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Client Alert – 21 August 2017

Indonesia power sector: Update on regulation on the supply of natural gas for power generation

Speed read

Six months after issuing an initial regulation on the utilisation of natural gas for power generation (**Reg. 11/2017**), the Indonesian Minister of Energy and Mineral Resources (**MEMR**) has revoked Regulation 11/2017 and replaced it with MEMR Regulation No. 45 of 2017 (**Reg. 45/2017**), which governs utilisation of natural gas for power plants owned by PT Perusahaan Listrik Negara (**PLN**) and independent power producers (**IPPs**), including with respect to:

- the allocation of natural gas to power plants;
- certain key terms governing natural gas supply arrangements;
- the development of wellhead gas-fired power plants; and
- benchmark prices for the import of liquefied natural gas (**LNG**);

– In line with the spirit of the short-lived Reg. 11/2017, the new regulation intends to maximise the procurement of natural gas for gas-fired power plants from domestic sources.

– The new regulation raises the ceiling of the gas purchase price, and maps out a possible future IPP scheme by which PSC Contractors are allowed to develop Wellhead Power Plants through an affiliated entity on the basis of a direct appointment by PLN.

This client alert is an update to our previous client alert issued on Reg. 11/2017 which you can find here.

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1. Allocation of natural gas for power generation

Reg. 45/2017 provides that natural gas may be allocated directly to an IPP or PLN for the purpose of power generation[1]. This provision is intended to be read in the context of MEMR Regulation No. 6 of 2016 on Guidelines and Procedures for the Designation, Allocation, Utilisation and Price of Natural Gas (**Reg. 6/2016**), which provides that an upstream gas contractor (a **PSC Contractor**) must make available a specific volume of natural gas for domestic needs (the **Domestic Market Obligation** or **DMO**)[2]. Under Reg. 6/2016 the allocation of natural gas produced by PSC Contractors is determined by MEMR[3].

Pursuant to Reg. 45/2017, the MEMR may now allocate DMO for purchase by an IPP or PLN. In addition to the allocation of DMO, an IPP and/or PLN may also purchase natural gas from the holder of a gas trading licence (a **Gas Trading Entity**), provided the Gas Trading Entity has the appropriate natural gas infrastructure and facilities to supply natural gas to the relevant power project operated by the IPP or PLN[4].

Under these arrangements it is the obligation of a PSC Contractor to deliver gas to the upstream purchase point; thereafter, it is the obligation of the IPP, PLN or the Gas Trading Entity to deliver natural gas from the upstream purchase point to the plant gate. In this regard, the IPP, PLN or the Gas Trading Entity must enter into a natural gas distribution/transportation agreement with the owner of a pipeline or must construct the appropriate facilities to connect the upstream purchase point to the plant gate.

2. Gas price and alternative supply sources

The MEMR will determine the price of natural gas for power generation based on the: (a) economics of the gas field, (b) the national and international gas price, (c) the payment capacity of domestic gas consumers, and (d) any additional value deriving from the use of domestic natural gas[5].

The maximum purchase price of natural gas at the plant gate is set at 14.5% of the Indonesian Crude Price (the **ICP**)[6]. This is an increase from the previous maximum price under Reg. 11/2017, which was set at 11.5% of the ICP. We understand that this increase is in response to industry feedback that the previous maximum price was too low, resulting in deadlocks between natural gas suppliers and IPPs and PLN.

Under Reg. 45/2017, if an IPP or PLN cannot source pipeline natural gas at a price lower than 14.5% of the ICP, it (a) may instead purchase LNG, provided the price of LNG at the plant gate is lower than the price of any available pipeline natural gas, and (b) must purchase domestic LNG if the price of the domestic LNG is "the same as"[7] the price of imported LNG[8]. Accordingly, Reg. 45/2017 aims to prioritise the use of domestic pipeline natural gas and domestic LNG over imported LNG.

Interestingly, Reg. 45/2017 also provides that if an IPP or PLN cannot satisfy (a) and (b), above, the MEMR can set out further policies to ensure the supply of gas to power generators. This implies that MEMR could issue policies allowing an IPP or PLN to import LNG at a price higher than 14.5% of the ICP.

3. Development of wellhead gas fired power plants

As with Reg. 11/2017, Reg. 45/2017 also contains provisions relating to the development of power plants located at a natural gas wellhead (**Wellhead Power Plants**). Gas for power generation by Wellhead Power Plants will be allocated to PLN[9]. In the event a Wellhead Power Plant is operated by an IPP, the IPP must use gas supplied by PLN[10].

The procurement of a Wellhead Power Plants can be by direct appointment or competitive tender. The procurement of Wellhead Power Plants through direct appointment may be carried out on the basis that (a) the price of natural gas must not be in excess of 8% of ICP/MMBTU at the power plant gate, (b) there must be sufficient reserves for an allocation of natural gas for the entire term of the power purchase agreement, and (c) the efficiency of the Wellhead Power Plant with specific fuel consumption is equal to high speed diesel amounting to 0.25 litre/kWh. Procurement of Wellhead Power Plants by competitive tender may be carried out in the event the price of natural gas exceeds 8% of the

1 Reg. 45/2017, Art. 3.
2 Reg. 6/2016, Art. 3.
3 Reg. 6/2016, Art. 3.
4 Reg. 45/2017, Art. 4.
5 Reg. 45/2017, Art. 5.
6 Reg. 45/2017, Art. 8.

7 Although Reg. 45/2017 refers to the price (of domestic LNG) being the same as the price of imported LNG, our view is that this should be read as meaning "the same or below".
8 Reg. 45/2017, Art. 8(2).
9 Reg. 45/2017, Art. 13(2).
10 Reg. 45/2017, Art. 13(3).

ICP/MMBTU[11]. Reg. 45/2017 also provides that the power interconnection point for Wellhead Power Plants must be located at the nearest main station[12].

A new concept introduced by Reg. 45/2017 is that PSC Contractors may develop IPP projects through an affiliated company which can be directly appointed to sell power to PLN, provided that the requirements of direct appointment set out above are fulfilled. Such IPP company may then receive gas allocation directly from the PSC Contractor's field for the development of the Wellhead Power Plant[13].

4. Gas Supply Agreements

Reg. 45/2017 also provides that a natural gas sales and purchase agreement for the supply of natural gas for power generation must contain at least the following provisions: (a) description of the supply sources, (b) volume and specifications of the natural gas, (c) gas price, (d) term of the contract, (e) price review mechanism, (f) details of transportation of the natural gas to the plant, and (g) other rights and obligations of the buyer and the seller of natural gas[14].

11 Reg. 45/2017, Art. 13(6).
12 Reg. 45/2017, Art. 13(7).
13 Reg. 45/2017, Art. 14(2).

5. Transitional provisions

Reg. 45/2017 provides that the allocation and price of natural gas for power plants which have been determined or agreed prior to its enactment on 25 July 2017 will remain valid until the end of the term of the determination. Further, applications for the allocation of natural gas which have been submitted prior to the enactment of Reg. 45/2017 will continue to be processed based on pre-existing principles and will not be subject to the principles set out in Reg. 45/2017[15].

14 Reg. 45/2017, Art. 11.
15 Reg. 45/2017, Art. 16.

Commentary

In line with the spirit of the short-lived Reg. 11/2017, Reg. 45/2017 is also clearly intended to maximise the procurement of natural gas for gas-fired power plants from domestic sources at the lowest possible price. The main changes brought by Reg. 45 against the regime under Reg. 11/2017 are (a) to raise the ceiling of the gas purchase price from 11.5% to 14.5% of the ICP, and (b) to map out a possible future IPP scheme by which PSC Contractors are allowed to develop Wellhead Power Plants through an affiliated entity on the basis of a direct appointment by PLN.

Although Wellhead Power Plants may simplify the allocation of natural gas for power generation and minimise overall costs, especially transportation costs, the viability of this goal will largely be determined by the proximity of the relevant gas fields and/or wellheads to existing transmission lines and consumers.

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