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Dávid Oršula david.orsula@bnt.eu
Laurent Le Pajolec lp@exco.pl

Insolvency in voluntary carbon markets

Çağdaş Umut Vardar and Emre Özdemir give an overview of the carbon markets, focusing on Turkey



ÇAĞDAŞ UMUT VARDAR
Partner, Vardar Şanlı,
Turkey

Various means can be deployed to combat climate change. One of these is the use of carbon credits for carbon offsetting,¹ traded on so-called “carbon markets”.²

Although it is uncertain whether carbon markets will scale up or down in the long run, it is worth reflecting upon the legal issues concerning carbon credits, as they are already being transacted and will likely maintain or gain some degree of importance in the near future for businesses. In this article, the authors briefly touch upon carbon credits traded in voluntary carbon markets in Turkey, particularly in relation to insolvency, and discuss the extent of the instrument-alization of insolvency laws to combat climate change.

Overview of the carbon markets

At the domestic level, it is accepted that there are two categories of carbon markets: “compliance carbon markets” and “voluntary carbon markets”.³ Compliance carbon markets involve administration by public authorities.⁴ They may be structured in a way known as “cap-

and-trade”.⁵ Voluntary carbon markets, on the other hand, generally lack the involvement of public authorities.⁶ In these markets, project proponents, entities or persons have overall control over and responsibility for researching and conceiving a climate mitigation project, which may take the form of a greenhouse gas (“GHG”) emissions reduction or removal project. These projects may then be registered, following *ex-ante* validation, with an entity, otherwise known as an independent carbon crediting program (“ICCP”). Examples of ICCPs are the Verified Carbon Standard (Verra) and the Gold Standard. After validation and registration, the practical reductions or removals achieved over a period are verified by a third-party verifier accredited by the ICCP. Subsequent to verification, the ICCP issues a verified carbon credit (“VCC”) to the project proponent. VCCs are issued into the registry accounts of the project proponent and may then be traded.⁷

Although carbon markets have a history dating back to the Kyoto Protocol, adopted in 1997, there is uncertainty as to the legal nature of carbon credits.⁸ In this respect, a working group at UNIDROIT is in

the process of developing an instrument.⁹ Recently, UNIDROIT and UNCITRAL have published a study on the legal nature of verified carbon credits issued by independent carbon standard setters.¹⁰

Carbon market regulation in Turkey

Currently, there is no legislation in Turkey regulating carbon markets, nor has there been, to the best of our knowledge, a court judgment endeavouring to ascertain the legal nature of carbon credits. However, Turkey has informed UNCITRAL that “legislative actions to implement a mandatory cap-and-trade system” are underway.¹¹ In parallel, the 2025-2027 Medium-Term Programme states that the legal infrastructure of a national emissions trading system (“ETS”) will be completed, with development aligned to ensure compatibility with the EU’s carbon border adjustment mechanism.¹² Besides, the Directorate of Climate Change within the Turkish Ministry of Environment, Urbanisation and Climate Change has announced that the first phase of ETS implementation is set to begin with on 15 October 2025 the

publication of the National Allowance Plan for 2027 by the Carbon Market Board in the Official Gazette.¹³ Nonetheless, the Turkey Sustainability Reporting Standards 2 Climate-related Disclosures¹⁴ provides for a definition of carbon credit as “an emissions unit that is issued by a carbon crediting program and represents an emission reduction or removal of greenhouse gases. Carbon credits are uniquely serialized, issued, tracked and cancelled by means of an electronic registry.”¹⁵ Furthermore, to the best of our knowledge, there is only one Turkish company that operates an online platform for carbon credit trading.

The lack of legislation in Turkey creates a gap in the legal framework for companies that want to engage in carbon credit trading. One consequence of this gap is the ambiguity regarding the legal grounds creditors can invoke against insolvent debtors holding carbon credits.

The legal nature of VCCs under Turkish law

The applicable insolvency laws will hinge upon the legal nature of carbon credits, which should, therefore, be considered. In our opinion, consideration should be made with respect to laws regulating proprietary rights (*ayni haklar*), contractual rights and digital assets.

Under Turkish law, proprietary rights have two main categories, i.e., the right to property (*mülkiyet hakkı*) and the right to limited proprietary rights. Limited proprietary rights, such as mortgage (*ipotek*), are subject to a *numerus clausus* under Turkish law. Hence, it is not possible to subsume VCCs under this category. The right to property can be in movable and immovable objects. An immovable object is mostly land, which a VCC cannot be considered to be. A movable object, on the other hand, needs to have tangible characteristics. For this reason, a VCC would not be considered a movable object, meaning that VCCs may not be eligible for the establishment of any proprietary right.

As explained above, there are multiple parties involved in the lifecycle of a VCC. Therefore, VCCs may be viewed as corresponding to a bundle of contractual rights. However, the contractual privity that gives the holder of the VCC the right to see the VCC recorded in a registry, the right to see the VCC transferred, and the right to withdraw the VCC, is between the holder of the VCC and the registry. Thereby, VCCs may be envisaged as the result of the continuous performance of contractual obligations by the registry.¹⁶ This sort of explanation for a VCC is plausible in accordance with Turkish law. However, in scenarios where the holder of the VCC is not the project proponent, but a third party, such as a custodian, it may become even harder for creditors to recover their receivables.

Pursuant to the Capital Market Law of Turkey No. 6362,¹⁷ crypto assets are intangible assets that can be created and stored electronically using distributed ledger technology or similar technology, distributed over digital networks, and can express value or rights. Yet, we do not believe VCCs would be subsumed under this definition: “As matters currently stand, registries do not currently operate like blockchains and do not provide the degree of control to holders that blockchains provide.”¹⁸

Insolvency laws applicable to VCCs

Creditors can attach (*haciz*) and sell tangible and intangible assets having economic value, so they may try to attach VCCs pursuant to provisions of the Enforcement and Bankruptcy Law of Turkey No. 2004 (“EBL”).¹⁹ If the VCC is considered a bundle of contractual rights, debtors may invoke Article 89 of the EBL. However, Article 89 of the EBL sets out rules for the attachment of claims for contractual receivables. Contrary to its wording, a contract between the holder of a VCC and a registry will, most likely, not include a clause setting the grounds for a claim for a contractual receivable. Therefore, it seems implausible for a debtor to recover its receivable by invoking



Article 89. Furthermore, the EBL provides no other provision to which debtors may resort, provided that the legal nature of a VCC is considered a bundle of contractual rights. Thus, the attachment of a VCC may occur only if the EBL is amended in such a way that allows bundles of contractual rights, such as VCCs, to be attached.

Another solution to the attachment of VCCs could be their consideration as movable objects. This again would require a legislative change. If we consider them as movable objects, Article 88 of the EBL would become applicable. As set out under that provision, once an asset is attached, the creditor may allow a third person to take the asset into their custody (*muhafaza etmek*) for a temporary term, provided that the third person agrees. Considering that a registry would be online, the plausible way to attach the VCC would be to ask the registry to take the VCC into its custody. If the registry refuses, which it may, then creditors would have no chance to attach the VCC, because it is also not possible for enforcement offices to attach assets on online platforms. It should be noted that the attachment process could have been made much easier had the

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The trading of carbon credits in voluntary carbon markets presents unique challenges within the framework of Turkish insolvency law



VCCs been registered with an official registry to keep track of the title and made attachable via the electronic attachment procedure provided for under Article 78 of the EBL. That being said, in instances where the holder of the VCC does not have title over the VCC, but is merely a custodian, it may again become harder for creditors to recover their receivables.

Moreover, even if a VCC is attached in some way, it is doubtful that the creditor may be able to find a willing buyer for the VCC. This stems from the very nature of the market where VCCs are traded. The willing buyer would need to be engaged in the carbon market to have an incentive to buy the VCC. As a result, this means that willing buyers will be limited to those companies on the carbon market, making the recovery process difficult. Alternatively, creditors may invoke Article 111/a of the EBL, provided that the VCC is considered a movable object, and request the debtor to be granted the power to sell the attached VCC. This could prove to be a better option to rely upon within the current legal framework.

De lege feranda: Should the law regulate the use of sale proceeds?

A pertinent issue for examination is whether the law should regulate how sale proceeds from attached VCCs can be utilised. Subsequent to the sale of the attached asset, creditors are generally free to use the proceeds as they see fit. Currently, no mandatory legal provisions preventing creditors, who have recovered debts through the sale of VCCs, from using the proceeds in ways that could be detrimental to the environment. For instance, an oil company might apply such proceeds to expand its operations, thereby exacerbating environmental harm.

The legislator could take this issue into account and formulate legal provisions governing the use of such sale proceeds. While such intervention may be viewed as infringing upon property rights, one can argue that, given the

environmental purpose of VCCs, the law should protect the broader objective of environmental sustainability. This may involve restricting how proceeds are applied, particularly through insolvency laws. Any such legal measures would need to strike a proportional balance between conflicting interests, including the fundamental rights and freedoms and the public interest in environmental protection. Further, when considering this intervention, the legislator would need to carefully determine the scope and limits of using insolvency laws as an instrument for combating climate change.²⁰

Conclusion

The trading of carbon credits in voluntary carbon markets presents unique challenges within the framework of Turkish insolvency law. The lack of clear legislation and established legal precedents creates significant ambiguity regarding the classification and treatment of VCCs during insolvency proceedings. As Turkish legislation evolves to incorporate comprehensive regulations on carbon markets, it will be essential to clarify the legal nature of VCCs, whether as proprietary rights, contractual rights, or potentially as digital assets. Until such clarity is achieved, creditors and debtors alike must navigate a complex and uncertain landscape, making it crucial for legislative bodies to address these issues promptly to provide a robust legal framework that supports the growth and stability of carbon markets in Turkey. ■

Footnotes:

- 1 There are also others that criticize use of carbon credit. A recent example to this view could be found in ClientEarth and other civil society organizations joint statement (“**Joint Statement**”) titled “*Why carbon offsetting undermines climate targets*”. Pursuant to the Joint Statement, the idea of carbon offsetting is built around the notion that emitter can get to keep emitting. Thereby, carbon offsetting should not be considered as having substantial impact on the fight against climate change. As such, prominent regulatory frameworks exclude the use of carbon credits in achieving interim emission reduction targets. “*In particular, the European Sustainability Reporting Standards (ESRS) state that carbon offsets cannot be merged with actual emissions reductions in corporate climate target reporting*.” See the Joint Statement, available at <https://changingmarkets.org>.
- 2 UNCITRAL Expert Group and UNIDROIT Working Group, “UNCITRAL/UNIDROIT study on the legal nature of verified carbon credits issued by independent carbon standard setters” A/CN.9/1191 (14 March 2024), Annex I (“UNCITRAL/UNIDROIT Study”).
- 3 *Ibid.*, paragraph 25.
- 4 *Ibid.*, paragraph 26.
- 5 *Ibid.*, paragraph 28.
- 6 *Ibid.*, paragraph 52.
- 7 UNIDROIT Working Group on the Legal Nature of Voluntary Carbon Credits’ Issues Paper’ Study LXXXVI – WG.2 – Doc. 2 (April 2024), paragraphs 45–54; UNCITRAL/UNIDROIT Study (above note 2), paragraphs 51–62.
- 8 UNCITRAL/UNIDROIT Study (above note 2), paragraph 24.
- 9 See UNIDROIT’s website about the project, available at <https://www.unidroit.org/>
- 10 See UNCITRAL’s website including the link to the UNCITRAL/UNIDROIT Study, available at <https://uncitral.un.org>
- 11 UNCITRAL/UNIDROIT Study (above note 2), paragraph 30.
- 12 Official Gazette, 5 September 2024, No. 32653 (bis).
- 13 Directorate of Climate Change of Republic of Türkiye Ministry of Environment, “Emission Ticaret Sistemi ve SKDM İlişkisi” (22 February 2024), available at < <https://ticaret.gov.tr> >
- 14 Official Gazette, 23 December 2023, No. 32414 (bis).
- 15 See the IFRS S2 Climate-related Disclosures, available at: [ifrs.org/issued-standards](https://www.ifrs.org/issued-standards); Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 Supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards for another carbon credit definition, available at: eur-lex.europa.eu/eli/reg_del/2023/2772, according to which, a carbon credit is “*a transferable or tradable instrument that represents one metric tonne of CO2eq emission reduction or removal and is issued and verified according to recognised quality standards*.”
- 16 UNCITRAL/UNIDROIT Study (above note 2), paragraphs 98–100.
- 17 Official Gazette, 30 December 2012, No. 28513 (as amended from time to time).
- 18 UNCITRAL/UNIDROIT Study (above note 2), paragraph 105.
- 19 Official Gazette, 19 June 1992, No. 2128 (as amended from time to time).
- 20 For reading on private law and environmental sustainability see: Barbara Pozzo, ‘Private Law and Environmental Sustainability’ in Marta Santos Silva et al. (eds), *Routledge Handbook of Private Law and Sustainability* (Routledge 2024).

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