Latest developments in Indonesia

Baker & McKenzie Indonesia

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Indonesia features 1,197 MW of installed capacity, making it the third largest producer of geothermal power next to the US and the Philippines.

It is reported to have 27 GW more of untapped generating capacity available for harnessing. Indonesia's current year-on-year generation growth for geothermal averages at 9% and is expected to leap to about 20% by 2016.

The Indonesian Government is now looking into developing 93 power plants for its second 10-GW power generation project, as a part of the country's 'fast-track' program aimed at satisfying the country's rising energy needs. This Second Fast-Track Program has empowered state utility company PT Perusahaan Listrik Negara (PLN) to develop geothermal, coal and hydropower generating plants in tandem with independent producers.

Pioneer projects under Second Fast-Track Program

The Muara Laboh geothermal power project and the Rajabasa geothermal power project are the first two projects to be finalized under the framework of Indonesia's 10-GW Second Fast-Track Program. Baker & McKenzie's member firms in Singapore and Jakarta facilitated a consortium of sponsors in concluding these projects' power purchase agreement and Government guarantee arrangements.

The sponsors consortium consisted of PT Supreme Energy, International Power - GDF SUEZ, and Sumitomo Corporation. The development and construction of these two projects are expected to be financed by the Japan Bank for International Cooperation and other international financial institutions.

Government offers Business Viability Guarantee to power projects

The Business Viability Guarantee is a Government guarantee that ensures PLN's ability to fulfill its payment obligations under the power purchase agreement (PPA) for projects belonging to the Second Fast-Track Program.[1]

The Business Viability Guarantee Letter is made available to power projects on a case-by-case basis through application by PLN to the Government of Indonesia (GOI) acting via the Ministry of Finance (MOF). The discretion as to which power projects will be given a Business Viability Guarantee lies with the Fiscal Policy Agency and the MOF. It is not a blanket guarantee which covers all independent power producers.

The MOF issued on August 2011 a regulation[2] (MOF Reg. 139/2011) stipulating the procedures for the granting of a Business Viability Guarantee in the development of power plants using renewable energy, coal and gas conducted by PLN in cooperation with independent power producers.

Evolution of Viability Guarantee regulation

Before the advent of MOF Reg. 139/2011, MOF Regulation No. 77/2011 (Regulation 77) had previously set out the details and the framework under which the GOI, through the MOF, will provide Viability Guarantees to PLN for specific power projects.

Under Regulation 77, the Viability Guarantee is to be given in the form of a letter to PLN stating that the GOI guarantees PLN's ability to fulfill its payment obligations under the PPA in the event of a "Shortfall". A shortfall occurs when PLN's financial condition is insufficient to meet its payment obligations under a PPA due to an act or a decision of the GOI that significantly results to loss in a project.

If the funding shortfall is not caused by GOI's decision or act, the GOI shall not cover the shortfall through the Viability Guarantee. Another requisite is for the GOI's act or decision to be "significant" in causing the loss to the project, which otherwise will not trigger a right to claim under the Viability Guarantee. This requisite adds another layer of uncertainty to the scope of the Viability Guarantee.

Regulation 77 does not offer the project company with a direct recourse against the provider of the guarantee (i.e. the GOI). It also has no mechanism that would enable the project company to require PLN to enforce its rights under the Viability Guarantee or to make a direct claim under the Viability Guarantee in the event that PLN fails to do so.

Viability Guarantee: Now

A positive development under the current regulation in force, MOF Reg. 139/2011, is that it grants the project company direct contractual rights against the GIO, making it more useful to sponsors and their lenders.

Under the regulation, the Business Viability Guarantee Letter shall be directly addressed to the project company that has committed to construct a power plant and supply electricity to the PLN on a long-term basis under a PPA or an equivalent agreement.

Scope of coverage

The Business Viability Guarantee Letter (BVGL) covers the risk of non-payment by PLN for amounts stated in a payment invoice for the purchase of electricity issued by the (project company) power producer, in line the applicable PPA.

In practice, the MOF specifies within the BVGL an exclusive list of PLN payment obligation clauses in the PPA that the GOI pledges that PLN will fulfill.

Such list of clauses calls for a careful review. The more apparent provisions that should be covered by the BVGL guarantee are monthly electricity sales payments, take-or-pay payments, late payment interest and deemed dispatch payment obligations of the PLN under the PPA. Sponsors, however, may also consider negotiating for some other payment obligations of PLN under the PPA, for instance any due payments arising from retrospective adjustments of payments under past invoices following any recalibration of the metering systems.

Since MOF Reg. 139/2011 requires that the guarantee be extended only to payment obligations that are stated in invoices for the purchase of electricity issued under a PPA, care should be taken during the drafting and negotiations of the PPA to address the point that payments which are sought to be covered by the BVGL should fall within the invoicing regime under the PPA.

Coverage – Termination Payments

MOF Reg. 139/2011 does not state whether or not a BVGL can cover the risk of non-payment by PLN of due amounts arising from the termination of a PPA.[3]

A plausible alternative is to incorporate within the BVGL, outside of the guarantee provisions, that the GOI will ensure that PLN fulfills its listed termination payment obligations under the PPA through GOI's fulfillment of certain statutory public service obligations to PLN under the relevant Indonesian laws and regulations.

The reference to public service obligations is linked to the rule under the existing law on State-Owned Enterprises that the GOI must pay compensation to PLN for performing a public utility function assigned to it by the GOI. This is further implemented by MOF regulations that endorse an electricity subsidy for PLN to cover the difference between its average selling price of electricity and the costs of supplying electricity.

The obligation imposed upon the GOI under the BVGL is not as favorable to sponsors as a clear guarantee for the termination payments, since there is no legal basis for the project company or the lenders to enforce PLN's rights in compensating the public service obligation. This is because GOI's obligation to compensate PLN is not owed to the project company.

If the BVGL does incorporate a rule requiring the GOI to fulfill its obligations to PLN, the quantum of damages that could be recovered by the project company on the breach by the GOI still remains unclear.

That said, without clearer legislation supporting the express coverage of the termination payments by the BVGL, this alternative could be a practical solution that may be considered as workable by both the MOF, and the sponsors and lenders in view of previous precedent IPPs that were project-financed in connection with the Umbrella Note of Mutual Understanding signed between JBIC and the GOI.

Under this Umbrella Note, GOI affirms its commitment to enable PLN to perform its PPA obligations in a timely manner by providing it with financial compensation for its public service obligations arising under the laws. The Umbrella Note is, in essence, a confirmation that specific public service obligations-related regulations apply to the power project in question, and does not actually increase the GOI's commitment to PLN.

Commencement

The MOF Reg. 139/2011 outlines that, in relation to a BVGL issued for a geothermal power project, a BVGL expires if financial close has not occurred within 48 months after its issuance. We understand that, as a practical matter, BVGLs will be signed on the signing date of the related PPA or shortly thereafter. The time period for achieving financial close under each BVGL will vary, but it should conform roughly to the equivalent deadline under the relevant PPA.

Tenor

Under MOF Reg. 139/2011, the financial model (cash flow model) for the project company is required as a part of the BVGL application package to be submitted to the MOF by PLN.

The practical purpose of providing the financial model is to allow the MOF to consider the required tenor of the BVGL coverage on the basis of the financial model, among other things. Each project will need to negotiate its own BVGL tenor with the MOF.

The regulation also provides that the BVGL only covers the risk of PLN's non-payment during the operation period of the power plant project (i.e. the period after the commercial operation date of the project). On the face of it, invoices for electricity generated during testing and commissioning of the power plant may not be covered by BVGL, if the commercial operation date is interpreted to only occur when the relevant commissioning tests stipulated under the PPA have been successfully completed.

To note, it is also uncertain whether or not the commercial operation date in the regulation can be read more broadly to include the deemed commercial operation date, so that invoiced electricity payments arising from the deemed commissioning under the terms of the PPA[4] can be covered by the BVGL.

Conclusion

The Business Viability Guarantee Letter marks a key improvement to the Government's level of support for geothermal power projects.

The outlook is positive for the Indonesian market as the terms and conditions of the BVGL is expected to evolve further, while project companies and their lenders hold discussions with the Ministry of Finance on future projects.

When a more bankable form of the BVGL is created, we will see a faster development of geothermal power projects in Indonesia under the Second Fast-Track Program.

Source :
http://www.lexology.com/library/detail.aspx?g=729a5626-2d4d-4a29-9016-29120d2b0587