

CLIFFORD CHANCE COLLABORATES WITH TASKFORCE ON SCALING VOLUNTARY CARBON MARKETS - PUBLIC CONSULTATION PHASE

From our extensive experience in advising clients on emissions trading (both in the voluntary carbon market as well as in the compliance market, e.g. EU-ETS), we have seen that the voluntary carbon markets for emissions trading have, in the past, been criticised for being highly fragmented, with questions also raised about the quality of certain carbon credits that have been issued. Today, however, we are seeing a rapidly growing demand for emissions trading initiatives in the voluntary carbon market (such as offsetting unavoidable emissions).

To satisfy this growing demand, the Taskforce on Scaling Voluntary Carbon Markets ("**TSVCM**") is working to establish the necessary infrastructure for a scaled and high-integrity voluntary carbon market that will address issues around fragmentation and carbon credit quality. As a core collaborator on the TSVCM, Clifford Chance is sharing our deep experience and insights into the voluntary carbon market.

The TSVCM will publish a report in mid-July summarising its findings (to date) of how best to scale up voluntary carbon markets. As part of this process, the TSVCM has recently concluded a public consultation focusing on the establishment of a voluntary carbon market governance body, progressing the standardisation of legal principles and contracts within the market and further consolidating carbon credit requirements. During this public consultation, experts from around the world have had the opportunity to make comments and recommendations on the TSVCM draft proposals for these areas.

Key facts:

- The TSVCM carried out a public consultation in the course of May and June 2021
- The aim of this consultation was to resolve pain points in the development of a voluntary carbon market governance body, standardising voluntary carbon market legal principles and ensuring carbon credits are of an adequate quality
- The TSVCM will publish a report detailing (inter alia) the conclusions of this public consultation in mid-July 2021

IN DETAIL

The public consultation took place between 21 May 2021 to 21 June 2021 and focused on the following three main areas:

Governance

TSVCM participants have emphasized that a lack of voluntary carbon market oversight and governance are key obstacles to overcome in order to increase the quality of carbon credits to a level that gives buyers the confidence to enter the market at scale. Many market players are experienced with the compliance market and demand a high integrity of carbon credits. Although the current market contains certain oversight bodies (e.g. the International Carbon Reduction and Offset Alliance), the TSVCM has concluded that a new umbrella governance body for the voluntary carbon market is required, which is independent, voluntary, stakeholder-led and self-regulating.

The future governance body would have a mandate to implement a set of Core Carbon Principles (namely, a threshold standard for defining high quality carbon credits – the centrepiece of a functioning market) and provide oversight over standard setting organizations and wider participants. As part of the public consultation, the TSVCM set out proposals for the governance body's mandate, funding requirements and operational principles.

Legal Principles & Contracts

A further key issue is the complexity and fragmentation of current voluntary carbon markets. At present - in the absence of proven regulation and standards, and unlike many compliance markets like the EU-ETS - carbon credit purchasers struggle to access truly fungible carbon credit products. This is for a number of reasons including the lack of standardisation of certain key trading terms of such products (for instance, dispute resolution and limitation of liability clauses). Market participants also more widely encounter an ambiguous and uncertain legal landscape, with differences across geographies, heterogeneous supply chains, unclear liabilities and concerns about fraud. These issues act as a significant hindrance to the scaling of the voluntary carbon credit markets.

As part of the public consultation, the TSVCM therefore proposed key general trading terms and best practice recommendations for quality standards on certification and registration of carbon credits. This forms a centrepiece of the legal discussion within the TSVCM working group, where Clifford Chance has contributed its substantial expertise. An eventual aim of the TSVCM following the public consultation is that external bodies, such as the International Emissions Trading Association, the International Swaps and Derivatives Association and the European Federation of Energy Traders will be able to integrate key general trading terms recommended by the TSVCM into their contract templates. This has already been successfully implemented for the EU-ETS and is a key aim for the voluntary market framework.

Credit-level Integrity

The TSVCM established a credit-level integrity working group to support the future voluntary carbon market governance body, which has proposed the key documentation that this governance body will need in order to adequately function. In particular, the governance body will need to develop the Core Carbon Principles which define high-quality carbon credit standards as well as high-quality carbon credits. The credit-level integrity working group has been

focusing on the development of the Core Carbon Principles and these principles will ultimately aid the market in adequately mitigating for key concerns of carbon credit purchasers such as additionality, permanence and leakage.

Looking forward and in the long-term, a key benefit of increased uniformity of the legal nature of carbon credits across jurisdictions is that it would allow further clarity around rules on their treatment (with respect to protection or taxation). The TSVCM has therefore called on international legal bodies (e.g. ISDA) to issue positive legal opinions on the legal nature of carbon credits and on intergovernmental bodies (e.g. UNFCCC) to provide respective recommendations, ideally in collaboration with market participants and regulators. Further, the TSVCM invites jurisdictional regulators to review their treatment of voluntary carbon credits with the aim of providing further guidance on their legal nature, aligned across jurisdictions.

We predict that, over the next 30 years, a huge amount of capital will flow into projects which reduce, avoid, sequester, and/or remove carbon. For quite some time we have accompanied and guided an increasing number of banks, financial institutions and corporates entering this space. A well-functioning voluntary carbon market will be fundamental to ensure these new market participants have access to liquid carbon credit products.

We view the work of the TSVCM to be crucial in improving liquidity in the voluntary carbon markets. As such, we have been involved as a Member of the Consultative Group of the TSVCM (focusing on the standardisation of legal principles) and will continue to consult with the TSVCM going forward. Following the public consultation, the TSVCM will release its report on (inter alia) the outcomes of the public consultation in mid-July 2021. If you have legal queries which you would like to raise in respect of the TSVCM's work, the development of your carbon (offset) projects or carbon trading more generally, please reach out to a Clifford Chance team member below.

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