

Cabotage in Indonesia



Nicholas Mavrias
Senior Claims Executive
+65 6506 2802
nicholas.mavrias@ctplc.com

Implemented in order to vitalise fledgling local shipping industries, cabotage laws in South-East Asia were passed to regulate shipping along coastal routes and restrict the operation of ships between sea ports within a particular country. In Indonesia, this has had a particular effect on the offshore industry.



Devandran Karunakaran, Partner
Ince & Co Singapore LLP
+65 6305 6966
devandran.karunakaran@incelaw.com

Cabotage in South-East Asia

Laws to restrict the operation of ships between South-East Asian ports were introduced to promote the development of domestic marine industries with the ultimate aim that the indigenous industry might one day compete against its foreign counterparts on a level playing field. The legislation was met with varying degrees of success and today boasts companies which are challenging their more prominent and historical competitors on the international stage. Invariably, cabotage legislation has had significant effects in the offshore industry as well, as projects and contracts have taken on increasing local content, and offshore players have had to consider the impact of this legislation, both financially and logistically, on their operations.

Cabotage in Indonesia

Under Indonesian cabotage laws, all vessels operating in Indonesian waters have to fly the Indonesian flag and be manned by Indonesian crew. Indonesian-flagged vessels have to be owned by entities whose shareholding structure must satisfy 'local content' requirements (essentially, such entities have to be at least 51% Indonesian owned). As such, a foreign owner would have to relinquish majority ownership of the asset to its Indonesian counterparty. There are, however, legal structures which can be put in place to protect a foreign owner's interest.

Global oil prices

With the dramatic fall in oil prices, a great number of oil and gas offshore projects have been shelved indefinitely. There has been a virtual cessation in drilling operations in Malaysia, and the outlook is equally bleak in the rest of South-East Asia. While measures are being undertaken to make major producers freeze output in order for prices to rise, the fact that players such as Iran have come back into the fold has exacerbated the global oversupply.

The effect on Indonesian cabotage

Against this backdrop of depressed oil prices, the Indonesian government has created an exemption to the cabotage restrictions for ships engaged in offshore drilling activities (namely, jack-up rigs, semi-submersibles, deep-water drillships, tender-assist ships and swamp barges) to allow foreign-flagged ships to operate.

It is commonly understood, however, that the intention of the Indonesian Government is to end this exemption on 31 December 2016. If the exemption is ended, foreign-flagged rigs currently operating in Indonesia will have to either be sold internally to Indonesian interests or be forced to discontinue activities and leave Indonesia. Should the rig re-enter Indonesia, once reflagged, it could face significant import taxes.

Cabotage in Indonesia continued

An uncertain future

As a result of the uncertainty, many shipowners have begun engaging law firms to advise on the consequent complicated procedures and legal work to be undertaken should the period of exemption expire as scheduled on 31 December, without any extension allowed. Ince & Co, for example, has advised a number of clients in the sector that in spite of the current exemption, owners should consider commencing the process of conforming with Indonesian cabotage laws now and reflag their rigs in favour of the Indonesian flag. If not, owners face the risk of logistical and financial fall-out should the exemption lapse on 31 December 2016.

As part of this process, owners should conduct due diligence on their prospective Indonesian counterparties in order to ensure they are trustworthy, financially secure organisations that will not overtake the operations

of the company, while essentially receiving a majority stake in the asset. In addition, in so far as these expensive assets are almost always financed through debt financing, the consent of the owner's bank will usually have to be sought in order to fly the Indonesian flag; otherwise, such a reflagging could contravene the financing arrangements or requirements imposed by the bank(s).

Further advice

Owners are encouraged to adopt a proactive approach in the circumstances as it may take, at the very least, between two to four months for a joint venture to be concluded and an Indonesian shipowning entity to be set up.

As for developments in cabotage policy within the region, members may contact the authors to receive up-to-date information on developments.

