyer Lubis, Santosa and Maulana dated 19 February 2002, signed by T. Mulya Lubis, Leylana Santosa and Fredrick Pinakunary, p. 10.

53) Response of KPC dated 19 February 2002, p. 29.

54) Response of KPC dated 19 February 2002, p. 30.

55) This opinion is presented by KPC legal adviser Fredrick Pinakunary (email correspondence on 8 January 2004).

56) Determination of South Jakarta District Court for case number 350/Pdt.G/PN. Jaksel dated 1 August 2002, signed by presiding judge IDG Putra Jadnya

The Framework Agreement

Noke Kiroyan, the CEO of KPC, and Purnomo signed on 5 August 2002 the Framework Agreement. In the earlier part of this paper the agreement was mentioned in relation to Purnomo's attempt to block Suwarna. This sub-section looks at the agreement from the perspective of the KPC when it had to face opposition from Suwarna. The agreement was an additional explanation to deliver on the divestment process. It aimed at providing detailed procedures and conditions for implementing the KPC share offer. Noke Kiroyan supported it and commented that the "twin principles of business-to-business and win-win solution advocated by the minister from the outset have finally led us to the conclusion of the Framework Agreement."⁵⁷⁾ KPC used the Framework Agreement as a means to protect its interest. KPC might welcome Suwarna as new shareholder, but he had to follow the terms and conditions set out in the agreement.

The Framework Agreement stated that the government of Indonesia or a state-owned company involved in mining may have shares of not less than 20% and provincial government of East Kalimantan, the regency of East Kutai or companies owned by them may have shares in aggregates of not less than 20%. It also mentioned that "the government of Indonesia will ensure that all the offered shares will not be held through a single entity and that the assignees will act independently of each other and not in concert or as a group."⁵⁸⁾ Later on the management of KPC insisted two important points that: "the qualified buyer to reveal its sources of funding; and that shares will not be held by a consortium which comprised of Perusda owned by East Kalimantan or East Kutai governments."⁵⁹⁾

In the following month governor Suwarna lodged a lawsuit against KPC in the court of Samarinda, the capital of East Kalimantan, to annul the Framework Agreement. Suwarna considered that his chance of owning the majority of KPC shares were better if he could work for the abolishing of the Agreement. Siding with Suwarna, the court handed down two decisions: first, it attacked the very foundation of the Agreement's existence as legal document that governed the divestment process by concluding that it was illegitimate,⁶⁰⁾ and second, it therefore ruled that the Agreement be annulled.⁶¹⁾

57) The Address of president director of PT Kaltim Prima Coal on the Signing of Framework Agreement with the Minister of Energy and Mineral Resources on 5 August 2002, as published by *Kabara* (internal Magazine of KPC) [September 2002: 2].

58) Framework Agreement between Government of Indonesia and KPC, dated 5 August 2002, signed by Purnomo Yusgiantoro, Minister of Energy and Noke Kiroyan, article 3.2 (b)

59) Attachment of the letter of KPC dated 13 February 2003

60) Decision of the court of Samarinda, number 118/Pdt.P/2002/PN.Smmda, dated 4 December 2002, p. 13

61) Decision of the court of Samarinda, p. 18

In response KPC wrote a complaint letter to the court of Samarinda questioning its decision to annul the Framework Agreement. KPC stated that the decree was not valid from a legal perspective; and that the court of Samarinda had no legal foundation for an annulment; and that this matter was beyond jurisdiction of the court.⁶²⁾ Yet, this complaint had no legal implication because it was not intended as a legal step.

In January 2003 Minister Purnomo intervened in this legal dispute by writing a letter to the court of Samarinda arguing that it had no authority to issue a decision to annul the Agreement. The minister insisted that any dispute must be settled by way of a proper mechanism set out in the Coal Contract through an international arbitration body.⁶³⁾ This legal matter remained unresolved⁶⁴⁾ as the parties involved preferred to continue the process. More than that, both KPC and the Minister of Energy still based their action on the Framework Agreement for procedures regarding the share offer.

Due Diligence

Since January 2003 due diligence emerged as a main bone of contention between KPC and Suwarna. Due diligence is a general term for a process to evaluate a transaction. KPC argued that, as it indirectly stated in the Framework Agreement, it had the right to conduct due diligence on the potential buyers. Suwarna argued that the Perusdas, the companies that represented Suwarna's interest, have the right.

On 13 February 2003 KPC had written a letter to Purnomo. It revealed that Purnomo proposed that KPC give consideration to allowing further exclusivity for PTBA and Perusdas to accept and complete the purchase of KPC's shares. Here, Purnomo still maintained his position that 51% shares of KPC must be divided into two. In replying to this proposal, KPC was pleased to take advice from Purnomo. The position of KPC was clear that it agreed for "an extension of the central government offer process; re-instatement of the Perusdas into the central government offer process; and due diligence by the Perusdas on KPC."⁶⁵⁾

Using the available opportunity, Suwarna wrote a letter to KPC demanding that the Perusdas

62) Letter written by Lubis, Santosa & Maulana Law Office to Chairperson of the court of Samarinda number 0206/LSM-FP/L/XII/2002 dated 17 December 2002, signed by T. Mulya Lubis and Fredrick J. Pinakunary

63) "KPC Tolak Due Diligence oleh Perusda Kaltim Bisnis Indonesia" [*Bisnis Indonesia*, 7 January 2003]. *Bisnis Indonesia* obtained a letter number 4016/SJN.H/2002 written by Minister Purnomo to the court of Samarinda.

64) Information from Fredrick Pinakunary, legal adviser of KPC (interview on 12 August 2003)

65) Letter of KPC to Ministry of Energy dated 13 February 2003 signed by Lex Graefe and Murray Easton

conduct due diligence on KPC. Suwarna demanded that KPC must provide all the necessary documents and information with regard to the divestment process for a thorough examination under the due diligence process.⁶⁶⁾ If Suwarna allowed evaluation of KPC, he would have been in a better position to judge the overall performance of the company. Suwarna preferred that his party, the potential buyer, conduct an evaluation of the seller.

KPC replied by sending a letter. The letter says that:

Under the terms of the Framework Agreement, GOI may assign part of its offer to the Indonesian Province of East Kalimantan, the East Kutai Regency (kabupaten), or companies owned by them, subject to certain agreed criteria. KPC is not aware of those criteria having been satisfied or of the GOI having made an assignment of the share offer to your Company. As a consequence all we can do at this time is to pass a copy of your letter and this letter in reply to the Secretary General of the Department of Mines and Energy for his consideration.⁶⁷⁾

This letter made clear the position of KPC to strongly deny due diligence process on KPC. The argument put forward by KPC was that it was not aware that the central government had transferred its right of share offer to Perusdas. The process of due diligence on KPC by Perusdas never materialized.

VI The Response

As mentioned before KPC responded to particular pressures from Suwarna. However, since April 2003 KPC saw signs of danger on the horizon when the authority shifted from Purnomo to Laksamana. Roes Aryawijaya, the chief of Divestment Solution Team who was also working under supervision of Minister Laksamana, had threatened KPC by revoking the legal base of KPC as the contractor and threatening to stop its coal mining operations on the grounds that KPC denied due diligence on KPC by two Perusdas that represented the interest of the province.⁶⁸⁾ In addition to that threat, Laksamana warned KPC of the closure of its operations because of its failure to fulfill the

66) Letter of Perusda Melati Bhakti Satya, number 94/A/MBS/2002, dated 6 November 2002, signed by its director Mandurdi, Samarinda. Perusda Pertambangan dan Energi of East Kutai regency government also wrote a letter, number 46/A.3-PPEK/XI/2002, dated 6 November 2002, signed by its director Wahyu Setiaji, Sangatta.

67) Letter of Kaltim Prima Coal to President Director Perusda Melati Bhakti Satya, dated 12 November 2002, signed by Director Lex Graefe

68) Tim Penyelesaian Divestasi Saham 51% PT Kaltim Prima Coal, Laporan Kemajuan Proses Divestasi 51% Saham PT Kaltim Prima Coal, 21 April–12 June 2003. The existence of this document and its recommendation was claimed by the chief of the team Roes Aryawijaya. See “Ijon Laba, Berbuah Masalah” [*Tempo*, 10 August 2003: 124].

obligation for a divestment of the company equities.⁶⁹⁾

In this crucial time the shareholders of KPC, BP⁷⁰⁾ and Rio Tinto, suddenly in the mid of July 2003 transferred their entire ownership to PT Bumi Resources⁷¹⁾ (Bumi hereinafter) for US\$500 million, much cheaper (by 40%) than the divestment price for US\$822 million. They defended their move to sell their interest in KPC. BP Vice President in Indonesia, Nico Kanter argued that the greatly reduced price was due to the fact that the US\$412 million for 51% of the firm was a 2001 valuation, and circumstances had changed since then, particularly the price of coal (the international coal price Japan Benchmark in June 2003 was around US\$36/ton. The average annual price for 2001 was around US\$33/ton).

Rio Tinto defended the decision to sell its shares by saying it was a transaction to transfer the parent companies, not that of KPC.⁷²⁾ Yet, it would be clear that for the next 10 years Rio Tinto and BP would lose a projected profit of US\$1,202.03 million, or US\$601.01 million each.⁷³⁾ The move of KPC to allow losses for future income was a clear signal of its frustration⁷⁴⁾ with the overall situation surrounding the divestment process. In addition, Lex Graefe stated that “we were not happy with the slow (divestment) progress, and were not happy with a number of disputes . . . we would much rather that the divestment process was more straightforward, that there were not a lot of legal issues.”⁷⁵⁾

69) “Kaltim Prima Coal Dianggap Default” [*Bisnis Indonesia*, 2 June 2003]

70) BP controls interest in Indonesia for about US\$6 billion in various companies such as PT Petrokimia Nusantara, PT Amoco Mitsui Indonesia, PT Polytama Propindo, and now concentrated on Tangguh project in Papua, in January 2004 got verbal agreement to extend its contract in Terang Sirasun oil field in East Java. See “Investasi BP di Indonesia Mencapai US\$6 miliar” [*Bisnis Indonesia*, 26 January 2004]. As put by Satya Widha Yudha, BP Indonesia vice president for government and public affairs, the company took the view that coal mining was not BP’s core business. See “Govt Proves Sale KPC shares” [*Jakarta Post*, 23 July 2003].

71) Bumi Resources started as Bumi Modern in 1973 and became a major player in the hotel and tourism sector. In 1998, however, the company, citing adverse economic conditions, shifted its core business to oil, natural gas and mining. At the time of the transaction Bumi had only IDR3 trillion in assets with a liability amounting to IDR4 trillion. Bumi Resources is a listed company in the Jakarta Stock Exchange, which operates in the mining sector. Aburizal Bakri controlled 2% of shares, he is a prominent businessperson and political figure from Golkar. At the time of this research he followed Golkar’s convention for nominating a presidential candidate that would represent the party for the election in 2004. In 2001 Bumi acquired PT Arutmin, a coal company in East Kalimantan, worth IDR1.2 trillion by issuing bond and debt, in “Kembali ke Titik Nol” [*Tempo*, 3 August 2003: 132].

72) As said by Anang Rizkani Noor, spokesperson of Rio Tinto Indonesia. See “Bumi Pinjam Dana ke Bank Asing” [*Koran Tempo*, 23 July 2003].

73) Calculated based on projected profit by Salomon Smith Barney, Bahana Securities and KKEDS. The number is the mean.

74) This impression is derived from an interview with Anang Rizkani Noor, Deputy Director for Communication of Rio Tinto Indonesia, on 7 August 2003.

Other than the reason put forward by Rio Tinto, BP was the driving force behind the deal because it wanted to get rid of its last mine and concentrate on the liquefied natural gas (LNG) business. In the sale process, BP Vice President in Indonesia Nico Kanter stated that Bumi Resources approached BP in London with an offer to both owners of KPC. At the time BP had planned to sell its stakes in KPC and found no takers.⁷⁶⁾ In Indonesia BP already started to sell its investment since 2002. For example BP sold its shares in PT Petrokimia Nusantara that it bought from Soeharto's son Sigit Hardjojudanto to Sudwikatmono, Soeharto's relative in the early 2004. The main reason stated was that BP wanted to concentrate on new liquefied natural gas (LNG) project, and only maintain small proportion of shares in some companies such as Amoco Mitsui Indonesia,⁷⁷⁾ Polytama Propindo.⁷⁸⁾ The annual report of BP in 2003 only mentioned Tangguh project, LNG in West Papua.⁷⁹⁾ BP recognized that Indonesia is still the world's main producer of LNG, and the Tangguh project will reinforce this market-leading position.

The transfer of the ownership of KPC to Bumi was an exchange between Aburizal Bakrie,⁸⁰⁾ who owns 2.12%⁸¹⁾ shares in Bumi, and shareholders of KPC. Bumi got a US\$404 million loan to finance the purchase. Singapore's United Overseas Bank and Credit Suisse First Boston provided US\$318 million; Australia's Macquarie Bank Ltd. provided US\$46 million and Leighton Financial around US\$40 million.⁸²⁾ The possibilities for Bumi to get funds from international lenders were open as KPC has been a profitable business entity. More than that, Rio Tinto and BP had acted as guarantors for Bumi in order to obtain funds from international lenders.⁸³⁾ The shareholders of KPC stated that "Rio Tinto and BP will work with PT Bumi Resources to ensure a smooth transition of ownership and are ensuring that there will be no impact on service to customer."⁸⁴⁾

BP and Rio Tinto, by siding with Aburizal Bakrie, were hoping to get political protection in two forms. First, BP and Rio Tinto intended the sale of KPC itself to receive political protection from possible attacks from Suwarna. Secondly, they had been intending to receive political protection for their entire interests in the country over the long term. Total BP interest in Indonesia has been

75) Interview with Lex Graefe. See *Jakarta Post* [30 July 2003].

76) "Why BP Had to Wash Its Hands of Coalmining after Two Decades" [*Times*, 22 July 2003]

77) BP holds 45% together with Mitsui Chemical of Japan.

78) BP holds 10%, while Nissho Iwai of Japan 10%, and Tirtamas Majutama 80%.

79) BP, Record of Annual Result, London, February 2004, p. 7

80) He was a candidate in Golkar Party Convention for president for the election in 2004 and then defeated.

81) "Aburizal Bantu Bumi Beli KPC" [*Koran Tempo*, 25 July 2003]

82) "Bumi Gets US\$404 Loan to Close Deal" [*Jakarta Post*, 14 October 2003]

83) "Kembali ke Titik Nol" [*Tempo*, 3 August 2003: 132]

84) Press release of PT KPC 21 July 2003

US\$6 billion spread out in many projects. British Minister for Energy Brian Wilson, who visited Indonesia in November 2001, said that BP had committed a total of US\$11 billion in investments, with US\$1.9 billion in current capital to spend on Indonesian projects. Rio Tinto's operation in Indonesia accounted for 4% of its earning, approximately US\$60 million,⁸⁵⁾ and its investment accounted for US\$1.2 billion.

After selling its business interests in the country, BP concentrated on its newly established Tangguh⁸⁶⁾ project. BP had planned to invest US\$3-4 billion in developing the Tangguh liquefied natural gas (LNG) project in West Papua's Bintuni Bay.⁸⁷⁾ BP has already sunk some US\$600 million into the Tangguh project.⁸⁸⁾ It has been a big project, and BP needs assurance in terms of political protection for a quite long period, at least during the life of the contract and project for 30 years, from powerful businesspersons. In the Soeharto era, BP adopted a strategy of cultivating close ties with politically powerful personages. It moved closer to Soeharto's circle by befriending his son and other relatives.

Rio Tinto also had stakes that need protection. It was involved in various mining operations around the country, one of the most important assets being Freeport MacMoran in West Papua. In this company Rio Tinto had first encountered Aburizal Bakrie, when Freeport must divest the shares, and Aburizal bought them. Through this encounter they established mutual trust. When Rio Tinto, and also BP, wanted to have a local partner, they specified several requirements such as experience in coal operation, trustworthiness, and political power. Aburizal Bakrie met all these criteria. The future political standing of Aburizal Bakrie might be increasing with his move of settling himself as a presidential candidate and then joining the presidential convention in the Golkar party for election in 2004.

As already anticipated by BP and Rio Tinto, in the early September 2003 Suwarna went to Jakarta and met President Megawati to express his disappointment over the sale of KPC to Bumi. In this meeting the governor still insisted on the possibility of the province obtaining 31% shares as decided by the central government in July 2002.⁸⁹⁾ Yet, no conclusion was reached.

85) See Walhi [2003: 4].

86) LNG Tangguh is operated under a production sharing contract with Pertamina. Shareholders of Tangguh are: BP Plc (50%); Mitsubishi Corporation (16%); Nippon Oil (12%); British Gas (10.8%); Kanematsu Group (10%); and Nissho Iwai (1.1%), data from database of *Bisnis Indonesia*. The project initiated in 2002 and in 2006 is hoping to start production. It already had commitment with Fujian of China to supply 2.5 million ton LNG, 1 million ton to SK Power and POSCO for the next 20 years. See *Tabura Newsletter for Tangguh Project* [October 2003]. Tangguh would be the third LNG project in the country after Arun and Bontang.

87) "BP and the Tangguh Test" [*Inside Indonesia*, April-June 2002]

88) "BP in Indonesia — Sociologist Before Geologist?" [*Economist*, 29 June 2002]

89) "Setelah Kambing Makan Sapi" [*Tempo*, 14 September 2003: 138]

Before Governor Suwarna went to Jakarta, he issued a press release on 6 August 2003 stating that “our aim is one: divestment of 51% of KPC must be done.”⁹⁰⁾ Next week the governor asked whether this transfer of equity was valid without approval from the government of the Republic of Indonesia.⁹¹⁾ He went on to say that based on the Coal Contract KPC was only a contractor that obtained permit to mine through a mining authorization issued by the central government. He stated that “if the transfer of equity was valid without approval from the government of Indonesia, did it mean that foreign investors that granted a right from the government could freely sell its equity?”

The next day, Suwarna attacked KPC and Bumi. His point was to question whether or not the transaction between KPC and Bumi was a pure business deal without back room dealing or not.⁹²⁾ Suwarna went on to question whether the transfer of asset was correct, and why BP and Rio Tinto did not fulfill their obligation to divest KPC’s equities and sell them to the government. Did Bumi finish in divesting 51% of KPC’s equity? On 11 October 2003 Bumi completed the acquisition of KPC from BP and Rio Tinto by paying a total of US\$500 million, including the assumption of its debts.⁹³⁾ But Suwarna had faced a great loss when the newly appointed East Kutai regent Mahyudin⁹⁴⁾ entered a new agreement with Aburizal Bakrie through Bumi to divest 18.6%⁹⁵⁾ of KPC’s shares, which the regency was appointed to purchase at the price of US\$104 million.

Furthermore, Minister Purnomo was of the opinion that this transaction was valid.⁹⁶⁾ The House of Representative (DPR) was also of the opinion that the divestment of KPC was completed following the agreement on 18.6% shares to East Kutai regency.⁹⁷⁾ In January of the following year 2004 the East Kutai regency government obtained a loan worth US\$25 million to purchase the equity of KPC,⁹⁸⁾ while an additional loan was still in the negotiation process between the regency

90) Press release of East Kalimantan Government [*Media Indonesia*, 6 August 2003]

91) Press release of East Kalimantan Government [*Media Indonesia*, 12 August 2003]

92) Press release of East Kalimantan Government [*Sinar Harapan*, 13 August 2003]

93) “Bumi Resources Concludes Purchase of KPC” [*Jakarta Post*, 11 October 2003]. Since then Bumi became the owner of KPC, and Edie S Hudaja appointed as president director of KPC replaced Noke Kiroyan.

94) Mahyudin was born in Tanjung, South Kalimantan on 8 June 1970, and graduated from the Engineering Faculty of Lambung Mangkurat University in Banjarmasin. He was the deputy regent of East Kutai since 2001 to 2003. He replaced Awang Faroek Ishak in May 2003 when Faroek decided to compete for the East Kalimantan governorship, which meant he had to resign from his position as the regent of East Kutai. Mahyudin is chairperson of Golkar branch in East Kutai. Since he is from Golkar, therefore there was a possibility that he would side with Aburizal Bakrie.

95) This number is calculated from 60% out of 31% of KPC’s shares because the rest 20% is nominated to PTBA.

96) “Pemerintah Setujui Penjualan 18.6% Saham KPC ke Kutim” [*Bisnis Indonesia*, 18 October 2003]

97) “Long Haul Sells Shares of PT Bumi” [*Bisnis Indonesia*, 11 December 2003]

98) “East Kutai Obtains Loan from the US to Buy KPC’s Shares” [*Bisnis Indonesia*, 15 January 2004]

and an England-based financier. With this event, the governor lost his battle in trying to control KPC shares.

VII Conclusion

On decentralization in East Kalimantan, scholars have argued that “tremendous opportunities present themselves by independently replicating at the local level the old centralized relationships between the state and capital” [Hadiz and Robison 2003: 13]. Their general conclusion may provide some truths like the predatory political and economic regime, yet their stories are far from accurate when mentioning that political economy in the region is simply a replication of what is happening in the center. First, they assume that the provincial elites can stand alone to oppose the central government. Second, they assume that the political process in the province can be insulated from political dynamics in the center. Third, the logical implication of their argument leads to the conclusion that the provincial elite should control economic resources in the region autonomously without political support from powerful politicians in Jakarta. Considering the process of divestment of KPC, it was not the case.

The argument running through this paper has been that the post Soeharto period of 1998–2003 has been a time of crucial change in Indonesia’s political and economic history, during which a new pattern of politics has begun to take form. As the New Order’s grip on the political system collapsed, this new pattern of politics was characterized by interconnectedness between the center and the region through a network of politicians and their converging interests. Governor Suwarna was able to establish a multi-layered network involving politicians in Jakarta of various fronts down to much lower local elites in the regency level. Suwarna heavily depended on such networks to boost his political bargaining. The interconnection also reflected the increasing importance of politics at the provincial level in relation to both Jakarta and other regencies and cities in the province. Even though Suwarna was able to construct political networks, he met with little success controlling KPC. At the provincial level, the strengths of Suwarna’s power were reduced when Mahyudin — the newly appointed regent of East Kutai — sided with Aburizal Bakrie, after KPC was bought by Bumi, his company. However, this study points out his enormous efforts to create networks to advance his economic interests.

Another character of this new pattern should be Suwarna’s source of power in form of mining operations in Kutai regency. Suwarna was able to translate the mining sites into power, which he used to bargain with the central government and the multinational companies. In the New Order a

mining site was the source of power for Soeharto to bargain with foreign investors, especially if they already invested heavily in the extractive sector of the country. Since the collapse of New Order, Suwarna learned that the mining site is in his administrative region; therefore, according to him, he also could use it to bargain to both the central government and the foreign investors. While Jakarta legally is the owner of the mine, Suwarna thought he, or his province, must also have right over it; therefore he strongly demanded a portion of shares in the KPC.

Faced with the twin challenges of the rise of provincial elites and the vulnerability of the political and economic structure, KPC strategically employed a classical method of forming an alliance with politicians. Logically, the foreign investors tended to seek a political protection for their overall investment in the country, especially in the long run. For sure, the chance for Rio Tinto and BP to withdraw from the country was very unlikely because they have massive investments in the extractive sectors such as LNG in Papua. Because the introduction of decentralization policies and political parties allowed political parties to become important players, KPC tended to side with businesspersons who were politically connected to relatively strong political parties. A businessperson, such as Aburizal Bakrie who is strongly connected to Golkar, could offer political protection to shareholders of KPC. Here, political parties replaced the role of Soeharto as the one that could offer viable protection over the long haul.

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