INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

EN

UNIDROIT Working Group on the
Legal Nature of Verified Carbon Credits
Fifth session (hybrid)
Rome, 2-4 April 2025

UNIDROIT 2025
Study LXXXVI – W.G.5 – Doc. 2 rev.
English only
March 2025

DRAFT UNIDROIT PRINCIPLES ON THE LEGAL NATURE OF VERIFIED CARBON CREDITS

TABLE OF CONTENTS

DRAFT UNIDROIT Principles on the Legal Nature of Verified Carbon Credits

INTRODUCTION

A. Reasons for the Principles

1. Carbon markets are increasingly being recognized as a pivotal mechanism to channel financial resources into initiatives combating climate change. As integral components of the climate policy architecture, these markets play a crucial role in reducing GHG emissions cost-effectively, mobilizing all important carbon finance in the case of international carbon markets and generating revenue in the case of domestic markets, and promoting the adoption of low-carbon technologies and solutions.

2. A range of carbon markets exists, spanning international and domestic levels these markets serve to:

(a) enable governments to pursue voluntary cooperation between countries in the implementation of their nationally determined contributions (NDC) and allow for higher ambition in their mitigation and adaptation actions and to promote sustainable development and environmental integrity, and

(b) incentivize and facilitate participation in the mitigation of greenhouse gas emissions by public and private entities. Private entity engagement may be through compliance frameworks or through voluntary activity to reach self-determined climate commitments.

3. There are two main types of instruments traded in carbon markets (i) government issued permits or "**Allowances**" and (ii) credits issued post independent verification that an emission reduction or removal has occurred as a result of specific project activity "**Verified Carbon Credits**" of "**VCCs**".

4. The core types of markets may be broadly described as follows:

(a) **Jurisdictional compliance markets** where covered entities must submit government issued permits or Allowances to offset their emissions e.g. the EU Emissions Trading Scheme (ETS) (there are now, at the date of writing this introduction, some [36] operational ETSs with [17] in development.

(b) **Jurisdictional Tax** where partial offset is permitted through the use of eligible VCCs e.g. Singapore.

(c) **Sectoral compliance** markets where covered entities submit eligible VCCs e.g. CORSIA.

(d) **International cooperative approaches** under Art 6 Paris Agreement using VCCs as the unit of measure.

(e) **Voluntary markets** where private entities make voluntary climate commitments including, (i) a commitment to voluntarily reduce its own emissions within their value chain outside of a compliance obligation and (ii) a commitment to voluntarily finance the reduction or removal of emissions outside of its own value chain through the purchase of VCCs.

5. It can be noted, therefore, that the market in VCCs is not just a voluntary market but a global market in VCCs that services both buyers for compliance obligations and voluntary buyers.

6. Although the importance of VCCs as a mechanism for raising finance and distributing benefits is rapidly being recognised across all parties to the Paris Agreement, the legal nature and the regulatory oversight of the market of VCCs is uncertain in many jurisdictions. Certainty on the classification of a VCC under Private Law is critical to support market participation by private entities including project developers and investors. It informs market mechanics such as: - how transfers may be completed by sale or as collateral, - the treatment of VCCs held by an entity in insolvency, and - it influences the accounting and tax treatment.

7. While in certain jurisdictions, derivatives in VCCs fall under the regulatory framework applicable to other derivatives, there is less certainty about the VCCs themselves. Derivative markets play a critical role in any market, facilitating raising capital and helping principle to principle (or Business to Business OTC "B2B") market participants manage risk. Derivatives also enhance transparency in the underlying B2B market and promote the liquidity necessary to raise finance. The derivatives markets and the underlying B2B market are co-dependent, with the derivatives market depending on the strength and integrity of the underlying B2B market, and that underlying B2B market relying on the derivatives market to promote transparency and liquidity. This is a further imperative to clarify the legal nature of the underlying VCC.

B. Typical life cycle of a VCC

8. To provide context to these Principles the key steps in the lifecycle of a VCC are broadly described below. In summary there are three stages:

- **ONE** Generation and Supply
- **TWO** Secondary Market Trading
- **THREE** Use and Retirement

9. All VCCs are issued as a consequence of activities in a project designed to reduce or remove emissions from the atmosphere. The lifecycle of a VCC has commonalities whether it is issued by a Governmental crediting program of country, the crediting program of the UN (a 6.4ER) or an Independent Carbon Crediting Program (ICCP)[1] . In summary that process entails the setting of the methodology that will be used by a project proponent, the validation and registration of the project at a carbon crediting platform, the implementation of the project, the independent third-party verification that the project has achieved certain emissions reduction or removals, followed by the issuance of a VCC and the recording of it in a registry.

10. Transactions in the secondary market may then be conducted between market participants with the VCC as the underlier.

11. The last stage usually entails an instruction by the end buyer to the relevant registry operator to retire the VCC thereby removing it VCC from circulation in the market. The party retiring the unit may use proof of such retirement to fulfil a compliance obligation or to fulfil a voluntary commitment.

12. Set out below is a more detailed description of the lifecycle of a VCC to add background and context to these Principles.

[1] Examples of such ICCPs include, but are not limited to, the Verified Carbon Standard (Verra), the Gold Standard, the American Carbon Registry, Climate Action Reserve, and Puro Earth.

1. Generation and Supply

(a) Methodology, Validation and Registration

13. A methodology for a carbon project refers to a set of detailed boundaries, procedures and criteria used to measure, quantify, monitor, and verify the emission reductions or removals achieved by that carbon project. The crediting program that will issue the VCCs (whether a private or public entity) often both develops and determines what methodologies it will accept. Methodologies fall into two key brackets, nature-based and technology-based programs, and within each of those categories are methodologies that remove emissions and methodologies that remove or reduce emissions. Examples include: nature based removals through reforestation and technology based removals through carbon capture and sequestration and nature based reduction through reduced methane from ruminants and tech based reduction through clean energy switching. Each crediting program publishes the details of the methodologies it has already accepted. New projects may adopt an existing methodology or develop a new methodology subject to approval of the relevant crediting program.

14. The key actors at this stage are the project proponent and the project developer who may or may not be the same entity. The project proponent is the individual or entity that possesses overall control and responsibility for the project. The Project Developer often has a broader role in bringing the project to fruition, including sourcing finance and engaging with all stakeholders. Importantly the project proponent is usually the party into whose registry account the crediting program will first issue the VCC.

15. The project proponent creates a project design document (PDD) that describes all aspects of the project, including its boundaries, objectives, the methodologies, monitoring plan, and expected outcomes. The PDD also includes a baseline, "business as usual" emissions scenario that represents the level of emissions that would occur in the absence of the project. The PDD serves as the blueprint of the project and provides the basis for subsequent validation of the project and verification of the emissions reductions or removals. The project developer will also compile associated documentation including technical specifications, environmental impact assessments, financial analyses and expected environmental and social benefits.

16. The [project proponent] then seeks validation of the project by an approved third-party validation/verification body (VVB). A VVB has three main roles, (i) assess methodologies, (ii) validates projects and monitoring plans, and (iii) verifies the achievement of claimed emission reductions and removals. Validation involves an assessment of the project to determine if it conforms to the rules of the relevant crediting program and the applicable methodology and also the likelihood that the expected environmental and social benefits will be achieved. If the project passes validation, it may then be registered with the relevant crediting program. Registered projects are generally published by the crediting programs along with key documents in accordance with crediting program rules.

(b) Measurement, Reporting, and Verification (MRV)

17. Once a project is implemented it is continuously monitored, in accordance with the monitoring plan set out in the PDD. Such monitoring runs through pre-stated time periods (monitoring periods) that are appropriate to the project and methodology during which emissions reductions or removals and other social or environmental benefits are measured. Throughout the project's implementation, the [project proponent] ensures monitoring reports are generated to support the verification of the project impact by the VVB in accordance with crediting program requirements.

18. The VVB is responsible for verifying the claimed achievement of emissions reductions or removals and other project impacts as being accurate, real and in accordance with the relevant methodology and rules of the crediting program. Verification occurs periodically (verification period) which may or may not coincide with the monitoring periods. [The duration of a verification period is a practical matter relating to the methodology. For example, for a carbon capture and sequestration project linked to an energy plant such verification would be largely a desktop process done through analysis of data relating to energy production and may be done monthly, whereas verification of forestry project usually requires gathering primary data on the ground and may be done only every six months or less.] The VVB creates a verification report that confirms the achievement of the claimed emission reductions or removals. The verification report is then used as the basis for crediting program's issuance of the corresponding number of VCCs claimed in respect of that verification period.

19. This process is designated as the measurement, reporting, and verification (MRV) process.

(c) Issuance and a Registry

20. The verification report is submitted for approval to the crediting program in accordance with the relevant rules and protocols of that crediting program. Once approved the project proponent may instruct the crediting program to issue VCCs into its account at the relevant registry. The crediting program issues VCCs and the registry operator registers each VCC (or batch of VCCs) with a unique identifier in the account of the project proponent. Each VCC represents a claim to the achievement of either the verified emission reduction or removal of specific greenhouse gases (GHG) measured on a one tonne of CO_2-equivalent basis. The equivalence is measured using a conversion factor based on the relative global warming potential of the relevant GHG, by way of example the conversion factor for methane is approximately 30, meaning the removal of 30 tonnes of methane would be equivalent to $30tCO_2e$ or 30 VCCs.

21. Registries are electronic record-keeping systems designed for the purpose of maintaining records and related documents of projects and the VCCs that have been issued in respect of those projects. Registries may or may not be owned and/or operated by the crediting program. The issues relating to registries and their operation are not covered in this report, only to note that as the market matures so does the development of registry infrastructure and management.

2. Secondary Market Trading

22. Once issued, a VCC may be disposed of by the current holder and acquired by a new holder. The transfer between parties is recorded in the in the applicable registry account(s) on instruction from the transferring party to the registry operator. Such dispositions and acquisitions may occur multiple times in a secondary market.

23. In this context there is also a primary market that refers to the original purchase of the VCCs from the project proponent through bespoke spot or forward contracts. The purchasers in the primary market are often investors that generate pre-financing for the project in return for the delivery of the issued or to-be-issued VCCs. This is critical for the functioning of the market as there is a considerable time lag (sometimes years) between project initiation and issuance of VCCs when material capital is required for development and operation of the project. The investor may be a market intermediary intending to on-sell the VCCs in a secondary market or a party wanting the VCCs for their own purpose, whether for voluntary or compliance use.

24. Buyers and sellers in the secondary market may transact bilaterally or on an exchange for spot, forward or futures delivery. There are considerable developments underway in the secondary market infrastructure with the growth in regulated exchanges offering cleared contracts and uncleared trading, some offering trading in fungible digital receipts representing the holding of VCCs

in a registry and others offering platforms for the transfer of VCCs within registries. These developments are out of scope for these Principles. Of relevance is the settlement of any transaction for delivery of VCCs is completed by account transfer.

3. Use and Retirement

25. The final stage in the lifecycle of a VCC is retirement. Retirement refers to the process of permanently removing the VCC from the circulation ensuring it cannot be transferred or transacted again. To complete retirement the holder of the VCC instructs the registry operator to retire the VCC. It is usually required to notify the registry operator whether it is retiring on its own behalf or on behalf of another party and the purpose of retirement. The registry operator then moves, tags, freezes, removes or otherwise encumbers the relevant VCC as retired, thereby removing the ability of that unit to circulate. In effect all that remains is the information relating to the VCC and what it was retired for and not the VCC itself.

26. Some parties retiring a VCC may be doing so to demonstrate a commitment to voluntarily finance the reduction or removal of emissions outside of its own value chain through the purchase of VCCs. In other instances, a party may have a compliance obligation that it may fulfil through proof of retirement of eligible VCCs. The governance and guidance on use case for VCCs is out of scope of these Principles.

4. Cancellation

27. It is possible that post issuance an event may occur that affects the effectiveness of the pre-issuance verification. Such event may relate to either circumstances where post issuance the verification process is found to have been or is deemed to have been incorrect; or to circumstances where post issuance the beneficial effects of the relevant project are reversed (for example a forest fire).

28. In such circumstances the rules of the relevant carbon crediting program determine the process for suspending or cancelling such VCCs. The risks associated with such cancellations are usually allocated at a transaction level and risk mitigation tools including insurance are in development.

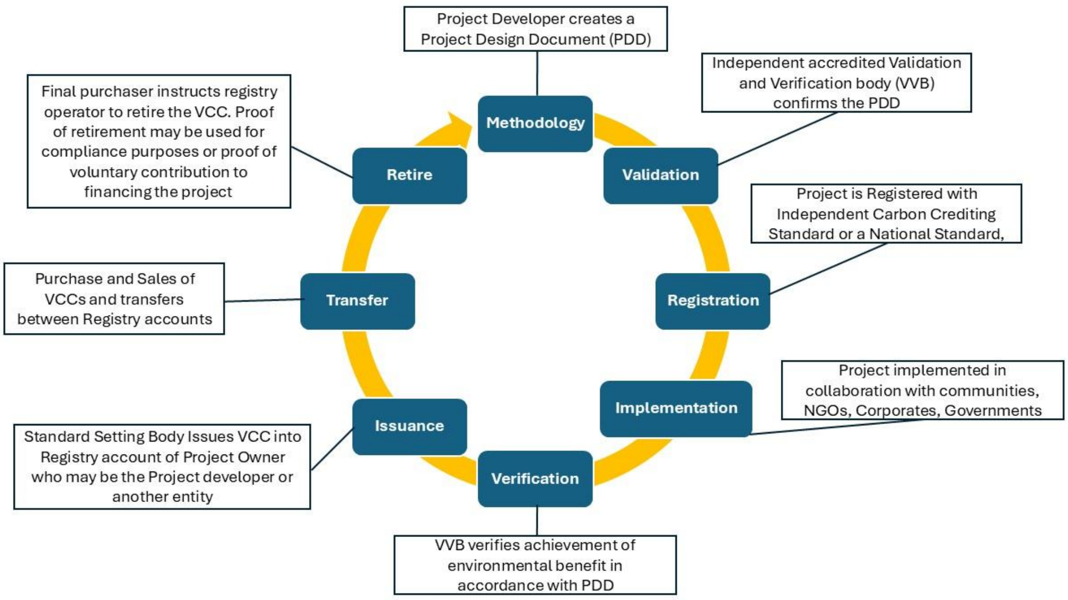

Fig (i) Life Cycle of a Verified Carbon Credit

5. Summary

29. VCCs are each transactable units that have been "issued" by a crediting program to represent a claim to one tonne of CO_2-equivalent emissions that has been verified as removed or reduced by a registered and validated project in accordance with the applicable crediting program and methodology. Each crediting program has its own set of rules and terms of business and may be a government, the UN or a private entity. VCCs are an important tool for providing finance upstream to environmental projects. Their importance and the size of the potential market is growing as the use case for VCCs expands in compliance and sectoral schemes and private entities are increasingly incentivized to purchase VCCs to make voluntary contributions to emissions mitigation projects. To facilitate the scaling of the market in VCCs and consequently provide financing to environmental projects it is necessary to ensure the issues relating to private law are clear to enable participants in the market to have certainty around the private transactions that raise the finance. [These Principles are intended to provide guidance to market participants, their advisors (including lawyers), and the courts and others who will consider the legal effects of these transactions. In sum, these Principles aim to reduce legal uncertainty which practitioners, judges, arbitrators, legislators, and market participants would otherwise encounter in the context of transactions in VCCs and thereby to help scale the VCMs, due to the positive externalities that they bring.]

30. Although the importance of VCCs as a mechanism for raising finance and distributing benefits is rapidly being recognised across all parties to the Paris Agreement, the legal nature and the regulatory oversight of the market of VCCs is uncertain in most jurisdictions. This uncertainty is an obstacle to scaling the finance needed to create impact. These Principles are designed to facilitate transactions in Verified Carbon Credits of the type covered by the Principles, which are defined in Principle [xx].

31. For transactions in these types of Verified Carbon Credits to have the maximum efficiency, it is important to have clear rules that apply to the key aspects of these transactions (briefly described in Commentary [xxx]). Without predictable results, the transactions will have inherent inefficiencies and there will be greater costs and a reduction in the value of the transactions in commerce.

32. These Principles are intended to provide guidance to principals in the transactions covered by these Principles, their advisors (including lawyers), and the courts and others who will consider the legal effects of these transactions. In sum, these Principles aim to reduce legal uncertainty which practitioners, judges, arbitrators, legislators, and market participants would otherwise face in the coming years in dealing with digital assets.

33. It is recommended that States adopt legislation consistent with these Principles. This will have several benefits. It will increase the predictability of transactions involving these assets that occur in those States. In addition, as these transactions frequently involve persons in different States, the greater the consistency among States, the greater the predictability in cross-border transactions. The increased predictability should reduce the costs of these transactions, both in direct transaction costs and pricing.

SECTION I: SCOPE AND DEFINITIONS

Principle 1

Scope

These Principles address the private law relating to verified carbon credits.

Commentary

1.1 These Principles are meant to provide guidelines for States to align their private laws with best practice and international standards regarding verified carbon credits (VCCs) as defined in Principle 2. Their aim is to foster clarity and uniformity in the private law treatment of VCCs, which is crucial for providing legal certainty and scaling up both primary and secondary markets for these assets. The Principles cover only private law issues relating to VCCs, and, in particular, proprietary rights (in the broad sense as explained in [Commentary 3.1]). Thus, they specifically address VCCs where these are the object of dispositions and acquisitions, and where rights and interests in VCCs are to be asserted against third parties. These Principles may include some matters that may be characterised as regulatory law, but generally they do not cover rules that are to be enforced by public authorities, such as rules regarding whether a person must obtain a licence for engaging in activities that concern VCCs.

1.2 Moreover, these Principles only address a specific subset of private law issues related to VCCs, while intentionally leaving many others out of their scope. For example, they do not cover matters concerning intellectual property, consumer protection or similar subjects and national law on these and similar subjects remain unaffected by the Principles. Also, they do not address many issues of contract law or property law, see Principle 3(3) and Commentary 3.6 – 3.10 .

Principle 2

Definitions

(1) 'Verified carbon credit' (VCC) means a unit that represents the achievement of a reduction in, or removal of, emission into the atmosphere of greenhouse gases equivalent to one tonne of CO_2 equivalent as a result of a carbon mitigation project if

(a) The achievement of the reduction or removal is verified by a positive verification statement;

(b) The positive verification statement is [approved][accepted] by a CCB;

(c) The unit is credited to an account in a VCC registry; and

(d) The unit is individuated using a unique identifier.

(2) 'Unit' means an intangible asset.

(3) 'Reduction' means a reduction in emission into the atmosphere of greenhouse gases equivalent to one tonne of CO_2 equivalent.

(4) 'Removal' means a removal of greenhouse gases equivalent to one tonne of CO_2 equivalent from the atmosphere.

(5) 'Unique identifier' means a number or other unique means of identification that relates to one VCC, or to a block of more than one VCC if a single record in a VCC registry relates to that block.

(6) 'Verified' means, in relation to an achievement of a reduction or removal, that a VVB has carried out a verification process resulting in a positive verification statement report.

(7) 'Verification statement', in relation to a VCC, can be either positive or negative. A positive verification statement means a statement that there has been an achievement of a reduction or removal as a result of the relevant carbon mitigation project in accordance with the applicable methodology. A negative verification report means a statement that there has not been such an achievement.

(8) 'Verification process', in relation to a VCC, is a process carried out by a VVB resulting in a verification statement.

(9) 'VVB' (validation and verification body) means a legal person that, in respect of a verification process, [is approved by the relevant CCB to carry out that verification process]

(a) is independent of any other natural or legal person
(i) who has undertaken the relevant carbon mitigation project or
(ii) who is to become or does become the first registered holder of the VCC
and

(b) produces a verification report as a result of that verification process.

(10) 'CCB' (carbon crediting body) means a legal person, including an ICCP, a Governmental body or an inter-governmental body, that, in relation to a VCC, performs [one or more of] the following functions:

(a) in relation to the carbon mitigation project from which the achievement represented by that VCC results, specification of the methodology applying to that carbon mitigation project;
(b) in relation to the carbon mitigation project from which the achievement represented by that VCC results, registration of that project in [ ];
(c) in relation to the VVB that carries out the verification process resulting in the positive verification report verifying that achievement, approval of the VVB to carry out that verification process;
(d) in relation to the positive verification report verifying that achievement, [approval][acceptance] of that report.

(11) 'ICCP' means an independent carbon crediting programme.

(12) Methodology

(a) 'Methodology' means a set of requirements for the implementation, [quantification][measurement], monitoring, reporting and assessment of achievement of a reduction or removal by a carbon mitigation project;

(b) The 'applicable methodology' in relation to a carbon mitigation project means that methodology [specified by a CCB as the methodology] [relating] [applying] to that carbon mitigation project.

(13) 'Carbon mitigation project' means a project aimed at the achievement of a reduction or removal.

(14) In relation to a transfer of a VCC:

(a) 'transfer' of a VCC means the change of a proprietary right in the VCC from a transferor to a transferee;

(b) the term 'transfer' includes the acquisition of a proprietary right in a VCC;

(c) 'transferor' means a person that initiates a transfer of a proprietary right in the VCC;

(d) 'transferee' means a person to which a proprietary right in a VCC is transferred;

(e) the term 'transfer' includes the grant of a security right in favour of a secured creditor, and 'transferee' includes a secured creditor.

(15) 'Reversal' means the loss or diminution of the benefits of a carbon mitigation project as a result of events following its issuance which lead to the cancellation of a VCC.

(16) 'Revocation' means the retrospective cancellation of a VCC when it is demonstrated that the benefits of a carbon mitigation project were never achieved from the outset.

(17) 'Retirement' means the voluntary cancellation of a VCC on the instruction of its registered holder.

(18) 'Principles law' means any part of a State's law which implements or is consistent with these Principles.

(19) 'Other law' means a State's [private] law to the extent that it is not Principles law.

(20) 'Insolvency-related proceeding' means a collective judicial or administrative proceeding, including an interim proceeding, in which, for the purpose of reorganisation or liquidation, at least one of the following applies to the assets and affairs of the debtor:

(a) they are subject to control or supervision by a court or other competent authority;

(b) the debtor's ability to administer or dispose of them is limited by law;

(c) the debtor's creditors' ability to enforce on them is limited by law.

(21) Words in the singular include the plural and those in the plural include the singular.

Commentary

2.1 The definitions in Principle 2 and Principles 12 and 14 are for the purposes of the Principles only and are not general definitions for any other purpose. They not only facilitate the reading of the Principles but also delineate the scope of the Principles. Each definition sets out the minimum characteristics that the defined concept, thing or person needs to have to fall within the defined word or phrase, and therefore to fall within the Principles. Each defined concept, thing or person is likely to have many characteristics other than those set out in the definition, but the presence or absence of these characteristics may vary, and does not affect whether the concept, thing or person falls within the relevant definition and therefore within the Principles. Generally, words defined in these Principles are defined in the singular, for ease of drafting. However, as Principle 2(21) points out, the singular includes the plural.

VCC

2.2 The definition of a verified carbon credit in Principle 2(1) is designed to reflect the nature of a VCC as an intangible asset (see Principle 2(2) and Commentary 2.5) that comes into existence as a result of the process that is described in [the life cycle]. The events leading up to the creation of a VCC are important, and in some cases, necessary precursors to the existence of that VCC. However, the VCC itself reifies the fact that these events have taken place and that (as verified, see Principle 2(6) and (7) and Commentary 2.8) emission into the atmosphere of greenhouse gases equivalent to one tonne of CO_2 equivalent has thereby been removed from the atmosphere or that there has thereby been a reduction in emission into the atmosphere of greenhouse gases equivalent to one tonne of CO_2 equivalent from the atmosphere. The definition in Principle 2(1) lists only those facts and events that are necessary (as a matter of Principles Law) for a VCC to exist. Depending on the circumstances, a VCC may represent additional facts, and may confer private law rights, such as a transferable contractual right against specific parties. However, because it is not always the case that a VCC represents these facts or confers these rights, they are not part of the constitutive elements in the definition for something to be a VCC within these Principles.

2.3 The definition of a VCC in Principle 2(1) includes a number of terms defined in subsequent Principles, each of which refers to an element that must be present for something to be a VCC. If something is a VCC, the Principles apply to it; it therefore can be the subject of proprietary rights (as defined broadly in Commentary 3.1), and therefore can be transferred (see Principle 6), used as collateral (see Principle 18), held in custody (see Principle 14) and so on. If something falls outside the definition, then it is not covered by the Principles, even though the term 'VCC' may be used colloquially to refer to it. As far as the Principles are concerned, such a thing is governed by 'other law' (see Principle 2(19)).

2.4 The following paragraphs in the Commentary explain the definition in Principle 2(1), including explaining the terms that are used in this definition. The terms used (many of which are defined) are defined for the purposes of the Principles.

2.5 A VCC is defined as a 'unit', which is itself defined as an 'intangible asset' (Principle 2(2)) The term 'intangible asset' is familiar in many jurisdictions, [with roots tracing back to the Roman law concept of *res incorporales*] and makes it clear that a VCC is not a tangible or corporeal thing. The use of the term 'unit', which is a word used for an individual thing, makes it clear that a VCC is individuated. This individuation is one of the important characteristics of a VCC that enables it to be the subject of proprietary rights (see Commentary 3.2).

2.6 A crucial element of the definition of a VCC is that it 'represents' the achievement of "a reduction in, or removal of, emission into the atmosphere of greenhouse gases equivalent to one tonne of CO_2 equivalent". The phrase in quotation marks is so important that it is set out in full in the definition of a VCC, even though, for ease of drafting in the rest of the Principles and in the Commentary, the terms 'reduction' and 'removal' are then defined. The definitions of these two terms reflect their use in the definition of a VCC exactly. These two definitions are solely for the purpose of these Principles and the Commentary.

2.7 The use of the term 'represents' signifies that a VCC reifies the fact that there has been a reduction or a removal. This reification is a critical element of the definition of a VCC. The word 'represents' is carefully chosen and does not entail any legal conclusion that a person with a proprietary right to a VCC has a proprietary right to the underlying reduction or removal. A reduction or removal, on its own, lacks the determinacy and other attributes necessary for something to be the subject of proprietary rights in private law. It is precisely for this reason that the definition of a VCC includes additional constitutive elements beyond merely the achievement of a reduction or removal. These constitutive elements must be met for a VCC to fall within the definition and therefore to be governed by the Principles.

2.8 The first constitutive element is that the achievement of the reduction or removal is verified by a positive verification statement (see Principle 2(6), (7) and (8) and see Commentary paragraph 2.15). Thus the achievement of a reduction or removal represented by a VCC is not just any achievement of a reduction or removal, but one that has undergone verification through a defined process. Moreover, the achievement of a reduction or removal represented by a VCC must have occurred as a result of a carbon mitigation project. This requirement reflects the reality that the creation and sale of a VCC is one of the methods by which carbon mitigation projects can be financed. A reduction or removal that was achieved by other means would not be able to be represented by a VCC (as defined). The phrase 'carbon mitigation project' is defined in Principle 2(13).

2.9 The second constitutive element that must be present for a VCC to fall within the definition is that the positive verification statement must have been approved by a CCB (defined in Principle 2(10)). A CCB may choose to make its approval decisions based on particular criteria, such as that a certain level of assurance is provided by the VVB in the verification statement. Approval is the process by which the positive verification statement is linked to the registration of the VCC. While approval may, [and often does] take place very shortly before or even contemporaneously with registration of a VCC, it is conceptually distinct. Approval, or sometimes the collective process of approval and instruction to register, is often referred to, colloquially, as 'issuance' (see Life Cycle paragraphs 9 and 14). The CCB who approves the report could be the same entity that runs the registry (the 'Registry Operator', see Principle 12(2)) although in these Principles these two people are treated as distinct as they have very distinct functions. If, as may be the case, the CCB is a different legal person from the Registry Operator, the distinction between approval and registration is clear. For a unit to be a VCC it cannot have been registered without the verification statement having been approved by the relevant CCB.

2.10 The third constitutive element that must be present for a VCC to fall within the definition is that the VCC must be recorded in a VCC registry. The term 'VCC Registry' is defined in Principle 12(1). Who actually instructs the registry to register the VCC will vary. It could be the CCB (defined in Principle 2(10)) who has approved the positive verification statement or it could be the project proponent (see Life Cycle paragraph 14). This does not matter as long as registration takes place. The instruction could be in any form. For example, it could be an electronic conformation of a pre-programmed request or even could be by the operation of a smart contract. As mentioned above, the Principles are drafted in the singular, and refer to one single VCC, but, as mentioned in paragraph 2.8 above, it is likely in practice that a verification statement will relate to the removal of, or reduction in, a number of tonnes of CO_2 equivalent, and therefore that a number of VCCs will be issued by one action and at the same time.

2.11 The fourth constitutive element is that the VCC must be individuated by a unique identifier. [The unique identifier is likely to be given to the VCC at the time of registration by the Registry Operator, but the definition is drafted so that this need not be the case.] Registration together with having a unique identifier means that a VCC has the characteristics of being identified and individuated. These characteristics are attributes that, in conjunction with other attributes, enable a VCC to be the subject of proprietary rights (see Principle 3(1) and the detailed discussion in Commentary 3.2).

2.12 However, as set out in Principle 2(21), the singular includes the plural in these Principles. Thus, if a block of a specific number of VCCs is given a unique serial number or other identifier, that block is individuated and can be the subject of proprietary rights. If, when that block is split up into smaller blocks or individual VCCs, a unique serial number is given to each smaller block or individual VCC, each smaller block or each VCC is then individuated. This splitting can occur if, for example, a block of 100 VCCs is credited to the registry account of A, and then 50 of those VCCs are debited from A's account and credited to the registry account of B and 50 of them are debited from A's registry account and credited to the registry account of C. Each block of 50 is then given a unique identifier, and B and C can each have proprietary rights in each block. If C then transfers one VCC from the block to D, and that one VCC is given a unique identifier, that VCC is individuated and capable of being the subject of proprietary rights, so that D can have a proprietary right in that one VCC. This point is further clarified in Principle 2(5).

2.13 Furthermore, as is made clear in Principle 12, a VCC is registered in a VCC Registry by crediting it to an account of a person (a 'registry accountholder' as defined in Principle 12(4)), whereupon that person becomes a 'registered holder' of the VCC. Thus, the VCC is able to be controlled in the way described in Commentary 3.2, which is another attribute that enables a VCC to be the subject of proprietary rights.

Verified

2.14 A verification process is a process carried out by a VVB (see Principle 2(9) and Commentary 2.15) to confirm that the achievement of the stated reduction or removal has in fact occurred as a result of the carbon mitigation project in accordance with the methodology. As a result of the process, the VVB will produce a statement that concludes either (a) that a removal of, or reduction in, emission into the atmosphere of greenhouse gases equivalent one tonne of CO_2 equivalent has taken place in the course of the carbon mitigation project (a positive verification statement), or (b) that it has not (a negative verification statement). The statement will [typically] give reasons for this conclusion. The achievement of a removal or reduction is verified if the verification statement reaches the first of these conclusions and is therefore a positive verification statement. It should be noted that, although this description is couched in terms of emission into the atmosphere of greenhouse gases equivalent to a single tonne of CO_2 equivalent, thus relating to a single VCC, a verification statement can, and often does, relate to a stated number of tonnes of CO_2 equivalent.

VVB

2.15 A VVB (validation and verification body) is a legal person who carries out a verification. A legal person is a person with legal personality, such as a company, but is not a natural person (a human being), although the legal person will use natural persons, such as employees, to carry out the verification. While a VVB is likely to have many characteristics (such as being an expert in a particular field), only one is required by the definition for a person to be a VVB within the Principles (and therefore for a VCC (as defined) to be able to represent an achievement of a removal or reduction verified by that person). This characteristic is that the VVB is independent of any person who has undertaken the relevant carbon mitigation project (such as the project proponent or project developer, see Life Cycle paragraph 14, or who is to become or does become the first registered holder of the VCC (while this would often be the project proponent, see Life Cycle paragraph 14, it could also be a funder). This independence is such a critical part of the system relating to VCCs, that it is part of the definition of VCC, so that something representing a removal or reduction that has been verified by a non-independent VVB is not a VCC within the Principles. It is also best practice for the VVB to be accredited, by a [recognised verification body], to carry out such verifications.

CCB

2.16 A CCB (carbon crediting body) is defined in Principle 2(10). A CCB is a generic term for various types of carbon crediting programmes. One type is an ICCP (see Principle 2(11) and paragraph 2.17) and other examples are UN crediting programmes and Government crediting programmes (see Life Cycle paragraph 9). The functions of a crediting programme are described in the Life Cycle. Put briefly, a crediting programme does some or all of: developing methodologies, determining what methodologies it will accept, publishing details of accepted methodologies, setting rules [and monitoring compliance with rules and methodologies], registering validated projects, approving verification statements, instructing a VCC registry to register one or more VCCs, [cancelling a VCC in accordance with the rules of the crediting programme]. Many of these activities predate the verification process, and therefore, while they are very important as part of the background to the creation of a VCC, are not covered by the Principles. For this reason, only those activities that [postdate the verification process] are included in the definition of CCB in Principle 2(10) for the purpose of the Principles.

ICCP

2.17 The acronym ICCP is defined as 'independent carbon crediting programme'. An ICCP is one type of crediting programme (see paragraph 2.16).

Methodology

2.18 The definition of a methodology makes it clear that it is a set of requirements relating to the achievement of a reduction or a removal by a carbon mitigation project. It covers not only how the project is to be implemented, but also how it is to be monitored, quantified and assessed. For a detailed description of a methodology, see Life Cycle paragraph 13. As mentioned above, a methodology will usually be developed, or at least accepted, by a crediting programme. The term 'applicable methodology' is also defined, as the methodology that applies to the carbon mitigation project as a result of which the achievement of the reduction or removal represented by the VCC occurs. In relation to a particular VCC (or VCCs) the verification process relates to the 'applicable methodology', thus ensuring that the achievement of the reduction or removal is verified as resulting from a particular carbon mitigation project (see paragraph 2.8 above).

Carbon mitigation project

2.19 As mentioned above, it is only if the removal or reduction results from a carbon mitigation project that it can be represented by a VCC as defined in the Principles. The definition of a carbon mitigation project in Principle 2(13) makes it clear that a carbon mitigation project is one aimed at a reduction in, or removal of, emission into the atmosphere of greenhouse gases equivalent to one tonne of CO_2 equivalent. The way in which a carbon mitigation project is typically developed and carried out is described in detail in the Life Cycle (paragraphs 13 – 16). [A carbon mitigation project can form part of a wider programme called a carbon mitigation programme].

Transfer

2.20 A transfer, as defined in Principle 2(14), means the change of a proprietary right in a VCC from one person (a 'transferor') to another (a 'transferee'). This concept is functional and intentionally broad, encompassing all types of proprietary rights, whether in whole or in part. It includes not only the transfer of full ownership rights, but also the transfer of limited proprietary rights such as usufruct or other partial rights recognised under national law.

2.21 In these Principles, the term 'transfer' is also used to denote the grant of a security right in favour of a secured creditor, and consequently, a 'transferee' includes a secured creditor. It is important to note that this broad use of 'transfer' is purely definitional within the context of these Principles. It does not imply that the grant of a security right necessarily constitutes a transfer of ownership or any other proprietary right under applicable national laws. This approach aligns with other international instruments, such as the Hague Securities Convention, which in Article 1(1)(h) defines 'disposition' to include both outright transfers of title and grants of security interests, whether possessory or non-possessory.

2.22 A transfer as defined here, i.e. a change of a proprietary right in a VCC, must be distinguished from a change in the registry account to which a VCC is credited. A change in the registry account to which a VCC is credited may or may not be associated with a transfer of proprietary rights. A custodian (as defined in Principle 14(3)), for instance, may have a VCC credited to its registry account for the benefit of a client, but will typically not acquire 'ownership' (as defined under the applicable national law) of that VCC. Conversely, a transfer of proprietary rights may or may not be accompanied by a change of registry account to which the VCC is credited. A State's law, for instance, may provide that under certain circumstances a proprietary right (such as ownership) in a VCC may pass to another person while it remains credited to the same account. An example of this could be a court-ordered transfer of ownership in a divorce settlement, where the VCC remains in the original account but legal ownership changes.

2.23 These Principles do not exhaustively prescribe the conditions for a proprietary right in a VCC to be validly transferred to another person. [Although Principle 7(4) prescribes the conditions for a transferee to qualify as an innocent acquirer], these Principles do not dictate all the requirements for a valid transfer of a VCC. For instance, they do not specify whether an agreement in a particular form is required, or consideration is necessary for the transfer, or if authorisation from any regulatory bodies is required for the transfer to be valid. These and other specific requirements for a valid transfer are left to other law, which may vary across jurisdictions.

2.24 The term ‘transferor’ is defined as ‘a person that initiates a transfer’ because [the person may have the power to transfer greater rights than the person has]. [Indeed, a person to whose account a VCC is credited may have no rights at all but has the power to transfer rights to an innocent acquirer]. [See Principle 6(1) and Commentary 6.1].

Reversal

2.25 Before dealing with reversal, revocation, and retirement, it is helpful to explain cancellation. Cancellation is the opposite of creation and a VCC is cancelled when it ceases to be the subject of a proprietary right (see Principle 8). Like creation, there is no definition of cancellation in Principle 2.

2.26 Similarly to revocation (Principle 2(16)) and retirement (Principle 2(17)), a reversal leads to the cancellation of a VCC (see Principle 9 read with Principle 8). Principle 2(15) distinguishes reversal from revocation and retirement however in that cancellations for reversal are the result of post-issuance events leading to a reversal of the benefits of a carbon mitigation project. Beyond Principle 8, which deals with the effect of cancellation generally, Principle 9 clarifies the proprietary consequences of cancellations for reversal and its Commentary further clarifies other legal consequences that could follow.

Revocation

2.27 Similarly to reversal (Principle 2(15)) and retirement (Principle 2(17)), a revocation leads to the cancellation of a VCC from the outset (see Principle 10 read with Principle 8). Principle 2(16) distinguishes revocation from reversal and retirement however in that revocations are the result of events leading up to issuance, typically fraud, that lead to the issuance of VCCs that would otherwise not have been issued. Beyond Principle 8, which deals with the effect of cancellation generally, Principle 10 clarifies the proprietary consequences of cancellations for revocation and its commentary further clarifies other legal consequences that could follow.

Retirement

2.28 Similarly to reversal (Principle 2(15)) and revocation (Principle 2(16)), a retirement of a VCC results in its cancellation (see Principle 11 read with Principle 8). Unlike reversal and revocation, however, which result in the cancellation of a VCC regardless of the intent of its registered holder, cancellation for retirement follows from the instruction of a registered holder and thus is dependent on its intent. Again unlike reversal and revocation, cancellation by way of retirement marks the end of the intended normal life cycle of a VCC. Although the instruction for retirement will be given by the registered holder of a VCC, the registered holder may or may not have a proprietary right in that VCC, for example, the registered holder may be acting as a custodian (see Principle 14). In such cases, the registered holder will be acting on agency or other similar legal principles (see Principle 11).

Principles Law and Other Law

2.29 Under Principle 1, these Principles cover private law issues relating to VCCs. They include various rules such as the rule that a VCC can be the subject of proprietary rights, and rules concerning transfer and custody of, and the taking of security in, VCCs. [[treatment on insolvency] maybe others…]. ‘Principles Law’ as defined by Principle 2(18) refers to all the rules in the Principles once they have become part of a State’s law, whether by express implementation, or because that State’s law is already consistent with them. Within the law of a State, all law that is not 'Principles law’ as defined here is referred to in these Principles as ‘other law’ (see Principle 2(19)). ‘Principles law’ and ‘other law’ as defined here together form ‘the law’. Other law includes administrative rules and judicially determined law, as well as legislation.

Insolvency-related proceeding

2.30 The definition of 'insolvency-related proceeding' is not meant to provide a general definition of insolvency proceedings but defines the concept only for the purpose of these Principles. A general definition of 'insolvency proceedings' can be found in the UNCITRAL Legislative Guide on Insolvency Law and subsequent insolvency law texts. The definition in Principle 2(20) seeks to include all forms of collective insolvency-related procedures, which may take place in court or out of court, so long as the procedure is aimed at dealing with a debtor's current or immediate financial or economic distress and some legal effect is attached to the commencement of the procedure. This definition captures the new generation of insolvency proceedings whose legal design, often labelled as 'hybrid', features characteristics of both formal in-court proceedings and out-of-court contractual collective workouts. The term 'insolvency-related proceeding', as defined in Principle 2(20), would include full in-court proceedings; proceedings the opening of which entails a limitation in the debtor's ability to manage and/or dispose of its assets outside the ordinary course of its business; and proceedings which merely trigger a temporary stay of enforcement against the debtor's assets necessary for the continuation of the business activity. Hence, unlike other legal texts such as the 2009 UNIDROIT Convention on Substantive Rules for Intermediated Securities ('Geneva Securities Convention') (Article (1)(h)), a debtor would find itself in an 'insolvency-related proceeding' for the purposes of these Principles even where its assets are not subject to the control or supervision of the court or an administrative authority.

Principle 3

General Principles

(1) A VCC can be the subject of proprietary rights.

(2) Principles law takes precedence over other law to the extent that they conflict.

(3) Except as displaced by these Principles, other law applies to all issues, including:

(a) whether a person has a proprietary right in a VCC;

(b) whether a proprietary right in a VCC has been validly transferred to another person;

(c) whether a security right in a VCC has been validly created;

(d) the rights as between a transferor and transferee of a VCC;

(e) the rights as between a grantor of a security right in a VCC and the secured creditor to whom the security right is granted;

(f) the legal consequences of third-party effectiveness of a transfer of a VCC;

(g) the requirements for, and legal consequences of, third-party effectiveness of a security right in a VCC.

Commentary

3.1 Principle 3(1) makes it clear that a VCC, [an intangible asset] as defined in Principle 2, is capable of being the subject of proprietary rights. All the other rules in these Principles are built on this premise. The phrase 'proprietary rights' is deliberately used in a broad sense, reflecting the functional approach of these Principles, which intend to cater for the largest variety of jurisdictions possible. 'Proprietary rights' includes both proprietary interests and rights with proprietary effects, that is, rights (or interests) that can be asserted against third parties (persons that are not necessarily contractual parties). For example, in the context of insolvency, an insolvency representative might assert a right or interest in a VCC on behalf of the insolvency estate against third parties, or a third party might assert a right or interest in a VCC against an insolvency representative. The term 'proprietary rights' is not limited to absolute rights or interests, and includes, for example, security rights.

3.2 A VCC (as defined) has attributes that make it possible for it to be the subject of proprietary rights. First, it is individuated: a VCC is registered using a unique identifier. A VCC itself is unique, and can be identified. Second, it can be controlled in that a VCC is registered by being credited to an account of a specified registry account holder (see Principle 12(4)). That registry account holder (who becomes, on registration of a specific VCC, the 'registered holder' of that VCC, (see Principle 12(6)), is the only person who can instruct the registry to transfer or retire that VCC. Third, a VCC is rivalrous in the sense that if one person 'has' it (i.e. controls it) another does not, and if one person 'uses' it (for example, by retiring it) another person cannot. Fourth, a VCC can be transferred from A to B by debiting A's registry account and crediting B's registry account. For these reasons, a VCC, although representing a fact (or, to put it another way, information) is susceptible to being dealt with in the same way as other types of asset which are capable of being the subject of proprietary rights, and therefore should itself be capable of being the subject of propriety rights.

3.3 [Whether VCCs can be the subject of proprietary rights (a legal consequence) must be distinguished from the classification of them in any particular jurisdiction. For example, in certain jurisdictions a VCC could be classified as 'property', 'a good', 'a thing' or a similar concept, but this would depend on the applicable law in question and is left for each State to decide. [If the law of a State includes a classification of different categories of assets that can be the subject of proprietary rights, and these different categories have different consequences, it is recommended that the law of that State should specify which category or categories of assets VCCs are. That is in order that VCCs can be the subject of proprietary rights in that State. This could mean the introduction of a new category of assets, but again, this is left for each specific State to decide.]

3.4 While Principle 3(1) states that a VCC (as defined) is capable of being the subject of proprietary rights, it does not prescribe any specific requirements for the acquisition of a proprietary right in a given VCC. Whether a person has a proprietary right in a VCC is left up to 'other law', as is whether a proprietary right in a VCC has been transferred from one person to another, see Principle 3(3).

Principle 3(2)

3.5 To give the rules of these Principles full effect, Principle 3(2) provides that they should take precedence over State laws wherever they conflict. Consequently, once they have been adopted and implemented into the law of a State, these Principles (by then 'Principles law' as defined in Principle 2(18)) must take precedence over other law (as defined in Principle 2(19)).

Principle 3(3)

3.6 Principle 3(3) makes it explicit that other law (as defined in Principle 2(19)) continues to apply to VCCs. For this purpose, Principle 3(3) lists several examples of issues of property law, but also of contract law, that may continue to be addressed by a State's other law, because these Principles do not cover those issues, nor do they intend to change or derogate from that other law. The list is not intended to be exhaustive or limitative. Although Principle 2(14) defines 'transfer' (as used in these Principles) as including the grant of a security right in favour of a secured creditor, the list in Principle 3(3) refers separately to transfers and security rights. This is for clarity of exposition, and because Principle 3(3) lists matters to which other law applies.

3.7 The examples in Principle 3(3) of issues that continue to be addressed by other law can be categorised as follows. First, Principle 3(3)(a) concerns the static situation in which it must be determined whether a person has a proprietary right in a VCC. Pursuant to Principle 3(3)(a), the requirements for a (valid) right or interest in a VCC that can be asserted against third parties continue to be a matter of other law. Therefore, and by way of example, whether, in any given factual situation, a person holds a valid right of ownership in a certain VCC, is, as a matter of principle, not regulated by these Principles.

3.8 Second, Principles 3(3)(b) and 3(3)(c) concern dynamic situations of acquisition and disposition of a VCC from the perspective of the transferor and security right provider respectively. If the question arises whether a person has validly transferred a proprietary right, or validly created a security right, in a VCC, Principles 3(3)(b) and 3(3)(c) make it clear that the requirements for a (valid) transfer or creation of a security right continue to be, as a matter of principle, a matter of other law. However, this last statement is subject to some exceptions, where these Principles provide specific rules regarding the transfer of, and third-party effectiveness of a security right in, a VCC [(Principles 19, 20 and 21)].

3.9 Principles 3(3)(d) and 3(3)(e) make explicit that the relationships between a transferor and a transferee, and between a grantor of a security right and the relevant secured creditor, respectively, continue to be a matter of other law and are not, as a matter of principle, dealt with by these Principles. In some situations and some jurisdictions, these relationships are characterised as primarily contractual in nature. Principles 3(3)(d) and 3(3)(e) provide that the rights between a transferor of a VCC and the transferee, and between a grantor of a security right in a VCC and the secured creditor, are left to be dealt with by other law, whatever the qualification of the relationships between those parties.

3.10 As explained above, Principles 3(3)(d) and 3(3)(e) concern the (contractual) relationships between a transferor and a transferee, and between a grantor of a security right and the relevant secured creditor, respectively. These provisions thus concern *inter se* relationships, i.e. relationships between (contracting) parties. Principles 3(3)(f) and 3(3)(g), on the other hand, concern *erga omnes* relationships, i.e. the relationships with third parties. Pursuant to Principles 3(3)(f) and 3(3)(g), whether a transfer and a security right, respectively, can be asserted against third parties, continues to be, as a matter of principle, a matter of other law. In some jurisdictions, the 'assertability' of a right or interest against third parties follows from the concept of 'effectiveness'. Principles 3(3)(f) and 3(3)(g) provide that, whatever the doctrinal context, the requirements for such effectiveness or assertability continue to be, as a matter of principle, a matter of other law, except where the Principles provide other rules (see Principles 7 and 18).

SECTION II: PRIVATE INTERNATIONAL LAW

Principle 4

Applicable Law

SECTION III: CREATION AND TRANSFER

Principle 5

Creation

(1) A VCC comes into existence when it is recorded in the VCC Registry that the VCC or a block of VCCs has been credited to an account in the VCC Registry.

(a) Subject to paragraph (b) the registered holder of a VCC at the moment it comes into existence has a proprietary right in that VCC;

(b) If, at the moment that a VCC comes into existence, the registered holder maintains the VCC for a client, that client has a proprietary right in that VCC.

(2) After that moment, [subject to Principle 7] the question of whether a person has a proprietary right in a VCC is a matter for other law.

Commentary

5.1 Principle 5(1) specifies the moment at which a VCC comes into existence. While approval of the relevant positive verification statement (see Principle 2(7) and Commentary 2.9) and individuation of the VCC using a unique identifier (see Principle 2(5) and Commentary 2.11 to 2.12) are necessary preconditions of the VCC coming into existence, it does not become a VCC as defined in Principle 2(1) until it has been registered in a VCC Registry. Typically registration and the allocation of a unique identifier will take place at the same time. At that point, Principle 3(1) applies and it can be the subject of proprietary rights.

5.2 In these Principles, the singular includes the plural (Principles 2(21)). This is for ease and precision of drafting. However, in most, if not all, cases, a carbon mitigation project will achieve a reduction in, or a removal of, emission of greenhouse gases from the atmosphere equivalent to more than one tonne of CO_2 equivalent. Thus, the positive verification report will relate to a reduction in, or a removal of, emission of greenhouse gases from the atmosphere equivalent to more than one tonne of CO_2 equivalent, which will be represented by more than one VCC. In many cases, as mentioned in Commentary paragraph 2.12, a block of VCCs will be recorded as credited to one account in the VCC Registry. That block may, in some cases, be given a single unique identifier, with a view to new unique identifiers being given to smaller blocks or single VCCs if they are later split from the larger block (see Commentary paragraph 2.12). For this reason, Principle 5(1)(a) and (b) refers to a VCC or a block of VCCs. However, the rest of Principle 5 is simplified by referring merely to a single VCC, and the content applies *mutatis mutandis* to each and every VCC in a block.

5.3 A VCC, once it comes into existence, is a new unit that has not, previously, been capable of being the subject of proprietary rights. Therefore, there has to be a person who is the first to have a proprietary right in the VCC. In practice, that person is usually the project proponent, who is then able to sell the VCC and can use the price to fund its financing of the carbon mitigation project (see Life Cycle paragraphs 22–24).

5.4 In a situation where the registered holder is not maintaining the VCC for anybody else, Principle 5(2) provides that that person is the registered holder (as defined in Principle 12(6)) (see Principle 14(5) for a definition of 'maintain'). If the registered holder maintains the VCC for a client, so that the registered holder is a custodian within the definition in Principle 14(3), Principle 5(2) provides that the client has a proprietary right in the VCC. The relationship between a custodian and a client is covered by Principle 17(1), which provides that a VCC maintained by a custodian for a client is not available for the satisfaction of claims of creditors of the custodian. How this conclusion is achieved in a State's law will vary. In some jurisdictions, it will be achieved by the custodian (the registered holder) having no proprietary rights in the VCC, while the client does have proprietary rights in the VCC. In other jurisdictions it will be achieved by both the custodian and the client having (different) proprietary rights in the VCC. Principle 5(2) must be read in the light of this analysis. In the former jurisdictions, it will be only the client who has proprietary rights in the VCC, while in the latter jurisdictions both the registered holder (the custodian) and the client will have proprietary rights (but of different sorts) in the VCC.

5.5 It should be remembered that Principle 5(2) only applies at the moment when the VCC comes into existence. As is made clear by Principle 5(3), after that point, all questions of whether a person has a proprietary right in a VCC are governed by other law (see Principle 3(3)). Principle 3(3) is subject to Principle 7, which sets out the circumstances in which a person will take a VCC free from conflicting claims, and which is a matter of Principles law.

Principle 6

Transfer

(1) Subject to Principle 7, a person can transfer only the proprietary rights that it has in a VCC, if any, and no greater proprietary rights.

(2) A transferee of proprietary rights in a VCC acquires all of the proprietary rights that its transferor had or had the power to transfer, except that the transferee acquires rights only to the extent of the rights that were transferred.

Commentary

Principle 6(1): nemo dat rule

6.1 Principle 6(1) embodies the fundamental principle of *nemo dat quod non habet*—no one can give what they do not have. It states the general rule that a transferor cannot convey rights in a VCC that they themselves do not have. However, *nemo dat* is not an absolute proposition within these Principles. It is qualified under Principle 7, which introduces an exception for innocent acquisition. This provision is designed to balance the protection of original owners with the need for transactional certainty and the facilitation of commerce in the context of global carbon markets where legal certainty is paramount.

Principle 6(2): shelter rule

6.2 Principle 6(2) embodies the shelter principle: a transferee acquires all the rights of the transferor that were transferred or that the transferor had the power to transfer. In these Principles, the inclusion of this rule clarifies that a transferee's rights are derivative of the transferor's rights. The phrase 'power to transfer' references and underscores the innocent acquisition rule articulated in Principle 7. This highlights the fact that, in certain instances, a person may be able to transfer rights they do not themselves have, whether through innocent acquisition or other circumstances where the law recognises such power. Principle 6(2) also recognizes that a transfer may be limited in scope - the transferee acquires only those rights that the transferor intended to convey through the transfer, not necessarily all rights that the transferor could have transferred.

Principle 7

Innocent Acquisition

(1) An innocent acquirer takes a VCC free of conflicting proprietary rights.

(2) No rights based on a proprietary claim relating to a VCC can be successfully asserted against an innocent acquirer of that VCC.

(3) An innocent acquirer can acquire a proprietary right in a VCC even if the transferor is acting wrongfully and has no proprietary right in the VCC.

(4) In order to qualify as an innocent acquirer, a transferee must:

> **(a) acquire the VCC from a transferor that is the registered holder of the VCC at the time of transfer;**
>
> **(b) have the VCC credited to their registry account by the VCC registry; and**
>
> **(c) comply with requirements equivalent to those found in the relevant good faith acquisition and take-free rules as specified by the relevant State.**

(5) A transferee of a VCC is not an innocent acquirer if the transfer of the VCC is made by way of gift or otherwise gratuitously and is not the grant of a security right.

Commentary

Principle 7(1)-(3): Innocent acquisition rule

7.1 As stated in Principle 6 and its Commentary, the basic rule of *nemo dat quod non habet* applies to VCCs. However, this is subject to the innocent acquisition rule set out in Principle 7, which serves as an exception to the general rule.

7.2 Principle 7(1) and 7(2) states that an innocent acquirer takes free of conflicting proprietary rights, and no rights based on a proprietary claim can be asserted against an innocent acquirer. Principle 7(3) makes clear that a transferee may qualify as an innocent acquirer even when acquiring a VCC from a transferor who obtained the VCC through wrongful means. Examples include cases in which the transferor obtained the VCC through fraud, breach of fiduciary duty, or unauthorised access to another person's registry account. The rule applies regardless of how the transferor obtained the VCC, provided the acquirer meets the requirements set out in Principle 7(4)-(5).

7.3 The innocent acquisition rule endows VCCs with attributes similar to those of negotiable instruments, negotiable documents of title, and negotiable certificated securities in many common law and civil law jurisdictions. This attribute enhances the transferability and liquidity of VCCs, as market participants can rely on their ability to acquire them free of unknown claims, provided they meet the requirements for an innocent acquisition.

7.4 It is recognised that the result of an innocent acquisition rule is that, in some circumstances, a person with a proprietary claim, who is the victim of wrongful activity, will not be able to assert that claim successfully against the innocent acquirer. The victim would have a claim against the wrongful actor, but that is unlikely to be effective. While this could be perceived as inequitable to the original owner, the rule embodies a deliberate policy choice favouring transactional certainty over strict protection of proprietary claims. In international carbon markets, where speed, efficiency, and trust are critical, the innocent acquisition rule provides a mechanism to reduce transactional risk and enhance market confidence. Without such a rule, potential acquirers might hesitate to participate in transactions, fearing hidden claims against VCCs, particularly in a cross-border context where legal systems vary. By prioritising the innocent acquirer's rights, the rule creates a robust and predictable framework for VCC trading, encouraging investment and liquidity in the market.

Principle 7(4): requirements for innocent acquisition

7.5 Principle 7(4) sets out the requirements for a transferee to be an innocent acquirer. The first is that the transferee must acquire the VCC from a transferor that is the registered holder for that VCC. This requirement restricts the scope of the innocent acquisition rule by establishing a crucial qualification for the transferor – only a person who appears as the registered holder of a VCC in the relevant registry can transfer the VCC in a way that triggers innocent acquisition protection. This requirement acknowledges and reinforces the public notice function of registries and their fundamental role as authoritative sources of information in VCC trading. As a practical consequence, any person acquiring a VCC from someone who is not a registered holder must undertake appropriate due diligence to verify the transferor's authority and title to transfer.

7.6 The second requirement is that a transferee must have the VCC credited to their registry account by the VCC registry operator. This requirement serves as a critical public notice mechanism that makes the transfer visible to market participants. Moreover, this registration requirement enables the transferee to subsequently become a transferor capable of initiating another innocent acquisition. The timing of registration is particularly significant as it marks the moment when innocent acquisition protection crystallizes. This underscores the central role of registries as the primary source of legally significant information about VCC ownership and transfers.

7.7 It is important to note that the registry's role in crediting VCCs to an acquirer's account does not imply that the registry confirms or warrants title to those VCCs. Registries operate as neutral infrastructure providers that credit and debit accounts in accordance with their terms of service, following instructions from their account holders. The registry requirement in Principle 7(4)(b) serves a public notice function analogous to that of possession in many good faith purchase exceptions across numerous jurisdictions. The action of a registry in crediting a VCC to an acquirer's account is merely an objective criterion for the application of the innocent acquisition rule and does not impose upon registries any duty or responsibility to substantively determine whether a party qualifies as an innocent acquirer. The final determination of whether a transferee meets all requirements to be considered an innocent acquirer remains a matter for the applicable national law.

7.8 The third requirement is that the innocent acquirer must comply with the requirements specified by the relevant State (that is, the State whose domestic law is the applicable law). As indicated by Principle 7(4)(c), States retain flexibility in determining the precise requirements for innocent acquisition of VCCs within their jurisdiction, provided these requirements align with their existing good faith acquisition and take-free rules for other types of assets. This flexibility allows States to integrate VCC transfers into their existing legal frameworks while maintaining consistency with their treatment of other assets.

Principle 7(5): exclusions

7.9 Principle 7(5) excludes gratuitous transfers from innocent acquisition protection. This exclusion reflects a long-standing principle found in many legal systems—from the innocent acquisition rules in common law jurisdictions to the *possession vaut titre* doctrine in civil law traditions—that special protection of acquirers against competing proprietary claims should be limited to those who have given value. This approach rests on two key considerations. First, the deprivation of an original owner's rights can only be justified where the acquirer has given value in exchange for the VCC – there is no policy basis for preferring a gratuitous recipient over the original owner's proprietary claim. Second, while the innocent acquisition rule aims to enhance transferability and liquidity in VCC markets by protecting parties engaged in voluntary market exchanges, these market efficiency objectives have no application to gratuitous transfers. Recipients of gifts or other gratuitous transfers must therefore rely on the general rules of transfer under Principle 6, taking only such rights as their transferor had to give.

7.10 The Principle makes an exception for transfers related to the grant of a security right (e.g., using a VCC as collateral for a loan). While such transfers might not involve an immediate exchange of value, they are embedded in commercial transactions with underlying obligations. As such, they are not gratuitous and align with the value-driven rationale of innocent acquirer protection. Transferees in these cases may still qualify as innocent acquirers if they meet the requirements set out in Principle 7(4). This carve-out ensures that legitimate secured transactions involving VCCs remain protected as value-generating commercial arrangements. By drawing this distinction, Principle 7(5) maintains the balance between protecting legitimate commercial interests and preserving the rights of original owners against unauthorised dispositions.

Scope Limitation of the Innocent Acquisition Rule

7.11 The innocent acquisition rule in Principle 7 does not address issues related to the existence of a VCC. It is not intended to rectify defects that would render a VCC revocable or reversible because it is demonstrated that creation requirements were never satisfied from the outset or because, due to subsequent events, it ceases to meet the definition of a VCC (See Principles 9 and 10 on Reversal and Revocation). Rather, the innocent acquisition rule is specifically designed to address defects in the transfer of proprietary rights in VCCs. The rule operates on the assumption that the VCC in question is valid and focuses solely on protecting innocent acquirers against competing proprietary claims that might arise in the transfer process.

7.12 Similarly, the innocent acquisition rule does not address situations where a party creates VCCs in breach of contractual obligations or through tortious or criminal conduct. These matters are governed by the relevant laws concerning contracts, torts, and criminal liability. However, once VCCs exist, the innocent acquisition rule applies to protect qualifying transferees, regardless of any underlying contractual disputes or misconduct that may have occurred during their creation or initial registration.

Illustration 1

7.13 Company A is the registered holder of 1,000 VCCs in Registry X. Company B fraudulently induces Company A to enter into a contract for the transfer of these VCCs. Based on this fraudulent contract, Company A instructs Registry X to debit its account and credit Company B's account with the 1,000 VCCs. Company B is not an innocent acquirer because it acquired the VCCs through fraud.

7.14 Subsequently, Company B transfers 500 of these VCCs to Company C, which pays market value and is unaware of the fraud. Company B instructs Registry X to debit its account and credit Company C's account, which Registry X does in accordance with its terms of service. Registry X does not confirm title or warrant that any account holder has good title to the VCCs; it merely follows the instructions of its account holders according to its account terms.

7.15 Later, Company A discovers the fraud. Company A attempts to assert a proprietary claim to recover the VCCs from Company C. Under Principle 7, Company C qualifies as an innocent acquirer because it acquired the VCCs for value, in good faith, from Company B (who was the registered holder at the time of transfer), and had the VCCs credited to its registry account. As an innocent acquirer, Company C takes the VCCs free of Company A's conflicting proprietary claims, notwithstanding that Company B acquired them through fraud. Company A can only take action against Company B for fraud.

SECTION IV: CANCELLATION

Principle 8

Cancellation

(1) A VCC that is cancelled ceases to be the subject of a proprietary right even if the VCC registry retains the record of its existence after its cancellation.

(2) A VCC can be cancelled as a result of a reversal in a carbon mitigation project, because it has been revoked, or when it is retired.

(3) Upon cancellation,

(a) the VCC registry must not comply with any instruction given by the registered holder or a user authorised by the registered holder to move the VCC into the account of another person or to retire the VCC.

(b) the VCC registry no longer owes the VCC's registered holder the duty set out in Principle 13(1)(d).

(c) the VCC registry must record that the VCC is cancelled if it retains a record of its existence.

(4) The effective time of cancellation of a VCC will depend on the cause for cancellation.

(5) Should a VCC be cancelled in error, the rights and remedies of the parties affected, including the possibility of the restoration of the VCC, is a matter for other law.

Commentary

8.1 Principle 8(1) provides that a VCC that has been cancelled ceases to be the subject of a proprietary right. It also clarifies that this is the case even if a VCC registry retains the record of the VCC after its cancellation.

8.2 Principle 8(2) provides that there are three categories of events that can lead to a VCC's cancellation. These are respectively, reversal (see Principle 9), revocation (see Principle 10), and retirement (see Principle 11). Cancellations resulting from reversal and revocation differ from cancellations resulting from retirement in that retirement is the voluntary cancellation of a VCC on the instruction of its registered holder whereas reversal and revocation are not, or at least not necessarily.

8.3 Principle 8(3) articulates the consequences of cancellation on the relationship between the registered holder of a VCC and the VCC registry. Since the VCC ceases to be the subject of proprietary rights, Principle 8(3)(a) clarifies that is it cannot be moved to another registry account nor can it be retired again. Principle 8(3)(b) further clarifies also that the VCC registry's duty to do so on the instructions of the registered holder or a user authorised by the registered holder no longer applies. Principle 8(3)(c) provides that if a VCC registry retains a record of a cancelled VCC's existence, it must record that the VCC is cancelled. Where the cancellation is exceptionally retrospective (see Principle 8(4) and Principle 10), this record should indicate this.

8.4 Principle 8(4) provides that the effective time of cancellation of a VCC will depend on the cause for cancellation. Whereas this is generally prospective and effective when a VCC registry makes an entry in its records (see Principles 9 and 11), in the case of revocation, the cancellation is retrospective because the VCCs are void *ab initio* (see Principle 10).

8.5 Principle 8(5) preserves such rights as a registered holder may have (whether against a VCC registry or a third party) where a VCC is cancelled in error. The nature of such rights (if any) following wrongful cancellation will vary across different jurisdictions. Some jurisdictions may provide relief in tort whereas others may do so in restitution. In principle, it should also be open to the parties to contractually agree to a particular solution, subject to any controls on contractual limitations of liability.

Principle 9

Reversal

(1) A VCC can be cancelled wholly or in part where it no longer meets the definition of a VCC because of a reversal.

(2) A VCC can be cancelled for reversal by an ICCP in accordance with its rules, by a court, or by a regulatory body determined by other law.

(3) A cancellation for reversal is effective at the time the VCC registry makes an entry indicating its cancellation as such.

(4) Although a VCC ceases to be the subject of proprietary rights after cancellation for reversal, cancellation for reversal does not affect such rights that a holder of a VCC may have against any parties (if any) that form part of the VCC.

(5) Unless otherwise agreed, any cancellation for reversal of the benefits of a carbon mitigation project should result in a pro rata reversal of VCCs among all registered holders.

Commentary

9.1 Principle 9(1) provides that a VCC can be cancelled wholly or in part where it no longer meets the definition of a VCC under Principle 2. Such cancellation occurs where there is a reversal (see Principle 2(16)) of the benefits of a carbon mitigation project or programme has been compromised post-issuance so that the VCC no longer "represents the achievement of a reduction in, or removal of, one tonne of CO_2 equivalent from the atmosphere". This distinguishes cancellation for reversal from cancellation for revocation (Principle 10) which deals with matters leading up to issuance. Principle 9(1) is in line with the treatment of existing intangible property such as trademarks that can be cancelled for non-use subsequent to registration. Principle 9 is essential to maintain the integrity of VCC markets as the continued existence of VCCs as subjects of proprietary rights even when they no longer meet the definition set out in Principle 2 will undermine confidence in a market that has seen a dramatic reduction from its peak because of uncertainty about emission reductions attached to VCCs. Principle 9 is also essential to promote adoption of the Principles as a whole as no significant legal system has conceived of a form of intangible property that is defined as having certain characteristics but which maintains its existence even if it loses one or more of those characteristics.

9.2 Principle 9(2) sets out the bodies that are able to initiate a cancellation for a reversal event. These include the ICCP acting in accordance with its rules as well as a court and such regulatory body (if any) as set up under other law. The question of who has standing to initiate a court action that leads to a court order to cancel a VCC for reversal is a matter for other law.

9.3 Principle 9(3) clarifies that the time of cancellation of a VCC should this come to pass is the time when the VCC registry updates its records as such. This avoids any dispute as to when the cancellation of a VCC is effective. Since cancellation for reversal is only effective when a VCC registry updates its records regardless of when the event of reversal occurs, it follows that it is not possible to cancel a VCC for reversal if the VCC has already been cancelled for retirement even if the event of reversal occurred before the instructions for retirement, and hence cancellation for retirement, occurred. The problem of how VCCs that have been used to claim for certain benefits (eg tax benefits) by a beneficial owner who is aware of the event of reversal but who unscrupulously retires the VCCs before they can be cancelled for reversal, is a matter for regulatory and other law and is beyond the scope of these Principles.

9.4 Although Principle 9(4) reemphasises that upon cancellation for reversal, a VCC ceases to be the subject of proprietary rights, it provides that where the cancellation follows from reversal, to the extent that a VCC comprises rights against certain parties (see Commentary to Principle 2), those rights survive cancellation of the VCC. This is different from cancellation following retirement, for which such rights are not preserved. Principle 9(4) ensures that the market will properly price in the difference between VCCs that carry rights against certain parties (such as a VVB) and VCCs that carry no rights whatsoever. Principle 9(4) is distinct from Principle 8(5), which deals with rights following an erroneous cancellation, as Principle 9(4) addresses rights (if any) inherent in a VCC, which survive a cancellation that is not in error.

9.5 Principle 9(5) provides for a schema for cancellation of VCCs in the absence of agreement and/or the failure of such agreement to provide an adequate solution. Many carbon mitigation projects and programmes address reversals today by keeping a buffer pool of VCCs which may be cancelled in place of affected VCCs following a reversal event. This would be an example of an agreement otherwise, although such an arrangement is incompatible with VCCs as the subject of proprietary rights. In the law of property, there is no concept of sacrificing one property to sustain another, so such an agreement, as currently conceived, is only compatible with a purely contractual understanding of VCCs. A revised buffer pool arrangement compatible with VCCs as the subject of proprietary rights would provide affected holders of VCCs with replacement VCCs from said buffer pool instead. The question of what VCCs are acceptable replacements would have to be agreed upon by the parties in advance. After all, it is unlikely that the holder of a VCC in a particular type of project or programme (eg energy distribution) that was organised around a particular methodology (eg ACM007) should be expected to accept VCCs produced under a vastly different type of project or programme (eg carbon capture and storage) following a completely different methodology (eg VM0049). This is merely one example of how the market may reassure investors in VCCs in the event of reversals by tweaking the current buffer pool arrangements. It is theoretically possible as well that VCCs within a project or a programme are issued in tranches of varying seniority, with junior tranches being cancelled ahead of senior tranches, with the result that they would be differentially priced by the market.

9.6 Principle 9(5) is accordingly not intended to be prescriptive but rather a default solution of last resort that ensures that the market can price in VCCs with superior post-cancellation solutions. By setting out a non-prescriptive rule, the market's ability to innovate is unconstrained, so that a variety of responses to the problem of reversal can be tested with no preconception as to what works best. Simultaneously, by presenting a default rule, the market is reminded to confront and address, rather than ignore, the problem of reversal. Not only is such a rule consistent with principles governing intangible property more generally, it is desirable for the purposes of shoring up the credibility of VCC markets.

Principle 10

Revocation

(1) A VCC can be cancelled wholly or in part where it is subsequently demonstrated that it never met the definition of a VCC and is revoked.

(2) A VCC can be cancelled for revocation by an ICCP in accordance with its rules, by a court, or by a regulatory body determined by other law.

(3) A VCC that has been revoked is void from the outset and never existed as the subject of proprietary rights.

(4) Although a VCC was never the subject of proprietary rights once it has been cancelled for revocation, cancellation for revocation does not affect such rights that a holder of a VCC may have against any parties (if any) that form part of the VCC.

(5) When a VCC registry cancels a VCC for revocation, it must make an entry indicating that the cancellation is retrospective to the time of creation.

Commentary

10.1 Principle 10(1) provides that a VCC can be cancelled wholly or in part when it is subsequently demonstrated that it never met the definition of a VCC under Principle 2. Such cancellation occurs where it is subsequently shown that the benefits of a carbon mitigation project or programme were never achieved in the first place, leading the VCCs to be revoked. This could be because the project or programme failed to abide by the methodology of an ICCP; the verification process is shown to have been compromised; or the methodology of an ICCP is shown to be flawed. In each of these circumstances, the claimed benefits of a project or programme were never achieved at the outset, thus distinguishing cancellation for revocation from cancellation for reversal.

10.2 Principle 10(2) sets out the bodies that are able to initiate a cancellation for revocation. These include the ICCP acting in accordance with its rules as well as a court and such regulatory body (if any) as set up under other law. The question of who has standing to initiate a court action that leads to a court order to cancel a VCC for revocation is a matter for other law.

10.3 Principle 10(3) provides that a VCC that has been revoked is void from the outset and was never the subject of proprietary rights. This is consistent with the effects of invalidity for other categories of intangible property, such as patents where it is subsequently demonstrated that a key element for the grant of such a property was never attained in the first place. Principle 10 does not deal with the consequences of such invalidity as this would not be a matter of property but contract and/or restitution. For example, parties can (and often do in the case of patents) undertake the risk of a patent being invalid so that any benefits conferred pursuant to a licence or sale are not subject to restitution because the risk of invalidity is contractually allocated to a licensee/purchaser of the patent. By way of contrast, in some jurisdictions, the law may provide that a seller warrants that it has title in the subject-matter of a sale (as many common law jurisdictions do in relation to the sale of goods) or the parties may contractually do so themselves. Where this is the case, a purchaser may be able to claim restitution from the seller of such property should it turn out that the property was void. However, as these are not matters relating to property, these Principles do not address them and it is up to the participants in the VCC markets to contractually allocate these risks themselves. If purchasers are unwilling to undertake the risk of avoidance *ab initio*, then the solution contractually is to require sellers of VCCs to warrant that they have title in the subject-matter. This solution may be imperfect as it relies upon a chain of contracts whereby each buyer pursues a claim against its seller, but if VCCs are to be conceived as the subject of proprietary rights, this is a necessary consequence. No significant legal system conceives of intangible property that is defined as having certain characteristics but which somehow maintains an existence – however temporary – even if it is demonstrated that it never had one or more of those characteristics. Whilst it is true that this does not necessarily dictate the unwinding of all transactions related to that intangible property, this is the result of contractual allocation of risks, not as a matter of fundamental property law treating the intangible property as having temporarily existed when it never attained the necessary constituent characteristics of that intangible property.

10.4 Although Principle 10(4) reemphasises that, upon cancellation for revocation, a VCC was never the subject of proprietary rights, it provides that where the cancellation is for revocation, to the extent that a VCC comprises rights against certain parties (see Commentary to Principle 2), those rights survive cancellation of the VCC. This is different from cancellation following retirement, for which such rights are not preserved. Principle 10(4) ensures that the market will properly price in the difference between VCCs that carry rights against certain parties (such as a VVB) and VCCs that carry no rights whatsoever. Principle 10(4) is distinct from Principle 8(5), which deals with rights following an erroneous cancellation, as Principle 10(4) addresses rights (if any) inherent in a VCC, which survive a cancellation that is not in error.

10.5 Principle 10(5) follows from Principle 10(3), requiring a VCC registry to especially note that a cancellation for revocation is, unlike cancellations for reversal (Principle 9) or retirement (Principle 11), retrospective so that the VCC is void from the outset. Accordingly, a VCC that has already been cancelled for reversal or retirement may nevertheless be cancelled for revocation and have the cancellation backdated to the time of creation. The consequences of such a retrospective cancellation, particularly in the context of retirement where certain benefits (eg tax benefits) have been claimed is a matter for regulatory and other law and is beyond the scope of these Principles.

Principle 11

Retirement

(1) The registered holder of a VCC can instruct the VCC registry to retire a VCC, whereupon the VCC registry must cancel the VCC forthwith.

(2) A VCC is cancelled for retirement when the VCC registry makes an entry indicating its cancellation as such.

Commentary

11.1 Principle 11(1) provides that it is the registered holder of a VCC that can instruct the VCC registry to retire a VCC. This may or may not be the beneficial owner of a VCC as a registered holder may be a custodian of the VCC for another person (see Principle 14). Where the registered holder is not the beneficial owner of a VCC, it will instruct the VCC registry either on the basis of agency or some other similar principle allowing the registered holder to act on behalf of the beneficial owner. In common law systems, for example, custodians will likely hold VCCs on trust for the beneficial owner and in these circumstances, it will be trust law principles rather than the law of agency that enables the registered holder to instruct the VCC registry on behalf of the beneficial owner. Principle 11(1) also provides that the VCC registry is obliged to act on such instruction and cancel the VCC in a timely manner. The Principles do not dictate any particular formality for instructions to retire a VCC as participants indicated a preference for VCC registries to provide their own requirements for instructions.

11.2 Principle 11(2) specifies that the time cancellation for retirement is effective is the moment that the VCC registry updates its record indicating its cancellation rather than some other time, such as the time instructions for retirement are given, providing certainty as to when retirement occurs.

11.3 Some VCC registries, eg Verra, issue retirement certificates upon the retirement of a VCC. However, since retirement certificates are not themselves VCCs, Principle 11 does not address such certificates. Where benefits (eg tax benefits) may be claimed in relation to the retirement of VCCs, the ability for the beneficial owner of a VCC to assign or allocate such benefits to a third party is beyond the scope of these Principles, since the ability to do so is a matter for the relevant tax laws and not the result of the retired VCCs having some sort of post-cancellation proprietary existence.

SECTION V: REGISTRY

Principle 12

VCC Registry: Definitions

(1) 'VCC registry' means an electronic database operated by a registry operator in which the following information is recorded:

(a) The unique identifier of a VCC or a block of VCCs;

(b) The identifier of the person to whose account the VCC or the block of VCCs is credited.

(1 bis) [It must be possible for any person to ascertain from the VCC registry

(a) Whether a VCC (or a block of VCCs) is credited to an account in that registry

(b) Whether a VCC (or a block of VCCs) is identified by a unique identifier.]

(2) 'Registry operator' means a legal person who operates a registry.

(3) 'Registry account' means an account maintained by a VCC registry to which VCCs may be credited or debited.

(4) 'Registry accountholder' means a person who has entered into a registry account agreement with the registry operator in relation to one or more accounts.

(5) 'Registry account agreement' means the agreement governing the registry account between a registered account holder and the registrar.

(6) 'Registered holder' means a registry accountholder to whose registry account a VCC is credited.

Commentary

12.1 Principle 12 covers matters relating to the VCC registry. For a brief explanation of the role of the VCC registry, see the Life Cycle paragraph 21. A VCC registry is, usually, established solely under private law as opposed to a registry established by, or pursuant to, legislation. The definitions in Principle 12 are therefore quite broad and minimalistic, so that most (if not all) registries that purport to be VCC Registries are covered by the Principles. This is important since under Principle 2 (1) a unit is only a VCC within the Principles if it is registered in a VCC registry (as defined in Principle 12).

12.2 A VCC registry is defined in Principle 12(1) as a database recording some very minimal information, namely, the unique identifier of a VCC or a block of VCCs (see Commentary 2.10-2.12) and the identifier of the person to whose account that VCC (or block of VCCs) is credited. A VCC registry is likely to record much more information than this, but given possible variations between registries, the definition is as minimal as possible.

12.3 The definition of a VCC registry in Principle 12(1) does not include any requirement that any information recorded on the VCC registry must be publicly accessible. However, as appears from the discussion in the Commentary paragraphs 3.1 and 3.2, the registration of a VCC in a VCC registry (by being credited to a registry account) is key to enabling it to have the attributes that make it possible for a VCC to be the subject of proprietary rights. Under these Principles, a VCC that is not registered is not a VCC since the definition of VCC in Principle 2(1) will not be met, neither will it be created under Principle 5. Moreover, it is the registration that means that a VCC is individuated, and it is the fact that it is credited to a registry account that means that it can be controlled, that it is rivalrous and (because it can be debited from one account and credited to another) it can be transferred (even though not every movement between accounts will necessarily result in a transfer as defined in Principle 2(14) see Commentary [ ]). These are the attributes mentioned above and in Commentary 3.2. If, therefore, some minimal information about the registration of a VCC is not publicly available it becomes impossible to discover whether something that purports to be a VCC actually is a VCC and therefore whether it is capable of being the subject of proprietary rights.

12.4 There is a distinction between information that enables a person to know whether something is a VCC and is capable of being the subject of proprietary rights, and other information about that VCC. Thus, for example, it is critical to know that a particular VCC is credited to an account in a registry, but it is not critical to know the name of the person in whose account that VCC is credited. It is also critical to know that a VCC (or block of VCCs) is individuated by a unique identifier but it is not, in theory, critical to know the content of that unique identifier (although in practice it is hard to see how one could know that a VCC is individuated by a unique identifier without having the means to identify that VCC). Principle 12(1bis) therefore sets out the need for it to be possible to discern these two critical pieces of information from the VCC registry.

12.5 A VCC registry is operated by a legal person called the 'registry operator' (see Principle 12(2). This could be the same legal person as the CCB or could be a different legal person. The Principles take no view on this point, but treat the two different functions separately so that the Principles apply if the functions are carried out by two different legal persons.

12.6 Principle 12(3) recognises that a VCC registry will maintain accounts to which VCCs can be credited or debited. Market participants, whose relationship with the VCC registry is governed by a contract called, in the Principles, a 'registry account agreement', can have one or more accounts with a VCC registry. A person who has entered into a registry account agreement is called a 'registry accountholder' (see Principle 12(4)). The registry account agreement is likely to include a number of rights and obligations between the parties to it, only some of which relate to a VCC (or more than one VCC) credited to that account. In relation to a VCC credited to a registry accountholder's account, that registry accountholder is called a 'registered holder' (Principle 12(6)). Whether a registered holder of a VCC has a proprietary right in that VCC is a matter 'for other law' (Principle 3(3)), with the exception of the very first registered holder who may have a proprietary right in the VCC under Principle 5(2). If the first registered holder is maintaining that VCC for a client, that client will have a proprietary right in the VCC under Principle 5(2) and the first registered holder will be a custodian under Principle 14. For further explanation, see Commentary 5.4.

Principle 13

VCC Registry

(1) In relation to a VCC credited to a registered holder's account, a registry operator owes the following duties to the registered holder:

(a) An obligation to comply with the registry rules;

(b) An obligation to allocate a unique identifier to the VCC (or to the block of VCCs containing that VCC) and to maintain one, and only one, registry entry in relation to that VCC;

(c) An obligation to keep an adequate record of the following matters:

(i) the creation of the VCC;

(ii) any credits and debits in registry accounts in relation to the VCC;

(iii) any retirement of the VCC;

(iv) any cancellation of the VCC.

(d) An obligation to comply with any instruction given by a registered holder or a user authorised by the registered holder in relation to the credited VCC, including to move the VCC into the account of another person and to cancel the VCC for retirement the VCC, unless:

(i) the registrar is prohibited from complying with the instruction by other law [including regulatory law], the rules of the relevant CCB or by any agreement between the registry operator and a third party to which the registered holder is a party or has consented;

(ii) the registry operator is not obliged, by other law or by the registry account agreement with the registered holder, under certain circumstances, to comply with the instruction;

(2) (a) Subject to subparagraphs (b) and (c), a registry operator has no proprietary right in a VCC credited to an account of registry accountholder in the registry it operates.

(b) A registry operator may maintain an account in its own name to which VCCs may be credited and debited

(c) A registry accountholder may grant a security right in favour of a registry operator over VCCs credited to the account of that registry accountholder.

(3) Subject to subparagraph(2) (b) and 2(c), a VCC registered in a VCC registry is not available for the satisfaction of claims of creditors of the registry operator.

(4) Subject to subparagraph 2(b) and 2(c), if a registry operator of a VCC registry enters into an insolvency-related proceeding, a VCC registered in that registry does not form part of that registry operator's assets available for distribution to its creditors.

(5) A registry operator must have a Recovery and Orderly Dissolution Plan providing for preservation of all entries on the VCC registry it operates if the registry operator enters into an insolvency-related proceeding.

(6) A registry operator must comply with any instruction from [an ICCP in accordance with its rules, by a court, or by a regulatory body determined by other law] to cancel a VCC for reversal in accordance with Principle 9 Or to cancel a VCC for revocation in accordance with Principle 10.

(7) A registry operator must

(a) record the cancellation of a VCC;

(b) not permit any movement or cancellation of a cancelled VCC.

Commentary

13.1 The obligations set out in Principle 13(1) are private law obligations arising out of the registry account agreement. This means that they are owed to the registry accountholder, and usual remedies apply if they are breached. They are not duties imposed by regulatory law. However, a State may consider whether regulatory law should impose regulatory obligations similar to the obligations set out in Principle 13(1), as well as other regulatory obligations, to mitigate risk including systemic risk. For example, it is very important from the perspective of the operation of the market that a VCC registry is operated free from conflicts of interest, such as the use of non-public market information for its own benefit. This type of risk is very commonly addressed as a matter of regulatory law.

13.2 The obligations set out in Principle 13(1) are drafted, for clarity, in relation to one, single, VCC; however, the duties apply in relation to each VCC registered in the registry and are owed to the holder of each of those VCCs. They are basic duties, and a State should not permit them to be excluded by the terms of the registry account agreement (see, however, Principle 13(1)(d)(ii) and Commentary [ ]).

13.3 The duty in Principle 13(1)(a) is to comply with the registry rules. The duty in Principle 13(1)(b), to allocate a unique identifier to the VCC (or to the block of VCCs containing that VCC, see Commentary 2.11) and to maintain one, and only one, registry entry in relation to that VCC, is critically important to the individuation and identification of the VCC, which in turn is an important attribute enabling the VCC to be the subject of proprietary rights (see Principle 3(1) and Commentary 3.2 and 12.3).

13.4 The duty set out in Principle 13(1)(c) is what might be loosely termed a duty of stewardship. It is a duty to keep adequate records of matters that need to be recorded in the registry. The obligation to keep a record of creation is critically important for the existence of the VCC, as described in commentary 12.3. The obligations to keep a record of credits and debits, retirement and cancellation are also very important as these records enable the market to function and Principles law to apply.

13.5 The duty set out in Principle 13(1)(d) is to comply with the instructions of a registered holder or a user authorised by them to give instructions. These instructions include an instruction to move the VCC into another account (which may or may not have the effect of transferring a proprietary right in the VCC to the accountholder of the receiving account: this will depend on other law, see Principle 3(3)). The instructions also include an instruction to retire the VCC (see Principle 11).

13.6 However, this duty is subject to a number of qualifications. First, it is qualified by any prohibition on whatever the registry operator is instructed to do to be found in other law, including criminal or regulatory law. If, therefore, it was illegal under the applicable law of a State to move assets into the name of particular person or type of person, and the instruction received by the registry operator from the registry accountholder was to do just that, the registry operator would not be obliged under the duty set out in Principle 13(1)(d) to carry out that instruction. Second, the duty is qualified by any prohibition found in the rules of the relevant CCB. Third, it is qualified by any agreement made between the VCC registry and any third party to which the registry accountholder is a party or has consented. For example, if the registry accountholder had created a security right over the VCC in favour of a third party, under the laws of some States that third party could have made the security right effective against third parties by entering into an agreement with the registry operator that the registry operator would not move the VCC from the registry accountholder's account, to which the registry accountholder consented. In that situation, the registry operator could refuse to carry out an instruction to move the VCC to another account.

13.7 Moreover, other law, or the agreement with the registry accountholder, may specify particular circumstances in which the registry operator is not obliged to comply with the registry accountholder's instructions. This would further qualify the basic obligation. For example, the registry account agreement may require the registry accountholder to pay all fees due in relation to a VCC before the registry operator is obliged to comply with an instruction to retire the VCC.

13.8 Principle 13(2)(a) makes it clear that in relation to VCCs registered in the VCC registry, the registered operator has no proprietary rights. One major consequence of this is that the VCCs registered in the VCC registry are not available for the satisfaction of the claims of the registry operator's creditors (see Principle 13(3) and 13(4). However, this statement is qualified in two respects. It is possible for a registry operator itself to have a registry account to which VCCs are credited (see Principle 13(2)(b)). This would typically be where the registry operator owns assets for a purpose other than operating the VCC registry (although it would also be possible for a registry operator to hold VCCs in a registry account as a custodian). An example of where a registry operator would own assets is where the legal person that carries out the function of registry operator may carry out many functions, of which being the registry operator is just one. In the course of carrying out other functions, it may wish to, for example, trade VCCs, and so it will have a registry account just like any other person, and can have proprietary rights in VCCs credited to that account.

13.9 The other respect in which Principle 13(2)(a) is qualified relates to where the registry operator, in carrying out its function as registry operator, takes a security right over a VCC credited to a registry accountholder's account to secure sums owed by that registry accountholder to the registry operator (for example, for fees payable in relation to the registry account) (see Principle 13(2)(b)). In those circumstances, the registry operator can have a proprietary right (that is, a security right) in relation to a VCC registered in the VCC registry.

13.10 Principle 13(3) and 13(4) makes it clear that, in relation to VCCs registered in the registry, those VCCs do not form part of assets available to its creditors. Principle 13(3) applies where the registry operator has not entered into an insolvency-related proceeding (defined in Principle 2(20)). Here, a creditor could seek to enforce a claim through enforcement procedures available under the applicable other law, but Principle 13(3) makes it clear that it cannot do so. This result parallels the substance of Principle 13(4), which provides that VCCs registered in the registry are not part of the assets available for distribution to the registry operator's creditors if it enters into an insolvency-related proceeding. These provisions reflect the baseline concept that such VCCs belong to the registered accountholders and not the registry operator, who merely effects the registration of information about the VCCs.

13.11 There are two exceptions to Principle 13(3) and 13(4). These relate to the situations set out in Principle 13(2)(b) (discussed in Commentary 13.8) and Principle 13(2)(c) (discussed in Commentary 13.9). The first situation is where the registry operator has its own registry account to which VCCs are credited. If the registry operator has proprietary rights in those credited VCCs, they will be available for the satisfaction of the claims of its creditors outside or within the registry operator's insolvency. The second situation is where the registry operator has a security right in a VCC registered in the VCC registry. The benefit of the security right over the VCC (including the right to enforce it) could be realised by the insolvency officer of a registry operator if the registry operator were in insolvency-related proceedings in the same way as the benefit of any other security right.

13.12 Principle 13 also sets out some obligations of the registry operator which are needed to enable the VCC system to work well and which are likely to be part of regulatory law. These are that the registry operator must have a Recovery and Orderly Dissolution Plan, that the registry operator must comply with an instruction to cancel a VCC, and that the registry operator must not enable any retired or cancelled VCC to be transferred, retired or cancelled.

13.13 Principle 13(5) addresses the practical and legal problems that are likely to arise if a registry operator goes into an insolvency-related proceeding. In that circumstance, it is unlikely to be able to continue to provide registry services in relation to the VCCs registered into the VCC registry it operates. In other words, it will not be able to move, retire, cancel or revoke VCCs recorded in the VCC registry and may not be able even to maintain a reliable record of the VCCs recorded on the registry. This would have a very harmful effect on the market, and swift action to provide replacement services would thus be required to restore market confidence. For the VCC market to function properly market participants will need to be reassured at all times that the registry operator has a workable and legally robust plan that can be put in place quickly on the insolvency of the registry operator.

13.14 Principle 13(6) sets out the duty of the registry operator to act on the instructions of an ICCP in accordance with its rules, by a court, or by a regulatory body determined by other law to cancel a VCC for reversal or revocation. [More to come in this paragraph after WG discussion]

13.15 Principle 13(7) sets out one of the main practical consequences for the VCC registry of a VCC being cancelled for reversal, revocation or retirement. These mirror Principle 8(3)(a) and 8(3)(c). The registry must record the cancellation of a VCC (see Principle 8(3)(a) and must not move or cancel such a VCC. [Probably more to come after WG discussion]

SECTION VI: CUSTODY

Principle 14

Custody

(1) 'Intermediary' means a person who provides services to another person in respect of a VCC.

(2) 'Client' means a person to whom an intermediary provides services.

(3) 'Custodian' means an intermediary who is a registered holder of a VCC and who provides services to another person pursuant to a custody agreement in respect of that VCC.

(4) 'Sub-custodian' means a custodian who provides services to another custodian pursuant to a custody agreement in respect of that VCC.

(5) A custodian 'maintains' a VCC for a client if:

(a) That custodian is the registered holder of the VCC; or

(b) That custodian enters into a custody agreement with a sub-custodian with respect to the VCC [in the circumstances set out in Principle 15(4)].

(6) An agreement between an intermediary and a client is a 'custody agreement' if:

(a) It relates to a VCC;

(b) It is entered into in the course of the intermediary's ordinary course of business; and

(c) The intermediary is obliged to:

(i) maintain the VCC for the client; and

(ii) [instruct the registry operator or, in the case of sub-custody, the intermediary's own custodian, to cancel the VCC for retirement if instructed by the client to do so.]

Commentary

14.1 The purpose of Principle 14 is to set out private law principles relevant to custody of VCCs. Other law, including regulatory law, may also apply to the provision of custody services. Custody, broadly speaking, is where a person known as a 'custodian' (usually a legal person, which may be a regulated entity), maintains a VCC on behalf of and for the benefit of another person called a 'client' in the ordinary course of business (for a definition of 'maintains' see Principle 14(5) and Commentary 14.5. The client might be another custodian. The VCC is maintained by the custodian is a manner that gives the client special protection against unauthorised dispositions of the VCC and against the insolvency of the custodian who maintains the VCC. The special protection for the client referred to is likely to be achieved in private law by the client having a proprietary right of some sort in the VCC, although the precise technique by which this protection is achieved will vary according to the private law of the relevant jurisdiction.

14.2 Principle 14(1) defines an intermediary as a person who provides services to another person in respect of a VCC. This definition is for the purposes of the Principles, and relates to definition of 'custody agreement' in Principle 14(6). Thus, whether the services provided by an intermediary are custody services will depend on whether the agreement between the intermediary and its client is a custody agreement as defined, that is, whether the agreement meets the criteria set out in Principle 14(6) (see also Commentary 14.6).

14.3 Principle 14(2) to (4) defines the important parties in relation to custody. To be a 'custodian' an intermediary must be the registered holder of the relevant VCC ('registered holder' is defined in Principle 12(6) as a registry accountholder to whose registry account a VCC is credited). It also must provide services to a client pursuant to a custody agreement (as defined) in respect of that VCC. If the client is a custodian, the intermediary is also a sub-custodian (see Commentary 14.4).

14.4 Sub-custody is where the registered holder of the VCC (the sub-custodian, who is a custodian) maintains the VCC for another custodian, who, in turn, maintains it for a client (who is not a custodian). In theory, there could be a chain of two or more sub-custodians, but there will always be a client at the bottom of the chain who is not acting as a custodian. Principle 14(4) defines a sub-custodian.

14.5 As set out in Principle 14(5), the concept of 'maintaining' a VCC includes two situations. The first is where a custodian itself is the registered holder of a VCC and 'maintains' it for the client by carrying out a custody agreement with that client in respect of that VCC. The second is where a custodian 'maintains' a VCC by entering into a custody agreement with a sub-custodian (the custodian thereby becoming the sub-custodian's client). Here, the sub-custodian is the registered holder of the VCC and the custodian has rights against the sub-custodian under the custody agreement. Where a sub-custodian is used, the sub-custodian and the custodian both 'maintain' the VCC.

14.6 Principle 14(6) defines a custody agreement relating to a VCC (Principle 14(6)(a)) and, therefore, custody of that VCC. Sub-paragraph (b) makes it clear that to be a custodian, the intermediary must be acting in the ordinary course of its business. Sub-paragraph (c) sets out the core duties of a custodian (see also Principle 15(1)). These duties are to maintain the VCC for the client (see Commentary 14.5) [and to instruct the registry operator to retire the VCC if the client instructs the intermediary to do so.]

Principle 15

Duties owed by a custodian to its client

(1) A custodian owes the following duties to its client in relation to a VCC that it maintains for that client:

(a) the custodian is obliged to safeguard the VCC;

(b) the custodian is not authorised to instruct the registry operator to move the VCC to the account of another person, [or use it for its own benefit,] except to the extent permitted by the client and by other law;

(c) the custodian is obliged to comply with an instruction given by the client to instruct the registry operator to move the VCC to the account of another person, unless:

(i) the custodian is prohibited from complying with the instruction by other law or by any agreement between the custodian and a third party to which the client is a party or has consented;

(ii) the custodian is not obliged, by other law or by an agreement with the client, under certain circumstances, to comply with the instruction.

(2) Unless prohibited by the custody agreement or by other law, a custodian may maintain VCCs [of the same description] for two or more of its clients as an undivided pool.

(3) The duties owed by a custodian to its client may include:

(a) the duty to keep a record of VCCs it maintains for each of its clients;

(b) the duty at all times to securely and effectively maintain VCCs in accordance with the records it keeps for its clients;

(c) [the duty to acquire VCCs promptly if this is necessary to satisfy the duty under subparagraph (b);]

(d) the duty to separate the VCCs maintained for clients from the VCCs maintained for its own account.

(4) Where authorised by a client or by other law, a custodian may fulfil its duties to its client under this Principle by entering into a custody agreement with a sub-custodian if, under that agreement, the sub-custodian is bound by the duties set out in Principle 15(1) and any other duties imposed on a custodian of VCCs by the applicable Principles law or other private law.

(5) A VCC maintained by a custodian for a client may be subject to a security right:

(a) granted to that custodian by the client;

(b) in favour of that custodian arising by operation of other law; or

(c) granted to a third party by the client.

Commentary

15.1 Principle 15(1) sets out basic private law duties which are owed by a custodian providing custody services under an agreement with a client. If the custodian is a sub-custodian, the client is itself a custodian. The duties relate to the VCC maintained by the custodian for the client, and, depending on the applicable law, will usually be contractual obligations. In some States, the general private law on custody of other types of assets will already incorporate these duties, or very similar ones, into custody contracts. Here, a State will only need to ensure that these duties also apply to the custody of VCCs. In other States, more clarification as to private law duties may be required. The duties themselves are general and, as will be seen from the commentary below, are qualified by the provisions of 'other law' (that is, the applicable law not including Principles law, see Principle 2(19)). A State should not permit these basic contractual duties to be excluded by the terms of the custody agreement. The language of Principle 15(1) is intended to be functional and neutral between legal cultures. In some jurisdictions, the relationship between custodian and client will be legally characterised as a trust while in other jurisdictions it may be characterised as a contractual or other type of legal relationship. [In many States, similar duties are likely to be imposed on custodians as a matter of regulatory law.]

15.2 Principle 15(1)(a) makes it clear that the custodian must owe to the client some duties in relation to safeguarding of the VCC. Safeguarding includes the attainment of the result set out in Principle 17(2) (that the assets safeguarded are not to be part of the assets available for distribution to the custodian's creditors if it enters into an insolvency-related proceeding). The details of these safeguarding duties will typically be included in the custody agreement. A State can choose which private law safeguarding duties should be imposed on a custodian, and therefore cannot be excluded by agreement. Some suggestions for States are contained in Principle 15(3).

15.3 The duty in Principle 15(1)(b) refers to the inability of the custodian to use the VCC for its own benefit except as permitted by the client and by other law (as defined in Principle 2(19)). The client may consent to that use either by contract or by an instruction to the custodian, and may consent to a use more limited than that permitted by other law. The other law of a State may permit a custodian to have a right of use in respect of VCCs in relation to which it provides custody services: this permission may be contained in regulatory law and/or in private law. In the latter case, the extent of the permission may depend on the way in which a custody relationship is characterised by that private law.

15.4 The duty in Principle 15(1)(c) makes the basic point that a custodian is a person who must deal with the VCC according to the client's instructions. However, this obligation is qualified by any prohibition on such dealing to be found in other law, including criminal or regulatory law, or any agreement made between the custodian and any third party to which the client is a party or has consented. If the client has granted the custodian a security right in the VCC, or any such security right has arisen by operation of law, this will also qualify the custodian's obligation (see Principle 15(5)). Moreover, other law, or the agreement with the client, may specify particular circumstances in which the custodian is not obliged to comply with the client's instructions. This would further qualify the basic obligation.

15.5 Principle 15(2) addresses the situation where a custodian maintains VCCs 'of the same description' for several clients. The phrase 'of the same description' is used in these Principles to refer to VCCs that are treated by market participants as fungible (see also Principle 17(4)-(6)). Fungibility is not a technical characteristic of a VCC, but a matter of market practice. The record of any VCC in a registry is individualised because it is uniquely identified. However, as a matter of market practice, many VCCs are treated as fungible so that any such VCC or VCCs will satisfy a delivery obligation in relation to a VCC. Moreover, a number of VCCs may be created as a block (see Commentary 2.12), bearing one serial number, and would therefore be treated as fungible. If a custodian was the registered holder of a block of VCCs which was maintained for more than one client, it would maintain that block as an undivided pool for those clients.

15.6 The ability of a custodian to maintain VCCs for several clients as an undivided pool under the Principles is qualified in Principle 15(2) by being subject to other law (such as the regulatory law or other private law of the relevant State) and the relevant custody agreement or agreements. The custodian's ability to maintain VCCs as an undivided pool has two consequences.

15.7 First, the custodian may maintain an undivided pool of client assets all of which are registered in the custodian's registry account (either as a block, a series of blocks or singly), so that no specific VCC or quantity of VCCs is specifically allocated to a particular client. The number of VCCs within the undivided pool allocated to each client will be recorded in the records of the custodian. If the custodian maintains VCCs for several clients with a sub-custodian, maintaining them as an undivided pool means that the custodian need not have a separate sub-account with the sub-custodian for each client. As a result, an undivided pool as described above includes all VCCs 'of the same description' registered in the registry account of the custodian as well as all VCCs 'of the same description' maintained with one or more sub-custodians.

15.8 Second, when the custodian receives an instruction from a client in respect of a VCC maintained for its clients as an undivided pool, it may comply with that instruction using any VCC or quantity of such VCCs registered in its registry account or that it maintains with a sub-custodian. This is because these various VCCs 'of the same description' are treated as fungible, as explained above in Commentary 15.7. Where the custodian is not allowed (by the custody agreement or by other law) to maintain an undivided pool, it must implement what is often called full segregation, that is, that a specific VCC must be registered in the name of the custodian, and must be recorded as maintained for the client in the records of the custodian. The reference to 'a custodian' in Principle 15(2) also applies to a sub-custodian, whose clients are custodians.

15.9 Principle 15(3) sets out private law duties which a State may wish to ensure are owed by a custodian to its client, although it is for a State to choose whether it wishes to do so, in which case it would have to make the chosen duties mandatory and non-excludable by agreement. Separately, a State may wish to impose these duties on custodians as a matter of regulatory law, that is, by imposing duties for which there is no private law redress but breach of which may incur sanctions imposed by the State. Again, it should be recalled that if the custodian is a sub-custodian, the client is a custodian. [For the result of Principle 17(2) [insolvency] to be attained under some domestic laws, the duty under Principle 15(3)(d) must not be permitted to be excluded by the terms of the custody agreement. A State may choose to impose a similar duty as a matter of regulatory law.]

15.10 The duty in Principle 15(3)(a) is a duty to keep proper records. Specifically, a custodian must keep a record of VCCs it maintains for each of its clients. In some States, this duty will already be part of the private law and/or regulatory law duties owed by a custodian to its clients in relation to other types of assets.

15.11 The duty in Principle 15(3)(b) is to actually maintain assets correlating to those records. Thus, if the record shows that a custodian maintains one VCC for A, the custodian must either be the registered holder of one VCC which it maintains for A, or must enter into a custody agreement with a sub-custodian in relation to at least one VCC which it maintains for A.

15.12 The duty in Principle 15(3)(c) is to replace any missing assets, in other words, to reconcile what the custodian actually maintains to the client records. The assets acquired must, of course, be of the same description and in the same quantity as the assets recorded in the records.

15.13 The duty in Principle 15(3)(d) is to separate client assets from house assets (i.e. the custodian's own assets). A custodian may separate its clients' VCCs from its own by ensuring that they are not registered as a single block (and recording the VCCs maintained for clients correctly in its own records, see Principle 15(3)(a). Alternatively, it could maintain house assets and client assets in different accounts with a sub-custodian. The legal effect of this separation depends on the applicable other law.

15.14 Principle 15(3)(d) does not address the segregation of VCCs of any particular client. Rather than maintaining client assets of the same description as an undivided pool, a custodian may offer to a client the possibility of the custodian maintaining the VCCs of that client separately from VCCs of the same description of other clients (sometime called full segregation). That would require the custodian to ensure that VCCs maintained for that client were either registered separately or in a separate block or to maintain them in a separate account with a sub-custodian so that such assets are exclusively allocated to the client. The legal effect of such arrangement will depend on the applicable other law, and may vary from jurisdiction to jurisdiction.

15.15 Principle 15(4) makes it clear that a sub-custody structure can be used. Under this structure, the custodian maintains the VCC by entering into a custody agreement with a sub-custodian with respect to that VCC (see Principle 14(4) and (5) and Commentary 14.4 and 14.5). The agreement will only be a custody agreement if the conditions in Principle 14(6) are met, including that the custodian is under a duty to maintain the VCC [and to instruct the registry to retire it if so instructed by the client]. A custodian would, however, be in breach of its own duties to the client if the chosen sub-custodian was not subject, in the sub-custody agreement, to the mandatory and non-excludable private law duties of a custodian under the applicable law. These duties include those set out in Principle 15(1) plus those listed in Principle 15(3) that the relevant State has chosen to make mandatory, and any other mandatory private law duties. Other law determines the extent to which, if at all, a custodian is responsible to its client with regard to the non-performance by the sub-custodian of its duties under the custody agreement.

15.16 Principle 15(5) recognises that a custodian may have a security right in the VCC it maintains for a client. For example, the client may owe the custodian fees, for which the custodian wishes to be secured, or the custodian may have lent the client money to acquire the VCC. Similarly, a third party may have a security right in a VCC maintained by a custodian for a client.

Principle 16

Innocent Client

(1) Subject to paragraph 2, if a transferee is a client of a custodian, a VCC is credited to the custodian's registry account by the VCC registry operator, and the custodian maintains the VCC for the client pursuant to their custody agreement, no rights based on a proprietary claim to that VCC may be successfully asserted against the client.

(2) Paragraph (1) does not apply if the client, at the time from which the custodian maintains the VCC for that client, [actually knows or ought to know that] [a State should specify requirements equivalent to those found in its relevant good faith acquisition] another person has an interest in the VCC and that the transfer violates the rights of that other person in relation to its interest.

(3) If VCCs are maintained by a custodian for two or more clients in an undivided pool, paragraphs (1) and (2) apply to each client for whom the VCCs are maintained.

Commentary

16.1 This Principle is an adaptation of the innocent acquisition rule (Principle 7), tailored to the context in which a person acquires VCCs through a custodian. It addresses the situation in which a client is the transferee of a VCC, and the VCC is credited to or maintained in an account by the custodian under a custody agreement. In such cases, the Principle provides that the client is protected from proprietary claims brought by third parties whose rights were infringed by the transfer—unless the client knew or ought to have known of the infringement.

16.2 This Principle applies at each level of a custody chain. If a sub-custodian maintains a VCC for a custodian, who in turn maintains it for a client, the custodian may benefit from this Principle in its role as a client of the sub-custodian. In turn, the client of the custodian is also protected, provided the requirements under paragraphs (1)-(2) are met.

16.3 Where VCCs are maintained in an undivided pool for the benefit of multiple clients, paragraph (3) makes clear that the regime articulated in paragraphs (1) and (2) apply individually to each client. The fact that VCCs are pooled does not diminish the individual protection of each client's position under this Principle.

Illustration 1

16.4 Client A agrees to purchase 500 VCCs from Seller B. Client A arranges for the VCCs to be credited to an account that Custodian Z maintains for Client A, pursuant to their custody agreement. Unknown to Client A, Seller B had fraudulently obtained the VCCs from Party C, who retains a proprietary interest in them. At the time the VCCs were credited to the account maintained by Custodian Z for Client A, Client A neither knew nor ought to have known of Party C's interest or that the transfer from Seller B violated Party C's rights.

16.5 Under this Principle, Client A is protected from any proprietary claim brought by Party C. The fact that the VCCs were credited to an account maintained by Custodian Z for Client A pursuant to their custody agreement is sufficient to trigger the protection, provided the standard of innocence under paragraph (2) is satisfied.

Principle 17

Insolvency of a custodian and creditor claims

(1) A VCC maintained by a custodian for a client is not available for the satisfaction of claims of creditors of the custodian.

(2) (a) If a custodian enters into an insolvency-related proceeding, a VCC maintained by a custodian for a client does not form part of that custodian's assets available for distribution to its creditors.

(b) If a custodian maintains a VCC for a client with a sub-custodian, and the custodian enters into an insolvency-related proceeding, the rights it has against the sub-custodian in respect of that VCC do not form part of the custodian's assets available for distribution to its creditors.

(3) If a custodian enters into an insolvency-related proceeding, the insolvency representative must take reasonable steps

(a) for a VCC registered in the account of the custodian to be moved to a registry account of the client or of a custodian nominated by that client;

(b) for any rights the custodian has against any sub-custodian in respect of a VCC maintained for the custodian's client to be moved to a registry account of that client or otherwise made accessible to that client, including through moving it to the registry account of another custodian nominated by that client.

(4) Paragraphs 5 and 6 apply if all of the following requirements are fulfilled:

(a) a custodian enters into an insolvency-related proceeding;

(b) VCCs of the same description are maintained by the custodian for two or more clients as an undivided pool; and

(c) the quantity of VCCs held by the insolvent custodian for those clients is less than the aggregate quantity of VCCs of the same description that it is obliged to maintain for those clients ('shortfall').

(5) [The shortfall is met first by any VCCs of the same description maintained by the custodian for itself.]

(6) Any [remaining] shortfall shall be borne by the clients for whom the custodian maintains the VCCs as an undivided pool, in proportion to the respective quantity of VCCs of the same description that the custodian is obliged to maintain for those clients.

(7) If a custodian maintains a VCC for a client with a sub-custodian and the sub-custodian enters into an insolvency-related proceeding, the custodian must seek to cause that VCC to be registered in its own registry account or to maintain the VCC with another sub-custodian.

Commentary

17.1 Principle 17(1) applies where the custodian has not entered into an insolvency-related proceeding. It makes it clear that VCCs maintained by a custodian for a client are not available for the satisfaction of the claims of the custodian's creditors. This result parallels the substance of Principle 17(2), which provides that VCCs maintained for clients are not part of the assets available for distribution to the custodian's creditors if it enters into an insolvency-related proceeding. These provisions reflect the baseline concept that such VCCs belong to the clients, not to the custodian.

17.2 Principle 17(2)(a) sets out the consequences of the insolvency of the custodian in a functional way rather than using legal concepts such as property or ownership. On the custodian's insolvency, VCCs it maintains for clients as custodian are not part of the assets available for distribution to its creditors. In Principle 17(2)(a), the 'custodian' could in fact be a sub-custodian and the 'client' could be a custodian. This situation is addressed by Principle 17(2)(b) which sets out the consequences where a VCC is held through a sub-custodian (see Principle 15(4)). As explained in Commentary 14.5, where a custodian maintains a VCC through a sub-custodian, the custodian (who will be the client of the sub-custodian under a custody agreement) has rights against that sub-custodian under the custody agreement. If the custodian is insolvent, its rights against the sub-custodian are not part of the custodian's assets available for distribution to its creditors.

17.3 Principle 17(3) to 17(7) gives guidance as to suitable rules which should (or, in the case of Principle 17(6), could) apply in relation to VCCs (or if a sub-custodian is used, rights against the sub-custodian) if a custodian enters into an insolvency-related proceeding. These rules are not comprehensive; the applicable insolvency law governs all other issues that could arise in these circumstances. It should be noted that a custodian or sub-custodian could have a security right over, or another type of right to, VCCs maintained for its clients (see Principle 15(5)). The effect of this on the actions taken by an insolvency representative would be a matter of other law.

17.4 Principle 17(3) imposes a duty on the insolvency representative to take reasonable steps so that the client can obtain the VCCs maintained for it by the custodian. If the VCCs are maintained by the custodian by entering into a custody agreement with a sub-custodian (Principle 14(5)(b)), the duty on the insolvency representative relates to the custodian's rights against the sub-custodian. The client may want the VCCs moved into its own registry account (or obtain the rights against the sub-custodian itself), or may want another custodian to maintain them on its behalf. The insolvency representative may need to take certain steps to achieve this result, such as instructing the registry to VCCs from one account to another.

17.5 Principles 17(4) to 17(6) apply where VCCs 'of the same description' (see Commentary 15.5) are maintained by a custodian for its clients as an undivided pool (see Principle 15(2) and Commentary 15.8). Undivided pools of VCCs 'of the same description' are explained in Commentary 15.5. A custodian can maintain VCCs as an undivided pool either by the VCCs being registered in the custodian's registry account or by entering into a custody agreement with a sub-custodian in respect of an undivided amount of VCCs. In this latter situation, its rights against the sub-custodian will be undivided. Principles 17(4) to 17(6) deal with the situation where there is a shortfall of VCCs, or rights against the sub-custodian, of a particular description. Principle 17(4) explains the situation of shortfall in an undivided pool, namely, that the custodian does not maintain sufficient VCCs to meet the number of VCCs it is obliged, under the relevant custody agreements, to maintain for the clients for whom it maintains the VCCs in the undivided pool. For example, suppose a custodian had a custody agreement with four clients, each relating to 100 VCCs. If the custodian only had 300 VCCs registered in its registry account, there would be a shortfall. In the insolvency-related proceeding of a custodian, there may be potentially as many shortfalls as there are undivided pools.

17.6 If there is a shortfall, a State may wish to provide that the loss is first met by any VCCs of the same description maintained by the custodian on its own account, whether these VCCs are registered in the custodian's 'house' registry account or whether the custodian uses a sub-custodian (Principle 17(5)). Thus, to the extent of any shortfall, the clients obtain priority over the custodian and its creditors, but only in relation to VCCs of the same description that the custodian holds. This approach follows that of Article 25 of the Geneva Securities Convention. However, under that Convention, a State can make a declaration that this rule is not to apply in that State. In a similar way, it is a policy decision for a State as to whether to adopt the rule set out in Principle 17(5). For this reason, Principle 17(5) is in square brackets.

17.7 Under Principle 17(6) the loss of VCCs (or rights against a sub-custodian) caused by the shortfall should be borne *pari passu* by all the clients for whom the custodian is obliged to maintain the VCCs of which there is a shortfall. The approach follows that of Article 26(2) of the Geneva Securities Convention. If a State chooses to adopt the rule in Principle 17(5), then the word 'remaining', which is in square brackets in Principle 17(6), applies. Otherwise, that word is not required.

17.8 Principle 17(7) sets out the consequences of the insolvency of a sub-custodian where a VCC is maintained through that sub-custodian (see Principle 17(2)(b)). In these circumstances, the custodian must seek to move the VCC from the registry account of the insolvent sub-custodian either to its own registry account or to the account of another sub-custodian.

SECTION VII: SECURED TRANSACTIONS

Principle 18

Secured Transactions: general

(1) A VCC can be the subject of security rights.

(2) Subject to Principles 19, 20 and 21, other law governs the creation, making effective against third parties, and priority of a security right in a VCC

Commentary

18.1 This Section addresses 'secured transactions' in which a security right is established in a VCC. Consistently with the UNCITRAL Model Law on Secured Transactions, the term 'secured transaction' refers to any transaction that creates a proprietary right in a movable asset by agreement, securing payment or performance of an obligation, regardless of the terminology used by the parties to describe such right.

18.2 The Principles assume that each State has its own domestic legal framework governing secured transactions and security rights. The precise scope of secured transactions and the definition of security rights will depend on the relevant domestic law. Such law might encompass various forms of security, including pledges, charges, and security assignments, and may even extend to outright transfers if their structure falls under the rubric of secured transactions law.

18.3 The Principles contained in this Section are not intended to supersede or interfere with domestic conceptions of secured transactions and security rights. Their purpose is limited to suggesting specific adaptations that domestic law should consider to effectively address security rights in VCCs.

18.4 Principle 18 extends the key tenet established in Principle 3(1) that VCCs can be the subject of proprietary rights. Since security rights are a subset of proprietary rights, it follows that VCCs can also be used as collateral in secured transactions, just like other types of movable assets.

18.5 Principle 18(2) generally defers to other law with respect to the creation, third-party effectiveness, and priority of security rights in VCCs. The Principles take a minimally invasive approach, introducing asset-specific rules in Principles 19, 20, and 21 to address the distinctive features of VCCs. The aim is to facilitate the integration of VCCs into existing secured transactions regimes without causing unnecessary disruption to well-functioning legal frameworks.

Principle 19

Registration in a VCC Registry as a method of achieving third-party effectiveness

(1) A security right in a VCC can be made effective against third parties upon the secured creditor becoming the registered holder of the VCC [pursuant to an agreement between the grantor and the secured creditor].

Commentary

19.1 Principle 19 establishes that, in addition to any other methods of third-party effectiveness that apply to a security right in a VCC under other law, a State should recognize that a security right in a VCC may be made effective against third parties upon the secured creditor becoming the registered holder of the VCC pursuant to an agreement between the grantor and the secured creditor. This applies both when the VCC is credited directly to the secured creditor's account and when it is credited to a custodian's account that maintains the VCC for the secured creditor.

19.2 In many jurisdictions, a general secured transactions registry provides a mechanism by which security rights in a wide range of assets may be made effective against third parties. Principle 19 does not seek to displace such registries. Accordingly, if a general registry filing renders a security right effective against third parties in all movable assets, that option remains available for VCCs. This Principle establishes an asset-specific alternative that aligns with the particular nature of VCCs.

19.3 The Principles consistently recognise the critical role of VCC registries in the creation, transfer, and overall commercial life cycle of these assets. Registration in a VCC registry is a constitutive requirement for the coming into existence of VCCs. Similarly, Principles 6 and 7 regarding transfers of VCC incorporate the crediting a VCC to a transferee's account as one of the requirements of the innocent acquisition rule. Principle 19 builds on these elements, integrating the perfection of security rights into the registry-based framework, thereby creating a cohesive legal regime.

19.4 VCC registries serve as critical sources of information and public notice mechanisms for VCCs. This function makes them particularly well-suited for achieving third-party effectiveness of security rights. In secured transactions law, third-party effectiveness is generally conditional upon the secured creditor providing public notice of the existence of security rights, thereby reducing information asymmetries and transaction costs while enhancing certainty in commercial transactions. VCC registries fulfil this notice function with particular efficiency, as they already serve as a source of information regarding the existence and transfers of VCCs.

19.5 Principle 19 offers several practical advantages for market participants. First, it bolsters the position of VCC registries as comprehensive information hubs for VCSs. Second, it aligns with market practices and expectations in VCC ecosystems, where market participants routinely consult VCC registries as the primary source of information concerning VCCs and their status. Third, it creates consistency between the treatment of outright transfers and security interests, reducing the potential for conflicting claims and legal uncertainty.

Principle 20

Control agreement as a method of achieving third-party effectiveness

(1) A security right in a VCC can be made effective against third parties upon the secured creditor entering into a control agreement.

(2) A control agreement is an agreement in relation to a VCC made between the grantor, the custodian who holds the VCC for the grantor and the secured creditor, according to which the custodian agrees to follow instructions from the secured creditor with respect to the VCC, without further consent from the grantor.

Commentary

20.1 Principle 20 establishes that, in addition to any other methods of third-party effectiveness that apply to a security right in a VCC under other law, a State should recognize a "control agreement" as a method to make a security right in a VCC effective against third parties. Under a "control agreement," the custodian who maintains the VCC on behalf of the grantor (debtor) commits to act on the secured creditor's instructions without further consent from the grantor. This principle builds on established secured transactions frameworks (including the UNCITRAL Model Law on Secured Transactions) that acknowledge control agreements as an alternative to registration or other forms of publicity for achieving third-party effectiveness in certain types of intangible assets.

20.2 Many legal systems recognise control agreements as a method of making a security right effective against third parties for assets subject to a custodian or intermediary relationship, notably deposit accounts or intermediated securities. This model is grounded in the notion that practical control over disposition or transfer of an intangible asset can substitute for traditional possession. Once the custodian becomes bound to comply with the secured creditor's instructions, the asset is effectively shielded from unauthorised dispositions by the grantor, preventing secret liens or priority contests. Principle 20 extends that rationale to VCCs, treating the custodian's engagement to follow the secured creditor's directions as an equivalent to possession.

20.3 A control agreement, in the context of VCCs, is an arrangement involving at least three parties: (i) the grantor, (ii) the custodian, and (iii) the secured creditor. The essential element is that the custodian agrees to follow the secured creditor's instructions concerning the VCC without any additional clearance from the grantor.

20.4 The significance of this control mechanism becomes particularly apparent when considered alongside the innocent acquisition rule in Principle 7, which provides that a transferee who has a VCC credited to their account, for value and without notice of conflicting claims, takes free of competing claims. Under this rule, even if the grantor attempts to dispose of the VCC, as long as the VCC remains credited to the custodian's account, the secured creditor can subsequently give instructions to the custodian regarding the disposition of the VCC. This arrangement effectively prevents the grantor from creating competing rights that could defeat the secured creditor's interest, since any potential transferee would be unable to have the VCC credited to their account without the secured creditor's authorisation through the custodian.

20.5 The recognition of control agreements as a method for achieving third-party effectiveness for VCCs is particularly well-suited to the emerging market practices in this field. The custodial model is becoming increasingly relevant for VCCs, especially for institutional investors and regulated entities. Custodians typically maintain VCCs in omnibus accounts or through other arrangements that facilitate the trading and safekeeping of these assets while minimising transaction costs and operational risks. Market participants are increasingly developing expectations around the ability to dispose of their VCCs without disrupting established custody arrangements or requiring transfers to different accounts. Control agreements satisfy these expectations by permitting the creation of enforceable security rights while preserving the operational efficiencies of the custodial model. This approach aligns with the broader objective of the Principles to accommodate commercial practices in the VCC ecosystem while providing legal certainty and protection for legitimate interests

Principle 21

Priority of security rights in VCCs

(1) A security right in a VCC that is made effective against third parties in accordance with Principles 19 and 20 has priority over a security right in the VCC that is made effective against third parties by another method.

Commentary

21.1 Principle 21 addresses priority conflicts between secured creditors that have made their security rights effective against third parties through the methods specified in Principles 19 or 20 (crediting to a securities account or control agreement), while another secured creditor has used alternative methods recognized by other applicable law (such as registration). The principle establishes a non-temporal priority rule: the secured creditor using the Principle 19 or Principle 20 methods will have priority even if these steps were taken after another creditor had already made its security right effective against third parties through registration or other means.

21.2 Although Principle 21 departs from the general rule in many secured transactions regimes that typically determine priority based on the temporal order of third-party effectiveness, it is nevertheless justified on several grounds. First, it recognises that a secured creditor who has a VCC credited to its account or enters into a control agreement is relying more substantially on the specific VCC as collateral, similar to how possession of negotiable instruments or documents receives priority treatment in many legal systems. Moreover, this approach is consistent with secured transactions rules found in international instruments—including the UNCITRAL Model Law and the relevant provisions of the Geneva Securities Convention—that grant priority to secured creditors who have acquired some form of control over the collateral.

21.3 Second, a secured creditor that perfects through the methods in Principles 19 or 20 should not need to carry out further due diligence to ascertain prior interests. This parallels the treatment of negotiable instruments, where parties taking possession are not expected to conduct additional searches, thereby reducing transaction costs and facilitating commercial circulation. This consideration is especially relevant for VCCs, given the practical challenges prospective secured creditors may face in identifying pre-existing encumbrances.

21.4 Third, the rule in Principle 21 aligns with established financing practices applicable to other assets subject to custodial arrangements, such as intermediated securities, for which control-based perfection is recognised as offering greater certainty in a multi-tiered holding system.

21.5 When multiple secured creditors perfect their security rights through the methods in Principles 19 or 20, priority conflicts may arise. This situation could occur when a VCC is held by a custodian who agrees to control the asset for multiple secured creditors. Generally, such secured creditors would be expected to regulate their respective priorities through subordination or intercreditor agreements. In the absence of such agreements, the priority conflict would typically be resolved based on the first-in-time principle—the secured creditor who first obtained credit to a securities account or an acknowledgment from the custodian would have priority. This approach maintains consistency with established principles for similar assets while accommodating the particular characteristics of VCCs. Moreover, in conflicts of priority between perfection via Principle 19 and Principle 20, the secured creditor who has the VCC credited to their account (Principle 19) will typically prevail over one who has established a control agreement (Principle 20). This is because the creditor with the VCC credited to their account will likely qualify as an innocent acquirer under the innocent acquisition rule in Principle 7, thereby taking free from competing interests, including those of secured creditors who have only established control agreements

Principle 22

Enforcement of security rights in VCCs

(1) Enforcement of a security right in a VCC is subject to other law.

(2) If a security right in a VCC maintained by a custodian is made effective against third parties pursuant to a method other than that in Principle 20, the secured creditor is entitled to enforce its security right only pursuant to an order of a court or other public authority, unless the custodian agrees otherwise.

Commentary

22.1 Principle 22 concerns legal rules governing enforcement of security rights in VCCs. This Principle explicitly defers to other law and does not prescribe particular enforcement methods for security rights in VCCs. Generally available methods provided under other law would apply, including judicial enforcement. The law of a State should not preclude secured creditors from exercising remedies that may exist under other laws or have been provided for in the security agreement.

22.2 All enforcement actions, including disposal and acceptance of the collateral in full or partial satisfaction of the secured obligation, should be available in relation to security rights in VCCs. In enforcing their rights, secured creditors must proceed in accordance with the applicable enforcement rules contained in general secured transactions law, including requirements to proceed in a commercially reasonable manner, provide notifications, and distribute any proceeds in accordance with the priority rules. General rules governing enforcement of security rights included in international standards on secured transactions appear to be flexible enough to accommodate the expectations of VCC lenders and other relevant parties.

22.3 The method used to make the security right effective against third parties can significantly impact the ability to enforce security rights. If a security right is made effective against third parties through the methods described in Principles 19 and 20, enforcement by the secured creditor is likely to be reasonably straightforward. However, if a security right in a VCC is made effective against third parties through other perfection methods provided by other applicable law, it may be difficult in practice for the secured creditor to enforce against that asset without the cooperation of the grantor, since the grantor retains control of the asset. In such cases, the secured creditor might need to obtain a court order to establish control if the grantor refuses to cooperate. This situation would be analogous to a grantor refusing to surrender possession of a tangible asset.

22.4 Principle 22(2) specifically addresses the situation where a secured creditor seeks to enforce a security right in a VCC maintained by a custodian, where that security right was made effective against third parties by a method other than a control agreement under Principle 20. In such cases, the custodian may have no relationship with the secured creditor and would typically be unwilling to follow enforcement instructions from an unknown party. For this reason, the Principle provides that the secured creditor is entitled to enforce its security right only pursuant to an order of a court or other public authority, unless the custodian agrees otherwise. This protection for custodians is consistent with similar provisions in other secured transactions frameworks, such as Article 82(4) of the UNCITRAL Model Law, which provides that extra-judicial enforcement of a security right over a bank account is only available when the bank has agreed to act on the instructions of the secured creditor.

SECTION VIII: PROCEDURAL LAW INCLUDING ENFORCEMENT

Principle 23

Procedural law including enforcement

SECTION IX: INSOLVENCY

Principle 24

Effect of insolvency on proprietary rights in VCCs[2]

(1) A proprietary right in a [VCC] that has become effective against third parties under Principles law or other law is effective against the insolvency representative, creditors, and any other third party in an insolvency-related proceeding.

(2) Paragraph (1) does not affect the application of any substantive or procedural rule of law applicable by virtue of an insolvency-related proceeding, such as any rule relating to:

(a) the ranking of categories of claims;

(b) the avoidance of a transaction as a preference or a transfer in fraud of creditors; or

(c) the enforcement of rights to an asset that is under the control or supervision of the insolvency representative.

[2] Draft Principle 24 is taken from DAPL Principle 19 with the term 'digital asset' replaced with the term 'VCC'. It is intended to provide the Working Group with an example of what an insolvency principle might look like in order to decide whether or not one is needed for the present instrument. The above language in draft Principle 24 is thus for discussion purposes only and is not an attempt to draft a Principle suitable for VCCs.