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WPG INDONESIA:

RELOCATION OF INDONESIA'S CAPITAL – IMPACT AND OPPORTUNITIES

By WongPartnership and Makes & Partners, member firms of WPG, a regional law network.

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Relocation of Indonesia's Capital – Impact and Opportunities

On 16 August 2019, President Joko Widodo formally announced the relocation of Indonesia's capital from Jakarta to East Kalimantan, on Borneo at an estimated cost of US$33 billion. About 80% of the cost is expected to be funded by private investments and public-private partnerships. In addition, the Indonesian government has also announced a planned investment of approximately US$40 billion to upgrade and modernise Jakarta's infrastructure.

These twin projects are expected to drive Indonesia's construction, utilities and finance sectors for the next decade, with investments from both within and outside of Indonesia. In this article, we outline some of the key considerations for investors and companies looking to capitalise on the potential opportunities in these sectors.

Construction

As a general rule under Construction Services Law No. 2 of 2017 ("**Indonesian Construction Law**"), foreigners are only allowed to participate in Indonesia's construction industry through the establishment of a joint venture with an Indonesian partner (subject also to the maximum foreign ownership restriction applicable to the relevant construction activity) or the setting up of a Foreign Construction Service Representative Office (*BUJKA*) to undertake a joint operation contract with an Indonesian partner. Furthermore, the Indonesia party who partners with a foreigner in such joint ventures or joint operation contracts is required to hold at a minimum, a B1 construction license in Indonesia. In addition, the established joint venture or BUJKA is only qualified to participate in projects which require the implementation of advanced technology or which are of high risk and/or high costs.

In June 2019, the Minister of Public Works and Public Housing ("**MoPW**") issued Regulation No. 09/PRT/M/2019 on Guidelines on Licensing Services for Foreign Construction Business Entities ("**Reg No. 9/2019**"). Reg No. 9/2019 requires foreigners who will be shareholders in a joint venture or who want to establish a BUJKA to hold a "large" construction qualification. However, no specific guidance has been issued by the MoPW as to the requirements for foreigners to satisfy the "large" construction qualification requirement. In addition, in order to encourage local involvement, Indonesian Construction Law and Reg No. 9/2019 also require that the majority of jobs in the joint venture and the BUJKA must be allocated to Indonesian nationals.

When foreigners enter into contracts in Indonesia, it is common practice that contracts are first finalised in English before they are translated into Bahasa Indonesia and that they would be governed by the law of choice and contain clauses stating that the English version would prevail in the event of any inconsistency. This typically means that less attention is placed on the Bahasa Indonesia version of the contract and the translation process. However a shift in mindset from this approach is required for construction contracts as under Indonesian Construction Law, construction contracts in Indonesia are required to be in Bahasa Indonesia and governed by Indonesian law.

Utilities – Water

The Indonesian House of Representatives (*Dewan Perwakilan Rakyat*) had in September 2019, passed a new law on water resources, which has been ratified on 16 October 2019 ("**New Water Law**") to address the lack of regulation in this area ever since Indonesia's Constitutional Court annulled the 2004 Law on Water Resources in 2015 and reinstated the previous governing law, Law No. 11 of 1974 on Water.

Under the New Water Law, the authority to utilise and procure water resources in Indonesia will rest with the state and as such, only state-owned entities ("**SOEs**") and regional government-owned entities ("**ROEs**") may be granted water resource procurement licences for the purpose of organising Indonesia's water supply system to meet the daily needs of the public. Based on discussions with the relevant government officials, we understand that the New Water Law is not intended to prevent, and does not restrict, private parties from entering into arrangements with SOEs or ROEs in relation to the utilisation of water resources in Indonesia.

Given that the New Water Law had only been recently ratified, it would be some time before regulations implementing the New Water Law will be issued. However, we expect that in the interim state agencies would be stricter in the handling of water resources and would do so in a manner that is consistent with the intent of the New Water Law. As a result of the state having greater control over the management of water resources under the New Water Law, investors and businesses (local or foreign) that are looking at opportunities in Indonesia's water industry would have to approach the relevant local government to discuss and explore ways to partner with them to achieve the aims of the New Water Law.

Utilities – Electricity

The Indonesian government had in 2015, set a target to increase the power capacity in Indonesia by an additional 35 gigawatts through the development of new infrastructure. This target is expected to be achieved by 2024. As part of a set of initiatives to achieve this target, Presidential Regulation No. 4 of 2016 (as amended by Presidential Regulation No. 14 of 2017) was issued, which paved the way for (i) the issuance of government guarantees for the development of power projects by PT Perusahaan Listrik Negara ("**PLN**"), the state-owned power distributor, as well as power projects developed by PLN and power producers; and (ii) the shortening of the time required for obtaining the requisite licences.

In addition to the above, under the 16th Economic Policy Package which the Indonesian government announced in November 2018, Indonesia will be relaxing the foreign investment restrictions over several business sectors. These will include the removal of the foreign ownership restrictions in the business of power plants with a capacity that is more than 10 megawatts (KBLI no. 35101) and ancillary power businesses such as the testing and commission of high voltage power installations (KBLI no. 71204) currently set out in Presidential Regulation No. 44 of 2016 on List of Business Fields that are Closed to Investment and Business Fields that are Conditionally Open for Investment ("**Negative Investment List**").

Although the required amendments to the Negative Investment List have not yet been made, recent government policies would indicate that Indonesia is looking to lower the barriers to entry for foreign investors in the power industry (and conversely provide local businesses with an additional source of capital to grow) in order to achieve the target of an additional 35 gigawatts by 2024.

Financing

Indonesian companies generally look to the equity capital, debt capital and loan markets to raise the capital that they need. In Indonesia, other than applicable foreign ownership restrictions, there are generally no restrictions for private companies to raise capital by issuing shares for cash provided that they have complied with the requirements set out in their constitutive documents and Indonesian company law; and in the case of publicly listed companies, with the requirements of the Financial Services Authority of Indonesia (*Otoritas Jasa Keuangan*) and Indonesia Stock Exchange.

For the issuance of debt instruments and incurrence of loans, all non-bank Indonesian companies are required under Bank Indonesia Regulation No. 16/21/PBI/2014 on Application of Prudential Principles in Management of Offshore Loan of Non-Bank Corporations, as amended by Bank Indonesia Regulation No. 18/4/PBI/2016 ("**PBI 16/21/2014**"), to comply with certain requirements when issuing foreign debt. This is intended to ensure that only companies which have a certain credit quality are able to tap into the international debt market.

Under PBI 16/21/2014, non-bank Indonesian companies are required to maintain a minimum hedging ratio of 25% of the shortfall between their foreign currency assets and foreign currency liabilities that are due within the next two financial quarters. In addition to the minimum hedging ratio, they are also required to maintain a liquidity ratio such that their foreign currency assets are at least 70% of their foreign currency liabilities due within the relevant financial quarter. Finally subject to some limited exceptions, a non-bank Indonesian company is required, when taking on foreign debt, to obtain a credit rating of at least BB minus from a rating agency recognised by Bank Indonesia.

Conclusion

We expect that with the impending relocation of Indonesia's capital and planned upgrades of Jakarta's infrastructure, numerous opportunities will arise for both domestic and international investors and businesses in the construction, utilities and finance sectors. Although clarity would still be required on certain aspects of the laws and regulations covering these sectors, with patience to navigate the regulatory landscape and active engagement with relevant government agencies, investors (both foreign and domestic) would be well-placed to see the benefits of their investments in the long run.

If you would like information on this or any other area of law, you may wish to contact the partner at WongPartnership or Makes that you normally work with or any of the following partners:

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WPG, a regional law network, brings together a group of five prominent law firms across seven countries in a collaboration to provide clients with legal services in ASEAN, China and the Middle East.

In addition to WongPartnership, a Singapore-headquartered firm with offices in Beijing, Shanghai and Myanmar, the network includes member firms Al Aidarous Advocates and Legal Consultants (Middle East), Foong & Partners (Malaysia), Makes & Partners (Indonesia) and Zambrano Gruba Caganda & Advincula (Philippines). Together, WPG is able to offer the expertise of over 400 professionals to meet the needs of clients in key sectors throughout the region.

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