

Carbon Market Oversight: Limits Under International Trade & Investment Law

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Core Distinction:

- Trade in goods and embedded carbon
 - Border carbon restrictions on e.g. steel imports
 - tax or regulation?
 - product or producer measure?
 - internal or border measure?
- Trade/investment in carbon credits
 - Covered by WTO/investment treaties?
 - Would not *enhance* but limit carbon market oversight against discrimination, import restrictions, expropriation etc.

Overview

- Legal classification & consequences
 - WTO coverage
 - Coverage under investment treaties
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I. Legal classification of “carbon credit”

- Strange bird not falling in any pre-existing legal boxes
- Legal boxes come with different types of regulation & protection
- Unique chance to “reverse engineer”
- Dual goal: Cut emissions (“cap”) at lowest cost (“trade”) through carbon price signal

Consequences of legal classification

- Tax
 - Accounting
 - Criminal law
 - Insolvency
 - Contract & commercial law
 - Financial market regulation
 - Conflict of laws
 - EU freedoms, competition, state aid law
 - WTO & investment treaties
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Core divide on legal classification

GOVERNMENT AUTHORIZATION

- Cap, allowance
- Personal right
- Government control
- Morality

USA, Belgium, Greece

TRADABLE ASSET

- Cap *and* Trade, credit
- Property right
- No expropriation
- Commodification of carbon

France, Netherlands,
Brazil

Sensitivity of “Property”

- “Such allowance [SO_x] does not constitute a property right”
(Sec. 403(f) of 1990 Amendments to the CAA)
- “An allowance or an offset credit established by the Administrator under this title shall not constitute a property right”
(Sec. 721(c)(1), American Power Act, May 2010)
- “The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership”
(Art. 345, Treaty on the Functioning of the EU)

Pick & Choose Level of Protection?

- Protection v. private parties

biens meubles (French code civil)

Ormet Corp. v. Ohio Power Co.

- Financial market regulation

valeur mobilière (excluded in Germany)

carbon derivatives only?

- Protection v. government

discrimination, expropriation without compensation

domestic v. international law?

II. WTO coverage

- Not purely sovereign trade
 - Not purely internal trade
 - Cross-border trade (EU ETS, CDM, JI)
 - GATT: trade in goods
 - GATS: trade in services
 - TRIPS: intellectual property protection
 - Subsidies
 - Government Procurement
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1. Carbon Credit = A “Good” ?

- “Product” is not defined in GATT
- Only tangible products (?)
China – Audiovisuals: film on reel = product
Canada – Periodicals: physical periodical = product
- Tangible then necessarily “product”?
1985 *Gold Coins* GATT Panel Report (gold as product)
paper carbon allowance, patent, land title ?
BUT: lottery ticket, fishing permit = service (ECJ)
currency, legal tender = free movement of capital (ECJ)
- Intangible then necessarily not “product”?
Newspaper, film over internet (GATT technologically biased?)
BUT: Electricity = good (*Almelo* case, ECJ)
Stumpage right = good (*Canada – Lumber*, WTO)
- Right to emit (tangible) carbon, carbon/energy input = product?

“So what” if GATT applies?

- Reverse engineer to see whether appropriate
- WTO adopts “evolutionary interpretation”
China – Audiovisuals: “sound recording distribution services”
- **US Bill**: limited recognition of foreign credits
discriminates against foreign offsets
(0.5 v. 1.5 b.; 25%; 1/1.25 ratio)
- No border restrictions, discrimination between
carbon credits, offsets
- Facilitate trade, avoid protectionism
- But are carbon credits/offsets “like products”?
- Environmental justification for any
discrimination?

2. Carbon Credit = A “Service” ?

- GATT and GATS can apply cumulatively
In EU: mutually exclusive
- “Service” is not defined
UN/WTO classification, Member schedules
- Carbon credit as such hard to qualify as a “service”
- CDM credit as “environmental service” of “reducing carbon”?
- Evolutionary interpretation
US – Gambling: “other recreational services”

“So what” if GATS applies ?

- GATS less developed than GATT
- MFN default, but market access and national treatment only where specific commitment
- (Future) disciplines on domestic regulation
- If “service” then no anti-dumping, anti-subsidy rules
 - US v. Eurodif* 2009 (feed v. low enriched uranium)
 - raw material transfer of ownership
 - raw material is fungible
 - substantial transformation
- If “service” could be covered by Government Procurement Agreement

3. Trading of carbon credits & derivatives = “**financial service**” covered by GATS ?

- GATS Annex on Financial Services, para. 5(a)(x)
Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:
...
(C) derivative products including, but not limited to, futures and options;
...
(E) transferable securities; [*French titre financier?*]
(F) other negotiable instruments and financial assets, including bullion. [*US Uniform Commercial Code?*]
- Carbon derivatives covered, but is/should spot/OTC forwards market be covered ?
- Reverse engineer, evolutionary, WTO (not national) law decides

“So what” if GATS financial service ?

- No restrictions on non-EC brokers, non-Kyoto countries ?
- “like service suppliers”?
- Prudential or environmental justifications?
- Possible precedents:

China – Financial Information Services, WTO 2008

(Reuters, Bloomberg v. Xinhua)

China – Electronic Payment Services, WTO 2010

(Visa v. UnionPay over transactions in yuan)

4. Free carbon credits as “**subsidy**”

- Even if carbon credit is not a “good” as such it could be “financial contribution” by government (“revenue foregone”)
- If so, and “specific” subsidy and causes “adverse effects” on other members, free allocation is “actionable subsidy”
- How likely is successful challenge ?

III. Coverage by investment treaties

- Carbon regulation as expropriation, violation of fair & equitable treatment
Coal-fired power plants in Australia (Australia-HK BIT)
- CDM projects and exclusion of certain foreign investors, performance requirements
- Carbon credit as “investment” in its own right
- New EU powers on FDI

US Model BIT 2004

Annex B, Expropriation, paragraph 4(b)

Except in rare circumstances, non discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.

US Model BIT 2004

“**investment**” means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include:

...

(d) futures, options, and other **derivatives**;

...

(g) licenses, authorizations, **permits**, and similar rights conferred pursuant to domestic law; and

(h) other tangible or intangible, movable or immovable **property**, and related property rights, such as leases, mortgages, liens, and pledges.

footnote 2: Whether a particular type of license, authorization, permit, or similar instrument (including a concession, to the extent that it has the nature of such an instrument) has the characteristics of an investment depends on such factors as the nature and extent of the rights that the holder has under the law of the Party. Among the licenses, authorizations, permits, and similar instruments that do not have the characteristics of an investment are those that do not create any rights protected under domestic law. For greater certainty, the foregoing is without prejudice to whether any asset associated with the license, authorization, permit, or similar instrument has the characteristics of an investment.

Conclusion

- Reverse engineer, pick & choose legal boxes to obtain appropriate protection
- Both government permit *and* tradable asset
- Limited role for WTO/investment treaties
- If anything, *limit* on carbon market oversight to protect traders against governments
- **WTO**: trading carbon derivatives = financial service; free allowance = subsidy
- **Investment**: regulation of foreign investors; carbon derivatives = investment