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Indonesia Introduces CCS/CCUS Regulation

Indonesia has set an ambitious target to reach net zero emissions by 2060. The deployment of clean energy technologies, such as carbon capture and storage (“**CCS**”) and carbon capture, utilization and storage (“**CCUS**”), will play a key role in enabling Indonesia to achieve this target. On 3 March 2023, the Ministry of Energy and Mineral Resources of the Republic of Indonesia (“**MEMR**”) issued Regulation No. 2 of 2023 on CCS and CCUS in upstream oil and gas business activities (the “**Regulation**”), which provides much needed guidance for this sector. This client alert outlines the key elements of this important new regulation.

SCOPE OF THE REGULATION

The Regulation applies to carbon emissions from upstream oil and gas business activities and “other industries”.¹ While both CCS and CCUS may be implemented in relation to carbon emissions generated from upstream oil and gas activities, the Regulation only provides for the implementation of CCUS in relation to carbon emission captured from “other industries”.² The Regulation does not define the “other industries”, but MEMR may issue guidelines regarding such “other industries” in the future. The Regulation also applies to the direct capture of carbon dioxide from the atmosphere.³ Captured carbon emissions may be injected and stored in oil and gas reservoirs, saline aquifers and coalbed methane gas seams located in areas designated for oil and gas exploration and production activities (“**Work Areas**”).⁴

Under the Regulation, only a company (“**Contractor**”) which has entered into a production sharing contract or other form of cooperation contract for oil and gas exploration and production activities (“**Cooperation Contract**”)⁵ with the Special Task Force for Upstream Oil-and-Gas Business Activities (“**SKK Migas**”) or, if the relevant Work Area is located within Aceh, the Aceh Oil-and-Gas Management Agency (“**BPMA**”) can carry out CC(U)S activities.⁶ The Contractor can be an Indonesian incorporated company or a foreign company that creates a permanent establishment in Indonesia.⁷



ADDITIONAL CCS/CCUS OPTIONS – PAVING THE WAY FOR CCS HUBS

Significantly, the Regulation allows: (i) Contractors that generate carbon emissions to propose plans to inject and store carbon emissions in another Contractor's Work Area;⁸ and (ii) Contractors to inject and store carbon emissions in their Work Area which are generated by a Third Party.⁹ This facilitates 'CCS as a service' business model, whereby Third Parties would pay for storage of their carbon emissions, and paves the way for multi-user CCS hubs. This forward-looking aspect of the Regulation could help with the cost effectiveness of CC(U)S technology, while also maximizing the use of existing infrastructure and storage reservoirs. However, further implementing regulations are required to give full effect to such third-party access rights and related business models.

The Regulation does not explicitly address the provision of CCS services to a Third Party that produces carbon emissions in *another country*. Importation of carbon dioxide into Indonesia for storage raises complex legal and political issues and would require further regulation, both domestically and regionally, including to address issues relating to the 1996 Protocol to the Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter, 1972.¹⁰

IMPLEMENTATION OF CC(U)S

To implement CC(U)S projects, Contractors must first propose a plan to the relevant Indonesian regulator (MEMR, SK Migas, or BPMA, as applicable).¹¹ Such plan must include at least the technical, economic and operational aspects of the proposed CC(U)S project, as well as safety and environmental aspects and details regarding closure of the proposed CC(U)S project.¹²

Once the regulator approves the proposed plan, Contractors should seek to amend the Cooperation Contract to modify the definition and provisions relating to "operating costs" (including, if applicable, to specify whether the costs of CC(U)S activities are cost recoverable)¹³ and to clarify the rights and obligations of the Contractor and the Government of Indonesia ("GOI") in connection with the CC(U)S activities.¹⁴

In carrying out CC(U)S activities, Contractors are required to conduct monitoring every six months to ensure worker safety, installation and equipment safety, environmental safety and public safety, and must report the results of such monitoring to the Directorate General of Oil and Gas ("DGOG").¹⁵ The Regulation also requires Contractors to carry out certain Measurement, Reporting and Verification ("MRV") activities at least once a year, including taking inventory of the amount of stored carbon emissions, and to submit MRV results to MEMR by March each year.¹⁶ In addition, MEMR may appoint an independent agency to inspect CC(U)S operations to verify the completeness and correctness of such MRV results.¹⁷

CLOSURE OF CC(U)S

CC(U)S activities must be closed when: (i) storage capacity of the injection location is reached; (ii) no more carbon emissions are being injected, (iii) the Cooperation Contract expires; (iv) unsafe conditions occur; or (v) a force majeure events arise which result in cessation of CC(U)S activities.¹⁸ In such cases, the Contractor is responsible for carrying out the closure of the CC(U)S activities, including the related costs.¹⁹ Similar to the process for the decommissioning of upstream oil and gas assets in Indonesia, a Contractor must submit a plan for the closure of CC(U)S activities to MEMR and such plan must be approved by MEMR before such Contractor can undertake any CC(U)S closure activities.²⁰

DGOG will verify the completion of the closure by a Contractor and may appoint an independent surveyor to determine whether the closure meets applicable standards.²¹ Prior to the expiry of the Cooperation Contract, a Contractor may also return the *part* of a Work Area in which CC(U)S activities have been carried out provided: (i) DGOG has verified completion of the closure of CC(U)S activities, and (ii) monitoring results indicate no carbon dioxide leakage, groundwater contamination or other risks caused by carbon emission injection.²²



Contractor must continue to conduct monitoring activities under the Regulation for a period of 10 years after closure of CC(U)S activities, including monitoring the injection location for carbon dioxide leakage and carrying out repairs if instructed to do so by DGOG.²³ (The 10-year post-closure continuation of liability for leakage is similar to what we have seen in other jurisdictions which have developed CC(U)S regulations (e.g., Australia).)²⁴ Contractors are also required to reserve an amount for the costs of such ongoing monitoring activities and to include such amount in an annual work plan and budget which is subject to approval by SKK Migas or BPMA (as applicable).²⁵ The budgeted reserve amount must be deposited in a joint account under the name of the Contractor and SKK Migas or BPMA (as applicable).²⁶

We note that, while it is clear under the Regulation that CC(U)S costs are considered as operational costs and therefore cost recoverable (depending on the form of Cooperation Contracts),²⁷ Government Regulation No. 79 of 2010 on Cost Recovery and Provisions on Income Tax in Upstream Oil and Gas Activities (“**GR 79/2010**”), as amended by Government Regulation No. 27 of 2017 regarding Amendment to GR 79/2010, still stipulates that save for Abandonment and Site Restoration reserve funds, other types of reserve funds are not cost recoverable.

ECONOMICS OF CC(U)S

Under the Regulation, Contractors are entitled to treat the costs of their CC(U)S activities as “operational costs” in accordance with their Cooperation Contract,²⁸ provided the relevant carbon emissions originate from upstream oil and gas activities in the respective Work Area.²⁹ If carbon emissions are sourced from other industries and used for CCUS purposes, the costs of such CCUS activities may also be treated as “operational costs” under the applicable Cooperation Contract, but only in respect of those CCUS activities occurring downstream of the point where the Contractor receives the carbon emissions from such other industries.³⁰ The extent to which Contractors may then treat such “operational costs” as recoverable under the applicable Cooperation Contract will depend on whether the Cooperation Contract is a traditional cost recovery contract or a gross split contract.³¹ For gross split contracts, it is the intention of the GOI that CC(U)S be used as component for the relevant split adjustment, however such concept has not been set out in the Regulation.

If the carbon emissions being injected are sourced from upstream oil and gas activities, the Regulation allows Contractors to monetize CC(U)S activities through either (i) carbon trading or (ii) “reimbursement of operational costs for the utilization of joint facilities”.³² (In recent years, the Indonesian government has laid the groundwork for the monetization of carbon emissions through international carbon trading with the introduction of *Presidential Regulation No. 98 of 2021 on Implementation of Carbon Pricing for the Purpose of Achieving Indonesia’s Nationally Determined Contribution and the Control of GHG Emissions in National Development* and *Ministry of Environment and Forestry Regulation No. 21 of 2022 on the Guidelines for the Implementation of Carbon Pricing*.)³³ The concept of “reimbursement of operational costs for the utilization of joint facilities” applies where carbon emissions are sourced from one Contractor’s Working Area and the facilities for the implementation of the CC(U)S are located in another Contractor’s Working Area, in which case, such CC(U)S facilities will be considered as “joint facilities”.

As for carbon emissions derived from sources other than upstream oil and gas business activities, the Regulation provides that Contractors may monetize CC(U)S activities in the form of revenue from injection and storage services.³⁴ However, we have some concerns regarding the feasibility of the monetization of injection and storage services. In principle, a Contractor is not allowed to generate revenue from the facilities constructed to support its operations. This is reflected in Government Regulation No. 35 of 2004 on Upstream Oil and Gas Business Activities, which stipulates that facilities constructed by a Contractor to carry out field processing, transportation, storage and sale of its own production are not intended to generate a profit.³⁵ The reason is because such facilities are owned by the GOI. The Regulation also stipulates that goods and equipment which are directly used for CC(U)S are owned by the State.³⁶ Without further



clarification, monetization of injection and storage services may be considered as “harmful to the State’s finance or economy”, with potentially serious repercussions.

Contractors should also take note that CC(U)S activities benefit from tax incentives applicable to upstream oil and gas business activities,³⁷ such as exemptions from import duty, or land and building tax deductions.³⁸

CONCLUSION

The Regulation provides a solid framework for implementing and monitoring CC(U)S. With 16 proposed CC(U)S projects at various stages of development in Indonesia which are targeted to operate by 2023, the Regulation may likely help these projects move towards a final investment decision.³⁹

However, there are areas of the CC(U)S value chain which require further clarity, for example:

- the extent to which carbon emissions generated by industries other than the upstream oil and gas industry fall within the scope of the Regulation;
- the guidelines for SKK Migas or BPMA consideration and approval of proposals by Contractors to inject and store carbon emissions generated by Third Parties;
- whether carbon dioxide may be imported into Indonesia from other countries;
- whether contributions to the reserve fund for the 10-year period of post-closure monitoring activities constitute operational costs which may be cost recoverable;
- how monetization from injection and storage services may be feasible in practice given the stipulation that goods and equipment used for CC(U)S purposes are owned by the State; and
- whether and how CC(U)S may be used as a component for the relevant split adjustment under those Cooperation Contracts which are gross split contracts.

We will continue to monitor the development of Indonesia’s CC(U)S laws and regulations and can provide further details and updates upon request.

This Client Alert was prepared in collaboration with Andy Kelana and Beria Wieke at Adnan Kelana Haryanto & Hermanto law firm in Indonesia (www.akhh.com).



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¹ The Regulation, Article 6(2).
² Article 6(2).
³ Article 6(4).
⁴ Articles 8(2) and 8(3).
⁵ Article 1(21).
⁶ Article 8(3).
⁷ Article 1(32).
⁸ Article 18(1).
⁹ Article 20(1). The Regulation defines a “Third Party” as a party that produces carbon emissions “outside of Work Areas”, including other Contractors and other industries”.
¹⁰ 1996 Protocol to the Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter, 1972, Article 6.
¹¹ The Regulation, Article 11(2). If the proposal is included as part of the first field development plan, MEMR’s approval is required. If the proposal is included as part of a subsequent field development plan, or an amendment to an existing field development plan, SKK Migas’ approval or BPMA’s where the relevant Work Area is located onshore or offshore Aceh Province (1 to 12 nautical miles) is required.
¹² Article 11(3).
¹³ Indonesian production sharing contracts which have adopted the gross-split mechanism may not allow for the costs of CCS/CCUS activities to be cost recoverable.
¹⁴ The Regulation is unclear as to whether approval of the CC(U)S plan automatically leads to an amendment to the Cooperation Contract or whether the approval simply affords the Contractor a right to propose an amendment. For certainty, we therefore recommend seeking an amendment to the Cooperation Contract.
¹⁵ The Regulation, Articles 27(1) and 30(1).
¹⁶ Articles 34 and 39(1).
¹⁷ Article 36.
¹⁸ Article 22.
¹⁹ Article 26.
²⁰ Articles 23(1), 23(2), 23(5) and 23(6).
²¹ Article 25.
²² Article 31(2).
²³ Articles 27(3) and 30.
²⁴ Offshore Petroleum and Greenhouse Gas Storage Act 2006 (Cth), part 3.4, divisions 7–8.
²⁵ The Regulation, Article 27(7).
²⁶ Article 27(8).
²⁷ Indonesian production sharing contracts which have adopted the gross-split mechanism may not allow for the costs of CCS/CCUS activities to be cost recoverable.
²⁸ The Regulation, Article 40(3).
²⁹ Article 40(1).
³⁰ Article 40(2).



³¹ MEMR Regulation No. 8 of 2017 on Gross Split Production Contracts was subsequently amended by MEMR Regulation No. 12 of 2020 and MEMR Regulation No. 35 of 2021 on Procedures for the Stipulation and Tender of Oil and Gas Working Area, which gives MEMR the discretion to determine whether any new production sharing contract shall adopt a cost recovery mechanism or a gross split mechanism.

³² The Regulation, Article 42(1).

³³ Minister of Environment and Forestry Regulation No. 21 of 2022 on the Procedures for Carbon Pricing Implementation, Article 18.

³⁴ The Regulation, Article 42(2).

³⁵ Government Regulation No. 35 of 2004 on Upstream Oil and Gas Business Activities, Article 45(1).

³⁶ The Regulation, Article 45(1).

³⁷ Article 43(1)

³⁸ Government Regulation No. 53 of 2017 on Tax Treatment for Upstream Oil and Gas with Gross Split Profit Sharing Contract, Article 25.

³⁹ <https://www.esdm.go.id/id/media-center/arsip-berita/16-proyek-ccs-ccus-ditargetkan-beroperasi-sebelum-2030>.