

Preliminary Report on the Inclusion of an Applicable Law Provision in the draft UNIDROIT Principles on the Legal Nature of Verified Carbon Credits (VCCs)

***to the Informal Subgroup on Private International Law
of the UNIDROIT Working Group on VCCs***

14 November 2024

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Preliminary Report on the Inclusion of an Applicable Law Provision in the draft UNIDROIT Principles on the Legal Nature of Verified Carbon Credits (VCCs)

to the Informal Subgroup on Private International Law (Informal Subgroup)

- 1 This Preliminary Report was drafted at the invitation of the UNIDROIT Secretariat and the UNIDROIT Working Group on the Legal Nature of Verified Carbon Credits (WG on VCCs). The HCCH was invited to provide input to the discussions by the WG on VCCs on the inclusion of a provision on the determination of the law applicable to VCCs in the draft UNIDROIT Principles on the Legal Nature of VCCs (draft Principles).¹
- 2 This Preliminary Report recommends that the draft Principles include a provision that the Principles do not impact on private international law (PIL) relating to VCCs. This recommendation is in line with the provisions included in other model laws relating to private law on other issues,² and referring to more elaborated work being undertaken at the HCCH.
- 3 If the UNIDROIT Members find that the draft Principles would nevertheless be incomplete without a more elaborated applicable law provision, they may want to consider including a placeholder for an applicable law provision that may be included after multilateral consultations on a holistic approach to the PIL relating to VCCs (on jurisdiction, applicable law, recognition and enforcement, and international cooperation mechanisms) are undertaken and completed at the HCCH.
- 4 This Preliminary Report elaborates on the reasoning behind this recommendation, focusing on general PIL considerations (I), the specific considerations raised by the carbon markets (II), and some particular PIL considerations in relation to the draft Principles (III). The Preliminary Report goes on to discuss, by way of illustration, various analogies that could be drawn on in identifying PIL issues relating to VCCs (IV), including:
 - a. contractual arrangements;
 - b. digital representations;
 - c. registration and inter-registry transfers; and
 - d. rights connected to immovable property.

I. General PIL Considerations

- 5 We understand that the Informal Subgroup has been requested by the UNIDROIT WG on VCCs to consider only applicable law, and in relation to the very specific and narrow context of proprietary and insolvency law issues arising from the holding of VCCs. We have considered at length both the objective of the request by UNIDROIT to consider only applicable law in order to provide input in this document that is helpful to achieving the aims of the UNIDROIT WG.
- 6 However, it is important to note that PIL is a discipline with objectives and methodologies distinct from private law. Indeed, PIL and the harmonisation of private law are generally viewed as alternative

¹ The draft Principles referred to in this Preliminary Report is the text of the draft Principles on the Legal Nature of Verified Carbon Credits (“draft Principles”) circulated by the UNIDROIT Secretariat to the UNIDROIT WG on VCCs on 27 June 2024. Following on information provided by representatives of the UNIDROIT WG on VCCs at the meeting on 16 July 2024, this Preliminary Report is premised on the understanding that the scope of any applicable law provision included in the draft Principles would be specific to the proprietary issues relating to VCCs.

² See, e.g., Art. 19.2 of the UNCITRAL 2017 Model Law on Electronic Transferable Records, which reads “2. Nothing in this Law affects the application to electronic transferable records of rules of private international law governing a transferable document or instrument.” See, also, Article 1.4 of the UNIDROIT 2016 Principles of International Commercial Contracts, which reads “Nothing in these Principles shall restrict the application of mandatory rules, whether of national, international or supranational origin, which are applicable in accordance with the relevant rules of private international law.”

strategies for dealing with the risks arising from cross-border private legal relations, although they can also work in a complementary way. For this reason, pausing to consider the broader PIL issues – and in relation to each of the three PIL pillars of applicable law, jurisdiction, recognition and enforcement, as well as the HCCH's fourth pillar of international cooperation mechanisms – is essential to the practical success of any applicable law rule. Various HCCH instruments and discussions within the context of ongoing normative projects point to the need of a holistic PIL analysis so that the interplay between the different PIL aspects is properly considered.

- 7 From this, while pausing to consider broader PIL issues might not be considered within the mandate of the UNIDROIT WG on VCCs and thus not an obviously necessary use of the WG's time, the wider PIL issues remain relevant for both practical and policy reasons. The two core issues are listed below to expand upon the view that simply inserting an applicable law provision into the draft Principles without considering and multilaterally consulting on the many aspects engaged in any PIL analysis would be ill-advised. As such, in the case that the UNIDROIT WG on VCCs considers it necessary to include an applicable law provision into the draft Principles, given the mandate of the HCCH, it will be best to allow time for the HCCH to undertake multilateral consultations on a holistic approach to PIL, in order that any applicable law provision included is suitable and effective.

A. The Relationship between Jurisdiction and Applicable Law

- 8 Traditionally, PIL has had an emphasis on applicable law. However, it is important to recognise that modern PIL has three equally important pillars: jurisdiction, applicable law, and the recognition and enforcement of judgments. A lack of coordination between the rules of jurisdiction and applicable law may result in gaps and inconsistencies or have other unintended effects.³
- 9 Although a focus on jurisdiction is more traditionally associated with common law legal systems, there is an increased recognition in civil law jurisdictions of the influence that jurisdiction exerts over applicable law in modern PIL. There are many reasons why this is so, including that the forum decides: (a) which law governs through (in part) application of its applicable law rules; (b) which particular applicable law rule should be applied in any given case following an exercise in characterisation; and (iii) whether the law to which that applicable law rule points should be overridden by the mandatory rules, or have its application excluded by the public policy, of the forum. These considerations are addressed below briefly in turn.
- 10 A first point to note is that each court applies its own applicable law rules. Whether an applicable law rule adopted as part of one legal system will be effective to determine the law that governs is thus dependent on whether the question arises for resolution in the courts of that legal system, or elsewhere, which will be determined by rules of jurisdiction. More broadly, one motivation for harmonisation of applicable law rules is to reduce the potential risk of conflicting judgments arising in

³ See, e.g., the considerations of the connections between applicable law and jurisdiction in the Explanatory Report on the *Convention of 19 October 1996 on Jurisdiction, Applicable Law, Recognition, Enforcement and Co-operation in respect of Parental Responsibility and Measures for the Protection of Children* (1996 Child Protection Convention), in relation to its Art. 15: "88. The application to measures of protection of the internal law of the authority exercising jurisdiction is general and applies whatever may be the basis for jurisdiction on the part of this authority. The re-ordering of bases for jurisdiction in favour of the authorities of the State of the child's habitual residence will have as a consequence application of the law of this State distinctly more frequently than under the 1961 Convention, which leaves a rather large scope to the national authorities and thus to the child's national law. [...] However, in order to compensate for the greater rigidity of the jurisdictional rules, the Convention gives more flexibility to the determination of the law applicable to the measure of protection. [...]". See P. Lagarde, "Explanatory Report on the HCCH 1996 Child Protection Convention", in *Proceedings of the Eighteenth Session* (2005), Tome II, *Protection of Children*, The Hague, SDU Publishers, 1998, 535-605. The HCCH has highlighted in its 1996 Child Protection Convention and the *Convention of 13 January 2000 on the International Protection of Adults* (2000 Protection of Adults Convention) the importance of establishing an integrated approach to PIL by addressing applicable law, jurisdiction, recognition and enforcement and cooperation within a single instrument. This integration ensures that there are no gaps or conflicts between these different aspects.

a dispute, but the degree of this risk is also dependent on whether more than one court may have jurisdiction.⁴ The design of an applicable law rule, which may in part be motivated by responding to risks of inconsistent decisions arising, may thus depend on the jurisdictional context in which it operates.

- 11 A second point relates to the role of the forum in the characterisation of the dispute. In the context of the draft Principles, the role of characterisation is particularly important as the UNIDROIT WG on VCCs appears to only be looking at proprietary issues arising from VCCs and conditioning an applicable law provision on the characterisation of VCCs as items capable of being subject to proprietary rights. Characterisation, or classification, is the process by which courts identify which particular applicable law rule is engaged by the nature of the cross-border legal issue that requires resolution under a foreign law. It exerts a considerable influence over how applicable law rules are applied in practice. Unless the court characterises the legal issue requiring resolution as being, for example, proprietary, the applicable law rules for property issues will not be applied. Characterisation is, furthermore, generally recognised as an issue determined by the law of the forum.
- 12 While the classifications used for applicable law rules tend to mirror private law categories, such as contract, property, or tort / delict, the complexity of the characterisation process should not be underestimated, nor should the extent to which private law categories and PIL categories align be overestimated. The classification of a legal relationship or issue within a domestic private law system and their characterisation within PIL are different processes, carried out for different purposes.
- 13 In consequence, it is important to note that private law and PIL differ significantly in how they approach the legal terms they use in common. There is, for example, a general acceptance that characterisation in PIL of legal issues is to be approached in a broad internationalist manner without undue constraints imposed by domestic classifications.⁵ This means that many legal concepts used in domestic private law contexts will not always fit neatly into the categories generally used in PIL, and that domestic courts might well classify the same issue differently for the purposes of domestic private law and of PIL. For example, the common law property torts are notoriously difficult to fit into the PIL categories of either tort / delict or property / rights *in rem*.
- 14 A third reason why the determination of the applicable law and consideration of jurisdiction go hand in hand is that elements of the applicable law may be taken from forum law. This includes, for example, forum “mandatory rules” which are rules which apply regardless of the applicable law, potentially subject to their own scope constraints. It may also include domestic public policy, which can exclude the application of foreign rules of law which would be considered contrary to the public policies or fundamental values of the forum. Although in some circumstances courts may apply foreign mandatory rules, in general the applicable mandatory rules and public policy are taken from forum law, which is again determined by rules of jurisdiction.
- 15 An applicable law rule is therefore only one part of determining the law which governs a legal relationship or issue, and in practice PIL codifications of applicable law rules and international instruments invariably also contain provisions dealing with other issues such as mandatory rules, public policy, and the distinction between questions of procedure (governed again by forum law) and questions of substance, as well as potentially specialised rules dealing with particular sub-questions which may arise.

⁴ The HCCH has established since 2021 a Working Group (WG) on matters related to jurisdiction in transnational civil or commercial litigation. The WG has continued to progress work on the drafting of core provisions of a possible future instrument that covers both parallel proceedings and related actions or claims.

⁵ A. Briggs, *Private International Law* (2nd ed 2023) p. 44.

B. Policy Considerations for Applicable Law Rules

- 16 A further issue relating to applicable law rules which should be noted is their policy implications. Historically, PIL rules have sometimes been under-analysed from a policy perspective as they have been considered highly technical and attention has been focused on their impact in practical cases. Modern PIL practice and scholarship recognise that whilst PIL is undoubtedly a technical field, it involves very important policy considerations. Policy considerations are not only found in the application of the public policy exception discussed above, but should inform both the design of PIL rules and also the design and operation of exceptions.
- 17 An applicable law rule is not simply a rule to give private parties greater certainty over their rights in a cross-border context – it also allocates, or as discussed above is part of allocating, regulatory authority from a private law perspective to a particular legal order (or, under one approach, it would give private parties the power to make that allocation themselves, perhaps subject to certain limitations). The question of who ought to have that authority, which also ties into the PIL question of jurisdiction, is a much broader question which needs careful consideration of the range of interests it impacts.
- 18 This range of interests would include those of different States which may be affected in different ways by particular applicable law rules. In this regard the HCCH processes would be helpful in framing suitable and effective applicable law rules. The HCCH processes are designed to facilitate wide consultation of different States and other interested parties, which allow for the various interests affected by PIL rules (including applicable law rules) to be discussed and debated. If common ground can be found on rules which balance these interests, then the process of drafting an applicable law provision to reflect this common ground is undoubtedly technical, but that should not obscure the importance of the underlying policy questions and ensure that decisions are made through processes which allow for their identification and discussion. Drafting an applicable law provision without these processes could raise legitimacy concerns, and would in any case risk undermining the adoption of the rules as a whole as States may consider that there has been insufficient opportunity for policy interests (including the potentially different perspectives of developing and developed States, among others) to be ventilated and debated.

C. Summary of General PIL Considerations

- 19 For the foregoing reasons, it should be kept in mind that modern PIL is far broader than the traditional focus on applicable law. To ensure the effectiveness in practice of any applicable law rule, including in the draft Principles, it is necessary to: (i) undertake a comprehensive analysis of the interconnected PIL issues of jurisdiction, and recognition and enforcement; and (ii) consider and multilaterally consult on the underlying policy that the rule is intended to further.
- 20 We therefore recommend that any applicable rule is drafted having considered all the relevant issues in a holistic way.

II. Specific Considerations Raised by Carbon Markets

- 21 The policy aspects of all three PIL pillars are particularly complex in the context of the carbon markets. The carbon markets comprise a complex web of diverse contractual arrangements, often specific to the nature of the projects,⁶ and occurring in a vast array of modalities which vary as to industry actors. They also engage public policy considerations, for example, because of the underlying public objectives

⁶ E.g., Verra's requirements for Agriculture, Forestry, and Other Land Use (AFOLU) projects that carry a non-permanence risk. Project Proponents are required to sign a deed, which imposes an obligation to compensate the buffer account where the project faces a reversal event. See Section 3.2.26 of "VCS Standard, v4.7", available at <https://verra.org/wp-content/uploads/2024/04/VCS-Standard-v4.7-FINAL-4.15.24.pdf>

of the carbon markets, and because particular projects often engage public interests, such as those relating to land usage. These considerations form the legal and policy framework for the analysis of PIL questions arising in relation to carbon credits.

- 22 Below, three of the most pressing issues are expanded upon.

A. Public Policy Considerations

- 23 The nature of carbon markets raises specific public policy considerations, which as noted above may affect both the design of an applicable law rule and its operation. Although voluntary carbon markets are mostly based on contractual and other relationships which are regulated by private law (which currently exist in some jurisdictions) and rules of PIL (which are currently mostly lacking), these markets are also understood as serving a broader public purpose, and potentially engage important national interests such as local environmental concerns, or in some cases competing claims over land rights (such as those of local or indigenous communities). Although compliance markets may be subject to greater direct public governance, voluntary markets also engage similar public interests, and in any case, there is widespread recognition of the increasing convergence between the two.⁷
- 24 For instance, VCCs can be used for compliance purposes. It is for that reason that some standard setters will issue credits that meet compliance requirements in case the holder wishes to use the credit for compliance purposes.⁸ Equally, some jurisdictions with compliance schemes provide lists of approved methodologies for each carbon crediting programme that can be accepted for offsetting purposes.
- 25 An issue of significance here is the matter of national carbon credit registries and inter-registry transfers of carbon credits. Several States have established or are developing national registries for carbon credits, which include credits in both compliance and voluntary markets. Such registries would help in addressing the matter of Nationally Determined Contributions (NDCs) and in general, ensuring transparency and avoiding double-counting.⁹
- 26 It is also important to appreciate that activity which takes place between private parties may nevertheless engage public interests. For example, even if some carbon credit registries are operated by private parties, if the law of one State gives effect to a registry as a determination of legal title this could raise broader public policy concerns. These concerns may relate to the recognition and enforcement of legal documents, as well as issues such as forum shopping and the potential unfair favouring of certain stakeholders over others. Further work would be required, in close consultation with a variety of jurisdictions, to ensure that these different concerns are mapped and common ground solutions envisaged.

B. Range of Diverse Private Interests

- 27 Transactions in the carbon markets engage a range of different private interests broadly, e.g., from landowners on whose land projects are carried out, investors on technology relating to carbon sequestration, to private entities interested in using credits from the voluntary market to fulfil their

⁷ See, e.g., the ICVCM (Integrity Council for the Voluntary Carbon Market) recent commentary on the integrity standards to support private sector transition to Article 6 markets: <https://icvcm.org/article-6-of-the-paris-agreement-and-the-integrity-councils-work/>

⁸ See, e.g., the Gold Standard's parallel registration process, where a project can apply for registration under the GSVER (Gold Standard label for Verified Emission Reduction) and GSCER (Gold Standard label for Certified Emissions Reductions) streams at the same time, pending UNFCCC approval for compliance purposes. If UNFCCC approval is received, the project will be cancelled under GSVER and proceed under the GSCER stream. If subsequently rejected by the UNFCCC, the project can proceed under the GSVER stream. Source: Gold Standard GHG Emissions Reduction and Sequestration Product Requirements V2.4.

⁹ See, e.g., in Colombia (RENARE), Brazil (SINARE)

compliance obligations. Among these are also project proponents, the carbon setters, the validation and verification bodies, the private registries, and affected indigenous and local communities. The objective of scaling the voluntary markets is only one private interest amongst many. Such interests are also to be contextualised in a wide diversity of fields in which carbon projects are carried out. These projects can range from initiatives in relation to forest conservation to the improvement of agricultural, industrial and waste management processes, the use of oil and gas, and different chemical processes, to name but a few.

- 28 Therefore, one important aspect for the consideration of an applicable law rule is the range of diverse actors, with diverse private interests, which would impact on such rules. For example, concerns have been raised in different case law raising the interests of communities that may not have title over the land on which some of the projects are carried out, but which do have rights of use over such land.¹⁰ There are, furthermore, complex legal relationships that directly or indirectly relate to the circumstances behind carbon market projects, and which are not only pertaining to those contractual arrangements specific to the development of a carbon project (as further explored below in para. 46), but which will also be impacted by eventual applicable law rules in relation to the credits.

C. Carbon Credit Lifecycle

- 29 PIL issues arise at all stages of the carbon credit lifecycle among a wide network of parties located in different jurisdictions. PIL questions arise, for instance, from the origins of the relevant carbon project, the issuance of the credit, the matter of revocations, retirement, and the different commercial transactions that may take place involving carbon credits (e.g., trading, granting of security rights, insolvency matters).¹¹
- 30 Given the complex and interconnected nature of these questions, one particular PIL question arising at a specific moment / stage of the lifecycle cannot be examined in isolation. If applicable law rules were to be developed with a focus on a particular moment or lifecycle stage, it would be necessary to consider not only the suitability of the rule for that moment / stage, but also how or whether that rule would affect the applicable law both before and after that moment / stage, and the implications of possible changes in applicable law during the lifecycle.

D. Summary of Carbon Markets Considerations

- 31 The carbon markets engage a range of diverse and complex interests, both public and private.
- 32 Solutions to PIL challenges arising in relation to VCCs should therefore involve a broad multilateral consultation on the various policy issues and taking into consideration the diversity of the stakeholders that are engaged. This would better allow the different interests and potentially different perspectives to be ventilated, with the support of technical experts who can then find the best way to draft any solutions that are agreed upon. The drafting of an applicable law rule by a technical group for insertion into the draft Principles, in isolation from any multilateral consultations, would raise significant legitimacy concerns.
- 33 For this reason, we are reluctant to propose any tentative solutions, except by way of pointing out a number of different analogies that could be drawn, and the range of different factors that could be relevant from a PIL perspective to start a discussion on further necessary work.

¹⁰ This is the case, e.g., in the Jari Pará Project in the Amazon in Brazil, and in Peru the case of the Kichwa Community concerning specific carbon projects.

¹¹ See paras 11-21 of “Proposal for Exploratory Work: Private International Law Issues related to Carbon Markets”, Prel. Doc. No 7 REV REV of March 2024 available on the HCCH website at www.hcch.net under “Governance” then “Council on General Affairs and Policy” and “Archive (2000-2024)”.

- 34 Without multilateral consultation, there is a clear risk of adopting a rule which may not only fail to adequately consider and balance relevant policy considerations and different private interests, but which may indeed have harmful consequences for the functioning and impact of carbon markets, or for the likely adoption of the draft Principles as a means to facilitate their growth and their positive contribution to climate change mitigation.

III. PIL and the Draft Principles

- 35 Turning to the draft Principles themselves, there are additional technical factors that require independent consideration.
- 36 Several identified technical challenges are discussed below.

A. Scope / Objective of the Intended Applicable Law Rule

- 37 It seems that a formal decision is yet to be taken by the WG on VCCs as to whether the intended applicable law rule is to complement draft Principle 3(1) and prescribe the scope of application of the draft Principles; or to complement draft Principle 3(3) and identify which particular (national) “other law” will apply to the issues that that sub-paragraph covers. Both options raise further technical considerations, which are discussed in more detail in subsection III.B.
- 38 Notwithstanding any such decision on form, however, we understand that the WG is primarily concerned with an applicable law rule that will answer the question of what kind of rights the holder of the VCC has (including if that holder would have proprietary rights).
- 39 If this is indeed the main consideration, the immediate question may be whether the question might more appropriately and substantively be answered as a matter of “Principles law”. To some extent, addressing cross-border legal risk through the strategy of harmonised private law, as opposed to the alternative strategy of applicable law rules, can be more effective in providing legal certainty to market participants and stakeholders. The WG on VCCs may want to consider how best to achieve its ultimate objectives, before taking decisions as to how those objectives might best be met using the alternative, and sometimes complementary, tools of uniform / harmonised private law and PIL.
- 40 If PIL does emerge as the preferred solution for the WG’s objectives, other formal considerations include the extent to which the intended rule is to be a default rule – applicable only in the absence of an existing or valid choice of law – and possible limitations to party autonomy and the recognition of agreements or other provisions in relation to applicable law. It would also be important to consider whether other common applicable law provisions, such as those relating to mandatory rules or public policy exceptions, are included or excluded, and how these are framed – for example, whether provisions on mandatory rules recognise in some cases the possibility for the application of foreign mandatory rules.

B. Relationship Between Private Law and PIL

- 41 As noted above, private law and PIL are distinct disciplines with different approaches to legal terms used in common. Here, it is worth emphasising that PIL is not bound by private law considerations or definitions. This is because the way in which private law and PIL interact has some important technical consequences for any intended applicable law rule. From this, irrespective of whether the intended applicable law rule is to complement draft Principle 3(1) or Principle 3(3), both options are not without some technical difficulty.

- 42 We understand draft Principle 3(1) to be the core Principle, and appreciate that the WG is concerned that the draft Principles should have an applicable law rule to complement its core Principle. However, draft Principle 3(1) is an unusual candidate for an applicable law rule.
- 43 The WG has acknowledged that the UNIDROIT VCCs project has a clear objective in helping the carbon markets scale and therefore may be more normative in approach than expected. Accordingly, the WG has also concluded that it is necessary for VCCs to be “capable of being the subject of proprietary rights”. These objectives are reflected directly in draft Principle 3(1).
- 44 As drafted, it may be difficult to consider the PIL issues arising from draft Principle 3(1). In the Informal Subgroup’s first meeting of 16 July 2024, it was discussed that, whilst a greater degree of specificity might indeed help narrow down the range of plausible connecting factors, the current form of draft Principle 3(1) does not necessarily preclude or impede a valid PIL analysis. Again, it is important to recognise that private law and PIL are distinct legal disciplines.
- 45 Nevertheless, the way in which draft Principle 3(1) has been drafted does have some bearing on the outcome of any PIL analysis. It is important to note that such outcome might diverge from, or even contradict, what is drafted on the face of draft Principle 3(1). Much will turn on the characterisation process (as explained in section I.A above) undertaken by the forum applying its own law. It may well be that the competent court might conclude that a VCC cannot be an object of proprietary rights, such that none of the issues that relate to the rights of the holder are proprietary issues. Given the broad way in which draft Principle 3(1) has been drafted, there is considerable scope for such conclusion to be validly reached as a matter of characterisation.
- 46 Furthermore, the complex contractual frameworks underpinning the way in which VCCs are being issued, verified, registered, held, transferred, retired, and generally processed or dealt with throughout their lifecycle are likely to hold significant weight in the characterisation process. In particular, contractual clauses that expressly define what a VCC “is”, prescribe the rights that a holder acquires and the obligations that the issuer undertakes,¹² and set out a choice of forum and choice of law¹³ are likely to militate towards a contractual characterisation of any issue to come before the courts. To

¹² *E.g.*, concerning the cancellation and retirement of Instruments, Verra’s Registry Terms of Use (April 2024) establish that “8.2. The User acknowledges and agrees that, if the User wishes Verra to cancel or retire Instruments, upon such cancellation or retirement: (a) all legal and beneficial title and interests in such Instruments will be extinguished; and (b) neither Verra, the User, nor any other person with Legal or Beneficial Ownership Rights will have any further rights to take the benefit of such Instruments nor the underlying Environmental Benefits corresponding to such Instruments.” In relation to “Legal Title to Instrument”, Verra’s Registry Terms of Use establish that: “9.1. Notwithstanding anything in Clause 6, the User acknowledges and agrees that Verra does not in any way guarantee legal title to the Instruments and the User relies on any content obtained through the Verra Registry at its own risk.”/ “9.2. For the avoidance of doubt, Verra is under no obligation to verify or otherwise enquire into the validity of, or legal title to, the Instruments or any Related Instruments and does not recognize any interest in an Instrument or any Related Instruments other than the interest of the entity named as the holder of the Instrument in the Registry or any Approved Sub-Register.” Concerning third party claims or interests, according to Verra’s Registry Terms of Use, Clause 21.2 establishes that, “[e]xcept as set forth elsewhere in these Terms of Use, these Terms of Use confer no rights whatsoever upon any person other than the parties and shall not impose, or be interpreted as imposing, any standard of care, duty, or liability upon any person other than a party.”

¹³ UNIDROIT WG 2, paras 220-228 (Verra); WG 1 para. 60 Gold Standard. See, *e.g.*, the Dispute Resolution clause under the Gold Standard Terms and Conditions, which establish that “Governing Law. These Terms and Conditions are governed by the laws of Switzerland, without regard to its conflict of laws rules. These laws will apply no matter where in the world You live.” See also the similar provision from the American Carbon Registry Terms of Use “Governing Law. These Terms of Use shall be governed in all respects by the laws of the State of Arkansas, USA, without giving effect to any choice or conflict of law provision or rule. Account Holder understands and agrees that all transactions take place in Pulaski County, Arkansas and agree that the federal and state courts located in Pulaski County, Arkansas have exclusive jurisdiction over any disputes with ACR arising from or related to these Terms of Use. Account Holder irrevocably consents and submits to the exclusive personal jurisdiction of that court, and Account Holder irrevocably waives any jurisdictional, venue, or inconvenient forum objections to such court.”

the extent that the issue might arise from transfers of a VCC, express provisions defining VCCs as a claim¹⁴ may well lead a court to the applicable law rules on the assignment of claims.

- 47 From this, although the way in which draft Principle 3(1) has been drafted does not necessarily preclude a PIL analysis, its broad formulation and normative nature will meet with some technical PIL difficulties that will need to be carefully considered further if the intended applicable law rule to complement draft Principle 3(1) is to function as intended. One important point is that the WG on VCCs may need to decide whether the draft Principles are intended to override these contractual frameworks, which clearly set out the rights of a holder, in favour of the draft Principles.
- 48 Draft Principle 3(3) raises different considerations. On the one hand, the issues left to “other law” are far more conventional candidates for applicable law rules. On the other hand, it would be difficult to justify the inclusion of applicable law rules for issues expressly excluded from the scope of the draft Principles. If the concern is that draft Principle 3(3) would be incomplete without complementary applicable law rules to determine what rights a holder of a VCC may have, the WG may want to consider addressing these within the substantive scope of the draft Principles rather than leave them to “other law”.

C. Tokenisation

- 49 VCC tokenisation was alluded to at the first meeting of the Informal Subgroup on 16 July 2024 as one of the issues that will arise and should be discussed. There was a suggestion that VCC tokens would fall under the “linked assets” category, following on the UNIDROIT Principles on Digital Assets and Private Law (PDAPL).
- 50 In this respect, it is important to note that the PIL issues arising from “linked assets” were discussed at the second working meeting of the HCCH Digital Tokens Project, which concluded on 8 October 2024. After some debate, it was generally accepted that the question of “the law governing the link” is somewhat misplaced. To the extent that the issue asks whether the person holding the token has any rights in the underlying “linked asset”, the question of whether the link is “effective” is rather one of substantive law. Such law would be identified by the traditional PIL rules that may apply to the issue of entitlements to or arising out of the “linked asset”.
- 51 It is anticipated that further work may be undertaken by the HCCH Digital Tokens Project in relation to sub-divisions of “linked assets”, with possible exclusions or special rules for particular types of underlying assets. Although carbon credits are currently expressly excluded from the work of the Digital Tokens Project by mandate, if the WG on VCCs considers that the tokenisation of VCCs would simply be a matter of “linked assets,” then the work carried out under the HCCH Digital Tokens Project would have direct implications on an applicable law provision relating to VCC tokens.

¹⁴ E.g., according to Verra’s VCS program definitions, a verified carbon unit (VCU) is a unit issued by and held in the Verra Registry representing the right of an account holder in whose account the unit is recorded to claim the achievement of a GHG emission reduction or removal in an amount of one (1) metric tonne of CO₂ equivalent that has been verified by a validation/verification body in accordance with the VCS Program rules. (Source: VERRA VCS Program Definitions v.4.5/April 2024). In Verra’s Registry Terms of Use, the term “instrument” is used to designate “a unit issued by, and held in the Verra Registry representing the right of an accountholder in whose account the unit is recorded to claim the achievement represented by the unit. Such achievement may include, but is not limited to, a GHG emission reduction or removal in an amount of one (1) metric tonne of CO₂ equivalent that has been verified in accordance with the applicable Verra Program Rules.”

D. Summary of Draft Principles Considerations

- 52 Further consideration on formal issues, such as scope, objectives, and legal method, is recommended to find the most appropriate and effective way to achieve the WG on VCCs' ultimate objectives as they relate to the inclusion of applicable law rules in the draft Principles.
- 53 The broad way in which draft Principle 3(1) has been drafted does not necessarily preclude or impede a PIL analysis. However, its current form and normative nature will meet with some technical PIL difficulties. Further consideration should be given to how PIL techniques might be used to overcome these difficulties to ensure the intended applicable law rule functions as intended. The same considerations may affect draft Principle 3(3).
- 54 Tokenisation of VCCs is highly likely to be impacted by the HCCH Digital Tokens Project.

IV. PIL Analogies for VCCs

- 55 Below is a sample of analogies taken from other areas of PIL that serve to illustrate the discussions raised by the considerations above. It is not suggested that this list is exhaustive, or that a simple choice has to be made between these models, but these analogies are illustrative of the complexity attached to the range of solutions which may be adopted reflecting the different policy considerations which arise in designing applicable law rules for different types of issues and, in particular, different types of property.
- 56 Further analogies other than those elaborated in this section could be pursued, for example, on the basis of the law governing obligations and other issues arising under negotiable instruments. There also remains the possibility that the nature of the intangible property being considered in the case of VCCs is *sui generis* and would require a novel approach in PIL. The analysis below is preliminary, and further work would be necessary to consider both technical and policy implications of different possible approaches.

A. Contractual Arrangements

- 57 One possible analogy for VCCs would focus on the underlying contractual arrangements through which the VCC is created, such as the contracts between a project proponent and the validation and verification body and / or the independent carbon standard setter. This approach would suggest drawing on the applicable law rules which have been developed in the context of assignments of contractual rights. This is a complex area, particularly as the legal characterisation of contractual rights may differ between legal systems, but solutions generally focus on the law applicable to the contract under which the right was created, which may be selected through party autonomy (although this is typically subject to both general constraints and limitations for particular types of contracts) or, in the absence of a choice, through a rule which focuses on the parties or their obligations. The suitability of such a rule for the context of VCCs, and in particular whether such a rule would fit with the proprietary character of VCCs as proposed in the draft Principles, would need careful consideration.

B. Digital Representations

- 58 Another possible analogy would focus on the anticipated market for trading in digital representations of VCCs, and consider the classification of a VCC as comparable to a digital asset and its characterisation as intangible property. The simple adoption or adaptation of rules developed for other digital assets would, however, be very likely to be unsuitable, given the connection between the VCC and an underlying real world "asset" (whether that asset is understood to be in the form of contractual rights, or rights connected to an underlying project such as a restriction on land use). It would be

necessary to consider whether or how the applicable law provision for the digital representation of the asset would relate to the real-world asset it represents, as discussed above. If the digital representation were considered to exist as a standalone object, subject to its own applicable law rule, it would still be necessary to consider the further question of what law would govern the legal effect that rights in the digital representation would have in relation to the underlying asset. An applicable law rule for the digital asset could, for example, be ineffective if the jurisdiction in which the relevant mitigation project is carried out considers that title to the underlying asset should be determined by a different law or be subject to overriding mandatory provisions or public policy of the jurisdiction.

- 59 Differences among the VCCs would also need to be considered in this kind of analysis as they might also account for the different ways in which VCCs are linked to real world assets (as in the case of nature-based projects) and, more generally, careful consideration should be given to the particular ways in which VCCs can be cancelled, suspended, revoked, reversed and / or retired in contrast with (other) digital assets.

C. Registration and Inter-Registry Transfers

- 60 Another possible analogy would focus on the process of registration of VCCs. As in other areas of law when applicable law provisions are indicated for registered or registrable intangible property (such as in relation to intellectual property), consideration could be given to the law of registration of the property. If a registry does not have a specific location, however, this raises further complex and controversial questions concerning the possibility of a choice of applicable law for or by a registry. The appropriateness of such an analogy would also require very careful consideration in the case of private registries, which raises challenges in relation to the ability of private entities to create property rights. Careful consideration would also need to be given to the contours of the application of the *lex registri*, and the question of what law would govern the legal effect which the registry would have in relation to the underlying asset.
- 61 Other factors that would impact the consideration of this analogy include the type of registry (whether it is public or private), as well as whether the registration will be publicised and the process of serialisation / fractioning of the relevant units. A further complication relates to the possible developments in the inter-registry transfers of VCCs, and the complex web of contractual arrangements that may result from such inter-registry transfers.

D. Rights Connected to Immovable Property

- 62 Given that a large portion of VCCs is created by nature-based projects concerning, for example, forestry and land use, another crucial analogy to be considered is that of rights connected with immovable property. For example, if an agreement is reached with a landowner to stop or prevent deforestation, determining if the rights involved may be considered rights *in rem*, and if so, what law would govern transactions involving those rights, could be considered a matter for the *lex situs* of the property. Different legal systems deal with rights *in rem* in different ways. In particular, some systems provide for a closed, *numerus clausus* list of rights *in rem* attached to certain types of property. Public policy, mandatory regulatory rules and other public registration issues concerning land use will also weigh in the consideration of the applicable law, which limit the rights associated with the land use. Further complexity is added if the land in question is, for example, in public ownership, is indigenous land or land in which conservation projects are subject to environmental regulation for the purposes of protecting that land, the environment, and affected indigenous and local communities. These questions would not only impact on applicable law considerations as a result of domestic regulations: the application of international treaties that provide for specific rights associated with the use of the land will also play a role in scoping any applicable law provision.

V. Conclusion: Recommendations to the WG on VCCs

- 63 The issues raised in this Preliminary Report are aimed at ensuring a coherent PIL framework for VCCs. The examination of issues relevant for the determination of applicable law, and the drafting of any applicable law provision on proprietary issues related to VCCs should be undertaken in line with other general applicable law considerations (including non-proprietary issues), as well as matters relating to jurisdiction and to recognition and enforcement. Applicable law considerations will need to be nuanced with the complexities of the market, its stakeholders, and the existing legal arrangements (including contractual) that underpin the individual stages of the lifecycle of the credits, each of which should not be singled out and considered in isolation from the others.
- 64 In order to ensure future acceptance of an applicable law rule by the largest number of jurisdictions, it is essential that multilateral consultations with States representing different legal systems be undertaken ahead of the adoption of an applicable law principle. As it currently stands, we are not in the position to endorse the approach in which an applicable law provision is drafted without multilateral consultation, *in abstracto* and in isolation from more holistic considerations of other PIL issues.
- 65 We therefore recommend that the WG on VCCs consider including a provision that the draft Principles do not impact on PIL relating to VCCs and refer to more elaborated work being undertaken at the HCCH.
- 66 In case the UNIDROIT Members find that the draft Principles would nevertheless be incomplete without a more elaborated applicable law provision, we suggest that consideration is given to including a placeholder for an applicable law provision that may be included after multilateral consultations on a holistic approach to the PIL relating to VCCs (on jurisdiction, applicable law, recognition and enforcement, and international cooperation mechanisms) are undertaken and completed at the HCCH.

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