Bonded Logistics Centers

Opportunities abound in the establishment of Bonded Logistics Centers

by Eka Wahyuning Siswani, S.H., LL.M

The government has expressed interest in developing Indonesia's manufacturing capacity. Indonesia is in fact a sizeable market for manufactured goods, and domestic consumption is a major driver of economic growth. Many of the materials for manufacturing are imported from abroad and stored in Singapore or Malaysia until needed. This lengthens the supply chain since ideally it would be more efficient to warehouse goods domestically for quicker supply in-land to industrial estates and manufacturing centers.

Why then are goods stored in a neighboring country? The answer is complex: one obvious reason is that Indonesia has very few deep water ports and so it is easier to go through Singapore, which has one of the most modern and high tech blue water ports in the world for subsequent trans-shipment to Indonesia. Let's not forget the soft logistics question as well: in addition to operating world-class facilities, over the years Singapore has developed world-class logistics systems, which encompass education, laws, procedures, insurance coverage and expertise. The combination of infrastructure and soft logistics has made Singapore the gateway to South East Asia.

To improve Indonesia's poor logistics situation, in the second incentive package, the government of Indonesia decided to pass new regulations which introduce a new form of bonded stockpile zone or area (*tempat penimbunan berikat*), the so called "**Bonded Stockpile Zone",** to shorten the supply chain. The idea is to store goods in Indonesia by creating bonded logistics centers that can lure suppliers into parking their goods in Indonesia.

Under Government Regulation no. 32 of 2009 on Bonded Storage Zone ("**GR 32/2009**"), there are various types of Bonded Stockpile Zones, i.e. Bonded Zone (*Kawasan* Berikat), Bonded Warehouse (*Gudang Berikat*) or "**BW**", Bonded Exhibition Place (*Tempat Penyelenggaraan Pameran Berikat*), Bonded Auction Place (*Tempat Lelang Berikat*), Bonded Recycling Area (*Kawasan Daur Ulang Berikat*), Duty Free Shop (*Toko Bebas Bea*).

In addition to the foregoing zones or places, in 2015 through Government Regulation no. 85 of 2015 which amended GR 32/2009, the government created a new model called the Bonded Logistic Centre (*Pusat Logistik* Berikat) or "**BLC"**.

Let us first elaborate upon the important distinction between BW and BLC. The benefit of having a BW and BLC is that a company can enjoy excise exemption (*dibebaskan*), from import taxes which are not collected (*tidak dipungut*) and have import duties postponed (*ditangguhkan*) until the goods are actually shipped to a buyer. However, for BW, one company may only operate one BW, whilst an operator of BLC may operate more than one BLC under one license. Furthermore, the goods stored in BW are strictly controlled. A company that operates the BW must have an approval from customs for all goods that are to be warehoused. Additional processing activity may be carried out on the goods stored in BW, such as sorting and packaging/ repackaging, kitting, etc., and the goods can be stored only for up to one year, whilst for BLC it is up to three years, and certain goods may be stored for more than three years. The operators of these BW generally act as distributors for duty free stores or hold goods in transit that are to be exported onto a final destination or alternatively, their goods can be stored pending an order from various [SME] industrial concerns, industrial estates and special economic zone ("SEZ") around the archipelago.

In contrast, BLC can only carry out basic processing before the goods are sent onward, generally to another Bonded Area or SEZ. The BLC is thus a transit area meant to facilitate the movement of imported goods around the archipelago among other bonded areas. As a concept, BLC is meant to be a flexible link in the supply chain to facilitate operations in SEZs, Bonded Stockpile Zones and local SMEs by avoiding import dwell-time.

There are some concerns however. It is feared that BLCs could cannibalize business that is already being handled by BW because of the BLC's more favorable location or terms. The fact that various companies can use a BLC means that operational costs can be cut. In addition, BLCs are primarily meant to service SEZs, but of the 11 planned SEZs, work has only started on two, and they are only 10 percent complete. As a result, although the government plans 50 BLCs, we query as to when the SEZs they are meant to feed will be operational.

Another worry is intermodal transport since even if goods can be brought up to the 'doorstep' in BLCs instead of sitting on 'in the front yard' in Singapore, it is inter-island transport which is expensive, complex and uncertain. Two BLCs are ready to operate, one in Cikarang (West Java) and another in Merak (Banten); manufacturing companies in these areas can thus in theory order their goods from these BLCs instead of from overseas. This could play a part in avoiding the long dwell time at Tanjunjg Priok which on average is 4.7 days: goods can be warehoused with no import/excise taxes until they are needed for manufacturing.

All things considered, the bottom line is the prices that the BLCs can offer; if they are competitive with Singapore, companies will use them. if they are not we wonder what steps the government would then take: would it oblige companies to use them, thus making the supply chain more expensive? Or would companies close the BLCs because there is no economic reason to keep them open?

Time will tell if this initiative will enjoy success and improve logistics, and we suspect that there could be considerable 'creative destruction', as BW, BLC, and Bonded Zones vie for business among themselves. We suspect that BLC licenses could be acquired for speculative purposes; competition with Singapore could be fierce, as the tiny nation state has considerable resources to bring to bear in this field. Notwithstanding the foregoing, for certain, the new paradigm will open up new opportunities that manufacturing companies, especially SMEs, should take note of.

Bankability and scope of geothermal BVGLs

by Ferdinand Jullaga, S.H., LL.M

IPP developers, including geothermal project owners and financiers regularly enquire about the Business Viability Guarantee Letter (**BVGL**) issued by the Minister of Finance (**MoF**). There is some confusion over whether the BVGL is a full guarantee, a comfort letter, or a simple restating of the prevailing law on the MoF's obligations to the state electricity utility (PLN).

Business Viability Guarantee Letter is meant to facilitate financing and financial close for power projects. The BVGL essential serves as a comfort letter to assuage fears over the risk of non-payment for the purchase of electricity by PLN. However, the BVGL does not give the project owner what he really would like to have: i.e. an explicit guarantee from the MoF that it will cover the obligations of PLN and make good on any breach of contract, including termination of contract. The BVGL in fact solely covers funding support by the Government to PLN so as to make PLN able to perform the payment obligations for electricity and any other ancillary expenses in the course of operations. The MoF's financial responsibility is not to the project owner but to PLN, and there is no way to cut through to the MoF to oblige it to cover all potential risks.

Policy reasoning

The reason for the foregoing is that the policy reasoning is based on the concept of the **Public Service Obligation** (PSO) of PLN as articulated in State-Owned Enterprise law regime. PLN is mandated by the government to provide electricity to the people, even if it must do so at a loss, which allows it to even enter into loss-making power purchase agreements, with the tacit understanding that the government will inject funds into PLN to keep it afloat. A good illustration of PLN's PSO is a project structured around a Feed-In-Tariff (FIT) where there is inherently an unfavorable mismatch between the production price and the sales price. PLN commits itself to loss-making FIT power projects at the behest of the government which has an obligation to provide power to remote communities at FIT rates. Such projects are not commercially driven; green energy projects are another case in point where the project meets political and social goals and not commercial ones.

It is on this conceptual basis that we must view the BVGL: the BVGL is thus not, and will probably never be, a panacea for all risks the project owner is exposed to in the PPA. The mandate of the MoF is ultimately not to come to the rescue of project owners, but to ensure that PLN is in a financial situation to be able to meet its obligations to the Seller and eventually continue supplying electricity to the people. It is along these lines that the BVGL should be approached.

Implications for the geothermal industry

The BVGL is issued by the MoF and covers the pre-construction, construction and operation period of the power project. The BVGL is typically issued after the signing of the PPA. The project must then achieve financial close within the following 12 months (48 months are given for geothermal projects due to their complexity and in view of their high risk profile). The BVGL is indeed an important component in the financing of a power project, and if the power project benefits from external financing, the financiers will likely request such an assurance. It is very possible that the government will issue stronger guarantees and cover more risks in the BVGL if it hopes to ramp up the development of geothermal projects. It is unlikely that project owners or financiers will ever gain direct recourse to the MoF as would be possible in an ideal situation, but it is possible that a BVGL could be issued with stronger wording and a clearer "guarantee" in the event of non-payment or default. Such a move would underline the government's commitment to geothermal projects.

New portable wellhead technology calls for new legal structures

MKK geothermal team

Portable wellheads offer geothermal project owners new opportunities to reduce risk and improve the bankability of their projects. But a new legal framework must be established to make it work. The cost of coal-fired produced electricity is only around 6.5 cents/kWh and by no stretch of the imagination can such a low tariff be used on a project finance basis to fund a geothermal project. Given the high level of risk that will be incurred, the daunting amount of risk does not translate into commensurate financial revenues. The high upfront costs for exploration are major challenges in addition to the fact that the chance of total project failure is as high as 50 percent. In fact, even after exploration, the risk that the steam is not the amount anticipated or sought after in the PPA is very high.

Complicated financial structures have been brought into play to compensate for the risk/reward mismatch but the necessity for a feed-in tariff (**FIT**) greatly weakens the whole geothermal business model. Frankly, it is not in PLN's interests to sign PPA's that put it at a disadvantage economically. Meaning that PLN has to buy electricity from a geothermal project owner at a FIT rate while it sells the same electricity to consumers at a much lower consumer rate.

Is there an alternative to the FIT? Perhaps technology has come to our rescue in the form of portable wellheads (PW). Portable wellheads cannot change the basic dynamics of exploration, but they offer the possibility of spreading out the risk, proving bankability and 'selling' the project politically to local residents and to financiers by proving a resource's bankability and then scaling up. PW produce electricity at a much less expensive cost, comparable to the cost of coal-fired power production.

The idea of portable wellheads is simple. A portable one-size-fits-all unit is simply fitted to the wellhead, and electricity can immediately be produced. There is no need for a power island, for an expensive system of piping if portable wellheads are used, and thus it goes without saying that there will be lower operating costs and lower O&M since the system has fewer moving parts. Experience has shown in countries such as Kenya that PW can sometimes be fitted to exploration wells, and thus a production well does not need to be drilled to immediately harness the steam field.

PW are highly reliable and have a simple, standardized design. Power can immediately be fed to the grid during the resource development stage, and this power can be used to operate on-site rigs and supply power needs and/or even be dispatched to the local community.

This could potentially go a long way to winning over the local populace and immediately showing them the benefits of the project and overcome any community resistance to the perceived negative impact of geothermal exploration and development. While the portable wellheads produce electricity, reservoir delineation and monitoring can continue, providing invaluable data on the long-term viability of the manifestation. At a certain point, the portable wellheads can be 'daisy-chained' to scale up power or removed once the bankability of the resource has been established.

Unfortunately, even though there are undoubtedly social and political benefits as well as benefits for achieving financial close, we must now turn to the obstacles hampering the implementation of this relatively new technology. First, it stands to reason that PLN probably prefers to sign PPAs for one large project rather than many small individual ones. A PPA is 20-30 year contract which is the bedrock basis for financiers to green light the project. Although PW facilitate certain elements of the geothermal project, they also admittedly complicate the signing process with PLN since slowly scaling up is, as a matter of practice, not something that is traditionally provided for in a geothermal PPA.

Some ideas for a new legal framework

A new regulatory framework would be needed to allow for slow scaling up or what we may call 'intermediate power generation', 'pre-PPA power generation', etc. The law could provide for a **Pre-PPA phase** or a **CSR phase**, in which power can be produced and used for on-site use as well as distribution to the local community. The law could set out the details for the interconnection and time and capacity limits for the CSR phase; the electricity would be provided for free for a trial period to demonstrate to financiers as well as members of the local community the viability of the resource. Since the electricity is used for onsite needs and given for free to the local community, in theory, there would be no need for a PPA.

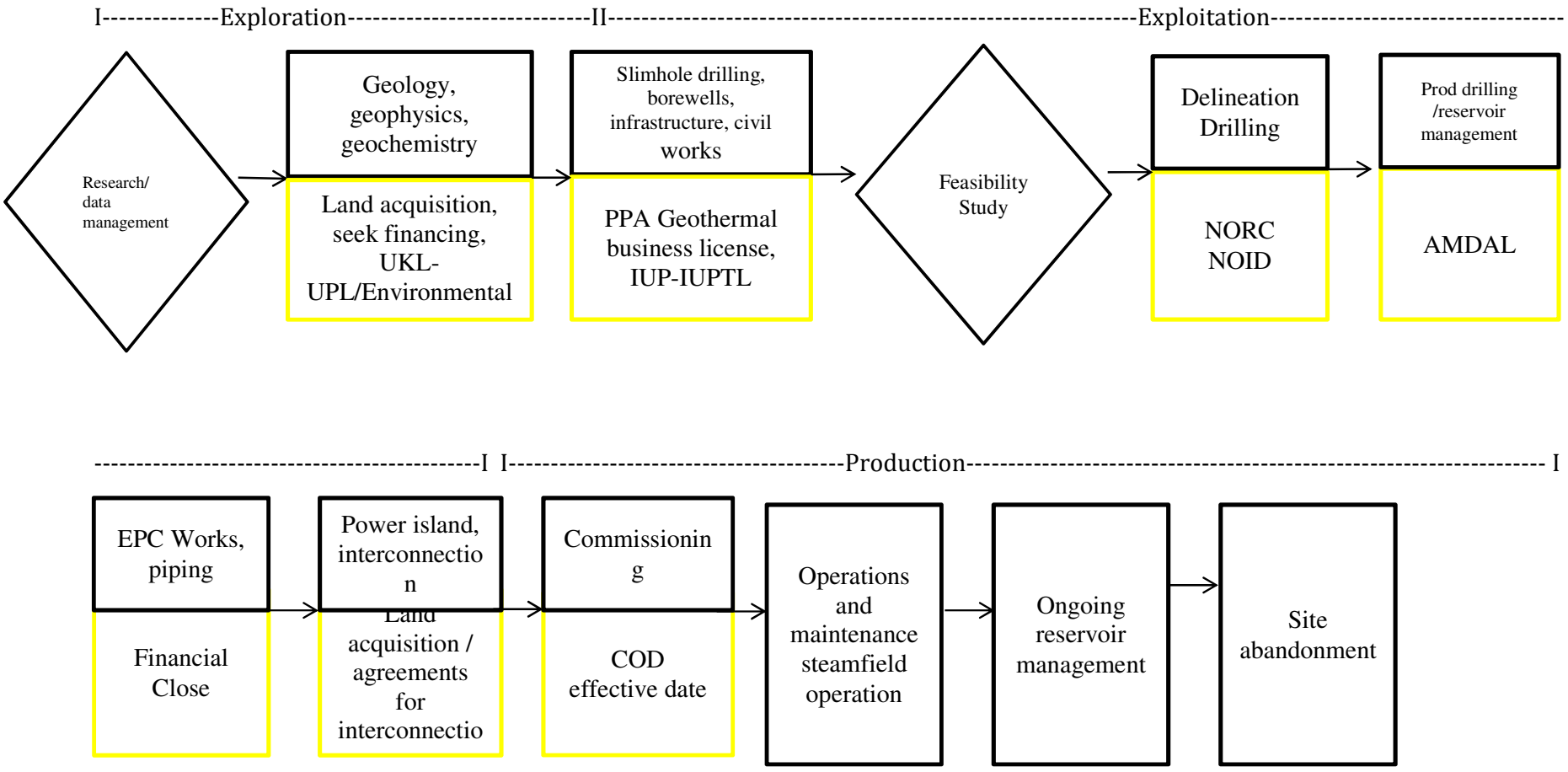
After a certain period, however, the project owner would scale up and enter into a formal PPA agreement. A new type of PPA would have to be written which could be termed a **Probability PPA** (**P-PPA**) in which a scaled-up schedule would be agreed to.

The P-PPA would give an approximate range of MW to be purchased by PLN with multiple CODs as each new PW is fitted. The P-PPA could have multiple CODs and one tariff for all could be negotiated or various tariffs could be agreed to in the interests of escalation. Eventually, all the PW could be replaced with a conventional power island, civil works and production wells or continue as is if it is commercially viable to do so.

The benefits would be to facilitate development of geothermal energy in Indonesia, but it would require cooperation and agreement among various government bodies for the relevant changes to be made. It is in the interests of the regulator to promulgate such a regulation since it would facilitate financial close, and project owners would be less dependent upon government support, such as the BVGL and IIGF to bring projects to fruition.

We hope that this short note may serve as a starting point for discussion.

Geothermal Operations Flow Chart



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