Consultant *Chris Cook* offers a sceptical view of the development of European emissions trading, and suggests a new global energy solution based on an alternative to the financial market paradigm

The ETS law is an ass

Chris Cook: **An international energy clearing union or transaction registry could be an altrernative to emissions trading**

★ It is a rare but always eye-opening experience to attend an event at which top traders discuss markets in a public forum. Rare, because they are not often able to get away from their desks: eye-opening, because some traders inhabit a strange morality- and value-free zone where everything is viewed through the twin lenses of risk and reward.

So it was that during the FIA and FOA's Futures Week in June last year, three senior energy traders were asked for their views on the likely chances of the post-Kyoto emission credits trading schemes bursting forth all over the globe.

The consensus was "slim to zero". And when the question was thrown to the audience no-one departed from that view, which was best summarised by an analogy from the floor: "If you want to keep a donkey healthy, you don't take care of what comes out of it – you take care of what goes in".

Why, then are the massed armies of politicians, NGOs, consultants and financial services experts bent on taking this apparently rocky road?

The answer to that question lies with the 'enterprise model' – a legal and financial structure we take for granted in the form of the Joint Stock Limited Liability Company.

It is not necessary to make any moral or ethical judgment in relation to the structure: we merely observe that the managers of OilCo Inc or GasCo Plc are likely to be held to account by their shareholders if they fail to minimise costs and to maximise shareholder value. And there, as Shakespeare had it, is the rub.

Energy market intermediaries who buy, process and sell non-renewable energy are well aware that any tax or levy applied to their raw material is going to compress their profit margins and will therefore be unacceptable to investors. Emissions trading, on the other hand, takes place at the other end of the energy market 'donkey' at the point where the end consumer uses the processed fuel or product.

That would explain why the idea was funded and heavily promoted by the smarter oil companies and conglomerates who, through their formidable lobbying power – allied to that of complaisant NGOs who might have been expected to look more closely – are focusing on trading emissions credits rather than on initiatives likely to affect costs at the other end that they would find more difficult to pass on to consumers.

Or perhaps we could look upon the whole subject from the other end of the telescope and ask what would happen if – contrary to the pessimistic views of our traders – emissions trading were to be wildly successful and to result in a reduction in consumption of non-renewables. Where exactly would such a downturn leave the expectations of investors for further growth in profits and hence shareholder value?

Clearly it is not just the cynics among us who would draw the conclusion that it is only because it cannot work that the energy industry is enthusiastically going along with it.

Accepting that we cannot effectively regulate the back end of the energy donkey, how then

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may we keep it healthy?

One of the most difficult issues in relation to emissions trading lies in 'capturing' the data in relation to distribution and consumption of non-renewable fuels, the resulting emissions and the prevention of cheating by corporations or even countries intent on obtaining a competitive advantage through misreporting. Students of the behaviour of the Organisation of Oil Exporting Countries' scant observance of production allocations will recognise the problem.

The solution for both problems is the same: the requirement is for an international energy clearing union or transaction registry that would neutrally 'capture' energy transactions and in so doing create an energy market user group involving producers, intermediaries and consumers alike. Having captured transactions, it is then a simple matter to apply a tax or levy that would then contribute to create a global 'energy investment fund'.

Such a fund would be a source of cheap investment capital for upgrading and improving existing non-renewable energy market infrastructure, renewable energy sources, and energy-efficient housing and infrastructure.

However, in order both to create the neutral transaction registry and to invest across borders in a way acceptable to national governments, a simple but radical new enterprise model is necessary.

This would be a revenue-sharing 'capital partnership' whereby the financier and the user of the finance agree to a 'capital rental agreement' consisting of proportional revenue shares or partnership interests as opposed to either the equity or debt forms of finance that constitute the existing financial market paradigm[1].

The suggested structure outlined above is not so far-fetched as it may seem, particularly now that – post 9/11 and Iraq – the fact that one nation with 5% of the global population consumes 25% of global energy supplies and that this is becoming recognised as economically unsustainable. In particular, as daily the dollar plumbs new lows, the oil producers, such as Iran and Saudi Arabia, have woken up to the fact that oil is not priced in dollars, but rather that dollars are priced in oil.

A new global energy settlement is clearly needed. As the US continues to pursue unreconstructed policies, the next four years promise to be – as the Chinese maxim has it – "interesting times". ER

1. *For more information, visit www.ecademy.com/node.php?id=3467*