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Government-Directed Lng Export Cargo Diversion, Joint Lifting, And Contractor Entitlement Under Indonesian Production Sharing Contracts

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Keywords:
LNG; production sharing contract; joint lifting; contractor entitlement; domestic market obligation; cargo diversion; energy security; long-term LNG SPA; force majeure; investment arbitration; Indonesia.

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Abstract

Indonesia's dual role as an LNG exporter with long-term contractual commitments and a country experiencing increasing domestic natural gas demand creates legal tensions when the government requires previously scheduled export cargoes to be canceled, postponed, or diverted to domestic consumers. This study aims to develop a structured legal framework for examining government-directed liquefied natural gas (LNG) cargo diversion under Indonesian Production Sharing Contracts (PSCs), particularly in circumstances where joint lifting consolidates government and contractor entitlements into shared cargoes. Employing a normative juridical approach, the study conducts a doctrinal analysis of legislation, regulatory frameworks, and international arbitral jurisprudence, including Union Fenosa Gas v. Egypt, Karaha Bodas v. Pertamina, and Vivendi. The analysis distinguishes five frequently conflated legal dimensions: public law authority, PSC allocation and Domestic Market Obligation (DMO), joint lifting and accounting mechanisms, LNG Sale and Purchase Agreement (SPA) obligations and consequences, and international investment law. The findings indicate that although Indonesian law establishes a strong constitutional and statutory foundation for ensuring domestic energy security, governmental authority does not automatically extinguish contractors' contractual entitlements or obligations arising from existing SPAs. Joint lifting is characterized as a commercialization and accounting mechanism rather than an independent source of substantive ownership rights. Consequently, diverted LNG volumes exceeding DMO requirements necessitate transparent reconciliation through replacement lifting, appropriate valuation, or compensation arrangements. The study concludes that Indonesia's LNG cargo diversion policy should incorporate seven essential elements: a clear legal basis, well-defined triggering conditions, explicit treatment of DMO requirements, identification of economic entitlements, transparent lifting reconciliation procedures, provisions governing existing SPAs, and appropriate compensation mechanisms. These elements are essential for balancing national energy security objectives with investment credibility, contractual stability, and legal certainty.

INTRODUCTION

Liquefied natural gas (LNG) has long played a significant role in Indonesia’s petroleum economy. Large-scale LNG projects require substantial upstream investment, liquefaction infrastructure, shipping arrangements, and long-term offtake commitments. Historically, long-term export contracts have supported the financing and commercial viability of major LNG projects. At the same time, Indonesia’s domestic demand for natural gas has increased due to

its widespread use in electricity generation, industrial production, fertilizer manufacturing, petroleum refining, and other strategically important sectors. This dual role—as an LNG producer with international contractual commitments and a country facing growing domestic energy needs—creates legal challenges when domestic gas demand increases after binding export commitments have already been established (Law No. 22 of 2001 on Oil and Natural Gas, 2001; Government Regulation No. 35 of 2004 on Upstream Oil and Gas Business Activities, 2004; Government Regulation No. 34 of 2005 Amending Government Regulation No. 35 of 2004 on Upstream Oil and Gas Business Activities, 2005; Government Regulation No. 55 of 2009 on the Second Amendment to Government Regulation No. 35 of 2004 on Upstream Oil and Gas Business Activities, 2009; Presidential Regulation No. 9 of 2013 Concerning Administration of Upstream Oil and Gas Business Activities, 2013).

The most challenging legal issue does not arise from allocating uncommitted natural gas but rather from circumstances in which LNG cargoes have already been scheduled for delivery under binding long-term Sale and Purchase Agreements (SPAs), and the government subsequently directs that these cargoes be canceled, postponed, or diverted to domestic consumers. Such interventions may be justified by legitimate concerns regarding electricity supply reliability, industrial continuity, or national energy security. Nevertheless, public policy considerations do not automatically resolve the private-law and Production Sharing Contract (PSC) implications of governmental intervention. A comprehensive legal analysis must establish the statutory or regulatory basis for governmental authority, identify the affected economic entitlements, and determine how the resulting contractual and financial losses should be allocated (Commission, 2001; *Decision No. 002/PUU-I/2003*, 2004; *Decision No. 36/PUU-X/2012*, 2012; Presidential Regulation No. 36 of 2018 Amending Presidential Regulation No. 9 of 2013, 2018; *Karaha Bodas Company, L.L.C. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara (Pertamina)*, 2002; *Unión Fenosa Gas S.A. v. Arab Republic of Egypt*, 2018).

Indonesia’s PSC framework introduces additional legal complexities. Under the applicable constitutional, statutory, and contractual framework, the state exercises constitutional control over petroleum resources, while contractors assume investment and operational risks in exchange for an agreed share of production or its corresponding economic value (Bindemann, 1999; E. I. T. I. Indonesia, n.d.; M. of F. of the R. of Indonesia, n.d.; Migas, n.d.; Taverne, 1999). Although contractors do not possess ownership rights over hydrocarbons in situ, they acquire legally recognized economic entitlements under the terms of their respective PSCs. The Domestic Market Obligation (DMO) applies to the contractor's allocated share of production, subject to the applicable legal and contractual provisions. This arrangement requires a clear distinction between the state's constitutional authority over petroleum resources and the economic rights accruing to contractors following production allocation (*CMS Gas Transmission Company v. Argentine Republic*, 2005; *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, 2002; *Continental Casualty Company v. Argentine Republic*, 2008; *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic*, 2006; *Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention)*, 1965; Johnston, 1994).

LNG joint lifting further complicates this legal framework. LNG produced from a particular project may originate from multiple PSC areas and incorporate both government and contractor economic entitlements. From a commercial perspective, these interests may be consolidated into a common LNG production stream and marketed through centralized sales arrangements. Consequently, the physical LNG cargo loaded onto a vessel does not necessarily correspond directly to the underlying legal allocation of economic interests. The central legal question is therefore not merely which party physically owns a particular cargo, but rather whose economic entitlement is affected by its diversion and whether the resulting imbalance is subsequently reconciled through appropriate contractual or accounting mechanisms.

This article argues that government-directed LNG cargo diversion should be examined through five distinct but interconnected legal dimensions. The first concerns Indonesian public law, particularly whether the competent governmental authority possesses the statutory or regulatory power to mandate additional domestic gas supply. The second involves the PSC framework, specifically whether the diverted LNG volumes fall within existing DMO requirements or otherwise affect government and contractor economic entitlements. The third addresses joint lifting and production accounting, including whether resulting imbalances can be reconciled through underlifting, overlifting, replacement lifting, or other applicable adjustment mechanisms. The fourth concerns LNG SPAs, particularly whether sellers remain contractually liable to foreign buyers and whether government-directed diversion may qualify as force majeure or another recognized contractual excuse. The fifth, where applicable, involves international investment law and the potential implications of governmental measures for treaty-based investor protections.

Distinguishing these legal dimensions is essential to maintaining legal certainty and contractual stability. If governmental directives are automatically interpreted as extinguishing existing contractual obligations, the commercial reliability and enforceability of long-term LNG SPAs may be substantially undermined. Conversely, treating contractors' economic entitlements as entirely immune from domestic regulatory intervention would overlook the constitutional and statutory authority of the Indonesian government to safeguard national energy security. A coherent legal approach must therefore reconcile legitimate governmental regulatory powers with the contractual allocation of economic rights and obligations established under the PSC framework.

Accordingly, this article develops a structured legal test for assessing government-directed LNG cargo diversion. Indonesian legislation and regulations constitute the primary legal framework, while relevant international arbitral decisions provide comparative legal perspectives. Unión Fenosa Gas v. Egypt is particularly relevant because it involved governmental measures affecting natural gas supplies to an LNG project, illustrating how domestic gas supply shortages and governmental interventions can give rise to investor–state disputes. Karaha Bodas v. Pertamina provides a different but complementary perspective by addressing Indonesian LNG sales proceeds and their allocation between government and PSC contractor interests. Finally, Vivendi provides a doctrinal foundation for distinguishing contractual obligations from independent obligations arising under international investment treaties. Together, these cases offer comparative insights into the interaction between

governmental regulatory authority, contractual entitlements, and international investment protections in the context of LNG export cargo diversion.

METHOD

This study employed a normative juridical research approach through doctrinal analysis of legislation, regulations, judicial decisions, contractual principles, and international arbitral jurisprudence. The analysis focused on developing a legal framework for government-directed LNG cargo diversion rather than determining liability in specific LNG projects, as confidential contractual documents, including Production Sharing Contracts (PSCs), LNG Sale and Purchase Agreements (SPAs), and lifting agreements, were not examined.

The statutory analysis examined Article 33 of the Constitution of the Republic of Indonesia, Law No. 22 of 2001 on Oil and Natural Gas, Government Regulation No. 35 of 2004 on Upstream Oil and Gas Business Activities, as amended by Government Regulation No. 55 of 2009, and the presidential regulations governing the Special Task Force for Upstream Oil and Gas Business Activities (SKK Migas). Constitutional Court Decisions No. 002/PUU-I/2003 and No. 36/PUU-X/2012 were also examined to assess the constitutional principles governing state control over petroleum resources, domestic energy supply, and upstream petroleum governance. The conceptual analysis distinguished state control over petroleum resources, ownership of hydrocarbons before the contractual delivery point, contractors' economic entitlements under PSCs, Domestic Market Obligations (DMOs), and lifting arrangements.

The comparative case analysis examined Unión Fenosa Gas S.A. v. Arab Republic of Egypt to assess governmental gas allocation measures affecting LNG investments, Karaha Bodas Co. v. Pertamina to examine the allocation of LNG sales proceeds under Indonesian petroleum arrangements, and Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic to distinguish contractual claims from treaty-based investment claims. Additional international investment disputes involving emergency regulations and public necessity were considered to assess treaty obligations, proportionality, state attribution, causation, and compensation.

The legal analysis followed five sequential stages: identifying the public-law basis for LNG cargo diversion, examining PSC allocations and DMO requirements, assessing joint-lifting and accounting consequences, evaluating contractual obligations under LNG SPAs, and determining potential implications under international investment law. This approach enabled a systematic examination of governmental authority, contractual entitlements, and international legal obligations while maintaining a clear distinction between domestic legal rights and treaty-based protections.

RESULTS AND DISCUSSION

The analysis produces six principal findings. First, Indonesian law recognizes strong governmental authority over petroleum resources and domestic energy security, but the existence of that authority does not eliminate the need for a legal basis for a specific LNG diversion. Article 33 supplies the constitutional foundation; Law No. 22 of 2001, implementing

regulations, and the PSC determine how that authority operates in a concrete upstream relationship.

Second, DMO is the clearest statutory mechanism through which contractor production is committed to domestic requirements. Because DMO is calculated against the contractor's share, it simultaneously limits and recognizes contractor entitlement. The distinction between outstanding DMO and additional post-DMO diversion is therefore analytically central. Treating all domestic diversion as merely "DMO" risks obscuring the legal basis and economic consequences of volumes beyond the prescribed obligation.

Third, joint lifting should be characterized as a commercialization and accounting mechanism rather than an independent source of substantive Government ownership over the contractor's final economic share. This conclusion is consistent with the logic of production sharing and with the description of Indonesian LNG revenue allocation in Karaha Bodas. The physical fungibility of LNG does not make economic entitlement legally irrelevant.

Fourth, the consequences of Government diversion must be traced through the lifting accounts. A Government instruction can affect physical delivery without permanently reducing contractor entitlement if the contractor is credited through replacement lifting, underlifting settlement, or equivalent value. Conversely, if contractor entitlement is permanently transferred to domestic use without agreed value or reconciliation, the intervention is more substantive and requires closer legal scrutiny.

Fifth, the long-term LNG SPA remains an independent source of obligations. The buyer's rights do not disappear because the upstream cause of nondelivery is governmental. Whether the seller is excused depends on the wording of force majeure, government-action provisions, mitigation requirements, and governing law. This is commercially important because a lawful domestic policy can still generate private contractual liability if the SPA allocates the risk to the seller.

Sixth, international investment law should be treated as a residual and independent layer, not as the starting point. Unión Fenosa demonstrates that gas-allocation decisions affecting an LNG project can lead to investor–State arbitration, but an Indonesian claimant would still have to establish a protected investor and investment, consent, attribution, a substantive treaty breach, causation, and damages. Vivendi confirms that contractual and treaty obligations should not be collapsed.

These findings suggest a broader theoretical point. The apparent conflict between sovereignty and contract is often overstated because the two operate at different levels. Sovereignty determines the State's authority to regulate resources. The PSC determines the economic bargain through which private capital participates in production. Joint lifting determines how the resulting production is commercialized and reconciled. The SPA determines obligations to the buyer. International investment law, where applicable, constrains certain forms of State conduct. Legal uncertainty arises when one layer is used as a shortcut to answer another.

The practical implication is that a Government policy on LNG diversion should contain more than a statement that domestic demand has priority. It should specify the competent authority, triggering conditions, duration, relationship with DMO, method of identifying Government and contractor shares, valuation of redirected LNG, treatment of existing export

SPAs, and mechanism for lifting reconciliation or compensation. Such details convert a broad policy objective into a legally administrable regime.

For PSC contractors, the same framework suggests a documentation strategy. Contractors should maintain clear records of DMO fulfillment, entitlement calculations, cargo allocation, lifting balances, Government directions, domestic sale prices, export contract values, and mitigation efforts. These records are necessary not only for PSC accounting but also for any subsequent contractual or investment dispute.

For LNG buyers, the analysis emphasizes the importance of government-action and force-majeure drafting. Long-term SPAs involving regulated supply jurisdictions should address whether domestic allocation orders excuse delivery, whether replacement cargoes are required, how prolonged force majeure is treated, and whether the seller must use reasonable efforts to source alternative LNG. Contract drafting can therefore allocate some of the risk that public law leaves unresolved.

For Indonesia, transparent allocation can support both energy security and investment attractiveness. If emergency domestic needs are met through a predictable hierarchy and affected contractor value is reconciled, the State preserves operational flexibility without creating the perception that PSC economics can be altered informally. This is especially important for capital-intensive gas developments whose economics depend on long-term monetization arrangements.

The comparative cases do not dictate Indonesian outcomes. Unión Fenosa arose under Egyptian facts and the Spain–Egypt BIT. Karaha Bodas concerned execution against LNG-derived funds and older Indonesian arrangements. Vivendi concerned a different public-service concession. Their value lies in legal reasoning: they demonstrate respectively the possibility of treaty scrutiny of gas diversion, the separability of economic interests in common LNG proceeds, and the distinction between contractual and treaty causes of action.

CONCLUSION

A government policy requiring the cancellation or diversion of LNG export cargoes in response to increasing domestic demand operates at the intersection of constitutional resource control, petroleum regulation, Production Sharing Contract (PSC) economics, joint-lifting arrangements, international sales contracts, and potentially international investment law. A reliable legal assessment requires these interconnected but distinct legal dimensions to be examined separately.

Indonesia has a strong constitutional and statutory foundation for securing domestic oil and natural gas supplies. Law No. 22 of 2001 on Oil and Natural Gas expressly recognizes domestic supply requirements, while its implementing regulations establish Domestic Market Obligation (DMO) requirements applicable to contractors' allocated production shares. However, this regulatory authority does not automatically permit the diversion of all contractor-entitled production without establishing the applicable legal basis, contractual mechanisms, and resulting economic consequences.

Joint-lifting arrangements are particularly significant in this context. The aggregation of LNG production into shared cargoes does not, by itself, eliminate the distinction between government and contractor economic entitlements. Consequently, the central legal issue is not

merely the physical origin or ownership of the LNG loaded onto a vessel, but how the diverted cargo is allocated under the relevant PSCs and whether contractors' economic entitlements are preserved through sales proceeds, replacement lifting, underlifting settlements, or other contractual adjustment mechanisms.

When diverted LNG cargoes have already been committed under long-term Sale and Purchase Agreements (SPAs), the contractual relationship between sellers and buyers must be assessed independently. Government-directed diversion may qualify as force majeure where the relevant SPA expressly or sufficiently encompasses such governmental measures and the applicable contractual conditions are satisfied. Conversely, sellers may remain exposed to contractual remedies where the agreement allocates the relevant risks differently. The applicable PSCs and related contractual arrangements must then be examined to determine whether the resulting contractual liabilities or losses of economic entitlement are allocated to contractors, the government, or other participating parties.

International investment law may also become relevant when qualifying foreign investors are protected under applicable investment treaties. Unión Fenosa Gas S.A. v. Arab Republic of Egypt demonstrates that governmental measures affecting natural gas supplies to LNG projects may give rise to investment treaty disputes. However, the decision does not establish that government-directed LNG diversion for domestic consumption is inherently unlawful under international law. A claimant must independently establish jurisdiction, attribution of the challenged conduct to the state, breach of an applicable treaty obligation, causation, and compensable damages. Similarly, Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic underscores the importance of distinguishing contractual claims from treaty-based claims according to their respective legal foundations.

Accordingly, this article proposes that Indonesia's LNG cargo diversion policy incorporate seven essential elements: a clear statutory or regulatory basis; well-defined conditions triggering governmental intervention; explicit treatment of DMO requirements; identification of government and contractor economic entitlements; transparent joint-lifting reconciliation procedures; provisions addressing existing LNG SPA commitments; and mechanisms for replacement lifting, valuation, or compensation when contractor-entitled LNG volumes exceeding applicable DMO requirements are subject to compulsory diversion.

This approach does not prioritize private contractual interests over national energy security. Rather, it recognizes that sustainable energy security requires both effective regulatory authority and a credible investment environment. A transparent and legally consistent diversion mechanism would enable Indonesia to respond to legitimate domestic natural gas shortages while maintaining the contractual predictability, protection of economic entitlements, and legal certainty necessary to support long-term upstream natural gas investment and LNG commercialization.

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CONFLICT OF INTEREST

The author states that there is no conflict of interest in the preparation of this article.

AUTHOR CONTRIBUTIONS

All authors contributed to conceptualization, search and synthesis of literature, interpretation of results, manuscript preparation, and critical review of manuscripts. All authors have read and approved the final version of the manuscript.

GENERATIVE AI STATEMENT

The authors declare that Generative Artificial Intelligence (Generative AI) was used solely to assist with language refinement, grammatical correction, and improvement of manuscript readability. All scientific concepts, interpretations, literature synthesis, analyses, and conclusions were developed by the authors. All AI-assisted content was carefully reviewed, verified, and revised by the authors, who take full responsibility for the accuracy, integrity, and final content of the manuscript.

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