Global carbon market taking shape through approval of standards at COP29

By Pamela Wu, Esq., Morgan Lewis

DECEMBER 2, 2024

During the 2024 United Nations Climate Change Conference (COP29), climate negotiators adopted standards that will underlie a global carbon market backed by the United Nations (UN). As countries and businesses continue their efforts to decarbonize and fight climate change, the adoption of these standards is a significant development that paves the way for the operation of a global carbon crediting mechanism.

At COP29, the Supervisory Body adopted two sets of standards. One set of standards addresses the requirements for the methodologies that are used to assess creditable emissions reductions or removals in the UN-backed carbon market.

The generation, purchase, and sale of carbon credits through the carbon markets are expected to continue to play a critical role in the ability of countries and businesses to meet their emissions reduction goals and achieve net zero. This is because the carbon markets serve as a platform where parties can transact carbon credits, which can be used to offset an entity's emissions. Through the carbon markets, entities engaging in activities that either remove or reduce emissions from the atmosphere can generate carbon credits, which can then be sold. Entities that cannot reduce their emissions through business and operational changes can purchase these carbon credits to offset their emissions.

The Paris Agreement

The Paris Agreement, a legally binding international treaty on climate change, was adopted by 196 parties during the UN Climate Change Conference on Dec. 12, 2015, and entered into force on Nov. 4, 2016.

The Paris Agreement's overarching goal is to strengthen the global response to the threat of climate change, to hold the increase in the global average temperature to well below 2 °C above pre-industrial levels, and to pursue efforts to limit the temperature increase to 1.5 °C above pre-industrial levels. Since 2020, countries have been submitting their national climate action plans, demonstrating increasingly higher levels of ambition through adjustments to their plans.

Article 6 of the Paris Agreement addresses how carbon credits generated from the reduction or removal of greenhouse gas (GHG) emissions can be transferred between countries and used to help meet climate action plans and targets, thereby enabling international cooperation to combat climate change.

Article 6.4 of the Paris Agreement provides that an integrated and global carbon crediting mechanism will be established to facilitate the trading of carbon credits among countries and companies, overseen by a Supervisory Body. The carbon credits that are traded would be validated, verified, and issued under the framework that is established in accordance with Article 6.4 and can be used to meet climate targets.

Until COP29, countries had not been able to agree on the principles that should apply to the carbon market.

Standards adopted

At COP29, the Supervisory Body adopted two sets of standards. One set of standards addresses the requirements for the methodologies that are used to assess creditable emissions reductions or removals in the UN-backed carbon market. For example, the methodologies should contain provisions to ensure that all emissions reductions or removals are real, transparent, conservative, and credible through third-party verification systems, data-driven technical performance standards, and transparent demonstrations of the changes in GHG emissions achieved by and attributable to the activity.

Furthermore, the methodologies must require the participant to identify the business-as-usual emissions or reference benchmark emissions against which the emissions reduction activity can be assessed.

The methodologies must also specify the approach to demonstrating the additionality of the activity and avoid leakage. Additionality must be demonstrated using a robust assessment that (1) shows the activity would not have occurred without the incentives

from the carbon credits, (2) accounts for all relevant national policies, and (3) exceeds any mitigation that is required by law or regulation.

To avoid leakage, the methodologies must ensure that potential sources of leakage in activities are identified and avoided, and where unavoidable, they should be minimized or addressed through measures such as deducting emissions reductions from credited volumes.

The second set of standards addresses the requirements for emissions removal and emissions reduction projects with reversal risks under the global carbon crediting mechanism. These requirements include: ensuring that the monitoring of removals is carried out based on data that is robust, conservative, and appropriately accounts for uncertainties; preparing a monitoring report after implementing the monitoring activities specified in the monitoring plan; and accounting for removals eligible for crediting in a consistent unit of measurement.

The requirements also include preventing and minimizing the risk of reversals, remediating reversals of removals, addressing the risk of leakage and accounting for leakage in the calculation of net removals, and avoiding negative environmental and social impacts.

Potential impacts of adoption of standards in carbon credit markets and transactions

The creation and implementation of a UN-backed carbon market will likely have a significant impact on the carbon markets and carbon credit transactions.

First, it would open up a large market in which countries and businesses would be able to generate, sell, and purchase carbon credits. While many already transact in the voluntary carbon markets, which provide a forum for businesses and individuals to purchase and sell carbon credits to offset their unavoidable GHG emissions, the voluntary carbon markets are continuing to develop, expand, and standardize.

An international carbon market that will be backed by the UN may be viewed as an attractive option for businesses to transact carbon offsets. The adoption of the standards discussed above should facilitate standardization and transparency in the market, as well as an increased confidence in the carbon credits transacted.

Second, the newly adopted standards and requirements may have some effect on the standards and requirements currently being applied in the voluntary carbon markets. It is possible the current standards applied in the voluntary carbon markets may see some modifications to incorporate the standards and requirements applicable in the UN-backed international carbon market.

In addition, the requirements set forth in the standards may be adopted in climate legislation. In the United States, several climate-related laws have been enacted. This includes the Voluntary Carbon Market Disclosures Act (AB 1305), which requires companies operating in California that purchase, market, or sell carbon offsets, as well as companies that make net- zero or carbon neutral claims in California, to make certain disclosures on their websites starting Jan. 1, 2025. Other climate legislation may be forthcoming and may take notice of the standards and requirements applicable in the international carbon market.

Participants in the carbon markets — whether in the international carbon market or in the voluntary carbon markets — should take note of the standards and requirements adopted at COP29. Although the standards set forth the framework within which the global carbon crediting mechanism will operate, additional work will need to be done to further develop the standards and explain how they will be implemented and applied.

Nonetheless, the adoption of the standards represents significant progress toward the operation of a global carbon market, which is expected to increase confidence in the carbon markets, encourage continued investment in carbon removal and reduction projects, and provide another platform through which carbon credits can be transacted.

Pamela Wu is a regular contributing columnist on energy and decarbonization issues for Reuters Legal News and Westlaw Today.

About the author

Pamela Wu, a partner at **Morgan Lewis**, represents companies in the energy industry in a range of matters involving rates, market rules and regulation, and energy commodity trading before the Federal Energy Regulatory Commission (FERC) and Commodity Futures Trading Commission (CFTC). She advises clients seeking to reduce their carbon footprint through new infrastructure assets, clean energy technologies, and transacting carbon credits and carbon offsets. An active member of the firm's energy commodity trading and compliance working group, hydrogen working group, electric vehicles working group, and renewables working group, she is resident in the Washington, D.C., office and can be reached at pamela.wu@morganlewis.com.

This article was first published on Reuters Legal News and Westlaw Today on December 2, 2024.