

# Commodities in Focus

## Emissions Certificates – rights and wrongs

July 2012

In the case of *Armstrong DLW GMBH v Winnington Networks Ltd* [2012] the court dealt with issues of fraud in emissions trading, and made an important ruling on the legal nature of emissions certificates and their associated rights.

Each operator under the EU ETS is given an annual allocation of EUAs, with each EUA giving the right to emit one metric tonne of carbon dioxide. Operators are fined €100 for each tonne of carbon dioxide for which it does not have an allowance. Any excess EUAs may be carried forward, retired or traded with other operators or registered EUA traders. Each EUA is given its own unique reference number and may be bought or sold many times in one day.

The claimant in this case, Armstrong owned and held 22,000 EUAs in its account with the German national registry. On 28 January 2010, Armstrong was the victim of an email 'phishing scam' which successfully tricked an employee into revealing the company's password and account details. These details were then used by the sender of the scam to transfer 1,000 of Armstrong's EUAs to an account in the Danish registry, and the remaining 21,000 EUAs into Winnington's account in the UK registry. Winnington then, almost immediately, sold them on via a broker to a third party. It is important to note that Winnington failed to carry out proper "Know Your Client" checks on the seller of the stolen EUAs, and this fact was held against them.

Armstrong made a claim against Winnington in respect of the stolen EUAs, even though the price they were purchased at was not suspicious, and they had already been sold on to a third party.

### Decision

The judge held that Winnington ought to bear the loss caused by the fraudster's actions and should compensate Armstrong. Winnington's conduct in entering into the transaction with the fraudster, and in particular its failure to carry out proper due diligence, made the trade by Winnington *'unconscionable'*. It is therefore clearly important that any trader considering whether to do business with a new client should stand back and consider the transaction as a whole, looking out for anything suspicious.

However, one of the most significant points dealt with by the judge was the legal nature of such emissions certificates. Both parties considered that the EUAs were some sort of property, but the exact nature of their characterisation was a key issue, as it determined what proprietary claims would be applicable. The Court used the following threefold test to ascertain if the certificates were "property":

- 1 Is there a statutory framework conferring an entitlement on the holder of the property in question to exemption from a fine;
- 2 Can the property be transferred under a statutory framework; and
- 3 Does the property have value?

The Court found that EUAs could be classed as intangible property at common law. There was a statutory framework governing them which entitled the holder of the EUA to be exempt from a fine. The exemption was transferrable and had value, as there was an active market from the trading of such EUAs.

### Comments

This was an important decision, as the precise legal status of EUAs (and, by extension, other emission certificates such as CERs) has been an issue that has arisen frequently since the emergence of the trading market. However, whilst this decision does provide some useful clarity in this area, the court declined to rule on whether the EUAs were chose in action or some other form of intangible property. The judge expressed a view that EUAs are not strictly chose in action *"in the narrow sense"* as they *"cannot be claimed or enforced by action. However to the extent that the concept encompasses wider matters of property, then it could be so described"*.

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The precise legal classification of these products therefore remains to be determined. Nevertheless, it is now clear that an EUA is personal property and can therefore be the subject of a trust under English law. As a consequence of this fact, when legal title has been obtained due to a wrong (for example, fraud) being done against the title holder, the principles of equity make that property subject to a constructive trust, so that the fraudster is considered to hold the property on trust for the victim. Even though regulations and practices have been tightened up since this fraud was carried out, it is reassuring for both parties involved in the carbon market, and their lawyers, that a legal definition of EUAs has been created, and that there are now clear causes of action available to assist victims of fraud in the context of the carbon trade.

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