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Update

Environment

Portuguese voluntary carbon market under public consultation

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The draft Decree-Law establishing the **Voluntary Carbon Market in Portugal** and setting out the rules for its operation is in **public consultation** until April 10, 2023. It clearly prioritizes forest carbon sequestration projects, involving here the so-called vulnerable territories (in particular those with Landscape Reordering and Management Plans or Integrated Landscape Management Areas (AIGP), areas forming part of Forest Intervention Zones (ZIF) and Common Land Areas, which may also include burnt forest areas or other areas requiring intervention identified by the Institute for Nature Conservation and Forests, I. P. (ICNF, I.P.), or by the APA, I.P.).

1. From *mandatory* to *voluntary* market regulation: the missing step

With the implementation of the voluntary carbon market, and according with what already happens in other countries in the world, Portugal intends to anticipate an issue that is being discussed within the European institutions (**Proposal for a European Regulation establishing a Union certification framework for carbon removals**): that is, the regulation of the voluntary carbon markets that already operate in practice, outside the space occupied by the mandatory carbon market.

It is well known the current regulated European carbon market, called EU Emissions Trading System (EU-ETS), applicable only to some activities (e.g. commercial aviation or in energy-intensive industrial installations) and which submits obliged operators to apply for a greenhouse gas emissions permit (GHGP) and to acquire permits relating to GHG emissions resulting from the exercise of their activity. It is a mandatory market.

The rules now subject to public consultation refer to the creation of the **voluntary market**: participants are not obliged to purchase permits nor are they limited to a number of carbon emissions. Differently, the incentives to participate in the voluntary market are often reputational in a perspective of *green marketing* and corporate social responsibility.

Although with converging final objectives and similar quantitative methods (each EUETS license or carbon credit corresponds to 1 ton of carbon), the two markets – mandatory and regulated – are not the same. In fact, the draft decree-law now under public consultation prohibits the use of credits issued under the voluntary market to comply with obligations arising from other European and international regimes, such as the EU-ETS regime.

This step aims to boost carbon sequestration projects, which will thus have an economic incentive that will contribute to their economic viability, thus contributing to the decarbonisation of the economy. This will be the case of forest management projects, which are priority areas. It remains to be seen – only the market will reveal – whether this incentive will be sufficient and whether it is not necessary to create public mechanisms to support the investments involved in these projects.

2. Key features of the national voluntary carbon market

This new voluntary carbon market promotes an ***inclusive participation of several agents***, both public and private, as well as individual or collective, on the supply and demand side. On the supply side, the promoter of GHG mitigation projects, which may be emission reduction projects or carbon sequestration projects, appears as an agent of the voluntary carbon market. On the demand side, there are, as market agents, the individuals and organizations that acquire these credits for the purpose of offsetting their emissions or promoting policies in favour of climate action.

The second feature associated with this market and visible in its operating rules (see below) is the idea of ***carbon commercialisation at the service of environmental's protection and improvement***, specifically, of several environmental components, from "air", with the mitigation of GHG emissions, to "biodiversity", with the improvement of natural habitats, also ensuring the protection of "water" and "soil", by reducing erosion and increasing the content of the organic fraction.

The third and fourth marks are related to ***addition*** and ***permanency***. Both aim to ensure sustainability and effectiveness in the reduction of emissions or carbon sequestration, assuming that these only occur with the implementation of the proposed project (addition's logic),and seeking to ensure the maintenance of sequestered emissions and safeguard possible reversals (permanency's logic).

The ***credibility*** of the functioning of this market is safeguarded by subjecting the project to *ex ante* and *ex post* assessments, carried out by an independent verifier, as an essential measure to combat *greenwashing*. Nevertheless these evaluations, it is also established the possibility of inspections or the application of penalties, ranging from the blocking of existing credits to the inhibition of the agent's participation in the market for a period of 5 years.

Finally, **transparency**, enshrined as one of the fundamental principles and also at the service of credibility, is ensured with public access to information relative to the activities developed by the market participants, as well as avoiding double counting of GHG emissions reduction or carbon sequestration.

3. The functioning of the *voluntary* market

Here are brief notes on some of the most relevant points on the regime of its operation – which is dense and relatively extensive:

1. Presentation of a *project proposal* by the *GHG mitigation project promoter*: it must comply with the applicable carbon methodology and demonstrate how the eligibility criteria will be met, quantification method, identifying externalities, start of implementation, project monitoring plan, as well as risks of emission reversals and respective mitigation measures.

The carbon methodologies to be considered in the project report are not yet fixed. They will be developed by a technical monitoring committee coordinated by the APA and approved by the APA (although in the case of forest sequestration projects, the APA should work together with the ICNF for this approval). However, it is quite possible that these entities will take into consideration the set of quality criteria (QU.A.L.ITY Criteria) defined in the European Commission's Proposal for a European Regulation establishing a Union certification framework for carbon removals, of 20 November 2022, if this is approved.

2. Validation: prior to the registration of the project in the electronic platform, the project shall be subject to an initial validation process, *ex ante* evaluation, by an independent verifier, duly qualified, in accordance with the criteria to be established by ordinance.

3. Monitoring and reporting: the projects shall be monitored by the promoters themselves, under the terms set forth in the applicable methodology, submitting monitoring reports for that purpose.

4. Verification: the project will also be subject to a process of verification, an *ex post* assessment, by an independent verifier, without clarifying who the independent verifier is or what requirements apply.

5. Issuance of Carbon Credits: will be generated following a validation or verification process. Carbon credits are (i) *tradable*, with credit flows between market agents being registered on the electronic platform managed by the APA and (ii) are *valid for an indefinite period*.

There are two legal types of Carbon Credits:

a) ***Future Carbon Credits* (FCC):** credits generated at the project's zero moment (prior to its implementation) based on an estimate validated by an independent auditor, in an amount not exceeding 10 % of the total credits expected to be generated during the life of the project; this percentage may not be sufficient to contribute to the viability of the initial investment.

b) ***Verified Carbon Credits* (VCC)** generated after an effective GHG emission reduction or carbon sequestration by the project duly verified by an independent auditor.

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The draft Decree-Law also contemplates the figure of ***Carbon Credits +***, i.e. those resulting from projects that besides carbon sequestration include "*significant additional benefits at the level of biodiversity and natural capital*" – it is not, however, clear what advantages are associated with these Carbon Credits +.

6. Emission reversal: occurs when it is verified that the net volume of carbon sequestrated in a specific moment is lower than the same volume determined in a previous moment); the carbon credits already issued and not traded are cancelled, in proportion to the reversal occurred.

a) If this **reversion is intentional**, the promoter is required to replace the credits equivalent to the volume of emissions reverted or to implement more carbon sequestration projects to which the credits generated are discounted and cancelled in an amount equivalent to the emissions that have been intentionally reverted.

b) The **non-intentional reversion** is safeguarded by a "guarantee fund" to which 20 % of the carbon credits issued by carbon sequestration projects (or 10 % in the case of projects developed in Integrated Landscape Management Areas) are reverted. The big challenge will be to establish what could effectively be considered intentional reversion, as there may be many causes for this reversion, from forest fires to cutting down trees or simple crop rotation.

It is on this legal regime that everyone is invited to participate, bringing their vision, contributing to its improvements, which will then be closed after the closure of the public consultation.

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