DENTONS HPRP

Insights and Commentary from Dentons

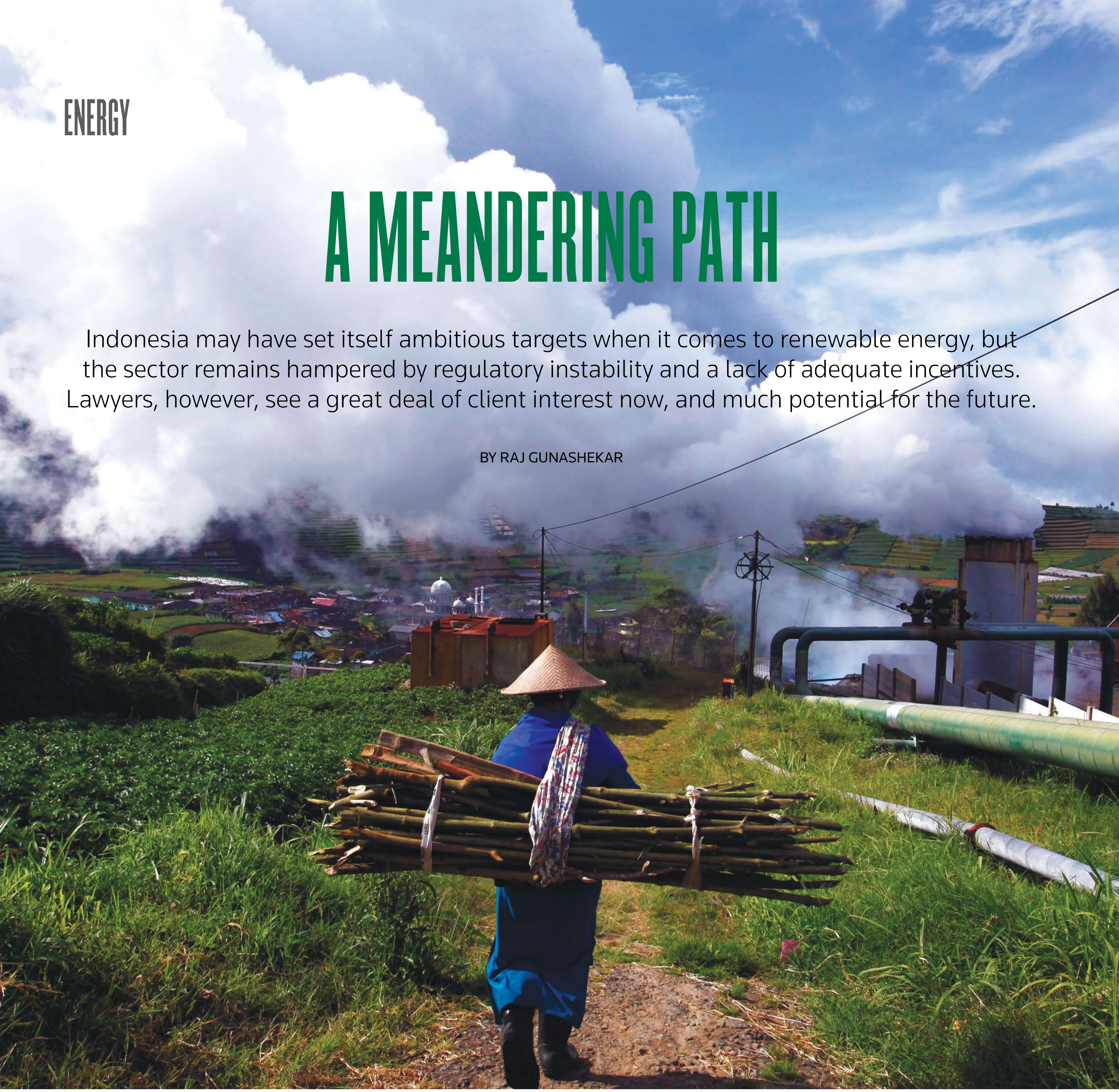
The combination of Dentons and Hanafiah Ponggawa & Partners (Indonesia) offers our clients access to 9000+ lawyers in 167 locations and 73 countries around the world.

This document was authored by representatives of Hanafiah Ponggawa & Partners prior to our combination's launch and continues to be offered to provide clients with the information they need to do business in an increasingly complex, interconnected and competitive marketplace.

A MEANDERING PATH

Indonesia may have set itself ambitious targets when it comes to renewable energy, but the sector remains hampered by regulatory instability and a lack of adequate incentives. Lawyers, however, see a great deal of client interest now, and much potential for the future.

BY RAJ GUNASHEKAR



A villager carrying wood for cooking walks near Dipa Energi's Geothermal Power Plant (PLTP) project at Dieng mountain area, Central Java province. REUTERS/Beawiharta

In its climate action plan submitted to the United Nations Framework Convention on Climate Change in 2015, Indonesia has committed to increasing the renewable portion of its energy mix to 23 percent by 2025. That number currently stands at 12 percent, but the country expects to reach 18 percent in just three years' time. The long-term plan is not only to increase energy production from renewable sources, but also curb the country's dependence on fossil fuels by deploying more clean energy projects.

And if 2017 is any indication, the government is off to a strong start. In the first nine months of this year, Indonesia signed a total of 1,023 megawatts of renewable energy contracts, or about double the total amount signed in the three years before that, Reuters reported. However, coal makes up around 57 percent of the energy mix in the country, which is the world's top thermal coal exporter, with consumption expected to reach 101 million tonnes this year.

To advance its clean energy agenda, the government has passed various regulations stipulating procedures for the purchase of electricity from renewable sources like geothermal, hydropower, biofuel, and solar. However, lawyers working in the sector feel there is much that can be done to attract more investment into the sector.

"Indonesia has great potential in terms of renewable energy resources, and this should have attracted more investors to get into this sector," says Hendra Ong, a partner at Hanafiah Ponggawa & Partners (HPRP) in Jakarta. "The development of renewable energy has been an important part of the government's plans for years now. However, the sector has not developed in the way it should have, and the current utilisation and exploitation of renewable energy is well below maximum potential capacity."

"The rapid changes in regulations reflects the instability of the regulatory framework relating to electricity pricing and causing uncertainty in the implementation of power projects using renewable energy which we are afraid may lead to slow progress of the development of 35,000MW program initiated by President of the Republic of Indonesia, aimed to be achieved in 2019." **— Hendra Ong, Hanafiah Ponggawa & Partners**

REGULATORY INSTABILITY

One of the key challenges for investors is the regulatory environment. Take, for instance, Presidential Regulation No. 22 of 2017 on the General Plan for National Energy (RUEN), which was passed earlier this year. While ostensibly setting out a gradual approach to developing and delivering renewable energy sources in the coming decades, it was panned by some investors as creating an unstable environment that could eventually discourage investment in the centre.

The main issue was that RUEN placed geothermal, hydroelectric and bioenergy as the cornerstone sources for the development of renewable energy in Indonesia. One reason for the push towards geothermal energy is that Indonesia's reserve is the largest in the world, amounting to 40 percent of world's total reserve. Currently however, the total amount of geothermal energy that has been developed in Indonesia is only around 6 percent, placing it third in the world in geothermal power generation, behind the United States and the Philippines.

The government expects Indonesia to be the world's largest geothermal power producer by 2021. This expectation is supported by the RUEN regulation mentioned above, which looks to provide more incentives to encourage private businesses to get involved in this sector. Additionally, the geothermal law No. 21 of 2014 has stated that geothermal activity is no longer considered as a mining activity, and thus exploration, exploitation and utilisation of certain forested areas are now allowed. This has certainly paved the way for geothermal exploration in Indonesia, as 80 percent of the country's reserves are located in protected forest and conservation areas.

However, critics said it placed far less emphasis on solar and wind energy by offering very few incentives for the operation of such plants by independent power producers.

Additionally, lawyers say that while the government has introduced a number of laws and rules to regulate and implement the development of renewable energy-based power, the framework remains quite unstable, with regulations being issued one month, and then amended the following month.

An example is the Ministry of Energy and Mineral Resources (MEMR) Regulation No. 50 of 2017 which specifically applies to the implementation of power plant projects utilising new and renewable energy. Even as the regulation aims to provide certainty in the purchase price of electricity, it has become an area of major confusion for investors as its issuance substitutes previous regulations having the same substance and issued in the same year, namely MEMR Regulation No. 12 of 2017 as amended by MEMR Regulation No. 43 of 2017.

REUTERS/Beawiharta

"The rapid changes in regulations reflects the instability of the regulatory framework relating to electricity pricing and causing uncertainty in the implementation of power projects using renewable energy which we are afraid may lead to slow progress of the development of 35,000MW program initiated by President of the Republic of Indonesia, aimed to be achieved in 2019," says Ong.

The price provision remains another sticking point. According to Reuters, the government has said it will continue to prioritise price in deciding power sources. But capital costs for renewable energy projects tend to be high, and price competition with coal fired power projects may result in uneconomical renewable projects.

In countries like Indonesia where electric utility is a monopoly, the electricity purchase price will be fully dictated by the government and the independent power producers will merely be "price takers" instead of "price makers." Hence, it is essential for independent power producers to operate under sustainable pricing mechanism to ensure that PLN will pay an economically viable price for the electricity produced by them.

In addition, procurement methods, negotiations and renegotiations of power purchase agreement, and technical issues regarding land acquisition have been and will remain major challenges for investors to tap in into renewable energy sector in Indonesia.

That said, lawyers like Luke Devine, a foreign legal consultant with Hadiputranto, Hadinoto & Partners (HHP), feel that not all regulatory changes have been negative.

"While this level of regulatory uncertainty is always a worry for investors and lenders, the good news is that a lot of the recent regulatory amendments have been as a result of the government listening to concerns from investors and lenders regarding the regulatory landscape, and taking steps to address those concerns by amending regulations," he says.

CLIENT INTEREST

Law firms are today receiving a steady

NO NEW COAL POWER STATIONS IN JAVA, INDONESIA ENERGY MINISTER SAYS

Indonesia will not approve any new coal-fired power stations on the heavily-populated island of Java as the country strives to reach its renewable energy development targets, the energy minister has said.

"We will not approve any coal-fired power plants in Java, this island, any more," Energy and Mineral resources minister Ignasius Jonan told a press conference.

Java is home to about two thirds of Indonesia's population of 250 million, but the island is also far better supplied with electricity than the rest of the archipelago, particularly eastern Indonesia.

"We will push, very hard, in the near future that Java should build the renewables, as well as geothermal especially, as well as gas-fired power plants," Jonan said, referring to gas power plants "at the well head."

The government has also revived plans to develop high voltage undersea power cables linking the islands of Sumatra, Java and Bali, he said.

"So whenever Java needs the power, Sumatra can send it to Java and the other way around."

Indonesia is committed to a target to increase the renewable portion of the energy mix to 23 percent by 2025 from about 12 percent at present, and expects to reach 18 percent in the next three years, Jonan said.

However, the government will continue to prioritise price in deciding power sources, he added.

"While I do understand that it's not easy to compete with coal-fired power plants, especially with mine-mouth power plants, they do have to compete with gas power," Jonan said, referring to "strict" power tariff negotiations.

In the first nine months of this year, Indonesia signed a total of 1,023 megawatts of renewable energy contracts, about double the total amount signed in the three years before that, Jonan said.

Coal makes up around 57 percent of the energy mix in Indonesia, the world's top thermal coal exporter, with consumption expected to reach 101 million tonnes this year.

State electricity utility PLN, tasked to oversee President Joko Widodo's target to build 35 gigawatts (GW) of new power stations in Indonesia, is under pressure to improve its efficiency and reduce costs.

Widodo recently "advised" that PLN could halve its target to contribute 5 GW to the programme from more than 10 GW at present, Jonan said. "If PLN thinks their financial position in the long term or even in the mid term will not be quite sound, it's acceptable for them not to continue," he said. "They can offer it to the private sector."

"From the political realm, Indonesia will face the next general election in 2019. If the incumbent president, Joko Widodo, does not win the next presidential election, there is no certainty that the new government administration will uphold his program to develop renewable energy infrastructures in Indonesia." **— Kanya Satwika, Assegaf Hamzah & Partners**

stream of queries about how to invest in Indonesia, what the challenges and obstacle to investing in renewable energy are, and how to structure the business model, including from a tax perspective.

Devine says that the firm has been developing bankable power purchase agreement (PPA) models for the Indonesian renewables sector.

"Our role has been to assist the sponsors with the development of the PPA models, drafting and negotiation of the key project documents such as construction and supply contracts and operations and maintenance agreements, and assisting in securing international project financing from international banks and multilateral agencies," he says.

TNB & Partners, which operates in association with Norton Rose Fulbright Australia, says it has been advising clients on the market in general, as well as about partnering with local companies, and also participating in developments such as engineering, procurement and construction (EPC) models and PPAs.

"Our job on one hand is to demystify and on the other try to minimise uncertainties and risks, and where we cannot remove risks altogether we can at least try to clearly identify those risks. Indonesia often looks more daunting than an analysis of the close detail supports," says Shamim Razavi, senior foreign counsel with TNB & Partners.

Lawyers are also involved in the financing aspect. Given the high investment costs, especially in geothermal projects, independent power producers usually rely on project financing provided by international lenders. One of the most critical elements in the lenders' analysis is the economics or bankability of the projects. To secure financing, it is important for independent power producers to secure a firm and long-term revenue stream.

Kanya Satwika, a partner at Assegaf Hamzah & Partners, says her firm assists investors to review project documents and to provide investors with observations and recommendations for any amendments, or supplements necessary for the project documents from a bankability perspective. "Our clients come from various backgrounds and some of them are new to Indonesia," she says.

Legal advisors tell clients that power project development in Indonesia is seen as more of an endurance race than a sprint, so a slow and steady approach is advised. "There are setbacks along the way, particularly in relation to political and regulatory changes, but time has shown that although occasionally there is one-step backward, it is inevitably followed by two steps forward. So patience is a highly-valued virtue in developing renewable projects in Indonesia," says Devine.

> "Our job on one hand is to demystify and on the other try to minimise uncertainties and risks, and where we cannot remove risks altogether we can at least try to clearly identify those risks. Indonesia often looks more daunting than an analysis of the close detail supports." — **Shamim Razavi, TNB & Partners**

[redacted]

POSITIVE OUTLOOK

For Indonesia's energy sector, these are certainly exciting times. While the government may have mandated a target of 23 percent renewables in the energy mix by 2025, it will likely miss the target, but that's not something to be unduly worried about, say lawyers. "While it is likely that they will fall short of that target, due to the huge power demands in Indonesia, even if renewables capture a smaller percentage share of the energy mix, that translates into a lot of individual renewable projects," says Devine.

Unlike some of its neighbors in Southeast Asia such as Thailand and the Philippines, Indonesia is short of domestic champions operating in the renewables space, and hence there is certainly room for foreign investors to come to Indonesia and pick up large share of the renewables market opportunities.

Besides geothermal power, Indonesia's large plantations offers promising opportunities for bioenergy development but concerns remain on the sustainability of supply.

Efforts to maintain supply or resources have been criticised due to negative environmental impacts, as it relates to the expansion of palm oil plantations.

Going forward, a comprehensive legislative framework is required for bioenergy deployment in Indonesia to secure a sustainable and efficient use of resources.

It is expected that the new administration will continue to focus on the development of renewable energy in one of Asia's most exciting economies.

Indonesia's vast marine territory also means that ocean thermal and tidal energy are also promising alternative resources.

"In the political realm, Indonesia will face the next general election in 2019. If the incumbent president, Joko Widodo, does not win the next presidential election, there is no certainty that the new government administration will uphold his program to develop renewable energy infrastructures in Indonesia," adds Satwika of Assegaf Hamzah & Partners.

REUTERS/Roni Bintang