

# Carbon Trading as Prospective Business in Indonesia

Prepared by:

**Winda Tania** (Partner), Dinda Triwijanarko (Senior Associate), Carlos William Rettobjaan (Associate) and Nikita Priscila (Associate)

As a member country that ratified the Paris Agreement to the United Nations Framework Convention on Climate Change through Law Number 16 of 2016, Indonesia has committed itself to making a national contribution that is legally determined (Nationally Determined Contribution / “NDC”) in order to limit the global average temperature rise to 1.5°C - 2°C from pre-industrial levels, with a Net Zero Emission (“NZE”) target of no later than 2060 through the submission of the Enhanced NDC to the Secretariat of the United Nations Climate Change Conference (“UNFCCC”) on 23 September 2022 with an unconditional 31.89% emission reduction target by 2030 or 43.20% with the support of international technical cooperation. The mechanism the Government is pursuing to achieve these aims is a market-based mechanism using emission trading, joint implementation, and clean development. This market-based mechanism is known as carbon trading.

The carbon trading business is considered to have the potential to enhance a company's reputation for clean, green, or renewable energy and for being in line with the global community, which is slowly moving towards an environmentally friendly technology regime. Carbon trading can provide financial incentives for businesses that reduce carbon emissions and can be an alternative way of meeting emission reduction targets for companies that are regulated by the government. Thus, the carbon trading business is able to provide long-term benefits for companies, as well as contribute to global efforts to reduce carbon emissions and deal with climate change that the world is already experiencing.

Indonesia's commitment to achieving the NDC has been further implemented by the issuance of Presidential Regulation Number 98 of 2021 concerning Implementation of Carbon Economic Value to Achieve Nationally Determined Contribution Targets and Control of Greenhouse Gas Emissions in National Development (“PR 98/2021”). PR 98/2021 is the basis for implementing Carbon Economic Values (*Nilai Ekonomi Karbon* or “CEV”) and also a guideline for reducing Greenhouse Gas (*Gas Rumah Kaca* or “GHG”) emissions through the implementation of various policies and actions aimed at achieving the country's NDC target in line with national development.

Carbon trading is a market-based mechanism to reduce GHG emissions through carbon unit selling and purchasing activities. Objects traded in carbon trading activities are carbon credit certificates containing evidence of efforts to reduce emissions in the air through certain projects or activities, which have gone through Measurement, Reporting, and Verification (MRV) and been recorded in the National Registry System in the field of Climate Change and Control (*Sistem Registri Nasional Pengendalian dan Perubahan Iklim* or “SRN-PPI”) in the form of a registry number and/or code. In Indonesia, these are referred to as Greenhouse Gas Emission Reduction Certificates (*Sertifikat Pengurangan Emisi Gas Rumah Kaca* / “SPE-GRK”). An example of a project which has succeeded in obtaining carbon emission reduction certificates is the Kalimantan Forests and Climate Partnership (“KFCP”) project, which has been planting forests under the REDD+ concept in Kalimantan since January 2010. KFCP aims to reduce greenhouse gas emissions originating from the forestry sector and reduce deforestation and forest degradation in Kalimantan.

SPE-GRK can be traded through 2 (two) types of carbon market: the compliance market and the voluntary market. The compliance market is used by companies that legally must calculate the GHG emissions they produce and have a “mandatory report” status regarding their GHG emissions. The voluntary market is built on business actors who voluntarily reduce carbon emissions without having an “obligatory report” regarding emissions like market players in the compliance market.

The carbon trading mechanism can be carried out by (i) emission trading, and (ii) GHG emission offsets. In essence, emission trading applies to businesses and/or activities with an upper limit GHG emission set by the government (compliance market), where companies pay for carrying out activities that produce emissions at a certain price, called a carbon credit. Meanwhile, the GHG emission offset mechanism applies to businesses and/or activities that do not have an upper limit on GHG emissions (voluntary market) but voluntarily strive to achieve certain targets for the reduction of emissions beyond the sectors regulated by the government. The fundamental difference between these two methods is how carbon credits work to reduce emissions, where emission trading involves a company buying carbon credits from other parties if it does not reduce its emissions, while GHG emission offsets encourage emission reduction so that a company can obtain carbon credits which it can then sell to companies that are producing excessive emissions.

In September 2022, based on the mandate from PR 98/2021, the Minister of the Environment and Forestry of the Republic of Indonesia (“**Ministry**” or “**Minister**”) issued an implementing regulation of PR 98/2021, Minister of the Environment and Forestry Regulation No. 21 of 2022 concerning Procedures for the Application of Carbon Economic Value (“**MOE Reg. 21/2022**”), which contains further provisions to support the achievement of NDC targets and control over GHG emissions. MOE Reg. 21/2022 provides that climate change mitigation to be carried out in the following sectors and sub-sectors:

#### Sectors

- a. energy;
- b. waste;
- c. industrial processes and product use;
- d. agriculture;
- e. forestry; and/or
- f. other sectors in accordance with the development of science and technology.

#### Sub Sectors, among others:

- a. solid waste;
- b. liquid waste;
- c. rubbish;
- d. industry;

- e. plantation;
- f. forestry;
- g. peat and mangrove management; and/or
- h. other sub-sectors in accordance with the development of science and technology.

The government (ministries, regional governments), business actors and the community can apply CEV in the aforementioned sectors through the following mechanisms:

- a. carbon trading;
- b. performance based payments;
- c. carbon levies; and/or
- d. other mechanisms in accordance with the development of science and technology.

In general, the provisions of MOE Reg.21/2022 specify the application of each of the aforementioned mechanisms. Nevertheless, we have focused in this article on the underlying principles related to carbon trading under the Indonesian regulations. Notwithstanding the foregoing, please note that the relevant Government institutions will issue the implementing regulation to be used as the legal basis for business actors to get involved in the mitigation of climate change.

#### **Domestic and Overseas Carbon Trading**

The issuance of MOE Reg. 21/2022 makes it clear that carbon trading in Indonesia can be achieved through domestic and overseas trading through emission trading and GHG emission offsets. Both of these mechanisms are applied through carbon exchanges (*bursa karbon*) and/or direct trading. In order for business actors to be able to engage in carbon trading, they are must first register through SRN PPI, as explained above.

Once a business actor has registered, it can use the following mechanisms in order to engage in carbon trading, which must be in accordance with the carbon trading roadmap determined by the Government authorities: (i) obtaining SPE-GRK for cross sector carbon trading, (ii) achieving NDC targets, and (iii) obtaining authorization from the Ministry.

Notwithstanding the above, prior to engaging in overseas carbon trading, sellers must obtain approval from the Minister by submitting an application to the Ministry along with a proposal and cooperation agreement related to carbon trading. However, business actors’ applications to carry out overseas carbon trading will be approved subject to the fulfillment of the domestic NDC target and whether the project is deemed fit for sale on an international scale. On the other hand, to date the Minister’s approval has not been required for domestic carbon trading.

## **Challenges in Carbon Trading Practices**

As explained above, cross-border carbon trading can be carried out based on cooperation agreements between the countries concerned, whereby each country records emission reductions. For example, an SPE-GRK buying country and an SPE-GRK selling country can both make claims on the carbon value of a Clean Development Mechanism project. The biggest challenge to cross-border carbon trading practices is double counting and double claims. The solution to this problem is the concept of corresponding adjustment, which is a form of adjustment of registration in the SRN-PPI with the UNFCCC registry system for foreign carbon trading. Corresponding adjustments are made to track SPE-GRK transfers so that the number of SPE-GRK issued is the same as the amount of SPE-GRK transferred abroad and in accordance with the number of SPE-GRK remaining domestically.

Nevertheless, such a solution cannot be implemented if the cooperation between the business actors and the overseas party is not reported to Ministry (to obtain the authorization) and such cooperations related to carbon/GHG must therefore be registered with SRN-PPI in accordance with prevailing regulations. In order to encourage the relevant parties (regional government and business actors) to register with the SRN-PPI, the Ministry has issued Circular of the Minister of Environment and Forestry of the Republic of Indonesia No. SE.5/MENLHK/SETJEN/PPI.3/5/2023 on Climate Action and Governance of Carbon Cooperation.

In addition, as we note from the Minister of Environment and Forestry Regulation No. 7 of 2023 concerning Procedure for Carbon Trading in Forestry Sector, carbon trading activities (and registration with the SRN-PPI) may only be conducted by the holder of a Forestry Exploitation Business Permit (*Perizinan Berusaha Pemanfaatan Hutan - PBPH*). Investors who are not engaged in the forestry business but are willing to invest and participate in the forestry sector they need to thoroughly prepare a business and commercial analysis when developing carbon trading business activities in Indonesia.

Lastly, although there are still legal uncertainties in carbon trading practices in Indonesia since the implementing regulations and roadmaps for carbon trading in the relevant sectors are still being formulated by sectoral agencies, the Indonesian government are committed to discussions with business actors and legal and strategic innovations to increase the effectiveness of existing carbon trading practices in Indonesia. Thus, we consider that even though Indonesian regulations are not fully/perfectly ready for carbon trading practices, the good intentions of business actors, both from the compliance market and voluntary market groups, will always be matched by the government's efforts in order to achieve Indonesia's NDC target.

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*The article above was prepared by Dentons HPRP's lawyers*

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