

An Emerging Field of International Administrative Law, the Emissions Trading System under the Kyoto Protocol¹

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I. Introduction

The mechanisms under the Kyoto Protocol serve as fine examples of emerging international administrative law, for they mark a field of creative international regulatory solutions,² where various actors participate on different levels in supranational and transnational institutions of the climate change regime.³

Climate change management is not a genuine international law field of regulation – there are various attempts to tackle its symptoms on the domestic level, such as for example the 1990 *Clean Air Act* of the US foreseeing also pollution trading. However, States have recognized that the transboundary effects of air pollution as well the high costs of mitigation may only be rationally dealt with through some form of international

⁴² Can. 1752. (...) servata aequitate canonica (...) quae in Ecclesia suprema semper lex esse debet.

¹ Based on a presentation held at the Max Planck Institute for Comparative Public Law and International Law on 25 April 2007 in connection with the project „International Administrative Law”.

² M. BOTHE: The United Nations Framework Convention on Climate Change – an Unprecedented Multi-level Regulatory Challenge. *ZaöRV* 63 (2003), 239, 245.

³ M. D'AURIA: Emissions Trading and Polycentric Negotiation. *Global Jurist Advances*, Vol. 6. Iss. 3, Article 9, 12.

cooperation.⁴ It has further been recognized, that climate change poses threats to international security by destroying natural habitats and industries inducing poverty, mass migration and organized crime and is therefore a common concern of mankind.⁵ Already the 1979 *Geneva Convention on Long-Range Transboundary Air Pollution* as well as the 1985 *Vienna Convention for the Protection of the Ozone Layer* and its 1987 *Montreal Protocol* constituted serious international treaty efforts to face the problem of climate change adopting novel mechanisms of international environmental law. However, these conventions targeted but special facets of the problem of climate change, and thus calls for a comprehensive treaty regime strengthened.

II. The climate change treaty regime

The United Nations Framework Convention on Climate Change (UNFCCC) was adopted on the Rio Earth Summit of 1992 and it entered into force in 1994.⁶ The Convention foresees a “double track approach” aiming at stabilizing greenhouse gas (GHG) concentrations in the atmosphere to prevent dangerous interference with the climate system and at the same time it seeks to enable ecosystems to adapt to changes effectively taking place. The main body of the Convention, the Conference of the Parties (COP) on its first session found that the commitments under the UNFCCC were insufficient to face the challenges posed by climate change⁷ and decided to supplement the Convention with a Protocol⁸ which was to lay down further commitments. As a result, the Kyoto Protocol (KP) was adopted in 1997, and it entered into force in 2005 after states accounting for over 55% of global GHG emissions have ratified it.⁹

The Kyoto Protocol is an international agreement that stands on its own in the sense that it is a self-contained regime under the UNFCCC. At the same time it is intrinsically linked to the Convention sharing its aims, principles and institutions, as well as its objects of legal protection. These objects are the environment and its climate system in general, and specifically the quality of air. Indirectly, climate change affects biodiversity, human health as well as wildlife habitat and the anthroposphere, thus, the Protocol ultimately also protects these entities.¹⁰ The aim of the Protocol is

⁴ M. J. MACE – C. HENDRIKS – R. COENRAADS: Regulatory challenges to the implementation of carbon capture and geological storage within the European Union under EU and international law. *International Journal of Greenhouse Gas Control*, 1 (2007), 253; D. LEAF – H.J.H. VEROLME – W.F. HUNT: Overview of regulatory/policy/economic issues related to carbon dioxide. *Environment International*, 29 (2003), 303, 305.

⁵ C. R. SUNSTEIN: Of Montreal and Kyoto: A Tale of Two Protocols. *Harvard Environmental Law Review*, 31 (2007), 1, 2.

⁶ As of date the UNFCCC has received 191 ratifications including the EC (18 April 2007). See: http://unfccc.int/essential_background/convention/status_of_ratification/items/2631.php.

⁷ Decision 1/CP.1, preamble (The Berlin Mandate: Review of the adequacy of Article 4, paragraph 2 (a) and (b), of the Convention, including proposals related to a protocol and decisions on follow-up).

⁸ Based on Article 17 UNFCCC.

⁹ So far the Kyoto Protocol has received 170 ratifications (18 April 2007). On the reasons behind the resistance of one of the most substantial GHG emitter, the United States, see: C. R. SUNSTEIN: *op. cit.*, 1–65.

¹⁰ R WOLFRUM – N MATZ: *Conflicts in International Environmental Law*. Springer, 2003, 79–80.

to set forth effective rules and facilitate the adoption of measures necessary to mitigate the effects of climate change. Thus, it foresees the compilation of relevant data and its report to the Protocol bodies as well as binding emission reduction commitments for developed signatory states, called Annex I Parties and possibilities for voluntary participation by developing non-Annex I Parties. To facilitate meeting these reduction commitments in a cost-effective way the Protocol envisages flexible mechanisms, such as the Joint Implementation,¹¹ the Clean Development Mechanism¹² and Emissions Trading.¹³ The following brief analysis focuses on emissions trading which allows for the transfer and acquisition of emission allowances between states possibly also with the participation of private entrepreneurs. The system implies creating rules for the establishment of national registries and their management, standardized accounting and reporting system as well as the review of the latter for compliance.

III. Multi-level governance aspects

The KP establishes a multilevel governance¹⁴ system by distributing relevant competences between the international and national levels, also allowing for the participation of 'regional economic integration organizations' such as the European Community.¹⁵ Although significant regulatory power is allocated to the international plane, characteristic of this regulatory approach is that it is well balanced by offering flexible implementation schemes which leave Parties considerable freedom in deciding exactly how they prefer to fulfill their commitments.¹⁶ This new system of administration not only establishes the vertical relations of international institutions and national governments but also builds on the horizontal cooperation of national governments in the ambit of the various Kyoto mechanisms. It also involves the private sector¹⁷ relying on entrepreneurial interest, input from the scientific community in the field of research and the civil society in the areas of awareness-raising. The various actors pursue different interests, thus, civil society, NGO-s and certain states promote environmental interests, while the entrepreneurial sector as well as developing countries and countries with old, inefficient industries follow predominantly economic pursuits. While developed countries are interested in preserving a high standard of living, all states strive for retaining some sovereignty over the field of environmental regulation.

IV. Regulatory nature

The regulatory repository of the Protocol includes norm setting (prescribing binding rules and standardized guidelines), the allocation of funds as well as mechanisms for

¹¹ Article 12 KP.

¹² Article 6 KP.

¹³ Article 17 KP. B. DELVAUX: The EU Greenhouse Gas Emission Allowance Trading Directive. *EnvLRev*, 7 (2005), 63, 64–65.

¹⁴ N. KRISCH – B. KINGSBURY – R. STEWART: The emergence of Global Administrative Law. *ILJ WP* 2004/1, 7.

¹⁵ Article 20 UNFCCC and Article 24 paragraph 1 KP on the accession of regional economic integration organisations.

¹⁶ BOTHE *op. cit.* 247.

¹⁷ D'AURIA *op. cit.* 13.

the dissemination of information and best practices. These measures take the form of binding decisions, while the so-called resolutions are non-binding, constituting mainly “expressions of gratitude” toward the state hosting the relevant COP meeting.

The Kyoto emissions trading regime itself may be defined as a form of regulatory administration. The specific regulatory technique adopted by the Protocol marks a move toward novel methods¹⁸ characterized by economic incentives and relying upon the self-interest of actors. Although sanctions and prescriptions do play a certain role in this regulatory system, the overall perspective is to enable public and private parties to identify their individual interests and to act upon them. Decisions of general scope are brought by the COP however the bodies and levels involved in the regulatory work under the Kyoto Protocol are also diverse. Apart from the supreme body of the treaty regime, the COP acting as a Meeting of the Parties to the Kyoto Protocol as well as the regional and national levels deploying Kyoto measures in need of implementation, the regulatory process also foresees the advisory involvement of subsidiary organs such as the Compliance Committee, the Subsidiary Body on Scientific and Technical Advice, the Subsidiary Body on Implementation.

V. Legal assessment from an international administrative law aspect

The organisational setting of the emissions trading system is the climate change treaty regime consisting of the UNFCCC and its KP. Although it has been set up under the auspices of the United Nations the treaty regime is both institutionally as well as financially highly independent from the UN,¹⁹ which may only participate as an “observer” at the COP meetings. The institutional structure of the Kyoto regime is partly predetermined by the UNFCCC, from which the Protocol borrows some of its institutions. Institutionally, the ETS is mainly managed by the COP as the Meeting of the Parties (MOP) of the Kyoto Protocol and the Compliance Committee, as well as Expert Review Teams.

1. Institutional framework

The COP – hereinafter also referred to as MOP – is established by the UNFCCC²⁰ as “the supreme body”, the highest decision-making authority of the Convention and the Protocol. The MOP’s responsibility is to keep under regular review the implementation of the Protocol and to make decisions necessary for the effective implementation of the KP.²¹ The MOP comprises the representatives of the governments of signatory states, and, if admitted, representatives of non-party states as well as other bodies “qualified in matters covered by the Convention” may participate in an observer status. The MOP takes its decisions mainly by consensus, except in certain cases where

¹⁸ D’AURIA *op. cit.* 6.

¹⁹ Institutionally the Secretariat of the UNFCCC and the KP is linked to the UN.

²⁰ Article 7 UNFCCC.

²¹ Article 13 paragraph 4 KP.

it proceeds by 3/4 majorities on a one state-one vote basis. The MOP and the Parties are assisted in their functions by the Secretariat, which among others secures the backbone of emissions trading by preparing national reports for in-depth reviews and elaborating technical methods for reporting and inventory compilation.

The Compliance Committee is a genuine Kyoto body established by way of decision²² by the Meeting of the Parties with the aim of facilitating, promoting and enforcing compliance with Kyoto commitments. Its Facilitative and Enforcement branches constituting are elected by the COP from both Annex I and non-Annex I countries. Its complicated decision-making procedure requires a quorum of $\frac{3}{4}$ of its members, and, if no consensus is reached, decisions are brought by $\frac{3}{4}$ majority of members present with the additional requirement of a majority among both Annex-I and non-Annex I members. With regard to emissions trading, the Facilitative Branch provides advice and facilitation on implementation to the Parties and also provides information on Parties' involvement in the trading system. The Enforcement Branch is responsible for determining whether a Party in question is eligible for participation in the emissions trading system, it makes corrections to Parties' accounting of emission allowances when necessary and applies so-called "consequences" in cases of non-compliance.

Established by the UNFCCC and borrowed by the Protocol, the Subsidiary Body for Scientific and Technological Advice as well as the Subsidiary Body for Implementation play an important role in the design of the trading system by providing technical advice to the MOP.²³

2. Principles

The Protocol affirms its adherence to the principles laid down in the Convention.²⁴ These include the principles of intergenerational equity, sustainable development, policy integration and cost-effectiveness as well as the precautionary principle. Based on the principle of equity the Convention also realizes the different capabilities of the Parties in contributing to the protection of the climate system. By applying the 'common but differentiated responsibilities'²⁵ principle, the Convention acknowledges that the protection of the climate system is a common responsibility of all, however at the same time it foresees a leading role for developed countries in combating climate change and grants developing countries a more favourable position marked by voluntary commitments. The principle is operationalised by classifying the individual Parties into different categories such as Annex I Parties and non-Annex I Parties with different obligations under the Convention, however further sub-categories are also developed such as countries with economies in transition (EIT), to reflect the capacities of the different Parties and to provide for flexibility in achieving respective commitments. Finally, in the ambit of actions taken to mitigate the effects of climate

²² Decision 27/CMP.1. (Procedures and mechanisms relating to compliance under the Kyoto Protocol)

²³ Article 9, 10 UNFCCC.

²⁴ 4th recital of the Preamble of the KP.

²⁵ Recital 6 of the Preamble of the UNFCCC.

change the principle of free trade requires that the principles of non-discrimination and the prohibition of disguised restrictions on international trade apply.

3. Substantive rules of the emissions trading system

The system of emissions trading is based on the common rules relating to registries, transfers of allowances between these registries and the review of transfers within the system. The legal basis of the emissions trading system is found in Article 17 of the Protocol. Further preconditions and elements of the system are either laid down in specific articles of the Protocol itself, or are dispersed in decisions of the MOP. The emissions trading regime is concretized in “principles, modalities, rules and guidelines” laid down in respective decisions of the Meeting of the Parties based on advice delivered by the Subsidiary Body for Implementation and the Subsidiary Body for Scientific and Technical Advice. Both the relevant Articles of the Protocol as well as the respective decisions contain specific provisions on actions to be carried out by the Protocol bodies or the national level.

The instrument for administering the emissions trading system is the decision. This measure deploys the individual Articles and mechanisms of the Protocol and is usually very elaborate and precise. Decisions may be brought by the MOP itself, usually containing binding rules of general scope detailing various aspects of the trading system, prescribing actions for the Protocol bodies or the national systems specifying the rules of implementation. Finally, it is important to note that the Protocol’s emissions trading regime forms an umbrella encompassing also domestic or regional emissions trading systems. All transfers within these systems have to be accounted for, if they affect any transactions between the Parties. This way, distortions of the Kyoto commitments can be avoided.

4. Management of the emissions trading system

As the reduction commitments of Annex-I countries embrace 5 year commitment periods, the ETS which facilitates meeting these commitments may be analysed in this framework.

a) In the first step, eligibility for participation in the ETS is assessed. This implies that allowances according to reduction commitments are allocated to the Parties, which in turn must meet the technical requirements set out for participating in flexible mechanisms and respective reporting and reviews are carried out.

b) In the next step, if eligibility criteria are met, Parties in the framework of the trading system acquire and transfer allowances with a view to meeting their reduction commitments. This process implies the existence and management of registries on which the transactions are tracked as well as uniform rules for accounting allowances between registries.

c) In the final stage, at the end of the commitment period Parties’ compliance with their respective reduction commitments is reviewed based on reporting.

a) Eligibility assessment

The functioning of the system is premised on a precise allocation and accounting of emission allowances of the Parties. Annex B of the Protocol itself contains the data

necessary for the quantification of the emission allowances assigned to each Annex-I state.²⁶ Article 5 paragraph 1 KP obliges Annex I Parties to establish and maintain national greenhouse gas inventories of emissions and national registries on holdings and transactions of the Party's emission allowances.²⁷ In line with the guidelines set out by the MOP the Parties compile annual reports and periodic national communications on their inventories and emission allowances.²⁸ These are first reviewed by international Expert Review Teams which may make recommendations for corrections.²⁹ Then they are forwarded to the Enforcement Branch of the Compliance Committee which determines whether the Party has fulfilled all requirements to be eligible for participation in the ETS.³⁰ It suspends Parties that no longer fulfil requirements³¹ for reasons of overselling their assigned allowances (or with other words not preserving their so-called commitment period reserve),³² and reviews their compliance action plans and subsequent annual progress reports to determine whether to reinstate the Party.³³ It is important to note, that a Party may appeal to the COP against final decisions of the Compliance Committee directed against it if it "believes it has been denied due process". By $\frac{3}{4}$ majority the MOP may override the decision of the Compliance Committee and may refer the matter back to the Enforcement Branch.

b) Trading³⁴

Transactions from emissions trading are tracked on both the respective national registries and the International Transaction Log (ITL). The Log checks all transactions and includes only transactions from flexible mechanisms that have been verified, that is, it examines whether the transaction is properly accounted, whether the Party is eligible for participation in the ETS and whether the allowances of the Party have not dropped beneath the commitment reserve. The ITL rejects transactions that do not meet these criteria and directs national registries to terminate such transfers. Based on advice delivered by the Subsidiary Body for Scientific and Technological Advice, the MOP brings the decisions

²⁶ Article 3 paragraph 7 KP.

²⁷ Decision 13/CMP.1. (Modalities for the accounting of assigned amounts under Article 7, paragraph 4, of the Kyoto Protocol).

²⁸ Decision 15/CMP.1. (Guidelines for the preparation of the information required under Article 7 of the Kyoto Protocol), Article 7 paragraph 1–2 KP.

²⁹ Decision 22/CMP.1. (Guidelines for review under Article 8 of the Kyoto Protocol), Article 8 paragraph 1–3 KP.

³⁰ Decisions 24/CP.7. (Procedures and mechanisms relating to compliance under the Kyoto Protocol), 2/CMP.1. (Principles, nature and scope of the mechanisms pursuant to Articles 6, 12 and 17 of the Kyoto Protocol).

³¹ Decision 18/CP.7. (Modalities, rules and guidelines for emissions trading under Article 17 of the Kyoto Protocol).

³² Amounting to 90% of the AAU-s of the respective seller Party or 100% of five times its most recently reviewed inventory – whichever is lowest.

³³ Decision 27/CMP.1. (Procedures and mechanisms relating to compliance under the Kyoto Protocol).

³⁴ Decision 11/CMP.1. (Modalities, rules and guidelines for emissions trading under Article 17 of the Kyoto Protocol).

on the standardized rules and modalities for the accounting – that is the rules regarding the addition and subtraction – of allowances.³⁵ All national electronic registries as well as the Log administered by the Secretariat of the Convention must conform to these accounting rules.

c) Compliance review

The final stage of the process is the assessment of compliance. If at the end of the commitment period after all corrections have been applied by the Compliance Committee in the compliance assessment process a Party has retired more emission allowances than its total emissions, subject to certain limitations it may carry them over to the next commitment period. If, on the other hand, the Party failed to meet reduction commitments, the excess amount of emission shall be deducted from its assigned amount for the next commitment period.

The proceedings of the Compliance Committee are also concluded by a formal decision. This can relate to the referral of questions between the Branches as well as a decision on the compliance of a given Party with its commitments, ranging from decisions of the Bureau of the Committee on the preliminary examination of implementation to final decisions of the Committee Branches themselves.

5. Enforcement

Oversight of the ETS is practiced by the MOP which, in accordance with Article 13 paragraph 4 KP is responsible for reviewing implementation, and it also serves as the forum of appeals against final decisions of the Compliance Committee. The Compliance Committee's application of consequences such as suspension of eligibility of Parties to participate in the ETS, the declaration of non-compliance and the obligation of elaborating a plan of compliance as well as direct deduction of Parties' emission allowances secures the effective enforcement of measures.

VI. Conclusions

Finally, the question arises, in how far the Kyoto system complies with requirements of legitimacy. With regard to in-put legitimacy, it may be pointed out that the members of the MOP are government representatives, that is, officials not directly elected but delegated by the signatory states. Also the Compliance Committee lacks direct legitimation, for its members are elected by the MOP. The participation of private and non-state entities in the elaboration and review of the trading system is not foreseen. At the same time the elaborate rules on decision-making, the possibility of majority voting and the formal requirements related to decisions enhance the democratic credentials of the system. The publicizing of documents, decisions as well as the

³⁵ Decision 13/CMP.1. (Modalities for the accounting of assigned amounts under Article 7, paragraph 4, of the Kyoto Protocol).

inclusion of external experts in certain matters provides transparency and openness to the system. Possibilities for the hearing of the Parties and the institution of (a very political form of) appeals also mark a tendency toward the internalization of the principle of the rule of law. From the perspective of output legitimacy, it seems true that even the perfect functioning of the system shall not be able to stop climate change. However, the trading regime constitutes an important step in the international administration of climate change and provides useful data and practices for further development.