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Recent Developments in Japanese/Global Climate Change/Carbon Credit Regulations *Focusing on Japanese ETS (GX League Phase 2) and other developments*

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1. Introduction

With the inauguration of the Trump administration in the United States in January 2025, the ideas of prioritizing carbon net-zero (carbon neutrality) and emphasizing fossil fuels have once again become intertwined. However, if we view carbon net-zero (carbon neutrality) and green transformation (GX) not as narrow climate change measures, but as a medium- to long-term shift in industrial structures, the trend toward carbon net-zero is likely unstoppable, particularly in the EU and Japan. For instance, the Japanese government has decided to submit an ambitious Nationally Determined Contribution (“NDC”) to the Secretariat of the United Nations Framework Convention on Climate Change (UNFCCC) as part of Japan’s 2035/2040 NDC, setting a target to reduce greenhouse gas (“GHG”) emissions by 60% in fiscal year 2035 and by 73% in fiscal year 2040, compared to fiscal year 2013 levels. Carbon credits are expected to be one of the means to promote carbon net-zero, but carbon credit regulations are likely to evolve in different directions in different countries. In particular, Japanese companies with global operations will need to develop their investment strategies while closely monitoring changes in carbon credit regulations in various nations. In this newsletter, we will provide an overview of carbon credit regulations in Japan and

abroad and highlight some of the issues that both Japanese and international players should be aware of.

2. Recent developments in Japan

2.1. Japanese ETS (GX League Phase 2)

Based on the Paris Agreement, an international agreement on climate change, the Japanese government has set a target of net zero carbon emissions by 2050 and a 46% reduction in GHG emissions by 2030 from 2013 levels, with only five years remaining until 2030.

The GX Implementation Council and other deliberative bodies have been established as forums to discuss macroeconomic strategies for achieving the government's GHG emission reduction target, and the direction of various carbon credit regulations, including the GX League, has been decided. For example, on December 27, 2024, the "GX2040 Vision (Draft) - Revised Strategy to Promote the Transition to a Decarbonized Growth-Oriented Economic Structure" was released, and on page 35 and the following pages, it positions emissions trading systems as institutionalized measures to realize the growth-oriented carbon pricing concept. The GX2040 Vision (Draft) also outlines the direction of the consideration of specific issues, including measures to be implemented through the design of appropriate systems, based on discussions to date.

Among these measures, the GX League, an emissions trading system, has been established as an institutionalized measure to realize the growth-oriented carbon pricing concept, and a voluntary participation system has been in operation as the first phase from FY2023 to FY2025. Companies accounting for 50% or more of Japan's GHG emissions have already participated in the first phase of the GX League, and active discussions are underway. A mandatory emissions trading system (cap-and-trade system) similar to the EU ETS is planned to be introduced in April 2026. Based on the discussions by the following working groups established during 2024, the draft amendment to the Act Concerning the Promotion of a Smooth Transition to a Decarbonized Economic Structure (the "2025 Draft Amendment to GX Promotion Act") has been approved by the Cabinet Office of Japan on 25 February 2025.

- Special Working Group on Carbon Pricing to Achieve a Green Transformation (the Cabinet Office) (the "CPWG");
- Legal Issues Study Group Conducive to Examining Emissions Trading Systems for Achieving a Green Transformation (the Ministry of Economy, Trade and Industry and the Ministry of the Environment) (the "Legal Issues Study Group"); and
- Working Group on Financial Infrastructure for Carbon Credit Transactions (the Financial Services Agency) (the "Financial Infrastructure Working Group").

This newsletter discusses (A) major issues under the 2025 Draft Amendment to GX Promotion Act and (B) major issues (focusing on civil and regulatory laws) discussed at the CPWG, the Legal Issues Study Group, and the Financial Infrastructure Study Group mentioned above.

2.1.1. 2025 Draft Amendment to GX Promotion Act

2025 Draft Amendment to GX Promotion Act provides statutory framework of Japanese ETS (GX League Phase 2) which will have impact over Japanese companies in all sectors. Although 2025 Draft Amendment to GX Promotion Act is still a draft which is subject to changes, major issues

are summarized below.

- (1) Compulsory Participation: From April 2026, Large Emitters (i.e., Companies with Scope 1 GHG emission of 100,000tone/year (CO2 equivalent)) will be obliged to participate in Japanese ETS (GX League Phase 2).
- (2) Allowances (*haishutsuwaku*): Allowances will be allocated to Large Emitters without any fee/auction in accordance with the allocation guideline to be determined by the Japanese government (which has not been published yet). It is expected that allowances will work as “cap” of Scope 1 GHG emission of Large Emitters.
- (3) A Large Emitter will need to purchase allowances and/or other carbon credits if such Large Emitter will have emitted Scope 1 GHG exceeding the total amount of allowances allocated to such Large Emitter. We will need to take a close look at detailed rules (which have not been published yet) on to what extent carbon credits other than allowances (e.g., J credits, JCM credits or Japanese / international voluntary carbon credits) can be used for offsetting Scope 1 GHG emissions of such Large Emitter.
- (4) GX Accelerating Agency (*GX-shiishin-kikou*) will operate the allowance trading market (*haishutsuwaku-torihiki-shijou*). We will need to take a close look at how the allowance trading market will be operated together with other carbon credit markets in Japan (e.g., the carbon credit markets operated by Tokyo Stock Exchange).
- (5) Certain mechanism for stabilizing the price of allowances will be put in place (e.g., the highest/lowest price of allowances will be determined by the government).
- (6) Statutory protection of allowance trading will be put in place under the GX Promotion Act (e.g., legal requirement for valid transfer of allowances, protection of bona-fide purchasers). In this regard, 2025 Draft Amendment to GX Promotion Act does not contain any provision which prohibits creation of pledge over allowances while there are provisions under the Global Warming Countermeasures Act which prohibits creation of pledge over Kyoto credits (*santei-wariateryou*) and JCM credits. We will need to take a close look at on-going discussions on whether or not any security interests (e.g., pledge) can be validly created over allowances and / or other types of carbon credits (e.g., J-credits or JCM credits) since demands for secured finance in terms of underlying GHG reduction projects may be increasing.
- (7) Based on discussions at Legal Issues Study Group below, it is expected that certain regulations (e.g., obligations for allowance trading to be centralized at the designated exchange and prohibition on unfair allowance trading) will be put in place.

2.1.2. CPWG

The CPWG discussed the overall system design to promote carbon net-zero investments once the second phase of the GX League becomes fully operational. In particular, issues related to emission allowances in the second phase of the GX League were identified. As a result of discussions during the five meetings, the Secretariat made the following proposals, and it was confirmed that the system will be reconstructed in accordance with future changes in economic and social conditions, etc., while fully ensuring the continuous review and predictability of the system.

Issues related to the framework of the system in the second phase	Concrete proposals
(i) Basic concept of the system	(i) Business operators that emit a certain amount of greenhouse gases or more will be required to amortize their emission allowances in an amount equal to their actual emissions in each fiscal year. To this end, a system will be introduced under which business operators will be allocated 100% of their calculated emission allowances free of charge.
(ii) Persons covered by the system	(ii) Companies with direct GHG emissions (“scope 1 emissions”) of 100,000 tons or more of CO2 equivalent per year (“large emitters”)
(iii) Concept of allocation of emission allowances	(iii) Calculations will be made based on industry-specific benchmarks, particularly in energy-intensive sectors where there is a strong need to consider industry characteristics. For sectors where it is difficult to create benchmarks, allocations will be made based on a grandfathering basis.
(iv) Rules imposed on persons covered by the system (rules for the performance of the amortization obligation)	(iv) In the event of non-performance of the amortization obligation, a monetary payment equal to the shortfall in the procurement of emission allowances will be required.
(v) Emission allowance exchange (rules on emission allowance trading)	(v) It was proposed that measures be taken to ensure that orders for emission allowance trading are concentrated on exchanges (e.g., an exchange-trading obligation). As for market trading participants, some business operators will be allowed to participate in trading on the condition that they have a certain level of experience in emission allowance trading.
(vi) Investment predictability (price stabilization measures)	(vi) The upper and lower price levels will be determined based on the opinions of the industry and other stakeholders in

	<p>the future, assuming that the upper and lower limits of the trading price of emission allowances will be set and the price range will be indicated in advance to increase the predictability of the trading price and promote investment.</p>
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2.1.3. Legal Issues Study Group

In the Legal Issues Study Group, constitutional, administrative law, and civil law issues related to emission allowances in the emissions trading system were discussed in more detail, and a “Draft Report on Legal Issues and Concept of the Emissions Trading System Conducive to Achieving a Green Transformation” (the “Draft Report”) was formulated. The following is a summary of the policies on civil law, regulatory law, and market trading, as proposed during the 6th meeting of the Legal Issues Study Group based on the Draft Report.

Civil law issues	
Nature of emission allowances	<ul style="list-style-type: none"> ■ The emission allowances allocated as a result of a 100% allocation will be managed electronically with serial numbers. Since emission allowances are substitutable rights in that they can be offset against GHG (scope 1 emissions), the “amount” of emission allowances (i.e., the number of tons of CO2 equivalent emission allowances) is important.
How to regulate trading	<ul style="list-style-type: none"> ■ The Legal Issues Study Group will consider creating a legal framework for the ownership of rights, requirements for the effectiveness of transfer, and bona fide acquisition of emission allowances, etc. (rights will be transferred by registration in the registry). However, since liquidity is expected to be low at the beginning of the second phase of the GX League, the subjective requirements of a third-party protection clause (protection of persons who are not grossly negligent) will not be relaxed. ■ The Legal Issues Study Group will also consider specifying in the relevant law the right of the true holder of emission allowances to request the holder of record to amend the record if the true holder of emission allowances and the holder of record are different.
Issues concerning security interests	<ul style="list-style-type: none"> ■ Although there is no provision in the relevant law prohibiting the creation of pledges, it will be virtually impossible to create pledges at the beginning of the second phase of the GX League, as no records will be made in the registry at such time (however, security by way of assignment (<i>jouto tanpo</i>) could be established as a form of security interest).

Issues related to market trading of emission allowances	
How to regulate traders and brokers	<ul style="list-style-type: none"> ■ As for market trading participants, in addition to those covered by the system, some business operators will be allowed to participate in the trading on the condition that they have trading experience. ■ In view of the above, since trading participants will be those covered by the system and some business operators (and not individuals, etc.), no legal restrictions will be imposed on traders and brokers.
How to regulate emission allowance exchanges	<ul style="list-style-type: none"> ■ The Legal Issues Study Group will consider measures to impose obligations for allowance trading to be centralized at the designated exchange in order to ensure that emission allowances are traded on exchanges that meet certain requirements and are subject to government oversight.
How to deal with unfair trading	<ul style="list-style-type: none"> ■ The Legal Issues Study Group will consider prohibiting market participants from engaging in unfair trading under the business rules of exchanges, and barring market participants who violate the rules from trading on exchanges (however, the Legal Issues Study Group will consider in detail in the future whether market manipulation, insider trading, and some other activities should be recognized as unfair trading, and what specific requirements should be in place for such activities to be recognized as unfair trading).

2.1.4. Financial Infrastructure Working Group

Direction of development of a trading infrastructure for carbon credits was discussed at the Financial Infrastructure Working Group. To date, the working group has held three meetings, discussing issues such as the ideal form of carbon credit trading and application of technologies such as blockchain to such trading for more transparent and sound voluntary carbon credit trading.

In the meantime, the (proposed) GX2040 Vision and the Legal Issues Study Group, etc., have pointed out the use of external credits (such as J-Credits) for emissions trading and a need for alignment with the existing legislation for that purpose, which will be discussed in the future, and it is, thus, necessary to pay close attention to how carbon credit trading will be utilized in the second phase of the GX League.

2.2. Disclosure regulations

The Financial System Council of the Financial Services Agency established the “Working Group on Sustainability Disclosure (Reporting) and Assurance” (“Disclosure WG”) to discuss the disclosure of sustainability information and how it should be verified based on the proposed standards disclosed by the Sustainability Standards Board of Japan (the “SSBJ”) on March 29, 2024 (collectively, the “Proposed SSBJ Standards”).

As for the disclosure standards, the policy was presented to incorporate the SSBJ Standards into the Financial Instruments and Exchange Act and related regulations of Japan assuming that the functional consistency with the standards disclosed by the International Sustainability Standards Board (the “ISSB”) (the “ISSB Standards”) is ensured. In addition, the Disclosure WG (5th session) discussed (i) the scope and timing of application of the SSBJ Standards as well as the timing and method of sustainability disclosure, (ii) the method of disclosure in Japan for overseas, (iii) disclosure of GHG emissions from the entire supply chain (the “Scope 3 Emissions”), (iv) material false statements concerning sustainability disclosure, and (v) a verification system.

2.2.1. Overview of Disclosure WG

The Disclosure WG discussed sustainability disclosure, sustainability verification system, and the direction of sustainability information verification system in the total of five sessions. While the current Financial Instruments and Exchange Act (the “FIEA”) provides for an obligation to disclose sustainability information, companies are not required to disclose total GHG emissions. The Disclosure WG is currently discussing to impose an obligation to disclose total GHG emissions on companies listed on the Tokyo Stock Exchange Prime Market with market capitalization of 3 trillion yen or more from around 2027.

2.2.2. Points of discussion on sustainability disclosure

There have been discussions on the need for review of safe harbors in particular for disclosure of Scope 3 Emissions in addition to the statements regarding the liability for false statements concerning future information in the Guideline for the Disclosure of Corporate Affairs 5-16-2, which were added by the amendment that came into effect on January 31, 2023. This is because the disclosure of Scope 3 Emissions in particular involves uncertainty, as such disclosure relies on data from third parties (such as direct or indirect business partners in the supply chain) over which the reporting company has no direct control. At the Disclosure WG (4th session), the secretariat, therefore, proposed to amend the guidelines to clarify that a company would not be held liable for false statements if (1) it has explained that it had properly examined internally the appropriateness of the use of information obtained from third parties over which the company has no direct control and the reasonableness of estimates, and (2) the contents of the disclosure fall within the range considered reasonable in general. Members generally agreed with the proposal. In response to the proposal, there was also an opinion that that discussion need not be limited to Scope 3 Emissions, as the discussion was also relevant to value chain information in general. The Disclosure WG (5th session) confirmed that it would continue discussions, including the necessity of law amendment, on the assumption of amending the guidelines to address the safe harbors for false statements concerning disclosure of Scope 3 Emissions.

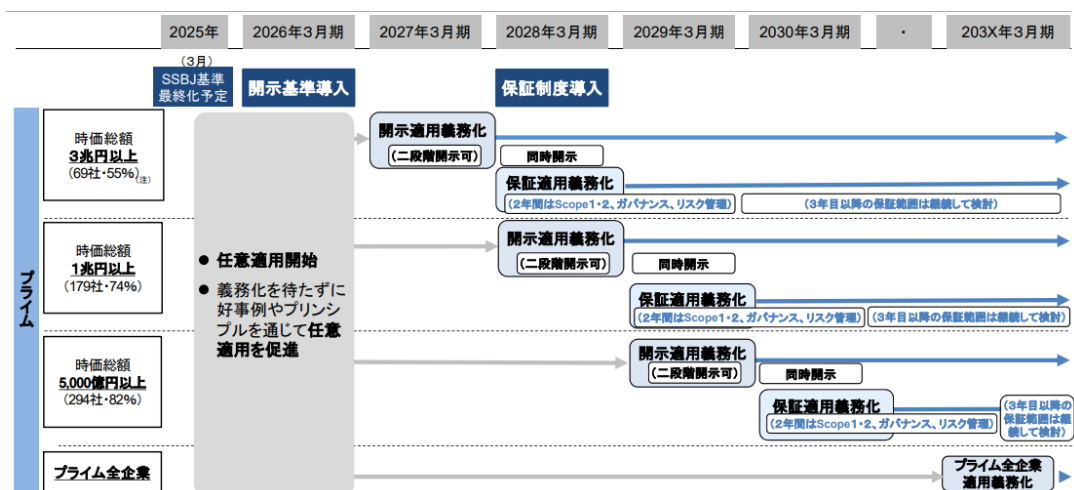
2.2.3. Points of discussion on sustainability verification system

The points of discussion in relation to the introduction of a sustainability verification system included the scope and level of verification, the entity responsible for verification services, the verification standard and the ethical and independence standards for verification services, inspection and supervision over verification service provider, and the nature and role of governing bodies of self-regulatory organizations. Proposals for the direction of the system were presented for each of these points, and below is the outline of the proposals:

Point	Direction of verification system (proposed)
Scope and level of verification	<ul style="list-style-type: none"> ■ For companies with market capitalization of over 3,000 billion yen, over 1,000 billion yen, and over 500 billion yen, the scope of verification will be Scope 1, Scope 2, and Governance and Risk Management for the first two years after the introduction of the verification system, and the Disclosure WG will continuously review this based on international trends and other considerations for the third and subsequent years.
Entity responsible for verification services and required abilities	<ul style="list-style-type: none"> ■ The system will be a professional agnostic system where the entity responsible for verification services will not be limited to audit firms, provided that the entity has in place an adequate system to fairly and correctly perform sustainability verification services.
Registration system, obligations and responsibilities for verification services	<ul style="list-style-type: none"> ■ A registration system will be introduced to ensure the quality of services provided by the verification service provider. ■ Obligations, responsibilities, ethics, and independence will be the same under the system regardless of whether the entity is an audit firm or other verification service provider.
Verification standards, inspection and supervision, self-regulation	<ul style="list-style-type: none"> ■ Establish Japan original verification standards in reference to international verification standards. ■ Inspection, supervision, and self-regulation will be same whether the entity is an audit firm or other verification service provider.

2.2.4. Direction of sustainability information verification system

In addition to the above directions, the roadmap for the verification system was presented as below. Furthermore, the following points were identified as requiring further consideration for the roadmap: (i) the use of external professionals by a verification service provider as necessary assuming that the verification service provider is an audit firm or other verifying entity that is registered under the new registration system; (ii) as for the outline of the system for application of verification, the level of verification being limited verification, and reconsideration of whether it should be changed to reasonable verification based on the implementation status, international trends, and other considerations; and (iii) the scope of verification being Scope 1, Scope 2, and Governance and Risk Management for the first two years after the introduction of mandatory verification, and the scope being reviewed in light of international trends and other considerations for the third and subsequent years.



Source: Disclosure WG (5th session) material 1 “Secretariat Briefing Material” (Financial Service Agency, December 2, 2024) P.21

2.3. Practical issues on carbon credit trading

2.3.1. Legal nature

On June 27, 2024, the Financial Law Board published "Summary of Discussion: The Status of Carbon Credits under Private Law, Focusing on Their Legal Nature and the Legal Principles of Attribution and Transfer" to address arguments under the civil laws concerning external credits other than emission allowance (baseline & credit-type credits such as J-Credit), which discussions will be presented below.

A. Nature of carbon credits under private law

There are two different views on the nature of carbon credits under private law: (i) the position that rights pertaining to carbon credits exist outside of records and that attribution and transfer are certified and governed by records in account registry; and (ii) the position that views records in account registry themselves as rights pertaining to carbon credits and does not believe rights exist outside of records.

According to the position (ii), the record's and right's locations always match, and it is relatively straightforward to explain that the record transfer is treated as a right transfer. Since such an explanation, however, can be seen to deviate from the general understanding shared by parties to transactions of carbon credits, the position (i) seems in line with the understanding shared by parties to transactions.

Secondly, carbon credits do not have an accompanying physical object, and their existence is based on records in an account registry, so they are not tangible objects. Therefore, it is natural to consider that carbon credits cannot be the object of ownership.

Furthermore, there are two views on the legal nature of carbon credits: (i) the position of viewing carbon credits as a bundle of contractual rights or a claim against an account administrator and (ii) the position of viewing carbon credits as a type of proprietary rights other than rights explicitly set forth under law, such as real rights (bukken) and claims (saiken), and the position (ii) seems to fit in light of the previous trading practices.

B. Attribution and transfer of carbon credits

With regard to book-entry transfer securities under the Act on Book Entry of Corporate Bonds and Shares, it is expressly set forth in law that rights attribution is determined by an account entry or record in a book-entry transfer account registry, and a transfer of rights goes into effect in accordance with a record of an increase or decrease (i.e., transfer) in an account. As with book-entry transfer securities, it is in line with the previous trading practices to consider that account records are also a requirement for a rights transfer to go into effect in relation to carbon credits that are managed according to records in account registry and for which it is assumed that transferring rights in a manner independently from those records will not take place.

2.3.2. Contract templates

For carbon credit trading outside Japan, the International Emissions Trading Association (IETA) and the International Swaps and Derivatives Association (ISDA), for example, have published contract templates (in English) to help expedite transactions and reduce transaction costs. As carbon credit trading in Japan is expected to become more popular, contract templates written in Japanese are desired.

2.3.3. Dealing with greenwashing risk

Greenwashing (i.e. claiming an environmental improvement effect despite no such an effect actually) by a company may cause risks that consumers and investors will be unable to make appropriate consumption and investment decisions thereby exacerbating environmental problems, and that the company will lose the trust of consumers and investors.

Europe and the U.S. have been developing regulations targeting greenwashing in particular, going beyond misleading indications covered by the Act against Unjustifiable Premiums and Misleading Representations in Japan. In March 2023, the European Commission published a “proposal for Green Claims Directive,” which requires that environmental claims be based on recognized scientific evidence and latest technology, that the impact be assessed throughout the entire life cycle of the product or service, and that it be clearly stated whether the claim applies to the entire product or only to a part of it. In September of the same year, the EU Council and the European Parliament reached a provisional agreement on amendments to the Unfair Commercial Practices Directive (UCPD) and the Consumer Rights Directive (CRD). In the U.S., the Federal Trade Commission (FTC) has been regulating environmental advertising and has published guidelines “Green Guides.” As such, regulations on greenwashing have been discussed vigorously around the world, and it is difficult to accurately comprehend the details of such regulations. It is, however, necessary to keep up with the situation of law amendments and the trends in greenwashing lawsuits and to take actions accordingly to the fullest extent possible.

Greenwashing lawsuits are characterized in that they are brought based not only on the consumer protection laws, but also on legal grounds other than regulatory laws, such as unjust enrichment, misleading indication, and breach of express warranties. As such, it is important for companies to reduce risks and improve the reliability of their business by taking actions in accordance with recommended guidelines, and their own disclosed environmental policies and rules, in addition to the laws and regulations of the countries to which they export or in which they operate business.

3. Recent developments outside of Japan

3.1. Paris Agreement/COP29

Under Article 3 of the Paris Agreement, all Parties are required to set reduction targets for greenhouse gas emissions every five year (Article 4, Paragraph 2) as the Nationally Determined Contributions (“NDCs”). Article 6 sets out a mechanism for distributing or transferring additional emission reduction credits obtained through each Party’s cooperative effort to realize NDCs among cooperating countries and companies. However, many aspects of the detailed rules for the operation of Article 6 had not been reached agreement.

At the 29th session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (COP 29) and the sixth session of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (CMA 6) held in Baku, the Republic of Azerbaijan in November 2024, the Parties agreed on the detailed rules for the operation of Article 6 and realized the complete operation of the mechanism under Article 6. Key points from the agreed matters are summarized in the table below.

Article	Overview of mechanism	Agreed matters
Article 6, Paragraph 2	<ul style="list-style-type: none"> ■ A mechanism for transferring the Internationally Transferred Mitigation Outcomes (“ITMOs”) achieved by a Party through cooperative actions taken by two or more Parties with the aim of assisting other Parties to achieve their NDCs ■ Managed by each Party 	<ul style="list-style-type: none"> ■ Require items such as the date of approval, the amount of ITMOs, the purpose of use, and the commencement of the corresponding adjustment be included in the approval of the Parties' government, as to a prerequisite for the transfer of ITMOs ■ Add the method for applying corresponding adjustments and addressing greenhouse gas emissions to the initial reporting items ■ Decide on other matters, such as processes of identifying, noticing, and correcting the information inconsistencies
Article 6, Paragraph 4	<ul style="list-style-type: none"> ■ A mechanism for transferring the emission reductions achieved by a Party through cooperative actions taken by two or more Parties to promote sustainable development with the aim of assisting other Parties to achieve their NDCs ■ Managed by the United Nations 	<ul style="list-style-type: none"> ■ Confirm standards for project methodology requirements ■ Confirm the standards for setting requirements for reduction and removal activities

The JCM credits issued under the initiative of Japan are promising as the ITMOs under Article 6, Paragraph 2 above, of which 100 million tons are expected to be used to achieve the government's target of 46% GHG reduction by 2030. It is anticipated that investments and loans for JCM credits will be activated while the rules related to Article 6 of the Paris Agreement are finalized and their operations are promoted.

3.2. Voluntary Markets

Until the detailed rules under Article 6 of the Paris Agreement were finalized at the COP 29 held in November 2024, international voluntary carbon credits (“VCCs”) certified and issued under various standards had been actively traded in international markets. However, there is persistent criticism against VCCs as greenwashing (false economic countermeasures). Therefore, discussions are now underway to ensure the quality of VCCs.

3.2.1. ICVCM

The Integrity Council for the Voluntary Carbon Market (ICVCM) is an independent organization that establishes a quality requirement for carbon credits, especially for VCCs. Among others, ICVCM has published the Core Carbon Principles (the “CCPs”) which set out detailed requirements of “high quality” VCCs.

ICVCM uses the two-step assessment framework: (i) program-level assessment and (ii) category-level assessment. Under (i), programs implemented by their administrators will be recognized as “CCP-Eligible” if they are certified. Under (ii), methodologies of credits issued will be recognized as “CCP-Approved” if they are certified.

For a specific credit to be recognized as CCP-Eligible, carbon-crediting programs should establish procedures based on the ICVCM Assessment Framework. CCP-Eligible crediting programs must commit to implement the methodologies underlying CCP Approval, which ensures that the standards and commitment underlying CCP Eligibility and CCP approval are maintained. As a process to ensure the steady implementation of these methodologies, the ICVCM reviews market information, collects opinions from stakeholders, and monitors complaints and problems.

According to materials disclosed by ICVCM, crediting programs certified by Verra and Gold Standard, which have a large market share in VCCs, have been approved as “CCP-Eligible.” In the future, attention will be paid to the amount of trading costs for CCP-eligible VCCs and the availability of an adequate supply of CCP-eligible VCCs.

3.2.2. CORSIA

The Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) is a framework operated by the International Civil Aviation Organization (ICAO) to decarbonize the international aviation sector. In addition to technological innovation, operational improvements and the use of sustainable aviation fuels, the organization aims to reduce the greenhouse gas emissions from the international aviation sector through an offsetting scheme. Since it is difficult to ascertain the status of international aviation operating across national borders based on the Paris Agreement, the CORSIA was established to directly bind large international airlines. However, tied to the issue

of carbon credit quality, obtaining certification as CORSIA Eligible would be one of the methods available for guaranteeing quality.

CORSIA divides the period from 2021 to 2035 into three phases with different participation obligations and scope. The three phases consist of (i) the pilot phase (2021-2023), (ii) the first phase (2024-2026), (iii) the second phase (2027-2035), and it currently stands in the first phase. In the first phase, large international airlines are obliged to reduce GHG emissions on flights between the countries that voluntarily participate, and are allowed to offset their emissions through qualified carbon credits (Phase 1) as described in (a) below. It is expected that there will continue to be strong demand for credit to enable leading airlines to meet their CORSIA offsetting requirements. At the time of publication, 129 countries participate in CORSIA, indicating that a large portion of international routes and flights are subject to CORSIA. In the second phase, all countries will be required to participate in CORSIA.

(a) CORSIA eligible carbon credits (CORSIA-eligible Units)

Many carbon credits including Verra and Gold Standard have traditionally been certified as eligible carbon credits (pilot phase). In October 2024, Verra and Gold Standard were newly certified as CORSIA-eligible carbon credits (Phase 1). As in the case of CCP-Eligible, attention will be paid to the amount of trading costs for CORSIA-eligible VCCs and the availability of an adequate supply of CORSIA-eligible VCCs.

(b) CORSIA Eligible Fuels

For aircraft operators to claim a reduction in their offsetting requirements through the use of sustainable aviation fuels (SAF) and lower carbon aviation fuels (LCAF), these fuels must be certified as CORSIA-eligible. Fuels will be certified as CORSIA-eligible if they receive the Sustainability Certification Scheme (SCS) certification by (i) RSB (Roundtable on Sustainable Biomaterials) or (ii) ISCC (International Sustainability and Carbon Certification) standards.

3.3. Recent climate change lawsuits in foreign countries/Greenwash-related lawsuits

Movements including lawsuits related to climate change and greenwashing (false solutions to environmental issues) have been activated outside of Japan, including in the United States and European countries, typically exemplified by a lawsuit against a major airline. Such lawsuits help Japanese companies to examine litigation risks related to carbon credit transactions. Some recent examples are listed below.

3.3.1. Belgium | NPO v. National Bank

An NPO filed a lawsuit against the Belgian National Bank for failing to meet environmental, climate, and human rights requirements when purchasing bonds from fossil fuel and other greenhouse-gas intensive companies, which is in violation of EU law. The NPO withdrew this case.

3.3.2. Australia | Regulating authority v. Asset management company

A regulating authority filed a lawsuit against an asset management company because its ESG fund's disclosure materials stated that it had screened issuers engaging in business activities related to a specific industry such as fossil fuels, but it had not actually screened any products. The regulating authority won the case.

3.3.3. United States | Compensation claim for overissued carbon credits

A voluntary credit issuer canceled over 5 million units of credits issued to a carbon credit development company and sought compensation. The company engaged in a project in Asia and Africa to replace fuels used for cooking stoves with clean fuels. The company is alleged to have overestimated the GHG emission reduction effect achieved by the project.

3.3.4. Matters to be noted by Japanese companies

As stated above, there are increasing risks outside Japan related to climate change and greenwashing (false solutions to environmental issues). For example, when Japanese companies offer carbon neutral products or services in the overseas market, they should avoid these risks by using CCP-eligible or CORSIA-eligible VCCs as evidence of "carbon neutrality."

4. Final Remarks

While there are various risks associated with countering carbon credit regulations, including the regulatory risks and litigation risks discussed above, they can help create new business opportunities by expanding loans and investments in GHG gas emission reduction technology and projects. Companies can attract ESG loans and investments by setting GHG reduction targets for 2030 or 2050 based on their own GHG emissions and those of their supply chains, and then presenting them to domestic and international investors. It is worth building proactive decarbonization strategies as a business opportunity before the commencement of the mandatory emission trading system in 2026.

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