

## CARBON EXCHANGE – IDX’S AMBITIOUS PLANS AND REGULATORY LIMITATIONS<sup>12345</sup>

### INTRODUCTION

The Indonesia Stock Exchange has outlined ambitious plans for its proposed additional role as the organizer of the new “Carbon Exchange” which is meant to facilitate the realization of Indonesia’s 2016 Paris Agreement commitment to significantly reducing its greenhouse gas emissions.

A recently issued 2023 law now provides the legal basis for establishing and operating a Carbon Exchange in Indonesia. This is an important milestone in making the Carbon Exchange a reality.

The wording of this new law may, however, fall somewhat short of what is actually required, in terms of providing a sufficient legal basis, for the Indonesia Stock Exchange to be able to implement the entirety of its ambitious plans for the Carbon Exchange. It is not clear that subsequently issued implementing regulations can necessarily make up for the possible shortfall in the legal basis as set out in the new law itself.

Any insufficiency in the legal basis recently created for the Carbon Exchange could mean that the actual “roll-out” of the Indonesia Stock Exchange’s ambitious plans for the Carbon Exchange will have to be quite limited, at least for the time being.

In this article, the writer will review the relevant provisions of the new law before considering how the same may restrict the potential scope of the operations of the Carbon Exchange as presently envisaged by the Indonesia Stock Exchange.

### BACKGROUND

In 2016, Indonesia ratified the Paris Agreement entered into pursuant to the United Nations Framework Convention on Climate Change (**Paris Agreement**).

As part of its updated Nationally Determined Contribution (**NDQ**) under the Paris Agreement, Indonesia made a 2021 commitment to achieve net zero greenhouse gas emissions (**GHG Emissions**) (**NZE**) by 2060 at the latest and with an interim 2030 target of a reduction in Indonesia’s greenhouse gas emissions of between 29% (without international assistance) and 41% (with international assistance) (**Updated NDC**).

---

<sup>1</sup> Bill Sullivan, Senior Foreign Counsel with Christian Teo & Partners and Senior Adviser to Stephenson Harwood.

<sup>2</sup> Bill Sullivan is the author of “*Mining Law & Regulatory Practice in Indonesia – A Primary Reference Source*” (Wiley, New York & Singapore 2013), the first internationally published, comprehensive book on Indonesia’s 2009 Mining Law and its implementing regulations.

<sup>3</sup> Copyright in this article belongs to Bill Sullivan and Petromindo.

<sup>4</sup> This article may not be reproduced for commercial purposes without the prior written consent of both Bill Sullivan and Petromindo.

<sup>5</sup> An earlier version of this article appeared in the May - June 2023 issue of Coal Asia Magazine.

In late October 2021, Presidential Regulation No. 98 of 2021 re Implementation of Carbon Economic Value to Achieve Updated NDC and NZE in National Development (**PR 98/2021**) was issued.

Among other things, PR 98/2021 outlines the broad parameters of Indonesia's approach to Climate Change Mitigation and Climate Change Adaptation through the implementation of the concept of Carbon Economic Value or "*Nilai Ekonomi Karbon*" (**NEK**).

PR 98/2021 makes clear that the implementation of NEK is to be realized through a combination of (i) **Carbon Trading**, (ii) performance-based payments, (iii) charges on carbon and (iv) other mechanisms reflecting the development of science and technology.

Carbon Trading comprises **both** (i) Emissions Trading **and** (ii) Emissions Offsetting.

Emissions Trading is buying and selling of proof of carbon ownership (**Carbon Units**) by way of either (i) business to business dealings (**Direct Trade**) or (ii) through an organized and public exchange (**Carbon Exchange**).

Emissions Offsetting is the approved/recognized deemed fulfilment of all or part of target GHG Emissions, as evidenced by GHG Emissions offset statements, in respect of business activities in a particular industrial sector/sub-sector and during a particular period of time, on the basis of GHG Emissions reduction efforts carried out in respect of another activity/business whether in the same sector/subsector or in a different sector/subsector.

Carbon Units are evidenced by Carbon Emissions Reduction Certificates (**SPE-GRKs**)/other GHG Emission certificates recorded in Indonesia's web-based, national registry system for managing data, information and resources on/for climate change adaptation, climate change mitigation and NEK (**SRN PPI**).

PR 98/2021, however, provides only the most basic outline of the intended mechanics of Carbon Trading, with all the detail to follow in a series of ministerial regulations.

On 20 October 2022, the Minister of Environment & Forestry (**MoEF**) issued Regulation No. 21 of 2022 re Procedures for Implementing Carbon Economic Value (**MoEF Regulation 21/2022**), being one of the ministerial regulations envisaged by PR 98/2021.

MoEF Regulation 21/2022 provides much needed detail, which is lacking in PR 98/2021, on the use of climate change mitigation efforts to implement NEK. More particularly, MoEF Regulation 21/2022 deals, at some length, with (i) domestic Carbon Trading and offshore Carbon Trading, (ii) performance based payments, (iii) charges on carbon, (iv) the mechanics of implementing other aspects of Indonesia's NDC, (v) measurement, reporting and verification of the implementation of NEK, (vi) organizing SRN PPI, (vii) GHG Emission reduction certification, (viii) management of funds for Carbon Trading, (ix) participation in the implementation of NEK and (x) monitoring and evaluation of the implementation of NEK.

MoEF Regulation 21/2022 specifies that the Carbon Exchange must be a stock exchange or trading organizer (**Market Organizer**) which has obtained a business license from the Financial Services Authority (**OJK**) for the conduct of Carbon Trading and/or the recording of ownership/transfers in the ownership of Carbon Units.

PR 98/2021 and MoEF Regulation 21/2022 are **not** industry sector/subsector specific but, rather, set out the general regulatory framework applicable to Carbon Trading and other NEK implementation initiatives applicable to **all** industry sectors/subsectors.

On 27 December 2022, the Minister of Energy & Mineral Resources (**MoEMR**) issued Indonesia's first industry sector/subsector specific regulation on Carbon Trading, being MoEMR Regulation No. 16 of 2022, dated 27 December 2022, re Procedures for the Implementation of NEK in the Power Plant Subsector (**MoEMR Regulation 16/2022**).

MoEMR Regulation 16/2022 introduces the concept of GHG Emissions quotas (**i.e.**, maximum GHG Emissions allowed for individual power plant units of a particular type of power plant in a particular compliance period) (**PTBAE-PU**s).

MoEMR Regulation 16/2022 appears to expand the concept of Emissions Trading, at least as it applies in the power plant subsector, to include buying and selling of surplus GHG Emissions; that is, the buying and selling of unused PTBAE-PU

Readers interested in knowing more about PR 98/2021, MoEF Regulation 21/2022 and MoEMR Regulation 16/2022 are referred to the writer's earlier articles on these topics, being (i) "*Carbon Trading – Regulatory Framework Now Available*", December 2021 – January 2022 edition, Coal Asia Magazine, Petromindo, (ii) "*More Clarity on Carbon Trading Mechanics*", December 2022 – January 2023 edition, Coal Asia Magazine, Petromindo and (iii) "*Power Plants and Carbon Trading – New Rules*", February – March 2023 edition, Coal Asia Magazine, Petromindo.

**None** of PR 98/2021, MoEF Regulation 21/2022 and MoEMR Regulation 16/2022, however, provide a legal basis for the establishment of the Carbon Exchange, the existence of which is an essential prerequisite for Emissions Trading to the extent that it does not take place by way of Direct Trade.

The absence of a legal basis for the establishment of the Carbon Exchange has now been rectified by Law No. 4 of 2023 re Development and Strengthening of the Financial Sector which was signed by the President on 12 January 2023 (**Law 4/2023**).

At this stage, the Carbon Exchange is meant to commence operations in the second half of 2023 and, initially, focus on the power plant subsector only. The operations of the Carbon Exchange are to be expanded to include other industrial sectors/subsectors after 2025.

The Indonesia Stock Exchange (**IDX**) has outlined its ambitious plans for the Carbon Exchange in a 22 February 2023 document entitled "*Carbon Exchange Plan in Facilitating Trade Power Generation Subsector*" (**IDX Carbon Exchange Plan**).

## **ANALYSIS AND DISCUSSION**

### **1. Law 4/2023 - Legal Basis for Carbon Exchange**

1.1 **Overview:** The establishment and operation of the Carbon Exchange is provided for in Division Three of Law 4/2023.

1.2 **Relevant Concept of Carbon Trading:** "Carbon Trading" is defined as being:

*“a market-based mechanism to reduce greenhouse gas emissions through the selling and purchasing of **carbon units**”* (Article 23(1) of Law 4/2023).

This definition of Carbon Trading is interesting for two reasons.

First, the definition is concerned with Emissions Trading only whereas Carbon Trading, as envisaged by PR 98/2021, MoEF Regulation 21/2022 and MoEMR Regulation 16/2022, actually includes **both** Emissions Trading **and** Emissions Offsetting.

Second and much more importantly, the definition only refers to the selling and purchasing of “**carbon units**”. Although Law 4/2023 does not include a definition of “carbon units”, Carbon Units are defined in PR 98/2021 as being proof of carbon ownership evidenced by SPE-GRKs /other GHG Emission certificates recorded in the SRN PPI. This definition of Carbon Units is subsequently used in MoEF Regulation 21/2022 and MoEMR Regulation 16/2022. Assuming the expression “carbon units”, as used in Article 23(1) of Law 4/2023, is intended to mean the same thing as “Carbon Units” as defined in PR 98/2021 and as subsequently used in MoEF Regulation 21/2022 and MoEMR Regulation 16/2022, this seems to imply that Carbon Trading, for the purpose of Division Three of Law 4/2023, does **not** include the sale and purchase of unused PTBAE-PU as contemplated by MoEMR Regulation 16/2022 in the case of business actors in the power plant sub-sector. This is because PTBAE-PU **are** not Carbon Units but, rather, GHG Emissions quotas.

For the purposes of the rest of this article and unless expressly indicated otherwise, the writer assumes that “carbon units”, as referred to in Article 23(1) of Law 4/2023, are the same thing as “Carbon Units” as defined in PR 98/2021 and as subsequently used in MoEF Regulation 21/2022 and MoEMR Regulation 16/2022.

- 1.3 **Carbon Units as Securities:** Carbon Units, as referred to in Article 23(1) of Law 4/2023, constitute “securities” (Article 23(2) of Law 4/2023).

As securities, the trading of Carbon Units is a matter to be regulated by OJK (Article 24(4) of Law 4/2023).

- 1.4 **Domestic and Foreign Carbon Trading:** The Carbon Exchange may be used for the purpose of both domestic and foreign Carbon Trading (Article 24(1) of Law 4/2023).

It is important to note that MoEF Regulation 21/2022 imposes significant limitations on foreign Carbon Trading, at least until such time as Indonesia has achieved its Updated NDC in connection with the particular industrial sector/subsector proposed for foreign Carbon Trading. Accordingly, Law 4/2023’s recognition of the availability of the Carbon Exchange for foreign Carbon Trading might seem to be “aspirational” only at this stage given Indonesia is, currently, a long way from achieving its NDC in respect of any industrial sector/sub-sector.

Notwithstanding the above, the Minister of Investment announced on 3 May 2023 that, following further consideration, the Government has decided Carbon Trading, via the Carbon Exchange, should be “open” as long as it is “registered”. More particularly, the Investment Minister has been quoted by several media outlets as saying:

*“It has been decided that carbon trading in Indonesia is open but it must be registered and everything must go through a trading governance mechanism on the carbon exchange in Indonesia.”*

“Open” Carbon Trading is, apparently, to be understood as meaning that, contrary to what is provided for in MoEF Regulation 21/2022, Carbon Trading via the Carbon Exchange (i) will now **not** be confined to Carbon Trading for the purpose of achieving Indonesia’s Updated NDC only and (ii) foreign parties, as well as local parties, may participate in such Carbon Trading. Likewise, “registered” Carbon Trading is, apparently, to be understood as meaning that parties (both foreign and local) wanting to buy and sell Carbon Units via the Carbon Exchange must, first, register with the Ministry of Environment & Forestry.

The Government has sought to portray its change of position, on “closed” vs “open” Carbon Trading, in very altruistic and high-minded terms, with one of the Investment Minister’s staff being quoted as having said:

*“Indonesia has great potential in the carbon market. That’s why we need to lead with an open market.”*

The altogether more likely explanation, however, for the Government’s change of position is the belated realization that, without foreign party participation, there would be insufficient trading activity on the Carbon Exchange to make it a viable proposition.

The Investment Minister was, however, careful to make clear that Carbon Units, originating in Indonesia, **cannot** be bought and sold in other countries.

Despite the seemingly very clear statements from the Investment Minister about the Carbon Exchange being open to foreign parties, a considerable degree of caution is required in taking those statements too literally. This is because the Finance Minister has previously indicated that foreign parties would **not** be allowed to participate in the so-called “cap and trade market” which is what is the now relevant market for Indonesia’s coal fired, power plant subsector where electricity business actors, with excess GHG Emissions, are legally obliged to offset their excess GHG Emissions through Carbon Trading. The “cap and trade market” is to be distinguished from the “voluntary market” which is the relevant market for business actors from sectors/sub-sectors other than the coal fired, power plant subsector and where there is presently **no** legal obligation to compensate for excess GHG Emissions through Carbon Trading. It is possible, therefore, that a distinction may ultimately be drawn, in respect of Carbon Trading via the Carbon Exchange, as between the “voluntary market” and the “cap and trade market”, with the “voluntary market” being open to foreign parties as well as local parties while the “cap and trade market” is open to local parties only. We will have to wait and see what the relevant regulation, now being drafted by OJK, ultimately provides for in this regard.

Whatever ultimately happens, in terms of foreign party participation in the both the “cap and trade market” and the “voluntary market” or in the “voluntary market” only, it may well be necessary to amend MoEF Regulation 21/2022 in order to reflect the change in the Government’s position on “closed” vs “open” Carbon Trading.

The Government is also apparently considering creating a new body or authorizing an existing body to act as a “market maker” in order to ensure that large institutions and/or foreign companies do not become “hoarders” of Carbon Units through Carbon Trading via

the Carbon Exchange. The Coordinating Minister for Economic Affairs has indicated that he sees the “market maker” as being a body like the Indonesia Investment Authority or a State-owned enterprise.

- 1.5 **Market Organizer:** The Carbon Exchange must be established by a Market Organizer which has obtained the required business licenses from OJK (Article 24(2) of Law 4/2023).

Subject to OJK regulation, the Market Organizer is authorized to “*develop activities or products based on carbon units.*” (Article 24(4) of Law 4/2023).

The authority to “develop activities or products” is, potentially, quite broad. However, this grant of authority is qualified by the fact that these activities or products **must be in respect of Carbon Units**. As highlighted in 1.2 above, the reference to Carbon Units very arguably excludes activities or products related to unused PTBAE-PUs given that unused PTBAE-PUs do **not** strictly fall within the definition of Carbon Units in PR 98/2021 and as subsequently used in MoEF Regulation 21/2022 and MoEMR Regulation 16/2022.

Law 4/2023 does not say anything about who the Market Organizer will be. It is, however, now accepted that the Market Organizer will be the IDX. What presently remains somewhat unclear is whether the Carbon Exchange will be made part of the IDX itself or, instead, be established as a standalone special exchange for selling and purchasing Carbon Units as securities. OJK is said to be still considering which of these two alternatives is preferable.

- 1.6 **Implementation of Carbon Trading:** Law 4/2023 makes clear that the operation of the Carbon Exchange, to carry out Carbon Trading, requires:

- (a) the development of Carbon Trading “infrastructure”;
- (b) regulation of the utilization of State revenues from Carbon Trading; and
- (c) “administration” of Carbon Trading transactions (Article 24(5) of Law 4/2023).

The development of Carbon Trading “infrastructure” is to be carried out by way of coordination between relevant ministries/agencies and OJK (Article 24(6) of Law 4/2023).

Just what constitutes Carbon Trading “infrastructure” is not specified in Law 4/2023 but, presumably, it includes the trading platform as well as all required supporting facilities.

Likewise, what is covered by the “administration” of Carbon Trading transactions is not specified in Law 4/2023 but, probably, includes the procedures for settling and recording Carbon Trading transactions.

- 1.7 **Domicile:** The Carbon Exchange must be domiciled in Indonesia (Article 24(7) of Law 4/2023).

- 1.8 **Supervisory Role of OJK:** Carbon Trading, via the Carbon Exchange, must be in accordance with the requirements laid down by OJK (Article 25 of Law 4/2023).

- 1.9 **Implementing Regulations:** The requirements for Carbon Trading, via the Carbon Exchange, are to be set out in one or more implementing regulations to be issued by OJK

following (i) consultation with the House of Representatives (**DPR**) and (ii) coordination with relevant ministries and authorized institutions (Article 26 of Law 4/2023).

The authority of OJK to issue implementing regulations, in respect of the requirements for Carbon Trading via the Carbon Exchange, gives OJK considerable discretion as to just what those regulations provide for. It is important to remember, though, that Indonesia's hierarchy of laws and regulations does **not** allow an implementing regulation to contradict or expand the scope of the law it is purporting to implement. Instead, implementing regulations are, as the name implies, only meant to make provision for how the relevant higher-ranking law is to be administered or implemented. Accordingly, an implementing regulation issued by OJK, in respect of the requirements for Carbon Trading via the Carbon Exchange, should **not** seek to expand what Division Three of Law 4/2023 provides for; namely, "*the selling and purchasing of Carbon Units*" only, so as to include the selling and purchasing of excess or unused PTBAE-PUs and/or other instruments as well as the selling and purchasing of Carbon Units.

## 2. **IDX Carbon Exchange Plan**

2.1 **Overview:** The IDX Carbon Exchange Plan provides a lot of useful detail on the operation of the Carbon Exchange as envisaged by the IDX.

2.2 **Two Markets:** As envisaged by the IDX, the Carbon Exchange will comprise two separate markets being:

- (a) a market for PTBAE-PUs involving the selling and purchasing of both:
  - (i) **additional or new** PTBAE-PUs allocated by MoEMR; and
  - (ii) **excess or unused** PTBAE-PUs offered by electricity business actors in the power plant subsector which, in respect of particular power plant units, have generated less GHG Emissions than allowed by their PTBAE-PUs (together, **PTBAE-PU Market**); and
- (b) a market for SPE-GRKs involving the selling and purchasing of both:
  - (i) SPE-GRKs in respect of Carbon Units generated by project developers or companies operating in a particular industry subsector as between companies operating the **same** industry subsector – intra or sub-sectoral trading; and
  - (ii) SPE-GRKs in respect of **excess** Carbon Units generated by project developers or companies operating in a particular industry subsector as between companies operating in **different** industry subsectors and after sectoral NDCs have been met – cross-sectoral trading (together, **SPE-GRK Market**).

2.3 **Trading Features:** Again, as envisaged by the IDX, the Carbon Exchange will offer the following trading features:

- (a) an **auction function**, whereby:

- (i) regulators (**eg**, MoEMR) will specify the auction price range for additional or new PTBAE-PUs to be offered;
  - (ii) prospective buyers will submit their preferred volume and price for the offered additional or new PTBAE-PUs, thereby creating an on-line Auction Book; and
  - (iii) regulators will allocate the offered additional or new PTBAE-PUs to prospective buyers in accordance with the Auction Book (**Auction Function**);
- (b) a **regular trading function**, whereby:
- (i) prospective buyers and sellers of excess/unused PTBAE-PUs and SPE-GRKs will submit buy orders and sell orders to the Carbon Exchange specifying volume and price requirements, thereby creating an on-line Order Book;
  - (ii) the Carbon Exchange will match buy orders and sell orders on the basis of price and time priority; and
  - (iii) the match price will be the market price (**RT Function**);
- (c) a **negotiated trading function**, whereby:
- (i) prospective buyers and sellers of excess/unused PTBAE-PUs and SPE-GRKs will deal directly with one another outside of the Carbon Exchange;
  - (ii) in the case of agreed transactions, the participating buyers/sellers will input to/notify the Carbon Exchange of the details of the volume and price of the agreed transaction as well as the ID of the counterparty; and
  - (iii) the Carbon Exchange will handle the settlement of the agreed transactions (**NT Function**); and
- (d) a **marketplace function**, whereby:
- (i) developers/owners of projects expected to generate Carbon Units in the future will submit to the Carbon Exchange details of the price and number of units in the relevant project they are seeking buyers/investors for, thereby creating an on-line Available Project Book;
  - (ii) prospective buyers/investors will browse the Available Project Book and buy offered units in projects that they are interested in; and
  - (iii) the transaction price will be the unit price specified by the developer/owner of the relevant project (**i.e.**, the seller's price) (**MP Function**).

**Assessment:** The full title of the IDX Carbon Exchange Plan; namely, “*Carbon Exchange Plan in Facilitating Trade Power Generation Subsector*” indicates that the focus of the IDX Carbon Exchange Plan is very much electricity business actors in the power generation subsector which, following the issuance of MoEMR Regulation 16/2022, are the subject of



compulsory Carbon Trading if the actual GHG Emissions, from a particular power plant unit, exceed the PTBAE-PU for that power plant unit in a particular compliance period.

MoEMR Regulation 16/2022 provides that excess/unused PTBAE-PU may be sold by way of either Direct Trade or through the Carbon Exchange. MoEMR Regulation 16/2022 does, however, qualify the possibility that the Carbon Exchange may be used to sell excess/unused PTBAE-PU by providing that any such trading must be in accordance with the provisions of relevant laws and regulations (Article 14(4) and (5) of MoEMR Regulation 16/2022).

MoEMR Regulation 16/2022 also envisages that, should MoEMR determine (i) Carbon Trading by electricity business actors is not achieving its intended results and (ii) the unsatisfactory results of Carbon Trading are due to there being insufficient availability of PTBAE-PU, MoEMR may conduct an auction of additional PTBAE-PU (Articles 30 and 31 of MoEMR Regulation 16/2022).

Given the above, the IDX Carbon Exchange Plan should be understood as primarily being a response to MoEMR Regulation 16/2022 and the particular needs of the power plant subsector. MoEMR Regulation 16/2022, though, was **not** concerned with creating a legal basis for the establishment and operation of the Carbon Exchange and, indeed, this is **not** something that is within the authority of MoEMR to do as clearly evidenced by the fact that the DPR considered it necessary to subsequently pass Law 4/2023 in order to provide the required legal basis for the establishment and operation of the Carbon Exchange. Accordingly, it is **not** permissible to rely on MoEMR Regulation 16/2022 in an endeavour to broaden the actual legal basis for the establishment and operation of the Carbon Exchange otherwise created by Division Three of Law 4/2023.

The writer sees no problem with the Carbon Exchange operating as an SPE-GRK Market, given that SPE-GRKs are the evidence of ownership of Carbon Units and this is what is specifically contemplated by Division Three of Law 4/2023; namely, “*the selling and purchasing of Carbon Units*”. It should not make any difference whether prospective buyers and sellers of SPE-GRKs make use of the RT Function or the NT Function in order to take advantage of the SPE-GRK Market.

More problematic, though, is the proposed PTBAE-PU Market. This is because, as pointed out in 1.5 and 1.9 above, (i) Division Three of Law 4/2023 does **not** say anything about the Carbon Exchange being a venue for the selling and purchasing of PTBAE-PU (whether additional/new PTBAE-PU offered by MoEMR or excess/unused PTBAE-PU offered by electricity business actors) as opposed to being a venue for the selling and purchasing of Carbon Units as evidenced by SPE-GRKs, (ii) the authority granted by Article 24(4) of Law 4/2023 to the Market Organizer to “*develop activities and products*” is limited by the follow-on reference to “Carbon Units” and (iii) the envisaged implementing regulations to be subsequently issued by OJK **cannot** permit what is not permitted by Division Three of Law 4/2023 itself. In this regard, the envisaged PTBAE-PU Market would seem equally problematic regardless of whether prospective buyers and sellers of PTBAE-PU make use of the Auction Function, the RT Function or the NT Function in order to take advantage of the PTBAE-PU Market.

Also problematic is the MP Function which seems to envisage the Carbon Exchange operating as a market or “clearing house” for investment units in projects that are expected to generate Carbon Units in the future. Self-evidently, investment units in projects that are

expected to generate Carbon Units in the future are **not** the same thing at all as already realized Carbon Units evidenced by SPE-GRKs.

It is, of course, always possible that the DPR did not intend the references to “carbon units” in Articles 23(1) and 24(4) of Law 4/2023 to be narrowly interpreted and this is why there is no actual definition of “carbon units” in Law 4/2023 but, rather, was intending to allow the Carbon Exchange to be used for a wide variety of trading activities that, in one way or another, will facilitate the reduction of GHG Emissions and the realization of Indonesia’s Updated NDC. The Elucidation to Division Three of Law 4/2023 does **not**, however, give any indication whatsoever that the DPR was using the expression “carbon units” in a more generic sense or otherwise intending that the references to “carbon units” in Articles 23(1) and 24(4) of Law 4/2023 be more broadly interpreted and understood than the term “Carbon Units” as defined in PR 98/2021 and as subsequently used in MoEF Regulation 21/2022 and MoEMR Regulation 16/2022.

It is not clear to what extent, if at all, the IDX Carbon Exchange Plan has been discussed with and approved by OJK.

It is also not clear to what extent the IDX Carbon Exchange Plan reflects how the IDX expects the Carbon Exchange will operate from day one as opposed to merely setting out the IDX’s long term “vision” of what the operations of the Carbon Exchange may eventually come to include. The latter, however, seems more likely.

Finally, it is not clear from the IDX Carbon Exchange Plan itself whether, in the case of the Auction Function and the MP Function, the IDX envisages that the Carbon Exchange would really be doing anything more than merely acting as a “notice board” for (i) available additional/new PTBAE-PU’s offered by MoEMR and (ii) investment units, in projects that are expected to generate Carbon Units in the future, offered by the promoters of those projects, with the actual allocation/settlement of transactions in respect of additional/new PTBAE-PU’s and investment units, in projects that are expected to generate Carbon Units in the future, being handled by MoEMR or project promoters as the case may be. It may be that, if the Carbon Exchange’s role in respect of these transactions is only very limited and does not involve the actual settlement of transactions, an argument can be made that this is permissible as an “*activity*” developed by the Market Organizer in reliance upon Article 24(4) of Law 4/2023. The writer remains concerned, though, that the follow-on words in Article 24(4) of Law 4/2023 (***i.e.***, “*based on carbon units*”) inevitably qualifies and restricts what is permissible as an “*activity*” developed by the Market Organizer.

## **SUMMARY & CONCLUSIONS**

Division Three of Law 4/2023 has finally given a clear legal basis for the establishment and operation of the Carbon Exchange. As such, the Carbon Exchange is now much closer to being a reality than it was previously.

The Government’s recent decision to allow foreign parties to carry out Carbon Trading, via the Carbon Exchange, is a sensible one given it increases the likelihood of the Carbon Exchange hosting a meaningful level of Carbon Trading activity. This is essential for the Carbon Exchange initiative to be a success. It remains unclear, though, whether foreign parties will ultimately be allowed to participate in Carbon Trading, via the Carbon Exchange, for the purposes of both the “cap and trade market” and the “voluntary market” or just the “voluntary market”.

As the designated Market Organizer, the IDX has prepared an ambitious and expansive plan for how the Carbon Exchange will or could operate either immediately upon its establishment or in due course and assuming the necessary supporting implementing regulations are issued by OJK. This is a good thing as it indicates the IDX has a worthwhile “vision” of what the Carbon Exchange can and should be if it is to achieve the DPR’s objective of meaningfully facilitating the reduction of GHG Emissions and the realization of Indonesia’s Updated NDC.

A literal reading of Division Three of Law 4/2023 suggests, however, that the newly created legal basis for the Carbon Exchange may not, in its present form, fully support all aspects of the IDX Carbon Exchange Plan. Further, there is only so much that the OJK can subsequently do, by way of the envisaged implementing regulations, to make it legally possible to carry out the entirety of the IDX Carbon Exchange Plan when the legal basis created by Division Three of Law 4/2023 is arguably insufficient for this purpose.

Having regard to the above, the IDX may have to accept that, at least initially, the actual scope of the operations of the Carbon Exchange will need to be considerably more limited than what might otherwise be suggested by the IDX Carbon Exchange Plan read in its entirety. If the IDX was to immediately implement the entirety of the IDX Carbon Exchange Plan and while unresolved issues exist about the sufficiency of the existing legal basis for the establishment and operation of the Carbon Exchange, this would inevitably give rise to uncertainty about the validity of at least some of the transactions carried out via the Carbon Exchange. Self-evidently, this is not desirable as it might well discourage the widespread use of the Carbon Exchange by more risk averse parties.

The sensible approach would seem to be for the Carbon Exchange to initially confine itself to the trading of Carbon Units evidenced by SPE-GRKs as this is clearly allowed by Division Three of Law 4/2023. The trading of PTBAE-PU and investment units, in projects that are expected to generate Carbon Units in the future, should only follow if and when the existing uncertainty, about an adequate legal basis for this proposed expanded Carbon Trading activity, is resolved.

\*\*\*\*\*

*This article was written by Bill Sullivan, Senior Foreign Counsel with Christian Teo & Partners and Senior Adviser to Stephenson Harwood. Christian Teo & Partners is a Jakarta based, Indonesian law firm and a leader in Indonesian energy, infrastructure and mining law and regulatory practice. Christian Teo & Partners operates in close association with international law firm Stephenson Harwood which has eight offices across Asia, Europe, and the Middle East: Dubai, Hong Kong, London, Paris, Piraeus, Seoul, Shanghai, and Singapore.*

*Get in touch*



Bill Sullivan

T: +62 21 5020 2789

M: +62 815 8506 0978

E: [bsullivan@cteolaw.com](mailto:bsullivan@cteolaw.com)



Christian Teo

T: +62 21 5020 2789

M: +62 818 124 747

E: [cteo@cteolaw.com](mailto:cteo@cteolaw.com)



Claudius Novabianto

T: +62 21 5020 2789

M: +62 818 0858 9235

E: [cnbianto@cteolaw.com](mailto:cnbianto@cteolaw.com)