# REPORT ON THE LEGAL AND REGULATORY ASPECTS OF VOLUNTARY CARBON CREDITS

*of the Legal High Committee for Financial Markets of Paris*

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## SUMMARY OF RECOMMENDATIONS

Carbon credits are tradable instruments used to finance projects aimed at reducing greenhouse gas (“GHG”) emissions, mainly located in developing countries. They are issued to project developers (or their funders), who raise funds by selling the carbon credits generated by their projects, directly or through intermediaries, to companies located mainly in developed countries. These companies use the carbon credits to offset all or part of their GHG emissions, primarily for financial reporting purposes as part of their sustainable development strategies.

The working group identified a number of legal obstacles to the development of this market. It noted that the establishment of a legal regime adapted to the voluntary carbon market is particularly complex due to its cross-border nature. In addition, this market is currently poorly regulated, particularly in France and the European Union. Against this backdrop, the working group made a number of recommendations to strengthen the legal and regulatory regime applicable to carbon credits:

- Clarify the legal nature of carbon credits by clearly establishing that they are intangible assets.
- Establish a presumption that the owner of a carbon credit is the holder identified in the registry in which the carbon credit is registered.
- Consider the advisability of creating a European carbon credit registry, which market players can use on a voluntary basis, to harmonize ownership transfer practices and ensure cross-border legal recognition.
- Monitor the market and remain vigilant as to the possible need, depending on market growth, to strengthen the regulation of carbon credit trading in the secondary market, and in particular to include carbon credits at least partially under the rules applicable to financial instruments. In addition, the regulatory status of carbon credit derivatives should be clarified.
- Enhance the transparency of carbon credits used by European companies, by clarifying the interpretation of certain points in the CSRD/ESRS scheme.
- Encourage international coordination, in particular by monitoring and, where appropriate, supporting the work of UNIDROIT, in order to reduce the legal uncertainty associated with the cross-border nature of carbon credits with a view to harmonizing practices worldwide.

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The Legal High Committee for Financial Markets of Paris (*Haut Comité Juridique de la Place Financière de Paris*, "**HCJP**") established a working group[1] to examine the legal and regulatory aspects of carbon credits and the "voluntary" carbon market. This report presents the working group's analysis and recommendations. Some of the technical terms used in this report are defined in the glossary in the appendix.

After a brief introduction (**I**.) and a brief description of the voluntary carbon market (**II**.), the report will examine the nature and legal status of voluntary carbon credits (**III**.). It will also address issues relating to the secondary market for carbon credits (**IV**.) and the consequences of the regulatory framework for sustainability disclosure on the use of carbon credits (**V**.). Finally, the report will present the working group's conclusions and recommendations (**VI.**).

## I. INTRODUCTION

A French company decides to adopt a climate strategy aimed at reducing its carbon footprint, with clear, quantified targets—eliminating 30% of its greenhouse gas (GHG) emissions by 2030, and virtually all its GHG emissions by 2050. The company communicates its objectives to the market in its sustainability report, in anticipation of the application of the CSRD/ESRS regime.[2] The company reports on this strategy and its objectives in the section dedicated to sustainability information in its management report (commonly referred to as the "sustainability report"), in application of the *European Sustainability Reporting Standards* ("**ESRS**"),[3] complementing the *Corporate Sustainability Reporting Directive* ("**CSRD**").[4]

The company's practical ability to achieve its reduction targets is limited by the current status of technological innovation and scientific knowledge, as well as by operational constraints (i.e. the level of training of the workforce, the time it takes to implement new production methods, the difficulty of obtaining cooperation from parties in the company's value chain, etc.) and financial constraints. In the medium term, unless it closes its doors, it will inevitably emit residual GHGs, despite its efforts to reduce them.

The company may decide to pursue another option—financing GHG reduction or absorption projects developed by third parties, such as the production of renewable energy, the planting of trees, or the capture and storage of carbon already present in the atmosphere. For the planet, the result is identical: the elimination of GHGs has the same effect whether it is carried out in the company's own facilities, or elsewhere.

[1] See **Appendix 1**, "*Composition of the Legal Aspects of Voluntary Carbon Credits Working Group*".

[2] Commission Delegated Regulation (EU) 2023/2772 of July 31, 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability information standards.

Directive (EU) 2022/2464 of December 14, 2022 amending Regulation (EU) No 537/2014 and Directives 2004/109/EC, 2006/43/EC and 2013/34/EU as regards the publication of sustainability information by companies.

[3] Commission Delegated Regulation (EU) 2023/2772 of July 31, 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability information standards.

[4] Directive (EU) 2022/2464 of December 14, 2022 amending Regulation (EU) No 537/2014 and Directives 2004/109/EC, 2006/43/EC and 2013/34/EU as regards the publication of sustainability information by companies.

But how can the company find projects to finance? And how can it be certain that these projects really reduce permanently the GHG emissions that would otherwise be produced? The voluntary carbon market has been developed to answer these questions.

The voluntary carbon market is a system by which companies finance projects indirectly, through intermediaries who stand between them and the project developers. These intermediaries—certification bodies—certify a project's GHG reduction potential and, when the reductions are achieved, issue certificates to the project developer or to the project's funders—i.e. carbon credits. Each carbon credit is intended to represent one tonne of $CO_2$ (or its equivalent) eliminated, reduced or avoided[5]. Carbon credits are issued by the certification body either to the project developer, who can sell them to finance their project, or to the project's funders. Companies wishing to reduce their carbon footprint can purchase carbon credits to offset their own GHG emissions.

The idea is simple, but its implementation is complex. The first certification mechanism—the *Clean Development Mechanism* established under Article 12 of the Kyoto Protocol[6]—was implemented by a supervisory entity set up by the United Nations, which relied on private parties to verify GHG reductions. The practices and rigor of these private verification bodies were sharply criticized.[7]

More recently, studies have raised doubts about the reality and quantification of carbon credits validated by private certification bodies, mainly in the context of forest preservation projects in tropical zones.[8] According to some analyses, the projects financed by carbon credits had no real effect, because deforestation would in any event have been avoided by other means in the regions covered by these projects. What's more, GHG reductions were not permanent—a forest protected from destruction by human activity could still be ravaged by fire. Finally, according to some critics, project developers did not always respect the rights of local communities in the areas where the projects were carried out.

The companies that bought these carbon credits, characterized as "lacking integrity", were also criticized, accused in particular of a lack of vigilance regarding the reality of GHG reductions, eliminations or avoidances allegedly achieved by the projects they financed. These criticisms have weighed heavily on the market—the volume of carbon credits issued worldwide has fallen from around

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[5] Some carbon credit certification frameworks include "avoided" emissions. It should be noted, however, that European and national regulatory frameworks equate carbon credits with project financing for the reduction of GHG emissions or the absorption of GHG emissions. For example, the ESRS defines carbon credits as "a transferable or tradable instrument that represents a reduction or absorption of emissions of one tonne of CO2 equivalent", and Article L. 229-55 of the French Environment Code refers exclusively to "reductions and sequestrations resulting from projects that make it possible to offset greenhouse gas emissions".

[6] Kyoto Protocol to the United Nations Framework Convention on Climate Change, December 11, 1997, https://digitallibrary.un.org/record/250111/files/FCCC_CP_1997_L.7_Add.1-FR.pdf?ln=en. The Clean Development Mechanism no longer certifies new projects. It will be replaced by a new system provided for in Article 6.4 of the Paris Agreement, which is currently under development. Paris Agreement, 2015, https://unfccc.int/sites/default/files/french_paris_agreement.pdf.

[7] *COP28: Carbon Market Rules Should Protect Rights*, Human Rights Watch, March 7, 2023,

https://www.hrw.org/news/2023/03/07/cop28-carbon-market-rules-should-protect-rights; Mark Shapiro, "Conning the Climate: Inside the Carbon Trading Shell Game," *Harper's Magazine*, February 2010.

[8] Thales A. P. West, Sven Wunder, Erin O. Sills, Jan Börner, Sami W. Rifai, Alexandra N. Neidermeier, and Andreas Kontoleon, "Action Needed to Make Carbon Offsets from Tropical Forest Conservation Work for Climate Change Mitigation" (2023), https://doi.org/10.17863/CAM.99745; Patrick Greenfield, "Revealed: More Than 90% of Rainforest Carbon Credits by Biggest Certifier Are Worthless, Analysis Shows," *The Guardian*, January 18, 2023, https://www.theguardian.com/environment/2023/jan/18/revealed-forest-carbon-offsets-biggest-provider-worthless-verra-aoe.

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US$2 billion in 2021 and 2022 to less than US$800 million in 2023, mainly due to a sharp drop in carbon credit prices.[9]

In 2023 and 2024, international measures were introduced to strengthen the integrity—and perception of integrity—of carbon credits. Independent organizations published new standards to which certification bodies could adhere in order to obtain an integrity label for their carbon credit certification programs.[10] In the European Union, a new regulation has been adopted, enabling certification bodies to obtain a label of trust issued by national authorities after examining the integrity of their programs.[11] In France, since 2018 the government has established a certification scheme—the Label Bas Carbone—which incorporates high-quality certification standards, which has registered substantial growth in the number of its "labeled" projects.[12]

At the same time, a number of governmental and multilateral bodies have taken steps to confirm the strong interest in developing a high-integrity voluntary carbon market. This interest was confirmed at the Summit for a New Global Financial Pact held in Paris in June 2023,[13] and at the G7 Finance Ministers' meeting in May 2023.[14] In March 2024, France and Brazil announced a High-standard coalition aimed at combating greenwashing on the voluntary carbon market, supporting the finalization of negotiations at the UN level on the establishment of an efficient and transparent regulated carbon market. In May 2024, the White House announced new Principles for Responsible Participation in the Voluntary Carbon Market, aimed at strengthening the integrity of the market to promote its development.[15]

The voluntary carbon market has also inspired the design of a new high-integrity product, the "biodiversity credit" or "nature credit", currently under active study by *the International Advisory Panel on Biodiversity Credits* (IAPB), a Franco-British initiative created in June 2023.[16] In support of the creation of this new product, the President of the European Union declared in September 2024: "We can create a real market for the restoration of our planet."[17]

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[9] *2024 State of the Voluntary Carbon Market*, Ecosystem Marketplace, https://www.ecosystemmarketplace.com/publications/2024-state-of-the-voluntary-carbon-markets-sovcm.

[10] *Core Carbon Principles*, ICVCM, July 26, 2023, https://icvcm.org/wp-content/uploads/2023/07/CCP-Book-R2-FINAL-26Jul23.pdf

[11] Political agreement was reached between the European Parliament and the Council of the European Union in early 2024 on the proposal for a Regulation of the European Parliament and of the Council establishing a Union certification framework for carbon offsets, COM(2022) 672 final, 2022/0394, November 30, 2022, https://eur-lex.europa.eu/resource.html?uri=cellar:60d407c8-7164-11ed-9887-01aa75ed71a1.0016.02/DOC_1&format=PDF. The European Parliament formally adopted the text in April 2024, which should be officially published after adoption by the EU Council.

[12] *Label Bas Carbone—Ministère de la transition énergétique*, https://label-bas-carbone.ecologie.gouv.fr

[13] *Presidency Conclusions of the* Summit for *a new global* financing pact, https://www.elysee.fr/admin/upload/default/0001/15/35d90cfb1d97aa5b47aab3de3877c01882178429.pdf

[14] "Principles of High Integrity Carbon Markets," G7 Ministers' Meeting on Climate, Energy and Environment (Sapporo, April 2023), https://www.env.go.jp/content/000127540.pdf.

[15] *FACT SHEET: Biden-Harris Administration Announces New Principles for High-Integrity Voluntary Carbon Markets*, The White House, https://www.whitehouse.gov/wp-content/uploads/2024/05/VCM-Joint-Policy-Statement-and-Principles.pdf

[16] A description of this Franco-British approach is available at https://www.iapbiocredits.org/.

[17] *Saving the planet by monetizing it: Ursula von der Leyen's ambitious project*, Le Point, September 13, 2024.

It is against this backdrop that the HCJP working group studied the legal and regulatory aspects of the voluntary carbon market, which is currently poorly regulated, both in France and internationally. Its working hypothesis is that it is desirable to see the high-integrity voluntary carbon market develop, thereby mobilizing significant resources from the private sector to finance decarbonization, particularly in developing countries, where the vast majority of projects financed by carbon credits are located.[18]

The working group noted a number of legal obstacles likely to impede the development of this market, particularly in the following areas:

- *Financing decarbonization projects*. Project developers often receive funding through bank loans, with revenues from the sale of carbon credits used to repay the loans, at least in part. Lenders obtain security over the carbon credits. The development of the financing market depends on the effectiveness of these security interests.

- *Over-the-counter trading of carbon credits*, along the entire chain between project developers and carbon credit users, via one or more intermediaries. These transactions depend in particular on the ability of market players to identify with certainty the owner of a carbon credit (which is a dematerialized instrument), and to protect innocent buyers against the risks associated with fraudulent transactions.

- *The establishment of deep and liquid secondary markets,* whether for trading carbon credits or for spot or derivative contracts involving carbon credits. The development of secondary markets depends on the same legal certainty as the OTC market. In addition, in the event of a significant increase in market size, it may become necessary to strengthen the regulatory framework by including carbon credits at least partially in the regime applicable to financial instruments, along the lines of emissions allowances traded in the European Emissions Trading Scheme (EU ETS).

- *Transparent communication* by companies using carbon credits to offset their GHG emissions.

In this context, the working group made a number of recommendations to strengthen the legal and regulatory regime applicable to carbon credits:

- Clarify the legal nature of carbon credits: It is important to make clear that carbon credits are intangible assets, as any other legal model would be inconsistent with their economic nature and ill-suited to the needs of market transactions.

- Establish a presumption that the owner of a carbon credit is the holder identified in the registry in which the carbon credit is registered. It is essential for market players to know that the seller of a carbon credit is its legal owner. In the case of dematerialized assets, identification of the holder by entry in a registry is the only way to establish ownership with the required level of certainty.

- Monitor the market and remain vigilant to the eventual need to strengthen the regime applicable to carbon credit trading in the secondary market. The size of the market is currently modest. While most trading takes place over-the-counter, there are also spot and futures contracts traded on organized markets, mainly outside the European Union. Market development should be

[18] *See* Bernstein, Andrew A. (2023) "The Perfect is the Enemy of the Good: Carbon Credits and Funding for Decarbonization in Developing Countries," *New England Journal of Public Policy*: Vol. 35: Iss. 2, Article 4, https://scholarworks.umb.edu/nejpp/vol35/iss2/4.

monitored and, if necessary, carbon credits should be at least partially included in the rules applicable to financial instruments.

- Strengthen transparency rules on the use of carbon credits by European companies by clarifying certain points of the CSRD/ESRS regime, and by confirming the responsibility of companies to be able to prove the effective cancellation of carbon credits used, as part of the verification by the statutory auditors or independent third-party bodies responsible for certifying the sustainability reports of companies subject to this regime.

Establishing an appropriate legal and regulatory regime for the voluntary carbon market is particularly complex due to its cross-border nature—the country where the project is located could be different from that (or those) of the developer, certification body, intermediaries, markets and companies using carbon credits. The working group believes there is no simple solution to this problem, but that the authorities of the main countries involved in this market should coordinate to limit legal uncertainties. The working group notes the work in progress within UNIDROIT on the legal nature of carbon credits.[19] The working group considers that it is important for the French and European authorities to follow and, where appropriate, support this work.

## II. THE VOLUNTARY CARBON MARKET

### 2.1 Description

Carbon credits are tradable instruments used to finance projects aimed at reducing or absorbing greenhouse gas (“GHG”) emissions, mainly located in developing countries. They are issued to project developers (or their funders), who raise funds by selling the carbon credits generated by their projects, directly or through intermediaries, to companies located mainly in developed countries. The latter use or “consume” the carbon credits to offset all or part of their emissions, or in some cases to contribute to reducing global emissions without any direct link to their own emissions, primarily for financial communication purposes as part of their sustainable development initiatives.

In principle, a carbon credit represents one metric tonne of carbon dioxide (“$CO_2$”) (or equivalent) removed, absorbed or avoided. Carbon credits can be issued for several types of projects, including :

- reforestation projects, involving the planting of new forests or the restoration of degraded forests to absorb $CO_2$ ;
- projects aimed at avoiding deforestation, including REDD+ projects (*Reducing Emissions from Deforestation and Forest Degradation*), a program established under the aegis of the United Nations Framework Convention on Climate Change (“UNFCCC”);
- renewable energy projects, including wind farms, solar power plants and hydroelectric power stations;
- projects aimed at preventing methane leaks from facilities such as coal mines or waste treatment centers, or capturing methane from animals;
- projects to deploy clean cooking stoves to people who cook their meals using fires that burn solid biomass fuels, such as wood and charcoal; and

[19] *Legal nature of voluntary carbon credits*, UNIDROIT Governing Council, May 10-12, 2023, https://www.unidroit.org/wp-content/uploads/2023/05/C.D.-102-14-Nature-juridique-des-Credits-Carbone-Volontaires.pdf

- carbon capture and sequestration projects, using new technologies to capture CO2 directly from the atmosphere or from industrial emissions, then store it permanently, particularly in geological formations.

Carbon credits are issued by "certification bodies", which are private, governmental or international organizations whose role is to confirm the eligibility of projects for the issuance of carbon credits. Certification bodies confirm that projects comply with quality standards and have the potential to reduce or absorb GHGs. Following certification, an independent verification body, similar to an auditor, validates the GHG reductions or absorptions achieved, enabling carbon credits to be issued by the certification body and allocated to developers.

Project developers can sell carbon credits or raise funds through pre-financing, by promising to deliver the carbon credits issued, or the revenues from their sale, to lenders. Carbon credits are often purchased by intermediaries who maintain inventories of carbon credits in order to offer them to end-users, usually companies located in developed countries, or to financial market players.

Carbon credits are used by companies to offset their GHG emissions, mainly as part of their public communications, particularly financial communications. In the past, some companies have used carbon credits to communicate the "carbon neutrality" of their products, but this communication practice has given rise to several legal actions for greenwashing[20] and more recently has been the subject of a legislative ban in the European Union.[21] The initial proposal for a dissuasive regulatory framework in the EU has had a significant impact on the demand for carbon credits.

The use of carbon credits is mainly voluntary—hence the name "voluntary" carbon market. In general, carbon credits cannot be used in place of emissions allowances under mandatory cap-and-trade systems, such as the EU ETS.[22] However, some carbon credits can meet regulatory offset obligations—for example, airlines operating flights within France can use carbon credits that meet certain integrity criteria to satisfy their GHG offset obligations under Article 147 of the French Climate and Resilience Law.[23]

### 2.2 The "integrity" of carbon credits

The use of carbon credits to offset GHG emissions has been strongly criticized by some environmental NGOs, who consider that companies are buying carbon credits of "dubious" integrity

[20] Bryon J. McLain, *Carbon Neutrality Suit Against Delta Airlines Signals the Arrival Time of "Greenwashing" Litigation*, The Guardian, June 15, 2023, https://www.foley.com/insights/publications/2023/06/carbon-neutrality-suit-delta-airlines-greenwashing/; Greenfield Patrick, *Delta Air Lines faces lawsuit over $1bn carbon neutrality claim,* The Guardian, May 30, 2023, https://www.theguardian.com/environment/2023/may/30/delta-air-lines-lawsuit-carbon-neutrality-aoe; Ari M. Selman, *Court Finds 'Carbon Neutral' Claim May Be Misleading, Permits Class Action to Proceed*, Morgan Lewis, February 7, 2024, https://www.morganlewis.com/pubs/2024/02/court-finds-carbon-neutral-claim-may-be-misleading-permits-class-action-to-proceed

[21] Directive(EU) 2024/825 of February 28, 2024 amending Directives 2005/29/EC and 2011/83/EU to empower consumers to act in favor of the green transition through better protection against unfair practices and better information.

[22] Some cap-and-trade systems allow carbon credits to be used to meet a very small proportion of the requirements applicable to companies in the sectors concerned. *State and Trends of Carbon Pricing 2023*, World Bank Group, May 2023, p.54]

[23] Law no. 2021-1104 of August 22, 2021 to combat climate change and strengthen resilience to its effects.

instead of taking steps to reduce their own emissions. These criticisms had a major impact on the market in 2023, particularly on the price of REDD+ carbon credits, which are regularly criticized in the press.[24]

In the voluntary carbon market, the notion of the "integrity" of carbon credits is very important. Generally speaking, the certification of projects aimed at reducing, absorbing or avoiding a certain quantity of GHGs in the atmosphere as part of a carbon credit emission program requires compliance with several key integrity criteria:

- Additionality: Project developers must demonstrate that emissions reductions would not have occurred without the financing provided by carbon credits. This means that projects must deliver additional environmental benefits compared to a baseline scenario in which the project does not exist.
- Robust quantification: The environmental benefits of projects must be accurately and verifiably quantified. Quantification methodologies must be transparent, based on sound scientific data, and regularly updated to reflect best practice.
- Permanence: Emission reductions, absorptions or avoidances must be sustainable and long-term; certification bodies maintain mechanisms to cancel carbon credits in the event of a reversal of environmental benefits (for example, in the event of a fire in a forest covered by a preservation project financed by carbon credits), including the creation of "*buffer pools*," through which a given percentage of the carbon credits issued under the underlying projects are issued to a central pool maintained by the certification body, in order to mutualize this risk.
- Avoiding double-counting: Mechanisms must be put in place to prevent carbon credits from being counted more than once.

According to critics, however, the norms or standards set by certification bodies are not sufficiently robust to guarantee the integrity of carbon credits, particularly those issued as part of deforestation prevention (REDD+) and renewable energy projects.[25] Some certification bodies have also been accused of governance failures and conflicts of interest.[26]

Faced with this criticism, which has been widely publicized in the press, market players adopted a cautious stance that impacted the development of the market in 2023. In order to restore and strengthen confidence in the market, several initiatives have been launched. In July 2023, the Integrity Council for Voluntary Carbon Markets (the "ICVCM") published its "*Core Carbon Principles*" with standards that carbon credit certification programs must meet in order to claim compliance with these principles.[27] A similar approach is being developed under a new European Union regulation, permitting certification bodies to apply through national authorities for an integrity label for certification programs meeting

[24] Patrick Greenfield, *Revealed: more than 90% of rainforest carbon credits by biggest certifier are worthless, analysis shows*, The Guardian, January 18, 2023, https://www.theguardian.com/environment/2023/jan/18/revealed-forest-carbon-offsets-biggest-provider-worthless-verra-aoe

[25] B. K. Haya et al, "Quality Assessment of REDD+ Carbon Credit Projects," Berkeley Carbon Trading Project (September 20, 2023), https://gspp.berkeley.edu/research-and-impact/centers/cepp/projects/berkeley-carbon-trading-project/REDD+; Verra, Verified Carbon Standard (VCS), v. 4.4 (January 17, 2023), § 2.1.3, pp. 2-3, https://verra.org/wp-content/uploads/2022/12/VCS-Standard-v4.4-FINAL.pdf.

[26] "COP28: Carbon Market Rules Should Protect Rights," Human Rights Watch (March 7, 2023), https://www.hrw.org/news/2023/03/07/cop28-carbon-market-rules-should-protect-rights.

[27] *Core Carbon Principles, Assessment Framework and Assessment Procedure, Integrity Council on Voluntary Carbon Markets*, July 26, 2023, https://icvcm.org/wp-content/uploads/2023/07/CCP-Book-R2-FINAL-26Jul23.pdf

quality criteria to be defined in a Commission delegated regulation.[28] In the United States, the federal government announced in May 2024 principles to promote integrity and accountability in the carbon credit market.[29]

### 2.3 Certification bodies and registries

The first step in issuing carbon credits is project certification. Certification bodies—key players in the voluntary carbon market—certify projects' compliance with standards published on their websites, the main purpose of which is to validate and quantify the potential of a project to eliminate GHG emissions as it is implemented.

Once the project's GHG reductions have been achieved and validated by an independent verifier, the certification body issues carbon credits and allocates them to the project developer or its funders, by registration in a registry. The carbon credits are registered in the account of either the developer, its bank or a buyer. Registries can be consulted online. Each carbon credit receives a unique identification number. It is linked to the underlying project, the main characteristics of which are described on the website of the certification body, which also publishes the certification file documents and reports on the actual implementation of the project.

When a carbon credit is transferred, the seller's account is debited in the registry and the buyer's (or its agent's) account is credited. When a carbon credit is used (or “retired”), the holder notifies the registrar, and no further transfers can be made in the registry.

However, the terms and conditions published by certification bodies disclaim any responsibility for questions of title to carbon credits, with the result that registrations are solely for the convenience of market participants.[30]

The first carbon credits, known as *Certified Emission Reductions* (CERs), were certified under the Clean Development Mechanism established under Article 12 of the Kyoto Protocol.[31] However, this mechanism has now expired and no longer grants certification to new projects, although projects

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[28] Regulation of the European Parliament and of the Council establishing a Union certification framework for carbon offsets (adopted by the European Parliament on 10 April 2024), https://www.europarl.europa.eu/meetdocs/2014_2019/plmrep/COMMITTEES/ENVI/DV/2024/03-11/Item9-Provisionalagreement-CFCR_2022-0394COD_EN.pdf .

[29] *FACT SHEET: Biden-Harris Administration Announces New Principles for High-Integrity Voluntary Carbon Markets*, The White House, May 28, 2024,

https://www.whitehouse.gov/briefing-room/statements-releases/2024/05/28/fact-sheet-biden-harris-administration-announces-new-principles-for-high-integrity-voluntary-carbon-markets/

[30] Verra Terms of Use: “the User acknowledges and agrees that Verra in no way guarantees legal title to the instruments and that the User relies on any content obtained through the Verra registry at the User's own risk on any content obtained through the Verra registry at the User's own risk.” (https://verra.org/wp-content/uploads/2024/04/Verra-Registry-TOU-April-2024-FINAL.pdf); Gold Standard Terms of Use:: “account holder acknowledges and agrees that Gold Standard in no way guarantees legal title to units and that account holder relies on any content obtained through the Gold Standard Registry at its own risk.” (https://globalgoals.goldstandard.org/standards/T-Preview-V1.1-Registry-App-Terms-of-Use.pdf); American Carbon Registry, T&C: https://acrcarbon.org/wp-content/uploads/2023/10/ACR-Standard-v8.0.pdf; Climate Action Reserve T&C, https://www.climateactionreserve.org/wp-content/uploads/2023/07/Final-TOU-7.26.2023.pdf

[31] Kyoto Protocol to the United Nations Framework Convention on Climate Change, December 11, 1997, https://digitallibrary.un.org/record/250111/files/FCCC_CP_1997_L.7_Add.1-FR.pdf?ln=en

certified before its expiry continue to be awarded CERs. This mechanism will be replaced by a new one established under article 6.4 of the Paris Agreement, which is currently under development.[32]

Carbon credits are also certified and issued by private certification bodies, generally organized as non-profit entities, the most important of which are Verra (USA), Gold Standard (Switzerland), American Carbon Registry (USA) and Climate Action Reserve (USA). A number of other certification bodies have recently emerged, some specializing in atmospheric carbon capture projects with underground storage (such as Puro.earth).

Other certification programs have been established under government sponsorship. In France, since 2018 the government has established the Label Bas Carbone,[33] a high-integrity carbon credit certification program with a certification body operating under the supervision of the Ministry of Ecological Transition. The program has two components: (i) avoiding greenhouse gas emissions through changes practices in sectors such as building, transport, waste, agriculture, and (ii) increasing carbon sequestration in natural sinks (forest and soil). Over 1,200 projects have been certified (or "labelled"), and the first carbon credits are due to be issued soon.

For the purposes of this report, the term "carbon credit" includes products certified and created by organizations acting under the aegis of the UN, private-sector players and public bodies, since the same legal and regulatory considerations apply to them.

### 2.4 The voluntary carbon market

The voluntary carbon market is currently small. In 2023, the estimated value of carbon credits issued worldwide amounted to less than US$800 million, according to Ecosystem Marketplace, down by more than 50% compared with US$1.9 billion in 2022, mainly due to a sharp drop in prices (particularly for REDD+ and renewable energy projects).[34] In terms of volume, new issuances of carbon credits represented 277 million tonnes of $CO_2$ removed in 2023, down from 408 million tonnes in 2021 and 367 million tonnes in 2022, according to MSCI Carbon.[35]

According to a Bloomberg analysis quoted in an IOSCO report published in December 2023,[36] approximately 57.6% of carbon credits finance projects located in the Asia-Pacific region, 25.4% in Latin America and 14.7% in Africa (Europe accounts for just 0.4% of projects financed). In terms of demand, approximately 46.3% comes from companies located in North America, followed by Europe (including the UK) with 37.4% and Asia-Pacific with 12.1%.

Carbon credits are mainly traded over-the-counter, often through intermediaries. Market organizations (including the International Emissions Trading Association) publish standard contracts for the sale of carbon credits in the primary market (i.e. sales agreements entered into prior to the issuance of carbon credits), as well as for the sale of carbon credits in the secondary market.[37] In addition,

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[32] Paris Agreement, 2015, https://unfccc.int/sites/default/files/french_paris_agreement.pdf.

[33] A description of the Label Bas Carbone scheme is available on its website, https://label-bas-carbone.ecologie.gouv.fr.

[34] *2024 State of the Voluntary Carbon Market* https://www.ecosystemmarketplace.com/publications/2024-state-of-the-voluntary-carbon-markets-sovcm/, p. 17.

[35] *2023 Voluntary Carbon Markets Webinar*, MSCI Carbon Markets, p. 9.

[36] *Voluntary Carbon Markets Consultation Report*, IOSCO/OICV, document CR/026/23 (December 2023), p. 18 ("OICV 2023 Consultation").

[37] "Trading Documents" IETA, https://www.ieta.org/resources/trading-documents/.

ISDA has published definitions for the voluntary carbon market, one of the aims of which is to facilitate the exchange of carbon credits registered in different registries.[38]

In addition to over-the-counter transactions, carbon credits can also be traded on organized trading platforms, including the CTX (*Carbon Trade eXchange*) market, which claims to be the world's leading trading platform for carbon credits.[39] ICE Futures Europe operates a carbon credit auction platform to facilitate the sale of carbon credits by project developers.[40]

In addition, some carbon credit transactions take the form of trades of spot contracts and derivatives based on carbon credits (or a basket of carbon credits), mainly on exchanges based in the United States. The leading spot market, CBL, managed by Xpansiv, enables operators to trade contracts on individual carbon credits and baskets of carbon credits in several categories (under the GEO, or *Global Emissions Offset*, brand).[41] The Nodal Exchange (USA, managed by EEX, a subsidiary of Deutsche Börse) and ACX (Abu Dhabi and Singapore) also offer markets for spot contracts and settlement services for OTC transactions in carbon credits.[42] Futures contracts based on Xpansiv-CBL GEO contracts are traded on the futures market operated by the CME Group (Chicago Mercantile Exchange).[43]

### 2.5 Distinctions between carbon credits and emissions allowances

Carbon credits are often presented as a product comparable to emissions allowances created under cap-and-trade programs such as the EU-ETS (known as “compliance markets”). Indeed, both carbon credits and emissions allowances are tradable instruments, each representing one tonne of $CO_2$ or its equivalent. But carbon credits and regulatory emissions allowances differ fundamentally in nature, scope and regulation.

***Voluntary vs. compulsory use***

Carbon credits are mainly used voluntarily by companies to offset their GHG emissions, primarily as part of their corporate communications (particularly financial communications). On the other hand, allowances issued in compliance markets, such as those of the EU (ETS), are used to meet regulatory obligations set by public authorities. If companies operating in an industry subject to emissions caps exceed their allowances, they must purchase additional allowances or face fines. Companies that fail to comply with EU emissions caps can be penalized, whereas the failure to use carbon credits in the voluntary market does not result in legal consequences.

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[38] *2022 ISDA Verified Carbon Credit Definitions*, International Swaps and Derivatives Association, version 1.0, December 13, 2022, https://www.isda.org/book/2022-isda-verified-carbon-credit-transaction-definitions/.

[39] See the CTX website, https://ctxglobal.com.

[40] *Carbon Credit Auctions*, ICE Futures Europe, https://www.ice.com/emissions/auctions/carbon-auctions.

[41] See the CBL Xpansiv website, https://xpansiv.com/geo/.

[42] *Legal Implications of Voluntary Carbon Credits,* International Swaps and Derivatives Association December 2021, https://www.isda.org/a/38ngE/Legal-Implications-of-Voluntary-Carbon-Credits.pdf. p. 27.

[43] See the CME website, CBL Global Emissions Offset Futures, https://www.cmegroup.com/markets/energy/emissions/cbl-global-emissions-offset.html?redirect=/trading/energy/cbl-global-emissions-offset-futures.html.

Some mandatory emissions trading systems accept carbon credits issued by approved certification bodies to satisfy a limited portion of companies' obligations that are subject to emissions caps.[44] But this is not the case in the European Union, where carbon credits cannot replace emissions allowances.

***Market size***

The size of the global voluntary carbon credit market is significantly smaller than that of EU emissions allowances system. In 2023, while EU allowances generated revenues of 47 billion euros,[45] voluntary carbon credit issuance worldwide generated less than 800 million US dollars (and in any case has never exceeded the 2 billion US dollar annual threshold).[46]

***Cross-border nature***

Voluntary carbon credits are cross-border instruments, involving several countries. A project developer may be located in one country, the certification body in another, the independent verification body in a third, while the initial purchasers, intermediaries and end-users may be located in various other countries. This cross-border aspect substantially complicates the legal analysis of carbon credits, since determining the law applicable to a carbon credit is not straightforward.

EU emissions allowances, on the other hand, are strictly intra-EU, limited by their nature to the borders of EU member states (as well as Switzerland). They are clearly governed by European regulations and directives transposed into national law by member states.

***Legal and regulatory status***

The legal and regulatory status of EU allowances is clear and well-defined. Article L.229-11 of the French Environment Code stipulates that "*greenhouse gas emissions allowances are movable assets exclusively materialized by an entry in their holder's account in the relevant European registry.*"

In addition, these allowances benefit from the organized and regulated framework of the European Union Emissions Trading System ("EU ETS"). Emissions allowances are designated as a specific category of financial instrument within the framework of the MIFID II directive[47] and are subject to specific provisions in MIFIR, MIFID II, MAR and EMIR (for derivatives on emissions allowances).

In contrast, the voluntary carbon credit market is unregulated (in France and the European Union), and the legal nature of carbon credits is uncertain. This lack of regulation and the uncertainties linked to the legal nature of carbon credits are among the factors that impede the market's development. These uncertainties are analyzed by the working group in the following chapters of this report.

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[44] *Solutions for North America's largest Cap-and-Trade Program*, California-Quebec Cap-and-Trade https://www.targray.com/environmental-commodities/carbon-markets/canada/california-quebec-cap-and-trade

[45] International Carbon Action Partnership, EU Emissions Trading System (EU-ETS), https://icapcarbonaction.com/en/ets/eu-emissions-trading-system-eu-ets

[46] *2024 State of the Voluntary Carbon Market*, Ecosystem Marketplace, https://www.ecosystemmarketplace.com/publications/2024-state-of-the-voluntary-carbon-markets-sovcm.

[47] Directive 2014/65/EU of the European Parliament and of the Council of May 15, 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, Annex I, Section C, paragraph 11.

# III. THE LEGAL NATURE OF VOLUNTARY CARBON CREDITS

Determining the legal nature of a carbon credit is a fundamental issue for market development. Carbon credit projects are often funded by bank loans, which are repaid from the proceeds of the sale of carbon credits. These bank credits are often secured by interests in the carbon credits or undertakings to deliver carbon credits, whose enforceability against third parties depends on the legal nature of the product and the applicable law. When transferring a carbon credit, it is obviously essential to be able to identify its owner with certainty, and to check that the carbon credit has not already been used or transferred. More generally, determining the legal nature of a carbon credit will provide greater legal certainty for all transactions relating to voluntary carbon credits.

The development of the voluntary carbon credit market requires the free circulation of carbon credits under satisfactory legal conditions. Legislative action in France on the points set out below, in line with initiatives at the European and international level, will help promote the voluntary carbon credit market, and mobilize private and public funds for projects to reduce GHG emissions or for projects to capture and store GHG emissions.

## 3.1 Conflict of laws

Any analysis of carbon credit transactions can raise complex issues of conflict of laws, as well as differences in substantive rules between jurisdictions. This is due to the fragmented, cross-border nature of today's carbon credit market, and the absence of any international treaty or convention providing for a common legal regime for such credits.

This chapter analyzes the legal nature of carbon credits primarily from the perspective of French law. But before analyzing the legal nature of voluntary carbon credits from the point of view of French law, it is first necessary to consider when French law would be relevant and applicable to the questions presented.

French law may apply to a cross-border transaction involving voluntary carbon credits if there is a sufficient link between the transaction and France. This could be the case, for example, in the following situations:

- One or both parties to the transaction are registered or incorporated in France. This is particularly relevant if the French-registered entity is required to meet eligibility criteria with regard to its assets (as in the case of French collective investment schemes[48]), or if the services provided to a French entity relating to carbon credits are subject to regulation in France (e.g. investment services within the meaning of MIFID II).

- In addition, the treatment of a carbon credit under French law is particularly important in the context of insolvency proceedings involving a French party, either the owner of the carbon credits or a party to a carbon credit transaction.

[48] Carbon Offsetting by Collective Investment Schemes—A Guide for Asset Management Companies, Autorité des marchés financiers, March 2019, www.amffrance.org/sites/institutionnel/files/contenu_simple/guide/guide_professionnel/Guide%20on%20carbon%20offsetting%20by%20collective%20investment%20schemes.pdf.

- The registry in which the carbon credits are registered is located in France; or the registry rules and conditions of use governing the creation, transfer, retirement and cancellation of carbon credits are governed by French law.

- A financial institution located in France acts as an intermediary, either executing the transaction on behalf of a customer, or holding carbon credits on behalf of one or both parties to the transaction.

- The documentation relating to the transaction is contractually subject to French law or is recognized as being subject to French law.

From the point of view of French private international law, the applicable law is determined according to the relevant topic:

(i) matters relating to the capacity of a person or entity to hold or deal with a particular asset are governed by the law governing his, her or its personal status (subject to the application of Article 13 of the Rome I Regulation);[49]

(ii) questions relating to contractual or non-contractual obligations in connection with a contract (e.g. a contractual transaction involving carbon credits) are governed by the Rome I and Rome II Regulations;[50]

(iii) questions relating to the treatment of assets in the context of insolvency proceedings are, with certain exceptions, governed by the law governing the proceedings in question;[51]

(iv) the law applicable to a security interest is determined in accordance with the *lex rai sitae* principle.

### 3.2 The legal status of carbon credits under French law

When a conflict of laws rule designates French law as applicable to a specific legal issue (relating to ownership, the effective transfer of ownership, the creation of a security interest or treatment in an insolvency situation, etc.), the applicable regime depends on the legal qualification of the voluntary carbon credit.

The legal nature of voluntary carbon credits issued by private certification bodies is not currently specifically addressed in French legislation.[52]

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[49] Regulation (EC) No 593/2008 of June 17, 2008 on the law applicable to contractual obligations (known as the Rome I Regulation).

[50] Regulation (EC) No 864/2007 of July 11, 2007 on the law applicable to non-contractual obligations (known as the Rome II Regulation).

[51] See in particular Regulation (EU) of May 20, 2015 on insolvency proceedings.

[52] As defined in Commission Delegated Regulation (EU) No 2023/2772 of July 31, 2023 (ESRS) supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards (SRS), a carbon credit is "*a transferable or tradable instrument that represents a reduction or absorption of emissions of one tonne of CO2 equivalent and that is issued and verified in accordance with recognized quality standards*".

This is not the case for emissions allowances under the European Union Emissions Trading Scheme (EU ETS) Directive,[53] or for certain instruments analyzed in this report as voluntary carbon credits: Certified Emission Reductions (CERs) under Article 12 of the Kyoto Protocol. The French Environment Code expressly qualifies these instruments as "*movable assets exclusively materialized by an entry in the account of their holder in the European registry mentioned in article L. 229-12 (of the French Environment Code)*"[54] and "*negotiable, transmissible by transfer from account to account*".[55] Emissions allowances and CERs are therefore assets over which the holder (the party identified as holder of the account in which they are registered) benefits from a negotiable right of ownership, i.e., one that can be transferred from account to account in a simplified manner compared with the rules of the French Civil Code.

What about voluntary carbon credits issued by a private certification body?

In order to determine the legal status of these voluntary carbon credits under French law, it is essential to attempt to analyze and identify their common characteristics, despite their great diversity.

### 3.2.1 Common features

Generally speaking, a voluntary carbon credit is an instrument whose issue, transfer, withdrawal and cancellation are governed by rules set out in the general terms and conditions of certification bodies. Carbon credits are generated by the reduction of emissions of GHG or equivalent, or by the absorption of such emissions, meeting the eligibility criteria of the certification body. A voluntary carbon credit thus represents a reduction in GHG emissions, or absorption, of up to one metric tonne of carbon dioxide (CO2) or equivalent. It is a "credit" because it can be used to offset the emission of one metric ton of CO2.

Carbon credits issued by private certification bodies are not registered in the European registry that is created by Regulation (EU) 389/2013. This is a voluntary market instrument (as opposed to a compliance market) that enables private or public entities to voluntarily finance eligible GHG emission reduction or absorption projects by purchasing carbon credits generated by these projects. Once an entity has obtained a carbon credit, it can "retire" it, apply it to its carbon footprint, and offset it. The carbon credit is then permanently withdrawn from circulation, and can no longer be transferred or used again.

In the absence of binding regulations dictating the quality and nature of carbon credits, various carbon credit standards have emerged. Each certification body has issued its own rules governing the eligibility of projects intended to generate carbon credits, and the quantification, verification and monitoring of emissions reductions or absorption by these projects. These standards have their own conditions of use, which specify the terms and conditions under which users can access and use their registries. Registries, generally maintained by certification bodies, are essential for tracking carbon credits from their issuance to their retirement.

As this is an entirely dematerialized product, registration in a registry is the most practical way of identifying the owner of a carbon credit. However, the legal value of the entry in the registry is uncertain, due to limitations in the general terms and conditions of use of certification bodies, which disclaim any

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[53] Directive 2003/87/EC of the European Parliament and of the Council of October 13, 2003 establishing a scheme for greenhouse gas emissions allowance trading within the Community

[54] The European registry created by Regulation (EU) no. 389/2013 of May 2, 2013

[55] Articles L. 229-11 (relating to Emission Quotas) and L. 229-22 (relating to certified emission reduction units and emission reduction units) of the French Environment Code.

responsibility for determining the ownership of carbon credits. The registry is effectively maintained for the convenience of the parties, but without any acceptance of responsibility on the part of the registrar.

For example, the conditions of use of the four largest certification bodies (Climate Action Reserve, American Carbon Registry, Verra Registry and Gold Standard Impact Registry) concerning the ownership and transfer of credits stipulate that a user may only hold or cancel credits in his account for which he is the sole holder of all legal rights of ownership and all beneficial rights, with the exception of certain cases where the user may hold and cancel carbon credits on behalf of third parties (in particular, when the user is authorized in writing by the third-party owner, or when it maintains its own registry on behalf of third parties). These terms and conditions specify that the registrar assumes no responsibility for the legal title to the carbon credits, nor for the settlement or execution of transactions. It should be noted that the conditions of use of these certification bodies are expressly subject to the laws of certain states of the United States of America, or to Swiss law in the case of Gold Standard.

### 3.2.2 Legal status

#### 3.2.2.1 Carbon credits are not securities (*Securities*)

Carbon credits are created in accordance with the rules of the certification body chosen by the project sponsor. The credit is not a security issued by a legal entity or a collective investment scheme giving rights or access to its share capital, nor is it a debt security.[56] A carbon credit would therefore not be considered a financial security within the meaning of the French Monetary and Financial Code, which contains a restrictive list of the types of financial securities.

Nor is a carbon credit a "unit" within the meaning of the French Environmental Code. A unit in the sense of the Environmental Code includes, for example, EU emissions allowances, which are treated in the French Monetary and Financial Code in a manner similar to financial securities.[57]

It is important to note in this context that certain regulated entities governed by French law may not be authorized to hold assets that are not financial securities.

#### 3.2.2.2 Carbon credits are not contractual claims

Given its nature, could a carbon credit be considered a contractual claim against a third party? For example, could it be considered as a claim against the registrar/certification body that issued the carbon credit under its terms of use, or as a claim against the project developer carrying out the emissions reduction project that generates the credits?

Although a right *in personam* (contractual claim) can be an object of a property right under French law,[58] the legal qualification of a carbon credit as a contractual claim against a third party does not reflect the fundamental utility of the carbon credit. Unlike a contractual claim, whose value derives from a legal

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[56] Article L. 211-1, II. of the French Monetary and Financial Code: "financial securities are: 1. equity securities issued by joint-stock companies; 2. debt securities; 3. units or shares in collective investment schemes". Equity securities are further defined by article L. 212-1-A of the same code as including "shares and other securities giving or capable of giving access to capital or voting rights". Lastly, article L. 213-1 A of the same code defines debt securities as representing "a claim on the legal entity or securitization mutual fund which issues them ".

[57] These units are covered by articles L. 229-7, IV. et seq. of the French Environment Code. This assimilation stems from the revised Markets in Financial Instruments Directive (MIFID II), Annex I, Section C, point 11.

[58] For example, Article L. 313-24 of the French Monetary and Financial Code refers to the ownership of a personal right, in this case, a right to a claim.

relationship (such as the right to receive payment or obtain performance of an obligation from another person), a carbon credit is an object with its own economic utility for its owner. A parallel can be drawn with EU emissions allowances and CERs, which are recognized as movable assets by laws that statutorily recognize their transfer with a view to facilitating a market. However, compared with an allowance, which is created by the competent authority and allocated free of charge or by auction to entities within the scope of the EU ETS, the creation of a carbon credit is purely contractual in nature according to the relevant standards that market participants in dealing with carbon credits have accepted, and it is supposed to correspond to a reality of a CO2 emissions reduction, absorption or avoidance.

However, the working group believes it would be inappropriate to confuse the contractual nature of the services provided by the certification body/registrar (creation and allocation of a carbon credit to its initial owner, maintenance of the registry for the convenience of market participants), with the legal nature of the carbon credit itself, which does not correspond to that of a contractual claim.

#### 3.2.2.3 Carbon credits as intangible assets

French law traditionally requires that a movable asset have three fundamental characteristics: (i) it must have value or be useful, which legally explains the desire to possess it; (ii) it must be subject of a right of ownership, which is necessary to enable a person to use or dispose of the property exclusively; and (iii) it must be transferable.

Unlike tangible property, intangible property is not recognized by French law as an autonomous legal category endowed with a specific and homogeneous legal regime. From intellectual property to databases, trademarks and copyrights, intangible assets are recognized by French law as they emerge, with a body of specific rules applicable to each.

Emissions allowances, CERs and energy saving certificates have recently been expressly recognized by legislative provisions as movable and transferable assets.[59] Unlike these assets, carbon credits issued by private certification bodies are not specifically recognized under French law.

However, a carbon credit has a value and can be the subject of a right of ownership (subject to the uncertainties linked to the conditions applicable to registries described above). The owner may also use or consume the carbon credit by retiring it and claiming an offset against its carbon footprint, or may transfer it to a third party. The owner has an exclusive right to the carbon credit (double counting is not permitted under certification body standards).

Consequently, carbon credits can be considered as intangible assets. These assets are effectively created by the initial entry in a registry, and their value results from the value that the market wishes to attribute to it at a given moment.

It seems important to the working group that the legislature intervene to ensure the legal security of the voluntary carbon credit market, and to specify the legal status and transfer mechanism of voluntary private carbon credits, as it has done for emissions allowances and CERs. Such an approach would also have the advantage of predictability and of defining the regime applied to credits issued under the future scheme provided for in article 6.4 of the Paris Agreement.[60] The same applies to the biodiversity credits

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[59] Article L. 229-11 of the French Environment Code concerning emission quotas, Article L. 229-22 of the same code concerning certified emission reduction units, and Article L. 221-8 of the French Energy Code concerning energy saving certificates.

[60] Paris Agreement, 2015, https://unfccc.int/sites/default/files/french_paris_agreement.pdf; Art. 6.4 of the Paris Agreement, https://unfccc.int/process-and-meetings/the-paris-agreement/article-64-mechanism.

proposed in 2022 by the French President and currently being structured by *the International Advisory Panel on Biodiversity Credits*.[61]

It would also be advisable to consider creating a carbon credit registry at the European level that market participants could use on a voluntary basis, so that the account-to-account transfer of voluntary carbon credits and its legal effect are assured and recognized within EU territory. The working group notes in this regard that, in December 2022, the World Bank launched a platform (*Climate Action Data Trust*[62]) that encompasses the various registries and could become a global registry, helping to strengthen the legal certainty of carbon credit transactions.

### 3.2.3 Carbon credit legal regime under French law

The legal regime applicable to intangible property is heterogeneous, in the absence of *ut universi* recognition of intangible property under French law. For certain types of intangible assets, such as intellectual property, emissions allowances or CERs, French law has specific rules applicable to ownership and transfer of ownership of these assets, primarily intended to ensure the legal certainty of transactions involving these assets.

The legal regime applicable to carbon credits can be examined from four angles (on the assumption that carbon credits are intangible assets): (i) title and ownership; (ii) transfer; (iii) the creation of a security interest; and (iv) the applicability of close-out netting and financial guarantees.

#### 3.2.3.1 Property

With regard to movable property, French law contains a general rule under Article 2276 of the Civil Code, which equates possession with title.[63] Case law specifies that this rule applies only to individual tangible property.[64] It is a simple presumption of ownership, which can be rebutted by proof to the contrary. This rule protects subsequent purchasers who have acted in good faith, and guarantees the legal certainty of transactions involving tangible property for which no formal procedure or publicity is required for the transfer of ownership.

For intangible assets such as patents, whose transfer is subject to registration, deposit or other publicity rules, the general rule of article 2276 of the Civil Code is not applicable, and specific rules apply.

For financial securities (which are entirely dematerialized in France), French law specifies that "*no one may claim, for any reason whatsoever, ownership of financial securities whose ownership has been acquired in good faith by the holder of the securities account in which these securities are registered*".[65]

Although there is no specific rule governing the possession of carbon credits and the legal effect of possession, and the entry in an account in a registry (maintained under terms and conditions subject to foreign law) is not expressly recognized as having legal effect under French law, it seems reasonable to assume that the registration of a carbon credit in a registry account in the name of the holder (as indicated on the registry website) constitutes a simple presumption of ownership for the holder. As the registry is

[61] A description of this Franco-British approach is available at https://www.iapbiocredits.org/.

[62] Information on the *Climate Action Data Trust* platform is available on its website, https://climateactiondata.org.

[63] Article 2276 of the French Civil Code

[64] See, for example, Cass. 1re civ., May 6, 1997, no. 95-11.151

[65] Article L. 211-16 of the French Monetary and Financial Code

public, it enables third parties to know the name of the holder and any changes to the carbon credit holder. In this respect, it would be useful for the legislature to define the legal effect of an account entry in the relevant registry.

3.2.3.2 Sales contract and delivery

The sale or transfer of a carbon credit involves delivery of the credit. Under French law, delivery is the transfer of the property sold to the power and possession of the buyer.[66] For an intangible asset such as a carbon credit, delivery should generally mean the transfer of the credit from the seller's account in the registry to the buyer's account. However, the sales contract can also contractually structure delivery as the transfer of the right to exclusively use the carbon credit from the seller to the buyer (i.e. the retirement of the credit by the seller for the benefit of the buyer). The contract could also structure delivery in any other way agreed between the parties (for example, the seller may undertake to hold the carbon credit on behalf of the buyer), but in this case the buyer cannot benefit from any presumption of ownership enforceable against third parties.

3.2.3.3 Collateral and security

Parties may create a security interest in a carbon credit. The rules governing the perfection and enforcement of a security interest are governed by the *lex rei sitae* (i.e. the law of the state in which the carbon credit is located). In the absence of an express rule, determining the location of an intangible asset such as a carbon credit may pose difficulties, but it is reasonable to assume that the location of the registry in which the carbon credit is registered, or the location of the registrar, will be considered relevant. On the other hand, if the beneficiary of a security interest is registered in the registry as the holder (with the respective rights of the holder and the giver of the security interest governed by contract), then the beneficiary should be able to benefit from the same presumption of ownership that may be granted by legislation, assuming the adoption of legislation such as that recommended by the working group.

The carbon credit location rule must be the subject of an international consensus via an international treaty if we are to create a secure international legal environment for market operators, even if achieving such a consensus may be difficult.

Assuming that French law is the relevant *lex rei sitae*, certain specific regimes exist for a security interest in certain types of intangible assets, under French law.[67] For intangible assets that are not subject to specific rules under French law (such as carbon credits), the regime applicable to tangible movables will apply.[68] The security interest must be registered in a special registry maintained by the commercial court.[69] The security interest may be enforced by public sale, judicial allocation or appropriation on the basis of a valuation determined by an expert.

3.2.3.4 Close-out netting and financial guarantees

A spot sale or forward sale settled exclusively by physical delivery of carbon credits between two user companies or between a financial institution and a company generally would not benefit from the French close-out netting regime in the event of the French counterparty becoming subject of insolvency

[66] Article 1604 of the French Civil Code

[67] Like patents or goodwill

[68] Article 2355 of the French Civil Code

[69] Decree no. 2006-1804 of December 23, 2006 implementing article 2338 of the French Civil Code and relating to the publication of non-possessory pledges.

proceedings in France. However, the legal close-out netting regime may apply to derivative instruments relating to carbon credits if they are financial instruments within the meaning of section C of Annex I of MIFID II. However, as mentioned in chapter 4 of this report, it is not certain that derivatives relating to carbon credits are covered by Section C of Annex I of MIFID II.

Under French law, carbon credits are not considered eligible assets for the purposes of financial collateral under the European Financial Collateral Directive.[70] A collateral agreement covering carbon credits therefore cannot benefit from protection against the insolvency of the collateral provider in France.

#### 3.2.4 Allocation of over-issuance risk

The working group considered whether the legal regime applicable to carbon credits should include specific provisions for the cancellation of carbon credits in the event of “over-issuance”, in two situations.

- “Reversal,” which involves the cancellation of carbon credits when, after the credits have been issued, the carbon reduction or removal project or program that led to its creation is compromised. This means that the quantity of $CO_2$ that had been verified as having been reduced or removed is diminished due to events occurring after the carbon credits were issued (for example, a fire that impacts the CO2 absorption capacity of a forest, or a leak observed on a technological CO2 storage facility).
- “Revocation,” which could occur when it is demonstrated that the claimed environmental benefits were never realized, due in particular to methodological non-compliance, a compromised verification process or faulty methodology.

There are currently three mechanisms in place in the general conditions of the main certification bodies to deal with over-issuance:

- *Buffer pool*: A percentage of the carbon credits issued for each project is reserved and credited to a common account maintained by the certification body in order to mutualize the risk of over-issuance. When an event occurs that calls into question the GHG reduction confirmed for a project, carbon credits in the buffer pool are cancelled by the certification body;
- *Cancellation obligation*: When a reversal occurs, the project developer is obliged to cancel a number of carbon credits corresponding to the over-issuance. If the developer has already sold its carbon credits in the market, then it must purchase carbon credits in order to cancel them; and
- *Suspension*: The issuance of new carbon credits for the relevant project is suspended for at least the time needed to rectify the over-issuance.

Currently, no certification body provides in its terms and conditions for the cancellation of carbon credits held by third parties (i.e. a party other than the project developer and the certification body). The question that arose during the working group’s discussion was whether to go beyond the existing mechanisms.

The working group did not reach a consensus on this point. The working group noted that this is a question of allocating the risks associated with over-issuance, currently borne by project developers and

[70] Directive 2002/47/EC of the European Parliament and of the Council of June 6, 2002 on financial collateral arrangements.

certification bodies through existing mechanisms. The question is whether the holders of carbon credits (other than the project developer) should also bear this risk. Two main positions emerged.

Part of the working group considered that the risks associated with credit integrity and over-issuance should not be borne by innocent buyers, just as the working group recommended protecting innocent buyers from the risks associated with questions concerning the determination of title. The working group members who took this position noted that forcing the carbon credit holder to bear the risk of cancellation would have a negative effect on market liquidity. In addition, cancelling carbon credits that have been traded several times in the market would give rise to complex disputes between the parties to these trades, and it is far from certain that at the end of these disputes the parties bearing the losses would be those responsible for the default.

On the other hand, some members of the working group took the view that, as carbon credits are intended to serve a common good, it makes sense to share responsibility among buyers, emitters and certifiers. Allowing a company to use a defective carbon credit to offset its own GHG emissions could compromise the *raison d'être* of the voluntary carbon market, which is to finance the effective reduction or absorption of GHG emissions. According to these working group members, existing mechanisms are useful and complementary, but not sufficient.

The working group decided to address these issues, considering that they are closely related to the main topics of its mission, but in the absence of consensus, the working group did not make any recommendation. It noted the decision of the UNIDROIT Working Group to consider these issues as part of its analysis of the legal nature of carbon credits.

## IV. REGULATION OF THE VOLUNTARY CARBON MARKET

Carbon credits are not “financial instruments” within the meaning of the MIFID II Directive.[71] However, they share a number of characteristics with financial instruments, and entail some of the same risks. Carbon credit trading is often carried out by financial intermediaries, in the same way as transactions involving financial instruments. Carbon credits are purchased by end-users, but also by financial players engaging in trading, in order to profit from price variations.

The vast majority of carbon credits are traded through over-the-counter transactions between sophisticated parties. To the best of the working group's knowledge, voluntary carbon credits are not currently admitted to trading on an exchange subject to European Union regulations. According to a major international bank interviewed by the working group, most transactions go through intermediaries located mainly outside the European Union, even when they involve European buyers.

In the financial markets, spot contracts and derivatives linked to carbon credits are traded on organized markets. Trading mainly involves spot contracts for baskets of carbon credits, as well as futures contracts based on these spot contracts. Contracts are traded mainly on exchanges based in the United States. The most liquid contracts are GEO-branded spot contracts traded on the CBL platform managed by Xpansiv,[72] and GEO futures traded on the CME (Chicago Mercantile Exchange) market. Carbon credit contracts are also traded on the Nodal Exchange in the USA[73] (an affiliate of EEX, a

[71] Directive 2014/65/EU of the European Parliament and of the Council of May 15, 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (“MIFID II”).

[72] See the CBL Xpansiv website, https://xpansiv.com/geo/.

[73] See the Nodal Exchange website, https://www.nodalexchange.com/.

subsidiary of Deutsche Börse), and ACX in Abu Dhabi and Singapore.[74] In the UK, ICE Futures Europe (London) has been offering carbon credit futures since 2023.[75] However, to the best of the working group's knowledge, no spot contracts or derivatives involving carbon credits have been admitted for trading on a European trading venue, as defined by the MFID II Directive.[76] However, European market participants have access to foreign trading venues, including the US market.

According to some market observers,[77] carbon credit derivatives could constitute "financial instruments" within the meaning of the MIFID II directive.[78] If these observations are correct, then the full panoply of European regulations should apply to these products. However, according to the working group's analysis, this conclusion is not entirely clear, since the relevant paragraph of the definition of financial instrument only covers contracts on "fungible" underlying instruments.[79] However, it is not certain that carbon credits are "fungible" assets within the meaning of this regulation.

Against this backdrop, the working group analyzed trading markets for carbon credits and carbon credit contracts, with a view to considering whether the risks associated with these products could justify their inclusion in the European Union's financial market regulation system. The working group's conclusions are as follows:

- Given that carbon credits and spot contracts are not traded on regulated trading venues in the European Union, and that transactions involving carbon credits are mainly carried out by sophisticated parties in markets outside the European Union, it does not appear essential at this stage to amend the definition of financial instrument to include carbon credits or spot contracts involving carbon credits.
- However, the market should be monitored and, if necessary, carbon credits should be included in the definition of financial instrument, particularly if operators of organized markets in the European Union begin to admit carbon credits or spot contracts involving carbon credits to trading.
- The working group recommends that the authorities clarify whether derivatives on carbon credits are covered by paragraph 10 of Section C of Annex I of MIFID II, i.e. the part of the definition of financial instrument that covers derivatives on assets not mentioned in another paragraph of the definition. This requires clarification as to whether carbon credits are "fungible" assets within the meaning of Article 8(f) of Delegated Regulation 2017/565.

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[74] *State and Trends of Carbon Pricing 2023*, World Bank Group, May 2023, https://openknowledge.worldbank.org/entities/publication/58f2a409-9bb7-4ee6-899d-be47835c838f

[75] *ICE Launches 10 Carbon Credit Futures Vintages Extending Out to 2030*, August 17, 2022, https://ir.theice.com/press/news-details/2022/ICE-Launches-10-Carbon-Credit-Futures-Vintages-Extending-Out-to-2030/default.aspx ;

[76] MIFID II, Art. 24.

[77] *Legal Implications of Voluntary Carbon Credits*, International Swaps and Derivatives Association (December 2021), https://www.isda.org/a/38ngE/Legal-Implications-of-Voluntary-Carbon-Credits.pdf., p. 11

[78] Derivatives involving carbon credits are not traded on European platforms, but could be considered financial instruments within the meaning of paragraph 10 of Section C of MIFID II if they meet the criteria of paragraph 10, since they are traded on organized markets in third countries, notably the USA and the UK. Cf. Commission Delegated Regulation (EU) 2017/565 of April 25, 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and the definition of certain terms for the purposes of that Directive ("Delegated Regulation 2017/565"), Art. 7(3).

[79] See Delegated Regulation 2017/565, Art. 8(f).

- The working group also considered whether European regulations should incorporate specific provisions for carbon credits and related products, particularly concerning the integrity of the carbon credits underlying derivatives that might be traded on EU markets, following the example of the guidelines adopted in this respect by the US regulator, the CFTC. The working group considers that the current state of the market does not justify the adoption of specific rules for carbon credits, but recommends that the authorities monitor developments and, if necessary, consider introducing specific provisions.
- If the authorities decide to incorporate carbon credits and carbon credit derivatives into European market regulations, it will be important to ensure proper coordination with other countries facing similar issues, notably the USA. International regulatory harmonization is particularly important given the cross-border nature of carbon credits.

The remainder of this section examines the background to, and main reasons for, the working group's conclusions set out above.

### 4.1 The IOSCO Consultation Report of December 2023

In December 2023, the IOSCO Board published a Consultation Report on the voluntary carbon market, based on the results of a public consultation launched in November 2022.[80] The Consultation Report notes the existence of certain potential vulnerabilities in the carbon credit market. To address these, IOSCO proposed a list of "best practices" for the regulation of the primary and secondary carbon credit markets for comment in a second public consultation.

IOSCO first recommended a general approach, including the establishment of methods to ensure effective market surveillance, investor protection and market integrity, noting specifically that these issues should be considered in a manner "similar to other financial markets." IOSCO also stressed the importance of international consistency.

For the secondary market, IOSCO recommends the implementation of best practices on points that are, indeed, common to all financial markets, including in particular :

- Open access to markets to increase the number of participants;
- Integrity and good practices in transactions: quality standards for the admission of carbon credits and carbon credit products to trading venues; publication of rulebooks by trading venues; archiving and availability of transaction data;
- Publication of information: transparency on prices, volumes and bid-offer spreads;
- Communication of pre- and post-trade information by market participants, similar to other financial markets;
- For derivatives, assessment of the certification methods and integrity of the underlying carbon credits by market operators, as well as other matters concerning these underlying carbon credits, including the reliability of settlement arrangements for contracts providing for physical delivery; and
- The application of measures to combat market abuse, including market surveillance and transaction monitoring.

[80] *Voluntary Carbon Markets*, Consultation Report, CR/06/2023, December 2023, December 2023, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD749.pdf

IOSCO also stresses the importance of governance, risk management and the prevention of conflicts of interest for the operation of secondary markets.

IOSCO's recommendations are by their very nature fairly general, not addressing the regulatory system of any specific country or bloc. Nevertheless, IOSCO's public consultation revealed certain risks inherent in the secondary market for carbon credits, which IOSCO's proposed best practices are designed to address. These best practices could be integrated into the regulatory systems of the jurisdictions impacted by this market, where justified, in the same way as rules for other financial products.

### 4.2 Treatment of carbon credits under European Union law

Carbon credit trading is not regulated under EU financial markets laws and regulations. In particular, carbon credits are not defined as "financial instruments" in Section C of Annex I of the MIFID II Directive. Consequently, market operators can open their platforms to trading in carbon credits and spot contracts for carbon credits, without any authorization and without complying with MIFID II and MIFIR regulations. The Market Abuse Regulation (MAR) would not apply to trading on these platforms.

The treatment of carbon credits is therefore different from that of emissions allowances, which are covered by European market regulations. Emissions allowances are a specific category of financial instruments covered by Section C of Annex I of the MIFID II Directive.[81] Specific provisions for emissions allowances can be found in numerous articles of MIFID II, MIFIR and MAR.

The difference between the treatment of carbon credits and emissions allowances seems justified in the current context of these markets, in particular for the following reasons:

- Emissions allowances are traded on a regulated market in the European Union (EU-ETS), while carbon credits are not traded on any regulated trading venue in the EU.
- The size of the carbon credits market, with less than one billion US dollars worth of carbon credits issued worldwide in 2023, is not comparable to that of emissions allowances, with around 47 billion euros issued in 2023 in the European Union market alone.
- Emissions allowances are purely European products: they are created by EU legislation, they are sold on the market through auctions organized in the EU, and they are used to comply with emissions limits imposed by EU legislation. By their very nature, carbon credits are cross-border products.
- Emissions allowances are perfectly fungible instruments—each allowance represents the right to emit one tonne of $CO_2$ (or equivalent), and there is no difference between emissions allowances. Carbon credits are heterogeneous, identified with the underlying project throughout their lifetime. The price of a carbon credit depends on its category (nature restoration, forest preservation, renewable energy, etc.) as well as factors specific to the certification body and the underlying project. While carbon credits related to a single project are fungible with one another, there is no fungibility between carbon credits related to different projects, certified by different certification bodies, or belonging to different categories (unless a specific contractual provision provides for fungibility).

While these distinctions seem to justify the differences in regulatory treatment, their importance may change as the voluntary carbon market develops. In terms of market size, for example, prior to the decline observed in 2023, some analysts had forecast significant growth in the carbon credit market,

[81] MIFID II, Annex I, Section C, paragraph (11).

which they believed could reach tens of billions of US dollars, or even hundreds of billions of dollars in the medium term.[82] And as far as trading carbon credits in the European Union is concerned, several operators had announced in 2022 their intention to admit carbon credits and associated products to trading, including the EEX market in Frankfurt (which has established the Nodal Exchange market in the USA but has not yet set up a trading venue in the EU).[83] In addition, the Carbon Trade eXchange, which presents itself as the world's leading carbon credit trading platform, says that it has a presence in the European Union.[84]

According to a Bloomberg study cited in the IOSCO Consultation Report, Europe (including the UK) accounts for around 37% of global demand for carbon credits, behind North America with 46%.[85] And according to research firm MSCI Carbon Markets, the two biggest declared users of carbon credits in 2023 are UK and German companies.[86]

Since carbon credits are not included in the definition of financial instrument, a market operator can open its trading venue to carbon credits without approval and without complying with MIFID II/MIFIR requirements, even if trading volumes increase. If this were to occur, it would have the following consequences:

- Lack of transparency on carbon credit prices and spot contracts; no centralized reporting of transactions;
- Conflicts of interest would not be regulated—for example, intermediaries who arrange and execute transactions could also provide advisory services to customers and publish recommendations, without having to establish information barriers;
- No obligation on intermediaries to obtain best execution for their customers;
- Intermediaries active in the carbon credit market would not be required to obtain a license to provide an investment service or engage in a carbon credit investment activity, nor would they be required to comply with capital adequacy requirements, even if they accepted and held customer funds;[87]
- Participants in the carbon credit market would not have to comply with rules on market abuse; thus, a party in possession of confidential information on an underlying project likely to influence the price of carbon credits could carry out transactions without fear of being accused of insider trading;
- Manipulation of carbon credit prices would not be penalized or supervised.

[82] *Where the Carbon Offset Market is Poised to Surge,* Morgan Stanley Research, April 11, 2023, https://www.morganstanley.com/ideas/carbon-offset-market-growth

[83] *Voluntary Carbon Markets,* EEX Group, https://www.eex.com/en/markets/environmental-markets/voluntary-carbon-markets

[84] Carbon Trade eXchange (CTX) website, https://ctxglobal.com/

[85] *Voluntary Carbon Markets*, Consultation Report, CR/06/2023, December 2023, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD749.pdf. p.18.

[86] *2023 Voluntary Carbon Markets in Review Webinar*, MSCI Carbon Markets, p. 18.

[87] The acceptance by an operator of funds paid into a payment account may, however, require approval under the Payment Services Directive (as transposed into national law by the Member States), Directive (EU) 2015/2366 of the European Parliament and of the Council of November 25, 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

Furthermore, the agencies that rate carbon credits (mainly with regard to their integrity) are not subject to any regulations.[88]

International practice regarding the treatment of carbon credits is mixed. Carbon credits are included in the definition of a financial instrument in several countries that have expressed a desire to develop markets for this product, such as the United Arab Emirates and Egypt.[89]

In the United States, carbon credits are treated as commodities.[90] Consequently, derivatives on carbon credits are subject to regulation by the Commodities Futures Trading Commission (CFTC), whose jurisdiction includes combatting fraud in the physical commodity market underlying derivatives. But the CFTC's jurisdiction does not include regulation of the carbon credit market or carbon credit spot contracts, apart from fraud issues affecting derivatives. In September 2024, the CFTC adopted guidelines recommending that market participants in carbon credit derivatives exercise vigilance regarding the integrity of the carbon credits underlying contracts admitted to trading.[91] In this way, the CFTC has effectively established regulatory guidelines for carbon credits themselves.

### 4.3 Treatment of carbon credit derivatives under European Union law

Carbon credit derivatives, like carbon credits themselves, are not currently traded on regulated markets, MTFs or OTFs in the European Union. But even if trading of these products were to begin on European platforms, the regulatory treatment of carbon credit derivatives would remain uncertain. According to the working group's analysis, it is not certain that carbon credit derivatives are covered by one of the categories of derivatives included in the definition of financial instruments.

To analyze this question, it is necessary to go through a cascade of definitions that appear in the MIFID II Directive and in the Commission Delegated Regulation (EU) 2017/565.

The first step is to analyze the list of financial instruments contained in Section C of Annex I to the Directive. Section C explicitly mentions derivatives on certain underlying instruments—such as securities, interest rates, currencies, emissions allowances, credit risk and commodities. Carbon credits are not among the underlying instruments explicitly mentioned in Section C.[92]

[88] Even if carbon credits were added to the definition of financial instrument, agencies that rate carbon credits would not be covered by the regulations applicable to credit rating agencies, since the rating of carbon credits does not concern credit. Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of September 16, 2009 on credit rating agencies, Art. 1(a) (definition of "credit rating"). With regard to the draft European Regulation on ESG ratings, it is unclear whether the definition of an "ESG rating" could include the rating of the integrity of carbon credits, https://data.consilium.europa.eu/doc/document/ST-6255-2024-INIT/en/pdf. A legislative amendment may therefore be required to cover carbon credit integrity rating agencies.

[89] See the December 2023 IOSCO document cited above, and for the United Arab Emirates, https://acx.ae/regulation.

[90] Commodities Exchange Act, Art. 1(a)(9), 7 U.S.C. Ch. 1 (definition of "commodity" includes "services, rights and interests ... in which contracts for future deliver are presently or in the future dealt in").

[91] Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts, Commodity Futures Trading Commission, Release RIN 3038-AF40 (September 20, 2024).

[92] Unlike in the United States, carbon credits are not commodities within the meaning of Article 6 of Delegated Regulation 2017/565 ("any fungible good that can be delivered, including metals and their ores and alloys, agricultural products and energy supplies, such as electricity").

The only Section C category likely to accommodate carbon credit derivatives is found in paragraph 10 of Section C, which includes *inter alia* contracts for “assets, rights or obligations” not mentioned elsewhere in Section C, and which “have the characteristics of other derivative instruments.”

The working group believes that certain derivatives on carbon credits should have the characteristics of other derivative instruments within the meaning of paragraph 10. But it is not clear whether carbon credits are among the “assets” covered by paragraph 10.

According to the working group's analysis presented in Chapter 3 of this report, carbon credits should indeed be considered as “assets” (intangible movable property) in the broadest sense. But for the purposes of paragraph 10, we need to look at a second list that appears in Article 8 of Commission Delegated Regulation 2017/565. Several categories of assets are mentioned in Article 8, but carbon credits are not included.

Article 8 of Delegated Regulation 2017/565, like paragraph 10 that it interprets, contains a general category: “any other asset or right of a fungible nature, other than a right to receive a service, capable of being transferred”.

The question is whether carbon credits are “fungible” assets within the meaning of Article 8. The answer is not obvious.

On the one hand, carbon credits are identified (by registration in a registry and assignment of an identification number) and linked to their underlying projects, and the value of a carbon credit could be impacted by developments specific to its project, or to its category or certification body. A carbon credit linked to a certain project is not fungible with a carbon credit linked to another project, even less so if the other project is of a different category or has been certified by another certification body.

On the other hand, all carbon credits identified with a project are fungible with each other. In this sense, carbon credits are comparable to shares in a company, fungible among themselves (provided they belong to the same category), but not fungible with shares in other companies.

The working group believes it is desirable to clarify the question of the “fungibility” of carbon credits within the meaning of Article 8, possibly in the form of a question and answer on the ESMA website (which recently clarified a similar point concerning derivatives on emissions allowances that are not traded in the EU ETS).[93]

In the absence of such a clarification, a market operator could attempt to admit carbon credit derivatives to trading without complying with the regulations applicable to financial instruments, with the consequences discussed above for carbon credits and spot contracts. And without clarification of the treatment of carbon credit derivatives in MIFID II, these products could fall outside the requirements of the EMIR regulation applicable to OTC derivatives contracts, including risk mitigation and trade reporting obligations.[94]

Admittedly, the risk associated with carbon credit derivatives is currently far from systemic for the European market, given the small size of the market and the fact that it is largely situated overseas.

[93] Interpretation of emissions allowances under C4, ESMA_QA_847 (July 12, 2024), https://www.esma.europa.eu/publications-data/questions-answers/847.

[94] Articles 4 to 13 of Regulation (EU) No 648/2012 of July 4, 2012 on OTC derivatives, central counterparties and trade repositories.

However, this risk should be managed before it gets too close to the systemic threshold, or in any case to reinforce market transparency and integrity.

### 4.4 Adapting market regulations to address the specific characteristics of carbon credits

In addition to questions linked to the definition of a financial instrument and the treatment of carbon credits in European market regulations, the working group considered whether it would be appropriate to adopt regulatory provisions specific to features of carbon credits, along the lines of those concerning emissions allowances.

The working group's analysis relates to two topics.

First, contracts for carbon credits (spot or derivatives) involving physical delivery could present an adverse selection risk—i.e. the party required to deliver the carbon credits at contract maturity could choose to deliver low integrity carbon credits to its counterparty. This risk exists for contracts covering a category or basket of carbon credits (for example, Xpansiv's GEO contracts in the United States). At maturity, the party obliged to deliver a carbon credit has an incentive to deliver the cheapest carbon credit within the category or basket concerned, i.e., a priori, the carbon credit with the lowest integrity. The question is whether this choice should be regulated to avoid the risk of abusive practices, particularly if contracts begin to be traded on regulated trading venues in the European Union.

Second, the absence of a duty of care regarding the integrity of the carbon credits underlying derivatives traded in the European Union could have a negative impact on the market or the perception of market quality. Most market participants do not have the resources or expertise to assess the integrity of carbon credits. As mentioned above, in the United States, the CFTC adopted guidelines in September 2024 calling on market operators to ensure the integrity of the carbon credits underlying contracts admitted to trading on their markets. The question is whether European operators should be invited to exercise similar vigilance.

It is undoubtedly premature at this stage to consider adopting provisions in European regulations to address these issues. However, the working group recommends that these points be taken into consideration if the authorities decide in the future to regulate carbon credits in the European Union's market regulations.

## V. CONSEQUENCES OF SUSTAINABILITY DISCLOSURE REGULATIONS ON THE USE OF CARBON CREDITS

The use of carbon credits is part of a climate strategy, the content of which is generally freely determined by companies. This climate strategy is set out in the company's corporate communications, aimed at investors and the market in general, and to some extent in commercial and advertising communications addressed to customers and consumers.

The main reason why companies voluntarily acquire carbon credits is so that they can include them in their communications: they highlight their efforts to offset the GHG emissions generated by their activities, or use them as part of their ambition to achieve carbon neutrality or a so-called "net zero" objective, declaring that they are financing projects outside their value chains through carbon credits.

Directive (EU) 2022/2464 (known as the *Corporate Sustainability Reporting Directive* or CSRD), supplemented by the European *Sustainability Reporting Standards* (ESRS),[95] aims to standardize and improve the quality of sustainability information published by companies for the market and sustainability stakeholders. In addition to improving the comparability of sustainability information between companies, CSRD aims to anchor sustainability information in corporate financial reporting, seeking interoperability with financial statements. To this end, the CSRD is an amendment to the Accounting Directive[96] and the Auditing Directive[97], whose terms apply *mutatis mutandis*.

A section of the Sustainability Report published under CSRD is dedicated to climate issues.[98] This contains, among other things, information on the company's climate strategy,[99] its gross GHG emissions[100] and its GHG emissions reduction targets,[101] as well as information on its use of carbon

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[95] In practice, the content of the Sustainability Report is set out in Delegated Regulation (EU) 2023/2486 adopted by the European Commission on July 31, 2023, to which the European Sustainability Reporting Standards (ESRS) are annexed. As the ESRS are part of a European regulation, they are directly applicable. The transposition of the CSRD into French law, as set out in Article R. 232-8-4 of the French Commercial Code, is virtually identical to the wording of the CSRD and refers to the ESRS.

[96] Directive 2013/34/EU of the European Parliament and of the Council of June 26, 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of companies.

[97] Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

[98] The section in question corresponds to ESRS Publication Requirements E1—Climate Change. It is included in the Sustainability Report, unless the company establishes that climate change is not an important issue in the sense of the CSRD (it would then be said to be "non-material") and justifies this in its Sustainability Report (ESRS 1, §32). If a company has published, in any medium whatsoever, commitments to climate neutrality or offsetting based, where applicable, on carbon credits, it would be difficult for it to argue that climate issues are "non-material".

[99] ESRS E1, Publication Requirement E1-1—Mitigation transition plan, Publication Requirement E1-2—Policies related to climate change mitigation and adaptation and Publication Requirement E1-3—Actions and resources related to climate change policies.

[100] ESRS E1, Publication requirement E1-6—Scope 1, 2, 3 gross GHG emissions and total GHG emissions.

[101] ESRS E1, Publication requirement E1-4—Targets related to climate change mitigation and adaptation.

credits.[102] However, carbon credits can only be included in corporate communications if they meet certain criteria.

Certain restrictions on such communications will be reflected in the *Green Claim Directive*, currently under discussion at European level,[103] which aims to provide a framework for "environmental claims", i.e. voluntary statements made by companies as part of a commercial communication aimed at consumers, which assert or suggest that a product or professional activity has a positive or zero impact on the environment.[104] This draft directive will expressly regulate environmental claims based on the offsetting of GHG emissions,[105] including those based on the use of carbon credits.[106]

While there does not appear to be an opportunity to impose a hard regulatory framework on the *content* of carbon credits,[107] their *use* by companies is already subject to regulation through the CSRD[108] and consumer law provisions that are to be reflected in the *Green Claim Directive*.

Consequently, if companies subject to EU law wish to use carbon credits to offset their GHG emissions, they should ensure that the carbon credits they acquire comply with the methodological principles (5.1) and that they use them in accordance with the conditions of use (5.2) that emerge from the CSRD. By mentioning carbon credits in their sustainability reports, companies will also need to deal incidentally with certain financial issues linked to the use of carbon credits (5.3).

### 5.1 Methodological principles required by the CSRD

For a carbon credit to be mentioned in the Sustainability Report, it must be "*issued and verified in accordance with recognized quality standards*."[109] The ESRS do not specify in what way a standard can be "recognized": is a standard recognized because of its popularity? Its age? Or its recognition by a public authority?

In the absence of precision, it would seem consistent to rely on the notion of integrity of carbon credits as identified by the market (5.1.1). Under CSRD, the integrity criterion requires that the cancellation of retired carbon credits be assured (5.1.2).

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[102] ESRS E1, Publication requirement E1-7—GHG absorption and mitigation projects financed with carbon credits.

[103] Proposal for a Directive of the European Parliament and of the Council on the substantiation and communication of explicit environmental claims (Green Claims Directive), March 22, 2023, COM(2023) 166 final (the "Draft Commission *Green Claim Directive*").

[104] The draft *Green Claim Directive* refers on this point to Directive 2005/29/EC of May 11, 2005 concerning unfair business-to-consumer commercial practices, as amended by Directive (EU) 2024/825 of February 28, 2024, to empower consumers to act in favor of the green transition.

[105] Article 3(1)(h) of the Commission's draft *Green Claim Directive*.

[106] Recital 21 of the Commission's draft *Green Claim Directive*. While the Commission's draft was relatively vague on the subject, the Council's draft provides for the adoption of Commission implementing rules that should be consistent with the framework set by the ESRS (Recital 21b and article 3(1a)(e)(i) of the Council's draft Green Claim Directive).

[107] Carbon credit certification bodies are often based outside the European Union.

[108] On the liability issues associated with CSRD, see HCJP, Report on the Corporate Sustainability Reporting Directive (CSRD): Analysis of the risks of civil liability claims and stock market sanctions, October 2023.

[109] ESRS, Acronyms and glossaries of terms, "Carbon credit

### 5.1.1 Integrity principles for carbon credits

In a Q&A published in July 2024, EFRAG, which initiated the ESRSs that were subsequently incorporated into a Delegated Regulation by the European Commission, pointed out that there was no list of carbon credit standards recognized by the European Union or recommended by it.[110]

The working group regrets the absence of such a list, especially since the requirement to disclose "*recognized quality standards*" for carbon credits raises a number of questions. According to EFRAG, carbon credits are issued in accordance with recognized quality standards if :

(i) They can be verified by an independent third party;

(ii) The standards used by the certification body are made public, as are reports on funded projects; and

(iii) On the substance, the standards in question meet at least the criteria of additionality, permanence, avoidance of double counting[111] and enable project monitoring and verification of the project's impact on GHG emissions.

In the absence of a European list identifying recognized quality standards for carbon credits, it is up to the companies acquiring the carbon credits to take a position in their sustainability report (and, where applicable, in their commercial documentation), in order to ensure compliance with these substantive and formal criteria (i.e., "quality" in the sense of ESRS standards) by the certifiers.[112]

In this respect, the working group recalls that :

(i) The ESRS requires companies to include a certain amount of information on these projects in their sustainability reports.[113] Before acquiring a carbon credit, companies should ensure that they have access to the information in question.

(ii) The information published in the sustainability report must meet certain qualitative criteria:[114] it must give a true and fair view, which implies that it must be complete, neutral and accurate.[115]

This information must also ensure comparability and therefore a certain level of consistency in the approaches and methods used for the same sustainability issue.[116] What then of the

[110] EFRAG, ESRS Q&A Plateform—Compilation of explanation, Question ID 536, January-June 2024

[111] These methodological principles are in line with those adopted by the main reference frameworks for voluntary credits (see *above*) and by the French Environment Code (Code de l'environnement, art. L. 229-55 and R. 229-102-1).

[112] Publication requirement E1-7—GHG absorption and mitigation projects financed with carbon credits ("Publication requirement E1-7"), §61(c) and AR 61

[113] This information relates to the share of carbon credits financing reduction projects, the share of those financing absorption projects (with a breakdown between those based on a biogenic carbon sink and those based on a technological carbon sink), the share of projects financed that are located on European Union soil and those that can be considered as an adjustment to Article 6 of the Paris Agreement (Publication requirement E1-7, AR 62).

[114] ESRS 1,§19.

[115] ESRS 1, Appendix B, QC 5.

[116] ESRS 1, Appendix B, QC 10.

case where the method used by the company to account for its GHG emissions differs from that used by certification bodies to assess offset emissions?

In such a situation, the working group suggests that companies should ensure that the methodology used by the carbon credit certification body is not diametrically opposed to or incompatible with the one they use to quantify their GHG emissions and assess the methods used to account for GHG absorptions in their value chain. Indeed, the principle of comparability does not require uniformity of methodologies,[117] but rather a certain level of consistency, particularly in terms of the orders of magnitude of emissions factors and global warming potential values.

(iii) As with any activity, the operation of GHG emissions offsetting projects financed by carbon credits is likely to have some negative consequences for the environment (for example, a technological carbon sink could disrupt wildlife), and impact social issues (the transition to a low-carbon activity may mean eliminating certain jobs) or even human rights (the desire to reduce GHG emissions does not obviate the need to respect the rights of local communities).

On this basis, an investment can only be qualified as "sustainable" under EU law if it does not have a significant negative impact on a different sustainability issue *(Do no significant harm* or DNSH)[118] [119].

The search for overall consistency in sustainability measures[120] suggests that companies should be encouraged to acquire carbon credits applying a similar principle, thus limiting their risk of being associated with a controversy that could call into question their environmental, social and societal efforts as described in their sustainability report.[121]

### 5.1.2 Ensuring the cancellation of carbon credits

To report on its use of carbon credits in its sustainability report, a company must specify, among other things, the total quantity of carbon credits (expressed in tonnes of $CO_2$ or the equivalent ) that were

[117] ESRS 1, Appendix B, QC 11.

[118] Regulation (EU) 2019/2088 of November 27, 2019 on sustainability disclosure in the financial services sector (SFDR), art. 2(17).

[119] Qualification as an environmentally sustainable activity within the meaning of the Taxonomy (commonly referred to as "Taxonomy-aligned") is conditional on a similar criterion: it must not undermine any of the environmental objectives targeted by the Taxonomy and must be carried out in compliance with minimum social and human rights guarantees (Regulation (EU) 2020/852 of June 18, 2020 on the establishment of a framework to promote sustainable investment (Taxonomy Regulation), art. 3, 17 and 18).

[120] HCJP, Report on corporate extra-financial transparency, July 2022

[121] For certification bodies, compliance with such a principle would guarantee a certain degree of liquidity: some investment products (mainly FIAs) have carbon credits as their underlying assets. Subject to SFDR, these products are often "article 9" products within the meaning of this regulation, and as such can only be invested in investments qualified as sustainable. Some "articles 8" are committed to investing a percentage of their assets in sustainable investments. Thus, a carbon credit complying with a DNSH principle would, in principle, be an eligible asset for "articles 9" and would enable the "articles 8" concerned to achieve their sustainable investment ratio.

retired and cancelled during the fiscal year[122] and those scheduled for retirement and cancellation at a given date.[123]

As a matter of principle, all carbon credits that have been used to offset a company's emissions and have been declared as such by the company must be cancelled and formally retired in the registers in which they are recorded. This cancellation is part of the ban on double-counting: it ensures that credits cannot be used by other entities, or several times by the same entity (i.e., avoidance of double-counting). More generally, this cancellation ensures greater credibility for companies' declarations of their efforts to offset their emissions, and maintains the integrity of the carbon credit market by preventing the circulation of credits that have already been used.

Information on carbon credits and their retirement and cancellation is published in the sustainability report under the responsibility of the company. The information in this report is certified by the statutory auditor or by an independent third-party body, initially on the basis of limited assurance, and potentially based on reasonable assurance in the future. In the absence of standards likely to be imposed on certification bodies, it is up to companies to ensure that the carbon credits they acquire are cancelled and retired when they are used. They must be able to demonstrate the steps they have taken as part of the attestation process on their sustainability reports, by obtaining an attestation of cancellation issued by the relevant registry when the carbon credit is used and retired.

### 5.2 Conditions for using carbon credits generated by the CSRD

Once a company has acquired carbon credits in line with ESRS methodological requirements, it will wish to "use" or "consume" them, i.e., to use them in its sustainability report, or, where allowable, in its marketing communications.

Following the adoption of the Directive on Empowering Consumers for Ecological Transition in 2024,[124] claims based on the offsetting of greenhouse gas emissions are deemed unfair commercial practices in all circumstances. In other words, once this directive is transposed into national law,[125] a company will not be able to "*claim, on the basis of greenhouse gas emission offsetting, that a product has a neutral, reduced or positive impact on the environment in terms of* greenhouse *gas emissions*."[126]

Only carbon-neutral claims made at company level will remain possible. However, if the *Green Claim Directive* is adopted in its version as reviewed by the Council, these claims will have to comply with the criteria set out in the ESRS.[127]

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[122] Publication requirement E1-7, §59(a)

[123] Publication requirement E1-7, §59(b), AR 63 and AR 64; EFRAG IG 3 List of ESRS Data Points, May 2024.

[124] Directive(EU) 2024/825 of February 28, 2024 amending Directives 2005/29/EC and 2011/83/EU to empower consumers to act in favor of the green transition through better protection against unfair practices and through better information, cons. 12: "*It is particularly important to prohibit claims based on the offsetting of greenhouse gas emissions in order to assert that a product, whether a good or a service, has a neutral, reduced or positive impact on the environment in terms of greenhouse gas emissions. Such claims should be prohibited in all circumstances and added to the list in Annex I of Directive 2005/29/EC*."

[125] By September 2026 at the latest

[126] Annex I of Directive 2005/29/EC as amended by Directive (EU) 2024/825 of February 28, 2024

[127] Proposal for a Directive of the European Parliament and of the Council on substantiation and communication of explicit environmental claims (Green Claims Directive)—General approach, Council of the European Union, 17 June 2024, 2023/0085(COD), art. 3(1a)(e).

Under the ESRS, the use of carbon credits in the sustainability report is subject to several constraints The first is that only carbon credits financing projects outside the company's value chain can be reported (5.2.1). The second is that the way in which carbon credits can be reported depends on the nature of the company's climate commitments (5.2.2).

### 5.2.1 Use of carbon credits to finance projects outside the company's value chain

Only carbon credits financing projects outside the company's value chain may be mentioned in a company's sustainability report.[128] If the company has contributed to an offset project within its value chain, it will disclose this in a separate section of its sustainability report.[129]

Because the concept of a company's value chain has a broad meaning under the ESRS,[130] companies must be vigilant in selecting carbon credits so as to acquire only those that do not finance a project associated with their value chain, failing which they would not be able to claim them in the section of the sustainable report on carbon credits.

### 5.2.2 Differentiated use depending on the nature of the company's climate commitments

The way in which a company may disclose the use of carbon credits depends on whether it has made a net zero commitment (5.2.2.1.) or another type of climate commitment (5.2.2.2.).

#### 5.2.2.1 Net-zero commitment: limited use of carbon credits

The ESRS stipulate that a company can only claim a net-zero target if its climate strategy aims to (i) reduce the emissions in its value chain by 90-95%, or otherwise in line with its sectoral decarbonization trajectory, and (ii) neutralize residual emissions through removals.[131] It should also be noted that the Council's draft *Green Claim Directive* refers to the notion of a net-zero target as established by the ESRS.[132] The ESRS definition of net zero provides that different standards could be applied to specific sectors, where justified.

Claiming a net-zero target implies a demanding strategy for a company, with EFRAG recently stating in a Q&A that "*Net-zero target means neutralizing the impact of any residual emissions (after approximately 90-95% of GHG emission reduction) by permanently removing an equivalent volume of CO2 (see the definition of net-zero target above). As such, neutralising more than 10% (e.g. 20%, as stated in the question) of carbon removals would not qualify to a claim of achieving a net-zero target in accordance with the ESRS definition*."[133] This interpretation does not, however, take into account any sectoral variations that may be established.

Carbon credits can only be used for the second part of the net-zero commitment, i.e. to neutralize residual emissions.

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[128] Publication requirement E1-7, §56(b), AR 63 (c) and (d).

[129] Publication requirement E1-7, §58

[130] A company's value chain includes its upstream supply chain, its own activities and those of its subsidiaries, its downstream distribution or marketing channels, and the players with whom it has direct and indirect business relationships (ESRS, Acronyms and glossaries of terms, "Value chain").

[131] Publication requirement E1-7, §60; ESRS, Acronyms and glossaries of terms, Zero net objective.

[132] Green Claim Directive, article 3 (1a)(e)(i)

[133] EFRAG, ESRS Q&A Plateform—Compilation of explanation, Question ID 432, January-June 2024

The working group notes that the Autorité des Normes Comptables (ANC)[134] and the Commission Consultative pour la Finance Durable (CCFD) of the AMF[135] consider that, as part of a net-zero strategy, residual emissions can only be neutralized through the development of absorption projects in the value chain of the companies concerned, not through the use of carbon credits. As the ambiguous wording of the ESRS would seem to lead to a different conclusion, it would be useful for the authorities to clarify this point.

#### 5.2.2.2 Other offsetting commitments

Outside the context of a net zero commitment, companies may use carbon credits in connection with their carbon neutrality and GHG reduction policies, without quantitative limitations.

Thus, the section of the sustainability report dedicated to carbon credits must specify whether the company is simultaneously pursuing reduction targets[136] and the extent to which the use of carbon credits is compatible with the achievement of these reduction targets.

Companies claiming to be pursuing a carbon-neutral objective must therefore be vigilant about the overall consistency of their public climate commitments, bearing in mind that such an objective only makes sense at the level of the company as an entity, and not of its products taken individually.

## 5.3 Financial aspects of carbon credits dealt with incidentally in the sustainability report

The ESRS do not require the price of carbon credits to be included in the sustainability report. However, one of the aims of the CSRD is to strengthen the consistency and interoperability of financial and sustainability information published by companies.

Accordingly, a monetary valuation of carbon credits may, depending on the specific circumstances of each company, be mentioned in the information on the financial impact of climate change (5.3.1). If a company has set up an internal carbon pricing system, this must be put into perspective in the light of several factors, including the price emerging from the voluntary credits market (5.3.2).

### 5.3.1 Financial impact of climate change and carbon credits

The ESRS require the publication of information on the expected financial impact of climate change on companies.[137]

These disclosures include "*liabilities that may need to be recognized in the financial statements in the short, medium and long term*"[138], which may include "*potential future liabilities associated with [carbon credits]*" if they are expected to be cancelled in the near future.[139]

[134] Guide de l'ANC, Déployer les ESRS : Un outil de pilotage au service de la transition, June 2024, p. 26

[135] CCFD AMF, Guide pédagogique à destination des entreprises : Rendre compte de son plan de transition climatique au format ESRS, p. 12.

[136] Publication requirement E1-7, §61(a)

[137] Disclosure requirement E1-9—Expected financial impact of significant physical and transitional risks and potential opportunities related to climate change ("Disclosure requirement E1-9")

[138] Publication requirement E1-9, §67(d).

[139] Publication requirement E1-9, AR 75.

In addition, companies must disclose "*the monetary value and proportion of assets exposed to significant transition risk*", i.e. the assets in question are exposed to material risk resulting from the transition to a low-carbon economy, which includes political, legal, technological, market or reputational risks. [140]

As assets[141] that are part of the transition, carbon credits are likely to be exposed to at least one (if not all) of the above-mentioned transition risks: a GHG emissions absorption and storage technology used by a financed project may fail (technological risk), the regulatory framework for carbon credits may tighten (political and legal risk), controversies affecting financed projects may impact the image of the companies that hold them (reputational risk). On this basis, companies should consider taking into account the transition risks affecting carbon credits they hold in their materiality analysis.[142]

Whether the value of carbon credits is included in "liabilities likely to need to be recognized" or in "assets exposed to material transition risk", the amounts involved must be reconciled to the relevant notes and line items in the financial statements.[143]

### 5.3.2 Internal carbon pricing and carbon market prices

Some companies have introduced internal carbon pricing systems as part of their overall decarbonization strategy. Where applicable, they are the subject of a dedicated section in the sustainability report, which is required to specify in particular the type of methodology used (allocation of a "carbon budget" by activity, internal carbon tax or fee, investment decisions made on the basis of capital expenditures corrected according to their impact on the quantity of GHG emissions...) and carbon price applied for each mechanism.[144]

This raises the question of the possible discrepancy between the internal price assigned to a carbon unit (tonnes of $CO_2$ or the equivalent) and the price as it would emerge from the voluntary carbon market when the company participates significantly in this market:[145] too great a discrepancy could call into question the relevance of the internal price used (bearing in mind that the analysis is complex, as there is no single "market price" of carbon credits, since prices vary according to the category of carbon credit).[146] While companies are required to explain the "critical assumptions used to determine internal prices," the price calculation method itself does not have to be published (publication is optional).[147]

However, in the event of a significant difference between the internal carbon price used and that generated by a market that is important for the company, it might be good practice to foster, as transparency called for by the ESRS, by publishing the calculation method and providing information on the extent to which the internal price has "*been [set] on the basis of scientific guidelines.*"[148]

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[140] Publication requirement E1-9, §67(a).

[141] On the classification of intangible assets, see *surpra.*

[142] Publication requirement E1-9, AR 72 (b).

[143] Publication requirement E1-9, §68.

[144] Publication requirement E1-8—Internal carbon pricing ("Publication requirement E1-8"), §63.

[145] Or, where applicable, the European Emissions Trading Scheme ("ETS").

[146] Or, conversely, the one used by the carbon market if it is unable to reflect the real cost of implementing decarbonization efforts.

[147] Publication requirement E1-8, §63 (c).

[148] Publication requirement E1-8, §63 (c)

## VI. THE WORKING GROUP'S CONCLUSIONS AND RECOMMENDATIONS

The voluntary carbon credit market raises numerous legal and regulatory issues. The Working Group has analyzed these issues with the aim of reconciling the need for appropriate regulation to ensure market integrity with the flexibility required for the market's proper development and liquidity.

Clarification of the legal and regulatory regime applicable to carbon credits will be important for the development of the Label Bas Carbone program in France. It will also promote the success of the Franco-British initiative to develop "biodiversity" or "nature" credits, a project supported by the French government whose interest was confirmed by the President of the European Union in September 2024, with a view to "*creating a market for the restoration of our planet*."

The Working Group's first recommendation concerns clarification of the legal nature of voluntary carbon credits. They should be recognized as intangible assets, a qualification that corresponds to their economic and operational nature. Any other classification would risk introducing inconsistencies and undermining the fluidity of trade and the legal certainty of the market. It is also important to establish a simple presumption of ownership based on registration in carbon credit registries. This recognition would make transactions more secure, by ensuring that the holder identified in the registry is indeed considered the legitimate owner. This clarification could be enhanced by the creation of a European carbon credit registry, used on a voluntary basis, to harmonize ownership transfer practices and ensure cross-border legal recognition.

With regard to the secondary market in carbon credits, the Working Group recommends increased monitoring to anticipate any need to strengthen the regulatory framework. At present, the majority of transactions are in the form of over-the counter transactions, as well as spot or futures contracts, mainly traded outside the European Union, primarily in the United States. And the size of the market remains small. For the time being, therefore, it does not appear necessary to include carbon credits in the definition of financial instruments, or to specifically regulate these products in the EU. However, if the market were to grow, particularly within the European Union, it would be appropriate to reassess the situation. Depending on the development of the secondary market, carbon credits could be at least partially integrated into the framework of financial instruments governed by MIFID II, in the same way as emissions allowances traded in the EU-ETS system. It is also recommended to clarify whether carbon credit derivatives fall within the scope of products covered by European regulations applicable to the derivatives market, including by specifying whether carbon credits can be considered "fungible" assets, within the meaning of the MIFID II directive.

While the Working Group does not yet consider it necessary to adopt specific rules for the carbon credits underlying derivatives traded in the EU, it recommends increased vigilance regarding the integrity of these credits. Particular attention must be paid to the quality of the carbon credits underlying any products traded on European trading venues, ensuring that they meet the criteria of additionality, permanence and absence of double-counting. Where appropriate, European authorities could establishing specific guidelines for these products, drawing inspiration from the guidelines already adopted by the CFTC in the United States. Importantly, any future regulation of carbon credits and their derivatives should be coordinated with other countries facing similar challenges, particularly the United States. Harmonization of international practices is crucial to ensure smooth trading and avoid regulatory divergences that could harm the cross-border carbon credit market.

The Group also recommends increasing the transparency of carbon credits used by European companies, by clarifying the interpretation of certain aspects of the CSRD and ESRS standards. The Working Group reminds companies of their responsibility to retire and cancel the carbon credits used,

by notation in the registries. They must be able to demonstrate the completion of these steps as part of the certification of sustainability reports by statutory auditors or independent third-party bodies.

Lastly, and more generally, the Working Group stresses the importance of international coordination, in particular through monitoring and, where appropriate, supporting the work of UNIDROIT, in order to reduce the legal uncertainty associated with the cross-border nature of carbon credits. International harmonization of practices is necessary to ensure the legal certainty of transactions and the harmonious development of the carbon credit market. This cooperation between national and international authorities will contribute to the emergence of a global market, while limiting the risk of regulatory inconsistencies.

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**Appendix 1** Composition of the “Legal aspects of voluntary carbon credits” working group

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## *APPENDIX 1*

Composition of the "Legal aspects of voluntary carbon credits" working group

## COMPOSITION OF THE "LEGAL ASPECTS OF VOLUNTARY CARBON CREDITS" WORKING GROUP

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## *APPENDIX 2*

Glossary

**Additionality** — Principle that GHG emission reductions or removals generated by a project must exceed the reductions or removals that would have occurred without the carbon credit financing.

**Cancellation** — The process by which a carbon credit ceases to exist and can no longer be traded. A carbon credit is cancelled when its holder notifies the registrar of its withdrawal, as well as in any other circumstances provided for in the general conditions published by its certification body.

**Carbon credit** — A transferable or tradable instrument that represents a reduction or absorption of GHG emissions of one tonne of $CO_2$ or the equivalent, and that is issued and verified in accordance with recognized quality standards.

**Carbon dioxide equivalent ($CO_2$)** — The universal unit of measurement used to indicate the Global Warming Potential (GWP) of each GHG, expressed in units of carbon dioxide or its equivalent. It is used to assess the release (or non-release) of different GHGs on a common basis.

**Certification body** — A private, governmental or multilateral body (including the supervisory bodies of the Article 6.4 mechanism and the Clean Development Mechanism), whose purpose is to certify that projects comply with the quality standards set out in published conditions, prior to the issuance of carbon credits to developers.

**Clean Development Mechanism** — A program under the Kyoto Protocol and implemented by a supervisory body acting under the aegis of the UNFCCC, providing for the certification of project compliance with its standards, and the allocation of carbon credits (*certified emission reductions* or "CERs") to developers.

**Core Carbon Principles** — Standards published by the ICVCM for confirming the integrity of certification body certification programs.

**Emissions allowances** — Instruments enabling their holders to comply with emission limits imposed by governments under cap-and-trade systems.

**GHG** — Greenhouse gases

**ICVCM** — *Integrity Council for the Voluntary Carbon Market*, an independent organization whose purpose is to validate the integrity of carbon credit certification programs published by certification bodies. The *Core Carbon Principles* are published by the ICVCM.

**Independent verification body** — Independent body that validates the GHG reductions or removals of projects certified by a certification body, enabling carbon credits to be issued and allocated to developers.

**Integrity** — A quality standard for a carbon credit certification program. A program is deemed to have integrity when its certification body respects certain conditions of good governance, and its certification conditions require (among other things) permanence, additionality, rigorous standards for quantifying GHG reductions or removals and standards to avoid double-counting, as well as criteria to ensure respect for the rights of communities and indigenous peoples impacted by projects.

**Low Carbon Label** — French government program certifying forest regeneration projects and other GHG emission reduction initiatives, with the aim of issuing carbon credits.

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**Article 6.4 Mechanism** A program under Article 6.4 of the Paris Agreement to replace the Clean Development Mechanism. This mechanism is currently being developed by the designated supervisory entity under the UNFCCC.

**Paris Agreement** The international climate agreement adopted in Paris on December 12, 2015 at the 21st Conference of the Parties to the UNFCCC. It entered into force on November 4, 2016.

**Permanence (or permanent character)** Permanent (or at least long-term) nature of GHG emission reductions generated by a project financed by carbon credits.

**Project developers** Entities that design and implement projects aimed at reducing or absorbing GHG emissions, financed in whole or in part by the issue and sale of carbon credits.

**Recognized quality standards** Quality standards for carbon credits that are verifiable by independent third parties, make project requirements and reports public, guarantee at least additionality, permanence and avoidance of double-counting, and provide rules for calculating, monitoring and verifying project GHG emissions and removals.

**Registrar** Organization that maintains a registry of carbon credits. These are generally certification bodies.

**Registry** Registry in which carbon credits are recorded when they are issued, along with information on the underlying project and the name of the project developer to which the carbon credits are initially allocated. Transfers and cancellations of carbon credits are recorded in the registry. Currently, each certification body keeps a specific registry of the carbon credits it has certified.

**Retirement** Process by which the holder of a carbon credit notifies the registrar of its cancellation following its use to offset GHG emissions produced by the holder or companies in its group.

**Scope 1 GHG emissions** Direct GHG emissions from sources owned or controlled by the company.

**Scope 2 GHG emissions** Indirect GHG emissions resulting from the production of purchased or acquired electricity, steam, heat or cooling consumed by the company.

**Scope 3 GHG emissions** All indirect GHG emissions (not included in scope 2 GHG emissions) produced in the reporting company's value chain, including upstream and downstream emissions.

**EU-ETS** European Union Emissions Trading Scheme.

**United Nations Framework Convention on Climate Change ("UNFCCC")** International treaty overseeing global efforts to combat climate change, adopted in New York on May 9, 1992.

**Voluntary Carbon Markets Integrity Initiative ("VCMI")** Organization establishing standards for the communication by carbon credit holders of the offsetting of their GHG emissions through the use and retirement of carbon credits.