

## **Compatible Concept of Contract Law with Oil and Gas Production Sharing Contract in Indonesia**

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**Abstract:** The practice of Gross Split and Cost Recovery contracts for oil and gas production sharing results in inconsistency in the concept of oil and gas production sharing contract. This inconsistency will contribute to inability to reach the natural resource management as mandated by the fourth paragraph of the preamble of the 1945 Constitution, related to Article 33, point (3) of the 1945 Constitution, related to Article 1 and 2 of the Agrarian Law, related to Article 4 of oil and gas law, related to Article 25 in point (1) of Government Regulation No 55 of 2009. The regulations for oil and gas production sharing contract which is public and private have not been integrated into one guideline, and thus private, and public laws are often used as the guideline. Based on the comparison of the two types of oil and gas production sharing contracts, Gross Split contract might degrade the principle of ownership by the state in managing oil and gas compared to Cost Recovery contract. This disadvantage is evident from the lack of government role in supervising and monitoring the management of oil and gas, and this lacking government role can reduce the chain effect of the national economy.

**Keywords:** contract, oil and gas production sharing contract, Gross Split and Cost Recovery contracts

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### **I. INTRODUCTION**

Indonesia as one of the countries with the largest oil and gas potential in the world has proven and potential oil reserves of 3,305.7 MMstb (Million Standard Tank Barrel) and proven and potential natural gas reserves of 3,331.15 TSCF (Trillion Standard Cubic Feet), therefore Oil and Gas has become Indonesia's most important export commodity since the 1970s, even before 2006, Indonesia had become the world's largest exporter of LNG (Liquified Natural Gas) for almost three decades (Nugroho, 2011: 14). However, in 2012 oil lifting realization tended to decline with lifting only 898.5 thousand barrels on average per day. This condition has produced negative sentiment not only on state revenues but also on Indonesia's energy security program (Rosdiana, 2015: 342).

The increase and decrease in oil and gas production in Indonesia is inseparable from the policies and regulations implemented by the state through the Government both through legislation in general and contracts that specifically bind the Government with Oil and Gas investors. In Indonesia, the regulation on Oil and Gas is regulated in Law Number 22 of 2001 concerning Oil and Gas (Oil and Gas Law). Implementation of Production Sharing Contracts is a translation of the Production Sharing Contract (PSC), hereinafter using the term Production Sharing Contracts, is a form of cooperation contract that has been the basic concept of oil and gas management in Indonesia which focuses on the maximum benefit for the country and the results are used for the greatest prosperity of the people (Pudyantoro, 2012: 139).

The definition of Production Sharing Contracts is regulated by Article 1 Number 12 Government Regulation Number 27 of 2017 concerning Amendment to Government Regulation Number 79 of 2010 concerning Refundable Operating Costs and Treatment of Income Taxes in the Upstream Oil and Gas Business Field (PP concerning Cost Recovery) that is, "Production Sharing Contract is a form of Cooperation Contract in Upstream Business Activities based on the principle of sharing production."

Initially the technical concept of Production Sharing Contracts was regulated in the PP on Cost Recovery, this provision was one of the implementing regulations of the Oil and Gas Law. Then on August 29, 2017 the Government of Indonesia promulgated Regulation of the Minister of Energy and Mineral Resources Number 52 of 2017 concerning Amendment to the Regulation of the Minister of Energy and Mineral Resources

Number 08 of 2017 concerning Gross Split Production Sharing Contracts (ESDM Ministerial Regulation on Gross Split). With the enactment of the ESDM Ministerial Regulation on Gross Split, the current concept of Oil and Gas Production Sharing Contracts in Indonesia can be implemented in 2 (two) forms, namely the concept of Cost Recovery or Gross Split.

Cost Recovery Revenue Sharing Contracts are demonstrated by the return of costs that are the responsibility of the Government based on the Work Plan and Budget which must be approved in advance by the Special Task Force for Upstream Oil and Gas Business Activities (SKK Migas) in accordance with the details stipulated in the Minister of Energy Regulation and Mineral Resources No. 22/2008 concerning Types of Costs for Upstream Oil and Gas Business Activities (ESDM Ministerial Regulation on Cost Recovery).

Another characteristic possessed by the concept of Cost Recovery is the existence of First Tranche Petroleum (FTP) or taking the first oil and gas production as a security of state revenue. So that this FTP directly has a function as a government control tool in relation to the amount of state revenue from the oil and gas sector and cost recovery issued (Umaruddin, 2010: 9). In contrast to Cost Recovery, Gross Split Production Sharing Contracts are based on the principle of distributing gross production without a mechanism of returning operating costs. The main characteristic that distinguishes between Cost Recovery Production Sharing Contracts with Gross Split is clearly seen in the presence or absence of state returns on operational costs that were first incurred by the Cooperation Contract Contractor (KKKS) and abolished the FTP system which should be a source of state revenue in the Oil and Gas sector if at any time KKKS no longer invests in Indonesia.

With the implementation of the Gross Split Production Sharing Contract in the implementation of the Oil Sharing Production Contract, there is an inconsistency of the Government in making regulations in the Oil and Gas sector for the purpose of managing Oil and Gas itself, this can be seen from the reduction in the percentage of production sharing, which is the basic split (base split) for state revenue in the oil sector reduced from 85% (eighty five) percent to 57% (fifty seven) percent and the KKKS share increased from 15% (fifteen) percent to 43% (forty three) percent, for Gas income the state has decreased from 70% (seventy) percent to 52% (fifty two) percent and the share of KKKS has increased from 30% (thirty) percent to 48% (forty eight). The reduction in the percentage of profit sharing explicitly shows a decrease in state revenue in the oil and gas sector.

Based on the ESDM Ministerial Regulation on Gross Split, in addition to reducing the basic percentage of oil and gas revenue sharing received by the state, the share of oil and gas revenue sharing can also be adjusted based on variable components and progressive components. This further shows that the Production Sharing Contract with the concept of Gross Split has legal inconsistencies as the purpose of establishing a contract between the Government of Indonesia and KKKS.

## **II. PROBLEMS IDENTIFICATION**

Based on the introduction above, problem identification is limited to several things, which are as follows: (1) How is the mechanism for the preparation of Oil and Gas Production Sharing Contracts?, and (2) How the Oil and Gas Production Sharing Contract Dispute Resolution Mechanism?

## **III. OBJECTIVE OF THE RESEARCH**

The objective of this research was to describe the mechanism for the preparation of Oil and Gas Production Sharing Contracts and the concept of contract law in Indonesia implemented in oil and gas production sharing contract

## **IV. RESEARCH METHODS**

This research was a normative law research study with legal approach, comparison, and philosophy, with prescriptive analysis. The technique adopted for the current research was library research of primary, secondary, and tertiary documents.

## **V. CONCEPTUAL FRAMEWORK**

In normative legal research, the preparation of conceptual frameworks is absolutely necessary as a framework used to formulate the problems that form the basis of research (Amiruddin Asikin, 2004: 119). Therefore, as a basis for the conceptual framework in this study are as follows:

### **5.1 Contract Legal Arrangements in Indonesia**

Indonesia is a follower of the continental European legal system inherited from the Netherlands. Written law is typical of continental Europe, where an action can be punished if there is a law or written law in advance. In contrast to the Anglo-Saxon legal system that uses the rule of law derived from judges in court, therefore the continental European system is very thick with an element of legal certainty (Suwardi Sagama, 2016: 28). The legal certainty to be achieved by the parties conducting legal relations is a consequence of the

emergence of the contract. This is regulated in Article 1338 of the Civil Code, i.e. "all agreements made in accordance with the law apply as the law for those who make them. The agreement cannot be withdrawn other than by agreement of the two parties, or for reasons determined by law."

The definition of contract in the Indonesian legal system is regulated in Article 1313 of the Civil Code, which is: "an act by which one or more persons commit themselves to one or more other people" (Muljadi and Widjaja, 2010: 59). Furthermore, in Article 1233, the contract is the source of the engagement, in which each engagement can be born from agreements or agreements or laws. In general, the Civil Code through Article 1320 regulates the legal conditions of a contract, namely: (1) There is agreement between the two parties; (2) The ability to carry out legal actions; (3) The existence of objects; and (4) The existence of lawful causes.

The classification of types of contracts in Indonesia in addition to the contracts stipulated in the Civil Code *nominaat* (named contract) are also known to be a variety of contracts that cannot be found in the Civil Code. Forms of contracts that are not found in the Civil Code are categorized into *innominaat* contracts (anonymous contracts), ie contracts that arise, grow, and develop in the community after the Civil Code (Muljadi and Widjaja, 2010: 83). Examples of forms of *innominaat* contracts are Franchise Contracts, Leasing, and Oil and Gas Production Sharing Contracts.

## **5.2 The concept of Oil and Gas Production Sharing Contracts in Indonesia**

The Production Sharing Contract Agreement between the Government of Indonesia and the KKKS is a civil contract that contains a public element (Government to Business) but is still implemented with a Business to Business mechanism, because the Government of Indonesia in this case requires a business entity that is a representation or an arm of the state in entering into business contracts with KKKS (Maulana Arba, 2016: 7). The business contract between the Government and the KKKS does not necessarily become a means for KKKS to transfer oil and gas ownership from the Government to the KKKS, because the Oil and Gas Production Sharing Contract that is implemented is only a legal relationship that confirms the position of the KKKS as the Government's partner in helping manage Oil and Gas. In addition, the presence of KKKS, especially in the form of Foreign Investment (PMA), is expected to increase the competitiveness of the Indonesian economy as a developing country (Saru Arifin, 2017: 11).

The definition of Oil and Gas Production Sharing Contracts is regulated by Article 1 Number 12 Government Regulation Number 27 of 2017 concerning Amendment to Government Regulation Number 79 of 2010 concerning Refundable Operating Costs and Treatment of Income Tax in the Upstream Oil and Gas Business Sector (PP concerning Cost Recovery), i.e. "Production Sharing Contract is a form of Cooperation Contract in Upstream Business Activities based on the principle of production sharing."

This definition is further elaborated by Soedjono Dirdjosisworo in Salim HS (2008:38) as follows: "Production Sharing Contracts are cooperation with the profit sharing system between a State Company and a contracted foreign company. If the contract has expired, the machines brought by foreign parties will remain in Indonesia. Cooperation in this form is a foreign credit in which the payment is made by sharing the production of the company."

Oil and Gas Production Sharing Contracts currently being implemented in Indonesia can be implemented in two concepts, namely the Gross Split concept and the Cost Recovery concept. The understanding of the two concepts is described as follows: The Gross Split Production Sharing Contract is a production sharing contract in the upstream Oil and Gas business activities based on the principle of gross production distribution without a mechanism of returning operating costs. While the definition of Cost Recovery Revenue Sharing Contracts are contracts that are oriented towards returning costs paid by the Government to contractors as reimbursement of production and investment costs during the exploration, exploitation and development of oil and gas blocks that are being carried out within the territory of a country.

Oil and Gas Production Sharing Contracts in Indonesia, both in the concept of Gross Split and Cost Recovery, are implemented by SKK Migas with Business Entities or Permanent Establishments as regulated by Article 6 paragraph (1) juncto Article 11 paragraph (1) of the Oil and Gas Law in conjunction with Article 24 paragraph (1) PP Migas which at least contains the following requirements: (1) Ownership of natural resources remains in the hands of the government until the point of delivery; (2) Operations management control is at SKK Migas; (3) All capital and risks are borne by the Business Entity or Permanent Establishment; (4) The Minister of Energy and Mineral Resources establishes the forms and main provisions of the contract; (5) KKKS through SKK Migas can propose to the Minister of Energy and Mineral Resources a change in contract terms and conditions; and (6) Other Technical and General Provisions as general clauses in an agreement.

The main provisions or clauses that must be regulated in an Oil and Gas Production Sharing Contract based on Article 26 of the Oil and Gas PP are: (1) state revenue; (2) Work Areas and returns; (3) obligation to release funds, (4) transfer of ownership of production results from Oil and Gas; (5) the period and conditions of contract extension; (6) dispute resolution; (7) oil and gas supply obligations for domestic needs; (8) contract termination; (9) post-mining mining obligations; (10) occupational safety and health; (11) environmental

management; (12) the transfer of rights and obligations; (13) required reporting; (14) field development plans; (15) prioritizing the use of domestic goods and services; (16) the development of the surrounding community and the guarantee of the rights of indigenous peoples; and (17) prioritizing the use of Indonesian workers.

For the period of Oil and Gas Production Sharing Contract, it can be given for a maximum period of 30 (thirty) years and can be extended with an extension period of no longer than 20 (twenty) years for each extension, but the provisions do not specify how many times the extension is extended can be done (Pudyantoro, 2012:202). Based on the Oil and Gas Law, after the effective signing of the Oil and Gas Production Sharing Contract, within a period of 180 (one hundred and eighty) days, the KKKS must start their activities. Oil and Gas Production Sharing Contracts, both those involving Indonesian legal entities and those involving foreign parties are usually included aspects of dispute resolution, this is one of the objectives of the preparation of a contract between the parties, namely to guarantee actions that might arise in the future such as disputes (Simatupang, 1996:41).

Settlement of disputes over Oil and Gas Production Sharing Contracts, both in the Oil and Gas Law and PP Migas, is not found in the article governing dispute resolution in the event of a dispute between SKK Migas with a business entity and / or permanent establishment. In practice the dispute resolution clause is set forth in the Production Sharing Contract based on the agreement of the parties. In the event of a dispute between SKK Migas and the KKKS in the form of an Indonesian legal entity, the law used is Indonesian law because both parties are legal entities established under Indonesian law and they are subject to Indonesian law.

Disputes that if later occur between KKKS in the form of permanent businesses and SKK Migas, use the rules in the International Chamber of Commerce (ICC) because the permanent establishment is a foreign company operating in Indonesia. From this, the dispute resolution used by the parties in the Production Sharing Contract for Oil and Gas business activities refers to Law Number 30 of 1999 concerning Arbitration and Alternative Dispute Resolution (Muryati, 2013: 51).

## **VI. THEORETICAL FRAMEWORK**

The theoretical framework referred to in this paper is the theoretical thinking used in analyzing the problem being studied. The existence of a theoretical framework is absolute in research activities as a basis for argumentation and theoretical basic support in the framework of problem solving approaches that are faced or which are the object of research. In order to examine the problems in this study, the writer needs to analyze the problem using several theories as follows:

### **6.1 Commercial Contract Theory**

The legal certainty to be achieved by the parties conducting legal relations is a consequence of the emergence of the contract. This is regulated in Article 1338 of the Civil Code, i.e. "all agreements made in accordance with the law apply as the law for those who make them (*pacta sunt servanda*). The agreement cannot be withdrawn other than by agreement of the two parties, or for reasons determined by law." In law, there are various theories known, each of which tries to explain aspects of the contract. From various theories that explain aspects of the contract, there are theories relating to commercial contracts where the State has control of natural resources, namely: (1) underlying presuppositions, (2) legal liability, and (3) liberal theory.

The three contract theories above when implemented in a contract so that the contract is legally binding and legally enforceable requires certain conditions, namely the so-called contractual capacity or ability to agree, the intention is that the parties making an agreement in a contract must have legal ability ( legal capacity) to commit themselves to contracts and be able to enforce any promises made to them. Legal ability here is defined as the ability to understand the nature and impact of one's actions (Fuady, 2001: 5).

An immature person is deemed not to have the ability to understand the consequences of a legal action and therefore the law is declared incapable of taking legal action or does not have legal capacity. Whereas for legal capacity, a legal entity for a limited liability company will be fulfilled if the establishment deed has been registered with the Minister of Law and Human Rights and published in the state gazette and additional state gazette.

In addition to the requirements regarding the subject matter, contract law also regulates the requirements concerning objects. The object of the contract is a "thing" that can be traded freely and is not prohibited by the provisions and / or decency. "Things" here is intended more to matter matter. In its development, the object of the contract is not only about objects, but also services that are regulated in legal provisions outside the Civil Code (Article 1601 of the Civil Code). The second objective condition is that the promised "thing" is not prohibited by law, is not contrary to decency, and does not violate public order, known as a *halal cause* (Article 1337 of the Civil Code).

The classification of types of contracts in Indonesia in addition to the contracts stipulated in the Civil Code *nominaat* (named contract) are also known to be a variety of contracts that cannot be found in the Civil Code (Muljadi and Widjaja, 2010:83). Forms of contracts that are not found in the Civil Code are categorized into

innominate contracts (anonymous contracts), ie contracts that arise, grow, and develop in the community after the Civil Code (Salim, 2008:18). Examples of forms of innominate contracts are Franchise Contracts, Leasing, and Oil and Gas Production Sharing Contracts.

In the business or commercial world, contracts have an important role in business transactions that are not limited only to cross regions but also transnational as well as Oil and Gas Production Sharing Contracts. Such transactions are usually contained in contract documents (Adolf, 2008:3). The contracts that arise from these business transactions are growing in shape because they were born and developed from various kinds of agreements between the parties.

Oil and Gas Production Sharing Contracts regulated by the Oil and Gas Law are written contracts with terms and conditions contained in Indonesia. As has been stated in Article 1319 of the Civil Code which states that all contracts, whether they have a special name or are not known by a certain name, are subject to general regulations (Tri Utomo, 2016), therefore, in addition to being subject to statutory provisions in the oil and gas sector Oil and Gas Production Sharing Contracts are also subject to general regulations such as the Civil Code.

Sornarajah in Huala Adolf (2008:3) categorizes Oil and Gas Production Sharing Contracts into economic development contracts or state contracts because the form of the contract contains the characteristics: (1) a long period of time, 25 (twenty five) to 70 (seventy) year; (2) the contract value is quite large; (3) the object of the contract is not solely for profit, but has a purpose for social purposes; (4) the object of the contract is subject to government monopoly; (5) applicable and selected law is the national law of the host country; (6) the existence of administrative requirements that are public; and (7) the object concerns the interests of the people.

Mariam Darus Badruzaman (2001: 69) categorizes contracts between the Government and business entities or permanent establishments such as Oil and Gas Production Sharing Contracts as public contracts because some of these contracts are controlled by public law such as legal subjects, one of which is the Government. Government involvement in a contractual relationship such as Oil and Gas Production Sharing Contract is different from commercial contracts in general, this is because the legal relationship that is established is not only limited to the form of private legal relations, but also the public. Government involvement in Oil and Gas Production Sharing Contracts shows that the government's actions are classified in governmental actions that are civil in nature.

With regard to civil legal action in the administration of government affairs, Philipus M. Hadjon (2002:167) stated that: "Even though civil legal action for government affairs by state administrative bodies or officials is possible, it is not impossible that various public law provisions (state administrative law) will infiltrate and influence civil law regulations. For example, several statutory provisions that specifically regulate certain procedures or procedures that must be taken in connection with civil law enforcement efforts carried out by state administrative bodies or officials."

Blonberger in Sanusi Bintang (2016: 852), states that the enactment of public law and private law on contracts occur simultaneously, which are complementary and not in conflict with each other. Thus the two kinds of law intersect, but still show the characteristics of each. The difference between contracts in general and public contracts (*publiekrechtelijke overeenkomst*) is not very clear. Furthermore, according to Herlien Budiono, the difference is relative, because basically all the provisions of civil contracts apply to public contracts. This means that a public legal entity can use private legal instruments, and be bound by all related rights and obligations, except in cases that are prohibited by statutory regulations.

The existence of a public element in the Oil and Gas Production Sharing Contract is inseparable from social interests as the purpose of the management of Oil and Gas itself so that sometimes the meaning of the balance in the contract shifts. According to Mariam Darus Badruzaman (in Hernoko, 2013: 79), the principle of balance has a meaning as a balance of the position of the parties who carry out the contract, therefore, in the event of an imbalance in position that causes disruption to the substance of the contract, intervention from certain authorized parties such as the Government is needed.

Unbalanced position between the subject of the Contract for Oil and Gas Rights, separated by experts based on the status of the country as a sovereign state (*jurio imperii*) and the status of a country that commits commercial action (*juryi gestionis*). Based on the principle of *juryi gestionis*, the state is deemed to have renounced its sovereignty in relation to state actions in business, this is done so that the position of the parties in commercial contracts can be in a balanced position (the principle of equality of the parties) (Adolf, 2008:56), but the balance here is not only seen from the context a balance that can be calculated, but also in the process and mechanism for the exchange of rights and obligations that takes place fairly (Hernoko, 2013: 84).

In order to create a balance and maintain the rights possessed by the parties before the contract made into a binding agreement for the parties, the Civil Code as a national law has set general principles which are guidelines that become guidelines in regulating and forming a contract that is applies to the parties. These principles include the principle of personality, the principle of consensuality, the principle of freedom of

contract, the principle of balance, the principle of propriety, the principle of good faith, and the principle of *pacta sunt servanda* (the contract applies as a law)(Hernoko,2013:107).

## **6.2 Concession Theory**

The economic development of a developing country like Indonesia is inseparable from the establishment of relations of foreign cooperation with other countries. In the case of oil and gas resource management cooperation, one of the initial forms of contractual relations between the Government of Indonesia (formerly the Dutch East Indies) and the oil and gas manager is the Concession system. The legal basis for the implementation of the concession system in Indonesia is based on *Indische Mijn Wet* in *Staatblad* No. 124, 1899 was further amended in 1910 which was then followed by the *Wet Ordonantie* (*Staatblad* No. 38, 1930) which was the legal basis for all forms of mining activities in Indonesia at that time(Simamora, 2000: 82).

Huala Adolf (2008:131) defines the concession agreement:"... is an agreement that permits a foreign entity to enter the country in which the resources are located and, generally for royalty payments and other remuneration to the host government, permits the company to remove the resources and sell the elsewhere."Free explanation of the definition of concession according to Huala Adolf is an agreement between the Government that gives permission to a foreign entity (company) to enter the country where the resources are located and in general will be paid royalties and other benefits to the Government, and allow the company to take the source southwest and sell it elsewhere.

Howard R. Williams and Charles J. Meyer(1994:196) in the *Manual of Oil and Gas Terms* provide the following definition of concessions:"An agreement (usually from a host government) permitting a foreign petroleum company to prospect for and produce oil in the subject area to the agreement. The terms ordinarily include a time limitation and a provision for royalties to be paid to the government. "Free explanation of the definition of the concession according to Williams and Meyer above is an agreement (usually from the host government) that allows foreign oil companies to find and produce oil in the area in accordance with the agreement. The requirements usually include a time limit and royalty terms that companies must pay to the Government.

R. Subekti and R. Tjitrosudibio(1969:30) defines the concession as a permit from the government to open land and run a business on it, open a road, mine and so on. R. Subekti's understanding is also related to state authority in terms of the right to control the state contained in Article 33 paragraph (2) and (3) of the 1945 Constitution in conjunction with Articles 1 and 2 of the LoGA which constitutes the legal basis for managing the Indonesian economy(Fuady, 2002:173).

Prajudi Atmosudirjo(1988:98)defines the concession as a state administration determination which is legally very complex because it is a set of dispensations, licenses, licenses accompanied by granting limited government authority to the concessionaire.According to H. D. van Wijk(inRidwan, 2008:205), the concession system is generally used for management related to public interests that cannot be carried out by the government alone either for economic reasons or human resources, so the management is left to the private sector.

Concessions granted by the Government of Indonesia to private parties such as foreign companies were initially granted for a long period of time and were exclusive (Hasan, 2009: 28), because the management company was given extensive authority to exploit resources in full, in this case the country as the concession giver would receive benefits including but not limited to royalties, bonuses and taxes(Simamora, 2000:55).Concession rights are then seen as a legal relationship which is detrimental to the state because the management company is only profit oriented, therefore the UN General Assembly through the "Declaration on the Establishment of a New International Economic Order" and Resolution 3202 (S-VI) concerning the "Program of Action on the Establishment of a New International Economic Order "then ratifies the Charter of Economic Rights and Duties of States, one of which stipulates that the state has full permanent sovereignty rights over all assets , natural wealth, and economic activities.

With the adoption of the renewed Concession concept, the management company is bound to more complex obligations other than natural resource management itself, such as social responsibility obligations, supervision, use of local workforce and work program accountability. Another feature of the updated concession concept is greater state profits, both directly through the amount of royalties and from government participation through participating interests(Adolf, 2008: 132-133).The basic difference between the initial concession system and the renewed concession system, namely the existence of contractual relationships that are subject to the provisions of the state or government body, therefore the authority of the management company is no longer as large as the initial concession concept(Simamora, 2000:56).

Based on the explanation above, the main characteristics of the concession system are: (1) KKKS will act as operator as well as being responsible for operations management; (2) The ownership of oil and gas produced is in the hands of KKKS; (3) Ownership of assets is in the hands of KKKS with certain restrictions; (4) The state gets a share of royalty payments; and (5) Income tax is levied on net profits(Simamora, 2000:58).

Currently the concession system is the most widely used Oil and Gas management system in the world, which is approximately 57 (fifty seven) countries (Hasan, 2009:53). These countries include the United States, the United Kingdom, Australia, Dubai, Brunei Darussalam and Canada. The number of oil and gas producing countries that use the concession system does not necessarily make this system the best system among other oil and gas management systems. The concession system still has weaknesses, namely the lack of state involvement in management including the use of domestic component levels and the ability to determine the selling price and availability of domestic oil.

## **VII. RESEARCH RESULTS**

### **7.1 Mechanism for the Formulation of Oil and Gas Production Sharing Contracts**

Oil and Gas Production Sharing Contracts compiled by the government with the KKKS begin with an offer of a Work Area by the Minister of Energy and Mineral Resources to business entities or Permanent Establishments (BUT). This offer can be made through an auction stage or direct appointment to a business entity or permanent establishment. In contract theory, these two stages are in the pre-contractual stage, where the parties have not been legally bound in the contract. This pre-contractual stage is a stage for the government to be able to get a contractor who has qualifications in terms of both financial and expertise as a manager of upstream business activities on the Work Area offered (Rahayu, 2017:338).

The existence of this auction process will result in the emergence of competition from bidders to get the KKS on the WK offered in which are prone to illegal actions such as conspiracy. Therefore, special attention is needed regarding legal principles which should be carried out in an auction as an entry point for the upstream oil and gas activities (Rahayu, 2017:338). According to regulations regarding procurement, government contracts should be given to bidders who provide the 'best value' to the government. Determination is based on cost and non-cost factors such as technical excellence, management capability, and professional experience (Berrios, 2006:120).

WK auction participants who have submitted participation documents are required to submit a bid bond (bid guarantee) which aims to avoid participants withdrawing from the auction that is being followed. The required collateral is a guarantee stating the bank's ability to guarantee and provide funding in the amount of 100% (one hundred percent) of the value of the signature bonus offer.

The winner of the auction will receive a Cooperation Contract, where the contract in upstream oil and gas activities is a type of commercial contract based on commercial criteria related to the discovery of oil and gas reserves and exploitation that meets the standard, which is potential enough to generate large profits from the production of upstream business activities. Government involvement in Oil and Gas Production Sharing Contracts will affect justice for the nation and state, therefore its implementation must be based on the philosophy of the implementation of Oil and Gas Production Sharing Contracts that are supported by strong legal principles so that they can be realized dogmatically in regulations on oil and gas resources that are managed with a Cooperation Contract in particular with the profit sharing system.

Oil and gas revenue sharing contracts are signed by SKK Migas and KKKS as the parties. Things that are different from contracts in general, besides being signed by the parties, the Oil and Gas Production Sharing Contract is also signed by the Minister of Energy and Mineral Resources on behalf of the Government of Indonesia. Article 11 of the Oil and Gas Law regulates that every Cooperation Contract that has been signed must be notified in writing to the House of Representatives of the Republic of Indonesia by sending a copy of the contract to the House of Representatives Commission of the Republic of Indonesia in charge of Oil and Gas as a form of ratification and a form of confirmation of state control.

The form of Oil and Gas Production Sharing Contract shall be made in written form between SKK Migas and the winning bidder KKKS. The contract can be made in both bilingual and bilingual forms according to where the parties come from or in accordance with mutual agreement. As stipulated in Article Article 37 Paragraph (1) of Oil and Gas PP, Oil and Gas Production Sharing Contract shall be made in Indonesian and / or English, afterwards Paragraph (2) regulates if the Cooperation Contract is made in Indonesian and English, in the event of a difference in interpretation then what is used is interpretation in Indonesian or English according to the agreement of the parties.

These provisions are in addition to being a form of freedom of contract as well as the implementation of the provisions of Article 31 of Law Number 24 of 2009 concerning Flags, Languages, and National Emblems, as well as National Anthems. The sound of the provisions of the Article is as follows: Paragraph (1) "Indonesian must be used in a memorandum of understanding or agreement involving state institutions, government agencies of the Republic of Indonesia, Indonesian private institutions or Indonesian citizens." Paragraph (2) "Memorandum of Understanding or the agreement referred to in paragraph (1) involving a foreign party shall also be written in the national language of the foreign party and / or English. "

The Cooperation Contract shall be carried out for a maximum period of 30 (thirty) years. KKKS may submit an extension of no more than 20 (twenty) years. This contract consists of a period of exploration and

exploitation. The exploration period is 6 years and can be extended for 4 years. During the exploration period, SKK Migas supervised the implementation of the commitments promised by KKKS. If during the first 6 (six) years, the KKKS does not carry out commitments or fail to find commercial reserves, SKK Migas will provide a recommendation to the Ministry of Energy and Mineral Resources to terminate the contract or extend the contract for 4 (four) years. If successful in finding sufficient commercial reserves, the contractor will prepare a first development plan or Plan of Development (POD) I. SKK Migas will submit an evaluation and recommendation for this POD I to the Minister of Energy and Mineral Resources. The decision to approve POD I is in the hands of the Minister of Energy and Mineral Resources. This approval of POD I indicates that a work area has entered the production phase.

In the production phase, SKK Migas continues to control the cooperation contract through the approval of the annual Work Program and Budget (WP&B) from the PSC contractor and the authorization for Expenditure (AFE). SKK Migas also gave approval for the second POD and the subsequent POD. The control carried out by SKK Migas aims to maximize the results of upstream oil and gas business activities for the people's welfare.

All proceeds from state revenues from upstream oil and gas activities, both those from revenue sharing and from tax revenues entering the state treasury through the Minister of Finance. These funds are then distributed to all Indonesian people through the APBN mechanism. Distribution of results in Production Sharing Contracts will not be separated from the achievements of the object of the contract that must be divided in accordance with their rights and distributed proportionally. However, the proportionality referred to is limited to the rights and obligations stipulated in the agreed contract.

The success of the entire process of oil and gas management as outlined above cannot be separated from the application of general principles of good governance. One of them is the principle of transparency because it is related to the type of contract that contains the public element. In addition, the role of the principle of transparency in the implementation of Oil and Gas Production Sharing Contracts is also important to obtain optimal results so that it will fulfill a sense of fairness over the results obtained without suspicion of results that are not appropriate for the implementation of upstream Oil and Gas activities.

Regarding the contents and provisions in the Oil and Gas Production Sharing Contract, Article 26 of the Oil and Gas Regulation stipulates that the Contract must contain at least the main provisions, namely: state revenue, working area and return, obligation to release funds, transfer of ownership of the production of oil and gas, the period and conditions of contract extension, dispute resolution, obligation to supply petroleum and / or natural gas for domestic needs, contract termination, post-mining mining obligations, occupational safety and health, environmental management, transfer of rights and obligations, required reporting, field development plans, prioritizing the use of domestic goods and services, development of surrounding communities and guaranteeing the rights of indigenous peoples, prioritizing the use of Indonesian workers. Furthermore, Article 32 of the PP Migas regulates in the event that a Contractor cannot carry out his obligations in accordance with his Cooperation Contract and the applicable laws and regulations, the Implementing Body may propose to the Minister to terminate the Cooperation Contract.

## **7.2 Oil and Gas Production Sharing Contract Dispute Resolution Mechanism**

Differences in the national legal system, the location of business activities, as well as the provisions of contract law in each country open up opportunities for conflicts and disputes. It is different with contracts that are carried out by legal subjects originating from countries that adhere to the same legal system, of course in resolving disputes the same legal choice can be used. In a commercial contract, arrangements for dispute resolution mechanisms are very commonly included. Arrangements regarding disputes are closely related to which legal choices are agreed upon by the parties which will later become a reference if disputes arise (Anindita, 2008:537).

Alan Schwatz and Robert E. Scott (2003:547) argued that contract law has a tendency to contain more clauses governing various aspects of contractual relations than the clauses needed to carry out their enforcement and interpretation functions. Usually the clause regarding dispute resolution is made in a standard form because it is considered to only function as a control when the parties do not carry out the contract. Oliver Hart in the *Incomplete Contract* (2013) states that because the contract is basically unable to accommodate all the desires of the parties, both for the achievements that are being carried out and for the achievements that will be carried out in the future, in a contract needs to involve the public sector, in this case the institution that has the authority to later resolve and decide legal issues. In legal institutions, there are two ways to resolve disputes over legal relations, namely through litigation and non-litigation or alternative dispute resolution (APS).

Settlement of disputes taken by the parties through litigation is the ultimate means (*ultimum remedium*) after other alternative dispute resolutions that do not reach agreement. According to Suyud Margono (2004:23), litigation is "a lawsuit over a conflict that is ritualized to replace the actual conflict, where the parties give the decision maker two conflicting choices." As a form of government attention to business needs that move quickly



and reduce the number of cases in civil court that have not been resolved, the government established an institution for resolving disputes outside the court (non-litigation) through Law Number 30 of 1999 concerning Arbitration and Alternative Dispute Resolution (Rahayu, 2014:450). The concept of dispute resolution through Alternative Dispute Resolution is rooted in the self-governing system, which is a consequence of the enactment of private law in the business world which is a legal regime that gives freedom to the parties to determine their own dispute resolution based on their concepts and interests (the principle of freedom of contract)(WeinribinPrasetianingsih, 2014:371). For example, the freedom to choose experts in certain fields who are considered to have the competence to resolve disputes (FuadyinSutiyoso, 2012:168).

Alternative Dispute Resolution (APS) or Alternative Dispute Resolution (ADR), hereinafter referred to as APS, is an effort to settle disputes outside litigation (non-litigation). In APS there are several forms of dispute resolution. The forms of APS according to Suyud Margono(in Kapindha, 2014:7) are: (1) consultation; (2) negotiations; (3) mediation; (4) conciliation; (5) arbitration; (6) good offices; (7) mini trial; (8) summary jury trial; (9) rent a judge; and (10) arbitration mediation. Article 1 number 10 of the APS Law provides limits on the definition of Alternative Dispute Resolution namely, the dispute resolution agency or dissent through a procedure agreed by the parties, namely settlement outside the court by means of consultation, negotiation, mediation, conciliation, or expert judgment.

Frans Hendra Winarta (2012:1-2) believes that conventionally, dispute resolution in the business world, such as in trade, banking, mining projects, oil and gas, energy, and infrastructure is carried out through litigation or litigation. In the litigation process, the parties are opposed to one another. Unlike the settlement of disputes through litigation, the resolution of disputes carried out on a non-litigation basis will enable the parties to achieve a peace or win-win solution. Erman Rajagukguk(inNeveyVaridaAriani, 2012: 279) believes that business people prefer to settle disputes through non-litigation channels. Business practitioners' preference for preferring non-litigation paths is because business dispute resolution is carried out in private, judges have the ability or expertise in the field that is the object of the dispute, and decisions made through non-litigation institutions are oriented to the results of compromise rather than right or wrong. Aside from this, dispute resolution outside the court is relatively inexpensive and requires a shorter time than litigation settlement(MuryatiandHeryanti, 2011:49).

The tendency of business actors to settle business cases through non-litigation is the reality that litigation disputes are undergoing a crisis of trust due to obstructed bureaucracy and procedures that tend to be rigid and long and more oriented to bureaucratic justice(S. SusantoinAriani, 2012:278). Williamson argues that arbitration institutions have advantages over court institutions because they have better capacity in terms of knowledge to evaluate contract disputes and fill contract gaps(Robin A. danUlfa, 2013:14).

Related to the resolution of Oil and Gas Production Sharing Contract disputes in which there are foreign elements, parties usually prefer to use alternative dispute resolution through arbitration institutions, both domestically through BANI (Indonesian National Arbitration Board) or international arbitration such as SIAC (Singapore International Arbitration Center ), even though at the stage of implementation the decision still refers to national law.

Huala Adolf in Natasha Yunita Sugiastuti(2015:40-41) revealed the fact that the majority of Indonesian entrepreneurs (especially small and medium-sized entrepreneurs) did not pay much attention to contracts. Generally, if they sign a contract, they are less concerned about the sound of the clauses in the contract. For those who are important is a business transaction. In their minds, it is enough how to carry out the transaction.

Article 38 PP Migas regulates that Oil and Gas Production Sharing Cooperation Contracts comply with and apply Indonesian law in it. However, both the provisions of PP Migas itself and the provisions of other relevant laws do not regulate the procedure or mechanism for dispute resolution. The absence of norms that specifically designate which dispute resolution mechanism should be used by the parties is a space for the parties to choose the method they use in resolving Oil and Gas Production Sharing Contract disputes. this is a form of implementation of the principle of freedom of contract which can be used by the parties to determine the best mechanism and benefit the parties or each party.

Agreement on choosing a forum for dispute resolution can be done in 2 (two) ways, that is, prior to the dispute where the clause regarding the forum choice is included in the main contract (pactum de compromittendo), or after a dispute in which the contract or agreement regarding its settlement is made separately from main contract (compromise deed).

Achmad Madjedi Hasan is of the opinion that if a dispute is settled through litigation it will make the position between the parties unequal. This is because the tendency of disputes in the business world involves parties with different cultural and legal backgrounds. After all, in international trade arbitration is preferred as a dispute resolution option. this is because the arbitrators who have specific knowledge related to the disputed field. Furthermore Sylvia Tee Director of Arbitration and Alternative Dispute Resolution ICCAsiadalam Hukumonline said that the selection of arbitrators is an important thing that must be considered by the parties in

resolving disputes in the oil and gas sector because people who understand the problems in the energy sector comprehensively are still minimal (Sutiyoso, 2012:169).

In drafting an arbitration clause in a contract, there are several other things that should not be overlooked. First, the effect of national and international arbitration decisions on the contract, second, the state's track record in enforcing contracts to mediate and award arbitration in the jurisdiction, and Third, the neutrality and impartiality of law enforcement in that country towards the arbitration award.

For example, in the Oil and Gas Production Sharing Contract between BP Migas (before SKK Migas was formed) with the Union Oil Company of California, or Unocal, provisions regarding dispute resolution in Chapter XII regarding Consultation and Arbitration shall be initiated by means of consultation to amicably resolve all issues. problems that arise. If there is a dispute arising between BP Migas and the Republic of Indonesia in connection with the implementation of the contract or the interpretation and implementation of one of the clauses in the contract will be settled amicably, and mutually understand within 90 (ninety) days of receipt of notification by one of the parties regarding the dispute. Disputes as intended which cannot be settled amicably will be submitted to arbitration decisions.

BP Migas on one party and KKKS on the other party appoint an arbitrator and then advise the other parties and both arbitrators appoint a third arbitrator. If each party fails to appoint an arbitrator within 30 (thirty) days after receiving a written request to do so, the arbitrator will, at the request of the other party, if both parties disagree, with the appointment by the president of the International Chamber of Commerce ( President of the International Chamber of Commerce). If the first two appointed arbitrators fail to approve the third arbitrator within 30 (thirty) days after the appointment of the second arbitrator the third arbitrator will, if the parties to the dispute do not also approve, be appointed, at the request of both parties, by the President of the International Chamber of Commerce . If an arbitrator fails or is unable to carry out, his successor will be appointed in the same manner as the arbitrator he replaces.

The decision of the majority votes of the arbitrators is final and binding on the parties. Arbitration will take place at a place agreed by both parties and refers to the Conciliation and Arbitration rules of the International Chamber of Commerce.

## VIII. CONCLUSION

The development of upstream oil and gas law in various countries presented the prevailing legal relationship regarding Oil and Gas Production Sharing Contracts related to the legal relationship between the government and the private sector (Business to Government) which seeks to form a transition from business results. In Indonesia, the current regulations regarding Oil and Gas Production Sharing contracts are still guided by the Civil Code in general and specific oil and gas regulations. Therefore, regulations regarding the relationship between the government and the government have not been unified, making Oil and Gas Production Sharing Contracts approved by private law and / or public law so that legal certainty is not achieved because it is more dominant

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