ABSTRACT: In its judgment of 22 June 2016, *DK Recycling und Roheisen GmbH v. Commission*, the Court of Justice ruled on an appeal brought by a German undertaking operating installations subject to the European Union Emissions Trading System (EU ETS), i.e. a “carbon market” where operators trade greenhouse gas emission allowances. At issue in the case were the rules on free allocation of emission allowances. After putting the case in context by providing an overview of the normative framework of the mechanism, the present analysis examines how the case contributes to the understanding of the theoretical implications of the EU ETS.


I. Introduction

In its judgment of 22 June 2016, *DK Recycling und Roheisen GmbH v. Commission*, the Court of Justice ruled on an appeal brought by a German undertaking operating installations subject to the European Union Emissions Trading System (EU ETS), i.e. a “carbon market” established by Directive 2003/87 (ETS Directive) where operators trade greenhouse gas (GHG) emission allowances. At issue in the case were the rules on free allocation of emission allowances, and more precisely a Decision by the Commission rejecting Germany’s proposed increase of free allowances on the basis of the so-called “hardship
clause”, included in the German legislation implementing the scheme. Three similar appeals were decided by reasoned order on 13 September 2016.³

The present contribution aims at clarifying how the Court approached the case using a competence-based reasoning, emphasising the link between the new regulatory framework on allowance allocation, characterised by a strong harmonisation, and the objective of competition preservation. The case, and more generally the normative landscape on allowance allocation, are examined against the background of a particular theoretical construction of emissions trading, which puts competence issues and the symbiotic relationship between the State and the market at the core of the analysis of emissions trading systems.

II. THE JUDGMENT IN CONTEXT

II.1. THEORY AND PRACTICE OF MARKET-BASED ENVIRONMENTAL REGULATION

The means of environmental regulation can be grouped in two categories: command-and-control and market-based.⁴ Under a command-and-control regulation, uniform standards are applied to all relevant operators,⁵ imposing, for instance, a quantitative limit on the amount of pollutants, mandating a particular technique, or banning a substance or practice.⁶ Command-and-control environmental regulation has been criticised for imposing the same standards to operators which can face very different compliance costs.⁷ It has been argued that such inefficiencies can be overcome thanks to market-based mechanisms, based on the idea of “harnessing market forces”:⁸ through taxation schemes or tradable emission allowance systems (“emissions trading”),⁹ a “price” is put on pollution, so that each firm will be able to decide whether to reduce their pollution level or pay the corresponding “price”.¹⁰ Market-based instruments promise to achieve

⁵ R.N. STAVINS, Experience with Market-Based Environmental Policy Instruments, cit., p. 358.
⁷ R.N. STAVINS, Experience with Market-based Environmental Policy Instruments, cit., pp. 358-359; D.M. DRIESEN, R.W. ADLER, K.H. ENGEL, Environmental Law, cit., p. 297 et seq.
⁸ R.N. STAVINS, Experience with Market-Based Environmental Policy Instruments, cit., p. 358.
⁹ For an overview of the different systems and of the related legal issues, see D.M. DRIESEN, R.W. ADLER, K.H. ENGEL, Environmental Law, cit., p. 297 et seq.
environmental objectives “at the lowest overall cost to society, by providing incentives for the greatest reductions in pollution by those firms that can achieve these reductions most cheaply”. With regard to the conceptual origins of market-based regulation, while Pigou had argued for taxing emissions, the theoretical basis of emissions trading can be traced to the Coase theorem, which made it possible to frame the discourse on pollution control in terms of rights. According to this approach, by identifying these rights and making them transferable, private negotiation will achieve the optimal allocation of resources.

The US was the first to put the emissions trading theory into practice, and its pioneering efforts, advancing the popularity of this type of regulation, can arguably be seen as a crucial factor in the design chosen in the Kyoto Protocol, which put three market-based mechanisms at the core of the international legal architecture on climate change: Joint Implementation (JI) and the Clean Development Mechanism (CDM), allowing Parties to acquire credits generated from emission reduction projects to offset their emissions, and International Emissions Trading (IET), enabling the purchase and sale of emission allowances and emission reduction credits. The functioning of these mechanisms has


16 Art. 6 of Kyoto Protocol.

17 Art. 12 of Kyoto Protocol.

18 Art. 17 of Kyoto Protocol.

been marked by controversy, and their ability to guarantee environmental integrity and create actual incentives for pollution reduction has been questioned.\textsuperscript{20} The Paris Agreement, which established a new global climate framework, provides in its Art. 6 that Parties can engage “in cooperative approaches that involve the use of internationally transferred mitigation outcomes”, this being “the new jargon for emissions trading and other mechanisms to link national climate policies”.\textsuperscript{21} Art. 6, para. 4, establishes a “mechanism to contribute to the mitigation of greenhouse gas emissions and support sustainable development”, an offset mechanism which will replace CDM and JI.\textsuperscript{22}

II.2. Emissions Trading in the EU

The EU ETS was established by Directive 2003/87\textsuperscript{23} “to contribute to fulfilling the [Kyoto Protocol] commitments of the European [Union] and its Member States more effectively, through an efficient European market in greenhouse gas emission allowances, with the least possible diminution of economic development and employment”,\textsuperscript{24} and it aims at promoting “reductions of greenhouse gas emissions in a cost-effective and economically efficient manner”.\textsuperscript{25} The system design is that of “cap-and-trade”: a cap is established on the total amount of emissions allowed, and such amount is divided into emis-
mission allowances (each granting the right to emit one tonne of CO₂ equivalent)\textsuperscript{26} which are allocated to the operators covered by the system.

The EU ETS – which is the first and largest international emissions trading system –\textsuperscript{27} has until now gone through three phases of operation: phase I, from 2005 to 2007; phase II, from 2008 to 2012; phase III, which started in 2013 and will last until 2020. The first two phases were governed by Directive 2003/87; an important revision for phase III was carried out with Directive 2009/29.\textsuperscript{28} An analysis of the ETS regulatory evolution with regard to cap-setting, allowance allocation and monitoring and verification procedures is necessary for a broader understanding of the scheme.\textsuperscript{29}

In the first two trading phases, every State decided on how many allowances to allocate and on their distribution to the relevant operators through National Allocation Plans (NAPs), which were reviewed by the Commission and could be rejected for failure to comply with the requirements included in the Directive.\textsuperscript{30} This system, however, proved complex, dysfunctional and not transparent, and the different methodologies adopted by Member States were deemed to create distortions of competition. As a consequence, the EU legislator has opted for the centralisation of the cap, abandoning the NAPs system from 2013.\textsuperscript{31} Monitoring and verification procedures, which fell originally under the responsibility of Member States, have also been centralised.\textsuperscript{32}

\textsuperscript{26} Art. 3 of Directive 2003/87, cit.
\textsuperscript{27} Commission, \textit{The EU Emissions Trading System (EU ETS)}, ec.europa.eu.
As regards the allocation method, in the first two phases most allowances were allocated for free on the basis of historical GHG emission levels ("grandfathering"). This allocation mechanism was criticised under many aspects. The compatibility of this system with the "polluter pays principle" has been questioned. Another controversial issue was related to "windfall profits", a phenomenon concerning mainly the electricity-producing sector, which is able to "integrate the value of used emission allowances which were allocated free of charge into the price of electricity".

In the third phase, auctioning has become the default method of allocation. Under the new system, emission allowances are sold through an auctioning platform where operators bid for allowances, which are allocated to the highest bidder. Auctions are governed by Regulation 1031/2010 (hereinafter Auctioning Regulation), according to which Member States and the Commission shall procure jointly a common platform to auction allowances on behalf of the Member States. The common platform mechanism is described in Recital 6 of the Regulation as a system that avoids "any distortions of the internal market". Member States, however, are entitled to opt-out and appoint their own auctioning platform. Germany, Poland and the UK have made use of this possibility.

While the power sector will have, from now on, to purchase all its allowances, for other sectors the transition to auctioning will be gradual. As a consequence, some allowances will still be allocated for free. The amount of free allowances is now determined on the basis of fully harmonised rules established in the ETS Directive and in the

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37 Commission, EU ETS Handbook, cit., p. 135, p. 28 et seq.
40 Ibidem.

This brief overview shows that the history of the EU ETS has been characterised by multiple power shifts, with the centralisation of many aspects in the third phase. These changes have been considered problematic from the point of view of the subsidiarity principle, and in general the problem of competence allocation has been at the centre of several recent studies. It is here submitted that the DK Recycling case should be read through this lens, and appears to be in line with a particular theoretical construction of emissions trading which will be discussed infra, at section V.

III. THE DK RECYCLING CASE

III.1. BACKGROUND

Germany implemented Decision 2011/278 with, inter alia, the law on greenhouse gas emissions trading (Treibhausgas-Emissionshandelsgesetz, TEHG) of 21 July 2011. Art. 9, para. 5, of the TEHG allowed for the allocation of additional allowances free of charge to undertakings for which the allocation based on Art. 10 of the Directive would entail “undue hardship” (hereinafter “the hardship clause”).

Under Art. 11 of the ETS Directive on “National Implementation Measures”, each Member State had to submit to the Commission, by 30 September 2011, a list including the installations covered by the Directive in its territory as well as the preliminary amount to be allocated for free to each installation for the period 2013-2020, determined on the basis of harmonised rules on allocation. Para. 3 of the same Art. prevents Member States from issuing free allowances “to installations whose inscription in the list has been rejected by the Commission”. Germany sent its Art. 11 list to the Commission in May 2012. For the applicants’ installations, Germany calculated the amount of free allowances also on the basis of the mentioned hardship clause, proposing the allocation of additional free allowances to avoid “undue hardship” for the undertak-

41 For a critical account from the perspective of subsidiarity, see J. DE CENDRA DE LARRAGÁN, Too Much Harmonization? An Analysis of the Commission’s Proposal to Amend the EU ETS from the Perspective of Legal Principles, in M. FAURE, M. PEETERS (eds), Climate Change and European Emissions Trading: Lessons for Theory and Practice, Cheltenham/Northampton: Edward Elgar, 2008, pp. 53-84. On a more nuanced interpretation of the competence shifts undergone by the ETS, see S. BOGOJEVIĆ, The EU ETS Revised, cit., p. 279 et seq.


43 See supra, section ii.2.
ings concerned. The list was rejected by the Commission with Decision 2013/448.\textsuperscript{44} The Commission recalled how the EU legislator has opted for full harmonisation of the rules on free allocation, with a view to guaranteeing equal treatment of all installations. This harmonised approach would be jeopardised by national unilateral changes such as that provided for by the German “hardship clause”, as assigning extra-allowances to certain installations “would distort or threaten to distort competition and has cross-border effects given Union-wide trade in all sectors covered by [the ETS Directive]”, in violation of the principle of equal treatment.\textsuperscript{45}

DK Recycling,\textsuperscript{46} as well as three other undertakings, Arctic Paper,\textsuperscript{47} Raffinerie Heide\textsuperscript{48} and Romonta,\textsuperscript{49} sought annulment of the Commission Decision. The General Court upheld in part DK Recycling’s application, dismissing the pleas in law concerning the rejection of free allocation of emission allowances based on the hardship clause. The actions brought by Arctic Paper, Raffinerie Heide and Romonta were dismissed in their entirety. The four judgments have all been appealed, and AG Mengozzi has delivered an Opinion on the four appeals altogether.\textsuperscript{50} The Court has ruled on DK Recycling with its judgment of 22 June 2016.\textsuperscript{51} Given the similarity of the issues at stake, the other three appeals were subsequently dismissed by reasoned order on the basis of Art. 181 of the Rules of Procedure, which concerns cases where an appeal is manifestly inadmissible or manifestly unfounded.\textsuperscript{52}

iii.2. \textit{DK Recycling} before the General Court

First of all, the admissibility of the case was contested by the Commission, which argued that DK Recycling lacked standing under the requirements foreseen in Art. 263, para. 4, TFEU. It is worth noting that the Court has consistently showed a restrictive approach towards actions for annulment brought by individuals in the context of the EU ETS. Un-

\textsuperscript{44} Commission Decision 2013/448/EU of 5 September 2013 concerning national implementation measures for the transitional free allocation of greenhouse gas emission allowances in accordance with Article 11(3) of Directive 2003/87/EC.

\textsuperscript{45} Recital 11 of Decision 2013/448, cit.

\textsuperscript{46} General Court, judgment of 26 September 2014, case T-630/13, \textit{DK Recycling und Roheisen v. Commission}.

\textsuperscript{47} General Court, judgment of 26 September 2014, case T-634/13, \textit{Arctic Paper Mochlenwangen v. Commission}.

\textsuperscript{48} General Court, judgment of 26 September 2014, case T-631/13, \textit{Raffinerie Heide GmbH v. Commission}.

\textsuperscript{49} General Court, judgment of 26 September 2014, case T-614/13, \textit{Romonta GmbH v. Commission}.


\textsuperscript{51} \textit{DK Recycling}, C-540/14 P, cit.

\textsuperscript{52} \textit{Arctic Paper}, C-551/14 P, cit.; \textit{Raffinerie Heide}, C-564/14 P, cit.; \textit{Romonta}, C-565/14 P, cit.
der the NAPs system, actions for annulment of the Commission Decisions rejecting national plans brought by private applicants were consistently considered inadmissible. In particular, the Court held that such Decisions could not be considered as administrative authorisations, concluding, in its teleological interpretation of the system, that the purpose of the procedure was not to confer rights upon the operators concerned, but rather to provide “legal certainty for the Member States”. The Court affirmed its position after the introduction, by the Lisbon Treaty, of the new Art. 263, para. 4, TFEU, by making it clear in the case Arcelor that the EU ETS Directive could not be regarded as a regulatory act not entailing implementing measures. The exclusion of private operators from the possibility of challenging the Commission Decisions on NAPs has been seen as a source of concern in terms of access to justice. The third phase has brought about the end of the NAPs mechanism, and it is in this new and different regulatory context that the admissibility of the case has been discussed. The Court recalled the settled case-law according to which the contested measure must “directly affect the legal situation of the individual” and “must leave no discretion to its addressees, who are entrusted with the task of implementing it, such implementation being purely automatic and resulting from Community rules without the application of other intermediate rules”. The new regulatory framework of national EU ETS measures provides that Member States must submit to the Commission a list containing installations and any free allocation to each installation (Art. 11, para. 1, of EU ETS Directive). Member States cannot allocate free allowances to installations whose inscription is rejected by the Commission (Art. 11, para. 3, of EU ETS Directive). In light of this, the Court found that the rejection of the inscription of installations and free allowances impacts directly the legal situation of the applicant and


56 As discussed above, section II.2.


58 See supra, section II.2.
leaves no discretion to Germany in its implementation. It is of no consequence, according to the Court, that Art. 15, paras 4 and 5, of Decision 2011/278 provides for national implementing measures, since the disputed Commission Decision determined all the factors that Germany had to consider to calculate the final amount of free allowances to be allocated per year to the applicant’s installations, making the Member State’s implementation action purely automatic. The end of the NAPs system seems therefore to have brought about a greater degree of openness to private challenges.

On the merits, DK Recycling put forward four pleas in law. The first and second pleas concerned the Commission’s decision to reject the allocation based on the hardship clause. More precisely, DK Recycling alleged, with its first plea, failure by the Commission to have regard to Decision 2011/278 and, with its second plea, a violation of its fundamental rights and of the proportionality principle. The third plea alleged a violation of the obligation to state reasons concerning the rejection of free allocation for a process emissions sub-installation for the production of zinc in the blast furnace and related processes. The fourth plea was based on a violation of the right to be heard. The General Court upheld only the third plea and rejected all the others. Of particular importance for present purposes is the GC’s analysis of the second plea.

With the first argument of the second plea, DK Recycling argued that the Commission failed to have regard to Decision 2011/278 by considering that this Decision did not allow free allocation on the basis of a hardship clause, in violation of the undertaking’s fundamental rights and of the proportionality principle. However, the GC concluded that free allocation on the basis of the hardship clause was not possible according to Decision 2011/278. In the GC’s view, it is possible to conclude that the latter did not allow the Commission to authorise free allocation on the basis of a hardship clause given, first, the exhaustive nature of the rules on free allocation established in the Decision, which exclude the possibility of assigning free allowances beyond what is established in the rules themselves, and, second, the lack of discretion on the Commission’s part in reviewing the Member States’ list, as its Decision entirely depends on whether the proposed allocation has been determined in conformity with the Directive.

After concluding that it was not possible for the Commission to allow Germany’s proposed allocation, the GC turned to the second argument of the plea, according to which, in the absence of a hardship clause, Decision 2011/278 violated the claimant’s fundamental rights as well as the proportionality principle. According to the GC, such an infringement could not be ruled out a priori, since Art. 10 of the ETS Directive, which constitutes the legal basis of the Commission’s implementing Decision, did not rule out free allocation on the basis of a “hardship clause”. The GC’s conclusion is supported, first, by the observation that the inclusion of a hardship clause applicable to all Member

59 DK Recycling, T-630/13, cit., para. 32.
60 DK Recycling, T-630/13, cit., paras 33-34.
States would not have been in contrast with the full harmonisation approach and that the clause would not be such as to amend the Directive’s essential elements in light of its narrow scope of application, limited to exceptional cases. The second element highlighted by the GC is based on the discretion held by the Commission in cases where developing a product benchmark was not possible: “[w]ithin the scope of that discretion, therefore, the Commission could also, in principle, have provided for free allocation of allowances on the basis of a hardship clause”.61

Having established that the Commission could have included a “hardship clause”, the GC went on to evaluate whether the lack thereof amounted to a breach of fundamental rights and proportionality, concluding that the Decision was lawful.

### III.3. DK Recycling before the Court of Justice

DK Recycling brought an appeal against the General Court’s judgment. The Commission disputed the GC’s finding that the Commission had competence to introduce a hardship clause in its implementing Decision,62 essentially asking for a substitution of grounds.63 This issue is considered to be a precondition for any further analysis: should it be concluded that the Commission was not competent to include such a clause in its implementing act, any pleas raised by DK Recycling would be rendered ineffective.64 This point had already been made by the AG, whose analysis also turned on the Commission’s competence.

Therefore, both in the Opinion delivered by AG Mengozzi and in the judgment, what appears to be a technical question on the regulatory details of allowance allocation is approached through a reasoning entirely based on competence. It is not the first time that the Court frames an EU ETS case by focusing on questions of allocation of regulatory power, to the point that the Court has been said to have a “constitutional” law approach towards the EU ETS.65

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62 DK Recycling, C-540/14 P, cit., para 45.

63 DK Recycling, C-540/14 P, cit., paras 31-35; Opinion of AG Mengozzi, DK Recycling, cit., paras 34-35.

64 DK Recycling, C-540/14 P, cit., para. 34.

65 As will be discussed infra, at section V, Bogojević has underlined how the EU judges have approached the EU ETS as a “matter of constitutional law” (see generally S. BOGOJEVIĆ, EU Climate Change Litigation, cit.) in the sense that EU climate change litigation “is concerned with questions, such as competence allocation, subsidiarity and ensuring effective judicial protection, demonstrating that the EU courts remain within a settled constitutional law framework in giving meaning to and interpreting EU climate change law” (S. BOGOJEVIĆ, EU Climate Change Litigation, cit., p. 559). On the use of “constitutional” language with regard to the European Union, see, e.g., R. SCHÖTZE, European Constitutional Law, Cambridge: Cambridge University Press, 2012, p. 1 et seq.
As regards the Court’s analysis, which essentially reflects the Opinion of the AG, after recalling that the Commission’s measures for the harmonisation of the rules on free allocation were meant to amend “non-essential elements” of the Directive, as the latter clarified in its Art. 10a, and that the essential elements of basic legislation cannot be amended by Commission’s implementing measures, the focus of the analysis becomes whether the inclusion of the “hardship clause” in the Commission’s implementing Decision would amount to amending an essential element of the Directive.

Therefore, the reasoning unfolds by recalling the case-law on the identification of the essential or non-essential nature of an element, which “must be based on objective factors amenable to judicial review, and requires account to be taken of the characteristics and particular features of the field concerned”. Thus, a broader look at the context and aims of this EU policy is taken, which leads to the identification, next to the main objective of reducing GHG emissions, of a series of sub-objectives: “the safeguarding of economic development and employment and the preservation of the integrity of the internal market and of conditions of competition”.

Competition protection, whose essential character is demonstrated, according to the Court, by the multiple references in the Directives 2003/87 and 2009/29, is the key element in the development of the analysis. In particular, the Court highlights the link between harmonisation of free allocation rules and competition protection. This connection emerges, in the Court’s view, from Recital 23 of Directive 2009/29 – stating that “[t]ransitional free allocation to installations should be provided for through harmonised Community-wide rules (ex-ante benchmarks) in order to minimise distortions of competition with the Community” – and from Art. 10(a) of Directive 2003/87, providing for the adoption by the Commission of fully harmonised allowance allocation implementing measures, and establishing the criteria on which such harmonisation was to be based, i.e. “in essence, on the basis of benchmarks in sectors and subsectors”. In light of this, the Court concludes that the harmonised, sectoral approach should be seen as a “concrete expression” of the objective of avoiding competition distortions.

That requirement would be violated by rules that are not fully harmonised and of a sectoral nature, which would therefore amount to an amendment of an essential element of Directive 2003/87. This is the case of the “hardship clause”, which “would necessarily have implied a case-by-case approach based on there being particular and individual circumstances peculiar to each operator affected by such ‘undue hardship’”, in apparent contrast with the principle of harmonised and sectoral allocation of free al-

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66 DK Recycling, C-540/14 P, cit., paras 46-47.
67 Ibidem, para. 48.
68 Ibidem, para. 49.
69 Ibidem, paras 50-53.
allowances. Such a clause, in conclusion, would have amounted to an amendment of an essential element of the ETS Directive.70

Such conclusion cannot, according to the Court, be called into question by the discretion enjoyed by the Commission in cases where deriving a product benchmark is not possible, since, first, that discretion does not constitute a derogation from the harmonised and sectoral approach and, second, a contextual analysis of the text leads to the conclusion that “ex-ante benchmarks must be set ‘in individual sectors or subsectors’, those being the words used in Article 10a(2) of Directive 2003/87”.71

Competence, and in particular the competence of the Commission in adopting implementing measures, is at the core of the Court’s analysis. As a consequence, the Court reaches its decision through the use of categories and principles aimed at defining the scope of the Commission’s implementing powers. The preservation of competition is integrated into the Court’s competence-based reasoning. In particular, the avoidance of competition distortion is achieved through a delimitation of the Commission’s competence which ensures that the uniformity of allocation methods throughout the Union is not jeopardised: thus, centralisation and uniformity appear to be co-essential to the preservation of competition.

IV. A PARALLEL BETWEEN DK RECYCLING AND THE REGULATORY SHIFT TO AUCTIONING: THE NORMATIVE LANDSCAPE OF ALLOWANCE ALLOCATION

Much like in DK Recycling, a close interrelation between harmonisation and avoidance of market distortions can be identified by examining the evolution of the regulatory framework on allowance allocation from the perspective of the shift from grandfathering to auctioning. There had been significant discussion concerning possible State aid implications of the ETS, especially with regard to free allocation of allowances.72 For phase III, described above, auctioning has become the default method for allocating allowances in the EU ETS. Auctions are generally expected to eliminate State aid issues,73 but it has been underlined that they “may not constitute the problem-free solution they are at times proclaimed to be”.74 The analysis below suggests that it is the upward power shift, and thus the centralisation of allowance allocation methods, that significantly reduces the risk of competition distortion, rather than auctioning in and of itself.

Considering Art. 107, para. 1, TFEU requirements, a first point to be highlighted concerns the requirement that an advantage is transferred. A common belief by policy-

70 Ibidem, para. 55.
71 Ibidem, para. 57.
72 See supra, footnote 35.
73 See, e.g., S. Weishaar, E. Woerdenman, Does Auctioning Emission Rights Avoid State Aid?, cit., p. 114.
makers and academics is that auctioning eliminates the issue of windfall profits, but Weishaar and Woerdman have questioned the assumption that undertakings participating in auctions will certainly not receive an economic advantage. The authors collected data in relation to auctions carried out by Germany during phase II and concluded that a “statistically significant” under-pricing effect could be observed. This means that undertakings purchased allowances in the auctions paying less than the market price. As auctions can be openly traded in a secondary market, bidders are “unwilling to pay more at auction than on the secondary market”. As a consequence, Member States might receive an economic benefit through auctions.

On the other hand, what appears to reduce the possibility of State aid is centralisation. First, with regard to the requirement that the measure is adopted by the State, it should be recalled that a measure is not imputable to a State to the extent that the State is complying with obligations imposed by EU law. It should be recognised, from this point of view, that Member States’ discretion was strongly limited for phase III. As explained supra, the NAPs system was replaced with a centralised cap at the EU level. Moreover, auctions are governed by Regulation 1031/2010, which provides for a common auctioning platform. Member States did retain a certain degree of discretion, as they are entitled to opt out of the common auctioning infrastructure. It should be stressed, however, that also national auctioning platforms are governed by the Auctioning Regulation. It follows that the imputability requirement can be satisfied only if the State proves able to exercise discretion in governing auctions within the Regulation requirements.

As regards the transfer of State resources, if a Member State, in the exercise of its discretion, was found to have chosen a less profitable auctioning mechanism, it could be argued that it is “foregoing revenue that it could have been attaining by failing to maximize auction revenues”. This could therefore be construed as a transfer of State resources.

With regard to selectivity, in the first and second phases Member States did retain discretion as regards the total amount of allowances to be distributed, the allocation method and the number of allowances to be assigned to each installation. Allocation

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75 See S. WEISHAAR, E. WOERDMAN, Does Auctioning Emission Rights Avoid State Aid?, cit., p. 115. On windfall profits, see supra, section II.2.
76 For this discussion, see S. WEISHAAR, E. WOERDMAN, Does Auctioning Emission Rights Avoid State Aid?, cit., pp. 115-118.
77 Ibidem, p. 115.
78 Ibidem, p. 121.
79 S. WEISHAAR, Towards Auctioning, cit., p. 197.
methodologies varied both between and within Member States, for instance new entrants were assigned allowances on the basis of benchmarks whereas existing installations on the basis of historic emissions.\(^81\) Moreover, certain activities were governed by special rules.\(^82\) In its assessments of NAPs, the Commission generally concluded that, if the existence of a selective advantage was established, then the measure had the potential of distorting competition and affecting inter-State trade.\(^83\) Weishaar has underlined that, in a grandfathering system, four kinds of competitive relationships can be distorted: between incumbent and new entering firms; between trading and non-trading sectors; between competing firms of the same Member State; between trading sectors.\(^84\) The conclusion is that free allocation is not per se discriminatory, but in practice grandfathering has been characterized by different reference periods and allocation methods that led to differentiation between undertakings.\(^85\)

The ETS scheme in the third phase can be considered selective in that the electricity sector is singled out, being the only one for which 100% of allowances are assigned through auctioning. However, in this case one should consider that it is the ETS Directive itself to determine the sectors involved, and therefore, again, selectivity could only be found with regard to the exercise of discretion by the States that have opted for national auctioning platforms.\(^86\)

The comparison between auctioning and free allocation shows that the problem of windfall profits does not seem to have been completely eradicated, and therefore installations might still receive an economic advantage. However, in phase III the discretion of Member States has been drastically limited and, therefore, it seems unlikely that the imputability criterion would be satisfied. Moreover, the centralisation of many aspects seems able to reduce differentiation and consequent competition distortions.\(^87\) This analysis shows that it is harmonisation, rather than the fact that undertakings will now have to pay for allowances, to significantly reduce the risk of distortion of competition.

On the one hand, this case-study reinforces and supports the analysis developed by AG Mengozzi and confirmed by the Court, because it shows the inextricable link between the normative option for harmonisation and competition protection. More generally, the landscape that appears to be delineating with regard to allowance allocation


\(^{82}\) Ibidem.

\(^{83}\) J. DE SÉPIBUS, The European emissions trading scheme put to the test of state aid rules, cit., p. 15; G. CATTI DE GASPERI Making State Aid Control “Greener”, cit., p. 795.

\(^{84}\) S. WEISHAAR, Towards Auctioning, cit., pp. 170-171.

\(^{85}\) See G. CATTI DE GASPERI, Making State Aid Control “Greener”, cit., p. 795.

\(^{86}\) S. WEISHAAR, E. WOERDMAN, Does Auctioning Emission Rights Avoid State Aid?, cit., p. 120.

\(^{87}\) Ibidem, p. 122. According to the authors, even if aid was found it would probably be deemed compatible with the internal market because of the limited anti-competitive effects. See ibidem, and S. WEISHAAR, Towards Auctioning, cit., p. 200.
in the EU ETS can be construed as adding another facet to the theoretical approach which will be discussed below.

V. **DK Recycling, Allowance Allocation and Theoretical Constructions of the EU ETS**

The *DK Recycling* case appears to sit well within the theoretical approach developed by Bogojević. The author moves from the consideration that a common idea in legal literature is that emissions trading is a simple and straightforward system that can easily be replicated in different jurisdictions, and in which law and legal issues have a marginal role.\(^8\) The research developed by the author “dissected” the emissions trading legal discourse, highlighting the different ways in which this mechanism has been conceptualized. Her work showed that emissions trading, far from being a simple and uniform instrument, can give rise to diverse and complex governance structures, embedded with legal complexities. At the core of the emissions trading discourse, according to Bogojević, lie questions concerning the allocation of regulatory power and the interplay between the State and the market. This means that not all emissions trading systems are equal. It follows that an emissions trading system can only be understood against the background of the legal context in which it operates: the prevailing emissions trading literature, which is technical, economics-centred and globally-oriented, proves methodologically inadequate.\(^9\) In other words, emissions trading schemes should not be regarded as “self-contained” regimes, in that they are not mere economic mechanisms insulated from the legal context within which they are established: on the contrary, every emissions trading system is created and functions in the context of a legal order, which sets the rules that create and govern the system itself, with a necessary interaction between the law and the market. Paraphrasing Irti,\(^9\) the (emissions) market cannot be understood as a *locus naturalis*, separate and independent from the law, but rather as a *locus artificialis*, determined and shaped by the normative structure that creates it. With reference to the EU ETS case-law, Bogojević has underlined how the EU judges focus almost exclusively on questions of competence, to the point that the EU ETS is treated as a “matter of constitutional law”.\(^9\)

It is here submitted that *DK Recycling*, and in general the normative framework on allowance allocation, appears coherent with these considerations. The Court, following AG Mengozzi’s Opinion, adopted an approach which focuses on competence, by putting


\(^9\) S. Bogojević, *EU Climate Change Litigation*, cit., p. 545 et seq.
at the centre of the analysis the scope of the Commission’s discretion in order to assess, in essence, the lawfulness of a national measure allowing for an increase in the amount of free allowances for certain enterprises. It is the norms governing the adoption of implementing acts to provide the tools for finding the answer. The sub-objective of the preservation of conditions of competition in the internal market is deemed to have an essential character. The method of free allocation provided for by the Directive, characterised by full harmonisation and by a sectoral approach, is the “concrete expression to the essential requirement that distortions of competition in the internal market be minimised”. The introduction of a hardship clause, and the consequent “case-by-case” approach that this would entail, would be in contrast with the essential objective of avoiding distortions of competition. This reasoning, in substance, ensures the preservation of the uniformity of the allowance allocation mechanism throughout the internal market. The protection of competition thus becomes an integral part of the assessment of the Commission’s implementing powers. In light of this, multiple elements show the connection of the Court’s approach to Bogojević’s construction: the whole case revolves around competence and distribution of power, and the issue of the State-market interplay is apparent in the inextricable link between harmonisation, centralisation and uniformity at the normative level, on the one hand, and avoidance of competition distortion, on the other.

This should be coupled with the analysis, developed supra, of the shift from free allocation to auctioning, which has shown how the harmonisation of allocation methodologies has a central role in reducing State aid concerns, and thus, again, in avoiding market distortions.

Both examples can be seen as an expression of Bogojević’s take on the tendency to construe the State-market relationship in emissions trading as a dichotomy. The author underlines how the use of a market mechanism should not be seen as a “‘retreat’ of the state”, or lead to marginalising legal issues, but, on the contrary, should inspire an in-depth reflection on the “overlaps between market, states, and rights and how these exist symbiotically in emissions trading regimes”. The ＤＫ Recycling case also provides some interesting insights with regard to the implications of the Court’s “constitutional” approach towards the EU ETS as defined by Bogojević. The author underlines how the EU judiciary, by focusing mainly on competence allocation, avoids any consideration of the impact of the legal structure on the functioning of the emissions market and, more generally, on environmental effectiveness, in an exercise of self-restraint. In the case at issue, however, the elements of competence,
internal market and emissions market are deeply intertwined. The decentralised – and dysfunctional – system that was in place before has been substituted by a harmonised and uniform structure, which the Court protects by integrating competition protection into its reasoning on competence. Thus, the impact of the rules on the functioning of the market is taken into account, and is actually the decisive element, in the evaluation of the extent of the Commission’s implementing powers.

In conclusion, emissions trading is emerging more and more as a complex legal instrument, as shown by the ever-growing case-law on the EU ETS,\(^{96}\) as well as by a number of doctrinal contributions adopting a comparative perspective on carbon markets,\(^{97}\) or examining the legal context in which the trading systems are or would be established, in particular with regard to the role of the regulation of energy markets.\(^{98}\) The inextricable link between harmonisation, competence and competition that emerges from the present analysis shows how market-based mechanisms have the potential of providing useful insights in the study of the relationship between the State and the market.

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