

The Legal Nature of Voluntary Carbon Credits: France, Japan and Singapore

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INTRODUCTION

ISDA published a paper in December 2021 that considered the legal implications of voluntary carbon credits (VCCs)¹. Specifically, it investigated the legal treatment of VCCs and considered certain other aspects of VCC transactions, including when they might be regulated as derivatives. It also recommended steps that could be taken to further develop legal certainty in VCCs at both a global and jurisdictional level.

The legal nature of VCCs is currently a jurisdiction-specific question that must be determined by reference to national laws. The 2021 whitepaper explored the legal treatment of VCCs under English, US and German laws.

In response to continued interest in VCCs, this paper considers the legal nature of VCCs under French, Japanese and Singapore laws².

¹ *Legal Implications of Voluntary Carbon Credits*, ISDA, December 2021, www.isda.org/a/38ngE/Legal-Implications-of-Voluntary-Carbon-Credits.pdf

² This paper focuses on the legal definition of voluntary carbon credits (VCCs), as opposed to the regulatory classification, which is a separate issue

FRANCE

Applicability of French Law

French law may be relevant in a cross-border VCC transaction if there is sufficient nexus with France. This could include:

- One or both parties to the transaction are incorporated or organized in France. This is particularly pertinent if the French-law-governed entity is required to meet assets eligibility criteria (as in the case of French collective investment schemes³) or any services relating to VCCs provided to the benefit of a French entity are regulated services;
- The registry specified in the transaction is located in France or the relevant registry rules or terms of use governing the creation, transfer, retirement and cancellation of VCCs in connection with the transaction are governed by French law;
- A French bank, subject to French insolvency laws, acts as an intermediary holding VCCs on behalf of one or both parties to the transaction; or
- The transaction documentation has a French-governing-law clause or is determined to be governed under French law.

When French private international law designates French law as applicable for a specific legal question (such as good title to the asset, effective transfer of ownership, creation of security interest or treatment under an insolvency situation), the determination is driven by the legal characterization of the VCC.

The legal nature of VCCs is not currently addressed specifically under French statutory law. This is in contrast to emissions allowances under the EU Emissions Trading System (ETS) Directive⁴ and certified emission reductions (CERs) and emission reduction units (ERUs) generated under Articles 6 and 12 of the Kyoto Protocol, which the French Environment Code expressly characterizes as “movable property exclusively evidenced by a book entry in the account of its holder in the European registry”⁵ and “negotiable, transferable by transfer from one account to another”⁶. CERs and ERUs are therefore properties on which the holder (holding the account where they are recorded in book entry form) benefits from an ownership right.

To ascertain the legal characterization of VCCs under French law, it is critical to analyze the common features that VCCs share, despite the diversity in VCCs, VCC standards and registry rules. It is also important to understand the legal regimes applicable to certain key issues relating to VCCs.

Any analysis of cross-border VCC transactions that involve French law may raise complex conflicts of laws issues, as well as discrepancies in substantive rules between jurisdictions. This is due to the fragmented and multi-jurisdictional nature of the current VCC market and the absence of an international treaty or convention providing a common statutory regime for VCCs.

³ *Carbon Offsetting by Collective Investment Schemes – A Guide for Asset Management Companies*, Autorité des marchés financiers, March 2019, www.amf-france.org/sites/default/files/contenu_simple/guide/guide_professionnel/Guide_on_carbon_offsetting_by_collective_investment_schemes.pdf

⁴ Directive 2003/87/EC of the European Parliament and of the Council establishing a scheme for greenhouse gas emission allowance trading

⁵ The European registry created by Regulation (EU) 389/2013

⁶ Articles L.229-11 (with respect to emissions allowances) and L.229-22 (with respect to certified emission reductions and emission reduction units) of the French Environment Code

Common Features of VCCs

Broadly speaking, a VCC is a carbon credit, the issuance, transfer, retirement and cancellation of which are governed by the rules of a voluntary standard. VCCs are generated by the reduction of greenhouse gas emissions or a removal project that meets the eligibility criteria of that voluntary standard. A VCC represents a reduction in emissions or removal from the atmosphere of one metric ton of carbon dioxide equivalent of a greenhouse gas.

VCCs are not covered by the EU ETS Directive or the revised Markets in Financial Instruments Directive (MIFID II)⁷ and are not recorded in the European registry created by Regulation (EU) 389/2013. It is a voluntary market (as opposed to a compliance market) instrument that allows private or public entities to voluntarily finance eligible emission reductions or removal projects by purchasing VCCs generated by these projects. Once an entity has obtained a VCC, it can ‘retire’ it and apply it against (and thereby offset) its carbon footprint. At this point, the VCC is permanently taken out of circulation and can no longer be transferred.

In the absence of mandatory regulation dictating the quality and character of VCCs, a variety of carbon offset registries have emerged. Each has its own standards governing the eligibility of projects to receive offsets and the quantification, verification and monitoring of project-based emission reductions. These registries have their own terms of use specifying the conditions under which users may access and use the registries. The standards implemented by these registries ensure the VCCs – and the projects that result in the issuance of VCCs – are acceptable quality and represent actual emission reductions. The registries are also essential in enabling the tracking of offsets from issuance to retirement.

Table 1 provides a summary of the terms of use of the four most prominent voluntary registries (the Climate Action Reserve, the American Carbon Registry, the Verra Registry and the Gold Standard Impact Registry) relating to the title, ownership and transfer of VCCs.

Based on the terms of use of the registries set out in Table 1, and subject to the specific rules of each applicable relevant standard and registry, VCCs are capable of being subject to ownership and are transferable.

⁷ Directive 2014/65 of the European Parliament and of the Council of May 15, 2014 on markets in financial instruments

Table 1: Carbon Offset Registries: Summary of Terms of Use Relating to Title, Ownership and Transfer

| | Climate Action Reserve | American Carbon Registry | Verra Registry | Gold Standard Impact Registry |
|---------------------------------------|--|--|---|--|
| Title and Ownership of Offsets | The user may only hold or retire in its accounts the offsets for which it is the sole holder of all legal title and all beneficial ownership rights, except that the user may: (a) retire the offsets on behalf of third parties that own such offsets: (i) in a group retirement subaccount in compliance with the reporting requirements set forth in § 9(b) of the terms of use; and (ii) with such third parties' written authorization; and (b) hold the offsets in its accounts on behalf of third parties that own such offsets, provided (x) the user: (i) is a regulated person (as defined in the terms of use); (ii) has such third parties' written authorization; and (iii) maintains a reasonable customer identification program, and (y) such third parties' ownership rights are limited to holding the offsets in the user's account for purposes of retirement or future transfer to other registry users. (§§ 3(a)(vi), 9(a)-(c) of the Climate Action Reserve's terms of use) | The user may only hold or retire in its accounts the offsets for which it is the sole holder of all legal title and all beneficial ownership rights, except that the user may: (a) retire the offsets on behalf of third parties that own such offsets: (i) in a group retirement subaccount in compliance with the registry's operating procedures; and (ii) with such third parties' written authorization; and (b) hold the offsets in its accounts on behalf of third parties that own such offsets, provided the user: (i) is a regulated person (as defined in the terms of use); (ii) has such third parties' written authorization; and (iii) maintains a reasonable customer identification program. (§§ 6(a)-(e), 7(j)-(k) of the American Carbon Registry's terms of use) | The user represents that it holds all legal title to and all beneficial ownership rights in each offset held, retired or cancelled in any registry account by the user. (§ 11.1(i) of the terms of use). The registry does not guarantee, and is under no obligation to verify, legal title to the offsets. (§ 9 of the Verra Registry's terms of use) | The user may only hold the offsets on behalf of third parties if: (i) such offsets are held in a sub-account; and (ii) the user has provided satisfactory documentary material as required by the registry to open the subaccount. (§ 7.10 of the Gold Standard Impact Registry's terms of use). If the user requests retirement of any offsets in the registry and the user is found not to have legal title to such offsets, the registry may require the user to provide replacement offsets of a quality and quantity specified by the registry. (§ 12.1 of the Gold Standard Impact Registry's terms of use) |
| Agreement to Transfer Offsets | All offset transactions will be settled or performed by the user and any third party in accordance with such separate agreements as may exist between them. The registry assumes no responsibility for the settlement or performance of any transactions. (§ 4(b) of the Climate Action Reserve's terms of use) | Not expressly addressed | All offset transactions will be settled or performed by the user and any third party in accordance with such separate agreements as may exist between them. The registry assumes no responsibility for the settlement or performance of any transactions. (§ 11.4(d)-(e) of the Verra Registry's terms of use) | The registry is not party to any agreements relating to a project or offset among project developers, buyers or any other parties. (§ 3 of the Gold Standard Impact Registry's terms and conditions) |

Legal Characterization Under French Law

VCCs Are Not Financial Securities (*Titre Financier*)

VCCs are created by the registry in accordance with the relevant standard and registry rules. A VCC is not a security issued by a legal person or a collective investment scheme giving rights or access to its share capital, nor is a VCC a debt security⁸. A VCC would therefore not be considered a financial security (*titre financier*) within the meaning of the French Monetary and Financial Code, which lists financial securities in a limitative manner.

A VCC is also not a 'unit' under the French Environment Code. This includes EU emission allowances, which are incorporated in the French Monetary and Financial Code as a financial security⁹.

⁸ Article L.211-1, II of the French Monetary and Financial Code: "Financial securities include: 1. Equity securities (*titres de capital*) issued by joint-stock companies (*sociétés par actions*); 2. Debt securities (*titres de créances*); 3. Units or shares in collective investment undertakings". Equity securities (*titres de capital*) are further defined by Article L.212-1-A of the same Code as "shares and other securities that give or could give access to the capital or voting rights". L.213-1 A of the same Code further defines debt securities as representing "a claim against the legal entity or securitisation common fund (*fonds commun de titrisation*)"

⁹ Such units are referred to in Articles L229-7-IV of the French Environment Code. Such assimilation stems from the revised Markets in Financial Instruments Directive (MIFID II) Annex I Section C (11)

A spot sale or a physically-settled forward sale of a VCC would therefore not fall within the scope of MIFID II, as covered investment services and activities only relate to financial instruments¹⁰ and units specified under the French Environment Code.

However, futures, forwards, options or swaps on VCCs that are cash-settled or capable of being cash-settled could be considered financial instruments¹¹ under certain conditions. They would then qualify as financial contracts and investment services under MIFID II, triggering the need for an investment firm license and adherence to a code of good conduct (such as best execution requirements and suitability/appropriateness tests). The European Market Infrastructure Regulation would also be applicable.

When a market participant intends to trade with or provide services to a French party relating to VCCs, it is important to assess whether the transaction may qualify as a financial contract (and therefore as a financial instrument).

Certain French regulated entities may not be authorized to own assets that are not financial securities. As a result, appropriate due diligence is necessary before entering into a VCC transaction.

VCCs as Intangible Movable Property (*Bien Meuble Incorporel*)

French law traditionally requires a property (*bien*) to have three fundamental features: (i) it must have a value or be useful, which legally accounts for the desire to have it; (ii) it must be capable of being subject to ownership, which is necessary to allow a person to exclusively use or dispose of the property; and (iii) it must be transferable.

Unlike tangible property (*bien corporel*), intangible property (*bien incorporel*) is not recognized under French law as an autonomous legal category with a specific homogeneous legal regime. From intellectual property and databases to trademarks and a person's image rights, intangible properties are recognized by French law incrementally as they emerge, with a specific set of rules applicable to each of them.

Emissions allowances under the EU ETS Directive, CERs, ERUs and energy saving certificates were recently recognized by statutory laws as movable properties (*biens meubles*) and transferable¹². Unlike these properties, VCCs are not specifically recognized under French law.

However, a VCC has value and can be subject to an ownership right (as per the registry terms of use). The owner can also use the VCC by retiring it and claiming the offset against its carbon footprint, or dispose of it by selling it to a third party. The owner has an exclusive right over the VCC. Therefore, VCCs are capable of being considered as property.

Given its intangible nature, could a VCC be considered an intangible right, such as a claim (*droit de créance*) against a third party? For example, could it be considered a claim against the registry that issued the VCC in accordance with its terms of use and operating rules, or a claim against the project owner performing the emissions reduction capable of generating VCCs?

¹⁰ Pursuant to Article L.211-1 of the French Monetary and Financial Code, financial instruments (*instruments financiers*) include financial securities (*titres financiers*) and financial contracts (*contrats financiers*). Financial contracts typically cover most derivatives transactions

¹¹ As set out in Section C of Annex I to the MIFID II

¹² Article L.229-11 of the French Environment Code with respect to emission allowances, Article L.229-22 of the French Environment Code with respect to certified emissions reductions and emissions reduction units and Article L.221-8 of the French Energy Code with respect to energy saving certificates (*certificats d'économie d'énergie*)

Although a right *in personam* (*droit de créance*) can be an object of property right under French law¹³, characterizing a VCC as a claim against a third party does not reflect the fundamental utility of the VCC. Unlike a claim, the value of which derives from a legal relationship (such as the right to receive payment or obtain performance of an obligation from another person), a VCC is an intangible object/property with its own economic utility for its owner. Parallels can be drawn with EU emission allowances, CERs and ERUs, which are recognized as movable properties by laws that statutorily recognize their transfer with a view to organizing a market.

Certain Applicable Legal Regimes Under French Law

The legal regime applicable to intangible movable property is heterogeneous, absent a recognition *ut universi* of intangible properties under French law. For certain types of intangible property, such as intellectual property, securities, emissions allowances, CERs or ERUs, French law sets out specific rules applicable to the ownership and transfer of ownership of such properties, mainly designed to ensure the legal certainty of transactions in these assets.

The legal regime applicable to VCCs can be considered from four standpoints: (i) title and ownership; (ii) transfer; (iii) the creation of security interest over VCCs; and (iv) the applicability of the close-out netting and financial collateral regimes.

Title and Ownership

With respect to movable properties, French law sets out a general rule under Article 2276 that views possession as equivalent to title¹⁴. Case law specifies that this rule only applies to individual tangible properties¹⁵. This is a simple presumption of title that can be overcome by evidence to the contrary. This rule protects subsequent buyers that have acted in good faith and ensures the legal security of transactions in tangible properties where no formal process or publicity is required for the transfer of ownership.

For intangible properties like patents, the transfer of which is subject to a registration, filing or other rules of publicity, the general rule under Article 2276 will not be relevant and specific rules apply.

For financial securities (which are fully dematerialized in France), French law specifies that “no person may claim, for any reason whatsoever, the title to a financial security whose ownership has been acquired in good faith by the holder of the securities account in which these securities are registered”¹⁶.

Even though there is no specific rule governing the possession of VCCs and the legal effect of possession, and a registry’s tracking of a VCC is not specifically recognized as having legal effect under French law, it seems reasonable to assume that the record of a VCC being held in a registry account in the name of the holder (eg, as shown on the registry website) constitutes a simple presumption of good title for the holder. The registry is a public ledger informing third parties of the name of a holder and any change to a holder of a VCC.

¹³ For example, Article L.313-24 of the French Monetary and Financial Code refers to the title/ownership of a personal right (*droit de créance*)

¹⁴ Article 2276 of the French Civil Code

¹⁵ See, for instance, Cass. Civ. 1ère, May 6, 1997, n° 95-11.151

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

Sale Agreement and Delivery

The sale or transfer of a VCC results in the delivery (*livraison*) of the VCC. Under French law, delivery means the transfer of the sold asset into the power and possession of the buyer¹⁷. For intangible property such as a VCC, delivery in general means the transfer of the VCC from the seller's account in the registry to the buyer's account. However, the sale contract could also contractually structure delivery as the transfer from the seller to the buyer of the right to use the VCC (ie, the seller's retirement of the VCC for the benefit of the buyer).

Security Interest

Parties can create a security interest over a VCC. The perfection and enforcement rules of a security interest are governed by the *lex rei sitae* (ie, the law of the jurisdiction where the VCC is located). Absent an express rule, determining the location of an intangible property like a VCC may create difficulties, but it is reasonable to assume the location of the registry in which the VCC is recorded or the location of the administrator of the registry would be considered relevant.

Assuming French law is the relevant *lex rei sitae*, certain specific regimes exist for a security interest over certain types of intangible properties under French law¹⁸.

For those intangible assets that are not subject to specific rules under French law (such as VCCs), the regime applicable to tangible properties (*meubles corporels*) will be applicable¹⁹. Registration of the security interest must be made on a special registry, held at the Commercial Court²⁰. The enforcement of the security interest can take place by a public sale, judicial attribution or appropriation based on the valuation determined by an expert.

Netting and Financial Collateral

A spot sale or a physically-settled forward sale of VCCs between two corporates or between a financial institution and a corporate would not benefit from the French close-out netting regime in the event the French counterparty becomes subject to insolvency or bankruptcy proceedings in France. However, the statutory close-out netting regime may be available for derivatives transactions of the type referenced in Section C of Annex I to MIFID II²¹ relating to VCCs.

Under French law, VCCs do not currently qualify as eligible collateral assets for the purposes of financial collateral under the EU Financial Collateral Directive²². A collateral arrangement over VCCs is therefore not entitled to protection against the collateral provider's insolvency in France.

¹⁷ Article 1604 of the French Civil Code

¹⁸ Such as patents or *fonds de commerce*

¹⁹ Article 2355 of the French Civil Code

²⁰ Decree (*décret*) n°2006-1804 of December 23, 2006

²¹ It is debatable whether VCCs are 'commodities' in the meaning of MIFID II (ie, "any goods of a fungible nature that are capable of being delivered, including metals and their ores and alloys, agricultural products, and energy such as electricity", as specified in Commission Delegated Regulation (EU) 2017/565 supplementing MIFID II). Derivatives transactions could be considered financial instruments in the meaning of either paragraphs 5, 6, 7 or 10 of Section C, Annex I of MIFID II

²² Directive 2002/47/EC of the European Parliament and of the Council of June 6, 2002 on financial collateral arrangements

JAPAN

Possible Legal Nature of VCCs

Discussions on the legal nature of VCCs are still at a very early stage in Japan. There is no specific legislation stipulating the legal nature of VCCs and ISDA is not aware of any concrete movement to legislate to clarify the legal nature of VCCs²³.

As set out in ISDA's December 2021 whitepaper, there are two possible approaches to characterize the legal nature of VCCs under Japanese law:

- Title or any other real right (*bukken*) (or something similar to them) to an intangible asset; or
- A bundle of claims (*saiken*) and the corresponding obligations (*saimu*) (including contractual or statutory ones).

Similar to the approach under German law²⁴, determining the legal nature of a VCC under Japanese law would require a detailed analysis of the relevant carbon standard, registry rules and any other relevant contractual arrangements for that specific VCC.

Intangible Asset Approach

The prevailing view is that the law should be capable of accommodating VCCs as a form of intangible property. If the legal status of VCCs is determined as such under Japanese law, it could result in the omission of certain procedural requirements for the transfer of contractual claims (such as a notice to, or consent from, an obligor). From this perspective, the question is whether any title or other real right (or similar right) could be recognized for VCCs.

Japan adopts the civil law system. Courts therefore do not have the power to create laws, and take a conservative stance on the recognition of new property rights, unlike the English courts, which have demonstrated significant flexibility in recognizing property rights in intangible assets. For instance, in a 2004 case where a 'publicity right' was questioned, the Japanese Supreme Court did not recognize the right on the basis it was not prescribed in any particular law and was ambiguous in terms of its establishment, content and range²⁵.

The Japanese civil law system has a general principle (under Article 175 of the Civil Code) that no real right (*bukken*) (ie, a property right over a tangible asset) can be established other than being prescribed by law. The principle is called *bukken houtei shugi*. Literally interpreted, it states that any and all property rights over tangible assets can only be created when stipulated in law.

²³ The Ministry of Economy, Trade and Industry of Japan established a study group to discuss issues related to carbon credits (including VCCs). In June 2022, the study group published the outcome of its discussions in the Carbon Credit Report (www.meti.go.jp/shingikai/energy_environment/carbon_credit/pdf/20220627_2.pdf). The Carbon Credit Report simply states: "In order to promote the circulation of carbon credits in Japan, clarification of the legal status, accounting treatment, and taxation method of carbon credit trading should also be considered". It seems the legal nature of VCCs (including how to clarify it) was not discussed in the study group

²⁴ ISDA's December 2021 Legal Implications of Voluntary Carbon Credits paper covers English, US and German laws, www.isda.org/a/38ngE/Legal-Implications-of-Voluntary-Carbon-Credits.pdf

²⁵ Supreme Court, February 13, 2004, www.courts.go.jp/app/files/hanrei_jp/332/052332_hanrei.pdf (Japanese only)

Although the text of Article 175 of the Civil Code covers property rights over tangible assets, there is an argument that recognizing a property right over an intangible asset could also be limited due to this principle. A few exemptions have been recognized by court cases but there was a particular theory or customary law on recognizing non-statutory property rights in these cases. It does not seem those circumstances would exist in relation to VCCs.

In contrast, in a report published by the Ministry of Environment that addressed the legality of certain controversial points relating to credits issued under the Kyoto Protocol scheme²⁶, it was pointed out that it seems difficult to characterize these credits as something similar to a claim (*saiken*). Instead, it states these credits should be recognized as 'similar to a tangible asset' (*dousan ruiji*), which could be subject to a property right. Under this view, by way of analogy to credits issued under the Kyoto Protocol scheme, VCCs would be characterized as an intangible asset. However, the report does not provide any legal grounds for reaching this conclusion.

The similarity between crypto assets and VCCs is sometimes pointed out. The nature of crypto assets is also being discussed, and some academics and legal practitioners argue that certain property rights or similar should be admitted for these assets, but there is no consensus on this point.

Bundle of Contractual Claims/Obligations Approach

From a Japanese law perspective, a contractual claim (*saiken*) is a right to demand/request a person to do something. Since multiple contractual frameworks could be involved in a specific VCC, the question is whether it is possible to recognize who can claim whom to do what in a VCC transaction.

This should be examined based on the relevant carbon standards, registry rules and any other relevant contractual arrangements. However, there do not seem to be any detailed discussions from a Japanese law perspective on how this examination should be conducted. If a VCC was characterized as a contractual claim (*saiken*), a notice to a debtor or acknowledgment by the debtor would be required in the event of a transfer of that VCC. It is likely this would be an undesirable outcome.

Conclusion

On balance, the intangible asset approach should be more appropriate because:

- It seems to be in line with most market participants' understanding and the current settlement practice;
- Neither notice nor acknowledgement is required for the transfer of a VCC; and
- It is consistent with the ongoing legislative approach taken in the US and UK.

However, without legislative action, the legal nature of VCCs under Japanese law remains unclear. In order to make the VCC market in Japan safer, more stable and more liquid, further legislative action is highly recommended.

²⁶ www.env.go.jp/council/28kyoto-gitei/y280-kentou.pdf (Japanese only)

Related Issues

Similar to other jurisdictions, ambiguities over the legal nature of VCCs could give rise to certain legal issues at various stages. For instance:

- Whether it is possible to establish collateral over VCCs;
- How to perfect the transfer of VCCs;
- Whether VCCs can be incorporated into an insolvent estate or netted in the relevant insolvency proceedings; and
- Whether a financial institution (banks, securities companies, etc) can trade or intermediate VCCs under the Japanese Banking Act and/or the Financial Instruments and Exchange Act.

Other

In September 2022, the Tokyo Stock Exchange launched a carbon credit demonstration project²⁷. In this experimental stage, only J-Credits (ie, domestic and governmental carbon credits²⁸) can be traded in the market, although it is expected to cover both domestic and foreign VCCs in the future.

Japanese authorities and market participants must be aware of the need for greater legal certainty for VCCs to accelerate VCC transactions and markets (see footnote 23). At this stage, practical implementation is being prioritized in response to growing demand for trading VCCs.

²⁷ www.jpx.co.jp/equities/carbon-credit/market-system/index.html (Japanese only)

²⁸ Credits issued by the governmental mechanism and operated by the Ministry of Economy, Trade and Industry, the Ministry of Environment and the Ministry of Agriculture, Forestry and Fisheries (<https://japancredit.go.jp/english/>)

SINGAPORE

Possible Legal Nature of VCCs

Statutory Definition of Property

Under the Conveyancing and Law of Property Act 1886 of Singapore, property is defined as including “real and personal property and any estate in any property, real or personal, and any debt and any thing in action, and any other right or interest in the nature of property, whether in possession or not”. This statutory definition is not by itself conclusive as to the legal characterization of VCCs under Singapore law (ie, whether VCCs are a form of intangible property or a bundle of contractual rights).

The Carbon Pricing Act 2018 of Singapore (CPA 2018) imposes, among other things, a carbon tax on certain greenhouse gas emissions of business facilities in Singapore. Registered persons subject to the carbon tax under the CPA 2018 have to pay that tax by surrendering carbon credits equivalent to their carbon tax liability. For the purposes of the CPA 2018, carbon credits can only be bought from the National Environment Agency (established by the National Environment Agency Act 2002 of Singapore), and each carbon credit (as at November 2022) has a fixed price of S\$5. The purpose of the carbon credits under the CPA 2018 is to enable registered persons subject to the carbon tax under the CPA 2018 to pay that tax.

Although CPA 2018 refers to those carbon credits as being transferable and capable of being sold, which suggests they are in the nature of property, VCCs differ from those carbon credits in certain key respects. In particular, VCCs are constituted outside any statutory framework and their role is not to facilitate compliance with tax or other regulatory obligations.

The Ministry of Sustainability and the Environment completed an online public consultation on August 5, 2022²⁹ on the draft Carbon Pricing (Amendment) Bill (the Amendment Bill) which, among other things, proposed that eligible international carbon credits may be used to offset the carbon tax in Singapore. In the Amendment Bill, the definition of carbon credits will be amended to refer to both fixed-price carbon credits and eligible international carbon credits, suggesting both could be treated similarly. Pending any further development on this, the CPA 2018 (as it will be amended by the draft Amendment Bill when it becomes law) may shed more light on the legal characterization of VCCs under Singapore law.

²⁹ [www.reach.gov.sg/Participate/Public-Consultation/Ministry-of-Sustainability-and-the-Environment/public-consultation-on-the--draft-carbon-pricing-\(amendment\)-bill](https://www.reach.gov.sg/Participate/Public-Consultation/Ministry-of-Sustainability-and-the-Environment/public-consultation-on-the--draft-carbon-pricing-(amendment)-bill)

Case Law

Case law in Singapore suggests that VCCs should be capable of being recognized as a form of intangible property under Singapore law. Similar to the position under English law, whether VCCs constitute a form of property under Singapore law must be established by reference to whether they are “definable, identifiable by third parties, capable in its natures of assumption by third parties, and have some degree of permanence or stability”³⁰. In recent case law, intangible assets such as cryptocurrencies have been held to fulfil the criteria of property³¹.

Conclusion

Despite the flexibility of Singapore courts in recognizing property rights in intangible assets where the market treats those assets as property, it remains the case that, pending an authoritative statement, there is currently a degree of perceived or residual uncertainty over the characterization of VCCs under Singapore law.

Related Issues

The legal nature of VCCs is not a purely academic question. The legal nature determines how ownership rights in VCCs can be created and transferred (for example, whether formalities for a statutory assignment are required to be met). It also affects what type of security may be taken and enforced and how that can be achieved, as well as how VCCs would be treated following an insolvency (including with regard to netting).

Greater certainty over the legal treatment of VCCs would contribute to a more robust market as it governs not only their creation, transfer and retirement, but also affects broader considerations such as fungibility, security of transfer and the treatment of VCCs in an insolvency situation.

³⁰ *National Provincial Bank v Ainsworth* [1965] AC 1175 (Ainsworth), cited with approval in *Quoine Pte Ltd v B2C2 Ltd* [2020] 2 SLR 20; [2020] SGCA(I) 2 at [34], *CLM v CLN and others* [2022] SGHC 46 (CLM) and *Janesh s/o Rajkumar v Unknown Person (Chefpierre)* [2022] SGHC 264. The Chefpierre case considers whether non-fungible tokens (NFTs) or, specifically, the data encoded onto the blockchain that represents ownership of the NFT, can be considered a form of property. However, there was no conclusion on whether it would be a chose in action, tangible property or whether Singapore law would recognize some third form of property, as these issues were not pleaded. As with CLM, the judge applied the criteria in Ainsworth and was of the view that the Ainsworth criteria was satisfied. These cases are in the context of an urgent ex parte hearing for interlocutory applications, and the judge left open the possibility that a different conclusion might be reached with the benefit of fuller submissions

³¹ *CLM v CLN and others* [2022] SGHC 46

ABOUT ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 79 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In

addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on [Twitter](#), [LinkedIn](#), [Facebook](#) and [YouTube](#).