

Indonesia: New carbon emission regulations - Green shoots?

In brief

The trading of carbon credits has not been fully implemented in Indonesia due to the absence of an umbrella regulation on carbon trading, and due also to the overlap between regulations issued under the Kyoto Protocol and those issued under the Paris Agreement. In addition, the Government's moratorium on carbon trading transactions has acted as a drag on investment activity in this area.

Just in time for the 26th United Nations Climate Change Conference (COP) 26 in Glasgow, President Joko Widodo passed the long-awaited Presidential Regulation No. 98 of 2021 on the Implementation of Carbon Economic Value (CEV) for the Achievement of Nationally Determined Contribution (NDC) Target and Greenhouse Gas (GHG) Emission Control in National Development ("**Reg 98**"). Reg 98 revokes two prior regulations relating to GHG, i.e., Presidential Regulation No. 61 of 2011 on National Action Plan to Reduce GHG Emissions and Presidential Regulation No. 71 of 2011 on Implementation of GHG Inventory. The new regulation was enacted and became effective on 29 October 2021. Implementing regulation(s) must be issued by the same date next year.

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Driving Factor: NDC Target Achievement

The Government ratified the Paris Agreement through Law No. 16 of 2016 on Ratification of the Paris Agreement to the UNFCCC. This sets out the Government's commitments to reduce GHG emissions.

Indonesia's current NDC target is to achieve a 29% to 41% GHG emission reduction compared to the GHG emission baseline by 2030 (i.e., 2,869 million tonnes of CO₂ equivalent). The sectors subject to the NDC commitment include energy, waste, industrial processes and product uses, agriculture and forestry. Each of these sectors will have its own GHG emission baseline. With the issuance of Reg 98, the Government now regulates several mechanisms (as further elaborated below) in a bid to achieve Indonesia's NDC target.

What is CEV?

Under Reg 98, CEV (also known as 'carbon pricing') refers to the value of each GHG emission unit produced from human and economic activities. In Indonesia, the implementation of CEV will be carried out through (i) carbon trading (perdagangan karbon), (ii) results-based payments (pembayaran berbasis kinerja), (iii) carbon levies (pungutan atas karbon), and/or (iv) other mechanisms to be determined by the Minister of Environment and Forestry (MOEF) depending on scientific and technological developments.

1. Carbon trading

Reg 98 provides that there are two types of carbon trading activity: i.e., emission trading and emission offset.



Emission Trading

The emission trading mechanism applies to businesses and/or activities that have a GHG emission upper limit that has been determined by the relevant ministry. The relevant ministry will set emissions caps for its respective sectors, and will then issue emissions allowances to comply with that cap.

It seems, therefore, as if the Government will introduce a cap and trade scheme.

Emissions Offset

Emissions offset is generally defined as a reduction in GHG emissions that is carried out using the results of mitigation actions from other businesses and/or activities, in order to compensate for the emissions of business actors created elsewhere.

Further details on the implementation of the emission offset will be regulated in a separate MOEF regulation.

2. Result-Based Payment (RBP)

An RBP is an incentive or payment obtained for achieving a verified/certified GHG emission reduction or other validated non-carbon benefits. Reg 98 divides RBP into three types:

- a. International RBP, i.e., international parties provide an RBP to the central or provincial government
- b. National RBP, i.e., the central government provides an RBP to a provincial/regency/city government, business actors and/or society
- c. Provincial RBP, i.e., a provincial government provides an RBP to a regency/city government, business actors and/or society

The MOEF will prepare further guidelines to cover the implementation of RBP (including monitoring and evaluation of RBP).

3. Carbon Levies

Carbon levies are imposed by the State (either central or regional government) on: (i) goods and/or services that have carbon potential and/or content, and/or (ii) businesses and/or activities that have the potential to create carbon emissions and/or emit carbon, which can cause negative impacts on the environment and/or performance of mitigation actions.

Carbon levies can take the forms of tax or non-tax state revenues.

As discussed in [our previous alert](#), carbon taxes will be imposed on individuals or entities that purchase goods containing carbon and/or carry out activities that produce carbon emissions. Initially, the Government will impose carbon taxes from 1 April 2022 on coal-fired power plants. Carbon taxes will be rolled out for other sectors of the economy by 2025.

In addition, the Government will also impose non-tax state levies (penerimaan negara bukan pajak or PNBP) on all sale and purchase transactions of carbon units. Currently, these are levied at 10% of the value of the carbon involved in such transactions in the forestry sector.¹

Other Provisions

- Measurement, Reporting and Verification (MRV)

The relevant minister, governor, regent/mayor and business actor (as applicable) must measure and report the implementation of their climate change adaptation actions and CEV at least once a year through the National

¹ Based on Government Regulation No. 12 of 2014 on Types and Tariff of Non-Tax State Revenue Types Applicable in the MOEF.



Registry System for Climate Change Control (Sistem Registri Nasional Pengendalian Perubahan Iklim or "SRN"). The MOEF will validate and verify these reports.

Businesses implementing CEV through carbon trading and RBP are also required to submit the results of the validation and verification carried out by their independent consultants. Further provisions on validation, verification, and the applicable competency standards for validators and verifiers will be regulated in an MOEF regulation.

- SRN

The SRN was first established in 2016 as a web-based system for managing data and information on mitigation, adaptation and means of implementation (finance, capacity building, and technology transfer and development). The SRN performs the following functions:

- a. Registration of mitigation and adaptation actions
- b. Provision of information to government entities that recognize the mitigation and adaptation contributions of various actors
- c. Provision of public access to data and information on actions and resources
- d. Management of database to support policy analysis and formulation
- e. Crucially, avoidance of double counting of carbon mitigation actions

Under Indonesia's updated NDC for 2021, the SRN is targeted to be fully functioning by 2030, with the interim target that by 2024 the SRN will be able to provide most data and information needed for preparing national communication (Natcom) and biennial transparency reports (BTR), in line with the COP transparency framework.

- Mutual Recognition

The MOEF adopts the "mutual recognition" concept for cross-border carbon trading through among other things, (i) mutual disclosure of information on the use of the MRV standards, (ii) carrying out conformity assessments against international and/or national standards, and (iii) recording any certification that has been recognized by both parties in the SRN. Further provisions on mutual recognition will be regulated in an MOEF regulation.

Challenges

1. Cross-border carbon trading

While the Government expressly acknowledges the possibility of cross-border carbon trading, Article 86 of Reg 98 provides the following:

- (i) Business actors that implemented carbon trading or performance-based payment before Reg 98 came into force (i.e., 29 October 2021) must register and report the implementation of climate change mitigation actions and carbon units owned through the SRN by no later than 29 October 2022.
- (ii) Carbon units that are still owned by business actors and have been registered and reported through the SRN may be sold only for domestic carbon trading.

There are different views on how to interpret Article 86 - one of these is that carbon units generated from any existing projects can only be traded domestically. The Government has also signalled that it might also prohibit any cross-border carbon trading until Indonesia meets its GHG emissions targets.

This being said, the wording of this provision is unclear, and would also seem to support the position that until a scheme is registered, credits from that scheme can continue to be traded. This is particularly the case given that the mechanisms for domestic trading, both with regard to registration of schemes, and also the existence of a domestic carbon exchange, are not yet in place. For the time being, pending the issuance of further clarification/implementing regulations, we suspect that most existing investors will adopt a 'business-as-usual' approach.



2. Distribution to the Government and local communities

Previously, through MOEF Reg 36², the Government set out the requirements for the distribution of the value of environmental services sales (nilai jual jasa lingkungan or "NJ2L"), which applies for income from certified carbon credit trading. In such cases, a percentage of carbon units were allocated to the Government, local community and project developers. As MOEF Reg 36 has been revoked by MOEF Reg 83, currently there is no specific law governing the distribution of NJ2L, since both MOEF Reg 8 and Reg 98 do not provide any further details on this. Perhaps significantly, Reg 98 defines carbon rights as the control of carbon by the state. Accordingly, it may be the case that further implementing regulations will seek to regulate the allocation of carbon units to state entities.

Conclusion

The provisions of Reg 98 are very broad. Further, a number of issues arise from the current regulations:

- a. To what extent can project proponents continue being able to sell credits on the international voluntary market?
- b. To what extent will the Government insist on receiving a share of the verified carbon units generated by a project?
- c. What will the final carbon tax levy be - will it remain at USD 2 - 3 per tonne?
- d. How will the non-tax state revenue be applied - for example, does it apply to transactions on the international voluntary market?

As always, the 'devil will be in the details' of the implementing regulations.

² MOEF Regulation No. 36/Menhut-II/2009 on Procedures for Business Licensing for Utilization of Carbon Absorption and/or Storage in Production and Protected Forests

³ MOEF Regulation No. 8 of 2021 on Forest Management and Preparation of Forest Management Plan, and Forest Utilization in Protected and Production Forests



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