

**PUBLIC LAW**

The new portuguese voluntary carbon market law

Decree-Law 4/2024, which establishes, organises and regulates a voluntary carbon market in Portugal (the “VCM”), was published on 5 January and came into force the following day.

The new Decree-Law (the “**Decree-Law**”) follows on from a proposal published for public consultation by the government, which we discussed in a previous [Informative Note](#) of 15 March 2023.

Comparing the version of the document published for public consultation (the “**Proposal**”) with the Decree-Law, it is apparent that, in general, the Proposal has not been substantially amended, although there are some notable changes, such as:

- The types of emissions that can be offset, which are no longer just residual emissions, although this is still stated in the preamble to the Decree-Law;
- The concept of additionality, which is no longer as demanding as in the Proposal;
- The intention to align the VCM with the requirements of other international certification schemes;
- Greater attention to blue carbon projects and opportunities to enhance the value of protected areas and the Natura 2000 Network;
- New offsetting rules for the reversal of sequestered emissions to the atmosphere.

This note focuses only on the most significant changes from the proposal. A more complete characterisation of the VCM can be found in the previous [Informative Note](#).

One of the most important changes is that the emissions that can be offset with carbon credits are not limited to residual emissions.

Types of emissions that can be offset with VCM credits

The two types of use are maintained: offsetting emissions and contributing financially to climate action. However, it is no longer required that offsets only cover residual emissions.

Previously, offsetting was required to be part of a clear strategy to decarbonise and reduce an organisation's GHG emissions and could only cover emissions that could not be avoided after efforts to reduce emissions, i.e., residual emissions.

The Decree-Law relaxes this requirement in its articles, although the preamble still mentions the residual emissions offset as the core function of the VCM.

This deviation from what was originally envisaged may have the advantage of initially boosting the establishment of the VCM by making participation and the implementation of carbon sequestration projects more permissive, so that at a later stage, in an expected context of consolidation and development of the VCM, progress can be made towards restricting the use of carbon credits to offsetting residual emissions.

The VCM in the context of European Union initiatives

The Decree-Law now directly provides for alignment with the European Commission's legislative initiative on the certification of carbon removal and reduction projects. At the time of the Proposal, this alignment had not yet been expressed, as the European initiative was presented at almost the same time as the Portuguese one.

This alignment does not mean that the VCM is waiting for the European legislative process to be completed and its methodologies to be approved. It simply means that as the European legislative initiative takes shape, the VCM may also transfer these contributions to the national level, where appropriate.

On the European side, the much slower legislative process is currently in its first reading in the European Parliament. It is clear from the legislative developments to date that there is a desire to broaden the scope of European legislation. While the Commission's proposal was mainly aimed at the project certification phase, the European Parliament now seems to want to regulate the carbon credits themselves, for example the conditions under which they can be used.

The alignment with the European Union legislative initiative does not mean that the VCM is waiting for it to be completed and its methodologies to be approved.

The revised version of the Decree-Law keeps the technical sub-criterion as mandatory, but allows the legal and financial sub-criteria to work alternatively.

Risks associated with project additionality

One of the most complex eligibility criteria for carbon sequestration projects is additionality, which requires that the existence of the VCM is causal to the implementation of the project. Typically, this criterion is broken down into three sub-criteria that operate cumulatively:

- Technical, which requires that the project does not represent mere business-as-usual, i.e., the project must add something to the situation that would have existed if the project had not been implemented;
- Legal, which requires that the project is not implemented pursuant to a legal obligation;
- Financial, which requires that the certification of the project is an essential condition for the decision to implement it in view of the financial gain it will represent and without which such decision would not be financially rational.

The requirement for all three of these sub-criteria was the line taken in the Proposal and this is also the direction in which the discussion on the European initiative on the certification of carbon removal and reduction projects is heading.

It is important to note that the revised version of the Decree-Law keeps the technical sub-criterion as mandatory, but apparently allows the legal and financial sub-criteria to work alternatively.

Emphasis on blue and river carbon projects

The Decree-Law emphasises the role of the sea and its ecosystems, including salt marshes, seagrass meadows, reefs and kelp forests, in carbon sequestration and the benefits that can be derived from implementing the VCM.

The reference to these ecosystems is twofold: on the one hand, as a location for the implementation of “blue carbon” projects, a type of nature-based project aimed at carbon sequestration in the sea and coastal zone, and on the other hand, as beneficiaries of the implementation of the VCM. This is because it is recognised that these ecosystems can benefit from the positive externalities of projects generating carbon credits + that take place nearby, whether they are blue carbon or not.

For blue carbon projects, methodologies are approved by the APA (the Portuguese Environmental Agency) in consultation with the Institute for Nature Conservation and Forests, I.P. (ICNF) and the Directorate-General for Natural Resources, Safety and Maritime Services (DGRM).

The individualisation and prominence given to this type of project is in line with the provisions of the Basic Climate Law and the National Strategy for the Sea 2021-2030, which already recognise the ocean, along with forests, as carbon reservoirs to be preserved.

Still on the subject of nature-based projects, although they have not been given the same prominence as projects in the marine environment, there is nothing to prevent river-based projects from emerging. This is all the more true as the preamble to the Decree-Law now emphasises that there are other nature-based projects in addition to forestry and marine projects.

Projects in priority areas

The range of areas considered priority for the development of carbon sequestration projects has been broadened and is no longer associated only with forestry projects.

Although the title of the article identifying these areas retains the reference to forest sequestration projects, the body of the article opens up the list to include projects developed in areas where the natural value to be conserved is not necessarily forest-related. Thus, areas included in the Natura 2000 Network and the National Network of Protected Areas (RNAP) are also given legal priority.

The granting of this status to areas included in the RNAP can be seen as an additional incentive for the classification of protected areas on the initiative of private operators.

The Decree-Law maintains the possibility for the APA or the ICNF to prioritise other areas that they consider justified for this status, with the addition of a new provision exempting projects in those areas from the fees to be charged under this legislation.

The Decree-Law makes the status of priority areas more attractive by reducing the percentage of carbon credits retained in the guarantee pool from 20% to 10% and by providing for a higher rate of release of these credits at the end of the project, 40% for projects in priority areas and 30% in other cases (see below for the guarantee pool).

The granting of this status to areas included in the RNAP can be seen as an additional incentive for the classification of protected areas on the initiative of private operators – the private protected areas – whose recognition leads to their inclusion in this Network and thus to the above-mentioned benefits.

More future carbon credits

One measure to encourage the implementation of carbon projects is to increase the limit on the issuance of future carbon credits from 10% to 20%. As the sale of this type of credit is a way of anticipating the revenue that the project is likely to generate, this increase helps to alleviate any initial difficulties in project financing.

Reversing carbon sequestration

One of the most significant changes introduced by the Decree-Law compared to the Proposal concerns the consequences of carbon sequestration reversals and the mechanisms for managing this risk.

As highlighted in a previous [Informative Note](#), reversals are one of the most serious challenges facing projects of this type, namely the unplanned release of sequestered carbon into the atmosphere.

As this is a carbon offset market, the natural way to address the risk of reversal is precisely to allow the reversal of emissions to be offset themselves. Reversals, whether intentional or unintentional, must have different consequences, particularly with regard to the promoter's responsibility for one or the other.

The Decree-Law stipulates that if the reversal is intentional, the project promoter must compensate in carbon credits the equivalent of twice the reversed emissions, thus creating a deterrent effect against intentional or negligent reversal. This means that any credits held in the account on the registration platform will be used first for said offset. If there are not enough credits on the platform, the promoter has one year to acquire the missing credits. If the promoter does not meet this deadline, it will be levied an amount equal to twice the average price of credits on the VCM in the previous calendar year. It is not clear whether, in the event of a shortage of credits on account, the acquisition should take place within the perimeter of the VCM or whether the promoter can turn to other markets, European or international. This may be necessary if there is an intentional reversal at an early stage of the VCM when the supply of credits tends to be low.

If the reversal is unintentional, the Decree-Law maintains the provision for a guarantee pool as a mechanism for the contribution of carbon credits, which is aimed exclusively at managing the risk of reversal in unintentional situations. The guarantee pool is therefore a set made up of a portion of the carbon credits generated by the projects, which is limited to compensating for unintentional reversals, and the contributions made under these conditions constitute the limit of what the promoter can use when faced with a reversal that needs to be compensated.

The main change introduced by the Decree-Law is the possibility of taking out insurance to replace or supplement contributions to the guarantee pool. It will be up to the promoter to decide, when registering the project, which of the two options or both it prefers, although it will have to choose at least one of them. However, the choice of insurance is subject to the approval of an ordinance setting out the conditions under which insurance is considered appropriate to guarantee compensation for reversed emissions.

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Finally, with regard to the operation of the guarantee pool, once the projects have been completed without reversals and the last periodic check has been carried out, the credits will be released to the promoters concerned: 40% for projects developed in priority areas and 30% in all other cases.

The fate of the credits not released at the end of the project has not yet been clarified. This may be because the very idea of the duration of a carbon sequestration project is still under discussion (even at EU level). In addition, the legislator did not want to resolve this issue before taking a final position on such controversial topic, which may have to be resolved in the methodologies.

The Decree-Law gives private bodies a truly active role in the development of the new VCM through pilot projects on their own initiative.

ADENE is the new manager of the VCM platform

Another significant change introduced by the Decree-Law compared to the Proposal is the fact that the APA has been replaced in the role of developing and managing the platform for registering projects and carbon credits, although it will now be responsible for supervising the new manager: ADENE – Agency for Energy.

As a result of these functions, the fees associated with the registration of projects, transactions and the cancellation of carbon credits will be paid to this agency. It will also be ADENE's responsibility, together with the APA, to prepare annual reports presenting the activities and conclusions of these two organisations in their role of monitoring and supervising the VCM.

ADENE, a legal person of public utility in the form of an association under private law, was created in 2000 by Decree-Law 223/2000 of 9 September, and its main members are the DGEG (Directorate General for Energy and Geology), the DGAE (Directorate-General for Economic Activities), the LNEG (National Laboratory of Energy and Geology) and the APA (Portuguese Environmental Agency), which together hold 73% of the shares.

Emphasis on private initiative demonstration projects

As far as demonstration projects are concerned, the Decree-Law breaks new ground compared to the Proposal in that it gives private bodies a truly active role in the development of the new VCM through pilot projects on their own initiative, but always in liaison with the competent authorities. ■