

High Court of England and Wales Rules Emissions Allowances to be Treated as Property

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Following a decision of the High Court of England and Wales in *Armstrong DLW GmbH v Winnington Network Ltd* [2012] EWHC 10 (Ch) the legal status of European Union Allowances (EUAs) traded under the EU Emissions Trading Scheme (EU ETS), has now been clarified, with the Court holding that EUAs should be classed as intangible property under English law.

The Trading Scheme and Allowances

Under the EU ETS, all operators within the European Union that own an installation that emits a certain level of carbon dioxide, must participate in the EU ETS. Each participating operator is given an annual allocation of EUAs, credited into the company's account. All operators must have enough EUAs to meet their compliance obligations, with each EUA representing the right to emit one metric tonne of carbon dioxide into the atmosphere. Operators are fined €100 for each tonne of carbon dioxide for which it has not surrendered an allowance.

Any surplus EUAs may be carried forward by the operator, retired by arrangement with the relevant national administration entity, or traded with other operators or registered EUA traders. EUAs are entirely electronic and, unlike shares for example, they are not evidenced by a title document. Each EUA has a unique identifier number and when it is bought and sold it is moved from one registry account to another registry account. The trading of EUAs may take place very quickly several times a day.

Armstrong DLW GmbH v Winnington Network Ltd

In *Armstrong v Winnington*, one of the matters considered by the Court was the legal status of EUAs. This needed to be determined as it affected the cause of action that was available to Armstrong following the theft of its EUAs.

Armstrong is an operator of two installations in Germany and held an EUA account with the German registry for each of the installations. Winnington, a trader of futures and spot trader EUAs and other commodities, had a registered EUA account in the United Kingdom. As a result of a fraudulent phishing e-mail received by Armstrong, Armstrong's EUA account was hacked. Zen Holdings Limited, a company based in Dubai, contacted Winnington, offering them EUAs from Armstrong's account. Winnington bought and immediately sold on the 21,000 EUAs that it bought from Zen, not knowing that the EUAs had been taken illegally from Armstrong's account.

Armstrong argued, *inter alia*, that Winnington was holding the proceeds from the sale of the EUAs on trust for Armstrong and sought an order for payment of a sum equal to the value of the EUAs. Winnington denied the claim on the basis that it did not know how Armstrong lost the EUAs, making Winnington a *bona fide* purchaser for value without notice. The case raised several points of law, one being the status of an EUA in law.

Legal Status of EUAs

Both Armstrong and Winnington agreed that EUAs constitute property. However, what the parties disagreed on was their precise nature and characterisation as property. Winnington argued that EUAs are not a type of property that could be protected by a relevant cause of action and, in particular, a common law proprietary claim would not be applicable to EUAs.

After considering the nature of property that can be recognised under English law, the Court had to consider whether EUAs could be properly considered to be “property”. The Court referred to a threefold test identified by Morritt LJ in *Re Celtic Extraction* (which considered the legal nature of waste management licences):

- First, there must be a statutory framework conferring an entitlement on the holder of the property in question to an exemption from a fine.
- Second, the property in question must be transferable under a statutory framework.
- Third, the property in question must have value.

In applying this test, it was held that an EUA could be classed as intangible property at common law. The statutory framework governing EUAs—Directive 2003/87/EC which established the EU ETS—confers an entitlement on the holder of the EUA to exemption from a fine. Second, the exemption is transferable, pursuant to the statutory framework. Third, the EUA is an exemption that has value, as it can be used to avoid paying a fine and there is an active market for the trading of EUAs.

The Court held that for the purpose of this analysis, it was unnecessary to consider whether the EUA was a chose in action or another form of “other intangible property”. Having ascertained the legal status of EUAs, the Court went on to consider the remaining legal issues that arose from the case and concluded that Armstrong was entitled to a money judgment, on the basis that EUAs were a type of property that could be the subject of a proprietary restitutionary claim. It is not yet known whether Winnington will appeal the decision.

Future Trading of EUAs

The legal status of EUAs is a question that has arisen frequently since the start of the EU ETS, particularly in relation to the issue of stolen EUAs. In January 2011, the spot trading of EUAs was suspended temporarily following the theft of carbon credits from various national registries by computer hackers accessing accounts and transferring EUAs. The law governing the consequences of holding stolen EUAs, even those acquired in good faith, differs between each EU Member State as each State is responsible for setting out the status of stolen EUAs in accordance with domestic legislation. Such clarification has to confirm whether or not the stolen EUAs could be recovered by the original owners.

It is hoped that the introduction of a single registry for EUAs in 2013 will eliminate the discrepancies that exist currently between EU Member States concerning the status of EUAs. The centralised security measures will mean that EUAs will no longer be as susceptible to thefts as they have been in the past, with hackers no longer being able to target registers in those Member States that have weaker security settings. Certain interested parties are even lobbying for the introduction of the single registry of EUAs before 2013, however, there is little to suggest that such a register will be in place any sooner than planned.

Simone Goligorsky, trainee lawyer in McDermott Will & Emery based in the London office, also contributed to this newsletter.

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