New Legislation Gives Geothermal Power Sector Much Needed Boost

The House of Representatives passed the new Geothermal Resources Act ("**the 2014 Act**")[i] on 26 August 2014. The 2014 Act gives an important boost to the geothermal energy industry as it provides that pricing will henceforth be based on economic cost, something that is of the utmost importance in an industry where upfront costs can be enormous. In addition, it significantly liberalizes the rules regulating the development of geothermal power projects, in particular by no longer classifying geothermal energy exploitation as a form of "mining," thus exempting it from the restrictive rules governing mining in designated forest areas. This is in marked contrast to the legislation it repeals and replaces -- the Geothermal Energy Act 2003 ("**the 2013 Act**")[ii] -- which specifically characterized geothermal energy exploitation as mining. The new legislation also places all authority in respect of the licensing of geothermal resources for power generation purposes in the hands of the central government, whereas previously it was shared with local government.

Background

Located on the Pacific Ring of Fire, Indonesia boasts enormous geothermal potential. According to the Ministry of Energy and Mineral Resources, the country's harnessable geothermal resources are sufficient to generate 28,000 Megawatts of electricity. To put this into context, PLN's Java-Bali operations area currently has a total capacity of some 6,511 Megawatts. Even better, about 9,000 MW of this potential is found in Java-Bali, where the bulk of the country's population lives, while another 14,000 MW is close at hand in Sumatra. Despite this enormous potential, however, the industry has been very slow to develop (only 1,300 MW is currently being tapped). This is not just due to the expense and cutting-edge technology required to harness geothermal energy, but also other factors such as frequent changes in the regulatory framework, onerous investment requirements, overlapping legislation and licensing requirements, and a lack of qualified human resources. It is expected that the 2014 Act will help to overcome at least some of these constraints.

Key Changes

a. Pricing

Article 22 contains one of the most significant provisions in the 2014 Act, namely, the price payable for the use of the state's geothermal energy resources shall be set by the government "having regard to economic cost." As alluded to in the opening paragraph above, upfront costs in the geothermal industry are daunting, and very few investors are willing to bear the risks involved without some form of long-term price security. Article 22 goes some way towards providing such security.

Also regarding pricing, the Minister of Energy and Mineral Resources issued a regulation on 3 June 2014 that increases the purchase prices payable by state power utility PT Perusahaan Listrik Negara (Persero) ("**PLN**") for electricity produced by geothermal power plants and for geothermal steam that is used in generating electricity. The regulation, which also specifically requires PLN to purchase electricity produced by geothermal power plants, received a generally warm welcome from the industry.

Another significant provision on pricing in the 2014 Act is Article 85, which provides that an IUP holder that signed a geothermal power purchase agreement prior to the legislation's coming into effect may renegotiate its contract.

b. Centralized Licensing

As with the 2003 Act, the 2014 Act distinguishes between geothermal energy that is "directly used" and that which is "indirectly used." The former includes the exploitation of geothermal for such things as tourism, agribusiness and industrial purposes, while the latter refers to the use of geothermal to generate electricity. This is a crucial distinction as Article 5(1)(b) of the 2014 Act places the licensing authority for all aspects of indirectly exploited geothermal energy (that is, electricity generation) in the hands of the central government, while licensing authority in respect of directly exploited

geothermal energy is shared by central and local government. Under the 2003 Act, licensing authority for both directly and indirectly exploited geothermal energy was shared by central and local government. Thus, Article 5(1)(b) introduces a crucial change as it makes the central government the sole licensing authority for the use of geothermal energy for power generation, thereby helping to greatly simplify the licensing process.

c. Mining No More

The third major change is that geothermal exploitation is no longer specifically classified as a form of "mining." By contrast, the 2003 Act characterized geothermal exploration and exploitation as "mining operations." This caused a serious problem as the Forestry Act 1999[iii] prohibits mining in designated forest conservation areas (where much of the country's geothermal potential is located). As with the 2003 Act, the 2014 Act vests sole authority to determine the boundaries and extent of geothermal concessions[iv] for power generation in the central government. However, a major change from the 2003 Act is that Article 16 of the new legislation specifically states that concessions may be granted in respect of state land, registered land (that is, land for which a title certificate has been issued), tribal lands, water areas and, perhaps most importantly, forest conservation areas (Article 5(1)(b)). Should the geothermal project be located in a designated forest area, the Geothermal License holder must obtain:

a. A borrow-use permit for a production or protection forest area; or
b. a license for the use of a conservation forest area.
c. In the case of a forest conservation area, an Environmental Services Utilization License[v] will also be required.

Thus, based on the twin legal maxims of *Lex specialis derogat legi generali*[vi] and *Lex posterior derogat legi priori*[vii], it is now clear that geothermal resources may be developed for electricity generation purposes in forest conservation areas. However, in order to give effect to this, it is expected that an ancillary / implementing regulation will be issued down the line either by the Ministry of Forestry, or jointly by the Ministry of Forestry and Ministry of Energy and Mineral Resources, in order to clarify the nuts and bolts of precisely how geothermal operations may be conducted in conservation forest areas.

d. Concession Size Rules Relaxed

Another significant change is that unlike the 2003 Act, which capped the extent of a geothermal concession at 200,000 hectares, the 2014 Act provides that the size of the concession shall have regard to the geographical extent of the geothermal sistem. Further, it provides the government with the leeway to regulate this aspect by way of government regulation.

Licenses

As regards power generation, the 2014 Act replaces the Geothermal Mining License ("**IUP**")[viii] required under the 2003 Act with a Geothermal License ("**IPB**")[ix] to be issued, following an auction process, by the minister responsible for the geothermal sector ("**the Minister**"). Under Article 27 of the 2014 Act, the IPB may not be assigned to a third party. However, the IPB holder may sell its shares on the Indonesia Stock Exchange after the exploration phase has been completed, subject to the approval of the Minister.

The maximum validity of an IPB is set at 37 years, but it may be extended for unlimited consecutive periods of 20 years.

The 2014 Act differentiates geothermal operations into (i) exploration, and (ii) exploitation and utilization phases. The duration of the exploration phase is set at five years from the issuance of the IPB, extendable for two periods of one year each, while the duration of the exploitation and utilization phases is capped at a total of 30 years from the date of approval of the feasibility study by the Minister. The fact that the legislation caps the length of the two stages rather than setting fixed terms means that the Minister has discretion in determining the duration of each stage. What is not so clear is whether a separate IPB will be required for each stage. Logically, we believe that only one should be required given that the operator will need certainty in preparing its estimates and calculations to support its bid as part of the IPB auction process. However, going by the way the legislation is drafted, it appears that two IPBs are contemplated.

Under Article 31(3) of the 2014 Act, before commencing the boring of exploratory wells, the IPB holder must obtain an Environmental License[x] from the Ministry of the Environment, and then must obtain a further Environmental License before commencing the exploitation and utilization phases (Article 32(2)). This is because a new Environmental License must be obtained each time there is change in a company's operations (although in some cases our lawyers have seen mining companies include all of their operations in one environmental impact analysis[xi] or environmental

management/monitoring report,[xii] so that their environmental licenses apply to both the exploration and exploitation / utilization phases).

Taxes and Other Levies

Article 54 of the 2014 Act provides that an IPB holder must pay taxes and other levies to central and local government. In the case of the central government, besides the normal taxes that are payable to the central government by all commercial entities, an IPB holder must also pay a dead rent[xiii] and production royalties, and, in a catch-all provision, "such other state levies as may be provided for by law" (the Elucidation explains that these include such things as education and training fees, and R&D fees).

At the local government level, the IPB holder is required to pay local government taxes, local government service charges (such as charges for the provision of public lighting, garbage disposal, etc), and, once again in a catch-all provision, ""such other levies as may be provided for by law."

In addition to central and local government taxes and levies, Article 53 provides that an IPB holder is required to pay what is termed a "production bonus" to the local government within whose jurisdiction the geothermal project is located. The amount of the bonus is to be determined as a fixed percentage of the IPB holder's "gross earnings since first commencing operations." Obviously, this gives rise to questions, such as when is the bonus to be paid, is it a one-off payment, are there any exemptions? The 2014 Act gives no answers to these, merely stating that the bonus's "size and payment procedures shall be provided for by Government Regulation." It should be noted that the bonus is payable in respect of all concessions, including those issued prior to the 2014 Act. For concessions issued prior to the 2014 Act that are currently in production/operation, the bonus is payable starting from January 2015.

Unlike the 2003 Act, the 2014 Act does not contain a detailed breakdown of the division of tax and other revenues as between central and local government, but merely states that this shall be determined "in accordance with the provisions of the laws and regulations in effect" (Article 54(6) of 2014 Act).

Article 55 allows the government to provide fiscal and other incentives, as authorized by law, to encourage the development and exploitation of geothermal resources.

Ownership of Data and Information

Article 57 of the 2014 Act provides that all data and information obtained as a result of geothermal operations shall belong to the state and be managed by the government. Consequently, approval from the government is required prior to any disclosure or dissemination of such data and information. This rule is similar to the rules on data and information confidentiality in the oil and gas industry. However, a clear approval process for information disclosure will need to be put in place or the financing of geothermal projects could be hampered.

Rights of the Public

Unlike the 2003 Act, the 2014 Act contains a specific chapter devoted to the role and rights of the public. These include (i) the right to obtain information on geothermal matters from government; (ii) to benefit from corporate social responsibility and community development efforts; (iii) to be compensated for negligence on the part of a geothermal operator; and (iv) to sue for damages in respect of any losses suffered as a result of the operations of a geothermal operator.

Transitional Provisions

Article 78 of the 2014 Act provides that all geothermal concessions granted prior to the legislation's enactment will remain valid for 30 years from that date; all geothermal operating contracts will remain in effect until their expiry; and all geothermal licenses granted prior to the enactment of the legislation will remain in effect until their expiry, provided that exploitation has commenced by not later than 31 December 2014. Upon the expiry of such geothermal concessions, operating contracts and licenses, they may be converted into IPBs. This would appear at first sight to be a grandfather clause. However, the problem is that IPBs will be issued under more onerous conditions, particularly in the taxation arena, than the contracts that were entered into with geothermal operators in the past. Thus, the grandfathering does not extend to 100%.

Article 79 provides that all IUPs issued prior to the coming into effect of the 2014 Act must be converted into IPBs by the Minister.

Article 82 provides that the holders of geothermal concessions, geothermal operating contracts, geothermal licenses and IUPs issued prior to the coming into effect of the 2014 Act may now conduct operations in conservation forests based upon an Environmental Services Utilization License.

Should a company have been named the winner of a concession auction prior to the coming into effect of the 2014 Act but has yet to be issued with an IUP, Article 81 provides that an IPB will be processed by the Minister (in a situation where the license would have been issued by local government prior to the coming into effect of the 2014 Act).

Conclusion

The markedly more liberal approach to the development of the geothermal energy sector in the 2014 Act (as compared with the 2003 Act) represents a breath of fresh air amid a rising tide of economic nationalism. However, it merely reflects the reality facing the sector, whose long period of stagnation has been nothing short of a national scandal. Given the recent shortages in the country's petrol stations and the regular blackouts that affect much of Indonesia, it is to be sincerely hoped that this legislation will mark the dawn of a new era for renewable energy and that, at the very least, it will help to finally bring electricity to the many parts of the country that have been so long deprived of what is nowadays a basic human need.

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i. *Undang-Undang Panas Bumi. The Act has yet to be numbered by the State Secretariat.*
ii. *Undang-Undang No. 27/2003 tentang Panas Bumi*
iii. *Undang- Undang No. 41 Tahun 1999 tentang Kehutanan*
iv. *Wilayah kerja*
v. *Izin Pemanfaatan Jasa Lingkungan*
vi. *Where two laws govern the same factual situation, a law governing a specific subject matter (lex specialis) overrides a law which only governs general matters (lex generalis)*
vii. *Where a latter law conflicts with an earlier law, it is the latter law that will prevail.*
viii. *Izin Usaha Pertambangan Panas Bumi*
ix. *Izin Panas Bumi*
x. *Izin Lingkungan*
xi. *Analisis mengenai Dampak Lingkingunan (AMDAL)*
xii. *UKL-UPL*
xiii. *A fixed rent payable irrespective of whether the project is operational or profitable.*