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MEMR Regulation No. 10 of 2018: Resolving the Investors' Concerns?

In February 2018, the Minister of Energy and Mineral Resources enacted the second amendment to MEMR Regulation No. 10 of 2017 concerning Principles of Power Purchase Agreements, under MEMR Regulation No. 10 of 2018. What is the impact of this enactment to the industry? Is it resolving the investors' concerns? Actually, what are their concerns?

Background

In early 2017, the Minister of Energy and Mineral Resources ("MEMR") issued a controversial regulation, MEMR Regulation No. 10 of 2017 concerning Principles of Power Purchase Agreements ("Regulation No. 10/2017"), which requires certain mandatory provisions to be stipulated in a Power Purchase Agreement ("PPA").

Regulation No. 10/2017 caused controversy as the regulation triggered concerns among the investors, both existing and potential investors in the power sector, as the requirements thereunder eroded the implementation of freedom of contract principle in the preparation of a PPA which had been and should have been made based on business to business arrangements between an independent power producer ("IPP") and PT PLN (Persero) ("PLN") due to its nature as an agreement.

Of the several issues that were raised from the enactment of the Regulation No. 10/2017, the unfair risk allocation between IPP and PLN relating to government force majeure ("GFM") was the biggest issue raised among the IPPs and the lenders due to the material change from the force majeure concept under the previous PPA model and its material impact on the bankability of PPA and power projects. MEMR issued the first amendment to Regulation No. 10/2017 under MEMR Regulation No. 49 of 2017 ("Regulation No. 49/2017") in response to such reaction, but the amendment did not substantially remove the concerns, because ….. Regulation No. 49 of 2017 only removed the GFM from the scope of force majeure events and the liability of PLN and IPP for the risk resulting from GFM and still kept other requirements which the private stakeholders felt were burdensome. The private stakeholders in the power sector have been expecting a further amendment to the Regulation No. 10/2017 to address their concerns on the bankability issue and risk allocation of force majeure events raised from the enactment of those regulations. MEMR Regulation No. 10 of 2018 ("Regulation No. 10/2018") was expected to be the answer.

Implications of Regulation No. 10 of 2018

Under Regulation No. 10/2018, MEMR removed change in laws from the force majeure events and removed the opportunity of PLN or IPP to request a price adjustment based on a change in law event. This amendment clearly shows the inability of Regulation No. 10/2018 to accommodate IPP's concerns and boost the interest of investors in power sector in entering PPA with PLN, and leaves the investors, IPPs and lenders with much bigger concerns.

The enactment of this new amendment will surely add another issue to the prolonged discussions among the IPPs and investors with respect to the following aggravating requirements relating to force majeure events which remain applicable and have not yet been amended or eliminated under Regulation No. 10/2017 and its amendments ("PPA Regulation"):

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a) as provided in Articles 5 and 6 thereof, IPP will remain unable to receive deemed dispatch payments from PLN 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.

   Moreover, as the PPA Regulation does not specify the possibility of PLN's buying out the power plant due to the occurrence of force majeure events, which was usually provided for in the previous PPA model, this provision clearly does away with the IPP's rights over deemed dispatched payments and causes IPP to share the risk of PLN's force majeure events and has a materially adverse effect on the ability of the IPP to repay the debt to the lenders. The PPA model which applies this requirement will definitely make the PPA less bankable; and

b) the PPA Regulation stipulates several implications of force majeure event, namely the requirement of IPP and PLN to bear the risk of force majeure events, no payment of deemed dispatch by PLN due to disruption of PLN's grid resulting from force majeure event, termination of PPA and release of obligations of the parties to the PPA. All such implications refer to 'force majeure events' without mentioning the type of force majeure events and MEMR's amendments under MEMR No. 49/2017 and MEMR No. 10/2018 which removed the change in laws and GFM from the description of force majeure under Article 28(2) leaves natural disaster/natural force majeure ("NFM") as the only description of force majeure events under Article 28(2) of the PPA Regulation. This can be interpreted as follows:

   i. the implications of force majeure event stipulated under the PPA Regulations only refer implications of NFM as the only force majeure event being acknowledged under the PPA Regulation and therefore, the removal of change in laws and GFM from the description of force majeure under Article 28(2) of the PPA Regulation and the removal of equal risk allocation undertaken by PLN and IPP in respect of GFM may give the IPP the opportunity to negotiate with PLN to set out provisions regarding the change in laws and other events of a GFM nature and their consequences, with the expectation of having such events being treated as triggering events for receiving deemed dispatch payments and tariff adjustments and the possibility of PLN buying out the relevant power project. With regard to the PPA Regulation, the IPPs will only need to focus on keep trying to find the best way to enable them to get the deemed dispatch payment from PLN due to NFM events effecting PLN's grid; or

   ii. on the worst assumption, those amendments may also seem to the private stakeholders merely to limit the scope of force majeure events and remove MEMR and PLN's acknowledgement of such events and limit PLN's liability to the IPP upon the occurrence of change in laws and GFM. The private stakeholders in the power sector always expect that PLN, as a state-owned enterprise and thus closer to the government, which gives it bigger capacity to mitigate the impact of change in laws and GFM (which includes unjustified government action or inaction), would bear the risk resulting from change in laws and GFM. If this assumption is embodied in the PPA, the IPPs may have difficulties negotiating for change in laws and GFM (which includes unjustified government action or inaction) and their consequences to be included in the PPA.

In addition to the above, the narrowing of the scope of force majeure events made by MEMR remains and raises more questions on the MEMR's reasons for such removal. In the considerations for Regulation No. 49/2017 and Regulation No. 50/2017, the amendments made thereunder are to give legal certainty in the performance of electricity supply business, yet .....

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this PPA Regulation does not give clarity on whether PLN will acknowledge other common types of force majeure events (e.g. acts of war, sabotage, rebellion, riots) and the consequences of such events having force majeure nature.

Pursuant to the foregoing, the PPA Regulation still leaves questions among the private stakeholders in the power sector on (i) clarity on how much opportunity they have to negotiate the terms and risk allocation relating to the change in laws and GFM on which the PPA Regulations are silent, (ii) ….

(ii) how they can find the best strategy to deviate from or waive the consequences of NFM events effecting PLN's grid, which is expressly provided in the PPA Regulation and (iii) how they could construct the best solution which enables them to regain their rights under the previous PPA model with the opportunity to receive deemed dispatch payments, tariff adjustments and payment of termination costs, in relation to the GFM events.

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

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