

NEWSLETTER

13 December 2021

PRESIDENTIAL REGULATION ON CARBON PRICING ISSUED

The government has finally issued the long-awaited Presidential Regulation No. 98 of 2021 on Carbon Pricing for Achieving NDC Target and Controlling GHG Emission in National Development (PR 98/2021). PR 98/2021 aims to serve as an overarching regulation for controlling climate change and reducing greenhouse gas emission (GHG) through carbon pricing. PR 98/2021 formulates steps to create climate change mitigation and adaptation action plans and how national and local government, business actors and the public can participate. Among the measures to carry out climate change mitigation and adaptation is carbon pricing which comprises carbon trading, result-based payment, carbon levy, and other mechanisms determined by the Minister of Environment and Forestry (MOEF). PR 98/2021 also introduces GHG Emission Reduction Certificate which is required for carbon pricing activities.

Background

The pressing situation of climate change has necessitated all countries to take concrete measures in tackling the negative impacts. Indonesia has ratified the Paris Agreement to the United Nations Framework Convention on Climate Change (**Paris Agreement**) through Law No. 16 of 2016, and as a party to the Paris Agreement, Indonesia has submitted its Nationally Determined Contribution (**NDC**) to reduce emissions in 2020-2030 by 29% (unconditional) up to 41% (conditional, with international support) against the 2030 business as usual scenario.

The enactment of PR 98/2021 reaffirms the NDC target which is set based on the GHG emission baseline of 2,869 million MtCO₂e in 2030. PR 98/2021 sets out that the effort to achieve NDC target is done by conducting climate change mitigation and climate change adaptation actions. Simply put, climate change mitigation action is a set of measures to reduce the impact of climate change, while climate change adaptation



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action is a set of measures to increase our adaptability with climate change.

Carbon Pricing

Climate change mitigation actions may be carried out through carbon pricing. Carbon pricing is value on each GHG emission unit generated from human and economic activities.

PR 98/2021 requires carbon pricing to be implemented in certain **Sectors** and **Sub-sectors**. Sector and Sub-sector are defined as NDC sectors and sub-sectors having a field of activity relating to GHG emission. Article 7 of PR 98/2021 further sets out: (i) Sectors as energy, waste, industrial process and product use, agriculture, forestry, and/or other Sectors in accordance with development of science and technology; and (ii) Sub-sectors as generation, transportation, building, solid waste, liquid waste, garbage, industry, rice field, husbandry, plantation, forestry, peat and mangrove management, and/or other Sub-sectors in accordance with development of science and technology. Other Sectors and Sub-sectors will be stipulated by the MOEF in coordination with relevant ministries. Ministries/agencies, local government, business actors and communities can conduct carbon pricing.

There are four mechanisms of carbon pricing: (i) carbon trading; (ii) result-based payment; (iii) carbon levy; and/or (iv) other mechanisms pursuant to science and technology development as determined by MOEF.

Carbon Trading

Carbon trading is a market-based mechanism to reduce GHG emission through sale and purchase of carbon unit domestically or internationally and may be done across Sectors. Carbon trading can be conducted through carbon exchange (*bursa karbon*) or direct trading.

PR 98/2021 asserts the State's control over carbon.¹ PR 98/2021 indicates that the State's control will be implemented by the government, through

¹ PR 98/2021 defines Carbon Right as State's control over carbon.

a strict carbon rights transfer requirement. PR 98/2021 requires carbon rights transfer (both domestic and international) to be done through the national registry system, i.e. National Registry System on Climate Change Control (*Sistem Registri Nasional Pengendalian Perubahan Iklim/SRN PPI*).

Carbon trading is divided into two schemes, namely:

a. Emission Trading

Emission trading is conducted by businesses and/or activities with: (i) emission above the determined GHG emission cap; or (ii) emission below the determined GHG emission cap.

b. GHG Emission Offset

GHG emission offset applies to businesses and/or activities without GHG emission cap. Businesses and/or activities with emission surplus can sell, and *vice versa*.

Result-Based Payment

Result-based payment is an incentive or payment from a verified and/or certified GHG emission reduction and other validated benefits outside carbon. Result-based payment: (i) includes the government either as the payee (international scale) or the payor (national and provincial scale); and (ii) does not cause transfer of carbon ownership and its result will be counted as part of NDC target achievement.

Carbon Levy

Carbon levy is conducted in a form of tax levy (national and regional levels), customs and excise, and other state levies, on the basis of carbon content and/or carbon emission potential and/or carbon emission amount and/or climate change mitigation action performance.

At the same time with the issuance of PR 98/2021, the House of Representative also issued Law No. 7 of 2021 on Harmonization of Tax Laws (**HPP Law**) which provides a framework on carbon tax implementation in Indonesia. The intention to align carbon tax and carbon trading schemes is indicated in the elucidation of Article 13 (3) of

HPP Law which states that the carbon tax imposition will be conducted as follows:

- **2021:** develop the carbon trading mechanism.
- **2022-2024:** implement a tax mechanism based on emission limit (**cap and tax**) for coal-fired power plants.
- **2025 onwards:** fully implement carbon trading and expansion of the carbon tax taxation sector depending on the readiness of the relevant sectors.

It is also reported that a carbon tax roadmap is being prepared. Based on published news,² the carbon tax roadmap will be set out in two schemes: (i) cap-and-trade; and (ii) cap-and-tax. Under the cap-and-trade scheme, entities generating emission exceeding the determined cap must purchase an emission license certificate (*sertifikat izin emisi/SIE*) or emission reduction certificate (*sertifikat penurunan emisi/SPE*) from other entities whose emission is below its cap. We note that the cap-and-trade scheme is similar to the emission trading regulated under PR 98/2021. If such entities are not able to purchase SIE or SPE to offset all its excess emission, the cap-and-tax scheme will apply to the excess emission that could not be offset. If these two schemes apply correspondingly, business actors may be incentivized to conduct carbon trading in order to reduce the amount of carbon tax imposed to them.

Reporting and Certification

To record emission reduction accountability, PR 98/2021 sets out reporting requirements and acknowledges the achievement of emission reduction by providing certification procedures.

Measurement, Reporting, and Verification (MRV)

Based on PR 98/2021, MRV for the climate change mitigation, adaptation actions and carbon pricing is conducted in an integrated manner. As a general rule, the measurement and reporting for mitigation actions are carried out by the relevant sectoral ministers, governor, regent/mayor,

² <https://indonesia.go.id/kategori/editorial/3374/penerapan-berkeadilan-dan-mengutamakan-keterjangkauan>.

and business actors at least once a year. The report will be recorded in SRN PPI as a basis to conduct verification. In principle, validation and verification is administered by MOEF. However, for carbon trading and result-based payment mechanisms, validation and verification from a bona fide independent verifier is required.

SRN PPI

PR 98/2021 requires every business actor to record and report the implementation of: (i) climate change adaptation and mitigation actions; (ii) implementation of carbon pricing; and (iii) climate change resources into the SRN PPI. If the relevant business actor fails to comply with such reporting obligation under SRN PPI, such business actor may be imposed with certain administrative sanctions.

Greenhouse Gas Emission Reduction Certificate (GHG Reduction Certificate)

PR 98/2021 introduces GHG Reduction Certificate issued by the MOEF. GHG Reduction Certificate can be obtained by registering in SRN PPI and obtaining verification. GHG Reduction Certificate can be used by the holder for, e.g. carbon trading or result-based payment, or obtaining green labeling or green financing.

In addition to GHG Reduction Certificate, PR 98/2021 allows other GHG emission certification schemes as long as they fulfil certain criteria and are recognized by the MOEF. However, the regulation indicates that other certification schemes may only be used in domestic carbon trading if they were generated from mitigation actions in Indonesia prior to 2021. Query whether this means that following the issuance of PR 98/2021, other GHG emission certification schemes will only be allowed for international carbon trading. In any case, business actors intending to use other GHG emission certification schemes need to ensure that the particular scheme is recognized by the MOEF to avoid any issue with future registration in SRN PPI and/or transfer.

Further Clarity Needed for PR 98/2021

Despite the extensive issues addressed by PR 98/2021, PR 98/2021 needs further clarity on numerous aspects, particularly in relation to carbon pricing activities and GHG Reduction Certificate. Some of these aspects are:

- a. **Further clarity on whether carbon pricing activities are mandatory or optional** – For emission trading, since it requires a GHG emission cap to be established, it seems that it will become mandatory to a Sector when the GHG emission cap has been established for the Sector. However, for other carbon pricing activities such as GHG emission offset, it is still unclear whether it will be mandatory to be undertaken for Sectors without GHG emission cap to a certain level.
- b. **Further clarity on GHG Reduction Certificate mechanics** – PR 98/2021 does not stipulate the detailed procedure for, e.g. transferring GHG Reduction Certificate and its application including the party eligible to apply for GHG Reduction Certificate.
- c. **Further clarity on benefits to be certified under GHG Reduction Certificate** - Whether only carbon benefits must be certified or non-carbon benefits such as other environmental or social benefits must also be certified in the GHG Reduction Certificate.
- d. **Further clarity on whether GHG Reduction Certificate is mandatory for domestic carbon trading onwards** – Whilst PR 98/2021 allows other GHG emission certification schemes if they fulfil certain criteria and are recognized by the MOEF, the regulation indicates that other certification schemes may only be used in domestic carbon trading if they were generated from mitigation actions in Indonesia prior to 2021.

PR 98/2021 mandates further implementing regulations on the carbon pricing activities and GHG Reduction Certificate to be issued. Once issued, it is expected that those regulations will provide more clarity on the above.

Transitional Provisions

In light of the enactment of PR 98/2021, business actors who engage in carbon pricing activities must note the following transitional provisions:

- a. Carbon trading or result-based payment prior to the enactment of PR 98/2021 must be adjusted to conform with the regulation by 2023, and the mitigation actions and carbon unit owned must be reported and recorded in SRN PPI by 29 October 2022. Such registered carbon unit can only be traded domestically, and the remaining unregistered carbon units cannot be traded.
- b. New transactions following the enactment of PR 98/2021 must be adjusted to conform with the regulation by 29 October 2022, otherwise an additional obligation in the form of payment for benefit sharing may be imposed.

Closing

The issuance of PR 98/2021 shows the government's strong will to comply with the Paris Agreement and the NDC. Although PR 98/2021 was recently issued, carbon trading and other carbon pricing activities have long been carried out in Indonesia on a contractual basis. PR 98/2021, as the first overarching legal framework on climate change control in Indonesia, could create certainty on the procedures and requirements for carbon pricing and help the government in making carbon claims towards achieving the NDC by 2030. However, PR 98/2021 needs certain implementing regulations to be issued to provide further clarity on numerous aspects. The implementing regulations of PR 98/2021 can hopefully provide such clarity for an effective and seamless implementation of carbon pricing.

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