2011 Indonesian Law Review: Geothermal Mining & Power Production

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In response to heightened investor interest in Indonesia's geothermal resources, the government issued several new legislative changes for the sector in 2011. However, the changes may not provide sufficient legal certainty to stimulate immediate investment. The main challenges for geothermal developers include uncertainty governing the price of electricity, as well as land acquisitions issues. While several new regulations attempt to provide greater clarity with regards to price, the implications of a recent land acquisition law remain unclear.

Geothermal activity in Indonesia is broadly governed under the Geothermal Law (Law No. 27 of 2003). Additional implementing regulations were issued in 2007 and the government's National Energy Management Blueprint for 2006-2025 envisions an increase in geothermal electricity generation from 807 MWe in 2005 to 9500 MWe in 2025.

Geothermal resources are regulated under the Directorate of Geothermal, even though the primary (if not only) use of geothermal energy is to generate electricity. An overview of the geothermal regulatory regime can be found here.

Government Guarantee of PLN's PPAs

In an effort to more attract private power investors, the Minister of Finance recently issued Regulation No. 139 in August 2011 in which the Government of Indonesia guarantees the financial obligations of PT Perusahaan Listrik Negara (Persero) ("PLN"), the state-owned electricity provider, under their power purchase agreements. Based on this Regulation, the guarantee will be signed by the Ministry of Finance and issued to the investors instead of PLN.

The guarantee would be provided based upon a proposal from PLN to the Ministry of Finance for part or the full period of the power plants operation (i.e. the commercial operation date through the expiration of the PPA). A full period guarantee will be valid until the PPA expires and a partial period guarantee will expire on a certain date as specified in the guarantee.

For geothermal power plants, the guarantee will be cancelled if the investor fails to achieve financial close (i.e., executing financing agreement(s) and receiving funds there from) within 48 months after the guarantee is issued. While Regulation No. 139 seems to have improved the form and structure of the guarantee, many believe that the guarantee is not sufficient to ensure the realization and sustainability of power plant projects as the guarantee does not cover risks beyond the possible non-payment by PLN.

There remain various non-financial issues that are not guaranteed such as difficulties in obtaining forestry licenses, the commercialization of the guarantee process, lack of ministerial coordination and costly land acquisition. Moreover, the guarantee also does not the cover pre-commercial operation period, meaning that any issues that may cause delays to the commercial operation are not covered by the guarantee.

PLN required to purchase electricity from geothermal power producers

In 2010 PLN was instructed to accelerate the development of renewable energy power plants under Presidential Regulation No. 4 of 2010. The Minister of Energy and Mineral Resources ("MEMR") subsequently issued Regulation No. 2 of 2011 ("Regulation No. 2") which specifically applies to geothermal power plants.

Regulation No. 2 requires PLN to purchase electricity from geothermal producers, including both the bid winners of a geothermal working area as well as those producers granted geothermal rights or concessions before the enactment of the current Geothermal Law of 2003. In addition, the Ministry of Energy and Mineral Resources stated that the assignment also applies to power plant projects listed in MEMR Regulation No. 15 of 2010. This regulation lists certain accelerated power plants projects.

The benchmark price for electricity purchased from a bid winner is a maximum of 9.70 cents US$ per kilowatt-hour (kWh). This price ceiling is final and non-negotiable. For geothermal working areas in which bids were made before the issuance of Regulation No. 2 and have prices higher than 9.70 cents per kilowatt-hour (kWh), the parties must negotiate a new price. Parties must also negotiate the price for electricity purchased prior to the Geothermal Law of 2003. Any negotiated prices must be approved by the MEMR.

While the MEMR assigns electricity purchases by letter to PLN, ongoing purchases of electricity prior to the issuance of Regulation No. 2 are considered assigned and the electricity prices must be approved by the MEMR.

Regulation No. 2 is expected to accelerate the utilization of geothermal resources for power plants as there is now certainty on the electricity purchaser. However, the necessity of separate assignment letters would likely cause delays and should actually not be an issue if Regulation No. 2 also constituted an assignment letter.

Proposed New Price Regulation

In addition to the above regulation, some reports have recently indicated that the government is preparing a new regulation to amend or modify the price of electricity produced at geothermal power plants. While the 9.70 cents per kilowatt-hour (kWh) price ceiling remains in effect, it may be modified to promote the development of geothermal production in specific areas of Indonesia, including those that are geographically remote. This new regulation was scheduled to be issued by the end of 2011, however, it is likely to be issued next year.

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