

LATEST DEVELOPMENTS IN THE INDONESIAN ENERGY AND RESOURCES SECTOR, MARCH 2018

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Legal Briefings - By **David Dawborn, Matthew Goerke, Mira Fadhya, Ninditya Prijono and Hanna Meliana**

ASR obligations further regulated, PPA regulation amended and 27 regulations revoked

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PURPORTED EXPANSION OF ASR OBLIGATIONS IN THE OIL AND GAS INDUSTRY

In late February 2018, the Indonesian Ministry of Energy and Mineral Resources (**MEMR**) issued an important new regulation regarding abandonment and site-restoration (**ASR**) obligations for oil and gas operations in Indonesia. Regulation No. 15 of 2018 regarding Post-Operation Activities in the Upstream Oil and Gas Industry (**MEMR Regulation 15/2018**) revokes and replaces MEMR Regulation No. 01 of 2011 regarding the Technical Guidelines for the Dismantling of Oil and Gas Offshore Installations. MEMR Regulation 15/2018 covers general post-operation obligations and notably, unlike the 2011 regulation, is not limited to offshore installations. Further, MEMR Regulation 15/2018 *expressly* states that it is applicable to PSC contractors with PSCs which do not contain any post-operation or other abandonment and site-restoration (**ASR**) obligations. This represents a change in approach by the Indonesian Government in tackling head-on the ASR obligations of older form PSCs in Indonesia (many of which will expire in the coming few years) and for which ASR obligations have previously been, and remain, the subject of significant legal and regulatory uncertainty.

ASR OBLIGATIONS

The fundamental purpose of MEMR Regulation 15/2018 is to require PSC contractors to carry out ASR activities until the end of the relevant PSC period by utilizing the ASR funds that are required to be reserved and deposited by the PSC contractors (**ASR Reserved Funds**). This ASR obligation is expressly stated to apply to those PSC contractors with PSCs which do not contain any ASR obligations. Previously, PSC contractors with PSCs that do not contain any ASR obligations have sought to resist including any ASR obligations as part of their new work program and budget (**WP&B**) and POD applications. However, in practice, and based on the existing SKKMIGAS guidelines, it has been more difficult for PSC contractors to maintain this position in recent years, particularly in relation to new or expanded exploration or exploitation activities.

Under MEMR Regulation 15/2018, ASR activities are defined to mean any activities related to the dismantling of any equipment, installation and/or supporting facility, including the closing of any well permanently, the restoration of a location and the removal of equipment, installations and/or facilities in upstream activities conducted prior to or at the expiry of the relevant PSC. As noted above, MEMR Regulation 15/2018 is not limited to offshore installations and, by its terms, applies to all upstream oil and gas operations in Indonesia.

Based on MEMR Regulation 15/2018, these ASR obligations will be applied by MEMR through the process for the approval of a WP&B during the exploration stage and the approval of a plan of development (**POD**) during the exploitation stage. In preparing an exploration WP&B or a POD, PSC contractors must include an ASR plan which is required to be filed with the chairman of SKKMIGAS (**ASR Plan**). An ASR Plan must contain details of the equipment, installation and/or facilities to be dismantled, including the wells to be closed permanently, and a calculation of estimated costs for such ASR activities.

While it is not expressly stated, it appears that the processes and procedures under MEMR Regulation 15/2018 regarding ASR obligations will only apply to activities undertaken under new exploration WP&Bs and new PODs. In this regard, we note that MEMR Regulation 15/2018 does not expressly require PSC contractors which have existing exploration WP&Bs or existing PODs to amend those approvals in accordance with MEMR Regulation 15/2018. As a result, and while there remains some uncertainty in relation to this issue and until further regulations or guidance is issued, we expect that PSC contractors operating under previously approved WP&B and PODs will be able to continue to operate under their existing arrangements. In any event, the purported expansion of the ASR obligations to include PSCs without any ASR provisions creates tension between the terms of the PSCs (including the basis on which investment originally occurred) and the development of the ASR regulatory regime by the Indonesian Government. Initial statements from the industry suggests that PSC contractors will continue to resist the imposition of new ASR obligations in relation to existing operations under PSCs which do not contain any express ASR requirements.

Prior to actually carrying out any ASR activities, the relevant PSC contractors must submit a proposal to MEMR (through SKKMIGAS) attaching the approved ASR Plan. Once this proposal has been approved by MEMR, the PSC contractors must then immediately carry out the relevant ASR activities in accordance with the relevant technical and regulatory requirements. PSC contractors are also required to submit a report to MEMR within 30 days of completing the relevant ASR activities.

ASR RESERVED FUNDS

As mentioned above, ASR activities must be carried out by PSC contractors by using the ASR Reserved Funds. ASR Reserved Funds must be reserved and deposited in a joint account in the name of SKKMIGAS and the PSC contractor in an Indonesian Government owned bank, in Indonesia. The amount of the ASR Reserved Funds to be deposited will be based on the estimated costs calculation for ASR activities set out in the ASR Plan. The amount of ASR Reserved Funds must also be adjusted by the PSC contractor if there is a change in the ASR Plan which results in a change to the estimated costs calculation for ASR activities.

ASR Reserved Funds must first be deposited in the year when commercial production commences – as a result, MEMR Regulation 15/2018 suggests that no ASR Reserved Funds will be required to support an ASR Plan during the exploration stage (as no commercial production will commence during this stage). ASR Reserved Funds must then be deposited gradually over the life of the asset, pursuant to the relevant WP&B. MEMR Regulation 15/2018 expressly states that SKKMIGAS will be entitled to issue further procedures in relation to the reservation of ASR Reserved Funds for PSC contractors with PSCs which do not contain any ASR obligations and, accordingly, we expect that these processes and procedures will shortly be further clarified by SKKMIGAS.

ASR RESERVED FUND TREATMENT - COST RECOVERY, GROSS-SPLIT AND EXPIRING PSCS

MEMR Regulation 15/2018 retains the principle that PSC contractors operating under the cost-recovery regime will be permitted to treat ASR Reserved Funds as a recoverable operation cost. However, under the gross-split system, ASR Reserved Funds will be borne solely by the relevant PSC contractors but will be tax deductible for the purposes of income tax calculations. Consistent with this concept, MEMR Regulation 15/2018 clarifies that after the completion of ASR activities and the expiry of the relevant PSC:

- for PSC contractors operating under the cost-recovery regime, any excess ASR Reserved Funds shall become the property of the Indonesian Government; and
- for PSC contractors operating under the gross-split system, any excess ASR Reserved Funds shall be returned to the relevant PSC contractors.

MEMR Regulation 15/2018 expressly clarifies that if a PSC expires and a third party is appointed as the new PSC contractor for the relevant working area, all existing ASR obligations become the responsibility of the new PSC contractor. Further, any ASR Reserved Funds deposited by the previous PSC contractors will be able to be utilized by the new PSC contractor for the purposes of carrying out ASR activities. However, it remains to be seen how any underfunded ASR Reserved Funds (and any outstanding ASR obligations) will be taken into consideration for the purposes of calculating the relevant gross-split for the new PSC contractor.

IMPROVED BANKABILITY FOR INDONESIAN POWER PURCHASE AGREEMENTS

On 13 February 2018, MEMR issued MEMR Regulation No. 10 of 2018 (**MEMR 10/2018**), the second amendment to MEMR Regulation No. 10 of 2017 (**MEMR 10/2017**) on the Principles of Power Purchase Agreements (**PPAs**). Our previous e-bulletin on MEMR 10/2017 (as amended) is available [here](#).

MEMR 10/2017 set out, for the first time, the risks that were required (by law) to be shared between PLN and independent power producers (**IPPs**) in PPAs. These shared risks included change of government policy risk and government force majeure risk. This prescribed allocation of risk raised substantial uncertainty in the industry and led many people to question the bankability of PPAs where IPPs would be required (at least partially) to bear change of government policy risk and government force majeure risk.

MEMR 10/2018 makes a single (but significant) amendment to MEMR 10/2017 by removing change of government policy risk and government force majeure risk from the list of risks to be shared by PLN and the relevant independent power producer. While not expressly stated, the strong implication of this amendment is that change of government policy risk and government force majeure risk will instead be borne solely by PLN based on the negotiated terms of the relevant PPA.

This is potentially a positive development for the Indonesian power industry, provided that this concept is fully incorporated by PLN into its standard-form PPAs.

REGULATORY REFORM: REVOCATION OF 27 REGULATIONS IN THE ENERGY AND RESOURCES SECTOR

On 8 February 2018, MEMR issued four new regulations that revoked 27 old regulations in the energy and resources sector (**the Reform Regulations**). In particular, the Reform Regulations revoked 11 regulations in the oil and gas sector, 7 regulations in the mining sector, 4 regulations in the electricity sector and 5 regulations in renewable energy sector. A complete list of the regulations that have been revoked by the Reform Regulations is set out [here](#).

The Indonesian Government stated that the rationale behind the issuance of the Reform Regulations is to promote investment into the Indonesian energy and resources sector. However, in reality, the main effect of the issuance of the Reform Regulations was to revoke old regulations which are no longer relevant or have already been addressed in other regulations (i.e. to remove regulatory redundancy). As a result, while the number of valid regulations has now reduced, with limited exceptions, the issues covered by the revoked regulations continue to be regulated. Therefore, the Reform Regulations only represent a very modest improvement in the complex regulatory mix relevant to the Indonesian energy and resources sector. We have set out below the most material regulatory changes introduced by the Reform Regulations.

OIL AND GAS SECTOR REFORMS

The most significant impact of the Reform Regulations in the oil and gas sector is in relation to the employment and use of expatriate workers. Previously, MEMR Regulation No. 31 of 2013 on Provisions and Procedures to Utilize Foreign Workers and the Development of Indonesian Workers in Oil and Gas Business Activities set out very specific requirements for the hiring of expatriate workers in the oil and gas sectors (including, for example, an age limitation of workers of between 30 - 50 years old) (**MEMR Regulation 31/2013**). However, with the revocation of this regulation, the employment of expatriate workers in the oil and gas sector only needs to comply with the general requirements set out by the Ministry of Manpower (which are, in general, more liberal). Further, MEMR Regulation 31/2013 expressly prohibited the inclusion of contractual provisions requiring the use of expatriate workers in oil and gas supporting services contracts. However, this prohibition has now been revoked (without replacement).

RENEWABLE ENERGY SECTOR REFORMS

In the power and renewable energy sector, the most significant impact of the Reform Regulations is the revocation of three renewable energy regulations (which were issued relatively recently in 2015 and 2016) in relation to mini-hydro, solar and biomass/biogas power projects. In general, mini-hydro, solar and biomass/biogas power projects are now governed by MEMR Regulation No. 50 of 2017 on the Utilization of Renewable-Energy Resources for the Production of Electricity (issued in August 2017).

However, with the revocation of the old 2015 and 2016 regulations, certain obligations applicable to IPPs have now been removed, including:

1. the registration requirement: (i) as a developer, for solar, biogas or biomass power plants; and (ii) as a water manager, for mini-hydro plants;
2. the requirement to achieve financial close within a certain period time, which was previously 6 months for solar power projects, 12 months for biogas/biomass power projects and 15 months for mini-hydro power projects – however, this issue will in practice likely continue to be regulated under the relevant PPA with PLN (and potentially be subject to even shorter periods to achieve financial close); and
3. the performance-bond requirement for mini-hydro power plant projects – again, this will likely still be required under the terms of the relevant PPA with PLN.

Further, the revocation of the old 2015 and 2016 regulations has eliminated the imposition of sanctions for late performance in the event that the commercial operations date is not achieved within a certain period of time. However, similar to the above, this issue will in practice likely continue to be regulated under the relevant PPA with PLN.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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