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Geothermal in Indonesia: The Heat is On

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In late April, Indonesia's President Susilo Bambang Yudhoyono announced that the country had signed geothermal energy deals worth a total of US\$5 billion, an auspicious start to his government's ambitious plan to raise Indonesia's installed geothermal generating capacity to 9,000MW by 2025 and turn the country into the world's largest producer of geothermal power.



Press reports at the time of the announcement emphasised the ambitiousness of these goals and the challenges that Indonesia (and the partners that had signed the deals) would face in achieving them.

The challenges most analysts identify are not linked to the technical problems associated with harnessing a larger portion

of the country's estimated 28,000MW of geothermal energy potential. Generally, the concerns that have indeed been expressed are associated with the legal and regulatory hurdles that these large projects face.

Little has been written about the nature of these legal and regulatory challenges, which might lead one to assume that

such challenges are indicative of a lack of political will. However, while the Indonesian legal system is regarded as overdue for reform in a number of areas, the last ten years have seen the Government introduce several new laws and initiatives that have fundamentally restructured the domestic geothermal industry.

Continued on page 2

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The limited commentary is more a function of the untested, and consequentially uncertain, operation of the new legal regime, especially as it relates to the changing role of Indonesia's state-owned oil and gas company – Pertamina – in the development of geothermal sites, impact of government-wide decentralisation of regulatory power to state and local governments and the changes in the electricity market wrought by the country's Electricity Law of 2009.

The Changing Role of Pertamina

Historically, Pertamina has held a monopoly over geothermal development in the archipelago. In 1982, the Government issued regulations allowing Pertamina to enter into joint venture partnerships with both local and international private sector developers to develop its geothermal resources. Under this regime, Pertamina was granted special privileges to manage and supervise the state's mining authority and to award concession rights. Pertamina was then permitted to appoint local and international contractors to carry out these activities under joint operation contracts.

This scheme began to change in 2001 with the enactment of Law Number 22 concerning Oil and Gas, under which the geothermal industry was separated from the oil and gas sector and geothermal activity was removed from Pertamina's permitted lines of business.

Two years later, Government Regulation Number 31 of 2003 concerning the Corporatisation of Pertamina was issued. This,

coupled with Pertamina's new Articles of Association, paved the way for the transfer of Pertamina's existing geothermal businesses and assets to a dedicated subsidiary. The transfer occurred in 2006, when PT Pertamina Geothermal Energy (PGE) was established and took charge of Pertamina's geothermal portfolio.

From Pertamina's perspective, these changes were more than cosmetic: while its



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subsidiary, PGE, remains by far the largest producer of geothermal power in Indonesia, holding licenses to develop geothermal sites or "Working Areas" with an estimated potential to produce a total of 8,480 MW, PGE will be a legally separate entity and Pertamina's liability for PGE's obligations may be limited (a change that may prove challenging to private counterparties and investors seeking the comfort of Pertamina's more robust credit rating).

At the same time, Pertamina has lost its powers to manage and oversee the mining authority and has ceased to have a monopoly over development. Moreover, the

Government has retained for itself the right publicly to tender licenses for additional Working Areas and reserved the power to revoke PGE's existing licenses if it does not develop them within an agreed timeframe.

Decentralised Regulatory Authority

At the same time that Pertamina's monopoly was being unwound, responsibility for

respect to the interpretation and implementation of the regulations. They may, for example, revoke a developer's geothermal licence or withhold the approval of environmental impact assessments.

An important first step for developers in assessing a new geothermal site will thus be to determine which level of government has responsibility for licensing and environmental regulation for the particular Working Area. Additionally, developers need to recognise that the local agencies with jurisdiction over matters affecting a proposed project will invariably be new to the (often less than straightforward) process of interpreting national government regulations and so still building their own capabilities.

New Rules for Electricity Markets

A third and even more recent change promises to transform the geothermal industry still further. Some of the most protracted delays in past geothermal projects have arisen from negotiations between the developer and PLN, the national electric utility. With its Electricity Law of 2009, the Government ended PLN's monopoly over the production and distribution of electricity in the country. While geothermal developers intending to supply power to the major Java-Bali grid system will in most cases still sell directly to PLN, the new Electricity Law does contemplate that they could sell to so-called "captive markets" in the form of provincial and regional utilities and private end users.

regulating the geothermal industry - formerly within the purview of the national Ministry of Mining and Energy - was also being decentralised as part of the government-wide effort to devolve powers to provincial and regional governments.

Thus, under Geothermal Law 27 of 2003, provincial and local ("regency"-level) officials are given the power to grant geothermal mining business licenses for Working Areas located solely within their jurisdictions. While in principle the basic regulatory framework remains the same across Indonesia, the local government agencies have been given considerable authority with

One of the features that is generally seen as a cornerstone of the Government's public-private partnership scheme is that private developers should be paid a tariff sufficient for full recovery of their costs (including finance costs). However, notwithstanding this backdrop and the potential opportunities under the new Electricity Law, regulations promulgated by the Ministry of Energy and Mining

developers and investors will also need to bear in mind that Indonesia's strategy for managing PLN's credit risk is still evolving. PLN's solvency was severely tested in the Asian financial crisis during the late 1990s and led to the renegotiation of many tariff agreements at considerable cost to the suppliers.

Since the crisis, many developers have received (and relied on) assurances in the form



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in 2009 have set the maximum price for geothermal power at USD\$0.097/kWh.

While it is unclear whether these regulations will increase or reduce the speed of negotiations with PLN or other off-takers, the current absence of a provision for the payment of a higher tariff in cases where the specified maximum will not allow full cost recovery means that these regulations appear to be at odds with an important element of Indonesia's public-private partnership model.

In addition to taking account of this potential uncertainty in relation to tariffs, in analysing proposed geothermal projects

of letters of support in which the Government commits to back PLN if it is faced with future financial challenges. The Government is now moving away from this ad hoc system of letters of support to a system under which the state-owned Indonesian Infrastructure Guarantee Fund (IIGF) guarantees PLN's obligations under eligible power purchase agreements.

The creation of this new fund promises to add transparency and order to Indonesia's support of its power sector. However, the fund itself is newly established, with a limited (and untested) regulatory structure and a limited

capital base. It remains to be seen whether the government agencies that have in the past provided letters of support for power projects will continue to do so whilst the way in which the IIGF will operate continues to develop. The IIGF will need to establish a track record that demonstrates its ability to meet its guarantee liabilities.

Conclusion

Indonesia's regulatory environment in relation to the geothermal industry has reached a turning point. It offers private developers and investors new opportunities whilst also posing some unanswered questions. The successful developers will be those who, while playing an active and alert role in the negotiation of risk allocation under the new rules, are willing to learn the ropes in conjunction with regulatory officials, particularly those in the newly empowered provincial and regional agencies, as they, too, navigate the new legal and regulatory regime.

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