

REDD+ Opportunities and Challenges in Indonesia

Structuring Indonesian REDD+ projects and compliance with national regulations

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Outline

- Indonesian REDD+ Regulatory Developments
- Voluntary vs Compliance
- Indonesia VCM Regulation
- Project Structuring Issues

Indonesian REDD+ Regulatory Developments

Recognition of forestry carbon rights

- Prior to December 2008...
 - Very few references in Indonesian regulations to entitlement to carbon rights
 - In CDM area, the Indonesian DNA has acted as vetting body, but no clearly defined rules
 - Explicit reference in forestry sector regulations
 - PP 6/2007: Environmental Services Concession (IUPJL) for “carbon sequestration and storage”
 - KepMen P.14/Menhut-II/2004: to apply for A/R CDM project in forest area, must hold either IUPJL or IUPHHK-HT
 - Despite “IUPJL for carbon storage”, still not clear statement in regulations that IUPJL holder is entitled to all carbon rights
 - But generally accepted that IUPJL carries carbon ownership rights

Recognition of forestry carbon rights

- Prior to December 2008...
 - However bottleneck has been inability to obtain IUPJL
 - Absence of implementing Ministerial Decrees providing for procedures of issuing IUPJL
- The result:
 - Ownership of carbon entitlements for Avoided Deforestation projects uncertain
 - Investors have been able to obtain forestry concessions (e.g. Ecosystem Restoration concessions, HTI concessions), but still a question over where ownership of carbon rights resided absent the IUPJL

Recognition of forestry carbon rights

- Post December 2008....
 - A flurry of MoF regulations issued:
 - PerMenHut P.68/Menhut-II/2008
 - PerMenHut P.30/Menhut-II/2009
 - KepMenHut P.36/Menhut-II/2009
 - Regulations seem to be heading down two independent paths within two different Departments of the MoF:
 - Compliance market projects (P.68 and P.30)
 - Voluntary market projects (P.36)
 - Key message: the regulations must be very clear as to how “REDD” projects are to be treated
 - Uncertainty and overlapping regulation deters much needed investment

Voluntary vs Compliance

Voluntary vs Compliance

- Areas of regulatory overlap have already started to appear in regulatory framework:
 - VCM references in P.30
 - Covers activities of “Reducing Emissions from Deforestation and Forest Degradation”
 - Definition not limited to UNFCCC Demonstration/ compliance market projects
 - Prior to UNFCCC international framework on REDD being developed, REDD activities can be implemented through voluntary carbon trading
 - i.e. once international REDD rules developed, VCM ceases?

Voluntary vs Compliance

- Areas of regulatory overlap have already started to appear in regulatory framework:
 - Compliance market references in P.36
 - Once Compliance Market commences, VER certificates will have to be validated based on the new procedures
- Both sets of regulations (and particularly transition to compliance market regime) will need to be aligned to give necessary investment certainty

Indonesia's VCM Regulation

Focus on P.36

- Background
 - Implementation of the general provisions of PP6/2007 on IUPJL for carbon sequestration/storage
- Key points
 - Explicitly recognises that “REDD scheme” (i.e. compliance) and CDM projects separately regulated
 - Accordingly, this leaves the VCM
 - Different regimes for “Environmental Services Business” and Carbon “Developers”
 - Applies to Production Forest and Protected Forest
 - For Carbon “Developers”, prescribed split of income from selling VERs between Developers, Government and Community
 - Non-forest lands not covered (e.g. avoided palm oil conversion)

Focus on P.36

- Activities covered as “environmental services”:
 - Carbon sequestration in Production Forest through SFM
 - Planting and maintenance, enrichment of logged over areas, selective logging
 - Carbon storage in Production Forest through SFM
 - Lengthening of cutting cycles, delaying cutting, increasing protection/conservation areas within block
 - Carbon sequestration in Protected Forest
 - Planting and maintenance, use of silviculture techniques
 - Carbon storage in Protected Forest
 - Protection and security

Focus on P.36

- Who can obtain licence for “Environmental Services Business”?
 - Existing timber utilisation licence holders
 - IUPHHK-HA (natural forest timber concession)
 - IUPHHK-RE (ecosystem restoration concession)
 - IUPHHK-HTI (timber estate concession)
 - IUPHHK-HTR (smallholder timber concession)
 - IUPK-HL (Protected Forest utilisation concession)
 - Community Forest Licence
 - Manager of Village Forest
 - Where no existing timber utilisation licence:
 - Individual, Cooperative, BUMN/BUMD or Indonesian Private Legal Entity (PT, CV, Firma)

Focus on P.36

- Who issues licence (IUP)?
 - Where existing timber utilization licence:
 - Minister deals with application (except for IUPHHK-HTR)
 - Minister issues IUP (except for IUPHHK-HTR)
 - Where no existing timber utilization licence:
 - Not clear from wording, but seems Regional/ Provincial/ Central will issue
 - For Carbon “Developers”, no IUP can be issued

Focus on P.36

- Carbon Sequestration/Storage “Project Developers”
 - Who?
 - Manager of Production Forest (BUMN)
 - IUPHHK-HA (natural forest timber concession)
 - IUPHHK-RE (ecosystem restoration concession)
 - IUPHHK-HTI (timber estate concession)
 - Therefore:
 - No “Project Developer” for:
 - Protected Forests
 - Smallholder, Community or Village Forests
 - But confusing references to these other concessions in revenue split table

Focus on P.36

- Carbon Sequestration/Storage “Project Developers”
 - Structure
 - Project Developer works together with Investor
 - Unlike P.30, no prescription on who “Investor” can be (local, foreigner etc)
 - Result of project development is carbon credit which can be marketed in national/international VCM
 - VERs issued in name of Project Developer (not investor)
 - Tight Ministerial control over VERs
 - VER certificate sold directly to buyer or through Carbon Exchange as approved by Minister
 - Proceeds of VER sales can be transferred or donated with Minister approval
 - A step too far?

Focus on P.36

- Carbon Sequestration/Storage “Project Developers”
 - Revenue Share (Non-Tax State Revenue)
 - Split based on “income” from selling VERs based on Emission Reduction Purchase Agreement
 - Similar to other natural resources (e.g. coal levy is 13.5% of sales price of coal)
 - Examples of split:

Permit	Government	Community	Developer
IUPHHK-HA	20%	20%	60%
IUPHHK-HT	20%	20%	60%
IUPHHK-RE	20%	20%	60%
Protected Forest	50%	20%	30%
Community Forest	20%	50%	30%

- Government share split 40/20/40 Central/ Provincial/ Regional

Focus on P.36

- Carbon Sequestration/Storage “Project Developers”
 - Revenue Share
 - How do deal with “pre-purchase” arrangements?
 - e.g. Investor provides up-front payment of US\$X million to Project Developer
 - In consideration for upfront payment, Developer sells forward all future VERs to Investor
 - Investor monetises the VERs as and when they choose
 - What is “income”?
 - What about structures that involve a split of the VER revenues after deduction of costs?

Focus on P.36

- Transition to Compliance Market
 - Once Compliance Market starts in December 2012, for VERs generated from carbon storage Project development:
 - VER will need to be included in the National Baseline and registered with national registration body
 - ERPA for VER must be re-negotiated
 - Will impact long term ERPAs
 - Not clear what needs to be re-negotiated, but likely aimed at the pricing
 - This does not apply to VERs generated from carbon sequestration activities
 - assumption that sequestration activities will not be covered by REDD

Focus on P.36

- Term of Project
 - Maximum 25 years
 - 30 years maximum permitted under PP6/2007
 - Extensions permitted, but to be separately regulated
- Resourcing of Project
 - Financing can come from:
 - Own funding
 - Funding from CSR in country or overseas
 - Grant from bilateral or multilateral donor
 - What about other sources? Investors?

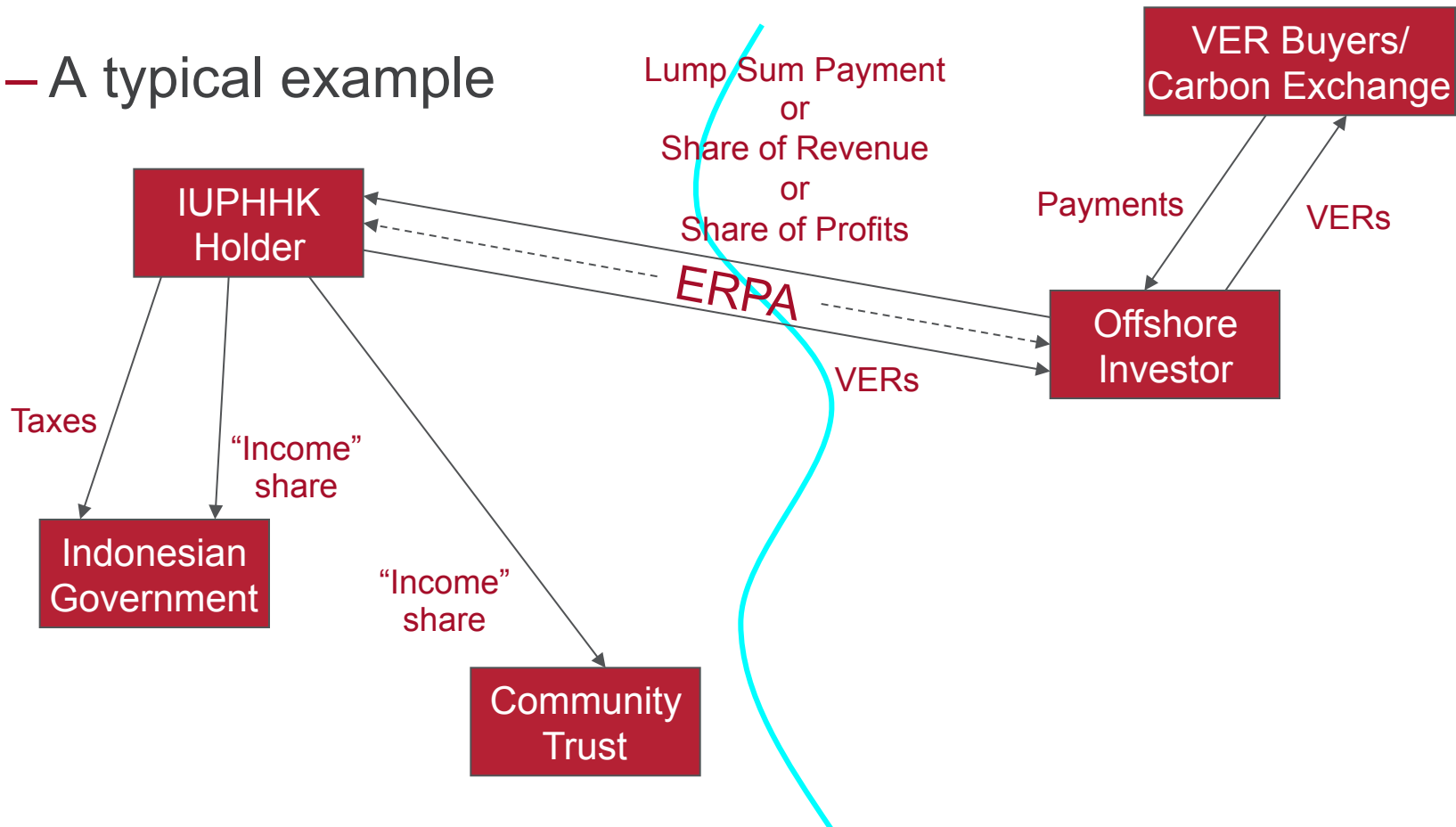
Focus on P.36

- Issues with P.36
 - Despite its name, it creates a new form of licence, not an IUPJL
 - Why?
 - Under PP6/2007, IUPJLs are issued by Regional Governments
 - Regardless, clear enough to vest carbon entitlements in holders

Project Structuring Issues

Project Structuring

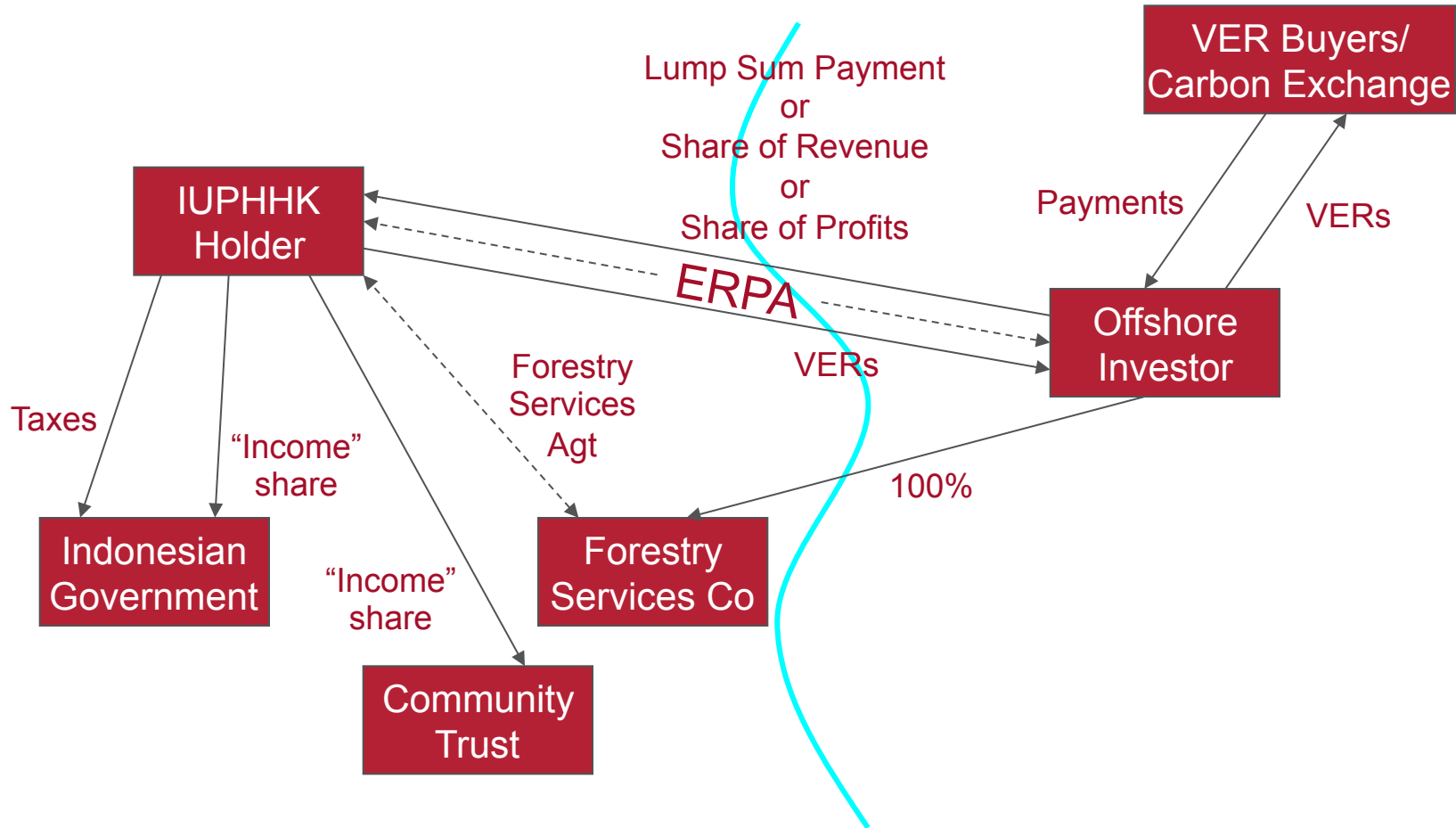
– A typical example



Project Structuring

- Foreign ownership
 - Foreign investors may like to carry out on-the-ground forest activities themselves to mitigate risk of non-delivery of VERs
 - At present, only HTI concessions are open for foreign investment
 - *Hutan Alam* and Ecosystem Restoration must be 100% Indonesian owned
 - One option is for foreigners to set up a Forestry Services company (i.e. a services company, not a concession holder)
 - Can be 100% foreign owned
 - Concession company sub-contracts the day to day activities to Forestry Services Company

Project Structuring



Project Structuring

- Tax issues
 - Like other of Indonesia's natural resources (e.g. coal, minerals and oil and gas) it is likely that the Indonesian Tax Office will want to ensure that “full value” for the sale of carbon is brought into Indonesia
 - Where the Concession Holder and the Offshore Investor are related, transfer pricing studies may be required
 - If terms of the ERPA provide for little risk to Concession holder (e.g. no non-delivery penalty, Offshore Investor funds every cost incurred by Concession Holder, then lower return to Concession Holder may be justified)
 - But Government will likely scrutinise
 - Taking into account Revenue share, tax burden too high?