Indonesia's New Public Private Partnership Rules

The President of the Republic of Indonesia recently issued Presidential Regulation No. 38 of 2015 on Cooperation between Government and Business Entities in Procurement of Infrastructure ("PR 38/2015") - another attempt to boost infrastructure development in Indonesia. This new regulation revoked and replaced in full the previous Presidential Regulation on public private partnership ("PPP"), namely Presidential Regulation No. 67 of 2005 as amended lastly by Regulation No. 66 of 2013.

PR 38/2015 introduces some key changes to PPP implementation rules in Indonesia, including the inclusion of new types of infrastructure that can be developed through PPP schemes, the introduction of a direct appointment mechanism and expanding the types of investment return schemes that can be adopted in structuring PPP projects.

Key Changes

1. Expansion of Types of Infrastructure

PR 38/2015 extends types of infrastructure that can be developed using PPP schemes to include not only transportation, road, irrigation, drinking water, waste, telecommunication and informatics, power, and oil and gas infrastructure, but also infrastructure projects related to, among other things, education facilities, sports and arts facilities; tourism; health; and public housing. This expanded list of projects which can be implemented through a PPP mechanism has brought the Indonesian regime more closely into line with PPP-like schemes in other countries – where large social infrastructure related projects (e.g. schools, hospitals etc) are developed through PPP-type mechanisms.

PR 38/2015 also allows development of commercial facilities in a PPP project. PR 38/2015 does not provide specific examples of what these projects are, but we suspect that this change is to address concerns from some infrastructure projects where the projects will be feasible and bankable (e.g., without having to charge a very high tariff to customers) only if commercial areas around the project can be developed as part of the project (e.g., restaurants, shopping malls).

2. Introduction of Direct Appointment and New Tender Procedures

The old PPP regulations only allowed procurement of a PPP project through a tender mechanism (albeit that an unsolicited proposal could be submitted to the relevant Government initiator, who would then conduct a tender and give the original project proponent a preference in the tender process). In PR 38/2015, a direct appointment mechanism is allowed if:
i. the project is an infrastructure development project which was developed or operated by that same developer;

ii. the project utilizes a new technology and only one developer can provide that technology; or

iii. the developer has acquired all or a majority part of the land required for the project.

It is interesting to see that point (iii) above is included as a reason to select a developer using a direct appointment mechanism. This in effect substantially expands the ability of PPP projects to be implemented on a direct appointment basis.

Further, aligned with the inclusion of point (iii) above, in the same week as the issuance of PR 38/2015, the President also issued a new implementing regulation of the New Land Acquisition Law. This new regulation allows private entities to acquire land on behalf of the government or Central Government-owned companies (Badan Usaha Milik Negara - BUMN) / Regional Government-owned companies (Badan Usaha Milik Daerah - BUMD) for development of infrastructure projects. Please click here for our latest Client Alert on land acquisition for public interest.

3. Land procurement

Under the old PPP regulations, land procurement was implemented by the relevant government institutions before submission of tender documents and if the project was financially feasible, the winning bidder could reimburse the land procurement costs which have been incurred by the relevant government institutions.

As mentioned above, the new regulations accommodate private developers carrying out land procurement on their own, although, when they use powers under the New Land Acquisition Law for procuring the land, the private developers will act on behalf of the relevant authority-in-charge (not on their own behalf). Under PR 38/2015, the procurement process for a project will only be implemented after stipulation of the location of the project. Further, if the authority-in-charge is a BUMN/BUMD, PR 38/2015 also allows the land procurement funding to be sourced from the internal budget of the relevant BUMN/BUMD or from the relevant developer through cooperation with the relevant BUMN/BUMD.

4. Form of Cooperation

The previous regulation stipulates two forms of PPP, namely: (i) cooperation agreement and (ii) concession license (izin pengusahaan).

PR 38/2015 only provides one type of PPP form, i.e., PPP through cooperation agreements. The changes seem to reflect the current PPP development practice; so far, we are not aware of any PPP project which has been developed through a concession license scheme alone (without any bilateral contract between Government and the private developer). Looking at the PPP projects already implemented (or currently being implemented), Central Java 2x1000MW power project was implemented under a long term Power Purchase Agreement between the Indonesian State-owned power utility (PLN) and the private developers.
5. Criteria of PPP projects initiated by private developers and the reward

PR 38/2015 simplifies criteria for unsolicited projects:

<table>
<thead>
<tr>
<th>Old PPP regulations</th>
<th>PR 38/2015</th>
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<tbody>
<tr>
<td>The proposed project is not included in the master plan of the relevant sector</td>
<td>No requirement</td>
</tr>
<tr>
<td>The proposed project is technically integrated into the master plan in the relevant sector</td>
<td>No change</td>
</tr>
<tr>
<td>The project is economically and financially feasible</td>
<td>No change</td>
</tr>
<tr>
<td>The project does not need any government support in the form of fiscal contribution in financial forms</td>
<td>The initiator has sufficient financial capability to finance the implementation of the project</td>
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The additional score provided for the initiator during the tender in the old PPP regulations was set at a maximum 10%, meanwhile, PR 38/2015 provides a fixed 10% additional score. The other compensation option given to the initiator during the tender remains the same, i.e., right to match and right to buy out the initiated project (including the intellectual property rights).

6. English as the “Official Translation” and Dispute Settlement Mechanism

As with the previous regulation, dual language cooperation agreements are allowed. However, PR 38/2015 now stipulates that the English version is the “official translation” of the agreement. It is not clear what is meant by “official translation”, however whatever its meaning, PR 38/2015 does not require Bahasa Indonesia to be the prevailing language in the case of inconsistency, and accordingly our view is that it is open to parties to expressly provide for English to be the prevailing language in the event of a conflict.

PR 38/2015 also stipulates the use of Indonesian language for settlement of disputes within the jurisdiction of Republic of Indonesia. It is also not clear: (i) whether this new provision means that parties can only agree to have dispute settlement forums within Indonesia using Indonesian language or (ii) whether this new provision simply provides that if the parties agree to have a dispute settlement forum in Indonesia, then the agreed language for settlement of disputes must be Indonesian language. Our best reading of the regulation in this regard is that the latter meaning is the intended one.

7. Investment Return

While the old regulations only provided investment return in the form of tariff, PR 38/2015 expressly stipulates three forms of investment return:

i. tariff from end customers;
ii. availability payment; and/or

iii. other forms of payment, as long as they do not violate prevailing laws and regulations.

If the investment return is in the form of a tariff, the initial tariff will be determined by the relevant authority-in-charge or determined based on the capability of end users to pay the tariff. In the second case, the authority-in-charge can provide feasibility support (e.g. fiscal contribution) to ensure that the investment return can be obtained.

An availability payment is a periodic payment made by the authority-in-charge to the developer during the operational period of the project based on the availability of the services (depending on quality or performance). This availability payment will take into account the capital costs, operational costs and/or profit of the implementing business entity. Details of this availability payment will be stipulated in ministerial regulations which must be issued within 30 days after promulgation of this PR 38/2015. However, from the provisions of PR 38/2015, it seems to us that the availability payment mechanism reflects the payment method generally used in base-load PPP thermal power projects. However the same concept could be used in toll roads (e.g. shadow tolls whereby the Government agrees to provide a base level of revenue to the concessionaire).

Other Changes

Other than the changes mentioned above:

i. PR 38/2015 expressly accommodates cooperation between more than one authority in charge (i.e. minister/head of agency/head of region or BUMN/BUMD in charge for the development of the infrastructure) for cross-sector infrastructure projects.

ii. The old PPP regulations allowed BUMN/BUMD to act as the authority-in-charge in a PPP project. PR 38/2015 highlights that this scheme will need to be implemented through a cooperation agreement between the authority-in-charge and the relevant developer - which is in line with the current practice in development of PPP power projects where PLN (a BUMN) acts as the authority-in-charge and signs a cooperation agreement (namely the Power Purchase Agreement) with the private developer.

iii. PR 38/2015 expressly regulates that maximum value of the performance bond is 5% of the investment value. It is not entirely clear how "investment value" is to be calculated. In certain sectors, e.g. power, the value of the performance bond is typically tied to a percentage of one year of the project's fixed revenue components.

iv. PR 38/2015 highlights that preparation of the project can involve private entities/international organizations.

v. PR 38/2015 provides detailed provisions on procedures of transfer of assets owned or controlled by the Minister/Head of Agency/Head of Region to the relevant developer.
vi. PR 38/2015 provides that a cooperation agreement must now include mechanism of change of work and/or services and mechanism of takeover right by the Government and lenders.

vii. PR 38/2015 shortens each extension period to reach financial close from 12 months to 6 months. Similar to the old PPP regulations, the extension can be granted "from time to time", without any express stipulation of the maximum number of extensions that can be granted to the developer.

viii. PR 38/2015 expressly stipulates that the authority-in-charge may finance a part of the PPP project funding needs.

ix. PR 38/2015 provides that ministers/heads of agencies/heads of regions may appoint a working unit in their organizations as Simpul PPP. This unit will synchronize, coordinate, supervise, evaluate and prepare policies on the development of PPP.

In terms of the application of these new rules to PPP projects which have already commenced their procurement process but have not yet reached the point of having the cooperation contract signed, PR 38/2015 provides that the cooperation contract must be prepared in accordance with PR 38/2015.

Closing

Infrastructure opportunities are abundant in Indonesia. However, there are many ingredients necessary to make an infrastructure project successful. The Ministry of National Development Planning (Badan Perencanaan Pembangunan Nasional - BAPPENAS) has estimated that IDR5,452 trillion (equivalent to approximately USD450 billion) will need to be invested in Indonesia’s infrastructure development from 2014 to 2019, out of which the state and regional budget can only cover approximately USD99 billion (around 22%), resulting in a financing gap of about USD356 billion. Therefore, involvement of private entities - through various PPP schemes - is crucial to fill that void.

Although the PPP scheme has been in place for close to 10 years, there have been very few projects awarded under this scheme. It is hoped that these further refinements to the PPP regime will hasten the achievement of the Government’s infrastructure development targets.