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The Urgency of Implementing Step-In Rights Clauses in Project Financing Contracts in Indonesia

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ABSTRACT

The increasing infrastructure development in Indonesia today is directly proportional to the growing need for funding to support such projects. The funding model commonly used in infrastructure development is project finance, where risk management and cost allocation are shared among the project participants. As infrastructure projects become more complex and long-term, they often face various issues such as cash flow problems and losses incurred in the event of default. These issues can actually be addressed by implementing the Step-In Rights Clause, which grants the employer the right to intervene in the work of the contractor. However, the regulation of the step-in rights clause has not yet been explicitly governed by Indonesian legislation. This paper aims to explain the urgency of applying the step-in rights clause in construction contracts. The article employs a normative legal research method with a statute approach and a conceptual approach. In practice, the application of the step-in rights clause offers many advantages and has been implemented in several countries, including Australia.

Keywords: Infrastructure projects, Step-in rights, Project finance

ABSTRAK

Meningkatnya pembangunan infrastruktur di Indonesia saat ini berbanding lurus dengan meningkatnya kebutuhan pendanaan untuk mendukung proyek-proyek tersebut. Model pendanaan yang umum digunakan dalam pembangunan infrastruktur adalah project finance, di mana pengelolaan risiko dan alokasi biaya dibagi di antara para peserta proyek. Seiring dengan semakin kompleksnya proyek infrastruktur dan berjangka panjang, proyek-proyek tersebut kerap kali menghadapi berbagai permasalahan seperti masalah arus kas dan kerugian yang timbul jika terjadi wanprestasi. Permasalahan tersebut sebenarnya dapat diatasi dengan penerapan Step-In Rights Clause yang memberikan hak kepada pemberi kerja untuk melakukan intervensi terhadap pekerjaan kontraktor. Akan tetapi, pengaturan mengenai step-in rights clause belum diatur secara tegas dalam peraturan perundang-undangan di Indonesia. Tulisan ini bertujuan untuk menjelaskan urgensi penerapan step-in rights clause dalam kontrak *konstruksi. Artikel ini menggunakan metode penelitian hukum normatif dengan pendekatan perundang-undangan dan pendekatan konseptual. Dalam praktiknya, penerapan step-in rights clause memiliki banyak keuntungan dan telah diterapkan di beberapa negara, termasuk Australia.*

Kata kunci: Proyek infrastruktur, Hak campur tangan, Pembiayaan proyek

1. Introduction

In recent decades, infrastructure development has received special attention as an indicator to measure the progress of a region. This is based on the findings of the World Bank in 2015 which stated that the elasticity of GDP (Gross Domestic Product) to a country's infrastructure ranged from 0.07 to 0.44.[1] Infrastructure development is not only seen from the development of transportation but also in other fields such as health, economy, and education. In addition, it is necessary to increase the quantity and quality of infrastructure development such as expanding access to transportation, equitable development of health facilities and the development of water, electricity and telecommunications networks that are evenly distributed throughout the region. If this infrastructure is achieved, the productivity of the community will increase so that economic growth will also be achieved.[2]

In recent years, the Indonesian government's efforts to enhance infrastructure development have shown significant progress. This can be observed through the substantial increase in government spending. For example, in 2023, the state budget allocated Rp 125.18 trillion for infrastructure development, a significant rise from the Rp 116.37 trillion allocated in 2022. This increased investment highlights the government's commitment to improving infrastructure across the country to support economic growth and development.[3]

The Indonesian government has made significant efforts to improve infrastructure conditions. This is evident from the increased government budget allocated to infrastructure through the state budget, with Rp. 125.18 trillion allocated in 2023, a rise from Rp. 116.37 trillion in 2022. The high budget for infrastructure projects reflects the fact that such development requires substantial funding. Adequate funding is essential to ensure the smooth progress of infrastructure projects, as a lack of sufficient funds could lead to delays, which in turn would negatively impact the surrounding community's activities. Moreover, infrastructure projects are often high-risk, making careful and thorough planning essential before embarking on any project.

To address these challenges, infrastructure projects typically rely on a project finance funding model. Project finance is a method of financing that involves shared risk management and fund allocation among project participants. This model is especially suitable for long-term projects and usually involves the creation of a special entity, such as a Special Purpose Entity (SPE) or Special Purpose Vehicle (SPV), to oversee the development and operation of the project. A key feature of this model is the use of non-recourse loans through the SPE, which limits potential risks such as liquidation to the assets of the SPE, protecting the other shareholders' assets.[4]

Regulations regarding this project finance funding model have not yet been regulated in legislation although it is often used, especially in infrastructure development projects. However, there are various regulations that can support this project finance, such as Presidential Regulation Number 38 of 2015 concerning Government Cooperation with Business Entities in the Provision of Infrastructure. In the event that project finance is carried

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[1] Kementerian Keuangan Negara Republik Indonesia. (2019). Kebijakan Pembiayaan Perubahan Iklim: Suatu Pengantar. IPB Press, Hal.143-144.

[2] Lina Afriyana. (2023). Analisis Dampak Pembangunan Infrastruktur Terhadap Pertumbuhan Ekonomi Inklusif Pada Kabupaten/Kota di Provinsi Nusa Tenggara Barat Tahun 2016-2021. Jurnal Ekonomi Pembangunan, 5(1), 1-2.

[3] Kementrian Keuangan. Pembangunan Infrastuktur Jadi Fokus APBN Pada Tahun 2023. Available at https://www.kemenkeu.go.id/informasi-publik/publikasi/berita-utama/Fokus-APBN-2023. (Accessed on 16 Oktober 2024)

[4] Kementrian Keuangan. Project Finance-Konsep, Aplikasi dan Evaluasi-KPBU. Available at https://kpbu.kemenkeu.go.id/read/75-222/umum/kajian-opini-publik/project-finance-konsep-aplikasi-dan-evaluasi. (Diakses pada 16 Oktober 2024)

out using foreign funds, there are several relevant laws and regulations that can be considered. One of the regulations that can be considered is Law Number 25 Year 2007 on Investment.

Despite these supporting regulations, challenges remain in implementing project finance. These challenges include long project timelines, large financing requirements, and potential default by one of the parties, all of which can hinder the continuation of the project. These issues can be addressed by incorporating specific provisions into the infrastructure agreements that account for such risks.

One important contractual provision that can mitigate some of these risks is the step-in clause. This clause allows the project owner (often the government or a private entity) to intervene when the contractor (or work recipient) fails to meet the agreed-upon milestones in the project contract.[5] In simple terms, the step-in clause is a term contained in a construction agreement where this clause gives the work provider the right to intervene in work that the work recipient fails to complete. In practice, this clause can be activated if the work recipient has failed to achieve the progress agreed in the contract. There are several reasons why this clause is important to use such as:[6]

1. *Budget Efficiency*

   If the employer terminates the contract, it is necessary to demobilize (change) the work recipient. Where this demobiliation certainly requires costs and the procurement process again so that the budget swells even more. If a step-in clause is used, no demobilization is required because the employer can appoint a third party to use the equipment and supplies of the work recipient who fails to make progress.

2. *Time Efficiency*

   If a contract termination occurs, the employer must go through the procurement process again, which requires significant time and stages. By utilizing the step-in option, the employer is not obligated to appoint a third party through a new procurement process. This means that the step-in option can reduce the time needed, allowing the infrastructure project to be completed on time. Unfortunately, the step-in right clause is rarely found in infrastructure agreements, particularly in construction contracts in Indonesia. Therefore, this study aims to further examine the urgency of implementing the step-in right clause in infrastructure contracts that use the project finance funding model in Indonesia.

2. Research Method

This research method is a normative legal research method. This research is conducted through a statutory approach (statue approach) and conceptual approach (conceptual approach). The statutory approach is used to examine various laws and conventions related to the application of the step in right clause in infrastructure contracts with project finance funding models. While the conceptual approach is used to review and examine legal theories, concepts, and principles. This research also uses legal materials consisting of primary legal materials and secondary legal materials. The research data collection uses library research techniques by studying various books, articles and related documents. Furthermore, the data that has been obtained will be presented descriptively analytically.

3. Analysis and Discussion

3.1. Overview of Project Finance

As part of its commitment to achieving the Indonesia Maju 2045 vision, the government has made infrastructure development one of the central focuses of its policies. This emphasis stems from the belief that infrastructure development is essential for building Indonesia's economy and achieving economic equity. A concrete example of this focus is the increased allocation of funds to the Ministry of Public Works and Public Housing (PUPR), which rose to Rp125.18 trillion in 2023 from Rp116.37 trillion in 2022.[7]

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[5]Practical Lae. Glossary Step-In Right. Availabe at https://content.next.westlaw.com/practical-law/document/Ia00a9ba620d311ebbea4f0dc9fb69570/Step-in-right?viewType=FullText&transitionType=Default&contextData=(sc.Default). (Accessed on 16 October 2024)

[6] Kennywiston. Efektivitas Penggunaan Hak Step-In dan Intervensi Pada Kontrak Konstruksi. Available at https://www.kennywiston.com/efektivitas-penggunaan-hak-step-in-dan-intervensi-pada-kontrak-konstruksi/. (Accessed on 16 October 2024)

[7] *Ibid*.

One of the major infrastructure initiatives is the construction of a new capital city, Ibu Kota Nusantara (IKN). The large amount of funds required for this project has prompted the government to seek foreign investment to support this project. Project finance has emerged as one of the methods used by the government to meet these investment needs. The need for foreign capital stems from the shortage of domestic funds available to meet the government's ambitious infrastructure development goals. This shortfall is evident in public-private partnership (PPP) projects. In 2023 alone, the PUPR Ministry has targeted 31 PPP projects worth Rp212.52 trillion targeted by the government. In fact, in 2023 alone, 31 PPP projects worth Rp212.52 trillion have been targeted by PUPR.[8]

Given the growing prevalence of projects using the project finance scheme, it is important to first define what project finance entails. Project finance refers to a financing structure used for long-term projects, typically involving the creation of a Special Purpose Entity (SPE) or Special Purpose Vehicle (SPV) to develop and manage the project. Project finance serves as a tool for various parties (public, private, or public-private partnerships) to secure funding for projects that are complex and require substantial investment. Its unique funding model and structure make it ideal for financing long-term projects such as infrastructure and energy developments. Typically, project finance is closely tied to syndicated loans, given the substantial financial needs of such projects.[9]

Project finance is distinct because its financing mechanism relies on non-recourse loans provided through the SPE. This means that any risks arising from the project, such as liquidation, are limited to the SPE's assets, safeguarding the shareholders' other assets. Moreover, loan repayment in project finance is based entirely on the project's anticipated future cash flows, restricting liability to the SPE's assets and cash flows, not to the parent company's or shareholders' broader financial position.[10]

From this overview, it is clear that project finance is often closely linked with public-private partnerships (PPP). The combination of high capital requirements and the frequent use of project finance for infrastructure projects has made it integral to development efforts in Indonesia, from toll roads to power plants. According to Indonesian law, foreign legal entities are allowed to participate in project finance within the PPP framework. While project finance is commonly associated with PPPs in Indonesia, it is also widely used in financing private-sector projects.[11]

3.1.1 Legal Basis for Project Finance in Indonesia

In essence, there are no specific regulations governing project finance in Indonesia. However, several general provisions from various regulations can serve as the legal foundation for project finance. For instance, in the context of Public-Private Partnerships (PPP), project finance is indirectly regulated under Presidential Regulation No. 38 of 2015 concerning Government Cooperation with Business Entities in Infrastructure Provision. For projects involving foreign funding, relevant legal provisions must be considered. One such regulation is Law No. 25 of 2007 on Investment.

According to this law, if part of the shares or equity in the Special Purpose Entity (SPE) will be owned by foreign parties for project finance purposes, the SPE must be established as a Limited Liability Company (PT). Additionally, Presidential Regulation No. 10 of 2021 on the Investment Business Fields mandates that foreign investments in an SPE involve a minimum capital of more than Rp10 billion. Meanwhile, if the foreign party only acts as a creditor in the project finance arrangement, the SPE may receive foreign credit (foreign loans) as long as it does not place any guarantees or obligations on the Indonesian government or state-owned banks.[12]

[8] Kementerian PUPR op.cit
[9] KPBU Kementerian Keuangan RI op.cit.
[10] Adam Hayes. Project Finance: How It Works, Definition, and Types of Loans. Available at https://www.investopedia.com/terms/p/projectfinance.asp#:~:text=What%20Is%20Project%20Finance%3F,flow%20generated%20by%20the%20project. (Accessed on 13 October 2024).
[11] E. R. Yescombe. (2002). Principles of Project Finance.San Diego: Academic Press. hlm. 5-7.
[12] OCBC NISP. Apa itu Kredit Sindikasi, Pengertian, Jenis dan Fungsinya., Available at https://www.ocbcnisp.com/id/article/2022/09/01/kredit-sindikasi-

3.1.2 Parties Involved in Project Finance

Project finance is a scheme used in Indonesia primarily to support Public-Private Partnership (PPP) projects, known locally as Kerjasama Pemerintah dengan Badan Usaha (KPBU), which involves cooperation between the government and private entities in providing infrastructure or public services. Under this scheme, the private sector does not provide direct financing for the project but instead operates through a special entity dedicated to the project, known as a Special Purpose Vehicle (SPV).[13] Due to the large-scale nature of these projects, which come with significant risks, various types of risks must be addressed, including commercial risks, macroeconomic risks, regulatory and political risks[14], country risks, and institutional and legal development risks. To mitigate these risks, a risk diversification.[15] Strategy is essential, ensuring that no single party bears all the risks associated with a large-scale project. Typically, several different parties are involved in the project, including:[16]

1. *Project Company*

   This is a company established specifically to carry out the operations of a particular project. The project company is responsible for developing, constructing, implementing, and maintaining the project. It obtains financing from sponsors and lenders.

2. *Sponsor*

   Sponsors, or capital providers, contribute funding in the form of equity and may provide subordinated loans to the project company if the project financing has not been fully secured. Additionally, sponsors act as guarantors for the project company's obligations to the lenders.

3. *The Lenders*

   Lenders provide financing to the project company. Given the large scale of most projects, financing is typically provided by a group of lenders, rather than a single lender, through syndicated financing. Syndicated financing helps mitigate potential risks faced by the project company. Various roles in syndicated financing include arranger, manager, facility agent, technical/engineering bank, account bank, insurance bank, and security trustee.

4. *Government*

   The government plays an important role in project finance, particularly in PPP schemes. Beyond providing regulations and permits for project finance, the government also participates in the financing process. However, the government’s financial contribution is usually smaller compared to that of private sponsors or lenders. In Indonesia, the return on investment for sponsors and lenders is structured through mechanisms such as availability payments (periodic payments from the government) and tariff mechanisms (payments from service users).

5. *Others*

   Other parties involved in project finance include constructors, suppliers, insurers, lawyers, offtakers, borrowers, financial advisers, technical advisers, and equity investors.

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adalah#:~:text=Sehubungan%20dengan%20peraturan%20pemerintah%2C%20landasan,%2F23%2FDPD%20tahun%202005, (Accessed on 13 October 2024).

[13]Maulana, Mochamad Rifki. Pemahaman dan Pembelajaran Tahap Perencanaan dan Penyiapan Pembangunan Infrastruktur di Indonesia Melalui Kerja Sama Pemerintah dan Badan dalam Penyediaan Infrastruktur (KPBU).

[14] E. R. Yescombe. Op. cit. hlm. 197 – 311

[15]KPBU Kementerian Keuangan RI, Loc. Cit

[16]Andrew Fight. (2006). Introduction to Project Finance. Elsevier. Hal 11 – 15

3.1.3. Contracts in Project Finance

In general, contracts in project finance can be categorized into three main groups:[17]

1. *Project Agreements*

These agreements are intended to diversify obligations and risks among the various parties involved in the project. The purpose of these agreements is to clearly outline the responsibilities and risk-sharing between the project participants, such as the Engineering, Procurement, and Construction (EPC) contract, offtake agreements, and operation and maintenance agreements.

No.	Parties	Form of Contract
1	Project company - Sponsors	Equity Agreement and/or shareholders loan agreement
2	Project company - Lenders	Facility Agreement
3	Project company - Government	Permit and Regulation
4	Project company - Constructor	EPC Contract
5	Project company - Operator	O & M Contract
6	Project company - Supplier	Supply Agreement
7	Project company - Insurance	Assurance Agreement
8	Project company - Offtaker	Offtake Agreement

2. *Finance Document*

During the due diligence process, prospective lenders negotiate the terms of the loan agreement with the project company's sponsor, addressing critical issues. Once an agreement is reached, the finance documents become effective. These typically include the loan facility agreement, equity support agreement, security documents, account agreements, inter-creditor agreements, and amendment and waiver agreements. These documents govern the financial obligations and relationships between the project company, its sponsors, and the lenders.

3. *Security Document*

Security documents provide guarantees to lenders during both the construction and operational phases. For instance, during the construction phase, lenders may rely on guarantees related to the EPC contract, equity support agreements, or completion guarantees from the sponsors. In the loan phase, lenders may take

[17] KPBU Kementerian Keuangan RI, Loc. Cit

assignments of project contracts or rely on political risk insurance to mitigate their exposure to potential political or regulatory risks.

3.1.4. Differences Between Project Financing and Other Types of Financing

Aspect	Project Financing	Corporate Financing
Borrower	The borrower is a special purpose vehicle (SPV) or project company established for the project.	The borrower is the main company and its operating subsidiaries.
Recourse	Non-recourse or limited recourse for the sponsor. The sponsor's liability is limited or non-existent if the project company defaults.	Full recourse to the parent company and its subsidiaries. In the event of default, all assets of the parent and operating companies are liable to be claimed by creditors.
Economic Basis for Lending	Future cash flows generated by the project.	Assets and cash flows from the main company and its operating subsidiaries.
Key Collateral	Project contracts, future cash flows, and assets of the project itself.	Assets of the main company and its subsidiaries.
Likely action on enforcement.	Lenders will use the step-in clause from their direct agreement to ensure the project continues with the support of a third party. Other lender guarantees as senior lenders will protect the remaining assets.	The lender is likely to initiate asset sales from the main company group.

3.1.5 Implementation of Project Finance in Indonesia

In principle, project finance cannot be applied to all projects but is only suitable for projects with specific characteristics, such as: (a) Major infrastructure projects with long-term construction and operational periods, (b) Repayment through cash flow generated from the project's operations, (c) A debt-to-equity ratio of 70%-90%, (d) Assets whose value is typically lower than the total financing, (e) Limited project lifespan, and (f) No guarantees from investors..[18] Given these characteristics, sectors that can benefit from the project finance mechanism include oil and gas infrastructure, telecommunications, mining, energy, and transportation infrastructure, as well as other projects such as schools, prisons, hospitals, and factories.[19] In 2016, IJGlobal reported the top 10 project finance transactions globally, two of which were located in Indonesia[20] the Central Java Coal Fired Power Plant and the Tangguh LNG Expansion, with transaction values of $4.3 billion and $3.745 billion, respectively.

1. *Central Java Coal Fired Power Plant*

   The Central Java Power Plant (CJPP), or PLTU Batang, is an ultra-critical coal-fired power plant in Batang, Central Java, built under the project finance model using the Build-Operate-Transfer (BOT) scheme. PT Bhimasena Power Indonesia (BPI) serves as the project executor. With a total investment of approximately $4 billion (over Rp40 trillion), the project was funded through loans from international banks and financial institutions. Revenue is generated through a 25-year Power Purchase Agreement

[18]E. R. Yescombe. Op. Cit. Hal 7-8
[19]Andrew Fight, *Op. Cit.*, Hal 2 – 3
[20]KPBU Kementerian Keuangan RI, Loc. Cit

(PPA) with PLN. Although the project faced construction, operational, and regulatory risks, it also brought economic benefits, such as job creation and increased electricity capacity. The ultra-critical technology used in the plant is more efficient and environmentally friendly compared to conventional plants.

2. Tangguh LNG Expansion

The Tangguh LNG Train 3 Expansion project, managed by BP Berau Ltd., was financed with a $3.745 billion loan. This project, the first to involve domestic financial institutions in Indonesia, includes national and international banks as lenders. The expansion aims to increase the LNG production capacity of the Tangguh plant, supporting Indonesia's 35,000 MW power program and meeting gas demands in Papua and West Papua. The project is expected to have a multiplier effect on Indonesia's economy, boosting local financial industry participation and job creation.

3. Trans Java Toll Road

The Trans Java Toll Road is a large-scale infrastructure project connecting Merak in Banten to Banyuwangi in East Java. The project consists of several toll segments built under a concession scheme, where private entities are responsible for constructing, operating, and maintaining the toll road. Private sector involvement is demonstrated by the fact that 50% of the funding comes from private investors, while the remaining portion is provided by the Toll Road Regulatory Agency and the national budget (APBN) through loans between Indonesia and China, as well as the national and regional budgets.[21]

4. Jakarta–Bandung High-Speed Rail Project

The Jakarta-Bandung High-Speed Railway is a modern transportation initiative designed to connect two major cities in Indonesia with high-speed trains, significantly reducing travel time. The project is a collaboration between Indonesia and China, with 75% of the financing coming from a loan provided by China Development Bank, and the remaining 25% from equity contributions by the shareholders, including a consortium of Indonesian state-owned enterprises (PT Pilar Sinergi BUMN Indonesia) and a consortium of Chinese companies (Beijing Yawan HSR Co. Ltd).[22]

5. Water Management Project

The Semarang Barat Water Supply Project (SPAM Semarang Barat) utilizes project finance mechanisms. A consortium of PT Aetra Air Jakarta and MedcoEnergi formed PT Air Semarang Barat as the project company. The project received both equity funding and loans from PT Bank BCA as lenders. The investment is returned to private parties through a tariff mechanism, where fees are charged to service users. The project's investment value reached Rp1.19 trillion, with Rp1.4 trillion from the national budget (APBN), Rp227.9 billion from non-APBN sources, and the remaining funds provided by sponsors and lenders.[23]

6. Telecommunications Infrastructure

The Palapa Ring Barat is a public-private partnership (PPP) project in the telecommunications sector, located in the Riau and Riau Islands regions. Sponsors PT Moratelindo and PT Triasmitra established PT Palapa Ring Barat (PT PRB) as the project company. PT Bank Mandiri also participated as a lender. The project's investment return is structured through an Availability Payment (AP) mechanism, where the Ministry of Communication and Information Technology's (BAKTI Kominfo) makes regular payments

[21]Kompasiana. Anggaran dan Sumber Pembiayaan Pembangunan Jalan Tol Trans-Jawa. Available at https://www.kompasiana.com/rahmaniviapermatasari1836/5e7ee0c7d541df12d63a7af3/anggaran-dan-sumber-pembiayaan-pembangunan-jalan-tol-trans-jawa. (Accessed on 14 October 2024).

[22]Kcic.id. Pinjaman Luar Negeri KCJB Bersumber dari China Development Bank. Available at https://kcic.co.id/kcic-siaran-pers/pinjaman-luar-negeri-kcjb-bersumber-dari-china-development-bank/. (Accessed on 14 October 2024).

[23]KPBU Kementerian Keuangan RI. Progres Proyek KPBU SPAM Semarang Barat. Available at https://kpbu.kemenkeu.go.id/berita/read/1354/progres-proyek-kpbu-spam-semarang-barat/. (Accessed on 14 October 2024).

throughout the concession period to PT PRB. The total investment value for this project was Rp3.48 trillion, with a 15-year concession period.[24]

3.2. Application of Step In Rights Clause in Project Financing Contracts

Step-in rights are designed to protect the interests of funders and others who are major stakeholders in construction or engineering projects. The rights will be contained in a collateral warranty, schedule of third party rights or direct agreement given by (say) a contractor or sub-contractor under its project contract or sub-contract. Essentially, the rights allow the funder (or other beneficiary of the rights) to "step into" the relevant contract in place of the contractor or sub-contractor's counterparty. In the case of a funder receiving the right to step into a construction contract, the counterparty would be both the contractor's employer and the person borrowing finance from the funder to carry out the project. The step-in rights would be exercised to keep the contract to which they relate "alive", in a situation where it might otherwise be terminated due to the insolvency or default of the borrower or the contractor. Basically, there are two kinds of step-in trigger events, both of which appear in typical step-in clauses: "top down" and "bottom up". Take, for example, the step-in rights included in the third party rights in favour of a funder in the JCT Standard Building Contract.1 These provide that: if the finance agreement between the funder and the borrower/contractor's employer is terminated, the funder may give the contractor a notice by which it steps into the contract; and if the contractor intends to terminate its employment under the contract, it must first give the funder prior notice of its intention to do so. The funder may, within the notice period, opt to serve a step-in notice. If it does, the funder becomes the employer and the contractor's right to terminate ceases. In either case, the funder becomes responsible for payments due to the contractor under the contract.[25]

Step-In Rights are a crucial clause in Project Financing contracts, particularly in projects involving Public-Private Partnerships (PPP). This right grants lenders or creditors the ability to "step in" and take over the management of a project when the project company fails to fulfil its obligations as per the agreement. Typically, these rights are activated in situations of financial failure, technical issues, or serious contractual breaches that could potentially halt project operations.

In Indonesia, where infrastructure project financing often involves multiple lenders from various financial institutions, the implementation of Step-In Rights is intended to protect the creditors' interests and ensure the project's continuity, thus avoiding significant financial losses. Creditors are given the right to temporarily take control of the project management until the issues are resolved, or even appoint a more capable third party to continue the project.

This clause does not only involve the temporary transfer of responsibilities but also serves as a form of security for lenders. In non-recourse financing models, commonly used in Project Finance, the repayment of loans is based on the future cash flows generated by the project itself, rather than the assets or capital of the project's parent company. Therefore, if the project fails, creditors face significant risks of losing their investments. Step-In Rights function as a risk mitigation tool, allowing creditors to manage, control, and redirect the project to ensure it continues and generates the expected returns.[26]

In Indonesia, the PPP scheme, governed by Presidential Regulation No. 38 of 2015, emphasizes the importance of private sector involvement in infrastructure development, with a risk-sharing mechanism between the government and the private sector. Step-In Rights ensure that infrastructure projects such as toll roads, airports, and power plants can continue to operate, even when the project company encounters major challenges.[27]

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[24]Kementerian Komunikasi dan Informatika. Proyek Palapa Ring Barat Diluncurkan. Available at https://www.kominfo.go.id/berita/artikel-gpr/detail/proyek-palapa-ring-barat-diluncurkan. (Accessed on 14 October 2024).

[25] The JCT Standard Building Contract Without Quantities. (2016). The funder third party rights are in paragraphs 5 and 6 of part 2 of schedule 5 of the contract.

[26] Carla M. (2016). Step-In Rights Mechanisms In Poject Finance Transaction and Lenders' LiabilitiesI the English and Brizilian Legal Approach . London: King's Collage London

[27] Asian Development Bank. (2020). Public-Private Partnership Monitor: Indonesia. Metro Manila: Asian Development Bank. Hal. 23.

Step-In Rights are part of a protection system that safeguards the interests of lenders, typically embedded in loan agreements. These agreements often include various guarantees, which are agreed upon as conditions for loan disbursement. In Project Finance, the types of guarantees may include: Share pledges on the project company's shares, Receivables pledges on the project company's income, Bank account pledges on the project company's accounts, Real property pledges on the project's assets (e.g., a plant being constructed), Pledges on other project company assets, provided they have economic value and are permitted as collateral under the respective jurisdiction, Direct agreements with third parties involved in the project.

3.2.1 Purpose of Step-In Rights Clause in Project Finance Contracts

Step in Rights is one of the rights that can be used by the lender in project financing with the aim of minimizing the possibility of losses that will be experienced in the event of failure to complete the project that has been agreed upon by the work recipient. In project finance, the most important thing for the lender is the ability of the project company to repay the loan. The natural independence of project financing is basically under the financial structure of the project, so that when the project fails, the lender can expect significant losses as a good thing (Non-Recourse).[28]

Intervention rights or Step in rights in project finance-based construction projects is a right that can be exercised by the lender to take over the workmanship and completion of the ongoing project if there is a problem in the construction contract. In its application, Step In Rights can only be exercised if the work recipient is negligent in carrying out their work so that it results in not achieving the objectives agreed upon before the agreement. The existence of a step in rights clause is an effort that can be made by the surety so as not to lose its rights or suffer losses when the project undertaken by the work recipient is not in accordance with the previously agreed agreement.

The purpose of the step in rights clause in project finance can be seen in the following explanation, namely:[29]

1. *The employer can complete the remaining work*
   In this case, the contract that has been agreed upon previously but cannot be completed by the work recipient will not be determined. This means that the work recipient is still responsible for all work results so that the costs incurred in completing the work will be borne by the work recipient even though the employer has exercised its right to complete the work that has not been completed by the work recipient.

2. *Avoiding employer's loss*
   In project finance, the financing that will be received by the work recipient by the employer to finance the project that has been agreed to be carried out mostly comes from the bank, so in this case, the only opportunity for the employer to get back the money is if the project continues to operate and make a profit. So that if the conditions that occur are the opposite, then the employer can intervene with the previously agreed step in right to take over the project from the work recipient to avoid greater losses and the lender can find a solution between completing the project itself or appointing another party as the work recipient.

3. *Protection of third parties*
   In project finance work, the parties involved in the agreed project work besides the recipient of the work and the lender (work), there are also third parties who usually in this case will be the supplier of all the needs needed when the project will be carried out until completion. So in this case, with the Step in rights, third parties can also be protected and increase their trust in the funder (investor). In the event of a loss, or the recipient makes a mistake that causes the agreed objectives in the project to not be achieved, the third party will not suffer losses due to the step in rights.[30]

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[28] Deddy Supriady (2009). Pemodelan Pendanaan Project Finance Berbasis Risiko Pada Proyek Properti (Studi Kasus: Proyek Kondominium di Kebayoran Baru Jakarta Selatan). Universitas Indonesia.
[29] Akbar Perdana. Efektivitas Penggunaan Hak Step In dan Intervensi Pada Kontrak Konstruksi. Available at https://www.kennywiston.com/efektivitas-penggunaan-hak-step-in-dan-intervensi-pada-kontrak-konstruksi/. (Accessed on 15 October 2024).
[30] Wick, P. (1997). Step-in Rights: A Supplier's Perspective. AMPLA Yearbook, 118-123.

4. *Maintaining supply reliability*

In the course of the agreed project, it is necessary to maintain the reliability of supply in the course of the project, in this case the project funder wants to maintain the cash flow of the offtaker to ensure the project continues to run in order to fulfill their debt obligations. For offtakers, step-in rights are usually only needed when there is no ready market for the service or product whose supply they want to protect. Conversely, if it takes a long time to develop an alternative supply and no market is available, then the need for the offtaker to consider this solution will increase.

These are the purposes of step-in rights in project financing-based projects, simply put, the purpose of step-in rights is to minimize the losses suffered by the funder or third party when the work recipient does not complete the work agreed upon in the contract.

3.2.2. Forms of Step-In Rights Clauses in Project Finance Contracts

Step-In Rights clauses in project finance contracts are tailored to the specific needs of the project and the agreements made between the involved parties. These clauses provide mechanisms for lenders or creditors to intervene if the project encounters significant problems, ensuring that the project can continue to meet its objectives. Here are several common forms of Step-In Rights clauses:

1. *Management Takeover Clause*

This clause grants the lender or investor the right to take over the operational management of the project if there is a significant breach of contract. The takeover typically occurs after formal notification and a pre-determined cure period that gives the project company an opportunity to address the issues. If the project company fails to rectify the situation within this period, the lender can assume control of the project management to protect their investment.

2. *Contractor Replacement Clause*

Under this clause, the lender has the right to replace the main contractor if they fail to meet their contractual obligations. The replacement process involves an assessment of the contractor's performance, and the lender may appoint a pre-approved alternative contractor who meets the project's requirements. This ensures that the project continues without significant delays or quality issues due to the underperformance of the original contractor.

3. *Project Oversight Clause*

This clause allows the lender to monitor and oversee specific aspects of the project, such as spending, schedule adherence, and construction quality. The goal is to ensure that the project proceeds according to the agreed-upon plan and that it meets the required standards. By maintaining oversight, the lender can intervene early if deviations from the plan occur, helping to mitigate risks before they escalate into major problems

4. *Dispute Resolution Clause*

This clause outlines the procedure for resolving disputes related to the exercise of Step-In Rights. It includes processes such as mediation, arbitration, or litigation that the parties must follow before the lender can take over the project. Having a clear dispute resolution process helps to avoid prolonged conflicts and ensures that issues are resolved efficiently, reducing the risk of project delays.

5. *Financial Clause*

The Financial Clause provides the lender with the right to access the project's financial information and control the project's cash flow. It ensures that the funds are being used appropriately and that the project remains financially viable. If necessary, the lender can intervene to manage the project's finances, protecting their investment by ensuring that resources are allocated correctly and the project can continue to meet its financial obligations.

3.3. The Urgency of Implementing Step-In Rights Clauses in Project Financing Contracts in Indonesia

The implementation of Step-In Rights clauses in project financing contracts is increasingly critical in Indonesia, particularly given the country's ambitious infrastructure development plans. Indonesia's infrastructure sector has seen significant growth, driven by the need for improved transport, energy, and public service facilities. This expansion is often financed through Public-Private Partnerships (PPPs) and other project finance mechanisms that involve complex risk-sharing between government, private companies, and financial institutions.

The inclusion of Step-In Rights in project finance contracts in Indonesia is not only crucial for protecting the interests of lenders and investors but also for ensuring the continuity and success of vital infrastructure projects. By mitigating risks, maintaining project momentum, and safeguarding public services, Step-In Rights play a fundamental role in the sustainability of infrastructure development in the country. Given the growing complexity and scale of these projects, the urgency of implementing such clauses is clear, especially as Indonesia seeks to modernize its infrastructure and bolster economic growth.

3.3.1 Comparison of Step-In Rights with Contract Termination

Step-In Rights offer significant advantages over contract termination, especially in large-scale construction projects. When a contract is terminated, the project often comes to a complete halt, leading to substantial financial and time losses. Contract termination involves resolving prior agreements, which often requires a lengthy legal process and consumes significant resources. Furthermore, finding new contractors or restarting the project from scratch entails major costs and delays the project's completion.

In contrast, Step-In Rights provide a smoother and more efficient alternative. When lenders or third parties are granted the right to "step in" and take over the project, the project can continue without significant delays. This is especially important in large projects, such as public infrastructure, where a total halt could have widespread societal impacts. For example, if the construction of a toll road is stopped, it not only affects the project's completion but also burdens road users and hinders economic development in the surrounding areas.

Additionally, Step-In Rights allow for significant cost savings. Lenders can intervene and resolve issues without the need for costly and time-consuming renegotiations. This process enables the project to continue with minimal disruption, avoiding the time-consuming task of finding a completely new party to take over. Financially, Step-In Rights offer strong protection for lenders. In Project Finance contracts, debt repayment is usually contingent on the cash flow generated from the project itself. If the project is halted, lenders risk losing part or even all of their investment. With Step-In Rights, lenders can ensure that the project continues, cash flows are maintained, and the debt is repaid on time. This allows them to manage risks more effectively without facing the potential large losses that can arise from project termination.

Another benefit of Step-In Rights is their ability to avoid prolonged legal disputes. Contract termination often leads to long-drawn-out legal battles, with each party defending its position. This process is not only time-consuming but can also damage the relationships between the parties involved. With Step-In Rights, such conflicts can be avoided because lenders can directly take over the project without needing to terminate the contract or take the case to court.

Lastly, Step-In Rights help protect the reputation of the parties involved. In large projects with many stakeholders, project failure can significantly damage the credibility and trust in the company or contractor. The use of Step-In Rights allows lenders or third parties to keep the project running, avoiding negative publicity or perceptions of failure that could harm the long-term reputation of all parties involved.

Overall, Step-In Rights offer a much more flexible and adaptive mechanism compared to contract termination. This right allows the project to continue, minimizes financial losses, maintains relationships between the parties, and helps avoid reputational damage. The application of this right not only protects the interests of lenders but also ensures that construction projects can achieve their goals without significant disruption.[31]

3.3.2. Challenges in Implementing Step-In Rights Clauses in Project Financing Contracts in Indonesia

Despite the many advantages offered by Step-In Rights, their implementation in Indonesia faces several obstacles, including regulatory limitations, a lack of understanding within the industry, and concerns over project control. Clearer regulations and education about the benefits and mechanisms of Step-In Rights are needed to ensure these rights can be more effectively implemented in construction projects across Indonesia.

The application of Step-In Rights in Project Financing contracts in Indonesia has not yet been widely adopted, even though it offers more benefits compared to contract termination. Several factors contribute to this, including regulatory, industry-specific issues, and perceptions of risk.

One of the primary challenges is regulatory ambiguity. Law No. 2 of 2017 on Construction Services, which serves as the main legal framework for construction projects in Indonesia, does not explicitly regulate or provide a solid legal foundation for the application of Step-In Rights. This law focuses more on construction work standards, worker protection, and dispute resolution through more conventional mechanisms like arbitration or courts. As a result, the Indonesian construction industry is more accustomed to using contract termination as a solution when problems arise, rather than relying on Step-In Rights.

Additionally, there is a lack of understanding and practical experience regarding Step-In Rights among project managers and lenders. Many parties feel that granting lenders the right to take over a project poses too much risk, as it may reduce their control over the project. However, in Project Finance schemes, Step-In Rights are designed to protect the continuity of the project and the investments involved without having to completely halt the project. Due to this lack of understanding, industry players tend to prefer the option of contract termination, which is more familiar and clearly regulated by existing laws.

Another challenge is the concern over project control. In construction projects, especially those involving multiple parties such as employers, main contractors, subcontractors, and lenders, control issues often become a sensitive matter. There is concern that when Step-In Rights are enforced, lenders who do not fully understand the technical aspects of the project may take over, potentially disrupting the project's progress. As a result, many contractors or project owners prefer to avoid the application of these rights, even though it may be more beneficial for the long-term success of the project.

Lastly, within the context of Indonesia's construction industry, dispute resolution methods like arbitration or litigation are still considered the standard approach when contract failures occur. Step-In Rights, which offer a more proactive solution by allowing third-party intervention, are often viewed as inconsistent with industry practices that tend to resolve issues after contract breaches rather than preventing them through early intervention.

3.3.3. The Implementation of Step-In Rights in the North West Rail Link (NWRL) OTS PPP Project in Australia

Step-in rights play a crucial role in public-private partnership (PPP) contracts, providing the government with the authority to take over operational or financial obligations from the private entity (in this case, OpCo) in cases of emergencies or significant failures. The North West Rail Link (NWRL) OTS PPP project in Sydney, Australia, is an exemplary case of how step-in rights are structured and applied in the context of large-scale transport infrastructure.

1. *Project Overview: NWRL OTS PPP*

The NWRL project is one of the largest transport infrastructure undertakings in Australia, aimed at enhancing accessibility and transport capacity in the northwest region of Sydney. The OTS PPP

[31] Wiston, K. (n.d.). Efektivitas Penggunaan Hak Step In dan Intervensi pada Kontrak Konstruksi. Kenny Wiston. Available at https://www.kennywiston.com/efektivitas-penggunaan-hak-step-in-dan-intervensi-pada-kontrak-konstruksi/. (Accessed on 16 October 2024).

(Operations, Trains, and Systems Public-Private Partnership) involved the construction, operation, and maintenance of a rapid transit rail line, with a total contract value of AUD 3.7 billion. The contract was between Transport for NSW, representing the state of New South Wales (NSW), and OpCo, a private sector consortium responsible for executing the project. OpCo's responsibilities included financing, designing, and operating the rapid transit system, which entailed procuring new-generation trains, building new stations, and integrating a communication-based train control (CBTC) system.

2. Step-In Rights Implementation in the NWRL Project

The step-in rights in the NWRL project were comprehensively detailed in the OTS Project Deed, signed on 15 September 2014. These clauses granted Transport for NSW the authority to intervene and assume OpCo's functions under specific conditions:

1. *OpCo's Performance Failure:*
   If OpCo failed to meet its obligations according to the performance standards outlined in the contract (for instance, failure to provide safe, timely services or maintain infrastructure as expected), Transport for NSW had the right to exercise step-in rights. This intervention aimed to ensure the continuity of critical public services, especially when OpCo's failure jeopardized the project's sustainability or posed a risk to public safety.
2. *Emergency Situations:*
   Step-in rights could also be invoked during emergency situations that posed serious threats to public health, safety, the environment, or property. In such cases, Transport for NSW could take immediate action to address the emergency without needing additional approval from OpCo.
3. *OpCo Contract Termination:*
   If OpCo terminated the contract, either due to bankruptcy or other serious financial issues, Transport for NSW had the right to take over the project. This allowed the government to continue operations previously handled by OpCo, either by directly managing the project or by appointing a third party to resume the work.
4. *Carrying Out OpCo's Responsibilities:*
   During the step-in period, Transport for NSW could assume all rights, obligations, and assets necessary to carry out OpCo's responsibilities. Once the conditions triggering the step-in were resolved, Transport for NSW was expected to hand back control of the project to OpCo.

The application of step-in rights was further governed by side deeds, which were signed between Transport for NSW, OpCo, and the core contractors involved in the project. These agreements ensured that when Transport for NSW invoked step-in rights, the related rights and obligations of OpCo towards contractors were transferred to Transport for NSW as well

3. Legal Basis for Step-In Rights in Australia

The implementation of step-in rights in Australia, particularly in the North West Rail Link (NWRL) OTS PPP project, is governed by a comprehensive legal framework designed to manage public-private partnership (PPP) projects. The main sources of legal guidance include the National Public Private Partnership Guidelines and state-specific legislation like the Transport Administration Act 1988 (NSW).

1. *National Public Private Partnership Guidelines:*
   These guidelines, issued by Infrastructure Australia, provide a legal and regulatory framework for the execution of PPP projects across the country. They address risk allocation, contractual standards, and government intervention mechanisms, including step-in rights. The guidelines ensure that public interest is safeguarded, particularly in critical infrastructure projects, by allowing the government to intervene when private contractors fail to meet their obligations.
2. *Transport Administration Act 1988 (NSW):*
   In New South Wales (NSW), step-in rights are further reinforced by the Transport Administration Act 1988. This legislation gives Transport for NSW the authority to intervene in transportation projects to protect public safety and ensure continuity of essential services. The law allows the

government to assume control over projects, such as the NWRL, if operational failures or contractor default pose a risk to public welfare.

3. *Application in the NWRL Project:*
   In the case of the NWRL OTS PPP project, step-in rights were incorporated into the OTS Project Deed, allowing the state to take over responsibilities from OpCo in specific circumstances. This legal structure ensured that the public interest was prioritized, enabling Transport for NSW to step in during performance failures, emergencies, or financial distress without lengthy legal processes or termination of contracts.

The implementation of step-in rights in the North West Rail Link (NWRL) OTS PPP project in Australia can serve as a reference for other countries looking to adopt similar mechanisms in public-private partnership (PPP) infrastructure projects. This approach offers a practical solution for governments to intervene in critical infrastructure projects when private sector partners face operational challenges or fail to meet contractual obligations. By establishing a clear legal framework, as demonstrated in Australia, governments can better protect public interests, ensure project continuity, and manage risks more effectively in large-scale infrastructure developments.[32]

4. Conclusion

In recent decades, infrastructure development in Indonesia has significantly increased across various regions. This growth in infrastructure aligns with a rise in funding for infrastructure projects, which often employ the project finance model. Project finance typically involves risk management and shared funding responsibilities among project participants. A key feature of project finance is the creation of a Special Purpose Entity or Special Purpose Vehicle (SPE/SPV) to facilitate the development and operation of the project. Examples of projects utilizing project finance include the Central Java Coal-Fired Power Plant and the *Tangguh* LNG Expansion, each with transaction values of $4.3 billion and $3.745 billion, respectively.

Although widely used, project finance is not explicitly regulated under Indonesian law. However, regulations like Presidential Regulation No. 38 of 2015 on Public-Private Partnership in Infrastructure Provision indirectly cover aspects of project finance. In infrastructure projects involving Public-Private Partnerships (PPP), *step-in rights* clauses are essential. These rights allow lenders or creditors to "step in" and take control of project management when a project company fails to fulfill its contractual obligations. Step-in rights serve as a risk mitigation tool, enabling creditors to control, manage, and redirect the project to ensure its continued operation and expected profitability.

Implementing step-in rights provides multiple benefits, especially by reducing risk for creditors and promoting long-term project stability. This mechanism enables lenders to safeguard their investments by ensuring that project operations continue even when the primary operator faces difficulties. For Indonesia's construction sector, adopting step-in rights more extensively could strengthen investor confidence, secure funding, and enhance the sector's resilience to operational risks. A clearer regulatory framework on step-in rights in project finance arrangements would further support these benefits and encourage sustainable infrastructure growth in Indonesia.

One country that has successfully implemented step-in rights in project finance is Australia, notably in the North West Rail Link (NWRL) OTS PPP project. This project, aimed at enhancing transport accessibility and capacity in northwestern Sydney, demonstrates how step-in rights can mitigate risks in long-term, high-risk infrastructure ventures. However, Indonesia still faces several challenges in adopting step-in rights, such as unclear regulations, a lack of practical understanding and experience with step-in rights, concerns over project control, and the construction industry's reliance on both litigation and non-litigation methods for dispute resolution when contract failures occur.

[32] See Transport for NSW, OTS PPP Project Deed (2014) for more details on step-in rights

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