

Energy – Facts: Carbon Allowances and Credits from Project Activities



Increased regulation and focus on carbon allowances and credits from project activities means that it is an area of growing importance to both Danish and foreign undertakings. This involves legal and commercial implications for undertakings – specifically in relation to compliance with the Danish Carbon (CO₂) Allowance Act; aspects relating to the purchase and sale of carbon allowances and credits from project activities; and considerations regarding company-specific CSR policies.

A number of energy-intensive undertakings are subject to the Danish Carbon Allowance Act (“CO₂-kvoteloven”) governing greenhouse gas emissions from specific types of installations. Moreover, many undertakings and sectors which are not currently subject to the Act will, in the coming years, be subject to the regulation and thus become compliance undertakings. Undertakings within the transportation, agricultural and industrial sectors are already adjusting to the new process. Further, carbon allowances and credits from project activities are relevant to undertakings which, on the basis of their company-specific CSR policies, contemplate including carbon offsetting in their business strategies or making climate-related efforts as part of their product differentiation.

ISSUES TO BE CONSIDERED BY THE UNDERTAKING

Relevant commercial and legal considerations in relation to carbon allowances and credits from project activities will depend on whether the

undertaking is a compliance undertaking or whether carbon offsetting measures have been chosen by the undertaking on the basis of other aspects, such as a company-specific CSR policy.

Relevant considerations for compliance undertakings:

- Which obligations apply to the operator of the undertaking?
- Which rights and obligations are imposed on the compliance undertaking in relation to the allowances issued?
- Which requirements apply with regard to the undertaking's surrender obligations?
- What options are available to the undertaking for excess allowances? Is it possible to sell excess carbon allowances to third parties or transfer excess allowances to subsequent years/periods? Which considerations are most relevant to the decision?
- How does the compliance undertaking acquire (extra) allowances or credits if it does not have sufficient allowances to cover its emissions?
- Which legal and commercial considerations should be taken into account when purchasing credits from project activities? What are the implications of engaging in a CDM or JI project? Which expectations are placed on project participants? Which regulatory approvals should be obtained? How does the undertaking best safeguard its interests, both for due diligence investigations into the relevant project and in negotiating contracts? Are there any special circumstances for management of suppliers which apply to the project activity market?

Relevant considerations for non-compliance undertakings:

- How does the non-compliance undertaking incorporate carbon offsetting into its CSR policy?
- How will the undertaking implement its CSR target (e.g. by becoming carbon neutral within a certain number of years)?
- Are carbon allowances or credits (including emission reductions) the right tool for the particular undertaking to use to comply with its CSR policy?
- Which legal and commercial challenges does the undertaking face in connection with its purchase of carbon allowances and credits? Is the undertaking governed by any special (e.g. sector-specific) rules?
- How does the undertaking safeguard its interests and values when contracting for the purchase of emission allowances and/or credits from project activities?
- Does the undertaking's CSR policy include a set of clear guidelines which makes it applicable as an instrument for management of suppliers? Has the undertaking adopted a code of conduct that could be used for aligning its expectations with contracting parties and with a view to defining the opposing party's (the supplier's) contractual obligations?
- For legal and commercial considerations relevant to the purchase of emission allowances or credits, please refer to the section above concerning compliance undertakings. In that respect, the undertaking may also consider whether any particular opportunities exist for product differentiation by selecting certain carbon offsetting measures over others.
- What are the undertaking's own requirements for self-regulation of activities such as monitoring and verifying greenhouse gas emissions?

THE REGULATION GOVERNING CARBON ALLOWANCES AND CREDITS

A number of international conventions and agreements have been adopted in this respect, including the United Nations Framework Convention on Climate Change (UNFCCC) and the Kyoto Protocol. The regulatory objective is to globally reduce greenhouse gas emissions.

The Kyoto Protocol includes the following methods to achieve reductions in greenhouse gas emissions:

- the Carbon Market (Emission Trading);
- the Clean Development Mechanism (CDM) projects that reduce greenhouse gas emissions in developing countries; and
- Joint Implementation (JI) projects that reduce greenhouse gas emissions in countries with binding emissions targets).

On the basis of the UNFCCC and the Kyoto Protocol, the EU has adopted the Emission Trading Directive (2003) and the Linking Directive (2004). The two directives establish the scheme for the EU's Emission Trading System (EU ETS). The Danish Carbon Allowance Act implements the directives and provides obligations applicable to compliance undertakings.

Also adopted are two amending directives – an amending directive to include aviation activities in the scheme for greenhouse gas emission allowance trading within the Community (2008), and an amending directive to improve and extend the Community's greenhouse gas emission allowance trading scheme (2009).

Today, the EU constitutes the largest regional market for trading in carbon allowances. Carbon allowances allocated in the EU are called EU Allowances (EUAs). Moreover, compliance undertakings may use credits from CDM and JI projects to meet their surrender obligations.

There are currently ongoing international negotiations for the adoption of a new climate treaty to replace the Kyoto Protocol. The goal is to reach a global agreement during the UN Climate Change Summit (COP15) in Copenhagen in December 2009.

CORPORATE SOCIAL RESPONSIBILITY (CSR)

Pursuant to the new rules in the Danish Financial Statements Act, a number of the largest undertakings in Denmark are obliged to report on their CSR policies, including any climate measures.

If you would like to know more about carbon allowances and credits or are interested in arranging a no-obligation meeting, please do not hesitate to contact your usual legal adviser with Kromann Reumert or one of our specialists within this area.

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