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Seventh session (hybrid)
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SUMMARY REPORT

OF THE SEVENTH SESSION

(17 – 19 December 2025)

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1. The seventh session of the Working Group on the Legal Nature of Verified Carbon Credits (the 'Working Group') was held in hybrid form from 17 to 19 December 2025 at the seat of UNIDROIT in Rome. The Working Group was attended by a total of 57 participants, including individual experts as well as representatives from government agencies, intergovernmental organisations, industry associations, and non-governmental organisations (the list of participants is available in Annexe II).

Item 1: Opening of the session and welcome

2. *UNIDROIT Secretary-General, Professor Ignacio Tirado* opened the seventh session of the Working Group and welcomed the in-person and online participants. He especially welcomed and thanked Professor Christophe Bernasconi, Secretary-General of the Hague Conference on Private International Law (HCCH), for his in person attendance.

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

3. *The Chair of the Working Group, Professor Hideki Kanda* introduced the Annotated Draft Agenda and the organisation of the session.

4. *The Working Group* adopted the Agenda (Study LXXXVI – W.G.7 – Doc. 1, available in Annexe I) and agreed with the organisation of the session as proposed.

Item 3: Consideration of the iterated draft Principles and Commentary and of the comments provided by the Consultative Committee

5. *The Secretariat* offered a brief explanation of the documents that had been circulated to the Working Group in advance of the session (Study LXXXVI – W.G.7 – Doc. 2 rev. – Secretariat's Report and annexes; Study LXXXVI – W.G.7 – Doc. 3 rev. – Draft Principles and Commentary; Study LXXXVI – W.G.7 – Doc. 4 rev. – Draft Principles and Commentary – Redline; Study LXXXVI – W.G.7 – Doc. 5 – Consultative Committee comments and Drafting Committee responses (confidential)).

6. In relation to Study LXXXVI – W.G.7 – Doc. 5, it was explained that the document listed the comments on the draft VCC Principles and Commentary (the Principles) that had been provided by the Consultative Committee in response to the Secretariat's request for input of 10 July 2025. During the intersessional period, the Drafting Committee had been asked to review the comments and categorise them as follows: (i) Drafting Issue, to delineate non-substantive issues for the attention of the Drafting Committee; (ii) Out of Scope, to delineate comments that pertained to issues that fell outside the scope of the Principles; (iii) Addressed/To Be Addressed, to confirm that the comment had been addressed in the iterated draft of the Principles or would be addressed in the next iteration; and (iv) For Working Group Discussion, to flag comments to be further discussed by the Working Group. It was noted that the Consultative Committee's comments would be highlighted and brought to the Working Group's attention throughout the course of the discussion.

7. *The Chair of the Consultative Committee, Ms Sharon Ong* recalled that the Consultative Committee had been formally established on 28 February 2025 and was made up of 31 experts appointed by 20 Member States. She thanked UNIDROIT's Member States for supporting the Consultative Committee process, as well as the Consultative Committee members for providing the Working Group with invaluable advice, comments, and information from a domestic and regional perspective. The Chair of the Consultative Committee noted that comments had been received from the appointees of 10 Member States: Austria, Canada, Chile, Finland, Italy, Pakistan, the Russian Federation, Saudi Arabia, Singapore, and Türkiye. The comments had been initially presented and discussed at the sixth session of the Working Group from 10 to 12 September 2025. On 31 October 2025, the Consultative Committee was further invited to comment on the proposed intersessional iteration of Principle 4. Comments were received from the appointees from four Member States:

Finland, Italy, Saudi Arabia, and Singapore. The Chair of the Consultative Committee concluded by stating that, given the importance attached to the role of the Consultative Committee, following the seventh session of the Working Group, the Consultative Committee would be invited to provide input on the full iterated text of the draft Principles. She closed her intervention by inviting the Working Group to consider and respond to the views of the Consultative Committee as set out in Study LXXXVI – W.G.7 – Doc. 5.

8. *The Chair of the Working Group* provided an overview of the general project timeline going forward. He recalled that the eighth session of the Working Group had been scheduled for April 2026 and that the Working Group's first target was to submit the draft Principles to the UNIDROIT Governing Council in May 2026. The Working Group would then continue to work on the instrument, in particular on the tokenisation annexe, to submit the final document to the UNIDROIT Governing Council at its special session in December 2026.

(a) Applicable law (Principle 4)

9. *The Chair of the Working Group* began the discussion of the instrument with Principle 4 on applicable law and gave the floor to the UNIDROIT Secretary-General.

10. *The UNIDROIT Secretary-General* explained that Principle 4 remained fully open for review and discussion. He noted that the Institute had the privilege of working with its sister organisation, the HCCH—the world's leading private international law organisation with a mandate complementary to that of UNIDROIT. Cooperation and coordination with the HCCH were UNIDROIT's priority. It was in this context that, from the outset of the project, UNIDROIT had sought to work together on a principle on applicable law. This was the only traditional private international law (PIL) provision in UNIDROIT's draft instrument, which the Working Group considered from the outset to be a necessary provision without which the instrument would be incomplete. The HCCH Council on General Affairs and Policy (CGAP) appointed an expert group to, in part, assist UNIDROIT with the drafting of a provision on applicable law. The UNIDROIT Secretary-General thanked the HCCH for the cooperation, emphasising that it involved the expenditure of effort and resources and was not something that could be taken for granted. He stressed the importance of avoiding fragmentation with the work of the HCCH. For this reason, he explained, Principle 4 remained open for discussion. If necessary to achieve a solution acceptable to both organisations, the UNIDROIT Secretary-General stated that the Secretariat would be prepared to present the applicable law principle for consideration of the Governing Council at its special session in December 2026, instead of the ordinary session in May, in order to allow for a full year of continued discussion between experts from both organisations.

11. *The Secretary-General of the HCCH, Dr Christophe Bernasconi*, present in the room, endorsed the comments of the UNIDROIT Secretary-General, adding that the two organisations had effective, proper cooperation and coordination as a primary rule for guiding their work. With respect to the work on carbon markets that was being carried out at the HCCH, he shared that the HCCH Experts Group on Carbon Markets (HCCH EG) currently comprised 115 designated experts from 25 HCCH members, as well as nine international organisations sitting as observers, including UNIDROIT. After its second meeting in October 2025, the HCCH EG had sent comments on the wording of Principle 4 to the UNIDROIT Secretariat, explaining that, from the HCCH EG's perspective, there were issues that needed to be addressed. These issues related in particular to questions of sovereignty, project host States' concerns, and relevant safeguards that needed to be included in the provision. The HCCH EG had noted that a number of these concerns had not been implemented in the current iteration of Principle 4 and, therefore, at the third meeting which took place in December 2025, the HCCH EG expressed that it was not in a position to support the current wording of Principle 4. The *HCCH Secretary-General* explained that the HCCH EG had also recommended that the HCCH PB step down from the UNIDROIT Working Group while inviting UNIDROIT experts to continue attending as observers the discussions of the HCCH EG. The HCCH EG had recommended that the Working Group include, for the time being, a placeholder in its future instrument for as long as the HCCH EG

continued to discuss the private national or conflict of laws aspects with the active involvement of UNIDROIT experts. The *HCCH Secretary-General* further explained that the expert groups of the HCCH issued recommendations that would then be submitted to the HCCH CGAP, which was the HCCH body responsible for taking formal decisions. He noted that the next HCCH CGAP meeting would take place in early March 2026 and that the HCCH CGAP would have before it the formal statement of the HCCH EG on the current wording of Principle 4 as well as the *Aide Memoire* from the last meeting of the HCCH EG, which he stressed was not yet complete.

12. *The HCCH Secretary-General* further noted that, while the HCCH EG was actively working in The Hague in December 2025, he had met with the *UNIDROIT Secretary-General* in Hong Kong, where they had the opportunity to exchange views on the current status of the work coming out of The Hague. The *HCCH Secretary-General* stressed that they both continued to strongly believe that there was a possibility for continued active cooperation to develop a proper, sound, effective, conflict of laws provision and expressed gratitude for the openness and flexibility shared by the *UNIDROIT Secretary-General*, including the possibility of pushing back the adoption of the applicable law provision to December 2026. The *HCCH Secretary-General* thus stated that the HCCH PB was of the firm opinion that cooperation should continue on the basis of a two-way stream, based on full respect of the expertise of each organisation so that a conflict of laws provision that effectively addressed the questions raised could be developed. He expected the HCCH CGAP to stress the importance of continued cooperation between the two organisations, though he noted that the implementation of such cooperation would be largely dictated by the calendars of the two organisations. *The HCCH Secretary-General* further underscored that the HCCH EG's position related to the current wording of Principle 4—should there be another iteration of Principle 4, the HCCH EG would be happy to consider it. The bottom line, he stressed, was that there could not be conflicting provisions in the two organisations' instruments. He recalled that the scope of the two projects was indeed quite different, with the HCCH project having a much broader scope and addressing jurisdiction, applicable law, recognition and enforcement, as well as cooperation mechanisms. He noted that the work of the HCCH would certainly extend past December 2026, meaning that it would be for UNIDROIT to decide in December 2026 whether or not to take on what had been developed jointly. He again stressed that the door for cooperation remained open.

13. *The HCCH Secretary-General* asked whether it would be possible to receive any new version of Principle 4 that would be circulated before the eighth session of the Working Group in April 2026, suggesting that the HCCH EG could organise intersessional work to provide comments on the iterated draft before the meeting of the HCCH CGAP in March 2026. *The UNIDROIT Secretary-General* confirmed that there would be a new draft taking into account the substantive considerations from this Working Group session as well as the HCCH EG's input, and that UNIDROIT would be glad to share it with the HCCH. He stressed UNIDROIT's flexibility and openness to adjust its processes in order to have a substantive exchange.

14. *The Chair of the Working Group* opened the floor for questions or comments on the current iteration of Principle 4.

15. *A Working Group participant* made a push for some urgency in the resolution of these issues, stressing that there currently were a number of global transactions and questions of choice of law were very live. *Other participants* agreed, noting that there was a market that was developing and wanting to grow and which was looking at the work being carried out by both institutions for guidance. The least helpful thing would be the creation of conflicting rules.

16. *A participant* suggested that the commentary to Principle 4 include a reference to the ongoing HCCH project on carbon markets. *Another participant* raised concerns with respect to the reference to the time of creation of the VCC in Principle 4(5) and suggested deleting any reference to the law of the registry, which, in the participant's view, was not related to the legal nature of a VCC, or at least, eliminating any reference to particular points in time.

17. In response, *a member of the Drafting Committee* noted that there was a significant difference between the change of connecting factor and the change of the content of the applicable law. The reference in Principle 4(5) to the time of creation was not a reference to the national law at the time of creation, but rather to the place of the central administration at the time of creation. This was necessary to cater to the possibility that the central place of administration would change. *Other participants* agreed, adding that the language was needed to avoid what was known as a *conflit mobile* in a change of connecting factor.

18. In terms of the substance of Principle 4, *the Drafting Committee* stressed that three main points of discussion had arisen out of the exchanges with the HCCH EG, namely:

- The influence of the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Agreement. The HCCH EG members felt a strong need to connect Principle 4 with the UNFCCC. The Drafting Committee had not included this reference in its first iteration of Principle 4 on the basis that it was more appropriate for inclusion in the preamble of the instrument given the broad framework of the UNFCCC and its importance. However, because it was felt by the HCCH EG that it had to go into Principle 4, the reference had now been included in Principle 4(11).

- The extent of free choice of law. Some HCCH EG members had advocated for free choice of law of the registry, without the need to refer to the place of the registry or otherwise limit the registry's choice of law. Another group of HCCH EG members, however, had opposed any choice of law and preferred to retain the place where the registry was maintained. The Principle as proposed by UNIDROIT sat between these two positions, providing a limited choice of law which was tied to certain connecting factors such as the place of the seat of the registry, or the place of incorporation, or the place where the registry was maintained. It was noted that such a compromise position was in line with previous HCCH conventions and was indeed modelled after the Hague Intermediated Securities Convention which also provided for a limited choice of law. The Working Group was thus asked to consider whether to maintain the current approach providing for a limited choice of law or whether to provide for full choice of law or, alternatively, completely exclude choice of law.

- The sovereignty of project host States and related safeguards. Certain HCCH EG members were of the view that the law of the project host State should have a bearing and be directly reflected in Principle 4. This concern had been taken up by the UNIDROIT Working Group. The current iteration of draft Principle 4 provided that a court could always refuse to apply a certain law when there were applicable overriding mandatory rules, including those of the State hosting the underlying carbon mitigation project. However, at the last meeting of the HCCH EG, it was felt by some HCCH EG members that this was not sufficient and that there should instead be some kind of automaticity—i.e., a mechanism by which the project host State could cancel credits in the registry. This was to deter the practice of VCCs being issued and traded despite the underlying projects having been carried out against the mandatory rules of the host State. While acknowledging the concerns of the host States, it was noted that such automatic cancellation via the law of the host State would create enormous transaction costs for investors who would generally treat credits fungibly and would not necessarily be aware of where the underlying project was located. It was further stressed that while the regulatory power of the host State over the project itself was always recognised, the application of such sovereignty concerns in the context of a private international law rule would establish a completely new mechanism allowing one State to cancel property rights registered elsewhere.

19. *A participant* stressed that the purpose of the project was to provide certainty to support the finance objective of VCCs. Not having an applicable law section in the Principles would be detrimental to that purpose. Inclusion of Principle 4(11) providing that the principle was without

prejudice to the UNFCCC and the Paris Agreement, at least without significant explanation, was unfortunate, since it was not clear what the language meant and how, if at all, Principle 4 conflicted with those provisions. *Other participants*, while broadly supporting reference to the UNFCCC framework, stressed the importance of making it clear that VCCs could be created both within and outside of that framework, which was still very much under development. For example, the Paris Agreement Crediting Mechanism (PACM) was still being developed. It was thus noted that care should be taken to ensure that any reference to the UNFCCC and Paris Agreement in the Principles must not be taken to indicate that there was only one framework within which the credits could exist.

20. With respect to host State sovereignty, *a participant* acknowledged that if a project issued credits in violation of the law of the host State, the host State would have a legitimate interest in ordering that the credits be cancelled. However, it was noted that there were other mechanisms available other than automatic cancellation of the credits in the relevant registry. For example, Verra had provisions on illegality of projects and suspension, and would comply with and respect any court order to that effect, including in relation to the cancellation of credits. It was further posited that, under the Principles, it would be the carbon crediting bodies (CCB) that mechanically implemented the cancellation due to a revocation. The right mechanism would thus be for the host State to provide that, if a CCB were to operate in that country, it had to abide by certain rules, including an obligation to cancel credits if so ordered by the government, unless a court provided otherwise. On this basis, it was suggested that Principle 4 did not interfere with State sovereignty, since it merely concerned the mechanical aspect of how to implement a cancellation for revocation whatever the underlying reasons for that cancellation.

21. *Another participant* observed that there were also a number of issues on which the HCCH EG and UNIDROIT Working Group seemed to agree, including the scope of the law applicable to proprietary rights. The participant welcomed the inclusion of Principle 4(11) since it addressed concerns raised at the HCCH EG without harming the conflicts rule. As to the sovereignty concerns, the participant suggested that it could be possible to consider a system whereby the law of one State would be considered in relation to the validation of the creation of the VCC and then, if such law were respected, the law of the registry or the chosen law would apply to property rights. *Other participants* similarly suggested that the proprietary effects of a cancellation (proprietary effects being the limited focus of Principle 4) could be governed by the law of the registry and the grounds for the cancellation could instead depend on other provisions, including those coming from the host State.

22. It was further observed that the HCCH project was looking at carbon markets as a whole and the complete life cycle of a carbon event, including the production, creation, reduction or removal of carbon and then the lifespan of the credit, including the spending, removal, or surrender of the credit. In that context, it was critical to consider the rights of the host project State. However, when it came to the carbon credit, which was the focus of the UNIDROIT project, the asset needed to be (i) transferable; and (ii) fungible. It was posited that addressing the issue of State sovereignty through private international law could cap out the growth of the market, since the credits would no longer be fungible and would instead carry different risks depending on the applicable State law.

23. *A participant* noted that choice of law issues were currently being exacerbated with registries changing status. For example, the EU had wound down its international Kyoto registry and EU Member States were winding down registries created under EU law. Questions arose as to, for example, whether the proprietary rights in the credits recorded on such registries continued to exist.

24. It was clarified that choice of law with respect to contractual rights and obligations from transactional matters was outside the scope and thus not addressed by Principle 4. With respect to cancellation of VCCs for reasons related to the law of the project host State—whether, for example, criminal or regulatory—it was highlighted that the Principles already provided for an obligation on the registry to cancel VCCs if instructed by a CCB upon the order of a court or other competent authority (see Principle 10 and Principle 13). It was thus suggested that the Working Group consider

whether something further should be said in the substantive principles about the reasons for cancellation—i.e., that a competent authority in the host State had the right to order the CCB to cancel. It was recognised that this did not necessarily address which law applied to the actual cancellation, since that would depend on whether the applicable law had adopted the Principles.

25. *The Deputy Secretary-General of the HCCH* noted that the HCCH EG had specified that the UNFCCC and other international climate frameworks should be mentioned explicitly in a black-letter principle, and recognised that this had now been done in Principle 4(11). With respect to the issue of illegality she clarified that the HCCH EG had not landed on automatic cancellation. Rather, the HCCH EG had deemed it important that the illegality of the project not create two different kinds of rules and that there be space for project host States in the case of revocation by their national courts. While no solution had been identified by the HCCH EG at this stage, the HCCH EG members noted that divergences in approaches could create tensions between State sovereignty and the expectations of the market. She mentioned the importance of integrity of carbon credits which included, at least for private international law considerations, social equity, co-sharing of benefits, and not just public policy and mandatory overriding rules. She specified that project validity was extremely important as a first safeguard—not as a public policy or overriding mandatory rule, but as a safeguard on top of all the private international law issues. With respect to cancellation, she noted that, if this were to include revocation, it could be an issue for certain HCCH EG members in light of the specific rules on project illegality and the role of the host State law rather than the *lex registri*.

26. As to connecting factors, she noted that the HCCH EG had not reached an agreement on party autonomy since for certain HCCH EG members the connecting factor issue was strongly tied to the safeguards issue. The question was how to reconcile the market growth approach with the broader objectives of climate change and the Paris Agreement. With respect to transferability and fungibility, the *HCCH Deputy Secretary-General* observed that, while these were important for credits to scale, certain HCCH EG members had also noted that the integrity of the credit was extremely important. She underscored that there had been no specific agreement or disagreement with respect to the *lex registri*. The issues that had been raised by the HCCH EG included what limits there would be on party autonomy and how the *lex registri* would work with safeguards. She explained that unfettered *lex registri* would lead to jurisdictions establishing their own registries such that their own national laws would apply to projects within their territories. The concern was thus with non-fragmentation.

27. With respect to mechanisms for enforcement, she queried whether having one court in a country say that the credits needed to be revoked, but then noting that the credits could only be revoked in a registry in a different jurisdiction would raise a private international law issue or whether it might simply be an enforcement mechanism issue. *The HCCH Deputy Secretary-General* concluded by noting that it all came down to connecting factors and the question of how and where in the cycle of private international law considerations the safeguards would make the most sense.

28. With respect to the question of how an order to revoke a VCC in the host State would be carried over to the jurisdiction where the registry was located, *a participant* suggested that the host State would order the CCB to cancel the VCCs. It was argued that the host State should have jurisdiction over the CCB which was doing business in its country. If the CCB did not comply, the CCB would be in violation of the law and subject to whatever penalties the host State's law would apply.

29. *Another participant* observed that one way to address the risk of creating an actual or perceived rule clash was to limit the scope of Principle 4 such that it was not trying to do too much work—i.e., attempting to solve the protection of the host State within a private international law rule relating to the law applicable to the proprietary rights in a VCC. In response, it was stated that, at the very least, Principle 4 had to cover the proprietary matters that were covered by the Principles.

30. On the issue of automatic revocation, it was observed that this was very problematic. One had to accept the possibility that a project host State would not act lawfully or in accordance with international law when cancelling a project. In such a case, an enforcing State would likely not recognise a cancellation based on the removal of a project that was contrary to either public policy or international law.

31. In response, it was suggested that the reference to cancellation in Principle 4(1) be qualified to make it clear that it concerned the proprietary side of cancellation. It was also noted that the issue of a host State ordering the cancellation of credits on the basis of the illegality of the project could be addressed in the substantive principles.

32. It was observed that, if cancellation was to be governed by the law of the host State, this would mean that the host State had full control over the existence of the VCC throughout the entirety of the life cycle—even where the VCC was traded in a different country, it would be for the host State to decide whether the VCC and proprietary rights in that VCC existed. Even assuming that a host State would never wrongfully cancel a VCC, it was queried whether such a mechanism would not undermine fungibility and transferability. With respect to integrity, it was noted that this would be guaranteed by the registry State, which could take account of cancellations in the host State, as well as the law of the host State. It was stressed that investors chose to buy in the registry State because they trusted the legal system of the registry State, which was where they wanted their property rights administered. It was further observed that there was no real legal connection between the project and the VCC—there was no claim represented in the VCC; rather what the investor bought was an affirmation by the registry that the project had been carried out in conformity with the law of the host State. Should the standard setter fail to ensure the integrity, the consequence fell on the standard setter, which would then attract less investments.

33. *Other participants* agreed and did not support such a potential carve-out in light of the significant issues it would create around transferability, fungibility, and market certainty. While noting the importance of the integrity of both the market and the credit, it was posited that the way to ensure the integrity of the credit was to focus on the registries and how they were authorised and managed. If the credits issued by the same registry had certain aspects of their law governed by a different State, that would make the credits not fungible. It was further suggested that the correct process, which was also current practice, was for the host State to require the project developer, or whomever was implementing the project, to cancel the relevant credits and to issue that instruction to the registry.

34. A suggestion was made that the ability of States to cancel could be limited to revocation, meaning illegality in the lead-up to the creation of the VCCs. It was further noted that the impact on transferability and fungibility of a cancellation based on the legality of the project would also depend on the moment at which that cancellation occurred, which could be specified in the conflicts rule. However, caution was urged. It was noted that, at least under the Verra system, it was the project implementer who was required to follow the national law of the State where the project was located. It was also recalled that there had been instances of States deciding that all carbon credits in that jurisdiction should be nationalised.

35. A question was raised as to whether it was proper to allow the choice of law in the account agreements (Principle 4(4)), since that would allow each account holder to have a different governing law over its VCCs, even if these were from the same project. It was suggested that the choice be in the rules of the CCB, or that it be specified that the VCCs from the same project were intended to be fungible and thus had to be governed by the same law. In response, it was explained that the Principle currently allowed for the possibility to specify the applicable law in the account agreement to address exceptional circumstances where a register needed to accommodate the needs of a particular investor who, for political or other reasons, would not agree to the law specified in the

general registry rules. It was acknowledged that the registry would only do this in exceptional cases because of the difficulties in administering accounts under different laws.

36. With respect to Principle 4(7) concerning security rights, it was explained that it provided a special rule, putting the creation, perfection, priority, and extinction of security rights under the law of the State in which the grantor was located rather than the *lex registri*. The Working Group was asked whether they were satisfied with this special rule or whether they saw any issues.

37. In response, *a member of the Drafting Committee* indicated that the only available alternative would likely be a *dépeçage*: with respect to creation and extinction, the connecting factor would point to the law of the grantor, while with respect to perfection, security, and the effects of security, the connecting factor would indicate the law of the registry. This would be premised on the idea that the law of the State where the registry was based would be more likely to have implemented Principles 19-21 in its national law. It was further noted that this approach would be aligned with the position of the UNCITRAL Model Law on Secured Transactions in relation to assets with similar rules to those envisioned for VCCs, such as registered IP rights.

38. It was, however, observed that the proposed *dépeçage* could trigger some uncertainty, since it would entail the provision of two conflicts rules within an applicable law provision, though it made sense from a practical perspective. *Other participants* added that, if the proposed approach were adopted, there would also need to be a provision addressing where a security right was made effective by registration in a securities registry (rather than through the methods identified in Principles 19-20). Because security rights registries were always going to be debtor-based, then the law applicable would have to be that of the State of the debtor. It was further observed that if a security right was given over a VCC as well as over several other assets, then it was likely preferable to have the law of the place of the grantor in order to avoid a floating charge to be governed by the law of the registry. If instead the security right was made effective by a control agreement, or via registration on a VCC registry, then it made sense to have the law of the registry apply.

39. In response it was noted that there likely would not be a problem in such a scenario because even if for perfection and security the law of the registry would apply, if the security interest had been perfected with a method other than those provided in Principles 19 and 20, the law of the registry would not disturb the likely position under the law of the grantor. The argument for looking to the law of the registry was premised on the idea that the registry was more likely to be based in a jurisdiction that had adopted the Principles and would thus recognise the asset-specific perfection methods under Principles 19 and 20 and the special priority rule. By looking at the law of the jurisdiction of the registry for perfection and priority as a whole, the problem of all-assets security would not be displaced—it was posited that it would almost be inconceivable that a jurisdiction sophisticated enough to implement rules consistent with the Principles would then have a rule that disturbed an all-assets security right that was perfected by way of registration.

40. *The Chair of the Consultative Committee* raised for the Working Group's attention some of the comments that had been provided by the Consultative Committee experts, including those provided by the appointees of Austria, Saudi Arabia, and Singapore. She invited the Working Group to consider the comments and share written feedback.

<u>*Conclusions and recommendations*</u>[1]

41. *There was a suggestion to include a reference to the HCCH project in the commentary.*

42. *With respect to the inclusion of a reference to the UNFCCC and Paris Agreement, it was noted that it must be clear that VCCs can be created outside and within that framework—the Paris Agreement was not the only framework under which credits existed.*

43. *It was noted that the scope of the conflict of laws rule could be narrowed to make it clear that it concerned proprietary rights in VCC, not the validity of a VCC.*

44. *With respect to cancellation, it was recommended that it be made clear that the Principle concerned the proprietary side of cancellation—i.e., when a registry was required to suspend, remove or substitute a VCC because the original credit issued was against a project which was removed.*

45. *With respect to Principle 4(7) concerning the law applicable to the creation, perfection, priority, effects, and extinction of a security right in a VCC, it was suggested that the provision provide for a dépeçage splitting the law governing creation and extinction of security rights on the one hand (the lex registri), and the law governing perfection, priority, and effectiveness of the security rights on the other (the law of the State in which the grantor was located). It was agreed that an alternative on the basis of this suggestion would be drafted for the Working Group's consideration.*

(b) Registry (Principles 12 and 13)

46. *The Chair of the Working Group* gave the floor to the Drafting Committee to address the registry principles.

i. Principle 12

47. Starting with Principle 12, *the Drafting Committee* outlined the changes for the Working Group's attention. It was explained that the revised draft attempted to address the potential confusion between the registry in which the project was registered and the registry in which the VCC was registered. The distinction was relevant to the question of transparency, with publicity being required in the registry in which the project was registered but not in the registry of the accounts in which VCCs were held or maintained since those accounts were akin to bank accounts.

48. Thus, the suggestion was to rename the VCC registry as '*VCC account registry*' and to change Principle 12(1) to add the words '*accounts are maintained*' to make it clear that the principle related to the registry in which the accounts were maintained rather than the registry in which the projects were recorded. In response to a query from the Working Group, *the Drafting Committee* clarified that the intent of the instrument was to separate the functions of the registries and not to provide that they had to be separate entities. It was agreed that this would be clarified in the commentary.

49. It was suggested that the sentence in Commentary 12.1 which read, ' *A VCC registry is, usually but not always, established solely under private law as opposed to a registry established by, or pursuant to, legislation*' be deleted as it was unnecessary.

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[1] See also the conclusions and recommendations in relation to the discussion of Principle 10 (Revocation), below.

<u>Conclusions and recommendations</u>

50. *There were no objections from the Working Group to the proposed changes, though there was a suggestion against changing the name of the Principle.*

51. *In relation to the project registry and the VCC account registry, it was suggested that the commentary be tweaked to clarify that it could be the same entity performing different functions.*

52. *It was suggested that the sentence in Commentary 12.1 which read, ' A VCC registry is, usually but not always, established solely under private law as opposed to a registry established by, or pursuant to, legislation' be deleted.*

ii. Principle 13

53. *The Drafting Committee* explained that Principle 13(1) concerned the duties of a registry operator under private law, meaning duties that had to be owed to an identified person, in this case the registered holder, and which could not be excluded by agreement. They were basic duties without which the system set up by the Principles would not work. *The Working Group* agreed on the need to reconcile Principle 13(1) (cannot be excluded by agreement) with Principle 13(1)(c)(ii) (which provided for exclusion by agreement).

54. Principle 13(5) included an obligation for the registry operator to have a recovery and orderly dissolution plan. It was observed that this was a matter of regulation likely outside the scope of the Principles and thus better addressed in the commentary. *Participants* noted the importance of ensuring that the VCC continued to exist as an object of proprietary rights even if the registry operator disappeared. *The Chair of the Consultative Committee* indicated that a member of the Consultative Committee had proposed the deletion of the entire paragraph on the basis that the requirement might not apply to public programmes—i.e., programmes whose registry operator was a government organisation.

55. It was observed that, without registration, there was no VCC and under the Principles—registration was integral to the VCC's existence. While insolvency was one possibility when a registry may cease to exist, it was noted that there could be other possibilities as well (such as, for example, a cyber attack or an earthquake). A suggestion was made to state in the Principle that a register must install all technological measures allowing segregation and transfer of data and information. This could then be the foundation for civil liability claims should the register fail to do so. The Drafting Committee was directed to Article 973D, paragraph 2 of the Swiss Code of Obligations, which outlined some technical measures which had to be implemented by the registry. *Other participants* added that the obligation not to destroy the VCC would be in the registry's contracts with its users, as well as protected under general tortious liability in case it amounted to wilful destruction of property which could cause damage to third parties. When it came to insolvency, the power of disposition over the assets of an insolvency estate was fully or partially restricted. Further, even within insolvency, there were provisions allowing for the continued performance of a service which was deemed worthy of protection.

56. It was suggested that the commentary could make it very clear that, while it was for regulators to address the registry's obligations to secure the account information, these obligations were of fundamental importance for private law—the records had to be able to exist, or at least be able to be reconstituted, for the VCCs to exist as objects of property.

57. *The Drafting Committee* explained that two options had been provided in Principle 13(6) and 13(6bis) concerning a registry operator's obligation to comply with instructions provided by someone other than the account holder. Instances in which the registry operator would be instructed by someone other than the account holder would arise in relation to creation (where the instruction

could come from the CCB or project proponent) and cancellation for reversal or revocation (where the instruction would come from a CCB, a court, or a competent authority). There were two basic differences between Principle 13(6) and Principle 13(6bis): (i) Principle 13(6) provided that it was an obligation to have the rules of the registry say something; and (ii) Principle 13(6) did not specify from whom the instructions had to come.

58. A query was raised concerning whether Principle 13 should also address instances of transferring or exporting VCCs from one registry to another, whether because the registry was being wound down or for other reasons. The question of destruction and reissuance had also been raised by a member of the Consultative Committee. *Participants* enquired whether a VCC that was destroyed and re-issued by a different registry was the same or a different VCC. Addressing this question was important to determine whether a particular event amounted to a reversal or a revocation. The crucial issue to address this question, it was suggested, was whether the CCB retained governance over the VCC that was being exported—i.e., the right to cancel, revoke, and administer the accounting rules associated with the standard. In other words, it was posited that the private law obligations ran with the CCB rather than the registry operator.

59. It was agreed that the Principles would refer to the fact that a VCC could be cancelled and reissued. If the reissuance entailed the approval of a new verification statement, then it would amount to the issuance of a new VCC. Thus the relevant date—including for purposes of determining whether an event amounted to a reversal or revocation and for purposes of Principle 4—would be reset. In that case, if something happened between the first and the second issuance, it would amount to a revocation event rather than a reversal event.

60. A concern was raised with respect to the potential for double-counting if VCCs could be retired, cancelled, and then reissued elsewhere. It was stressed that it was essential that there remained traceability through consistency and continuity in the unique identifier. It was further suggested that the commentary could address the different kinds of movements of a VCC from one registry to another, including: (i) where the same VCC, with the same serial number and under the same CCB governance structure, was moved (*exportation*); and (ii) where a unit verified under one standard was moved to another registry under a different standard (*re-verification or reissuance*).

61. Given the multitude of scenarios discussed, it was observed that the language in the instrument should remain flexible. To avoid double-counting, rather than saying that the VCC had to have the same serial number, it was suggested that it be said that the VCC had to be traceable. The Working Group was also urged to take into account the variety of market approaches without focusing solely on the practice of one CCB or registry.

62. It was observed that something along the lines of Principle 13(6) would be needed. The rules should enable other people to instruct for creation and it would then be up to the registry to determine who's instructions it would accept. However, for reversal and revocation, the Principles would have to specify that there were only certain parties that could instruct the registry.

63. *The Chair of the Working Group* summarised the discussion, noting that the Drafting Committee would attempt to merge Principles 13(6) and 13(6bis) for the Working Group's consideration. As to the change of registry, either because the registry experienced problems or because the account holder wished to move their VCCs to another registry, the Chair asked the Drafting Committee to consider whether a new paragraph was required in the Principle or whether this could be addressed in the commentary, and to prepare a proposal for the Working Group to consider at the next session.

64. *The Chair of the Consultative Committee* noted that a member of the Consultative Committee had suggested providing greater clarity around the registry operator's liability for any actions taken in good faith and based off the instructions of a CCB, court, or regulatory body. In response, *Working*

Group members suggested that it could be specified in the commentary that private law liability—i.e., arising in contract or tort—would be governed under the Principles by the applicable law.

65. With respect to Principle 13(7), the Working Group was asked whether Principle 13 should address what the registry operator must do in relation to cancellation, despite this also being covered under Principle 8(4). It was agreed that the provision be left in, subject to later revision.

Conclusions and recommendations

66. *There was agreement on the need to reconcile 13(1) (cannot be excluded by agreement) with 13(1)(c)(ii) (which provides for exclusion by agreement).*

67. *With respect to Principle 13(5):*

- *i. There was agreement to remove Principle 13(5) since the obligation to have a recovery and orderly dissolution plan was regulatory.*
- *ii. It was agreed that a reference would be included in the Principle to systems and procedures to keep adequate records to provide a private law duty and then the commentary would be expanded to address why it was necessary for the records to exist or to be able to be reconstituted in order for VCCs to exist as an object of property.*
- *iii. There was a suggestion to review Article 973D, paragraph 2 of Swiss Code of Obligations, outlining some technical measures which must be implemented by the registry.*
- *iv. There was agreement to address in the commentary:*
    1. *The importance to protect the proprietary nature of VCCs in case the VCC registry was wound down, including some guidance as to the practicalities of ensuring the preservation of the registry.*
    2. *That it was an inescapable consequence of VCCs devised as intangible property that if, for whatever reason, all the information were to disappear, VCCs could not continue to exist. The commentary should explain that this was a problem that did not only exist with VCCs, and that there were a myriad of ways in which precautions could be taken to avoid this, and that obligations could be placed not through these Principles, but at a regulatory level in terms of best practices for a registry to preserve the information.*
    3. *A suggestion for regulation that mandated the maintenance of VCCs in another registry.*

68. *With respect to Principle 13(6) and 13(6bis):*

- *i. It was agreed that the Drafting Committee would prepare a proposal to address the movement of VCCs between registries, whether in the Principles or commentary:*
    1. *The Working Group agreed on the need to cover the potential movement of a VCC between registries (either because the original registry was being wound down or because the account holder wanted to change registry).*

2. *The Working Group, however, differentiated between: (i) a change of CCB, which would mean a change in governance structure and which would require a new verification, thus likely resulting in a new VCC; and (ii) a change in registry operator, which would likely not result in a new VCC (even if the serial number changed).*

3. *The Working Group also suggested including a warning against double-counting of VCCs reissued on different registries, and stressed the importance of ensuring traceability of the serial number.*

4. *It was noted that if there was a new verification and thus a new VCC, the clock started ticking again for purposes of revocation and reversal.*

5. *There was a suggestion to delete the sentence at commentary 13.3 concerning a second attempt to create a VCC.*

6. *It was noted that, in the future, there could be multiple registries accredited by the same CCB, making it possible to transfer between registries, but the VCCs still needed to be linked to the same governance structure by the original CCB.*

ii. *There was agreement to keep the structure of Principle 13(6) but indicate that, while for creation it was up to the VCC registry to determine who it would accept instructions from, for reversal and revocation there were only certain parties who could provide the instructions.*

iii. *With respect to the question on liability by a member of the Consultative Committee, the Working Group agreed to note in the commentary that liability was a matter for applicable law.*

69. *The Working Group agreed to leave Principle 13(7) for the moment; if repetitive, it could be tidied up later.*

(c) Custody (Principles 14-17)

70. *The Drafting Committee* introduced the provisions on custody, which addressed the situation in which there was a registered account holder who held the VCCs for someone else under a number of different possibilities—they could, for example, be an intermediary who provided a service and held VCCs for others as part of their business model. The Drafting Committee stressed that the Principles were meant to address not just how the market worked presently, but also how it was likely to evolve in the future. The custody principles included: (i) a definitional principle that addressed what custody was; (ii) a principle concerning the duties owed by a custodian; (iii) a principle with a version of the innocent acquisition rule that applied to VCCs held in custody; and (iv) a principle addressing the insolvency of the custodian and the claims of the creditors of the custodian.

i. Principle 14

71. As to the definition of custody, *the Drafting Committee* explained that it sat in the middle between the simple provision of ancillary services to the asset owner and the full transfer of the asset to the custodian. The custodian did not own the entire asset, which did not form part of their insolvency estate and it was not available to satisfy the claims of the custodian's creditors.

72. The Working Group was asked whether the Principles should address sub-custody—i.e., where the sub-custodian was the registered holder who held the VCC for a custodian and that person held the VCC for a client. There could be a number of layers to sub-custody, which was very present in the holding of intermediated securities. It was further explained that the word '*maintain*' was used rather than '*hold*' in order to address situations where there was a direct custodian as well as where there was a custodian who held the VCC through a sub-custodian.

73. In response to a participant questioning whether the provisions on custody were necessary, *the Drafting Committee* stressed that the provisions on custody were of fundamental importance because there was no fallback in terms of general principles when it came to intangible assets. General common law and civil law principles regarding the custody of intangibles were almost non-existent. Therefore, there tended to be asset-specific custodial rules. *The Working Group* thus agreed to keep the provisions on sub-custody.

74. *A participant* queried whether use of the word '*maintain*' would cover escrow-type instructions to transfer, which were becoming increasingly common in the market. *The Working Group* discussed the use of the term '*in the course of the intermediary's ordinary course of business*' in Principle 14(6)(b). It was explained that the language was meant to ensure that custodial obligations were only put on people who were providing the service as a business, and exclude situations where, for example, someone was holding VCCs in a family trust for their children or grandchildren. It was suggested that the language be moved to Principle 15 concerning the duties of the custodian.

75. The Working Group was also asked whether Principle 14 should include Principle 14(6)(c)(ii), which addressed the scenario in which a transferor was the registered holder who had agreed to retire the VCC for the benefit of the person to whom they would otherwise have transferred the VCC; thus, instead of transferring the VCC to the transferee's account, they just held it for the transferee and agreed to retire it on the transferee's behalf. It was agreed that the provision be kept within the Principle.

<u>*Conclusions and recommendations*</u>

76. *The Working Group agreed to keep Principle 14(6)(c)(ii).*

77. *Concerns were raised in relation to what would or would not be encompassed within the term 'ordinary course of business' in Principle 14(6)(b). The Working Group discussed either taking the language out or moving it to Principle 15.*

78. *The Working Group agreed to maintain references to sub-custody.*

ii. Principle 15

79. *The Drafting Committee* explained that Principle 15 was meant to include the core duties of a custodian.

80. *The Working Group* discussed whether language related to the right of use should be included in Principle 15(1)(b). *A participant* explained that, with respect to financial assets, the right of use referred to short selling and margin lending which existed in a delicate balance given the very complex and sophisticated overlay of regulations that existed in that context. It was thus suggested that the Principles maintain a neutral approach and not open the door to this since it was not needed. *Another participant* suggested that the instrument specify that it was for regulators and the parties to decide what to do. In response, it was observed that the language in Principle 15(1)(b) was rather strict as it required permission by both the client and by other law.

81. The Working Group was asked whether the Principle should address omnibus accounts. Principle 15(2) essentially provided that there could be omnibus accounts. Commentary 15.5 addressed what was meant by '*of the same description*'—i.e., VCCs treated by the market as fungible.

82. *The Chair of the Consultative Committee* raised a comment by a *member of the Consultative Committee*, who had suggested that the term '*of the same description*' could be more clearly defined to be in line with market practice. *A participant* observed that omnibus accounts were currently the creature of certain CCBs and, as such, should not be addressed in the Principles. However, *other participants* disagreed, noting that since omnibus accounts were the practice of certain registries, they should be included in the instrument. *A participant* raised concerns with the keeping of records and traceability of VCCs in omnibus accounts. It was suggested that, if Principle 15(2) were to be maintained, there should be duties on the registry operator or CCB relating to transfers and retirements. *Other participants* suggested that the concept of '*ordinary course of business*' could be introduced in this paragraph, on the basis that omnibus accounts should not be allowed to be maintained by any custodian but solely by a professional. In addition, it was suggested that the duty to maintain records be included as a mandatory rule in relation to omnibus accounts and only be applicable to custodians in the ordinary course of business.

83. It was proposed that Principle 15(3), concerning the duties that a custodian could owe to a client under certain systems, be addressed in the commentary rather than in the Principle. It was further stressed that these were obligations that had to be fleshed out according to national law.

<u>*Conclusions and recommendations*</u>

84. *In relation to Principle 15(1):*

- *i.* *There was a proposal to change the chapeau so that it matched the registry provision: 'A custodian owes the following private law duties to its client in relation to a VCC that it maintains to that client that cannot be excluded by agreement'.*

- *ii.* *There was agreement to leave in language related to the right of use but making sure it functionally worked (in relation to use of the word 'maintain') and adding explanations in the commentary.*

85. *In relation to Principle 15(2):*

- *i.* *The Working Group agreed to keep the provision on omnibus accounts and keep discussing their relationship with retirement.*

- *ii.* *It was suggested that the 'ordinary course of business' language from Principle 14 be included in Principle 15(2).*

- *iii.* *There was a suggestion that the duty to maintain records be a mandatory rule in relation to omnibus accounts, and it was queried whether this should be included in the Principle or commentary. If included in the Principle, it could be a duty only applicable to custodians in the ordinary course of business.*

86. *There was agreement to move Principle 15(3) to the commentary, noting that these were duties that a State could make mandatory and would have to flesh out according to its own laws.*

87. *The Drafting Committee requested factual examples (e.g., in relation to escrow) to address in the commentary.*

iii. Principle 16

88. *The Drafting Committee* explained that Principle 16 concerning innocent client was necessary because the innocent acquirer rule in Principle 7 did not fit well with all types of custody situations since it depended on the innocent acquirer having the asset registered in their name. In the event that the custodian was also an innocent acquirer, the custodian would hold it for the client who would then take it free of conflicting claims under the shelter rule in Principle 6(2). If, however, the acquirer was a client of the custodian, the innocent acquirer rule in Principle 7 would not apply because the asset was going to be registered in the custodian's name.

89. *The Working Group* did not have any comments in relation to Principle 16.

iv. Principle 17

90. *The Drafting Committee* introduced Principle 17, underscoring that it was perhaps the most important Principle since it addressed the purpose of custody—i.e., the assets held by the custodian did not form part of the assets for distribution in the event of the custodian's insolvency. The Principle then addressed particular situations, including in relation to the actions that the insolvency representative had to take when the custodian became insolvent and entered into insolvency-related proceedings. One of these was to provide that the VCCs be moved to a registry account of the client or other custodian. Principle 17(4)-(6) addressed omnibus accounts, providing a *pari passu* mechanism to deal with the allocation of assets in the event of a shortfall. It was specified that Principle 17(5) was in square brackets as it was being offered as an option to enacting States. Principle 17(7) concerned the insolvency of the sub-custodian and provided that the custodian had to seek to cause that the VCC be registered either in the custodian's own registry account or to maintain it with another sub-custodian.

91. *The Working Group* did not have any comments in relation to Principle 17.

(d) Cancellation (Principles 8-11)

i. Cancellation (Principle 8)

92. *The Chair of the Working Group* turned the discussion to the Principles on cancellation.

93. *The Drafting Committee* opened the discussion by asking the Working Group whether the term '*cancellation*' should be maintained or whether the term '*extinction*' should be used.

94. *Certain participants* observed that the term '*cancellation*' might carry two different concepts. In particular, it could seem harsh to refer to '*cancellation*' in those instances where the credit had been retired and thereby had fulfilled its purpose. It was suggested that the term '*cancellation*' be limited to instances where the underlying project had failed. However, it was recalled that the Working Group had, in previous sessions, made the substantive decision to have one term for a VCC ceasing to be and then, within that term, specifying that the VCC could be cease to be for retirement, revocation, or reversal. *A participant* observed that the term '*cancellation*' was commonly used for bonds to refer to the bond being taken off the registry and no longer being the subject of any kind of rights or transfers.

95. *Another participant* suggested that Principle 8 start with a definition of cancellation and then address the legal effects of cancellation. *The Drafting Committee* clarified that there was currently no definition of cancellation because cancellation was the opposite of creation, and there likewise was no definition of creation in the Principles. However, *a participant* pointed out that creation was indeed defined in Principle 5 with reference to the VCC when it first existed as a record on a registry. It was noted that this was the same as the definition that was recently used in the United Kingdom for the creation of a crypto asset. That definition identified the moment in which the asset was

entered into as a severable thing on a blockchain as the moment in which the asset crystallised into existence. A suggestion was made to invert paragraphs (1) and (2), such that the Principle would start by addressing when a VCC could be cancelled and then turn to the legal effect of cancellation.

96. *The UNIDROIT Secretary-General* recalled that the instrument had to be useful, and for it to be useful, it had to be something that every legal system could implement. This, he explained, could only happen if the instrument avoided heavily-loaded terms which carried very specific meanings in domestic systems. He stressed that what mattered was that the text clearly described the effect of a particular event or situation. Then each implementing State would translate that into their own categories.

97. *A member of the Drafting Committee* queried whether creation and cancellation could be included in Principle 2 (definitions) by stating that creation had the meaning given in Principle 5 and cancellation had the meaning given in Principle 8. Support was expressed for this proposal on the basis that it signalled to implementing States that the terms were meant to be independent and internally coherent and not taken from any particular legal system. An alternative was to define cancellation as the moment in which a VCC ceased to exist as a result of a reversal, because it had been revoked or because it had been cancelled. It was stressed that any such language would have to be quite basic to avoid giving the impression that cancellation was an automatic process.

98. *The Drafting Committee* further explained that Principle 8(7) had been added to make it clear that the entire section on cancellation (i.e., Principles 8-11) only addressed proprietary rights in relation to VCCs and had no impact on contractual issues. At the request of the Working Group, the relationship between Principle 8(7) and Principles 9(4) and 10(4) was addressed. It was clarified that Principles 9(4) and 10(4) covered VCCs that carried rights. For example, under the Verra system, the holders of a VCC could have rights against the validation and verification body (VVB) if the VVB made an incorrect verification. Principles 9(4) and 10(4) provided that those rights were preserved despite the cancellation of the VCC. On the other hand, Principle 8(7) addressed something different; it clarified that the Principles did not constrain the parties in terms of the contractual arrangements they could enter into. *The Working Group* generally agreed to maintain Principle 8(7) but a suggestion was made to clarify the relationship with Principles 9(4) and 10(4).

99. As to the commentary, some additions had been made to paragraph 8.4 to address how certain CCBs presently treated reversals and revocations, including by getting the consent of the registered holders before cancelling VCCs. There was also a reference in commentary 8.4 that Principle 8(4)(c) did not prescribe how records were to be maintained. *The Drafting Committee* urged the Working Group participants to provide examples of what registries other than Verra were doing, so that those examples could be included in the commentary.

100. *The Chair of the Consultative Committee* highlighted some of the issues raised by the members of the Consultative Committee in relation to the cancellation principles. One member of the Consultative Committee did not support having separate principles for revocation and reversals and recommended bundling the two principles as some of the drivers for Principle 8 on cancellation. The member of the Consultative Committee had also indicated that revocation did not necessarily occur because the VCC did not meet the definition, but could occur due to national challenges (such as the ability to achieve national climate ambitions) when engaging in a cooperative approach under Article 6 of the Paris Agreement, which was beyond the scope of the Principles. Another member of the Consultative Committee had observed that the term '*cancellation*' was problematic if it was used as an overarching term for retirement, revocation, and reversal. It was noted that in carbon markets, the term cancellation had been historically used as having the same meaning as retirement and used for compliance purposes, including within the UNFCCC architecture. It was thus suggested that the term be addressed in the introduction to avoid any confusion. Another member had also suggested that cancellation might not be the best term, and that the discussion might be better placed earlier in the document rather than at Principles 8-10.

Conclusions and recommendations

101. *The Working Group agreed to keep the term 'cancellation'.*

102. *There was agreement to remove the phrase 'in a carbon mitigation project' from Principle 8(2).*

103. *There was a suggestion to switch Principle 8(1) and Principle 8(2) so as to start with when a VCC can be cancelled and then describe the effect of cancellation.*

104. *There was a suggestion to include a definition of cancellation either in Principle 2 (cancellation has the meaning given in Principle 8) or in Principle 8 ('cancellation means the moment when a VCC ceases to exist').*

105. *The Working Group agreed to keep Principle 8(7), though there was a suggestion to explain in the commentary the relationship with Principle 9(4) and Principle 10(4).*

ii. Reversal (Principle 9)

106. *The Drafting Committee* introduced the changes to Principle 9. Principle 9(1) had been changed slightly to mention reversal earlier and to explicitly point out that reversal related to events after the creation of the VCC. The other substantive change related to the waterfall schema at Principle 9(5). The alternatives that had been previously drafted for the Working Group's consideration had been taken out since the Working Group had expressed a preference for *pro rata*. There was now new language to distinguish between two sets of circumstances: one where there was a sequence for a particular project, and one addressing the general rules of the CCB. It was explained that a suggestion made by a Working Group participant to provide that a court could order a particular sequence of cancellation had not been taken on board. This was due to the fact that it was difficult to understand on what basis a court could do so and it would risk allowing courts to ignore the parties' agreements and order cancellations in particular sequences. However, if the Working Group disagreed, this suggestion could be added back in.

107. An issue had been raised with the Drafting Committee concerning projects that involved the sequestration of greenhouse gases (GHGs). In particular, it had been noted that it was possible for multiple such projects to use the same system to store carbon dioxide (CO_2). If there were issues with the storage system such that there was a leakage, it could be impossible to know which project was affected. There was thus a need for a system to allocate losses in the event of a reversal or revocation. It was suggested that a provision essentially the same as Principle 9(5) could be drafted, but which addressed losses as between projects rather than within a project.

108. It was further noted that Principle 9(5) had been amended to no longer require a valid agreement in Principle 9(5)(a), thus allowing individual holders to unilaterally choose to sacrifice their VCCs ahead of others.

109. With respect to the commentary, *the Drafting Committee* explained that there were new drafts of paragraphs 9.2 and 9.3 to indicate that current arrangements whereby buffer pools could be established from several different projects with the unissued credits from one project used to cover losses from another project did not work from a property law perspective and were not consistent with the Principles. For buffer pools to be used consistently with the Principles, they would need to be reconceptualised as a reimbursement process. The commentary made it clear that the Principles did not cover contractual rules and the market was free to innovate and develop any number of ways to make up the reversal or revocation; for example, through the offering of replacement credits, financial compensation, or the provision of insurance.

110. Commentary paragraph 9.12, which concerned VCCs that were the subject of a security right, clarified that all the parties with a proprietary right in the VCC should agree before the registered holder gave instructions in accordance with the waterfall schema.

111. *Participants* addressed commentary paragraph 9.1, which provided that Principle 9 was not limited to events where the GHGs were released back into the atmosphere since any post-issuance event that led to the VCC no longer meeting the definition of a VCC could trigger a reversal. It was observed that reversals were generally understood as events where the CO_2 escaped back into the atmosphere. They concerned the overall project boundary, the number of credits coming out of that project, and events happening inside that project boundary that meant that the amount of credits issued no longer represented the amount of mitigation achieved. Reversals were thus described as a uniquely scientific-related issue. They concerned how many tonnes were credits issued for versus how many tonnes of actual sequestration from the atmosphere were achieved. It was suggested that the idea of reversal should not be allowed to drift beyond the very physical concept of GHGs. There were other tools to deal with everything else, including revocation and erroneous issuance (to address administrative errors). Revocation would address problems such as the issuance of credits that should not have been issued due to a failure in robust quantification of the actual tonnes. Reversal, on the other hand, concerned instances where the atmospheric benefit of the credit—the GHG reduction or removal—was lost.

112. Based on the Working Group’s discussion it was agreed that the Principle would not be changed but the relevant sentence in commentary 9.1 would be deleted.

113. The Working Group was encouraged to consider whether the withdrawal of a verification statement by the CCB triggered a cancellation and whether that amounted to a revocation or a reversal event. *A participant* noted that nothing a VVB did actually created an asset. It was only at the point where the CCB determined that the verification report allowed for the creation of a credit that there actually was a credit. It was further emphasised that withdrawal of a verification report was not a reversal. It was rather part of a process that included the CCB deciding to review the project and then determining whether there had been an over issuance of credits.

114. *A member of the Drafting Committee* recalled that the definition of VCC was there to enable the VCC to be the subject of proprietary rights and to define the scope of the Principles. It was suggested that the definition of reversal may need to be revisited to indicate that reversal was slightly different from merely not complying with the definition at a later point in time. The relevance of the verification statement to the definition of a VCC lay in that it certified the existence of a mitigation outcome.

115. *The Chair of the Consultative Committee* raised for the Working Group’s consideration the comments of a member of the Consultative Committee, who had queried whether the loss or diminution of the environmental benefits of a carbon mitigation project was the sole valid reason to reverse a VCC, and whether the fact that the environmental benefits were never achieved in the first place was the sole reason to revoke a VCC. The member had noted that Principle 8(2) was worded in a permissive manner with the word ‘*can*’, and that the definition of ‘*reversal*’ referred to environmental benefits, but not the definition of ‘*revocation*’.

116. In response, it was suggested that the definitional elements in Principle 2(b)-(d)—and possibly 2(e) with the addition of illegality (see discussion of Principle 10, below)—would not trigger reversals because they were ‘once and for all’, meaning that either they were present or they were not. Reversal would be a one-way only cancellation relating to the escape of GHGs, while revocation would remain a multi-trigger cancellation. The commentary would be updated to reflect this. *Participants* expressed agreement with the proposal and noted that the inclusion in the definition of the concept of ‘*mitigation achievement*’ supported the approach.

<u>*Conclusions and recommendations*</u>

117. *The commentary would be updated to reflect the agreement that reversal only referred to the loss or reversal of the climate mitigation achievement within the project boundaries—this was fundamentally different to revocation or administrative error.*

118. *It was specified that a VCC could be cancelled where it no longer met the definition of a VCC, because due to events after its creation, the mitigation achievement had been reversed.*

119. *It was agreed that the sentence in commentary 9.2 ('However, although this would be the typical cause for cancellation for reversal…') would be deleted.*

iii. Revocation (Principle 10)

120. A suggestion was made to address in the cancellation principles the situation in which a VCC was issued despite it not being authorised in the project host State, or a VCC was issued in violation of the law of the project host State. It was noted that this could be achieved in Principle 10 on revocation. A possibility was to make the legality of the process part of the definition of a VCC, since revocation was tagged to the definition. It was observed that, to the extent that the CCB rules provided that the project had to comply with the law of the host State, revocation on the basis of non-compliance was already built into the definition of a VCC. Revocation due to project illegality was also already built in the definition of a VCC because an illegal project that did not move ahead would not generate mitigation benefits. However, it was further stated that, given the legitimate concerns of host States in this area, it would be appropriate to address this matter explicitly in the Principles.

121. It was flagged that, if project illegality were to be added as a specific ground for revocation, then Principle 10 and Principle 4 on applicable law should be made consistent. It was thus suggested that it be provided in Principle 4 that the law of the host State governed the question of illegality; the consequence of illegality would be then spelled out under Principle 10. However, caution was urged in splitting the law in view of the many ways in which something could be obtained illegally. It was explained that there were two different matters being discussed. On the one hand, there appeared to be broad agreement that the substantive grounds for revocation should include illegality of the project, and that this could be addressed in the black-letter Principles via Principle 10 or the definition of a VCC in Principle 2. A different question, however, was whether the law of the host State could then impact the proprietary rights in a VCC via Principle 4. For example, if the project went ahead in Country A, but the firm seeking the credit fraudulently submitted papers to the registry in Country B, the resulting credit would have been illegally sought on the basis of fraud. However, it was suggested, the applicable law would be the law of the registry where the documents were submitted.

122. In response, it was observed that the underlying project was an integral part of the definition of a VCC within the Principles—if there was no project, then there was no VCC. The Principles provided that a VCC could be cancelled when it did not meet the definition of VCC in Principle 2. What could be clarified was the scenario in which the credit did not meet the definition because the host State determined under its own laws that there was no project due to illegality.

123. As for consistency with Principle 4, it was suggested that this issue be addressed in Principle 4(1), by either deleting parts of the provision or amending it. It was observed that only the law of the host State could determine the legality of a project within that State, and this could be noted in Principle 4. It was further suggested that it be made clear that the terms '*creation*' and '*cancellation*' in Principle 4(1)(a) were used in relation to proprietary rights in a VCC. It was further noted that Principle 4 referred to creation within the terms of Principle 5 and cancellation within the terms of

Principles 8 to 11 and thus was naturally limited to proprietary rights—it would, however, be helpful to spell this out also within Principle 4.

124. In terms of the substantive treatment of illegality, it was clarified that the Principles could be amended to address illegality of the project at the time in which the VCC was created. Subsequent illegality, on the other hand, such as a State passing a law making the project illegal after VCCs were created and determining the effect of that law on the existing VCCs, was a more complex issue. *A participant* expressed concerns with political risk, raising as an example the fact that Indonesia had issued a decree providing that credits originating from projects within the country were not to be traded internationally outside of Indonesia. That decree was reversed several years later. A question was raised as to whether and when the VCCs affected by such a scenario would be cancelled.

125. In response to the question concerning political risk, it was stressed that there was no reason to always trust the host State and its assessment of illegality. States may have different motives to cancel credits; one such motive may be to expropriate, or because the State did not believe in the fight against climate change. It was suggested that the only way to manage political risk was through the court or authority who could actually pronounce the revocation. And that was why Principle 10 provided that it could be done by a competent court or authority determined by other law. This, it was argued, would allow an implementing State to determine that its own courts were competent to order the revocation of VCCs if they found that the project was illegal under the law of the host State. The Working Group was cautioned against including in the Principles a new condition providing that the VCC did not come into existence if the host State said so—this would increase rather than mitigate political risk. Instead, it was proposed that it be left to the adopting State to determine that its own authorities would make the final determination as to whether there was an illegality, taking into account the law of the host State. This, it was observed, was consistent with the expectations of investors who invested in the State of the registry and trusted in the courts of the registry.

126. *A participant* provided further background to help explain the heightened concerns over these issues. The participant explained that host States were concerned with people putting in place carbon projects without sufficient authority to do so and effectively exporting the benefit of the climate mitigation project, thereby preventing the host State from using the carbon mitigation in their own carbon accounting frameworks under the Paris Agreement.

127. A distinction was made between the legality of the credit and the legality of the project. It was observed that the relevant point in time had to be determined. It was thus suggested that the creation-related definitions also provide that the project itself must not be illegal. On the other hand, the question of what would happen to existing credits in the event that frameworks were later put in place which rendered the project illegal was likely outside the scope of the Principles. It was observed that crediting bodies would likely conform to a host State's request to remove credits from circulation if put forth for a valid reason. However, it was outside the remit of the Principles to provide that a host State would have jurisdiction over every other jurisdiction in relation to the removal from circulation of a credit that had already been issued.

128. *A participant* further clarified that there were three groups of host States: (i) those still developing regulations around carbon markets, in relation to which there were no specific rules in their country; (ii) those trying to wrestle control of their carbon markets; and (iii) those who always had control over their carbon markets. Generally, CCBs would have rules providing that a project had to comply with local law, including environmental impact assessments and land permits. The question would be whether these laws were complied with and properly verified at the time of the development of the project. It was explained that host States that were trying to control their carbon markets did not necessarily want to shut down those markets; rather, they wanted to put frameworks around them and leverage their financial value for delivery of the State's nationally determined contributions (NDCs) under the Paris Agreement. With respect to Indonesia, it was clarified that Indonesia did not say that the credits were illegal. Instead, it had established a moratorium on all

exports of credits until the country was able to get its arms around the regulatory framework. It was further observed that declarations of illegality would likely happen only in a few instances, since States understood the investment value of assets. States were currently trying to take oversight of the independent carbon market and would have to allow for illegality *ex post* to address instances where they found problems with a project that had been previously set up outside of their oversight. It was possible that a project was found to be illegal but that credits that had been issued from the project would be allowed to remain as legal assets.

129. In response, it was noted that this description had to be linked to the task at hand, which concerned the various proprietary law issues relating to VCCs. If somebody carried out a project that was illegal and never created a VCC, then it never would come within the scope of the Principles. Instead, what the Principles should address was the case where the creation of the VCC was somehow illegal or unauthorised, for example, because the project was illegal or because there was a failure to sufficiently consult with indigenous communities or comply with other local requirements. It was suggested that the Principles specify that whether the creation of the VCC was illegal or unauthorised could be determined by a court, a competent authority, or in accordance with the rules of the CCB. The Principles should not cover cases after creation, for example where a host State decided to use its expropriation powers to get the VCCs back. These were outside the scope of the Principles which, it was recalled, addressed the questions of whether a VCC existed and whether it was capable of being transferred from one account holder to another.

130. It was further suggested that, while the question of illegality should be addressed clearly in a black-letter principle within Principle 10, it should not be added to the definition of a VCC since this would create confusion in instances where, for example, a court first found that the project was not illegal but that decision was reversed on appeal. *Other participants* added that the question of States' rights needed to be well-framed within the Principles since, among other things, States themselves had been implicated in the breach of safeguards while at the same time being responsible for determining who should benefit from free prior and informed consent (FPIC).

131. *Participants* suggested that specific examples of what could trigger a reversal or a revocation be included in Principles 9 and 10. It was, however, clarified that reversal was different from illegality. Reversal implied that something had changed within the methodological aspects of the GHG emission reduction or removals; it was understood as a question of the GHG measurements in the projects themselves.

132. *A Drafting Committee member* reminded the Working Group that the instrument being drafted was a set of Principles and not a model law. There were two streams of issues being discussed: there was a matter of substance, and then there was a PIL issue. As to the first point of substance concerning illegality, the Drafting Committee member stated that there was no problem in emphasising more strongly in the instrument that for a VCC and property rights to come into existence, the project had to be compliant with the laws of the State where the project was being carried out. Support was expressed for this requirement to be addressed through the definition, since it would be consistent with how similar issues were addressed in a variety of realms of intangible assets, including intellectual property. The Principles would thus include a clear statement that, for the coming into existence of a VCC, there had to be compliance with the laws of the State where the project was being carried out. The second substantive point concerned whether the Principles should address illegality *ex post*—i.e., instances where there was no issue of legality at the time at which the VCCs were created but the host State later changed or updated its laws and this affected the VCCs currently in circulation. Concerns were raised with this latter scenario. It was noted that each State had its own expropriation framework which the Principles should not address. Including in the Principles as a point of substance that an *ex post* declaration of illegality affected the proprietary rights in existing VCCs would not amount to a good rule.

133. With respect to the PIL issue, this concerned connecting factors and which law governed what issue. Support was voiced to make it even clearer in the instrument that it was for the law of State where the project was being carried out to determine whether a particular project at a particular moment in time was compliant with the laws of that State. On the other hand, it was stressed that it would be improper to use Principle 4 to insert a provision whereby even if the VCC was created under the laws of one State, one could look at the law of another State to destroy that property.

134. There was broad consensus that illegality should only go up to the point of creation and not thereafter. Thus, if a host State wished to expropriate VCCs, that was a matter outside the Principles. *The Working Group* considered whether the substantive illegality provision was better addressed in Principle 2 (definitions) or within Principle 10. *Certain participants* stressed that currently, States were addressing the absence of laws around existing carbon projects. The absence of laws did not necessarily mean that the project was illegal. Rather, it was potentially legal and subject to subsequent regulation by the host State.

135. *The Working Group* agreed to include the absence of illegality—i.e., that the project was not being carried out in violation of the laws of the host State in any way, shape or form—as a requirement for the coming into existence of the VCC. On the other hand, the Principles would not address supervening illegality, meaning illegality arising not at the time of creation but at a later point in time. This was akin to expropriation, and was outside the scope of the Principles. As to PIL, Principle 4 would provide that the applicable law rules would look to the law of the host State for those matters of illegality at the time of creation of the VCC. However, it was noted that it would be extremely problematic to have an applicable law rule that provided for application of the law of the host State for *ex post* expropriation matters, regardless of which law governed the creation of the VCC.

136. It was added that it was crucial to address who would determine the consequences of the question of illegality. It was posited that it could only be the courts and competent authorities of the State of the registry that could determine whether violation of the host State's law warranted cancellation of the credits or other actions, taking into account the law of the host State at the time of the project.

137. To capture both instances where the project was illegal and where the credits were not properly authorised, it was stressed that it should be stated that the creation was illegal, rather than just the project. The CCB, a court, or a competent authority would then have to instruct the registry to revoke. It was therefore suggested that the question of illegality be addressed in the definition of a VCC because (i) it bolstered the simple property rule that revocation addressed instances where the VCC never came to be because the VCC never met the definition; and (ii) a requirement of legality could bring clarity to the earlier players, particularly CCBs, who could refuse registration or approval if the project was illegal. In other words, the reason for stating it in the definition was to make it explicit that if the VCC was created illegally, then it was not created. Revocation, on the other hand, would address those rare instances where the illegality was not discovered at the time of creation but it was realised later on, and the credits would thus be taken off the registry. *The Working Group* agreed that the illegality issue would be drafted in both Principle 2 and in Principle 10 for consideration at the next session. It was further suggested that the definition of illegality in the Principles should be kept quite broad and the commentary would then specify that it would be for the implementing States to include their own definition of illegality.

138. *The Chair of the Consultative Committee* brought to the Working Group's attention a comment by a member of the Consultative Committee who had requested the inclusion of an explicit recognition of the host State's sovereign rights over VCCs generated within its territory. While a broad statement, it was relevant to address two points: (i) to ensure alignment with the country's NDCs; and (ii) to avoid unauthorised international transfers. In response, it was observed that there seemed to be an assumption in the comment that credits generated from projects within a country

all went towards the same framework, i.e., Article 6 of the Paris Agreement, and that would be quite limiting. Instead, the Principles were broader and encompassed all the different frameworks, including the voluntary market.

139. With respect to Principle 10(7) (concerning revocation due to evolving scientific knowledge) it was stressed that the science behind the methodologies was constantly evolving and the methodologies might therefore be updated. CCBs could thus require that, going forward, an updated methodology be applied by the project developer. However, it had never happened that a CCB retrospectively found that a methodology was bad and revoked anything that had been issued under it. It was further explained that methodologies were the system for allocating baseline and credits. As the understanding concerning how that measurement worked evolved, the methodologies were updated. Projects registered after the date of the update would use the newer version, while projects registered on an earlier version of the methodology would generally move to the latest version when they reached a new crediting period—i.e., when, usually every 5 or 7 years, they had to update all of their assumptions to the current date. Thus, the methodology was a live system for integrating peer-reviewed and stakeholder-consulted scientific findings.

140. The Working Group was urged to consider the extent to which any statement in the Principles that addressed the question of science and scientific knowledge added specific value that was implementable beyond the instrument. In response, *the Drafting Committee* recalled that Principle 10(7) was not meant to address simple methodological updates but rather, the scenario in which it was later determined that the methodology that had been applied was entirely wrong causing, for example, an over issuance of 100 percent. Principle 10(7) mitigated the harsh consequence of the revocation principle by providing that, if the only reason it had become known that there had been no achievement of the mitigation outcome at the outset was because of the advance of science, then such a scenario would be treated as a reversal, meaning that the cancellation would be prospective rather than retrospective. In response, it was emphasised that revocations on this basis were extremely rare and it was suggested that this be reflected in the commentary.

141. *The Drafting Committee* turned to commentary 10.3bis which had been drafted for the Working Group's consideration and addressed how parties could contractually allocate the risk of revocation. Following discussion, it was agreed that the language would be edited to provide shorter examples of contractual allocation of risk.

<u>*Conclusions and recommendations*</u>

142. *The Working Group agreed that the substantive grounds for revocation should include illegality of the project at the time when the VCC was created. The Drafting Committee would draft a requirement of legality in the definition of a VCC and also include a subclause on project illegality in Principle 10 for the Working Group's consideration.*

143. *There was agreement that illegality only went up to the point of creation, not thereafter. Expropriation of VCCs was deemed a matter outside the Principles.*

144. *There was a suggestion to delete Principle 4(1)(a) (creation and cancellation of a VCC) or to spell out that reference to creation meant creation as within the terms of Principle 5 and reference to cancellation meant cancellation as within the terms of Principles 8-11, thus naturally limited to proprietary rights.*

145. *It was stressed that the proprietary matters in Principle 4 needed to be, at least, the proprietary matters covered by the Principles.*

146. *With respect to project illegality and Principle 4:*

i. *There was agreement to include in Principle 4 that the question of illegality of the project was determined by the host State.*

ii. *However, later changes in law should not matter. The applicable law of the host State should be frozen to the time of the completion of the project. It would be the law of the registry that then determined whether a finding of illegality in the host State warranted the cancellation of credits. Pursuant to Principle 10, it would be up to a court or competent authority of the registry State to determine whether a finding of illegality could lead to the revocation of credits.*

147. *There was agreement to elaborate on commentary 10.1 with further examples of what could trigger revocation.*

148. *Revocation for credits that were overestimated was described as a rare occurrence and participants would provide examples to include in commentary 10.8.*

149. *It was agreed that commentary 10.3bis would be revised to provide that parties could deal with the matter contractually, and to include shorter examples of contractual allocation.*

150. *There was agreement to keep the reference to the VVB in commentary 10.5 and not add any further party.*

iv. Retirement (Principle 11)

151. *The Drafting Committee* explained that the only substantive change to Principle 11 concerned the addition of a small passage in Principle 11(1) to tie the provision to Principle 13 concerning the registry. The Working Group was encouraged to provide examples that could be added to the commentary, in particular in relation to the practices of registries other than Verra.

152. It was suggested that, while appropriate to refer to Principle 13(1)(c)(i) in Principle 11, the reference to Principle 13(1)(c)(ii) was not required and should not be covered.

153. Noting that retirement could often happen on behalf of another person, *a participant* suggested that this could be mentioned in the commentary. In response, it was observed that the custody principles addressed those situations, but it was added that it should be specified in the instrument that agency law was presumed, i.e., everything that somebody did under the Principles could be done by a party on behalf of someone else.

<u>*Conclusions and recommendations*</u>

154. *The Drafting Committee requested that Working Group participants provide examples of what registries other than Verra did.*

155. *There was a suggestion to delete the reference to Principle 13(1)(c)(ii) from Principle 11(1).*

156. *There was a suggestion to mention in the commentary that retirement could happen on behalf of another person.*

(e) Definitions (Principle 2)

157. *The Chair of the Working Group* turned the discussion to Principle 2 concerning definitions.

158. *The Drafting Committee* explained that all changes had been implemented either in response to feedback from the Working Group or from the Consultative Committee. The main change concerned the introduction of the term '*mitigation achievement*', which had been defined as reduction in and or avoidance of emissions or removal.

159. The Working Group was asked to provide views on the inclusion of the term '*avoidance*'. In response, it was clarified that avoidance was a subset of reduction. Because avoidance credits existed and were traded in the market, it was stressed that they should be covered by the Principles.

160. *Participants* confirmed that there could be projects that generated both reductions and removals. However, it was important that it could be ascertained whether a credit represented a reduction or a removal. A credit could either be a reduction or a removal—it could not be both at the same time.

161. *The Drafting Committee* explained that the core functions that had to be performed by an entity in order to be a CCB under the Principles were: (i) approval of the methodology applied to the project; (ii) approval of the VVB; (iii) approval of the methodology to be applied to the verification programme; and (iv) approval of the verification statement. *A participant* queried why the definition of CCB no longer included instruction of the VCC registry to issue the credit as a core function of the CCB. In response, it was observed that the definition now included only those activities that a CCB always performed, because if a CCB did not carry out those activities, then it was not a CCB under the Principles. The Working Group had been informed that sometimes the instruction to the registry to issue the credits came not from the CCB but from the project proponent upon the approval by the CCB of the verification report.

162. In response to questions as to whether the CCB had to be independent from the project proponent and other entities such as the VVB, it was noted that this could be a matter for jurisdictions to regulate.

163. *The Chair of the Consultative Committee* highlighted that several Consultative Committee members had provided comments on Principle 2. She thanked the Working Group members for discussing, and the Drafting Committee and its Chair for addressing, many of these comments. She noted that the revised draft of the Principles would be shared with the Consultative Committee members, who would have another opportunity to provide any further input.

<u>*Conclusions and recommendations*</u>

164. *There was agreement to delete 'or more' in Principle 2(2) since a project could generate both reductions and removals but a credit could either be a removal or a reduction (including avoidance).*

165. *It was suggested that 'carbon programme' be changed to 'carbon crediting programme' (CCP) and 'carbon crediting body' to "carbon body" (CB).*

166. *It was suggested that the language in square brackets at commentary 2.26 should remain.*

167. *There was agreement to take out 'private' in Principle 2(18).*

168. *Principle 2(6) was to be amended to reconcile with changes to Principle 2(1) and Principle 2(2).*

169. *Commentary paragraph 2.20 should clarify that while CCBs could do lots of different things, in order to be a CCB under the Principles, a CCB had to perform four required activities listed in that paragraph.*

(f) Introduction

170. *The Chair of the Working Group* turned the discussion to the Introduction and gave the floor to the Drafting Committee.

171. *The Drafting Committee* explained that language had been added to the introduction to provide some general points about the law; for example, that the Principles only addressed private law and not regulation, and that the Principles were designed as a *lex specialis* to be incorporated into a State's law without changing the fundamental concepts of that State's law. This language, currently at paragraphs 1-10, could be moved anywhere within the introduction. A question was raised as to whether it should be recommended that the Principles must be adopted by States on an all or nothing basis or on a different basis. In response, it was noted that the instrument was drafted as a whole and everything was meant to fit together. However, in practice, it was not unusual for States to take portions of the instrument and implement it in stages—this was for example, what was happening with the UNIDROIT Principles on Digital Assets and Private Law (UNIDROIT DAPL Principles).

172. *A participant* queried whether something would be said about technological neutrality in addition to organisational and jurisdictional neutrality. In response, it was noted that the topic of technological neutrality would be addressed in the instrument, but the language would be drafted following advancements on the tokenisation annexe.

173. *Several participants* expressed support for the current version of the Introduction, noting that it provided the right level of detail and valuable context to implementing States. It was generally thought that the Introduction should start with current paragraph 11 (with the general points of law to be moved to later in the section).

174. A question was raised as to whether the word '*issuance*' should be used in the Introduction since it was not used elsewhere in the Principles. In response, it was noted that this was a term used in the industry and it would therefore appear odd if it was not used at all within the instrument. The draft did specify that the term was used colloquially. It was further observed that '*issuance*' related to the process whereby the CCB approved the verification report and then told the project proponent and registry that they could register the credits. Creation, on the other hand, was a moment rather than a process. It was suggested that the word '*issuance*' could be defined to mean a process at the end of which a VCC was created. *Other participants*, however, described issuance as the last step in the creation process—the crediting of the registry in the account of the first holder amounted to the issuance of the credit. It was urged that the Principles be clear as to why and how certain terms were used within the instrument, particularly if their meanings or usage differed from those of the industry. The Working Group was encouraged to not take a position on whether '*issuance*' was the process or the ultimate step. Rather, it was suggested that it be mentioned in the Introduction or commentary that the Working Group had deliberately not used the term '*issuance*' in the Principles because, despite it being used in the market, it was not used in a consistent manner. For that reason, the term '*creation*' was chosen to refer to the specific time when the VCC and proprietary rights came into existence.

175. *A participant* raised the issue of *ex ante* credits, noting that the possibility of creating security interests over future VCCs was an important aspect of project financing which the Principles did not currently mention. It was agreed that, although outside the scope of the Principles, *ex ante* credits would be mentioned in the Introduction given their use in the market.

176. It was further noted that the description of reversal and revocation in the Introduction did not actually fit with the corresponding principles as currently drafted.

177. *A participant* thought that there was a need to update the Introduction to acknowledge that the market had experienced certain difficulties over the past two or so years, but that there had been some changes which could lead to significant developments, including the increased use in compliance programmes and the fact that the EU had decided that credits would be used. It was also suggested that the Introduction could address why the Working Group selected the intangible asset model for the private law treatment of VCCs rather than calling VCCs a bundle of contractual rights or something else. It was underscored that, unlike digital assets, VCCs had been around for 25 years and market participants clearly considered them to be assets.

178. It was suggested that a glossary could be included at the outset to address the many acronyms and special terms used in the Introduction.

179. *The Chair of the Consultative Committee* observed that most of the Consultative Committee's points pertaining to the Introduction had been addressed. She queried how the suggestion of one member of the Consultative Committee not to delve into specific examples of the different methodologies and carbon crediting programmes would be tackled. The *Drafting Committee* noted that the draft had been tweaked in response to that suggestion, but it would be further revised.

180. Finally, it was agreed that the Introduction section would be expanded to include some additional background to describe certain issues that were of importance to the market but not addressed by the Principles. These would include: (i) host State benefit sharing and safeguards, which would normally be embedded within the legal frameworks tied to the carbon projects; (ii) discussion of some of the other infrastructure organisations such as the Integrity Council for the Voluntary Carbon Market (ICVCM); (iii) the concepts of carbon accounting, double-counting, and corresponding adjustments; (iv) some of the issues related to post-retirement, including the statements made in the voluntary market and what net zero meant.

Conclusions and recommendations

181. *The Working Group agreed to include a note on terminology / a glossary at the beginning of the Introduction.*

182. *There was general agreement to start the Introduction with paragraph 11.*

183. *The Working Group agreed to keep the word 'issuance' in the introduction but clarify that it was an industry term that was deliberately not used in the Principles and which was used in the market to mean different things, including a process involving several actions at the end of which the VCC was created, or the ultimate step through which the VCC was created. The Principles did not take a position on this.*

184. *It was suggested that a short discussion could be included to explain why the Working Group selected the intangible asset model as opposed to VCCs as bundle of contractual rights or digital assets.*

185. *It was agreed that examples from other jurisdictions (not just EU Emissions Trading System(ETS) could be added to paragraph 25.There was a suggestion to include a table with various ETSs from the International Carbon Action Partnership (ICAP).*

186. *The Introduction would be expanded to:*

   i. *Address why the instrument did not deal with certain concepts such as host State benefit sharing and safeguards, which were normally embedded within the legal frameworks applicable to the setting up of the projects;*

ii. *Include reference to other infrastructure organisations, like the ICVCM, to give more context to the market;*

iii. *Address the concepts of carbon accounting, double accounting, and corresponding adjustments to explain where they came from and what they were;*

iv. *Address what happened after retirement, including in relation to some of the issues that arose in respect of statements made in the voluntary market, what net zero meant, and the overall objectives for net zero;*

v. *Acknowledge ex ante credits, including their use in financing and why they were not covered by the Principles.*

(g) General Principles (Principle 3)

187. *The Drafting Committee* explained the added language at Principle 3(4)(g)-(i) was included in response to comments from UNCITRAL.

Conclusions and recommendations

188. *There was agreement to expand commentary 3.8 to include reference to Principle 3(4)(g)-(i).*

(h) Innocent acquisition (Principle 7)

189. *The Drafting Committee* explained that language had been added to commentary paragraph 7.11 in response to input from a member of the Consultative Committee concerning intra-group transfers. The commentary now clarified that, generally speaking, intra-group transfers were not gratuitous transfers because there typically was value that was being exchanged. On the other hand, if the intra-group transfer was deemed to be under the applicable law entirely gratuitous, then the innocent acquisition rule would not apply.

190. *The UNIDROIT Secretary-General* raised concerns with the added language, as it seemed to address a rare situation and imply that gifts could be made amongst corporate entities within the same group. To address such concerns, it was suggested that the wording be changed from '*are not ordinarily considered gratuitous*' to '*may not be gratuitous*'.

191. *The Chair of the Consultative Committee* also raised for the Working Group's consideration the comment from a member of the Consultative Committee who had queried whether Principle 7 should go further in its attempt to harmonise and standardise the innocent acquisition rules across jurisdictions. At the moment, Principle 7(4)(c) referred to the requirements equivalent to those found in the relevant good faith acquisition and take free rules as specified by the relevant State. Thus, the Principles were choosing to refer to national law and not harmonise on this point. The Principles were accepting that different jurisdictions had different understandings of the relevant good faith acquisition and take free rules. The view previously expressed by the Working Group was to not try to arrive at harmonised standards but rather to defer, effectively, to the laws of each State on this point. It was further observed that when this issue was considered in the context of other UNIDROIT projects, including the UNIDROIT DAPL Principles, the consensus was that this was a very difficult issue, this being a point of private law that typically displayed considerable divergence across jurisdictions. Thus, harmonising this point with one standard would be extremely challenging and unlikely to lead to a consensus solution.

192. *Other participants* further noted that the current approach in Principle 7 could be seen as a strength in that it allowed the Principles to be incorporated more easily within domestic property law

and without trampling over existing legal culture. It was observed that the feedback from the UNIDROIT DAPL Principles was that this was a positive feature of that instrument. The Principles were an instrument of soft law and the message to enacting States was to implement the Principles in the way in which they wanted to within their own State. Even if the Principles contained a detailed rule, it was likely that States would just adapt the language to fit it within their existing system.

Conclusions and recommendations

193. *It was suggested that the language concerning intra-group transfers in commentary 7.11 be amended to state 'may not be gratuitous'.*

(i) Procedural law including enforcement (Principle 23)

194. *The Drafting Committee* introduced the Principle, explaining that the proposed text was meant as a placeholder to encourage the Working Group's discussion. At the moment, the main part of the provision was Principle 23(1), which provided that other law applied to procedural matters, including enforcement. It was recalled that the Principles already had a principle on enforcement in Principle 22, which concerned enforcement of security rights and provided that enforcement was subject to other law.

195. Principle 23(2) as currently drafted provided that a registry had to comply with a court order to move the VCC from the account of a registered holder to the account of another account holder. It was noted that the provision could also be phrased in the negative, i.e., that the registry did not have to move a VCC to another account without a court order. It was also stated that this could be moved to the commentary, since the registry principle already provided that the registry had to comply with the order of the account holder.

196. *The Drafting Committee* further explained that there were various approaches the Working Group could take. The bare minimum would be to include Principle 23(1) only. Another option was to either include a provision along the lines of Principle 23(2) or to address in the commentary whose instructions the registry had to comply with, for example, in the context of enforcement of a claim by someone who asserted to be the true owner of VCCs registered in someone else's name. It was noted that UNIDROIT had a separate instrument on best practices for effective enforcement with a section dedicated to enforcement of digital assets.

197. *A participant* emphasised that, because the Principles provided for custody arrangements and innocent acquisition, this necessarily allowed for situations in which the registered holder and the property right holder could diverge. It was thus analytically important to distinguish claims that the proprietary right holder could have against the registered holder (a non innocent acquirer), which would be left to other law, and claims against the registry for the rectification of registry entries which would be addressed either in Principle 23(2) or the commentary.

198. It was suggested that the two types of claims could be clarified in the commentary and that the wording of Principle 23(2) could be flipped to follow the wording of Principle 22(2) to make it easier to understand that it addressed claims that the proprietary rights holder could have against the registry.

199. *Other participants*, however, questioned whether the Principle was necessary. It was suggested that a principle on enforcement was outside the scope of an instrument addressing proprietary rights and that most of what it provided could be addressed elsewhere in the instrument. In particular, it was queried whether Principle 23(2) was necessary, since it was not for the Principles to indicate what a court could or could not do. If, however, the Working Group thought the provision was needed, then it would be preferable to use the negative formulation to soften its approach.

200. In response, it was observed that the concerns raised could be addressed by changing the language at Principle 23(2) to provide that a registry did not have to comply with the instructions of someone claiming a VCC without a court order—that formulation did not say anything about what a court could or could not do. It was also clarified that the registry remained free to go ahead without a court order, thus addressing concerns raised in relation to stakeholders' access to courts.

201. With respect to the usefulness of the provision, *a participant* explained that Principle 23(2) was crucial. The provision recognised that there could be a situation where a registered holder and the holder of a proprietary right diverged. In that case, there needed to be something mentioned in the instrument to make sure that the property claim of the proprietary rights holder could be executed against the registry only with a court order. It was observed that, at least in civil law jurisdictions, the question to be addressed was what to do with the fact that there was a diversion between the registered holder and the holder of the property and whether this basic property law claim existed as against the registry. The negative formulation of Principle 23(2) was important to prevent claims against the registry in the absence of a court order.

202. *Another participant* agreed and added that one could not count on the registry's terms and conditions addressing the type of situations covered by Principle 23. It was suggested that the provision was valuable in that it clarified the applicable procedure.

203. A question was raised as to whether VCCs on blockchains raised particular challenges in relation to enforcement. It was observed that a blockchain was not as easy to correct by the registry itself, but that was not an unsurmountable obstacle. For example, the Principles could provide that a court could order the person who held the VCC to transfer using its private key or whatever other means it had to transfer the VCC on the blockchain. It was suggested that this could be addressed in the context of the tokenisation annexe.

204. A proposal was made to replace the word '*enforcement*' with the word '*execution*' in order to clarify that the Principle did not cover cross-border enforcement but rather only concerned domestic execution of a court order. In response, it was noted that '*enforcement*' was a legacy term that was used in other UNIDROIT instruments. Rather than changing the term, it was offered that the clarification could be added to the commentary. It was, however, suggested that at least the word '*enforcement*' be deleted from the title of the Principle, since it could convey that the provision related to the enforcement of a VCC.

205. It was clarified that Principle 22(2) covered custodians, while Principle 23(2) was meant to address registries.

206. *A member of the Drafting Committee* noted that the Working Group was trying to address three distinct issues with Principle 23. First, as drafted, Principle 23(2) was trying to signal that when a dispute over ownership rights and enforcement came into play, a court could instruct the registry that they must credit the VCC elsewhere. Second, Principle 23 appeared to have a function of shielding registry operators by signalling that a registry operator was not required to do anything in the absence of a court order. Third, Principle 23 appeared to be addressing asset-specific problems with VCCs that could arise in enforcement. It was suggested that the three issues be addressed separately.

207. With respect to the first issue, there was general agreement to take this out of Principle 23 as it raised too many issues. The second issue was one that needed to be addressed by the instrument, and Principle 23 provided a venue for it. The third issue was only necessary if the Working Group came up with anything that was very VCC-specific. It was thus suggested that Principle 23 be confined to enforcement of what in civil law was referred to as *vindicatio*. The provision would not say anything about what actual types of claims the owner had, but would address the protection of registry operators.

<u>Conclusions and recommendations</u>

208. *There was agreement to amend the wording in Principle 23(2) from a positive to a negative formulation and to align with the wording in Principle 22(2).*

209. *There was also agreement to address in the commentary: (i) a potential conflict between the registered holder, who was an unauthorised holder, and the holder of the proprietary rights in the VCC (e.g., vindicatio in civil law); as well as (ii) the protection of registry operators.*

210. *It was decided that the term 'enforcement' should be maintained because it was a legacy term used in other instruments, but that the commentary would address the domestic nature of the provision.*

(j) Insolvency (Principle 24)

211. *The Chair of the Working Group* turned the discussion to Principle 24 which addressed insolvency in general, rather than the insolvency of custodians, which was addressed separately.

212. *The Drafting Committee* explained that Principle 24 addressed other situations where somebody might become insolvent and which could affect proprietary rights in a VCC. The text was thus a general description, drafted on the basis of the UNIDROIT DAPL Principles, of what might happen in various situation when one was insolvent. Principle 24 covered three things: (i) it reiterated that a proprietary right continued to be effective against an insolvency representative, creditors, and third parties to insolvency-related proceedings; (ii) it recognised the basic rule that a proprietary right survived insolvency but acknowledged that there were insolvency rules that might change the effect of the basic rule; and (iii) the commentary explained what would happen in the event that various market players became insolvent.

213. *The UNIDROIT Secretary-General* observed that VCCs resembled assets which had very strong personal components to them, for example in relation to the decision to retire a credit outside of a compliance scheme. He queried whether, given the special nature of the asset and the need for guidance, the Principles should expressly state that an insolvency representative could realise value in a VCC through retirement and not just by means of a sale.

214. *Several participants* agreed. It was noted that the value that could be realised through retirement could be reputational, or it could be that an organisation made certain offsetting commitments, or a company could have issued a sustainability-linked bond where the interest rate depended upon the company's compliance with its CO_2 targets which could be affected by the retirement of credits. It was suggested that this issue be addressed positively, by specifying that the insolvency representative was the effective owner-controller of the proprietary rights in the VCC and could thus do whatever an owner could do with the VCC. However, a concern was expressed with not giving the impression that the Principles were authorising an insolvency representative to do something even where it did not generate value. It was suggested that the commentary could include examples of when an insolvency representative may want to dispose of a VCC in certain ways, for example retiring a VCC to comply with a sustainability bond.

215. *A participant* shared that the Japanese Ministry of the Environment had recently issued a report providing that if VCCs were characterised as property or a proprietary asset, then it followed that they would be part of the debtor's estate and there would be no personal rights that would prevent the disposition or execution of the asset. The report also mentioned that commitment reserves could be used in the case of insolvency.

216. *Other participants* cautioned against making any comparisons to moral rights in copyright, recalling that VCCs did not necessarily carry any rights. It was explained that certain stakeholders,

possibly more traditional communities and indigenous groups, had the concept that there might be some kind of moral right in the credits issued from the land. This was a hugely complex and unsettled issue and, while important to acknowledge, it was beyond the scope of the Principles. It was further noted, however, that the issue was more closely connected with monetary value rather than moral value—the concern of certain communities within project host States was with others monetising the value of their environment. It was recalled that the forestry department of the United Nations Food and Agriculture Organization (FAO) had been supporting countries in accessing results-based payments in the context of REDD+ since 2010. FAO aimed to give an economic value to the efforts made by local communities and indigenous people in restoring and conserving forests. Local actors were now well-aware of the fact that by reducing emissions, they could have certain benefits, including payments. What had emerged from discussions with communities and indigenous peoples groups was that they: (i) wanted to be key players in any decision-making process that related to the valuing of the asset, particularly if it was associated to their land or forests; and (ii) they also wanted to be considered as beneficiaries and key players in developing benefit-sharing arrangements associated with the valuing of the asset.

217. *The Chair of the Consultative Committee* raised comments by a member of the Consultative Committee who had stated that it would be helpful to understand the implication of insolvency on property rights and security rights, if the insolvency resulted in the revocation of VCCs. As an example, the member of the Consultative Committee had indicated that insolvency could mean that the project proponent could no longer monitor the permanence of the removals, meaning that all VCCs issued for that project would then be invalid and subject to revocation. The member of the Consultative Committee had queried whether there would be principles to address how the creditors of any third party in an insolvency-related proceeding would need to maintain the underlying asset, to further maintain the proprietary rights of the registered holders of the VCCs.

218. *Members of the Drafting Committee* observed that the scenario posited by the Consultative Committee member was, at the moment, outside the scope of the Principles which looked at the VCC as an object of property and addressed the people who transacted in the VCC. The Principles therefore addressed the insolvency of the registry operator and the insolvency of the custodian. The Working Group had not considered the insolvency of the CCB or of the project proponent.

219. In relation to the example provided by the Consultative Committee member, it was noted that, should it no longer be possible to monitor the emissions reductions or removals, it would not necessarily mean that the previous monitoring period was invalid and thus automatically lead to a revocation. Further, it would be possible for someone else to take over the project.

220. Given the CCB's continuing monitoring role, a question was raised as to whether the Principles needed to address what would happen in the event a CCB went bankrupt. It was recalled that several principles and, in particular, those addressing reversal and revocation, were tied to CCBs initiating certain actions. In response, it was observed that this was a risk that the market was aware of and had yet to address. *Certain participants* also questioned how this related to the proprietary rights in the VCC. If the registry was independent of the CCB and the CCB became insolvent—or disappeared for reasons other than insolvency—the credit still existed as an object of property on the registry, though it might be significantly less valuable.

221. The question then was how that credit would be maintained if there was a maintenance obligation for that credit going forward. It was explained that this eventuality could be addressed contractually by providing an obligation on the project proponent to re-register the project with another CCB. If the project developer failed to do that, then things like step-in rights could be instituted.

222. It was suggested that the ability of a CCB to continue monitoring the credit was not tied to the legal nature of the VCC, but was rather an integrity point. It was further clarified that the

disappearance of a CCB (due to insolvency or other reasons) did not prevent the monitoring and independent verification of a project, because these were separate activities carried out by the VVB. What it did prevent was approval of those activities by the original CCB. It was noted, however, that even if a VVB continued the monitoring of the project, without the CCB, the VVB would be unable to trigger cancellations for reversal or revocation. It was thus suggested that there be a process whereby somebody stepped in the shoes of the defunct CCB.

223. It was ultimately agreed that the Principles did not need to address this issue. The risk of the CCB going away was inherent in the product, but it was also a very unlikely occurrence. There was, however, the fallback of a court where parties could request that the reversal or revocation of VCCs be ordered. That order would then most likely go to the registry.

Conclusions and recommendations

224. *There was a suggestion to specify in the commentary that an insolvency representative could dispose of the VCC in any way, including by retirement, if that generated value in the asset.*

225. *The Working Group considered whether provisions were needed to address the insolvency of a CCB. It was observed that, if a CCB were to become insolvent, the VCCs would be moved to a different CCB. It was agreed that this was an inherent risk and it was not necessary to address it in the instrument.*

(k) Secured Transactions (Principles 18-22)

226. *The Chair of the Working Group* introduced the topic of secured transactions.

227. *The Drafting Committee* explained that Principles 18-22 had been revised in response to comments from the Consultative Committee and from UNCITRAL. With respect to Principle 18, the commentary had been expanded to clarify that, when using VCCs as collateral, the object of the security right was the VCC itself rather than a right or entitlement with respect to the VCC or to a registry account. The language responded to the suggestion to clearly distinguish between the structure of the Geneva Securities Convention and the structure of the Principles.

228. However, it was noted that the Principles did provide a similar structure to that of the Geneva Securities Convention in relation to VCCs held through a custodian. It was posited that what one was giving securities rights over would depend upon the national law and how the national law conceptualised custody.

229. *The Chair of the Consultative Committee* raised a recommendation from a member of the Consultative Committee for the insertion of a clarification to align VCCs with secured transactions law, in order to ensure enforceability in developing countries. The Chair noted the Drafting Committee's request for more information to be provided in relation to this suggestion, and noted that this would be relayed back to the Consultative Committee member.

230. With respect to Principle 19, *the Drafting Committee* explained that it had been amended in response to a suggestion from UNCITRAL to specify that the agreement referred to therein was indeed a security agreement. The commentary had been slightly expanded to specify that Principle 19 was an asset-specific rule and thus an exception to the general secured transaction rules that one would expect to find in domestic law. Further, commentary paragraph 19.4 had been revised to better present the interplay between Principle 19 and Principle 7 (innocent acquisition) to essentially state that the rules on innocent acquisition also applied to a secured creditor who was acquiring a security right in a VCC.

231. *Several participants* expressed doubts about the insertion of the reference to a '*security agreement*' in Principle 19(1), emphasising that the Principles needed to remain neutral as to the type of secured transactions law. It was explained that, while the reference made Principle 19 better aligned to the UNCITRAL Model Law on Secured Transactions, it made it potentially harder for jurisdictions which had not adopted the UNCITRAL Model Law on Secured Transactions to incorporate the Principles into their national laws. It was reiterated that, if the Principles were to be adopted globally, they could not be aligned to any particular system of secured transactions, whether it was the UNCITRAL Model Law, Article 9 of the Uniform Commercial Code, or any other. It was agreed that the words '*security agreement*' should be removed from Principle 19(1) and that the commentary could explain that, for jurisdictions that had adopted the UNCITRAL Model Law, this would be a security agreement.

232. In relation to commentary paragraph 19.2, it was suggested that it provide both that (i) a general registry filing against all movable assets could include VCCs; and (ii) the general registry filing could directly be a registry filing against VCCs.

233. With respect to Principle 21, *the Drafting Committee* explained that it had been revised to align the provision with the UNCITRAL Model Law on Secured Transactions in relation to control agreements. The Working Group was asked to consider whether the Principle should specify, as it currently did, that a control agreement be in writing. No similar requirement was found elsewhere in the Principles in relation to other significant agreements.

234. *The Working Group* agreed to eliminate the requirement from Principle 20 that a control agreement should be in writing and to note in the Introductory section on enactment of the instrument that States would need to make decisions concerning how the Principles were implemented into domestic law, which would depend on their legal culture.

235. Further, *the Working Group* discussed the use of the word '*can*' as opposed to the word '*may*'. It was noted that this was a linguistic preference of the Drafting Committee because the word '*can*' signalled something that one was able to do as opposed to something that one might or might not do—thus, it was suggested, '*may*' was less certain than '*can*'. In addition, use of the word '*can*' was consistent with the language used in the UNIDROIT DAPL Principles. *A participant* strongly urged the Working Group not to use the word '*may*' in relation to the reversal and revocation Principles, as that would risk creating wrong impressions. *Another participant* suggested that use of the terminology within the Principles be addressed at the outset, in the glossary that had been discussed in relation to the Introduction. This section could explain that use of the word '*can*' was meant to refer to something that it was possible to do under the Principles and an alternative word that could be used was '*may*'.

236. With respect to Principle 21, *the Chair of the Consultative Committee* brought to the Working Group's attention, a recommendation from a member of the Consultative Committee who had indicated that the Principles should avoid prescribing that the methods under Principles 19 and 20 should take priority over other methods. The member of the Consultative Committee had pointed out that, although Principle 18 and its commentary recognised that each State had its own domestic framework governing secured transactions and security rights, Principle 21 could contradict how security rights were prioritised under domestic law by stating that VCC-specific methods of perfecting security rights in Principle 19 (registration in a VCC registry) and Principle 20 (control agreement) should have priority over other methods of perfecting security rights.

237. In response, *the Drafting Committee* noted that the provision, which gave super priority to security rights that had been perfected in accordance with Principles 19 and 20, was not a special feature of the Principles. It was instead aligned with similar asset-specific rules under the UNCITRAL Model Law on Secured Transactions. Further, it was observed that most jurisdictions had asset-specific rules under their national security transactions law that granted super priority to security

rights that were perfected a certain way. The substantive rule in Principle 21 was also consistent with a very similar rule in the UNIDROIT DAPL Principles and had been supported unanimously by the Working Group.

238. It was suggested that the Consultative Committee member's comment was due to the fact that in many common law jurisdictions there tended to be no such super priority rights. It was further suggested that implementing States remained free to drop provisions that they deemed inconsistent with their own domestic systems. *Participants* added that, other than consistency, there were good substantive reasons for Principle 21, which reflected a sound and well-established rule that would assist registries in relation to VCCs.

239. With respect to Principle 22, *the Drafting Committee* recalled that the Working Group had previously agreed on the desirability of a principle concerning the enforcement of security rights that was, however, limited in scope. It was explained that commentary paragraph 22.5 addressed concerns raised by UNCITRAL as to possible confusion between Principle 21 and Principle 19. A suggestion was made that the commentary to Principle 22 link the provision to the registry principles, noting that the secured creditor only had to comply with the instructions of the account holder.

240. It was further agreed that a new paragraph would be added to Principle 22 to address a situation where the registered holder was the grantor and thus did not involve a custody agreement but rather concerned the court order and the registry in the ambit of an enforcement of a security right. In such a case, the secured creditor had to get a court order to enforce.

Conclusions and recommendations

241. *It was agreed that the language in square brackets would be removed from Principle 19(1) and the issue of consistency with the UNCITRAL Model Law on Secured Transactions would be addressed in the commentary.*

242. *It was agreed that commentary 19.2 would be amended to reflect that the general registry filing could either be the filing of a general security agreement or of a security agreement just about VCCs.*

243. *The Working Group agreed to eliminate the requirement from Principle 20 that a control agreement must be in writing, and to note in the Introductory section on enactment of the instrument that States would need to make decisions concerning how the Principles were to be implemented into domestic law, which would depend on their legal culture.*

244. *It was agreed that the super priority rule in Principle 21 would be maintained, but it would be noted that States remained free to not incorporate this if this was inconsistent with national frameworks.*

245. *It was suggested that the commentary to Principle 22 could link the provision to the registry principles, noting that the secured creditor only had to comply with the instructions of the account holder.*

246. *It was agreed that a new paragraph could be added to Principle 22 to address a situation where the registered holder was the grantor and did not involve a custody agreement. In such a case, the secured creditor had to get a court order to enforce.*

(l) Tokenisation annexe

247. *The Chair of the Working Group* turned the discussion to the development of the tokenisation annexe. It was explained that this was currently a moving target, but the rationale was to recognise

what was happening in the market and provide an annexe for principles on tokenisation. *Certain participants* observed that there were many issues related to tokenisation and, at the very least, the Principles should not impede it.

248. It was recalled that at a prior session of the Working Group, there had been expert presentations addressing what tokenisation could mean.[2] This included primarily two scenarios: (i) the possibility that a VCC was created as described in the Principles and then, at a later point in time, a digital asset purporting to represent that VCC was created (i.e., what the UNIDROIT DAPL Principles presented as the linked asset paradigm); and (ii) the possibility of the digital asset and the VCC being, rather than linked, completely merged such that the digital asset was the VCC (i.e., native tokens created as data entries in a distributed ledger or similar system). The question for the Working Group was to consider what legal significance the law gave to certain technological arrangements—i.e., what private law principles should be developed to address the two tokenisation scenarios.

249. It was observed that, when it came to linked assets, the UNIDROIT DAPL Principles provided the rules of the road since they deferred to the law of the asset. The tokenisation annexe would then reflect on the kind of additional rules that would be required in the case of a digital asset linked to a VCC.

250. The alternative option—i.e., native VCC tokens—would instead be more challenging since many of the steps envisioned by the Principles (such as, for example, registration) would not be in play in the same way. The importance of determining whether and how this was currently happening in the market was stressed. *A participant* shared that, currently, when it came to native tokens, the industry saw a need in having the CCBs direct the native token, but the distributed ledger would replace the traditional registry operator.

251. *The UNIDROIT Secretary-General* underscored the importance of addressing tokenisation in the instrument in order to provide guidance to the market and legislators. He noted that the tokenisation of VCCs entailed a sectoral application of the UNIDROIT DAPL Principles. The reason why the UNIDROIT DAPL Principles did not provide a standard on how to address linked assets was because digital assets could be linked to so many things that it was not possible to cover everything. In this context, however, the analysis was specific to VCCs and thus, even if complex, it could be carried out and would be enriching also to the UNIDROIT DAPL Principles.

Conclusions and recommendations

252. *It was noted that the tokenisation annexe would articulate private law principles that would recognise the legal significance of certain technological attempts, either linking a digital asset to a VCC, as now defined and understood in the Principles, or in relation to a VCC that was natively created in the form of a digital asset, i.e., a data entry in a distributed ledger or a similar system.*

253. *Especially in relation to the latter scenario, examples from current market practice would be critical.*

Item 4: Organisation of future work

254. At the request of the Chair of the Working Group, *the Secretariat* provided a brief overview of the timeline going forward. The eighth session of the Working Group was scheduled to take place from 15 to 17 April 2026. Before this next session, the Principles would be iterated and shared with the Consultative Committee for its review and comment. UNIDROIT's Governing Council would be meeting twice in 2026. At its first session in May 2026, the Secretariat planned to ask the Governing Council for approval to proceed with the public consultation of the instrument. At least one but likely

[2] See Study LXXXVI – W.G.5 – Doc. 3 – Summary Report, at paragraphs 33 to 98.

two additional Working Group sessions would be scheduled for the remainder of 2026. One session would be dedicated to bringing before the Working Group the feedback received in response to the public consultation. The instrument would then be submitted to the Governing Council for final approval at the December 2026 session.

Item 5: Closing of the session

255. *The Chair of the Working Group* expressed his deep thanks to the Working Group participants for the constructive and proactive interventions and suggestions. He especially thanked the Drafting Committee, including its Chair, Professor Louise Gullifer. The Chair of the Working Group also extended his gratitude to the Secretariat and to the Chair of the Consultative Committee and closed the session.

ANNEXE I

AGENDA

1. Opening of the session and welcome

2. Adoption of the agenda and organisation of the session

3. Consideration of the iterated draft Principles and Commentary and of the comments provided by the Consultative Committee

4. Organisation of future work

5. Closing of the session

ANNEXE II

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