

COFINANCING THE RIAU IPP

THE RIAU COMBINED-CYCLE GAS TURBINE POWER PLANT PROJECT ACHIEVED FINANCIAL CLOSE IN NOVEMBER 2019. BY **YUICHIRO YOI** AND **JUAN-PABLO MARTINEZ-MOLINA MERCADO** OF **ASIAN DEVELOPMENT BANK**, **YUJI KANO** OF **INTERNATIONAL FINANCE CORPORATION**, AND **JAMES MURRAY** OF **MILBANK LLP** IN SINGAPORE.

The Asian Development Bank (ADB) and International Finance Corporation (IFC), along with MUFG Bank and Sumitomo Mitsui Banking Corporation (SMBC), are providing a total of US\$222m of debt for the development of the Riau gas-fired IPP.

The project is owned by PT Medco Ratch Power Riau (MRPR), an Indonesian special purpose vehicle owned by PT. Medco Power Indonesia (Medco Power) has 51% of the SPV and Thailand's Ratch Group Public Company Ltd has 49%.

Established in 2004, Medco Power has extensive experience in infrastructure projects, including O&M, with an asset portfolio spread across 20 locations in Indonesia and is aiming to be the leading clean and renewable independent power producer (IPP) in Indonesia. Ratch's proven track record in infrastructure developments in the region is expected to benefit the project, which is scheduled to become operational in May 2021.

The project benefits from a long-term (20-year) power purchase agreement (PPA) under a build-own-operate-transfer (BOOT) scheme with PT PLN (Persero) (PLN), the Indonesian government-owned electricity company. When completed, the Riau gas-fired IPP will have a generating capacity of 275MW.

ADB and IFC collaboration

The Riau IPP is ADB's and IFC's first collaboration on an infrastructure project in Indonesia. The project evidences both institutions' commitment to the development of Indonesia and improving access to electricity for communities in parts of Indonesia.

Their involvement in the project helped secure the long-term commercial bank financing necessary for such a large-scale infrastructure investment, which has remained a challenge in Indonesia without the support of development finance institutions or export credit agencies.

This cooperation involved aligning and harmonising each of ADB's and IFC's environmental and social guidelines and requirements. The collaboration is of particular significance for both ADB and IFC as it facilitates the financing of a large-scale project owned by a partnership of two Asean countries.

Loan structure

The financing consists of a US\$70m ADB A term loan, a US\$82m ADB Term Loan B funded by

MUFG Bank and SMBC – with ADB providing a partial risk guarantee to the participating commercial banks for the first time in Indonesia – and a US\$50m IFC term loan.

ADB will administer a US\$20m loan from the Leading Asia's Private Sector Infrastructure Fund (LEAP), supported by the Japan International Cooperation Agency (JICA). Established in March 2016, LEAP's mandate is to help fill financing gaps and increase access to finance for ADB-supported infrastructure projects in Asia and the Pacific.

Diversification of energy source

Once completed, the Riau gas-fired IPP will supply electricity to the power grid of Sumatra, Indonesia and aims to mitigate the electricity deficit in the region.

In the last few years, the Indonesian government has made an increasing effort to diversify its sources of energy to include more geothermal, wind and hydro, in addition to coal – which has underpinned electricity generation in Indonesia for decades.

The use of combined-cycle gas-fired power generation in this project is another important illustration of the diversification process. It is expected that the Riau project will improve the environmental sustainability of power generation in Sumatra by providing an alternative energy source to diesel and coal.

The Riau IPP follows the Jawa-1 LNG to power project in West Java, which was led by a consortium including Pertamina Power Indonesia, Marubeni Corporation and Sojitz Corporation – and also backed by ADB among others – and signed in October 2018.

Gas supply

In a departure from the more typical approach in prior Indonesian PPAs, PLN has single point responsibility for gas supply between MRPR and PLN under a tolling arrangement.

In prior PPAs with PLN, project companies have typically been responsible for procuring fuel to operate the power plant. The tolling arrangement used in the Riau IPP necessitated a number of new approaches and structural considerations under both project and financing documentation, which are likely to be used on other deals coming into the market.

The gas supply aspects of the project also presented a unique challenge as the gas pipeline connecting to the power plant spans more than 40km and stretches over an array of different types of land interests.

While it is not unusual on Indonesian IPPs for the project company to be responsible for constructing the transmission lines connecting the plant to PLN's network, and for procuring the necessary land rights for that purpose, the need to do this with respect to an underground gas pipeline presented unique challenges.

This required negotiation with a very broad range of different private land owners and local and central government agencies, and required close cooperation between the sponsors and the ADB and IFC environmental and social teams so as to ensure that the process was undertaken in a manner consistent with best practice and a harmonised set of environmental and social guidelines and requirements.

Given the complexity of land rights in Indonesia, Medco Power's strong knowledge and familiarity with local conditions and deep experience in developing gas-related infrastructure, combined with the efforts and experience of the lenders and their advisers with the Indonesian legal landscape, meant that the parties were able to successfully navigate this challenge.

Indonesian regulatory landscape

Unlike the majority of export credit agency/development finance institution-financed projects in Indonesia, this project is one of the first to not include a guarantee – either in the form of a government guarantee agreement or a business viability guarantee letter, more commonly known as BVGL – from the Indonesian government of PLN's obligations as power offtaker.

In the power sector, BVGLs were originally applicable for power plant projects under the fast track Programmes I and II, and they have not generally been available for newly signed PPAs since the introduction of the Indonesian government's 35GW programme in 2015.

While a limited number of other development finance institution/ECA-financed renewables projects have recently been financed without BVGLs – including several smaller renewables projects – the Riau gas-fired IPP is one of the first large conventional IPPs to achieve financial close on this basis.

The non-availability of BVGLs or other government guarantees is likely to be a feature of Indonesian power projects for the foreseeable future and underscores the importance for sponsors and lenders to independent power producer projects in understanding PLN's funding arrangements.

These arrangements include the Public Service Obligation (PSO) scheme, which in broad terms recognises PLN's obligations as the state-owned electricity supplier to provide electricity to the public at affordable prices and provides a

mechanism for the government to put PLN in sufficient funds to meet those obligations by way of the state budgeting process.

The PPA for the Riau IPP included a number of relatively new features, in addition to the gas tolling arrangements already mentioned. The close cooperation between lenders and sponsors through the negotiation of those provisions with PLN, prior to signing of the PPA, was invaluable in ensuring that the final agreed positions were workable for all parties.

Another point worth noting is that the PPA for the Riau IPP was one of the first PPAs in the market following a revised approach in terms of when the financing date is achieved – which starts the clock on the required construction schedule obligations under the PPA.

Unlike in prior PPAs, where the financing date was typically only achieved upon satisfaction or waiver of CPs under the financing agreements, the new trend is to allow the financing date to be achieved on the basis of a lenders' commitment letter.

The effect of this was to place a greater time pressure for the financing, in terms of necessitating a condensed time period between agreement of the term sheet/commitment letter and achievement of actual financial close. This required all parties to work with particular efficiency and cooperation to ensure that could be achieved.

Key counterparties and roles

Lotte Engineering and its domestic partner PT Hutama Karya, in a joint operation with Lotte Engineering, are carrying out the engineering, procurement and construction of the power plant and PT Citra Panji Manunggal is carrying out the engineering, procurement and construction of the gas facilities.

General Electric and its domestic partner are the long-term services providers. Both Medco and Ratch are providing technical services and operation and maintenance services for the project.

Milbank LLP acted as international legal counsel to the lenders, supported by Assegaf Hamzah & Partners as Indonesian counsel to the lenders. Linklaters LLP and Widyawan & Partners acted as international legal counsel and Indonesian counsel to the sponsors.

The success of this project is attributable to the collaboration of many parties that bring their particular strengths and expertise.

ADB, IFC and the lender group supported by Milbank LLP acting as international legal counsel and Assegaf Hamzah & Partners as Indonesian counsel were able to navigate the challenges facing this deal given the parties' familiarity with the Indonesian landscape.

Milbank and AHP were also attuned to the requirements of development finance institutions in projects of this type. The two sponsors bring extensive experience in infrastructure projects and local and regional experience. ■