

**PUBLIC LAW**

Voluntary carbon markets in Portugal and the European Union

1. Background

The Government has published for public consultation the draft decree-law establishing the Voluntary Carbon Market (“VCM”). The importance of this proposal is justified by the objectives of avoiding “greenwashing” in the acquisition of carbon credits and increasing the confidence of investors and purchasers of this type of product.

The consultation is open until 10 April to gather input from citizens, businesses and other stakeholders. The creation of a VCM in Portugal was announced at the end of 2020, when the Minister for the Environment and Climate Action issued Order 12401/2020 of 21 December, which aims to develop a proposal for a regulatory framework for voluntary carbon markets.

In parallel, a similar proposal is going through the legislative process at EU level. In particular, the European Commission has put forward a proposal for a Regulation to ensure the quality of carbon offset projects and systems in the European Union (COM(2022) 672 final / 2022/0394(COD), available [here](#)).

The aim of carbon markets is to value different types of projects that convert their greenhouse gas (“GHG”) sequestration capacity into tradable titles (“carbon credits”). These markets broadly allow companies and other organisations to offset their GHG emissions and thereby leverage their internal ESG objectives by making a meaningful contribution to the overall goal of climate neutrality.

The purpose of this informative note is to summarise what is at stake in these two proposals and the main similarities and differences between them.

2. The legislative process

The legislative initiatives came to light about three months apart, with the European one being made public before the Portuguese one. However, as far as we can see, there is no obvious link between the two proposals. What is certain is that, under normal circumstances, the European proposal will take longer to be adopted because the European legislative process is longer and more bureaucratic than the Portuguese one.

The European proposal aims to establish a regulation which, if adopted, will be directly applicable in all Member States. Although there is a principle of supremacy of European law over national law, the specific design of the European proposal, based on a voluntary system, will lead to a simple coexistence of national and European proposals.

3. Purpose of the legislative initiatives and standards for eligible projects

The European and Portuguese proposals have different objectives:

- The European Commission's proposal defines the bases for the creation of voluntary carbon markets in the Member States, in particular the rules for the recognition of certification systems and the operation of certification bodies, as well as the eligibility criteria for projects, including the bases for determining how many carbon credits they can generate.
- The Portuguese proposal goes further and aims to create a VCM covering the whole country, managed by the Portuguese Environmental Agency ("APA"), which will regulate carbon sequestration/reduction projects. It also regulates in some detail the means by which projects are converted into carbon credits and the rules for the market.

As we can see, what they have in common is the definition of eligibility criteria for the projects that have been established, that is, standards that a given carbon sequestration or reduction project must meet in order to be able to issue carbon credits.

The innovation proposed by the Commission does not lie in the criteria themselves, as they follow the main criteria already known since Kyoto: quantification, additionality, permanence and sustainability¹, which the Commission has grouped together under the acronym Q.U.A.L.I.T.Y ("QUantification", "Additionality", "Long-term storage" and "sustainabILLTY").

The European Commission's proposal regulates the recognition of effective carbon sequestration/reduction capacity.

The Portuguese government's proposal also regulates the eligibility criteria for projects under the Kyoto Protocol. However, as mentioned above, the Portuguese proposal also focuses on the establishment of a true VCM, which specifically regulates:

- The parties operating in this market.
- The products sold in it - carbon credits and their types.
- The way in which they are supplied - through projects considered eligible to issue credits.
- The conditions for their traceability after sale - platform and credit account.
- Etc.

¹ On them, please see the previous PLMJ Informative Note (available [here](#)).

The VCM to be created by the Portuguese proposal can therefore be integrated into the voluntary carbon markets disciplined by the future European regulation, provided that it ensures compliance with the requirements that may be included in the latter.

4. The structure of VCM and certification of eligible projects: the european and portuguese models

VCMs are markets for carbon credits issued with reference to projects that have the capacity to sequester carbon that would otherwise remain in the atmosphere, in particular, afforestation. The rules for certification of eligible projects are therefore an essential part of the regulation to be created.

The Commission's proposal bases the functioning of VCMs on two key players:

- The certification systems, platforms accessible to the public and managed by public and private bodies, to be recognised by the European Commission under certain conditions, whose role is to supervise the certification of projects to ensure that they meet the eligibility criteria.
- The certification bodies will be the bodies accredited to assess and certify the eligibility of projects and contractually linked to the certification schemes. These bodies must provide guarantees of impartiality and independence, in particular from project promoters. They must also be contractually bound to the certification schemes.

The Commission proposes a voluntary framework for the recognition of the eligibility of projects with the following outline:

- The promoter or a group of promoters - referred to in the proposal as the “operator or group of operators” - submits an application for certification of a specific project to a certification scheme.
- A certification body will carry out a certification audit to confirm the conformity of the declarations and documentation submitted by the promoter and, in particular, the net carbon removal benefit generated by the project. The body then issues a certificate at the end of the process.
- In order to ensure the permanence criterion, certification bodies are required to carry out periodic re-certification audits of the project, which must also be published in the public register of the certification scheme.

According to the Commission's proposal, only projects that comply with the sub-criteria of quantification, additionality, permanence and sustainability, and the methodologies to achieve them, after verification by an independent body will be eligible for Q.U.A.L.I.T.Y certification.

For reasons of transparency and credibility, the Commission's proposal creates an obligation for registries to use automated systems and to be interoperable between the public registries of the different certification systems. The aim is to avoid double counting of credits, i.e., the certification of the same project in more than one system resulting in the emission of carbon credits more than once.

Finally, the European proposal provides for the establishment of methodologies to determine the conditions for compliance with the Q.U.A.L.I.T.Y standard, depending on the type of project, and refers to delegated acts for their approval.

The Portuguese Government's proposal aims to establish a certification scheme, which may even be recognised by the Commission if Portugal so wishes, in order to strengthen the quality of this market. In other words, the aim is not to create a framework for the creation of VCMs, but to create a VCM managed by the APA.

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To avoid double counting, the government stipulates that projects registered in the VCM cannot be subject to other analogous market systems at national or international level. By referring to analogous market systems at national level, the proposal suggests, albeit without full clarity, the possibility of other carbon markets being implemented in Portugal in addition to the VCM.

As in the Commission's proposal, the draft decree-law provides for the definition of methodologies for the certification of projects (forestry, blue carbon, etc.), to be specified by a technical commission appointed by the government for this purpose. This will be subject to public discussion and then approved by the APA, working together with the Institute for Nature Conservation and Forests (ICNF), if it relates to forestry sequestration projects.

These methodologies are intended to achieve:

- A guarantee of compliance with the criteria of additionality and permanence of CO₂ removals and, in particular, define the relevant quantification criteria and the minimum and maximum duration of the project type.
- Measures to monitor the implementations and guidelines to identify externalities and indicators for their assessment during the project; and, where possible.
- Approaches that associate co-benefits with the environmental impacts of carbon projects in support of biodiversity.

Among the projects considered eligible, the government intends to divide them into priority and non-priority projects:

- Forest sequestration projects that contribute to fire resistance and other forms of nature and landscape conservation, i.e., priority projects because of their nature.
- Projects carried out in priority areas, including common land, burned forest areas and forest intervention areas (ZIF), i.e., priority projects because of their location.

However, the proposal could be clearer on the benefits of a project being classified as a priority project, both in terms of checking the eligibility of the project and in terms of the credits to be granted.

The process to confirm a project's eligibility is similar to the Commission's proposal, with some minor differences in terminology. It also provides for the role of independent verifiers in the process of initial approval and periodic verification.

In terms of reporting, the Portuguese proposal requires periodic reports on the state of implementation/compliance of the project, according to a model to be approved by the APA, and the obligation to inform this authority of any substantial changes to the project. Under the Commission's proposal, this role will be entrusted to independent bodies in the context of the re-certification of projects and in accordance with the internal rules of the certification system, which is specifically recognised by the Commission every five years.

Once registered with the VCM, projects will generate carbon credits, each of these representing one tonne of CO₂ equivalent and with a unique serial number. The proposal prohibits the use of carbon credits to meet European and international obligations, in particular obligations under the EU ETS and CORSIA.

5. Structure of the portuguese VCM

Anyone wishing to offset their GHG emissions under the VCM must register on a platform managed by the APA and designed to accommodate all project and emission registrations, transfers, cancellations and retirements of VCM carbon credits.

The Portuguese government's proposed decree-law stipulates that companies can only acquire carbon credits to offset their emissions that are residual, i.e. that cannot be reduced or avoided, and after all possible reduction efforts have been made. However, there are insufficient ex-ante control mechanisms to determine this residuality, so there are doubts as to how this will be ensured.

Behind this simplicity of operations (issuance, transfer and use/cancellation), there can be an infinite number of commercial and financial operations that cause transfers and use between operators, from primary market operations to secondary market operations.

Carbon credits under the VCM are issued without term to the project developer, who can then trade them. They are divided into two main types: verified carbon credits (“VCCs”) and future carbon credits (“FCCs”).

FCCs are credits that are issued prior to project implementation, at the request of the project developer when submitting the project report, in an amount not to exceed 10% of the expected net benefits/total credits for the duration of the project. VCCs are generated after the full implementation of the project, i.e., after the effective reduction of GHG emissions, and under periodic review, discounting any FCCs already issued, if applicable.

For transparency purposes and to avoid double counting, all consumed/requested credits are cancelled in the name of a “consuming” market participant registered on the platform. In practice, if an operator claims to have offset 100 tonnes of CO₂e, the corresponding number of credits must have been cancelled in its favour on the platform.

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6. Reversal and Carbon Credits Fund

As a general rule, 20% of all credits generated are contributed to the Carbon Credits Fund, which is responsible for compensating the risks of non-permanence of the net benefits expected from each project recognised as eligible. In fact, projects that generate carbon credits are subject to a permanence criterion, so it is necessary to ensure that the credits issued are actually related to the emissions removed. Promoters even have to describe the measures taken to mitigate such risks.

If the project does not deliver the expected results during a verification period, for example due to fire or pest infestation in the case of a forestry project, a reversal situation occurs, which implies compensation obligations for the project developer.

In the event of reversal, all available credits (i.e., those issued but not yet traded) in the promoter's account will be liable for the compensation obligation up to the amount of the reversal. In other words, they will be cancelled. If the available credits are not sufficient, the consequences differ depending on whether the reversal was intentional, for example due to arson or failure to address typical risks identified in the methodology, or unintentional.

If the reversal is intentional, the developer has only one year to purchase the missing credits from other VCM participants or to submit additional projects that generate that number of credits. If this obligation is not met in time, the promoter will be sanctioned with the equivalent value of the credits it has not managed to offset by the end of that year. The Environmental Fund will be the beneficiary of this amount.

The law provides for the possibility of random checks by the competent authority to ensure that projects comply with their project, verification and monitoring reports.

If the reversal is not intentional, after the promoter has accounted for the credits to be compensated, if it does not have a sufficient number of such credits, the remainder must be compensated by resorting to credits from the Carbon Credits Fund, which will cancel them.

If there is no reversal of emissions, 30% of the credits placed in the guarantee pool will be returned to the project promoter, gradually and in accordance with the applicable methodology, as long as the project promoter guarantees that the project will be maintained for a further period.

7. Penalties

To ensure the transparency and reliability of the VCM, in addition to the periodic verification procedures and checks on compliance with information duties, the law provides for the possibility of random checks by the competent authority to ensure that projects comply with their project, verification and monitoring reports.

With regard to penalties, the law only specifies as offences, the provision of false information and “the occurrence of any non-compliance”. This is something that disregards the principles of law on penalties. These offences may give rise to the penalties of (i) suspension of the participant from the APA platform, (ii) freezing of the existing carbon credits and subsequent reversal to the Carbon Credits Fund, and (iii) inhibition of MVC participation for 5 years. ■