CIREBON EXPANDS INDONESIAN POWER PUSH

THE ACHIEVEMENT OF FINANCIAL CLOSE FOR THE 1,000MW COAL-FIRED CIREBON IPP EXPANSION PROJECT (CIREBON EXPANSION) WAS ANOTHER STEP BY PLN IN ACHIEVING PRESIDENT JOKOWI'S OFTEN TALKED ABOUT TARGET OF CREATING AN ADDITIONAL 35,000MW OF NEW POWER GENERATION CAPACITY BY 2019. BY JAMES MURRAY, PARTNER, AND JAMES ORME, SENIOR ASSOCIATE, MILBANK TWEED HADLEY & MCCLOY LLP.

The Cirebon Expansion is based in the Cirebon Regency, West Java Province of Indonesia and, once built, will be one of the largest power plant expansions in Asia. Cirebon Expansion is being developed by PT Cirebon Energi Prasarana (CEPR), a project company established by an impressive sponsor group comprising Marubeni Corporation, JERA, Samtan Co, Korea Midland Power Co Ltd (KOMIPO), PT Indika Energy Tbk (Indika) and PT Imeco Inter Sarana (Imeco).

In addition to being sponsors to the existing, and now operating, 660MW Cirebon IPP project, Indika, KOMIPO, Marubeni and Samtan have a long history of developing power projects in Indonesia. For JERA – the newly incorporated joint venture between TEPCO and Chubu Electric – it was an exciting opportunity to develop, and manage, a high class power generation asset in Indonesia.

Cirebon Expansion is being constructed on a full turn-key basis using ultra super-critical technology provided by an EPC consortium comprising Hyundai Engineering & Construction, Mitsubishi Hitachi Power Systems and Toshiba Corporation. As part of the EPC contractor's scope of work, a transmission line will also be constructed that will connect the power plant to PLN's electricity grid. Consistent with the approach taken on other Indonesian power projects, ownership of, and responsibility for, the transmission line is handed over to PLN once the project has achieved commercial operations.

The project is scheduled to begin commercial operation in 2022 and, once operational, will sell the electricity generated for 25 years to PT PLN (Pesero), Indonesia's state-owned power utility.

PLN's payment obligations under the power purchase agreement (PPA) are guaranteed by the Indonesian government pursuant to its BVGL scheme. This is particularly noteworthy given that the financing for the original Phase 1 Cirebon IPP did not benefit from an equivalent government guarantee in favour of the project company.

It remains to be seen how many more projects will receive such similar support though, as the Government of Indonesia has been signalling in a variety of ways its desire to move away from guaranteeing PLN's payment obligations.

Long-term operation services will be provided by KOMIPO, JERA and Marubeni, thereby allowing CEPR to take full advantage of Japanese and South Korean project development, technical advisory and management expertise.

Long-term coal supply contracts were also entered into with several large Indonesian coal suppliers that will provide coal to the project on and after commercial operations. It is expected that in excess of 3.2m tons of coal per annum will be consumed by the project.

Total project costs for Cirebon Expansion are in excess of US$2bn, and this will be financed on the basis of an 80:20 debt-to-equity ratio.

The senior debt is being provided by a leading group of regional export credit agencies and commercial banks, and includes a direct loan by each of Japan Bank for International Cooperation (JBIC) and Export-Import Bank of Korea (KEXIM), and commercial loans that are covered by insurance provided by Nippon Export & Investment Insurance (NEXI) and a guarantee provided by KEXIM.

The senior commercial banks participating in the NEXI covered loan and the KEXIM covered loan are ING Bank, Mizuho Bank, Sumitomo Mitsui Banking Corporation (SMBC) and Bank of Tokyo-Mitsubishi-UFJ (BTMU).

The sponsors will fund their equity for the project initially through equity bridge loans (EBLs) provided by various commercial banks.

While equity bridge loans are an ever-increasing feature of Indonesian IPP transactions, unlike in prior deals, the equity bridge lenders and the senior lenders were not the same group of lenders, thereby creating a new dynamic between the senior loans and equity bridge loans.

The equity bridge loans are subordinated to the senior loans and, as a condition to project completion, are required to be refinanced prior to commencement of commercial operations through a mixture of cash equity and shareholder loans contributed by the sponsors.

There is hedging in place for interest rate exposure under both the senior debt and the equity bridge loans. Given the large notional amount of debt to be hedged, and the extended maturity of the loans, CEPR entered into a swap arranger mechanism whereby the co-swap arrangers executed the entire hedge and then subsequently novated portions of the hedge to the participating hedging banks.

This swap arranger mechanism has been used on a number of other transactions and provides an effective arrangement to allow the project company to put in place all of its required hedging through one initial trade.

The loans and the hedges benefit from security granted in a number of jurisdictions. In addition to Indonesia, a multi-jurisdiction security package of assets located in South Korea, Singapore and the Netherlands were pledged.

Further, given the importance of the various project contracts to the financing, CEPR procured that direct agreements were entered into with the EPC contractors, the O&M suppliers, the coal suppliers, PLN and a number of other project document counterparties. The relationship between the senior lenders and the hedge banks is governed by an intercreditor agreement pursuant to which the parties set out a regime for voting and decision making, a process for taking enforcement action under such security arrangements and then a post-enforcement waterfall addressing how security proceeds would be enforced.

As an expansion project, Cirebon Expansion was implemented on a direct appointment basis, rather than needing to be tendered out. Facilities such as the ash pond will be shared with the existing Cirebon IPP.

The Cirebon Expansion PPA was signed on October 23 2015 and negotiations on the terms for the financing gathered real momentum shortly thereafter.

While a number of stakeholders involved in Cirebon Expansion are also participants in the existing Cirebon IPP, there were a number of issues that were unique to the project that required careful thought and structuring. In particular:

● *Land* - As with many projects in Indonesia, procuring the land necessary to build a power plant and related facilities and the transmission line can be challenging.

For Cirebon Expansion, procurement of the land involved entering into an arrangement with the Ministry of Environment and Forestry (MOEFO) to grant rights of use over a significant part of the land required for the main power block.

While there are several instances of PLN directly procuring land for a project company, having a government agency totally distinct from PLN and the other Indonesian government bodies responsible for delivering the project created a new dynamic as CEPR, and the lenders, were keen to ensure that the project had rights to quiet enjoyment of the land for the term of the PPA, and associated remedies under the PPA if such rights were affected.

● *BI Regulation No 17* - While a number of Indonesian power projects have closed since the introduction of Bank Indonesia Regulation No 17/3/PBI/2015, and its related requirements, regarding the mandatory use of rupiah in Indonesia, Cirebon Expansion also had to accommodate this feature.

To address the requirement that monetary transactions in Indonesia be settled in IDR unless a specific exemption is obtained, CEPR, PLN and an Indonesian state bank entered into a tripartite converting arrangement whereby PLN makes payments in Indonesian rupiah but ultimately still bears foreign exchange rate risk until all of PLN's payment obligations are discharged.

● *MEMR Regulation 48* - During 2017, the Minister of Energy & Mineral Resources issued Regulation No 48 of 2017. Reg 48 imposes restrictions on share transfers in IPPs, such as CEPR, and applies to both new projects and existing projects.

The IPP must obtain PLN's prior approval for pre-COD share transfers, and report any such share transfer to MEMR. However, pre-COD share transfers are in any case only allowed - and PLN can only provide consent - where the transfer is to (90%) affiliated parties. These restrictions appear to apply equally to any share transfers resulting from lenders enforcing pledges over shares in the IPP.

Such requirements raised bankability concerns for lenders who needed certainty, in an enforcement scenario, that they could either transfer the shares in CEPR to a third-party purchaser or that they could otherwise take control of CEPR themselves and appoint a new board of directors to develop the project. The finance documents that were signed sought to mitigate these bankability concerns in a number of ways.

● *MEMR Regulations No 10 and 49 of 2017* - Reg 10 and Reg 49 imposed new requirements for PPA provisions that are also potentially challenging from a bankability perspective.

Such requirements include, for example, requiring that PLN must be relieved from its obligations if affected by natural force majeure or changes of laws and regulations, meaning that PLN may not be able to agree to provide the traditional deemed dispatch or termination compensation remedies in such circumstances.

● *Transfer obligations under the PPA* - Cirebon Expansion was one of the first projects to be implemented under which PLN can (at its option) require a transfer of the project by way of share transfer upon termination or expiration of the PPA. This is in contrast to most earlier PPAs, which only provide for asset transfer in these circumstances.

Milbank Tweed Hadley & McCloy, using separate teams, represented both the senior lenders and the equity bridge lenders to CEPR, with ABNR providing Indonesian legal advice to them. Latham & Watkins and Makarim & Taira S, respectively, providing international and Indonesian legal advice to the sponsors and CEPR.

ING Bank acted as financial adviser, mandated lead arranger and technical bank, with BTMU acting as mandated lead arranger, coal bank, insurance bank and co-swap arranger. SMBC acted as documentation bank and co-swap arranger. Mizuho acted as modelling bank and was also appointed administrative agent, security agent and account bank.■