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SUMMARY REPORT

OF THE THIRD SESSION

(4 – 6 September 2024)

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1. The third session of the Working Group on the Legal Nature of Verified Carbon Credits (the "Working Group" or "Group") was held in hybrid format from 4 to 6 September 2024 at the seat of UNIDROIT in Rome. The Working Group was attended by a total of 58 participants, including 12 members and 27 observers, with representatives from intergovernmental organisations, industry associations, and non-governmental organisations (the list of participants is available in Annexe II).

Item 1: Opening of the session and welcome

2. *The Secretary-General* opened the session and welcomed all participants to the third meeting of the Working Group, acknowledging the diverse participation from in-person and remote attendees across various time zones. He highlighted the significant progress made on the principles and their commentary, emphasising the importance of the commentary for those unfamiliar with UNIDROIT instruments. He noted that the drafting process was still in its early stages and that the commentary was crucial.

Item 2: Adoption of the agenda and organisation of the session

3. *The Chair* introduced the Annotated Draft Agenda and the organisation of the session.

4. *The Working Group adopted the Agenda (*Study LXXXVI – W.G.3 – Doc.1*, available in Annexe I) and agreed with the organisation of the session as proposed.*

Item 3: Consideration of matters identified in the Revised Issues Paper (Study LXXXVI – W.G.3 – Doc. 2) **and discussion of the UNIDROIT Draft Principles** (Study LXXXVI – W.G.3 – Doc. 3)

(a) Preliminary matters

5. *The Chair* introduced the documents provided and encouraged participants to refer to Document 3. He indicated that Principles 10 and 11 on custody and security would not be covered in this session due to time constraints. He expressed his concern over the allocation of time for the introduction and definitions in Principle 2, which were vital components of the discussion. He suggested focusing first on the introduction, consisting of two sections: (A) Development of Carbon Markets and (B) Typical Lifecycle of a Verified Carbon Credit (VCC).

(b) Content of the future instrument

i. Introduction

6. *The Chair* brought the Group's attention to the UNIDROIT Draft Principles, addressing the Introduction, and opened the floor for discussion.

7. *A Working Group participant* raised concerns about the introduction section of draft Principles, noting that it was overly complex and detailed compared to the rest of the document. He suggested either minimising it or correcting it section by section. His feedback focused on accuracy, particularly in references to international agreements such as the Kyoto Protocol and Paris Agreement, where he advocated for using the exact language from the documents themselves to avoid introducing new definitions. Following his detailed feedback, *the Secretary-General* reminded the Working Group to restrict their comments to the technical and to avoid political and social considerations, as these considerations would be polished and sanitised by the Secretariat before the finalised version. He also encouraged the Working Group to submit comments in writing if they pertained more to language than substantive legal matters.

8. The Drafting Committee suggested to improve the clarity of the introduction by adding a brief explanation to set the scene and describe its purpose to help address concerns about summarizing complex legal concepts and resolve some of the technical issues related to the language used since the introduction serves as an illustrative summary of how carbon markets have evolved.

9. The Working Group discussed the inconsistencies between the introduction and the principles in how terms such as avoidance, reduction, and removal were used throughout the document. It was suggested that "avoidance" should either be mentioned consistently across all relevant paragraphs or not at all, to align with the principles. This issue of consistency was particularly significant in paragraphs 16 and 23, where different combinations of these terms were used, causing potential confusion. *One of the Drafting Committee members* suggested that the term "avoidance" should likely be removed, as it was currently under discussion by the Article 6 Committee and could cause confusion. She suggested sticking to reduction and removal, which were more clearly defined terms. *One participant* proposed adding a footnote explaining avoidance, but this was also seen as potentially unnecessary due to its complexity.

10. The discussions then moved to the phrasing around settlement processes, particularly in paragraph 29, pointing out that settlement completion was often a contractual matter involving risk allocation, much like how money transfers were treated between bank accounts. The Working Group recognised the complexity of these contractual matters and considered more neutral language to reflect the varying interpretations of risk in contract law. *One Drafting Committee member* acknowledged the need for the introduction to align more closely with the principles, particularly regarding settlement and private law frameworks. While the introduction explained what happened in practice, the principles were still focused on basic elements like transfer of property and good faith purchases, with settlement yet to be addressed adequately. A question was raised about the settlement of transactions involving the physical delivery of VCCs. According to paragraph 29, the settlement was considered relevant when the seller instructed the registry to transfer the VCCs from its account to the buyer's account. *One participant* expressed concern about whether settlement should occur only after the registry had executed the instruction, questioning if it was intentional for the document to suggest that settlement happened upon the instruction itself, rather than after the transfer was completed.

11. Further on in paragraph 29, a suggestion was made to remove the term "physical" or "physically" when referring to VCCs to avoid unnecessary metaphors that could mislead or confuse the understanding of VCCs' intangible nature. In response, the Drafting Committee highlighted the distinction between terms like "physically settled" and "financially settled" futures, common in market language. It was emphasised that in this context, "physically settled" referred to delivering the underlying asset rather than settling in cash, reflecting the typical market practice. She suggested that the sentence could be removed, but noted it had been included to illustrate how the market operated. In response, it was suggested to retain the term "physically settled futures delivery" but recommended further elaboration to clarify its meaning. However, it was proposed to remove the next two instances of the word "physical", as these did not appear to be technical terms and only added confusion.

12. *One Working Group participant* recommended to revise the language in paragraph 25, specifically in relation to the use of "or" when discussing the equivalence of VCCs to tonnes of CO_2. It was proposed that instead of "or," the phrase "representing VCCs" would be clearer, as it more accurately reflected the relationship between the removal and the credits.

13. The Working Group noted that suspension was mentioned in the introduction but not addressed with a clear principle. It was discussed whether the document needed to define suspension as a separate concept or create a principle around it, particularly since revocation and reversal already had associated principles. The increasing importance of suspension in managing legal risks was emphasised, and it was recommended to delete the line that mentioned suspension as

uncommon, as this issue was expected to grow. It was also suggested to include miscalculation and oversight as additional reasons for suspension alongside fraud or illegality. The need for definitions around these issues was suggested to provide clarity and avoid ambiguity regarding suspensions and their causes. The Working Group emphasised the need to distinguish between fraud and the impact of a suspension. Attention was drawn to the risks project proponents bore when over-issuance issues arose, and it was questioned why project proponents should shoulder all the risks, particularly when fraud was suspected. *One participant* cautioned about using terms like "illegality", which could be problematic depending on the applicable law.

14. However, the Working Group participants generally recognised the challenge of integrating suspension into a property law framework. The Drafting Committee noted that issues surrounding the ownership of credits were contractual and non-proprietary in nature. It was asserted that the principles being discussed would not address these contractual concerns, as they fell outside the scope of the current framework. It was also suggested that suspension was like freezing a bank account where property rights remained intact, but access was restricted. *One participant* questioned whether suspensions applied to the account or the credits themselves. In response, the Drafting Committee suggested to include the suspension of accounts in the registry section rather than referring to the suspension of units.

15. The Drafting Committee expressed confusion regarding the scope of suspension in registry systems, questioning whether suspension applied to an entire account (including all projects within it) or only the affected VCCs. In response, it was emphasised that suspension of an account and suspension of a VCC itself needed to be clearly distinguished. Also, it was suggested to focus on account suspensions, as freezing an account was more common, and trying to suspend VCCs after issuance could lead to confusion. Therefore, it was recommended to exclude the concept of suspending VCCs from the document altogether, unless absolutely necessary. *The Secretary-General* raised a procedural question, asking if there should be a duty for registries to notify exchanges or markets about suspensions so that trading would be simultaneously suspended there as well. *The representative from Verra* clarified that Verra's approach distinguished between temporary and permanent suspensions, primarily affecting accounts rather than projects. *Some of the Working Group participants* questioned whether permanent suspension was essentially revocation; there was no clear consensus. It was highlighted that different crediting programs might use different terms for suspension, and it was made clear there was a need for clarity on what suspension actually referred to, whether it was freezing an account or halting activities related to VCCs. Also, it was suggested that the principles should reflect all market practices and allow for varying approaches to suspension. *One participant* vouched for distinguishing among suspension, revocation, and reversal, suggesting that suspension could serve as an interim measure in cases where there was prima facie evidence of issues with certain credits but where revocation had not yet been determined.

16. *One member of the Drafting Committee* emphasised the need to focus on building the framework for rules, rather than setting policy, identifying three fundamental questions to address regarding suspension: "why," "who," and "how", focusing on causes, authority, and process or method, noting that reasons for and methods of suspension varied and that registries generally held the authority. This suggested that suspension was an issue between the account holder and the registry, with methods differing based on registry practices. *The representative from Verra* clarified that, in Verra's context, the suspension was typically temporary, affecting the account holder's ability to manage its credits and not the individual VCCs that had already been transferred, and that the grounds for suspension included fraud, illegality, and failure to comply with programme rules.

17. The Working Group generally agreed that suspension should be clarified or supplemented with an additional principle. Furthermore, the need to better define these terms and how they affected property rights was acknowledged by the Working Group, with some suggesting alternatives like "cancellation" as a more appropriate term. *The representative from the HCCH* mentioned the

HCCH 2006 Securities Convention[1] as a potential resource for guidance on instruments that fell outside of purely contractual rights and obligations, which could help clarify the distinction between account suspensions and credit suspensions. *The Chair* suggested the need for further discussion on how suspension affected the validity of existing VCCs and the proprietary rights associated with them, particularly in cases where fraud was suspected or when credits were under review for potential cancellation.

18. The Working Group next discussed the distinction between the "issuance" and "registration" of VCCs. The recommendation was to clearly differentiate these processes, as they represented distinct legal functions, even if they occurred simultaneously. Moreover, the terminology and process of "issuance" and "recording" of VCCs were discussed. *Some Working Group participants* then argued that they should be seen as the same action, with no legal distinction between the two, while *other participants* sought clarification on this point. Finally, the Working Group agreed that further refinement of these terms was needed for the sake of precision in the document.

19. Further clarification was also sought regarding the role of the Validation and Verification Body (VVB), ensuring that its function as the verifier of VCCs in the registry was well-defined. *Many of the Working Group participants* highlighted the independent role of the VVBs, which was approved by the crediting programme but operated as an independent auditor, as well as the importance of clarifying the relationship between VVBs and accreditation standards in the document, noting that VVBs could operate independently of crediting programmes.

20. The Working Group next discussed the term "claim" and its varying implications in market practice and different legal cultures. In civil law systems, it denoted a right against a person, while in common law systems, it implied the process of enforcing that right. There was a strong recommendation to either define "claim" or use alternative language to avoid confusion as to whether it was being used in a legal or colloquial sense in the document. The Working Group largely agreed that the term "claim" posed difficulties in translation and legal consistency and that it needed to be handled carefully to avoid confusion with other types of claims, such as green claims. Stressing the importance of precise language, the Working Group agreed to find alternative terms to avoid ambiguity.

21. Additionally, the concept of transfer was flagged for further refinement, particularly distinguishing between the transfer of rights (proprietary rights) and transfers within accounts. *One Working Group participant* raised concerns about ambiguity in the document regarding the transfer of VCCs. It was questioned whether ownership transfer was strictly tied to registration or if a consensus rule applied.

22. Moreover, participants raised the need to incorporate social and environmental safeguards, especially when discussing nature-based carbon credit projects, and it was recommended to include references to sustainable development and ensuring that all projects align with these principles. These safeguards were crucial towards ensuring that carbon projects do not negatively impact biodiversity or local populations, and they should be mentioned in relation to additionality and other project requirements. *One participant* proposed adding the phrase "sustainable development in accordance with Article 6, paragraph 2", which would serve as an opportunity to introduce the concept of safeguards. She also suggested expanding on this concept in Section B, which seemed to be the appropriate place to introduce social and environmental safeguards, as these were currently not mentioned in the study. *The representative from Verra* agreed with the proposal of including references to sustainable development and safeguards, noting that Verra had already incorporated these under certain programmes and continued to develop them further. However, it was noted that not all programme standards were uniform in this regard. While Verra's biodiversity and sustainable development standards included safeguards and sustainable development, this might not be the case

[1] https://www.hcch.net/en/instruments/conventions/specialised-sections/securities

for every programme, as standards varied depending on the specific programme and its applicable requirements.

23. The Working Group also suggested the concept of "additionality" for further discussion, to determine its appropriate placement within the document. *One member of the Drafting Committee* suggested that paragraph 20 should include a discussion about additionality. It was noted that paragraph 24 referred to environmental and financial additionality. *Some participants* stressed that, in addition to these, compliance with social and environmental safeguards, particularly for nature-based programmes, should be demonstrated in the document. *Other participants* advised caution regarding the concept of additionality, urging not to delve too deeply into it. It was emphasised that additionality was complex, encompassing various forms, such as financial and technical additionality. The reference to additionality in paragraph 20 only touched upon one aspect, and including it in the document might create confusion without adding significant value.

24. It was also suggested that including a reference to ITMOs (Internationally Transferred Mitigation Outcomes) under Article 6.2 in paragraph 16 would be helpful to ensure completeness.

25. There were several other recommendations to better reflect industry practices. Regarding paragraph 12, it was suggested to consider that some VCCs might be linked to carbon pricing mechanisms, such as in Singapore, where VCCs could offset part of the carbon tax. Regarding paragraph 16, the phrase "followed by the issuance of a VCC and the recording of it in a registry" was deemed more appropriate than "followed by the issuance of a VCC into the registry". This proposal was made to distinguish between the issuance of VCCs and their recording in a registry, as these were legally distinct functions. Additionally, it was recommended to change the term "rights associated with the project" to "the nature of rights associated with the project", as simply referring to "rights" could imply that no credit existed.

26. A recommendation was made by *one Working Group participant* to introduce clearer language in paragraph 19 for concepts like project proponents and their role in the carbon markets. The Working Group then discussed the interchangeable use of "project proponent" and "project developer". It was noted that while these roles were often the same at present, the market might evolve, making it essential to distinguish between the two. It was also pointed out that in some jurisdictions these roles could be separated. *One participant* supported using "proponent", as it was more aligned with crediting programmes and differed from "developer", which was related to the trade aspect. The Working Group generally agreed on the importance of reflecting this distinction in the document.

27. *One Working Group participant* suggested that the introduction could benefit from a section explaining the purpose and rationale behind the principles, similar to the beginning of the UNIDROIT Principles on Digital Assets and Private Law (DAPL),[2] which would help readers understand the context and importance of the principles being set out.

Conclusions

28. *The Working Group consistently agreed that there needed to be alignment between the principles and the introduction.*

29. *The Working Group agreed that further refinement of "issuance", "registration", "recording" and the distinction of "project proponent" and "project developer" were needed for the sake of precision in the document. It was also agreed to consider the role of suspension and whether it*

[2] https://www.unidroit.org/wp-content/uploads/2024/01/Principles-on-Digital-Assets-and-Private-Law-linked.pdf

affected the validity of existing VCCs, avoidance and additionality, as well as the technical points in the transfer process, including the instructions from account holders to the registry and settlements.

30. *The Working Group largely agreed to find an alternative for the term "claim", which posed difficulties in legal consistency. The Secretary-General and the Chair suggested to use the term "right".*

ii. Principle 2 - Definitions – (1)-(10)

31. The discussion moved on to Principle 2, addressing definitions. The Drafting Committee began by explaining that it had spent the most time on Principle 2, as the definitions were critical to understanding the entire framework of the principles. It was noted that some other principles, such as Principle 1, had been adapted from previous work, such as the DAPL. However, Principle 2 required more detailed revisions to suit the context of VCCs.

32. It was also emphasised that the definitions had been designed to work together with the commentary. Without the commentary, understanding the principles in isolation could be challenging. The drafting style followed UNIDROIT conventions, ensuring consistency with their established methods.

33. The reasons for defining terms carefully were outlined: first, to clarify the meanings of specific words used in the principles, and second, to define the scope of the principles themselves. Since Principle 1 provided a broad definition of scope, the definitions under Principle 2 helped narrow what was covered.

34. The definition of a VCC was crafted to support Principle 3.1, which stated that a VCC could be the subject of proprietary rights – enforceable against third parties. The definition had to align with this, ensuring that a VCC was something individuated and capable of being owned in a proprietary sense. The use of the term "unit" to define a VCC was chosen because it reflected a single identifiable thing, resonating with both civil and common law. The term "intangible asset" was included to help clarify the concept for civil law practitioners. A member of the Drafting Committee questioned whether the word "individuated" needed to be included in the definition, explaining that individuation was implicit in the word "unit" but expressed concern that some jurisdictions might interpret the term "individuated" as incompatible with the concept of fungibility, potentially causing confusion.

35. Next, she explained why the definition stated that a VCC "represented" a reduction or removal of one tonne of CO_2 equivalent. It was stressed that owning a VCC did not mean owning a tonne of carbon, as the carbon was no longer present – it had been reduced or removed from the atmosphere. She raised a question about whether the term "CO_2 equivalent" needed to be defined more clearly in the principles.

36. The importance of the issuance and registration of a VCC was elaborated upon. While these two concepts were distinct, they often happened simultaneously in practice. Ensuring they remained conceptually distinct was important for the future, especially in cases where the issuer and the registry might not be the same entity.

37. Regarding verifiers, it was questioned whether verifiers needed to be accredited and whether that accreditation should be a criterion for the VCC to be valid under the principles. Also, the need for verifiers to be independent from the carbon mitigation project to ensure unbiased verification was highlighted. She invited feedback from the Group on these issues, particularly regarding the accreditation of verifiers and the wording of certain terms.

38. The Working Group discussing the term "claim". *One of the Working Group participants* repeated the importance of defining the term "claim" in the context of VCCs, pointing out that Verra defined a VCC as "representing a claim to a verified reduction or removal",, and stressed that the claim, not the reduction itself, was what was transacted, since VCCs recorded the claim to the emission reduction, and this claim was transferred to the ultimate buyer, giving him exclusive rights. It was argued that defining it as a claim was crucial for mapping, tracking, and ensuring compliance, particularly under frameworks like the Paris Agreement. *The representative from Verra* supported this view by noting that Verra defined VCCs as representing a claim, but she acknowledged the complexity of integrating the term into legal frameworks. She suggested that while the term "claim" might not fit easily into legal definitions, it reflected a certain right in the industry, particularly concerning onward transactions and especially concerning exclusivity and preventing double counting.

39. However, this approach was not welcomed by the members of the Drafting Committee. *One member* opposed to the use of the term "claim", arguing that, in a legal sense, a claim implied a right against someone, which was not applicable in this context. It was highlighted that the term "claim" did not fit within the traditional private law framework, which saw claims as a right against a party. It was explained that this colloquial use of "claim" implied ownership or appropriation, which was not applicable to VCCs, emphasising that a VCC represented a verified reduction, which could be owned, and the term "claim" did not fit well within private law. *Another member of the Drafting Committee* explained that a claim in legal terms implied an obligation from another party, which was absent in VCCs. Verra used a deed poll system to transfer certain rights, but it was emphasised that ownership of facts, like emission reductions, could not be claimed. *Another member of the Drafting Committee* strongly opposed using "claim" in either the principles or lifecycle of a VCC due to its specific legal meaning in different jurisdictions. The risks of introducing colloquial language into legal frameworks was highlighted. She suggested using "represents", which was a more neutral and accurate term with the potential to avoid legal complications, and refining the commentary to explain what "represents" entailed. She pointed out that using "claim" could result in circular definitions. The challenge posed by the term "claim," especially given its multiple meanings in legal and everyday contexts, was acknowledged by *other participants of the Working Group*.

40. *One participant* emphasised that what was being transacted was not just any claim but a well-defined claim. From the project's inception, the claim tied to a specific mitigation outcome was predefined and immutable, with the end-user holding a singular, defined claim after the transaction. So, this "defined claim" was what the market dealt with – not just a representation of emission reduction, but the right to publicly assert ownership of the mitigation outcome. *One of the members of the Drafting Committee* noted two key aspects on the idea of "defined claim". First, she supported the concept of something clearly defined, which had already been incorporated into the VCC definition through the use of unique identifiers. Second, she pointed out that VCCs could be used in multiple ways (e.g., selling, holding, retiring), and tying the definition to one specific use would limit the flexibility of the VCC concept. She also highlighted the difference between market usage and private law concepts, reiterating that using the word "claim" in a legal context could be problematic. She preferred the term "represents" and suggested that the Group could resolve these tensions through commentary rather than immediate changes to the definitions.

41. The Working Group then discussed the necessity of using "unit" in the definition of "VCC", citing potential confusion due to the term's specific legal meaning in various jurisdictions, particularly regarding emission production units in relation to Article 6, and suggesting its elision might be beneficial. *One Working Group participant* suggested that removing "unit" would avoid ambiguity but recalled the need to specify VCCs as intangible assets early in discussions. *One member of the Drafting Committee* acknowledged industry input suggesting that "unit" was widely recognised, but noted that it must be clearly defined to avoid misinterpretation related to the Kyoto Protocol or financial titles, emphasising the intent to classify VCCs as intangible assets for legal clarity. *Another*

Working Group participant raised concerns regarding the potential implication of fungibility inherent in the term "unit" and underscored its relevance to VCCs.

42. It was questioned whether all individual units were assigned a unique serial number and proposed that their identification for trading purposes is crucial and should be verified with registries. *The representative from Verra* clarified that typically a unique serial number as assigned to blocks of credits, which could change based on transactions, allowing for individual units to also receive new serial numbers if sold separately. The Working Group generally agreed on the importance of assigning serial numbers to VCCs to ensure exclusivity in ownership and to maintain market integrity. Some participants pointed out that selling VCCs simultaneously to multiple parties could lead to systemic issues rather than individual harm. *One Working Group participant* proposed the definition of a VCC as an individual, individuated, intangible asset, while noting that issuance typically occurred in blocks.

43. *One member of the Drafting Committee* reflected on the importance of defining VCCs to have proprietary rights while addressing concerns about registry reliability and potential regulatory improvements, and she suggested that the commentary could clarify the use of singular terms in drafting, ensuring it encompassed bulk issuance.

44. *The Secretary-General* raised a concern about the creation of security interests over assets that might not be well supported by registries. *One member of the Drafting Committee* acknowledged this was a significant point but explained that a full answer might depend on jurisdiction-specific laws, suggesting that more thought was needed on this matter.

45. The importance of discussing registries was stressed, with the Working Group noting that registries were subject to various risks, such as insolvency and errors, and it was proposed to revisit this in greater depth when Principle 9 was discussed. The Drafting Committee agreed that the robustness of registries was a crucial aspect, suggesting the need to consider disaster recovery protocols to ensure the system remain reliable.

46. The discussions then moved towards the accreditation and independence of verifiers. The Drafting Committee asked whether these should be essential components of the verifier's definition. *One participant* favoured a simpler approach, suggesting that the verifier's role could be limited to issuing a verification report, without needing to meet stringent accreditation standards. *Others* argued for retaining the requirement of accreditation to ensure integrity and to guide the market toward good practices, also highlighting the need for verifiers to work within their expertise, and emphasising that improper verification could lead to market integrity issues. *The Secretary-General* commented on the potential limitations created by requiring accreditation from a recognised international standard, which might overly narrow the project's scope and lead to ambiguity about what constituted a "recognised" standard, suggesting that these requirements might be better handled in the commentary rather than as strict definitional criteria.

47. *One participant* raised the question of whether the term "asset" should be replaced with "property", noting that property might be a better fit in private law contexts and also stressing that the verification report should reflect both positive and negative outcomes, finally suggesting that the definition of "verified" needed to account for cases where the verification process revealed that no significant outcome had been achieved. In response, *one member of the Drafting Committee* explained that negative verification reports would not lead to the issuance of credits, and thus the system did account for non-positive outcomes.

48. The Drafting Committee then raised a drafting issue regarding how to define "verified", as it might need to include the idea that the verification report must be accepted to trigger the issuance of credits. The Working Group expressed concerns about conflicts of interest in the relationship between verifiers, project proponents, and the registry. Issues in defining "independence" and the

risks of market manipulation were highlighted, with the Working Group noting that in regulated markets, verifiers were chosen from a pre-approved list, which complicated the notion of independence. The Working Group generally agreed on the need for a clearer definition of a verifier. Suggestions included linking the verifier to accreditation by the issuer and ensuring that the verifier be independent from the project proponent. However, concerns persisted about the limitations this introduced to more independent projects that might not follow established standards.

49. The Working Group emphasised the need for clearer definitions regarding the verification process, suggesting that the term "means a statement that states" should be revised to "means a statement that confirms" and raised the possibility of fractional VCCs, comparing them to fractional digital assets like Bitcoin. *One member of the Drafting Committee* responded that while fractional VCCs were technically possible, industry practice currently limited VCCs to one tonne of CO_2 each. The idea of fractional VCCs was ultimately considered outside the scope of the current discussion, as VCCs were usually tied to whole tonnes of CO_2.

Conclusions

50. *The Working Group generally agreed to review and finalise definitions (e.g., verifier, independence, transfer, retirement) in conjunction with related principles.*

51. *The Working Group reached a consensus on the importance of individuation and serialisation for the effective functioning of VCCs with proprietary effects.*

iii. Principle 2 - Definitions – (13) Transfer

52. The Drafting Committee turned to Principle 2(13) to focus on the definition of "Transfer". In introduction, the Drafting Committee explained the definition of "transfer" from a technical perspective, emphasising that "transfer" should refer specifically to the change of proprietary rights between parties, such as ownership or security rights, rather than the mere movement of VCCs between accounts. Additionally, it was suggested "crediting" and "debiting" be used to accurately describe the process of moving VCCs from one account to another, which did not necessarily involve a change in proprietary rights. This approach also aligned with the terminology used in the Geneva Securities Convention.[3] It was emphasised that using the correct terminology was crucial for legal clarity, allowing for an accurate understanding of the different implications of these transactions. Despite the fact that terms like "credit" and "debit" might not be commonly used in practice, it was crucial to use language that was legally precise rather than just market-specific.

53. Regarding the conditions for a valid ownership transfer, *a Working Group participant* argued that while conditions such as the validity of a contract could be governed by other law (as stated in Principle 3(3)), the precise timing of when a transfer was perfected needed to be uniformly addressed in the principles. He further suggested that the point of perfection should be registration. In civil law systems, he explained, ownership transfer required publicity, such as through physical delivery or changes in a registry. In contrast, in common law systems, ownership transfers could occur bilaterally before registration, but this only affected the parties involved, not third parties. Therefore, transferring VCCs without publicity through registration could pose significant challenges, particularly in cases of innocent acquisition. *Another participant* also highlighted the critical legal effect of registration on transfers across different jurisdictions, arguing that whether registration was a requirement for an effective transfer should at least be addressed in the commentary.

54. However, *several participants* expressed different views, noting that the current definition of "transfer" was both effective and ideal. They cautioned against getting too specific about how proprietary rights should be transferred, as this could lead to legal complexities and confusion. One

[3] https://www.unidroit.org/instruments/capital-markets/geneva-convention/

example highlighted was the difference between English and Swiss law. Under English law, a transfer could be effective based on a contractual agreement, even if the asset itself had not moved. Swiss law, however, required physical movement for transferring physical goods, while digital assets needed a change in registration within a registry or special securities ledger, with no physical movement necessary.[4]

55. Therefore, it was suggested that the principles should remain focused on the legal treatment of VCCs without mandating conditions for a valid transfer, as this could negatively impact the market.

56. The Drafting Committee, in response, explained the approach adopted to be compatible with different law systems. To begin with, a distinction would be made between the transfer of proprietary rights and the mere movement of VCCs in a registry by using different terms in Principle 2. Following that, several aspects, such as the validity of the underlying contract and legal capacity, would be left to be governed by the relevant national law, as outlined in Principle 3. The introduction of an innocent acquisition rule in Principle 7 would protect a good-faith acquirer from competing claims, provided certain conditions were met – one of which would be publicity through registry. This rule would allow for different national legal requirements around publicity to coexist, ensuring that in systems where ownership transferred upon bilateral agreement, registration still played a decisive role in resolving disputes.

57. *One participant* raised concerns about the functional language used in Commentary 2.23, particularly the use of "initiating transfer" and having the "power to transfer". She argued that this terminology differed from the Model Law on Factoring[5] and might not align with civil law concepts of immediate acquisition; thus, further explanation on this matter was needed in the commentary.

58. In response, it was clarified by the Drafting Committee that the current phrasing closely followed the approach used in the DAPL and might be less familiar to those from a civil law background. Nevertheless, if the Working Group agreed to include an innocent acquisition rule for VCCs, the Drafting Committee would recast the commentary following a functional approach that could bridge such differences.

59. When examining the role of a registry in transferring VCCs, *the representative from Verra* explained how transfers happened within the Verra registry. She clarified that there was no such mechanism for "transferring" credits; instead, actual transfers occurred through bilateral contractual agreements between parties. Within the registry, moving credits between accounts was referred to as "delivery", which happened after the transfer had been arranged bilaterally. Additionally, she cautioned against using terms like "registration" in relation to credits, arguing that it misrepresented industry practices and the nature of what occurred in the registry. She emphasised that the registry reflected the delivery or settlement of credits rather than the transfer itself, whereas "registration" was used in relation to projects.

60. To support this argument, *another participant* explained the difference between the execution and settlement of a transfer, particularly in relation to varying legal systems. Under English law, the execution of a transfer made the transfer effective, meaning ownership was transferred upon agreement in a sale and purchase contract, while settlement occurred when the asset was physically moved. Even if settlement happened later, ownership was effective from the contract date. It was important to note that the registries were not involved in this process, as it was governed by the bilateral agreement and the applicable laws chosen by the parties.

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[4] Swiss Federal Act on the Adaption of Federal Law to Developments in Distributed Ledger Technology: https://www.newsd.admin.ch/newsd/message/attachments/60601.pdf

[5] https://www.unidroit.org/wp-content/uploads/2023/10/UNIDROIT-Model-Law-on-Factoring-En-PDF-version.pdf

61. Private and national registries also differed in tracking and establishing property rights, as *one participant* highlighted. It was observed that private registries focused on monitoring emission reductions rather than serving as public registries with legal authority over property. For instance, in Peru, it was important to obtain national authorisation for VCCs to maintain their value in the market.

62. *The representative from the HCCH* expressed support for the current definition of "transfer", highlighting the importance of clearly distinguishing between the transfer of credits and the transfer of proprietary interests in those credits. This distinction was critical for determining when proprietary rights arose and how applicable law was determined under Principle 3. It was also observed that any change to the current definition would affect the work that the subgroup on private international law was doing.

63. She also referenced the 2006 HCCH Securities Convention, specifically Article 1, Paragraph 1(h),[6] which stated that "'disposition' means any transfer of title whether outright or by way of security and any grant of a security interest, whether possessory or non-possessory", and Paragraph 2-18[7] of its explanatory report. She suggested that this terminology could help the Drafting Committee avoid dealing with classification inconsistencies across different jurisdictions.

<u>Conclusions</u>

64. *The Working Group generally agreed to use different terms for the two types of transactions involving VCCs, and acknowledged the importance of distinguishing between the transfer of credits and the transfer of proprietary interests in those credits.*

65. *Regarding the publicity of transfers, it was generally agreed that some form of registration might be required for the purposes of innocent acquisition, but further discussion was needed for outright transfer situations.*

iv. Principle 2 - Definitions – (7) Issuance of a VCC

66. The Working Group next discussed Principle 2(7) regarding the "Issuance of a VCC". The Drafting Committee then explained the reasons to define "issuance", as this determined what qualified as a VCC. One concern raised was about situations where a registry operator might independently register a VCC without proper authorisation or acceptance of the verification account. Hence, the issuance process was critical to the creation of a VCC, and defining "issuance" addressed not only the timing of VCC creation but also the necessary steps that had to occur for a VCC to come into existence.

67. The conceptual distinction between "issuance" and "recording in a registry" was also noted, where "issuance" referred to the process of acceptance of a positive verification report by the issuer, followed by an instruction to the registry to record the VCC in the account, while "recording in a registry" referred to the actual crediting of the VCC in the registry. The issuance process could be automated and quick.

68. The Drafting Committee then asked the Working Group to decide on two questions: whether the acceptance of the verification report should be "public" and whether to use the term "accept" or "ratify" for the issuer's approval.

69. Regarding word choice, it was suggested to remove the term "publicly" due to its lack of legal clarity concerning its private law effect on issuance, and to use the term "accept" instead of

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6 https://www.hcch.net/en/instruments/conventions/full-text/?cid=72

7 https://assets.hcch.net/docs/d1513ec4-0c72-483b-8706-85d2719c11c5.pdf

"ratify", as "ratify" might carry different connotations in this context. *Another participant* also recommended to use the term "registry operator" instead of "registrar" in Principle 7(b) to refer to the entity that recorded the VCC in the registry.

70. However, *several participants* found the term "issuance" problematic, observing that from a market perspective, "issuance" could be misleading since it was used in different ways in the industry. The focus therefore should be placed on "creation", as the market only considered a VCC relevant after it was credited to an account.

71. In response, the Drafting Committee explained that the definition needed to clearly state that a VCC came into existence only when certain conditions were met, and "issuance" was defined because it fed into the definition of a VCC. If there was a general concern about using the term "issuance", a question was raised as to whether the essential steps for creating a VCC were intrinsic to its very definition: in other words, whether a VCC could exist solely based on having a verified reduction and recording in the registry, or if more was required for it to be considered a VCC.

72. To clarify the necessary steps for a VCC to come into existence, *the representative from Verra* shared the "issuance process" from Verra's perspective. She explained that Verra's programme management team had to first approve the verification request made by the project proponent. This request was based on a verification report issued by the validation verification body (VVB), which also provided a separate positive or negative verification statement that determined whether the verification request could be approved. Once the request was approved, the project proponent requested issuance from Verra, and issuance happened once the project proponent paid the fees, at which point it was publicly displayed in the Verra registry.

73. With respect to Verra's approval of verification requests, it was further noted that such approval only occurred when a positive verification statement was attached to the verification report. Once the positive verification statement was received, Verra approved the verification request, allowing the associated documents to become part of the public registry for the project. To clarify this process, it was underscored that Verra generally relied on the positive verification statements from the VVBs, but Verra also conducted reviews to check for non-alignment or non-conformity with programme rules. If an issue arose, they might reject a verification report, though such cases were rare. A VCC effectively came into existence when it received a unique serial number during issuance. For Verra, this process tied the issuance of the VCC to its registration in the account, marking the point at which it gained market value.

74. *Several participants* agreed that the key component of the creation process was verification, and the "issuance process" could differ from one platform to another.

75. When it came to the point of time at which a VCC came into existence, the Working Group expressed divergent views. *One participant* argued that the proprietary rights were created at the point of verification report and statement, not at the point where ICCPs issued credits, and the VCC existed when the project proponent could request recordation of the VCC in a centralised or decentralised registry. Therefore, it was questioned whether an intermediary was essential to this process, as what should be assessed was the VVB's role in issuance, not the ICCP's role in validation or issuance.

76. *Another participant* observed that a carbon credit (CC) was technically created at the time of the emission reduction activity, such as removing one tonne of greenhouse gases from the atmosphere. However, it only became a VCC once there was a positive verification report.

77. When seeking feedback on reconsidering the term "verification statement" in place of "verification report" for Principle 2(4), *one participant* suggested that the verification report should be combined with a positive verification statement during what was currently referred to as

"issuance", at least from Verra's perspective. Therefore, the concept of the "verification report" should be retained in the draft.

Conclusions

78. *It was generally agreed by the Working Group that for Principle 2(7), "accept" would be preferable over "ratify", and "public" should be removed due to lack of legal clarity.*

79. *With respect to the term "issuance", it was agreed that this part would be reconsidered and revised, probably dropping the word "issuance" due to its ambiguity. It was also noted that the key component of the creation process was verification, and the "issuance process" could differ from one platform to another.*

v. Principle 3 - General Principles

80. The Drafting Committee began by providing an overview of the development of Principle 3, clarifying that the proprietary rights referenced in Principle 3(1) were defined as rights with proprietary effects, as explained in Commentary 3.1. It was suggested to postpone discussions on Principle 3(2) for later consideration, and it was explained that Principle 3(3) aligned with the approach taken in the DAPL, offering a non-exhaustive list of issues to be governed by other law. Additionally, as the Working Group had previously agreed, the matter as to whether a proprietary right had been validly transferred to another person would also be subject to other law (Principle 3(3)(b)).

81. *One participant* questioned why Principle 3 stated that a VCC "can be" the subject of proprietary rights instead of simply stating it "is" the subject of such rights, as he saw no situation where a VCC would not be.

82. In response, the Drafting Committee explained that while they currently could not think of a situation where a VCC would not be subject to proprietary rights, the phrasing "can be" was used for clarity in drafting. It allowed the principle to apply in cases where all legal conditions for proprietary rights were met, while maintaining flexibility and avoiding the implication that every VCC was automatically subject to proprietary rights in all cases.

83. *The representative from the HCCH* emphasised the significance of Principle 3 in relation to applicable law rules, agreeing with the Drafting Committee's earlier comments. She highlighted the importance of maintaining a jurisdiction-neutral approach, and pointed out that aspects like transferability were crucial for determining the applicable law, making Principle 3(1) and (3) both essential to their discussions.

Conclusions

84. *The Working Group generally agreed that matters as to whether a proprietary right had been validly transferred to another person would be subject to other law (Principle 3(3)(b)).*

85. *It was observed and agreed that Principle 3 was significant for drafting rules on applicable law.*

vi. Principle 4 - Creation

86. The Drafting Committee opened discussion on Principle 4, which focused on when a VCC came into existence. Based on the previous discussion on the definition of "issuance", it was proposed that certain language in Principle 4(1)(a) might be changed by taking out the word "issued", while the need for the VCC to be recorded in the registry would likely remain unchanged. It was also

suggested by the Drafting Committee to use "unique identifier" as a defined term in Principle 4(1)(b), and such a definition could be inserted into Principle 2. Regarding Principle 4(1)(c), it was clarified that the VCC came into existence only once it had been credited to an account, with the registered holder obtaining proprietary rights at that moment. The question of custody and proprietary rights after this initial creation would then fall under applicable law, referencing discussions in Principle 3.

87. Following the discussion on the point of time at which a VCC came into existence under Principle 2(7) (Issuance), the Working Group continued to explore the timing issue for VCC creation. *One participant* argued that the VCC came into existence when the verification report was presented. He therefore proposed that 4(1)(a) be revised to indicate the presentation of the verification report, 4(1)(b) to reflect the registry recording the VCC in an account, and 4(1)(c) to address the unique identifier as the final step.

88. *Another participant* suggested that VCCs only came into existence when they were put on the market, and that before that, they were called "certificates" at the registry level. She further argued that the registry itself did not issue a VCC, but an initial statement of emission reductions, which was a certificate. She suggested replacing "VCC" with "emission reduction or removal certificate" in this principle.

89. However, *several participants* expressed concern over putting too much focus on "certificate", noting that this might confuse the concept of VCCs as tradable assets, and paper certificates were not necessary in practice.

90. It was also clarified that Verra did not issue certificates; instead, the issuance and serialisation happened simultaneously, with serial numbers being visible in the registry. The cumulative process of verification, issuance, and attaching a unique identifier created the VCC, making the list in Principle 4(1) essential.

91. With respect to defining "unique identifier" in 4(1)(b), a query was raised as to whether the term "unique" was necessary, suggesting that a serial number could sufficiently identify a block of credits, even if not uniquely.

92. The Drafting Committee acknowledged this perspective and indicated that they needed to carefully consider how to define the concept. One possible approach was to propose a simple definition for the Working Group to review, allowing them to determine its necessity.

93. In terms of 4(1)(c) regarding the recording of VCCs, *several participants* highlighted the fact that the volume of credits confirmed in the verification report might differ from the actual issuance request from the project proponent, which could be lower than the maximum confirmed. This was because parties financed carbon projects with the claim and purchase of environmental attributes prior to the issuance of VCCs; thus, investors could transact based on unrecorded units. This also demonstrated the importance of recordation, which was to effect delivery.

Conclusions

94. *Regarding the necessary actions to be taken before a VCC was created, the Working Group generally agreed that Principle 4(1) would be redrafted to remove the word "issued" and to re-evaluate the sequence of actions.*

vii. Principle 7 - Transfer

95. The discussion moved on to Principle 7 (Transfer). As introduced by the Drafting Committee, the key issue of this principle was the innocent acquisition rule (Principle 7(3)-(6)), which aimed to provide certainty for buyers on the market. This would ensure that buyers of VCCs could acquire

ownership free from competing claims. The Drafting Committee then sought decision from the Working Group as to whether the principles should include an innocent acquisition rule, and if so, what the criteria for being considered an innocent acquirer should be.

96. Regarding the necessity of an innocent acquisition rule, *most participants* expressed their support, observing that this would bring legal certainty and benefit the market.

97. The Working Group then examined the requirements for an innocent acquirer listed in 7(4), with some pointing out that it currently required a VCC to be credited directly to the acquirer's account, which might not align with future market practices that involved custodial arrangements, where many acquirers instructed the retirement of credits without holding an account themselves.

98. In response, the Drafting Committee clarified that once the Working Group decided to incorporate an innocent acquisition rule, they then would address how to adapt it for scenarios involving custodians, as that would be the next step.

99. In terms of the approach to drafting the innocent acquisition rule, *one participant* suggested that instead of detailing rules, the principles should refer to other laws that might apply to specific VCC transactions. In relation to that, *another participant* highlighted the need for explicit statutory protection for innocent buyers of carbon credits, drawing from the example of stolen EU allowances in 2009-2010. He explained that traditional protections for bona fide purchasers of value without notice typically applied only to tangible property, and common law had not extended these protections to intangible assets like carbon credits. Therefore, statutory language was crucial to safeguard innocent buyers of such intangible goods.

100. The Drafting Committee acknowledged these concerns, explaining that it was precisely because traditional legal frameworks in both common and civil law jurisdictions often did not extend innocent acquisition protections to intangible assets, that referring to other laws for this part might not work effectively. This also spoke to the necessity of establishing an innocent acquirer rule within the principles to address this gap. While it might challenge existing approaches, it aimed to provide clarity and protection for intangible assets like VCCs.

101. *Another participant* raised questions about how the innocent acquirer rule interacted with potential revocation of carbon credits, particularly in cases where credits were later deemed invalid. She questioned whether an innocent acquirer would still retain value in such credits after they were revoked, which could undermine market confidence.

102. In response, the Drafting Committee clarified that the innocent acquirer rule only addressed ownership, ensuring that the acquirer held the VCC free from competing claims. However, if the credits themselves were flawed or later invalidated, that was a separate issue often addressed through contractual remedies, not through the innocent acquirer rule itself.

103. A question was raised as to why the principles bestowed a very high level of negotiability to a VCC, even more so than what had been done in the DAPL Principles, suggesting that this at least needed to be explained in the commentary.

104. The Drafting Committee, however, expressed the opposite view, that the VCCs would be less negotiable than digital assets due to the stringent requirements for registration and registry accounts in VCC transactions. Nevertheless, it was noted that negotiability should be fully addressed in the commentary and to some extent in the principles.

105. Following up on the point on negotiability, *another participant* highlighted the importance of classifying VCCs as negotiable instruments to protect innocent buyers effectively. It was observed that traditionally, intangible assets had not been recognised as negotiable without statutory

clarification, which posed a challenge for VCCs. Granting VCCs negotiability could automatically extend the protections of a bona fide purchaser of value without notice, thus enhancing buyer security.

Conclusion

106. *It was generally observed and agreed that the principles should include an innocent acquisition rule to provide protection for intangible assets, such as VCCs.*

107. *Regarding the criteria for being considered an innocent acquirer, it was agreed that the content would be further reviewed and refined based on the feedback from the Working Group.*

viii. Principles 5, 6 – Reversal and Revocation

108. With respect to the definitions of the terms, it was explained by the Drafting Committee that each, as in Principle 2(11), (12), and (14), referred to the permanent removal of a VCC from circulation for different reasons. Retirement was a consensual process where the owner instructed the registered holder to remove the VCC at the end of its lifecycle. In contrast, reversal occurred post-creation when a carbon reduction had reversed, while revocation happened pre-creation due to issues like fraudulent verification reports. The Drafting Committee was open to any terminological issues regarding the definitions before moving on to examine Principles 5, 6 and 8.

109. Regarding the concept of "reversal", *several participants* expressed concern about the confusion that it might cause. *One participant* observed that from a market standpoint, the use of the term "reversal" was very specific and related to issues potentially concerning nature-based projects. Using "reversal" in a broader term here could cause some confusion, as "reversal" was specifically related to a re-release of sequestered carbon back into the atmosphere.

110. *Another participant* stressed the need to distinguish between "reversal" and "revocation". She argued that "reversal" was linked to permanence, occurring when emissions that were supposed to be permanently sequestered returned to the atmosphere, thus indicating a loss of permanence. In contrast, "revocation" was associated with integrity issues, such as fraud or over-issuance, leading to the cancellation of credits.

111. However, *yet another participant* argued that the focus should instead be on defining the circumstances under which a VCC no longer met its original definition. She further observed that once a VCC existed, it underwent various life-cycle events that might affect its status, and reversal and revocation were just part of that.

112. The Working Group explored the relationship between a VCC and the underlying environmental benefits, particularly in circumstances where a reversal happened. It was underscored by *one participant* that VCCs, under Verra's rules, represented a verified claim or an appropriated fact, not the environmental benefit itself. An analogy for that would be an "Amazon box", where the VCC was like an empty box if the environmental benefit or project was later found to be fraudulent or reversed. While Verra did not delete VCCs from the record, they removed them from circulation.

113. *Another participant* pointed out the overall implications of defining VCCs in relation to their underlying environmental benefits, emphasising the need to consider how concepts like reversal and revocation could affect marketability. He highlighted the risk that if a VCC did not accurately represent a tonne of carbon reduced, it could undermine buyer confidence, especially if there was no clear compensation mechanism. He cautioned against allowing the concept of reversal to be the solution for dealing with the problem associated with the loss of the underlying environmental benefit, as it could diminish the VCC's marketability.

114. In addition, it was argued that the reversal of the VCC was not necessarily a characteristic of whether or not a VCC was treated as property, and the permanence of the underlying benefit did not need to match the lifespan of the VCC itself. While the market determined the value of the VCC, the standard set the criteria for whether it continued to represent an environmental benefit. It was argued that even if the original environmental benefit was lost, the VCC could still retain its value and integrity if the standard had mechanisms to address such scenarios, such as a buffer pool or insurance, because from an environmental perspective, a tonne of CO_2 reduced was the same regardless of the method used or the type of the project from which it generated.

115. In terms of risk allocation in the event of a reversal of environmental benefits, *one participant* suggested leaving it to market participants to navigate the implications of this loss, whether through reversal or revocation, arguing that Principle 5 should be reformulated to convey the fundamental concept that property rights were contingent on the existence of the underlying asset.

116. In response, the Drafting Committee observed that VCCs were ideational properties that were based on how they were tied to particular projects, meaning that substituting one type of project for another would alter the VCC's market value. It was further explained that while reversals were associated with nature-based projects, the principles should remain generic and applicable to all VCC types, and helpful explanations could be added to the commentary if necessary.

117. *The representative from Verra* shared Verra's understanding on reversal, stating that reversal referred to a situation where the GHG benefit was negative during a given monitoring period. It was the monitoring report or a notification from the project proponent that alerted Verra to the reversal, but the situation itself was an environmental event.

118. Furthermore, it was noted that Verra had mechanisms for compensating the affected parties with an equivalent number of credits in case of over-issuance, although these would have different serial numbers. This led to a question about the status of the original unit, which might be deemed void, but the right's holder retained the right to receive an equivalent amount of credits.

119. The Drafting Committee explained that Principles 5 and 6 were intended to address worst-case scenarios in the carbon market, such as situations where the benefits were lost or never acquired, and no provisions or mechanisms, such as a buffer pool, were in place to manage those circumstances. The Drafting Committee also expressed its flexibility in redrafting based on the comments received from the Working Group, stressing that Principle 5 was not mandatory.

120. The Working Group then examined cancellation of VCCs. *One participant* challenged the concept of "cancellation", arguing that it could be a misleading term. One example highlighted was the Clean Development Mechanism (CDM), where credits being cancelled meant they were taken out of circulation and kept in a separate cancellation account, where the unit of property stayed in perpetuity. Consequently, the registry was entitled to no longer comply with the instructions of the account holder if the account holder had so pre-agreed to the registry operator.

121. *The representative from Verra* explained the mechanisms of cancellation from Verra's perspective, stressing that cancellation could be a request made by the account holder, not just a unilateral decision by the standard. This distinction was important because it underscored the roles of both the standard and the account holder in the cancellation process.

122. *One participant* explained that there were many potential "life-cycle events" beyond just reversal or revocation that could lead to a carbon credit's cancellation. Hence the focus should not be too narrow, as the key issue for traders was whether the credit remained in the registry and could be traded, regardless of the specific cause for its cancellation. In addition, it was important to note that cancellation of a VCC could vary across registries according to their different terms of use.

123. The Working Group then discussed the timing of revocation under Principle 6. *One participant* raised doubts about the timing of when a revoked VCC became void. She suggested that rather than being "void from the outset", a revoked or cancelled VCC should be considered void from the moment of cancellation. This was because such credits were previously valid property rights that project developers relied on for funding and transactions. Declaring that a credit never existed as a subject of proprietary rights, particularly in cases of over-issuance and subsequent cancellation, would be problematic.

124. *Another participant* therefore highlighted the issue of the timing of revocation – whether it was immediate or retroactive – could lead to various implications. She argued that if the definition of a VCC was not met at any point, it raised questions about whether it ever qualified as a VCC, which was central to the discussion on revocation.

125. In response, the Drafting Committee clarified that the drafting was based on the notion that VCCs were considered intangible property. An analogy was that of intellectual property, such as patents, which could be deemed non-existent if they failed to meet essential requirements after being challenged. Likewise, if the essential conditions for a VCC to exist as property were never met, it could not be considered to have existed at all. The consequences of cancellation were a separate matter from property law issues.

126. Furthermore, the Drafting Committee proposed establishing clear requirements for creation, asserting that if these requirements were later found not to have been met, it should result in the recognition that the VCC was never valid from the outset. It was also noted that the principle of creation should remain agnostic to carbon standards; however, individual standards might possess unique features that could affect their processes for revocation, cancellation, or suspension. It was also underscored by the Drafting Committee that the current definitions should be seen as minimum standards, allowing for additional contractual stipulations that different standards might impose.

127. To address the Working Group's concern that the current wording might not align with the operational practices of different registries, the Drafting Committee underscored that the overarching goal was to create a set of rules that provided certainty within the market, thus preferring a consistent property rule approach that would provide a stable foundation for market operations over a more flexible contractual approach that would lead to market segmentation. However, it was also acknowledged that redrafting these principles was necessary to better reflect the realities of the market and usage of VCCs.

Conclusions

128. *It was agreed that the rules for revocation and reversal might differ by registry, but VCCs existed until they were either retired or cancelled, subject to those standards' specific conditions.*

129. *It was generally agreed that Principles 5 and 6 would be redrafted based on the Working Group's feedback to better align these principles with the practicalities of how the market functioned.*

130. *Participants acknowledged that there was a collective desire to establish uniform principles to ensure clarity and predictability, while allowing flexibility for countries and parties to contract differently.*

ix. Revised Definitions

131. Following the discussions of the first day, the Working Group reached a preliminary understanding that the terminology used to define VCCs required careful consideration to avoid ambiguity and potential legal complications. Accordingly, a revised set of definitions was provided by the Drafting Committee.

132. The Drafting Committee began by presenting the revisions made to Principle 2, explaining that they had worked for a few hours the previous night. The revisions were primarily focused on redefining "issuance", which had caused confusion, particularly for those working in securities markets. The Committee proposed replacing "issuance" with "acceptance", where a "positive verification report" would be accepted instead of issuance occurring. The changes in definitions for "standard setter" (previously called issuer), "positive verification report", and "verifier" were discussed. The revisions aimed to clarify that the report could be either positive or negative, and the revised definitions were open to discussion. The Drafting Committee also urged that, while participants thought about the definitions, they should consider how revocation and reversal would connect to them. For example, revocation could occur if one of the requirements for acceptance was not met.

133. The Working Group raised two main concerns: first, whether using "achievement" to define the VCC was appropriate, as it might seem more philosophical than concrete; and second, whether the new definitions would still apply to independent projects. *One participant* suggested that a project proponent might also act as a standard setter. As a response, the Drafting Committee clarified that the amendments were not intended to exclude smaller, independent projects or limit who could be a standard setter, and that the draft definitions reflected the importance of independence at various stages of a project's lifecycle. However, the Working Group had not yet reached a consensus on whether a project proponent could also act as a standard setter.

134. The Working Group generally found that the revised draft was an improvement but raised concerns about the circular definition of "standard setter" as the person who accepted a positive verification report. The discussion focused on the definition of "standard setter" as a legal person that accepted a positive verification report. *The Deputy Secretary-General* raised the question of whether the definition should be limited to acceptance, noting that even if a negative report was issued, it would still remain a standard setter, and she stated that the definition could be more flexible, reflecting the fact that the standard setter had the possibility to accept or reject verification reports, rather than being strictly tied to acceptance. It was further suggested that the definition could be clarified since the issue might be more about drafting rather than substance. The Drafting Committee addressed the term "standard setter", explaining that it had been used quickly during drafting but might not be the best fit and that they struggled to find a suitable term for the entity performing the acceptance, having initially settled on "standard setter". However, it was suggested that the term might create confusion since it implied a different function. The definition served a linguistic purpose, ensuring consistency, but might require further revision. *The Secretary-General* suggested adding a statement to clarify that the definitions were specific to the principles in question and not intended to have universal applicability.

135. The Working Group next discussed whether the definition of "standard setter" should be broad or specific. *Some participants* argued that it was too narrowly focused on accepting verification reports, whereas standard setters also managed methodologies and other aspects of carbon crediting programmes (e.g., Verra). *Certain participants* also emphasised the distinction between a standard setter and a registry or ICCP. It was highlighted that while these roles might be fulfilled by the same entity (as in the case of Verra), they performed different functions operationally. Accordingly, it was suggested either to broaden the term "standard setter" or to create a new term for the entity that accepted or approved verification reports in relation to VCCs.

136. The Drafting Committee further raised the question of whether there was a need for clarity between "acceptance" and "approval" of verification reports, noting that the Committee had settled on "accept" but that it might require further thought to avoid confusion between the two terms, perhaps clarifying their distinctions. Likewise, the role of the "acceptor" or "approver" could be defined more precisely, ensuring independence in the verification process. The discussion also addressed the need to redefine or better clarify what constituted a "verification report", with *some*

participants advocating for using the term "verification statement" to reflect a simpler acknowledgment that the project complied with the relevant protocols.

137. The debate continued over whether negative verification reports were necessary in the definitions, as many participants suggested them as unnecessary and potentially confusing in the context of carbon credit issuance. *The Deputy Secretary-General* raised a question about the relevance of defining a "negative verification report". She noted that the rest of the document seemed to focus on positive verification reports, which were tied to the issuance of carbon credits. Given this focus, she questioned the need for a definition of a negative verification report, asking whether it played a significant role in the rest of the text and its implications.

138. *One participant* suggested refining the definition of a verification report to include a "positive verification statement", distinguishing it from the verification process, highlighting how the report and the statement served distinct purposes, and how acceptance of the report by the standard setter ensured compliance with broader programme requirements, not just emission reductions. As a response, the Drafting Committee emphasised the focus on identifying the minimum standards necessary for creating a legal object of a property right from a VCC. It was mentioned that while certain procedural steps like fee payment were essential from a market perspective, they did not necessarily define the VCC as an object of property. It was suggested by the Drafting Committee that aspects like registry instructions could be reflected in other parts of the document or commentary without necessarily including them in the core definitions.

139. *One participant* suggested that the term "standard setter" should be replaced with "carbon crediting body" to avoid confusion, underscoring the importance of using precise terms like "VVB" and discussing the potential controversies surrounding the term "avoidance" in carbon credit methodologies. *Other participants* proposed a more straightforward definition: for the purposes of the principles, emission reductions and removals should include emission avoidance without going into further detail on what avoidance entailed.

140. The Working Group then moved on to the discussion of the importance of including the term "achievement" in the definition of emission reductions and removals, linking it to the concept of "reversal". It was questioned whether there was consensus on this and whether the definition should focus on the actual reduction or compliance with the methodology. The Drafting Committee agreed with this point and suggested that the concept of achievement could be clarified in the commentary, with the definitions focusing on the core element of reduction. It was emphasised by the Drafting Committee that the term "achievement" was meant to reflect the steps taken in a carbon mitigation project, underlining that these steps were verified, respected, and essential for creating a VCC. The term helped avoid the misconception that reductions happened spontaneously and underscored the methodology and actions behind the project. The use of the term "achievement" was supported by *other participants* as well since it tied into ensuring that the reduction be linked to a specific carbon mitigation project, not just a spontaneous event like the self-seeding of a forest.

141. The Working Group generally agreed that the inclusion of the term "achievement" did not touch upon the discussion around revocation or reversal of VCCs. However, the term strengthened the notion that something deliberate had been accomplished and verified, making it easier to discuss revocation in a more structured manner.

142. The importance of recording a VCC in a registry with a unique identifier was also discussed by the Working Group. The Drafting Committee added that the definitions should specify the necessary steps to create a VCC. Recording was identified as the key moment when a VCC came into existence, and it was essential that this step be part of the criteria in Principle 2.1. The Working Group also addressed the potential issue of a registry creating VCCs without acceptance of the verification report, arguing that this link had to be clearly defined to prevent such occurrences. It

was concluded that recording must be explicitly tied to the acceptance of the verification report, to ensure legal clarity.

143. The need for clarity in methodologies, especially concerning biodiversity and social safeguards in projects, was emphasised. *Some Working Group participants* proposed that the introduction or commentaries be used to detail these broader aspects, helping to make the drafting easier. Regarding programme standards, it was noted that while certain elements were present in the programme standard, they might not be as clearly defined within the methodology. *One participant* highlighted the importance of land ownership and consultation in the approval of a verification report as key components in verification, affecting the volume of credits a project could generate. Specifically, confirming project ownership – including land tenure or licenses – and ensuring proper consultation with affected parties were critical. These factors, though not strictly part of the methodology, influenced credit volumes and safeguard concerns. The need to consider these broader elements in project evaluations was emphasised.

144. The main concern raised was whether a VCC could be recorded by a registry without the acceptance of a verification report. The Drafting Committee argued that if the registry, acting independently, recorded a VCC without verifying the acceptance, the VCC would not be valid. This lack of a clear link between the verification and the recording could lead to issues. Therefore, the definition of a VCC had to include this connection, ensuring that acceptance of the verification report be a necessary step for creating a valid VCC. Even in the absence of an explicit instruction, the acceptance of the verification report had to serve as the foundational criterion to ensure legal validity.

145. The need for the term "achievement" when "verification" already so implied was questioned. *One participant* commented on the relationship between "recording" and "crediting", suggesting a clearer definition to account for different processes and ensuring that the language be precise and appropriate for the legal framework, especially for small-scale projects and the use of the term "credited to an account" as opposed to "recorded". In response, the Drafting Committee mentioned that this subtle distinction in terminology was significant, particularly in the context of defining VCC-related processes. While the term "credited" might be used in most situations, there was some hesitation to definitively commit to its use in the definition at this stage, but it should be considered.

146. *The Deputy Secretary-General* raised concerns about circularity in the definition of a verification report in Principle 7. The Drafting Committee acknowledged the need to rethink the use of terms like "issuance".

147. The discussion moved on to addressing Principle 5 (Reversal). The Drafting Committee explained the idea of eliminating Principle 5 and integrating it into the registry principle or commentary was discussed, emphasising the conceptual clarity of ceasing a VCC if it lost its defining qualities. *Some participants in the Working Group* supported retaining the concept of reversal to maintain market credibility, while *others* cautioned against using "reversal", as it held specific meaning in the industry, even though they agreed with the concept. The Drafting Committee proposed collapsing reversal and revocation under a unified term, such as "cancellation", to reflect either the retroactive or immediate invalidation of a VCC. The Drafting Committee considered adding more content on reversals in the registry principle or its commentary. This could involve various responses to reversals, depending on the registry's practices. It was proposed whether suspension could also be discussed.

148. *One Working Group participant* raised a question rooted in property law, focusing on whether a carbon credit could still be considered property even if the underlying transaction failed or disappeared. Drawing an analogy to a stock certificate, while the value of the stock might diminish or become worthless, the certificate itself remained property; similarly, even if the carbon credit lost its value due to the failure of the mitigation, it still remained property under the law. It was

emphasised that while the market might treat the credit differently in such circumstances, from a property law perspective, the credit itself did not vanish – it just lost its value.

149. *The Secretary-General* added a follow-up question, focusing on whether there was a difference between a share and a VCC in terms of potential recovery of value. It was noted that a share might lose its value, but there remained a possibility of recuperation – such as if the business were acquired or revitalised with new investment. The question posed was whether a VCC could experience a similar revival in value. He also highlighted the importance of this distinction, as it could have a significant impact on the legal and market analysis of VCCs, particularly in situations where the underlying mitigation failed. This enquiry raised a key point for consideration in assessing the longevity and value retention of VCCs in the marketplace.

Conclusions

150. *The Working Group generally agreed on the inclusion of the term "achievement", whether in the definitions or in the commentary, with the definitions focusing on the core element of reduction.*

151. *The Working Group reached a consensus on the idea of eliminating or redrafting of Principle 5 (Reversal).*

x. Principle 8 - Retirement

152. The Working Group moved on to discuss Principle 8 (Retirement). The Drafting Committee opened the discussion by stressing that this principle focused on the consensual termination of VCCs at the end of their lifecycle. The instruction to retire a VCC should come from the registered holder rather than the proprietary rights holder. The Drafting Committee also expressed its support for creating a separate principle specifically on retirement and its definition. It was clarified that retirement, as a core aspect of VCCs, should be addressed separately, because retirement was a consensual event that brought the VCC to an end as the subject of proprietary rights for a very different reason. A question was raised as to whether the process for instructing the VCC registry should include any formal requirements, and whether actual retirement occurred when records were updated in the registry.

153. It was generally agreed that no formal requirements needed to be mentioned, suggesting that the registry should determine how to receive these instructions.

154. Additionally, *one participant* suggested including language that clarified the registered holder's rights to retire the VCC on its own or on behalf of others. It was also proposed that there should be mentioning of further steps necessary to render the retirement effective against third parties.

155. The Working Group then examined the implications of retirement on ownership. *One participant* observed that retirement was intended for the end-user to claim the carbon reduction or removal for corporate accounting purposes. Even after a VCC was retired, ownership rights tied to the achievement might continue to be relevant for auditing, net-zero calculations, or even litigation. It was underscored that inalienability in this context was important to ensure that the proprietary interest be clearly attributable to one party for purposes of carbon accounting. In relation to this point, a query was made as to how the ongoing assertion of ownership after retirement should be reflected, especially when multiple companies claimed proprietary rights over the same retired VCC.

156. In response, the Drafting Committee noted that if VCC retirement meant that the achievement was permanently attributed to the party retiring the VCCs, then a redrafting was needed for Principle 8 to reflect that, upon retirement, the VCC became inalienable – remaining owned by

the entity but no longer transferable – instead of stating that the VCCs ceased to be the subject of proprietary rights.

157. Concerning the ongoing assertion of ownership after retirement, it was explained that the principles should remain neutral concerning the reasons why people bought or retired them. It was also clarified that the issue of proprietary rights and claims about VCCs were distinct. Even if the VCC could continue to exist after retirement, it would not grant any rights to a holder against another corporation making false claims. Liabilities related to false claims should fall under other laws, such as regulatory or tort law.

158. The Working Group went on to discuss whether retired credits might still hold value and could be used for other purposes, such as taking a security interest. This also implied that making the VCC inalienable upon retirement might not necessarily mean a complete cessation of all property rights associated with it.

159. *Several participants* observed that if retired credits could not be the subject of proprietary rights, then security interests should not be allowed.

160. However, *other participants* held a different opinion, suggesting that in some jurisdictions, it was possible to have a security interest in an inalienable asset, but it could not be transferred if enforced. Another example was where individuals might hold a portfolio of carbon credits, and even if a specific credit went in and out of circulation, a security interest could still be created for the entire portfolio.

161. In addition, it was noted that retired credits might still play a role in sustainability reporting, where companies could claim to have offset a percentage of their emissions, even if this did not involve proprietary rights.

162. *One participant* raised concerns about market practices that involved transferring retirement claims to third parties. It was noted there was an integrity issue when parties retired credits without knowing the beneficiaries and later transferred the retired VCCs, complicating the tracking of actual retirements. Another example was in the oil and gas industry, where companies had their holding companies retire VCCs, only to later transfer the retirement certificates to their affiliates for carbon accounting purposes. This allowed the affiliates to book the intangible assets and report their achievements.

163. However, it was clarified by the Drafting Committee that under the drafted principles, the final stage of what was described in this scenario was a matter of contract rather than property rights – a private agreement between the individual who retired the credits and any party wishing to engage with them afterward. Registries might merely follow instructions to retire credits, and any actions following that retirement were governed by private agreements, not property law.

164. It was further clarified that what was done by the oil and gas companies was the transfer of retirement certificates which were tangible documents that could be sold, which were distinct from VCCs. If there was a concern on the publicity of transfer and retirement, there might be a need to include commentary on the publicity of such practices.

165. In summary, the Drafting Committee observed that while there may be no need to amend the current draft stating that retirement resulted in the VCC as an object of property ceasing to exist, the discussion so far had highlighted the importance of adding robust commentary. This commentary should explain the ongoing economic, social, and environmental impact of retirement. It was suggested that the Drafting Committee take time to ensure they were comfortable with the conclusion that VCCs ceased to exist after retirement.

Conclusions

166. *Regarding the necessity of formal requirements for the retirement instruction process, the Working Group reached a general consensus that such requirements were not needed in the principles.*

167. *It was generally agreed to keep a separate principle for retirement, given that retirement was a consensual event that brought the VCC to an end as the subject of proprietary rights.*

168. *It was noted and agreed that a robust commentary on retirement was necessary to clarify its ongoing economic, social, and environmental implications, while carefully considering the assertion that VCCs ceased to exist after retirement.*

xi. Principle 9 - VCC Registry

169. To begin with, the Drafting Committee presented a structured overview of this principle.

170. It was noted that Principle 9(1)-(6) were definitions related to the registry, which, upon decision of the Working Group, might be moved to Principle 2. In addition, it was generally agreed that "registry operator" was a more commonly used term in the industry, rather than "registrar".

171. With respect to the definition of "registry" in Principle 9(1), the Drafting Committee explained that defining a VCC registry was essential for treating VCCs as proprietary rights, as a VCC must be recorded in a proper registry to qualify as such. Hence the idea was to set out the minimum criteria needed for a registry to be able to support the contention that a VCC could be the subject of proprietary rights.

172. *One Working Group participant*, in response, proposed that the language used in relation to a registry account should be consistent throughout the principle, thus "debited" should also be added in 9(1) to align with 9(3), making it clear that the registry would record the holding amount of VCCs.

173. *Another participant* suggested adding "public" before "electronic database", stressing the need for registries to be public to ensure transparency. It was observed that allowing the public to view when credits were issued or transferred (and to whom) was necessary for resolving disputes.

174. Regarding the definition of "registry account holder" in Principle 9(4), it was generally agreed that the account holder could have multiple accounts and those accounts might or might not have sub-accounts. For Verra, sub-accounts were a way for account holders to organise credits, similar to a spreadsheet. However, it was suggested that instead of mentioning sub-accounts in the principles, it would be preferable to put it in the commentary, where it could be further explained that the registry account holder might or might not have a separate off-registry ledger in respect to those accounts, as most brokers would just have a single account and run an off-registry ledger in respect to the positions that they were holding for their customers.

175. Regarding Principle 9(6) on "registered holder", it was explained by the Drafting Committee that their focus was on a single VCC, even though they were issued and traded in blocks. That was why there needed to be a term to refer to the "registry account holder" associated with a specific VCC, given the possibility that one entity might have several accounts in a registry. It was suggested that the term "registered holder" could address this relationship.

176. However, *the representative from Verra* argued that compared to "registered holder", "account holder" was more straightforward and commonly understood in the industry. She further explained that it was the account holder that was essentially seen by Verra to be the holder of the VCC and entitled to instruct Verra in relation to the VCCs in an account.

177. The Working Group then turned to examine the private law duties owed by a registry operator concerning VCCs, as outlined in Principle 9(7)-(13). It was noted by the Drafting Committee that the focus should be on the minimum obligations necessary for a registry to fall within the definition of a VCC.

178. With respect to Principle 9(7)(a), *several participants* observed that the "rules of relevant issuer" should be taken out, noting that registries should remain distinct from issuers, as registries increasingly became regulated entities, and many standard setters would be likely to withdraw from the registry market in the future.

179. It was further noted that the use of "obligation" in Principle 9(7) was unusual for registries, acknowledging that it might be legally correct but did not align with how registries typically phrased their commitments in their terms and conditions. Registries often expressed their responsibilities in service-oriented terms, stating what they would or would not do, rather than framing them as formal obligations.

180. Regarding Principle 9(7)(c), which currently referred to an obligation to comply with instructions from a "registered holder", it was suggested that "authorized user" or "registered holder and/or its authorised users" should be better, since it was common practice for registries to take instructions from an authorised user, who might not necessarily be the registered holder, especially in cases of custody.

181. *Another participant* sought clarification on Principle 9(7)(c)(i), sharing a scenario where a registry operator received a complaint from a third party regarding VCC ownership without any existing agreement. In this case, an indigenous community challenged a state's issuance of VCCs on their land, raising jurisdictional concerns about who held the rightful title to the mitigation activity.

182. The Drafting Committee responded by indicating that further consideration would be given to the necessity of a general provision to address situations where a court or authority prevented a registry from complying with certain instructions, as outlined in Principle 9(7)(c)(i).

183. When discussing how to protect account holders' interests from the operators' creditors in both solvent and insolvent situations, as stated in Principle 9(8)-(11), *several participants* questioned the accuracy of these provisions. It was noted that registry operators typically held liens over account assets, including VCCs, to secure claims such as regular fees. *One participant* therefore challenged the idea that registries lacked proprietary rights, noting that it was extremely common in the custody sector for a registry operator to have certain rights in relation to the VCC.

184. Furthermore, it was observed that current major registries did not have accounts that were insolvency-remote, which posed challenges for market scalability and financing. While future regulation might address this issue, the content of (9) and (10) were not accurate at present. It was also acknowledged that this lack of insolvency protection was a significant obstacle for the market. It was also noted that most major registries lacked Recovery and Orderly Dissolution Plans for managing insolvency and other disruptive events like force majeure or legal changes.

185. Given the gap between what was described in the principle and the current market practices, *some participants* recommended a more realistic approach to assess the current state of registries and consider whether to set such requirements. *Others*, however, advocated for ambitious drafting aimed at integrity and market certainty, suggesting that these provisions should be included in the principles for the benefit of market development.

186. In response, the Drafting Committee expressed concerns about the language used in registry terms, where obligations might not be clearly stated. There would be a possibility that registries had the discretion to refuse issuing carbon credits when all requirements were met, suggesting this could

not only undermine the integrity of registries but also the true ownership of VCCs from the property rights perspective.

187. It was also noted that registries and custodians should be distinguished in the discussion about publicity and ownership. Registries, often established by legislation and regulated, served a different purpose than custodians, which were private entities managing assets. The Drafting Committee invited the Working Group to consider whether they were comfortable maintaining this distinction.

Conclusions

188. *The Drafting Committee agreed to redraft this principle based on the comments from the Working Group.*

189. *The Working Group reached a general consensus that further consideration was needed to evaluate the level of ambition for this principle, especially concerning insolvency remoteness.*

Item 4: Organisation of future work

190. *The Chair* noted that the next session was scheduled to take place in January 2025 and the fifth session in early April.

Item 5: Closing of the session

191. *The Secretary-General* thanked the Working Group participants for their time and valuable contributions and closed the meeting.

ANNEXE I

AGENDA

1. Opening of the session and welcome

2. Adoption of the agenda and organisation of the session

3. Consideration of the draft principles and commentary, and, where applicable, matters identified in the Issues Paper

4. Organisation of future work

5. Closing of the session

ANNEXE II

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