

CARBON TRADING AND FORESTRY SECTOR – NEW REGULATION ¹²³⁴⁵

INTRODUCTION

Indonesia has issued a new regulation that deals with carbon trading by business actors in the forestry sector.

The new regulation continues the process of moving forward with the creation of a comprehensive regulatory environment for carbon trading in Indonesia, which process is transitioning from general regulations on carbon trading, that are applicable to business actors in all industry sectors/subsectors, to much more specific regulations on carbon trading that are only applicable to business actors in particular industry sectors/sub-sectors.

For the purpose of the new regulation, Indonesia's forestry sector includes peatlands and mangrove areas as well as more commonly understood types of forest areas. As such, the proper management of business activities carried out in Indonesia's forestry sector is an essential part of the country's efforts to reduce its overall level of greenhouse gas emissions.

Indonesia's forestry sector is also an important potential source of carbon credits that can be used by business actors in other industry sectors/subsectors for the purpose of offsetting their excess greenhouse gas emissions. Accordingly, there is a need to carefully regulate the trading of carbon credits resulting from forestry sector activities.

In this article, the writer will review the new industry sector/subsector specific regulation on carbon trading by business actors in the forestry sector.

BACKGROUND

In late October 2021, Presidential Regulation No. 98 of 2021 re Implementation of Carbon Economic Value to Achieve Updated National Development Contribution (NDC) and Net Zero Emissions (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).

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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.

PR 98/2021 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 with, among other things, (i) domestic Carbon Trading and offshore Carbon Trading and (ii) measurement, reporting and verification of the implementation of NEK.

PR 98/2021 and MoEF Regulation 21/2022, however, 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.

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**).

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.

MoEF has now followed the lead of MoEMR and issued Indonesia's second sector/subsector specific regulation on Carbon Trading, being MoEF Regulation No. 7 of 2023, dated 14 June 2023, re Procedures for Carbon Trading in the Forestry Sector (**MoEF Regulation 7/2023**).

ANALYSIS AND DISCUSSION

1. Overview of MoEF Regulation 7/2023

The stated purpose of MoEF Regulation 7/2023 is to support the achievement of Indonesia's NDC by (i) controlling the level of greenhouse gas emissions (**GHG Emissions**) generated from forestry sector business activities and (ii) specifying the procedures to be followed by forestry sector business actors in carrying out Carbon Trading.

MoEF Regulation 7/2023 is concerned with GHG Emissions generated from forestry sector business activities involving (i) Conservation Forests, (ii) Convertible Production Forests, (iii) Customary Forests, (iv) Permanent Production Forests, (v) Private Forests, (vi) Protected Forests and (vii) State Forests, each of which forest type is defined in Law No. 41 of 1999 re Forestry as subsequently amended, as well as forestry sector business activities involving mangrove areas and peatlands.

MoEF Regulation 7/2023 is to be properly seen as providing the next level of detail for the regulation of Carbon Trading in the forestry sector.

While many of the Carbon Trading concepts/defined terms used in MoEF Regulation 7/2023 are taken from PR 98/2021 and MoEF Regulation 21/2022, MoEF Regulation 7/2023 also introduces various new concepts/defined terms that are forestry sector specific.

MoEF Regulation 7/2023 came into effect on 15 June 2023.

2. Key Concepts Used in MoEF Regulation 7/2023

The most important concepts/defined terms used in MoEF Regulation 7/2023 are as follows:

- (a) **Baseline GHG Emissions** – estimates of GHG Emissions in the Forestry sector, during a particular period of time, as determined without any regulatory intervention and/or without any Climate Change Mitigation;
- (b) **Carbon Trading** – market-based mechanism to reduce GHG Emissions through either Emissions Trading or Emissions Offsetting;
- (c) **Climate Change Mitigation** – control efforts to reduce GHG Emissions or increase GHG absorption to reduce the risk of climate change;
- (d) **Climate Change Mitigation Action** – any action/activity that can help achieve Climate Change Mitigation;
- (e) **Compliance Period** – period of time stipulated by the Minister for measuring the compliance or otherwise of Forestry Business Actors in reducing GHG Emissions in accordance with the applicable GHG Emissions Upper Limit for the Forestry sector;
- (f) **Conservation Forest** – a forest area possessing certain characteristics, the main function of which forest area is preserving the diversity of plants and animals and the forest area's ecosystem;
- (g) **Convertible Production Forest**-production Forest area which may be spatially reserved for activities or development, other than activities or development related to Forestry activities, and that may be converted into a Permanent Production Forest;
- (h) **Customary Forest** - any forest located in the territory of customary law (i.e., adat) communities;

- (i) **Director General** – director general with responsibility for organizing the formulation and implementation of drawing up and implementing policies in the field of sustainable forest management;
- (j) **DRAM** – documents in respect of Climate Change Mitigation Action plans prepared by Forestry Business Actors for the purpose of obtaining SPE-GRKs;
- (k) **Emissions Offsetting** – approved/recognized deemed fulfilment of all or part of Target GHG Emissions, as evidenced by GHG Emissions Offset Statements, in respect of Forestry business activities 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 Forestry sector or in a different sector/subsector;
- (l) **Emissions Trading** – buying and selling of surplus GHG Emissions; that is, unused PTBAE-PUs by Forestry Business Actors;
- (m) **Forest Area** – a certain forest area designated by the Government as a Conservation Forest, Customary Forest, Convertible Production Forest, Permanent Production Forest, Private Forest, Protected Forest or State Forest for the purpose of maintaining its existence as a permanent forest;
- (n) **Forestry** – the system of management related to forests, Forest Areas and forest products which is organized in an integrated manner;
- (o) **Forestry Business Actors** – individuals or business entities carrying out business activities in Forest Areas;
- (p) **Forestry Sector Carbon Trading Road Map** – “road map” prepared/approved by the Minister, covering the Forestry sector or a particular subsector/sub-subsector of the Forestry sector and for the purpose of facilitating due diligence in respect of Carbon Trading in the Forestry sector and (ii) as reference for the Director General to use in connection with administering/monitoring Carbon Trading in the Forestry sector;
- (q) **GHG** – gases contained in the atmosphere, both natural and anthropogenic, which absorb and re-emit infrared radiation;
- (r) **GHG Emissions** – the release of GHG into the atmosphere in a certain area and during a certain period as a result of human activities and economic activities;
- (s) **GHG Emissions Monitoring Plan** – plan for managing/monitoring GHG Emissions prepared by Forestry Business Actors;
- (t) **GHG Emissions Upper Limit** – highest permitted GHG Emissions level for the Forestry sector;
- (u) **Minister** – MoEF;

- (v) **MRV** – activity of measuring, reporting and verifying, in accordance with established procedures and standards, Climate Change Mitigation activities/performance/results;
- (w) **NDC** – Indonesia’s 2021 commitment to achieve 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);
- (x) **PBPs** – performance-based payments that are intended to provide incentives for Climate Change Mitigation Action by Forestry Business Actors;
- (y) **PBPHs** – Forest Utilization Business Permits issued to Forestry Business Actors and authorizing the holder to carry out certain business activities in a Forest Area;
- (z) **Permanent Production Forest** - any forest that has as its main function producing forest products while being maintained as a permanent forest;
- (aa) **PNBP** – non - tax state revenue;
- (bb) **Private Forest** - any forest located on land that is encumbered with land use rights;
- (cc) **Protected Forest** - a forest area the main function of which is protecting life support systems to facilitate water management, prevent flooding, control erosion, prevent sea water erosion and maintain soil fertility;
- (dd) **PTBAE** - GHG Emissions Upper Limit for the Forestry sector;
- (ee) **PTBAE-PU** - PTBAE for Forestry Business Actors and/or determination of GHG Emissions **quotas** covering a particular Compliance Period for each type of Forestry business activity;
- (ff) **Social Forestry Management Approval** – the granting of legal access to Forest Areas for forest management and utilization activities to be carried out by community, customary or village users as well as by Forestry partnerships in Conservation Forests, Convertible Production Forests, Permanent Production Forests and Protected Forests;
- (gg) **SPE-GRKs** – GHG Emissions Reduction Certificates, being certificates issued by the relevant Indonesian government authority, providing proof of GHG Emissions reduction activities/performance/results that have gone through MRV and that are recorded in the SRN PPI in the form of a registry number and/or code;
- (hh) **SRN PPI** – web-based national registry system for managing data, information and resources on/for Climate Change Mitigation and NEK in Indonesia;
- (ii) **State Forest** - any forest located on land that is not encumbered with land use rights;
- (jj) **Target GHG Emissions** – target levels of reduced GHG Emissions, applicable to Forestry business activities during a particular period of time, as a result of Climate Change Mitigation;

- (kk) **Validation** – systematic and documented process conducted by an independent third party (**i.e.**, a Validator) to ensure that the design of Climate Change Mitigation Action implementation meets the specified requirements; and
- (ll) **Verification** – an activity conducted by an independent third party (**i.e.**, a Verifier) to ensure the accuracy and quality assurance of data and resources submitted for inclusion in the SRN PPI by the person in charge of a particular Climate Change Mitigation Action.

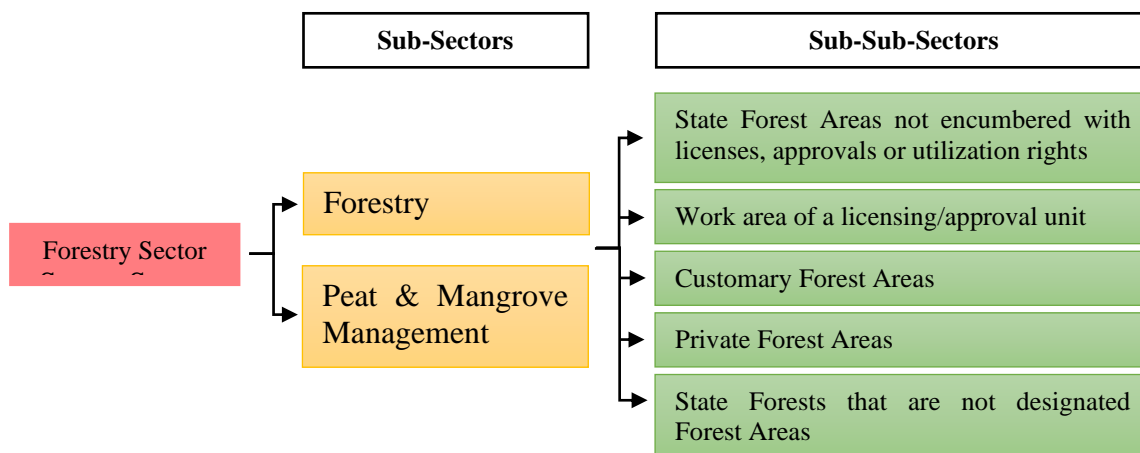
3. **MoEF Regulation 7/2023 in Detail**

- 3.1 **Climate Change Mitigation in Forestry Sector:** Climate Change Mitigation Action in the Forestry sector may take the form of (i) GHG Emissions reduction and/or (ii) the storage and/or sequestration of forest carbon (Article 3(2) of MoEF Regulation 7/2023).

Recognized Climate Change Mitigation Action in the Forestry sector includes (i) reduction of the **mineral-bearing land** deforestation rate, (ii) reduction of the **mineral-bearing forest** degradation rate, (iii) plantation forest development, (iv) sustainable forest management, (v) rehabilitation with rotation, (vi) non-rotational rehabilitation, (vii) peatland restoration, (viii) improvements in peatland irrigation systems, (ix) mangrove area rehabilitation, (x) **reforestation of ex-mining areas**, (xi) construction of permanent nurseries, (xii) plant rehabilitation under 5 years, (xiii) biodiversity conservation, (xiv) promotion of social forestry activities, (xv) assistance with the management of Customary Forests, (xvi) introduction of ecosystem replication, (xvii) open green space development, (xviii) eco-riparian initiatives, (xix) Forest Area supervision and law enforcement for the purpose of ensuring Forest Area security and protection and (xx) science and technology development activities relevant to Forest Areas (Article 3(3) of MoEF Regulation 7/2023).

The importance of the above list of what will be recognized as Climate Change Mitigation Action in the Forestry sector is twofold. First, the provision of some 20 specific categories of recognized Climate Change Mitigation Action in the Forestry sector makes it much easier to understand what is meant by the otherwise somewhat obtruse concept of Climate Change Mitigation Action which has, previously, only been dealt with in very general terms in other Indonesian laws and regulations. Second, the references to mineral-bearing lands, mineral-bearing forest and ex-mining areas highlight the importance the Government clearly attaches to promoting the rehabilitation and/or reforestation of these areas which, typically, comprise some of the most seriously environmentally degraded land in Indonesia due to the unavoidably invasive nature of mining activities.

- 3.2 **Forestry Subsectors for Purpose of Carbon Trading:** For the purpose of better regulating Carbon Trading in the Forestry sector, the Forestry sector has been divided into various subsectors and sub-subsectors (Article 4 of MoEF Regulation 7/2023) as follows:



3.3 **Availability of Carbon Trading in Forestry Sector:** The availability of Emissions Trading and/or Emissions Offsetting in the Forestry sector is dependent upon the type of Forest Area (Articles 6 to 8 of MoEF Regulation 7/2023) that is to be utilized for business activities and is subject to certain restrictions as follows:

	Type of Forest Area	Mechanism		Restrictions
		Emissions Trading	Emissions Offsetting	
(a)	Permanent Production Forest Areas, Convertible Production Forest Areas and utilization blocks of Protected Forest Areas that are the subject of PBPHs, Social Forestry Management Approvals or management rights		√	To be carried out by PBPH holders, holders of Social Forestry Management Approvals or management rights holders
(b)	Permanent Production Forest Areas, Convertible Production Forest Areas and utilization blocks of Protected Forest Areas that are not the subject of PBPHs, Social Forestry Management Approvals or management rights		√	May only be carried out after PBPHs, Social Forestry Management Approvals or management rights have been obtained
(c)	other Protected Forest Area blocks		√ (taking into account the carbon stock/supply)	May only be carried out after Ministerial approval has been obtained

	Type of Forest Area	Mechanism		Restrictions
		Emissions Trading	Emissions Offsetting	
(d)	peatlands and mangrove areas inside Forest Areas	Emissions Trading or Emissions Offsetting		May only be carried out after PBPHs, Social Forestry Management Approvals or management rights have been obtained
(e)	peatlands and mangrove areas outside Forest Areas	Emissions Trading or Emissions Offsetting		May only be carried out after approval of the relevant governor, regent/mayor or Minister/head of relevant institution is obtained
(f)	Conservation Forest Areas		√ (taking into account the carbon stock/supply)	May only be carried out after approvals are obtained from: (i) relevant regent or mayor, in the case of forest parks located in a regency/city; (ii) relevant governor, in the case of forest parks covering 2 or more regencies in the same province; or (iii) the Minister, in the case of conservation areas other than Forest Areas
(g)	Customary Forest Areas		√	May only be carried out by customary law communities
(h)	Private Forest Areas		√	May only be carried out by Private Forest Area owners
(i)	State Forest Areas which are not designated Forest Areas		√	May only be carried out after determination of locations and/or receipt of approval from the relevant governor/Minister

3.4 **Reserve Requirement:** As a form of risk control and in order to ensure Indonesia achieves its NDC, Forestry Business Actors with excess GHG Emissions (**i.e.**, unused PTBAE-PU) will **not** be allowed to deploy all of their unused PTBAE-PU, for the purposes of Carbon Trading, in the years prior to 2030 (Article 7 of MoEF Regulation 21/2022). Some part of the unused PTBAE-PU will have to be set aside as a reserve or “buffer”.

The reserve or “buffer” requirement applies to (i) Emissions Trading utilizing SPE-GRKs, (ii) domestic Emissions Offsetting, (iii) international Emissions Offsetting and (iv) international Emissions Offsetting falling outside the scope of NDC, with the amount of the required reserve or “buffer” to be specified in the Forestry Sector Carbon Trading Road Map as determined by the Minister (Article 12 of MoEF Regulation 7/2023).

3.5 **Other Requirements:** Carbon Trading by Forestry Business Actors is also subject to the following additional requirements:

- (a) holders of PBPH, management rights and land use rights must have (i) a certificate of sustainable forest management, (ii) a certificate of forest products legality or (iii) a declaration of forest products origin;
- (b) social forestry management approval holders must have at least a “silver” classification in respect of their implementation of social forestry; and
- (c) customary law communities, social forestry management approval holders, and community land rights holders wanting to carry out Emissions Offsetting must receive relevant technical assistance in the form of or have partners with experience or expertise related to carbon measurement, project planning and implementation or accessing carbon markets (Article 8 of MoEF Regulation 7/2023).

3.6 **Limitations on Carbon Trading in Forestry Sector:** Forestry Business Actors may not engage in Carbon Trading if they are already bound by (i) a PBP (**i.e.**, performance-based payment) arrangement, (ii) an international cooperation agreement or (iii) other written commitment equivalent to an GHG Emissions reduction PBP (Article 16 of MoEF Regulation 7/2023).

3.7 **Process of Carbon Trading in Forestry Sector:** The process of Emissions Trading and Emissions Offsetting in the Forestry sector involves the following procedural steps (Articles 10 to 16 of MoEF Regulation 7/2023):

Emissions Trading	Emissions Offsetting
<p>Emissions Trading is carried out through:</p> <ul style="list-style-type: none"> (a) preparation and determination of the Forestry Sector Carbon Trading Road Map; (b) determination of surplus GHG Emissions reduction reserves; (c) determination of PTBAE; (d) determination of PTBAE-PUs; (e) stipulation of quotas for peatland and mangrove area management in the peatland and mangrove area management sub-sectors; (f) actual GHG Emissions measurement; (g) PTBAE-PU report submission; (h) PTBAE-PU report Verification; (i) preparation of Verification results report; and (j) implementation of: (i) domestic and/or international Emissions Trading by PTBAE-PU holders or (ii) storage of any unused PTBAE/PTBAE-PU. 	<p>Emissions Offsetting is carried out through:</p> <ul style="list-style-type: none"> (a) preparation and determination of the Forestry Sector Carbon Trading Road Map; (b) determination of surplus GHG Emissions reduction reserves; (c) determination of Baseline GHG Emissions; (d) determination of Target GHG Emissions; (e) preparation of DRAM; (f) DRAM Validation; (g) preparation of DRAM Validation results report; (h) implementation of Climate Change Mitigation Actions; (i) Verification of the results of implementation of Climate Change Mitigation Actions; (j) preparation of report on Verification of results of implementation of Climate Change Mitigation Actions;

Emissions Trading	Emissions Offsetting
	(k) formation of and review by MRV Team; and (l) issuance of SPE-GRKs.

3.8 **PNBP Consequences of Forestry Sector Carbon Trading:** Both Emissions Trading and Emissions Offsetting in the Forestry sector are subject to the payment of PNBP (**i.e.**, non-tax State revenue) (Articles 17 to 19 of MoEF Regulation 7/2023).

3.9 **Reports, Evaluation and Development:** PBPH holders, carrying out Carbon Trading activities in respect of Convertible Production Forest Areas, Permanent Production Forest Areas or Protected Forest Areas, are required to prepare and submit to the Director General monthly reports on their business activities, which reports are then used for the purpose of evaluating the Carbon Trading performance of PBPH holders at least once every year (Articles 20 to 24 of MoEF Regulation 7/2023).

3.10 **International Carbon Trading Quotas:** Forestry Business Actors, which have achieved the NDC target for their particular Forestry sub-subsector, are allowed to carry out international Carbon Trading, subject to the imposition of maximum quotas that are to be determined as follows (Article 15 (5) of and the Appendix to MoEF Regulation 7/2023):

Emissions Trading	Emissions Offsetting
<p>Formula:</p> $KPE = \frac{EA\ PU}{\sum EA\ PU} \times (\sum TP\ PTBAE - \sum TEA)$	<p>Formula:</p> $KO = \frac{CS\ PU}{\sum CS\ PU} \times (\sum TEA - \sum TPE)$
<p>Explanation:</p> <p>KPE = allowed quota of surplus GHG Emissions for international Emissions Trading by individual Forestry Business Actor</p> <p>EA PU = GHG Emissions allowed under individual Forestry Business Actor's PTBAE-PU</p> <p>$\sum EA\ PU$ = total GHG Emissions allowed for all Forestry Business Actors</p> <p>$\sum TP\ PTBAE$ = GHG Emissions Upper Limit for Forestry sector</p> <p>$\sum TEA$ = total actual GHG Emissions of all Forestry Business Actors</p>	<p>Explanation:</p> <p>KO = allowed quota of surplus GHG Emissions for international Emissions Offsetting by individual Forestry Business Actor</p> <p>TEA = actual GHG Emissions of individual Forestry Business Actor</p> <p>TPE = GHG Emission Reduction Target of individual Forestry Business Actor</p> <p>CS PU = GHG Emissions surplus of individual Forestry Business Actor</p> <p>$\sum TEA$ = total actual GHG Emissions of all Forestry Business Actors</p> <p>$\sum TPE$ = total GHG Emissions Reduction Targets of all Forestry Business Actors</p>

Emissions Trading	Emissions Offsetting
	\sum CS PU = total GHG Emissions surpluses of all Forestry Business Actors

SUMMARY & CONCLUSIONS

MoEF Regulation 7/2023 provides much needed clarity of what will qualify as Climate Change Mitigation Actions in the Forestry sector.

In recognition of the importance of the Forestry sector in Indonesia, MoEF Regulation 7/2023 also sets out specific rules for Carbon Trading by Forestry Business Actors.

The requirements for and the restrictions imposed by MoEF Regulation 7/2023 on Carbon Trading by Forestry Business Actors are quite complicated and require careful study in order to properly understand the same. Further, various areas of uncertainty remain and require clarification from the Minister, particularly with respect to the calculation of international Carbon Trading quotas.

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