

TANGGUH LNG GOES DOMESTIC

THE TANGGUH EXPANSION PROJECT REACHED FINANCIAL CLOSE IN LATE 2016, MARKING AN IMPORTANT MILESTONE FOR THE LNG MARKET IN INDONESIA AND SOUTH-EAST ASIA GENERALLY.

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Not only is the Tangguh Expansion Project the only upstream and fully-integrated Indonesian LNG project to reach financial close since 2007, but it is also the first Indonesian LNG project financed primarily off the back of domestic LNG sales.

Previous Indonesian LNG projects were financed almost exclusively on the basis of export sales while the Tangguh Expansion Project's sales to PT PLN (PLN), the Indonesian state-owned electricity company, will account for 75% of the project's estimated LNG production capacity. The transaction is also the first major Indonesian project financed by both international and domestic banks and sets the stage for greater Indonesian bank participation in project financings within the republic and across the region.

Indonesian oil and gas sector

Ever since oil was first discovered in North Sumatra in the late 19th century, the Indonesian oil and gas industry has become a critical sector of the country's economy and a vital contributor to state revenues. According to the Ministry of Finance, the sector's contribution to government revenues was over Rp216trn in 2014 and more than Rp78trn in 2015. Investment in the sector has significantly increased over the years from US\$7.6bn in 2006 to US\$22.2bn in 2015.

Indonesia became a significant player in the global natural gas market in the 1970s. Following the Middle Eastern oil crisis of 1973, Japanese government and energy traders began focusing on Indonesian LNG as means of diversifying from crude oil, which was then the primary fuel for Japanese industry.

This encouraged the development of two large LNG liquefaction facilities at Arun and Bontang in Indonesia and other Indonesian LNG plants, turning Indonesia into one of the world's largest LNG producers and exporters for years to come. As of 2014, Indonesia held an estimated 2.97trn cubic metres of proven gas reserves.

The diversity of Indonesia's geological make-up bodes well for the future of the oil and gas sector in the country. Indonesia has more than 50 sedimentary basins. Fourteen of these basins are already being exploited for their hydrocarbons, but many have yet to be fully explored.

The western part of the country has historically been the primary focus for oil and gas exploration and production and accounts for around 75% of the activity in the sector. That said, the eastern part

of the country, including West Papua where the Tangguh LNG facility is located, has shown particular promise. It is estimated that this region contains more than 35 tertiary and pre-tertiary basins with strong potential for new oil and gas finds.

Project overview

The Tangguh LNG facility is located in Teluk Bintuni Regency, West Papua. It currently consists of offshore gas production facilities that supply two 3.8m tons per annum liquefaction trains.

The Tangguh Expansion Project includes the construction of an onshore LNG process train with liquefaction capacity of 3.8m tons per annum, two offshore platforms, 13 new production wells and a new LNG jetty and supporting infrastructure that will bring the Tangguh LNG plant to a total capacity of 11.4m tons per annum. The Tangguh Expansion Project is expected to come on stream in July 2020.

The Tangguh Expansion Project is operated by BP Berau on behalf of the other production-sharing contract partners (the PSC contractors). BP Berau and its affiliates in Indonesia hold a 37.16% stake in the project, followed by MI Berau BV (16.30%), CNOOC Muturi (13.90%), Nippon Oil Exploration (Berau) (12.23%), KG Berau Petroleum and KG Wiriagar Petroleum (10%), Indonesia Natural Gas Resources Muturi Inc (7.35%), and Talisman Wiriagar Overseas (3.06%).

The US\$8bn project secured more than US\$3.745bn in project debt, split into a JBIC direct loan of US\$1.2bn, an ADB loan of US\$400m, an international commercial bank tranche of US\$2.045bn, and an Indonesian bank tranche of US\$100m.

The international banks include four Japanese banks, BTMU, Mizuho Bank, SMBC and Shinsei Bank; three Singaporean banks, DBS, OCBC and UOB; two Chinese banks, Bank of China and China Construction Bank; two French banks, BNP Paribas and Credit Agricole, and KDB and KfW.

The domestic banks comprise four state-owned Indonesian banks – Bank Mandiri, Bank Negara Indonesia, Indonesia Infrastructure Finance, and Bank Rakyat Indonesia. The door-to-door tenor of the debt is almost 13 years. The debt is supported by guarantees from the PSC contractors' designated guarantors.

The Tangguh Expansion Project is underpinned by long-term LNG sale and purchase agreements with Kansai Electric Power Co and PLN (the LNG SPAs). The PLN volume represents 75% of

the project’s capacity, with the Kansai volume representing the remaining 25%.

Notable features

- *Financing structure, unique trustee borrowing structure* – The financing involves a complex multi-tranche Indonesian trustee borrowing structure. Under this structure, loans are repaid from an agreed portion of gross proceeds under identified offtake contracts, in this case the LNG SPAs.

The buyers make payments directly to the trustee and paying agent. The trustee is also the borrower under the loan agreement with the lenders, and the debt service payments are made from the trustee accounts. Except otherwise provided, the lenders look to this source of debt service for all loans, with no recourse to the project and no security interest in the project assets or contacts.

The Tangguh Expansion Project’s trustee borrowing structure is innovative compared with other Indonesian trustee borrowing schemes for two reasons. First, the financing structure had to function independently from the schemes used to finance the original Tangguh LNG plant.

In addition, the Tangguh Expansion Project’s TBS had to be structured to comply with the Bank Indonesia regulation No.16/10/PBI/2014 as amended by Bank Indonesia regulation No 17/23/PBI/2015 (PBI 16/10). Pursuant to PBI 16/10, all export proceeds and foreign exchange debt must be paid onshore into an account maintained with a bank in Indonesia. To ensure compliance with this regulation, the Tangguh Expansion Project’s TBS includes a parallel onshore trustee structure.

- *Domestic content* – In addition to its unique financing structure, the Tangguh Expansion Project also distinguishes itself by the unusually high degree of Indonesian participation in the project debt and LNG offtake.

Consistent with the Indonesian government’s mandate to increase supply to the domestic energy market and encourage local economic growth, the Tangguh Expansion Project contracted to sell 75% of its annual LNG production to PLN while precedent

Indonesian projects have almost always exported the majority of their LNG production.

The design and structure of an onshore bank tranche with Indonesian commercial banks is also a first for a major Indonesian project. The inclusion of this tranche was important for the Indonesian government as it seeks to encourage the onshore banking sector to tool up and refine its expertise and deal sheet in the project finance space.

The Tangguh Expansion Project’s strong economic and cashflows contributed to the lenders’ positive perception of the financing. The robust political and economic environment provided an excellent backdrop. The lenders also drew comfort from the well-established trustee borrowing structure.

Conclusion

The Tangguh Expansion Project is vital to meet the growing energy demands in Indonesia and reinforces the Indonesian government’s commitment to increase the country’s energy supply and grow the LNG sector. The project is expected to generate about 10,000 jobs over its life cycle.

As the only fully integrated upstream LNG project in Indonesia to reach financial close since 2007 and the first Indonesian LNG project financed primarily off the back of domestic LNG sales with onshore bank participation, this landmark project will serve as a template for many other Indonesian oil and gas developments that are scheduled to reach financial close in the near future (eg, the Balikpapan refinery development project).

Latham & Watkins represented the Republic of Indonesia through its oil and gas upstream regulatory agency Satuan Kerja Khusus Pelaksana Kegiatan Usaha Hulu Minyak dan Gas Bumi, SKKMIGAS. Linklaters was the international legal counsel to the borrower, the contractor and the operator. Allen & Overy was international and Indonesian legal counsel to the lenders. Ali Budiardjo Nugroho Reksopdiputro was Indonesian counsel to the Republic of Indonesia through SKKMIGAS. Widyawan & Partners was Indonesian legal counsel to the borrower, the contractor and the operator. ■

FIGURE 1 - TANGGUH EXPANSION PROJECT’S TBS

