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CLIENT UPDATE
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DISPUTE RESOLUTION

New Regulation Issued to Boost Public-Private Partnerships

1. Introduction

New rules governing the establishment and operation of Public-Private Partnerships ("**PPP**") have been put in place by the recently issued Presidential Regulation No. 38 of 2015 (the "**New Regulation**"), which focuses on collaboration between the governmental and private sectors for the procurement of essential infrastructure.

The New Regulation repeals the previous PPP regime established by Presidential Regulation No. 67 of 2005, as subsequently amended (the "**Old Regulation**").

2. Background

PPPs have traditionally been regarded with some suspicion by many segments of Indonesian society, which continue to believe that infrastructure provision should be the sole responsibility of the State. However, it has become increasingly apparent that the State does not have the financial capacity to tackle Indonesia's enormous infrastructure deficit on its own. Accordingly, the development of the PPP sector over the last 10 years been characterized by a slow progression from a highly restrictive regime to a more liberal one, as embodied by the New Regulation.

3. Permissible Sectors and Participating Investors

While PPP schemes under the Old Regulation were only allowed in nine sectors (transportation, highways, irrigation, drinking water, wastewater, telecommunications and informatics, electricity, and oil and gas infrastructure), the list of permissible sectors has now been expanded to 19 with the addition of water resources, waste management, renewable energy, energy conservation, urban facilities, education facilities, sports and arts facilities, industrial estates, tourism, healthcare, correctional facilities and public housing.

Under the New Regulation, foreign investors may participate in the tender process directly without establishing a company in Indonesia. Once an investor has been selected, it should establish a project company in Indonesia to implement and execute the PPP ("**Executing Entity**"). The same rules apply to foreign and local investors. The purpose of having an Executing Entity is to ring-fence the risks.

4. Land Procurement

As is widely known, one of the major constraints on infrastructure development in Indonesia has been land procurement. The New Regulation attempts to overcome this by making land procurement the responsibility of Government (Article 10(1)), with the specific procedures to be governed by Law No. 2 of 2012 on the Acquisition of Land in the Public Interest and its implementing regulations ("**Mandatory Land Acquisition Regulations**"). A tender process may not commence until the Government obtains a site determination (*penetapan tanah*) from the relevant provincial governor. The process of land acquisition under the Mandatory Land Acquisition Regulations sets out a clear timeframe and accordingly lends greater operational certainty for the private-sector partner as the project site will be final from the outset. Additionally, under Presidential Regulation No. 30 of 2015, the Government may now also place the land procurement process in the hands of the private-sector partner to act on its behalf through a special power of attorney, which gives the private entity more room to operate.

5. Incentives

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Government guarantees for PPP projects have an important role to play in encouraging investment in the infrastructure sector. The Government may now provide guarantees on political and sub-sovereign risks that can, for example, ensure the continuity of a PPP project despite a change in government, and assure the deliverables made by a regional public sector authority.

The possibility of government support in the form of tax incentives and fiscal contributions should also help to improve the attractiveness of PPP projects, thereby potentially resulting in more competitive bids from the private sector. Partial financing and viability support for PPP projects of social interest and public benefit in relation to the construction of new infrastructure, or the operation and maintenance of infrastructure, should also help boost private investor interest. The details of these government support mechanisms are to be further provided for by Minister of Finance regulations, which are expected to be issued shortly.

6. Financial Close

Financial close must be achieved within 12 months of the execution of the PPP agreement, which may be extended for a maximum of a further six months if a failure to achieve financial close is not the fault of the Executing Entity.

Financing will be deemed to be completed if (i) the loan agreement has been executed, and (ii) some of the financing can be disbursed for commencement of the construction work. Should the maximum permissible period for securing financing have expired, the PPP agreement will be automatically terminated and the performance bond will be forfeit to the Government.

7. Executing Entity Payment Mechanisms

Under Article 11 of the New Regulation, the PPP Project Manager (the relevant Ministry or Regional Government) determines the return on investment that is payable to the Executing Entity so as to cover (i) capital expenditure; (ii) operational expenditure; and (iii) the Executing Entity's profit. Such return on investment is sourced from:

7.a. User Charges

The PPP Project Manager sets the initial charge for use of the relevant infrastructure. The charge may subsequently be adjusted based on user purchasing power.
If such adjustment adversely affects the return on investment of the Executing Entity in the case of a PPP project that is of social importance and benefit, the PPP Project Manager will provide viability support in a form of a financial contribution to secure the Executing Entity's return on investment.

7.b. Availability Payments

Availability payments are defined as periodic payments made by the Government to the Executing Entity in relation to the provision of infrastructure that satisfies the quality standards and/or criteria under the PPP Agreement
Should the Executing Entity's return on investment be sourced from availability payments, the PPP Project Manager must allocate sufficient funds through the ministry/government agency/regional government budget for the making of the payments over the course of the operational period stipulated in the PPP agreement.
The PPP Project Manager will only start disbursing availability payments if the infrastructure has been completed and has commenced operating commercially, and if the Government declares that it satisfies the service requirements under the PPP Agreement

7.c. Catch-all Clause

Article 11 also contains a catch-all clause under which return on investment may take other forms provided that they do not conflict with the prevailing laws and regulations. This allows the Government some flexibility to adjust to new PPP arrangements as they are developed by the market.

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8. Specific Issues

There are a number of specific issues in the New Regulation that merit further discussion and analysis. These are as follows:

8.a. Land Procurement Expenses

The New Regulation provides that financing for land procurement in relation to a PPP project shall be sourced from the National Budget (APBN), Local Government Budget (APBD) or State/Local Government Enterprise's Operational budget.
If the PPP project is deemed to be financially viable, the Government may stipulate in the tender document that the Executing Entity shall be required to reimburse all or part of the cost of land procurement, with project viability to be determined prior to the tender process. Unfortunately the New Regulation does not specify who precisely is responsible for determining whether or not the project is financially viable.

8.b. Performance Bond

The New Regulation provides that the PPP agreement must contain a clause requiring the Executing Entity to post a performance bond, which shall be assessed at a maximum of 5 percent of the project's investment value. However, no definition of investment value is given, thus potentially giving rise to uncertainty. By contrast, the Old Regulation provided that the amount of the performance bond should be based on the cost of land procurement.

8.c. Governing Language

While the Old Regulation does not so provide, the New Regulation specifically stipulates that a PPP Agreement must be prepared in Bahasa Indonesia and, if needed, an English version may be prepared as an "official translation" of the Bahasa Indonesia version. It inferred that in the event of a conflict, Bahasa Indonesia shall prevail over any other language versions. Further, the New Regulation also regulates that Bahasa Indonesia must be used in any dispute resolution process within Indonesia jurisdiction, but not before an overseas forum.

Conclusion

Compared to its antecedents, the New Regulation reflects developments in the PPP sector that have been taking place around the world, and also the Indonesian state's urgent need for private-sector capital to be invested in the country's underdeveloped infrastructure sector. The introduction of a number of new benefits and incentives for private entities is expected to encourage greater interest from the private sector in entering into partnerships with Government. Most importantly, the New Regulation provides greater assurances as regards the vexed question of land procurement, and greater government support so that it is hoped it will make the PPP sector more attractive to investors than was the case in the past.

That said, barely two months since the coming into effect of the New Regulation, it is still early days. Whether or not it will succeed where other PPP regulations have failed will only become apparent further down the line.

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