



Case & Project Experience

Expert Testimony in Emissions Credits Breach of Contract Case *Economic Advice in Litigation*

The Situation

In March 2010, reports that used emissions credits were being re-sold into the European Union's Emissions Trading System for greenhouse gases (the EU ETS) sent shockwaves through the burgeoning emissions trading markets. The reported "recycling" of Certified Emissions Reductions (CERs) closed markets and caused widespread alarm. Market participants and governments feared that re-use of emissions credits could jeopardize environmental goals, bring the European Union's flagship policy into disrepute, and put at risk billions of Euros invested in projects to reduce emissions.

Some of the trades in emissions credits at the centre of this dispute have recently been the subject of litigation. In March 2010 a financial institution acquired from Total Global Steel Ltd (TGS) 492,000 CERs that the acquirer believed to be valid for use in the EU ETS. The financial institution subsequently discovered that these CERs, which it acquired for 5.7 million Euros, had previously been used for compliance within the EU ETS, and therefore could not be used again under European Commission rules.

In 2011, the financial institution sued TGS for breach of contract, arguing that the CERs it acquired from TGS could not be used to comply with the EU ETS because they had already been "surrendered" once for compliance with the EU ETS.

The Commercial Court of the High Court of England and Wales had to consider whether the CERs delivered by TGS met its contractual obligations, and, if not, how the financial institution's compensation for damages (if any) should be calculated.

NERA's Role

NERA Associate Director Daniel Radov was retained by the financial institution to provide expert testimony to the Court.

Mr. Radov testified on the market for CERs and emission rights more generally. His testimony also considered TGS's claim that the financial institution could have sold the CERs, thereby mitigating any damages from the alleged breach of contract.

Mr. Radov reviewed each of the markets in which TGS and its expert claimed that the previously surrendered CERs could have been sold, corresponding to different national and international emissions trading programmes. Mr. Radov also assessed other markets that TGS had not considered. He also carefully reviewed the nature of the underlying emissions reduction projects associated with each of the CERs. Based on this analysis, Mr. Radov found that in most of the trading programmes (and corresponding markets) into which TGS claimed the CERs could have been re-sold, government policy actually would have prevented their use. Moreover, even in markets where the surrendered CERs might in principle have been used, Mr. Radov showed how demand would have been so low that a sale would have been very unlikely.

Mr. Radov also testified on the valuation of the surrendered CERs relative to the price of Kyoto Protocol Assigned Amount Units (AAUs). TGS and its expert had claimed that the value of the surrendered CERs would be somewhat less than the value of standard, un-surrendered CERs, but in any event would never be less than the value of AAUs. Mr. Radov presented analysis suggesting that the AAU price actually put an upper limit on the value of surrendered CERs, and that the value of the surrendered CERs would have been significantly below that of AAUs.

The Result

On 11 May 2012, Mr. Justice Andrew Smith of the Commercial Court issued his ruling in the case. He concluded that, despite TGS's claims to the contrary, the financial institution that acquired the surrendered CERs could not have sold them in the autumn of 2010. He also rejected TGS's argument that the financial institution could have mitigated its losses by, for example, using the CERs itself to fulfil its own voluntary emissions targets. He ruled that the financial institution was therefore entitled to compensation.

In determining damages, the Court accepted Mr. Radov's analysis of the various markets considered. The judge praised Mr. Radov's "impressive knowledge of the markets for trading instruments of the kind with which this litigation is concerned."

Mr. Justice Smith concluded "The reasons that Mr. Radov gave in support of his opinion about this [the value of CERs] were, to my mind, powerful and cogent and they persuade me that the surrendered CERs were worth much less than AAUs."

On this basis, the Court ruled in the financial institution's favour, and awarded them 4.2 million Euros in damages.

About NERA

NERA Economic Consulting (www.nera.com) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. We bring academic rigor, objectivity, and real world industry experience to bear on issues arising from competition, regulation, public policy, strategy, finance, and litigation.

NERA's clients value our ability to apply and communicate state-of-the-art approaches clearly and convincingly, our commitment to deliver unbiased findings, and our reputation for quality and independence. Our clients rely on the integrity and skills of our unparalleled team of economists and other experts backed by the resources and reliability of one of the world's largest economic consultancies. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

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