

The Brief

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The Derivatives Group

Editorial

Implementation in France of the Greenhouse Gas Allowances Trading Scheme

New derivatives products arrive!

French Ordinance no. 2004-330 dated April 15, 2004 relating to the establishment of a market for greenhouse gas emission allowances (the "**Ordinance**") and implementing the Directive 2003/87/EC of the European Parliament and of the Council of October 13, 2003 establishing such a market within the Community (the "**Directive**") has now been published.

The text of the Ordinance has been prepared by a working group, which Gide Loyrette Nouel was member of, set up by the French Ministry of Ecology and Development, representing regulators, markets makers and professional associations..

You will find below, for information, an non official English translation of the text.

Key features of the Ordinance include the following:-

- a greenhouse gas allowance is defined as "*a unit of account representative of emission of one tonne of carbon dioxide equivalent*";



Gide Loyrette Nouel

Algiers
Tel. +213 (0) 21 48 18 52
gln.algiers@gide.com

Beijing
Tel. +86 10 65 97 45 11
gln.beijing@gide.com

Belgrade
Tel. +381 (11) 32 85 120
gln.belgrade@gide.com

Brussels
Tel. +32 2 231 11 40
gln.brussels@gide.com

Bucharest
Tel. +40 21 223 03 10
gln.bucharest@gide.com

Budapest
Tel. +36 1 411 74 00
gln.budapest@gide.com

Hanoi
Tel. +84 4 825 19 58
gln.hanoi@gide.com

Istanbul
Tel. +90 212 325 35 81
gln.istanbul@gide.com

London
Tel. +44 (0)20 7826 9700
gln.london@gide.com

Moscow
Tel. +7 095 258 31 00
gln.moscow@gide.com

New York
Tel. +1 212 765 2600
gln.newyork@gide.com

Paris
Tel. +33 (0)1 40 75 60 00
info@gide.com

Prague
Tel. +420 222 871 111
gln.prague@gide.com

Riyadh
Tel. +966 1 476 60 39
gln.riyadh@gide.com

Shanghai
Tel. +86 21 53 06 88 99
gln.shanghai@gide.com

Tunis
Tel. +216 71 891 993
gln.tunis@gide.com

Warsaw
Tel. +48 22 583 67 01
gln.warsaw@gide.com

- greenhouse gas allowances themselves will not qualify as financial instruments, but rather are characterized as movable assets represented by book entry and transferable through accounts only – allowances are negotiable and deemed fungible among themselves – they "*confer identical rights to their holders*" - they are legally not personal rights, but rights *in rem*;
- the Ordinance sets up a national registry of allowances which accounts all allowances issued, held, transferred and cancelled – registrar functions for the national registry will be delegated to an entity to be designated by decree;
- derivative products on allowances are specifically addressed by the Ordinance which characterizes them as "*forward financial instruments*" (*i.e.* derivatives products) provided that they are either (i) exclusively cash settled, (ii) alternatively cash or physically settled, or (iii) if exclusively physically settled, cleared through a clearing house or subject to periodic margin calls – for this purposes Article L.211-1-II of the French Monetary and Financial Code has been modified by the addition of the words "*or greenhouse gas allowances*" – **this confirms eligibility of such instruments to the favourable insolvency close-out netting and collateral regime of Article L.431-7 of the same code, which, as a reminder, applies in France even in ordinary corporate insolvencies provided that certain conditions relating to the status of its counterparty and the documentation of the transactions are met.**

Please note that the French government is now preparing the National Allocation Plan for allowances trading. The Plan, which will follow the guidelines established by the European Commission, will set out the details of the number of allowances that each sector and company will be administratively allocated. The Plan will then be submitted for public consultation and then reviewed by the European Commission.

Alban Caillemer du Ferrage

Avocat à la Cour, Partner

acf@gide.com

Philippe Goutay

Avocat à la Cour

goutay@gide.com

Carlo Spadafora

Barrister & Solicitor, Bar of Ontario, Canada

spadafora@gide.com

Kim Lam

Avocat à la Cour

lam@gide.com

This memorandum is a summary of certain legislative reforms introduced in France. It is circulated for information purposes only and should not be used as the basis for any business or investment decision without prior specific legal assistance. For further explanation or additional information, please do not hesitate to contact the signatories.

Gide Loyrette Nouel

Association d'Avocats à la Cour de Paris

26, cours Albert 1^{er}
75008 Paris - France

Tél. : +33 (0)1 40 75 60 00
Fax : +33 (0)1 43 59 37 79

Ordinance no.2004-330 dated April 15, 2004 creating a scheme for greenhouse gas emission allowances trading

(English translation for information only)

[...]

Article 1

The Chapter IX of title II of book II of the environment code entitled: "Greenhouse effect" is modified as follows:

I. –Articles L. 229-2 to L. 229-4 constitute a section 1 entitled : "National Observation on the effects of global warming".

II. – Following section 1, section 2 is added, written as follows:

Section 2

Greenhouse gas emission allowance

Art. L. 229-5. – The provisions of this section shall apply to the classified installations emitting greenhouse gas in the atmosphere while exercising one of the activities listed by the decree of the *Conseil d'Etat*. This decree shall take into account the capacity of production or productivity of the installation.

Art. L. 229-6. – The installations which fall within the scope of this section shall be subject to a greenhouse gas emission permit.

The permit mentioned in Article L.512-1 shall be recognized as the permit mentioned in the previous paragraph subject to particular provisions contained in this section.

An order taken by the Minister in charge of the classified installations shall determine the terms and conditions of application of the particular monitoring, communication and control obligations which shall apply to the installations that fall within the scope of this section. This order shall also specify the terms and conditions of verification of the emission statement mentioned in III of Article L. 229-14.

Art. L. 229-7 – A greenhouse gas emission allowance for the purpose of this section is a unit of account representative of the mission of one tonne of carbon dioxide equivalent.

For each installation benefiting from a greenhouse gas emission permit, the State shall attribute to the operator, for a specified period, allowances of emission and shall issue each year a portion of the allowances attributed for this period.

The quantity of greenhouse gases emitted by this installation for the calendar year period shall be calculated or measured and expressed in tonne of carbon dioxide.

At the end of each civil year of the allocation period, the operator shall surrender to the State, under penalty of sanctions laid down in Article L. 229-18, a number of allowances equal to the total of greenhouse gas emission of its installations, these allowances being issued or acquired in accordance with Article L. 229-15.

However, when an installation uses in a combustion process, gases supplied by an iron and steel installation, the corresponding allowances shall be allocated and issued to the operator of this latter installation. This operator shall be responsible for the obligations under this section.

Art. L. 229-8 – I – Greenhouse gas emission allowances shall be attributed by the State for a duration of three years starting 1st January 2005, and thereafter, by periods of five years in the context of an established national plan for each period.

II – This plan shall establish the maximum quantity of emission allowances attributed by the State for a period, excluding those acquired pursuant to II of Article L. 229-15, the repartition criteria of such allowances and the list of beneficiary installations.

III – The maximum quantity of emission allowances attributed for a certain period is determined in the light of:

1° France's international commitments relating to greenhouse gas emissions;

2° the portion of the emissions of the installations subject to the provisions of this section of the global emissions estimated in France;

3° the forecasts evolutionary trends of the emissions in all activity sectors and the production of activities falling under the categories referred to in Article L. 229-5 ;

4° the technical and economic possibilities of reducing the greenhouse gas emission in the whole sector of activity ;

5° the forecasts of creation, expansion and closing of installations falling within the scope of application of this section.

IV. – The plan shall distribute the emission allowances between the different installations mentioned in Article L. 229-5. This distribution shall take into account technical and economic possibilities of reducing the emissions of the beneficiary activities, the evolutionary forecast of the production of these activities, the measures taken to reduce the greenhouse gas emissions before the establishment of the scheme for allowance trading, as well as if any, competition activities located in countries outside the European Community.

V. – The plan shall keep in reserve emission allowances intended to be attributed to the operators of permitted installations during the period of the plan, as well as those whose permit would come to be modified or whose level of production would vary substantially. The State may acquire allowances pursuant to II of Article L. 229-15 in order to complete such a reserve.

Art. L. 229-9 – Subject to respecting industrial secrecy and business secrecy, the project of a national plan of attribution of the greenhouse gas emission allowance shall be subject to a public consultation pursuant to conditions determined by decree. It shall be published and notified to the European Commission. The plan shall be approved by decree of the *Conseil d'Etat*.

Art. L. 229-10 – Allowances issued during the first triennial period beginning on 1st January 2005, shall be issued free of charge.

Art. L. 229-11 – The administrative authority shall notify the operators of the installations permitted to emit greenhouse gas, the total amount of the emission allowances allocated to each period covered by a plan and the quantity issued each year.

A decree of the *Conseil d'Etat* shall determine the notification terms and conditions of the decisions of attribution and issuance of the allowances, the conditions in which the corresponding information shall be accessible to the public, the rules of annual issuance of the allowances, the rules applicable in case of a change of operator or assignment or transfer of activities as well as the conditions in which the allocation or issuance decisions and the national plan of allocation of the allowances of the Article L. 229-8 may be contested.

Art. L. 229-12 – I – The administrative authority may, following public consultation, ask the European Commission that installations be temporarily excluded, until 31st December 2007, from the obligations referred to in Article L. 229-7.

The administrative authority shall determine, pursuant to the provisions of book V, the prescriptions relating to the monitoring of the excluded installations and to the limitation of their emissions of greenhouse gases in the same proportion as if those installations were subject to the obligations referred to in Article L. 229-7.

The operators of those installations shall be subject to requirements relating to monitoring, reporting and verification equivalent to those provided for the operators participating in the scheme for emission allowance trading and, in case of excess of the limitation of gas emissions imposed, to the payment of a penalty of the same amount by tonne of excess carbon dioxide, as the one referred to in Article L. 229-18 for a non-restored allowance.

II – For the triennial period beginning on 1st January 2005, the administrative authority may, with the approval of the European Commission, attribute to an operator supplementary non-transferable emission allowances, in case of external and unforeseeable circumstances for the operator and the State, therefore having as a consequence a substantial modification of the emissions of one or many of its installations that could not reasonably be prevented.

Art. L. 229-13. – Allowances shall be valid within the period of the plan during which they are attributed as long as they remain unused.

Allowances issued or acquired within an allocation period that remained unused during this period and were cancelled pursuant to Article L.229-14 shall be returned to the State and cancelled at the beginning of the following period. The same quantity of emission allowances valid for the new period shall be simultaneously issued to the previous holders of the cancelled allowances.

However, at the end of the triennial period beginning on 1st January 2005, in the event that the application of the preceding paragraph would risk compromising the compliance with international commitments of mastering greenhouse gas emissions taken by France, the administrative authority may decide to limit the issuance of emission allowances done at the beginning of the following period pursuant to this paragraph, to the only operators of installations permitted to emit greenhouse gases and for each operator a quantity equal to the difference between the quantity allocated for the preceding period and the amount of the emissions of its installations for the same period.

Art. L. 229-14. – Allowances surrendered each year to the State by the operators pursuant to Article L. 229-7 shall be cancelled.

II. – The persons holding allowances may at any time ask their cancellation by the State.

III. – Allowances shall be surrendered on the basis of a reporting done by each operator of the greenhouse gas emissions of its installations, verified at the expense of the operator, by an entity authorized to this end by the administrative authority, and then validated by the inspection of the classified installations. The reporting of greenhouse gas emissions of an operator shall be deemed validated if the inspection of the classified installations did not formulate any observation within the delay determined by order mentioned in Article L. 229-18.

Art. L. 229-15. – I. – Greenhouse gas emission allowances issued to operators of installations permitted to emit such gases shall be movable assets exclusively represented (i.e. materialized) by inscription on the account of their owner in the national registry mentioned in Article L. 229-16. Allowances shall be negotiable, transmissible by transfer from one account to another and confer identical rights to their holders. They may be assigned following their issue, subject to the provisions of the II of Article L. 229-12 and Article L. 229-18.

The transfer of ownership of allowances shall result from their registration, in the name of the beneficiary in the booking of the national registry, to the date and according to the conditions defined by decree.

II. – Emission allowances may be acquired, held and assigned by any operator of an installation, for which a greenhouse gas emission permit has been issued by a European Community member State, by any individual national or any corporation having its head office in an European Community member State and by the member States themselves.

Provided that a mutual recognition agreement has been concluded by the European Community with a third country mentioned in Annex B of the Kyoto protocol on 11th December 1997 to the United Nations Master Agreement on Climatic Change and that such country has ratified this protocol, the allowances may be acquired, held and assigned by individuals of such country and corporations having their head office in this third country.

III. – The same legal effects shall be granted on the national territory to the emission allowances issued by the French authorities and to those issued by the competent authority of any European Community member State or any other State party of a mutual recognition agreement concluded with the latter.

IV. – When the State does not have at its disposal, in the reserve constituted pursuant to V of Article L. 229-8, allowances to be allocated to operators, the latter shall be released from their obligations determined by this section, notably the obligation to surrender the allowances provided in Article L. 229-7. No allowances shall be allocated to them in the context of the actual plan. The competent authority shall determine those operators prescriptions pursuant to the provisions of book V of this code in the conditions mentioned in the second and third paragraphs of I of Article L. 229-12.

Art. L. 229-16. – A national registry of greenhouse gas emission allowances shall account for the allowances issued, held, transferred and cancelled. All persons mentioned in II of the article L. 229-15 may hold allowances and open an account in this registry.

The national registry shall contain an account for each person holding allowances.

It shall be accessible to the public in conditions set by decree.

The keeping of the national registry may be delegated to a legal entity designated by a decree of the *Conseil d'Etat* that shall determine the terms and conditions of application of this article, and notably the role of the delegator, the conditions of its remuneration and the terms and conditions of the inscription of the different transactions relating to allowances on the national registry.

Art. L. 229-17. – The State may, following approval of the European Commission, authorize many operators of installations exercising the same activity to put in common, during the triennial period beginning on 1st January 2005 and during the following quinquennial period, the management of the allowances relating to each installation.

When the authorization is granted to many operators, they shall designate an agent to which the provisions of this section shall be applicable.

A single account for the installations whose allowances are managed in common shall be opened in the national registry. The role of the agent designated by the operators is the management of the allowances registered on this account. If the agent does not comply with the sanctions provided in II of Article L. 229-18 in case of absence of surrendering of emission allowances, the operator of each installation shall become responsible for the surrendering of the allowances corresponding to the emissions from its installation and subject to the sanctions provided in this section if it contravenes this obligation.

A decree by the *Conseil d'Etat* shall determine the terms and conditions of implementation of the provisions of this article.

Art. L. 229-18. – I. – The operator may not assign the allowances it holds, to the extent of those that were issued to it for an installation and a specific year:

- in case of absence of reporting of the emissions of the installation during this year made by the operator before the date determined by decree;
- or when the inspection of the classified installations notices that the reporting relating to emissions of the installation during this year does not comply with the conditions determined by the order provided to in Article L. 229-6. The decision, which must be founded, shall intervene at the latest of the expiration of the delay mentioned at III of Article L. 229-14.

The operator shall recover the availability of its allowances when a reporting from it was judged satisfactory or, otherwise when the volume of emissions has been officially set by decree by the administrative authority, on the basis of a forfeit calculation established at the latest two months after being informed of the unsatisfactory character of the reporting or, in the case of absence of reporting, by 31st May at the latest. An order shall specify the methods used for this calculation and the conditions in which the operator was previously consulted.

II – Each year, when the operator or the agent has not, at a date determined by decree, surrendered a sufficient number of allowances to cover its emissions of the previous year, and when the authority in charge of the keeping of the national registry has informed the administrative authority of the non-compliance with this obligation and of the surplus of greenhouse gas emissions by comparison with the number of allowances surrendered, the competent authority shall instruct the operator or the agent to comply with this obligation within delay of one month.

The administrative authority shall impose, against the operator or agent that does not respect the prescriptions of the notice in the given delay, a penalty proportional to the number of unsurrendered allowances. The payment of the penalty shall not release the operator or the agent of the obligation to surrender a quantity of allowances equal to the volume of exceeding emissions. It must be discharged of this obligation by the following year at the latest. The allowances it holds shall remain unassignable and a new penalty shall be imposed for every following year as long as the obligation is not satisfied.

The amount of the penalty shall be set at 40 euros per unsurrendered allowance for the triennial period beginning on 1st January 2005 and at 100 euros for the following periods. The collection shall be made to the profit of the Treasury as in the case of non-tax claims and non-state property claims.

The decision imposing the penalty may provide that the name of the operator or the agent will be published when it has become definitive.

Art. L. 229-19. – The terms and conditions of application of this section shall be determined by decree of the *Conseil d'Etat*.

Article 2

At the 4th subparagraph of paragraph II of Article L. 211-1 of the Financial and Monetary Code, after the words : "on commodity", the following words shall be inserted: "or greenhouse gas emission allowances".

Article 3

The permits issued on the basis of Article L. 512-1 of the environment code before the publishing of this ordinance shall consist in the greenhouse gases emission permit provided in the first paragraph of Article L. 229-6 of this code.

Article 4

The Prime Minister, the State Minister, the Minister of economy, finance and industry, the Minister of ecology and sustainable development shall be responsible, each, with respect to the application of this ordinance, which will be published in the *Journal officiel de la République française*.

[...]



Gide Loyrette Nouel