



Правовой энергетический форум 2013-2024

ISSN 2079-8784

URL - <http://ras.jes.su>

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Выпуск №4 Том . 2022

Carbon Units as an Object of Civil Rights

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Аннотация

Federal Law No. 296-ФЗ on Limiting Greenhouse Gas Emissions dd. July 2, 2021, was adopted to implement the Paris Climate Agreement adopted at the 21st UN Conference and meant to reduce the carbon footprint. The Law introduces a new article into the stream of commerce, “carbon units”, which can be transferred to another person under a contract. Taking into consideration the novelty of this object of civil rights, the article reviews the possibility of referring carbon units to the existing objects of civil rights as per Article 128 of the Civil Code of the Russian Federation, proposes an approach to the legal regulation of carbon unit transfer contracts, and analyzes the possibility of circulation of carbon units at exchanges.

Ключевые слова: energy law, legal regulation of exchange trading, legal regulation of relations connected with greenhouse gas emissions, circulation of carbon units

Дата публикации: 27.12.2022

Ссылка для цитирования:

Сидорова Е. А. , Хачатурова К. Carbon Units as an Object of Civil Rights // Правовой энергетический форум – 2022. – Выпуск №4 С. 15-23 [Электронный ресурс]. URL: <https://mlcjournal.ru/S231243500023791-8-1> (дата обращения: 19.05.2024). DOI: 10.18254/S231243500022875-0

¹ As of 2020, the global average surface air temperature exceeded the pre-industrial level of 1850-1900 by 1.1 degrees Celsius, [1] and the level of greenhouse gas concentration in the atmosphere was above the level recorded in 2011-2019. Possible consequences of climate changes may be global warming, an increase in extreme weather events, and risks of degradation of various ecosystems as a result of changes in thermal and moisture conditions. The Paris Climate Agreement was adopted at the 21st UN Climate Conference in 2015 to avoid the consequences of climate risks. Article 6 of the Paris Agreement stipulates a mechanism to help reduce greenhouse gas emissions and support sustainable development. Russia ratified the Paris Agreement in 2019. Order of the President of the Russian Federation No. 666 on Reducing Greenhouse Gas Emissions dd. November 4, 2020, was adopted to implement the Paris Agreement. The Order establishes the need to ensure the reduction of greenhouse gas emissions to 70 percent from 1990 levels by 2030 and the need to enable measures to reduce, prevent greenhouse gas emissions and increase the absorption of such gases. These measures are stipulated, in particular, in Federal Law No. 296-ФЗ on Limiting Greenhouse Gas Emissions dd. July 2, 2021 (hereinafter referred to as the Greenhouse Gas Law). The creation and development of regulations to enable the sustainable and balanced development of the economy of the Russian Federation while reducing greenhouse gas emissions is justified not only by environmental and legal reasons but also by economic reasons. It is planned to introduce a mechanism of cross-border carbon regulation since 2023 introducing a fee for the import of carbon-intensive commodities to the EU, the production of which is associated with greenhouse gas emissions, to implement the Paris Agreement in the European Union. The possibility for Russian exporters to pay this fee to the EU budget encourages the State to take measures and create a national system of carbon regulation and ensure its recognition by foreign countries. V.V. Romanova rightly stated that such issues stir up interest and become the subject of legal research. [2]

² According to the Major Areas of Development of the Financial Market of the Russian Federation for 2022 and the Period of 2023 and 2024 approved by the Board of Directors of the Bank of Russia, Russia has plans to create a national system of carbon units trading. Carbon units are allowed to be traded, inter alia, in the form of on-exchange trading to form a price indicator and determine the market value.

³ In view of the planned exchange trading of carbon units, it is important to understand the legal qualification of carbon units, contracts entered into to transfer carbon units, and the admissibility of exchange trading of carbon units.

⁴ The legal qualification of an object admitted to trading, i.e., commodities under Federal Law No. 325-ФЗ on On-Exchange Trading dd. November 21, 2011 (hereinafter referred to as the On-Exchange Trading Law), is essential to arrange exchange trading because as per sub-clause 9 of Part 1 of Art. 2 of the On-Exchange Trading Law commodities mean things (except for securities and

foreign currency) of a certain type and quality and in any aggregate state not excluded from circulation and are admitted to on-exchange trading.

⁵ The Greenhouse Gas Law stipulates that a carbon unit is a verified result of the implementation of a climate project expressed in the mass of greenhouse gases equivalent to one ton of carbon dioxide. Carbon units are not referred to as an object of civil rights in Article 128 of the Civil Code of the Russian Federation (hereinafter referred to as the CC RF). However, given the dispositive nature of civil law, the absence of a closed list of objects of civil rights in the CC RF, and the potential economic value and transferability of carbon units, we can assume that carbon units are objects of civil rights in the context of Article 128 of the CC RF. However, the type of such objects is not obvious.

⁶ Objects of civil rights include things, other property, including property rights, works and services deliverables; protected intellectual activity deliverables and similar means of individualization (intellectual property); or intangible benefits. It is obvious that carbon units do not belong to works and services deliverables; protected intellectual activity deliverables and similar means of individualization (intellectual property); intangible benefits. We would like to further analyze the possibility of referring carbon units to things, other property, including property rights.

⁷ 1. Are carbon units things?

⁸ Carbon units have no tangible medium of expression, i.e., they are “intangible”, and have no aggregate state because they are only a result expressed in the mass of greenhouse gases equivalent to 1 ton of carbon dioxide and are an entry made by the operator of the carbon units register. The scientific literature is ambiguous about referring “intangible objects”, such as electricity, to things [3]. There is almost no judicial practice in referring “intangible” objects to things. In its Resolution No. 1944/12 dd. July 17, 2012, the Presidium of the Supreme Commercial Court of the Russian Federation determined that based on the specific features of a non-certificated share *it was impossible to own it as a tangible thing in the form of physical possession*. Ruling of Judicial Chamber for Civil Cases of the Supreme Court of the Russian Federation No. 35-KT21-1-K2 dd. April 13, 2021, stipulates that “the WMZ title unit is a conditional virtual accounting unit, which can only be used within Webmoney Transfer, the issuer of these conditional virtual units, *is not a subject of the tangible world, does not exist in a physically tangible form, does not have attributes of a thing...*” Things include objects in physical and tangible forms. Moreover, by virtue of provisions of the continental legal doctrine, which recognizes only material (tangible) objects as things, intangible objects cannot be subject to proprietary rights. The Greenhouse Gas Law mentions no right of ownership or other proprietary rights to carbon units. The right holder of carbon units is the owner being a legal entity, an individual entrepreneur, or an individual owning carbon units. The legislator uses a similar approach to non-certificated securities. As per Art. 2 of Federal Law No. 39-ФЗ on the Securities Market dd. April 22, 1996, the owner is a person indicated in accounting records (personal account or custody account records) as the right holder of non-certificated securities or a person owning or otherwise possessing non-certificated securities.

⁹ Given the above, carbon units are not a material physically tangible object having any aggregate state, to which a person may have the right of ownership or any other proprietary right, and, therefore, are not things. Therefore, carbon units are not subject to norms of the CC RF governing relations concerning things, in particular, carbon units cannot be returned by means of proprietary remedies.

¹⁰ 2. Do carbon units refer to property rights?

¹¹ As per Article 128 of the CC RF, property rights include digital rights, non-certificated securities, and non-cash funds. Non-certificated securities are rights of obligation and other rights stated in the decision on issue or any other act of an entity that issued the securities (Art. 142 of the CC RF). Non-cash funds are rights of claim of the owner of a bank account with a bank to the lending institution providing services to the bank and are records on the bank account of their owner. [4] Digital rights are rights of obligation and other rights stated in a respective law, the content and terms and conditions of which are determined under information system rules (Art. 141.1 of the CC RF).

¹² Thus, property rights include both a legal requirement (rights of obligation) and other rights expressed in monetary terms, which list is not limited by the law. [5] For example, property rights may include corporate rights.

¹³ In addition to the rights included in property rights, such rights have another characteristic: potential or actual economic value, [6] which means that the exercise of such rights has value. Do carbon units have such value and does the possession of such units mean a right of claim or any other rights?

¹⁴ Owners of carbon units have a right of claim against the operator for transactions with the carbon units in the register, but it seems that such right of claim has no commercial value for the unit owner. The Greenhouse Gas Law does not provide for material or any other discharge for such carbon units, i.e., the carbon unit owner has no right to receive income or exercise voting or any other rights. At the same time, carbon units themselves have value. For instance, as per Decree of the Government of the Russian Federation No. 518 dd. March 30, 2022, on Procedure for Determining the Payment for the Services of Making Transactions in the Carbon Units Register by the Operator, the value of carbon units is deemed equal to RUB 2,000, and if carbon units are traded at on-exchange trading, to the weighted average price determined by the exchange based on the preceding 20 trading days, but not less than RUB 2,000.

¹⁵ The comparative legal analysis suggests that there are differences between property rights and carbon units. Carbon units do not have the characteristics inherent in property rights, namely, they do not imply any rights of obligation or other rights. At the moment, it is not quite clear whether there is any economic value in possessing carbon units: the Greenhouse Gas Law and the regulations adopted to support it do not yet offer companies incentives to develop the carbon units market, such as benefits to carbon units owners.

¹⁶ At the same time, it should be noted that in addition to the Greenhouse Gas Law, there is also Federal Law No. 34-ФЗ on Holding an Experiment to Limit Greenhouse Gas Emissions in Certain Constituent Entities of the Russian Federation dd. March 6, 2022, the provisions of which allow us to conclude that carbon units may still have some attributes of property rights. For example, it is possible to set off carbon units and allowance units to comply with the allowance for greenhouse gas emissions established for certain companies. There is a fee for exceeding the allowance. In this respect, we can assume that these units may represent rights of claim to reduce the carbon footprint of the owner of such units. Meanwhile, allowance set-off is only possible as part of certain experiments in a particular territory, but is not established by the Greenhouse Gas Law.

¹⁷ We believe that the original intention of the legislator was to categorize carbon units as property rights according to the explanatory note to the draft Law on Limiting Greenhouse Gas Emissions, in which carbon units were mentioned as a new institution of property rights, [7] but currently, based on the provisions of the Greenhouse Gas Law, it is difficult to refer carbon units to property rights given the above differences.

¹⁸ The European regulation has no unified approach to the legal qualification of low-carbon instruments. There is no concept of “carbon units”. They use the concept of “emission allowances” instead.

¹⁹ The legal essence of emission allowances is a controversial issue in EU countries. As per Directive 2003/87/EC, [8] the emission allowance is the permission to emit the equivalent of one ton of carbon dioxide over a specified period of time, which is valid only for the purposes of compliance with the requirements of the Directive and is to be transferred as per the provisions of the Directive. The allowances can be treated as a property right, a right to emissions granted by the State, which refers them to administrative regulation, as well as a combination of property and administrative law. Supranational European regulation (MiFID II, Directive 2003/87/EC, etc.) does not provide a clear answer on how to properly regulate the allowances. The EU member states choose their own allowance regulation regime. For example, in Belgium, the UK, and France, the allowances have features of property rights, while in Poland and Germany the allowances include elements of both property and administrative rights. [9] In the UK, Slovenia, Sweden, Croatia, and Austria the allowances are property rights in the form of financial instruments. In Spain and Finland, they are commodities, and in Denmark, they are business assets. [10]

²⁰ The following facts can support the approach of qualifying the emission allowances as property rights (according to the European Commission):

²¹ 1. The object of property rights is the satisfaction of human needs. Property rights exist autonomously (they are separated from a person) and can be owned on an exclusive basis.

²² 2. Property rights are divided into tangible and intangible rights. The allowances obviously refer to the latter.

²³ 3. Since the allowances are distributed free of charge by the state or can be “obtained” in an auction, they are clearly defined, identifiable, personal, and unique; they are also subject to the owner’s exclusive right of ownership or use, which cannot be revoked.

²⁴ 4. Negotiability (e.g., the ability to own or sell, buy) without the supervision of public authorities is a characteristic of property. Thus, the allowances are freely alienable, negotiable, and interchangeable.

²⁵ 5. Registration in a property rights register is similar to compulsory registration for certain goods (cars, ships, etc.). Registration means that such property right exists. The emission allowance register shows the ownership of emission allowances by specific owners; thus, the register determines the existence of allowances and the similarity of allowances and property rights.

²⁶ 6. Property rights are flexible (can be subject to restrictions from other property rights).

²⁷ 7. Any person other than the owner shall refrain from actions that may prevent or make it difficult for the owner to exercise their right.

²⁸ 8. According to Article 3 of Directive 2003/87/EC, the allowance is an allowance to emit an equivalent of 1 ton of carbon dioxide over a certain period of time, i.e., the allowance holder may emit pollutants.

²⁹ MiFID II refers to the emission allowances to financial instruments. Under financial market laws, such qualification makes it possible to regulate market liquidity, contributes to trading efficiency, protects against market abuse, and promotes market transparency and allowance circulation in the secondary market. Despite the above positive aspects, the propagation of MiFID II and other acts to emission allowances made allowance trading more expensive (due to increased transaction costs), and some capital may also be diverted from direct investment in the industry due to more stringent capital requirements. [11] The inclusion of the emission allowances as financial instruments is justified by the fact that the secondary spot market witnessed some cases of EU emission allowance fraud, which could undermine the credibility of the emission allowance trading program established under Directive 2003/87/EC, therefore to improve the integrity and effective market operation, including comprehensive trading supervision, it was appropriate to include the emission allowances in the scope of MiFID II by qualifying them as financial instruments in addition to the measures taken under Directive 2003/87/EC.

³⁰ 3. Are carbon units other property?

³¹ Given the analysis of the legal qualification of carbon units, we believe that carbon units could be defined as “other property” as per Article 128 of the CC RF. However, we should note that neither the CC RF nor other regulations disclose the content of “other property”. [12] Referring to carbon units as “property” does not clarify their legal nature as “property” is a collective term, [13] but this way it is possible to include carbon units into civil-law circulation.

³² If carbon units are other property, how can such units be transferred, and can the sale and purchase provisions of the CC RF be applied to such transactions?

³³ As per the Greenhouse Gas Law, a transaction in carbon units is a contract or any other transaction in accordance with the CC RF effected to transfer carbon units. Article 454 of the CC RF stipulates that only a thing can be transferred under a sale contract. The provisions of Article 454 of the CC RF also apply to the sale of securities and currency values, to the sale of property rights, including digital rights, unless the content or nature of these rights defines otherwise. According to the word-by word content of Article 454 of the CC RF, carbon units as other property cannot be transferred under a sale contract.

³⁴ A similar problem arises in considering the issue of cryptocurrency transfer. According to some authors (A.V. Sazhenov, D.V. Fedorov), cryptocurrency belongs to other property. [14] A.V. Sazhenov suggests that the sale of cryptocurrencies can be treated as the sale of a third thing. In this case, the transaction cannot be treated as a sale contract. It should be interpreted as a mixed or non-defined contract (using an analogy). [15] A.I. Savelyev supports a similar point of view. He notes that the qualification of cryptocurrency as other property is comparable to the qualification of a contract as non-defined: the contract can be legitimized, but the applicable provisions are not clearly defined. [16] At the same time, D.V. Fedorov believes that the lack of wording “other property” in clause 4 of

Art. 454 of the CC RF is hardly a reason to exclude the qualification of cryptocurrency alienation as a sale contract in terms of current laws.

³⁵ As per clause 5 of Resolution of the Plenum of the Supreme Commercial Court of the Russian Federation No. 16 on the Freedom of Contracts and Its Limits dd. March 14, 2014, [17] the court in assessing whether a contract is non-defined, takes into account the subject matter of the contract, the actual content of the rights and obligations of the parties, the distribution of risks, etc. Resolution of the Plenum of the Supreme Court of the Russian Federation No. 49 on Certain Issues of Application of General Provisions of the Civil Code of the Russian Federation on the Conclusion and Interpretation of Contracts dd. December 25, 2018 (hereinafter referred to as Resolution of the Plenum No. 49) [18] stipulates that if the content of the contract makes it impossible to establish the type of the contract or *its individual elements* (non-defined contract) according to law or other regulations, the rights and obligations of the parties under such contract shall be established by the interpretation of its terms and conditions. In this case, the relations of the parties to such a contract, in view of its substance by analogy of law (clause 1 of Article 6 of the CC RF), may be subject to the rules on certain types of obligations and contracts stipulated by law or other regulations of the CC RF (clause 2 of Article 421 of the CC RF).

³⁶ It is obvious that the carbon units transfer contract and the sale contract have the same purpose: transfer (alienation) of the object of civil rights. The Greenhouse Gas Law contains no title or detailed terms and conditions of such contract. For the purposes of this article, a contract concluded to transfer carbon units shall be defined as a carbon units transfer contract.

³⁷ As per Articles 456 and 458 of the CC RF, the seller shall transfer the goods to the buyer, i.e., in fact, initiate actions to transfer the goods, which are deemed transferred, in particular, upon delivery to the buyer. The seller of units, who shall send an instruction to withdraw the units from the account, has a similar obligation. The units are deemed transferred when the operator makes a corresponding entry on the account of the carbon units buyer. Under both contracts, the buyer shall accept the goods and pay the price stipulated by the contract.

³⁸ However, not all sale contract provisions stipulated by the CC RF apply to the relations arising under the carbon units transfer contract. For example, the material terms and the subject matter of these contracts are different: the sale contract does not stipulate the transfer of “other property” to the buyer, who will subsequently have proprietary rights to the property. Accidental loss of carbon units, requirements for units completeness and units quality as well as quality guarantee are not provided for.

³⁹ On the one hand, there are similarities between the above contracts (purpose, rights and obligations), which may mean the similarity of relations arising out of these contracts suggesting the possibility to interpret the sale institution in broad terms and include transactions with carbon units in the perimeter of sale contracts. On the other hand, the differences in the contract elements (subject matter, material terms, type of rights (proprietary rights)), as well as the explanations of Resolution of the Plenum No. 49, make it impossible to establish the type (category) of a contract as stipulated by law or other regulations, wherefore the carbon units transfer contract can be qualified as non-defined. Therefore, the relations arising out of such a contract will be subject to the general provisions of the CC RF on obligations, agreement of the parties, and analogy of stature, i.e., the sale and purchase provisions.

⁴⁰ Given the above, the problem of qualification of carbon units as other property is the uncertainty of the legal regime applicable to relevant contracts, i.e., given the qualification, it is impossible to determine which contract shall mediate the carbon units transfer relations.

⁴¹ Apparently, clause 4 of Art. 454 of the CC RF stipulating that the sale provisions also apply to other property (if such objects of civil rights are qualified as other property) should be amended soon due to new “intangible” articles, such as carbon units, allowance units, certificates of origin of electricity, tariff quotas, and taking into account the needs of market players for transactions with such articles.

⁴² 4. On-exchange trading of carbon units.

⁴³ The analysis of the scientific literature, laws, and judicial practice made it possible to determine whether carbon units are acceptable for on-exchange trading.

⁴⁴ As per sub-clause 7 of Part 1 of Art. 2 of the Law on On-Exchange Trading, on-exchange trading means trading held regularly under established rules determining the procedure for admitting persons to trading for the conclusion of *sale and purchase contracts for commodities*, securities, foreign currency, repo agreements, and agreements being derivative financial instruments. At the same time, commodity means mean *things* (except for securities, foreign currency) of certain type and quality not excluded from civil circulation and in any aggregate state and admitted to on-exchange trading. Thus, it is obvious that law directly stipulates the conclusion of contracts of sale and purchase of things (commodities) at on-exchange trading, which, on the one hand, makes it impossible for carbon units to be admitted to trading and traded. However, as per Part 7 of Article 4 of the Law on On-Exchange Trading, on-exchange trading allows for both directly stipulated and *other contracts* to be included under the on-exchange trading rules. We believe that this provision is rather broad and may be interpreted as permission to conclude not only the types of contracts specified in the Law on On-Exchange Trading, i.e., sale contracts, but also to admit other objects of contracts, which may include any “other property” or property rights. It seems at first that this makes it pointless to list specific objects of contracts in the law, such as commodities, securities, and foreign currency, and also enables abuse by allowing any objects to be admitted to on-exchange trading. However, this provision contains an important clarification: other contracts can be concluded under on-exchange trading rules. Since the on-exchange trading rules are subject to registration with the Bank of Russia (Part 9 of Article 4 of the Law on On-Exchange Trading), the Bank of Russia shall determine at the stage of registration whether another type of contract may be a subject of on-exchange trading or not. At the same time, the broad interpretation of the provision of Part 7 of Article 4 of the Law on On-Exchange Trading creates uncertainty for market players (inter alia, in terms of possible interpretation of this provision by the Bank of Russia). Therefore, it seems necessary to make a clearer list of objects that may be referred to as commodities. Let us also note that, in order to regulate the relations arising out of on-exchange trading, commodities shall also be analyzed in economic terms, since participants in exchange trading are, first of all, economic market participants. The concept of commodities in civil-law terms is different from the concept of commodities in economic terms, meaning any benefits that can be converted into money. Based on the economic concept of commodities, we can conclude that commodities may include any objects that have value expressed in a monetary form.

⁴⁵ Thus, given the importance of exchange trading for creating representative indicators and market pricing, it would be necessary to amend sub-clause 9 of Part 1 of Art. 2 of the Law on On-Exchange Trading by adding *other property or property rights* that

may be admitted to on-exchange trading to the definition of commodities. At the same time, the Bank of Russia as a regulator should establish requirements for the procedure for admission and trading of “other property” or property rights at exchange trading.

⁴⁶ Considering the results of the analysis of the legal nature of carbon units and the legal regime applicable to carbon units transactions, the legal uncertainty possibly caused by the novelty of this instrument should be emphasized.

⁴⁷ De lege lata, there is no doubt that carbon units belong to other property, but not to property rights, because the Greenhouse Gas Law does not mention rights of obligation and other rights certified by carbon units. However, such classification means complicated regulation of contractual relations with units that parties to civil transactions do not always understand.

⁴⁸ De lege ferenda, it seems that it is possible to eliminate the current legal uncertainty if carbon units are referred to property rights in the future.

⁴⁹ The advantages of this approach are as follows: firstly, achieving the certainty in the regulation of the legal regime of transactions with the units, the application of sale and purchase provisions of the CC RF; secondly, a clear definition of the subject of on-exchange trading admitted to trading; thirdly, property rights are a tool understandable to parties to economic and civil transactions (investors, producers, etc.), which can be used to encourage the development of a national system of carbon regulation and a system of exchange trading of carbon units.

⁵⁰ Recently adopted Federal Law No. 34-ФЗ on Holding an Experiment to Limit Greenhouse Gas Emissions in Certain Constituent Entities of the Russian Federation dd. March 6, 2022, may, in our opinion, also be considered as the beginning of the legislator’s journey towards qualifying carbon units as property rights. In the case of tax incentives, such as the cancellation of VAT on carbon units sale, the right to pay taxes in a smaller amount will be provided for, which may also contribute to the qualification of carbon units as property rights. Besides, such qualification could speed up the recognition of Russian units by EU countries and other foreign countries for the purposes of cross-border emissions tax, i.e., Russian importers would not have to pay a carbon fee to the EU budget or the amount of payment would be minimal due to the deduction of the amount of carbon payments made to the Russian budget from the amount payable to the EU budget by a Russian exporter. In addition, the greenhouse gas emission allowances introduced as part of the “Sakhalin experiment” are similar, in our opinion, to property rights.

⁵¹ Thus, we believe that the planned first experiment of market players dealing with carbon units will form a fair market price on the exchange, which will increase the appeal of the carbon market for the players themselves and foreign countries and will promote a greater inflow of players to the commodity market. The development of economic processes and economic activity in the market will help to gradually determine the most understandable approach to treating carbon units as a specific object of civil law as well as the legal regime for carbon units contracts.

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Abstract

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Publication date: 27.12.2022

Citation link:

Sidorova E., Khachaturova K. Carbon Units as an Object of Civil Rights // Energy law forum – 2022. – Issue 4 C. 15-23 [Electronic resource]. URL: <https://mlcjournal.ru/S231243500023791-8-1> (circulation date: 19.05.2024). DOI: 10.18254/S231243500022875-0