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Risk Allocation of Legal Changes in Infrastructure Provision Agreements Through Public-Private Partnership Schemes

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ABSTRACT

Infrastructure development is essential for boosting economic growth and improving the welfare of society. However, due to budget constraints, the government has been driven to involve private entities in infrastructure development through the Public-Private Partnership (PPP) scheme. Agreements under the PPP scheme typically span a long period. During the term of such agreements, legal changes that impact the execution of the agreements may occur. This article discusses the allocation of risks associated with legal changes between the parties in a PPP agreement based on internationally accepted risk allocation principles. The research method employed is a normative juridical approach, focusing on secondary data. The research specification used is descriptive-analytical, analyzing issues based on the principles of risk allocation in the PPP scheme, and comparing them with international practices. The research findings reveal that although the risk of legal changes is beyond the control of the private entity, the government only bears the risk of legal changes that are specific and discriminatory, while the risk of general legal changes is regarded as a business risk borne by the private entity. This risk allocation is inconsistent with international risk allocation principles and the specific conditions in Indonesia. Given that the government is the most capable of managing legal change risks, it is more appropriate for the government to bear both specific and discriminatory legal risks, as well as general legal risks.

Keywords: legal change; public-private partnership; risk allocation.

INTRODUCTION

The concept of a welfare state is an idea that employs a democratic government system responsible for the welfare of its citizens.[1] Spicker, as outlined in Oman Sukmana's work titled Concept and Design of the Welfare State (*Konsep dan Desain Negara Kesejahteraan*), conveys that a welfare state can be defined as a social welfare system in which the state (government) takes a greater role in allocating public funds to ensure the fulfillment of its citizens' basic needs. Meanwhile, Husodo, as stated in Oman Sukmana's article, defines a welfare state succinctly as a state where the government is considered responsible for guaranteeing a minimum standard of living for all of its citizens.[2]

The Unitary State of the Republic of Indonesia is a welfare state. This can be seen from the preamble of the 1945 Constitution, which states: "The government shall protect the entire nation and all of its bloodshed, promote the general welfare, and educate the life of the nation." Furthermore, several articles in the 1945 Constitution reflect the core values of a welfare state, including Article 27 paragraph (2), which reads: "Every citizen has the right to a decent job and livelihood for humanity,"

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[1] V. Hadiyono, "Indonesia dalam Menjawab Konsep Negara Welfare State dan Tantangannya", *Jurnal Hukum Politik dan Kekuasaan,* Vol. 1, No. 1, 2020, p. 24.
[2] Oman Sukmana, "Konsep dan Desain Negara Kesejahteraan (*Welfare State*)", *Jurnal Sospol*, Vol 2, No.1, 2016, p. 107.

Article 28A, which states: "Every person has the right to live and the right to defend their life and existence," as well as Articles 28B, 28C, 28H, 31, 33, and Article 34 of the 1945 Constitution.[3] As one of the manifestations of a welfare state, the government is responsible for providing adequate public services to society, including infrastructure.

Infrastructure refers to the physical systems that provide transportation, irrigation, drainage, buildings, and other public facilities required to meet the basic needs of humans in social and economic environments.[4] The availability of adequate physical infrastructure supports the smooth operation of economic activities, including the distribution and flow of production goods and services.[5] The presence of infrastructure encourages increased income levels among society due to improvements in the productivity of production factors, the mobility of production factors, and trading activities.[6] Infrastructure is also a variable that has a positive and significant influence at a 99% confidence level on foreign direct investment in the long term.[7] According to the Ministry of Public Works and Public Housing ("**Ministry PWPH**"), the construction of infrastructure valued at Rp. 1 trillion can absorb as many as 14,000 workers.[8] Based on the historical development of the economy in Indonesia, infrastructure is regarded as a vital sector in the process of achieving high economic growth.[9]

The Indonesian government recognizes the importance of infrastructure development. Law Number 17 of 2007 on the National Long-Term Development Plan (*Rencana Pembangunan Jangka Panjang Nasional* - "**RPJPN**") for 2005-2025 states that the national development vision, which is to create an independent, advanced, just, and prosperous Indonesia, must be supported by advanced infrastructure. The National Long-Term Development Plan document for 2005-2025 mentions that infrastructure development is mandated in order to realize Indonesia as a competitive nation (subsection 4.1.2 RPJMN) and to achieve more equitable and just development (subsection 4.1.5 RPJMN).[10]

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[3] *Ibid*, p. 104.
[4] Warsilan dan Akhmad Noor, "Peran Infrastruktur terhadap Pertumbuhan Ekonomi dan Implikasi pada Kebijakan Pembangunan di Kota Samarinda", Jurnal Mimbar, Vol. 31, No. 2, 2015, p. 361.
[5] Karisma Idola Arga, Muhammad Safe'I, Mullatifah Yossi, Mutia Amalia, Rafli Saputra, dan Fefi Gustiwalan, "Pengaruh Pembangunan Infrastruktur terhadap Pertumbuhan Ekonomi di Indonesia", *Salam: Islamic Economics Journal,* Vol. 3, No. 1, 2022, p. 68.
[6] Anisa Fahmi, "Efek Spasial Infrastruktur terhadap Pertumbuhan Ekonomi", *Jurnal Akuntansi dan Keuangan*, Vol. 19, Issue 2, 2022, p. 469.
[7] Sony Hendra Permana dan Admira Rivani, "Pengaruh Produk Domestik Bruto, Inflasi, Infrastruktur, dan Risiko Politik terhadap Investasi Langsung Asing di Indonesia", *Jurnal Ekonomi & Kebijakan Publik*, Vol. 4, No. 1, 2013, p. 84.
[8] I Gede Made Artha Dharmakarja dan Epafras Nehemia Br Aritonang, "Apakah Program Percepatan Pembangunan Infrastruktur Mengurangi Tingkat Pengangguran?", *Jurnal Anggaran dan Keuangan Negara Indonesia,* Vol. 3, No. 2, 2021, p. 129.
[9] Suriani dan Cut Nanda Keusuma, "Pengaruh Pembangunan Infrastruktur Dasar terhadap Pertumbuhan Ekonomi Indonesia", *Jurnal Ecosains,* Vol. 4, No. 1, 2015, p. 2.
[10] Lumettu Jegiftha, Ronny Gosal, dan Sarah Sambiran, "Kinerja Dinal Pekerjaan Umum dan Tata Ruang dalam Pembangunan Infrastruktur di Kabupaten Kepulauan Talaud", *Jurnal Jurusan Ilmu Pemerintahan, Vol. 1, No. 1, Tahun 2018,* p. 2.

The government continues to increase the allocation of funding for infrastructure development. However, data from the Ministry of Finance shows that the government's ability to fund infrastructure development using public funds is very limited.[11] According to the 2020-2024 National Medium-Term Development Plan (Rencana Pembangunan Jangka Menengah Nasional – "**RPJMN**"), the total budget required to close the gap in infrastructure development in Indonesia amounts to IDR 6.421 trillion, or an average of 6.08 percent of GDP.[12] This figure represents a significant increase from the infrastructure funding requirement of IDR 4.796 trillion in the 2015-2019 RPJMN. Despite the increased allocation for infrastructure development, there remains a substantial funding gap.[13] The National Development Planning Agency (*Badan Pembangunan Nasional* - "**Bappenas**") has stated that based on the projected infrastructure needs for the 2020-2024 period, the government can only finance 37% of the total required funding, with the remaining 63% expected to be sourced from public participation and private enterprises.[14]

In light of this situation, efforts are needed to encourage public and private sector investment in infrastructure development. However, it is important to understand that the involvement of private enterprises in infrastructure development does not mean the government is absolving itself of its responsibility in infrastructure development. The participation of private enterprises should be seen as a method for the government to fulfill its obligations in infrastructure development amidst limited resources by leveraging the resources available to private enterprises. The government plays a crucial role in creating conditions that support investment in infrastructure projects by establishing a regulatory framework related to infrastructure development. This aims to enhance investor confidence and commitment to long-term investments, despite the inherent risks associated with political factors and the long-term nature of infrastructure projects.[15]

Public-Private Partnership (PPP) in Infrastructure Provision is one method of involving private enterprises in infrastructure development. Presidential Regulation No. 38 of 2015 on Public-Private Partnerships in Infrastructure Provision (hereinafter referred to as "**PR 38/2015**") serves as the legal basis for the implementation of PPPs in Indonesia. PR 38/2015 defines PPP as follows:

"Public-Private Partnership, hereinafter referred to as PPP, is a collaboration between the government and private enterprises in the provision of infrastructure for public interest, referring to the specifications set by the Minister/Head of Agency/Regional Head/State-Owned Enterprises/Regional-Owned Enterprises, where some or all of the resources used are provided by the private enterprises, with due consideration of the risk allocation between the parties involved."

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[11] Erika Sefila Putri dan Wisudanto, *"Struktur Pembiayaan Pembangunan Infrastruktur di Indonesia Penunjang* Pertumbuhan *Ekonomi"*, *IPTEK Journal of Proceeding Series,* No. 5, 2017, p.224

[12] Kementerian Perencanaan Nasional/Badan Perencanaan Pembangunan Nasional, "Rancangan Teknokratik, Rencana Pembangunan Jangka Menengah Nasional 2020-2024, Indonesia Berpenghasilan Menengah – Tinggi yang Sejahtera, Adil, dan Berkesinambungan", 2019, p. 135.

[13] *Ibid,* p. 135.

[14] Kementerian Perencanaan Nasional/Badan Perencanaan Pembangunan Nasional, "Public-Private Partnership Infrastructure Projects Plan in Indonesia", Jakarta, 2022, p. vi.

[15] Erika Sefila Putri dan Wisudanto, *Op. Cit*. p. 224.

Through Public-Private Partnerships (PPP), the government sets the quality and quantity of services to be provided by private enterprises. These enterprises may be assigned tasks including design, construction, financing, operation, and management of infrastructure assets to provide such services. In return, the private enterprise will receive payments from the government and/or service users.[16] The PPP financing scheme has key characteristics, including a competitive bidding process, efficient risk allocation between the government and private enterprises, and innovation from the private sector to enhance service quality.[17]

The PPP agreement signed by the government (the grantor) grants the project company (the private entity responsible for the project) the right to carry out some or all of the activities related to the PPP, such as designing, constructing, operating, and/or maintaining infrastructure assets for a predetermined period. Additionally, the PPP agreement generally includes provisions regarding applicable taxes or laws governing the project, including environmental obligations of the project company.[18]

The government has several reasons for using the Public-Private Partnership (PPP) scheme, including:[19]

1. Focusing procurement on the provision of infrastructure services.
2. Private enterprises initially finance the provision of infrastructure, helping to address the limitations in national/regional budgets.
3. Providing space for private enterprises to innovate both during the infrastructure construction phase and in driving efficiencies in service delivery.
4. Risk-sharing between the government and private enterprises.
5. A single contract with the private enterprise for all infrastructure provision activities.
6. Government support is available during the project preparation phase.

According to Jeffrey Delmon in his book Private Sector Investment in Infrastructure, Project Finance, PPP Projects and PPP Frameworks, several factors motivate the government to implement PPPs, including: [20]

1. Public utility services being below standard.
2. Limitations in technical and managerial resources within the government.

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[16] Philippe Burger and Ian Hawkesworth, "How to Attain Value for Money: Comparing PPP and Traditional Infrastructure Public Procurement", *OECD Journal on Budgeting*, Vol. 2011/1, 2011, p. 93.
[17] Muhammad Baidarus, Dicky Febrianto, Danang Andrian Mubarok, M. Agra Ramadhani, "Kajian Sistematis Kebijakan Skema Pembiayaan Kerja Sama Pemerintah dengan Badan Usaha (KPBU) pada Sektor Perumahan Guna Mengatasi Backlog di Indonesia", *Jurnal BPPK* Vol. 16, No. 1, 2023, p. 4.
[18] Jeffrey Delmon, *Public-Private Partnership Projects in Infrastructure an Essential Guide for Policy Makers*, New York: Cambridge University Press, 2011, p. 118.
[19] Kementerian Keuangan, "Mengapa KPBU", https://kpbu.kemenkeu.go.id/read/13-4/pjpk/mengapa-kpbu [01/11/2023].
[20] Jeffrey Delmon, *Private Sector Investment in Infrastructure, Project Finance, PPP Projects and PPP Frameworks*, Netherland: Wolters Kluwer, 2016, p. 12.

3. Investment needs exceeding government resources, especially due to high initial capital costs associated with large infrastructure investments and significant ongoing maintenance costs. In simple terms, the government lacks the necessary resources.

PPP is an approach to providing infrastructure services that is significantly different from conventional procurement of goods and services or regular procurement contracts. KPBU shifts the relationship from a traditional buyer-supplier dynamic, typically found in goods and services procurement contracts, to a partnership between the government and private enterprises to provide infrastructure services over a relatively long period. Jeffrey Delmon, in his book Private Sector Investment in Infrastructure, Project Finance, PPP Projects and PPP Frameworks, explains that KPBU combines the government's mandate to provide services and its role as a regulator and coordinator of public agencies, with the private sector's focus on profit and commercial efficiency.[21]

An infrastructure project implemented through the PPP scheme typically involves a long-term agreement, generally lasting approximately 25 years. According to Article 32 of PR No. 38/2015, the PPP agreement must, at a minimum, include provisions concerning, inter alia, the scope of work of the private entity, tariffs and the mechanism for their adjustment, rights and obligations including the allocation of risks, and performance service standards. The PPP agreement also contains an agreement between the government and the private entity regarding the rate of return on investment to be received by the private entity, based on assumptions such as project costs and revenue, which are discussed and agreed upon during the drafting of the PPP agreement.

During the long-term period of the PPP (Public-Private Partnership) agreement, several cycles of government leadership changes typically occur, often accompanied by policy shifts reflected in amendments to laws and regulations. These may include changes to tax regulations, such as higher tax rates, regulations on environmental standards, including stricter waste disposal standards, and regulations related to technical specifications applicable to the relevant infrastructure sector. Such amendments to laws and regulations can impact the private entity's investment in the PPP project, including the need for the private entity to incur additional costs to adjust infrastructure assets or services to comply with the new regulatory requirements. Alternatively, the private entity may be unable to generate revenue in accordance with the projections made at the time the PPP agreement was drafted. In light of these considerations, changes in laws and regulations during the term of the PPP agreement create uncertainty for the private entity as the government's partner in the PPP project.

In relation to legal changes, there is essentially a tug-of-war between the government, represented in the PPP agreement by the Project Management Unit (Penanggung Jawab Proyek Kerja Sama-"**PJPK**"), and the private entity regarding the allocation of the risk of legal changes. This is because legal changes can impact the costs and revenues of a PPP project, which ultimately affects the feasibility of the project from both the PJPK's and the private entity's perspectives. The private entity argues that the issuance of regulations is the prerogative of the government, and therefore, it

[21] *Ibid,* p. 3.

believes that the risk of legal changes is beyond its control, with such risks falling under the control of the government. On the other hand, the PJPK typically views legal change risks as something that can occur in general business activities (outside the PPP scheme), and in practice, business actors in those activities bear the consequences of legal changes themselves. In light of this, it is essential to review the allocation of risks associated with legal changes in PPP projects in Indonesia, in accordance with the risk allocation principles widely accepted internationally.

METHOD

The research method used in addressing the issues is normative juridical. This method emphasizes legal science, so the data used in addressing the issues in this study always refers to the juridical aspects, particularly secondary data, which includes primary legal materials, secondary legal materials, and tertiary legal materials. Secondary data covers a wide range of sources, including legislation, books of literature, legal journals, newspapers, magazines, and official documents issued by the government.[22] The research specification used is descriptive analytical, which analyzes the issues based on the principles of risk allocation and compares them with international practices. Descriptive research aims to resolve current issues by collecting data or information to be organized, explained, and analyzed.[23]

The research is conducted in two stages: library research and field research. Library research is conducted to obtain secondary data related to the legal foundation and theories explaining PPP and risk allocation, which are then studied to provide an explanation of the issues discussed in this study. Field research is carried out through direct interviews with parties relevant to the issues raised in this study.

DISCUSSION

Risk Allocation of Legal Changes Based on the Internationally Accepted Risk Allocation Principles

The World Economic Forum document, *Industry Agenda: Strategic Infrastructure Mitigation of Political & Regulatory Risk in Infrastructure Projects*, states as follows:[24]

> "During the different stages of a project's life cycle, infrastructure projects are exposed to very different types of political and regulatory risk. Among the risks are, for example: during the planning and construction phase-delayed construction permits, and community opposition; during the operating phase-changes to various asset-specific regulations, and outright expropriation; towards the end of a contract-non-renewal of licenses, and tightened decommissioning requirements. In addition, some broader risks apply throughout the life cycle

[22] Soerjono Soekanto dan Sri Mamudji, *Penelitian Hukum Normatif Suatu Tinjauan Singkat*, Jakarta: Rajawali, 2006, p. 23-24.
[23] Beni Ahmad Saebani, *Metode Penelitian Hukum*, Bandung: Pustaka Bandung Setia, 2008, p. 57.
[24] World Economic Forum, "Industry Agenda Strategic Infrastructure Mitigation of Political & Regulatory Risk in Infrastructure Projects", Geneva, 2015, p. 10.

and can affect an entire infrastructure sector (or even the entire national economy) – changes to sector regulation or taxation laws, for instance, and endemic corruption."

Referring to the above document, infrastructure projects are exposed to regulatory and political risks at every stage during the project period, starting from the development phase, operation, and even at the end of the contract. Furthermore, some more general risks may occur during the project period and can affect the infrastructure sector, or even the economy in general, such as changes in sector regulations or tax laws.

Infrastructure development involving private sector investment requires legal certainty and legal protection from the government for investors during the investment implementation period, including legal certainty regarding political risks such as legal changes. Erman Rajagukguk, in his book Hukum Investasi di Indonesia (Investment Law in Indonesia), mentions that before making an investment, investors will first assess aspects that influence the investment climate, such as economic benefits, legal certainty, and political stability. Therefore, for developing countries to attract investors, at least three conditions are required: first, economic opportunity (the investment must offer economic benefits to investors); second, political stability (investment is greatly influenced by political stability); third, legal certainty.[25]

The Indonesian government acknowledges the importance of legal certainty for businesses. Article 3 of Law Number 25 of 2007 concerning Investment stipulates that investment shall be organized based on the principle of legal certainty. This principle of legal certainty is defined as follows:

"a principle in a state of law that places law and the provisions of regulations as the foundation for every policy and action in the field of investment."

The business entity in a PPP project is a legal subject that must comply with laws and regulations, including any amendments thereto. In accordance with the provisions of Article 1320 of the Civil Code regarding the validity requirements of a contract, namely a lawful cause, the provisions in a PPP agreement cannot conflict with mandatory provisions in the law. Therefore, when changes in regulations or the issuance of new regulations cause the provisions in the PPP agreement to no longer align with these changes, the parties must amend the PPP agreement to ensure that the terms of the agreement are in accordance with the updated regulations. Article 53 of the Minister of National Development Planning/Head of the National Development Planning Agency Regulation Number 7 of 2023 concerning the Implementation of Government and Business Entity Cooperation in Infrastructure Provision stipulates that when there is a change in government policy or regulation, the contents of the PPP agreement must be amended to comply with such changes, with the limitation that the amendment cannot alter the previously agreed-upon risk allocation.

The costs required by the business entity to comply with existing or foreseeable regulations at the time of signing the PPP agreement should have been considered in the business entity's bid, which

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[25] Erman Rajagukguk, *Hukum Investasi di Indonesia: Anatomi Undang-Undang No. 25 Tahun 2007 tentang Penanaman Modal,* Jakarta: Fakultas Hukum Universitas Al-Azhar Indonesia, 2007, p. 27.

is subsequently incorporated into the PPP agreement. However, the business entity cannot predict and cannot account for costs arising from unforeseen legal changes at the time of signing the PPP agreement. In light of the above, PPP practices indicate that to address legal changes during the course of a PPP project, PPP agreements typically include a clause regarding changes in the law. This legal change clause includes provisions such as the definition of law, the definition of legal changes, whether the business entity is entitled to compensation in the event of legal changes that negatively impact the viability of the PPP project, and how such compensation will be calculated and paid.

In relation to the provisions regarding changes in law in PPP agreements, the Public-Private Partnership Legal Resource Center (PPPLRC) states as follows:[26]

"The change of law clause is a provision that may have a huge impact on the success of an infrastructure project and careful attention needs to be given to how the risk is shared."

Referring to the statement of the PPPLRC, the provisions regarding changes in law have a significant impact on the success of an infrastructure project, and careful attention is needed in the allocation of risks. Contract Law provides the parties with the widest freedom to make agreements that contain any provisions, as long as they do not violate public order and morality. The provisions of contract law are supplementary (optional law), meaning that these provisions may be set aside if the parties who make the agreement wish to do so. The open system, which includes the principle of freedom to contract, is summarized in Article 1338 paragraph (1) of the Civil Code, which reads as follows:[27]

"All agreements made legally shall have the force of law for those who make them."

The article seems to contain a statement to the public that it is permissible to make agreements in any form and containing any provisions (or about any subject), and such agreements will bind the parties as if they were laws. The provisions of contract law apply only when the parties involved in the agreement do not establish their own rules within those agreements.[28] Referring to the principle of freedom to contract as regulated in Article 1338 paragraph (1) of the Civil Code, the parties are free to agree on provisions related to changes in law in a PPP agreement.

The drafting of provisions that govern changes in law in a PPP agreement cannot be separated from determining the allocation of risks associated with legal changes among the parties to the PPP agreement. In general, risk is defined as the possibility of suffering a loss caused by an action or an event.[29] Risk is also understood as uncertainty that can be quantified, which may lead to loss or damage.[30] Specifically for PPP projects, based on Presidential Regulation No. 78 of 2010 on Infrastructure Guarantee in Government and Business Entity Cooperation Projects through

[26] Public Private Partnership Legal Resources Center, "Change of Law – Checklist and Sample Wording", https://ppp.worldbank.org/public-private-partnership/overview/practical-tools/checklists/change-of-law [29/08/2024].
[27] Subekti, *Hukum Perjanjian*, Jakarta: Intermasa, 2002, p. 13.
[28] *Ibid*, p. 14.
[29] Man Suparman Sastrawidjaja, *Aspek-aspek Hukum Asuransi dan Surat Berharga*, Bandung: Alumni, 2012, p. 181.
[30] Bramantyo Djohanputro, *Manajemen Risiko Korporat,* Jakarta: PPM Manajemen, 2008, p. 32.

Infrastructure Guarantee Business Entities (hereinafter referred to as "**PR 78/2010**"), infrastructure risk is defined as follows:

> *"Infrastructure Risk refers to events that may occur in the course of a Cooperation Project during the term of the Cooperation Agreement that could negatively affect the business entity's investment, including equity and third-party loans."*

The definition of infrastructure risk in PR 78/2010 emphasizes the impact of a risk on the business entity. Specifically, this impact is related to financial aspects, namely the equity or capital invested by the business entity to finance a KPBU project, and also the ability of the business entity to repay loans to financing institutions that have provided credit to the business entity for infrastructure development.

As the project implementer, a business entity typically finances a PPP project through equity contributed by shareholders and loans obtained from financial institutions or creditors. The equity-to-loan ratio commonly used in PPP projects in Indonesia is 70:30, meaning that a KPBU project will be financed by the business entity through a 30% equity contribution from its shareholders, and the remaining 70% will be financed through loans provided by financial institutions (creditors) to the business entity. This highlights the significant role of creditors in providing financing for a PPP project. The risks that may arise in a PPP project and how these risks are managed in the KPBU agreement are important considerations for financial institutions when providing financing for the PPP project.

Risk allocation is one of the crucial processes in a PPP project, as both the public sector/government and the business entity must decide on the level of risk each party is willing to take.[31] Regarding the importance of proper risk allocation for the success of a PPP project, Jeffrey Delmon in his book emphasizes that a successful project is one that is implementable, commercially viable, and has effective, cost-efficient risk-sharing. Given the differing interests and goals of the parties involved, effective risk allocation becomes an essential part of drafting the project documents and is integral to the success of the project.[32] A similar view is expressed by Takao Higuchi in his book Natural Resources and PPP Infrastructure Projects and Project Finance, stating that one of the most critical aspects in achieving profitability in a PPP scheme is the allocation of risk.[33]

Considering the importance of risk allocation as outlined above, PR 38/2015 mandates that the feasibility study of a PPP project must include an analysis of risks, and the PPP agreement must include provisions regarding the rights and obligations of the parties, including the allocation of risks. Regarding the principle of risk allocation, PPPLRC states the following:[34]

> *"A central principle of risk allocation is that each risk should be allocated to whoever can manage it best.* ***Irwin's book on guarantees and PPP risk*** *(Irwin 2007, 56–62) defines this principle more precisely, stating each risk should be allocated to the party:*

[31] Wipalak Asadornborikarn dan Xiao Wan, "The Review on Risk Identification and Risk Allocation in PPP Model", *Yhe International Jurnal of Business & Management,* Vol 8, Issue 8, 2020, p. 254.
[32] Jeffrey Delmon, *Op Cit*, p. 95.
[33] Takao Higuchi, *Natural Resource and PPP Infrastructure Projects and Project Finance, Business Theories and Taxonomies*, Singapura: Springer, 2019, p. 28.
[34] Public Private Partnership Legal Resource Center, "Allocating Risks", https://ppp.worldbank.org/public-private-partnership/allocating-risks [29/08/2024].

1. *best able to control the likelihood of the risk occurring-for example, the private party is usually in charge of project construction because it has the most expertise in that area. This also means it should bear the cost of construction cost over-runs or delays.*
2. *best able to control the impact of the risk on project outcomes, by assessing and anticipating a risk well and responding to it. For example, while no party can control the risk of an earthquake, if the private firm is responsible for project design, it could use techniques to reduce the damage should an earthquake occur.*
3. *able to absorb the risk at lowest cost, if the likelihood and impact of risks cannot be controlled. A party's cost of absorbing a risk depends on several factors, including: the extent to which the risk is correlated with its other assets and liabilities; its ability to pass the risk on (for example, to users of the service through price changes, or to third parties by insuring); and the nature of its ultimate risk bearers. For example, the ability of governments to spread risk among taxpayers means they may have lower risk-bearing costs than private firms, whose ultimate risk-bearers are their shareholders.*"

According to PPPLRC, the main principle of risk allocation is that each risk should be allocated to the party that is best able to manage that risk. The same principle is also stated by APMG International on its website, which affirms that the general principle of risk allocation is that risks should be allocated to the party most capable of managing them.[35]

Based on this internationally accepted principle of risk allocation, the party that is best able to control the occurrence of a risk and/or minimize its impact should be responsible for managing that risk. When the party responsible for managing the risk bears the cost of the risks that arise, this encourages that party to mitigate the occurrence of the risk. Risk allocation based on this principle will lead to efficient risk allocation and lower project costs.[36]

Risk allocation in PPP projects plays a significant role in determining the project cost and service tariffs. The business entity (along with the financial institutions providing financing for the project) will closely consider risks that are beyond the control of the business entity. If the business entity is compelled to bear these risks, it could drive up the bid price from the business entity.[37]

The government has made efforts to encourage the proper application of risk allocation in PPP projects, including by assigning PT Penjaminan Infrastruktur Indonesia (Persero) (PT PII) the task of preparing risk allocation guidelines for PPP projects, as outlined in the Minister of Finance Regulation No. 260 of 2010 on the Implementation Guidelines for Infrastructure Guarantee in Public-Private

[35] APMG International, "5.2 Preliminary Risk Allocation" (tanpa tahun), https://ppp-certification.com/ppp-certification-guide/52-preliminary-risk-allocation,[29/08/2024].
[36] Pauline Hovy, "Discussion Paper Risk Allocation in Public-Private Partnership: Maximizing Value for Money*",* International Institute for Sustainable Development, 2015, p. 2.
[37] Edward Farquharson, Clemencia Torres de Mästle, E.R. Yescombe, dan Javier Encina, *How to Engage with the Private Sector in Public-Private Partnership in Emerging Markets,* The International Bank for Reconstruction and Development/The World Bank, 2011, p. 3.

Partnership Projects, as amended by the Minister of Finance Regulation No. 8 of 2016 (hereinafter referred to as MOF Regulation 260/2010).

Referring to the 2023 Risk Allocation Reference Book for PPP in Indonesia, published by PT Penjaminan Infrastruktur Indonesia (Persero) (hereinafter referred to as the "**Risk Allocation Reference Book**"), risks in PPP projects are essentially categorized into location risks, design risks, construction and testing risks, sponsor risks, financial risks, operational risks, revenue risks, network connectivity risks, interface risks, political risks, force majeure risks, and asset ownership risks. One of the types of political risks is the risk of regulatory and legislative changes (laws and regulations).[38]

The PPP risk matrix per sector, as outlined by PT PII in the Risk Allocation Reference Book, states that regulatory changes (and taxes) are divided into two categories: first, general regulatory changes, and second, discriminatory and specific regulatory changes. Referring to APMG International on its website, specific legal changes are those that do not affect business activities in general but only certain sectors in which a business operates (e.g., public transportation, roads, etc.), while discriminatory legal changes are those directed at the project-implementing business entity.

The Risk Allocation Reference Book states that discriminatory and specific regulatory changes are risks that can occur at every stage of a PPP project. The risk of discriminatory and specific regulatory changes is allocated to the government. This means that the government is responsible for managing the possibility of such risks and bearing the consequences if they occur, including compensating the private sector if the impact of these discriminatory and specific legal changes results in additional costs for the business entity. Furthermore, the Risk Allocation Reference Book mentions that general regulatory changes are also risks that can occur at every stage of a PPP project; however, such risks are considered business risks and are allocated to the business entity. Therefore, the business entity must bear the consequences of these risks. If these general legal changes result in additional costs or other negative financial impacts on the business entity, it must bear them.

The Risk Allocation Reference Book published by PT PII serves as a guide in drafting risk allocations for PPP projects during the feasibility study phase. In connection with the allocation of risks due to legal changes, the PJPK, as the government representative and the party signing the PPP agreement with the business entity, tends to follow the risk allocation outlined in the Risk Allocation Reference Book published by PT PII, agreeing to bear the risk of discriminatory and specific legal changes, while allocating the risk of general legal changes to the business entity.

According to Jeffrey Delmon in his book Private Sector Investment in Infrastructure, Project Finance, PPP Projects and PPP Frameworks, regarding the allocation of the risk of legal changes (including tax law), there are several approaches as follows:[39]

1. Allocating the Risk of Legal Change to the PJPK

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[38] Acuan Alokasi Risiko 2023 Kerja Sama Pemerintah dengan Badan Usaha di Indonesia, PT Penjaminan Infrastruktur Indonesia (Persero), pp. 44-47.
[39] Jeffrey Delmon*, Op. Cit*, pp. 131-132

In certain cases, particularly in countries with unstable political systems, the PJPK may need to bear the risk of legal changes before a project can be considered bankable by financial institutions.

2. Sharing the Costs Arising from Legal Changes
   Legal changes can be shared among the parties based on allocation. For example, the project implementing entity may be required to bear the risk of minor legal changes, where the costs of complying with such legal changes do not exceed a certain amount (generally based on a percentage of the contract value), or the costs of complying with legal changes up to a maximum percentage of the project's costs for the first five years of the project.
3. Sharing the Risk of Legal Changes
   Another method of allocating the risk of legal changes is by categorizing the risk of legal changes into several different types. The PJPK may consider that the legal system in the country is sufficiently stable, so the project implementing entity must accept that the risks of doing business in that country include the risk of legal changes, as also borne by other businesses operating in the country. However, the business entity would not be willing to bear the risk of legal changes specifically targeted at the project or the sector in which the project is implemented. Therefore, the government may still retain the risk of discriminatory legal changes, i.e., legal changes that specifically apply to the infrastructure sector that is the subject of the partnership, apply to private financing for government projects in general, or apply to the project itself.

The approaches outlined above show that the determination of risk allocation related to legal changes is also influenced by factors such as the conditions of the country where the project is implemented. Risk allocation in a PPP project in one country cannot be directly applied to another country due to differences in political, economic, and social environments. Similarly, risk allocation in one PPP project cannot be directly applied to another PPP project.[40]

The internationally accepted principle of risk allocation mentioned above states that risks should be allocated to the party best able to manage the occurrence of those risks. From the perspective of the ability to control the risk of legal changes in Indonesia, PJPK (the government agency overseeing the project) has greater capacity to control such risks—whether they are specific and discriminatory or general—compared to the private entity. This is because legal products are issued by competent government authorities, and PJPK acts as a representative of the Government of Indonesia in a PPP project. PJPK (typically the Minister or Director General authorized by the Minister to represent the Ministry, or the Regional Head to represent the local government) has more control over the issuance of regulations, including through coordination with other government agencies responsible for issuing such regulations, compared to the private entity.

[40] Tongtong Zha and Yaling Du, Risk Sharing of Political Force Majeure in PPP Projects in the Belt and Road, 2020, IOP Conf. Ser.: Mater. Sci. Eng. 768 052026, p. 4.

Referring to the document Standardization of PFI Contracts Version 4 published by HM Treasury, it is possible to treat legal changes of any kind as a risk to the private sector entity. This has occurred in certain projects where the costs (resulting from legal changes) can be passed on to the infrastructure users. Furthermore, in projects where the government makes payments to the private sector entity for infrastructure services, and where there is a classification between specific, discriminatory, and general legal changes, the costs arising from general legal changes may be borne by the private entity or shared between the private entity and the government. Although it may appear that the private entity bears the risk of such general legal changes, this approach always involves methods to mitigate their impact on the private entity. For example, clauses related to market testing, benchmarking, and/or indexation will, in practice, guide the allocation of this risk, where additional operating costs will be reflected in an increase in payments to be made by the government, even though the private entity will bear the risk until benchmarking or market testing is carried out.[41] Based on the above, the allocation of legal change risks to the private entity must be accompanied by opportunities for the private entity to mitigate its impacts, including by passing on the additional costs arising from general legal changes through service tariff adjustments.

In relation to service tariffs, the PPP regulations in Indonesia, namely PR 38/2015, mandate the government to set the initial service tariffs for infrastructure services along with their adjustments to ensure that the tariffs align with the users' ability to pay. This indicates that the government must ensure the affordability of infrastructure service tariffs. The private entity in a PPP project is bound by the provisions regarding the initial tariffs and their adjustments as stipulated in the PPP Agreement. This situation differs from a private entity engaged in general business activities (i.e., not bound by a PPP agreement), as such entities, based on their own considerations, may adjust the tariffs of goods or services they sell if there are additional costs in producing or delivering those goods or services.

Considering the provisions of PR 38/2015, which mandates the government to set service tariffs to ensure affordability, allocating the risk of legal changes to the private entity could result in the entity having no room to mitigate the impact of those legal changes and being forced to absorb additional costs arising from legal changes without the ability to pass those costs through tariff increases. Therefore, in accordance with the principles of risk allocation and the PPP regulations in Indonesia, it is more appropriate for the risk of legal changes to be allocated to the PJPK (government) so that the PJPK assumes responsibility for managing the risk of legal changes and addressing the impact if legal changes detrimental to the private entity occur, including providing compensation for additional costs incurred by the private entity due to such legal changes.

The allocation of the risk of legal changes to the government is in line with the principle of good faith in the execution of a contract as stipulated in Article 1338 paragraph (1) of the Civil Code. This provides assurance to the private entity that the government, specifically the PJPK, will not use regulatory changes to compel the private entity to undertake actions not outlined or considered in

[41] HM Treasury, Standarisation of PFI Contracts Version 4, March 2007, p. 100 -101

the PPP agreement, without taking into account the impact on the private entity and the sustainability of the project.

Although the risk of legal changes is allocated to the government and the government must compensate the private entity in the event that legal changes result in additional costs in providing infrastructure services, international practice shows that private entities can be required to bear a certain portion of the increased project costs due to legal changes. This is intended to encourage the private entity to make the necessary savings when considering the financial impact of legal changes. For example, in PFI projects in the UK, the private entity is required to bear capital costs resulting from general legal changes during the service period, with an amount ranging from 2%-5% of the total initial capital costs.[42] This limitation encourages the private entity to be more efficient in capital expenditure and helps the entity consider the risk of general legal changes to capital costs during the bid submission phase.

A similar approach can be applied to PPP projects in Indonesia by setting a cap on the additional costs caused by legal changes that the private entity must bear, in line with the characteristics of each individual PPP project in Indonesia. Thus, although the risk of legal changes is allocated to the government, the private entity is encouraged to bear a portion of the additional costs resulting from general legal changes up to a certain percentage. This obligation should be outlined in the tender requirements so that the private entity can consider the associated risk in their bid.

CLOSING

The Risk Allocation Reference Book mentions that only discriminatory and specific legal change risks are allocated to the government, while general legal change risks are allocated to the private sector as business risks. However, international practices indicate that governments can bear the risk of general legal changes in addition to discriminatory and specific legal changes. Based on internationally accepted risk allocation principles and considering the regulations of PPP in Indonesia, it is more appropriate to allocate the risks of legal changes-whether discriminatory, specific, or general-to the government. This is because the government, as the authority responsible for issuing regulations, has more control over the issuance of legal provisions compared to the private sector.

Allocating the risk of legal changes to the government creates an obligation for the government to manage the emergence of legal change risks. This includes efforts to ensure that regulatory changes do not negatively impact the continuity of a PPP project and providing compensation to the private entity for any additional costs incurred as a result of legal changes, thus ensuring the sustainability of the PPP project. The private entity can be required to bear a certain portion of the additional costs arising from legal changes to encourage greater efficiency in managing the financial impact of these changes. In light of the above, it is recommended that the risk allocation provisions

[42] *Ibid*.

regarding legal changes be revised and further elaborated in the Risk Allocation Reference Book published by PT PII to align with the best practices and principles of PPP projects in Indonesia.

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