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**INDONESIA'S NEW DEVELOPMENT IN POWER
AND RENEWABLE ENERGY SECTORS**

by Hapsari Arumdati

Introduction

Indonesian power sector is one of the business sectors in Indonesia which is strictly regulated. For the purpose of having efficient, equitable and transparent electricity supply business and in order to enhance the electricity business development particularly the ones relating to renewable energy, the Ministry of Energy and Mineral Resources of the Republic of Indonesia (“MEMR”) has recently passed three new MEMR Regulations on January 2017: MEMR Regulation No. 10 of 2017 concerning Principles of Power Purchase Agreements (“MEMR Regulation No. 10/2017”), MEMR Regulation No. 11 of 2017 concerning Utilization of Natural Gas by Power Plants (“MEMR Regulation No. 11/2017”) and MEMR Regulation No. 12 of 2017 concerning the Utilization of Renewable Energy Resources for Electricity Supply (“MEMR Regulation No. 12/2017”).

MEMR Regulation No. 10/2017

MEMR Regulation No. 10/2017 in general requires 14 mandatory provisions having commercial aspects to be stipulated in a power purchase agreement (“PPA”). The requirement of such main provisions shall apply to PPAs for all types of power plants with the exception of intermittent power projects utilizing new energy and renewable energy, hydro power plants with a capacity below 10MW, biogas power plants and waste based power plants which will be specifically regulated in separate regulations.

The followings are the major implications to the terms of PPA:

a. Implementation of BOOT scheme

To date, the BOOT scheme is mostly applied in PPA for coal fired power plants. In this regulation, the PPA referred to must be made and implemented using a build-own-operate-transfer (“BOOT”) scheme in order to ensure that all power plants constructed under the PPA will be owned by PT PLN (Persero) (“PLN”) upon the expiry of the PPA term and this may limit the possibility of the independent power producer developers (“IPP”) requesting an extension of the PPA term in order to retain its ownership of the power plant.

b. Limitations on PLN's obligations

Article 6 provides that PLN will only make deemed dispatch payments if the disruption to PLN's grid is not caused by force majeure events. Such provision indicates that PLN will not make deemed dispatch payments if PLN's grid is disrupted due to force majeure events, regardless of whether the IPP has the ability to generate and supply power to PLN during the occurrence of the force majeure event.

In addition to deemed dispatch payment, the bankability of the existing PPAs were also used to rely on PLN's take or pay commitment during the term of the PPA in which the IPP was assured it would receive a monthly payment based on a formula using capacity and variable components. Unlike the assurance given under the existing PPAs in respect of the purchase of electricity by PLN, Articles 6(2) and 6(3) provide for the mandatory electricity purchase by PLN to be performed for a certain period agreed by the parties considering the period of the IPP's debt repayment to lenders. Furthermore, Article 16 extends the PLN's obligations relating to the take or pay commitment wherein PLN will be subject to a penalty for its failure to absorb the electricity during that period. This regulation provides that the determination of penalty must be made proportionally in accordance with the investment composition, which leaves the penalty arrangement unclear.

We view that there is a risk that the return on investment of the investors will be questionable and difficult to project as the IPP's investors will rely on PLN's dispatch orders. The lenders will consider the potential losses to the IPP's revenue which may materially and adversely affect the ability of IPP to repay the debt and the projection of debt repayment period.

c. Bankability concerns relating to risk allocation

The current PPAs typically give the IPP the opportunity to terminate the PPA and to have its plant purchased by PLN at a reasonable price (in amount which is at least sufficient to repay the senior debt) upon the continuance of occurrence government force majeure, which covers changes of law and unjustifiable refusal by the government relating to permits. However, Article 8 provides that both PLN and IPP must cover the risk from the government force majeure, while the details of risk allocation will be further regulated in the PPA. The risk allocation relating to force majeure events becomes unclear and if the new PPA model depriving the IPP of the rights to deemed dispatched payments and rights to have the plant purchased by PLN at a reasonable price which is at least equal to the senior debt repayment under circumstance of force majeure, the PPA may be less bankable.

d. Limitation on transfer of rights

Existing PPAs and/or sponsor agreements usually have limitation on transfer of ownership by the IPP with a certain lock-up period. Article 24 of this regulation has increased the restriction by prohibiting any transfer of ownership of the IPP prior to COD except for transfers to affiliate in which the relevant sponsor having more than 90% shares and requiring PLN's prior approval for any transfer of ownership after COD, and such transfers must be reported to MEMR through the director general in the electricity sector.

Upon its enactment, this regulation will not impact PPAs which at least has reached the bid closing date. As for any ongoing IPP procurement which has not reached its bid closing date, they shall make adjustments in accordance with this regulation.

Based on the explanation above, it is most likely PLN will prepare a new PPA model despite announcements from the government which suggest that there will be no significant changes to the current PPA model. However, the mandatory provisions above have turned out to have produced significant changes to the existing PPA model which may have material impact, triggering concerns among IPP developers and financiers.

MEMR Regulation No. 11/2017

MEMR Regulation No. 11/2017 aims to escalate the use of natural gas in the energy mix for power plants and to ensure the gas allocation and utilization of natural gas for fulfilling the domestic power supply at reasonable and competitive prices for the power sector, and therefore, this regulation provides a ceiling price of gas for IPPs and the opportunity for PLN or IPP to import LNG. This regulation requires PLN and IPP to ensure the availability of natural gas supply in accordance with the 20 year designed lifetime of the power plants. The contractor will have priority in the role of gas supplier, provided that the contractor guarantees fulfillment of its obligations under the gas sale and purchase agreement (“**GSPA**”) during the term.

The followings are the key items which need to be observed by PLN, IPP and the contractor:

1. The procurement of wellhead gas power plants

The procurement of power plant utilizing natural gas in wellheads may be performed through direct appointment at the ceiling price for natural gas at the plant gate which must be 8% Indonesian Crude Price (“**ICP**”) per Million British Thermal Units (“**MMBTU**”) or through public tender if the price for natural gas is higher than 8% ICP/MMBTU. Furthermore, the interconnection point for wellheads gas power plant will be at the nearest electrical main station.

2. The natural gas pricing

The price of natural gas for power plants will be determined by MEMR with no escalation. If escalation is required, the escalation amount will be mutually agreed. The following are the circumstances which must be observed in determining prices:

- a. In the case of natural gas downstream infrastructure at the power plant, the applicable natural gas price will be the price at the plant gate, comprising the price of upstream natural gas and cost of natural gas distribution;
- b. If there is no natural gas downstream infrastructure at the power plant, the upstream natural gas price will be the applicable price and the downstream infrastructure will be prepared by PLN;
- c. In the case of non-wellhead power plants, the ceiling price for natural gas will be 11.5% ICP/MMBTU. Further, PLN or the IPP may use liquefied natural gas

(“LNG”) at free on board (“FOB”) price and calculated based on the economic value in the field if the gas price exceeds 11.5% ICP/MMBTU.

The purpose of MEMR determining the above various pricing mechanisms is to provide competitive prices for natural gas and LNG.

3. Import of LNG

PLN or the IPP may import LNG if the domestic price of LNG is higher than 11.5% ICP/MMBTU and the price of the imported LNG is not greater than 11.5% ICP landed price. If the price of imported LNG exceeds the ceiling, PLN or the IPP may purchase domestic LNG (on FOB basis) or piped gas at a price greater than the 11.5% ICP/MMBTU ceiling.

The various circumstances particularly the options to use natural gas or LNG and to import LNG would make it easier for IPP investors to arrange the gas supply for sustainability and continuity of gas supply for power plants, taking into account the lack of gas supply and allocations for Jawa-1 combined cycle gas turbine power plant which has caused bankability concerns and delay in its PPA execution.

4. Gas sale and purchase agreement

This regulation provides mandatory items to be set out in the GSPA and further provides that GSPAs may be multi-destination in nature for any PLN power plant unit.

The requirements of this regulation to sustainably comply with the restrictions on ceiling price have changed the variable price formula which was typically used in existing long-term gas supply agreements. Although this regulation does not require adjustment to any existing gas or LNG sale and purchase agreements for power plants in accordance with this regulation, this regulation does not have a transitional clause which addresses the implication if the variable price formula results in a price greater than the ceiling price.

MEMR Regulation No. 12/2017

MEMR Regulation No. 12/2017 substantially provides a pricing mechanism which using an electricity supply cost (excluding the electricity distribution cost) (“BPP”) approach and the manner how PLN can procure electricity from renewable energy-based power plants, as follows:

| Renewable Energy for Power Plants | Procurement Mechanism | Capacity Quota | Tariffs | |
|--|-----------------------|---|--|--------------------------|
| | | | Local BPP ≤ National BPP | Local BPP > National BPP |
| Solar (photovoltaic) | Tender process | Minimum total offering package of 15 MW | Local BPP | Maximum 85% of Local BPP |
| Wind | Tender process | Minimum total offering package of 15 MW | Local BPP | Maximum 85% of Local BPP |
| Hydro Additional requirements: a. ≤10MW plant will require operability with 65% minimum capacity factor; b. the capacity factor for >10MW plant will depend on the system’s requirements; c. using BOOT scheme | Reference price | Not applicable | Local BPP | Maximum 85% of Local BPP |
| | Direct selection | | Price determined in the direct selection process | |
| Biomass with capacity ≤10MW | Reference price | Not applicable | Local BPP | Maximum 85% of Local BPP |
| Biomass with capacity >10MW | Direct selection | | Price determined in the direct selection process | |
| Biogas with capacity ≤10MW | Reference price | Not applicable | Local BPP | Maximum 85% of Local BPP |

| | | | | |
|---|------------------|----------------|--|-----------|
| Biogas with capacity >10MW | Direct selection | | Price determined in the direct selection process | |
| Municipal waste (the IPP developer may be granted incentives in accordance with applicable regulations) | Reference price | Not applicable | Including BPP of Sumatera, Java and Bali grid, based on mutual agreement | Local BPP |
| Geothermal (using BOOT scheme) | Reference price | | | |

The enactment of MEMR Regulation No. 12/2017 has provided a comprehensive regulation in respect of power plants utilizing renewable energy by providing clarity on the procurement mechanism and certainty in applicable tariffs for such power plants. As the transitional clause of this regulation, provides that previous MEMR’s regulations relating to renewable energy (except for MEMR Regulation No. 03 of 2015) will remain applicable, the IPP developers may need to seek more clarity on the implementation of this Regulation, particularly with regard to the following items:

- a. This regulation provides tariffs for renewable energy using a BPP approach referring to the BPP of the local grid (“**Local BPP**”) and the average of the national BPP (“**National BPP**”) in the preceding year as determined by MEMR. This provision leaves unclear the procedure and timeline for the determination or publication of Local BPP and the use of preceding year data indicates that the determination of the prices referring to the BPP may not project any future inflation, considering that the determination of BPP comes from PLN and no provision in this regulation gives the IPP developer the opportunity to negotiate any change to the price due to changes to BPP in following year. Based on confirmation we received from the government, they are currently prepare a regulation relating to the BPP.
- b. The use of Local BPP as a fixed tariff if the Local BPP is especially lower than the National BPP may not attract investment from IPP developers, especially those in solar and wind power plants. Considering the requirements of the tender process for both types of plant, the award process will be questionable as no bidder will compete on tariff if the tariff will be definitely set at the Local BPP.
- c. With regard to hydro power plants, there are options for direct selection and reference price, but no detailed explanation regarding the mechanism for direct selection and no clear explanation regarding which circumstance would be the basis for PLN to choose direct selection over the reference price and vice versa.

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- d. This regulation requires a tender process for procurement of solar power plants with a minimum capacity of 15MW for one or more projects and therefore, it indicates that there will be no tender process for capacities below 15MW and may remain be procured through direct appointment under MEMR Regulation No. 19 of 2016.
- e. With regard to geothermal power plants, Article 11 contemplates that PLN may only purchase electricity from an IPP if the IPP in question has proved reserves after exploration. If the execution of PPA for geothermal power plant is subject to the proved reserves, no IPP developer would wish to invest money for exploration without a guarantee of PLN's off-taking and pricing. This requirement may change the investment climate in the geothermal power plant business.

Please contact any of the partners in our firm if you have any further questions on the above.

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