



# Carbon emissions: Liability or opportunity?



The European Union (EU) has committed to reduce its greenhouse gas emissions to 8% below 1990 levels by 2012, in compliance with commitments made under the Kyoto Protocol. The EU Emissions Trading Scheme (EU ETS) will commence in **January 2005**.

Each member state has its own target based on 1990 levels, ranging from -21% (Germany), -12.5% (UK), to +25% (Greece), which must be reached by 2012. Member states will allocate a portion of their target to energy intensive installations within their national economy. The allocation will take the form of allowances equating to a proportion of the national target. The methodology by which allowances will be granted is currently being formulated by each member state.

## Non-compliance is not an option

Each installation must hold sufficient allowances to cover their annual emissions output or face significant mandatory fines and have any shortfall deducted from their next year's allowance. In Phase 1 (2005-2008) the fines are €40/tonne and

in Phase 2 (2008-2012), €100/tonne. Also, defaulting companies may suffer adverse consequences with regard to their environmental reputation.

An **emissions trading scheme (ETS)** will be established within each member state and across the EU as a whole. This will allow companies who over - or under - achieve their targets to trade allowances, in a formally organised market, such that they can gain sufficient allowances to cover their emissions output. The ETS will establish a transparent market price for carbon emissions, enabling installations to make informed judgements concerning the cost of failing to meet their emissions target, or the financial benefits of exceeding them.

## Management issues

Management will need to examine:

- adjustments to current and future revenue streams to take account of the cost of carbon
- the feasibility of current or planned installations in the light of the new environmental costs

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- new revenue opportunities such as cost savings from energy efficiency, available fiscal incentives to reduce emissions, the sale of carbon emissions allowances or the development of new technologies
- corporate risk management strategy in light of the new environmental risks or opportunities presented by the EU ETS. For companies who have excess allowances to sell, an optimal trading strategy must be formulated, whereas for those producers buying carbon emissions on the market, a hedging or abatement strategy must be formulated to minimise revenue volatility
- the carbon intensity of current energy usage and the consideration of the economic viability of alternative energy efficient fuels, products, processes or technologies
- the need to assess shareholder perceptions regarding disclosure and management of carbon emissions as part of the company's overall environmental profile

## Operational Issues

From the operational perspective the implementation of the EU ETS will bring with it new mandatory requirements for recording and reporting emissions levels. Industrial emitters may need to make significant operational changes to incorporate this necessary functional role.

The consequences of the EU ETS will be commercially far reaching and, as it takes effect in January 2005, prudent companies will already be assessing their risks and putting in place hedging strategies.

## Taylor Wessing LLP

Taylor Wessing is one of the few European law firms with experienced environmental finance lawyers. As a result, Taylor Wessing was selected to advise on developing the first commercial carbon emissions hedging tool, known as ICECAP. By using the combined skills of its environmental, finance and commercial lawyers Taylor Wessing was instrumental in designing and documenting this innovative product in an evolving market.

Taylor Wessing can help clients understand the risks and opportunities in this new area.

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## ICECAP

ICECAP offers companies a cost effective way to meet and/or hedge EU ETS carbon emissions reduction commitments through participation in a diverse portfolio to be sourced and managed by ICECAP.

ICECAP is sponsored and advised by Cumbria Energy Limited, Less Carbon Limited and Investec Bank (UK) Limited. AIBWorthytrust Limited, the Jersey based subsidiary of the Allied Irish Bank group, will act as administrator to ICECAP and AIB Bank (CI) Limited, the group's licensed banking arm in Jersey, will act as custodian to ICECAP. Taylor Wessing will advise ICECAP on project due diligence as well as providing legal advice on regulatory issues, the terms of carbon purchase agreements and arrangements with participating companies.



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