

Managing Disputes in Carbon Markets

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Managing Disputes in Carbon Markets

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Abstract

This paper critically discusses the need for effective management of disputes in carbon markets. The paper analyses the nature and causes of disputes in carbon markets. It argues that these disputes can hinder the fight against climate change and the attainment of Sustainable Development hence the need to effectively manage them. The paper explores some of the available mechanisms for managing disputes in carbon markets and their efficacy. It also proposes measures towards effective management of disputes in carbon markets for enhance climate action.

1.0 Introduction

There is widespread consensus that the carbon market is an important means to address the problem of climate change¹. Carbon markets have been defined as a trading system in which carbon credits are sold and bought². Carbon markets have also been defined as a trading system through which countries may buy or sell units of greenhouse-gas emissions in an effort to meet their national limits on emission³. Carbon markets can also refer to a mechanism that enables and allows public and private entities to transfer and transact emission reduction units, mitigation outcomes or offsets generated through carbon initiatives, programmes and projects subject to compliance of national and international laws⁴. Companies or individuals can use carbon markets to compensate for

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¹ Chen. B., Yuan. K., & Wen. X., 'The Legal Governance of the Carbon Market: Challenges and Application of Private Law in China' Available at <https://www.tandfonline.com/doi/full/10.1080/17583004.2023.2288591> (Accessed on 22/02/2024)

² United Nations Development Programme., 'What are Carbon Markets and Why are They Important?' Available at <https://climatepromise.undp.org/news-and-stories/what-are-carbon-markets-and-why-are-they-important> (Accessed on 22/02/2024)

³ UN-REDD Programme., 'Carbon Market' Available at <https://www.un-redd.org/glossary/carbon-market> (Accessed on 22/02/2024)

⁴ Climate Change (Amendment) Act, 2023., Laws of Kenya, Government Printer, Nairobi

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their greenhouse gas emissions by purchasing carbon credits from entities that remove or reduce greenhouse gas emissions.

The idea of carbon markets was introduced by the *Kyoto Protocol*⁵ which envisages the use of emissions trading in the global response towards climate change. The Protocol allows countries that have emission units to spare - emissions permitted them but not "used" - to sell this excess capacity to countries that are over their targets⁶. It has been pointed out that since carbon dioxide is the principal greenhouse gas, emissions trading as envisaged under the Kyoto Protocol mainly involves trading in carbon⁷. As a result, carbon is now tracked and traded like any other commodity through carbon markets⁸.

Carbon markets have since been widely embraced at global, continental, and national levels. The *Paris Agreement*⁹ envisages the development of carbon markets through internationally transferred mitigation outcomes and voluntary cooperation between countries among other measures. The United Nations has developed a *Carbon Offset Platform*¹⁰ which is an e-commerce platform where a company, an organization or a regular citizen can purchase units (carbon credits) to compensate greenhouse gas emissions or to simply support action on climate. The platform features United Nations Framework Convention for Climate Change (UNFCCC) certified projects that reduce, avoid or remove greenhouse gas emissions from the atmosphere¹¹. At the regional level, the African Carbon Markets Initiative (ACMI) has been developed in order to unlock the potential of voluntary carbon markets for financing Africa's energy, climate and

⁵ United Nations Framework Convention on Climate Change., 'Kyoto Protocol to the United Nations Framework Convention on Climate Change.' Available at <https://unfccc.int/resource/docs/convkp/kpeng.pdf> (Accessed on 22/02/2024)

⁶ Ibid, article 17

⁷ United Nations Climate Change., 'Emissions Trading' Available at <https://unfccc.int/process/the-kyoto-protocol/mechanisms/emissions-trading> (Accessed on 22/02/2024)

⁸ Ibid

⁹ United Nations Framework Convention on Climate Change., 'Paris Agreement.' Available at https://unfccc.int/sites/default/files/english_paris_agreement.pdf (Accessed on 22/02/2024)

¹⁰ United Nations., 'Carbon Offset Platform' Available at <https://offset.climateneutralnow.org/> (Accessed on 22/02/2024)

¹¹ Ibid

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development goals¹². The ACMI was inaugurated at COP 27 and aims to support the growth of carbon credit production and create jobs in Africa¹³.

At a national level, the *Climate Change (Amendment) Act*¹⁴ of Kenya introduces the idea of carbon trading. The Amended Act requires national and county governments to provide guidance in the development and implementation of carbon markets and nonmarket approaches in compliance with international obligations¹⁵. Part IV A of the Amended Act provides the framework for the regulation of carbon markets in Kenya¹⁶. It requires the state to formulate a policy direction on carbon markets which should prescribe carbon reduction credits that aim to reduce emissions from current sources through projects, removal or sequestration credits that take carbon dioxide out of the atmosphere and either use or store it via afforestation, reforestation, nature-based solutions or technology-based removal and technologies and projects towards this end¹⁷. The Act also requires the trade in carbon markets in Kenya to ensure that transactions in carbon trading aim towards a reduction of greenhouse gas emissions as per the prescribed carbon standards¹⁸. The Act envisions the participation in carbon markets through bilateral or multilateral trading agreements, trading with private entities and voluntary carbon markets¹⁹. In pursuance of the principles of Sustainable Development, the Act requires every carbon trading project authorized to undergo an Environmental and Social Impact Assessment in accordance *Environmental Management and Coordination Act, 1999*²⁰. It also requires every carbon project undertaken pursuant to the Act to take into consideration

¹² Sustainable Energy for All, 'Africa Carbon Markets Initiative (ACMI).' Available at <https://www.seforall.org/our-work/initiatives-projects/ACMI> (Accessed on 22/02/2024)

¹³ Ibid

¹⁴ Climate Change (Amendment) Act, 2023., Laws of Kenya, S 2, Government Printer, Nairobi

¹⁵ Ibid, S 3

¹⁶ Ibid, Part IV A

¹⁷ Ibid, S 23 A

¹⁸ Ibid, S 23 B

¹⁹ Ibid, S 23 C (1)

²⁰ Ibid, S 23 D (1)

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and aim to improve the economic, social and cultural wellbeing of the community around the project²¹.

Carbon markets can play a key role in the fight against climate change. It has been pointed out that if well designed, carbon markets can be an effective, credible and transparent tool for helping to achieve low-cost emissions reductions in ways that mobilize private sector actors, attract investment, and encourage international cooperation²². A price on carbon makes clean energy more profitable, allows energy efficiency to earn a greater return, makes low carbon products more competitive, and values the carbon stored in forests²³. Despite the efficacy of carbon markets, it has been observed that there has been rise in disputes in carbon markets²⁴. If not well managed, these disputes can hinder effective carbon trading and therefore affect the fight against climate change²⁵. It is therefore necessary to effectively manage disputes in carbon markets.

This paper critically discusses the need for effective management of disputes in carbon markets. The paper analyses the nature and causes of disputes in carbon markets. It argues that these disputes can hinder the fight against climate change and the attainment of Sustainable Development hence the need to effectively manage them. The paper explores some of the available mechanisms for managing disputes in carbon markets and their efficacy. It also proposes measures towards effective management of disputes in carbon markets for enhanced climate action.

²¹ Ibid, S 23 E (7)

²² Natural Justice., 'Kenya's Climate Change Bill: Paving the Way for Sustainable Development and Carbon Markets.' Available at <https://naturaljustice.org/kenyas-climate-change-bill-paving-the-way-for-sustainable-development-and-carbon-markets/> (Accessed on 22/02/2024)

²³ Ibid

²⁴ Darne. A., 'International Carbon Disputes - How can they be resolved through Arbitration?' Available at <https://www.pslchambers.com/article/international-carbon-disputes-how-can-they-be-resolved-through-arbitration/#:~:text=Arbitration%20has%20played%20a%20vital,issues%20be%20resolved%20through%20ADR> (Accessed on 22/02/2024)

²⁵ Ibid

2.0 Disputes in Carbon Markets

It has been pointed out that the growth of carbon markets has resulted in several disputes²⁶. For example, disputes in carbon markets can arise because of non-compliance of rules for carbon market cooperation and greenhouse gas emissions by developed nations²⁷. Further, it has been contended that the integrity of carbon markets depends in large part on the reliability of carbon accounting and this requires information about an entity's emissions and offsets to be genuine, precise and accurate²⁸. However, there are several challenges that make carbon accounting a difficult exercise, which contributes to increased risk of disputes²⁹. It has been noted that such challenges include the lack of a credible and consistent method of calculating both emissions produced by a business, and emissions avoided or stored by an abatement project³⁰; the lack of a standardised emissions data collection procedure across entities and sectors, which is often done manually and is error-prone³¹; inconsistencies in defining the scope of carbon accounting for example whether and how much upstream and downstream supply chain emissions are included³²; and the complex and heterogenous taxonomy of carbon accounting where the terminology commonly used to describe emissions and offsets lacks a universally recognised set of definitions³³.

It has been contended that the lack of clarity in carbon accounting practices is ripe for disputes³⁴. Carbon accounting practices lack a universally accepted standard, leading to

²⁶ Ibid

²⁷ Ibid

²⁸ Kwan. E., Nagra. S., Zou. A., 'Dispute Resolution in Carbon Markets' Available at <https://arbitrationblog.kluwerarbitration.com/2023/09/16/dispute-resolution-in-carbon-markets/> (Accessed on 22/02/2024)

²⁹ Ibid

³⁰ Ibid

³¹ Ibid

³² Ibid

³³ Ibid

³⁴ ESG., 'Understanding the Challenges and Risks of Carbon Accounting: Implications for Organizations' Available at <https://empoweredsystems.com/blog/understanding-the-challenges-and-risks-of-carbon-accounting-implications-for-organizations/#:~:text=Carbon%20accounting%20practices%20lack%20a,between%20organizations%20or%20across%20industries.> (Accessed on 22/02/2024)

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a fragmented landscape of methodologies and reporting frameworks³⁵. This lack of clarity may lead to exposure to claims of greenwashing, misleading or deceptive conduct and, contractual disputes regarding the proper value and/or veracity of carbon allowances and carbon offsets³⁶. It has been noted that the absence of credible standardization creates confusion, making it challenging to compare emissions data between organizations or across industries³⁷. Additionally, it increases the risk of greenwashing, where organizations may engage in misleading or exaggerated claims about their environmental performance³⁸. Such actions could result in disputes in carbon markets.

It has also been noted that carbon markets are associated with certain risks which could potentially result in disputes³⁹. These risks include the integrity risk which refers to possibilities that investors are influenced by misleading information when buying and selling carbon products, which also occur when companies abandon honest and credible trading strategies under imperfect regulation⁴⁰; the vulnerability risk which means incomplete infrastructures and imperfect systems, which make carbon markets susceptible to internal and external shocks⁴¹; market abuse risk where dominant or influential institutions engage in practices such as insider trading, price manipulation, and other unethical practices⁴²; and liquidity risk which reflects certain factors including the number of carbon products and marketization degree that affect confidences of market participants⁴³. It has been asserted that some of these risks are already being

³⁵ Ibid

³⁶ Ibid

³⁷ Ibid

³⁸ Ibid

³⁹ Chen. B., Yuan. K., & Wen. X., 'The Legal Governance of the Carbon Market: Challenges and Application of Private Law in China' Op Cit

⁴⁰ Ibid

⁴¹ Ibid

⁴² Ibid

⁴³ Ibid

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transmitted to participants, including compliance entities, institutions, and individuals creating the likelihood of disputes in carbon markets⁴⁴.

In addition, it has been opined that while the growth in carbon markets and market participants generates opportunities for much needed emissions reductions, it also requires participants to navigate regulatory and political risks⁴⁵. For example, a participant seeking to take advantage of cross-border trading opportunities may be subject to regulatory action by multiple states as well as inter-state bodies⁴⁶. It has been observed that some governments have decided to cancel emissions markets without notice following a change in administration, while others have limited the use of certain types of compliance units in their jurisdiction, or taken other measures that affect the value of compliance units, potentially with the aim of enhancing environmental integrity⁴⁷. Such actions by states could result in disputes with investors trading in carbon markets since they transform what was once a freely tradable commodity into a stranded asset⁴⁸.

From the foregoing, it is evident that carbon markets are susceptible to disputes. It has been pointed out that carbon disputes often turn on issues common to other contractual disputes⁴⁹. These issues include commodity non-delivery, breach of covenants or warranties, failure to fulfil conditions precedent, disputes over title or security among others⁵⁰. Further, it has been pointed out that distinctive elements of such disputes include the nature of the commodity, the carbon crediting project cycle, and the

⁴⁴ Ibid

⁴⁵ Green Arbitrations., 'Emissions Trading: What Role will Arbitration Play?' Available at <https://www.greenerarbitrations.com/news/emissions-trading-what-role-will-arbitration-play> (Accessed on 22/02/2024)

⁴⁶ Ibid

⁴⁷ Ibid

⁴⁸ Ibid

⁴⁹ Minas. S., 'COP26 Created New Carbon Market Rules: How Will Arbitration Respond?' Available at <https://arbitrationblog.kluwerarbitration.com/2022/01/23/cop26-created-new-carbon-market-rules-how-will-arbitration-respond/> (Accessed on 22/02/2024)

⁵⁰ Ibid

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application of international climate standards⁵¹. In addition, the project cycle itself can also generate disputes such as those concerning project registration or credit issuance⁵². It has also been noted that carbon disputes are not limited to carbon contracts themselves but extend to the full scope of disputes concerning the underlying infrastructure projects undertaken to generate emission reductions, potentially resulting in commercial or investment arbitration proceedings⁵³.

Disputes are undesirable in carbon markets. Such disputes can hinder the effective functioning of carbon markets and slow down the progress towards confronting climate change⁵⁴. It has been argued that carbon markets can be a powerful tool to help advance carbon justice⁵⁵. By entering carbon markets, all countries can advance their socio-economic development while transitioning to a low-carbon economy in a cost-effective way that puts a price on carbon, allows for carbon trading, and stimulates new market opportunities for companies⁵⁶. It is therefore necessary to effectively manage disputes in carbon markets in order to strengthen the global response towards climate change and foster Sustainable Development.

3.0 Managing Disputes in Carbon Markets

Various climate change instruments contain dispute resolution mechanisms for management of climate change disputes including those in carbon markets. For example, the *United Nations Framework Convention on Climate Change (UNFCCC)*⁵⁷, allows parties to seek settlement of disputes through negotiation or any other peaceful means of their own

⁵¹ Ibid

⁵² Ibid

⁵³ Ibid

⁵⁴ Chen. B., Yuan. K., & Wen. X., 'The Legal Governance of the Carbon Market: Challenges and Application of Private Law in China' Op Cit

⁵⁵ United Nations Development Programme., 'Carbon Justice for All: How Carbon Markets Can Advance Equitable Climate Action Globally' Available at <https://www.undp.org/africa/blog/carbon-justice-all-how-carbon-markets-can-advance-equitable-climate-action-globally> (Accessed on 23/02/2024)

⁵⁶ Ibid

⁵⁷ United Nations Framework Convention on Climate Change., United Nations, 1992., Available at <https://unfccc.int/resource/docs/convkp/conveng.pdf> (Accessed on 23/02/2024)

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choice⁵⁸. The UNFCCC also allows parties to submit their parties to the International Court of Justice (ICJ) or to arbitration in accordance with procedures to be adopted by the Conference of the Parties (COP)⁵⁹. The UNFCCC also envisages the management of climate change disputes via a conciliation commission which shall be created upon the request of one of the parties to the dispute⁶⁰. According to the UNFCCC, the commission shall be composed of an equal number of members appointed by each party concerned and a chairperson chosen jointly by the members appointed by each party⁶¹. The UNFCCC provides that the commission shall render a recommendatory award, which the parties shall consider in good faith⁶².

The *Kyoto Protocol* embraces the dispute management mechanisms set out under the UNFCCC⁶³. It thus envisages the management of climate change disputes including those in carbon markets through arbitration, litigation at the ICJ and conciliation through a conciliation commission⁶⁴. The *Paris Agreement* also embraces the dispute management mechanisms stipulated under the UNFCCC which are arbitration, submissions of disputes to the ICJ and conciliation⁶⁵.

At a national level, the *Climate Change (Amendment) Act*⁶⁶ provides for management of disputes in carbon markets. The Act provides that any dispute arising under a land-based project shall be subjected to the dispute resolution mechanism set out in the Community Development Agreement in the first instance and be resolved within thirty days from the date the dispute is lodged⁶⁷. In addition, the Act provides that any dispute that is not land based and is not subjected to a Community Development Agreement shall be resolved

⁵⁸ Ibid, article 14 (1)

⁵⁹ Ibid, article 14 (2)

⁶⁰ Ibid, article 14 (6)

⁶¹ Ibid

⁶² Ibid

⁶³ Kyoto Protocol, article 19

⁶⁴ Ibid

⁶⁵ Paris Agreement., article 24

⁶⁶ Climate Change (Amendment) Act, 2023, Laws of Kenya, Government Printer, Nairobi

⁶⁷ Ibid, s 23 (H) 1

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through Alternative Dispute Resolution in the first instance⁶⁸. The Act therefore envisages the use of Alternative Dispute Resolution (ADR) mechanisms in managing disputes in carbon markets. These mechanisms include negotiation, mediation, arbitration, and conciliation⁶⁹. Further, where any dispute is not managed within thirty days, the Act provides that such dispute shall be referred to the National Environment Tribunal⁷⁰. The Tribunal is established under the Environmental Management and Co-ordination Act with the jurisdiction to *inter alia* make orders to enhance the principles of Sustainable Development in Kenya⁷¹.

In addition to the foregoing dispute management mechanisms set out under climate change instruments, it has been pointed out that dispute management in carbon markets is also governed by carbon contracts⁷². While some of these contracts provide for litigation, most of them envisage the use of arbitration in managing disputes in carbon markets. For example, the International Emissions Trading Association's Emissions Trading Master Agreement for the European Union Emissions Trading Scheme (EU ETS) allows for the use of arbitration in managing disputes in carbon markets with the option to choose among the International Chamber of Commerce (ICC) Rules, United Nations Commission on International Trade Law (UNCITRAL) Rules or The Permanent Court of Arbitration (PCA) Optional Rules for Arbitration of Disputes Relating to Natural Resources and/or the Environment⁷³. In addition the World Bank's Forest Carbon Partnership Facility *General Conditions Applicable to Emissions Reduction Payment*

⁶⁸ Ibid, s 23 (H) 2

⁶⁹ Muigua. K., 'Alternative Dispute Resolution and Access to Justice in Kenya' Glenwood Publishers Limited, 2015

⁷⁰ Climate Change (Amendment) Act, 2023, Laws of Kenya, S 23 H (3), Government Printer, Nairobi.

⁷¹ Environmental Management and Co-ordination Act, No. 8 of 1999, Laws of Kenya S 125 & 129 (3) (c) Government Printer, Nairobi

⁷² Minas. S., 'COP26 Created New Carbon Market Rules: How Will Arbitration Respond?' Op Cit

⁷³ International Emissions Trading Association., 'European Union Emissions Trading Scheme (EU ETS)' Available at https://ieta.b-cdn.net/wp-content/uploads/2023/09/IETA_TradingDocuments_ETMA_Sched23A3B_v4.0.pdf (Accessed on 23/02/2024)

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*Agreements*⁷⁴ allows the use of conciliation and arbitration under the UNCITRAL Rules for managing disputes in carbon markets⁷⁵. The use of arbitration in managing disputes in carbon markets is also envisaged under Norway's *Certified Emission Reduction Purchase Agreement*⁷⁶. The Agreement provides that if a dispute has not been resolved by negotiation within twenty days of delivery of the Dispute Notice, the complaining Party may, at any time thereafter, submit the dispute to be resolved by arbitration in accordance with the Rules of Arbitration of the London Court of International Arbitration (LCIA) for the time being in force⁷⁷.

From the foregoing, it emerges that arbitration is a preferred mechanism for managing disputes in carbon markets. Arbitration refers to a private consensual process where parties in dispute agree to present their grievances to a third party for resolution⁷⁸. It has also been defined as a dispute management mechanism where parties through an agreement submit their dispute to one or more neutral third parties who make a binding decision on the dispute⁷⁹. Arbitration has emerged as the preferred mechanism for managing disputes especially those that are transnational in nature⁸⁰. It has a transnational applicability which means that it applies across different jurisdictions and therefore guarantees neutrality in the determination of disputes by addressing

⁷⁴ World Bank., 'General Conditions Applicable to Emission Reductions Payment Agreements for Forest Carbon Partnership Facility Emission Reductions Programs' Available at <https://www.forestcarbonpartnership.org/sites/fcp/files/2019/Sep/6.%20Emission%20Reductions%20Payment%20Agreement%20%28ERPA%29%20General%20Terms%20and%20Conditions%20%28English%29.pdf> (Accessed on 23/02/2024)

⁷⁵ Ibid, s 18.03

⁷⁶ The Norwegian Ministry of Climate and Environment., 'Certified Emission Reduction Purchase Agreement' Available at <https://www.regjeringen.no/contentassets/86680864084e47118f0086fccc0855fd/template-nmoce-erpa-2016-2020.pdf> (Accessed on 23/02/2024)

⁷⁷ Ibid, s 19.4

⁷⁸ Muigua. K., 'Settling Disputes through Arbitration in Kenya.' Glenwood Publishers, 4th Edition, 2022

⁷⁹ World Intellectual Property Organization., 'What is Arbitration' Available at <https://www.wipo.int/amc/en/arbitration/what-is-arb.html> (Accessed on 23/02/2024)

⁸⁰ Muigua. K., 'Promoting International Commercial Arbitration in Africa.' Available at <http://kmco.co.ke/wp-content/uploads/2018/08/PROMOTINGINTERNATIONALCOMMERCIALARBITRATION-IN-AFRICA.pdf> (Accessed on 23/02/2024)

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differences that may arise as a result of multiple legal systems⁸¹. It also guarantees enforcement of decisions through the *New York Convention*⁸² which provides a harmonized legal framework for the recognition and enforcement of foreign awards in arbitration.

The attributes of arbitration makes it a viable mechanism for managing disputes in carbon markets. These attributes include party autonomy, flexibility, confidentiality, ease of enforcement of outcomes, and the ability to foster neutral, expeditious and cost effective management of disputes⁸³. For example, it has been pointed out that arbitration gives parties freedom in selecting arbitrators which allows them to pick tribunals with sufficient expertise of the regulatory and technical problems at stake in carbon disputes⁸⁴. Furthermore, it has been pointed out that commercial arbitration also provides the option of choosing a neutral tribunal for resolving sensitive disputes, as well as seamless enforcement of awards since majority of country states are signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards⁸⁵. Investment arbitration also allows for the management of disputes in carbon markets between investors and states⁸⁶. It has been observed that there is growing appreciation of the suitability of arbitration for resolving carbon market disputes, including in the field of investment arbitration⁸⁷. It has correctly been observed that government regulation or intervention in carbon offset projects may lead to investor-state arbitration claims against states under applicable investment treaties, where investments in such carbon offset projects are foreign-owned⁸⁸. Actions by states such as cancellation of carbon markets or projects could result in disputes with investors trading in carbon markets since they

⁸¹ Moses, 'The Principles and Practice of International Commercial Arbitration' 2nd Edition, 2017, Cambridge University Press

⁸² United Nations Commission on International Trade Law., 'Convention on the Recognition and Enforcement of Foreign Arbitral Awards.' (New York, 1958)

⁸³ Muigua. K., 'Settling Disputes through Arbitration in Kenya.' Op Cit

⁸⁴ Darne. A., 'International Carbon Disputes - How can they be resolved through Arbitration?' Op Cit

⁸⁵ Ibid

⁸⁶ Green Arbitrations., 'Emissions Trading: What Role will Arbitration Play?' Op Cit

⁸⁷ Kwan. E., Nagra. S., Zou. A., 'Dispute Resolution in Carbon Markets' Op Cit

⁸⁸ Ibid

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transform what was once a freely tradable commodity into a stranded asset⁸⁹. Investment arbitration is therefore a key tool in managing disputes in carbon markets.

Arbitration is therefore a vital tool in managing disputes in carbon markets. It offers several advantages in managing disputes in carbon markets such as the ability of parties to select arbitrators and experts with relevant scientific, environmental and regulatory knowledge⁹⁰; neutrality especially in international carbon disputes since local courts of the jurisdiction where carbon offset projects are situated may be perceived to lack independence⁹¹; universal enforceability of arbitral awards and procedural flexibility to accommodate for the legal traditions of culturally diverse counsel, parties and arbitrators⁹²; and confidentiality by restricting public access to certain documents containing commercially sensitive information or matters concerning national security while opening proceedings or taking other measures to improve transparency⁹³.

However, the use of arbitration in managing disputes in carbon markets could raise certain challenges. For example, since climate change is a matter of public concern, the privacy of arbitration may result in certain stakeholders being left out of the dispute management process⁹⁴. A limited number of stakeholders in such disputes may ultimately lead to future disagreements given the public interest in such matters, requiring all parties to return to the negotiating table or face litigation⁹⁵. It has also been argued that the confidential nature of arbitral proceedings may also be of limited assistance to claimants seeking a more public forum for the ventilation and resolution of their dispute⁹⁶. Further, the use of arbitration in managing disputes in carbon markets could result in problems of costs and delays especially in cases of complex disputes⁹⁷.

⁸⁹ Ibid

⁹⁰ Green Arbitrations., 'Emissions Trading: What Role will Arbitration Play?' Op Cit

⁹¹ Ibid

⁹² Kwan. E., Nagra. S., Zou. A., 'Dispute Resolution in Carbon Markets' Op Cit

⁹³ Ibid

⁹⁴ Darne. A., 'International Carbon Disputes - How can they be resolved through Arbitration?' Op Cit

⁹⁵ Ibid

⁹⁶ Kwan. E., Nagra. S., Zou. A., 'Dispute Resolution in Carbon Markets' Op Cit

⁹⁷ Ibid

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Despite these challenges, arbitration is a more viable forum for managing disputes in carbon markets when compared to other mechanisms such as litigation. Litigating disputes in carbon markets can result in concerns such as lack of independence and bias in favour of host states, lack of flexibility, enforcement challenges in cross border carbon disputes, costs and delays⁹⁸. It is therefore necessary to embrace arbitration and other ADR mechanisms in order to foster the effective management of disputes in carbon markets.

4.0 Way Forward

Arbitration has been identified as a vital mechanism for managing disputes in carbon markets⁹⁹. It has been observed that there is growing appreciation of the suitability of arbitration for resolving carbon market disputes, including in the field of investment arbitration¹⁰⁰. For example, carbon credit standard bodies have incorporated arbitration into their standard templates for disputes with validation and verification bodies¹⁰¹. In addition, many institutions that publish standard form contracts for the production and delivery of carbon credits are also beginning to include arbitration as a method of dispute resolution¹⁰². As a result, it has been argued that international arbitration will continue to be considered as an appropriate dispute resolution mechanism to meet the challenges of uncertainty in carbon market disputes¹⁰³. It is therefore necessary to embrace arbitration for effective management of disputes in carbon markets.

It has been argued that there is need to strengthen the attributes of arbitration which makes it viable in managing disputes in carbon markets¹⁰⁴. These include the parties capacity to select arbitrators and experts with adequate scientific and environmental

⁹⁸ Ibid

⁹⁹ Green Arbitrations., 'Emissions Trading: What Role will Arbitration Play?' Op Cit

¹⁰⁰ Kwan. E., Nagra. S., Zou. A., 'Dispute Resolution in Carbon Markets' Op Cit

¹⁰¹ Ibid

¹⁰² Ibid

¹⁰³ Ibid

¹⁰⁴ Darne. A., 'International Carbon Disputes - How can they be resolved through Arbitration?' Op Cit

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skills¹⁰⁵; the capacity to accelerate legal processes and impose interim and conservatory remedies, particularly in situations involving potential permanent environmental harm¹⁰⁶; the capacity to apply certain governing or applicable law, including relevant environmental statutes¹⁰⁷; maintaining confidentiality while also taking efforts toward improved transparency in line with the parties' requirements and considering the public interest concerned¹⁰⁸; and the availability of arbitral rules that are sufficiently flexible to be applied to specific scenarios¹⁰⁹. It is therefore necessary to build capacity and awareness among arbitration practitioners regarding dispute settlement in carbon markets¹¹⁰. This includes developing familiarity with the unique regulatory context for carbon credits. In addition, arbitral institutions should also consider measures such as the adoption of specialised rules tailored to carbon markets, the establishment of a panel of arbitrators with relevant expertise and the creation of a list of technical experts¹¹¹. These measures will enhance the role of arbitration in managing disputes in carbon markets.

It is also necessary to embrace other ADR mechanisms including negotiation and mediation in managing disputes in carbon markets. These mechanisms contain certain key attributes which include privacy, confidentiality, flexibility, informality, party autonomy and the ability to foster expeditious and cost effective management of disputes¹¹². Mediation has been advanced as an ideal mechanism for managing climate change disputes including those in carbon markets¹¹³. It has been argued that climate-informed mediation can provide platforms to engage and better support the efforts of

¹⁰⁵ Ibid

¹⁰⁶ Ibid

¹⁰⁷ Ibid

¹⁰⁸ Ibid

¹⁰⁹ Ibid

¹¹⁰ Minas. S., 'COP26 Created New Carbon Market Rules: How Will Arbitration Respond?' Op Cit

¹¹¹ Ibid

¹¹² Muigua. K., 'Alternative Dispute Resolution and Access to Justice in Kenya.' Op Cit

¹¹³ United Nations Department of Political and Peacebuilding Affairs., 'The Implications of Climate Change for Mediation and Peace Processes' Available at <https://peacemaker.un.org/sites/peacemaker.un.org/files/DPPAPracticeNote-TheImplicationsofClimateChangeforMediationandPeaceProcesses.pdf> (Accessed on 23/02/2024)

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parties to a dispute to find a peaceful and sustainable solution to their dispute¹¹⁴. It can also enhance the chances that an agreement will stand the “climate test” over time¹¹⁵. In addition, it has been pointed out that mediation can be an ideal dispute resolution mechanism for carbon markets particularly for voluntary carbon markets¹¹⁶. It is therefore necessary to embrace mediation for management of disputes in carbon markets. In addition, international climate change instruments including the UNFCCC, Kyoto Protocol and Paris Agreement, allow parties to seek settlement of climate change disputes through *negotiation* or any other peaceful means of their own choice (Emphasis added)¹¹⁷. Further, the Climate Change (Amendment) Act of Kenya provides for the management of disputes in carbon markets through ADR mechanisms¹¹⁸. It is therefore necessary to embrace ADR mechanisms including mediation and negotiation for effective management of disputes in carbon markets.

Finally, it is imperative to promote proper functioning of carbon markets¹¹⁹. Carbon markets are associated with certain risks and challenges such as greenwashing, information asymmetry among participants, misleading or deceptive conduct, lack of clarity over the proper value and/or veracity of carbon allowances and carbon offsets, insider trading, and price manipulation among other unethical practices¹²⁰. Such practices often result in disputes in carbon markets. It is therefore necessary to promote proper functioning of carbon markets by addressing the risks and challenges involved¹²¹. This calls for enhancing transparency in carbon markets, avoiding conflict of interest, and fostering oversight and monitoring in order to minimize fraud, insider trading and price

¹¹⁴ Ibid

¹¹⁵ Ibid

¹¹⁶ ESG Investor., ‘Greater Scope for Carbon Markets Legal Action in Asia’ Available at <https://www.esginvestor.net/greater-scope-for-carbon-markets-legal-action-in-asia/> (Accessed on 23/02/2024)

¹¹⁷ United Nations Framework Convention on Climate Change article 14 (1); Kyoto Protocol, article 19; Paris Agreement, article 24

¹¹⁸ Climate Change (Amendment) Act, 2023, Laws of Kenya, s 23 (H) 2

¹¹⁹ ESG., ‘Understanding the Challenges and Risks of Carbon Accounting: Implications for Organizations’ Op Cit

¹²⁰ Ibid

¹²¹ Ibid

manipulation among other unethical practices¹²². This will promote proper functioning of carbon markets and minimize the likelihood of disputes¹²³.

The foregoing among other measures are key in managing disputes in carbon markets.

5.0 Conclusion

Carbon markets are an effective tool in the global response to climate change¹²⁴. If well designed, carbon markets can be an effective, credible and transparent tool for helping to achieve low-cost emissions reductions in ways that mobilize private sector actors, attract investment, and encourage international cooperation¹²⁵. Carbon markets can also be a powerful tool to help advance carbon justice¹²⁶. By entering carbon markets, all countries can advance their socio-economic development while transitioning to a low-carbon economy in a cost-effective way that puts a price on carbon, allows for carbon trading, and stimulates new market opportunities for companies¹²⁷. Despite their efficacy, risks and challenges such as greenwashing, information asymmetry among participants, misleading or deceptive conduct, lack of clarity over the proper value and/or veracity of carbon allowances and carbon offsets, insider trading, and price manipulation among other unethical practices make carbon markets susceptible to disputes¹²⁸. Such disputes are undesirable since they can hinder the effective functioning of carbon markets and slow down the progress towards confronting climate change¹²⁹. It is therefore necessary

¹²² The International Organization of Securities Commissions., 'Compliance Carbon Markets' Available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD719.pdf> (Accessed on 23/02/2024)

¹²³ Ibid

¹²⁴ ¹²⁴ Chen. B., Yuan. K., & Wen. X., 'The Legal Governance of the Carbon Market: Challenges and Application of Private Law in China' Op Cit

¹²⁵ Natural Justice., 'Kenya's Climate Change Bill: Paving the Way for Sustainable Development and Carbon Markets.' Op Cit

¹²⁶ United Nations Development Programme., 'Carbon Justice for All: How Carbon Markets Can Advance Equitable Climate Action Globally' Op Cit

¹²⁷ Ibid

¹²⁸ ESG., 'Understanding the Challenges and Risks of Carbon Accounting: Implications for Organizations' Op Cit

¹²⁹ Chen. B., Yuan. K., & Wen. X., 'The Legal Governance of the Carbon Market: Challenges and Application of Private Law in China' Op Cit

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to effectively manage disputes in carbon markets. This can be achieved through approaches such as embracing ADR mechanisms including arbitration, mediation and negotiation¹³⁰; and promoting the proper functioning of carbon markets by addressing the underlying risks and challenges¹³¹. It is imperative to deal with disputes in carbon markets effectively in order to strengthen the fight against climate change. Managing disputes in carbon markets is a key imperative that cannot be ignored.

¹³⁰ Kwan. E., Nagra. S., Zou. A., 'Dispute Resolution in Carbon Markets' Op Cit

¹³¹ ESG., 'Understanding the Challenges and Risks of Carbon Accounting: Implications for Organizations' Op Cit

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