

Terpercaya study

A model for sourcing palm oil from sustainable jurisdictions in Indonesia

Summary

- Increasing consumer, civil society and regulatory pressures are encouraging consumer goods companies and other supply chain actors to source palm oil that is legally produced and deforestation free.
- The limited scope of sustainability certification systems means that complementary measures for verifying the legality and sustainability of palm oil are needed.
- The Terpercaya approach offers a scalable district-level solution for assessing the sustainability of commodity production according to environmental, social, economic and governance indicators.
- This brief discusses how the Terpercaya system could identify and mitigate deforestation and legality risks, simplify traceability, assist companies in meeting due diligence requirements and facilitate sustainable sourcing.

Introduction

Efforts to reduce deforestation and environmental degradation resulting from agricultural commodity production are placing greater responsibility on consumer goods companies and other supply chain actors to ensure that commodities are legal and deforestation free. Large multinational companies are often the best placed to identify and mitigate deforestation risks in commodity supply chains, but others are not always well equipped to do so. To assess risks, companies need to access information on the production area of the commodities they source (e.g., farm or concession), and the legality and sustainability of production.

In the case of commodities with complex supply chains and many derivative products, such as palm oil, companies often source from many individual producers via intermediary companies and informal supply chain links, making traceability challenging and costly. Sustainable supply chain certification schemes such as the Roundtable on Sustainable Palm Oil (RSPO) and Indonesian Sustainable Palm Oil have been established to assure companies of the sustainability and legality of the commodities. However, the limited coverage of these schemes means that complementary, scalable and cost-effective solutions are needed.

Jurisdictional approaches to commodity production have been proposed as a large-scale solution to create incentives and demonstrate sustainable and inclusive production of all commodities within a single governmental, administrative unit. Subnational jurisdictions, such as districts, municipalities, states or provinces, encompass whole landscapes and their constituent forests and commodity producers. Jurisdictional sustainability therefore offers the opportunity for substantive improvements in environmental protection and social wellbeing at scale.

Subnational jurisdictions¹ are highly heterogeneous and the benefits and challenges of jurisdictional approaches have yet to be fully accounted for in supply chain models. Benefits of jurisdictional sourcing could include reducing the costs of achieving corporate environmental, social and governance commitments; reducing the cost and complexity of due diligence processes; and incentivising jurisdiction- and sector-wide sustainable production.

In this brief, we first discuss how the Terpercaya system could be used to facilitate preferential sourcing from sustainable and deforestation-free districts. Second, we examine how it could help demonstrate that commodities sourced from these districts are both legal and deforestation free, and how assurances might be given in relation to claims of legal and deforestation-free production. Third, we discuss potential complementary measures to simplify operators' due diligence processes and maintain market access for sustainable and deforestation-free producers located in non-performing jurisdictions.



▲
Using a jurisdictional
approach can
help monitor
deforestation and
sustainability risk
levels

Jurisdictional sourcing: A working definition

Despite being a relatively new concept, jurisdictional sourcing has been discussed in several articles.² One description of jurisdictional sourcing from 2016 is as follows:

‘Companies assess accountability for meeting their goals at the jurisdictional scale, perhaps including jurisdictional certification (certifying all production from a jurisdiction as meeting a standard if jurisdictional-scale performance criteria are met), and they preferentially source products based at least in part on the presence and success of place-based jurisdictional approaches.’³

A more recent discussion describes jurisdictional sourcing as:

‘A recently emerging hybrid between a jurisdictional approach to land-use management and producer or sectoral-based supply-chain strategies for providing market-based incentives for deforestation-free commodity production.’⁴

In the latter definition, an emphasis is placed on collective action among producers of one or more commodities, and once all producers meet a defined standard, then jurisdictional sourcing is possible:

‘The key is that producers in a given jurisdiction are bound together with a collective reputation so that if one producer engages in unsanctioned deforestation, then the entire jurisdiction is no longer certified. This in theory provides incentives for the government and/or peer producers to develop policies, create “recovery mechanisms” and enforce agreements to maintain their jurisdiction’s reputation.’⁵

In this brief, these definitions are built on in several ways. First, we use the Indonesian district as the unit for measuring social, environmental, economic and governance performance. How a district improves its performance is not prescribed by the system, enabling innovation and adaptive management at the jurisdictional level. Second, we do not hold that all producers are behaving sustainably and responsibly, nor contributing equally to jurisdictional performance but argue that this should not undermine the reputation of those that are. In relation, a means of excluding or blacklisting companies causing social or environmental harm is proposed.

Consequently, we define jurisdictional sourcing as:

The preferential sourcing of commodities produced in jurisdictions that fulfil a set of sustainability criteria taking into account complementary producer-level information recognised in relevant markets and other relevant information on producers.

Although jurisdictional sourcing relies on measurement of sustainability at the jurisdiction level, transactions are likely to remain on a company-to-company basis. For example, in its framework document for the jurisdictional approach to certification, the RSPO proposes a jurisdiction-level entity (institution) for certification.⁶ In this model, companies share collective responsibility, with support from the local government which provides an enabling environment. However, companies still trade on an individual, i.e., company, cooperative or village enterprise, basis.

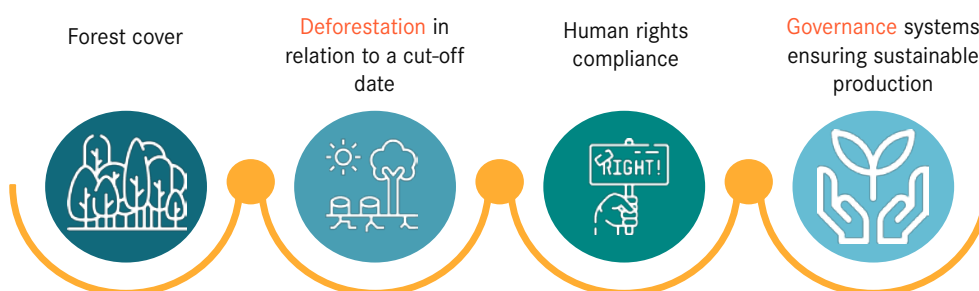
In the next section, we discuss how the proposed jurisdictional sourcing system could help companies fulfil requirements regarding legal and deforestation-free commodity supply.

Terpercaya: Monitoring sustainability performance and identifying risk at the district level

Incentivising district sustainability

The Terpercaya data platform is an instrument for monitoring the performance of Indonesian districts according to environmental, social, economic and governance principles, to support transitions to sustainability. The 23 indicators reflect and interpret elements of sustainability in accordance with the Indonesian legal framework, the UN Sustainable Development Goals and Indonesia's Nationally Determined Contribution under the Paris Agreement. Consequently, sustainable, legal and deforestation-free commodity production can be measured and evaluated at the district level through legitimate, broadly agreed means (Figure 1).

Figure 1. Sustainability measured at the district level



As a national system based on systematically collected district-level data, Terpercaya enables identification of districts progressing towards and attaining sustainability against defined thresholds. The indicators can provide information on the risk of deforestation and/or illegality associated with commodity production, and whether the situation is improving or not. In doing so, the Terpercaya system can incentivise districts to improve performance as a means of attracting investment and drawing in buyers seeking sustainably produced commodities, whether demand is driven by regulatory requirements or corporate commitments.

Simplifying due diligence

Under most models of corporate responsibility, it is companies, whether downstream or direct purchasers of commodities, who are ultimately responsible for ensuring that their supply chains are legal and deforestation free. Some multinational companies have the resources and capacity to conduct due diligence⁷ regarding sustainability and legality of cultivation, harvesting and extraction. Most, however, do not. Widespread implementation of due diligence processes under regulations imposed in global markets can therefore benefit from information from third-party sources including governments, private entities and civil society organisations.

The Terpercaya data platform, as a government-hosted and publicly accessible system, has the potential to inform companies on district deforestation and legality-related risk. Where risks are low, relaxed requirements for producer level-information could allow resources to instead be allocated to enhanced due diligence and remedial support in areas that present the greatest risks. Such an approach could also provide an opportunity for independent smallholders in low deforestation risk districts to maintain access to supply chains for sustainable palm oil where, for example, administrative and/or logistic challenges prevent short-term resolution of smallholder tenure legality issues.



Demonstrating that commodity supply chains are free from deforestation requires access to information to inform due diligence processes

Photo: Freepik.com

Geographical responsibility versus group responsibility

Current efforts to promote sustainable and responsible supply chains consider not only producer companies and the area of production, but also the sustainability practices of the parent companies and affiliates. Producers certified according to RSPO or the Forest Stewardship Council (FSC), among other certification schemes, have been held accountable for the practices of subsidiary or affiliate companies.⁸ More recently, parent company involvement in other sectors, such as mining, has also been used to challenge sustainability claims of agricultural commodity production.⁹ Although promoting broader accountability, this could detract from positive actions taken in specific locations or contributions to sustainable and responsible production at the jurisdiction level and therefore, interactions between geographical and group responsibility need to be further defined.

A system based on jurisdiction-level sustainability can help ensure the inclusion of smallholders.

Photo: Miguel Pinheiro, CIFOR



Identifying performing and non-performing producers within high- and low-risk and other jurisdictions

There is no guarantee that every producer (smallholder, concessionaire) or downstream actor (mill, processor) located within a district meeting specified sustainable or deforestation-free thresholds is producing and will continue to produce commodities sustainably and responsibly. Companies sourcing from these districts, especially downstream companies, will be unlikely to have sufficient information on individual producers to make decisions regarding compliance with environmental and social standards. There is therefore a role for registries of producers and downstream companies that comply and do not comply with environmental and social standards within a district. Such a registry could be supported by district governments and independently monitored to provide transparency and reinforce accountability and credibility.

Conversely, responsible and sustainable producers may find themselves in non-low-risk districts. These producers may not have the resources or power to influence district-wide sustainability, but could be given access to sustainable and deforestation-free supply chains based on certification and/or other information agreed by supply chain actors and in accordance with regulatory requirements. Consequently, they may require other pathways to recognise and incentivise their sustainability. Criteria and evidence required should be agreed by supply chain actors, and supporting regulatory measures could be implemented in producer and/or consumer countries.

Proposals for simplifying due diligence

Based on the considerations above, Terpercaya could facilitate jurisdictional sourcing as outlined in Figure 2. In this model, operators would conduct simplified due diligence in identified low-risk districts. Flexibility in the Terpercaya data platform could allow tailored definitions of low-risk districts and non-performing/blacklisted companies to be incorporated.

Defining low risk at the district level

For the purposes of commodity sourcing, the Terpercaya system could identify low risk and other districts. Over time, the goal would be to encourage all districts to qualify as low risk by establishing market visibility as a driver of positive change. The system could enable companies to specify acceptable levels of social and environmental risk at the national, provincial or district level according to thresholds assigned to individual indicators or groups of indicators. Thresholds could be based on domestic regulatory requirements and international commitments, voluntary or mandatory certification standards, and/or buyer's individual requirements.

Risk levels could also be defined according to regulations in global consumer markets that govern due diligence requirements for operators placing products on the relevant market. Different risk levels could be associated with different levels of required due diligence. Such a set-up could incentivise districts to improve performance and reduce risk in relation to key indicators, e.g., concerning commodity related deforestation. Possible formulations for differentiated obligations are discussed below.

Figure 2. Proposed role for Terpercaya in facilitating jurisdictional sourcing

Jurisdictional Sourcing

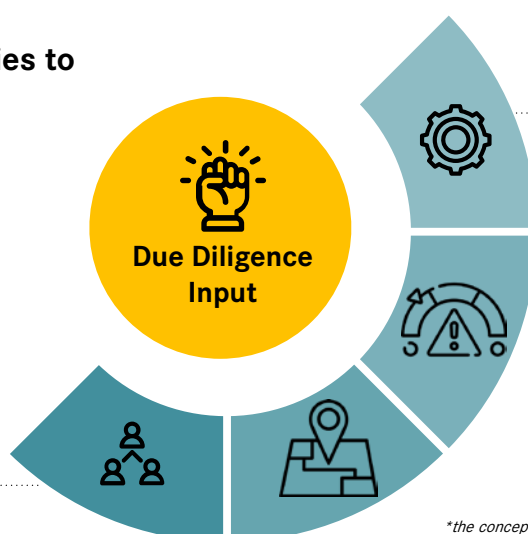
Proposed district registries to support due diligence

Low-risk District

No burden of proof: Companies should ensure that suppliers are not in a district blacklist.

Coverage of district registry & traceability: concessions and individual farmers above a certain size

District disclosure level: partial disclosure, only the list of non-performing actors is disclosed.



Other Districts

Burden of proof: Companies should ensure that suppliers are in the district whitelist

Coverage of district registry & traceability: All actors including smallholders

District disclosure level: Full disclosure

**the concept of 'blacklist', 'whitelist', 'district registry', and list of non-performing actors' would be defined in relation to requirements set under different regulatory frameworks or market standards*

Due diligence information sources: district whitelists and blacklists

Companies would need to provide certain evidence to prove their suppliers are producing commodities sustainably. The level of proof required would vary by location. Here we propose that in a low-risk district, a company purchasing from the district would only need to demonstrate that suppliers are not on a blacklist of companies. In contrast, for other districts, companies would need to demonstrate that their suppliers are on a district whitelist, which may require more action to ensure that suppliers provide the necessary information or make changes to enter into whitelists. The blacklist and whitelist concepts are summarised as follows:

- **District blacklist:** A list drawn up by the local government identifying companies that are not performing at the expected standard with respect to legality or sustainability. These could include companies that continue to clear forest areas within their concessions, companies that have concessions overlapping with forest areas or companies currently subject to criminal or civil proceedings. These blacklists would be required in districts defined as low risk.
- **District whitelist:** A list drawn up by the local government identifying companies that are legally compliant and performing according to relevant sustainability standards. The district would be required to create a whitelist when the entire district is not classified as low risk.

These concepts would allow tracking efforts to be tailored according to district profile, with a view to simplifying due diligence: risky operators would be tracked in low-risk districts and responsible operators would be tracked in other districts.

District registry

Ideally, a district should register all producers operating within their territory, including large, medium and small-scale producers, mills and crushers. In practice, there is limited data, both spatial and otherwise, on these producers, especially small-scale producers such as independent smallholders. Depending on their assigned risk level, districts would be subject to different requirements. Low-risk districts would only be required to maintain a registry of medium and large-scale companies. Other districts, however, would need a comprehensive database including smallholders.

Disclosure level

Although all districts would be required to maintain registries and data on producers and their performance status to varying degrees, the proposed level of public disclosure would differ according to risk status. Low-risk districts would only be required to publish the list of non-performing companies (blacklist). Other districts would be required to provide full disclosure on the companies operating in the district and their performance (including the whitelist).

Conclusions

The Terpercaya system provides potential support for companies to make better informed sourcing decisions in the context of increasing pressure to ensure that commodities are legal and deforestation free. Identifying low-risk districts and requiring higher levels of due diligence in other districts would guide buyers in making sourcing decisions. As well as informing operators in conducting due diligence, it could also guide them in providing support for suppliers and districts from which they source commodities.

Supplier companies with plantations in districts not considered low risk, however, would need clear guidance on how to prove their sustainability. Such evidence could build on existing systems such as ISPO and RSPO, rather than creating new requirements. Finally, such risk assessments should be seen through the lens of continuous improvement, where committed districts have the opportunity and are given the support they need to improve their sustainability performance and in return see positive benefits.



The Terpercaya system is one tool to inform on the deforestation risks of commodity production

Endnotes

¹ Busch, J. & Amarjargal, O. Authority of Second-Tier Governments to Reduce Deforestation in 30 Tropical Countries. *Front. For. Glob. Change* 3, (2020)

² Seymour, F. J., Aurora, L. & Arif, J. The Jurisdictional Approach in Indonesia: Incentives, Actions, and Facilitating Connections. *Front. For. Glob. Change* 3, (2020); also Essen, M. von & Lambin, E. F. Jurisdictional approaches to sustainable resource use. *Front. Ecol. Environ.* n/a, (2021).

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⁴ Boshoven, J. et al. Jurisdictional sourcing: Leveraging commodity supply chains to reduce tropical deforestation at scale. A generic theory of change for a conservation strategy, v 1.0. *Conserv. Sci. Pract.* 3, e383 (2021).

⁵ Ibid.

⁶ RSPO. RSPO Jurisdictional Approach Piloting Framework. <https://www.rspo.org/resources/archive/1581> (2021).

⁷ The three basic components of due diligence are: information, risk assessment and risk mitigation.

⁸ See for instance ‘FSC dumps palm oil giant Korindo amid rights, environmental issues in Papua’ <https://news.mongabay.com/2021/07/fsc-dumps-palm-oil-giant-korindo-amid-rights-environmental-issues-in-papua/>, and “New deforestation revealed as Indonesian minister arrives in EU to defend palm oil industry” <https://www.greenpeace.org/international/press-release/16194/new-deforestation-revealed-as-indonesian-minister-arrives-in-eu-to-defend-palm-oil-industry/>

⁹ See for instance “The Chain: Astra International’s mine expansion threatens forest and Astra Agro Lestari’s NDPE supply chain access” <https://chainreactionresearch.com/the-chain-astra-internationals-mine-expansion-threatens-forest-and-astra-agro-lestari-ndpe-supply-chain-access/>, and “Several large Indonesian palm oil companies also have risky mining businesses” <https://chainreactionresearch.com/report/indonesian-palm-oil-mining-deforestation/>

Cover image: Map of Indonesia.

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