



## NEGOTIATION: HOW INDONESIA USE ITS POWER BASED POSITION TOWARDS FREEPORT MINING INDUSTRY

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### ABSTRACT

*The problems studied in this study include: first, what is Indonesia's position in the Freeport Contract of Work? Second, how does Indonesia use its power-based position to win this renegotiation? Third, how is the progress of implementing renegotiation as a solution to the problems posed by the Contract of Work? This research was conducted using a library research method through a conceptual approach and a social approach. The results show that: Indonesia's position in the Kontrak Karya is equivalent to Freeport, same as the position of the parties in a contract. Second, Indonesia uses its power as an independent country by creating the IUPK Law and prohibiting the export of mineral concentrates to narrow Freeport's movement. Third, Indonesia proposed renegotiation for its losses arising from the operation of Freeport in Indonesia, but the renegotiation was difficult to reach the expected agreement because it was contradict with the principle of pacta sunt servanda. After a long negotiation process, a mutually beneficial decision was reached for both parties.*

**Keywords:** renegotiation; contract; Freeport; power-based position; Literature review.

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### I. INTRODUCTION

As a country that amount of natural resources, Indonesia have some of the mineral wealth from the mining sector that are very useful for human existence found in Indonesia are gold, copper, silver, tin, petroleum and others (Abrar, 2004). Therefore, this country has been named as one of the countries with the highest potential of mineral reserves in the world.

To manage this natural wealth, Indonesia requires large funds, qualified resources, and an advanced equipment. However, the Government of Indonesia still has limitations to meet these various aspects to carry out exploration and exploitation activities.

Therefore, there is a need for synergy between the Indonesian government and foreign investors. Cooperation between the government and investors in the mining sector is called Kontrak karya (Contract of Work). Kontrak karya is an agreement between Indonesia's government and a mining company that forms the legal basis for the company to operate mining activities in Indonesia. This makes Indonesia an easy target for business people who's working in the mining industry to exploit its natural wealth. One of the mining companies that we know today is Freeport.

PT Freeport Indonesia is one of the leading mining companies affiliated with Freeport-



McMoran (FCX) and Mining Industry Indonesia (MIND ID). In carrying out its activities, the company explores, mines, and processes ores containing gold, copper, and silver in the highlands of Timika, Papua, Indonesia. Mines in the Papua region, especially Timika, are considered to have the largest gold and copper mineral content in the world.

During the reign of President Suharto in 1967, there was an agreement of Kontrak Karya I between Indonesia and Freeport, then in 1991 Freeport-McMoran signed a Kontrak Karya II with an agreement that this contract is valid for 30 years with the possibility of a contract extension of 2x10 years. In other words, Kontrak Karya II will expire in 2021. One of the weaknesses of this contract model is that it establishes equality between a country and the company, which in this case is Freeport.

However, before the contract expires, since 2009 to be exact, the Indonesian government has proposed renegotiation because Indonesia feels disadvantaged by this contract. But it is difficult for Indonesia to obtain renegotiation rights because the Government of Indonesia is not allowed to unilaterally cancel the agreement that has been agreed as long as the foreign party carries out its obligations according to the agreement in the contract even though there are several agreements that inflict a financial loss to the Government of Indonesia.

After going through a long lobbying process, finally the renegotiation process can be carried out with a win-win solution. Therefore, the author raises this issue to

examine how Indonesia uses its power-based position to win this renegotiation.

## **II. LITERATURE REVIEW**

### **Renegotiation**

In the KBBI, renegotiation is re-do the negotiation. Renegotiation is a common practice in the mining industry. Renegotiation is legal because the contract period is relatively long while the country is vulnerable to changes in economic conditions, politics, and technological developments. Applications for renegotiation are usually submitted by the government where the mining activity is located and only a few requests are submitted by mining companies.

Some of the common reasons that become the basis for submitting renegotiations are the imbalance in profit sharing between mining companies and the government; there is an imbalance in the bargaining position of the government with mining companies in making contracts; the discovery of manipulation, abuse of office practices and corruption during contract making; the discovery of activities that damage the environment; and complaints from the public.

### **Power based Position**

Achmad (2000) defines power as the ability of a person or part of an organization to influence other people or other parts to carry out orders or do something to achieve goals according to the wishes of the power owner. Power is synonymous with authority and influence.

Meanwhile, according to Nord (in Thoha, 2010) power is defined as the ability to influence the flow, energy, and funds available



for a purpose. It can be concluded that power is one source of a leader to invite or influence others. With power, leaders can influence the behavior of their subordinates.

There are 5 forms of power according to French and Raven (1959)

1. Reward power, is the power that a person has from his ability to give rewards or wages to his subordinates so that the enthusiasm and performance of his subordinates can increase.
2. Coercive power, power obtain by a person because that person has a very strong position. Contrary to reward power, this power provides punishment for poor performance from subordinates.
3. Legitimate power, is the power obtained by someone from a certain position. The higher the position held, the greater the influence it has.
4. Expert power, is the power that exists because of the expertise or expertise possessed by a leader. This power comes from a person's knowledge, expertise, competence, and ability in a particular field.
5. Referent power, is the power that is owned because someone has charisma or an attractive personality.

Lewicki (1999) defines that there are two forms of power in a power-based position, namely legitimate power and power derived from location in an organizational structure. In power derived from location in an organizational structure, individuals can become powerful because of how their action and responsibility are embedded in a large

organization, even without a lofty position or title.

### **Contract of Work**

According to Mariam (1980) a contract is a legal act that gives rise to an engagement. The form of the contract is always written. A work contract can be defined as a written form of foreign capital cooperation and happened when a foreign investor forms a country's legal entity and this legal entity cooperates with a legal entity that uses national capital (Salim, 2003).

Meanwhile, according to Sudrajat (2013), the contract of work is the legality of the exploitation of minerals intended for foreign investors. The employment contract will be executed if there is a written agreement between the Indonesian government and a foreign company to carry out exploration and exploitation activities in the mining sector within a specific period of time.

The elements inherent in the CoW according to Salim (2005) are:

1. The existence of a contract, namely an agreement made by all parties,
2. The existence of legal subjects, namely the Government of Indonesia,
3. The existence of objects, namely exploration and exploitation,
4. In the mining sector, and
5. There is a period of time in the contract.

### **III. RESEARCH METHODOLOGY**

The author of this article using literature review as their design of research. A literature review is a study that investigates or critically reviews thoughts, lore and discoveries contained academically oriented literature,



including formulating theoretical and methodological contributions to specific topics (Cooper, 2010). The nature of this research is descriptive analysis, that is, the data obtained is regularly decomposed, and then give a clear, understanding explanation so the readers can understand it well.

#### **IV. RESULT AND DISCUSSION**

##### **Indonesia's Position in the Contract of Work**

The contract of work binds both parties based on the principle of *pacta sunt servanda*, which means that both parties must comply with the contents of the contract. In this principle, the Government of Indonesia has an equal position with Freeport. This binding nature is then faced with various problems caused by the implementation of the Contract of Work (CoW). On the one hand, the implementation of this contract causes various losses, while on the other hand the Government is obliged to obey and comply with the contents of the Contract of Work. This is also supported by the contents of Article 23 of the CoW which means that the Government of Indonesia is bound not to take any action that is contrary to the contents of the contract, or it can be interpreted as the government's submission to the Freeport CoW. This is why renegotiation efforts took so long and hardly resulted in a significant deal.

Various losses felt by Indonesia were caused by violations committed by Freeport during its operations in Papua. The most visible violations are environmental violations that have an impact on environmental damage. In addition, social

problems also arise, namely conflicts with indigenous peoples and labor issues. Therefore, the Government of Indonesia continues to make efforts for renegotiation efforts to reach a new agreement that is fairer for both parties.

##### **Indonesia Stipulates IUPK Law**

In 2009, Indonesia enacted Law No. 4 of 2009 which regulates mineral and coal mining, which automatically shifts the power of Law no. 11 of 1967 concerning the main provisions of mining. In this law, it is stipulated that the status of KK to IUPK is changed for mining companies. In Law No. 4 of 2009 concerning Minerals and Minerals and Coal, the Contract of Work has been removed and replaced with a Mining Business Permit. With this change, the position of the Indonesian government is higher than the mining companies, so it can supervise mining activities carried out by mining activities. With this, the regulation that considers the status of Business Entities as equal to the Government of Indonesia is no longer valid.

The provisions for changing the status of KK to IUPK are further regulated in Minister of Energy and Mineral Resources Regulation No. 4 of 2017 concerning Domestic Mineral Improvement and Purification.

##### **Indonesia Issued a Concencrate Export Ban Policy in 2017**

On January 11 2017, Indonesia enacted Government Regulation No. 1 of 2017 concerning amendments to Government Regulation No. 23 of 2010 concerning the Implementation of Mineral and Coal Mining Business Activities. In PP No.1 of 2017 it is



determined regarding the addition of government profits on share divestment by 51% for IUP and IUPK concessions, In addition, it is regulated on provisions that require sales to be at the benchmark price, and also regulates the purification of metal mineral processing products. PP No.1 of 2017 provides benefits and legal certainty for the government as a representation state that has the right to control over natural resources.

Government Regulation No. 1 of 2017 regulates the prohibition of export of concentrate by mining companies, but the government provides concessions with several requirements that must be met by mining companies. These requirements are:

1. Mining companies that have a Contract of Work must change their permit to IUPK if they wish to export in the form of mineral concentrates.
2. Mining companies that have IUPK are required to build a smelter within five years, if it is not fulfilled, the government has the right to revoke export recommendations.
3. Companies must divest up to 51%.

Of course, this requirement is not required to be fulfilled by Freeport, but the existence of Government Regulation No. 1 of 2017 is enough to put Freeport in trouble. On the one hand, Freeport wants to continue to maintain its Contract of Work, but on the other hand this prevents Freeport from exporting mineral concentrates.

### **Renegotiation Results**

After going through long negotiations, finally on February 10, 2017 Freeport

received the status of a Special Mining Business Permit (IUPK). Subsequently, in April 2017, negotiations were held between the Government of Indonesia and Freeport. This lengthy negotiation discussed the negotiation of the issue of extending Freeport's operations, construction of a smelter, investment stability, and divestment cases.

In August 2017, an agreement was reached that Freeport agreed to a 51% divestment. Finally, on July 7 2018 the HoA was signed between the Government of Indonesia (PT Inalum Persero, Rio Tinto) and Freeport-McMoran with a divestment value of 51% shares with a value of US\$3.85 billion. Then followed by the construction of a copper smelter in the JIPE Integrated Industrial Estate in Gresik in 2021, as an effort to fulfill the requirements of PP No. 1 of 2017.

The Indonesian government guarantees legal certainty for Freeport in carrying out mining operations in Indonesia. Therefore, the renegotiation this time is mutually beneficial for both parties.

### **V. CONCLUSION**

Indonesia has a wealth of abundant mining products, but is still unable to manage this wealth independently. Therefore, cooperation with foreign investors is needed, one of which is Freeport-McMoran. Freeport-McMoran is the world's leading mining company.

In 1967 a Contract of Work was established which stipulates the cooperation between the Government of Indonesia and Freeport for a period of 30 years, which was then extended again in 1991 with an



estimated contract completion in 2021. However, in 2009 Indonesia proposed to renegotiate because it suffered a lot of losses from the operation of Freeport in Indonesia. Indonesia.

In the renegotiation effort, Indonesia wants a 51% share divestment and the construction of a smelter by Freeport in Indonesia. However, renegotiation efforts almost always do not go as desired because they collide with the principle of *pacta sunt servanda* which binds the Contract of Work in which the Government of Indonesia has an equal position with Freeport. Then this action also contradicts Article 23 of the CoW, which means that the Government of Indonesia cannot take any action that is contrary to the contents of the contract as long as Freeport does not violate the contents of the contract.

Therefore, Indonesia uses its power-based position as a sovereign country by enacting Law No. 4 of 2009, replacing Law No. 11 of 1967. Law No. 4 of 2009 regulates the change of a Contract of Work into a Special Mining Business Permit. With this, the equal position between Freeport and the Government of Indonesia is no longer valid. In addition, in 2017 Indonesia issued a concentrate mineral export policy with conditions that made Freeport ask for negotiations to discuss this in April 2017.

Finally, an agreement was reached with a win-win solution. Freeport approved the divestment of a 51% stake in August 2017 and the construction of a smelter in the JIPE Integrated Industrial Estate in Gresik in 2021, and the Government of Indonesia guarantees legal certainty for Freeport in carrying out mining operations in Indonesia.

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