

Security Over EU ETS Allowances: A French Legal Perspective

Update

October 08, 2024 | 5 minute read

As the European Union doubles down on its commitment to reducing greenhouse gas emissions,[1] EU Emission Trading System (EU ETS) allowances have become not only an environmental tool but also a valuable financial asset. While in 2017, the price of a carbon credit (one ton of CO₂) was around €5–7, by the end of 2020, prices had increased to around €30–€35 per ton. They continued increasing dramatically in 2021, reaching over €60 per ton and finally €90 in 2022 and currently remain on the high side. These allowances, which grant companies the right to emit a specific amount of carbon dioxide (CO₂) or equivalent greenhouse gases, are now being eyed as potential collateral in financial transactions in certain countries.[2] But what does it mean to take security over EU ETS allowances, and what should companies and financial institutions be aware of?

The EU ETS operates as a cap-and-trade system, where a cap is set on the total emissions allowed within the system (this cap is reduced over time, meaning that total emissions fall), and companies receive or purchase allowances that permit them to emit a certain amount of CO₂. As the EU tightens emission caps, these allowances have grown in value, transforming them into assets that can be traded or used as security in financial deals. These allowances are traded on a robust market, offering companies both a way to comply with emission caps and an opportunity for financial maneuvering. Given their value, it's no surprise that companies and financial institutions are exploring ways to use these allowances as collateral in financial transactions. They have gained an extrinsic value beyond their intrinsic value.

For companies holding significant amounts of EU ETS allowances, leveraging these assets to secure loans or other financial obligations might seem like an attractive option. However, the process of taking security over such allowances raises technical legal issues.

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Legal Considerations: Nature and Type of Security

In France, EU ETS allowances are classified by law as intangible movable assets.[3] This classification means they can be subject to security interests, much like tangible assets. But unlike physical assets, taking security over intangible assets like EU ETS allowances involves unique legal and practical challenges.

Dedicated collateral in the form of a pledge is the most common security interest for securing movable assets under French law. There are two forms of pledges, *nantissement* and *gage*.

While the civil code points to *nantissement*[4] for security over receivables, it points to *gage* for security over intangible movable property other than receivables.[5]

A pledge (*gage*) over EU ETS allowances involves the company (the pledgor) offering these allowances as collateral to a creditor (the pledgee). The pledgee, in turn, holds a security interest in the allowances until the underlying obligation is fulfilled.

Interestingly, newly introduced CPBs (biogas production certificates – *certificats de production de biogas*)[6] are also qualified as moveable assets[7] and open similar financing perspectives.

The Importance of Registration or Dispossession

For a pledge to be enforceable and opposable to third parties under French law, it needs to be registered. In France, registering a pledge over EU ETS allowances in the registry of commerce is crucial. This registration ensures that the pledge is recognized in case of insolvency or disputes and that the creditor's rights are protected. When the pledgor is not registered in France, has no registered office, principal place of business, place of exercise or (for physical persons) personal domicile in France, the competent register is the *Registre du Commerce et des Sociétés* maintained by the *Greffes du Tribunal de Commerce de Paris*. While, as set out below, there are alternative modes of taking security, this is clearly the most flexible for traders.

An alternative to registration exists in the form of a pledge with dispossession. A pledge with dispossession means the pledgor must surrender possession of the asset to the pledgee. For physical assets, this is straightforward, but for intangible assets like EU ETS allowances, dispossession is more complex. It involves transferring control or access to the registry account where the allowances are held (this would typically involve some form of registration or notification to the *Caisse des Dépôts*, the public body in charge of maintaining the French portal of the EU ETS, to reflect the change in control), or for the EU

ETS allowances to be temporarily transferred onto the pledgee's EU ETS account. Without this transfer of control, the effectiveness of the security might be called into question. Dispossession would not be the preferred route due to the constraints it creates in terms of continued trading since trading would be impossible, save in case of partial and regular releases of the security, but is sometimes used to provide an advantage to the pledgee in terms of control.

EU ETS Allowances as Financial Instruments

Under the EU Financial Collateral Directive, allowances might be considered eligible collateral for financial obligations, particularly in transactions involving financial institutions.

Where the conditions are met, security is available in the form of a pledge (*nantissement*)[8] following the introduction under French law of the so-called Collateral Directive.[9] This is a very strong security from a bankruptcy point of view. Under such scheme, the pledgor agrees and acknowledges that, following the notification sent to the *Caisse des Dépôts*, the EU ETS allowances are under the control (*contrôle*) of the pledgee only.

Practical Implications for Companies and Financial Institutions

For companies looking to use EU ETS allowances as collateral, understanding the legal framework is essential. The security agreement must be carefully drafted, considering the need for registration and the potential requirement for dispossession. Financial institutions, on the other hand, must conduct thorough due diligence to ensure that the security they take is enforceable and robust, compliant with both national and EU regulations, and capable of withstanding potential challenges.

Since allowances are traded within the EU ETS, the security agreement must account for their transferability and the possibility of trading them on the market. Only a duly registered *gage* allows this. The security arrangement must also comply with the regulations governing the EU ETS, particularly the rules on the holding, transfer, and surrendering of allowances.

Conclusion: Navigating the Future of Carbon Finance

As the value of EU ETS allowances continues to rise, so too does their potential as financial assets. However, taking security over these allowances requires careful legal planning and an understanding of the regulatory

landscape. Not all jurisdictions are friendly in this respect. France is a jurisdiction where this is made possible. We have assisted clients in accessing the French portal of the EU ETS through multiple exchanges with the authorities to convince them of the merits of our approach, and supported several clients on the first key transactions in drafting and signing such security instruments. In the ever-evolving landscape of carbon markets and environmental finance, securing your interests through proper legal channels remains paramount.

In the fast-evolving world of carbon markets, securing your financial interests while contributing to global climate goals presents both opportunities and challenges. By navigating these complexities with the right expertise, companies and financial institutions can unlock the full potential of their carbon assets.

[1] https://climate.ec.europa.eu/eu-action/climate-strategies-targets/2040-climate-target_en

[2] <https://gunvorgroup.com/news/gunvor-signs-new-up-to-eur-240-million-eu-emissions-borrowing-base/>

[3] Directive 2003/87/EC Of the European Parliament and of The Council of October 13, 2003 introduced under French law by Ordinance (Ord. n°2004-330 of April 15, 2004) and later transposed into certain articles of the French environmental code (art. L. 229-5 to L229-19).

[4] Art. 2355, para 5° of the French civil code.

[5] Art. 2333 et seq. of the French civil code.

[6] Climat Résilience law n° 2021-1104 of August 22, 2021 to combat climate change and strengthen resilience to its effects.

[7] Art. L. 446-33 of the French energy code.

[8] Art. L.211-38 to L.211-40 of the French monetary and financial code.

[9] Directive 2002/47/EC of the European Parliament and of the Council of June 6, 2002, on financial collateral arrangements (the so-called Collateral Directive).