

## New concession model introduced to monetise existing Government/SOE infrastructure assets

On 18 February 2020, the Government introduced a new legal framework on the limited concessions scheme (LCS) in the infrastructure sector. The new rule is Presidential Regulation No. 32 of 2020 on Financing of Infrastructure through Limited Right of Utilisation (**Reg 32**).

### KEY TAKEAWAYS

Reg 32 expands the options through which the Government could raise private financing to fund future infrastructure projects. With the LCS model, the Government “recycles” certain good assets, enabling them to be monetised. A few key takeaways have been outlined below:

As an LCS model involves existing assets, it significantly reduces investors’ exposure to construction risks.

Reg 32 also provides that the LCS contracting authorities are the central Government and SOEs, which to a large extent are better than contracting with regional governments or regional state-owned companies from the perspective of creditworthiness and the associated counterparty risks.

LCS will not benefit from the guarantee against political risks by IIGF (Indonesian Infrastructure Guarantee Fund) which PPP projects would typically enjoy. This may be less of a concern if the LCS contracting authorities are the central Government or creditworthy SOEs. There are a number of precedents of infrastructure projects which have been successfully closed without such guarantee (eg power sector).

On the other hand, LCS seems to be lacking a uniform procurement process as in the PPP regime. A uniform procurement process is praised for its transparency and predictability.

### WHO SHOULD READ THIS?

Infrastructure companies, infrastructure funds and financing institutions.

### WHAT IS THE LIMITED CONCESSION SCHEME OR LCS?

LCS is an asset recycling model: it involves the use of existing public sector assets to access private financing. In the LCS, the Government grants a concession to the private sector to operate certain assets (perhaps with some upgrade works) and in return the Government receives cash (which is paid in advance) which it could further use to develop other new infrastructure assets. One notable LCS case is the Ataturk Airport in Istanbul, Turkey.

LCS does not equal privatisation because ownership of the assets remains with the Government and the private sector only has the right to operate the assets for a definitive period of time.

LCS is also different from PPP (Public Private Partnerships). The objective of PPP is to build new infrastructure assets (or in some cases, expansion of brownfield assets) on a risk-sharing basis between the Government and the private sector. In PPP, the Government grants concessions to construct, operate and maintain assets, and all of these are fully funded by the private sector. The private sector then recovers investment through user charges or from the Government (through Availability Payment). In contrast, in the LCS model, the Government grants the private sector a concession to operate existing – already constructed – assets for an upfront fee. This upfront fee would then enable the Government to fund future projects. In this sense, LCS is a fundraising instrument.

### CRITERIA OF ASSETS FOR THE LIMITED CONCESSION SCHEME UNDER REG 32

Reg 32 says that (i) assets belonging to the State (Barang Miliik Negara/ BMN), and (ii) assets belonging to State-owned companies (**SOE Assets**), may be the object of LCS (**LCS Assets**). These assets comprise various kinds of infrastructure assets, such as transportation (seaports, airports, railways and bus terminals), toll roads, water/drinking water, sewerage and waste management systems, telecommunications assets and energy (power/renewables, oil and gas).

LCS Assets must satisfy criteria set out in clause 4 of Reg 32, namely that:

- (a) the assets have operated for at least two years;
- (b) the assets require operating efficiency;
- (c) the life of the assets is at least ten years;
- (d) for BMN, the assets are accounted for in the relevant ministries/agencies’ audited balance sheet of the previous year (audited by the State Audit); and
- (e) for SOE Assets, the assets must have a track record of positive cash flow for at least two consecutive years and have been accounted for in the company’s audited balance sheet for at least three consecutive years.

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## UPFRONT FEES PAYABLE TO GOVERNMENT/SOES

The Government benefits from entering into the LCS by receiving an upfront fee from the operator (the **LCS Entity**). Determination of the upfront fee is based on the valuation by the State valuer for BMN and by an asset valuation company for SOE Assets. The proceeds of the LCS (ie the upfront fees) are to be used for, in the order of priority: (i) financing the improvement of assets which are similar to assets being put under the LCS; or (ii) if no similar assets are available, financing of other infrastructure assets which fall under the Government's list of priority projects (ie National Strategic Projects (PSN) or Priority Infrastructure Projects (PIP)).

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## PARTIES INVOLVED IN THE LCS

– KPPIP/*Komite Percepatan Penyediaan Infrastruktur Prioritas* (Committee for Acceleration of Provision of Priority Infrastructure):

KPPIP is a special committee which is given the task of co-ordinating the ministries/agencies and SOEs who will participate in the LCS. KPPIP will issue a so-called List of Plan for LCS Assets (*Daftar Rencana Pengelolaan Aset*), which will be made public.

– PJPK/Responsible Party (*Penanggung Jawab Proyek Kerjasama*):

In respect of BMN, the PJPK is a Minister/Head of Agency who is the current 'user' of the BMN.

In respect of SOE Assets, the PJPK is the President Director of the SOE.

– LCS Entity:

The LCS Entity may be a private entity in the form of a limited liability company, an SOE, a regional-owned entity, a foreign entity or a co-operative.

– BLU/*Badan Layanan Umum* (Public Service Agency):

Reg 32 mandated the Minister of Finance to establish or assign a BLU (which is a unit under the ministry) specifically for the purposes of implementing the LCS. The mandate is given to the Minister of Finance because under the regime of State-owned assets, all State assets are under the "management" of the Minister of Finance (ie asset manager (*pengelola*)). The Minister of Finance will determine the use of the assets and assign them to the relevant ministries/agencies (ie asset user (*pengguna*)).

In respect of the BMN that will be assigned as LCS Assets, the PJPK will have to hand over the BMN to the BLU, and the BLU will enter into a concession agreement with the LCS Entity and collect the upfront fees. Generally, a BLU has a separate balance sheet from the relevant ministry or agency that forms it. This makes it easier to manage and allocate the upfront fees that are collected by the BLU for future projects, independent of the State Budget cycle.

BLU is only involved with BMN, and not with SOE Assets.

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## LCS CONCESSION AGREEMENT

Reg 32 sets out that the terms of the LCS will be governed under a concession agreement. The scope of the concession agreement appears to be similar to other infrastructure concession agreements in general. However, there is a restriction to encumber the LCS assets, and this is because the ownership over the LCS assets (BMN or SOE Assets) during the life of the concession will remain with the State or the SOEs, and therefore the LCS Entity is not permitted to encumber the assets to third parties. At the expiry of the LCS period, the assets must be returned to the State/SOEs.

As for the term of the concession agreement, Reg 32 provides that if the objects of LCS are BMN, the term of the concession agreement will be in accordance with the requirements under the regime of use of State assets (this refers to Government Regulation No. 27 of 2014 on Use of State/Regional Assets (**GR 27**)). GR 27 stipulates prescriptive and strict forms of co-operation in respect of BMN, namely lease, borrow-use, asset utilisation, BOT, BTO and cooperation for infrastructure provisions – for which the term of co-operation/contract varies and lasts up to 50 years. How does the LCS fit into these existing co-operation schemes of BMN? The LCS should be construed in the same way the PPP regulation (Presidential Regulation No. 38 of 2015) is construed, that is as *lex specialis*. In practice, as in any PPP project where BMN is involved, it is likely that there would be a separate BMN utilisation agreement (which complies with GR 27) to supplement an LCS concession agreement.

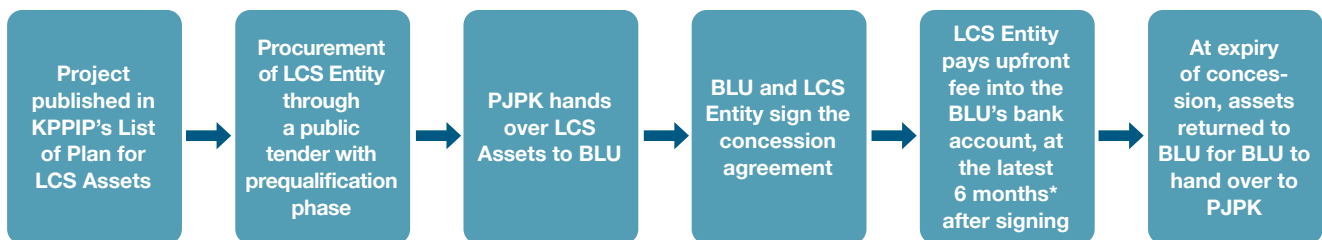
If the objects are SOE Assets, Reg 32 provides that the term of the concession agreement will follow the requirements under the applicable regulations in the relevant infrastructure sector; for example, in the airport sector the maximum term is 50 years.

## LCS CONCESSION STRUCTURE FOR BMN

The structure of the LCS for BMN is illustrated below, where the LCS Entity holds an operating concession but the Government continues to own the asset.



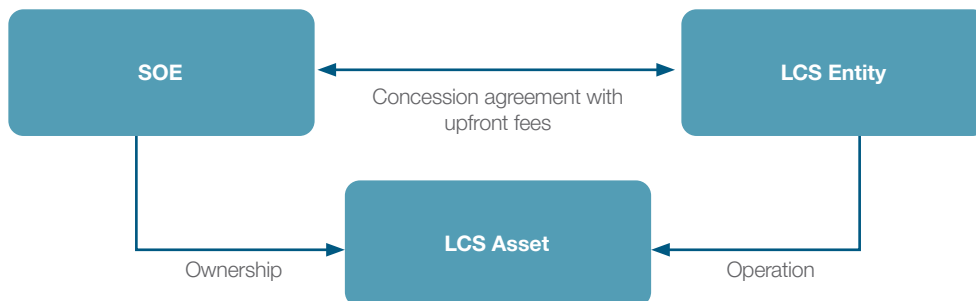
Steps involved in the implementation of LCS for BMN:



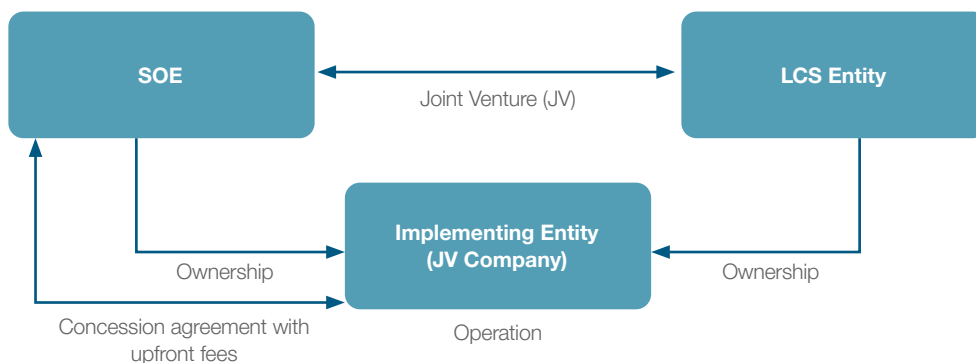
\*May be extended for up to 6 months if delay is not due to fault of the LCS Entity.

## LCS CONCESSION STRUCTURE FOR SOE ASSETS

Similar to the structure for BMN, for SOE Assets the LCS Entity holds an operating concession but the SOE continues to own the asset.

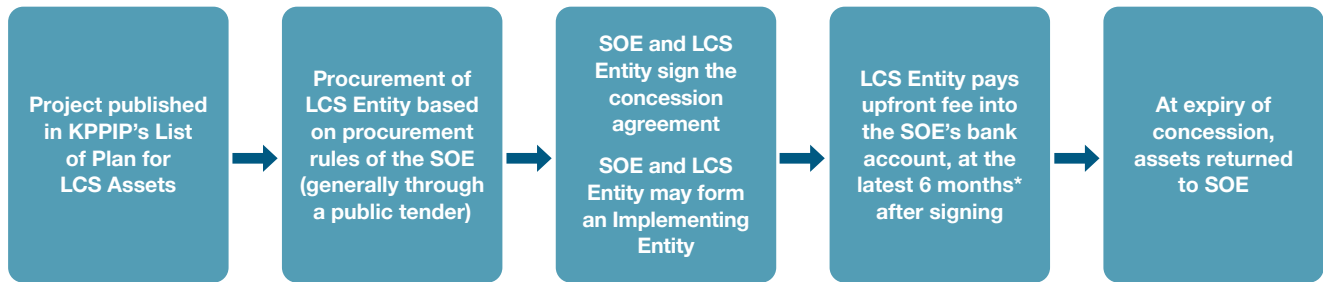


Further, clause 29(3) and clause 30 of Reg 32 provides that SOEs will enter into a co-operation with the LCS Entity and the co-operation may be by way of forming an implementing entity. There is no further guidance on this, but this suggests that the co-operation may be in the form of co-ownership through a joint venture company.<sup>1</sup>



<sup>1</sup> Kualanamu Airport of Medan (currently owned and operated by Angkasa Pura II) seems to be a potential pilot project for this LCS model.

Steps involved in the implementation of LCS for SOE Assets:



\*May be extended for up to 6 months if delay is not due to fault of the LCS Entity

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