Australia Indonesia Partnership
Kemitraan Australia Indonesia

SPECIAL RAILWAY GUIDELINES AND REGULATORY FRAMEWORK RECOMMENDATIONS

FINAL REPORT

INDONESIA
INFRASTRUCTURE
INITIATIVE

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We have appreciated the interest and ideas provided by other public and private Special Railway stakeholders not named specifically here. With the above support, we have been able to review Indonesian Laws, Regulations, Presidential Decrees and Ministerial Decrees and related materials in the transport, infrastructure development and mining sectors that relate to the development of Special Railways in Indonesia.

Richard G Sharp

HWTSK, Inc.

Jakarta, 10 February 2011

TABLE OF CONTENTS

ABBREVIATIONS AND ACRONYMS

AAR	Association of American Railroads
Adani	Adani Enterprises Ltd, a subsidiary of Adani Group (India), an investor in Bukit Asam proposed railway
AMDAL	Environmental Impact Assessment
AusAID	Australian Agency for International Development
B2B	Business-to-Business
BAB	Bukit Asam Bangko, a mining property of PT Bukit Asam
Bappeda	Badan Perencanaan dan Pembangunan Daerah; Regional Development Planning Board
Bappenas	Badan Perencanaan dan Pembangunan Nasional; National Development Planning Agency
BATR	PT Bukit Asam Transpacific Railway
BOT	Build – Operate – Transfer method of private participation in a publicly owned enterprise
BPN	National Land Agency
Bukit Asam	PT Bukit Asam (Persero)
BUMN	Badan Usaha Milik Negara; State-owned Enterprise. Sometimes also used to refer to the Ministry for State-owned Enterprises (Kementerian BUMN).
CFC	Comision Federal de Competencia (Mexico)
CMEA	Coordinating Ministry of Economic Affairs
CR	China Railways
DBOM	Design – Build – Operate – Maintain method of private participation in a publicly subsidised and publicly owned new enterprise
DBOO	Design – Build – Operate – Own method of 100 per cent private development and ownership in perpetuity
DGR	Directorate General of Railways (Direktorat Jendral Perkeretaapian)
EPC	Engineering Procurement Construction
FRA	Federal Railroad Authority (US)
GCOR	General Code of Operating Rules (US)
GoI	Government of Indonesia
GR	Government Regulation
HWTSK	Harral Winner Thompson Sharp Klein, Inc.
IGF	Infrastructure Guarantee Fund
IIFF	Infrastructure Financing Facility
IndII	Indonesia Infrastructure Initiative
Inpres	Presidential Instruction
IPP	Independent Power Producer
IPR	Public Mining License
IR	Indian Railways
IUJP	Mining Service Business Permit
IUP	Mining Business Permit

IUPJ	Specific Production Operation Mining Permit
IUPK	Special Mining Permit
IUPR	People's Mining Right Permit
KKPPI	Committee on Policy for the Acceleration of Infrastructure Provision
KP	Mining Authority
KPPU	Indonesian Anti-monopoly Commission
LPR	Limited Public Railway
MEC	MEC Holdings [Minerals-Energy-Commodities] a subsidiary of the Trimex Group
MEC Coal	A partnership of MEC with the Government of Ras Al Khaimah as holding company of PT Semesta Resources Investindo and PT Sinar Indonesia Perkasa (both are the shareholders of PT Tekno Orbit Persada/TOP (the coal company) and MEC Infra
MEC Infra	A subsidiary of MEC Coal for purposes of transport development and related infrastructure
MEMR	Ministry of Energy and Mineral Resources
MoF	Ministry of Finance
MoPW	Ministry of Public Works
MoT	Ministry of Transportation
NORAC	Northeast Operating Rules Advisory Committee (US)
NRMP	National Railway Master Plan
Permen	Peraturan Menteri; Ministerial Regulation
Perpres	Peraturan Presiden; Presidential Regulation
Persero	Perusahaan (Negara) Perseroan; State-owned Limited Liability Company
PLN	PT Perusahaan Listrik Negara; State Electricity Company
PP	Peraturan Pemerintah; Government Regulation
PPP	Public Private Partnership
PR	Presidential Regulation
PRC	People’s Republic of China
PSO	Public Service Obligation
PT	Perseroan Terbatas; Limited Liability Company
PTBA	PT Bukit Asam (Persero)
PTKA	PT Kereta Api Indonesia - Persero or PT Kereta Api (Persero): Indonesia’s national railway
Rajawali	PT Rajawali Corporation, 80 per cent owner of BATR
RAKIA	RAK (Ras Al Khaimah) Investment Authority
RMMI	RAK Minerals and Metals Investments, partnership between RAK Investment Authority (RAKIA), a government of Ras Al Khaimah initiative, and Trimex Group
RMP	Railway Master Plan, comprised of the National RMP prepared by the MoT and Master Plans prepared by provinces or other sub-national jurisdictions
RZD	Russian Railways
SCOR	Standard Code of Operating Rules (US)
SCT	Secretaria de Communicaciones y Transportes (Mexico)
SOE	State-owned Enterprise

SPR	Special Purpose Railway; sometimes used to describe railways established under infrastructure PPP regulations
SR	Special Railway
STB	Surface Transportation Board
SWOT	Strengths – Weaknesses – Opportunities – Threats
TKB	PT Trans Kutai Bahari, Indonesian subsidiary of MEC Infra for port operations
TKK	PT Trans Kutai Kencana, Indonesian subsidiary of MEC Infra for railway transport
TOP	PT Tekno Orbit Persada, an Indonesian company under indirect control of MEC Coal; the licensed coal concession holder
UU	Undang-Undang: a law passed by the national assembly; along with Perpu, the highest legal statute under the Indonesian Constitution. Law no. 23/2007 on Railways has this status.

REFERENCES TO SPECIFIC LAWS AND REGULATIONS:

Law no. 13/1992	Law Number 13 of 1992 on Railways
Law no. 23/2007	Law Number 23 of 2007 on Railways
Law no. 4/2009	Law Number 4 of 2009 on Mineral and Coal Mining
GR 56/2009	Government Regulation Number 56 of 2009 on Railway Development
GR 72/2009	Government Regulation Number 72 of 2009 on Railway Traffic and Transportation
GR 22/2010	Government Regulation Number 22 of 2010 on Mining Areas
GR 23/2010	Government Regulation Number 23 of 2010 on Implementation of Mineral and Coal Mining Business Activities
Perpres 67/2005	Presidential Regulation Number 67 of 2005 on Cooperation between Government and Business Entities in the Provision of Infrastructure
Perpres 13/2010	Presidential Regulation Number 13 of 2010 on Amendment to Presidential Regulation Number 67 of 2005 on Cooperation between Government and Business Entities in the Provision of Infrastructure
Permen 4/2010	Ministry of National Development Planning (Bappenas) Regulation Number 4 of 2010 on General Guidelines for PPP Implementation in the Provision of Infrastructure

EXECUTIVE SUMMARY

The Government of Indonesia hopes to encourage more private sector investment in railway infrastructure. Significant private investment would:

- Relieve serious capacity shortages in the railway freight sector
- Reduce the strain of competing demands on scarce public funds for infrastructure
- Promote development of business sectors vital to Indonesian economic growth, most notably the mining sector

To date, existing policy, law and regulations have not resulted in the desired level of private investment.

This Final Report focuses on the main regulatory mechanism for private investment in the railway sector: the Special Railway (SR).[1] A Special Railway, alternatively translated from the Indonesian as Exclusive Railway, is defined as a railway that may be constructed to serve a single enterprise. The current law is somewhat ambiguous with regard to ownership (a term not used in the law) but is explicit that a Special/Exclusive railway serves only one enterprise. Public-Private Partnership (PPP) procedures for developing railways were reviewed as an alternative for private investment. These provisions establish the resultant railway as a public railway, with the operator selected by competitive tender.

Two applications for constructing Special/Exclusive Railways are now awaiting approvals; so far, none has been constructed. This study assesses why no Special Railways (reverting to the more common term) have been developed. While the underlying railways law is barely three years old and its implementing regulation is only a year old, the Special Railways option has actually been available since the preceding law on railways was passed in 1992. Yet, no Special Railways have been built.2 The main alternative for private investment in rail infrastructure – a PPP structure – has fared no better, with just one application pending and no successful developments. However, the current PPP regulation is less than a year old and its predecessor five years old.

This Final Report addresses potential modifications in Special Railways regulation to make the provisions more "investor friendly" at two levels. The first potential modifications are those that can be achieved at the Ministerial level (discussed in Part I) and might lead to implementation of the two currently proposed Special Railways and other similar applications. Second are those that could be enhanced by new or modified Government Regulations (GRs) (Part 2). This Report does not propose

[1] Key provisions are contained in Appendix B.

[2] A diagnostic analysis presented in the Interim Report specifically addressed the two pending SR applications (MEC Coal and PT Bukit Asam) and the implementation difficulties they face. Those findings are summarised in Appendix E.

changes in the current railway law, although it provides a brief discussion of matters that might be considered should the law be revised.[3] While the current railway law could certainly be improved in areas related to special railways and private investment, we note that uncertainty tends to restrain investment and that any modifications in the railway law will require an act of parliament. The process is lengthy, involves political choices and trade-offs, and there is no guarantee that the changes would immediately make investment easier.

Findings Concerning Adequacy of Special Railway Regulation

The Indonesian legal framework provides fewer opportunities for private investment in railways than are available in other countries under international best practice (see Appendix D). This is true for established free market economies, economies with a tradition of central planning, and developing economies alike. Private investment in railways is not typically limited by tight restrictions requiring railway transport services to be exclusively for the account of one company or by the private railway being required to be owned or controlled by a single non-transport enterprise, as is now the case in Indonesia. Generally, any railway built with private resources for a particular purpose is an asset that could benefit other transport users and would not exist if the specialised investment had not been made. The argument that the specialised private railway would have a monopoly over secondary users is countered by the observation that the investment was made for private purposes which a licensing authority deemed appropriate. Hence, other parties are not entitled to use the property, and its availability is a net addition to other transport options. Indonesian law on private railway development is therefore restrictive and contains onerous conditions when compared with international practices.

These restrictive and onerous rules governing private investment in Indonesian rail infrastructure deprive the public railway of potential traffic from private railways, and deprive the public of economic benefits that would be generated by industries served by private railways. Defenders of the present restrictions point to the need to limit competition in order to preserve public investment in the existing national railway. However, this argument is undermined by the rail sector's poor performance. In Indonesia, as elsewhere, protecting the enterprise from competition is a 'lose-lose' proposition. Industries that might develop with efficient transport capacity will lose; the public that might benefit from increased economic activity fostered by private railways will lose; and the existing railway will not benefit from additional traffic from special railways, or from technical and operating innovations that private investment would bring. To illustrate these points, the development of the Bukit Asam Transpacific Railway (BATR) or other proposed Special Railways in South Sumatra and Lampung would not deprive any coal shipper of the transport options that it has today. Meanwhile, development of Bukit Asam coal production is limited by inadequate transport capacity, and communities in South Sumatra cannot receive the economic

[3] Terms of Reference for this study may be found in Appendix A.

benefits of increased production without this additional capacity. Finally, the new Special Railways could increase traffic on existing national railways run by PT Kereta Api Indonesia (PTKA) and give PTKA new business.

Legal Framework

The 2007 Indonesian railways law (Law no. 23/2007) made major changes to the previous law on railways. It ended the state railway monopoly of PTKA by permitting multiple train operators to access the public rail infrastructure. Changes with respect to private investment in railway infrastructure, however, were limited. Special Railway provisions remained substantially derived from the policy and philosophy behind the 1992 Railway Law, which treated railway transport infrastructure operations as essentially the preserve of the State. All railway lines except for captive industrial lines were to be owned and operated by the public sector. The 2007 law still defined a Special Railway (SR) as a railway constructed solely to serve the core business of a certain enterprise – a tightly defined exclusive purpose. The railway was to be 'special' in terms of being both exclusive and an exception – and a rare exception it has been.

Government Regulation 56/2009 (GR 56/2009), written to implement the 2007 law, reiterated the limited function and purpose of an SR, although it did recognise the need to extend the scope of an SR to include supporting activities outside an enterprise's immediate area of production. However, GR 56/2009 failed to precisely define and clarify several important aspects of special/exclusive railway developments. These included whether the SR operator's corporate structure and ownership could be different from the primary business owner (and if so, to what extent – e.g., affiliated parties, affiliated mines). The general descriptions of the purpose and definition of special/exclusive railways do not translate into unambiguous qualifications for an SR license applicant. Similarly, the regulations do not clarify whether other types of products than those produced by the business owner could be carried, including products used in the production process, such as fuel, supplies, and equipment; or whether intermediate pick-up or sale activities may occur. The general description of special railways is not translated into specific licensing terms. Instead, the licensing provisions focus narrowly on process.

Commercial criticism of the SR provisions

The above issues have serious commercial significance for an investor considering how to achieve least-cost transport operations with maximum economies of scale. In addition to the drafting weaknesses that leave Law no. 23/2007 and GR 56/2009 open to a range of interpretations, the devolution of infrastructure responsibilities as part of Indonesia's recent decentralisation initiative is reflected in a multiple-licensing process that generally requires several levels of approvals in principle. This has resulted in a private investment development framework that is uncertain, complex, time-consuming and not investor-friendly. Consequently, only large-scale SR projects funded

by powerful corporate interests are likely to be commercially feasible, and even these large projects have yet to move forward.

The existing Special Railway law limits rail services ***exclusively*** to one customer and requires that customer to own, or at least control, the Special Railway. Rather than create competition, this constrains it. Other more specific restrictions under Indonesia's Special Railway legislation are similarly out of touch with international best practices. A Special Railway is limited to using a private port that it owns, whereas a public port could benefit from the resulting traffic. If available public port capacity could be used instead, then efficiency would be improved, rather than creating duplicate infrastructure. The regulation that a Special Railway can only serve a district owned or controlled by an enterprise and one point in a support area for that enterprise is an unnecessary restriction on business scope – it implies that a Special railway could not serve an off-port stockpile *and* a port; nor could it serve a power plant along the railway *and* a port or separate storage area. Indeed, many of the existing Special Railway regulations replace ordinary business negotiations with inflexible bureaucratic rules, handicapping both public and private stakeholders in reaching a commercial accommodation.

In addition to the adverse impact on the transport sector of these narrow restrictions on private railway investment, the negative impact on the economy as a whole is even greater. Private investment in the railway sector in Indonesia is linked to an industry – typically the mining industry – that also requires long-term planning and tremendous amounts of capital. The establishment of a new railway infrastructure that efficiently supports the coal mining industry could provide huge financial benefits for the Indonesian economy, also contributing direct taxes and other state revenues. These benefits stem from the entire project development, which requires stability and consistency in both present and future laws and regulations relating to all project components, including transport.

When the ability to license supporting railway services in a timely manner is a weak link in the process, urgent action is needed. This Report concludes that (i) Ministerial Regulations are needed to improve the attractiveness of the current Special Railway provisions within the limits of exclusive one-company service, and (ii) a new or amended Government Regulation is needed to broaden the railway infrastructure development options that are available in Indonesia, as outlined below.

Guidelines for Regulation of Private Investment in Railways

The existing legal framework requires significant changes in order to:

- Clarify and improve the attractiveness of the current Special Railway provisions through a Ministerial Regulation
- Continue to support PPP railway development, where appropriate
- Allow Special Railways to provide broader services (based on a Ministerial finding on inadequate public capacity) through a Government Regulation

- Expand railway investment opportunities through a new or amended Government Regulation creating a new sub-category of public railways, namely a 'Limited Public Railway'

These multiple alternatives are offered because (a) different development contexts result in different strengths and weaknesses for each option[4], and (b) a single, broadly applicable approach would require a change in the underlying law, involving a difficult legislative process.

Our recommendations follow.

Ministerial Regulation Guidelines:

1. Provide a legally credible clarification of primary enterprise control of a Special Railway that will allow the project developer greater flexibility to structure project financing, permit opportunities for greater local participation in the enterprises served by the Special Railway, and secure commercial benefits for the railway.
2. Clarify and specify the regulations and outcomes that will apply when a Special Railway interconnects with another Special Railway or a Public Railway service.
3. Specify exceptions to the so-called point-to-point rule so that service interconnections and spur lines to third party facilities along the railway alignment may be approved as part of the SR services.
4. Specifically link, through consistent terminology and precise cross-references, proposed articles in the Ministerial Regulation with articles of existing Government Regulations, so as to minimise conflicting interpretations.

Some of the reform measures recommended, particularly primary enterprise control matters and the removal of the single customer constraint, may be subject to legal challenge and cannot be removed by Ministerial Regulation. For that reason, we also recommend that a new Government Regulation be issued containing provisions to overcome these constraints.[5] However, we note that the legal divisions of the Ministry of Transportation (MoT) and the Directorate General of Railways (DGR) take the position that it may be possible to provide broader interpretation on primary enterprise control matters through Ministerial Regulations.

Government Regulation Guidelines:

1. Empower the Minister of Transport with the authority to waive Special Railway service restrictions where public transport capacity is demonstrably inadequate.

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[4] See Chapter 6, *Context Specific Procedural and Organisational Guidelines* and Appendix F, *SWOT Analysis.*

[5] A number of new draft Ministerial Regulation provisions, in addition to the above, have been suggested by officials of the MoT and DGR (see, for example, Appendix H, Meetings 4 and 22), with whom extensive consultations have been held.

2. Provide a Limited Public Railway (LPR) option as a subcategory of public railways, permitting a broader scope of services than the SR, but with an infrastructure access option to serve the broader public interest. The LPR would permit core train services to be offered to one or more enterprises on a business-to-business (B2B) negotiated access basis, using facilities and equipment dedicated to those enterprises and not available for use by other parties except with the consent of the original investors. Unlike the Special Railway, an LPR would specifically allow infrastructure to be used by other train operators as agreed with the original investors and licensing authorities.
3. Exclude an LPR (like the SR) from (a) any government financial support or subsidy for the development, so that no public funds are risked; (b) the PPP requirements for competitive tendering under the provisions of GR 67/2005 as amended by GR 13/2010; and (c) inclusion in the National Railway Master Plan, which otherwise applies to a Public Railway.
4. Provide that negotiated LPR licenses (and not the Government Regulation itself) will specify (a) the applicable termination and handover requirements , subject to the consent of the original investor, (b) the applicable procedures for applications for access from suitably qualified third party transporters using their own equipment, and (c) that, in the absence of adequate public transport, the LPR operator may offer tariff services to cargo and passengers at its discretion and with the agreement of the licensing authority.
5. Simplify and consolidate the licensing requirements for SRs and LPRs with the aim of avoiding overlap and duplication, with (a) the MoT/DGR focusing on monitoring compliance with national technical, health and safety standards, and (b) sub-national authorities focusing on monitoring compliance with local spatial planning, environmental, and social safety net provisions.
6. Specify the process, including dispute resolution, and the broad parameters of provisions for access to railway infrastructure (using precedents based on generally accepted best international practice from heavy freight railway systems). Specify that negotiations for such access will be on a business-to-business basis between the original licensee and the third party.
7. Require license conditions for both SRs and LPRs to address compliance or adherence by railway infrastructure developers and operators with environmental protection, anti- discrimination and gender-equality and social mitigation measures that are consistent with existing norms in Indonesia.

The objective of these guidelines is to facilitate investment and achieve consistency with international best practices.[6] They would provide for development to be based on business-to-business negotiations between the investor and the licensing authority, and among the infrastructure manager, train operators, and major users. The railway would not be subject to government restrictions or regulations except in matters of safety and compliance with national standards, mutually agreed services, and the

[6] See Appendix D.

express requirements of Law no. 23/2007.[7] The recommended regulatory changes will enable Indonesia to obtain maximum public benefit from private railway initiatives by transiting from restrictive regulatory policies.

The chart below summarises the current regulatory framework and the recommended changes to that framework.

Current Railway Regulation of Private Investment			
	Special (Exclusive) Railway	**Negotiated Non-Exclusive Railway**	**Public-Private Railway**
MOT Ministerial Regulation	(None at Present)	(Not Authorized)	(Applies PP 56/2009 and PP 72/2009 on public railway licensing, but no Permen)
Government (PP) or Pesidential (Perpres) Reg.	**PP 56/2009 and PP 72/2009** Exclusive Service Control/Ownership by Main Enterprise	**(No authorizing Peraturan Pemerintah)** (Not authorized)	**Perpres 13/2010; Perpres 67/2005** Multiple customers served by tariff Railway operator by public tender

Recommended Railway Regulatory Reforms			
	Special (Exclusive) Railway	**Negotiated Non-Exclusive Railway**	**Public-Private Railway**
MOT Ministerial Regulation *(MOT Responsibility)*	**Urgently Required. New Permen should:** Permit SR to be subsidiary Clarify control requirement Relax "point-to-point" Specify intercconnection rules	**After new PP below is approved, new Permen should:** Specify LPR licensing procedure Clarify MOT-Provincial-Regency roles in LPR	**Non Urgent. Permen might provide:** More specific licensing for railway PPPs Guidance on LPR links to SRs, other PPPs, national railway
Government (PP) or Pesidential (Perpres) Reg. *(Inter-agency Responsibility)*	**PP 56/2009/ PP 72/2009 plus new PP or chapter of PP56/2009** Exclusive Service, but with inadequate public capacity waiver Control/Ownership by Main Enterprise	**Urgently Required. New Government Regulation to provide:** 1. Option for Ministerial waiver of Special Railway Service Restrictions 2. Limited Public Railway (LPR) designed to: (a)Provide core sector-exclusive train service (b) Provide negotiated train operator access	**Perpres 13/2010; Perpres 67/2005** Multiple customers served by tariff Railway operator by public tender

[7] For example, an LPR would need to comply in some fashion with tariff stipulation provisions in Law 23/2007, Article 151.

Implementation of Needed Reforms

A two-step process is recommended to implement an agenda to reform and reorient the railway infrastructure sector with minimum delay so as to facilitate and enhance private investment in freight railway services.

Ministerial Regulation Implementation

Prior to this Final Report, an initial draft of a Ministerial Regulation has been developed by the DGR, but this draft has not yet been reviewed by the MoT. Our preliminary review of the initial draft indicates that the proposed regulations are too broad, contain too much detail and repeat material found in GR 56/2009, which could be better addressed through reference to that regulation. The draft also addresses subjects that could be condensed, simplified or even eliminated. A more significant concern is that many of the proposed regulations represent a further narrowing of the SR provisions. This is counterproductive as a matter of public policy. These initial DGR efforts to broaden the scope of Special Railways would benefit from tight editing to reduce the Ministerial Regulation to core issues, and avoid the tendency to preserve ambiguities rather than confront policy choices. If requested by the MoT/DGR, IndII may wish to provide assistance with the legal drafting process to ensure the successful and expedited implementation of SR reforms that can have an immediate impact on the pending SR applications.

Government Regulation Implementation

Although the recommended Ministerial Regulation would address pressing issues, the scope of change is limited by the overarching policy and restrictive provisions of Law no. 23/2007. As discussed above, we also propose drafting a new Government Regulation (or new chapter of GR 56/2009), which would have two functions:

- Amend GR 56/2009 to clarify areas of uncertainty in its implementation (particularly with regard to ownership and control issues and the point-to-point limitation) and to permit the Minister to broaden application of the SR option where public railway capacity is inadequate.
- Create a category of Public Railway that would be privately financed and allow for limited access. This railway would be constructed without government support, would provide for limited access by other users, and would permit carriage of multiple products without point-to-point service restrictions.

Next Steps

To introduce international best practice in a new Government Regulation that receives inter-agency support is beyond the scope of the project summarised in this Final Report.

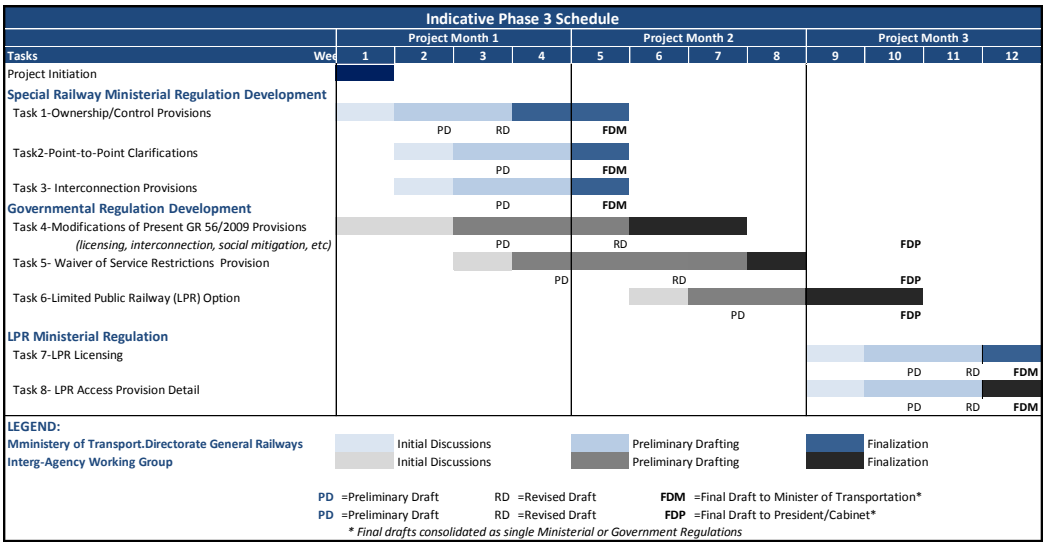
Requests for further development of these new Ministerial and Government Regulations through policy and legal drafting assistance to facilitate expedited implementation of the reforms should be favourably considered by IndII/AusAID.

A policy articulation team and a legislation drafting team could assist and advise the Government to help ensure successful public policy reform beyond Special Railways. While the present project focuses on clarifying the options available to the MoT, the next step would be to make the case for broader Government acceptance of a liberalised railway sector private investment policy. It is recommended that:

- The drafting of the proposed new Ministerial and Government Regulations should reflect international best practices in railways financing
- To achieve that end, the drafting exercise should be supported by international advisors on matters of policy and law
- The drafting process should be based on broad inter-agency participation, to include the Investment Coordinating Board (BKPM), the Coordinating Ministry for Economic Affairs (CMEA), the National Development Planning Agency (Bappenas), the MoT and the DGR, while recognising the prime role of the MoT in transport policy and of the DGR in matters of technical standards and safety
- The drafting process should be oriented towards private investment, including workshop or roundtable consultations with a cross-section of private stakeholders, so as to maximise the potential for future private investment participation in the railway sector and avoid policies intended to protect the status quo
- The policy articulation and legal drafting team should be empowered to lead the workshop and roundtable events and drive the drafting process, reporting directly to the MoT and the agency convening the inter-agency working group, and seeking technical advice and input from the DGR

Indicative Phase 3 Regulation Drafting Schedule

The chart below shows an indicative schedule for drafting regulatory changes, and is submitted for IndII's consideration in issuing the Phase 3 Terms of Reference (TOR). The final schedule would, of course, be prepared by IndII and finalised in discussions with the selected Phase 3 consultant.



The chart anticipates a three-month project implementation period. The schedule contemplates that the Minister of Transportation will be able to approve a new Special Railway Ministerial Regulation implementing GR 56/2009 well within the project period. It assumes a strong proactive role for the external drafting team with an emphasis on actual legal drafting with tightly organised and effective participation by the Government, and that the proposed inter-agency working group (Working Group) will be able to complete a draft new Government Regulation for the President's signature by the end of the period. It is expected that the effective date of the new Government Regulation will likely be beyond the project period, depending on Presidential priorities at the time the legal draft is submitted. Once the scope of the proposed LPR is determined, we recommend that the Working Group and MoT begin drafting a separate, detailed Ministerial Regulation to implement the new Government Regulation procedures. The effective date of that Ministerial Regulation will, of course, be contingent on Presidential approval of the Government Regulation.

Comments on Formal Final Report Reviews

Given the policy importance of the conclusions and recommendations of this study, IndII chartered two formal reviews of this Final Report. These reviews were conducted by URS Australia, Pty Ltd.(author, David Lupton[8]), and the law firm of Makarim & Taira. HWTSK has noted that these reviews of the Final Report are positive as a whole. We have not changed major findings and recommendations as a result of these reviews, but have taken detailed points of disagreement seriously and address them in Chapter 8: Peer Review Commentary. Some recommendations from the review teams have

[8] Makarim & Taira S. (Guy Des Rosiers and Hendri Naldi), *Peer review report for SR guidelines (Activity #225)* Memorandum, 28 January 2011 and URS Australia Pty (David Lupton), *Initial Independent Review: Guidelines for Special Railways Phase II* (January 2011).

been incorporated into our recommendations; for example, we expanded the discussion of regulations clarifying interconnections between special railways to take into account Dr. Lupton's observations. Chapter 8 also acknowledges the IndII/AusAID contributions from Messrs. Darwin Djajawinate, Wimpy Santosa, David Hawes and Efi Novara Nefiadi. Two highlights from the Makarim & Taira and Lupton reviews are noted here.

First, Makarim & Taira concludes in its summary that:

> "some of the more fundamental reforms – including the proposed creation of a new category of Limited Public Railway (LPR) and the proposed relaxation of the operation and exclusive use requirements currently applicable to Special Railways (SR) – would require changes in Law no. 23 of 2007 (Railway Law)."

Upon review of their supporting analysis, however, this statement requires qualification. We would agree with the statement if the last clause read " – may be subject to legal challenge and would be most effective with changes in Law no. 23 of 2007 (Railway Law)." In support of this view, we note that the three concerns cited with regard to the LPR option are all potential disadvantages for LPR investors, but not prohibited by Law no. 23. These three concerns were that the investor would need to:

- Have the LPR project accepted in the Railway Master Plan
- Forego government financial support
- Deal with public railway infrastructure access provisions that could not be avoided without a change in the law

Similarly, Makarim & Taira suggests that the concept of an emergency waiver of Special Railway service requirements is unlikely to be accepted. We take issue with this as the concept has already been accepted in the port and airport sectors. Nonetheless, Makarim & Taira is correct that the restrictive boundaries of Law no. 23's Special Railway provisions limit the extent of liberalisation that can be realistically achieved in that area, and that an LPR in compliance with Law no. 23 is unlikely to be optimal from a private sector investment perspective. We reaffirm our recommendations for two reasons:

1. They will certainly be achievable in a much shorter time period than would be required for changes in Law no. 23, which, if it were to be undertaken, would involve major changes with potential for significant political discussion and inherent delay; and
2. Changing Law no. 23 relatively soon after its enactment would be a sensitive political process, with different interests having different agendas. It is also uncertain whether Parliament would support liberalisation of private sector railway investment options.

Second, the Lupton report's conclusions and recommendations differ from those of HWTSK largely in matters of emphasis. Most notably, Lupton sees substantial potential in the as yet undeveloped procedures for an SR (Exclusive Railway) connecting with

another SR (or other railway) and thereby being transformed to a kind of public railway. While the HWTSK final report recommends that this be considered, and supports Ministerial Regulations to clarify interconnection rules, it is less enthusiastic about the potential of these procedures. In this regard, we note that Makarim & Taira's concerns over an LPR's limitations under Law no. 23 could not be avoided using the indirect interconnection approach to achieve the same objective.

INTRODUCTION

General Issues

Indonesia is faced with growing transport demands stemming from rapid GDP growth. But economic growth and important economic development efforts, notably in the mining sector, are increasingly constrained by a lack of transport capacity. At the same time, Indonesia has a relatively stagnant public railway system with limited scope and a very low transport market share, while the Indonesian government (GoI) has limited funding available to develop what should be commercial infrastructure. After years of focusing on reforming the public railway sector, the GoI has resolved to seek a greater role for private involvement in the public railway sector and railway development initiatives. The present study reflects this change of emphasis. Its Terms of Reference (TOR) are contained in Appendix A.[9]

The laws and regulations governing public and Special Railways are:

- Law (Undang Undang) No. 23/2007 concerning Railways (hereafter Law No. 23/2007)
- Government Regulation (Peraturan Pemerintah) Number 56 of 2009 on Railways Development (GR 56/2009)
- Government Regulation (Peraturan Pemerintah) Number 72 of 2009 on Railways Traffic and Transportation (GR 72/2009)

Indonesian law divides railways into two categories: *Perkeretaapian Umum* (Public Railways) and *Perkeretaapian Khusus*, which is most commonly translated as "Special Railways" (SR). (When applied to special train operations, the term *Kereta Api Khusus* is used).[10] Special Railway provisions, which are summarised in Appendix B, are the primary focus of this report. They allow private sector businesses, State-owned Enterprises (SOE, or "BUMN" in Indonesian) and other legal business entities (*badan usaha*) to develop non-public railway infrastructure and railway services for their particular enterprises. The special railway regulations provide the basic principles for

[9] The TOR calls for the following tasks: (1) recommendations as to the proper interpretation of the SR regulations (Part 1 of this Report); (2) a SWOT analysis of SR and alternate avenues for private sector participation (Part 2, Interim Report and Appendix F); (3) develop procedures to expedite approval of private sector applications for railway development; (4) recommendations as to how preferences in private sector involvement might change under different geographical and jurisdictional conditions; (5) recommendations for MoT/DGR actions to improve private sector opportunities (Chapters 2 and 6); (6) evaluation of Indonesian practices regarding private sector investment relative to international practices (see Interim Report and Appendix D); (7) recommendations for longer-term action (Chapter 7 of this Report) ;and (8) consideration of environmental and social impact issues.

[10] The term can also be translated as "exclusive railways," a term preferred by some observers. Special Railways is used here, as it is the more common translation. *Perkeretaapian Khusus* refers principally to exclusive railway infrastructure; *Kereta Api Khusus* refers to exclusive railway operations.

licensing the construction and operation of privately financed railway infrastructure outside the railway master plan framework. Within the public railway category, subject to the master planning framework, the relevant legal regulations governing private investment in rail infrastructure are principally the Public Private Partnership (PPP) provisions incorporated in multi-sector infrastructure regulations.

Special Railways are defined very narrowly under Indonesian law. A Special Railway may only carry the traffic of a single customer, and must be managed or controlled by that customer. The term "control" in the current regulations is generally interpreted as meaning "owned by," such that the Special Railway can be no more than an operating division, at most a subsidiary, of a non-transport enterprise.

Indonesia's hierarchy of legislation determines how the existing Special Railway rules may be modified. As shown in the text box, a Ministerial Regulation (*Permen*) is far down in the regulatory hierarchy (#5), while the rule that a Special Railway may serve only one company is unambiguously established in a Law (#2). However, since both the relevant Law (#2) and Government Regulation (GR, or "PP" in Indonesian) (#3) are ambiguous regarding control and ownership, and no Presidential Regulation applies, clarifications relating to control and ownership might be addressed in a Ministerial Regulation.

The Indonesian hierarchy of laws and regulations (as enumerated under Law 10/2004 on the Formulation of Laws and Regulations, Article 7) is:

1. The 1945 Constitution
2. Law (Undang Undang or UU) /Government Regulation in Lieu of Law (Perpu)
3. Government Regulation (Peraturan Pemerintah or PP)
4. Presidential Regulation (Peraturan Presiden or Perpres)
5. Ministerial Regulation (Peraturan Menteri or Permen; binding in relevant sectors as an administrative decision)
6. Regional Regulation (Peraturan Daerah or Perda)

Ministerial Regulations are limited to an interpretation or implementation of higher laws and regulations; they are not used to introduce new regulatory concepts.

A Ministerial Regulation cannot create conditions or regulations on matters not regulated by a Government Regulation. An example would be whether permissive amendment provisions in Law no. 23/2007 can waive the limitations of exclusive service to a single customer, based on a finding of inadequate capacity. While the port sector GR has such a provision, the rail sector GR does not. Consequently, a stand-alone Ministerial Regulation on this subject for railways could be regarded as improperly introducing a new regulatory concept that should be covered by an existing GR.

Part 1 Purpose: Guidelines for Ministerial Regulation under Current Government Regulation Authority

At present, Law no. 23/2007 and GR 56/2009 do not adequately define the MoT's procedure for assessing and approving proposals for special railways operations. Although the concept of special railways was established in Indonesia in 1992,

procedures for granting licenses for SR operations were only written in 2009. As yet, no application has completed the seven licensing stages required under GR 56/2009 to begin operation on completed infrastructure. This Report recommends that several provisions of the SR regulations be clarified in a Ministerial Regulation (*Permen)*.[11] Throughout this Report, we will refer to this as the proposed Ministerial Regulation on Special Railways, or SR Permen.

GR 56/2009 defines a special railway as *"a railway line that is used exclusively by a certain business entity to support the main activities of the enterprise*." This definition and other SR provisions (reproduced in Appendix B) are unclear as to:

what constitutes exclusive use;

- Whether a business entity developing a special railway must be a single legal corporation
- Whether a subsidiary of the non-transport industry served can be a licensed SR operator
- Whether a multi-company mining development organised as a project or association can qualify as a licensed SR operator
- Whether exclusive use and control by the primary enterprise served may be exercised through contracts

Other basic provisions on Special Railways also need clarifying, as discussed below.

Minimum Qualifications

Various articles of GR 56/2009 address differences in licensing procedures, depending on whether the special railway extends over multiple sub-regional jurisdictions or is connected to a common or public railway network.[12] These licensing provisions, however, do not precisely define the minimum qualifications to be an SR operator. This topic should be covered by an SR Permen.

Service Limitations

[11] Since the basic provisions for SRs are contained in a Government Regulation, a Perpres, although a step higher in the regulatory hierarchy than a Permen, can do little more than a Permen, unless an interpretation is required to eliminate conflict between sector regulations (e.g., between MoT and Ministry of Energy and Mineral Resources regulations).

[12] In many cases, sub-national governmental authorities have the right to approve special railways and issue licenses. In all cases, however, the Minister has ultimate authority over licensing, may refuse to authorise sub-national actions, and may revoke or compel revision of licenses to ensure compliance with standards and policy set at the national level.

Article 350 of GR 56/2009 restricts an SR to the district in which the main activities of the relevant legal entity are served, plus one point in a supporting area in another district (i.e., the "point-to-point" rule). Since the SR provisions are designed to apply to any economic sector, the scope of the terms "district" and "point-to-point" requires clarification for coal mining sector SRs, which are the focus of all SR proposals to date.

Clarification on Conversion

GR 56/2009 does not contain explicit provisions regarding the possibility of transforming a licensed special railway into a public railway. However, it does indicate that such a conversion may take place if the railway intersects with another public or private railway line. An SR license has a term or life linked to the length of the underlying enterprise's control of the district served by the SR (e.g., the term of a mining concession). Despite this licensing and contractual assurance, potential parties to an SR appear concerned that one or more public parties may seek to expand the scope of the SR, to the potential detriment of the private investor. Without further clarification on this subject, SRs may seek to avoid otherwise valuable interconnections that might expose them to conversion.

GR 56/2009 requires that a Permen be issued to define the terms for converting/integrating interconnecting special railway lines to other special railway lines and to public railway networks. A new Ministerial regulation governing such SR interconnection should permit the SR to continue to operate as a private entity but with some of the rights and obligations of a public railway. With further clarification of the point-to-point rules, and the special waiver proposed below, a network of special railways could serve as a form of limited public railway. If those issues are addressed in the SR Permen, this will mitigate investor risks while expanding the utility of private investment in Special Railways.

Licensing Process

A final topic for the SR Permen could be guidance on the timely filing of qualification certification to operate the completed SR. The question is at what stage the proposed SR operator should demonstrate that the scope of services it will provide, and its relationship with the enterprise that owns the goods being carried, are fully compliant with applicable laws and regulations. The current licensing process involves seven distinct steps in obtaining licenses/approvals (some at multiple governmental levels). If the "ownership" interpretation of control is accepted, then the pending SR operations of both MEC and Bukit Asam appear susceptible to legal challenge under current regulation as presently structured. However, since one legal option – for the SR to transport only those goods over which it has taken full legal title – requires no action prior to the transport itself, placing this condition in the final operating license could cure earlier deficiencies. While this restriction would provide a legal defence for prior licensing decisions, it is not necessarily an attractive option for prospective operators and financing sources. The SR Permen should provide clarification on this.

Part 2 Purpose: Guidelines Requiring New or Modified Government Regulations

Some constraints on private investment in special railways cannot be addressed at the Ministerial Regulation level, for one of two reasons:

- The most effective means of reducing these constraints would be inconsistent with the provisions of current GRs.
- Existing GRs are silent on this issue (a Ministerial Regulation can only interpret higher regulations, not implement broad policy).

There are at least two avenues for broadening the scope of the services available to the private railway investor through new or modified GRs (but not Ministerial Regulations):

- **Special Railways:** It is possible to amplify the emergency provisions in GR 56/2009 that permit the MoT to authorise a Special Railway to serve the public under certain conditions. For Special Port Terminals, the emergency provision has been interpreted to include a lack of adequate public port facilities.[13] Similar provisions should be added to government regulations applicable to Special Railways. To be consistent with the special port regulation, the underlying constraints on the core Special Railway service would remain (goods transported would be for the account of one enterprise that controls the SR), and authorisation to serve a broader public would be short term (e.g., a 1-5 year renewable license). However, such a provision would contribute to increased local government activities, could improve the short-term economics of the investment, and could help mitigate social impacts.
- **Public Railways**: Limited Public Railways (LPR). An LPR would be a sub-category of Public Railways that allows an investor to develop railway infrastructure and a dedicated train service for a given enterprise or economic sector. The train equipment investment would be exclusive to the investor (the public would have no right of access to locomotives or wagons that are owned or leased by the investor). However, the proposed category would allow additional suitably qualified carriers to access the infrastructure under terms negotiated between the investor and such carriers under a structure approved by the licensing authority. The separation of train operations and infrastructure access distinguishes an LPR from an SR, which is an integrated railway as required by Law no. 23/2007. The potential for competition on the infrastructure should eliminate the need for company-exclusive services and common control restrictions.

If the above provisions were incorporated into GRs, a private investor would have three choices:

[13] GR 61/2009, Article 124.

1. Invest in an SR with a tightly defined core service to one specific enterprise without competition on the infrastructure, but with the possibility that services to third parties may be permitted on a short-term renewable basis. Connect with other SRs or with public railway networks on a negotiated basis to broaden service options, reduce infrastructure redundancy, and enhance the value of private investment in special railways.
2. Invest in an LPR with core services to a defined enterprise or business sector, with the right to offer train service access to third parties on terms negotiated between the parties and under a process described in the license.
3. Invest in a PPP railway with no restrictions on customers served over the railway, but with the requirement to compete and win a public tender and to allow third party access to the infrastructure under terms incorporated in the winning bid.

More details on these three recommendations can be found in Part 2.

Issues Highlighted by Diagnostic Analyses

One of the initial tasks in this study was to investigate what legally sound steps might be taken to facilitate the approval of current SR applications or to identify another strategy to permit these projects to go forward. Three projects were reviewed in the Interim Report for this purpose:

- **Bukit Asam – Special Railway**. The preliminary license was issued by the MoT under GR 56/2009, as required for a railway that crosses two provinces. The licensee was PT Bukit Asam, as the mine operator to be served by the railway. This clearly qualified under the SR provisions. However, the project became stalled when PT Bukit Asam wanted to transfer the license to PT Bukit Asam Transpacific Railway – a proposed railway operator in which PT Bukit Asam has only a minority interest – in order to obtain project financing. It appears that the MoT can only transfer the license if a new Government or Ministerial Regulation liberalises the SR ownership provisions.
- **MEC – Special Railway**. In this case, the project is contained within one regency, with the MoT's role being to provide approval for the regency government to proceed with the licensing. The MoT has granted its approval and the regency government has issued the license to the proposed railway operator, PT Trans Kutai Kencana. PT Tekno Orbit Persada is in the process of acquiring about 5 percent of shares in PT Trans Kutai Kencana. Both companies are indirectly controlled by MEC Coal,. Again, approval of this license (or at least the final license issued for railway operation) is subject to challenge unless clarified by a Ministerial or higher regulation.
- **Central Kalimantan – PPP Railway**. In this case, private railway developers and investors are being selected through the PPP process under Perpres 13/2010. If the PPP tender is successful, which may require a year or more, the MoT will need to issue its approval e and Central Kalimantan province would then issue the railway sector licenses that are needed to implement the project. The MoT and the

provincial government appear to have sufficient authority to approve the resultant railway as a public railway. However, should the PPP process fail, the MoT could not then revert to the SR provisions to move the project forward, since the project is explicitly designed to serve multiple enterprises.

The results of these diagnostic analyses are amplified in Appendix F.

In the first two cases, the current rules relating to control over the SR will likely subject the projects to serious legal challenge. In both cases, the applicant would serve third parties if allowed, but would accept exclusive service to one enterprise. In each case, absent further clarification, the existing SR regulations (i) would increase project risk, (ii) may necessitate sub-optimal structuring of the project, (iii) have already caused lengthy delays, and (iv) threaten the ultimate financeability of the development. In the third project, the SR provisions offer no safety net should the PPP process fail.

Subsequent to the Interim Report, a more limited assessment was made of an SR initiative being undertaken by PT Adani in South Sumatra. That project would also require an elaboration of GRs or a Ministerial Regulation to permit the project to go ahead expeditiously. Here, the dilemma arises from the fact that the main enterprise served would be an international coal broker/consumer. While not prohibited by SR regulations, the concept of the main enterprise being a product consumer, rather than product producer, is not well developed. Concepts such as the main enterprise district and point-to-point service restrictions would require interpretation to be applicable to a consuming enterprise.

While the diagnostic analyses addressed these three specific cases, they appear to be representative of other potential private sector railway investment opportunities that may arise in the near future. Interest has been expressed in a number of railway projects to support the mining sector. For all these projects, the requirements of the mining regulations will need to be reconciled with the SR regulations (or some alternative rail sector option). In most cases, multi-jurisdictional approvals will be required. Often, a combination of international and domestic enterprises would be involved. Hence, without regulatory reform, the complexities that have prevented the pending applications from proceeding to construction and operation will also inhibit future projects.

PART 1: GUIDELINES UNDER CURRENT GOVERNMENT REGULATION

Part 1 of this Report recommends guidelines that are appropriate under the current regulatory framework for private domestic and foreign investment in Indonesian railways. In Part 1, we assume that Law no. 23/2007 on Railways, Government Regulation No. 56/2009 on Railway Development, Government Regulation No. 72/2009 on Railways Traffic and Transport, and Presidential Regulation No. 13 (amending Presidential Regulation No. 67/2005 on Government Cooperation with Business Enterprises in Infrastructure Provision) all remain unchanged. This section of the report focuses on more clearly defining the control and ownership structures that are permitted for exclusive/special railways. New Ministerial Regulations that interpret and implement the existing Laws and GRs are also discussed and proposed.

Part 2 will recommend more fundamental government regulations that can expand the scope of special/exclusive railways and define a new category of public railway – the limited public railway (LPR) – that expands the scope of private investment into public railways and should attract greater investment in the railway sector.

CHAPTER 1: OPTIONS UNDER CURRENT RAILWAY INVESTMENT FRAMEWORK

1.1 ASSESSMENT OF CURRENT POLICY

Recent changes in Indonesian law have liberalised previous restrictions on private investment in the railway sector in some important respects. Under the prior railway law (Law no. 13/1992), PT Kereta Api (Persero) or PTKA, the national railway, was established as an SOE, with greater commercial independence than its predecessor had as a government corporation. It retained an essential monopoly on railway services, except for a restricted ability of industries to develop SRs for their internal business. Private investment was largely restricted to the railway supply sector (where another SOE was prominent).

Perpres 67/2005 permitted private enterprises to cooperate with the Government through a PPP process to construct and operate railway infrastructure. Law no. 23/2007 opened up the possibility for private train operators to provide train services using existing railway infrastructure. The three brief references to SR in Law no. 13/1992 were expanded to eight provisions in Law no. 23/2007, in order to (i) accommodate the new possibility that SRs could be approved by sub-national governments, (ii) define an SR as serving the primary activity of the enterprise served, and (iii) provide for implementing GRs. GR 56/2009 contained these implementing regulations for Special Railways, providing (among other things) that an SR could (i) serve a supporting area outside of a main enterprise district, (ii) link to public or other special railways, (iii) link a storage area to a port, and (iv) be converted to public railway operational status after interconnection with another railway.

While opportunities for private investment in Indonesian railways (and SRs in particular) have been broadened under current Indonesian legislation, they are still quite restrictive when compared with the international practices described in Appendix D.

- Law no. 23 provides for independent above-rail operators on existing infrastructure, but there are no regulatory procedures governing how such a proposed operator would go about acquiring a license, and there is no “network statement” based on the European model specifying the terms and conditions for sharing infrastructure use with PTKA as the primary train operator. Consequently, this potential area for private investment remains undeveloped as yet.
- If an investor wishes to develop railway infrastructure for multiple customers, the only current alternative is to submit the proposal to a government entity at the national or sub-national level. The government entity would then, if desired, assume sponsorship for the proposal and develop and submit the proposal in a tendering process. The proposal originator, under Perpres 13/2010 rules, would be given a choice of certain advantages in the tender, but would not be guaranteed to be awarded the construction and operating concession under a Build-Operate-

Transfer (BOT) project structure. To date, this approach has not resulted in any successful railway developments.

- If an investor wishes to develop railway infrastructure without first winning a public tender, it is currently limited to developing and operating such infrastructure for a single enterprise. Private railway development to serve multiple enterprises is not permitted.

The regulations described above are overly restrictive and should be expanded to permit a wider range of private investment. The Final Report recommendations are contained in Part 2. There are, however, some expanded investment opportunities that may be developed under current regulations, including approval of one or more of the SR applications that are still pending. These opportunities are summarised below.

1.2 WHAT PROJECTS ARE LEGALLY AVAILABLE UNDER CURRENT SPECIAL RAILWAYS LAW AND REGULATIONS?

At present, an SR can serve only the primary business of the licensee. The applicable law does not restrict the products carried on a special railway to be either inputs or outputs of the enterprise; they could be either or both. Consequently, the enterprise moving traffic on the SR could be a consuming enterprise for the goods transported, a producing enterprise, or both. The enterprise served may be a service company rather than a producer or consumer of the goods transported. However, most SR proposals to date have been generated by developers in the coal mining sector, and scope concepts concerning an enterprise's operating district and point-to-point service have yet to be refined for consuming or service industries.

At present, the SR regulations require that the SR be operated and controlled by the enterprise it serves, but neither the law nor the implementing regulations specify the legal form of such control.[14] Control and ownership are clear if the SR is an operating

[14] The numerous varying legal interpretations concerning what qualifies a special or exclusive railway do not revolve around the question of whether "special" in this context means anything other than "exclusive," an alternative and universally accepted meaning of *khusus*. Rather, the multiple interpretations, debate and confusion over what qualifies a Special Railway relate to what kind of control and/or ownership is necessary for such a railway, in addition to the railway providing a dedicated service to a single enterprise. In the course of the project the following opinions have been expressed with respect to control by the primary enterprise: (1) must be no more than an operating division of an Indonesian PT; (2) must be an (at least 51 per cent owned) subsidiary of an Indonesian PT; (3) may be a subsidiary of an Indonesian entity other than a PT (e.g., a cooperative or association); (4) may be a subsidiary of a corporate entity that is not an Indonesian corporation; (5) may be considered a proper subsidiary in some situations where primary industry control is less than 51 per cent; (6) the combination of any shareholding by an enterprise that is the exclusive (or sole) client of the the railway is sufficient indication of control; (7) one or more combinations of opinions 2-6 may be established through a multiple tier chain of subsidiaries; (8) control may be established by contract requirements for what the railway can or cannot haul; (9) the railway

division of the enterprise. Under international standards, however, control is also generally exercised if an enterprise owns more than 50 per cent of another company (designated as a subsidiary). Control can also be exercised by having a majority of seats on the board of directors or as might be specified in the controlled company's bylaws. Internationally, control can also be exercised through contractual provisions.

If the enterprise served is defined as a service company, an issue arises as to how to distinguish the service being provided from that of being merely a transporter (which would not qualify as an SR operator). Evidence may include:

- Registration as a service provider under applicable sectoral regulations (e.g., registration as a mining business or mining service business under the coal mining laws)
- The SR operator purchases all products that it carries and/or
- The operator is a subsidiary of a logistics company or international broker and all products are transferred to or from that parent company on completion of railway transport

Further elaboration on these issues is contained in Chapter 2.

1.3 WHAT PROJECT OPERATORS ARE IMPLICITLY APPROPRIATE UNDER CURRENT SPECIAL RAILWAYS REGULATIONS?

Under the current legal framework, a company incorporated in Indonesia (an "Indonesian company") with a current business license, which produces or purchases all of the products transported on the special railway, is qualified to apply for an SR operator licence. During the study, we were advised that the legal divisions of the MoT and DGR take the position that it may be possible to provide broader interpretation on which companies qualify for an SR operator licence, as follows:

1. An Indonesian company with a current business license, which either produces or purchases all of the products transported on the SR
2. A subsidiary of an Indonesian company with a current business license, which either produces or purchases all of the products transported on the SR
3. An Indonesian company with a current business license, which can demonstrate that it is controlled (by contract) by another Indonesian company with a current business license

operator may be an appointed contractor or agent of the primary enterprise; (10) the licensed operator need not be the owner of the railway if the actual owner is controlled by the enterprise served; (11) the primary enterprise can only be the producer of goods carried; (12) the primary enterprise can be a consumer of the goods carried; (13) the enterprise can be a service provider; and/or (14) combinations of opinions 11-13.

Article 33(1) of Law no. 23/2007 provides that a legal entity may operate (develop) an SR in order to support **its** core activities. According to Article 33, there must be an organisational relationship between the legal entity operating the special railway and the business activity served by the special railway: the use of the word "its" in may indicate that the relationship is an internal activity of a single legal entity or, more broadly, may allow a subsidiary relationship, or may even be based on common ownership between the SR and the business activity served by the SR. Since Law no. 23/2007 does not simply specify that the enterprise must operate the SR directly under its own charter, some variation in structure may be considered permissible. HWTSK therefore accepts the MoT interpretation that an Indonesian company may establish a subsidiary company to manage the special railway to serve business activities conducted by the Indonesian company (parent company).

We understand that the legal divisions of the MoT and DGR currently prefer to interpret that an Indonesian company with a current business licence that can demonstrate it is controlled (by contract) by another Indonesian company with a current business license is qualified to apply for an SR operator licence. This interpretation is based on the argument that the intention of Llaw no. 23/2007 and GR 56/2009 is that the SR should serve one enterprise only, so as long as it can be demonstrated that the SR will only be used to serve a specific company, then a company controlled by another Indonesian company will be qualified to apply for an SR operator licence.

The above argument seems consistent with the definition of a Special Railway provided in Article 1(3) of GR 56/2009, which provides that a Special Railway is a railway that is used only to support the core activities of a particular legal entity, not to render public services. Accordingly, a Special/Exclusive Railway must serve one enterprise only, although GR 56/2009 does not expressly provide that the SR must be owned by the enterprise that is being served. However, the consistency with Article 33 (1) of Law no. 23/2007 may be subject to challenge. The law clearly intends that a Special Railways service must not be an arms' length commercial transaction that might compete with Public Railways. It is less clear whether a long-term contractual arrangement for exclusive services that effectively eliminates the use of tariffs accomplishes this intent.

In summary, the licensing provisions of GR 56/2009 simply are not drafted tightly enough. While it is clear that a Special/Exclusive Railway must serve one enterprise only, neither Llaw no. 23/2007 nor GR 56/2009 (either in the licensing provisions or elsewhere) expressly states that the SR must be owned by the enterprise being served, or that the enterprise (or a subsidiary) must be the licensee. A lawyer might even argue that the absence of direct unambiguous licensing requirements means that any enterprise could be the licensee, and the existing GR's silence on licensee requirements could not be remedied without a revised GR, because a Permen cannot interpret silence. In our view, while such an argument is not likely to be accepted, the lack of precise language has resulted in multiple interpretations as to the entity that can be licensed, with over half a dozen interpretations encountered by the project team. Many of these interpretations are supported by highly qualified legal representation and experienced mining and transport operators. Indeed, each of the companies

proposing various arrangements for the construction of SRs appears to have been properly advised and to have done adequate due diligence in this area. We therefore conclude that the laws and regulations covering the construction of SRs are vague, and that the permissible arrangements are not clearly defined.

1.4 WHAT PROJECTS ARE LEGALLY ALLOWABLE UNDER THE PPP STRATEGY?

Any railway project that a prospective investor is prepared to nominate to a national or sub-national agency as a PPP project is legally allowable as a potential investment. The party nominating the PPP project must accept the risk that it will not win a competitive public tender to build and operate the railway. A railway built under the PPP process will be a public railway that must provide infrastructure access to other train operators and comply with the regulatory provisions governing public railways.

Perpres 13/2010 was recently passed to clarify the previous statute governing infrastructure PPPs. The new regulation strengthens incentives for private sector project initiators by increasing their advantages in the tender process and reducing the amount of competition required for a valid tender.

1.5 WHAT PROJECTS ARE APPROPRIATE USING THE PPP STRATEGY?

While virtually any railway project can be nominated to be developed under the PPP process, the PPP is not a logical vehicle for an integrated natural resources development project with a railway transport component, such as the developments currently being pursued by MEC and Bukit Asam under the SR provisions. That is because the tender process disconnects the railway development from mine development. In addition to an uncertain development schedule and unclear technical standards, a PPP requires that the railway be opened up to broader public service obligations, with an uncertain capacity commitment for mining development. This disconnect makes it problematic to finance both the mining development and the railway. It also puts mine developments at risk from rent-seeking by PPP railways and generally increases mine development investor risk.

Where a private investor (or SOE) has the necessary resources and access to financing to develop a rail line that serves its own facilities exclusively, the PPP process becomes an unnecessary complication that will most likely make execution less efficient than would a stand-alone SR. Other prospective coal mine railway developments now in the early planning stages (e.g., proposed lines by Churchill Mining and Berau Coal in East Kalimantan) are unlikely to opt for a PPP arrangement if they can finance the railway development directly.

A PPP railway is likely to be most attractive under the following circumstances:

1. The cost of transportation is high relative to the market value of the coal; generally meaning relatively longer transport distances
2. Multiple mine operators (or other enterprises) could use the system
3. Financing would be difficult for individual mine operators
4. There is strong public interest in a public rail service beyond mine transport
5. There is public concern that a rail route controlled by a single enterprise should be avoided and/or
6. It is in the public interest to avoid having multiple dedicated rail lines, whether for environmental, spatial planning or other reasons

The currently proposed PPP railway project in Central Kalimantan meets most of these criteria. A possible line from Bukit Asam's Tanjung Enim mining in South Sumatra area to a port in Bengkulu province (previously proposed as an SR, but now inactive) might be another PPP candidate since the line could be economically stronger as a public railway rather than dedicated to a particular enterprise.[15] Similarly, the proposed Adani line in South Sumatra has been discussed as a potential PPP (in addition to the SR currently being proposed) due to the public interest in avoiding multiple dedicated railway developments. In such cases, however, the PPP process could reduce private investor interest and place a burden on a public sector with other pressing infrastructure development priorities.

Because the revised PPP rules have not yet been tested in the market, it is unclear whether the new procedures will be more effective in generating private sector interest than prior regulations, which resulted in no railway project implementation. Unlike the SR rules, the discouragement of private investment is primarily due to overly complex procedures for PPP project approval and implementation, rather than operator eligibility requirements and limitations in project scope.

[15] The potential route is difficult and only a single line may be possible, so there may be a public interest in preserving the route for an operator providing broader service.

CHAPTER 2: GUIDELINES FOR NEW MINISTERIAL REGULATION

Law no. 23/2007 provides the principles for Special Railways and Public Railways while GR 56/2009 specifies the licensing procedures. However, these two regulations primarily focus on administrative procedures with respect to the hierarchy of authority under the devolution statutes. Since they do not provide a detailed interpretation of how operator qualifications and scope of service restrictions should be interpreted in Special Railway licenses, a new Ministerial Regulation on Special Railways is needed to ensure that important private investor initiatives can be realised. GR 56/2009 also fails to specify the qualifications and scope of service for public railways, implicitly deferring to Perpres 67/2005 as amended by Perpres 13/2010 for the relevant procedures. Any new subcategory of public railways would therefore require a new Government Regulation interpretation before an appropriate Ministerial Regulation can be issued. Consequently, this chapter addresses only Special Railway options that are possible without an intervening Government Regulation.

The MoT and DGR have recognised the gap in the legislation created by the absence of a Ministerial Regulation, and have considered a number of potential items for incorporation in such a regulation. The DGR traffic department has suggested the following six principles, which would largely confirm and strengthen the restrictive provisions of GR 56/2009:

1. Elucidation of point-to-point restrictions, essentially restricting all SR traffic to one origin and one destination
2. Confirmation that SRs do not require a public tender
3. A determination that an SR should not receive any non-commercial government financial support
4. A provision that land should be transferred to the national government for public railway use at the end of a specified SR term
5. A restriction preventing the SR from charging for any service, whether through a by tariff or by other means
6. A provision allowing the government to take over the SR in a national emergency[16].

These provisions, along with a restatement of certain Articles of GR 56/2009 (particularly on licensing) were circulated in a preliminary form shortly before the draft of this report was issued. Meanwhile, the MoT's legal division has suggested a number of provisions for a Ministerial Regulation that would broaden the application of Special Railways, particularly with regard to ownership.

[16] See Appendix H, Meetings 4 and 22.

This Final Report supports DGR points 2, 3 and 6 above, but recommends more flexible policies with respect to points 1, 4 and 5. It is generally supportive of the MoT legal division's recommendations.

2.1 PERMISSIBLE TRANSPORT CLIENTS AND SERVICE TERMS

Law no. 23/2007 expressly states that the licensed entity for which a Special Railway provides transport services must be a single business entity (*badan usaha*), and that the railway shall be "used by" that entity "to support its main activities." Combinations of the two phrases are found in five distinct provisions of Law no. 23/2007.[17] GR 56/2009 also uses these two phrases in three of its provisions,[18] while GR 72/2009 uses them in one Article.[19] There is therefore no doubt that the transport service under the Special Railway provisions has to serve the primary activity of a single entity. An amendment to Law no. 23/2007 would be required to change this limitation.

Principle based on International Best Practices:

Do not incorporate conditions in a formal regulation if there are predictable circumstances in which the regulator might wish not to apply that condition. In those cases, the proper mechanism for conditions is the negotiated agreement or license.

Special Railway Applications:

The Government Regulation does not limit Special Railways to specific economic sectors. The Ministerial Regulation should also not limit Special Railways to a specific economic sector, as diverse industries (metals processing, chemicals, container facilities, passenger railways of various types, among other types of railways) could be Special Railways of interest to investors.

In many cases, right-of-way and fixed assets of a Special Railway concession might revert to the central government for incorporation in national railways. In other cases, local governments may prefer reversion to local use or another Special Railway operator might be found.

The current legislation does not limit Special Railway investment to a particular economic sector. A Ministerial regulation should not do so either, for reasons that are explained in the accompanying text box.

2.2 CONTROL AND OWNERSHIP

The existing Special Railway provisions are less definitive with respect to ownership and control of the legal entity. Law no. 23/2007 deviates from the "used by" phrasing

[17] Law 23/2007, Article 1(6), Article 5(1)b, Article 5(3), Article 33(1), and Article 149(1)
[18] GR 56/2007, Article 1(3), Article 1(a4), and Article 38(3).
[19] GR 72/2009, Article 161.

only once, to substitute a term meaning "carried out by" or "operated by,"[20] thus implying some form of operational control by the "legal entity." This is strengthened by Article 38(3) of GR 56/2009, which also uses a phrase meaning "carried out by" or "operated by."[21]

The definition of "*badan usaha*" (business legal entity) is itself open to some interpretation. Article 1(10) of Law no. 23/2007 defines Badan Usaha [capitalised] as "a State-owned enterprise, regional government-owned enterprise and/or Indonesian legal entity specially established for that purpose."[22] This definition raises a question as to how the private legal entity might be organised. GR 56/2009 and GR 72/2009 use the same definition. The licensing provisions in GR 56/2009 for special railways (Articles 350-376) focus on jurisdictional procedures and technical requirements, and do not elucidate further on the ownership or organisational qualifications of a *badan usaha* for Special Railways.

Principle based on International Best Practices:

Multi-million dollar investments, such as railway infrastructure investments, typically require complex organizational structures to accommodate international and national participants, to recruit specialized technical and management talent and to take proper advantage of financial opportunities.

Special Railway Applications:

The provisions addressing primary enterprise control of an SR should not be interpreted so narrowly as to require an SR to be only an operating division or subsidiary of an Indonesian Perseroan Terbatas (PT) or ordinary limited liability company. The focus should be on evidence of effective control.

The service area of an SR is defined to include the district or area of the enterprise served and a supporting area. Neither of these areas should be defined in terms of ownership or any control provisions that are particular to a specific economic sector. The mining arrangements that are the principal current focus of SRs have specialised licensing procedures and government regulations with respect to mineral rights, land use and other factors. These are more properly referenced in the SR licence rather than a Ministerial Regulation.

Three main issues arise with regard to the definition of *badan usaha*:

1. The definition does not specify the company's organisational form (i.e., a limited liability company (PT), legal association, cooperative, or other form), although it could be read to imply a PT, since the government enterprises described in the definition are all PTs.

[20] Law 23/2007, Article 33(1) *Penyelenggaraan perkeretaapian khusus sebagaimana dimaksud dalam Pasal 17 ayat (2) dilakukan oleh badan usaha untuk menunjang kegiatan pokoknya* [Operation of special railway as referred to in article 17 paragraph (2) shall be carried out by a legal entity to support its core activities.]

[21] GR 56/2007, Article 38(3). *Perkeretaapian khusus sebagaimana dimaksud dalam Pasal 37 huruf b dilakukan oleh badan usaha untuk menunjang kegiatan pokoknya*. [The special railway as intended in Article 37 sub-article b shall be operated by a legal entity to support its core activities.]

[22] "*Badan Usaha adalah Badan Usaha Milik Negara, Badan Usaha Milik Daerah, atau badan hukum Indonesia yang khusus didirikan untuk perkeretaapian.*"

2. The definition implies that the badan usaha must be an Indonesian corporation. This would prevent foreign holding companies and offshore subsidiaries from obtaining SR licenses.

3. "Badan Usaha" is capitalised in the definition under Law no. 23/2007, as it is in text provisions regarding public railways. This has led some readers to conclude that the term applies only to public railways, and that therefore a non-Indonesian company could be a valid badan usaha as SR sponsor. On the other hand, such an interpretation would mean that the phrase "specially created" used in the definition (which might imply separate organisational structures for the SR and the "certain enterprise") does not apply.[23]

As noted earlier, neither Law no. 23/2007 nor GR 56/2009 prohibits an enterprise building and controlling a Special Railway from being a service business rather than a producer. This Report concludes that a company whose primary activities are product trading and sales (e.g., coal trading and sales) may be eligible for a Special Railway license. By extension, a consumer of products (e.g., a power company using coal to produce electricity) may also be eligible for a Special Railway license. However, a Ministerial Regulation would be required to define the scope of the restrictions.[24]

On the other hand, this Report also concludes that several much discussed options to use Ministerial Regulations to broaden the scope of ownership and control permitted for Special Railways would be subject to objection and challenge under Law no. 23/2007. The first of these options is the use of board resolutions, notarised statements or company charters declaring that a railway line will be used exclusively for a certain enterprise. Another option that would likely be subject to a legal challenge is licensing an affiliated enterprise that is not majority-owned by the producer of the goods to be transported. We also conclude that contracts simply declaring the exclusive use of a railway for transporting the production of another enterprise are insufficient to permit licensing a Special Railway pursuant to Law no. 23/2007. Extensive analysis will be required to determine whether a contract form can be developed that would be sufficiently precise.

With reference to the accompanying text box, this Report concludes that demonstrating a minority shareholding in an SR by the industry served, or sworn statements or contracts of exclusivity, ***do not****, by themselves, indicate an acceptable level of control by*

[23] While a technical point, this issue has been part of the continuing debate over the propriety of transferring the preliminary SR license from PT Bukit Asam, the enterprise served, to BATR, a "specially created" railway operator.

[24] For a power plant or minerals processing facility, for instance, the "district" might be limited to just the primary plant site or expanded to include local storage and production stage facilities; an exporter's district might include one or more port terminals."Point-to-point" constraints might need to be separately defined for separate inputs to production. The complexity of defining such terms for different enterprises is a factor supporting broader alternatives to current Special Railway procedures, as recommended in Part 2.

*the industry served. A Ministerial Regulation therefore **should not** incorporate such claims.*

The following interpretations regarding the primary enterprise **might be** acceptable. We recommend that they each be considered as candidates for inclusion in a Ministerial Regulation, but should be adopted only after thorough review of each option.

2.2.1 Contract Relationship

The MOT has indicated that a "control-by-contract" relationship might be sufficient to receive a special railway license. In this case, the contract would be for substantially all the capacity of the railway (it is hard to judge ultimate capacity, since this is easily changed by various operational means and minor investments). Evidence that the term of the Special Railway license would be for the term of the mining license could support a contract control case. The license would permit the Special Railway to serve only the mine (or entity) specified and would retain the other limitations under GR 56/2009 (e.g., the point-to-point regulation). It is ***not*** recommended that a mere affiliate relationship be accepted as supporting evidence of control by contract.

Principle based on Legal Sufficiency:

Unless there are clear technical definitions, common meanings of terms shall prevail.

Special Railway Applications:

Nether Law 23/2007 or GR 56/2009 has any technical definition of subsidiary, affiliate or controlling shares. The Ministerial Regulation should use common meanings in addressing SR control issues.

2.2.2 Non-Producer Parent Arrangements

Law no. 23/2007 and GR 56/2009 do not require that the "primary enterprise" be a *non-transport producer of goods*. A tourism industry is explicitly cited in the elucidation of GR 72/2009 as a potential operator of a Special Railway.[25] Consequently, a special railway operator *could* be a service industry, a consuming industry or a legal association of enterprises – i.e., any legal entity that satisfies the definition of "badan usaha." The MoT is now considering a suggestion raised during this assignment that a

[25] GR 72/2009, Article 161: "*Pelayanan angkutan perkeretaapian khusus hanya digunakan untuk menunjang kegiatan pokok badan usaha tertentu. Penjelasan: Badan usaha tertentu antara lain usaha penambangan batu bara, usaha perkebunan, dan pariwisata."* [Special railway transportation services shall be used only for supporting the main activities of a particular legal entity. *Elucidation:* A particular legal entity shall include, among other things, a coal mining business, a plantation business, and tourism.]

group of mines be permitted to associate into some type of consortium that sponsors a special railway to serve the entire group of mines. The new mining law, which provides for a trading entity to receive a mining service IUP, supports such an interpretation. The mining regulations also seem to favour independence between mining services companies and mines so as to promote local involvement in mining development.

At least three types of non-producer arrangements might be sanctioned under GR 56/2009.

Cooperative or Association Parent. An Indonesian business entity owned by a number of mines (or other business interests) could form the core of a consortium designed to build a special railway, even if the entity concerned does not hold a mining-services IUP.[26] If this were permitted, the Special Railway might be a unit, subsidiary or affiliate of, or have a contractual relationship with, the consortium. (Most flexibility would be provided by a contractual relationship.) To protect the consortium and the Special Railway licensee, the contract with the Special Railway may prohibit it from providing coal transport services to entities that are not members of the consortium.

Such a special railway would still be limited by the point-to-point regulations. This might require that the consortium do all loading and unloading from a central loading facility and haul to a single terminal. Owner mines would be required to truck or conveyer their coal to the central loading facility. Ideally, the Ministerial Regulation would allow the special railway to unload at different stockpiles within a defined terminal area. It is also recommended that the Ministerial Regulation relax the point-to-point rule so that the Special Railway may construct loading facilities at a number of mines in a district operated by a given enterprise. This issue could also be resolved by expanding the definition of the consequences of Special Railway interconnections. Each mine could build a short SR connecting to the principal SR that goes to the port or other destination, thus developing a network of SRs. This would convert the principal special railway into a private public railway, with the consent of its owner.

Consuming Industry Parent. The law and regulation clearly permit a raw materials consuming industry (such as a steel or aluminium company) to establish an SR *for the purpose of shipping raw materials* ***to*** *the facility, even if it* ***shipped none of its output*** *over the SR.* For example, MEC's long-term plan to develop an aluminium plant in East Kutai regency would certainly qualify that enterprise to build and operate an SR from a private port terminal to the plant. Under current regulations, this special railway could not be the same special railway transporting coal from the mine to the special port, nor could that special railway carry coal to the aluminium industry. Such services should be permitted, and this could be done by expanding the definition of the consequences of interconnecting Special Railways.

[26] Possibly a cooperative or legal association.

Service Industry Parent or Integrated Enterprise. Since Law no. 23/2007 and GR 56/2009 allow for a Special Railway to serve a service industry, a maritime trading company might therefore own an SR that transports products through a private port terminal. An SR operator whose main business is as a coal broker should also qualify.

For each of these three scenarios, such types of arrangements should be explicitly sanctioned in the proposed Ministerial Regulation.

2.3 RELAXATION OF POINT-TO-POINT RULES

GR 56/2009 developed the point-to-point rule (which was not specified in Law no. 23/2007). It permits transport services between points within a service area and one destination in a single supporting area or district. Since the regulation applies to all industries, the concept of a service district is vague, but in many cases would be defined by a license to operate in a specific geographic area. This is the focus of most SR interest in the mining sector, where the license is an IUP for mine development in a rather small geographic area. It is unrealistically limiting to define service as being between a single IUP and a single supporting point (e.g., a port terminal). If the origin and destination can be defined as a mining area and terminal area respectively, it is possible that the mining operation could load from several locations within a mining area and discharge at several stockpiles in a terminal area. Such flexibility would be very useful. Since terminal property is so valuable, storage areas are often located some distance from the ship or barge loading jetty (for example, the BATR operation in Lampung would discharge at a storage area quite far from the terminal). It would therefore increase flexibility to allow a Special Railway to unload at a remote storage facility and at the terminal.

Where a power plant is built along a Special Railway alignment, it is recommended that the Special Railway be permitted to serve the power plant with coal from the principal owner's mine, whether or not the power plant is a subsidiary of the railway. There is no reason to limit the ability of the special railway to serve users of the primary product of the sponsoring mine. This will require revisions by way of clarification in the proposed Ministerial Regulation. Similarly, if a cooperative or association is allowed to be the sponsoring business entity for a special railway and if a broader service area is defined, the special railway should be able to load at the various locations of the cooperative members.

We feel that a Ministerial Regulation would be a proper mechanism to broaden the interpretation of the "point-to-point" rule. The MoT should consider an explicit interpretation of Article 350 of GR 56/2009 to mean that receiving points owned by third parties along the SR route and interconnections with public railways or other SRs are *not* violations of the single point and supporting district rule. Further liberalisation of the point-to-point regulation may require a revision to Article 150 of GR 56/2009. Although this is a desirable change, we note that the currently pending SR applicants do not seem to regard such a change as critical. If changes relating to the public interest benefits of private sector investment in railways are made by adding a new

chapter to GR 56/2009, then Article 150 should also be modified. If a separate Government Regulation is developed instead, then the modification of Article 150 might be deferred.

2.4 END-OF-PROJECT-LIFE PROVISIONS

Current special railway regulations appear to require all the assets of the special railway to be transferred to the relevant government unit at the end of the special railway license period. Some government units appear to expect that this transfer would be made at no cost to the government, on the grounds that the assets would have zero value to the SR company. This is not considered good public policy as it discourages proper maintenance of assets. It would not likely benefit the governmental units that would be responsible for depleted railway assets after the transfer.

2.4.1 Terminal Valuation Issues

Based on experience in other railway concessions, if the value of the railway's assets is set at zero, the railway company will avoid maintenance expenses and re-investment as it approaches the end of its concession period. The SR would tend to run its assets down to zero value at the end of the concession – for example, it would not replace worn rail, might sell all the rolling stock to a shell company and lease it back, and would take many other steps to ensure that it had extracted as much of the asset value as possible by the end of the license period. While the railway might still be safe, it would be transferred to the government with huge maintenance arrears and no rolling stock.

After a mining license has ended and there is no more coal to move, the local government might prefer that the SR company remove the railway line and return its right-of-way to a near natural state so that the land can be used for agriculture or other purposes. Absent a terminal valuation negotiation process, this is unlikely to happen. Hence, the Report recommends that the parties be free to negotiate a terminal valuation procedure, rather than being subject to a rigid regulatory policy. In computing their financial returns, investors will tend to assume zero value at the end of the concession. Permitting compensation for terminal value may make no difference to investors but can help ensure that the assets transferred at the end of the license period are in good condition and can continue operating or, alternatively, that the railway is removed and land restored, if needed.

2.5 LICENSING PROCESS

It is our understanding that the SR license does not independently have a specific term but is tied to the life of the underlying business being served by the SR. If the primary business license is renewed, therefore, the related special railway license will also be renewed for the same duration. To the extent that the potential changes to the

Government Regulation discussed above would create ambiguity in this respect, the new Government Regulation should clarify the renewal term and license renewal procedures.

The Republic of Indonesia is divided into provinces (*provinsi*), regencies (*kabupaten*) and cities (*kota*). Provinces, regencies and cities each have their own local governments and parliamentary bodies. Since the enactment of Law no. Number 22/ of 1999 regarding local government autonomy (as revised by Law no. Number 32 of 2004), local governments now play a greater role in administering their areas, including having primary authority for licensing activities that are entirely within their jurisdictions.

It is important to recognise that in several respects the Indonesian devolution process is not a purely federal system. At least two of these differences are important for an understanding of the SR licensing procedures. First, the MoT has the power and responsibility to approve a provincial or regional railway license in advance of the local license being issued. This is to ensure compliance with national laws and regulations. In a federal system, sub-national units would generally have greater authority to issue licenses without advance federal government authorisation, being subject only to federal review (if required). In other words, there is a greater degree of local autonomy in a federal system. Second, the 1999 law devolved many responsibilities directly to cities and regencies, largely bypassing the provinces. While the 2004 legal revisions brought greater authority back to the provinces, the balance between local and provincial government still favours the local government more than in most federal systems.

For railways, the hierarchy of primary licensing responsibility is simple. If the proposed rail line is entirely within one regency, the regency has primary licensing authority. If the line crosses two or more regencies in a single province, the province has primary authority. If the line crosses into two or more provinces, the MoT has primary responsibility. At lower jurisdictions, higher jurisdiction approvals are always required, even if there are no inter-jurisdictional issues. Moreover, adjacent regencies in a single province cannot cooperate in an SR project to bypass the provincial governor and MoT; and adjacent regencies located in separate provinces cannot bypass the MoT. The same rules apply to both railway PPPs and SRs. For example, the Central Kalimantan railway PPP is being conducted without MoT intervention. However, before the winning operator can begin operations it must receive advance preliminary, construction and operating approvals from the MoT before the main license at each level is issued by the Central Kalimantan government.

Licensing constitutes an economic barrier to entry; the more complex the licensing process, the greater the barrier to entry (and the greater potential for corruption). Indonesia's compromise between federalism and central authority inherently increases these barriers, so it is important not to multiply licensing complexity unnecessarily. In the European Union, where more than 360 train operating and railway infrastructure

licenses were issued between 1970 and 2002,[27] barriers have been reduced by enabling individual countries to adopt their own standards and by deferring to established network operating policies. A Ministerial Regulation concerning licensing should, if possible, permit consolidated review and approval of multiple licenses required, and limit the scope of secondary approval permits.

One particular consideration for Special Railways is whether the proposed SR operator should have to meet all organisational/control requirements ***prior to*** the issuance of an operating license. In some cases it may not be possible for the applicant to fully finalise its project structure before a railway operating license is issued (for example, some lenders may not be able to commit to financing until an entity has an established license for the activity being financed). As SR restrictions focus on the railway service, there is a strong argument that the MoT need not withhold preliminary and construction licenses pending evidence defining a qualifying SR control structure. If the MoT agrees with this view, an Article to that effect should be added to the proposed Ministerial Regulation.

2.5.1 National/Inter-Province Level

At the national or inter-province level, seven license steps are required to build a Special Railway. All licensing action is completed by the MoT. The related provinces and regencies have no formal role in the process. The license terms and steps under GR 56/2009 are contained in the following Articles:

- 352a (planning “in-principle” approval)
- 354(2)a (construction “in-principle” approval)
- 356(1)a (operations planning “in-principle” approval)
- 358(construction)
- 364a (network operation)
- 366a (railway operation)
- 369 (technical and safety)
- 373a (permit transfers).

2.5.2 Provincial Level

Seven license steps are also required at the provincial level,. The provincial government is the primary licensing agent, but all licensing action requires MoT pre-approval, post-

[27] Loris Di Pietrantonio and Jacques Pelkmans, *The Economics of EU Railway Reform* (2004), page 14.

approval or both. The license terms and steps under GR 56/2009 are contained in the following Articles:

- 352b (planning in-principle approval)
- 354(2)b (construction in-principle approval)
- 356(1)b (operations planning in-principle approval)
- 359 (construction)
- 364b (network operation)
- 366b (railway operation)
- 370 (technical and safety)
- 373b (permit transfers.

2.5.3 Regency

Principle based on Legal Sufficiency:

Investors require legal certainty, which is even more important in most cases than swift approval or avoiding limited constraints on operations.

Special Railway Applications:

Ministerial Regulations are far stronger if supported by specific Articles of Government Regulations.

Seven license steps are also required at the regency or city level. The regency or city is the primary licensing agent, but all licensing action requires Provincial Governor and MoT pre-approval, post-approval or both. The license terms and steps under GR 56/2009 are contained in the following Articles:

- 352c (planning in-principle approval)
- 354(2)c (construction in-principle approval)
- 356(1)c (operations planning in-principle approval)
- 360 (construction)
- 364c (network operation)
- 366c (railway operation)
- 371 (technical and safety)
- 373c (permit transfers).

2.5.4 License Simplification

In each of the above cases, consistent with the accompanying text box, we recommend that the Ministerial Regulation provide that the three in-principle licenses, while technically independent, can be issued in a consolidated filing. We also recommend that the network and railway operation licenses be filed jointly, since Law no. 23/2007 defines a Special Railway as an integrated railway combining infrastructure and train

functions. As noted previously, simplifying licensing has major public policy benefits in encouraging much needed private investment while reducing barriers to entry, project delays and opportunities for corruption.

2.6 UPGRADING SPECIAL RAILWAY INFRASTRUCTURE

Once a railway is built, the operator of an integrated railway (infrastructure and facilities or rolling stock) has many ways to increase the capacity of the railway. It can increase the size of trains, increase train speeds, use more powerful locomotives, and improve track configuration, among many other things. For a private railway employing private funds and operating lines not included in the railway master plan, these decisions should be left to the operator. We agree with proposed Ministerial Regulations that would require licensing agency approval only for railway line modifications that would change the scope of the licensed infrastructure. (This would include changes in the railway line that extend beyond the original licensing authority boundaries, and changes that impact other transport infrastructure.) Other railway improvements may be subject to minimum technical approvals but should not be subject to mandates by the licensing agency or to overruling management decisions on required capacity.

2.7 LEGAL LIMITS

Railway investors, like investors in other capital-intensive industries, seek to avoid regulatory risk. A Ministerial Regulation for Special Railways should thus be conservative with regard to the scope of its authority. Generally, if GR 56/2009 is silent on a subject, this Report recommends that the contemplated interpretation be included in a new or revised Government Regulation, rather than a Ministerial Regulation.

An important example here is a proposed Ministerial Regulation provision to enable the Minister under certain circumstances to allow an SR to carry goods for parties other than the original single producer, to connect with other private or public transport facilities without losing SR status, or to perform other functions that may be justified by absence of sufficient public capacity. Analogous provisions are available in seaport and airport regulations, but those fall under statutes other than Law no. 23/2007 and are supported by Government Regulations. We are not convinced that a Ministerial Regulation would, on

Principle based on International Best Practices:

Capacity decisions are best left to railway operators.

Special Railway Applications:

A Ministerial Regulation should minimize intervention in capacity improvement decisions that do not change the scope of railway infrastructure, impact health and safety, adversely impact the environment, or interfere with other transport.

its own, sustain legal challenge. HWTSK feels that this Ministerial right (if limited only to responding to requests from SR operators, rather than authorising MoT or local government mandates) could be valuable. However, prudence requires its incorporation in a Government Regulation, not a Ministerial Regulation.

CHAPTER 3: GUIDELINES FOR INVESTOR DUE DILIGENCE

Under the current regulations, an investor wanting to invest in the Indonesian railway infrastructure has three basic options:

1. Seek to work with the existing national railway, i.e., PTKA, to undertake a capacity expansion or line extension project
2. Initiate and/or seek to participate in a railway PPP project or
3. Apply for a license to construct and operate a Special Railway

These three modes of investment have all proven difficult to execute, as evidenced by the absence of any railway projects that have become operational to date. However, all three modes have been attempted in recent years. Both Bukit Asam and Adani approached PTKA with proposals for joint undertakings. Both initiatives were unsuccessful, in part because of the complex relationship between PTKA and DGR with respect to infrastructure funding. Around 12 railway PPPs are known to have been proposed in the last three years. Aside from the PTBA and MEC Special Railway initiatives addressed in the Interim Report, other SRs proposed recently or in the early planning stages include the proposed Pathway SR from mines in South Sumatra to a proposed private port in Bengkulu Province; the proposed Adani line within South Sumatra from the mining region to a private port near Api Api; a line from Puruk Cahu in Central Kalimantan to Balikpapan in East Kalimantan; and two pending SR applications in East Kalimantan.

3.1 ENTERPRISE STRUCTURE

The three modes of potential investment call for different enterprise structures, as indicated below.

3.1.1 Investment in expanding/extending PTKA Infrastructure

A decision to invest in expanding or extending PTKA infrastructure under current regulations requires, as a practical matter, that PTKA will control the assets to be developed. A negotiated joint venture would conflict with the SR rules on primary enterprise control and service exclusivity. PTKA would be unlikely to submit shared assets to PPP tendering. The most practical arrangement would therefore be one which provides for a contribution to PTKA infrastructure in exchange for favourable contract arrangements on PTKA rates and services. Typically, a shipper located near PTKA lines or an intermodal facility provider proximate to PTKA might best pursue this mode. In principle, an independent train operator receiving access to the national railway infrastructure might also seek to invest in that infrastructure. However, there appears to be little interest to date in doing so.

The advantage of this approach, where applicable, is that the party willing to invest in PTKA facilities need not apply to the MoT and/or a sub-national government unit in order for the project to be implemented. The enterprise would only need to be properly structured to serve its main line of business.

3.1.2 PPP Approach

The PPP process nominally applies only to the development of railway infrastructure, since that is the scope of authority under Perpres 67/2005 and Perpres 13/2010. The infrastructure manager must be selected by public tender under PPP, although the PPP proposal initiator is given certain competitive advantages. If the PPP were undertaken primarily to serve the needs of a dominant enterprise, that enterprise might compete to win the franchise to manage the infrastructure or support a close affiliate to do so. While such a close affiliation becomes more problematic where multiple enterprises are to be served, we note that the current PPP finalists in Central Kalimantan have affiliations with operators in the mining area to be served. Because the process is competitive, PPP competitors tend to be consortia that include the financing, construction and railway management expertise needed to address all aspects of project development. Indeed, all remaining competitors in the Central Kalimantan PPP are consortia. The tender winner will likely either have a qualified train operator as a member of its consortium or will have designated a contract train operator in its bid. It could elect to defer that selection, given the infrastructure focus of the PPP, but doing so would probably weaken the bid.

3.1.3 Special Railway Approach

Unlike the PPP's encouragement of consortia, the Special Railway vehicle requires a clearly defined SR operator with very close ties to the enterprise served – if it is not itself a department of the enterprise. Some of the current difficulties faced by MEC and Bukit Asam in obtaining SR approval are partly a result of inadequate due diligence to accommodate these requirements. As a result, the MEC and Bukit Asam cases described in Chapter 1 have compelled the MoT to explore somewhat strained interpretations of Law no. 23/2007 and GR 56/2009 in order to justify approval of the applications. As noted in Chapter 2, the merits of the expanded interpretations vary. Until clarifying language is adopted in new Ministerial or Government Regulations and new licenses are issued under these instruments, developers would be well advised to seek the license under the name of the enterprise served or as a subsidiary, and to structure their overall project accordingly. Construction, infrastructure management and train operations expertise should be engaged as contractors, not partners.

3.2 SPECIAL CONSIDERATIONS FOR MINING RAILWAYS

Virtually all of the current interest in Special Railways relates to mining operations, specifically coal mining. In January 2009 the GoI enacted a new mining law, Law no. 4 of 2009 on Mineral and Coal Mining (Law no. 4/2009, or the New Mining Law). Law no. 4/2009 transformed the old coal mining concessions (*Kuasa Pertambangan* or KP) into Mining Business Licenses (*Izin Usaha Pertambangan*, or IUP) and substantially simplified the range of coal extraction agreements. These changes may have a significant impact on how coal transport is conducted.

3.2.1 Mining Regulatory Framework

The definition of mining business under Law no. 4/2009 covers activities related to research, management and utilisation of minerals or coal, including general investigation, exploration, feasibility studies, construction, mining, utilisation and purification, transportation and sales, and after-mining activities. The law divides a mining business into mineral mining and coal mining. There are three types of mining business licenses:

- Mining Business License (*Izin Usaha Pertambangan* or IUP), the basic license
- Public Mining License (*Izin Pertambangan Rakyat* or IPR), a license to mine in a public mining area, with a defined geographic scope and investment
- Special Mining Business License (*Izin Usaha Pertambangan Khusus* or IUPK), a license to mine in a protected area

IUPs and these two alternate licenses are divided into:

- Exploration IUP, including activities of general investigation, exploration, and feasibility study
- Production Operation IUP, including activities of construction, mining, utilisation and purification, transportation, and sales

Every Exploration IUP holder is guaranteed an Operation Production IUP as a continuation of mining activities. IUPs are given to (i) business entities, (ii) corporations and (iii) individuals for only one type of mineral or coal. Business entities wanting to sell extracted minerals and/or coal that are not mining businesses are required to obtain a Production Operation License.

3.2.2 Potential Special Railway Impacts

A Special Railway seeking to purchase the coal it transports, which is a potential option to meet current regulatory requirements for SR operators, would need a Mining Business (Production Operation) License. However, if such a license were obtained by an SR, restrictions on transfer would apply. To transfer ownership and/or shares, the

holders must inform the minister, governor, or regent/mayor (the “authorities") to ascertain that the transfer is agreed by the authorities and does not conflict with the prevailing regulations. In addition, the time period for operating the railway would be limited to the term of the Operation Production License, which is 20 years, renewable twice for periods of 10 years each.

A further complication, which is both an opportunity for and a potential threat to a mining SR, is that IUP license holders are strongly encouraged to use the service of local and/or national mining service companies (IUJPs) to do all sorts of mining activities, including general investigation, exploration, feasibility studies, mining construction, transportation and many more activities. An IUP license holder using such a mining service company (IUJP) remains responsible for all mining business activities. However, the regulatory preference for an IUJP that has distinct local ownership may mean that an SR IUJP might not meet the GR 56/2009 standard of common SR ownership in order to qualify as an SR operator (although alternative means of qualifying, discussed elsewhere, may apply).

The New Mining Law provides that after five years of production, any legal entity whose shares are owned by foreigners must divest 20 per cent of these shares to the GoI, local government, state company, local company, or national public company. If a local company has 20 per cent or more of the shares from the outset, as is the case for MEC’s PT Tekno Orbit Persada (TOP) mine, no further divestment would be required. This provision could impact the legal status of an SR linked to a particular IUP holder that had not previously covered the investment contingency, as it the subsidiary status of the associated SR might be affected.

The State is deemed to have title to minerals in the ground and to mined and processed minerals and metals. Parties granted mining rights under the New Mining Law are in effect ‘contractors’ of the government and do not by virtue of holding mining rights acquire title to minerals in the ground. Parties holding mining rights for exploitation, transport and sale under an IUP are granted the exclusive right to sell and export mined minerals and retain the sale proceeds (assuming royalties and other payments to the GoI are paid in a timely manner).

On September 30, 2009, the Minister of Energy and Mineral Resources (MEMR) issued Regulation No. 28 of 2009 regarding Mining Service Business (Permen 28/2009). Permen 28/2009 implements certain provisions of the New Mining Law that relate to mining service business activities. To an extent, Permen 28/2009 redefines certain mining service business activities and practices that have been implemented in the Indonesian mining sector. For example, mining companies now have to undertake alone certain coal/mineral extraction and loading activities that have traditionally been contracted to mining contractors.

Local mining contractors are now given preferential treatment over foreign-owned mining contractors in securing mining service contracts, and there are stricter requirements for a mining company using subsidiary/affiliated mining contractors.

Permen 28/2009 still allows a large number of mining activities to be contracted out to mining contractors. However, certain mining activities – namely, coal/mineral extraction and loading – will have to be undertaken by the mining companies themselves. This has raised some concerns for both mining companies and mining contractors. For mining companies, their obligation to undertake their own coal/mineral extraction and loading means that they will have to procure their own mining equipment and make available the necessary manpower and expertise. For mining contractors, this same obligation means that they will lose a portion of their revenues. This change has required changes in Bukit Asam's arrangements for Special Railway transport, since the proposed railway was first linked to a mine contractor, whose activities may now need to be taken over by Bukit Asam directly.

A number of alternatives have been considered and discussed by Indonesian mining stakeholders to deal with such matters. One option is to have the mining contractors supply the equipment needed for coal/mineral extraction and loading activities on a 'dry-lease' basis. Effectively, mining contractors lease out the necessary equipment (whether on a fully maintained basis or otherwise) to the mining companies. Manpower would be excluded from such an arrangement because, if supplied, it would appear in substance that the lease arrangement was no different from an actual mining service contract arrangement, which is prohibited under Permen 28/2009.The mining companies would therefore have to provide their own manpower for the coal/mineral extraction and loading activities.

There are ongoing concerns on how to implement this separation of mining activities. Consequently, further changes in mining regulations and their interpretation could impact the relationship of an SR to the primary enterprise in the mining industry. It remains unclear whether an SR should become an IUP or an IUJP, or attempt to operate solely under MoT rules.

PART 2: GUIDELINES FOR NEW GOVERNMENT REGULATIONS

Careful MoT interpretation of existing Special Railways regulations, combined with investor caution in structuring proposed projects to comply with regulatory requirements, ***may*** suffice to allow some, if not all, pending projects to advance to the construction phase. However, there is no guarantee of that outcome.

- Land acquisition for the projects is not complete for any of the proposed lines. MEC is most advanced, with perhaps 85 per cent of the property obtained, while Bukit Asam and Adani are in a relatively early stage of acquisition. Negotiations with individuals, communities and local governments are continuing, as is obtaining Ministry of Forestry approvals for line segments crossing sensitive forest areas. SR applicants do not seek MoT intervention in these essential acquisitions beyond the approvals necessary to allow purchases or leases of property to go forward with limited risk.
- The business relationship between international and domestic investors in both mining operations and transport arrangements is proprietary and beyond the scope of MoT control, and may or may not be able to accommodate the project structures that best facilitate licensing.
- The external financing required for project implementation may or may not materialise.

As indicated in Part 1, under the current regulations, the MoT's ability to facilitate SR implementation is limited. Even assuming "best case" scenarios, it may not be sufficient to secure implementation.

CHAPTER 4: SPECIAL RAILWAYS SCOPE EXPANSION REQUIRING GOVERNMENT REGULATION

Chapter 2 addressed recommended interpretations that could make Special Railways more attractive to private investment and might be implemented under current provisions or within the scope of a Ministerial Regulation. Some of these changes might be better supported by a change in Government Regulation. In addition, a temporary GoI waiver of exclusive service requirements to offset inadequate public transport capacity has been accepted for both special/exclusive port terminals and exclusive private airports. While such a waiver would not absolve a special railway from meeting the service exclusivity requirements to be approved as a Special Railway, but might allow a licensed carrier to better serve the needs of the community in which it is located.

Although not itself an expansion of scope , GR 56/2009 is deficient in not having any language regarding adherence to environmental legislation, social impact mitigation, gender equality provisions, and so forth. Developers expect to be required to meet such requirements and prefer to have such measures explicitly enumerated. These matters should be covered in a new or revised Government Regulation.

4.1 IMPROVEMENTS TO GR 56/2009

There are several areas in which the proposed Ministerial Regulations discussed in Chapter 2 might be strengthened by revised Government Regulations. If the current regulations are to be amended by the waiver procedures discussed below, the proposed new Limited Public Railway option, or both, then these additional modifications should be implemented as well. These changes could be accomplished either by amending GR 56/2009 or by issuing a separate GR. Three of the most valuable changes are addressed below.

4.1.1 Reduction of Ownership Restrictions

A literal reading indicates that neither Law no. 23/2007 nor GR 56/2009 explicitly requires ownership, although such an interpretation is widely accepted. If the MoT decides to follow the course of accepting certain control measures, then specific guidelines for determining that control exists should be included in a GR Article, along with appropriate elucidation. Another Article should explicitly provide that subsidiary status is acceptable and should clarify whether (i) the primary business controlling the railway must be an Indonesian PT, (ii) the parent may be an offshore entity, and (iii) control may be determined through a chain of subsidiaries.

4.1.2 Point-to-Point Modifications

As noted elsewhere in this Report, the excess restrictiveness of the "point-to-point" rule was created by GR 56/2009 and was not required by Law no. 23/2007. A new or amended GR should liberalise this rule, as proposed elsewhere.

4.1.3 Simplification and Clarification of Licensing Articles

The following amendments to Special Railway licensing should be considered:

- Add an article that explicitly defines the minimum qualifications for an SR licensee
- Reduce the number of licenses and licensing steps required
- Limit the requirement to demonstrate SR ownership/control to the operating license
- Provide for transferability of licenses for conditions other than transfer of ownership of the primary enterprise, as currently provided

4.2 MINISTER'S RIGHT TO AUTHORISE USE OF SPECIAL RAILWAYS IN PUBLIC INTEREST

In combination with existing SR regulations and the PPP alternative, a new Limited Public Railway concept, outlined in Chapter 5, may accommodate potential private sector investment in railway infrastructure in most situations. However, this report also concludes that the public interest would be better served by permitting a Special Railway to voluntarily expand its services when requested by the government to provide a service in the absence of adequate public transport capacity. As noted above, the existing legal framework already provides for this situation in the port and airport sectors, but not in the railway sector. It is therefore recommended that a new or amended GR specifically provide details for the implementation of this option.

Principle based on International Best Practices:

While all national governments have inherent rights to mandate use of private property in event of true national emergencies, market economies sharply limit the scope of such powers to avoid investment disincentives.

Special Railway Applications:

A Government Regulation waiving SR limitations due to public capacity shortages should require the assent of the licensee.

Based on the rationale above, a GR should provide that the use of Special Railways for public benefit may be authorised with the permission of the Minister. This situation might be specified to apply in regions where no public railway transport is currently available, or where other transportation modes are inadequate or unable to serve the demand for land transport services. A GR provision detailing the power of the Minister

to make such a waiver may be viewed as an implementation of Article 150 of Law no. 23/2007, which authorises additional provisions through Government Regulation.[28]

The GR should provide that the permission to use special railways referred to above may only be implemented with the consent of the SR operator, and may only be given if:

1. The facilities are available on SR lines to ensure transport safety
2. Public use will not restrict the capacity of the railway to serve its original purpose and will not increase the cost of that service

The use of special railways for public use would be temporary and as needed to serve the public interest. However, the permit to use special railways capacity in the public interest should be extended automatically unless the licensing authority is petitioned to revoke the license by a duly licensed public railway.

Where a special railway operates in the same provincial jurisdiction as a public railway, assent for the use of special railways in the public interest should be based on cooperation between the special railway and public railway.

4.3 ENVIRONMENTAL AND SOCIAL IMPACT PROVISIONS

Activity Component 7 of the project's TOR provides for guidance related to environmental and social impact. In this regard, a detailed impact assessment is clearly quite project-specific for railways, as for infrastructure projects in general. Detailed assessment will be quite different for a railway in a low population but in a highly environmentally sensitive area, such as East Kalimantan's forests and wetlands, compared with a railway in a highly populated area in Sumatra with competing transport right-of-way, population and business displacement issues and greater air and noise pollution concerns. For policy consistency, the

Principle based on Legal Sufficiency:

While all businesses should comply with prevailing environmental and anti-discrimination statutes, and gender equality provisions, infrastructure development projects have particular responsibility due to their scale of potential impact.

Railway Applications:

The current Indonesian Government Regulation on railways is virtually silent on environmental impact and social mitigation measures, given the absence of substantial railway infrastructure development in recent decades. As development is encouraged, additional attention should be given to these issues by requiring affirmation of adherence to applicable legislation in the licenses issued under the proposed Government Regulation.

[28] *Ketentuan lebih lanjut mengenai angkutan perkeretaapian khusus sebagaimana dimaksud dalam Pasal 149 diatur dengan Peraturan Pemerintah.* [Further provisions concerning transportation services by special railway as referred to in Article 149 shall be regulated in a Government Regulation.]

environmental/social impact provisions for Special Railways (and other projects outside the PPP structure) should be consistent with those under Perpres 13/2010. Given that most new projects are likely to be in the mining sector, and that SR operators are likely to be IUP or IUJP holders, the environmental/social provisions should also be consistent with requirements in that sector. Having reviewed these regulations, we note that the provisions in the general sector regulations need not be complex, and can rely on references to legislation dealing specifically with environmental, social impact, discrimination and gender issues (e.g., Indonesia's Environmental Impact Assessment process, known as AMDAL). The proper place to refine these provisions is in the legislation that addresses those protections, not sector-specific regulations.

Railway regulations should not attempt to re-write environmental and social legislation. However, they should specifically require compliance with such legislation as a condition of the license. This is not explicitly addressed in the current railway regulations, most likely due to the absence of active project developments in the railway sector. This should be remedied by the GRs proposed in this Report, which should require licensees to comply with the existing laws on environmental impact, social impact mitigation and gender discrimination. One or more articles should be incorporated, with wording similar to the following:

> "Any party acquiring a construction or operating license under these regulations shall affirm that it will:

1. Abide by all existing legislation in the field of environmental protection and management
2. Obtain approval for all environmental documents required by legislation
3. Comply with all anti-discrimination and gender equality provisions applicable in its hiring practices
4. Implement required social impact mitigation measures that may be required by railway construction and/or operations"

Ministerial Regulations should provide more specific cross-references to mining and/or Perpres 13/2010 regulations that touch on these topics, as appropriate.

With regard to gender issues, non-discrimination in hiring practices should also be made a condition of licenses, and the process of land acquisition and routing approvals should be sensitive to the concerns of both female and male members of impacted communities. Ensuring that women's voices are heard with respect to the social impact of railway projects, however, requires not so much provisions in the railway sector regulations as measures to raise the level of gender sensitivity in community development programs in general. This is particularly true for projects in remote areas where traditional male-dominant cultures prevail. Railway sector regulations can call attention to prevailing legislation that should be complied with. They cannot effectively serve as the primary instrument of accountability for promoting gender equality. However, large international firms that do business in countries that have made greater progress in gender equality are likely to be responsive to license provisions on hiring and community impact. We do not think that a degree of affirmative action on

gender, negotiated as part of licenses, would be a substantial obstacle to investment. Regulatory language encouraging awareness of gender policy, such as that suggested above, is a small but important step towards gender equality goals.

Waiver provisions allowing Special Railways to extend services beyond the core business should provide opportunities for positive gender impact. Negative images associated with foreign exploitation of national resources, the impact of mining development and heavy haul railways serving mines frequently inspire developers to offset those images with community programs. A Special Railway seeking a waiver may properly be encouraged to make a case for a positive gender impact as part of a broader case concerning the need for expanded authority.

4.4 SUMMARY OF SPECIAL RAILWAY MATTERS REQUIRING NEW GOVERNMENT REGULATION

Each issue discussed above contributes to making a private investment in an SR project less risky and more valuable. We believe each recommended change is also in the public interest. A broader range of SR options could evolve under the proposed changes. A special railway could be financed based on a contract with a shipper (mine, agricultural company, or other business entity). The special railway company need not be owned by the mine or shipper. A group of shippers could form a company to serve as a trading company and, through a series of interlocking contracts, the group-owned trading company could sign a firm contract with the special railway company making financing of the special railway possible.

Next, with government approval, the special railway could be permitted to provide public services requested by the licensing authority at its option. The SR could negotiate with the licensing authority as to service terms and price. Should other mines need servicing, the SR could negotiate terms for those services and apply to the licensing authority for permission to extend the SR license to permit services to another mining development. The provisions of such an extension could be similar to those regarding special ports – a demonstration of limited alternative capacity and of the public benefit of the license extension. With specific respect to SRs serving mines, special railway licenses should remain in effect as long as the underlying mines continue to be licensed under the same IUP or extensions or modifications thereof.

These provisions might be progressively interpreted to allow special railway services to expand as long as such expansion is in the public interest. This would permit more rapid development of mines and plantations, since infrastructure could be shared if deemed in the public interest. The special railway might be able to provide public services if requested, provided the terms of service are agreeable to the special railway.

A new Ministerial Regulation can help put SRs on this path, but changes in Government Regulations will ultimately be required. If all these proposed changes were implemented, there might be less need for a Limited Public Railway (discussed in

Chapter 5). Incorporating waivers of SR limits to offset lack of public capacity into a new chapter of GR 56/2009 might be preferred both for ease of approval and to avoid conflicting Articles. On balance, however, this Report concludes that different context-specific situations may favour different regulatory mechanisms available under current law. The new provisions recommended in Chapter 6 should therefore be viewed as *in addition to* the GR reforms proposed in this Chapter.

CHAPTER 5: CONCEPT OF "LIMITED PUBLIC RAILWAY"

The current SR regulations offer an opportunity for private investment in the railway sector. But they also have serious disadvantages for investors. Nor do they allow the national economy to benefit from the optimum use of private investment in the rail infrastructure. The current legislation offers a private investor two options:

1. Develop and operate a fully integrated railway, providing infrastructure and train services for a single enterprise (i.e., the Special Railway). This requires that a single enterprise development be large enough to finance the rail infrastructure by itself.
2. Cooperate in a partnership with the government to develop public infrastructure on which it may offer public railway services subject to government regulation of tariffs and a range of restrictions that are inherent in the provision of public services (i.e., the PPP option). This option separates shippers from the rail investment and is likely to require some sort of government guarantee to find financing.

While both alternatives serve valid purposes, neither addresses the most fruitful circumstance for investment in railways. This occurs when:

- A willing and financially able private investor is interested to offer a railway service to support a core business opportunity, but which also seeks to capture a wider customer and revenue base to enhance the return on its investment and
- The public interest requires the accelerated development of railway transport infrastructure which does not conflict with existing railway master plans, but where public resources are not available to support such investments in a timely manner

The Limited Public Railway (*Perkeretaapian Umum Terbatas*) concept, defined in a Government Regulation and implemented in Ministerial Regulations, could better address these requirements in many situations.

Indonesian law divides railways into two categories: "*Perkeretaapian Umum*" (Public Railways) and "*Perkeretaapian Khusus*" (Special Railways). Limited Public Railways (LPR) would be a subcategory of Public Railways. The LPR concept would therefore have to be consistent with the concept of Public Railways under current law. Within this framework, we conclude that the concept of Public Railways would not conflict with the law and is legally sound.

A Limited Public Railway could be built by a private investment group not associated with a mine or business development. The LPR would need to have a contract with at least one major shipping enterprise to find finance. The LPR could serve a number of major shippers under contract terms and would be able to serve all points along its infrastructure. The LPR would not receive government support but could enter into contracts with governmental agencies at all geographic levels to provide services in the public interest. The LPR would be subject to access terms under the same mechanism

as its service to other shippers – through a negotiated contract. Government Regulations would define an access dispute mechanism to minimise rent-seeking by the LPR.

5.1 STRENGTHS AND WEAKNESSES: SPECIAL/EXCLUSIVE V. LIMITED PUBLIC RAILWAY

The accompanying table summarises the key strengths and weaknesses of the special railways framework and identifies the proposed alternative structure, described as a Limited Public Railway (LPR). Although not a complete substitute for the SR (which retains the advantage of being a fully integrated railway without access provisions) the LPR captures the SR's strengths and avoids most of its weaknesses. We then need to assess whether such an option is legally tenable so as to withstand legal challenge and due diligence analysis.

Special Railway Attributes Enhanced by Limited Public Railway		
Strengths	**Weaknesses**	**Recommended LPR Structure**
All investment and decisions on operational and maintenance aspects are fully within the control of the SR	Restricted to a tightly described service area, a point-to-point limitation, and a service limited to the core business activity of the SR licensee	Retains all responsibility for investment, maintenance and operational decisions; negotiates new business options comparable to public railway but without access constraints on core business
Not constrained by public sector tariffs, open access requirements, political interference or non-business priorities	Single product carriage restriction and ambiguity about the right to haul business-related but non-core products	Focus on core business efficiencies unconstrained by public sector limitations, with the right to negotiate access arrangements and tariff rates with third parties on a B2B basis without government intervention

The LPR would constitute a new category of railway service provider that satisfies the public railway characteristic of allowing more than one operator of railway facilities on the basic infrastructure, i.e., multiple access will be possible. However, the public railway attribute will be overlaid with the special railway characteristics of a private business-oriented service, with the key attributes of:

- Private investment-oriented decision making
- Exclusion of state financial support or the need for formal state participation
- Ability to limit access to the railway infrastructure

- Ability to allow multiple railway service providers under terms acceptable to the LPR investors
- Ability to carry a range of products and service a number of shippers at the discretion of the entity

A simple benchmark test for license planning principle approval is proposed: The Limited Public Railway would be required to demonstrate that the proposed investment creates a public benefit that is in the national interest.

The overriding characteristic distinguishing a "Limited" Public Railway from a Public Railway is the concept that, while multiple access to the public railway infrastructure will be possible (as in the case of a public railway), specific access to the infrastructure will be limited at the discretion of the LPR, bounded by conditions contained in the operating license.

5.2 LEGAL ATTRIBUTES OF PROPOSED LIMITED PUBLIC RAILWAY

Such a limited access service with public railway characteristics could be appropriately named a Limited Public Railway (*Perkeretaapian Umum Terbatas*). This will permit private investment in railways that is structured to be consistent with the public railways policy expressed in Law no. 23/2007. The Limited Public Railway would allow the separation of infrastructure and railway operations functions, as mandated for public railways.[29] At the same time, it would provide the investor with exclusive use of the railway operating equipment in which it has invested, to be deployed free of tariff oversight for the core services enumerated in the operating license. A framework process for access by third party operators would be described in the investor's operating license. If it so chose, the operator could voluntarily operate such tariff services as might be approved by the licensor. A summary of this concept is provided below.

5.2.1 Definition and Scope

The Limited Public Railway would, as in the case of a special railway, be based on a proposal wholly initiated by business investors or a consortium. Unlike a PPP Railway, the regency, provincial and central government would be act as licensing agencies, with responsibilities determined by the established relationships among these authorities, rather than acting as a procurement agency under a tender process, as occurs in a PPP project. A series of sequential licenses similar to those contained in Articles 350-376 of GR 56/2009 concerning Special Railways could regulate the third party services engagement process, with one important qualification.

[29] Law 23/2007, Article 17(1) and Article 50(4).

In the drafting of a Government Regulation to establish the proposed new category of Limited Public Railway (LPR), one objective should be to simplify the license application and approval granting process by bundling together licenses that have common attributes. For example, apart from the first activity planning principle approval, the construction in-principle approval and construction license might be combined in a single two-step process. Similarly, the operations planning in-principle approval, network operation and railway operation licenses might be combined in a single three-step process. This would reduce the total number of licenses to be secured at the start of the LPR process to five:

- Planning In-Principle Approval
- Construction In-Principle Approval and Construction
- Operations Planning In-Principle; Network Operation and Railway Operation
- Technical and Safety
- Permit Transfer

The same criteria that determine which government authority has primary responsibility for SR license approval would apply to the approval of Limited Public Railway licenses. The following process is recommended for seeking approval from the relevant government licensing authority (national/inter-province, provincial and regency).

The private sector business investor seeking to initiate the LPR first applies for LPR Planning In-Principle Approval. The applicant should propose the scope of its proposed limited railway service. The limited purposes to be served may be defined by commodity, at least in part, or by industry. However, but unlike a special railway, the LPR would not be limited to a serving a single enterprise on a point-to-point basis. While the license would identify the core transport activities of the LPR, the Planning In-Principle Approval would specify that the transport of other products or the provision of services to or by other parties shall be clearly authorised. The licensing agency may seek to modify the investors' proposed scope of service only on the grounds of national interest or public benefit. The resultant Planning In-Principle license and the following licenses would reflect a negotiated agreement between the licensing authority and the applicant.

The licensing agency would affirm that the proposed railway services fill a gap in transport capacity, which is another element of the "limited purpose" being proposed to be provided. Conceptually, this is similar to the rationale of the MoT in allowing a private port terminal to serve more than one enterprise.

An important condition for issuing an LPR Planning In-Principle license and all related licenses should be that State funding for the railway infrastructure project is expressly excluded for the LPR. This is another factor distinguishing the LPR from a PPP railway. This restriction reduces the need for the tender process safeguards contained in Perpres 13/2010, further distinguishing the LPR project process from that of a PPP railway.

5.2.2 Vertical Separation Provisions

Since the Limited Public Railway will be established as a public railway, infrastructure access is required to endow the railway with a public character. We recommend that the access provisions be administered by the responsible licensing authority, based on terms negotiated with the private sector investor. Provision of access rights (a) eases concerns over potential "monopoly abuse" of a pure integrated private sector railway, and (b) renders government regulation of contracts or tariffs unnecessary. In other words, actual or potential competition at the infrastructure access level should render end-price regulation unnecessary as a matter of economic theory.

Any third party railway service that seeks infrastructure access should not be constrained by the scope of service of the incumbent railway operator/investor. For example, the initial investor might be authorised, upon approval of its application to serve two specific coal mines, to provide a passenger service from the mining area to the regency capital at its discretion. Another railway operator might seek access to the infrastructure under the terms provided in the license in order to serve a third coal mine or another industry along an extension that this other operator would build. The original operator may elect to offer a competing service at its discretion.

To protect the investor's interest, there would be no public entitlement to use the investor's railway facilities, rolling stock and equipment. The investor should only be obliged to make locomotive or rolling stock available to third parties under license-specified national emergency conditions. Railway rolling stock costs are mostly variable (since rolling stock can be leased), so there should be no major barriers to entry, provided that infrastructure access terms are negotiated and mutually agreed between the parties.

5.2.3 Local flexibility in project and license approval

International best practice demonstrates that private investment in railways is encouraged by local government control over the approval/licensing practice, since the local jurisdiction typically has the greatest interest in the benefits of private railways. Private-investment railways are often located entirely within a single province, state or similar jurisdiction. Such jurisdictions are able to promote development through a range of land acquisitions and local permit requirements. Historically, the main drawback associated with local jurisdictions taking the lead in private railway licensing has been a tendency to create excess railway capacity when multiple jurisdictions are competing to promote economic development. At this time in Indonesia, however, given that there are no privately operated railways or capacity shortages on public lines, excess capacity is not a major concern.

For the above reasons, the primary licensing authority (regency/city, province or, for inter-province railways, the MoT) should have authority to negotiate the terms of the LPR license with respect to the definition of core services, the framework for third

party access and the arrangements under which the LPR might expand its service beyond the scope of the original license.

5.2.4 Dispute Resolution – Risk Minimisation

To minimise perceived investor risk and facilitate private sector financing, there are two areas in which the legal framework should be sufficiently specific to create certainty in the mind of the investors and their financiers. These two areas relate to (i) the process for acquiring third party access, and (ii) the applicable dispute resolution process.

- The negotiation process for the LPR operating license should be specified in the Government Regulations that introduce the Limited Public Railway concept. The description of this process should clearly specify that all commercial terms between the parties are solely a matter for negotiation between the private parties, but a dispute resolution process should also be specified.
- In case of a dispute between the LPR and a third party seeking access to the LPR, after a failure of business-to-business negotiation, the dispute should be referred to the competent anti-monopoly authority (KPPU) and thereafter be subject to judicial decision in Indonesia.
- In case of a dispute between the licensing authority and the LPR, the dispute may be decided on by the administrative court and thereafter be subject to judicial decision in Indonesian courts.

5.3 ISSUES RESOLVABLE THROUGH LIMITED PUBLIC RAILWAY OPTION

A number of issues flowing from Law no. 23/2007 and GR 56/2009, as well as other parts of the legal framework defining railways, need to be resolved in order to facilitate and encourage private investment. Several principles of best international practice are recommended for adoption in the legislative reform agenda, which could transform the ranking of Indonesia's railway infrastructure sector for discretionary private investment in the East Asia region from that of a laggard to a leader.

The following table lists some features of the current legal framework for railway infrastructure investments that deter private investment. The proposed LPR and government regulations concerning Special Railways will address these detrimental features.

Key Issues of concern to stakeholders under the current legal framework	Proposed reform agenda expressed in terms of key principles to be incorporated in new GR
Law no. 23/2007 Art. 5(1)(3), and GR 56/2009 Art. 38(3) Special Railway must be used exclusively by a certain legal entity to service/support the main activity of that certain legal entity; it may not service the public.	The LPR will be owned and operated solely by private investors – i.e., with no government financial support, equity participation or subsidy – to provide railway transport services to a business entity or business entities named in the operating license, or which may subsequently be included in such license at the request of the licensee and approved by the licensor, on the grounds that the ambit of the license is in the national interest and for the benefit of the local people. In the event that the licensing authority does not agree to the provision of the LPR service being applied for, the onus is placed on the licensing authority to disprove that the LPR is in the national interest and will benefit the local people. In case of a dispute between the licensing authority and the applicant for an LPR service or the holder of the license to operate the LPR, the dispute may be delivered to the administrative court for a decision and thereafter shall be subject to judicial decision. In case of a dispute between the licensee of the LPR and a third party seeking access to the LPR, after a failure of B2B negotiations, the dispute shall be referred to the competent anti-monopoly authority (KPPU) and thereafter is subject to judicial decision in Indonesia.
Law no. 23/2007 Art. 7, 19 and 49(2), and GR 56/2009 Art. 6(1), 12, 21 and 30 Public Railway must be described in the relevant Railway Master Plan.	The LPR is distinguishable from a Public Railway due to its inherent characteristic of not being required to provide unlimited public access, while its particular services are licensed and approved by the relevant government authority notwithstanding that it is not described in the relevant Railway Master Plan. The railway must not conflict with the Railway Master Plan. Once the railway has been approved, the government may incorporate the railway in the revised Railway Master Plan.
Law no. 23/2007 Art. 17(2), and GR 56/2009 Art. 39(2) Special Railway requires that the infrastructure operation and the facilities be integrated and conducted by the same business entity to support its primary business activity.	The LPR may allow facilities such as rolling stock to be operated by other licensed legal entities at its discretion, subject only to compliance by all parties with national technical standards and standards for safe operations.

Key Issues of concern to stakeholders under the current legal framework	Proposed reform agenda expressed in terms of key principles to be incorporated in new GR
GR 56/2009 Art. 306 and 307 Appointment of the operator of a Public Railway infrastructure shall be subject to regulation under the PPP process.	The application by a legal entity to construct, build and operate an LPR may be made through an unsolicited application to the appropriate licensing authority pursuant to the conditions and process specified in the LPR license application requirements. It shall not be subject to competitive tender requirements or conditions other than (a) the applicant must hold a business license, and (b) the applicant must establish to the reasonable satisfaction of the licensing authority that it has the business acumen and financial capacity to undertake the proposed LPR.
GR 56/2009 Art. 308 and 364(2) Under the SR regulation (Art. 308), the operation license shall be valid as long as the core business activity continues. Under Art. 364(2), the Public Railway operation shall be stipulated in the PPP concession agreement.	The terms and conditions of the operating license shall include the duration of the license, which shall be agreed by the licensing authority with the applicant. This license shall govern, and its validity may be extended or augmented by mutual agreement with the licensing authority, which agreement shall not be unreasonably withheld.
GR 56/2009 Art. 310(j) and 311 Ownership of the SR and Public Railway infrastructure shall be transferred to the government upon the expiration of the SR operating license or the termination of the PPP cooperation/concession agreement (no detail is provided on the terms of this transfer).	The transfer of ownership of the LPR infrastructure at the conclusion or termination of the operating license shall be governed by the terms and conditions of the license, which shall include the specific negotiation of termination conditions based on mutual agreement.
Law no. 23/2007 Art. 152(1)(2) and 155 The tariffs for carriage and access charges shall be calculated based on guidelines issued by the central government.	The charges for carriage of goods on and access to the LPR shall be negotiated on a bB2B basis between the parties by considering guidance issued by the government. The guidance issued by the government shall not be restrictive.
Law no. 23/2007 Art. 50(4), and GR 56/2009 Art. 71 A Public Railway shall be subject to open access by one or more operators of railway facilities on terms to be approved by the operator of the railway infrastructure.	Access to the LPR shall be open but limited to suitably qualified parties on terms and conditions to be negotiated between the LPR applicant or license holder and third parties on a B2B basis, subject to a decision by the licensing authority that such access and operations are in the national interest and for the public benefit.

Key Issues of concern to stakeholders under the current legal framework	Proposed reform agenda expressed in terms of key principles to be incorporated in new GR
GR 56/2009 Art. 317(1) Land to be acquired for the purpose of the Public Railway shall be paid for by the government or the PPP business entity on terms to be specified in the concession agreement.	The private investors in the LPR shall be solely responsible for the purchase of all land required for the LPR and all incidental costs.
GR 56/2009 Art. 350 A special railway is restricted to operations within the principal business area of the licensee or to a point in a supporting area (the point-to-point restriction). A Public Railway has no restrictions of a point-to-point nature.	The LPR operator shall be free to operate its railway transport services to and from all locations named in its operating license, including any intermediate locations along the railway alignment. The operator may apply at any time to the licensing authority for approval to extend the LPR services to other parties and other locations on the basis that such services are in the national interest or for the benefit of the local people.

5.4 AUTHORISATION OF LIMITED PUBLIC RAILWAYS

Several aspects of Limited Public Railways should be clearly regulated in a Government Regulation, as summarised below.

5.4.1 Railway line

A Limited Public Railway line is a railway line that is not included in the railway master plan, but also does not contravene the railway master plan. Any railway line mentioned in the railway master plan should be developed through an ordinary PPP process as provided in Perpres 67/2005 and Perpres 13/2010.

5.4.2 Rolling stock

A company having a license to operate an LPR railway line may also operate rolling stock. However, LPR train operations should be separately licensed, and are not required to be exclusively integrated with infrastructure operation, unlike Special Railways., in other words, an LPR has the discretion to allow rolling stock owned by another party to be used on its infrastructure.

5.4.3 Business entity

Any business entity incorporated in Indonesia may apply for a license to develop and operate an LPR. In its application, the business entity should clarify the purpose of the railway, and which companies it will serve. Supporting letters will be required from the companies to be served.

5.4.4 License

The licenses needed by a business entity to develop and operate an LPR are the same as for a general public railway, as follows:

Licenses needed for infrastructure operation:

- Business license
- Construction license
- Operation license

Licenses needed for operation of facilities:

- Business license
- Operation license

However, in the case of an LPR, there will be no partnership agreement between the business entity and the government (unlike a PPP railway chartered under Perpres 13/2010). The relationship between the business entity and the government will be based only on the license terms.

5.4.5 Authority

The authority entitled to issue an LPR license is the same as the authority entitled to issue licenses for general railways. In other words, the licensing authority should follow generally established policy under the decentralisation legislation.

5.4.6 Procedure to appoint railway infrastructure operator

Since an LPR will be fully financed by private investors and used to serve specific companies, the private business entity will not be appointed through a tender. Instead, the government will directly negotiate the terms of the required licenses with any company that submits an application and satisfies the qualification requirements.

CHAPTER 6: CONTEXT-SPECIFIC PROCEDURAL AND ORGANISATIONAL GUIDELINES

The preceding chapters present several ways to encourage private sector investment in railways. This is consistent with the expectation set out in the project TOR that different context-specific procedural and organisational guidelines may be required to provide adequate incentives for railway development (Activity Component No. 4 in the TOR). Four key options are recommended:

- The current Special Railways provisions, accompanied by a liberalised interpretation of ownership requirements and a relaxation of point-to-point restrictions
- The PPP option under Perpres 13/2010
- Authorisation for the Minister to waive exclusive service restrictions where the existing public rail service is inadequate
- Development of a broader Limited Public Railway (LPR) option, where development of an economic sector such as coal mining would benefit from a multi-user private railway development, and where the general public might be better served if train operator access could be negotiated

Referring to our earlier discussion, under Indonesian law, the primary authority for licensing varies in each of these cases, depending on whether the activity is located within one regency, one province, or is inter-province.[30] In the accompanying hypothetical map, a movement from Point A to private port P1 would be the primary responsibility of Regency A, but an extension of the line to point B would make it the primary responsibility of Province 1. A further extension to Point C would make it the primary responsibility of the MoT. Each lower-level approval, however, requires pre-approval from the higher jurisdictions, such that A-P1 would require both provincial and MoT approvals of the regency license, while B-A-P1 would require MoT pre-approval of the provincial license. In addition, GR 56/2009 provides for SRs to be integrated as public railways when they interchange traffic with a public railway or another SR. On the map, routes BA, BC, B-P2 and B-P1 could each be Special

[30] See Law No. 32 of 2004 on Regional Governance and Law No. 33 of 2004 on Central and Regional Fiscal Balance.

Railways, but if either B-P2 or B-P1 exchanged traffic with a public railway (represented by the dashed line), it might have to be re-chartered as a public railway. Under current rules, no SR could serve the public port represented by PP. While the rules need further clarification in a Ministerial Regulation, movement from point A to point C might also require re-chartering as a public railway, though it is also possible that a merger might allow the combined route to remain an SR. Finally, under the point-to-point rule, it is possible that an SR from B to P1 might not be allowed to serve Point A.

Given this context, the following context-specific guidelines are recommended for consideration.

6.1 RAILWAY IN A SINGLE PROVINCE OR LOWER-LEVEL JURISDICTION

The current procedures for approval of SRs are reasonable, and would also be appropriate for an LPR. However, in the spirit of Indonesia's decentralisation statutes, it is recommended that provinces and regencies be permitted wide latitude in determining the qualifications of licensees and the terms of licenses. As addressed elsewhere in this Report, the crucial license for determining whether an SR operator is appropriately qualified is the operating license. We think it appropriate for the MoT to defer to the province and regency on the prior issuance of licenses to parties deemed acceptable at the sub-national level. Any reservations the MoT might have over operator qualifications can be addressed, if necessary, by the conditions in the operating license. This procedure would reduce delays while allowing for the necessary MoT oversight. This Final Report finds MoT approval of preliminary licenses to PT Trans Kutai Kencana to have been acceptable based on these considerations, although ownership complexities still need to be resolved, pending a clarifying Ministerial Regulation.

This Final Report also recommends simplifying the licensing steps by consolidating the licensing procedures, even where technically separate license approvals are required (e.g., the three separate "in principle" licenses might be addressed in one consolidated process).

6.2 RAILWAYS CROSSING BETWEEN PROVINCES

While under a federal system, local jurisdictions might cooperate in a railway project without central government approval, under current Indonesian law approval of such projects is the MoT's responsibility. Current SR procedures are acceptable for SRs and would also be appropriate for an LPR or PPP. As in the case of sub-national projects, this Final Report finds deferring resolution of ownership issues to the final operating license to be acceptable, although early resolution is highly desirable from a financing standpoint. The MoT licensing procedures being used for the proposed Bukit Asam railway are acceptable.

6.3 CONNECTING SPECIAL RAILWAYS AND RAILWAYS NOT LINKED TO A PUBLIC RAILWAY

Where a proposed railway is not linked to a public railway, it is recommended that the proposed developer be allowed considerable discretion in terms of track standards, gauge, and rolling stock, subject to a demonstration that the infrastructure design and equipment standards meet generally accepted international standards. This policy will contribute greatly to accelerated project implementation.

Ministerial regulations regarding the treatment of connecting SRs will also help clarify the rights of each special railway and result in a more efficient railway infrastructure. Special railways should be able to interconnect but still remain private entities. Special railway entities should be able to reach commercial agreements on sharing portions of each other's railway to provide transport services for their underlying customers.

The shared portion of the special railway would become a privately-owned public railway over which other rail transport services could be provided and to which other rail service operators would have access under commercial terms agreed with the special railway owner. Under this provision, for example, another mine in East Kutai province could construct a special railway connecting to MEC's special railway if both railway enterprises could reach commercial terms on common-use segments (which may include common investments for providing additional capacity on the common-use segment). Such regulations will increase the value of and returns to private investment while providing increased public benefits.

Where there is no link to another special railway or the public railway network, the waiver process noted in Chapter 4 may be especially appropriate, as a simplified way of expanding the public benefit of a private railway development. For example, in the case of the MEC project in East Kutai, both the proposed developer and the regency indicate that they would be amenable to the SR providing limited cargo and passenger services to third parties. There appears to be no obvious public policy reason why they should not be allowed to do this. A waiver policy similar to that for special port terminals seems an especially attractive option in this case.

6.4 RAILWAY LINKED TO A PUBLIC RAILWAY AND USING PUBLIC RAILWAY ACCESS

Current policy provides that a Special Railway connecting with a public railway (or another SR) becomes integrated with it and is converted to a public railway. There is some ambiguity as to whether this integration requires only integration with public safety, maintenance, equipment and/or operating standards, or whether it also removes SR exclusivity restrictions and obligates the former special railway to provide access to other transporters, publish tariffs, and otherwise behave as a public railway. This Final Report generally concludes that the integration requirements regarding standards are acceptable and can be accommodated in a modified license. The latter form of integration – fundamentally changing the business of the former special railway – is unwise, as it increases investor risk and could amount to a "taking of

property" if assets acquired in an SR agreement are diverted for public purposes. Rather, Ministerial regulations ensuring the continued private ownership and use of the special railway would better serve the public interest. While connecting with the public network should entail access provisions for other rail operators, such access should be provided under commercial terms agreed by both parties and not be subject to government regulation on access prices or conditions.

Regulations amplifying the integration requirements should specify that any changes to the nature of the train service offered by an SR must be voluntary on the part of SR operator, and that any access granted to third parties should be voluntarily negotiated. Such changes should be explicitly excluded from the Minister's authority under a Ministerial Regulation. These limitations should apply to both Special Railways and Limited Public Railways, and should apply whether the integration is with the national public railway, a PPP, an LPR or an SR. International practice is to allow private railways to connect with public railways without any change in business structure or status (see Appendix D). This policy contributes to the cargo (or passenger) volumes on the connecting railway, and an overall improvement in the health of the railway network.

The waiver process described in Chapter 4 may be more important in an environment like East Kutai, where the case for broader service based on lack of public capacity is obvious. It may be somewhat less attractive in environments like South Sumatra and Lampung, where the private railway is located near a public railway and could be integrated with it. In the latter case, the proposed LPR concept – which provides for separate infrastructure and train operations, unlike the SR – might be the preferred option, allowing connecting lines to operate over separate infrastructure by mutual agreement.

6.5 RAILWAY INVOLVING A SINGLE FACILITY OPERATED BY A QUALIFIED LEGAL ENTITY

For a railway involving a single facility, the existing SR provisions may be adequate, assuming a more liberal interpretation of the ownership requirements. That said, any exclusive ownership requirement is essentially redundant to the service exclusivity requirement. This Final Report finds no public purpose in applying any ownership limitation to a railway license issued to a railway serving a single facility. Such a limitation would only create uncertainty for financing sources and could force investors into sub-optimal project structures. One of the advantages of the LPR option is that it can avoid this constraint.

6.6 RAILWAYS INVOLVING MULTIPLE FACILITIES OPERATED BY A QUALIFIED LEGAL ENTITY

Under the SR rules, railways cannot serve multiple facilities unless (a) an association or consortium of businesses is accepted as a qualified SR sponsor or (b) a waiver

procedure is adopted, as described in Chapter 4. Both options may be subject to legal challenge, while the conceptual basis for a waiver (inadequate public capacity) necessitates that waivers be relatively short term. Both options raise the risk profile for investors. In these circumstances, the LPR would be a superior option to a potentially controversial interpretation of SR scope.

6.7 INTERMODAL CONNECTIONS WITH PUBLIC OR PRIVATE PORTS

This Final Report acknowledges the rationale for the limitations on Special Railways and, separately, for Private Port Terminals. Such limitations serve to protect public railway and port investments, respectively. While we feel that such protectionism is sub-optimal in the long run, it was incorporated into the applicable laws for an arguably defensible purpose of protecting major public investments.

On the other hand, there is no economic rationale for limiting a special railway to service through a special port terminal. A public port with excess capacity would benefit from traffic brought to it by an SR. An SR able to serve an existing public port will shed investment costs and enjoy enhanced project feasibility. The ability of an SR to use public ports will tend to eliminate inefficient, redundant investment that might otherwise result in excessive, underutilised facilities with undue adverse environmental and social impacts. All of these outcomes are public benefits. Wherever possible, revisions of the regulations should eliminate the unfortunate linkages between the two restrictive regulatory regimes.

CHAPTER 7: LONG-TERM STRATEGY

The preceding chapters have proposed three specific areas of legal reform, to be embodied in:

- A Ministerial Regulation to address uncertainties inherent in or flowing from the implementation of Law no. 23/2007 and GR 56/2009. (See Part 1, Chapter 2.)
- A new Government Regulation, or a revision of GR 56/2009, to (a) address and amend areas of concern in GR 56/2009 that might be beyond the scope of a Ministerial Regulation, and (b) permit the waiver of Special Railway service restrictions where there is a lack of public transport capacity.
- Establishment of a sub-category of public railway called the Limited Public Railway, designed to address a lack of public railway infrastructure while securing economies of scale for private investors, macro-economic benefits for the national economy, and benefits for the local people.

These three initiatives should make Indonesian railway regulation substantially more attractive to private sector investment. We do not consider that any changes in Law no. 23/2007 are needed to achieve the above changes or are urgently required for other purposes related to this study. We do, however, believe that useful longer-term changes could be made to this law with respect to private investment when the law is being revised for other purposes.

7.1 PHASE-OUT OF SPECIAL RAILWAY PROVISIONS

The overly restrictive provisions on Special Railways in Law no. 23/2007 have inhibited private investment in railway infrastructure. As an archipelago nation, Indonesia already faces many obstacles to railway expansion:

- Relatively short hauls
- Barriers to domestic and international railway interconnections
- Dependence on intermodal transfers for much traffic
- Constraints on land availability on densely populated islands
- Insufficient population base to support railway services on islands with sparse or widely dispersed populations.

Adding to those constraints, the current legislation includes a number of policy and regulatory disincentives for potential railway investment – restrictions on scope of service and ability to expand railway services to meet commercial needs, a multi-tiered approval and licensing process, ownership restrictions, and other development barriers.

If the concept of a Limited Public Railway is accepted on the grounds of good public policy and consistency with good international practice, and is established by Government Regulation, as proposed, it is recommended that if and when an opportunity arises to revise the railway law, the category of Special Railway (*Perkeretaapian Khusus*) be eliminated. In that event, all Special Railway licenses should be converted to Limited Public Railway licenses without prejudice to any ownership/operating rights under SR rules. Railways established as integrated infrastructure/train services could remain so or might voluntarily offer third party access. Service could remain limited to transport functions performed as an operating division or subsidiary, or wider service could be introduced on either a contract or tariff basis. No changes in ownership arrangements would be required. It seems unlikely that this status conversion would have negative repercussions. Even if it did, any negative impact would certainly not be enough to offset the additional commercial opportunities that would be created.

This recommendation has an additional benefit. It would shift the balance between projects within the Railway Master Plan framework and those outside the government planning process. More projects might be anticipated from the private sector to respond to specific commercial opportunities. While private railway investment would result in fewer Railway Master Plan (Public Railway) projects as a percentage of total railway developments, it is likely to support greater public railway investment in absolute terms. Few Master Plan projects are currently being implemented, which is partially due to an acknowledged shortage of public funds. Private investment in lines that can generate greater traffic on the national network can only increase the feasibility of public Master Plan projects.

Privately-funded initiatives outside of the Railway Master Plan framework, but not conflicting with it, could reduce public funding requirements and increase prospects that a master plan project could be self-sustaining. A good example is the Central Kalimantan PPP program. With the elimination of the restrictive SR provisions, numerous branch lines to individual IUPs, which face a change of status and additional licensing procedures if connected to the PPP, might attract significant private interest in developing those branches. The positive impact on the associated mines could be significant and immediate.

7.2 MEASURES TO PROMOTE PRIVATE INVESTMENT IN OR WITH THE NATIONAL RAILWAY

The present study found little interest in private sector investment in the national railway network, in regard to:

- Line extensions to the national network
- Joint-venture projects that might be developed in partnership with PTKA) or the DGR

- Projects which would operate partly on private sector infrastructure and partly as a train operator through access to the national railway infrastructure
- Operating portions of the national railway network under a concession

All these forms of private sector involvement in railways are common in other countries. The lack of interest in Indonesia appears to stem in part from an unresolved division of responsibility between the DGR and PTKA, including the proper allocation of assets between them, which is partly because the present law (Law no. 23/2007) does not clarify its intent on these issues.

A Government Regulation can, in principle, implement the law in these areas even if the intent of the law is not explicitly stated. However, the political sensitivity associated with private sector involvement in a traditional public utility is such that legislative guidance is typically required (most notably on the concession option). In the case of potential private sector railway investment in southern Sumatra, there is significant potential for sub-optimal investment if the private sector is unable to cooperate with PTKA/DGR and instead builds parallel infrastructure. While this study strongly supports liberalisation of the regulations governing private sector investment in railways, we would also support providing greater policy guidance for public-private railway cooperation in any future legislative modifications of Law no. 23/2007.

CHAPTER 8: PEER REVIEW COMMENTARY

Given the policy importance of the conclusions and recommendations of this study, IndII chartered two formal peer reviews of this Final Report in addition to reviews and comments by IndII staff and Indonesian project reviewers. These formal reviews were by the law firm of Makarim & Taira and URS Australia, Pty. Ltd. (Author, David Lupton).[31] HWTSK is pleased that, as a whole, the reviews of the Final Report are generally positive. We have not changed major findings and recommendations as a result of these reviews, but take detailed points of disagreement seriously and address them herein.

8.1 MAKARIM & TAIRA REVIEW

We find Makarim & Taira's review to be generally supportive of our findings in many respects, but generally more conservative in terms of its willingness to consider interpretations that might be adopted within a Government Regulation, as opposed to a change in Law no. 23/2007 itself. For example, the authors state as follows:

> "We do not believe that a new Permen and/or PP [GR] would be sufficient to relax the legal constraints imposed in connection with the use and operation of a[n] SR. Given the current wording of the Railway Law, we believe that an amendment to the law itself would be preferable."

Similarly, with respect to the Limited Public Railway concept, Makarim & Taira conclude that:

> "…some of the more fundamental reforms – including the proposed creation of a new category of Limited Public Railway (LPR) and the proposed relaxation of the operation and exclusive use requirements currently applicable to Special Railways (SR) – would require changes in Law no. No. 23 of 2007 (Railway Law)."

The study team believes both statements require qualification. The Final Report agrees with Makarim & Taira that the limitation of an SR to exclusively serving a single enterprise cannot be eliminated without a change in Law no. 23/2007. We believe, however, that the scope of an "enterprise" may be open to broader interpretation and that there is a more well-established precedent for waivers of service scope in a broader sense than is acknowledged by Makarim & Taira.

[31] Makarim & Taira S. (Guy Des Rosiers and Hendri Naldi), *Peer review report for SR guidelines (Activity #225)* Memorandum, 28 January 2011 and URS Australia Pty (David Lupton), *Initial Independent Review: Guidelines for Special Railways Phase II* (January 2011).

Further, since Law no. 23/2007 does not specify common ownership of the "primary enterprise" and its railway (or use the term "ownership" at all), this leaves more room for interpretation than the legal review admits. Nonetheless, we agree that many desirable changes in the Special Railways provisions cannot be fully accomplished without a change in Law no. 23/2007. That is why we agree with David Hawes (see later in this chapter) that the most fundamental reforms that can be achieved without a change in Law no. 23/2007 are best achieved through the Limited Public Railway concept, rather than the Special Railway provisions.

As stated above, however, Makarim & Taira also concludes that implementing the Limited Public Railway (LPR) would require a change in Law no. 23/2007. We would agree with the Makarim & Taira statement on LPRs, if the last clause were worded "..may be subject to legal challenge and would be most effective with changes in Law no. 23 of 2007 (Railway Law)." With due respect, HWTSK believes that the constraints are overstated.

The three concerns that are cited by Makarim & Taira with regard to the LPR option, while perhaps posing potential disadvantages for LPR investors in some respects, are not rooted in specific prohibitions under Law no. 23/2007. These concerns follow, together with our responses.

- "… the LPR would need to be classified as a public railway within the existing framework of the Railway Law. As a public railway, however, the LPR would need to be included within the Railway Master Plan… Therefore, in order to create a new 'sub-class' of public railways not subject to the Railway Master Plan, we believe that an amendment to the Railway Law would be needed."

  HWTSK comment: We agree that Law no. 23/2007 requires that an LPR falling under the category of public railway, will need to be included in the Railway Master Plan. However, as the threshold for inclusion in the Railway Master Plan is not well defined, we believe that a GR could provide a path for LPR inclusion in the Master Plan that does not undermine project viability and permits the LPR to remain privately owned. The LPR would report its infrastructure plans for inclusion in the Master Plan.[32]

- "...the Final Report's key assumption that the LPR will be set up without any form of government assistance (presumably in order to avoid public tender requirements and regulated tariffs) requires further consideration, particularly if the LPR will be treated as a 'public' railway. For instance, if an LPR is established based in part on the existence of a 'public benefit in the national interest' …, the developers may wish to avail themselves of favourable land acquisition laws (which could be construed as a form of government support) or other rules that

[32] In addition, there is a precedent in Article 10 of Perpres 13/2010 that a business entity may propose a public infrastructure project not included in the master plan, provided that the project is consistent with spatial planning, among other things. The same concept can be applied to an LPR.

could facilitate the laying of infrastructure in sensitive areas (e.g., regulated forest areas)."

HWTSK comment: The underlying reason for specifying an exclusion of material government assistance was to eliminate potential difficulties with other laws and regulations founded in issues of monopolistic, non-competitive or singular vested interest practices. The lack of financial or direct government assistance is unlikely to be a major constraint to private investment. Current prospective investors interviewed have not identified lack of government assistance in land acquisition, or in securing government agency decisions on access routes, as a major obstacle. We have used the words "material" or "direct" government assistance to distinguish such assistance from the more general and entirely acceptable role of government in encouraging private investment through efforts to reduce or eliminate delays in decision making.

- " …even if the LPR is not subject to regulated tariffs per se, the ability of the private developers to fully recoup fixed infrastructure costs by offering services to third parties may be constrained by existing anti-monopoly rules (which, among others, contain anti-discrimination provisions)."

  HWTSK comment: Private railway concessions in virtually all countries are subject to various forms of anti-monopoly or competition laws; further, as Makarim & Taira acknowledges, this constraint does not distinguish an LPR from an SR. [33]

We agree with Makarim & Taira that the restrictive boundaries of Law no. 23/2007's Special Railway provisions limit the extent of liberalisation that can be realistically achieved in that area. We reaffirm our recommendations for two reasons:

1. Changes in regulations should be achievable, at least in significant part, in a much shorter time period than would be required for a parliamentary change to Law 23/2007.
2. Changing Law no. 23/2007 is an inherently political process and it is unclear whether Parliament would enact a law that liberalised private sector railway investment options, as desired by the private sector and some government agencies.

Consequently, we feel that the inter-agency working group proposed to draft regulatory changes, with private stakeholders included in the process, should consider the options for a broader interpretation of SR ownership and control, the permissible scope and structure of the "single enterprise," the precedents for waivers of services and the LPR option, as well as helpful reforms on which Makarim & Taira and HWTSK fully agree. We believe it is appropriate for the inter-agency working group to suggest,

[33] Note: A decision by Indonesia's Anti-Monopoly Commission (KPPU) in a case in respect of tariff for the utilisation of infrastructure (in this case, a telecommunication tower) found that the GoI should determine guidelines for stipulating tariffs for the use of infrastructure that is a natural monopoly. A Government Regulation for an LPR would need to include such guidelines.

for ultimate decision by the GoI, the scope of regulatory changes that are permissible without changing Law no. 23/2007.

Makarim & Taira supports HWTSK's findings on several desired changes: relaxing the point-to-point restrictions created by GR 56/2009; streamlining the licensing process consistent with jurisdictional authorities established in the law; and clarifying the interconnection requirements. Makarim & Taira's review is most helpful and will serve to sharpen and truncate the issues and time required by an inter-agency working group to draft the regulatory changes.

8.2 DAVID LUPTON'S REVIEW

The Lupton report's conclusions and recommendations differ from those of HWTSK largely in matters of emphasis. Most notably, Lupton sees substantial potential in the as yet undeveloped procedures for an SR (Exclusive Railway) connecting with another SR or a public railway, and thereby being transformed to a public railway. Dr. Lupton observes:

> "The law simply says that a special railway can connect to a general railway or to a special network of railway lines. The connection requires a permit. The government regulation says that a special railway can (with necessary approvals) be integrated with public railway transportation services network and other special railway transportation network in which case the provision of public railway services shall come into effect. Integration of the services shall be carried out through partnership between the parties. If we are able to elaborate the 'public railway services' along the lines proposed by HWTSK, we can define the outcome as a Limited Public railway."

The HWTSK Final Report has recommended that this be considered, but in a more muted fashion. Here we note that Makarim & Taira's concerns over an LPR's limitations under Law no. 23/2007 may not necessarily be avoided by using the indirect interconnection approach to achieve the same objective. If it is clear from the outset that the purpose of creating two or more SR railways is to link them together to evade the exclusive service limitations by then reclassifying them as "public," the process might well be as challengeable as the other approaches noted in the legal review. A simple waiver of service limitations, relying on precedents in other transport sectors to which we have referred, could be less controversial. However, we agree that, because of the limited time frame of the waiver, it will not be useful in helping to finance Special Railway projects. We would recommend using a Ministerial Regulation to widen the latitude for Special Railways to be interconnected to serve their original investment purposes while providing a larger public benefit.

As noted elsewhere in this report, the existing PPP process for infrastructure development projects tends to be attractive to private railway developers only in limited contexts. The Lupton review notes the possibility of designing a more useable

PPP process for privately sponsored railways, explicitly removing the railway sector from the general PPP process. This likely would require an amendment to Perpres 13/2010 (or successor PPP regulations). The HWTSK report does not address this option in detail, but we concur that it deserves further discussion with Bappenas, as the primary agency concerned. HWTSK found in several meetings with Bappenas that the agency is seeking ideas and assistance for ways and means to make the PPP process more attractive to private investors. Consequently, we agree that it would be entirely appropriate for the proposed inter-agency working group to take up this option and prepare draft changes in the PPP Regulations, provided this concept is endorsed within government ranks.

8.3 COMMENTS FROM WIMPY SANTOSA, INDII PAU RAILWAY COORDINATOR

Mr. Wimpy Santosa, along with Mr. Efi Novara Nefiadi, Senior Transport Program Officer, Indonesia Infrastructure Initiative (IndII) Facility called the team's attention to the desirability of bringing much of the material previously included in the Special Railways, Phase 2 Interim Report into the Final Report and to integrate that material with the final analysis. His observations contributed substantially to this Final Report.

Mr. Santosa correctly noted that this report devotes much attention to activities that could be undertaken under existing regulations (i.e., without requiring even a Ministerial Regulation) to speed up the development of Special Railways. Possible examples included licensing procedures, land acquisition, means of obtaining public resources, and guidelines or organisational structuring of Special Railway initiatives. To clarify our focus on the need for changes to Ministerial and Government Regulations, we note the following:

- On licensing, the main problem raised by potential investors is the need to clarify the licensing requirements concerning the ownership/organisational status of the licensee. Little can be done to resolve this issue without at least a Ministerial Regulation. The current licensing process is too cumbersome, but that is due directly to the procedures contained in GR 56/2009 and consequently requires regulatory reform. The same conclusion is valid with respect to the division of MoT/DGR and sub-national government licensing responsibilities. Uncertainties cannot be resolved without regulatory guidance on the scope of MoT pre-approvals for licenses issued at the sub-national level.
- Regarding land acquisition, HWTSK expected a greater desire for active government intervention than proved to be the case. Land acquisition, although not completed for any of the prospective private railway investments cited in this report, was not raised as a major problem during our interviews. While each of the proposed projects crosses environmentally sensitive areas (such as protected forests), investors seemed confident in their ability to acquire land and obtain permissions at the local and regional level and with relevant national agencies. MoT/DGR involvement in the process was not solicited.

- Regarding government financial support, government resources were only solicited in the case of the Central Kalimantan PPP proposal. Even in the Central Kalimantan case, while the full extent of the proposed network could involve potentially substantial government commitment, the initial stage seems to be a largely dedicated coal mining railway. Private financing would likely suffice in this case as well. In general, private resources are available for railway investment; the predominant constraint to such investment is the uncertain regulatory environment.
- On organisational structuring of private railway initiatives, we note elsewhere in this report that we are not heavily critical of prospective investors for inadequate due diligence. We debated the meaning of the regulations internally and found a wide divergence of opinion about exactly what is permitted, even within the MoT. One can argue that investors could have better structured their Special Railway applications to more closely conform to a narrow interpretation of the current legislation. However, given the uncertainty, the business structures chosen supported financing needs and served the interests of venture partners. If projects were structured to comply with the strictest interpretation of the legislation, they may no longer be feasible. Only feasible projects and structures have progressed. Regulatory reform, not better due diligence, is the key to securing viable private sector project structures.

Our thanks to Mr. Santosa for calling our attention to the need to address these issues more explicitly.

8.4 COMMENTS FROM DARWIN DJAJAWINATA, PAU-MOT LEAD ADVISOR

The comments from Pak Darwin Djajawinata also addressed the licensing process, directing attention to the fact that (1) technical competence considerations (e.g., railway development and operation experience) may cause an enterprise that constitutes a new entity to operate a railway service; and (2) financing sources typically require that all licenses be issued to the technically competent entity that also receives the financing.

These observations appear to fit the BATR case and help explain why BATR's applications for regulatory approval appear to be stalled. From a financing standpoint, the formation of BATR made a great deal of sense. An interpretation of the Law no. 23/2007 provisions caused the MoT to issue the preliminary license to PTBA. However, PTBA is not a competent railway operator, and therefore prefers that BATR hold the mineral transport license. Even if BATR were found to be an acceptable operator under the current legislation (which we have concluded is legally untenable under current law), the MoT's issuance of a principle license would not likely satisfy financiers, which will desire early approval of all necessary licenses (as well as any permissions required at the local/regional level, or by specialised Ministries such as the Ministry of Forestry).

The current licensing process is thus deficient by both (1) requiring a project structure that is sub-optimal in terms of financeability, and (2) institutionalising delay in the full

licensing approvals needed to satisfy financiers. Pak Darwin's observations support our conclusion that modifying licensing terms in the absence of regulatory reform to broaden acceptable deal structures and increase timeliness will create legal uncertainty and will be open to external legal challenge.

8.5 COMMENTS FROM DAVID HAWES – AUSAID INFRASTRUCTURE POLICY ADVISOR

The advice and comments received from Mr. Hawes throughout the study were particularly important in directing the HWTSK team's attention to the option of attracting private investment through public railway arrangements outside of the PPP provisions under Perpres 13/2010. Despite the comments by Makarim & Taira, we feel this purpose can be accomplished through a Government Regulation, as proposed by Mr. Hawes, although we acknowledge that this solution has certain drawbacks identified in the legal review. For that reason, the Final Report recommends that the scope of the current Special Railway provisions regarding ownership structures be broadened to the extent deemed appropriate by the inter-agency working group proposed for the next stage. This should be accompanied by simplifying the licensing procedures and relaxing the point-to-point rules. We also recommend that procedures be developed for waiving service restrictions based on inadequate public capacity, following precedents in the transport (ports and airports) sector. However, the Limited Public Railway option recommended by Mr. Hawes for our consideration and developed in this report is the core step in reform.

We have used the terminology "Special" Railway rather than "Exclusive" Railway throughout this Report partly because this term is used in the TOR and partly because it is the commonly accepted translation of the Indonesian term "*Khusus.*" However, this Final Report has taken considerable care to emphasise our mutual understanding that the scope of these provisions unambiguously applies to exclusive services to a single enterprise.

APPENDICES

APPENDIX A: TERMS OF REFERENCE FOR PHASE 2

SCOPE AND PROGRAM OF THE SUB-CONSULTANCY SERVICES

Guidelines for Special Railways: Phase II

September – December 2010

1. BACKGROUND

1.1 Summary

This project is intended to assist in developing Guidelines for Special Railways in Indonesia. It is directed principally to a particular mechanism, defined in the Indonesian railway law, to encourage railway infrastructure development for specialised purposes. This transport industrial/resource development mechanism, the Special Railway (SR), is described further below. However, there are other mechanisms available under Indonesian law to support the transport needs of enterprises, including the simple extension of a public rail line that, as a practical matter, may serve only one enterprise. Another mechanism is a railway infrastructure public private partnership (PPP) that may be developed under regulations specifically governing infrastructure PPPs.[34] Policy and procedures to best implement Guidelines for Special Railways cannot be determined without a consideration of other options to meet specialised railway needs. An assessment of those options is included in the project scope defined below.

Indonesian Law No. 23/2007 concerning railways, and Government Regulation No. 56/2009, concerning railway infrastructure, provide the basic principles for the operation of SR in Indonesia. Under Law 23/2007 "special railway lines" are lines "used by a certain legal entity to support its main activities" – that is, they are defined by ***purpose,*** not by the precise ***nature*** of the legal entity.[35] Although it is anticipated that in most cases the legal entity using a special railway to support its activities will be a private enterprise, most likely organised as a limited liability company (Perseroan Terbatas), under Law 23/2007, any legal entity under Indonesian law could support a special purpose railway, including a State owned limited liability company (Perusahaan Negara Perseroan; or

[34] Rules include requirements for competitive public tendering and requirements to offer access and status as a public railway (regardless of number of actual customers).

Persero), a public corporation (Perusahaan Umum or Perum), or any other legal entity, in the private or public sector (at any level of government).[36] Indonesian law also recognises legal associations based on pre-independence Dutch law.[37]

Government Regulation No. 56/2009 does not limit the approved use of the SR option to any more narrow sub-set of legal entities; nor does it:

- stipulate clearly the process for assessing proposals for SR operation;
- designate supervision processes;
- precisely define the relationship of SRs to other railway entities (interconnection issues, fair multiple access issues, choice of form or conversion process between SR and general public railway or public private partnership/PPP); nor
- delineate processes to eliminate jurisdictional conflicts between laws/regulations and within Government agencies and national and sub-national authorities.

The Government of Indonesia has determined it is important to develop general operational Guidelines for Special Railways as a reference for contracting agencies or other public authorities responsible for the approval of the contracting, construction and operation of SRs, and for investors and private enterprises (or other legal entities) desiring to establish a special railway. Therefore, the Guidelines called for in this Terms of Reference (TOR) are intended to provide sets of tools to review individual SR applications in all aspects of railway planning and operations, including technical operations, spatial planning, economic viability, risk management, legal aspects, financial and commercial aspects of railway investment, and the environmental and social impacts. Because the underlying objective of special railways' operations is to support an enterprise's business, the Guidelines are intended to also take into account the concerns of related sector and industry participants, such as mining companies, manufacturers, and financial institutions.

To ensure an adequate coverage of the issues to be addressed by Guidelines for Special Railways, a Phase I assessment was undertaken to:

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[35] Articl1 1, para. 6. See also Law 23/2007, Article 5 defining a special railway as "used specifically by a certain legal entity to support main activities of certain legal entity."

[36] Note: Under Law No. 19/2003, a "Perjan" (government department operating an enterprise) is no longer authorized and shall be converted to Persero or Perum.

[37] There are two types of associations in Indonesia: (1) incorporated associations, which possess legal personality; and (2) ordinary associations, which do not. Parties wishing to create an incorporated association submit the Articles of Association containing the statutory purposes to the Minister of Law and Human Rights. Approval by the Minister confers legal personality.

1. Assess the current issues for, and challenges facing, the implementation of SRs in Indonesia;
2. From the above assessment, determine if the activity should proceed to a second stage (complete study with detailed analyses);
3. Provide recommendations for the scope of activities necessary for the planned Phase II.
4. Draft an activity design and a task-oriented budget for Phase II.

This TOR is based on the Phase I findings concerning SR issues and challenges. The scope of activities in this TOR are described in the tasks below and summarised in section 3.1 “Activity Components”.

1.2 Scope of Work – Summary

The work under this TOR will involve the establishment of Guidelines for Special Railways. It will be conducted with approximately six person-months of technical effort over a twelve week (three calendar month) period. The appointed consultants will undertake a detailed analysis of the issues that have been identified and will develop (with reasons stated) draft Guidelines for Special Railways. Deliverables from this effort will also include establishing the basis for any recommendations for any proposed revision of GOI Regulation No. 56/2009 and perhaps other regulations.

2. GOAL & OBJECTIVES

2.1 Goal

The goal of this activity is to contribute to the long-term development of Indonesia by facilitating greater investment in Special Railways and the coordinated integration of Special Railways with PPP and Public Railways, where this is consistent with the public interest.

2.2 Activity objective

The specific objective of the activity is to develop comprehensive Guidelines for Special Railways (the Guidelines) that will serve as a template for Government and sub-national governments in developing licences and issuing clarifying regulations under which Special Railways (SRs) can be developed expeditiously - with minimum jurisdictional conflict and maximum consistency of interpretation of applicable laws and regulations. Supporting objectives include:

- To reduce uncertainties faced by prospective enterprises and investors requiring the development of dedicated railway services needed to make the main enterprise activity feasible;
- To recommend clarifications in licensing practices and regulations under existing railway law that will improve the attractiveness of SR investments and contribute to the development of consistent governmental precedents in implementing specialised railway services; and
- To suggest long term modifications in the Indonesian legal/regulatory framework that will progressively bring Indonesian practices regarding development of specialised railways into accord with well-accepted and recognised international practices.

3. DESCRIPTION OF PROPOSED SUPPORT

3.1 Activity components

This proposed activity comprises the second phase of an overall project to develop guidelines for Special Railways that will:

- enable DGR and national and sub-national agencies to more expeditiously approve or disapprove proposed SR projects supporting the main activity of the enterprise served by the SR; and
- provide guidance to enterprises as to the appropriateness of the SR mechanism versus alternative rail service options, and as to organisational and procedural options that might assist in expeditious railway project approval.

Four distinct options for developing term "Special Railways" will be conducted including:

(a) **A "pure" exclusive railway:** In this case the railway would be owned and managed as an integral part of the corporate entity whose primary business is, for example, coal mining. It could involve a separate profit centre, but the paper revenue transactions would be wholly internal.

(b) **An "arms-length" exclusive railway**: In this case this railway would be owned and managed by a separate corporate entity that is owned by the corporate entity whose primary business is, for example, coal mining. As mentioned, this is stretching the interpretation of the Railway Law to a degree that may result in different opinions from diligence lawyers.

(c) **A "special purpose / limited public railway"**: This is a concept has yet to be created in the governing legislation. The main purpose of creating a sub-category of public railway would be to avoid capture by Perpres 67/2005 and Perpres 13/2010.

(d) **A pure public railway**, which would be subject to the relevant provisions of the Railway Law and the existing Government Regulations on Railway Development and to those of Perpres 67/2005 and Perpres 13/2010.

The planned assessment will need to consider four main aspects:

- legal feasibility and limitations;
- railway development and operational considerations (e.g. control issues for public railways);
- project financing implications (which will be influenced by the above); and
- taxation implications.

There could be a case also for the study also assessing the arguments for amending the present Law to better accommodate development of this potentially important form of railway. However, such assessment would be a task for any subsequent stage (Phase III).

This phase (Phase II) will have eight main activity components that form the basis for the tasks described in the figure below:

Activity components

#	COMPONENT	DESCRIPTION
1.	***Develop a recommended interpretation of relevant legislation***	With counterparts from the responsible Government agencies, review the following with respect to implications for SRs: • Law No. 23/2007 on Railways • Law No. 25/2007 on Capital Investment • Government Regulation No. 56/2009 concerning Railway Development • Government Regulation No. 72/2009: Traffic and Transport • Government Regulation No. 6/2006: Management of State/Regional Assets as amended by Government Regulation No. 38/2008 • Presidential Regulation No. 67 of 2005 on the Partnership of the Government with Business Entities in the Provision of Infrastructure ("Perpres 67/2005"), as amended by Perpres 13/2010 • Identify other relevant laws and regulations which have a bearing on SR developments Discuss tentative findings with the Ministry of Transportation, Coordinating Ministry for Economic Affairs, Ministry for State-owned Enterprises, BAPPENAS, Ministry of Finance, the Committee on the Policy for the Acceleration of Infrastructure Provision (KKPPI) and any other relevant Government agency, as well as with Provincial authorities in at least three provinces that have pending SR or railway PPP projects and with at least three private sector sponsors of such projects. After consultation with stakeholders and feedback from them, draft a summary report on the legal/regulatory framework for SRs which is suitable for inclusion in the *Guidelines*.

#	COMPONENT	DESCRIPTION
2.	***Conduct SWOT analysis of alternatives for rail service for private developments***	Conduct a *Strengths-Weaknesses-Opportunities-Threats (SWOT)* analysis of alternatives for rail service for private developments for at least the following four options: • A "pure" exclusive railway • An "arms-length" exclusive railway • A "special purpose / limited public railway" • A pure public railway. The SWOT analysis will include special attention to two urgent cases involving proposed mining railway developments in East Kalimantan and South Sumatra, and one other case in Central Kalimantan. It should examine other impending cases sufficiently to group them by class as much as possible by the shared characteristics that differentiate one group from another, according to the key parameters that would guide government response to the license application.
3.	***Define procedures and organisational forms to best achieve and expedite approval of rail service supporting private enterprise developments***	Define procedures and organisational forms to best achieve and expedite the approval and implementation of Special Railway projects including: • Land acquisition process • Extent of permissible public support for special railway • Organizational structure of enterprise/ railway/ transporter • Licensing process. Define procedures and organisational forms to best achieve and expedite approvals if PPP required • Advantages/disadvantages of railway PPP with main enterprise separately licensed to transport only for own use vs. integrated infrastructure/transporter PPP . • Analyse and discuss whether the PPP process provides broader opportunities for railway services among subsidiaries and affiliates that may not be legally valid under Special Railway rules.
4.	***Develop context-specific procedural and organizational guidelines for SR railway developments***	Develop context-specific guidelines that are appropriate to each of the following contexts: • SR railway in a single Province or lower level jurisdiction; • SR railway crossing into a second or more provinces; • SR railway not linked to a public railway; • SR railway linked to a public railway and with transport service using public railway access; • SR service involving only a single facility operated by a qualified legal entity; • SR service involving multiple facilities operated by a qualified legal entity; and • SR service intermodal connections with public or private ports.

#	COMPONENT	DESCRIPTION
5.	***Recommended MOT/ DGR actions***	Recommended specific actions for MOT/ DGR that can reassure enterprises and investors of fair and expeditious treatment of SR initiatives, and provide reasonable standards for national and sub-national contracting agencies. Recommendations should encompass: • Licensing policy including jurisdictional cooperation; • Elaboration/modification to Regulation 56 to expedite private enterprise investment in railway/infrastructure development; • Elaboration/modification to Regulation 72 to expedite private enterprise investment in transport/rolling stock development; and • Other recommendations considered necessary
6.	***Comparison with International Practices***	Evaluate options available under current Indonesian law versus well regarded international practices, considering: • Constraints on expeditious approvals; • Assurances against measures undermining value of investment; • Ability to simplify and consolidate contract/licensing requirements; • Constraints to securing financing; and • Other relevant factors.
7.	***Identify desirable longer term changes***	Based on shortfalls relative to international best practices, identify desirable longer term changes, including: • Mechanisms to reduce jurisdictional conflicts at national Government level; • Mechanisms to reduce jurisdictional conflicts between the national Government and provincial governments; • Amendments to regulatory statutes at the Ministerial, Presidential, or Governmental levels • Potential Amendments to Law 23/2007; and • Potential Modifications to Law 25/2007 on Capital Investment and Presidential Regulation No. 36 of 2010 on list of negative investment.
8.	***Environmental & social impact***	Environmental and Social Issues that must also be considered include: • Indentifying potential positive and negative environmental impacts as a result of SR operations and outlining the procedures to be followed under Indonesian law to address those impacts; and • Indentifying potential positive and negative social impacts as a result of SR operations and outlining the procedures to be followed under Indonesian law to address those impacts. *(The project should assess environmental and social (including gender) impacts versus (a) non-rail options and (b) railway alternatives to SRs. Women, men and children may experience different impacts. Mitigation strategies to address the social (including gender) impact and environmental impacts in accordance with existing Indonesian laws and regulatory policies will be included in the licensing requirements for SRs.)*

3.2 Deliverables

Deliverable 1	An Inception Report outlining specific team schedules, due two weeks after project initiation
Deliverable 2	An Interim Report (including executive summary) due six weeks after project initiation. [38]
Deliverable 3	A Draft Final Report (including executive summary) covering all tasks due ten weeks after project initiation
Deliverable 4	A Final Report (including executive summary) due 12 weeks after project initiation, including *An Activity Completion Report* (ACR) to ensure compliance with the IndII M&E Framework. This report will also need to reflect compliance with the IndII Gender Strategy, EcoMAP and Risk Mgt Plan, by providing evidence to confirm the success of identified cross cutting indicators

4. TEAM COMPOSITION & PROCUREMENT

4.1 Procurement approach and Team Skills

In appointing international consultants (or consulting firm), to undertake the review, research, analysis, and policy development activities, IndII will comply with the GOA Commonwealth Procurement Guidelines, and will adhere to the requirements of the IndII Facility Procurement Guidelines.

The DGR has strongly requested IndII to begin implementation by early September, to ensure finalisation of the SR Guidelines by end-2010. As noted above, the timeline to complete all activity requirements is very short; therefore, IndII proposes to select and appoint the international and national consultants to undertake the Phase II works from those available on the IndII Consultant Pool.

Four international consultants (a Regulatory Policy Expert (Team Leader), Railway Infrastructure Expert, Transport Lawyer, Senior Policy Advisor) and two national consultants (an Indonesian Infrastructure Lawyer and Legal Due Diligence support) are required to undertake the identified components and to complete the above deliverables successfully, over a period of approximately three months.

[38] This report will emphasise options under existing law that may expedite completion of Special Railways projects designed to serve the two urgent cases in East Kalimantan and South Sumatera, respectively and one of the major SR proposals in Central Kalimantan (while the others will be treated by classes, grouped by class as much as possible by the shared characteristics that differentiate one group from another). Initial findings of Activity Components 4, 5 and 6 in Figure 1 above will also be incorporated in the Interim Report

4.2 Team members

HWTSK will provide the following team members for the activity. Replacement of team members can only occur with the prior written agreement of SMEC.

InternationalTeam Members		Days
Richard Sharp	Regulatory Policy Expert / Team Leader	32
John Winner	Railway Infrastructure Expert	31
Michael Kennedy	International Lawyer	21
Clell Harral	Senior Policy / Financial Adviser / Resident Liaison	10
National Team Members		
Asenar Nangtjik Rekap, S.H.	Infrastructure Lawyer	30
Shirley Oroh	Legal Due Diligence Support – Legal Translator / Interpreter	63

5. GENERAL ISSUES

5.1 Management

The responsible IndII Technical Director (Transport) will provide oversight and strategic management of the consultants' technical assistance and related activities. The appointed consultants will take responsibility for day-to-day project activities and will report to the relevant TD at regular intervals.

The consultants will achieve the required outputs in a timely manner and to ensure that the output will integrate with other related activities being undertaken and coordinated by IndII, DGR, other participating GOI agencies, and other donors.

As noted above, day-to-day operational management, technical review and clarification of technical matters will be the responsibility of the consultants, supported by IndII where necessary. Consultants are expected to develop good working relations with their stakeholder counterparts in related GOI national and sub-national agencies.

The consultants will act appropriately under the code of behaviour for personnel operating under the Australia Government's aid program. This includes behaving in culturally appropriate ways and ensuring probity in undertaking all the work contracted under this activity.

5.2 Monitoring and evaluation

To analyse the contribution of the activity to Facility's higher-level objectives (Program Level Framework), information generated in response to the performance questions about each individual activity contained in the activity results frameworks will be sought. These performance questions include:

- What are the immediate results of the activity (all IndII partners will be asked to comment in their own style and based on their own views and impressions)?
- What factors have contributed and/or inhibited to the "success" of the activity?
- What contribution has the activity made to result areas such as policy formulation and improved governance?
- Are benefits likely to be sustained?

The responsible IndII Technical Director will review/assess activity reports provided by consultants against the *broad* criteria outlined below/over.

IndII M&E activity assessment criteria

Criterion	Measures:
Efficiency	▪ the outputs of an activity in relation to its inputs, signifying the best approach used to achieve desired results.
Effectiveness	▪ the extent to which an activity attains its individual outcomes and purpose.
Impact	▪ the positive and negative changes produced by an activity (both intended and unintended).
Relevance	▪ the extent to which an activity is suited to the priorities and devt goals of the broader program framework.
Sustainability	▪ if the benefits of the activity are likely to continue after donor funding has been exhausted.

The consultants will be briefed by IndII personnel on their key responsibilities relating to M&E requirements at project inception; and will be provided with a copy of the IndII M&E guidelines (see http://www.indii.co.id/mon-eval), which must be read by the consultants to provide a broad evaluation framework for their activities.

The activity will be monitored by the responsible IndII Technical Director who will coordinate the preparation and submission by the consultants of all reports and related documents, using the standard IndII format. As noted above, it will be the responsibility of the consultants to collect and analyse any data required to assess whether the performance indicators have been met and include them in the *Activity Completion Report*.

The consultant(s) will ensure that evidence is provided to confirm the success of identified performance indicators, and that such data is included in the reports as specified in these TORs.

It is recognised by IndII that some activities have a number of phases and provide assistance over a longer period of time. To ensure the application of quality M&E it is important to periodically review the achievements and outcomes from earlier phases to provide evidence that current phases continue to contribute to agreed long-term development outcomes.

Guidelines for Special Railways is an activity of strategic importance to the GoI and therefore it is important to undertake an evaluation of Phase I outcomes during the course of Phase II. The evaluation is scheduled to occur in 2013 and a formal date will be proposed closer to the period. The evaluation's purpose is provide demonstrable evidence that the activity continues to to play a role and have had a positive influence on outcomes. The evaluation will also provide valuable insights into what lessons have been learned and what features could be considered for the future.

The evaluation will be completed by the IndII M&E team and a thematic expert may also be engaged to provide technical input and advice and to validate findings.

Activity M&E Framework

	GOAL: Greater investment in Special Railways and the coordinated integration of Special Railways with PPP and Public Railways					
KRA	**Objective**	**Performance indicators**	**Activity Inputs**	**Means of verification**	**Critical assumptions**	
Policy setting & implementation	**1. To develop comprehensive Guidelines for Special Railways as a template for Government and sub-national Government in developing licences and issuing clarifying regulations related Special Railways** **2. To develop recommendations in improving existing laws and regulations**	***Output 1.1:Formed the basis for developing Guidelines for Special Railways*** ▪ Assessed relevant laws, regulations and licences governing SRs ▪ Conducted SWOT analysis associated with successfully implementing SRs vs alternative means of providing rail service to enterprises ▪ Defined procedures and organizational options available to the enterprise requiring rail service in establishing SR ▪ Conducted initial diagnostic of SR initiatives undertaken in two urgent cases in East Kalimantan and South Sumatera, and one other case in Central Kalimantan (while the others will be treated by classes, grouped by class as much as possible by the shared characteristics that differentiate one group from another)	▪ Technical experts ▪ Consultation with key stakeholders ▪ Visits to key areas where SR development is of high priority	▪ Assessment report included in an interim report	▪ Sufficient resources exist within participating GOI agencies to support the consultants at appropriate stage ▪ Sufficient resources exist within consultants team to develop comprehensive understanding on related Indonesian law and regulations ▪ The consultants experience adequate cooperation from regional counterparts	**ACTIVITY CRITERIA** **Efficiency, Effectiveness (Partnerships), Relevance (Impact) and Sustainability**

	GOAL: Greater investment in Special Railways and the coordinated integration of Special Railways with PPP and Public Railways					
KRA	**Objective**	**Performance indicators**	**Activity Inputs**	**Means of verification**	**Critical assumptions**	
		Output 1.2: Developed SR guidelines with quality meet the satisfaction of GOI and IndII ▪ Assessed and incorporated findings from Output 1.1 into the guidelines ▪ Defined and incorporated the SR context-specific requirements into the guidelines ▪ Guidelines consulted toward enterprises as well as government agencies	▪ Technical experts ▪ Peer review within activity ▪ Workshop/consultation with national and sub-national agencies and other relevant key stakeholders	▪ Set of SPR Guidelines ▪ Workshop/consultation notes/feedback	▪ Sufficient resources exist within participating GOI agencies to support and give feedback to the consultants works ▪ GOI agencies are willing to discuss, assess and adopt consultants' recommendation	
		Output 2.1: Set of recommendation concerning regulation modification/law revision delivered to counterpart ▪ Provided comparison between Indonesian and International practices for approving rail lines serving individual enterprises ▪ Identified required revisions in relevant laws and regulations to enable SR implementation	▪ Technical expertise	▪ Set of recommendations included in the draft and final report	▪ Availability of all required data and documentation to make comparison	

	GOAL: Greater investment in Special Railways and the coordinated integration of Special Railways with PPP and Public Railways					
KRA	**Objective**	**Performance indicators**	**Activity Inputs**	**Means of verification**	**Critical assumptions**	
Cross-cutting issues	**3. To develop comprehensive Guidelines for Special Railways that will mitigate social and environmental impact**	***Output 3.1: Developed Guidelines included strategy to mitigate social and environmental impact*** ▪ Identified potential positive and negative social impacts (including gender) as a result of SR operations ▪ Identified potential positive and negative environmental impacts as a result of SR operations ▪ Outlined the procedures and strategy to mitigate the impacts	▪ Technical expertise	▪ Guideline on social, gender and environmental mitigation ▪ Activity completion report – cross cutting section	▪ Commitment by National and Sub-National governments to comply with social and environmental policy of GOI and GOA	

5.3 Reporting

IndII will require the completion of all *Deliverables* listed above in Section 3. Deliverable 4 requires consultants to provide in digital form a brief *Activity Completion Report (See Annexes)*, one week after satisfactory completion of all outputs.

Additional reporting requirements, if any, will be negotiated with the consultants selected to undertake the activity; the precise timing and nature of reports will be also determined with appointed consultants during initial activity implementation stages.

It will be the responsibility of the consultants to collect and analyse any data required to assess whether the performance indicators have been met, outputs completed successfully and deliverables achieved - and to include such data in the identified reports.

The acknowledged receipt, by the relevant IndII Technical Director, of an eCopy of all reports will be considered an appropriate submission of each reporting activity. Completion of each activity reporting will be subject to confirmed acceptance by the relevant IndII Technical Director. A small number (3-5) of print copies of the Reports may be required. These requirements will be negotiated during the activity preliminary stages

5.4 Language

The language for *all reports* will be English. The consultant will provide translations into Indonesian of all documents that will (or have the potential to) be included and/or used in subsequent GOI national or sub-national policy, planning and / or legislative documents.

All official correspondence shall be in both languages. All consultants engaged should be fluent in written and spoken English. All documents and reports prepared for IndII, GOI agencies or AusAID must follow the *IndII Style Guide*, (Refer www.indii.co.id/styleguide.), and any technical reports must adhere to the guidelines provided in the IndII *Technical Report Template*, available online at http://www.indii.co.id/technicalreport.

5.5 Cross cutting issues

The IndII Gender Strategy (refer www.indii.co.id/gender) focuses on the range of work and tasks involved in IndII's implementation, and provides direction to managers, planners and implementers on how they can ensure that the program and activities are gender responsive and improve gender equality.

Consultants will refer to the IndII Gender Strategy and Plan and consider the potential social impact that might be resulted by Special Railways development. This activity is categorised as *Activity Type D* where the Special Railways Guidelines must clearly defined the strategy of social/community impacts mitigation. Therefore, the appointed consultants are expected to be fully aware of and responsive to the AusAID approved IndII Gender Strategy.

All development work for guideline relating to mitigating social impacts in Special Railways development must provide the opportunity for women and men to participate in the consultation and feedback processes. The appointed consultants need to ensure that:

- consultations undertaken need to develop guidelines that will enable both women's and men's views to be heard.;
- the guidelines must acknowledge that women and men might experience different impact from special railway development, therefore the social guidelines will define and suggest strategy to obtain both women's and men's responses in the community consultation process before, during and after the project; and
- the strategy developed to mitigate social impacts must consider the different needs of women and men, and maximise the benefit for woman, men, children and vulnerable groups in the impacted community.

At a broader level, domestic GOI legislation protects the rights of women to support the country's move towards an increasingly democratic and civil society. The Technical Guideline of INPRES 9/2000 is considered to be the key reference document for the implementation of gender mainstreaming in national development. INPRES identified the GOI key gender equity principles as: (a) Gender mainstreaming is a priority of the Indonesian government; and (b) Gender mainstreaming is a strategy that is implemented to achieve gender equality and equity through the integration of experience, aspirations, needs and problems of women and men in the planning and evaluation of all policies, programs, projects and activities in all development sectors.

The development of definitive and transparent SR Guidelines will model good governance in public sector programs and thus improve institutional planning and review through the demonstration of effective and successful agency governance strategies.

In line, also, with its aim of supporting Indonesia's efforts to reduce corruption, all activities undertaken as part of this consultancy will adhere to the three main pillars of the 2004–2009 RAN-PK39: (i) prevention; (ii) enforcement; and (iii) monitoring and evaluation.

[39] Refer: Australia Indonesia Partnership - *Anti-corruption for development plan 2008–13*, p. 4

IndII's ECOMAP identifies five key issues / questions that must be addressed when implementing activities; all have relevance for the *Special Railways' Guidelines* activity:

(1) Are the planned transport system initiatives in environmentally sensitive locations or sectors?

(2) Is there potential for the activities to have an impact on the environment?

(3) Is the explicit, or implicit, aim of the activities to have a positive environmental impact?

(4) Is the overall activity relevant to multilateral environment agreements?

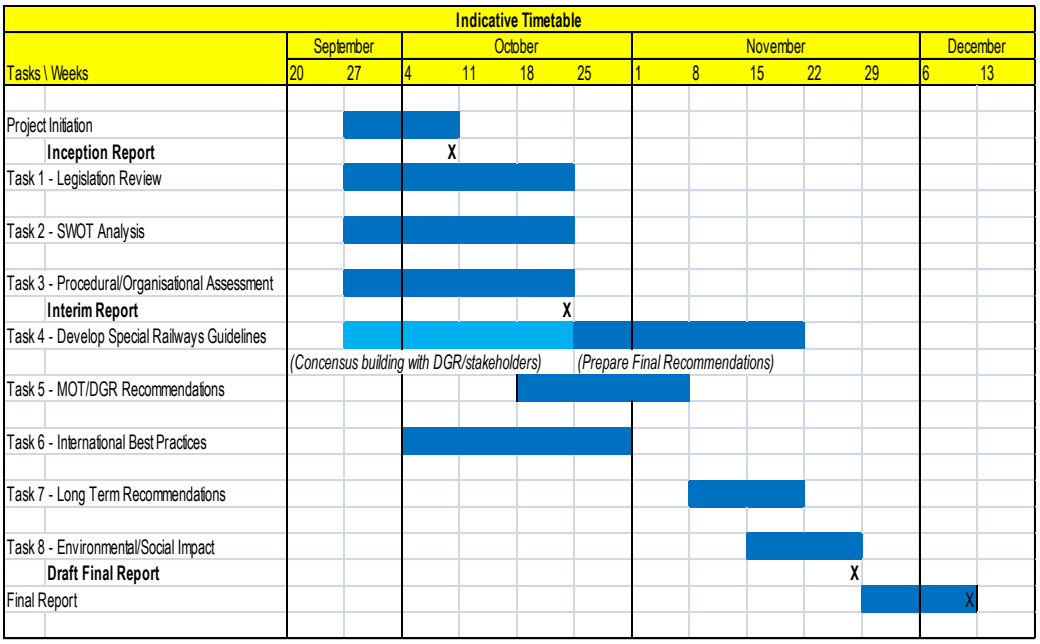
(5) Could the activities have significant negative environmental impacts?

The appointed consultants are expected also to be fully aware of and responsive to the 2003 AusAID document: "Environmental Management Guide for Australia's Aid Program", which provides for the assessment, management and mitigation of potential environmental impacts to be incorporated into Australia's aid activities. The guidelines also require that partners in delivery of the aid program implement the assessments and measures needed to manage the environment. This activity will also comply fully with the IndII Environment Compliance policy (www.indii.co.id/ECOMAP).

The review and scoping activity is not expected to give rise to any issues related to HIV/AIDs or Child Protection. However, should any issues develop during the assignment; consultants are expected to advise the IndII Office immediately.

6. INDICATIVE TIMING

The activity will begin in mid-September 2010 and finish within three months, reflecting the proposed scheduling recommended in Phase I, and as indicated in the schedule below / over. This schedule is subject to revision and final scheduling arrangements will be negotiated between the IndII Technical Director and the consultants appointed to perform Phase II.



7. BACKGROUND MATERIALS

Find attached the following resource/background materials:

Annexe 1	Monthly Report template
Annexe 2	Final Completion Report template
Annexe 3	IndII initial environmental management planning checklist

- The IndII Monitoring and Evaluation Plan is located at www.indii.co.id/mon-eval ("Consultant Resources"). Consultants should be aware of their obligations and responsibilities under that Plan.
- The IndII Environmental Management Strategy is located at www.indii.co.id/ECOMAP ("Consultant Resources"). Consultants should be aware also of their obligations and responsibilities under that Strategy.
- IndII complies with the AusAID gender policy. The IndII gender strategy is found at www.indii.co.id/gender) ("Consultant Resources"). Consultants should be aware of their obligations and responsibilities with regard to gender equality and be prepared to comply fully with the policy and strategy.

Potential consultants should familiarise themselves with the IndII Risk Management Plan (RMP), in particular with sections 2.3, 1.4, 1.5, 1.6, 2.1, 2.2, 3.3, 3.5, 3.6 and Annexes A & D. A copy of the IndII Risk Management Plan is available online at http://www.indii.co.id/RMP.

APPENDIX B: EXTRACTS OF PERTINENT LEGISLATION

PERATURAN TERKAIT BATASAN KERETAAPI KHUSUS	REGULATIONS RELATED TO SPECIAL RAILWAYS LIMITATIONS
Pasal 1 ayat 6 UU No. 23/2007 Jalur kereta api khusus adalah jalur kereta api yang digunakan secara khusus oleh badan usaha tertentu untuk menunjang kegiatan pokok badan usaha tersebut	**Article 1 paragraph 6 of Law no. 23/2007** Special railway lines are railway lines specially used by a certain legal entity to support its main activities.
Penjelasan Pasal 5 ayat 1 (b) UU No. 23/2007 Yang dimaksud dengan "perkeretaapian khusus" adalah perkeretaapian yang hanya digunakan untuk menunjang kegiatan pokok badan usaha tertentu dan tidak digunakan untuk melayani masyarakat umum	**Elucidation of Article 5 paragraph 1(b) of Law no. 23/2007** "Special railway" in this provision refers to a railway used solely to support the core activities of a certain legal entity, and not used to serve the general public.
Pasal 5 ayat 3 UU No. 23/2007 Perkeretaapian khusus sebagaimana dimaksud pada ayat (1) huruf b hanya digunakan secara khusus oleh badan usaha tertentu untuk menunjang kegiatan pokok badan usaha tersebut	**Article 5 paragraph 3 of Law no. 23/2007** Special railway as referred to in paragraph (1) sub-article b is only used specifically by a certain legal entity to support the core activities of the legal entity.
Pasal 33 ayat (1) UU No. 23/2007 Penyelenggaraan perkeretaapian khusus sebagaimana dimaksud dalam Pasal 17 ayat (2) dilakukan oleh badan usaha untuk menunjang kegiatan pokoknya	**Article 33 paragraph (1) of Law no. 23/2007** Operation of special railways as referred to in Article 17 paragraph (2) shall be carried out by a legal entity to support its core activities.
Pasal 149 ayat (1) UU No. 23/2007 1. Pelayanan angkutan perkeretaapian khusus sebagaimana dimaksud dalam Pasal 5 ayat (3) hanya digunakan untuk menunjang kegiatan pokok badan usaha tertentu. 2. Pelayanan angkutan perkeretaapian khusus sebagaimana dimaksud pada ayat (1) dapat diintegrasikan dengan pelayanan jaringan angkutan perkeretaapian umum dan pelayanan jaringan angkutan perkeretaapian khusus lainnya setelah mendapat persetujuan dari Pemerintah atau Pemerintah Daerah. **3.** (3) Pelayanan angkutan perkeretaapian khusus disesuaikan dengan ketentuan mengenai angkutan orang dan/atau angkutan barang perkeretaapian umum.	**Article 149 paragraph (1) of Law no. 23/2007** (1) Transportation services by special railways as referred to in Article 5 paragraph (3) shall be used only to support the legal entity in carrying out its core activities. (2) Transportation services by special railway as referred to in paragraph (1) can be merged with the transportation network services of general railways and the transportation network services of other special railways after receiving approval from the Government or Regional Government. (3) Transportation services by special railway shall be adapted to the provisions concerning transportation of passengers and/or transportation of goods by general railway.

PERATURAN TERKAIT BATASAN KERETAAPI KHUSUS	REGULATIONS RELATED TO SPECIAL RAILWAYS LIMITATIONS
Pasal 150 UU No. 23/2007 Ketentuan lebih lanjut mengenai angkutan perkeretaapian khusus sebagaimana dimaksud dalam Pasal 149 diatur dengan Peraturan Pemerintah.	**Article 150 of Law no. 23/2007** Further provisions concerning transportation by special railway as referred to in Article 149 shall be regulated by Government Regulation.
Pasal 1 ayat 3 PP No. 56/2009 Perkeretaapian khusus adalah perkeretaapian yang hanya digunakan untuk menunjang kegiatan pokok badan usaha tertentu dan tidak digunakan untuk melayani masyarakat umum	**Article 1 paragraph 3 of GR 56/2009** Special railway is a railway used only to support the core activities of a certain legal entity and not used to serve the general public.
Pasal 1 ayat 10 PP No. 56/2009 Penyelenggara perkeretaapian khusus adalah badan usaha yang mengusahakan penyelenggaraan perkeretaapian khusus	**Article 1 paragraph 10 of GR 56/2009** Special railway operator is a legal entity engaging in railway operation
Pasal 1 ayat 14 PP No. 56/2009 Jalur kereta api khusus adalah jalur kereta api yang digunakan secara khusus oleh badan usaha tertentu untuk menunjang kegiatan pokok badan usaha tersebut	**Article 1 paragraph 14 of GR 56/2009** A special railway is a railway line used exclusively by a certain business entity to support the core activities of the business entity concerned.
Pasal 38 ayat 3 PP No. 56/2009 Perkeretaapian khusus sebagaimana dimaksud dalam Pasal 37 huruf b dilakukan oleh badan usaha untuk menunjang kegiatan pokoknya	**Article 38 paragraph 3 of GR 56/2009** The special railway intended in Article 37 sub-article b shall be operated by a legal entity to support its core activities.

PERATURAN TERKAIT BATASAN KERETAAPI KHUSUS	REGULATIONS RELATED TO SPECIAL RAILWAYS LIMITATIONS
Pasal 350 PP No. 56/2009 (1) Perkeretaapian khusus diselenggarakan terbatas dalam kawasan yang merupakan wilayah kegiatan pokok badan usaha. *Penjelasan: Yang dimaksud dengan "kawasan" adalah wilayah kegiatan yang dibatasi oleh fungsi kegiatan yang dimiliki dan diusahakan oleh satu badan usaha.* (2) Dalam hal terdapat wilayah penunjang di luar kawasan kegiatan pokoknya, penyelenggaraan perkeretaapian khusus hanya dapat dilakukan dari kawasan kegiatan pokok ke satu titik di wilayah penunjang. *Penjelasan: Kegiatan dalam ketentuan ini seperti pengangkutan kegiatan hasil tambang dari lokasi pertambangan yang diangkut ke lokasi pelabuhan/dermaga khusus yang dimiliki oleh satu badan usaha atau ke lokasi penimbunan milik badan usaha*	**Article 350 of GR 56/2009** (1) Special railway shall be limited to operating in a district which is the area of the core activities of the legal entity. *Elucidation: Referred to as "district" shall be an area of activities limited by the functions of the activities owned and carried out by a legal entity.* (2) In case there is a supporting area outside the district of core activities, the special railway can only be operated from the core activities' district to one point in the supporting area. *Elucidation: Activities in this provision shall include, among other things, the activity of transporting mining products from the mining site to the site of a special harbour/quay owned by the legal entity or to a storage site owned by the legal entity.*
Pasal 353 PP No. 56/2009 Badan usaha yang akan menyelenggarakan perkeretaapian untuk menunjang kegiatan pokoknya, wajib mengajukan permohonan izin pembangunan perkeretaapian khusus *Penjelasan: Menunjang kegiatan pokoknya misalnya badan usaha penambangan batubara menyelenggarakan perkeretaapian khusus untuk mengangkut hasil usaha pokoknya berupa batubara.*	**Article 353 of GR 56/2009** A legal entity intending to operate a railway to support its core activities must file an application for a special railway construction license. *Elucidation: Supporting its core activities shall include, for example, a coal mining legal entity operating a special railway to transport the product of its core activities in the form of coal.*
Pasal 364 ayat 2 PP No. 56/2009 Izin operasi perkeretaapian khusus sebagaimana dimaksud pada ayat (1) berlaku selama badan usaha penyelenggara perkeretaapian khusus masih menjalankan usaha pokoknya	**Article 364 paragraph 2 of GR 56/2009** The special railway operation license as intended in paragraph (1) shall be valid as long as the legal entity operating the special railway continues to operate its core business.
Pasal 373 PP No. 56/2009 Izin operasi perkeretaapian khusus dapat dialihkan kepada badan usaha lain bersamaan dengan pengalihan usaha pokoknya setelah mendapat izin	**Article 373 of GR 56/2009** The special railway operation license can be transferred to another legal entity together with the transfer of the relevant core activities after obtaining permission.

PERATURAN TERKAIT BATASAN KERETAAPI KHUSUS	REGULATIONS RELATED TO SPECIAL RAILWAYS LIMITATIONS
Pasal 161 PP No. 72/2009 (1) Pelayanan angkutan perkeretaapian khusus hanya digunakan untuk menunjang kegiatan pokok badan usaha tertentu. *Penjelasan: Badan usaha tertentu antara lain usaha penambangan batu bara, usaha perkebunan, dan pariwisata.* (2) Pelayanan angkutan perkeretaapian khusus sebagaimana dimaksud pada ayat (1) dapat diintegrasikan dengan jaringan pelayanan angkutan perkeretaapian umum dan jaringan pelayanan angkutan perkeretaapian khusus lainnya. (3) Dalarn hal terjadi integrasi sebagaimana dimaksud pada ayat (2) maka berlaku ketentuan pelayanan perkeretaapian umum. (4) Dalam hal pelayanan angkutan perkeretaapian khusus diintegrasikan dengan jaringan pelayanan angkutan perkeretaapian umum sebagaimana dimaksud pada ayat (2), harus mendapat persetujuan dari: a. Menteri, pada jaringan jalur perkeretaapian nasional; b. gubernur, pada jaringan jalur perkeretaapian provinsi; atau c. bupati/walikota, pada jaringan jalur perkeretaapian kabupaten/kota. (5) Dalam hal pelayanan angkutan perkeretaapian khusus diintegrasikan dengan jaringan pelayanan perkeretaapian khusus lainnya sebagaimana dimaksud pada ayat (2), harus mendapat persetujuan dari: a. Menteri, untuk pengintegrasian dengan jaringan pelayanan angkutan perkeretaapian khusus lainnya yang menghubungkan antar provinsi; b. gubernur, untuk pengintegrasian dengan jaringan pelayanan angkutan perkeretaapian khusus lainnya yang menghubungkan antarkabupaten/kota dalam 1 (satu) provinsi; atau c. bupatijwalikota, untuk pengintegrasian dengan jaringan pelayanan angkutan perkeretaapian khusus lainnya yang menghubungkan pelayanan dalam 1 (satu) kabupaten/kota.	**Article 161 of GR 72/2009** *(1)* Special railway transportation services shall only be used to support the core activities of a certain legal entity. *Elucidation: Certain legal entity shall include, among other things, a coal mining business, a plantation business, and tourism.* (2) Special railway transportation services as referred to in paragraph (1) can be integrated with a public railway transportation services network and other special railway transportation networks. (3) In the case of integration as referred to in paragraph (2), the provisions on public railway services shall apply. (4) In the case of integration of special railway transportation services with a public railway transportation services network as referred to in paragraph (2), approval must be obtained from: a. the Minister, for a national railway line network; b. the governor, for a provincial railway line network; or c. the regent/mayor, for a regency/municipal railway line network. (5) In the case of integration of special railway transportation services with another special railway transportation services network as referred to in paragraph (2), approval must be obtained from: a. the Minister, for integration with another special railway transportation services network that connects provinces; b. the governor, for integration with another special railway transportation services network that connects regencies/municipalities within one province; or c. the regent/mayor, for integration with another special railway transportation services network that connects services within one regency/municipality.

PERATURAN TERKAIT BATASAN KERETAAPI KHUSUS	REGULATIONS RELATED TO SPECIAL RAILWAYS LIMITATIONS
Pasal 162 PP No. 72/2009 Pengintegrasian pelayanan angkutan kereta api khusus dengan jaringan pelayanan angkutan perkeretaapian umum dan/atau jaringan perkeretaapian khusus lainnya sebagaimana dimaksud dalarn Pasal 161 dilaksanakan melalui kerja sarna antara badan usaha perkeretaapian khusus dan penyelenggara prasarana perkeretaapian umum dan/atau badan usaha perkeretaapian khusus lainnya.	**Article 162 of GR 72/2009** Integration of special railway transportation services with a public railway transportation services network and/or another special railway network as referred to in article 161 shall be carried out through cooperation between the special railway legal entity and the public railway infrastructure operator and/or other special railway legal entity.
Pasal 163 PP No. 72/2009 Ketentuan lebih lanjut mengenai tata cara pemberian persetujuan pengintegrasian pelayanan angkutan perkeretaapian khusus diatur dengan peraturan Menteri	**Article 163 of GR 72/2009** Further provisions on the procedure for granting approval of integration of special railway transportation services shall be regulated in a Ministerial Regulation.
Pasal 36 PP No. 23/2010 Dalam hal pemegang IUP Operasi Produksi tidak melakukan kegiatan pengangkutan dan penjualan dan/atau pengolahan dan pemurnian, kegiatan pengangkutan dan penjualan dan/atau pengolahan dan pemurnian dapat dilakukan oleh pihak lain yang memiliki: a. IUP Operasi Produksi khusus untuk pengangkutan dan penjualan; b. IUP Operasi Produksi khusus untuk pengolahan dan pemurnian; dan/atau c. IUP Operasi Produksi.	**Article 36 of GR 23/2010** Where Production Operation Mining Permit (IUP) holders do not perform activities of hauling and sale and/or processing and refining/smelting, the hauling and sale and/or processing and refining/smelting activities may be performed by other parties that hold: a. a Production Operation Mining Permit specifically for hauling and sale; b. a Production Operation Mining Permit specifically for processing and refining/smelting; and/or c. a Production Operation Mining Permit
Pasal 39 PP No. 23/2010 Badan usaha yang melakukan kegiatan jual beli mineral logam atau batubara di Indonesia, harus memiliki IUP Operasi Produksi khusus untuk pengangkutan dan penjualan dari Menteri, gubernur, atau bupati/walikota sesuai dengan kewenangannya.	**Article 39 of GR 23/2010** An Entity that performs metal mineral or coal trading activities in Indonesia must obtain a Production Operation Mining License specifically for transportation and sale from the competent Minister, governor, or regent/mayor.

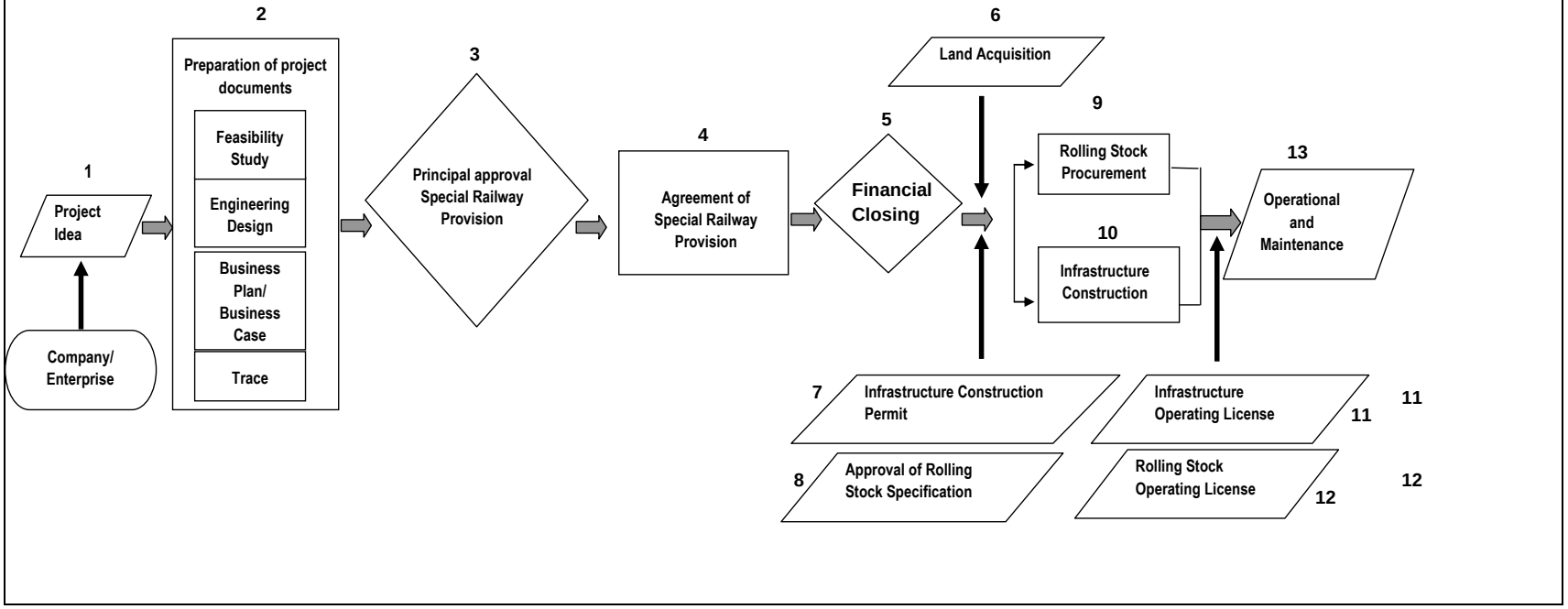
APPENDIX C: IMPLEMENTATION PROCESSES FOR SPECIAL RAILWAYS IN INDONESIA

The current processes for approval and implementation of Special Railways versus public/PPP railway investments in Indonesia, as summarised by the Directorate General of Railways for its internal planning purposes, are outlined in the following two charts, which compare the Special Railway procedures with the procedures for establishing Public Railways. The principal difference between the two procedures, as outlined in the flow charts, is the absence of a tendering and award process in the case of Special Railways, which contrasts with the explicit tendering process resulting in a concession agreement in the case of a PPP.

Annex Table A

FLOW CHART – INVESTMENT PROCESS OF SPECIAL RAILWAY PROVISION IN INDONESIA

In Line with:
Law No. 23 Year 2007 on Railways and Government Regulation No, 56 Year 2009 on Railway Provision

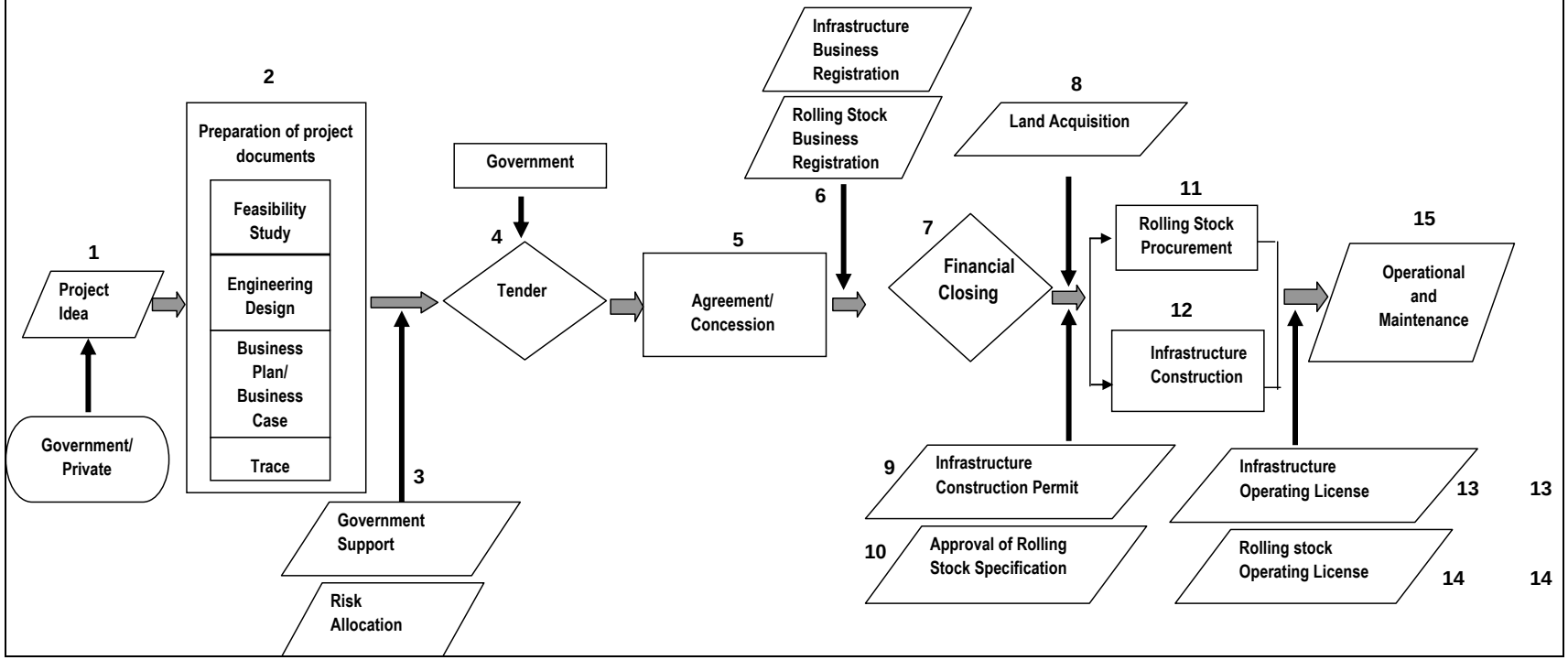


Annex Table B

FLOW CHART - INVESTMENT PROCESS OF PUBLIC RAILWAY PROVISION IN INDONESIA

In Line with:

Law No. 23/2007 on Railways, Government Regulation No. 56/2009 on Railways Provision and Presidential Regulation No. 13 /2010 on Revision of Presidential Regulation No.67/2005 on the Partnership of the Government with Business Entities in the Provision of Infrastructure



APPENDIX D: INTERNATIONAL PRACTICES

International experience shows that over the last two decades there has been a strong trend toward development of sector-specific industrial railway lines and toward decentralisation and privatisation of formerly monolithic national railway networks. Detailed data on these operations is difficult to obtain because sector-specific lines are often treated as an integral part of company operations and performance information may be proprietary. In many cases, rates are wholly unregulated and hence unpublished, or railway costs are simply absorbed into total product costs. Depending on railway size and particular conditions, sector railways may be regulated by transport ministries for safety or, in some cases, may be subject only to safety regulation applicable to industry generally.

Data availability issues aside, sufficient information exists to show that international trends are moving away from highly centralised national networks. Transport is essential for fostering economic growth in a sector such as mining, and most countries are encouraging the industries that benefit most from such sectoral development to take primary responsibility for their transport needs. Existing national railway networks typically benefit more from traffic generated by minimally-regulated, sector-specific railway lines than they are injured by competition from them.

United States

United States Railways have always been dominated by the private sector (except for Government operation during the two World Wars, still largely administered by the private owners) and today there are seven large “Class 1” railways, 30+ regional “Class 2” railways, and more than 500 smaller “short-line” railways. These short-line railways are particularly pertinent to the Special Railway issues addressed in this paper – they serve a variety of local purposes ranging from commuter services to strictly internal company operations. A number of the lines are minerals carriers. The United States has the world’s largest number of “special railways.” In 2009, US short-line railroads employed 20,000 people and owned 20 percent of the nation's railway lines (45,000 kilometres). About 25 per cent of all US rail freight travels on short-line railways for some part of its journey.

In the United States, railway developers are responsible for acquiring the property needed for railway construction and operation, with or without governmental support (mostly from local jurisdictions). The federal government has no more right to railroad land than it has to any other private property. That is, any claims would be based on the terms under which federal land was made available for railroad use. The federal government certainly could not require that any State or local property agreements for railroad use be reserved for integration into national rail networks after the private railroad ceased to operate (a regulation now being considered by the MoT).

Railways in England and the United States (along with banks, insurance companies and other transporters) were among the first businesses to require a corporate charter; i.e., to be incorporated. (Prior to the 19th century, almost all businesses were informal, with no rules of corporate governance.) In the US, incorporation was, and is, done mainly at the State level and without any limitation as to who can incorporate as a railway company. The equivalent in Indonesia would be for the provinces to be able to charter any railway activity they saw fit, subject only to any national safety standards established. Following the US model, there would be no restrictions on who could operate a rail line in, say, East Kutai – a coal mine operator, a group of affiliated mining interests, ports, other private parties, or a public-private joint venture.

Railroad operating rules were also developed by the private sector and had evolved to near universal application by 1887, when the Standard Code of Operating Rules (SCOR), was published by the Association of American Railroads (AAR). All railroad rule books in North America today (including Canada and Mexico as well as the US) have their foundation in SCOR. At present, most Class I railroads in the US use one of two standard rulebooks: the Northeast Operating Rules Advisory Committee (NORAC) rulebook and the General Code of Operating Rules (GCOR). Conrail, Amtrak, and several commuter and short line railroads in the north-eastern US use the NORAC rulebook. The GCOR is used by every Class I railroad west of the Mississippi River, most of the Class II railroads, and numerous short-line railroads. A few railroads, including CSX, Norfolk Southern, Illinois Central, and Florida East Coast, have adopted their own rulebooks.

The United States' Federal Railroad Authority (FRA) requires adherence to a code on industry safety practices and for years has been recommending the standardisation of operating rules and practices for cost-effectiveness in terms of both safety and efficiency. However, the FRA has elected to allow railroad operating rules to be established primarily by railway carriers and their association rather than imposing government rules on the industry.

Nearly all US short-lines are independently operated, privately owned enterprises that would be classified as public railways in Indonesia – they carry freight (and sometimes passengers) for hire. In addition to a number of pure "industrial facility" railways that are unreported, about 72 of the small US railways are "shipper-owned", defined as 50 per cent or more of the railway's traffic being the owner's own cargo. However, there is no prohibition on any other cargo being carried. US short-line railways are essentially free from economic regulation of rates and services, but are regulated in terms of safety and technical standards (though the specific codes remain industry-developed, as noted above).

Any citizen, including a public or private corporate entity, can develop a railway line – either a public or specialised railway – to serve its perceived needs. The railway line developer must comply with local rules and regulations regarding land use, the environment, endangered species, and other local terms and conditions. Local government agencies are free but not required to use their power of eminent domain to help assemble the right-of-way. Once the railway is built, it must have safety and

technical standards that comply with regulations issued by the Federal Railway Administration (part of the Department of Transportation). Generally, there are no access requirements for such railways – access to a privately built railway is subject to commercial contract negotiations. A railway built for a special purpose – e.g., to serve a mine or industrial complex – can serve other customers at its discretion and under commercial terms acceptable to it and the other customers.

In some cases, the Surface Transportation Board (STB; the US economic regulator for transport), as a part of its review of a merger or acquisition of one railway by another, can compel third-party access over the combined railway if it is in the public interest. The STB can also direct competing railways to reach a commercial arrangement to share facilities where it deems this to be in the public interest. Such cases generally only arise in major railway mergers and acquisitions, as a mechanism to protect an existing competitive environment. They rarely apply to smaller industry-focused lines.

In all cases, local governments have easement rights to cross private infrastructure with roads and utilities. Those rights are subject to local laws, and the terms are generally commercially negotiated in the public interest.

Canada

The Canadian rail sector is similar to that in the United States, adjusted for the size of the economy. More than 40 enterprises operate short-line and regional railways over 13,000 kilometres of track, representing about 30 per cent of the entire Canadian railway network. As in the US, there is little economic regulation of small railways except for rate oversight on certain grain traffic. In Canada, as in the US, small railways are incorporated in regional (provincial) jurisdictions; there are no requirements to limit traffic to the owner's own traffic; and the national government has no claim on the use of any property that it did not previously own and conditionally release for private railway use. A mining investor in, say, Saskatchewan province could:

1. Organise the railway under whatever corporate form it chose
2. Elect to transfer the property to an unaffiliated party
3. Carry other parties' goods or passengers under contract
4. Become a "common carrier," as long as it abided by safety regulations and limited tariff oversight required for public services

As in the US, in Canada any public or private enterprise can develop and build a railway, whether for exclusive use, limited use, or as a common carrier. The railway developer must meet local environmental and land-use regulations. While Canada, like the US, does not require public or competitor access to private railways, Canadian regulations do require that a railway provide infrastructure access to another private railway if the customer served is within 15 kilometres of the proposed point of interchange. Access is commercially negotiated but the commercial terms cannot be unreasonable and are subject to judicial oversight.

Any new railway must meet the safety and technical standards promulgated by Transport Canada, which are similar to those issued by the Federal Railway Administration in the United States. Local governments have the right to cross private (or publicly financed) infrastructure with roads, drainage structures, and utilities. Those rights are subject to local laws regarding terms and conditions and are generally commercially negotiated in the public interest.

Mexico

Mexico, after supporting a money-losing state-owned railway throughout most of the 20th century, concessioned its main railway to three private operators in 1996-97, followed by concessioning residual lines as six short-lines (ranging from 72 to 1,550 kilometres in length) in 1997-2000. Mexico's short-line railways serve a number of communities and businesses, and a few are special purpose mineral railway operations. As is true throughout North America, Mexico has no restrictions on the corporate affiliations of railway owners nor does it restrict the goods any railway can carry. Mexico gives primary regulatory responsibility to the Secretaria de Communicaciones y Transportes (SCT) to ensure compliance with safety rules and oversee certain policies on tariffs and access. The railway unit within the SCT publishes and enforces safety and technical standards for railways and any new railway must meet those standards. Safety and technical regulations are similar to those in Canada and the US.

Mexico, however, also has a strong competition law. It designed its privatised rail system to create competition at major commercial centres and assigns certain responsibilities concerning rates and competitive issues to a general competition agency (Comision Federal de Competencia or CFC). The CFC has prevented rail mergers on grounds that they might reduce competition. Under current Mexican law, railways similar to the proposed Bukit Asam ventures in Sumatra would be supported as pro-competitive, and multiple service points and transport connections would be encouraged rather than restricted as under Indonesia's Special Railway provisions and proposed Ministerial Regulations amplifying them.

As in the US and Canada, any public or private enterprise can develop and build a railway for limited or public use in Mexico. Each private railway development must meet local land-use and environmental regulations. As in the US and Canada, local governments can help the development of such railways either directly or indirectly, through land acquisition or other means, as long as their actions are legal and proper under general laws of public governance.

Russia

Although Russia is commonly thought of in terms of its large state-owned railway network, the image of a centralised system is false. Even in the USSR there were 17

major railroads and about 70 railway divisions which, while controlled by the Ministry of Railways, had a substantial degree of autonomy in many respects. Beyond that, there are many industrial railroads in Russia (such as mining or lumbering railroads) with a total length about half that of the common-carrier system (which now also hosts many above-rail operators). About two-thirds of industrial railway freight in Russia flows to and from the common-carrier railroads while the other third is internal transport only on an industrial railroad. (For example, a lumber company uses its private industrial railroad to transport logs from a forest to its sawmill.) About 4 per cent of the industrial railroad traffic travels on tracks jointly operated by two companies.

In addition to the thousands of kilometres of industrial and privately owned and operated railways, reforms in the Russian rail sector have resulted in the growth of hundreds of rail equipment operators. These reforms are transforming Russia's railways. Since 2003, private investors have acquired more than 400,000 freight cars (worth nearly USD20 billion), and more than 2,000 private operators have evolved, some of which are rail service companies only while others are affiliates of shipper/industrial lines. While Russian Railways (RZD) still dominates the rail-freight market, the private operators are gaining ground rapidly – jumping from a 26 per cent market share in 2003 to 38 per cent by 2007. A new equipment leasing market has developed and private investment in the sector (including new suppliers for passenger equipment, freight cars, locomotives, and railway infrastructure components such as signalling, sleepers, and electronic systems) has attracted billions of dollars in new investment. At the same time, the railway, transformed from a cabinet level ministry to an SOE, has thrived, become profitable and is now able to float Eurobonds and otherwise raise the capital needed to renew and transform itself.

Most railways in Russia that are not a part of the national railway network (RZD) are owned and operated by private enterprises (coal, timber and steel companies). Generally, the industrial railways are operated as separate subsidiaries and may be jointly owned by several enterprises and local government units. These railways are free to provide service to shippers that are not part of the enterprise group owning the rail unit. In the past, prices were related to the national tariff, but they are now largely unregulated. Pricing oversight is provided by a national competition commission, largely on the basis of complaints rather than strict oversight.

People's Republic of China (PRC)

While state-owned China Railways (CR) continues to run a large majority of rail lines in the People's Republic of China, regional networks and joint ventures have multiplied in recent years. Of China's 78,000-km railway network in 2007, 65,320 km (about 84 per cent) was owned and operated by the Ministry of Railways, 8,940 km was owned by joint-venture railways and 4,740 km was controlled by local authorities or industries. Continued growth in demand and the increasing need for reliable transportation have resulted in dedicated railway lines for each of the ten major coal-production areas, which form a key component of China's railway expansion plans. The railway financing

system in the PRC is based on the principle of "government taking the leading role, but diversified investment and market oriented projects."

Joint ventures are the major mode for new railway projects in the PRC. At the end of 2008, RMB300 billion (about USD45 billion) was committed from outside MOR. The decentralised portion of China's rail sector is expected to grow significantly in absolute size and system percentage. Strategic investors such as power plants, coal mines, ports, insurance groups, either public or private, are expected to play a major role. The Shenhua Group (a large coal mining and energy company) operates Shenhua Railway, now totalling 1,369 km, with various expansion projects planned. The private special purpose Shenhua Railway carries more than 150 million tons of coal annually. In the PRC, special rates are applied to non-national railway lines according to their investment costs and other factors. For Shenhua's railway lines, the rates are set by kilometre, with no base cost. Yankuang Group Corporation Limited also operates regional coal railways; Yanzhou coal, for example, operates a 184-km track connecting Yanzhou's mines with its largest client.

Asia Energy Logistics Group has recently become China's first private majority foreign-owned operator of cargo railways. Asia Energy has a 62.5 per cent stake in a CNY1.6 billion, 250-km, 10 million-tons-a-year coal railway project in Hebei province. Private companies, especially resources miners, have been eager to develop their own railways instead of waiting for the government to expand the railway network, providing room for private enterprises to engage in smaller projects.

Another privately funded rail project is planned to link the towns of Jiafeng and Nanchenpu over a stretch of 64.29 kilometres. The USD340 million rail line will have six stops and pass through six counties in Sanxi province. It has been funded by two private companies – Broad Union Investment Management Group Co., Ltd. and Ufeng Railway Construction Investment Co., Ltd. – in addition to the local state-run Railway Bureau of Zhengzhou. McKinsey & Company recently projected that private and foreign investment in China's railways will rise from 7 to 30 per cent in the coming years.

Private railway development is subject to the approval of the Ministry of Railways and must meet CR technical and safety standards.

Japan

Japan has 57 significant private railways (excluding numerous metros, trams and monorails and other urban systems) in addition to the seven major private railway systems (six passenger, one freight) created from the breakup of Japanese National Railways. While most conventional railway lines are regional systems that principally carry passengers, they include 14 freight lines, some of which are specialised in particular commodities (notably coal, limestone, cement, chemicals, oil, and containers). Despite specialisation and close affiliations with industries served, there are no ownership restrictions for operating a regional freight line.

While the pace of new railway development in Japan has slowed in recent decades, any national entity (public or private) is free to assemble the land and resources to develop a railway to meet its needs. New railways must meet local government standards and conform to safety and technical standards set at a national level. Access arrangements are subject to commercial negotiation, with the national government having a right to require access to private (or local government-financed) railway infrastructure.

India

Since independence, Indian Railways (IR) has enjoyed a strong monopoly in India, although a few private railways do exist on private estates or are operated by companies for their own purposes (including plantations, sugar mills, collieries, mines, dams, harbours and ports). The Bombay Port Trust runs a railway of its own, as does the Madras Port Trust. The Calcutta Port Commission Railway and the Vishakhapatnam Port Trust are special railways serving specific ports. The Bhilai Steel Plant has a freight railway network. Tata (a private concern) operates funicular railways at Bhira and at Bhivpuri Road (as well as the Kamshet-Shirawta Dam railway line, which is not a public line). The Pipavav Rail Corporation holds a 33-year concession for building and operating a freight railway line from Pipavav to Surendranagar. The Kutch Railway Company, a joint venture of the Gujarat state government and private parties, is involved (along with the Kandla Port Trust and the Gujarat Adani Port) in the Gandhidham-Palanpur freight railway line. In the past, IR generally set the freight tariffs on these lines except for own-use traffic, but after reforms in 2005 there has been a trend to allow the operating companies freedom to set freight tariffs and generally run the lines without reference to IR.

Recently, the railway ministry in India launched a major initiative to develop alternative sources of funding for developing infrastructure projects. It calls for involving the private sector in constructing tracks, developing private freight terminals, automobile and ancillary hubs, and the private operation of special freight trains on the network. The initiative accommodates a variety of approaches, including PPP arrangements under which private participants will share the cost of developing a new line and then be entitled to a discount of 10-12 per cent on incremental traffic carried on the network. Alternatively, new lines can be constructed under a "full contribution apportioned earning mode," where the private entity would finance the building of a new line and, in return, receive apportioned earnings for a period of 25 years (i.e., essentially a concession).

In addition, India is promoting a vertical separation "special freight train operation" scheme, allowing private operators to invest in private freight cars and use the railway network for a period of 20 years. These companies will pay IR an access charge and will set their own prices for services offered.

The development of railways requiring national government financing is still restricted in India, remaining largely under the control of the powerful Ministry of Railways.

Many developments have been slowed by the requirement for Indian Railway Ministry control.

Australia

The Australian railway system has greatly decentralised over the last two decades, with nine enterprises now operating railway infrastructure and train services, three separate infrastructure managers, nine train operators of freight services, five operators of commuter services, five others providing regional services, five special purpose iron ore railways, and a variety of small local train operations. Australian law provides for multi-carrier access to infrastructure in most cases and there is little constraint on railway pricing.

As in North America, any Australian entity can develop a private railway in Australia. It must comply with local and national land-use and environmental regulations and can use the support of local government units to help assemble the land needed for the railway development. For the most part, railway lines are considered strategic infrastructure and national open-access rules apply when the access is in the public interest. This sometimes requires a legal proceeding to determine the extent of the public interest. Generally, access requirements also require the accessing railway to bear the cost of any capacity additions needed to keep the accessed railway whole.

Brazil

Compelled largely by the need to reduce a railway subsidy burden amounting to approximately USD300 million annually, in 1992 Brazil began to develop a railway concessioning process modelled largely on Argentina's experience, but with a more complex structure. The concessioning design was completed in 1995 and concessions were let over the next two years. As in Argentina, the terms of freight railway concessions were set at 30 years, but with extensions possible for another 30 years.

Between 1996 and 1998, six freight concessions were developed from the federal railway (Rede Ferroviária Federal) and one from the Sao Paulo State railway. In addition, the huge state mining and industrial enterprise, Copanhia Vale de Rio Doce (CVRD, now Vale) was privatised in June 1997, along with its two private rail lines serving its own traffic: Estrado de Ferro Vítoria a Minas (EFVM) and Estrada de Ferro Carajás (EFC). Both private railways carry general freight traffic and determine their own prices for such transport. General freight traffic on the EFVM amounts to more than 30 per cent of all traffic on the network. In the passenger sector, Brazilian experience, as in Argentina, focused on urban transit, specifically in Rio de Janeiro and Sao Paulo. Budget deficits and the need to reduce state subsidies to the city subway and commuter rail (Flumitrens) led to the concessioning decision. The Rio de Janeiro metro system was concessioned in December 1997 to a consortium (Consórcio Opportrans), including Cometrans, the owner of the Mitre and Sarmiento passenger

rail concessions in Buenos Aires. Operational control was transferred in April 1998. The Flumitrens concession was signed in July 1998 and went into effect in November 1998.

In addition, there are a number of small Brazilian industrial lines. For example, Portofer-Transporte Ferroviário Ltda., a private company, provides railroad operations for Santos harbour. Other ports, cement plants and steel companies have small internal railway operations.

Today the Brazilian railway network consists of 15 privately owned and operated cargo lines, six privately owned and operated metropolitan networks and seven additional urban transport companies, about ten short-lines of up to 50 km that are used mainly for tourism, and a number of private internal company rail operations as indicated above. In the 10 years after the Brazilian state railway was divided up, the industry had a substantial revival. General cargo traffic increased by 112 per cent and steel and minerals cargo by 91 per cent, while containerised traffic increased more than 10 times compared with 1999 volumes. With concessioning rail pricing and rate levels remaining stable, labour and total factor productivity increased substantially. Overall, there has been a substantial increase in the sustainability of Brazil's railway sector.

In contrast to the Indonesian Special Railway regulation requirement for common ownership, the principal criticism of private railway operations in Brazil is that the affiliation between railway shareholders and major industries is too great. Although it is recognised that these affiliations were essential for attracting private investment to the railways, diversification of ownership is now being encouraged when new investment is solicited.

Conclusions

International experience shows that many countries are encouraging private participation in the rail sector. They are doing so by making it easy to get licenses, limiting regulation to safety, environment, and human resource issues, and providing an environment that permits a wide range of private finance mechanisms. Private participation in the rail sector generally results in (i) much greater investment in rail infrastructure, (ii) privately financed rolling stock, and (iii) the development of innovative means to finance rail sector investments – including development of leasing and contracting markets in everything from locomotives to track maintenance machinery.

The overall lesson from international experience is that liberalisation of transport regulations to encourage private sector participation in rail transport markets, including infrastructure, leads to greater investment, more competition, declining rail transport prices, and much better customer services. Private participation in the rail sector can transform the sector and contribute significantly to national economic development.

With regard to specific differences with Indonesia, no other country of which we are aware requires railways outside of the national network to serve only a single enterprise and be owned by it. On the contrary, private investment in railways without any enterprise connection is encouraged, and service other than to a particular industry is welcomed as creating transport capacity that would otherwise not exist. Whereas the current Special Railway rules appear designed to avoid competition between new lines and the national network, most railway sectors encourage competition as being in the public interest. International experience supports a range of organisational options and procedures to increase railway capacity: sector-specific investments, regional initiatives, PPPs and SOEs. Current international trends strongly suggest the need for Indonesia to liberalise the permissible scope of investment in the rail sector by either modifying the Special Railway provisions or designing workable alternatives to the Special Railway provisions, or doing both.

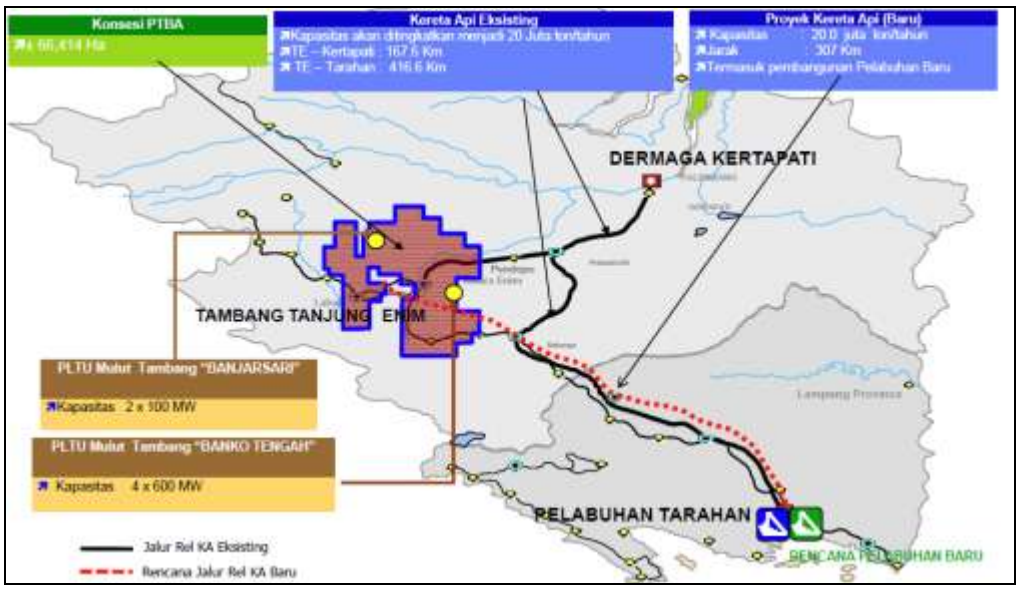
APPENDIX E: DIAGNOSTICS OF PENDING RAILWAY INVESTMENTS

Bukit Asam Project Diagnostic

PT. Tambang Batubara Bukit Asam (Persero), Tbk[40] (Bukit Asam or PTBA), is an SOE, with the GoI owning a 65 per cent stake in the company. The company's main coal mine is in Tanjung Enim, South Sumatra, and has long been in production. In addition to Tanjung Enim, PTBA also owns Ombilin and Cerenti mines in South Sumatra, plus several (mostly undeveloped) mines in Kalimantan. In total, PTBA's minable reserves stand at two billion tons. PTBA is now embarking on several projects that could increase its annual production volume from 11.4 million tons in 2009 to 55 million tons by 2015. That could make PTBA the second largest coal producer in Indonesia, after Bumi Resources.

Bukit Asam Project Description

To support this growth, Bukit Asam is planning a number of rail transport initiatives. These range from simple cooperation arrangements with PTKA to PPP initiatives in South Sumatra province and longer-term plans that might be developed under PPP, Special Railway, or other approaches. Of immediate interest is Bukit Asam's proposed development of a railway under a Special Railway license (see the dotted red line in the map below). The line crosses two provinces, so must be licensed directly by the MoT rather than by a sub-national entity.



[40] *Terbuka* (stock symbol for a public company in Indonesia)

PTBA has structured the investment in its proposed Special Railway through a joint venture company called PT. Bukit Asam Transpacific Railway(BATR). BATR is majority-owned by a company that is not controlled by PTBA or by the specific PTBA coal mining concession (Bukit Asam Bangko, or BAB) that would be served by the rail line.[41] Instead, PT BATR's ownership profile is understood to include a subsidiary of the Indonesia-based Rajawali Group (60 percent), China Railway Engineering (10 percent), and PTBA (30 percent).

At the coal mining level, Rajawali and PTBA have entered into a joint venture agreement under which profits from the incremental coal mining operations, to be transported via BATR, will be distributed 65 per cent to PTBA and 35 per cent to Rajawali. In this case, the MoT has issued its in-principle approval for special railway development to PTBA as the mine resource controlling owner rather than to BATR. However subsequent licenses, including a construction and an operating license, are yet to be issued. [42]

PTBA hopes to have the railway under construction by early 2011 and to start operation by late 2014. To meet this deadline, numerous approvals will be needed for route alignment, land acquisition and other matters. Clear MOT authorisation is a precondition for the permits and approvals needed. Many Indonesian contractors will be involved in developing the mine expansion, railway, and port. The maintenance and management of infrastructure and the operation of trains are also planned to be contracted. It is presently envisioned that these activities will be covered under primary licenses.

Diagnostic Results

The HWTSK team addressed the following issues with respect to the Bukit Asam Special Railway proposal:

1. Are the Special Railway provisions generally appropriate to the proposed railway development? If not, what is an appropriate alternative – PPP rules or a third option?

   In general, the Special Railway option appears to be the best alternative presently available for the Bukit Asam project. A PPP initiative would likely result in substantial delay. Moreover, the proposed railway line would be exclusively or, if

[41] This distinguishes the BATR situation from that of TKK, discussed in the next chapter. TKK is not controlled by TOP, the IUP license holder; this is similar to BATR's situation with BAB. However, TKK is controlled by the investors that control TOP, unlike BATR's relationship with PTBA.

[42] The PTBA license was issued prior to changes in the mining law which may provide a rationale for licensing the railway operator rather than the mine operator. Both PTBA and BATR are supportive of such a change in the Bukit Asam arrangements.

permitted to serve third parties, nearly exclusively devoted to a single customer, PT Bukit Asam and its affiliated companies. Investors are almost certain to prefer that the railway be integrated with the coal development project rather than operated by the winner of a competitive tender, as PPP regulations require.

2. Under the selected option, is PTBA, BATR or some other entity the preferred licensee?

   From an investor and public policy perspective, BATR is likely to be the preferred option. From a legal perspective, PTBA may be required to be the licensee, since the HWTSK team has not been able to reach an interpretation that would qualify BATR and a PTBA subsidiary under Indonesian law. Under the current Special Railways regulation, it appears that ***at a minimum*** *the railway licensee would need to be a subsidiary in order to be the licensee.*

   One possible way to license BATR as the Special Railway Operator is for BATR to take full title to the coal as a mining services company authorised for haulage and sales (requiring an IUJP license under current mining law). Because such an operator would be transporting for its own account, this could qualify as serving the primary business of an enterprise. The viability of this option would need to be assessed in terms of whether adverse tax consequences or other constraints could be avoided.

3. Should the MoT endorse the mine operator or the railway in the Bukit Asam case by applying the same standards as for MEC? Or, is the different treatment used in these two cases justified by the different corporate structures of the applicant groups?

   The team concluded that since the organisational structures of the PTBA and MEC ventures are substantially different, no simple or uniform approach can be recommended.

4. Since PTBA does not have a time-limited concession term like a foreign investor, and since its proposed Special Railway will run generally parallel to an existing national railway line, what should be the similarities or differences in policy concerning the possible transition of the special rail lines to public use?

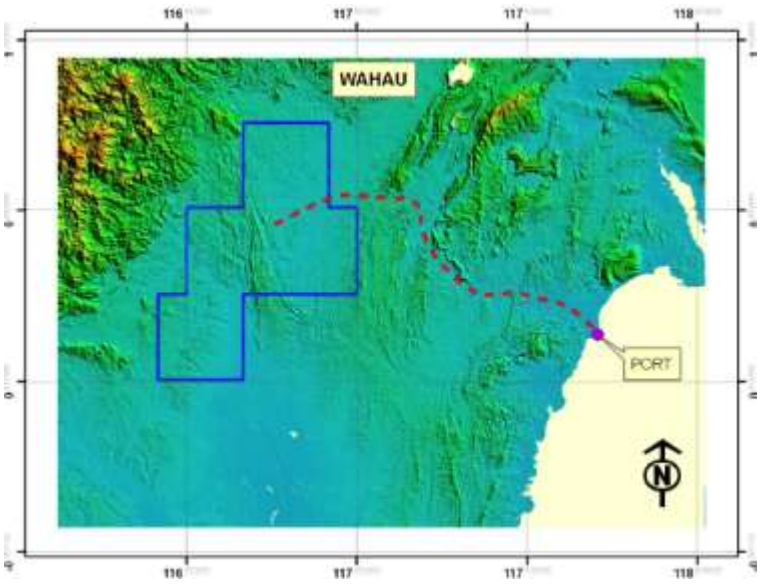
   The status of PTBA as an SOE, together with the fact that BATR would have greater potential than the Kalimantan projects to compete with PTKA, may justify different terms in any license granted for the BATR project (regardless of whether BATR or PT BA is the licensee). However, we recommend that different treatment not be mandated in a Ministerial Decree, but left to the licensing/negotiating process, where local interests may be more fully accommodated.

5. Are any Ministerial Regulation (Permen), Government Regulation (PP) amendments, elucidations or other modifications of legal/regulatory provisions necessary, beyond issuance of MoT approvals to the proposed railway operator?

A Ministerial Regulation is desirable in order to clarify the MoT's interpretation of valid Special Railway ownership requirements and to clarify other issues that may otherwise be subject to overly restrictive interpretations.

MEC Diagnostic

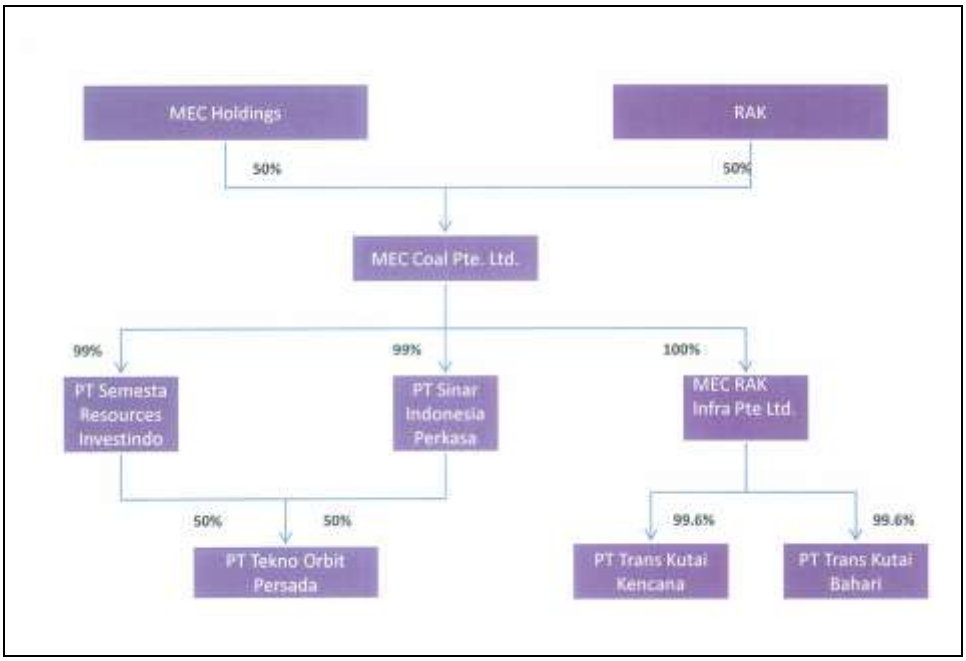
MEC Coal is developing a large greenfield coal project in East Kutai regency, East Kalimantan province, and will require transport of its production to a port for onward movement. Rail service over the distance involved is by far the most economical mode for the coal volumes anticipated. Coal exploration has been completed and mining licenses have been secured and accommodated to conform with the new provisions under the 2009 mining law as well as the implementing regulations that came into effect in March 2010. Speedy implementation of the project is thus substantially dependent on the timely approval and construction of a rail line to take coal to market. The proposed route is shown on the accompanying map. The MoT has issued a principle approval for the regency to license the initial stage of railway development (see Annex B). However, subsequent authorisations, including authorisation for an operating license, are yet to be issued.



MEC Project Description

The structure of the MEC Coal initiative is publicly described as follows:

> MEC, in partnership with the Government of Ras Al Khaimah [RAK, one of the United Arab Emirates], has established MEC Coal to invest in Indonesia's abundant resources and develop its infrastructure.



Indirect Subsidiaries of MEC Coal would be the actual Indonesian legal entities managing the mining operation (PT Tekno Orbit Persada or TOP), the port facility (PT Trans Kutai Bahari or TKB) and the proposed Special Railway (PT Trans Kutai Kencana or TKK).. TOP is in the process to acquire a small ownership interest in TKK.

For the latter purposes and the analysis undertaken in this Report, the critical entities are:

- PT Tekno Orbit Persada (TOP), the licensee for the coal concession under the mining law
- PT Trans Kutai Kencana (TKK), the licensee for the railway
- PT Trans Kutai Bahari (TKB), the licensee for the port operation

To develop the railway, mine and port, numerous contractors will be involved, and the actual maintenance and management of infrastructure and operation of trains is also planned to be contracted. While it is presently envisioned that these activities will be covered under primary licenses, the key issues to be addressed are as follows:

- Are the Special Railways provisions generally appropriate to the proposed railway development? If not, what is an appropriate alternative – PPP rules or a third option?
- Under the selected option, is TKK, TOP or some other entity the legally appropriate licensee?
- Should any conditions be attached to MoT endorsement of the East Kutai regency license to ensure the license will be valid for the length of the mining concession or other agreed term?

- What should be done to provide consistency and thus a stable system providing certainty to the industry?
- Is issuance of any Ministerial Decree (Permen), Government Regulation (PP) amendment, elucidation or other modification of existing legal and regulatory provisions necessary? Or, is issuance of MoT approvals with appropriate guidelines to provincial and regency governments and the proposed railway operator sufficient?

Diagnostic Results

The HWTSK team addressed the following issues with respect to the MEC Railway proposal:

1. Are the Special Railways provisions generally appropriate to the proposed railway development? If not, what is an appropriate alternative – PPP rules or a third option?

   In general, the Special Railway option appears to be the best alternative presently available for the MEC project. As with Bukit Asam, a PPP initiative would likely result in substantial delay. At least in the near term, the proposed railway line would exclusively or, even if permitted to serve third parties, nearly exclusively be devoted to a single customer – the MEC indirect subsidiary TOP. Investors are almost certain to prefer that the railway be integrated with the coal development project, rather than operated by the winner of a competitive tender, as PPP regulations would require if applied.

   For regency and provincial economic development purposes, there may be merit in eventually allowing TKK to provide limited public services in the region. To do this, regulations to authorise a Limited Public Railway might be established via a Perpres or other procedure. Such provisions would be in line with provisions available under private port terminals and airport regulations allowing the Minister to authorise such services where there is no other similar capacity available. We do not endorse this option for the PTBA/BATR case (although we do not reject it) because a wider variety of cargo and passenger services is available through PTKA and by other means.

2. Under the selected option, is TKK or some other entity the legally appropriate licensee?

   *From an investor and public policy perspective, TKK appears to be the preferred option. From a legal perspective, however, there are significant difficulties in approving TKK as the **SR operator**. However, since the focus of the SR provisions is the scope of **service** that may be offered by the SR, we do not regard the*

preliminary development/construction license approvals as a major concern.[43] *For TKK to receive an operating license, however, there may need to be greater transparency in ownership arrangements and modification of control arrangements to make TOP and TKK subsidiaries of a common Indonesian legal entity. At present, TKK is not a subsidiary of TOP and there appears to be no plan to make it one. Both TOP and TKK appear to be controlled by MEC Coal, which could make them subsidiaries that – if MEC Coal were an Indonesian PT – might qualify TKK to be an SR operator. However, MEC Coal is not an Indonesian legal entity. If that is unchanged by the time an operating license is to be issued, TKK might have to be limited to transporting coal that it legally owns. Absent that, another possible option would be for TOP to be offered the license. (TKK could then provide services as a contractor alongside Canac, which is presently expected to provide technical services to the railway operator).*

To restate, under the current Special Railways regulation, it appears that ***at a minimum*** *the railway licensee would need to be a subsidiary of the enterprise controlling the mining properties. As with BATR, a possible option to license TKK as the Special Railway Operator could be available if it took full title to the coal as a mining services company authorised for haulage and sales (probably requiring an IUJP license under current mining law). Because such an operator would be transporting for its own account, this might be argued as serving the primary business of an enterprise. The viability of this option would need to be assessed to determine whether adverse tax consequences could be avoided. We do not see a compelling need for TKK to resort to this option if MEC Coal takes timely action to solidify TKK's subsidiary status under Indonesian law.*

3. Should the MoT endorse the mine operator or the railway in the MEC case by applying the same standards as in the Bukit Asam case? Or, is the different treatment used in these two cases justified by the different corporate structures of the applicant groups?

   The team concluded that since the organisational structures are substantially different, no common yardstick can be applied.

4. Given the distinct difference in the MEC and Bukit Asam situations, what should be the similarities or differences in policy concerning the possible transition of the special rail lines to public use?

   The status of PTBA as an SOE, together with the fact that BATR would have greater potential than the Kalimantan projects to compete with PTKA might be argued to justify different terms in any license granted for the BATR project (regardless of whether BATR or PTBA is the licensee). However, we recommend that a different treatment not be mandated in a Ministerial Decree, but left to the licensing/negotiating process, where local interests may be more fully accommodated.

[43] TKK could be properly qualified as an operator by the time an operating license is issued, by virtue of a clarification/change in corporate ownership, a change in regulation, or (as with BATR) by the choice of TKK to own the coal that it carries.

The case for converting TKK to a Limited Public Railway may be greater than for BATR, for the reasons stated above.

5. Are any Ministerial Regulations, Government Regulation amendments, elucidations or other modifications of legal/regulatory provisions necessary, beyond issuance of MoT approvals to the proposed railway operator?

   A Ministerial Regulation is desirable in order to clarify the MoT's interpretation of valid Special Railway ownership requirements and to clarify other issues that may otherwise be subject to overly restrictive interpretations.

Central Kalimantan PPP Diagnostic

A full legal analysis is not possible at this stage for the proposed railway projects in Central Kalimantan, due to an ongoing PPP procurement process. The current status of the procurement process is subject to confidentiality constraints to avoid prejudging the tender evaluations. Because of the ongoing nature of current negotiations, the proposal of alternative structures and licensing methods. Even so, we discuss the proposed project in this chapter for three reasons:

- First, should the Special Railway option not be available to Bukit Asam and/or MEC for reasons discussed in the preceding chapters, a PPP process similar to that underway in Central Kalimantan is the only alternative process available under existing law and regulations. It is necessary to determine, therefore, whether that process might be applicable to either the Bukit Asam or the MEC case.
- Second, should the ongoing PPP process in Central Kalimantan fail, the next question would be whether the Special Railway provisions as currently constituted would be a viable option for prospective investors in a Kalimantan railway service.
- Finally, the Central Kalimantan project is unlike either the proposed MEC line (a regency project) or the BATR proposal (a national, inter-province project) in that it is a provincial project involving multiple regencies, even in the initial phase.

Central Kalimantan Project Description

The railway development process being used in Central Kalimantan falls under statutes passed to develop infrastructure through a PPP process outlined in two Presidential Regulations.[44] These regulations have the following important characteristics:

1. They pertain to infrastructure development broadly and have no provisions specifically dedicated to railways.

[44] Presidential Regulation No. 13 of 2010 *amending Presidential Regulation Number 67 of 2005*; and Presidential Regulation No. 67 of 2005 *Concerning Government Cooperation With Business Enterprises in infrastructure Provision*.

2. They are to be implemented through a public tender, with the operator of the infrastructure project to be competitively selected.
3. While a legal entity that may be served by the infrastructure project may bid to operate the project and may be given certain specific advantages in the bidding process (a percentage price advantage in financial bids or a right to match lowest bids), there is no guarantee that the proposal originator and prospective user will win the procurement.
4. It is envisioned that the service provided through the infrastructure development would be a public service. For railways, that would require General/Public Railway status under Law no. 23/2007.
5. As a General/Public Railway, a PPP railway would be subject to the infrastructure access rules for rail operations mandated for General Railways.

As illustrated in the accompanying map, the long-term plans for the Kalimantan PPP are ambitious. It envisions a total network of about 1,850 kilometres eventually connecting all regencies in the province and consisting of the following phases (shown on the map):

Phase 1A: Puruk Cahu-Bangkuang (185km)

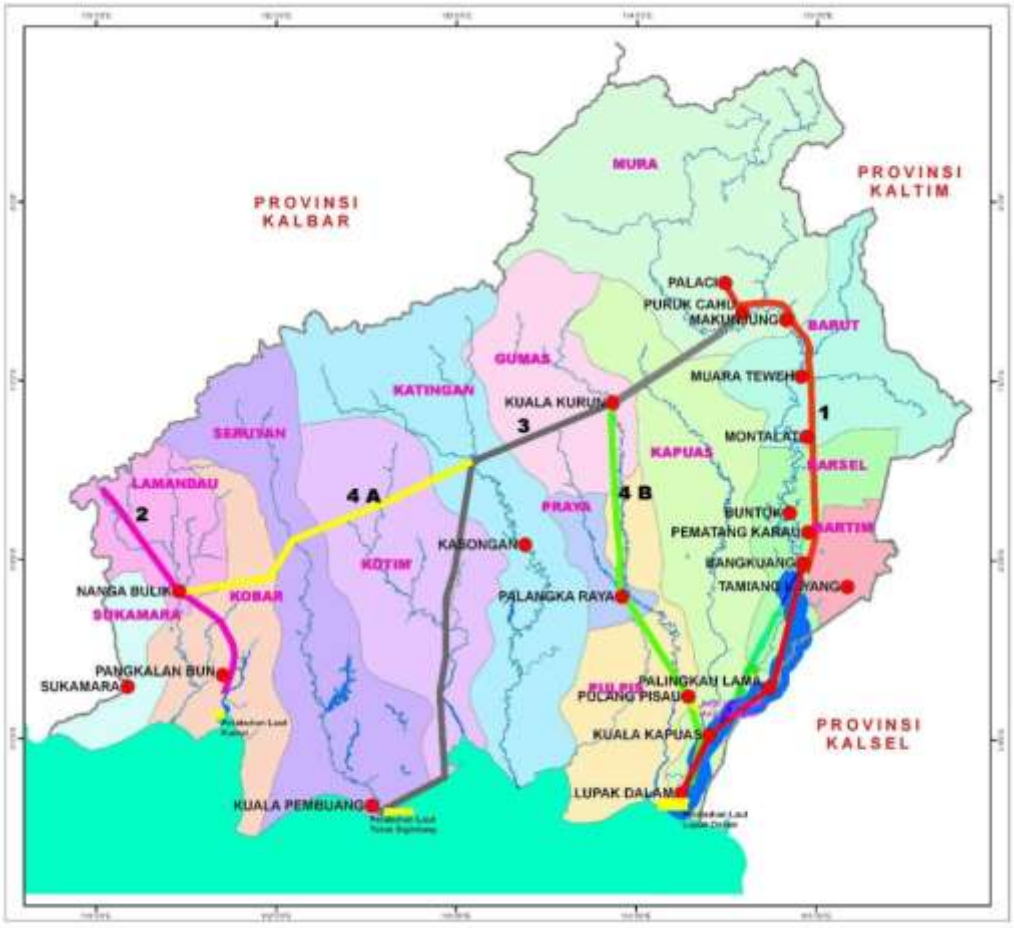
Phase 1B: Bangkuang-Lupak Dalam (175km)

Phase 2: Kudangan-Kumai (195km)

Phase 3: Puruk Cahu-Kuala Kurun-Kuala Pembuang (466km)

Phase 4: Tumbang Samba-Nangabulik (418km)

Phase 4B: Kuala Kurun-Lupak Dalam (390km)



While these may be long-term objectives, the priorities for the current Central Kalimantan PPP rest on the proposed 185-kilometer rail line linking Puruk Cahu and Bangkuang. This line — the red line on the right of the next map – is expected to cost about USD1.5 billion. The Central Kalimantan government hopes to have selected an operator by year-end 2011, if not by the earlier 2010 deadline that has been the subject of many press reports. The reason the PPP mode was selected, rather than the Special Railways approach chosen by Bukit Asam and MEC, is illustrated by the map below, which portrays coal holdings in the upper portion of the red rail line shown. There are at least 16 different mining licensees that would be served by the line, and these operators are associated with Indonesia's largest coal mining firms as well as several international concerns. Railway development by a single operator, therefore, would be politically difficult and economically inefficient.

Coal Mining Company (PKP2B)
① PT Marunda Graha Mineral
② PT Asmin Bara Bronang
③ PT Asmin Bara Jaan
④ PT Asmin Koalindo Tuhup
⑤ PT Batubara Duaribu Abadi
⑥ PT Bharinto Ekatama
⑦ PT Juloi Coal
⑧ PT Kalteng Coal
⑨ PT Lahai Coal
⑩ PT Maruwai Coal
⑪ PT Multi Tambang Jaya Utama
⑫ PT Pari Coa
⑬ PT Ratah Coal
⑭ PT Sumber Barito Coal
⑮ PT Suprabari Mapanindo Mineral
⑯ PT Eagle Coal

It is hoped that construction of the rail line will help maximise coal production in the province, whose coal is in high demand due to high calorific value and low ash and sulphur levels. The railway is seen as the only feasible option for transporting coal throughout the year, particularly for mining reserves that are further inland than already-developed holdings near the coast. That coal is currently transported by road and river, but existing roads are only able to support trucks carrying about eight tons, while river transportation further inland is impossible during the dry season, even for small barges (and both transport modes are controversial on environmental grounds).

As publically reported, the current proposal would be developed as a public-private partnership scheme, with the line being constructed by private investors that would be given a concession to operate it for 30 years. The initial line is expected to carry 10 million tons per annum during the first 10 years of operation. This figure is expected to increase to 20 million tons, so that about 500 million tons of coal would be transported by the railway over the course of the 30-year concession. The provincial government would contribute to land acquisition sufficient for a 15 to 25 percent share of the project.

The initial section shown in the map above, known as the Puruk Cahu-Bangkuang railway line, would be the focus of development for several years. Pre-tendering efforts received applications from 15 potential operators of the initial section. According to published reports, the number has subsequently been reduced to the following four bidders:

- An Itochu-Toll consortium
- a Drydocks-MAP Resources Indonesia consortium
- Bakrie Indo Infrastructure
- A Mega Guna Ganda Semesta-led consortium

The four finalists were reportedly selected based on their expertise and financial backing, as well as technical and administrative criteria. Each has various connections to the mining interests in the mining areas that would be served. In September 2010, the Itochu group was reported to have won the tender, but this has been denied and recent information indicates that selection may well be deferred until 2011 or beyond in order to resolve financing and guarantee issues.

Note on Central Kalimantan Proposals Beyond Puruk Cahu-Bangkuang

Several railway proposals in addition to the Puruk Cahu-Bangkuang line have been made over the years. All of these proposals (i.e., the five proposals designated on the earlier map) are now part of the long-term Central Kalimantan PPP plan. A separate diagnosis of these candidate railway projects is therefore not possible, pending Kalimantan to Balikpapan in East Kalimantan is also on hold awaiting resolution of the PPP. Referring to the SWOT analysis in Appendix F, in order to accelerate the process, it is possible that any of the several line segments in the PPP could be initiated as a Special Railway and converted to part of the PPP under existing legal provisions – assuming of course, that a properly qualified SR investor could be found.

Diagnostic Results

At this point in the process there have been no public reports that the process has been inappropriate or that any of the four final bidders under consideration would not be appropriate licensees. Of course, after a winner is selected, it is possible that protests will be filed by losing bidders. Appropriate technical requirements will need to be met for infrastructure development, infrastructure management and train operations. Tariff structures and track access charges will need to be established. While the procurement process appears significantly less restrictive than for a Special Railway applicant, post-selection licensing requirements are likely to be more onerous because of the public status of the resulting railway operation.

Given the ongoing competitive process, we believe that the MoT should defer action relating to this project until the PPP tendering proceedings are complete.

APPENDIX F: SWOT ANALYSIS

LAWFUL OPTIONS FOR SECTOR SPECIFIC RAILWAYS

This chapter addresses four options that the team has identified that could contribute to the realisation of pending railway projects (Bukit Asam, MEC) and the initiation of others (e.g. South Sumatra, a new initiative in Central and East Kalimantan). The Strengths-Weaknesses-Opportunities-Threats (SWOT) associated with alternative licensing procedures are addressed in this Appendix. Our recommendations for specific actions based on SWOT considerations can be found in this Final Report. The options considered here include:

1. A "pure" (non-transport sector company-owned) exclusive railway. In this case the railway would be owned and managed as an integral part of the corporate entity whose primary business products are transported by the exclusive railway. It could, for example, involve a separate profit centre, but the revenue transactions would be wholly internal, with the licensed Special Railway operator being the non-transport enterprise (or, if the team concludes it is possible, a subsidiary of the non-transport enterprise). This is the "base case" under prevailing interpretation of Special Railway provisions, but a number of questions resolving acceptable ownership arrangements require resolution.

   This option requires working within the context of current regulations for Special Railways and involves only licensing actions and other measures that can be undertaken by the MoT/DGR under the terms of GR 56/2009.

2. A pure (PPP-based) public railway or public railway extension. The PPP approach would be subject to the relevant provisions of the Railway Law, the existing Government Regulations on Railway Development, Perpres 67/2005 and Perpres 13/2010. An alternative public approach would be a mechanism to attract private investment to the national railway for industry-focused railway capacity expansions and/or line extensions.

   This option entails applying procedures currently available under Perpres 13/2010. Where Special Railways options are not applicable, the MoT would support tendering processes under Perpres 13/2010.

3. A "modified special purpose or limited public railway." The concept of a special purpose limited public railway has yet to be created in the governing legislation. The main purpose of creating a sub-category of public railway would be to avoid the application of tendering and other provisions of Perpres 67/2005 and Perpres 13/2010 that are deemed to inhibit sector-focussed railway development. Alternative strategies are to develop procedures to initiate privately managed general/public railways versus procedures to convert a rail service established as a Special Railway to serve a broader array of customers on a tariff basis.

   The Special Purpose Limited Public Railway would provide a new alternative to Special Railways and Perpres 13/2010 procedures through a Perpres enabling an

industry specific railway to have a broader scope of service by mutual agreement with governmental authorities.

4. An exclusive railway under the Special Railway provisions owned and managed by a *separate corporate entity*. Several variations on this option were assessed for their legal and economic viability within Indonesia's current policy, legal, and regulatory frameworks.

   Modifying the existing Special Railway law would seek to increase consistency with international practices by liberalising the Government Regulations applicable to Special Railways.

CURRENT SPECIAL RAILWAYS OPTIONS

This case refers to the "pure" (non-transport sector company-owned) exclusive railway as defined in Law no. 23/2007 and GR 56/2010. The case encompasses interpretations that consider and do not consider a subsidiary relationship between rail operator and non-transport company as falling within the definition of a pure exclusive railway.

Strengths

The primary strength of the current Special Railway provisions is that they provide an opportunity for a private enterprise, or an SOE such as Bukit Asam, to acquire land and develop an internal enterprise railway line that would be exempt from public railway economic regulation. The railway would have no obligation to offer service to third parties, would not have to publish tariffs, and would have no obligation to provide access to infrastructure to third party train operators (in fact, such transactions are prohibited under the current provisions). The SR provisions allow an SR to provide services beyond the immediate premises or operating district of the enterprise. That is, the definition has broader scope than an on-plant location industrial railway activity. The absence of public railway obligations is seen as an incentive for enterprises that desire railway services for their own exclusive commercial purposes.

Weaknesses

The current SR provisions are severely restricted by providing that the railway (1) must serve only the single enterprise with which it is associated, and (2) must be owned by the enterprise whose goods are transported. This dual requirement inhibits investors that would prefer to separate the main enterprise function (e.g., mining) from transport in order to (i) obtain the proper expertise in each entity, (ii) appeal to separate equity or debt capital sources, and/or (iii) take advantage of tax or other incentives associated with the separate functions. At the same time, the prohibition on

carrying any traffic other than that of the main enterprise prevents the offering of services that all parties may agree is in their mutual interest.

Opportunities

Under the current Special Railway provisions, there are some uncertainties that might be clarified without changes to the basic statute (Law no. 23/2007) or the recently-enacted Government Regulation implementing the law (GR 56/2009). Chief among these is clarification that a subsidiary of the main enterprise could be authorised to build and operate the Special Railway. Another opportunity is to clarify that if the operator of the Special Railway takes title to the property at issue (e.g., coal) and have ownership while the goods are in transit, such traffic would be considered transport of the main activity of the enterprise (trading and transport). This might permit a Special Railway to have different ownership than the mine being served and allow the Special Railway to serve other mines in the area. Both interpretations are difficult to justify under the existing legislation. Clarification of the interpretation should be made in a Permen (Ministerial Regulation) to avoid investor uncertainty. Some mechanism to assure fair pricing for government royalty payments may be needed, and the tax implications of such trading should be clarified.

Apart from establishing the legitimacy of subsidiary operation of an SR and of the propriety of an SR carrying property over which it has legal ownership, several opportunities to make the current provisions more workable might be included in a Ministerial Regulation. The language in GR 56/2009 implies that transport can be only between the main enterprise district and a single supporting point, but other provisions provide for off-port storage where the destination of a port may have limited capacity, and still other provisions provide for interconnections with the national railway. The regulations are silent with respect to dropping off cargo at third party facilities (e.g., a power plant that may locate along a Special Railway). This involves interpretation of the point-to-point requirements of the current regulations. A Ministerial Regulation could clarify that all of these contingencies are allowable for a Special Railway operator. A Ministerial Regulation should also clarify that matters of property disposal at the end of Special Railway operation are to be resolved within the Special Railway license.

Threats

A number of the above interpretations may be resisted by third parties. For example, PTKA has consistently argued for a narrow interpretation of the Special Railway application. In particular contexts, the opportunities noted above might not materialise. Hence the alternatives discussed below should be considered.

Applicability to Pending Proposals

Without accepting subsidiary operation of Special Railways as proper, current regulations would require PTBA and TOP to be the railway operator as well as the mine operator. The only apparent option to avoid this requirement would be for the railway operator to acquire the coal it transports, transforming its primary business to that of a coal broker, but this introduces complications that might not be acceptable to investors. The common ownership requirement creates problems in the pending cases without any discernable public benefit, specifically complicating investment arrangements and constraining the capacity of railway and mining units to develop specialised capabilities. Allowing subsidiaries to operate the rail units is not a major improvement for the two pending cases as neither BATR nor TKK qualifies as a subsidiary.

CURRENT GENERAL RAILWAY OPTIONS

This option concerns a pure (PPP-based) public railway or public railway extension. As a practical matter, this is largely limited to PPPs using the Perpres 13/2010 mechanism, since further clarification of the respective authorities of DGR and PTKA appear necessary if the private sector is to invest in national railway line extensions more extensive than industrial sidings.

Strengths

The only currently available option for private investment in railway infrastructure other than through Special Railway provisions is the PPP process provided in Perpres 13/2010 (modifying Perpres 67/2005). The strength of the PPP process is that it provides a means for the government to invest in infrastructure through government support, such as land acquisition and other means. This may permit a private sector investment to occur in some situations where 100 per cent enterprise investment is not feasible. In addition, the PPP process provides for a more transparent competitive procurement that may have advantages in terms of economic equity and social impact. Finally, the PPP process explicitly envisions that the public will benefit from the infrastructure development, whereas the SR process now prohibits service to parties other than the single enterprise to be served. The PPP process may be particularly valuable in natural resource development areas where there are multiple developers requiring improved infrastructure.

Weaknesses

Despite the abstract advantages of the PPP process, the track record for PPPs in Indonesia is poor. This is partly a result of government resources being insufficient to attract private sector investment. Beyond that, the process employed in Indonesia

(illustrated in Appendix D) is complex, involves multiple agencies at multiple jurisdictional levels, and has inherent potential for delay. This drives away time-sensitive investors. Finally, the PPP structure is not sector-specific and does not contain any incentives particular to the railway sector.

Opportunities

Perpres 13/2010 is new; it attempts to correct deficiencies perceived to exist in the earlier regulation, Perpres 67/2005. The new regulation provides for additional advantages to the originator of a PPP proposal, requires a less onerous tendering process for projects unlikely to attract a large number of bidders, and makes other changes that may prove more attractive to private investors.

Threats

Despite the recent changes, the PPP process remains cumbersome and is a source of real delay. Unless it can be demonstrated that Perpres 13/2010 will substantially speed up transactions, it may remain an under-utilised option for private investment in railways. In addition, a PPP process that addresses only one component (e.g., transport) of an integrated development process may fail to meet the requirements of project investors, which demand timely completion of all project components and whose financing for other project elements depends on the development of rail transport.

Applicability to Pending Proposals

The PPP option is being tested in Central Kalimantan and may or may not be successful in that case. It is not suitable for either the Bukit Asam or the MEC Coal situation, as neither is looking for public investment and neither developer would be willing to tolerate the loss of control and time delays that initiating a public procurement process would entail.

MODIFIED SPECIAL RAILWAY OPTIONS

This option addresses the possibility of rewriting regulations to permit an exclusive railway under the Special Railway provisions that is owned and managed by a separate corporate entity.

Strengths

If higher economic growth rates are to be achieved and sustained, Indonesia needs to move more rapidly to provide less constrained incentives for private capital. In the railway sector this should entail relaxed requirements for investment in Special Railways and implementation of policies that are less protective of the national railway infrastructure managed by the MoT/DGR and the railway operations of PTKA. The most effective action to attract private sector capital to the railway sector would be a thorough rewrite of the Special Railway provisions.

Weaknesses

A general fix of Special Railway provisions will require, at a minimum, revision of the applicable provisions of GR 56/2009 with respect to Special Railway ownership, and the ability to serve multiple customers. It may also require an amendment to Law no. 23/2007, since the restrictive articles in GR 56/2009 only moderately elaborate articles of the underlying law. Since these two legal instruments were changed quite recently, there may be reluctance to implement further changes at this time. In any case, the process of making changes to a GR and particularly a law is difficult and uncertain to succeed.

Opportunities

The importance of coal mining as a contributor to economic growth and the increasing need for rail transport if coal development is to reach is its potential is an incentive for major change, as it was for the electrical power industry, where major regulatory changes were made in short order.

Threats

Coal resource development is more controversial in Indonesia than electrical power development for reasons of environmental and social impact and climate change. Greater resistance may be anticipated to changes in the railway legislation designed to promote such development.

Applicability to Pending Proposals

Removal of the common ownership restrictions would alone be sufficient to move the Bukit Asam and MEC Coal proposals forward. BATR has not indicated any strong interest in serving third party coal producers or in hauling commodities other than coal. MEC Coal has indicated greater interest in carrying third party traffic, partly in response to the regency's interest in it doing so. Both potential operators would offer third party

services if allowed, but in neither case would the proposed investment be likely to not occur if the railway were restricted to PTBA and TOP traffic, respectively. If Law no. 23/2007 were modified to eliminate the common ownership provision, however, the service limitations should be eliminated or modified to at least allow service to a broader group of industry participants (e.g., to all members of an association of coal mine operators).

LIMITED PURPOSE GENERAL RAILWAY

This case addresses the option of creating a new category of "modified special purpose or limited public railway." The rationale for this approach is that creating a new option under public railway provisions may be easier than under special railway provisions. This is because special railway provisions are established in greater detail in higher ranking legal instruments than are public railway regulations.

The concept here is to provide a new legal instrument – the limited purpose general railway – which would be available as an alternative to the Special Railway provisions (or as an option for converting a Special Railway to broader use). The new instrument, created through a Presidential Regulation (or Government Regulation if necessary), would allow for more flexibility in railway operator ownership and scope of service than a Special Railway, but with an increase in public oversight and more frequent license renewal requirements. Unlike current PPP regulation, the provision would be specific to railways only; and licenses would be issued by a negotiated agreement with the licensee, rather than by public tender.

As observed in Appendix D, GR 72/2009 already provides that a Special Railway that interconnects with another Special Railway can be integrated with that railway and transformed into a public railway without resort to a public tender[45]. Approval for such a transformation may be made at the regency/municipal, provincial or Ministerial level based on the standard hierarchy concerning the locations served. To illustrate, if TKK were approved as a Special Railway linked to a private port in East Kutai Regency and MEC Coal (or another enterprise) were to build an aluminium plant and a short line to the port, both the TKK line and the new line could be converted to an integrated public line (or pair of coordinated public lines) with the approval of the regency. Given the possibility of this option under existing law, it is anomalous that such a limited purpose public line cannot be created directly without going through a two-step process. Under the same article, a Special Railway can be built to connect with an existing public line and then converted to a public line with the appropriate jurisdiction's approval. Again, it is anomalous that the Special Railway line would have to first meet the restrictive requirements of an SR, only to be converted to a public line without such restrictions. Allowing for a Limited Purpose General Railway to be directly approved would correct this inefficient process.

[45] GR 72/2009, Article 161(3).

Strengths

As a new legal instrument, there is no body of existing law or general regulation that must be modified to create this option. A Presidential Regulation may be sufficient to create the change. There is precedent for this approach in the shipping and aviation laws, both of which permit an otherwise private facility to be used for public purposes where there is a Ministerial finding of lack of public facility capacity. Moreover, the existing authority to convert an SR into a public line demonstrates that the existing law sanctions such small public lines, so permitting the direct creation of such lines would not change fundamental policy.

Weaknesses

The proposed provision would likely be received positively by industry as long as agreement to provide broader services is voluntary. If such service were to be mandated, as in current port regulations, the provision could be seen as raising risks and thus be received negatively. Because existing law provides for conversion of SRs to public lines when connections are established, it is important that a Ministerial Regulation be enacted including the provision that any conversion of a Special Railway to a public railway be conducted by voluntary application of the Special Railway.[46]

A shorter term for license renewals may be required to make the direct limited purpose general railway option politically acceptable (and to provide for desirable public oversight of environmental and social impacts given broader and less defined terms of service). This also may be perceived as adding to project risk.

Opportunities

The opportunities are similar to those for modification of the Special Railway law, except that this approach is more likely to permit the railway to serve traffic not associated with the main industry that is the investment target (e.g., to carry some passenger traffic, as desired by officials in East Kalimantan). Current legal opportunities for conversion of Special Railways to General Railways may be enhanced by a Ministerial Regulation clarifying that the SR must apply for the conversion, which cannot be mandated by the government.

[46] GR 72/2009, Article 163 specifically provides as follows: "Further provisions on procedures for granting approval of the integration of transport services will be specifically addressed by Ministerial Regulation."

Threats

Similarly, the threats are comparable to those for modification of the Special Railway law. The measure could be opposed by those committed to a transparent public tendering process for all general railway development, even if less investment is likely to be available than for project-based non-competitive investments.

Applicability to Pending Proposals

As with a relaxation of Special Railways regulations, a limited purpose general railway approach would be sufficient to move the Bukit Asam and MEC Coal proposals forward. The approach may be particularly attractive in the MEC coal case, since there is an obvious insufficiency in public transport capacity. Due to the presence of PTKA in the Bukit Asam region, interest in broadening service outside of coal haulage may be weaker, and there may be stronger opposition in the interest of building up PTKA capacity.

APPENDIX G: LEGAL OPINION

MICHAEL I. KENNEDY, INTERNATIONAL LEGAL COUNSEL

This Opinion is based on a Letter of Engagement from Harral Winner Thompson Sharp Klein, Inc. dated 16 September 2010. It is based on field work from 26 September to 13 October 2010. It addresses the deliverables specified in the Letter of Engagement for the Interim Report. It has been updated and revised following further field work in Jakarta from 22 November to 3 December 2010 and further discussions with the legal staff and certain management at the Ministry of Transport and the Directorate General of Railways, as well as senior management staff at BATR and MEC Coal.

As stated in my Letter of Engagement, my contribution to the Interim Report is to consist of the following written inputs:

- An assessment of whether development of a Special Railway and initiation of train service to serve Bukit Asam coal developments in South Sumatra may be licensed by sub-national authorities and/or the DGR under current authorities provided under Law no. 23/2007 and other relevant laws and regulations
- An assessment of whether development of a Special Railway and initiation of train service to serve MEC Coal developments in East Kalimantan may be licensed by sub-national authorities and/or the DGR under current authorities provided under Law no. 23/2007 and other relevant laws and regulations
- If mutually agreed, an assessment of whether development of a Special Railway and initiation of train service to serve another selected coal development in Central Kalimantan may be licensed by sub-national authorities and/or the DGR under current authorities provided under Law no. 23/2007 and other relevant laws and regulations
- If my opinion in any of the above cases is negative, if stakeholder public entities have a negative opinion, and/or if licensing appears appropriate only as an interim measure, to provide recommendations as to an appropriate course of action in each of the above cases, with emphasis on measures that may be taken by the DGR in the near-term to expedite railway development in these cases

In preparing this Preliminary Opinion, I have benefited greatly from consulting with Pak Asenar Nangtjik Rekap, SH, and from his interpretations and legal clarifications, and those of Shirley MM Oroh, SH, as well as from discussions and interchanges with the other members of the HWTSK team.

BACKGROUND

Given the nature of the specified deliverables, this Preliminary Opinion is limited to the analysis of the two primary Special Railway cases from the legal perspective. With regard to Central Kalimantan, the project team review confirmed that Central Kalimantan railway developments under consideration are comprehended in an ongoing PPP procurement with an uncertain outcome, so we are unable to address such matters as the legal status of the tender winner or licenses and other legal material that will be required to implement the winning proposal, until when and if the selection process is completed. However, based on pending discussions with Central Kalimantan Province officials, assessment of particular issues related to the ongoing Central Kalimantan process might be added in the Final Report.

In general and unless otherwise mentioned, the terms used in this Preliminary Opinion are as defined in the Phase 1 Inception Report. To avoid repetition, extracts from the HWTSK Phase 2 Inception Report are not reproduced here.

To limit the length of this opinion, the current relevant laws and regulations in force in Indonesia which pertain to special railways are set out in summary form in Annex 1 to this opinion.

BUKIT ASAM PROPOSED SPECIAL RAILWAY

This opinion seeks to determine:

Whether the development of a Special Railway and initiation of a train service to serve Bukit Asam coal developments in South Sumatra, *as currently proposed by the parties to that proposed transaction*, may be licensed by sub-national authorities and/or the DGR/MoT under current authorities provided under Law no. 23/2007 and other relevant laws and regulations (*clarification/emphasis supplied*).

In addressing this question, the team has been greatly assisted by information provided through meetings and individual discussions with senior management of PT Tambang Batubara Bukit Asam (Persero) (PTBA), Tbk. and particularly the senior management of its proposed railway transport entity, PT Bukit Asam Transpacific Railways (BATR).

The basic issue to be determined is what is the essential concept of a special railway as described in the relevant law and regulations? Once that is established, the question whether the grant of appropriate licenses to enable the construction, operation and management of a special railway to service the Bukit Asam coal development can be answered.

The concept of what constitutes a special railway is addressed primarily and repeatedly in Law no. 23/2007 and GR 56/2009.

The conclusion which I have reached draws significantly on the wording used in Article 1(6) of Law no. 23/2007 [Special railway lines refer to the railway lines especially used

by a certain legal entity to support its main activities], Article 5(1)(b), which distinguishes a special railway from a public railway by the functionality of a special railway, as clarified in the Elucidation of Article 5 paragraph 1(b),[special railway as referred to in paragraph (1)(b) refers to a railway which is only used specifically by a certain legal entity solely to support the main activities of the certain legal entity], Article 17(2) [Operation of a special railway as referred to in Article 5(1)(b) shall comprise the operation of railway infrastructure and railway facilities and Article 149(1) [Transportation services by special trains as referred to in Article 5(3) shall be used only to support a legal entity in carrying out its main activities].

In addition, in the context of the Bukit Asam development of a special railway to carry coal, I have considered Article 353 of GR 56/2009 [a legal entity intending to develop a railway to support its main activities must file an application for a special railway construction license] and the Elucidation of Article 353 which clarifies that [supporting its main activities shall include, amongst other things, a coal mining legal entity operating a special railway for transporting the product of its main activities in the form of coal].

Based on a reading of these articles and finding no other provisions in Law no. 23/2007 or GR 56/2009 which are inconsistent with this opinion, I consider that the clear intention of Law no. 23/2007 is that the company which will develop and operate a special railway shall be the owner of the business which will be served by the special railway.

It remains to consider what are the requirements of the grant of licenses to construct, operate and manage a special railway and whether what is proposed in the Bukit Asam development is consistent and compliant with the intention of Law no. 23/2007.

A starting point for this consideration is the Minister of Transport's Principle Approval for the construction of a special railway, Number KP. 462 of 2009, which was granted to PT Tambang Batubara Bukit Asam (Persero), Tbk. and dated October 14, 2009 (hereafter called "the Principle Approval"), attached as Annex 2.

The Principle Approval describes in its preamble the route alignment of the train service proposed to accommodate the new railway as extending from an area or district known as Bangko Tengah Tanjung Enim in South Sumatra province to a proposed new special coal port to be located at an area or district known as Srengsem in Lampung province.

Who is the responsible authority to issue the relevant licenses?

Article 33(4) of Law no. 23/2007 makes it clear that, as the proposed special railway route crosses over two provincial boundaries, the license issuing authority is the Directorate General of Railways in the national government, as the railway is classified as a national railway by Article 67 of GR 56/2009 (Special Railway) and Article 68 of GR 56/2009 (administrative area covering two or more provinces).

What principal licenses are specified as requiring to be issued and to whom?

Article 354 of GR 56/2009 requires that the business entity which will carry out railway activities to support its business must first apply for approval for its proposed development. It is understood that the application for development approval in principle was made by PTBA. This is confirmed by the fact that Decree KP 462/2009 by the Minister of Transport constituted the Principle Approval to PTBA for the construction of a special railway to support its mining product trading business.

Article 352(1) of GR 56/2009 requires the business entity "which will carry out railway activities to support its business activity" to possess a construction license and an operation license. Pursuant to this article and as PTBA is the holder of the Principle Approval, I am of the opinion that PTBA is required to possess both the construction license and the operation licenses and that both licenses are required to be held by the same business entity, i.e., PTBA.

Article 353 of GR 56/2009 requires that the business entity "which will carry out railway activities to support its business activity" shall apply for a construction license. I am of the opinion that consistent with Article 352(1), PTBA is the entity which should apply for that construction license.

Article 365 of GR 56/2009 specifies that an operating license will be provided to a business entity if the construction of the railway infrastructure and the provision of the related facilities (the train sets) are in place. Consistent with Article 352(1), I am of the opinion that as the Principle Approval was granted to PTBA, the operating license should be granted to PTBA.

May the operating license to be granted to PTBA be transferred to a subsidiary company of PTBA, or to a company in which PTBA owns less than a controlling shareholding?

This question arises for decision following events which occurred several years ago, when it is understood[47] that an investment entity called PT Transpacific Railway Infrastructure (TRI) agreed with PTBA to form a jointly owned Indonesian legal entity called PT Bukit Asam Transpacific Railways (BATR) by a Deed of Establishment of a Limited Liability Company dated 5 August 2008[48]. At that time in mid-2008, it is understood that a company called PT Bukit Asam Bangko (BAB) being a wholly (100 per cent) owned subsidiary of PTBA, had vested in it the mining and exploration license, rights and interests of PTBA in the coal reserves at Bangko Tengah Tanjung Enim. It is understood that these specific reserves are one of several mining reserve tenements that are owned by PTBA.

[47] Whenever reference is made to such an understanding, this refers to verbal or written information which has been obtained or inferred in discussion with different stakeholders but such information has not been independently verified.

[48] Despite a request for access to the deed which established BATR and the founding deed of PTBA, these had not yet been obtained for review at the time of writing.

The key issues to be determined are encapsulated in a letter dated 30 August 2010 written by the President Director of PT Bukit Asam to the Minister of Transport (attached as Annex 3 to this Opinion). That letter requests the transfer to PT Bukit Asam Transpacific Railways (BATR) of the Principle Approval to carry out the Special Railway development. The letter warrants careful examination in several respects:

- It reveals that the parties agreed to separate the mining and rail transport responsibilities as long ago as early 2008 and probably in 2007 after the enactment of Law no. 23/2007
- It suggests that the "primary business" basis of a special railway could be interpreted widely to encompass railway transport by a company in which the primary business shareholder (PTBA) does not have a majority or even a significant shareholding – this is the key issue to be addressed here
- It clearly suggests that the realities of financing the railway development have driven the structure, hence the equity participation of China Railway

An analysis of the PTBA letter to the Minister of 30 August 2010 is necessary as the letter suggests a legal interpretation of the relevant law (Law no. 23/2007) and associated regulation (GR 56/2009) which is at least questionable if not unsustainable. This analysis follows later in this opinion.

The Principle Approval granted by KP 462/2009 was granted to PTBA to support its "main business" activity. This is described in the FIRST DICTUM of the Principle Approval as "f. Main business": "Mining product trading."

As previously stated, in my preliminary opinion the clearly expressed intention of Law no. 23/2007 and the resulting legal requirement is that a Special Railway, as defined by Article 1(6) and Article 5(3) of Law no. 23/2007, is one which has a special (exclusive) purpose [and] use. Stated simply, a Special Railway may only be used, exclusively, by an Indonesian legal entity to support its primary activities.

Having said that, it is reasonable to infer from the use of the words "primary activities" that such Indonesian legal entity may have other non-primary activities. It is also reasonable, when seeking to interpret recent or current legislation in Indonesia, to take into account normal commercial, corporate financing and management practices whereby a legal entity, whether Indonesian or not, may carry on its primary and non-primary activities through subsidiary or affiliated companies. This begs the question: can a subsidiary or affiliated company of an Indonesian legal entity which supports its main business activities through a special railway fall within the definition of a special railway legal entity as defined by Article 1(6) and Article 5(3) of Law no. 23/2007?

What constitutes a subsidiary company; what constitutes an affiliated company?

The Indonesian Company Law provides some historical legal guidance. While Law no. 40/2007 on Limited Liability Company does not define either a subsidiary company or an affiliated company, it is an accepted norm of civil law statutory interpretation that earlier preceding legislation which is not at odds with or has been expressly repealed may be considered. The preceding Company Law, Law no. 1/1995 defined a subsidiary

company of a company as one which has a special relationship with another company because (a) more than 50 per cent of the shares or voting rights in that company are owned or controlled by the other company and/or (b) control of the operations of the company, for example the appointment and dismissal of its directors and commissioners is controlled by the other company.

Drawing on the company law framework, I am of the opinion that a subsidiary company is a company in which a special relationship exists through the holding by one company of more than 50 per cent of the shares or voting rights in another company. However, in this specific situation when considering what might constitute a subsidiary company of a State-owned Enterprise such as PTBA, it should be noted, as helpfully researched by Pak Asenar in his memorandum of 19 October 2010, which is attached as Annex 4, that Article 1(4) of Presidential Decree 24/2001 on the Consultation Team for Privatisation of State-owned Enterprises, that a subsidiary company is defined as a limited liability company in which all of its shares are owned by the SOE.

There does not appear to be a source of absolute legal guidance in the Indonesian civil law framework as to what constitutes an affiliated company. My colleague Pak Asenar has helpfully considered the concept of affiliation in his memorandum of 19 October 2010. He has referred to the Capital Markets Law (Law no. 8/1995), GR 23/2010 on Coal and Mineral Mining Business Implementation, the Limited Liability Company Law (Law no. 40/2007), the preceding Company Law (Law no. 1/1995) and Presidential Decree 24/2001.

In summary, I believe that a subsidiary company of a legal entity referred to in Article 1(6) of Law no. 23/2007, being a company in which a controlling interest is held by that legal entity and which has been established for the purpose described in Article 5(1)(b) of Law no. 23/2007, is qualified to operate special railway infrastructure and facilities as described in Article 17(2) of Law no. 23/2007. Conversely, I do not consider that an affiliated company in which a non-controlling interest is held by a special railway legal entity, not being a subsidiary company, can be licensed as a special railway legal entity under the current legal framework.

Present shareholdings in BATR and related companies

Based partly on information provided in meetings with officers of BATR and partly on information contained in the letter dated 30 August 2010, the inter-company structures, shareholdings and arrangements in the PTBA Special Railway transaction are understood to be as follows:

- **PTBA:** PT Tambang Batubara Bukit Asam (Persero), Tbk is an SOE, with the State holding 70 per cent of the issued capital.
- **BAB:** PT Bukit Asam Bangko is a wholly (100 per cent) owned subsidiary of PTBA, in which are vested the mining assets at the Bangko Tengah Tanjung Enim area.

- **TRI:** PT Transpacific Railway Infrastructure negotiated with PTBA to acquire an interest in the railway to transport coal from the BAB reserve (and perhaps other PTBA reserves) and established BATR in August 2008 as an Indonesian legal entity. The Rajawali group of companies acquired a 100 per cent shareholding in TRI in April 2010.
- **BATR:** PT Bukit Asam Transpacific Railways was established in August 2008 as a limited liability Indonesian joint venture entity owned jointly by TRI and PTBA. The activities of BATR were proposed to include the construction, operation, management and maintenance of coal special railway infrastructure and associated railway facilities such as rolling stock; as well as the operation, maintenance and management of the proposed special coal port in Lampung province and the railway transport of coal.
- **TRI and PTBA interests in BATR:** The two companies agreed in the period after April 2010 that TRI would own or hold 90 per cent of the shares in BATR, and PTBA would own or hold 10 per cent of the shares in BATR. Following discussions with the MoT and DGR, concerning the implementation of the special railway project, BATR has agreed to reduce its shareholding in BATR to 60 per cent while inviting China Railway, as the contracted or intended EPC (Engineering Procurement Construction) contractor for the special railway works, to take a 10 per cent share in BATR, while PTBA will increase its shareholding in BATR to 30 per cent.

It is understood these shareholding changes are in part conditional on BATR obtaining finance for the railway works and facilities from Chinese banking interests, which are scheduled to visit Jakarta in October 2010.

PTBA is reported by BATR to be considering an internal corporate restructuring.

BATR has stated that it has agreed with or is currently negotiating with PTBA to enter into a transport off-take agreement with BAB for the entire production of the BAB coal interests. It has also stated that it is proposed that BATR, if licensed, will enter into agreements with PTBA to transport coal from what were described as three or four other PTBA coal mine reserves.

Application Letter from PTBA to the Minister of Transport dated 30 August 2010

A review of the letter raised several questions and suggests several activities, which are recommended to be pursued with BATR in the next phase of the assignment and prior to the preparation of the Final Report:

- The Deed of Establishment of BATR dated 15 August 2010 should be reviewed to establish its status as a company related to PTBA, in the context of Law no. 23/2007 and the related regulations; and to establish the stated purpose of the establishment of BATR.
- The nature of the activities proposed to be carried out by BATR, described in paragraph 2 (a) to (e), should be examined in the same context.

- The statement by PTBA in paragraph 3 that actions have been taken by BATR "which is PTBA's subsidiary" should be examined and questioned.
- The taking by BATR of the actions described in paragraph 3 should be examined and clarified in the light of the requirement under Article 355(1) of GR 56/2009 that the business entity which has obtained a Principle Approval should implement the specified activities.
- The statement by BATR in paragraph 5 that BATR fulfils the specified criteria for a special railway operator, through an interpretation of the definition of a legal entity in Article 1(10) and Article 1(9) of GR 56/2009, simply by virtue of its establishment of an Indonesian legal entity specially established for the purpose for the purpose of carrying out special railway operations, should be carefully reviewed with BATR's legal advisors.
- Apart from the repeated reference to BATR as a subsidiary company of PTBA in paragraph 6, the issue raised in sub-paragraphs (a) and (b) that the special railway operation should be licensed to support the primary business activities of PTBA and its affiliated companies, by which it is assumed to mean to carry their coal, needs to be carefully examined and the legality of the proposal under current law should be verified.
- The statement in paragraph 7 that the proposed transfer of the Principle Approval is in line with the recommendation of the governors of the two provinces (specified as a requirement under Article 33(4) of Law no. 23/2007) should be verified.

To the extent that these issues are somewhat unclear, it is recommended that they be clarified in the next phase of the assignment and before final conclusions and recommendations are established.

Conclusion at this time

I believe that under the current legal framework a sound legal basis does not exist for the Ministry of Transport DGR to proceed to grant a license to BATR. This is for the reason that it is not, as at present constituted, an eligible special railway legal entity as specified in Law no. 23/2007 and GR 56/2009, nor is it a subsidiary of PTBA, which is such an eligible special railway legal entity.

MEC PROPOSED SPECIAL RAILWAY

To be determined:

Whether the development of a Special Railway and initiation of a train service to serve MEC Coal developments in East Kalimantan, *as currently proposed by the parties to that proposed transaction*, may be licensed by sub-national authorities and/or the DGR

under current authorities provided under Law no. 23/2007 and other relevant laws and regulations (*clarification/emphasis supplied*).

The team has been assisted by information provided through meetings and individual discussions with the management and staff of the MEC group.

The basic legal analysis which has been applied to the PTBA transaction can be applied here. However the status of the project and the corporate relationships and inter-relationships of the parties to the MEC transaction are totally different.

It is therefore proposed to briefly describe the company and inter-company transactions, then to discuss the license process. While a request was made for access to the Deeds of Establishment of the Indonesian entities which have been created for the purpose of the MEC development, those documents have not yet been made available. The following is based on understandings reached in meetings with the senior management and staff of MEC Coal.

Present shareholdings and proposed activities in the MEC transaction

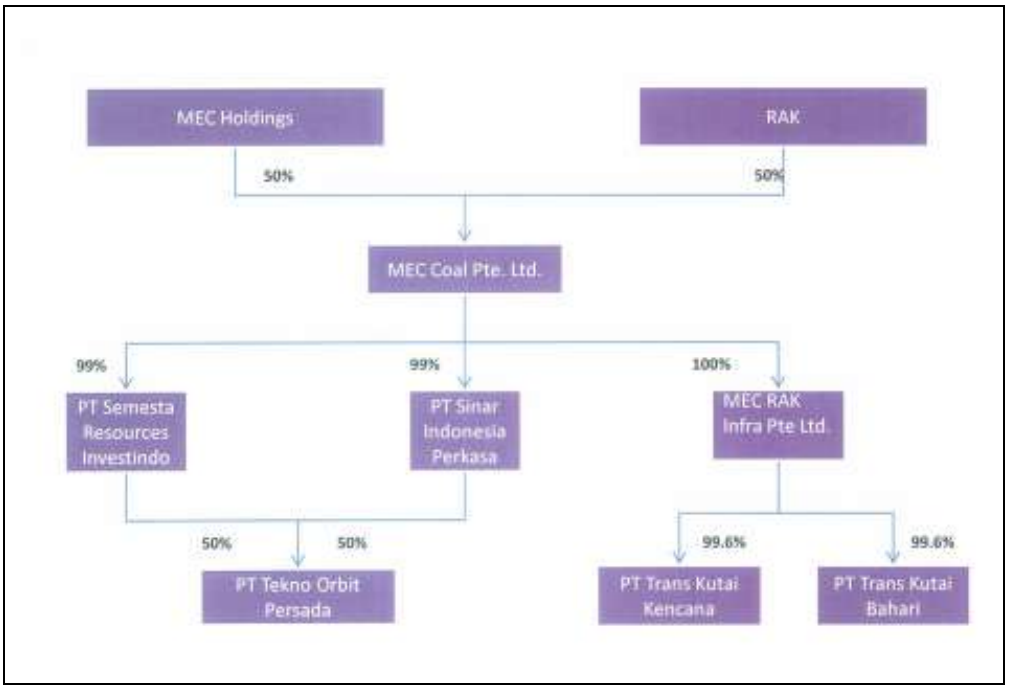
MEC Coal is understood to be offshore entity which operates as a holding company for the coal mine, special railway and special port activities..

TOP: PT Tekno Orbit Persada is the Indonesian entity that holds the mining license for the MEC project. It is understood that the shareholders of TOP are subsidiaries of MEC Coal.

TKK: PT Trans Kutai Kencana is an Indonesian entity established for the express purpose of constructing, operating, maintaining and managing the special railway being proposed to transport coal from the TOP mine reserves to the proposed special coal port at Lubuk Tutung. TOP is in the process of holding a minority shareholding in TKK, while the Singapore-based company (MEC RAK Infra Pte Ltd which is 100 per cent owned by MEC Coal) holds 99.6 per cent of the shares in TKK.

TKB: PT Trans Kutai Bahari is an Indonesian entity established for the express purpose of constructing, operating, maintaining and managing the port. The Singapore-based company (MEC RAK Infra Pte Ltd) which is 100 per cent owned by MEC Coal holds 99.6 per cent of the shares in TKB.

The accompanying diagram shows the interlocking shareholdings in the MEC Coal development.



Who is the responsible authority to issue the relevant licenses?

It is understood that the railway alignment from Muara Wahau to Lubuk Tutung traverses Kutai Timur regency and does not cross a regency boundary. So the responsible authority for issuing the various licenses is the regency government, with the endorsement of the national government – per Article 33(4) of Law no. 23/2007 and Article 72 of GR 56/2009.

What principal licenses are specified as requiring to be issued and to whom?

This question has been discussed in relation to the PTBA license process. The same articles of GR 56/2007 are applicable and the same licenses are required for the MEC development.

It is considered that Articles 353 and 354 of GR 56/2007 should be read together. Article 353 requires that the business entity which will carry out railway activities to support its business activity shall apply for a construction license. Article 354 requires that the business entity which will carry out railway activities, by implication to support its business activity, must first apply for development approval in principle.

In seeking to determine which is the appropriate legal entity to apply for and be granted the special railway licenses, I have used the same process in establishing the intention of Law no. 23/2007 in its application to the MEC development as was done in the examination of the PTBA special railways license process. I have drawn on the wording used in Article 1(6) of Law no. 23/2007 [Special railway lines refer to the railway lines especially used by a certain legal entity to support its main activities]; Article 5(1)(b) which distinguishes a special railway from a public railway by the functionality of a special railway, as clarified in the Elucidation of Article 5 paragraph

1(b) [special railway as referred to in paragraph (1)(b) refers to a railway which is only used specifically by a certain legal entity solely to support the main activities of the certain legal entity]; Article 17(2) [Operation of a special railway as referred to in Article (1)(b) shall comprise the operation of railway infrastructure and railway facilities] and Article 149(1) [Transportation services by special trains as referred to in Article 5(3) shall be used only to support a legal entity in carrying out its main activities].

In addition, in the context of the MEC development of a special railway to carry coal, I have taken into consideration Article 353 of GR 56/2009 [a legal entity intending to develop a railway to support its main activities must file an application for a special railway construction license] and the Elucidation of Article 353, which clarifies that [supporting its main activities shall include, among other things, a coal mining legal entity operating a special railway for transporting the product of its main activities in the form of coal].

Based on a reading of these Articles and finding no other provisions in Law no. 23/2007 or GR 56/2009 that are inconsistent with this preliminary opinion, I consider that the clear intention of Law no. 23/2007 is that the company which will develop a special railway shall be the owner of the business to be served by the special railway. Accordingly, I consider that the appropriate legal entity which should apply for the licenses to develop, construct, operate and manage the special railway is the owner of the business which will be serviced by the special railway.

In addressing the deliverable concerning the MEC development, we have established that the approval of licenses is more advanced than in the PTBA development.

Principle Approval

We have stated earlier that the regent of Kutai Timur is the responsible authority for the granting of licenses for the special railway proposed under the MEC development.

By letter dated 6 October 2009, the regent of Kutai Timur applied to the Minister of Transportation for approval to grant Principle Approval for the construction of a special railway in the regency to PT Trans Kutai Kencana (TKK) to support the mining activities by PT Tekno Orbit Persada (TOP). A copy of the application letter to the regent for the granting of Principle Approval for the development of the special railway has been requested from MEC staff, together with a copy of the application letter from the regent of Kutai Timur to the Minister for approval to grant the Principle Approval.

By Ministerial Decree No. KA.003/1/1 Phb-2010 dated 29 January 2010 addressed to the regent of Kutai Timur, the Minister of Transportation informed the regent that it was acceptable for the regent to grant Principle Approval for the construction of a special railway in the regency of Kutai Timur to TKK, provided that:

- The construction of the special railway infrastructure is in accordance with the spatial planning requirements of the regency and the province
- Implementation of the construction must comply with applicable law
- Crossings must be allowed for roads, public railway lines, tunnels, water channels and other infrastructure in the public interest
- The special railway operation of TKK shall be used only to support the main business of TOP in the field of coal mining, and not to render public services
- The period of the special railway operation license shall be for as long as TOP carries out mining activities

A copy of Ministerial Decree No. KA.003/1/1 Phb-2010 is attached as Annex 5.

Based on discussions with MEC staff, it is understood that shortly after Ministerial Decree No. KA.003/1/1 Phb-2010 was issued, the Principle Approval authorised by the Minister was issued by the regent of Kutai Timur to TKK. A copy of the Principle Approval has been received from the President Director of MEC Coal and reviewed.

Likewise, the construction licenses for the construction of the special railway and for the construction of the special coal port have been granted to TKK and TKB, respectively. Copies of these construction licenses have been received and reviewed, together with copies of the application letters for such licenses.

Assessment of MEC License Process

It is difficult to come to definite conclusions concerning the legal status of the license granting process in the absence of the Deeds of Establishment of the various companies which comprise the MEC interests and the non-MEC interests. These documents are anticipated to establish whether the particular companies are controlled by and therefore are subsidiaries of particular companies.

However, based on the earlier analysis of the corporate and inter-company relationships in the MEC development and using the same methodology of legal analysis as was applied to the PTBA development, it is suggested that the following conclusions can be reached:

- The main business activity of the MEC development is the development and exploitation of the mine owned by TOP.
- TOP would appear qualified to apply for a special railway to service its mine output.
- TOP has a proposed minority shareholding in the proposed railway operator and by virtue of that minority interest, which is not in itself a controlling interest, TKK could not be considered a subsidiary company of TOP. However, MEC Coal appears to have a controlling interest in TOP through its subsidiaries (PT Semesta Resources Investindo and PT Sinar Indonesia Perkasa).

- If the application for Principle Approval for a special railway was lodged by TOP as the holder of the mining interests which are proposed to be served by the special railway, the application would be legally consistent with the current legal framework.

However, as it appears that the application for Principle Approval for a special railway was lodged by TKK, as is suggested in Ministerial Decree KA.003/1/1 Phb.-2010, and as the Principle Approval was granted to TKK by the regent of Kutai Timur, neither that application nor the granting of the construction license is considered legally proper, on the grounds that TKK is not a special railway legal entity within the meaning of Articles 1(6) and 5(3) of Law no. 23/2007.

Conclusion at this time

In conclusion, it can be stated that the development a special railway to serve the MEC Coal project can be legally licensed by the regent of Kutai Timur. However, it is considered that the process followed in the granting of a Principle Approval to TKK and the granting of a construction license to TKK was not legally valid under the present legal framework.

POTENTIAL LEGAL ALTERNATIVES

To be determined:

If my opinion in any of the above cases is negative, if stakeholder public entities have a negative opinion, and/or if licensing appears appropriate only as an interim measure, I am to provide my recommendation as to an appropriate course of action in each of the above cases, with emphasis on measures that may be taken by the DGR in the near-term to expedite railway development in these cases. I have reached a negative conclusion regarding the proposed special railway license process in the Bukit Asam development and, to the extent that adequate information is unavailable at this time as regards the MEC development, I have serious concerns that the license granting process which has been followed is legal and proper under the current legal framework. It is not possible at this time to describe the state of the opinion of stakeholder public entities concerning the granting of licenses in either the PTBA or the MEC development.

Recommended appropriate courses of action

Short-term remedial action, either by the DGR in the case of the PTBA development or the Regent of Kutai Timur in the case of the MEC development, by suggesting a “flexible” interpretation of Law no. 23/2007 and GR 56/2009 as they now exist, is not endorsed. It is not recommended that an interpretation of Law no. 23/2007 and GR

56/2009 might be suggested so that special railway operations might be conducted by BATR while it is not a subsidiary of PTBA as the special railway licensed entity, so as to allow the developments to continue as currently proposed. Law no. 23/2007 and the more recent GR 56/2009 appear to have been drafted without careful consideration of the restrictive outcomes which are now clear, in terms of not allowing the business entity which will develop and operate a mine or other commercial activity to contract out the railway activities required to service the mine or other commercial business.

A practical and viable short-term solution is available. It can provide a holistic sector-wide solution to the commercial problems that result from the present legal framework.

This is to consider what changes or interpretations are appropriate to be made in GR 56/2009 to accommodate a reform agenda that will allow mining and other commercial development to be facilitated by the financing and contracting of a railway which will service the primary resource development, while also allowing access to that railway by other private users in a suitably regulated manner which will encourage competitive access and allow economies of scale and associated resource development. This agenda could be based on a new Government Regulation which can be proposed to amend and clarify GR 56/2009.

This reform agenda could be developed within a two-month period to accommodate stakeholder consultations, the drafting of amendments to GR 56/2009, and the promotion of the draft GR to the Cabinet.

The reform agenda should be developed by consideration of the development of a concept, within the general category of Public Railways under Law no. 23/2007, of privately funded Limited Public Railways. These might have some characteristics of a Public Railway, by allowing suitably regulated multiple-user access, but which are otherwise exempted from the competitive tendering and other restrictions found in Presidential Regulation 67/2005 as amended by Presidential Regulation 13/2010 and the exclusion of this category from the restrictions of a Special Railway, as regards the single user and point-to-point limitations imposed on the railway service.

The opportunity to develop this recommendation will arise in the final phase of this assignment and is anticipated in the TOR.

Jakarta

3 December 2010

Annex 1: Current Legal Framework

RAILWAY-SPECIFIC LEGAL FRAMEWORK

Law no. No. 23/2007 on Railway Transport:

Article 1(6) - …" railway lines especially used by a certain legal entity to support its main activities".

Article 1(10) – Legal entity refers to State-owned Enterprise, Regional Government-owned Enterprise and/or Indonesian legal entity specially established for that purpose.

Article 5(1)(b) – Railway by function consists of a Special Railway. [Elucidation: Special Railway as referred to in paragraph (1)(b) refers to a railway which is only used specifically by a certain legal entity solely to support the main activities of the certain legal entity.]

Article 5(3) – Special Railway as referred in paragraph 1(b) is only used specifically by certain legal entity to support (its) main activities.

Article 17(1) – Railway operation may consist of operation of infrastructure and/or operation of facilities.

Article 17(2) – Operation of Special Railway shall comprise operation of railway infrastructure and railway facilities.

Article 33(1) – Operation of Special Railways – per Article 17(2) – shall be carried out by legal entity to support its prime activities.

Article 33(2) – Special Railway operator shall have (a) construction permit and (b) operation permit.

Article 33(4) – Permits shall be given by national government when route crosses provincial boundaries; by provincial government when route crosses a regency or city boundary (after securing permit from national government); by regency or city government when route is within regency or city, after receiving recommendation from provincial government and permit from national government.

Article 52(1) – Special Railways can be connected to public railway lines network.

Article 52(2) – Special Railways can be connected to special railway lines network.

Article 149(1) – Transportation services by special railway train shall be issued only to support a legal entity in carrying out its main activities.

Article 149(2) – Transportation services by Special Railway train can be merged with Public railway network and special railway network after receiving approval from (relevant) government (national or regional).

Government Regulation No. 56/2009 on Railway Development:

Article 1(14) – Special railway line shall be railway line that is railway line especially used by a certain legal entity to support its main activities.

Article 1(37) – The construction permit for construction of a special railway must be owned by the business entity that will own the special railway.

Article 38(3) – The special railway as intended in Article 37 sub-article b shall be operated by a legal entity to support its main activities.

Article 67(1) – Railway lines can form a unified railway network consisting of (a) public railway network; and (b) special railway network.

Article 68 – Railway lines are classified as provincial railways if the lines cross regency or municipality boundaries within a province.

Article 72 – Railway lines are classified as municipal/regency railways if the railway line is located within a municipality or regency area.

Article 305 – The public railway operations license for infrastructure is separate from the operation license for facilities (transportation).

Article 350(1) – Special railway shall be limited to operating in a district constituting the area of main activities of the relevant legal entity. [Elucidation: The reference to a "district" shall be an area of activities limited by the activities' functions owned and carried out by a legal entity].

Article 350(2) – In case there is a supporting area outside the district of main activities, special railway can only be operated from the main activities' district to one point in the supporting area. [Elucidation: Activities in this provision shall include, among other things, the activity of transporting mining products from a mining site to the site of a special harbour/quay owned by the relevant legal entity or to a storage site owned by the relevant legal entity].

Article 352(1) – The business entity which carries out special railway activities shall possess (a) a construction license, and (b) an operation license.

Article 353 – A business entity intending to develop railway activities to support its main activities must apply for a special railway construction license. [Elucidation: Support of main activities shall include, among other things, a coal mining legal entity operating a special railway to transport the product of its main activities in the form of coal.]

Article 354 – The business entity which will carry out the railway activities must first apply for approval of its development principles, i.e., approval in principle from the relevant government authority.

Article 355(1) – The business entity which has obtained approval of its development principles should implement the following activities:

a. technical planning;
b. analysis of environmental impacts; and
c. procurement of land.

Article 355(2) – If within a period of two years after gaining the approval in principle, the business entity does not carry out the activities referred to in paragraph (1)(a) and (b), the approval in principle shall be declared invalid.

Article 364 – The special railway operation license as intended in paragraph (1) shall be valid as long as the relevant legal entity operating the special railway continues to perform its main business.

Article 373 – Special railway operation license can be transferred to another legal entity together with the transfer of the relevant main activities after obtaining permission.

Government Regulation No. 72/2009 on Railways Traffic and Transport.

Article 161 – Special railway transportation services shall be used only to support the main activities of a particular legal entity.

Elucidation: A particular legal entity shall include, among other things, a coal mining business, a plantation business, and tourism.

INFRASTRUCTURE-SPECIFIC LEGAL FRAMEWORK

Presidential Regulation 67 of 2005 on Cooperation between Government and Business Entities in the Provision of Infrastructure, as amended by Presidential Regulation 13/2010

This PR is intended to attract private sector investment in a range of infrastructure including rail transport. PR 13/2010 clarifies aspects of the inter-relationship between PR 67/2005 and other regulations.

LAND USE LEGAL FRAMEWORK

Presidential Regulation 36 of 2005, as amended by Presidential Regulation 65 of 2006 on Land Acquisitions for Development Activities for Public Purposes

Land use and spatial planning requires approvals at both the national and sub-national levels.

Sub-National Government responsibilities for Special Railways

Law no. 25/1999 on Regional Governance

COAL MINING SERVICES LEGAL FRAMEWORK

Law no. No. 4 of 2010 on Mineral and Coal Mining

Regulation No. 28 of 2009 of the Minister of Energy and Mineral Resources

On the conduct of Mineral and Coal Mining Services Business

Government Regulation No. 23 of 2010

On the Implementation of Mineral and Coal Mining Business Activity

Annex 2: Minister of Transportation Principle Approval KP. 462 of 2009

THE MINISTER OF TRANSPORTATION OF THE REPUBLIC OF INDONESIA

DECREE OF THE MINISTER OF TRANSPORTATION
NUMBER: KP. 462 OF 2009
REGARDING
PRINCIPLE APPROVAL FOR THE CONSTRUCTION OF A SPECIAL RAILWAY CONNECTING BANGKO TENGAH TANJUNG ENIM IN SOUTH SUMATRA PROVINCE AND SRENGSEM IN LAMPUNG PROVINCE TO PT. TAMBANG BATUBARA BUKIT ASAM (PERSERO), TBK

BY THE GRACE OF THE ONE ALMIGHTY GOD

THE MINISTER OF TRANSPORTATION,

Considering :

a. whereas based on Article 354 of Government Regulation Number 56 of 2009 regarding Railway Operation, in order to obtain a license for special railway construction, a legal entity must first obtain principle approval on special railway construction;
b. whereas based on the result of analysis and study of both the legal and technical aspects of the application from PT. Tambang Batubara Bukit Asam (Persero), Tbk for a license to operate a special railway, it has fulfilled the administrative and technical requirements, so it is appropriate to be granted principle approval on special railway construction;
c. whereas based on the considerations contained in points a and b, it is necessary to stipulate a Decree of the Minister of Transportation regarding Principle Approval for the Construction of a Special Railway Connecting Bangko Tengah Tanjung Enim in South Sumatra Province and Srengsem in Lampung Province to PT. Tambang Batubara Bukit Asam (Persero), Tbk;

In view of :

1. Law no. Number 23 of 2007 regarding Railways (State Gazette of the Republic of Indonesia 2007 Number 65, Supplement to the State Gazette of the Republic of Indonesia Number 4722);

2. Government Regulation Number 56 of 2009 regarding Railway Operation (State Gazette of the Republic of Indonesia 2009 Number 129, Supplement to the State Gazette of the Republic of Indonesia Number 5048);
3. Presidential Regulation Number 9 of 2005 regarding the Positions, Duties, Functions, Authorities, Organisational Structure and Working Procedures of the State Ministries of the Republic of Indonesia, as lastly amended by Presidential Regulation Number 20 of 2008;
4. Presidential Regulation Number 10 of 2005 regarding the Echelon I Organisational Units and Duties of the State Ministries of the Republic of Indonesia, as lastly amended by Presidential Regulation Number 50 of 2008;
5. Decree of the Minister of Transportation Number KM. 52 of 2000 regarding Railway Lines;
6. Decree of the Minister of Transportation Number KM. 43 of 2005 regarding the Organisation and Working Procedures of the Ministry of Transportation, as lastly amended by Decree of the Minister of Transportation Number KM. 20 of 2008;

With due observance of :

1. Letter of the Governor of Lampung Number 503/2266/04/2009 dated May 25, 2009 regarding Recommended Plan on the Utilisation of Ex-Srengs Harbour Land as a Private Coal Terminal of PT. Bukit Asam Transpasific Railway;
2. Letter of the Governor of South Sumatra Number 640/3117/IV/2008 dated October 13, 2008 regarding Principle License on Special Railway Operation;

HAS DECIDED:

To stipulate : DECREE OF THE MINISTER OF TRANSPORTATION REGARDING PRINCIPLE APPROVAL FOR THE CONSTRUCTION OF A SPECIAL RAILWAY CONNECTING BANGKO TENGAH TANJUNG ENIM IN SOUTH SUMATRA PROVINCE AND SRENGSEM IN LAMPUNG PROVINCE TO PT. TAMBANG BATUBARA BUKIT ASAM (PERSERO), TBK.

FIRST : To grant Principle Approval for the Construction of a Special Railway Connecting Bangko Tengah Tanjung Enim in South Sumatra Province to Srengsem in Lampung Province to:

	a.	company's name	: PT. Tambang Batubara Bukit Asam (Persero), Tbk
	b.	company's address	: Jalan Perigi No. 1 Tanjung Enim, Lawang Kidul District, Muara Enim Regency, South Sumatra Province 31716
	c.	Taxpayer Reg. No.	: 1.000.001.5-302
	d.	President Director's name	: Ir. Sukrisno
	e.	President Director's address	: Jalan Beringin No. 3 Tanjung Enim Sub-District, Lawang Kidul District, Muara Enim Regency
	f.	main business	: Mining product trading

SECOND : The Holder of Principle Approval for the Construction of a Special Railway Connecting Bangko Tengah Tanjung Enim in South Sumatra province and Srengsem in Lampung Province as intended in the FIRST DICTUM shall be obliged to:

a. comply with laws and regulations in the field of railways;
b. carry out technical planning activities, which shall at least contain the stage of planning the special railway infrastructure to be constructed, including predesign, design, construction and post-construction stages;
c. prepare environmental impact analysis or Environmental Management Efforts Report (UKL) and Environmental Monitoring Efforts Report (UPL);
d. conduct land procurement at least 10 percent of the width of land required in the context of obtaining license for special railway construction;
e. report change in company's ownership or company's domicile; and
f. report the activities as intended in points b to d above once every 6 (six) months to the License Grantor.

THIRD : The Principle Approval on Special Railway Construction as intended in the FIRST DICTUM shall be valid for 5 (five) years as of the issuance of this Decree upon the fulfilment of the obligations as intended in the SECOND DICTUM.

FOURTH : The Director General of Railways shall conduct supervision and shall provide further guidelines on the implementation of this Decree.

FIFTH : The Principle Approval on Special Railway Construction as intended in the FIRST DICTUM shall be revocable through written warning in the event that the relevant Holder of Principle Approval fails to perform the obligations as intended in the SECOND DICTUM.

SIXTH : This decree is valid from the stipulated date.

Stipulated in Jakarta
October 14, 2009
Minister of Transportation

Ir. Jusman Syafii Djamal

Carbon copies delivered to the Honourable:

1. Minister of Finance
2. Minister of Home Affairs
3. Minister of Public Works
4. Minister of Environment
5. Governor of South Sumatra
6. Governor of Lampung
7. Secretary General, Inspectorate General, and Director General of Railways, Ministry of Transportation

CEO of PT Tambang Batubara Bukit Asam (Persero), Tbk

Annex 3: Application letter for approval to transfer Principle Approval from PTBA to BATR

Jakarta, 30 August 2010

No : 210.J/Eks-0100/PU.05/VIII/2010
Kind : Urgent
Attachment : 1 (one) File
Regarding : Status of Special Railway Development Plan

The Honourable,
Minister of Transportation of the Republic of Indonesia
in Jakarta

With this letter, we would like to convey that PT Bukit Asam (Persero) Tbk. ("PTBA") has received principle approval to execute the Special Railway Development that connects from Blanko Tengah, Tanjung Enim in South Sumatra Province to Srengsem in Lampung Province, in accordance with Minister of Transportation Decree No. KP. 462/2009.

In regard to the above mentioned, we would like to convey that:

1. PTBA together with PT Transpacific Railway Infrastructure as the working partner has established an Indonesian Limited Liability Company, under the name of PT Bukit Asam Transpacific Railways ("PT. BATR") that based on Deed of Establishment of Limited Liability Company No. 16 dated August 5, 2008, made before Yulia, Bachelor of Law, Notary in Jakarta which has been ratified by the Minister of Law and Human Rights of the Republic of Indonesia as referred to in Decree No. AHU.48303.AH.01.01 of 2008 and registered in the Company Register under No. AHU-0067608.AH.09 of 2008 on August 6, 2008.
2. PT BATR will engage in the activities mentioned below:
    a. Operation of coal special railway infrastructure, covering constructing, operating, maintaining and managing the infrastructure.
    b. Operation of coal special railway facilities, covering procuring, operating, maintaining and managing the facilities.
    c. Operation of coal special port, covering constructing, operating, maintaining and managing the facilities.
    d. Business of coal transportation by train.
    e. Transportation business of pre- and post-railway transportation.
3. In relation to the above mentioned principle approval awarded, PTBA through PT BATR, which is PTBA's subsidiary, has implemented a series of activities with regard to the implementation of the above mentioned principle approval, with details as follows:

a. The initial draft of alignment (currently being reviewed by consultant).
b. Signing the Engineering Procurement Construction (EPC) contract with China's contractor (China Railway).
c. China Railway Contractor has conducted detailed research on the alignment plan in order to obtain accurate data required for the detailed engineering design process.
d. Conducting consultation and socialisation to all regency and provincial governments that will be passed by the above-mentioned railway line in order to secure the land utilisation approval and to align it with each region's spatial planning.
e. Conducting Land Assessment for jetty and port location.
f. Approaching international banking [institutes] for preliminary project financing.
g. Currently in the process of selecting a consultant to implement AMDAL (Assessment on Environmental Impact).

4. With regard to the preparation of the project funding, PT BATR is facing difficulties in securing Lender candidate, because PT BATR is not the Principle Approval Holder. Over several meetings with the Lender candidate, it was identified that since Principle Approval is not under PT BATR's name, this creates uncertainty for the Lender candidate in obtaining assurance that the planned business scheme will run smoothly.

5. Based on Article 1 point 10 of Government Regulation No. 56/2009 on Railway Operation ("PP No. 56/2009"), it is stated that "special railway operator shall be legal entity carrying out special railway operation." With regard to the definition of Legal Entity, Article 1 point 9 of PP No. 56/2009 has clearly identified that "Legal Entity refers to State-owned Enterprise, Regional Government-owned Enterprise and/or Indonesian Legal Entity specially established for that purpose", therefore PT BATR in our opinion has satisfied the norms/definition under PP No. 59/2009.

6. Considering that PT BATR is a subsidiary of PTBA, established specially to support the coal transportation activities of PTBA, therefore to address PT BATR's challenges in securing Lender candidate, it is our opinion that PT BATR needs to be optimally supported in order to obtain the Lender candidate's confidence. Therefore, we propose 2 (two) steps, which are:

   a. The above mentioned Special Railway Principle Approval shall be transferred to PT BATR as long as this special railway operation is only intended to support PTBA's main business as the Mining Business License Holder (IUP), and also its affiliated companies.

      The above mentioned Principle Approval shall be transferred to BATR as long as PTBA's shares in PT BATR is increased to at least 30 percent.

   b. The Special Railway Construction Permit and Operation Permit subsequent to the Special Railway Principle Approval shall be issued and addressed to

PT BATR, with the provision that this supports the main business of PTBA and its affiliated companies.

7. That recommendation is in line with the recommendation issued by the South Sumatra and Lampung Governors, which was as one of the requirements to secure Special Railway Principle Approval for PT BATR.

With regard to above mentioned matters, with this letter we would like to request that the transfer of the Special Railway Principle Approval from PTBA to BATR receive Minister of Transportation approval and enactment.

We thank you for your attention.

CEO

(Signature and Company's stamp)
Sukrisno

Carbon copies delivered to:
1. Directorate General of Railways
2. Secretary General of Ministry of Transportation of the Republic of Indonesia
3. Secretary of Directorate General of Ministry of Transportation of the Republic of Indonesia
4. Directors within the Directorate General of Railways, Ministry of Transportation of the Republic of Indonesia
5. PTBA BOD
6. BATR BOD

Annex 4: Legal Advice dated 19 October 2010 concerning the Concept of Affiliation, Subsidiary Company and Control

MEMORANDUM

To : Special Railways Team Richard G. Sharp, Michael I. Kennedy, John H. Winner, Clell Harral, Shirley Oroh
From : Asenar
Date : 19 October 2010
Subject : The Concept of Affiliation, Subsidiary Company and Control

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1. The concept of affiliation or "control" under Law No. 8 of 1995 on Capital Market (Law no. 8/1995):

   Under Article 1(1) of Law no. 8/1995 affiliation shall mean:

   a. a family relationship by marriage and descent to the second degree, horizontal as well as vertical;

      Elucidation:
      What is meant by a "family relationship by marriage" is the relationship of a person with:
      a husband or wife;
      a mother- or father-in-law, and a son- or daughter-in-law (1st degree, vertical);
      a grandfather- or grandmother-in-law, and a grandson- or granddaughter-in-law (2nd degree, vertical);
      a brother- or sister-in-law (2nd degree, horizontal); and
      a husband or wife of a brother- or sister-in-law (2nd degree, horizontal)

      What is meant by a "family relationship by descent" is the relationship of a person with:
      a parent or child (1st degree, vertical);
      a grandparent or grandchild (2nd degree, vertical);
      a sibling (2nd degree, horizontal)

   b. a relationship between a Person and its employees, directors, or commissioners;

      Elucidation:
      "Employee" means an individual who receives a periodic wage or salary and that works for a Person with authority to control and direct his actions.

c. a relationship between two Companies with one or more directors or commissioners in common;

Elucidation:
An example of a relationship between two companies with directors or commissioners in common, is as follows:
Mr. A is a Director of Company X and Company Y, or a Commissioner of Company X and Company Y, or a Director of Company X and a Commissioner of Company Y

d. a relationship between a Company and a Person that directly or indirectly controls or is controlled by that Company;

Elucidation:
"Control" means the ability to determine, directly or indirectly, and by whatever means, the management or policies of a Company.

An example of a relationship between a Company and a Person that controls the Company is as follows:
Mr. A controls Company X.

An example of a relationship between a Company and a Person that indirectly controls the Company is as follows:
Mr. A controls Company X and Company X controls Company Y. Therefore Mr. A indirectly controls Company Y.

An example of a relationship between a Company and a Person that is directly controlled by the Company is as follows:
Company Y is controlled by Company X.

An example of a relationship between a Company and a Person that is indirectly controlled by the Company is as follows:
Company Z is controlled by Company Y and Company Y is controlled by Company X. Therefore Company Z is indirectly controlled by Company X.

e. a relationship between two Companies that are controlled directly or indirectly by the same Person;

Elucidation:
An example of a relationship between two Companies that are directly controlled by the same Person is as follows:
Company X and Company Y are controlled by Mr. A.

An example of a relationship between two Companies that are indirectly controlled by the same Person is as follows:
Company X1 is controlled by Company X2 and Company Y1 is controlled by Company Y2. However, Company X2 and Company Y2 are controlled by Mr.

A. Therefore, Company X1 and Company Y1 are indirectly controlled by Mr. A.

f. a relationship between a Company and a substantial shareholder;

Elucidation:
"Substantial Shareholder" refers to a Person that directly or indirectly holds at least twenty percent of the voting rights of a Company's issued shares, or such lower percentage stipulated by BAPEPAM (capital market regulatory body).

An example of a relationship between a Company and a Substantial Shareholder is as follows:
Mr. A has voting rights to twenty percent of Company X's issued shares with voting rights.

2. The concept of affiliation under Government Regulation No. 23 of 2010 on Coal and Mineral Mining Business Implementation (GR 23/2010)

Article 1(2) of GR 23/2010 defines "affiliation" as follows:

Affiliation shall mean a company that has shares in the holders of IUP (mining business license) or IUPK (exclusive mining business license).

The above article is silent on the minimum amount or percentage of shares.

3. The concept of affiliation under Law No. 40 of 2007 on Limited Liability Company (Company Law)

The company law does not expressly provide a definition of "affiliation". However, the elucidation of Article 34(2) provides that "non-affiliated expert" shall mean an expert who does not have:

a. a family relationship because of marriage or descent up to the second degree, horizontally or vertically, with any of the Company's officers, members of the Board of Directors, members of the Board of Commissioners, or shareholders;
b. a relationship with the Company because one or more members of the Board of Directors or Board of Commissioners are the same;
c. a direct or indirect controlling relationship with the Company;
d. shares in the Company in the amount of 20 percent (twenty percent) or more.

The older company law (Law No. 1 of 1995, which was replaced by Law No. 40 of 2007) defines a "subsidiary company" as follows:

A subsidiary company shall mean a company which has a special relationship with another company because:

a. more than 50 percent of shares in that company are owned by parent company;
b. more than 50 percent of voting rights in the general meeting of shareholders are controlled by parent company; and/or
c. control of the company's operation, appointment and dismissal of directors and commissioners is determined by parent company.

4. The concept of subsidiary company of a State Owned Enterprise under Minister of State-owned Enterprises Regulation Number Per-01/MBU/2006 on Guidance for Appointment of Members of Board of Directors and Board of Commissioners of a Subsidiary of a State-owned Enterprise, as amended by Minister of State-owned Enterprises Regulation Number Per-03/MBU/2006 ("SOE Regulation 1/2006").

   According to Article 1(2) of SOE Regulation 1/2006, "state-owned enterprise subsidiary company" shall mean a limited liability company the majority of whose shares belong to an SOE and a limited liability company that is controlled by an SOE.

Annex 5: Ministerial Decree No. KA.003/1/1 Phb-2010

THE MINISTER OF TRANSPORTATION OF THE REPUBLIC OF INDONESIA

Number	:	KA.003/1/1 Phb-2010	Jakarta, 29 January 2010
Attachment	:		To
Regarding	:	Approval on Special Railway Construction by PT. Trans Kutai Kencana	The Honourable REGENT OF KUTAI TIMUR In Kutai Timur

1. In relation to your letter Number 182/112/HK/X/2009 dated October 6, 2009 regarding the matter as intended in the subject of this letter, we hereby state as follows:
   a. whereas provisions on special railway operation are provided in:
      1) Law Number 23 of 2007 regarding Railways;
      2) Government Regulation Number 56 of 2009 regarding Railway Operation; and
      3) Government Regulation Number 72 of 2009 regarding Train Traffic and Transportation.
   b. whereas following a review of the legality and administrative aspects on the required documents for the application for special railway operation by PT. Trans Kutai Kencana to support mining activities by PT. Tekno Orbit Persada, they have fulfilled the requirements according to the applicable laws and regulations;

2. In relation to the matters in point 1 above, it is acceptable to us for the regent of Kutai Timur to grant principle approval for the construction of a special railway in Kutai Timur regency to PT. Trans Kutai Kencana, provided that:
   a. The construction of special railway infrastructure is in accordance with the Regency Spatial Planning and Provincial Spatial Planning;
   b. The construction must be implemented in accordance with the provisions of the applicable law;
   c. Allowing crossing in the same section or not in the same section as the construction of roads, public railway lines, tunnels, water channels and/or other infrastructure in the public interest;
   d. The special railway operation by PT. Trans Kutai Kencana shall be used only to support the main business of PT. Tekno Orbit Persada in the field of coal mining and not to render public services;
   e. The term of the license for special railway operation by PT. Trans Kutai Kencana shall be for as long as PT. Tekno Orbit Persada carries out mining activities.

3. Thank you for your attention and cooperation.

THE MINISTER OF TRANSPORTATION
[Signed and Stamped; Stamp reads:
THE MINISTER OF TRANSPORTATION *
REPUBLIC OF INDONESIA *]
FREDDY NUMBERI

Carbon copies delivered to the Honourable:
1. Minister of Home Affairs;
2. Governor of East Kalimantan;
3. Director General of Railways;
4. PT. Trans Kutai Kencana.

APPENDIX H: SUMMARY OF KEY STAKEHOLDER MEETINGS

1. Project Preparation Meeting at IndII, 24 August 2010

Attendees: HWTSK, David Shelley, David Hawes, Suyono Dikun, Efi Novara

Appropriate translations for "*Perkeretaapian Khusus*" as used in the Railway Law were discussed, with a preference expressed for "Exclusive Railway", over the more common "Special Railway" as it refers to a railway that is used only and exclusively by a company to support its primary business. It was noted that the term "*Khusus"* is used in a similar context in the other modal transport laws, with the intent always that the special transport facility can only be used for the movement of the owner company's own products or inputs (which may include personnel) and may not carry 'for reward.' A company wishing to carry for reward should be established as a Public Railway. The concept of a "Limited Public Railway" was proposed with a view to this being defined as a sub-category of "Public Railway" that would be exempt from the onerous provisions of Perpres 67/2005 as amended by Perpres 13/2010.

Arrangements proposed in point (2) should preferably be accommodated through amending the pertinent Government Regulation (GR 56/2009) because a Government Regulation is higher in the legal hierarchy than a Perpres. A promising model is provided by Government Regulation 3/2005. GR 3/2005 amended Government Regulation 10/1989, among others to permit power to be purchased by direct appointment rather than by tender (this has enabled the state electricity company (PLN) to contract directly with Independent Power Producers (IPPs) rather than follow Perpres 67/2005 tender procedures).

HWTSK noted that the use of "Special Railway" as the term for "*Perkeretaapian Khusus*" is widely accepted and should be used in the study to avoid misunderstanding. However, the scope of "*Perkeretaapian Khusus*" should be further clarified under Phase 2. HWTSK acknowledged the need to have a "Limited Public Railway," and this would be a Phase 2 study topic. HWTSK agreed that any new category of public railway should avoid the tendering process under Perpres 67/2005 and Perpres 13/2010. Advantages and disadvantages of creating the new category in a Perpres (Presidential Regulation) or Government Regulation were discussed.

2. Special Railway Phase 2 Kick-off Meeting (at DGR office), 27 September 2010

Attendees: HWTSK, Nugroho Indrio, DGR Planning, DGR Legal, DGR Promotion and Investment, DGR Traffic, MoT Legal

The meeting was mostly devoted to setting up schedules and was immediately followed by a joint meeting with the MoT and DGR law departments where it was revealed that the MoT plans to issue a new set of Ministerial Regulations soon.

3. Meeting with David Hawes at IndII, 27 September 2010

Attendees: HWTSK team, David Hawes, David Shelley

At this meeting, Mr. Hawes presented the reasons why he felt that creating a new category of public railway was a preferable approach to modifying Special Railway regulations for attracting private sector investment to the rail sector. His arguments were partially procedural (it could be argued that modifying the basic definition of a Special Railway could require a change in Law no. 23/2007 itself, rather than simply implementing regulations, which appears possible for a new public railway category). It also might have the practical advantage of starting from a relatively clean slate, as public railway provisions are relatively undeveloped except for the PPP statutes.

Hawes addressed the legal status and use of "*khusus*" provisions for private sector investment in other modes, which was then discussed.

4. Meeting with DGR Investment and Promotion Section, 28 September 2010

Attendees: HWTSK team; Setyo Gunawan, Retno Sari, Prasetyo

Mr. Prasetyo presented six points that he proposed to include in a Ministerial Regulation (MR) and the discussion focused on these points. They were, specifically:

1. Point-to-point restrictions on Special Railways transport outside of the specific area in which the enterprise served had its main operation. Mr. Prasetyo favoured very tight limitations on this service.
2. No tender – the proposed MR would explicitly exclude tendering as a process for selecting the SR operator.
3. No special government aid – Any PPP type assistance for an SR would be excluded, although normal commercial transactions between government and SR operators would be permitted.
4. Land provisions – The focus here was not so much on acquisition of land, but on automatic reversion of land to the national government whenever the SR tenancy expired.
5. Not for hire – Essentially, Mr. Prasetyo would prohibit any charging for services; not only to third parties but to the enterprise it was dedicated to serve.
6. Emergency takeover by government would be allowed in event of a natural disaster or other national emergency.

HWTSK promised to review these points and get back to Mr. Prasetyo with our responses (see Meeting #22).

5. Meeting with Mr. Masjraul Hidayat, PT Railink

Attendees: C. Harral, R. Sharp (HWTSK); Mr. Hidayat

The discussion mostly concerned the effectiveness of PPP regulations for developing railway investment, especially in respect to the recent amendment of Perpres 67/2005 by Perpres 13/2010. This was discussed in terms of Railink's hope to become operator of the planned Jakarta airport rail line. Drawbacks in the PPP process were said to include a requirement for too many bidders (significantly eased by Perpres 13/2010) and insufficient implementation of conditions in the bidding process to give project initiators a competitive advantage. The existing process was viewed as still too cumbersome to be fully effective.

6. Meeting with Mr. Aldian Amilia, CMEA, 1 October 2010

Attendees: Asenar/Sharp (HWTSK), Aldian Amilia

The meeting covered the current status of the pending Special Railway applications of BATR and MEC, and obstacles to their approval under current legislation. It was indicated that CMEA favoured approval of the applications if the MoT could provide adequate justification. Overall, CMEA appeared unlikely to object to a broadening of services provided by an SR, if supported by the local jurisdiction, but expressed some concerns with constraints on competition, should the scope of an SR activity be extended beyond its basic, exclusive charter.

7. Meeting with Mr Thakur Singh, TKK, 1 October 2010

Attendees: Winner, Kennedy, Shirley Oroh (HWTSK), Thakur Singh

The discussion in this meeting covered a range of issues from the difficulty of acquiring land rights in Indonesia to the details of the MEC coal enterprise structuring for its East Kalimantan coal development, including the infrastructure subsidiary, special railway and special port subsidiaries, and the mining subsidiary. We also discussed potential mechanisms for the extension of a rail service when it might be in the public interest – for example, by providing incidental passenger services for not only MEC employees but also for the general public; or for moving coal for another mine in lieu of the other mine building its own special railway.

Mr Singh also discussed the intention of MEC to expand its development to include other activities such as a power plant using MEC coal and perhaps an aluminium smelter (using the power from the power plant). We also discussed the technical specifications of the railway that MEC intended to build – it would be standard gauge, and based on 32-ton axle loadings, using conventional standard gauge rolling stock (locomotives and wagons).

8. Meeting with Bukit Asam Transpacific Railway, 4 October 2010

Attendees: HWTSK team, Mr. Rudiantara

The discussion in this meeting focused on the structure of the relationship between BATR and PTBA. We also discussed PTBA's need for additional rail transport capacity and the mechanisms it is using to structure its coal operations to support multiple special railway developments as well as expansion in the capacity of existing PTKA-operated infrastructure. During the meeting, the terms of a concession-type license were discussed, as were land ownership issues. Alternative mechanisms for the development of the rail capacity PTBA needed were also discussed.

Considerable discussion was devoted to why it is deemed important for license approvals to be given to BATR, rather than to PTBA, which received the initial planning approval from the MoT.

9. Meeting with Mr Mesra Eza, MEC, 4 October 2010

Attendees: HWTSK team, Mesra Eza

This meeting was a follow-up to the previous meeting with the MEC Infra representative on October 1st. The organisational structure of the proposed MEC special railway project was the primary topic of discussion. The desirability of broader special railway utilisation, such as carrying other company's goods, was also addressed.

10. Meeting with Mr. Adi Herdiono, DGR, 5 October 2010

Attendees: Sharp, Winner (HWTSK), Adi Herdiono

The meeting focused largely on public railway capacity issues in Lampung and South Sumatra provinces as they might relate to the BATR and Adani SR applications. The meeting confirmed that PTKA is severely capacity-constrained in that area and that the DGR and PTKA have yet to work out arrangements to fully remedy the situation.

11. Meeting with Bappenas Transportation Directorate, 6 October 2010

Attendees: HWTSK team, Petrus Sumarsono

The meeting discussed the special railway and PPP project proposals and their connection with the provisions in the other sector such as road transportation and port.

12. Meeting with Bappenas - PPP Directorate (Deputy Director of Risk and Tariff Analysis), 6 October 2010

Attendees: HWTSK team; Rahmat Mardian

In the meeting, the group discussed the PPP mechanism and the difficulties with it. Case examples included the Central Kalimantan PPP project, which has been slow to

progress. The group also discussed the possibility of employing direct appointment, rather than competitive tendering, especially for private investment in the railway sector.

13. Meeting with MoT Legal, 6 October 2010

Attendees: HWTSK, Mr. Israful Hayat, Esq.

The discussion primarily concerned the rather complex structure of the MEC Coal venture in East Kutai, involving the mining concession.

14. Meeting with PKKPJT, 7 October 2010

Attendees: HWTSK, MoT PKKPJT (Land Transportation and Railway Partnership Studies), MoT Legal, MoT Planning, DGR Legal

This meeting had a wide range of participants, which helped the team to understand the positions and views of the various MoT offices with an interest in the development of Special Railways. The meeting addressed specific cases, with a variety of responses that were followed up later in separate meetings.

15. Meetings in Lampung, 7 October 2010

Attendees: HWTSK, Lampung Government (Mr. Eman Henderwan, head of the provincial transportation department; Mr. Barton Semarmarta, head of the forestry service among others): Bappeda, BPN; PT Bukit Asam (PTBA)

This meeting was attended by 18 officials from the Lampung Government and local authorities as well as representatives of BATR, translators/interpreters, and others. The wide-ranging discussion covered (i) the extent of the permits that BATR had acquired so far, (ii) the process for receiving provincial and regency approval for the use of forested areas, (iii) the province's need for various levels of approval and review of the proposed route, (iv) the impact of the railway on surrounding population developments, (v) the ability of the province to secure rights to cross the proposed railway infrastructure, and many other issues.

It was reported by several attendees that this was the first time the various agencies in Lampung had gathered with representatives of the DGR and MoT to discuss the issues related to special railway development. Some local government officials took the time to express their desire that the development should proceed much more quickly than it has so far, that the province needs additional transport capacity, and that moving more coal via railway will relieve local roads from overuse and stress caused by excessive truck weights.

A problem associated with the use of an existing bridge near the city of Lampung was also discussed. The consultants received a map showing the projected route of the proposed railway within Lampung.

16. Meeting with East Kutai Regent, 7 October 2010

Attendees: Sharp, Harral, Shirley Oroh (HWTSK); East Kutai regent Ir. H. Isran Noor, M.Si.; Febrina Danuningrat (MEC)

The discussion concerned the status of approvals (critical next approval is the construction license), land acquisition (roughly 85 per cent complete) and construction targets (to begin in late spring 2011) for TKK, the proposed MEC SR. The regent supports TKK being able to transport goods for others and passengers. He would support a PPP, but recognises public funding constraints.

17. Follow Up Meeting with MoT Planning Bureau, 8 October 2010

Attendees: HWTSK; Bernadette Mayashanti

The meeting addressed the regulatory philosophy relevant to the conditions imposed on SR operations. International standards for addressing market power of private railways were addressed.

18. Meeting with Bukit Asam Transpacific (BATR), 8 October 2010

Attendees: HWTSK; Rudiantara

The meeting discussed Mr. Rudiantara's concern over the critical need for full approval of all licenses in order to obtain financing. He reviewed the rationale for the current structure of BATR and prospective changes in the structure.

19. Mr. Djarot Tri Wahono (PKKPJT), DGR, 8 October 2010

Attendees: HWTSK, Djrot Tri Wahono, PKKPJT staff

This was a follow-up to the October 8 meeting. The meeting discussed the interpretation of Special Railway main activities, and the absence of provisions on alteration of a Special Railway to become a public railway. There are several concerns relevant to the special railway that may pose a market power to the main business owner if the special railway operator is another company. The meeting also clarified public railways under the PPP mechanism and special railways.

20. Meeting in South Sumatra, 11 October 2010

Attendees: Asenar, Sharp, Shirley Oroh (HWTSK); South Sumatra Government: Bappeda, Transport Department, BPN; PTKA South Sumatra

It was a busy week with meetings in Palembang (with South Sumatra transport, legal and planning staff, plus PTKA), Bandung (PTKA strategic planning), East Kutai regency and East Kalimantan (Governor, transport and planning), plus a meeting with Pak Prasetyo at the MoT. The following are highlights:

In South Sumatra, the issue of the legal requirements to be an SR seemed secondary, apart from the fact that they do not want every major coal mine running a rail line across the province, which a narrow interpretation of the SR rules would seem to require. Although PTKA may have done a good promotional job, this concern with an inefficient and redundant transportation network is not necessarily wrong. The Adani proposal for either an SR or PPP from the mines to Api Api is probably a long shot – there are too many issues of land acquisition, environmental access, road crossings and other planning matters for these to be resolved anytime soon. There does not seem to be much creative thinking, either, to "make it happen." The best option might be private investment in branch lines to PTKA and a line to Api Api from PTKA connections in the Palembang area (rather than private lines all the way from the mines), but under current SR interpretations there does not appear to be much room for that (although PTKA could, at a stretch, be an SR "parent" under the terms of Law no. 23/2007).

Regarding BATR specifically, the attitudes in Palembang seemed mildly hostile, but mostly they felt it was not their concern, –since the BATR line might be beneficial to the probably one regency in South Sumatra that it crosses, but neutral or negative to the rest.

In Bandung, we were informed that the Governor of South Sumatra had a major role in torpedoing the so-called " shortcut" deal that would have substantially reduced coal transport distances from Bukit Asam through Lampung province (as either a pure PTKA extension or a variety of joint venture options). It was not clear whether that was leverage to help secure an Api Api route through South Sumatra as a precondition to a Bukit Asam SR through Lampung, or whether the reduction of transport activity through PTKA's currently more direct route was the issue. In any case, it is clear that both a regency and a province have substantial power to block any deal through refusal or delay in land acquisition.

21. Meeting with PT Kereta Api, Bandung, 12 October 2010

Attendees: HWTSK; Rini Wahyu, PTKA Manager of Strategic Planning

In Bandung, we heard that PTKA had tried to argue, but failed to get GR 56/2009 to limit SRs to a purely "within district" rail activity. Since the need for rail services "on-the-property" are rare and not competitive with PTKA, they were obviously protecting the PTKA monopoly. They failed in that, but Article 350 of GR 56/2009 (district service plus connection to a single "supporting area") comes very close to achieving the same result. DGR Traffic (Prasetyo and his superior, Asril) seemed to advocate the "strict constructionist," pro-PTKA interpretation of SRs.

Apparently Jonan cancelled a pending joint venture with Bukit Asam to increase capacity due to concerns that Bukit Asam would have too much control.

22. Meeting with DGR Traffic, 13 October 2010

Attendees: Sharp, Asenar (HWTSK); Prasetyo, Setyo Gunawan (DGR)

This meeting focused on HWTSK's opinion concerning the six candidate items advocated for inclusion in a Ministerial Regulation by Mr Prasetyo. These were:

1. SR point-to-point restrictions – HWTSK felt the interpretation of this provision should be much liberalised or excluded from the proposed MR.
2. No tendering – HWTSK supported this proposed rule.
3. No special government aid – HWTSK supported this proposed rule.
4. Land provisions – HWTSK opposes requiring automatic reversion to national government in a MR. Leaving this option to the licensing process provides desirable flexibility.
5. Not for hire – HWTSK would support this rule only if tightly limited to published tariffs; under some conditions, contracts should be allowed (e.g., if the enterprise exerts control over the SR by contract terms rather than through its corporate status).
6. Emergency takeover – HWTSK supported this proposed rule as long as the possible emergencies were narrowly defined and outlined in detail in the MR. It was strongly recommended that shortage of public transport capacity should not be a qualifying emergency justifying a government takeover.

In our meeting with Prasetyo, we felt that he showed some flexibility on the point-to-point rule and perhaps would accept off-port coal storage (because a provision of GR 56/2009 (Article 91) allows for it), interchange with PTKA, and perhaps even coal drop-off at a customer's facilities (i.e., they might not count as supporting areas under GR 56/2009, Article 350). He was disappointed that we would not support the national railway automatically inheriting all SR assets, but seemed to expect it. However, he appeared intransigent on the ownership issue. There was little disagreement on the other points.

23. Gender Meeting at IndII, 13 October 2010

Attendees: Sharp, Shirley Oroh (HWTSL); Ruth Eveline, Juairia Sidabutar, IndII

Environmental, social and gender issues that might be associated with development of Special Railways were discussed. It was noted that such developments were obligated to comply with environmental protection measures under the law and that this was especially critical in the construction phase. The possibility of population dislocation was discussed, but not anticipated to be a serious issue given low population densities in most mining areas that might be served by SRs. Adherence to anti-discrimination and gender equality standards could be required in licensing provisions and HWTSK indicated that the project report would address such issues.

24. Meetings in East Kutai, 14 October 2010

Attendees: HWTSK; East Kutai Government: Head of Bappeda, Transport Department, BPN, deputy regent of East Kutai, TKK, Setyo Gunawan (DGR), Imelda M. (MoT Legal)

In East Kutai, there is strong support for the MEC Coal railway. The regent is content with TKK being the licensed operator and the regency seems confident in its high-level political backing. It seems to prefer that the MoT not intervene in plans to close agreements with the Forest Ministry and with hold-out communities. The regency believes it will be in a position to approve the construction license when the regency is ready. The regency/provincial endorsement of TKK appears to be based on purely practical judgements, not legal interpretation.

Discussions in East Kutai (and East Kalimantan) seemed to confirm that extension of an SR to serve other users on a step-by-step basis was acceptable to all parties. For MEC/TKK, that would be a sideline that they would be willing to undertake. As for the regency, it knows it will not get a public railway any time soon, so would be happy to get what it can from an SR. The port model under which the Minister is authorised to issue time-limited licenses to substitute for inadequate public capacity seemed attractive. The strategy of allowing a limited public service to make up for lack of public capacity might or might not be possible at the Ministerial Regulation level, noting that the port provision is in a GR.

25. Meeting in East Kalimantan, 15 October 2010

Attendees: HWTSK; East Kalimantan Government: Governor, Head of Bappeda, Transport Department; Tjejep Prasetya (MEC); Setyo Gunawan (DGR); Imelda M. (MoT Legal)

The governor and other provincial staff endorse East Kutai's support for the MEC venture and, if possible, the broadening of TKK's authority to serve a wider range of customers. They would support other SR applications from coal companies. The province would be very happy to see a PPP railway project come forward, but there seemed to be no awareness of anything pending or any detailed insights as to who would step forward with financing on either the private or public side.

Other proposed projects in East Kalimantan are far from realisation. Bayan Resources has an established private port for shipment of coal mined very near the port. It would like to haul coal from an inland holding to that port, but that would require crossing and/or sharing right-of-way with TKK. There is no specific proposal at the moment. A proposal from Churchill mining has nothing concrete, and even the legal status of the mining area is unclear. The same seems to be true of the alternatives to BATR being proposed in Sumatra. The main difference is that the options have been floating about without discernable progress for a longer time.

26. Meeting with DGR Traffic, 1 November 2010

Attendees: Sharp, Shirley Oroh (HWTSK); Asril Syafei, Prasetyo (DGR Traffic)

This meeting focused mainly on the difficulties in transferring the preliminary license for the Bukit Asam-Lampung SR from PTBA to BATR. As one avenue to satisfy BATR as the special railway licensee, the possibility under the new mining law regime for BATR to act not only as a railway transportation company but also as a sales company was addressed. The implications of railway network integration between a special railway and another special railway and/or public railway were also addressed.

27. Meeting with DGR Legal Staff, 2 November 2010

Attendees: Sharp, Shirley Oroh, Asenar (HWTSK); Baitul Ihwan (DGR Legal)

Mr. Baitul took several clear positions on the scope of a Special Railway. First, he held that an SR may carry other goods relevant to supporting the main activities of the enterprise it serves (e.g., for a mining railway, employees and equipment). HWTSK concurred with this interpretation. Mr. Baitul took the position that an affiliate could be a proper SR operator, even if the main enterprise's ownership is well below 50 per cent. HWTSK interviewers expressed the belief that this position might be untenable and that either full subsidiary status may be a minimum requirement or, possibly, that control should be very specifically guaranteed through contract arrangements. Mr. Baitul took the position that point-to-point means a single departure point in the main enterprise district to a single point in a single support area. HWTSK retained the position that the regulation could be read to allow more than one support area and/or that certain points on the route might not be support areas but points where a customer might receive products or where goods might be transferred to another carrier.

Mr. Baitul held that when an SR connects with another SR or public railway it must be converted to public railway status. This is an area with certain ambiguities that need to be clarified in a Ministerial Regulation. He believes that if BATR holds s license as an IUP (Mining Business License) production operation for hauling and sale, then BATR could be the SR licensee. HWTSK tends to believe that this may be administratively possible, but there is a risk of exposure to adverse treatment relating to royalties under the mining law, so this might not be a practical solution in the BATR case.

28. Meeting with PTKA Commercial Director, 2 November 2010

Attendees: Sharp, Shirley Oroh, Asenar (HWTSK); Sulistio Wimbo, Syamsul Arif (PTKA)

The meeting participants exchanged ideas on the positions taken by PTKA with regard to the development of special railways in general. It was proposed that PTKA with its extensive experience of being a railway operator in Indonesia could be a partner to bring expertise to the new railway operator. The meeting also addressed the possibility of creating a full double track on the existing PTKA track from Tanjung Enim to the port in Lampung province.

29. Meeting at IndII with Mr. David Hawes and Efi Novara, 3 November 2010

Attendees: Sharp, Shirley Oroh (HWTSK); Mr. David Hawes, Efi Novara (IndII)

The meeting discussion covered the following:

1. It is crucial to clarify the term "*Perkeretaapian Khusus*" with regard to its "exclusivity," as it refers to a railway that is used exclusively by a company in support of its main business activities. In the context of this activity, '*Umum'* is properly translated as 'Public' (e.g., *Angkutan Umum* is Public Transport rather than General Transport). Likewise, *Khusus* as used in *Perkeretaapian Khusus* is properly translated as Exclusive (e.g., *Jalur Khusus Bis* is an Exclusive Bus Lane; in other words, it is this 'exclusiveness' that permits prosecution of drivers of other vehicles that elect to use it).
2. The project Phase II is not undertaken with the intention to justify the existing licenses issued or any pending applications, but to further assess the current legislation on Special Railways (i.e., "*Perkeretaapian Khusus*") and to provide guidelines on possible extensions or modifications that might appear necessary. *Comment:* The need is to develop proposals for different situations and needs. The existing *Khusus* regulations are appropriate for the very narrow model for which they were designed.
3. To accommodate the needed flow of investment into the railway sector, it is desirable to form a new subcategory under Public Railway that is a "Limited Public Railway/*Perkeretaapian Umum Terbatas.*" This new category should be excluded from the existing regulations under Perpres 67/2005 and its revision, Perpres 13/2010, concerning PPP. As a follow-up, Mr. Hawes proposed that the team develop a recommendation for a "Limited Public Railway" to be presented at his luncheon appointment with Mr. Gita Wiryaman, Head of BKPM (Investment Coordinating Board).
4. Mr. Hawes proposed to accommodate the arrangement suggested in point 3 in a Government Regulation. Aside from this new category, it was agreed that an amendment of the existing GR 56/2009 is also crucial to accommodate more effective licensing and better practices in developing Special Railways. The recommendations for modification should refer to international best practices in addressing the terms for this GR amendment. *Comment:* The suggestion to use a GR reflects that the Law stipulates that its provisions will be further elaborated by GR. A Perpres could be used to exempt a Limited Public Railway from capture by Perpres 67/2005 and Perpres 13/2010, but cannot override the provisions of GR 56/2009.
5. Mr. Efi Novara discussed the application of a licensing model used in the toll road sector to ensure that the Special Railway operator possesses the capacity/merit required to operate the railway. His concern arose from the fact that Special Railway applicants might not have a proven track record, and therefore standards should be developed for evaluating applicants.

In addition to the above, the current status of the HWTSK Special Railway project, the Interim Report and the Interim Report presentation at the MoT were all reviewed. There was a general consensus on the major points discussed.

30. Meeting with PT Bukit Asam, 5 November 2010

Attendees: HWTSK; Heri Suprianto, Amir Faisol (PTBA)

The meeting was held to determine the PTBA position on the development of the special railway by BATR and other alternatives, including options associated with PT Pathway and Adani. BATR was affirmed to be the only active SR proposal under current consideration. At the meeting, the team requested a visit to the PTBA mine in Tanjung Enim to see the existing railway track and the mine itself. This visit took place the following week.

31. Interim Report Presentation Meeting, 5 November 2010

Attendees: HWTSK; Mr. Efi Novara (IndII); Mr. Nugroho (DG Secretary at DGR); Mr. Israful (MoT Legal), and others

The presentation and subsequent discussion covered the following topics:

1. The presentation by the SR Phase II Team Leader was titled “Rapid Assessment Report on Pending Applications” and included the objectives, background, international experience with private railways, Indonesia’s restrictive conditions, a pie chart of hypothetical assessment on investment caused by Indonesia’s special railway and PPP regulation, MoT restrictive interpretations, an assessment of three sample cases (MEC Coal, PTBA, and a PPP project in Central Kalimantan), a SWOT analysis, conclusions, and three steps of recommendations.
2. The biggest discussion was on the restrictive conditions, which were concluded by the SR team as being:
    - SR may transport only for main enterprise
    - Must be controlled by main enterprise
    - Traffic origin confined to a limited area (main district)
    - Point-to-point link to support area only
    - Uncertain government claims on project downstream
    - PPP option unacceptable to integrated project developers
    - Financing difficult with competitive tendering.
3. Schedules uncertain, affecting financing for main project.
4. Open access may conflict with dedicated service requirements.

The above main points were clarified by Mr. Nugroho, as the MoT had come with a liberal interpretation of the SR provisions, among other things not requiring ownership links. During the team’s presentation, Mr. Israful from the MoT legal bureau gave a

presentation of the MoT's latest position on the SR interpretation. The MoT (DGR) had engaged in an internal discussion and come up with a new approach to the Special Railway interpretation. Mr. Nugroho then invited the SR team to participate in this discussion, which would take place on 9 November 2010.

32. Meetings in Central Kalimantan, 8 November 2010

Attendees: Asenar, Winner (HWTSK); Imelda (MoT Legal), for separate meetings outlined below.

Mr. Humala Pontas, Head of Economic Development Division of Bappeda

Mr. Pertahanan Sipil, Economic Development Division of Bappeda

The economic development intent of the provincial government's PPP railway development effort was discussed first. The province had conducted preliminary feasibility studies (sponsored by the Japanese government) which concluded that rail transport would be the best solution for faster coal field development. A number of international and Indonesian coal companies have mining licenses in the region – including BHP with 7 licensed sites – but none of these is large enough to support a special railway on its own. Typical output from existing mining sites might be around 5 million tons a year per site.

The Central Kalimantan government considered special railway development but felt that the limitations under the existing rules governing special railways would not provide the kind of development potential they were seeking. The Central Kalimantan government wants to use the development of a general railway as a catalyst for economic development in the region, and sees a number of economic benefits arising from the development of a general railway, including:

- Reduced coal transport on area roads and highways, reducing congestion and road maintenance costs
- Reduced destruction of forested areas from the development of private mining roads
- The potential to develop a large, efficient power plant in the region to replace a number of smaller electrical generation stations and to support greater economic growth
- Faster and more practical development of lumber and agricultural industries
- Development of new industries like furniture (using locally produced wood products)
- Reduction in illegal mining with benefits of reduced private mining roads and greater income for the province from increased production at legally licensed mine developments.

Based on the feasibility studies and the transport regulatory environment, Central Kalimantan provincial officials believe that a general railway would produce the

greatest economic development benefits using the least amount of limited provincial funds.

Mr. Syahrin Daulay, Head of Bappeda

Mr. Daulay confirmed the information provided by Mr. Pontas. Private investment is essential to transport infrastructure investment. He cited several reasons for the selection of a railway as a development priority, including the difficulty of providing good road transport in the region due to poor soil conditions and the high-cost of road transport, let alone the cost of developing heavy haul coal roads. Private development of a general railway is the best course for economic development of Central Kalimantan province.

Mr. Daulay suggested that Bappeda may try to develop some mechanism to force coal and other bulk materials to use the railway – maybe by making it illegal to transport them on public roads. We discussed various mechanisms to encourage rail use rather than making transport of bulk materials on public roads illegal.

Mr. M Hatton, Head of Transport Department, Central Kalimantan Province

The provincial transport department has about 170 staff. They are currently mostly involved in safety regulation for road transport, though the department has participated in the PPP development process. Road planning, construction and maintenance is handled by Bappeda and the public works department. Mr. Hatton plans to add around five employees to his staff to regulate railway safety matters once the railway is built.

Mr. Hatton said that the province will provide the land to the PPP. The government has already issued directives to provincial, regency, and municipal governments not to issue mining or other development licenses in the railway right of way area. They have not given much consideration to how the railway and other parts of the PPP project will be regulated in terms of price, safety, and other aspects. Mr. Hatton expects to receive support from Bappeda, Bappenas, and the MoT in this area. He expects the tariff structure to be proposed by the bidders. Bappeda is responsible for developing the bid evaluation criteria.

Mr Hatton reiterated the objective of the Central Kalimantan government to restrict the use of public roadways for coal and other bulk goods transport (including logs, lumber, and agricultural products). We discussed how this might be done and suggested that technical regulation of axle load and truck sizes might be the best way. He mentioned that it is difficult to enforce the limitations that already exist.

33. Meeting with Mr. Graham Gleave, IndII M&E Specialist, 11 November 2010

Attendees: Winner (HWTSK); Graham Gleave, Yoke Saputra (IndII)

This meeting was with IndII's monitoring and evaluation (M&E) specialists. We discussed the progress of Phase II of the special railway project and the level of

cooperation the IndII team had received from the MoT (excellent); our progress on the originally proposed schedule (which started a week late, but was otherwise on time), and other issues related to monitoring the project from IndII's point of view.

34. Meeting with Mr. David Hawes, AusAID, 12 November 2010

Attendees: Winner (HWTSK); David Hawes (AusAID)

At this meeting the subject of the exclusivity of special railways was discussed along with the laws and regulations related to infrastructure development. Also discussed was the potential structure of regulations defining a public railway, built entirely with private funds, having limited access to expand the potential for private investment in Indonesian railway infrastructure.

35. Meeting with Coal Producer, 15 November 2010

Attendees: Winner (HWTSK); coal company executive

Met with a major Indonesian coal producer who preferred the meeting to be off the record. We met to discuss coal trading companies, royalty payments based on benchmark prices, and financing special railways.

First, the mining representative believed that the intent of the current law on special railways is that the railway is meant to be a unit of the producer, such that its costs are consolidated into overall production expenses and there is no question about transfer pricing. We discussed a company receiving a business license and IUJP for coal transportation and trading, and they agreed that this would be a possible business license under which a company building a railway might be issued railway construction and operating licenses. They believed that to comply with the conditions of the IUJP, the railway/trading company would have to buy the coal at the mine source.

The coal company might be able to show that the transport prices it was paying to the railway/trading company were not unreasonable by shipping some coal via road transport – the payment to the railway/trading company would theoretically be less than what they would pay to have the coal transported by road, and that could satisfy the intent of the transfer pricing regulations.

Another issue that came up was interesting. Indonesian accounting principles (IGAPP) recognise financial leases. They require any contract for assets that is longer than four years to be considered a financial lease, so the assets must be carried on the books of the company leasing the assets (which would create a one-year income of the value of the railway transferred to its books and a substantial tax liability). A special railway would certainly look like a financial lease – assets substantially dedicated to the producing company and a term of at least 20 years. So, to avoid being required to treat a special railway financed by someone else as a financial lease, a specific contract could only be for four years or less. It is possible to structure an umbrella contract with specific limited-term sub-contracts such that the transaction would not require the coal company to take the railway onto its balance sheet. However, it would take

careful structuring of the various contracts to assure the tax authorities that the asset was not acquired as a financial lease, to assure the DGR that the railway would only serve one client, and to assure investors that the income stream needed to pay back the loan was sufficiently assured that they could approve financing with a term longer than four years.

The coal mining representative did not believe that a railway subsidiary relationship would be sufficient for either licensing the construction of the railway or for including transport costs in production costs.

36. Meeting with Director General of Railways, 18 November 2010

Attendees: Winner (HWTSK); Mr Tundjung Inderawan, Director General of Railways

Much of this conversation was conducted in Indonesian since it involved legal issues relating to the approval of preliminary licenses. The DGR reported that the MoT is under pressure to issue the licenses in these particular cases. He indicated that the TKK license, issued to a subsidiary of MEC, would probably be approvable on the strength of a ministerial regulation sanctioning a subsidiary relationship. The transfer of the PTBA license to BATR is more problematic, as it is almost impossible to revoke a license. BATR and PTBA are currently pursuing a license for coal transport and trading, i.e. an IUP from the Ministry of Mines (see discussion below). A ministerial regulation might be adequate to solve the point-to-point regulations. A Special Railway should be able to haul the primary enterprise's own goods to any station along the railway to support its primary business activities.

The DGR consulted widely with the industry in setting up the special railway rules. At the time, the one thing the DGR was most worried about was having a private railway that they did not control capture their mining rents. One of the primary ideas was to ensure that the railway was a unit of the mine or a member of the mining consortium so that there was no tariff and the railway would not have market power over the mine. So they produced the existing rules and regulations regarding special railways with this input. Now it seems that the mining industry (primarily) does not particularly like these regulations.

The DGR will be very supportive of both Ministerial and Government Regulations to resolve the problem with private investment in railways, and would support a new type of railway – the private limited public railway we have been discussing – and is ready to meet with us again before our final report is done to review the findings and recommendations.

The DGR wants to better coordinate the DGR's rules with those of the other ministry and would like us to take this into account in our recommended actions. Finally, it was noted that the PTKA and DGR issues relating to infrastructure have been difficult. Currently, PTKA is still in charge of the infrastructure. Some accountants are working on completing a valuation of PTKA assets so that the balance sheet can be split. This should be completed in 2011 and when it is done, the DGR will be able to issue rules concerning access and access pricing. They will split PTKA into two or three sections –

infrastructure, rolling stock and operations, and perhaps Jabodetabek (the Greater Jakarta area) once this valuation is completed.

37. Meeting with DGR Traffic and MOT Legal Bureau, 18 November 2010

Attendees: HWTSK; Mr. Asril Syafei, DGR Traffic and Transport; Mr. Prasetyo, DGR Traffic Development; Mr. Israful Hayat, MoT Legal

This meeting was specifically requested by Israful or Asril. Prasetyo said that in addition to the six principles that we had already discussed, they had several more principles that they wanted to add to the ministerial regulatory scheme to make special railways work the way they should.

The first new principle was that if a special railway connects with the public railway (or another special railway), then it should become a public railway subject to the rules governing other public railways. The second principle is that the DGR sets the technical standards for the railway.

38. Meeting with Ministry of Energy and Mineral Resources, 18 November 2010

Attendees: HWTSK; Mr. Bambang Gatot, Director General of Mines and Minerals (DGM); Mr. Muhammad Karnova, Vice Chairman of Legal Working Group, Association of Mining Professionals

The Director General of Mines and Minerals (DGM) said they have been approached by MEC and BATR for transport and trading licenses to support their special railway application. In MEC's case, the DGM thought it was actually supporting TKK's ability to serve more than the MEC mine. An issue that was raised was the foreign investment component in special railways. A mining services license can be given to any company, even a 100 per cent foreign-owned enterprise. But under the transport (MoT) regulations, foreign ownership is limited to 45 or 49 per cent.

The DGM said that they would be prepared to issue mining services licenses for transport and sales businesses to companies wishing to build a special railway, even though they might have some concern about transfer pricing. The DGM agreed to discuss this situation with us again when our guidelines were more complete, and we wanted to discuss specific provisions with him (e.g., the provision that if you are not a subsidiary of a mine, the best (maybe only) way to get a special railway license is to get a transport and trading license).

39. Meeting with DGR Traffic, MOT Legal, DGR Legal, 29 November 2010

Attendees: HWTSK; Mr. Prasetyo, DGR Traffic; Mr. Israful Hayat, MoT Legal; Mr. Prawoto, DGR Legal

The meeting was largely a continuation of the meeting on 18 November 2010, and focused on MoT/DGR internal efforts to resolve internal differences among them

concerning the change of status that occurs when a Special Railway connects with another railway.

40. Meeting with DGR Traffic, MOT Legal, DGR Legal, 30 November 2010

Attendees: HWTSK; Mr. Prasetyo, DGR Traffic; Mr. Israful Hayat, MoT Legal; Mr. Prawoto, DGR Legal

The meeting was a continuation of the meeting on 29 November 2010, and focused largely on the proposal for a limited purpose railway.

41. Inspection of PTKA Line Palembang to Bukit Asam, 16 November 2010

The purpose of the trip was twofold: (1) to observe the geography and topography of the area between Palembang and Bukit Asam; and (2) to observe the technical capabilities of both PTKA's railway operations and Bukit Asam's mining operations at its Tanjung Enim mine site. To make these observations, we rode in the locomotive of an empty PTKA coal train from Palembang to Tanjung Enim. At Tanjung Enim we were met by Bukit Asam personnel who took us to various parts of the Tanjung Enim operation so we could observe coal mining activities as well as the train loading systems. In the course of these travels and inspections, we had an opportunity to closely observe the geography and topography of the region and draw some conclusions about the difficulty associated with constructing new railways in this area.

In general, the terrain is not difficult. Slopes are relatively gentle, there are no significant mountainous areas to navigate, the railway does not have any tunnels, and while there are some bridges, none are significant structures. The topography is characterised by gently rising land, surrounded by rubber plantations and agricultural communities.

There appears to be little reason for the carrying capacity of this railway line, which is now about 4 million tons a year, not to be increased significantly. Operations may currently be limited by locomotive and perhaps car shortages. Except for equipment shortages, there is no reason that current trains could not all be 50-car dual-locomotive trains, which would increase capacity by about 50 percent (about half the trains we saw were 25 cars, while the other half were 50-car trains). The new passing stations should provide additional capacity increases. Signalling improvements would increase capacity further. The line could be doubled in most places. Trains could be 75 cars with three locomotives with additional passing extensions.

In general, at additional cost, the PTKA line could be upgraded to be capable of 100-ton wagons and six-axle higher powered locomotives. Trains could be 100 cars long, 8,000 net-ton trains. This would be much cheaper than building a new special purpose railway.

APPENDIX I: ACTIVITY FINAL COMPLETION REPORT

IndII activity reference #: _225___	**Date of report: February 2011**
Activity name:	**Assistance to the CMEA & DG Railway [MoT] to establish Guidelines for Special Railway Operations: Stage 2**
Total budget: $AUD259,323	

PART 1: Executive summary

The specific objective of the activity was to develop comprehensive Guidelines for Special Railways (the Guidelines) that will serve as a template for Government and sub-national governments in developing licences and issuing clarifying regulations under which Special Railways (SRs) can be developed expeditiously with minimum jurisdictional conflict and maximum consistency of interpretation of applicable laws and regulations. Supporting objectives included:

- To reduce uncertainties faced by prospective enterprises and investors requiring the development of dedicated railway services needed to make the main enterprise activity feasible;
- To recommend clarifications in licensing practices and regulations under existing railway law that will improve the attractiveness of SR investments and contribute to the development of consistent governmental precedents in implementation of specialised railway services; and
- To suggest long-term modifications in the Indonesian legal/regulatory framework that will progressively bring Indonesian practices regarding development of specialised railways into harmony with well-accepted and recognised international practices.

PART 2: Background and context to activity

(A brief outline of the activity history and linkages to IndII objectives/outcomes in the IndII M&E Plan)

The Special Railway (abbreviated here as SR), is an industrial/resource development mechanism outlined in Indonesian Law no. 23/2007 providing for the development of specialised railway operations and services to serve the main activity on the sponsoring enterprise. However, there are other mechanisms available under Indonesian law to support the transport needs of enterprises, including the simple extension of a public rail line that, as a practical matter, may serve only one enterprise. Another mechanism is a railway infrastructure public private partnership (PPP) that may be developed under regulations specifically governing infrastructure PPPs. Policy and procedures to best implement Guidelines for Special Railways cannot be determined without a consideration of other options to meet specialised railway needs. Phase 2 implements a work plan developed in Phase 1 under which guidance is provided to the Ministry of Transportation (MoT), the Directorate General of Railways (DGR) and sub-national contracting agencies as to the options to be followed. Where the Special Railway approach is selected, guidance is provided as to the minimum qualifications for project approval at various stages of licensing, what terms and conditions might be attached and what procedures should be followed to secure Special Railway approval and licensing without undue delay.

The Guidelines would endeavour to reconcile the goals of promoting transport efficiency and expanded capacity in the rail sector with the infrastructure development objectives of multiple levels of government. And this is in line with IndII's goal to reduce policy, regulatory, capacity and financing constraints on infrastructure investment at national and sub-national levels.

PART 3: Key results of activity

(Provide details for each relevant key result area related to the activity; and a summary of achievements to date below.)

IndII Monitoring and Evaluation Framework Goal for project: Greater investment in Special Railways and the coordinated integration with Special Railways with PPPs and public railways,

Objectives	Output/ Performance Indicator	Achievements to date	Remarks
M&E Output 1: Development of Guidelines for Special Railways	*TOR Task1/Output 1.1, para.1 of M&E Framework: A review of relevant laws, regulations and licenses governing SRs.* Indicator: Reviews of relevant national and international rail transport data and practices completed covering – technical operations, spatial planning, economic viability, risk management, legal aspects, financial and commercial aspects	Findings reported in Project Inception, Interim and Final Reports. The Indonesian policy/legal/regulatory framework for investment in railways was compared to international best practices. Few issues were found with technical regulation and spatial planning aspects. The narrow legally available scope for private investment, however, increases risk, undermines financeability and generally reduces prospects for railway project economic viability.	The results of comparing the Indonesian framework to international practices supported recommendations for broadening approval of private sector railway investment to allow service to multiple companies, allow railway ownership by parties other than the primary enterprise served, and allow the private railway to also serve the public where approved by responsible jurisdictions.
	*TOR Task2/Output 1.1, para.2 of M&E Framework: **SWOT Analysis**: Assessment of strengths, weaknesses, opportunities and threats associated with successfully implementing SRs versus alternative means of providing rail service to enterprises; results to be reported in interim report* Indicator: A structured SWOT analysis for major existing and prospective options for private sector investment in railway infrastructure.	Results of the SWOT analysis were contained in the Interim Report and as an appendix to the Final Report. Four cases were evaluated: (1) Current SR, (2) current PPP, (3) SR with exclusive service restriction retained but ownership by the enterprise served eliminated, and (4) a limited purpose public railway providing that the private sector could develop a railway serving multiple enterprises in an economic sector under a negotiated license, and with third party train operators able to negotiate access with the developer.	In general, the existing PPP alternative to the SR as a vehicle for private investment in the rail sector was found to be applicable only in cases with multiple customers and with government support. The existing SR rules, with both service exclusivity and ownership constraints, were found to be unduly restriction. Removing the ownership restriction was found to be acceptable for immediately pending cases (MEC Coal and Bukit Asam), but the much less restrictive option represented by a limited public railway

			was the preferred option.
	TOR Task3/Output 1.1, para. 3 of M&E/(a) Diagnostics: Diagnostics of procedures and organisational options available to the enterprise requiring rail service in establishing an SR (or alternative private-investor railway option) were defined and assessed. Indicator: A diagnostic of private railway development initiatives currently under consideration (primary focus – MEC and Bukit Asam SR proposals and the Central Kalimantan PPP now in the procurement process) was conducted and reported on in the Interim Report. Generalised procedural and organisational recommendations were incorporated in the Final Report.	The study concluded that, at a minimum, the MoT would need to issue a Ministerial Regulation to fully justify approval of either of the pending MEC and Bukit Asam applications. Even a Ministerial Regulation would leave the two applications, and particularly Bukit Asam, open to legal challenge. Consequently, a new or revised Government Regulation was recommended as an essential step to reduce project risk and increase the probability of securing timely project financing. While the study had concerns that the Central Kalimantan PPP might not be successful, the PPP procurement process is ongoing and the MoT need not take action until that process is concluded.	A number of options to approve the pending SR applications were reviewed by the study team. The team cautioned against the MoT adopting interpretations found by the legal team to be highly subject to challenge and potentially subject to litigation, and urged use of the Ministerial and Government Regulation vehicles to create a more effective regulatory environment and reduce individual projects risks.
	TOR Task4/Output 1.1, para. 3 of M&E/(a) Context Specific: SR requirements may differ with respect to location in single vs. multiple sub-national jurisdictions; isolation versus linkages to public railways or other SRs, ports or other intermodal connections served and other factors. The project differentiated these contexts in analysis and reporting. Initial findings were included in the Interim report and elaborated in the Final Report for over a half dozen specific situations. Indicator: Case studies of proposed railway developments in South Sumatra, Lampung, Central Kalimantan and East	Based largely on the SWOT analysis above, the study found that PPP procedures under Perpres 13/2010 are most applicable where there are multiple potential railway customers and railway development is not part of an integrated industrial or mining project where all components are key to project financing and are best pursued together. In the latter case, current SR procedures are appropriate, but in many cases are handicapped by current exclusivity rules. As a remedy to exclusivity issues, waiver procedures were felt most appropriate in jurisdictions where there	Current SR constraints fail to recognise the complexity of modern project development and financing which make railway ownership by the enterprise served often undesirable and may make the ability to serve third parties critical to project viability. The project's recommendations were largely intended to introduce added flexibility in a legally sound manner to decrease risk and increase project viability. At the same time, the project recommended modifications in regulations to provide that a change in network conditions (e.g., the

	Kalimantan provinces.	is no existing public railway (e.g., Kalimantan), but a new sub-category of limited public railway was found to be generally preferable, and especially preferable where there is public railway capacity (e.g., in Sumatra).	connection of a formerly isolated railway to an SR, PPP railway or national public railway, or a railway extension that impacts jurisdictional authority) would not undermine the value of assets or the operational viability of the railway.
M&E Output 2 Regulation Modification / Recommendations	*TOR Task5/Output 2.1 (a) Recommendations for MOT/DGR: While general policy guidance and licensing provisions may substantially contribute to SR implementation, some near-term revisions to regulations may also be required, particularly to Ministerial Regulations interpreting GRs 56/2009 and 72/2009. Initial findings were covered in the Interim Report and recommendations regarding such revisions were included in the Phase 2 Final Report.* Indicator: Detailed analysis distinguishing between modifications in SR rules that could be accomplished under each level of the Indonesian legal hierarchy: Law, Government Regulation, Presidential Regulation and Ministerial Regulation.	At the Ministerial level, the project (1) reviewed and supported or recommended against the DGR's proposed Ministerial Regulations, and (2) developed several proposed provisions not included among the DGR's recommendations. A new Presidential Regulation was not found to be needed. At the Government Regulation level, four major reform categories were recommended: (1) provisions to waive exclusivity limitations where public railway capacity is inadequate (similar to port sector), (2) create sub-category of limited public railway, (3) simplify licensing procedures, and (4) explicitly require compliance with environmental, social impact, antidiscrimination and gender equality regulations [see below]. Changes in Law no. 23/2007 were not found to be essential at this time.	Drafting of legal provisions for a new Ministerial Regulation and a new Government Regulation would be undertaken in Phase 3. While most of the proposed reforms could be achieved by an amendment to GR 56/2009, item (2) might best be developed as a new Government Regulation exclusively devoted to outlining the provisions under the "limited public" subcategory. The study did not recommend any near-term modifications to Law no. 23/2007. However, it noted that if the Law is revised for other reasons and the limited public railway concept is firmly established as permitting private railway investment that is not exclusive to a single enterprise, then the SR category might be phased out as unnecessary.
	TOR Task6/Output 2.1, para 1, International Comparisons: Prior to finalising near-term recommendations above and to making longer-term recommendations for changes in Law no. 23/2007, Indonesian practices for	The review of international practices was included in the Interim Report and in an Appendix to the Final Report. International best practices supported recommendations for broadening approval of	While modifications of Special Railway regulations can bring Indonesia closer to international practices, the limitation of an SR to serving one customer is embedded in Law no. 23/2007. Without a

	approving rail lines serving individual enterprises were compared to international practices. Comparisons were incorporated into recommendations for changes in fundamental law and incorporated in the Interim Report. Indicator: Practices in major economies were surveyed, including Canada, US, Mexico, Brazil, Russia, India, China and Japan.	private sector railway investment to allow service to multiple companies, allow railway ownership by parties other than the primary enterprise served, and allow the private railway to also serve the public where approved by responsible jurisdictions.	modification of the law, service to multiple customers will require either (1) Ministerial waiver of exclusive service based on an emergency lack of public capacity, or (2) creation of a sub-category of public railways to support key industry sectors.
	TOR Task7/Output 2.1 (b) Regulatory Modifications Recommendations, longer term: Where changes in licensing policy and procedures or in Ministerial Regulations were insufficient to achieve SR goals, the study recommended broader changes in Government Regulations. No short-term changes in Presidential Regulations or in Law no. 23/2007 were felt necessary. Indicator: Potential environmental and social impacts as a result of SR operations identified and reviewed	While the study concluded [see above] that immediate issues with pending applications could be resolved through issuance of a new Ministerial Regulation and amendments to GR 56/2009, it also concluded that the best medium-term solution would be a new sub-category of limited public railways, combined with procedures to waive exclusivity restrictions similar to those in place in the ports sector. This may require one or two new Government Regulations, or at the least major new chapters to GR 56/2009.	Drafting of legal provisions for a new Ministerial Regulation and a new Government Regulation following inter-agency consultations would be undertaken in Phase 3.
M&E Output 3 **Social and Environmental Impact Mitigation**	*TOR Task8/Output 3.1 of M&E: Reflecting global experience generally, railway projects have lower environmental and social impacts relative to non-rail options, due to the smaller footprint of railway infrastructure compared to roads, and greater energy efficiency. While use of waterways compares favourably to rail by these criteria, the great potential pollution of water resources more than offsets any advantages of waterway use, thus heavily favouring*	*Mitigation strategies in accordance with existing Indonesian laws and regulatory policies may be included in the licensing requirements for SRs. However, current Government Regulations do not contain explicit guidance for compliance with environmental, social impact, anti-discrimination and gender equality laws and regulations. The Phase 2 Final Report recommended the addition of such*	Drafting of legal provisions for a new Ministerial Regulation and a new Government Regulation following inter-agency consultations would be undertaken in Phase 3.

	rail development. Indicator: Potential environmental and social impacts as a result of SR operations identified and reviewed	*provisions with specificity similar to and consistent with those contained in Government and Ministerial Regulations in the mining sector.*	

*Discuss and analyse key activity achievements objectives/outcomes – using the Activity Design and/or IndII M&E Plan's key result areas as a guide; i.e.: What has the activity contributed to program key result areas? Also identify inhibiting & contributing factors to achievements. ** **For Section 3.1-3.5 – Please only complete the section relevant to your activity. If your activity is primarily policy with capacity building, please only complete those sections (Refer to your activity design and results frameworks for more details) ****.** *Provide evidence where possible.*

3.1 Capacity building initiatives *Individual and work unit*

Development of enhanced Indonesian rail sector infrastructure capacity is substantially dependent on attracting private investment to the rail sector. The failure of either the current Special Railway or PPP regulations to achieve the completion of any private sector rail project attests to the need for new and revised regulatory provisions. The guidelines provided in the Phase 2 Final Report for a new Ministerial Regulation, revisions to GR 56/2009, development of exclusivity waiver provisions similar to those in the port sector, and the development of the limited public railway sub-category of public railways, individually and collectively have the ability to improve railway capacity. The project proposed streamlining licensing procedures and greater reliance on regency and provincial authority on projects within those jurisdictions, which should free up MoT institutional capacity to place additional focus on national Railway Master Plan requirements. On an institutional basis, the project team's sustained discussions with the MoT and DGR legal departments and with the DGR traffic department are generally understood to have contributed to the capacity of those departments to appropriately address licensing and regulatory matters related to private sector investment in a sound rule-of-law and good governance context.

3.2 Partnership building and performance *Linking with other departments, institutions and donors*

No other foreign assistance agencies or development banks were involved in this project. A number of national and provincial/regency offices were consulted in this project, including (at the national level) the Investment Coordinating Board (BKPM), the Coordinating Ministry for Economic Affairs (CMEA), and the National Development Planning Agency (Bappenas). In addition, constructive discussions were held with relevant private sector stakeholders to seek a consensus on the most appropriate way to proceed.

3.3 Policy setting and implementation

The study concluded that the existing legal framework requires significant changes to: (1) clarify and improve the attractiveness of the current Special Railway provisions through the mechanism of a Ministerial Regulation; (2) continue to support PPP railway development where appropriate; (3) through a Government Regulation, allow for the Special Railway to provide broader services based on a Ministerial finding on inadequate public capacity; and (4) expand railway investment opportunities through a new or amended Government Regulation creating a new sub-category of public railway called a Limited Public Railway. These multiple alternatives are offered because (a) different development contexts result in different strengths and weaknesses for each option, and (b) a single, broadly applicable approach would require a change in the underlying law that involves a cumbersome legislative process.

The study recommendations included the following:

Ministerial Regulation Guidelines:

1. Provide a legally credible interpretation of primary enterprise control of a Special Railway that will allow the project developer greater flexibility to structure project financing, permit opportunities for greater local participation in the enterprises served by the Special Railway, and better secure commercial benefits for the railway;
2. Clarify and specify the regulations and outcomes that will apply when a Special Railway interconnects with another Special or a Public Railway service;
3. Specify exceptions to the so-called point-to-point rule so that service interconnections and spur lines to third party facilities along the railway alignment may be approved as part of the SR services; and
4. Specifically link, through consistent terminology and precise cross-references, proposed articles in the Ministerial Regulation with articles of existing Government Regulations, so as to minimise conflicting interpretations.

Government Regulation Guidelines:

1. Empower the Minister of Transport with the authority to waive Special Railway service restrictions where inadequate public transport capacity is demonstrated to exist;
2. Provide for the development of a Limited Public Railway (LPR) option as a sub category of public railway, permitting a broader scope of services than the SR, but with an infrastructure access option to serve the broader public interest. The LPR would permit core train services to be offered to one or more enterprises on a B2B negotiated access basis, using facilities and equipment dedicated to those enterprises and not available for use by other parties except with the consent of the original investors. Unlike the Special Railway, an LPR would specifically allow infrastructure to be used by other train operators as might be agreed with the original investors and licensing authorities;
3. Exclude an LPR, like the SR, from (a) any government financial support or subsidy for the development, so that no public funds are at risk; (b) PPP requirements for competitive tendering under the provisions of GR 67/2005 as amended by GR 13/2010; and (c) inclusion in the National Railway Master Plan, which otherwise applies to a Public Railway;
4. Provide that negotiated LPR licenses, not the GR itself, will specify (a) the termination and handover requirements that will apply, subject to the consent of the original investor, (b) the procedures that will apply to applications for access by suitably qualified third party transporters using their own equipment, and (c) in the absence of adequate public transport, allow for the LPR operator to offer tariff services to cargo and passengers at its discretion and by agreement with the licensing authority;
5. Simplify and consolidate the licensing requirements for SRs and LPRs with the aim of avoiding overlap and duplication, with the MoT/DGR focusing on monitoring compliance with national technical, health and safety standards while sub-national authorities focus on monitoring compliance with local spatial planning, environmental and social safety net provisions;
6. Specify the process, including dispute resolution, and the broad parameters of provisions for access to railway infrastructure (using precedents based on generally accepted best international practice from heavy freight railway systems). Specify that negotiations for such access will be on a B2B basis between the original licensee and the third party; and
7. Require license conditions for both SRs and LPRs to address compliance or adherence by railway infrastructure developers and operators with environmental protection, anti-discrimination and gender equality and social mitigation measures that are consistent with existing norms in Indonesia.

3.4 Access

Not applicable

3.5 Cross-cutting issues *Gender, environment, disability*

GR 56/2009 is deficient in failing to call for compliance with Indonesian regulations relating to the environment, social impact mitigation, discrimination, disability and gender. The study recommended, for policy consistency, that the environmental/social impact provisions on Special Railways (or other projects outside the PPP structure) should be consistent with those under Presidential Regulation 13/2010. Given that most new projects are likely to be in the mining sector and that SR operators are likely to be IUP or IUJP holders, environmental/social provisions should also be consistent with requirements in that sector. Provisions in general sector regulations need not be complex, and can rely on reference to legislation specifically dealing with environmental, social impact, discrimination and gender issues (e.g., Indonesia's Environmental Impact Assessment process, AMDAL, Gender Mainstreaming and Gender Analysis/ Inpres No.9/2000). The proper place to refine those provisions is in the regulations dealing with those protections, not sector-specific regulations.

Railway regulations should not attempt to re-write environmental and social legislation. However, they should specifically require compliance with such legislation as a condition on licenses. The study recommended that one or more GR Articles should be incorporated with a tenor similar to the following:

Any party provided a construction or operating license under these regulations shall affirm that it will:

1) abide by all existing legislation in the field of environmental protection and management;
2) obtain approval of all environmental documents required by legislation;
3) comply with gender mainstreaming and gender equality provisions, for example, but not limited to anti gender-discrimination in its hiring practices;
4) otherwise undertake to mainstream gender best practices throughout operations of special railways, from planning to budgeting, implementation, monitoring and evaluation; and
5) implement social impact mitigation measures that may be required by railway construction and/or operations.

Ministerial Regulations should provide more specific cross-references to mining and/or Perpres 13/2010 provisions touching on these topics, as may be appropriate.

PART 4: Activity implementation

4.1 Progress *Outline progress for the period and discuss achievements listed in the table above in Section 3; Is the activity on schedule? If not what are the implications?*

Phase 1 was completed on a revised schedule approved by IndII and coordinated with related consultant commitments, and provides for Phase 2 to be implemented in a timely manner directly responsive to DGR short-term deadlines and medium-term objectives.

4.2 Sustainability *Factors contributing to sustainability overall*

Project sustainability will be enhanced by the close relationship between the consultant and DGR established in Phases 1 and 2, which should be a precedent for interactions required for drafting changes in regulation, should a Phase 3 be approved for that purpose. Transfer of results and

capabilities was enhanced by the location of project offices at DGR headquarters, frequent senior-level project oversight meetings, and the establishment of DGR staff/consultant working groups. Guidelines for Special Railways incorporated and amplified Special Railways planning documents prepared by DGR staff internally.

4.3 Activity expenditure *Outline expenditure for the period; note any significant underspend/overspend; specify the $A amount and percent variance*

Phase 2 was completed on budget and provides for a potential Phase 3 Regulation Drafting component, should IndII and the MoT elect to undertake that activity. Phase 3 is structured to be implemented in a timely manner directly responsive to (1) the DGR's short-term need for a Ministerial Regulation to help clarify the current GR and near-term need to implement reforms in GRs in coordination with the Investment Coordinating Board (BKPM), the Coordinating Ministry for Economic Affairs (CMEA), and the National Development Planning Agency (Bappenas), as well as with the MoT and the DGR.

PART 5: Program management

5.1 Management arrangements *Discuss management arrangements between partner ministry, stakeholders and IndII. Were management approaches effective and efficient? Include administrative issues, staffing, etc. If relevant, highlight innovative approaches to managing the activity.*

Co-location of project offices at the DGR has proven effective in increasing consultant/staff interaction. Continuity of IndII personnel dealing with MoT/DGR matters, combined with assignment of IndII staff to support the consultant team, has greatly improved consultant/DGR interaction as has carryover of consultant personnel from earlier assignments.

5.2 Lessons learned *What lessons have been learned to date and what impact have these lessons had upon the activity; i.e. What has changed?*

The consultant team was impressed in Phase 1 with the fact that most of the issues related to the effective implementation of Special Railways have been considered by DGR staff, but noted that avoidance of potential conflict among DGR departments and subordinate units, as well as between the DGR and other agencies and between national and sub-national jurisdictions, appear to have inhibited successful resolution of key issues regarding Special Railways. Both observations continued to appear valid in Phase 2. Consultant technical assistance has been of value not only for the generation of new ideas and the transfer of international experience, but also as a catalyst for bridging bureaucratic gaps in a neutral fashion that facilitated healthy debate and policy integration. Numerous project meetings with representatives from multiple departments proved to be a valuable vehicle for breaking down bureaucratic barriers and for transmitting concerns of officers in one department to their colleagues elsewhere in the MoT/DGR. The project also appeared to improve communication among jurisdictions on proposed Special Railway projects and among SR applicants and the MoT/DGR. The project may also have improved private sector awareness of its due diligence responsibilities with respect to legal and regulatory requirements.