

## **Submission in Response to the Call for Inputs on the Development of a Pledge System in the Mechanism Registry under Article 6.4**

Submitted by: Shawn HE

6 April 2025

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This submission is made in response to the call for inputs issued by the Supervisory Body on the potential development of a pledge system within the mechanism registry established under the Article 6.4 mechanism of the Paris Agreement.

I write in my personal capacity as a lawyer practising in the field of climate change law, with a particular focus on carbon markets and international regulatory frameworks. The views expressed herein are my own and do not represent the position of any institution or client.

It is respectfully submitted that the proposed pledge system should not be pursued under the current framework due to the substantial legal uncertainties it entails. In particular, the Supervisory Body has decided to frame account holdings in terms of a right to control, rather than confirming ownership. Without recognition of ownership, a pledge system risks operating on an unstable legal foundation.

In most jurisdictions, the creation of a pledge or security interest over an asset requires that the pledgor holds ownership of that asset. A right to control, while potentially operational within a registry system, does not by itself provide a sufficient basis for enforceable security interests. A pledgee cannot obtain more rights than the pledgor possesses. Therefore, pledging control rights alone is unlikely to afford the pledgee the ability to dispose of or realise the pledged A6.4ERs in the event of default. At best, it may entitle the pledgee to take control, but not to exercise ownership-like powers such as transfer or sale.

The Secretariat's information note outlines a potential enforcement mechanism whereby pledged A6.4ERs could be transferred to the pledgee's account upon mutual agreement or arbitral decision. However, the note is silent on whether the pledgee may further dispose of the A6.4ERs in satisfaction of a debt. Without clear legal authority to do so, the efficacy of such enforcement remains uncertain.

Furthermore, while a registry may be necessary for the creation and enforcement of a pledge over intangible assets like A6.4ERs, it is not sufficient. The existence of a functioning registry must be complemented by a designated governing law and jurisdiction. These are essential to determine the validity, priority, and enforceability of a security interest. However, the mechanism registry is expressly not subject to any national legal system, and no governing law has been designated to regulate security interests or pledges. This absence of legal anchoring may leave pledge agreements vulnerable to dispute and inconsistent interpretation across jurisdictions.

Even if parties designate a governing law and jurisdiction in their pledge agreement, this may not resolve all uncertainties. Insolvency rules, conflict of law provisions, and public policy considerations could override the parties' choices. Furthermore, if the mechanism registry does not recognise ownership, some national legal systems may not recognise the pledge as valid, irrespective of contractual agreement.

Leaving the issue entirely to national law while providing only registry-level support may appear to offer flexibility, but it risks creating confusion rather than clarity. In cross-border contexts, the absence of harmonised legal treatment or a governing framework may lead to conflicting claims and uncertainty about enforcement. In particular, creating a pledge system without recognising ownership of account holdings could result in a half-measure that undermines confidence rather than enhancing legal certainty.

In conclusion, while the Secretariat's consideration of a pledge system is a welcome effort to explore potential enhancements to the mechanism registry, such a system should not be developed without first ensuring the legal framework can support it. Without recognising ownership of account holdings and designating a governing legal system, a pledge system may ultimately introduce legal and operational complexity that outweighs its potential benefits.

Respectfully submitted,

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