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## CLIENT UPDATE

### 27 DECEMBER 2016

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# Constitutional Court OKs Private Sector Role in Electricity Sector Subject to Conditions

On 14 December 2016, the Constitutional Court once again ruled on the constitutionality of the Electricity Law.<sup>i</sup> The Court's ruling (the "**Decision**")<sup>ii</sup> came in response to a petition brought by two employees of PT PLN (Persero), the state electricity utility, in their capacities as labor union representatives (the "**Petitioners**").

#### **The Decision**

The Petitioners challenged six articles of the Electricity Law, but only two of the challenges were accepted by the Court, namely, the challenges to Article 10(2) and Article 11(1), which are respectively related to the issues of unbundling and private sector involvement in the electricity sector.

#### **Unbundling**

Article 10(2) of the Electricity Law provides that the "*the business of supplying electricity to the public [...]* **may be** conducted in an integrated manner." The electricity supply business refers to electrical power generation, transmission, distribution, and sale (as explained in Article 10(1) of the legislation). The words "**may be**", according to the Petitioners, could be interpreted as meaning that electrical power generation, transmission, distribution, and sale could each be conducted in a stand-alone or unbundled manner.

The Petitioners argued that such an interpretation would contradict Article 33(2) of the Constitution, which requires the State to "control" important sectors of production that have an impact on the lives of the Indonesian people. In addition, the Petitioners claimed that Article 10(2) of the Electricity Law was in contravention of a previous Constitutional Court decision handed down in 2003,<sup>iii</sup> in which the 2002 Electricity Law,<sup>iv</sup> which contained an "unbundling" provision, was held to be unconstitutional.

It is interesting to note that the very same Article 10(2) was challenged in 2009, when the Court in its ruling<sup>v</sup> back then rejected the petitioners arguments on the basis that unlike the 2002 Electricity Law, the 2009 Electricity Law does not expressly provide that the business of supplying electricity to the public must be conducted in a stand-alone or unbundled manner.

This time around, the Court acknowledging the concern that Article 10(2) could in practice be interpreted so as to allow unbundling. Accordingly, the Court held that "Article 10(2) of the Electricity Law is **conditionally unconstitutional** and has no binding power it were to be construed in such a way as to allow unbundling in the business of supplying electricity to the public so as to result in no state control over the relevant business.

#### **Private Sector Involvement**

Article 11(1) of the Electricity Law provides that the "business of supplying electrical power to the public [...] shall be conducted by state-owned enterprises, local government enterprises, private enterprises, cooperatives, and communities engaged in the supply of electricity." In view of Article 33(2) of the Constitution, as discussed earlier, the Petitioners argued that the principle of "state control" legitimized the state-owned company position in the sector, and, therefore, as the state enterprise mandated to supply electricity, PT PLN (Persero) should be the only entity permitted to undertake the business. Accordingly, private enterprises, cooperatives and communities should be prohibited from supplying electricity to the public as to allow them to do so would be a breach of the Constitution. Specifically on

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regional-owned enterprises, the Petitioners argued that such would be **conditionally unconstitutional** to the extent the supply of electricity was not interpreted as “performed together with PT PLN (Persero)”.

The Court held that Article 11(1) is conditionally unconstitutional and has no binding power if the article were to be construed or applied in such a way as to result in the state has no control. However, as long as the state continues to have control, the article will continue to be constitutional. Given that the involvement of the private sector is constitutional if the state retains control, the involvement of cooperatives and non-governmental bodies will also be constitutional if control remains vested in the state.

#### ***Conditionally unconstitutional, what does it mean?***

By ruling that a statutory provision is “conditionally unconstitutional” (or “conditionally constitutional,” as the case may be), the Constitutional Court establishes a new rule or norm governing how the relevant article should be interpreted. If this rule or norm is not complied with, the article will be rendered unconstitutional and has no binding effect. The full impact of a conditionality ruling is not immediate; it does not automatically deprive the relevant article of binding effect. However, if in the future the Government issues a regulation related to the said article that triggers a breach of the condition (in this case, a diminution of state control), then an aggrieved party will have a strong basis to have the article declared unconstitutional based on the Constitutional Court earlier decision.

#### ***State Control, how to define it?***

The term “state control” in the electricity sector, as well as many others, has long been a topic of debate. At the heart of the issue is the ultimate role of the state: should the state (through a state enterprise) conduct all aspects of the electricity business itself, or is it sufficient for the state to regulate the sector, populated by non-state enterprises, through the issuance of permits and licenses, setting price adjustments, and supervising performance?

The Court cited the test as to the meaning of ‘state control’ that it laid down in its 2003 decision, which may be summarized as follows: “*the phrase ‘controlled by the State’ must be interpreted to include the mandate given by the Indonesian Constitution to the State to conduct the actions of (i) licensing, which is done by the Government through its authority to issue and revoke licensing and permit facilities; (ii) regulating, through legislation issued by the House of Representatives and the Government; (iii) managing, through the mechanism of shareholding and/or through direct involvement with the management of state-owned companies or state-owned entities as an instrument of institution under the State’s name; and (iv) supervision, by the Government supervising and controlling the implementation of all sectors of production and/or which controls the livelihood of many.*”

These elements are used by the Court to determine the level of state control over the relevant sector, and whether it is sufficient to satisfy the Court’s interpretation of Article 33(2) of the Constitution.

We note that the Government has accepted the Court’s view of state control, as reflected in statements made to the media by Agus Triboesono (Secretary at the Ministry of Energy and Mineral Resources’ Directorate General of Electricity), and Arcandra Tahar (Deputy Minister of Energy and Mineral Resources) following the issuance of the Decision. In their statements, both said that the principle of state control in the electricity sector will not be violated as long as the business activities that are permitted to or performed by private enterprises are determined by the Government, are subject to permits and licenses issued by the Government, and the tariffs charged for electricity are controlled by the Government.

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#### *AHP Commentary*

Does the Decision change the regulatory framework governing the business of supplying electricity to the public? We are of the view that it does not. In our opinion, it does not restrict private enterprises from playing a role as currently permitted under the Electricity Law, to the extent that the principle of state control is upheld. However, the Decision also clearly sends a message to the Government that further liberalization of the electricity sector is unlikely to be tolerated by the Constitutional Court.

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- i. *Undang-undang No. 30/2009 tentang Ketenagalistrikan*
- ii. *Decision No. 111/PUU-XIII/2015*
- iii. *Decision No. 001-021-022/PUU-I/2003*
- iv. *Undang-undang No. 20/2002 tentang Ketenagalistrikan*
- v. *Decision No. 149/PUU-VII/2009*

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### ***ASEAN Economic Community Portal***

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By tapping into the professional knowledge and resources of the three organisations through this portal, small- and medium-sized enterprises across the 10-member economic grouping can equip themselves with the tools and know-how to navigate ASEAN’s business landscape. Of particular interest to businesses is the “Ask a Question” feature of the portal which enables companies to pose questions to the three organisations which have an extensive network in the region. The portal can be accessed at <http://www.businessinasean.com/>.

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