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Item No. 6 on the agenda: Ongoing legislative activities carried over from prior Work Programmes

(b) Legal Nature of Verified Carbon Credits

(prepared by the Secretariat)

<i>Summary</i>	<i>Update on the project on Legal Nature of Verified Carbon Credits</i>
<i>Action to be taken</i>	<i>The Governing Council is invited to take note of this update on the progress of the UNIDROIT project on the Legal Nature of Verified Carbon Credits</i>
<i>Mandate</i>	<i>Work Programme 2023-2025</i>
<i>Priority level</i>	<i>High</i>
<i>Related documents</i>	<u>UNIDROIT 2022 – C.D. (101) 4 rev.</u> ; <u>UNIDROIT 2023 – C.D. (102) 14</u> ; <u>UNIDROIT 2024 – C.D. (103) 11</u>

I. INTRODUCTION

1. The purpose of this document is to update the Members of the Governing Council on the progress of the UNIDROIT project on the Legal Nature of Verified Carbon Credits (VCCs). After briefly recalling the background of the project (Section II), this document provides an update on the composition of the Working Group on the Legal Nature of VCCs (Section III), the development of a set of Principles and Commentary (Section IV), the matters addressed during the last session of the Working Group (Section V), the establishment of a Consultative Committee (Section VI), cooperation and coordination with other organisations (Section VII), and next steps (Section VIII).

II. BACKGROUND

2. On 24 January 2022, UNIDROIT received a proposal from the International Swaps and Derivatives Association (ISDA) for a project to determine the legal nature of voluntary carbon credits. This proposal was expressly supported by the Government of Paraguay in a letter received by the Secretariat on 9 May 2022. At its 101st Session (Rome, 8-10 June 2022), the Governing Council recommended the inclusion of a project to analyse the private law aspects and determine the legal nature of voluntary carbon credits in the 2023-2025 Work Programme, with high priority. The

Governing Council's recommendation was endorsed by the UNIDROIT General Assembly at its 81st session with unanimous support ([UNIDROIT 2022 – A.G. \(81\) 9](#)).

3. An update on the preparatory work of the project was presented to the UNIDROIT Governing Council at its 102nd session (Rome, 10-12 May 2023) ([UNIDROIT 2023 – C.D. \(102\) 14](#)). The Governing Council confirmed the authorisation to establish a Working Group in close collaboration with the World Bank Group (WBG). The Governing Council also encouraged further coordination in this area with other international organisations.

4. Pursuant to the mandate received from the Governing Council, the Secretariat established a Working Group on the Legal Nature of Voluntary Carbon Credits in cooperation with the WBG. During its 103rd session in May 2024, the Governing Council received an update from the Secretariat concerning the first two sessions of the Working Group and the considerable work that had been carried out in the intersessional period. This included collaboration with UNCITRAL, in particular in the joint drafting of a paper entitled the "Legal Nature of Verified Carbon Credits Issued by Independent Carbon Standard Setters" (the "UNCITRAL/UNIDROIT Joint Study"). The UNCITRAL/UNIDROIT Joint Study set out a mapping exercise in the area of verified carbon credits to help States assess the options available to them in addressing relevant legal issues, especially as regards the legal nature of verified carbon credits.¹ A copy of the UNCITRAL/UNIDROIT Joint Study was shared for the Governing Council's consideration ([UNIDROIT 2024 – C.D. \(103\) 11](#)).

5. The Governing Council took note of the significant progress made by the Working Group and expressed a positive view on the publication of the UNCITRAL/UNIDROIT Joint Study. The Governing Council also approved changing the project title to the "Legal Nature of *Verified* Carbon Credits (VCCs)" ([UNIDROIT 2024 – C.D. \(103\) 30](#)).

III. WORKING GROUP ON THE LEGAL NATURE OF VCCS

6. Secretary-General Prof. Tirado chaired the first two sessions of the Working Group on the Legal Nature of VCCs. Prof. Hideki Kanda, UNIDROIT Governing Council Member and Emeritus Professor at the University of Tokyo, Japan, has since been appointed Working Group Chair to allow for a seamless transition from the concluded project on Digital Assets and Private Law (DAPL).

7. In keeping with UNIDROIT's established methodology, the Working Group is composed of 13 international experts² representing different legal systems and geographic regions, selected for their expertise in the fields of carbon credit trading, environmental law, property law, contract law, secured transactions, and digital technology.

8. International organisations, standard setters in the carbon market, industry associations, legal practitioners, financial sector representatives and members of academic institutions with expertise in the field of VCCs and private law participate as observers in the Working Group.³ Given the exceptional interest that UNIDROIT's VCC project has garnered, several additional institutional observers have joined the Working Group since the last Governing Council session. At the time of writing, these include the Ministry of the Environment of the Togolese Republic, the American Carbon Registry (ACR), the Global Carbon Market Utility (GCMU), the Haut Comité Juridique de la Place Financière de Paris (HCJP), the Integrity Council for the Voluntary Carbon Market (ICVCM), Kita Earth

¹ The UNCITRAL/UNIDROIT Joint Study is available at <https://docs.un.org/en/A/CN.9/1191/Rev.1>.

² Filippo Annunziata, Ipshita Chaturvedi, Géraud de Lassus St-Geniès, Luca Enriques, Louise Gullifer, Megumi Hara, Caroline Kleiner, Matthias Lehmann, Ludovino Lopes, Kelvin Low, Andrea Tosato, Rolf H. Weber, and Xiaoping Zhang.

³ See [UNIDROIT's webpage on the Legal Nature of Verified Carbon Credits](#) for the full list of Working Group experts and observers.

Limited, the Organization of the Petroleum Exporting Countries (OPEC), S&P Global Commodity Insights, and the Uniform Law Commission of the United States (ULC).

9. The breadth of the experience and viewpoints represented in the Working Group helps ensure that the draft instrument reflects not only the realities of the VCC market as it exists today, but also the foundation for how the market is expected to develop in the future, keeping in mind the fundamental goal of supporting the growth of VCCs as an essential tool of climate finance. In addition, other than contributing to the discussions of the Working Group, participation of these stakeholders is expected to assist in the promotion, dissemination and implementation of the international instrument that is ultimately adopted by the Governing Council. Indeed, the Secretariat has already begun discussing future implementation efforts with Working Group participants.

10. To date, the Working Group has met five times:

- First session: 10-12 October 2023 (UNIDROIT, Rome)
- Second session: 22-24 April 2024 (UNIDROIT, Rome)
- Third session: 4-6 September 2024 (UNIDROIT, Rome)
- Fourth session: 15-17 January 2025 (UNIDROIT, Rome)
- Fifth session: 2-4 April 2025 (UNIDROIT, Rome)

11. After the second Working Group session, a Drafting Committee was established consisting of three individual experts⁴ and two advisors to the Committee⁵.

IV. DEVELOPMENT OF A SET OF PRINCIPLES AND COMMENTARY

12. Since the last Governing Council session, the Working Group has been advancing in the development of a soft law instrument in the form of a set of black-letter Principles and Commentary (the “draft VCC Principles”). Currently, the draft instrument is comprised of an introduction and nine sections which include 24 draft Principles as follows:

Section	Principles
Introduction	<i>Reasons for the Principles</i> <i>Typical life cycle of a VCC</i>
Section I: Scope and Definitions	<i>Principle 1: Scope</i> <i>Principle 2: Definitions</i> <i>Principle 3: General principles</i>
Section II: Private International Law	<i>Principle 4: Applicable law</i>
Section III : Creation and Transfer	<i>Principle 5: Creation</i> <i>Principle 6: Transfer</i> <i>Principle 7: Innocent acquisition</i>
Section IV: Cancellation	<i>Principle 8: Cancellation</i> <i>Principle 9: Reversal</i> <i>Principle 10: Revocation</i> <i>Principle 11: Retirement</i>

⁴ Prof. Louise Gullifer, Prof. Andrea Tosato, and Prof. Kelvin Low.

⁵ Mr Cameron Prell, Managing Director The dCarbon Group and WBG Consultant, and Ms Belinda Ellington, IETA representative.

Section	Principles
Section V: Registry	<i>Principle 12: VCC Registry: Definitions</i> <i>Principle 13: VCC Registry</i>
Section VI: Custody	<i>Principle 14: Custody</i> <i>Principle 15: Duties owed by a custodian to its client</i> <i>Principle 16: Innocent client</i> <i>Principle 17: Insolvency of a custodian and creditor claims</i>
Section VII: Secured Transactions	<i>Principle 18: Secured transactions: general</i> <i>Principle 19: Registration in a VCC Registry as a method of achieving third-party effectiveness</i> <i>Principle 20: Control agreement as a method of achieving third-party effectiveness</i> <i>Principle 21: Priority of security rights in VCCs</i> <i>Principle 22: Enforcement of security rights in VCCs</i>
Section VIII: Procedural Law Including Enforcement	<i>Principle 23: Procedural law including enforcement</i>
Section IX: Insolvency	<i>Principle 24: Effect of insolvency on proprietary rights in VCCs</i>

13. A brief overview of each section is provided below. The draft of the instrument as discussed at the last Working Group session is available on the UNIDROIT website [here](#).

Introduction

14. The draft introduction addresses the reasons for the Principles, underscoring the role of carbon markets in supporting climate finance, offering a brief description of the types of carbon markets and the instruments that are traded therein, and identifying the scaling of voluntary carbon markets as one of the main purposes of the instrument. The section also provides an introductory context to the Principles by summarising the key steps in the typical life cycle of a VCC, namely: (i) generation and supply; (ii) secondary market trading; and (iii) use and retirement.

Section I: Scope and Definitions

15. Draft Principle 1 confines the scope of the Principles to the private law relating to VCCs. In particular, the draft VCC Principles cover a subset of private law issues relating to VCCs. They focus on proprietary rights and specifically where VCCs are the object of dispositions and acquisitions, and where rights and interests in VCCs are to be asserted against third parties. The prospective instrument builds on UNIDROIT's work in the context of digital assets, but adapts the proprietary framework to the specificities of VCCs. Like the DAPL Principles, the draft VCCs Principles are not meant to displace existing private law frameworks, but rather are intended to assist jurisdictions in taking a common approach by providing guidance on how to adapt existing law to account for the idiosyncrasies of VCCs.

16. Draft Principle 2 covers the main definitions of the draft instrument. The definitions are functional and developed solely for the purposes of their use in the Principles – they are not meant for general application or for the carbon market as a whole, though there is an attempt to use words consistently with the market.

17. Draft Principle 3(1) asserts that VCCs can be the subject of proprietary rights. Indeed, there is general agreement that, to attract the necessary scale of investment needed for VCCs to raise climate finance, VCCs have to be deemed property. From the outset, the Working Group focused on analysing whether and how VCCs could fit within existing proprietary law frameworks. At this stage, there is consensus in that the attributes of property common to all legal families can be found in a VCC, since it (i) can be individuated; (ii) it can be controlled; (iii) it is rivalrous; and (iv) it can be transferred.

18. Just like in the DAPL Principles, draft Principle 3(1) does not prescribe any specific requirements for the acquisition of a proprietary right in a given VCC. Instead, draft Principle 3(3) makes it explicit that ‘other law’—meaning the applicable domestic law—continues to apply to VCCs and to determine a number of important issues, including whether a person holds a proprietary right in a VCC, subject to limited exceptions.

Section II: Private International Law

19. Draft Principle 4 is expected to provide a conflict of laws rule for VCCs identifying only the law applicable to proprietary issues relating to VCCs. The draft Principle is to be developed in cooperation and coordination with an Expert Group of the Hague Conference on Private International Law (HCCH), as described further in Section VII below.

Section III: Creation and Transfer

20. Draft Principle 5(1) addresses the creation of a VCC, providing that a VCC comes into existence when a unique identifier has been allocated to the VCC and credited to an account in the registry. Draft Principle 5(2) provides that when a VCC first comes into existence, the person to first have a proprietary right in the VCC is either the registered holder of the VCC or, in cases of custodial arrangements, the person for whom the registered holder maintains the VCC.

21. In draft Principle 6(1) and 6(2), *nemo dat* and shelter rules are established. These provisions are, however, qualified by draft Principle 7, which provides for the protection of innocent acquirers. The Working Group is in agreement that an innocent acquisition rule is needed to allow the market to scale. This is because in the absence of an innocent acquisition rule, the *nemo dat* rule would normally apply unexempted in the context of intangibles. Unexempted application of the *nemo dat* rule would be particularly burdensome in the case of VCCs, particularly when purchasing VCCs on the secondary market after the VCCs had been traded multiple times. Without protection for innocent acquirers, potential buyers might hesitate to participate in transactions, fearing hidden claims against VCCs, especially in a cross-border context where legal systems vary. By prioritising the innocent acquirer’s rights, the rule creates a robust and predictable framework for VCC trading, encouraging investment and liquidity in the market.

Section IV: Cancellation

22. Section IV addresses a VCC’s cancellation and the categories of events that can lead to a VCC’s cancellation. Under draft Principle 8, a VCC that has been cancelled ceases to be the subject of a proprietary right. Thus, upon cancellation, a VCC registry must not comply with any instruction to transfer or retire the VCC and it must record the VCC as cancelled. The categories of events that can lead to a VCC’s cancellation are: (i) reversal; (ii) revocation; and (iii) retirement. While retirement is the voluntary cancellation of a VCC on the instruction of its registered holder, reversal and revocation are not and are typically carried out on the instruction of a crediting programme, a court, or a regulatory body.

23. Draft Principle 9 addresses the reversal of a VCC and draft Principle 10 addresses the revocation of a VCC. Cancellation for reversal occurs when the benefits of a carbon mitigation project

or programme have been compromised post-issuance so that the VCC no longer “represents the achievement of a reduction in, or removal of, one tonne of CO₂ equivalent from the atmosphere”. On the other hand, cancellation for revocation deals with matters leading up to issuance – *i.e.*, where it is subsequently shown that the benefits of a carbon mitigation project or programme were never achieved in the first place.

24. The Working Group has been discussing at length the consequences of cancellation for reversal and of cancellation for revocation and the related allocation of risk. Particular challenges are raised by the unique characteristics of VCCs as a form of property; including the fact that a VCC is currently defined in the draft Principles as representing the achievement of a certain climate mitigation outcome and that achievement may be re-evaluated during the often-lengthy lifespan of the underlying climate mitigation project. Concerns were thus raised by some Working Group participants in relation to provisions that allocate the risk of loss to the VCC buyer or, in the case of revocation, that would make the VCC void *ab initio*. Alternatives were suggested based on current market practice which involves, for instance, the provision of contractual representations and warranties, investment in buffer pools, and the purchasing of insurance as compensatory mechanisms. The draft Principles are currently being revised with this background in mind and with the goal of balancing the need for predictability and certainty in market transactions with fundamental tenets of property law that would be common to most jurisdictions.

Section V: Registry

25. Draft Principles 12 and 13 cover matters relating to VCC registries. Draft Principle 12 addresses definitions, while draft Principle 13 includes the duties owed by a registry operator to a registered holder. Among other things, draft Principle 13 provides that the registry operator has no proprietary right in a VCC registered in the registry it operates, that a VCC registered in a VCC registry is not available for the satisfaction of claims of creditors of the registry operator, and that a registry operator must have a Recovery and Orderly Dissolution Plan providing for preservation of all entries on the VCC registry it operates if the registry operator enters into an insolvency-related proceeding. For clarity and organisational purposes, draft Principle 13 is likely to be broken up into more than one provision in the next iteration of the instrument.

Section VI: Custody

26. The draft Principles set out private law principles relevant to custody of VCCs. Draft Principle 14 covers definitions, draft Principle 15 addresses the duties owed by a custodian to its client, draft Principle 16 is an adaptation of the innocent acquisition rule tailored to the context in which a person acquires VCCs through a custodian, and draft Principle 17 addresses the insolvency of a custodian providing that a VCC maintained by a custodian for a client is not available for the satisfaction of claims of creditors of the custodian.

Section VII: Secured transactions

27. Draft Principle 18 is an extension of Principle 3(1) (providing that VCCs can be the subject of proprietary rights). Since security rights are a subset of proprietary rights, it follows that VCCs can also be used as collateral in secured transactions, just like other types of movable assets. The draft Principles take a minimally invasive approach, introducing asset-specific rules in Principles 19, 20, and 21 to address the distinctive features of VCCs. The aim is to facilitate the integration of VCCs into existing secured transactions regimes without causing unnecessary disruption to well-functioning legal frameworks.

28. Draft Principle 19 establishes that, in addition to any other methods of third-party effectiveness that apply to a security right in a VCC under other law, a State should recognise that a security right in a VCC may be made effective against third parties upon the secured creditor

becoming the registered holder of the VCC pursuant to an agreement between the grantor and the secured creditor. Draft Principle 20 establishes that, in addition to any other methods of third-party effectiveness that apply to a security right in a VCC under other law, a State should recognise a “control agreement” as a method to make a security right in a VCC effective against third parties.

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

Section VIII: Procedural law including enforcement

30. This is currently a placeholder; the draft Principle needs to be developed and discussed by the Working Group. At the last session, the Working Group was encouraged to consider DAPL Principle 18 and whether it could be adapted to apply in the context of VCCs.

Section IX: Insolvency

31. As with Section VIII, Section IX of the draft VCC Principles also needs to be developed further by the Working Group.

V. FIFTH WORKING GROUP SESSION

32. At the last Working Group session held in April 2025, the Working Group considered the above revised draft Principles and Commentary. In particular, the Working Group addressed proposed changes to the provisions concerning cancellation, revocation, and reversal, as well as additional language on secured transactions.

33. In addition, with the benefit of expert presentations from the GCMU, the Climate Action Data (CAD) Trust, Mr Cameron Prell (WBG Consultant), and Prof. Dominik Skauradszun (representing the TOSCA project of the Centre for Responsible Digitality), the Working Group discussed the topics of registry interoperability (including with respect to the transfer from one registry to another both within and outside of insolvency) and tokenisation, and considered the extent of their impact on the draft instrument.

VI. CONSULTATIVE COMMITTEE

34. In August 2024, Member States were invited to nominate experts to join a Consultative Committee. The Consultative Committee is expected to follow the developments of the project through consultations on the draft documents and provide the Working Group with advice, comments and relevant information from a national and/or regional perspective as the work on the future instrument evolves. The Consultative Committee is chaired by Governing Council Member Ms Sharon Ong, Director-General, Ministry of Law, Singapore. At the time of writing, the Consultative Committee comprises 30 experts from 19 Member States and is expected to be convened in early June 2025 to provide written input on a revised draft of the VCC Principles currently being developed by the Drafting Committee (see Section VIII below).

VII. COOPERATION AND COORDINATION WITH OTHER ORGANISATIONS

35. The Secretariat continues to collaborate with UNCITRAL and the HCCH. Representatives from UNCITRAL and the HCCH continue to participate in the Working Group sessions as observers.

36. With respect to cooperation with UNCITRAL, the UNCITRAL/UNIDROIT Joint Study was presented to the UNCITRAL Commission held in June and July 2024. The Commission requested that the UNCITRAL secretariat circulate the UNCITRAL/UNIDROIT Joint Study to all States Members of the United Nations and give them sufficient time to provide the secretariat with their technical and editorial comments. The UNCITRAL Commission is to hold a further discussion on the UNCITRAL/UNIDROIT Joint Study during its fifty-eighth session in July 2025.⁶

37. In addition, at its fifty-eighth Commission session, UNCITRAL is expected to discuss possible work concerning “secured transactions using new types of assets and their treatment under the UNCITRAL Model Law on Secured Transactions”,⁷ following a colloquium held in February 2025 addressing the emergence of new types of assets that could be used as collateral in international finance, including VCCs.⁸ As noted above, the developing draft VCCs Principles provide specific rules of private law to address the characteristics of these new types of assets, including with respect to secured transactions. Given the probability of overlap, should the UNCITRAL Commission approve the proposed work on this subject matter, the Secretariat will need to follow UNCITRAL’s work closely to ensure consistency.

38. With respect to cooperation with the HCCH, the Secretariat and the HCCH’s Permanent Bureau (PB) have continued their close coordination to address applicable law questions in relation to VCC transactions. Two informal meetings of a group of experts appointed by the Secretariat and the HCCH PB took place on 16 July 2024 and on 27 November 2024. At its meeting in March 2025, the Council on General Affairs and Policy (CGAP) of the HCCH mandated the establishment of an Expert Group (EG) to study the private international law (PIL) issues arising from carbon markets with an initial focus on the possible inclusion of an applicable law provision in the draft UNIDROIT Principles on Verified Carbon Credits.⁹ The Secretariat will therefore coordinate with the HCCH EG in the development of an applicable law provision to be included in the draft VCC Principles.

VIII. NEXT STEPS

39. The Chair and the Secretariat will coordinate intersessional work with members of the Working Group, the Drafting Committee, and the Consultative Committee as follows:

- First, the Secretariat will collect any further written feedback on the draft VCC Principles from Working Group participants, who have been asked to submit their contributions by no later than 30 April 2025.
- Second, the Chair and the Secretariat will coordinate with the Drafting Committee to produce a revised draft of the instrument by early June 2025. The revised draft is expected to primarily address the provisions concerning cancellation and secured transactions, as well as some consideration of interoperability and tokenisation of VCCs. In parallel, several experts

⁶ See Report of the United Nations Commission on International Trade Law, Fifty-seventh session (24 June-12 July 2024), available at <https://docs.un.org/en/A/79/17>.

⁷ See [Calendar form of the agenda for the 58th Commission session \(unofficial document\)](https://uncitral.un.org/en/commission), available at <https://uncitral.un.org/en/commission>.

⁸ See <https://uncitral.un.org/en/colloquiumsecuredtransactions2025>; Report of the Colloquium on Secured Transactions (New York, 20–21 February 2025), available at https://uncitral.un.org/sites/uncitral.un.org/files/1201_colloquium_on_st_as_submitted.pdf.

⁹ See HCCH CGAP 2025, Conclusions and Decisions 14-16, available at <https://assets.hcch.net/docs/1828feba-831f-4f6f-a95e-6286e0495057.pdf>.

of the Working Group, together with the Secretariat, will work in cooperation with the HCCH in the drafting of a principle on applicable law.

- Third, the Chair, the Secretariat and the Chair of the Consultative Committee will develop a written request for feedback to be shared with the Consultative Committee members in early June 2025, together with the revised draft Principles.

40. The sixth session of the Working Group is scheduled to take place from Wednesday 10 September to Friday 12 September 2025. At this session, the Working Group is expected to consider: (i) a set of revised draft Principles; (ii) the written feedback of the Consultative Committee; and (iii) potential new draft Principles in relation to procedural law including enforcement and insolvency, as well as, possibly, tokenisation.

41. The seventh session of the Working Group is scheduled to take place from 17 to 19 December 2025. The eighth, and possibly final, session of the Working Group is currently being scheduled, likely for early April 2026. The Secretariat aims to submit a full draft of the draft VCC Principles for consideration by the Governing Council in 2026.

IX. ACTION TO BE TAKEN

42. *The Governing Council is invited to take note of this update on the progress of the UNIDROIT project on the Legal Nature of Verified Carbon Credits.*