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## Oil, Gas & Energy Law Intelligence

### **Legal Aspects of Carbon Trading Kyoto, Copenhagen and Beyond (eds. D. Freestone and C. Streck) - book review** by N. Ahner

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**OGEL** (Oil, Gas & Energy Law Intelligence): Focusing on recent developments in the area of oil-gas-energy law, regulation, treaties, judicial and arbitral cases, voluntary guidelines, tax and contracting, including the oil-gas-energy geopolitics.

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**Legal Aspects of Carbon Trading  
Kyoto, Copenhagen and beyond  
By David Freestone and Charlotte Streck**

*Publisher – Oxford University Press, Oxford*

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Five years ago, the Kyoto Protocol came into force. Setting in place three market mechanisms - namely emissions allowance trading, the Clean Development Mechanism (CDM) and the Joint Implementation mechanism (JI) - it led to the emergence of an international carbon market. Today the future of the carbon market is still afflicted with uncertainty. In fact, it is this uncertainty that is one of the key underlying themes throughout the book. The total of 27 chapters are connected by their dealings with the regulatory uncertainty, the inherent experimental aspects of a market-based approach for tackling climate change at international level and, moreover, they all touch upon those lessons learnt and possible concepts that can be derived out of the past experiences.

The book's objective is to explain in detail the main legal and political issues raised by emissions trading and carbon finance. Thanks to the wealth of information it contains, the book may also serve as a useful reference book, even for those who are already familiar with the subject. The reader will not only find a comprehensive analysis of the main ideas formulated elsewhere on these topics but also a number of proposals for improvement in well-known areas.

After first introducing *'The International Climate Change Legal and Institutional Framework'*, the various contributions examine subsequently more *'General Issues'*, such as, for example, the legal ownership and nature of Kyoto units and EU allowances, or the linking of emissions trading schemes. Thirdly, the book examines *'The Kyoto Protocol Mechanisms'* such as JI, CDM and contracts, fourth *'Carbon Trading Outside Kyoto: Regional Schemes'*, fifth *'Carbon Trading Outside Kyoto: National and Sub-National Schemes'*, sixth the *'Voluntary Markets'* and, finally the issue of *'Post Kyoto: Moving Towards Copenhagen'*. The book ends with a short and compact *'Summary and Outlook'* by the editors.

The list of authors contributing to this work is long. It contains some of the most renowned practitioners and scholars in the field of climate change law and policy. As a consequence, the book represents a more than comprehensive overview of all key issues in the area. That the editors put more emphasis on some issues (for example on the CDM) than others might lie in the nature of a collection of contributions.

It is not possible here to pay tribute to all contributions individually. Thus, the review has to be limited to a few selective remarks.

David Freestone provides the basis for the subsequent investigations in *'The International Climate Change Legal and Institutional Framework: An Overview'* (chapter 1). Starting with an introduction to the UNFCCC system, the key institutions and the processes leading up to, and from, the adoption of the Kyoto Protocol, he guides the reader through the historical development underlying the Kyoto Protocol, introduces its mechanisms and their implementation as well as the basics of carbon contracting. Moreover, the chapter gives an overview of the new climate funds, the governance of the climate change funds and particularly the World Bank climate investment funds.

As carbon markets emerge in various jurisdictions across the globe, their linking promises more efficient achievement of greenhouse gas mitigation objectives. It allows for the creation of larger, more liquid carbon markets, the reduction of volatility and the limitation of potential market abuse, as well as a reduced threat of leakage due to fewer competitive distortions for participants. Rightfully highlighting that less attention has been devoted to the legal and normative implications of linking, Michael Mehling, in his contribution on *'Linking of Emissions Trading Schemes'* (Chapter 5) provides an outstanding overview of the relevant legal and normative considerations. He concludes that linking can be done by accepting foreign units based on an international treaty, which would offer the greatest degree of certainty and predictability even though it faces the greatest range of formal and substantive constraints in international and municipal law.

Jelmer Hoogzaad and Charlotte Streck focus on *'A Mechanism with a Bright Future: Joint Implementation'* (Chapter 8). They evidence that the potential of this mechanism is greatly underestimated. Their contribution contains very interesting details on the current state of play, explaining the procedural requirements for successful participation in JI and subsequently illustrating to a great extent neglected potential of this mechanism while providing additionally an outlook on its post-2012 future. The authors point out that the post-2012 climate regime has to acknowledge the opportunities presented by JI as a trading mechanism with the potential to provide long-term flexibility to carbon market participants.

In *'The CDM Project Cycle and the Role of the UNFCCC Secretariat'* (Chapter 10), Maria Netto and Kai-Uwe Barani Schmidt introduce the issue of the CDM project cycle and various bodies and panels regulating the implementation of this mechanism. Under the CDM, the public and private sectors in developed countries have financed projects in developing countries that reduce emissions of greenhouse gases and contribute to their sustainable development. The difference between JI and CDM is that the latter is mainly regulated by an international authority whereas JI was intended to be regulated primarily by Annex I parties hosting the JI projects with more limited international supervision. Reason for this principal difference is that JI projects take place within an Annex I Party cap whereas CDM projects are outside of such caps. Following on from the preceding chapter the authors in this contribution shed light from a practitioner's

perspective on some of the reasons that led to a slow start of the JI mechanism. Investors and buyers in JI projects are more exposed to host country regulatory and political risk. A buyer wishing to purchase Emission Reduction Units needs not only to examine the risks connected with each host country separately; even in case of purchasing it from a single host country, uncertainty arises due to the fact that in most host countries the legislation and regulation governing JI projects are not yet complete and subject to addition and amendments. In addition, potential host countries are slow in embracing and supporting the mechanism, which leads to further significant delays in the development of national rules and regulations.

Andrew Hedges in his part on *'The Secondary Market for Emissions Trading: Balancing Market Design and Market Based Transactions'* (Chapter 15) gives a detailed overview of secondary trading transactions, an area of law which is becoming extremely sophisticated and complicated. The contribution *inter alia* explains the design elements of the European Emissions Trading Scheme (EU ETS) that provides market participants with the certainty necessary to underpin their participation, with a particular emphasis on the reforms to be implemented from 2013. The section on the interplay between secondary markets such as the EU ETS and the primary markets where emission reduction credits under the flexible mechanisms of the Kyoto Protocol are generated is particularly interesting. In this instance, examples of new types of transactions are used to demonstrate the innovation that such interaction drives.

Another important subject addressed in this book is carbon trading outside Kyoto. Markus Pohlmann's contribution on *'The European Union Emissions Trading Scheme'* (Chapter 16) starts with an inquiry into the reasons for implementing the EU ETS in Europe and describes its cornerstones, such as e.g. the cap setting, EUA allocation, auctioning, and the import of project based credits from the national to the EU level. Changes as of 2013 which are introduced by the 'EU climate action and renewable energy package' are taken into account as well, for example, the abolishment of the National Allocation Plans (NAPs) and their replacement by the EU-wide cap.

Navraj Singh Ghaleigh's contribution, entitled *'Emissions Trading before the European Court of Justice: Market Making in Luxembourg'* (Chapter 17) deals with the transaction-specific jurisprudence of the European Court of Justice which he states is needed in order to facilitate rigorous reductions in emissions. In fact, the 2003 EU ETS Directive has resulted in a significant number of proceedings before the courts, which range from challenges of the validity of the Directive as such over infringement proceedings, to challenges to Commission decisions on the NAPs. He concludes that the imminent changes to the EU ETS regime introduced by the green package and/or the revised EU ETS Directive mirror the findings of the case law.

The picture is completed by the subsequent section on national and sub-national trading schemes, such as emerging schemes in the United States, Australia and New Zealand. In this context, the reviewer would like to give particular attention to the

contributions of K. Russell La Motte, David Max Williamson and Lauren A Hopkins which provides an overview on *'Emissions Trading in the US: Legal Issues'* (Chapter 18) as well as of Christopher Tung on *'Carbon Law and Practice in China'* (Chapter 22).

La Motte, Williamson and Hopkins provide a comprehensive overview of the key legal issues presented by national and sub-national greenhouse gas regulatory initiatives in the United States. Uncertainty plays a large role in this chapter particularly with regard to the precise nature of the interaction between national and sub-national greenhouse gas regulation since essential features of US climate policy are currently fluctuating. The authors present sub-national trading schemes at the regional and state level, as well as survey those legal issues that would play a role when implementing a cap-and-trade scheme in the United States. Additionally, they address constitutional challenges specific to state or regional programs. Interestingly, the final section deals with the suggestion that no climate change specific federal statute will be adopted and the Environmental Protection Agency would probably seek to generate a market for emission trading adopted under the existing Clean Air Act.

Tung emphasizes that even though China is making progress towards a sustainable future and towards a move away from a carbon intensive industry, its response to carbon risk in the post-2012 period is likely to be a continuation of its current practice. The contribution takes stock of China's sustainable development and climate change policies and laws and their effectiveness in implementing its international obligations under the UNFCCC and the Kyoto Protocol. Particularly interesting is the description of the role of the implementation of CDM in China.

Looking at post-Kyoto, Murray Ward addresses the question *"What might a Future Global Climate Change Deal Look Like?"* (Chapter 24). He suggests a concept involving enhanced commitments to constrain emissions in a quantitative and legal manner, as well as a broad set of other elements that the author expects are required in order to find agreement between all countries. Obviously, the international climate change negotiation process itself addressed in this chapter, is one of the most important uncertainties in the current climate change debate. This chapter ends with two contributions on very specific topics: Robert O'Sullivan and Rick Saines on *'International Market Solutions to Protect Tropical Rainforests'* and Clayborne Fox Clarkes and Thiago Chagas on *'Aviation and Climate Change Regulation'*.

To conclude, it can be said that this book is unique in its legally comprehensive and profound approach, which includes the relevant political considerations when it comes to carbon finance and emissions trading. At the time of writing the Copenhagen COP-15 Summit was still forthcoming; the authors, however, managed to render this unproblematic. The editors previous volume published in 2005 on the "Legal Aspects of Implementing the Kyoto Protocol Mechanisms: Making Kyoto Work" has already become a standard work of reference for legal practitioners and researchers; this volume has the potential to live up to this success.