JUDGMENT OF THE COURT OF FIRST INSTANCE
(Third Chamber, Extended Composition)

7 November 2007 *

In Case T-374/04,

Federal Republic of Germany, represented initially by C.-D. Quassowski, A. Tiemann and C. Schulze-Bahr, and subsequently by C. Schulze-Bahr and M. Lumma, acting as Agents, and by D. Sellner and U. Karpenstein, lawyers,

applicant,

v

Commission of the European Communities, represented by U. Wölker, acting as Agent,

defendant,

APPLICATION for partial annulment of Commission Decision C(2004) 2515/2 final of 7 July 2004 concerning the national allocation plan for the allocation of greenhouse gas emission allowances notified by the Federal Republic of Germany in accordance with Directive 2003/87/EC of the European Parliament and of the

* Language of the case: German.

Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC (OJ 2003 L 275, p. 32), in so far as in the decision the Commission rejects certain measures for the ex-post adjustment of allowances as incompatible with criteria 5 and 10 of Annex III to the directive,

THE COURT OF FIRST INSTANCE OF THE EUROPEAN COMMUNITIES
(Third Chamber, Extended Composition),

composed of M. Jaeger, President, V. Tiili, J. Azizi, E. Cremona and O. Czúcz, Judges,

Registrar: K. Andová, Administrator,

having regard to the written procedure and further to the hearing on 21 June 2006,

gives the following

Judgment

Legal context

1 Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within

the Community and amending Council Directive 96/61/EC (OJ 2003 L 275, p. 32), which entered into force on 25 October 2003, establishes a scheme for greenhouse gas emission allowance trading within the Community ('allowance trading scheme') in order to promote reductions of greenhouse gas emissions, in particular emissions of carbon dioxide ('CO_2'), in a cost-effective and economically efficient manner (Article 1 of Directive 2003/87). The directive is based on the Community's obligations under the United Nations Framework Convention on Climate Change and the Kyoto Protocol. The latter was approved by Council Decision 2002/358/EC of 25 April 2002 concerning the approval, on behalf of the European Community, of the Kyoto Protocol to the United Nations Framework Convention on Climate Change and the joint fulfilment of commitments thereunder (OJ 2002 L 130, p. 1). It entered into force on 16 February 2005.

2 The Community and its Member States entered into commitments to reduce their aggregate anthropogenic emissions of greenhouse gases listed in Annex A to the Kyoto Protocol by 8% compared to 1990 levels in the period from 2008 to 2012 (recital 4 in the preamble to Directive 2003/87).

3 To this end, Directive 2003/87 provides essentially that a permit must be obtained in advance for greenhouse gas emissions from the installations listed in Annex I thereto and that the emissions must be covered by allowances allocated in accordance with national allocation plans ('NAPs'). If an operator manages to reduce his emissions, he may sell the excess allowances to other operators. Conversely, an operator of an installation the emissions of which are too high may purchase the necessary allowances from an operator who has excess allowances.

4 Directive 2003/87 provides for an initial phase from 2005 to 2007 ('the first allocation period'), which precedes the first commitment period provided for by the

Kyoto Protocol, and then a second phase from 2008 to 2012 ('the second allocation period'), which corresponds to the first commitment period under the Kyoto Protocol (Article 11 of Directive 2003/87).

5 With a view to observance of the commitments under Decision 2002/358 and the Kyoto Protocol, criterion 1 of Annex III to Directive 2003/87 states:

'The total quantity of allowances to be allocated for the relevant period shall be consistent with the Member State's obligation to limit its emissions pursuant to Decision 2002/358 ... and the Kyoto Protocol ... The total quantity of allowances to be allocated shall not be more than is likely to be needed for the strict application of the criteria of this Annex. Prior to 2008, the quantity shall be consistent with a path towards achieving or over-achieving each Member State's target under Decision 2002/358 ... and the Kyoto Protocol.'

6 More specifically, the allowance trading scheme is founded, first, on the requirement to hold a permit before emitting greenhouse gases (Articles 4 to 8 of Directive 2003/87) and, second, on allowances authorising the permit-holding operator to emit a certain quantity of greenhouse gases, with an obligation on that operator to surrender each year the amount of allowances equal to the total emissions from his installation (Article 12(3) of Directive 2003/87).

7 The conditions and procedures under which the competent national authorities allocate allowances to operators of installations on the basis of an NAP are provided for in Articles 9 to 11 of Directive 2003/87.

8 Article 9(1) of Directive 2003/87 states:

'For each period referred to in Article 11(1) and (2), each Member State shall develop [an NAP] stating the total quantity of allowances that it intends to allocate for that period and how it proposes to allocate them. The [NAP] shall be based on objective and transparent criteria, including those listed in Annex III, taking due account of comments from the public. The Commission shall, without prejudice to the Treaty, by 31 December 2003 at the latest develop guidance on the implementation of the criteria listed in Annex III.

For the period referred to in Article 11(1), the [NAP] shall be published and notified to the Commission and to the other Member States by 31 March 2004 at the latest ...'

9 The Commission set out the guidance referred to above in its Communication COM(2003) 830 final of 7 January 2004 on guidance to assist Member States in the implementation of the criteria listed in Annex III to Directive 2003/87 and on the circumstances under which force majeure is demonstrated ('the Commission guidance').

10 Article 9(3) of Directive 2003/87 states:

'Within three months of notification of [an NAP] by a Member State under paragraph 1, the Commission may reject that [NAP], or any aspect thereof, on the basis that it is incompatible with the criteria listed in Annex III or with Article 10.

The Member State shall only take a decision under Article 11(1) or (2) if proposed amendments are accepted by the Commission. Reasons shall be given for any rejection decision by the Commission.'

11 Article 10 of Directive 2003/87 states that the Member States are to allocate free of charge at least 95% of the allowances for the first allocation period, and at least 90% for the second allocation period.

12 Article 11, concerning the allocation and issue of allowances, provides:

'1. For the three-year period beginning 1 January 2005, each Member State shall decide upon the total quantity of allowances it will allocate for that period and the allocation of those allowances to the operator of each installation. This decision shall be taken at least three months before the beginning of the period and be based on its [NAP] developed pursuant to Article 9 and in accordance with Article 10, taking due account of comments from the public.

...

3. Decisions taken pursuant to paragraph 1 or 2 shall be in accordance with the requirements of the Treaty, in particular Articles 87 and 88 thereof. When deciding upon allocation, Member States shall take into account the need to provide access to allowances for new entrants.

4. The competent authority shall issue a proportion of the total quantity of allowances each year of the period referred to in paragraph 1 ..., by 28 February of that year.'

13 Annex III to Directive 2003/87 sets out 11 criteria applicable to NAPs.

14 According to criterion 1 of Annex III:

'The total quantity of allowances to be allocated for the relevant period shall be consistent with the Member State's obligation to limit its emissions pursuant to Decision 2002/358 ... and the Kyoto Protocol, taking into account, on the one hand, the proportion of overall emissions that these allowances represent in comparison with emissions from sources not covered by this Directive and, on the other hand, national energy policies, and should be consistent with the national climate change programme. The total quantity of allowances to be allocated shall not be more than is likely to be needed for the strict application of the criteria of this Annex. Prior to 2008, the quantity shall be consistent with a path towards achieving or over-achieving each Member State's target under Decision 2002/358 ... and the Kyoto Protocol.'

15 Criterion 5 of Annex III states:

'The [NAP] shall not discriminate between companies or sectors in such a way as to unduly favour certain undertakings or activities in accordance with the requirements of the Treaty, in particular Articles 87 and 88 thereof.'

16 According to criterion 9 of Annex III:

'The [NAP] shall include provisions for comments to be expressed by the public, and contain information on the arrangements by which due account will be taken of these comments before a decision on the allocation of allowances is taken.'

17 Paragraphs 93 to 96 of the Commission guidance include the following statements on criterion 9:

'93. This criterion is of a mandatory nature.

94. ... The [NAP] should be made available in a manner which enables the public to comment on it effectively and at an early stage ...

95. A Member State should provide for a reasonable time frame for submitting comments, and coordinate the deadline for comments to be submitted by the public with the national decision-making procedure, so that due account can be taken of comments before the decision on the [NAP]. "Due account" is to be understood as meaning that comments are to be taken into account if appropriate with reference to the criteria in Annex III or to any other objective and transparent criteria applied by the Member State in the [NAP]. A Member State should inform the Commission of any intended modifications following public participation subsequent to the publication and notification of the [NAP] and before taking its final decision pursuant to Article 11 [of Directive 2003/87]. Feedback is to be provided, in a general form, to the public about the decision taken and the main considerations upon which it is based.

96. It should be noted that the possibility for the public to comment on the [NAP] provided for under this criterion constitutes a second round of public consultation. Pursuant to Article 9(1) of [Directive 2003/87], the comments resulting from a first round of consultation of the public on the basis of the draft [NAP] should, where pertinent, already have been integrated into the [NAP] prior to notification of the [NAP] to the Commission and to the other Member States. For the overall public participation (consultation and taking account of comments) to be effective, the first round of public consultation is of particular importance. The rules described under this criterion should also be applied to the first round of consultation.

A Member State should inform the Commission of any intended modifications subsequent to the publication and notification of the [NAP] before taking its final decision pursuant to Article 11 [of Directive 2003/87].'

18 Criterion 10 of Annex III states that 'the [NAP] shall contain a list of the installations covered by this Directive with the quantities of allowances intended to be allocated to each'.

19 Paragraphs 97 to 100 of the Commission guidance state as follows with regard to criterion 10:

'97. This criterion provides for the transparency of the [NAP]. It implies that the quantities of allowances per installation are indicated, and therefore visible to the general public, when the [NAP] is submitted to the Commission and other Member States.

...

98. This criterion will be deemed as fulfilled if a Member State has respected its obligation to list all the installations covered by [Directive 2003/87] ...

...

100. A Member State has to indicate the total quantity of allowances intended to be allocated to each installation and should indicate the quantity issued in each year to each installation following Article 11(4) [of Directive 2003/87].'

20 Paragraphs 60 to 74 of the Commission guidance state that a Member State may set aside a reserve of allowances ('reserve') to which it may provide access free of charge, in particular to new entrants, in accordance with objective and transparent rules and procedures. The size of the reserve compared with the envisaged total quantity of allowances is to be indicated in the NAP.

21 Article 12(1) of Directive 2003/87 provides that allowances can be transferred between natural and legal persons within the Community and to natural and legal persons in third countries. By virtue of Article 12(3), before 1 May each year the operator of each installation must surrender to the competent authority an amount of allowances equal to the total emissions from that installation during the preceding calendar year in order for the allowances subsequently to be cancelled.

22 Article 29(1) of Directive 2003/87 provides:

'... Member States may apply to the Commission for certain installations to be issued with additional allowances in cases of force majeure. The Commission shall determine whether force majeure is demonstrated, in which case it shall authorise the issue of additional and non-transferable allowances by that Member State to the operators of those installations.'

23 Article 38(2) of Commission Regulation (EC) No 2216/2004 of 21 December 2004 for a standardised and secured system of registries pursuant to Directive 2003/87 and Decision No 280/2004/EC of the European Parliament and of the Council (OJ 2004 L 386, p. 1) provides, under the heading '[NAP] table for the [first allocation] period':

'A Member State shall notify each correction to its [NAP] together with each corresponding correction in its [NAP] table to the Commission. If the correction to the [NAP] table is based upon the [NAP] notified to the Commission which was not rejected under Article 9(3) of Directive 2003/87 ... or on which the Commission has accepted amendments and that correction is in accordance with methodologies set out in that [NAP] or results from improvements in data, the Commission shall instruct the Central Administrator to enter the corresponding correction into the [NAP] table ... In all other cases, the Member State shall notify the correction to its [NAP] to the Commission and if the Commission does not reject this correction in accordance with the procedure in Article 9(3) of Directive 2003/87 ..., the Commission shall instruct the Central Administrator to enter the corresponding correction into the [NAP] table ...'

Facts, procedure and forms of order sought

24 On 31 March 2004 the Federal Republic of Germany notified its NAP for the first allocation period ('the German NAP') to the Commission, in accordance with Article 9(1) of Directive 2003/87.

25 The German NAP comprises a 'macroplan' and a 'microplan'. The macroplan contains the apportionment of the national emission budget and sets the total quantity of allowances to be allocated in accordance with the Federal Republic of Germany's commitments to reduce emissions. The microplan governs the allocation of allowances to the operators of the various installations and provides for the setting aside of a reserve of allowances intended for new entrants.

26 In order to determine the amount of allowances to be allocated to the various installations, the part of the NAP comprising the microplan distinguishes between three periods, that is to say it provides for three separate methods depending upon the date of commencement of the installation's operation.

27 For installations which began to operate before 31 December 2002, the amount of allowances to be allocated free of charge is calculated on the basis of the annual average of their CO_2 emissions in the past, in accordance with the method of calculation known as 'grandfathering'. The amount of allowances to be allocated is determined by multiplying historic emission data by a 'compliance factor' (Erfüllungsfaktor) determined on the basis of the emission reduction objective to be achieved. The compliance factor is accordingly, as a general rule, below 1 so as to enable a reduction compared with the previous emission level and, ultimately, to limit the total amount of allowances to be allocated.

28 For installations which began to operate between 1 January 2003 and 31 December 2004, the amount of allowances to be allocated free of charge is calculated on the basis of data notified by the operators relating to annual average CO_2 emissions. The operator must include with his application for allocation of allowances an expert's report on the installation's key features. The application and the report must contain data on the installation's capacity, on the envisaged use of raw materials and on the utilisation rate of the installation's capacity. The compliance factor applied to these installations is 1 for a period of 12 years.

29 For installations beginning to operate after 1 January 2005, that is to say 'new entrants', the amount of allowances to be allocated free of charge is determined, in the absence of historic data, in accordance with the method of calculation known as 'benchmarking', that is to say on the basis of the mathematical product of the projected average annual production volume for 2005 to 2007, the installation's forecast emissions per unit of output and the number of calendar years during which the installation is to be operated during the allocation period. The forecast emissions per unit of output are determined by taking into account as a criterion (benchmark) the state of the 'best available technology'. For these new installations, the compliance factor remains unchanged and stays set at 1 during the first 14 years of operation.

30 In accordance with Article 11(4) of Directive 2003/87, the German NAP envisages that the allowances allocated for the first allocation period will be issued in equal annual tranches, by 28 February of each year.

31 The German NAP, as notified to the Commission, provides for ex-post adjustments of the amount of allowances allocated, in the following cases:

— Substantial reduction in the use of the installation's production capacity and closure of the installation ('de facto closure' rule): if operation of an installation

terminates, the operator is obliged to return the allowances allocated to him in so far as they have become excess allowances. Operation of an installation is deemed to have terminated when its emissions during the year in question are less than 10% of the average annual emissions recorded during the base period. If the emissions are less than 60% of the average annual emissions recorded during the base period, an ex-post adjustment proportional to the reduction in the use of the production capacity, that is to say to the reduction in the level of activity, is made to the tranche of allowances issued for the year in question. For following years, the tranche of allowances that is allocated will correspond to the initial allocation decision, without prejudice to subsequent renewed application of the ex-post adjustment rule;

— Transfer of allowances where an installation closes and is replaced ('transfer' rule): upon application, allowances allocated to a closed installation are not withdrawn where the operator commences operation of a new installation within a period of three months from closure of the old installation. In such a case, the allowances are allocated for four years on the basis of the historic emissions of the closed installation and then, for a period of 14 years, their allocation is calculated on the basis of a compliance factor of 1, this rule having the objective of encouraging operators to close their obsolete and inefficient installations. However, if the new installation's production capacity is lower than that of the closed installation, the difference between those capacities is deemed to correspond to closure of an installation and the proportion of the allowances that corresponds to the difference will no longer be allocated at the time of the following allowance allocation. Conversely, if the new installation's production capacity shows an increase, the rule for new entrants applies and additional allowances covering the capacity excess are allocated (see the fourth indent below);

— Existing installations the operation of which began in 2003 or 2004: the amount of emission allowances allocated to these installations will be adjusted according to whether, in the course of operation of the installation in question, the actual production volume is below or above the production volumes which were

declared for the purposes of calculating the amount of allowances that was initially allocated. When the tranche of allowances for the following year is issued, the quantity of allowances will be proportionately reduced or increased, as the case may be. If the production volume increases, the additional allowances will be drawn from the reserve;

— New entrants whose operation begins after 1 January 2005, or increase in the production capacity of existing installations: the amount of emission allowances allocated to these installations will be adjusted according to whether, in the course of operation of the installation in question, the actual level of activity is below or above the level of activity which was declared for the purposes of calculating the amount of allowances that was initially allocated. When the tranche of allowances for the following year is issued, the quantity of allowances will be proportionately reduced or increased, as the case may be;

— Cogeneration installations, producing combined heat and power (CHP) (Kraft-Wärme-Kopplung): these installations receive emission allowances by way of a special allocation (Sonderzuteilung), in the first allocation year according to the actual volume of electricity production. The amount of allowances may however be corrected subsequently on the basis of the volume of electricity production that is established the following year.

32 The German NAP also provides that emission allowances that are not issued or are withdrawn are transferred to the reserve. Finally, the allowances contained in the reserve are available for new entrants. At the hearing, the applicant made it clear that the reserve could be used only by operators of installations that were on German territory (minutes of the hearing, p. 2).

33 By letter of 8 June 2004, the competent German authorities replied to certain questions asked by the Commission.

34 In responding to those questions, the German authorities explained in particular that, as laid down by the Zuteilungsgesetz 2007 (German Law of 26 August 2004 on the allocation of emission allowances during the first allocation period; BGBl. 2004 I, p. 2211) ('the Zuteilungsgesetz') and contrary to the particulars contained in the German NAP as notified to the Commission, ex-post adjustments cannot in any event lead to an increase in the quota of allowances allocated to the installations concerned. The German authorities also observed that, in the case of cogeneration installations, the possibility of a downward ex-post adjustment enabled them to avoid the creation of a 'counter-productive incentive' — that is to say an ecologically undesirable incentive — for operators of installations of this type, who would otherwise be encouraged to reduce the level of their electricity production; therefore, this possibility served to maintain the justification for the special allocation of emission allowances (Sonderzuteilung). While such a reduction in production leads to a reduction in emissions and a lowering of demand for emission allowances within the framework of the allowance trading scheme, it results, generally, in additional emissions outside that scheme.

35 In accordance with the explanation provided by the German authorities (see paragraph 34 above), the Zuteilungsgesetz provides only for downward ex-post adjustments. These are governed by Paragraph 7(9) (allocation to existing installations on the basis of historic data), Paragraph 8(4) (allocation to existing installations on the basis of notified emissions), Paragraph 9(1) and (4) (installation closures), Paragraph 10(2) and (4) (allocation to new installations as replacement installations), Paragraph 11(5), read in conjunction with Paragraph 8(4) (allocation to new entrants), and Paragraph 14(5) (special allocation to cogeneration installations). Finally, Paragraph 6(2) of the Zuteilungsgesetz provides that allowances withdrawn pursuant to the foregoing provisions are to be transferred to the reserve.

36 By Commission Decision C(2004) 2515/2 final of 7 July 2004 concerning the German NAP as notified by the applicant ('the contested decision'), adopted on the basis of Article 9(3) of Directive 2003/87, the Commission rejected the German NAP in so far as it provided for certain measures for the ex-post adjustment of the allocation of emission allowances, declaring them incompatible with criteria 5 and 10 of Annex III to Directive 2003/87 (Article 1 of the contested decision) and requesting the applicant to omit them (Article 2 of the contested decision). The Commission left it open to the applicant, however, to allocate allowances in advance of implementation of the amendments requested in Article 2 of the contested decision (Article 3(4) of the decision). The ex-post adjustments in question were those envisaged for:

— new entrants (Article 1(a) of the contested decision);

— new installations operated following a transfer of allowances initially allocated to a closed installation (Article 1(b) of the contested decision);

— installations whose production capacity utilisation is lower than that initially foreseen (the first case in Article 1(c) of the contested decision);

— installations whose annual emissions are less than 40% of their base-period emissions (the second case in Article 1(c) of the contested decision);

— cogeneration installations producing a smaller quantity of energy than that recorded in the base period (the third case in Article 1(c) of the contested decision).

37 In recital 4 of the contested decision, the Commission states that the ex-post adjustments applicable to new entrants are contrary to criterion 5 of Annex III to Directive 2003/87, given that new entrants are unduly favoured compared to operators of installations already covered by the German NAP, in respect of whom such adjustments are not permitted during the first allocation period.

38 In recital 5 of the contested decision, the Commission states that adjustment of the amount of allowances allocated to a new installation operating following the closure of an old installation is incompatible with criterion 10 of Annex III to Directive 2003/87, under which the amount of allowances to be allocated during the trading period referred to in Article 11(1) of Directive 2003/87 to the various installations listed in the NAP must be determined in advance.

39 In recital 6 of the contested decision, the Commission states that criterion 10 of Annex III to Directive 2003/87 is also contravened by the adjustments envisaged: (a) for installations whose production capacity utilisation is lower than that initially foreseen; (b) for installations whose annual emissions are less than 40% of their base-period emissions; and (c) for cogeneration installations producing a smaller quantity of energy than that recorded in the base period.

40 At the hearing, the Commission explained that the second case in Article 1(c) and recital 6 (see (b) in paragraph 39 above) of the contested decision in fact related to installations whose annual emissions were less than 60% of the emissions recorded in the base period and that the reference in the decision to 40% was due to an error (minutes of the hearing, p. 2).

41 In its Communication COM(2004) 500 final to the Council and to the European Parliament on Commission Decisions of 7 July 2004 concerning [NAPs] for the allocation of greenhouse gas emission allowances of [the Republic of] Austria, [the Kingdom of] Denmark, [the Federal Republic of] Germany, Ireland, [the Kingdom of] the Netherlands, [the Republic of] Slovenia, [the Kingdom of] Sweden and the United Kingdom [of Great Britain and Northern Ireland] in accordance with Directive 2003/87 ('the Commission Communication of 7 July 2004'), the Commission expressed the following views, in point 3.2, on ex-post adjustments:

'[Directive 2003/87] foresees in Annex III, criterion 10, and Article 11 that a Member State has to decide upfront (before the trading period starts) about the absolute quantity of allowances allocated in total and to each installation's operator. This decision may not be revisited and no allowances may be reallocated by means of adding to or subtracting from the quantity determined for each operator on the basis of a government decision or a pre-determined rule. The Directive expressly allows for ex-post adjustments in case of force majeure subject to the procedure laid down in Article 29. In addition:

— these Decisions allow corrections to be made to intended allocations in respect of data quality at any time before the decision on allocation under Article 11(1) is taken;

— the Directive does not exclude, where an installation is closed during the period, that Member States determine that there is no longer an operator to whom allowances will be issued; and

— where allocation takes place to new entrants from a reserve, the exact allocation to each new entrant will be decided upon after the decision on allocation under Article 11(1) is taken.

Criterion 10 requires the quantity of allowances to be allocated to existing installations to be stated in the [NAP] prior to the commencement of the [allocation] period. The admissibility of ex-post adjustments has been assessed by the Commission irrespective of whether an intended adjustment, or the magnitude of it, may be attributed to or be independent of the behaviour of the operator that it is proposed to change the allocation for during the period.

On the basis of Annex III, criterion 5, the same principle applies to new entrants. Once a Member State has decided in the course of the trading period the absolute number of allowances to be granted to a new entrant out of a new entrant reserve, it may not revisit this decision. Otherwise some companies may be unduly favoured or discriminated against by the application of a principle that is not acceptable for existing installations.

Ex-post adjustments would create uncertainty for operators, and be detrimental to investment decisions and the trading market. Ex-post adjustments substitute more efficient solutions found in the marketplace by administrative processes that would be cumbersome to implement. Also downward ex-post revisions, that might be argued have a beneficial environmental effect, are detrimental to the certainty that businesses need in order to make investments that lead to reductions of emissions.

The Commission finds that the intended ex-post adjustments in the [NAPs] of Germany and Austria contravene criteria 5 and/or 10.

The Commission finds that the German [NAP] contravenes criterion 10 because [the Federal Republic of] Germany intends to adjust or potentially adjust the allocated amount per installation during the [first allocation] period in case (i)

existing installations starting operation as of 1 January 2003 experience lower capacity utilisation; (ii) existing installations have annual emissions lower than 40% [sic] of base-period emissions; (iii) existing installations receive additional allowances due to a transfer of allowances foreseen for a closed installation; (iv) existing installations or new entrants benefiting from the CHP bonus allocation demonstrate a lower amount of CHP-mode power production than in the base period. The intention of [the Federal Republic of] Germany to potentially adjust the allocation of allowances to new entrants contravenes criterion 5 which requires non-discrimination in accordance with the Treaty, because the application of such ex-post adjustments would discriminate new entrants compared to the operators of other installations in respect of which no ex-post adjustments to their allocation are permitted by [Directive 2003/87].

...'

42 By application lodged at the Registry of the Court of First Instance on 20 September 2004, the applicant brought the present action.

43 Pursuant to Article 14 of the Rules of Procedure of the Court of First Instance, and on the proposal of the Third Chamber, the Court decided, after hearing the parties in accordance with Article 51 of the Rules of Procedure, to refer the case to a Chamber sitting in extended composition.

44 Upon hearing the report of the Judge-Rapporteur, the Court of First Instance (Third Chamber, Extended Composition) decided to open the oral procedure and, by way of measures of organisation of procedure as provided for in Article 64 of the Rules of

Procedure, requested the parties to answer written questions and the Commission to lodge a document before the hearing. The parties answered the questions and the Commission submitted the document within the time-limit set.

45 The parties presented oral argument and answered the oral questions put by the Court at the hearing on 21 June 2006.

46 The applicant contends that the Court should:

— annul Article 1 of the contested decision;

— annul Article 2(a) to (c) of the contested decision in so far as it directs the applicant to make, and to give notice of, certain amendments to the German NAP;

— order the Commission to pay the costs.

47 The Commission contends that the Court should:

— dismiss the action;

— order the applicant to pay the costs.

Law

I — *Preliminary observation*

48 In support of its action, the applicant puts forward three pleas in law, namely: (i) infringement of Article 9(3) of Directive 2003/87, read in conjunction with Annex III thereto; (ii) infringement of Article 176 EC; and (iii) breach of the duty under Article 253 EC to state reasons, as regards Articles 1(a) and 2(a) of the contested decision.

II — *The first plea: infringement of Article 9(3) of Directive 2003/87, read in conjunction with Annex III thereto*

A — *Arguments of the parties*

1. Arguments of the applicant

(a) Preliminary observation

49 By its first plea, the applicant disputes the findings made by the Commission in the contested decision to the effect that ex-post adjustments as provided for in the

German NAP are incompatible with criteria 5 and 10 of Annex III to Directive 2003/87. These findings are, in its submission, contrary to Article 9(3) of Directive 2003/87, read in conjunction with Annex III, which do not prohibit the Member States from making ex-post adjustments. The applicant considers that the Commission's position obstructs effective implementation by the Member States of Directive 2003/87, in particular of the criteria set out in Annex III.

(b) Observance of criterion 10 of Annex III to Directive 2003/87

50 The applicant submits that the contested decision is incompatible with criterion 10 of Annex III to Directive 2003/87 in that the decision reflects neither its wording nor its legislative context. In particular, it cannot be inferred from that criterion that the amount of allowances to be allocated during the period referred to in Article 11(1) of Directive 2003/87 to the various installations listed in the NAP must be determined in advance (recital 5 of the contested decision).

51 In the applicant's submission, the wording of criterion 10 of Annex III to Directive 2003/87 does not prevent ex-post adjustments from being made where it becomes apparent that certain allocations are based on erroneous assessments by the operator. It points out that, according to this criterion, the NAP must contain a list of the installations covered by Directive 2003/87 with the quantities of allowances 'intended to be allocated' to each. It follows that the allowance allocation quantities appearing on that list reflect only the quantities that the Member State 'intends' to allocate within the meaning of Article 9(1) of Directive 2003/87. It cannot be inferred from either the German version or the other language versions of Directive 2003/87 that the installations referred to in the NAP are entitled to precisely the amount of allowances that has been notified to the Commission.

52 The applicant states with regard to the legislative context of criterion 10 of Annex III to Directive 2003/87 that Article 9(1) of the directive provides that the NAP must solely disclose 'the total quantity of allowances that [the Member State] intends to allocate for [the] period and how it proposes to allocate them'. Also, it is apparent from Article 11(1) of the directive that individual allocation of allowances will not take place until after public participation and following notification of the NAP to the Commission and the other Member States. Consequently, if that participation and that notification are not to be rendered nugatory, a difference must necessarily be capable of existing between, on the one hand, the amount of allowances 'intended to be allocated', within the meaning of criterion 10 of Annex III to Directive 2003/87, by the Member State and, on the other hand, the quantity actually allocated in accordance with Article 11(1) of the directive, by a decision 'based on [the NAP]'. Accordingly, the Commission's argument that criterion 10 of Annex III to Directive 2003/87 prohibits any ex-post adjustment by the Member State of the allocations appearing in the NAP is misconceived. The applicant adds that the Commission's point of view is also incompatible with Article 38(2) of Regulation No 2216/2004, which permits, without requiring any special scrutiny, downward ex-post adjustments of allocation decisions, provided that those adjustments are based on more specific data or are consistent with the procedures provided for by the NAP.

53 With regard to the teleological interpretation of criterion 10 of Annex III to Directive 2003/87, the applicant submits that, as the Commission itself stated in its guidance, the objective of this criterion is to ensure that the NAP is transparent, so that undertakings, the public, the Commission and the other Member States may react according to the quantities of allowances that the Member State envisages allocating (Commission guidance, p. 23). That interpretation is confirmed by the justification given for introducing this criterion in the course of the process of drawing up Directive 2003/87, that 'data which enable the state of emissions allowances trading to be gauged must be made available' (European Parliament Committee on the Environment, Public Health and Consumer Policy, Session document A5-0303/2002, I, p. 46, Amendment 73). The applicant infers therefrom that criterion 10 of Annex III to Directive 2003/87 contains only a procedural requirement that the Member State must notify to the Commission an NAP

including a list of the installations covered by the directive and the projected individual quantities of allowances which it intends to allocate to each of them. Finally, it submits that the Commission itself chose not to lay down additional requirements in this regard in its own guidance (Commission guidance, pp. 20 and 21).

(c) Observance of criterion 5 of Annex III to Directive 2003/87

54 The applicant submits that, contrary to the Commission's view, the ex-post adjustments envisaged by the German NAP are also compatible with criterion 5 of Annex III to Directive 2003/87 which states that, in accordance with the requirements of the Treaty, the NAP must not unduly favour certain undertakings or activities. The applicant explains that it would, on the contrary, be if the Member States were not able to withdraw allowances, even if they were based on incorrect or exaggerated production forecasts, for example in the case of new entrants, that an undue competitive advantage would arise for the operator in question because of the possibility of selling profitably the excess allowances on the market and, conversely, undue competitive disadvantages would arise for the other operators. In cases of this kind, downward ex-post adjustments would be an appropriate and necessary means of preventing such distortions of competition which are contrary to criterion 5, while compensating for the advantage which the new entrants would obtain by virtue of the fact that the allocation of allowances to them is based on a rate of production capacity utilisation resulting from their own calculations.

55 The applicant adds that if there is no possibility of making such ex-post adjustments to avoid 'over-allocations' it cannot comply with the obligation owed by it under criterion 1 of Annex III to Directive 2003/87, according to which it must ensure that the total quantity of allowances to be allocated is not more than is likely to be needed for the strict application of the criteria of that annex. The Commission fails to recognise the fundamental difference between downward ex-post adjustments and upward ex-post adjustments. While the latter are incompatible with Annex III

to Directive 2003/87 in so far as they would result in the total quantity to be allocated being exceeded (criterion 1), downward ex-post adjustments do not infringe any of the relevant criteria. On the contrary, criteria 1 and 5 of Annex III to Directive 2003/87 require excess allocations to be revoked in individual justified cases.

56 Finally, the applicant contests the Commission's argument that the possibility of making ex-post adjustments is liable to reduce the precision of, and care taken over, the preventive checks to be carried out in relation to the calculations and forecasts submitted by operators for the purposes of the initial allocation of allowances. In the applicant's submission, even if the forecasts are based on the best possible estimate of future production capacity utilisation, there cannot actually be absolute certainty as regards those forecasts. The risk of an excess allocation of allowances, that is to say one exceeding the actual needs of the operator in question, accordingly requires application of ex-post adjustments. In addition, the initial forecasts must be checked as carefully and fully as possible, given that an initial 'over-allocation' may result in an insufficient allocation for other operators.

(d) The extent of the Commission's power of review under Article 9(3) of Directive 2003/87, read in conjunction with Annex III thereto, and the freedom of action left to the Member States by the directive

57 The applicant calls generally into question the extent of the Commission's power to review NAPs. It states that Article 9(3) of Directive 2003/87 limits the Commission's power of review to examination of an NAP on the basis solely of the criteria contained in Annex III to the directive and of the provisions of Article 10. Accordingly, it is possible to reject an NAP only in so far as it is incompatible with those criteria and provisions. In particular, criterion 10 cannot be interpreted in a

broad manner in the light of the general context or of the general scheme of Directive 2003/87. If the Commission were intending to contest the national allocation rules in the light of other considerations, it would have to exercise its general supervisory powers, as provided for in Articles 211 EC and 226 EC.

58 The applicant further submits that neither Directive 2003/87 nor Article 9(3) read in conjunction with Annex III prohibits the making of ex-post adjustments, which are left for the Member States to decide upon in their discretion. On the contrary, the exclusion of such a possibility in individual cases would mean that the applicant would no longer be in a position to observe in an effective manner the criteria set out in Annex III. Furthermore, in accordance with the second sentence of Article 9(1) of Directive 2003/87, the Member States may provide in their NAPs for criteria apart from those set out in Annex III, provided that those additional criteria are objective and transparent. In the applicant's view, all the ex-post adjustments under the German NAP satisfy those requirements of objectivity and transparency, since operators are informed upon the allocation of allowances of the conditions under which and the extent to which the allowances can be withdrawn.

59 The applicant disputes, moreover, that a general prohibition on measures for downward ex-post adjustment can be deduced from Article 29 of Directive 2003/87, since that provision allows solely, and by way of exception, for the grant of additional allowances in cases of force majeure. The aim of Article 29 is thus to limit strictly, from the beginning of trading, issue by the Member States of additional allowances, that is to say upward ex-post adjustment, in order to prevent an increase in the total quantity allocated in a Member State. On the other hand, that provision does not in any way cover the converse situation, namely that of downward ex-post adjustment.

60 The applicant concludes therefrom that the ex-post adjustments provided for by the German NAP are consistent both with the objectives and with the wording of Directive 2003/87.

(e) The economic arguments put forward by the Commission

61 The applicant submits that, contrary to the Commission's contentions, its own case is supported by the objectives, both ecological and environmental, of Directive 2003/87, namely reducing greenhouse gas emissions in a cost-effective and economically efficient manner (Article 1 of Directive 2003/87), preserving the integrity of the internal market and conditions of competition (recital 7 in the preamble to the directive) and taking account of the potential for industrial process activities to reduce emissions (recital 8).

62 The downward ex-post adjustments contested by the Commission are designed to prevent distortions of competition in the internal market by righting abuse and providing a remedy for 'over-allocations' prejudicial to competitors. They also enable corrections to be made in the event of erroneous forecasts and of reductions in production that depart from the forecasts, while, in the case of cogeneration installations, they enable the consequences inherent in the misuse of a special allocation of allowances contrary to its environmental objective to be remedied.

63 The applicant contests the Commission's argument that the ex-post adjustments are detrimental to the certainty that businesses need in order to make investments that lead to reductions of emissions (Commission Communication of 7 July 2004, pp. 7 and 8). These adjustments turn not on the reduction of emissions, but on the reduction of the installation's actual production, should it diverge from forecast production. In the applicant's submission, the ex-post adjustments in fact facilitate the effective functioning of the market and increase investment certainty, inter alia in the case of investments for the substitution of fuels producing a high level of CO_2. They make the operator's decision to sell or purchase allowances depend on the efficiency of his installation and free up unused allowances for new installations. Furthermore, the Commission's argument that the ex-post adjustments and the

surrender of the allowances to the reserve affect new entrants' investment decisions is incorrect, given the total investment certainty enjoyed by the latter as a result of the obligation to purchase allowances which the NAP and Paragraph 6(3) of the Zuteilungsgesetz impose on the State. The increase to the reserve resulting from the restoration of allowances under those adjustments is moreover intended to prevent that purchase obligation from becoming too extensive.

64 So far as concerns the Commission's argument that the ex-post adjustments are not necessary in order to combat abuse and erroneous forecasts and that false information must be corrected before the allocation decision, the applicant observes that it does not become apparent that forecasts are erroneous until after that decision, that is to say on the basis of a comparison of actual production with that initially forecast. In those circumstances, ex-post adjustment is the only means of avoiding the resulting risk of 'over-allocation' and, therefore, the only means of preventing the proper functioning of the allowance trading scheme from being affected. Nor does Directive 2003/87 draw a distinction in this regard on the basis of the gravity of the fault committed by the operator. It follows that forecasting errors committed by negligence must also be corrected subsequently and that, contrary to the Commission's view, the national legislation concerning the combating of intentional abuse is not sufficient for this purpose.

65 The applicant adds that the only measure recognised as lawful by the Commission in the contested decision, namely revocation of the allocation of allowances following an installation's closure, is also an ex-post adjustment. In this connection, it contests the Commission's argument that the closure of an installation leads to the disappearance of the installation and, therefore, of the operator as such. First, an operator does not cease to exist in law simply because an installation closes. Second, German environmental law imposes extensive aftercare obligations on the operator following the closure. In those circumstances, the operator could profit from assigning allowances that he no longer needs. Accordingly, the withdrawal, to which the Commission does not object, of allowances in the event of closure of an installation in reality constitutes a downward ex-post adjustment.

2. Arguments of the Commission

(a) Decisiveness of the effect of the criteria in Annex III to Directive 2003/87 in the review carried out by the Commission under Article 9(3) of the directive

66 The Commission submits that its power to review NAPs, as laid down in Article 9(3) of Directive 2003/87, relates in particular to the criteria set out in Annex III to the directive, which have to be read in the light of the general context and the system of the directive as a whole. According to the Commission, the matter at issue in the case is whether the contested decision is compatible with the directive and, in particular, with the criteria laid down in Annex III, the general objective of which is to offer operators, on the basis of clear and fixed allowances, an economic incentive to reduce their emissions. The contested decision would be lawful if the NAP dealt with by it were not consistent with those criteria. Consequently, the effect of those criteria is decisive with regard to the legality of the contested decision and that of the NAP.

(b) Consistency of the German NAP with criterion 10 of Annex III to Directive 2003/87

67 The Commission takes the view that ex-post adjustments, even if made in accordance with pre-established rules, are not compatible with criterion 10 as interpreted in the general context of Articles 9 and 11 of Directive 2003/87. It contends that it is no longer possible to make such an adjustment once the allocation decision has been adopted under Article 11(1). This stems from the fact that the allowances allocated must be issued to the operators (Article 11(4)) and that they may be transferred within the Community (Article 12(1)). The Commission explains that, from the moment when the allocation decision is adopted, the general

objective of Directive 2003/87 — to offer operators, on the basis of predetermined allowances, an economic incentive to reduce their emissions — applies to its full extent.

68 With regard to the necessity, pleaded by the applicant, to avoid abuse and erroneous forecasts, the Commission observes, first of all, that it remains possible to correct erroneous information until the allocation decision is adopted pursuant to Article 11(1) of Directive 2003/87. Next, a system such as that chosen by the applicant inherently entails certain risks and a certain margin of error — for example in the case of the forecasts which new entrants must make — and they are not capable of justifying a failure to comply with the provisions of Directive 2003/87. Besides, apart from the applicant only a very small number of Member States consider, or initially considered, themselves unable to do without ex-post adjustments. The Commission adds that general legislative provisions intended to combat intentional abuse exist in any event in the Member States.

69 In response to the applicant's argument that downward ex-post adjustments permit greenhouse gas emissions to be limited to a minimum and help in that way to combat climate change, the Commission states that that effect can be achieved only if, in the absence of demand, the reserve is not exhausted and the allowances are cancelled. Such a case involves purely an unexpected side effect, explained by there being a smaller number of new entrants than forecast. Had the applicant wished to pursue that environmental objective, it should have provided from the beginning for a smaller total quantity of allowances in order to avoid an 'over-allocation' or, at the very least, for the immediate cancellation of subsequently withdrawn allowances. The Commission thus concludes that ex-post adjustments are environmentally neutral, because the total quantity of allowances remains unchanged. They are even capable of removing operators' incentive to reduce emissions, since operators lose the possibility of assigning on the trading market allowances obtained through their own economic decisions, such as a decision to reduce production.

70 The Commission submits that its view is not contrary to Article 38(2) of Regulation No 2216/2004, since that provision only authorises corrections in accordance with the allocation method provided for by the NAP and also this method must be consistent with the criteria set out in Annex III to Directive 2003/87. Furthermore, the reference in that provision to Article 9(3) of the directive merely confirms the decisiveness, for the purposes of assessing the NAP's compatibility, of the criteria set out in Annex III and of the other provisions of the directive.

71 The Commission adds that, contrary to the applicant's contentions, the withdrawal of allowances when installations close does not constitute an instance of ex-post adjustment, given that allowances are linked to installations. According to the Commission, an installation which shuts down no longer needs emission allowances. Therefore, as soon as it shuts down, the objective of encouraging it to reduce its emissions in order to free up allowances is no longer relevant and the Member State is thus free to withdraw the allowances which the closed installation no longer needs. Accordingly, in such a case, withdrawal of the allowances does not constitute an ex-post adjustment comparable to the ex-post adjustments provided for by the German NAP.

(c) Consistency of the German NAP with criterion 5 of Annex III to Directive 2003/87

72 In the Commission's submission, the contested decision cannot be challenged from the point of view of criterion 5 either. It considers that the possibility of making downward ex-post adjustments may give rise to unjustified preferential treatment of new entrants in that they are liable to obtain at the outset a higher quantity of allowances than the quantity which they could have hoped for had such a possibility not existed, placing other operators, whose initial allocation is not accompanied by this inherent possibility of correction, at a disadvantage. Given the need for new entrants themselves to assess the envisaged level of capacity utilisation and the

anticipated production volume, they have less incentive to provide precise estimates and will carry out controls only if an allocation is irrevocably fixed at the outset. Too high an initial allocation could confer an undue advantage on a new entrant if it transpires that he can sell more products because of an increase in demand without incurring additional expenditure on the acquisition of allowances. On the other hand, the operator of an existing installation must purchase additional allowances in the market for each additional unit of unforecast production.

73 The Commission adds that an emission allowance trading scheme relating to a period of a number of years can function effectively only on the basis of an ex-ante examination founded essentially on forecasts. Apart from the fact that if ex-post adjustments are possible the parties concerned will tend to display less diligence in developing the NAP, thereby affecting the precision of the allocation decision, if the logic of the applicant's arguments is followed the definitive allocation can be made only at the end of the allocation period, when all the information on emissions actually produced is available. Accordingly, the consequence of ex-post adjustments would be that observance of criterion 5 could only be ensured a posteriori. The Commission is of the view, however, that the existence of any discrimination, under this criterion, in relation to certain installations should be determined in advance, that is to say at the time when the NAP is drawn up and the Commission adopts its decision. It follows that ex-post adjustments run counter to the spirit and to the functioning of the allowance allocation and trading scheme. The Commission further explains that it is inherent in a scheme based on forecasts that reality, in the form in which it subsequently emerges, departs from the forecasts. However, subsequent developments cannot call into question the allocation decision, adopted on the basis of an ex-ante examination, which seeks to create economic incentives to reduce emissions. To require the withdrawal of allowances that are no longer needed because emission reductions have been achieved, but which might be sold, would be tantamount to removing part of the incentive to make such reductions. The effectiveness of the allowance trading scheme would thereby be decisively prejudiced.

74 In this connection, it makes no difference whether the ex-post adjustments are linked to the emission rate or to production volume because, in the Commission's submission, there is a positive correlation between these two parameters, both

influencing the economic decision to maximise the profit from the installation's production. In the Commission's view, by linking ex-post adjustments to production volume, an element of uncertainty is introduced into the economic calculation as to whether it is worthwhile to lower emissions by means of efficiency gains or of a reduction in production volume, in order to be able to sell excess allowances. On the other hand, this uncertainty created by ex-post adjustments causes operators of installations to invest to a lesser extent in clean production technologies and not to reduce their production more substantially. That is precisely what the Commission wishes to avoid. The Commission adds that this effect on an operator's incentive is even liable to have an adverse environmental impact, while the possible positive impact pleaded by the applicant will be achieved only in specific hypothetical circumstances, in particular if there are not sufficient new entrants.

75 With regard to the applicant's argument that withdrawn allowances are transferred to the reserve so as to be made available to new entrants, the Commission submits that if the applicant considers an increase in the reserve to be necessary it should from the outset provide in its NAP for a larger reserve. The Commission also observes that the quantity of allowances obtained by means of ex-post adjustments is uncertain and therefore does not ensure greater legal certainty for new entrants with regard to their investment decisions. Furthermore, the fact that the NAP and Paragraph 6(3) of the Zuteilungsgesetz provide for the possibility of increasing the reserve through the purchase of allowances by a private body and their transfer free of charge to the authorities entrusted with the reserve's management confirms that feeding the reserve by means of ex-post adjustments is not necessary. Finally, the Commission points out that it is not essential to provide for a reserve for new entrants, given that they may obtain the necessary allowances on the market (see also the Commission guidance, paragraph 56).

76 For all those reasons, the Commission considers that the contested decision is consistent with the criteria set out in Annex III to Directive 2003/87 and that the plea alleging infringement of Article 9(3) of the directive, read in conjunction with Annex III, must be dismissed.

B — *Findings of the Court*

1. The allocation of tasks and powers between the Commission and the Member States and the extent of judicial review

77 It is to be recalled first of all that the applicant's main submission is that, contrary to the Commission's findings in the contested decision, the ex-post adjustments provided for in the German NAP infringe neither criterion 5 nor criterion 10 set out in Annex III to Directive 2003/87. In this context the parties discuss in particular whether or not these ex-post adjustments hinder the proper functioning of the allowance trading scheme and, therefore, whether they are compatible with the directive's objectives and general system, in the light of which those criteria must be read. In this connection, the Court must take account of the boundaries which separate, on the one hand, the extent of the Commission's power of review and decision-making power, in particular under Directive 2003/87, and, on the other hand, the extent of the freedom of action available to Member States when transposing the directive into national law in accordance with the requirements of Community law.

78 So far as concerns the allocation of tasks and powers between the Commission and the Member States when transposition of a directive in the environmental field is at issue, the wording of the third paragraph of Article 249 EC is to be remembered, according to which 'a directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods'. It follows that, when the directive in question does not prescribe the form and methods for achieving a particular result, the freedom of action of the Member States as to the choice of the appropriate forms and methods for obtaining that result remains, in principle, complete. Nevertheless, the Member States are required, within the bounds of the freedom left to them by the third paragraph of Article 249 EC, to choose the most appropriate forms and

methods to ensure the effectiveness of directives (see Case C-40/04 *Yonemoto* [2005] ECR I-7755, paragraph 58, and the case cited there). It also follows that, where there is no Community rule prescribing clearly and precisely the form and methods that must be employed by the Member State, the Commission has the task, when exercising its supervisory power, pursuant in particular to Articles 211 EC and 226 EC, of proving to the required legal standard that the instruments used by the Member State in that respect are contrary to Community law.

79 It should be added that it is only by applying those principles that compliance with the principle of subsidiarity enshrined in the second paragraph of Article 5 EC can be ensured, a principle which binds the Community institutions in the exercise of their legislative functions and which is deemed to have been complied with in respect of the adoption of Directive 2003/87 (recital 30 in its preamble). According to that principle, in areas which do not fall within its exclusive competence the Community is to take action only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community. Accordingly, in a field, such as that of the environment governed by Articles 174 EC to 176 EC, where the Community and the Member States share competence, the Community, that is to say the Commission in the present case, has the burden of proving the extent to which the powers of the Member State and, therefore, its freedom of action, are limited in light of the conditions set out in paragraph 78 above.

80 With regard, more specifically, to the Commission's power of review under Article 9(3) of Directive 2003/87, it is to be noted that while the Member States have a degree of freedom of action when transposing the directive, the fact remains that, first, the Commission is empowered to verify whether the measures adopted by Member States are consistent with the criteria set out in Annex III to the directive and with Article 10 thereof and, second, in carrying out that review it itself has a discretion in so far as the review entails complex economic and ecological assessments carried out in the light of the general objective of reducing greenhouse gas emissions by means of a cost-effective and economically efficient allowance trading scheme (Article 1 of Directive 2003/87 and recital 5 in its preamble).

81 It follows that, in its review of legality in this regard, the Community judicature conducts a full review as to whether the Commission applied properly the relevant rules of law, whose meaning must be determined in accordance with the methods of interpretation recognised by the case-law. On the other hand, the Court of First Instance cannot take the place of the Commission where the latter must carry out complex economic and ecological assessments in this context. In this respect, the Court is obliged to confine itself to verifying that the measure in question is not vitiated by a manifest error or a misuse of powers, that the competent authority did not clearly exceed the bounds of its discretion and that the procedural guarantees, which are of particularly fundamental importance in this context, have been fully observed (see, to this effect, Case T-13/99 *Pfizer Animal Health* v *Council* [2002] ECR II-3305, paragraphs 166 and 171; Case T-70/99 *Alpharma* v *Council* [2002] ECR II-3495, paragraphs 177 and 182; and Case T-392/02 *Solvay Pharmaceuticals* v *Council* [2003] ECR II-4555, paragraph 126).

82 As regards, in the present case, the review carried out by the Commission under Article 9(3) of Directive 2003/87 as to whether the ex-post adjustments at issue are compatible in particular with criteria 5 and 10 of Annex III thereto, it is to be noted that the conduct of that review depends in the first place on determination of the meaning of the relevant rules of law and entails only secondly complex economic and ecological assessments, in particular where the practical consequences of those adjustments for the functioning of the allowance trading scheme are to be assessed. Accordingly, it is appropriate to examine first of all whether, in conducting the review, the Commission observed the limits of the relevant rules of law, as interpreted by the Court, in order to determine whether the contested decision is vitiated by an error of law. It is only subsequently, once it becomes apparent that the Commission correctly applied the relevant rules of law or furnished the proof required of it, in accordance with the rules relating to the burden of proof which are defined in paragraphs 78 and 79 above, that the question arises as to whether its assessment, on the factual and economic level, is plausible or vitiated by a manifest error.

83 It is common ground between the parties that the question of the permissibility of the ex-post adjustments at issue is not expressly addressed by Directive 2003/87. In

those circumstances, it must be presumed that they fall within the Member State's freedom as to the forms and methods for transposing the directive and the Commission therefore has the task of proving that they are liable to compromise the practical effect of its provisions.

84 It is expedient to begin by examining the legality of the contested decision in so far as it relates to the permissibility of certain ex-post adjustments in the light of criterion 10 of Annex III to Directive 2003/87, given that the meaning of this criterion, as interpreted by the Commission, is intrinsically linked to the issue of the compatibility of those adjustments with the objectives and general system of the allowance trading scheme as established by the directive.

2. The legality of the contested decision with regard to criterion 10 of Annex III to Directive 2003/87

(a) The ex-post adjustments at issue

85 First of all, it is appropriate to note the identity of the ex-post adjustments at issue that are considered by the Commission to be contrary to criterion 10 of Annex III to Directive 2003/87.

86 At first sight the Commission appears to find in Article 1 of the contested decision that all the ex-post adjustments listed in that article are contrary to criterion 10 of Annex III to Directive 2003/87. Nevertheless, it is clear from recitals 4, 5 and 6 of the contested decision, in the light of which the operative part must be read (see, to this effect, Case C-415/03 *Commission* v *Greece* [2005] ECR I-3875, paragraph 41,

and Case T-93/02 *Confédération nationale du Crédit mutuel* v *Commission* [2005] ECR II-143, paragraph 74), that that determination does not apply to the ex-post adjustments envisaged for new entrants, as referred to in Article 1(a) of the decision, since the Commission considers that they are only contrary to criterion 5. Accordingly, as the Commission confirmed at the hearing (minutes of the hearing, p. 2), the opening words of Article 1 of the contested decision are to be understood as follows:

'The following aspects of the [NAP] of Germany are incompatible with criteria 5 and[/or] 10 of Annex III to Directive 2003/87 ...'

87 In Article 1(b) and recital 5 of the contested decision, the Commission finds that ex-post adjustments pursuant to the transfer rule are unlawful. While the Commission does not contest the transfer rule as such, in so far as it enables the operator of a new installation to take the allowances issued to an installation which he has previously operated and then closed (see, in particular, the Commission Communication of 7 July 2004, point 3.3), it refuses, however, to accept that such adjustments are lawful where the production capacity of the new installation is lower than that of the closed installation.

88 In the first case in Article 1(c), and recital 6, of the contested decision, the Commission also finds that ex-post adjustments linked to reductions in installations' production capacity utilisation that are inconsistent with the operator's forecasts are unlawful. According to the additional explanation provided in the Commission Communication of 7 July 2004 (point 3.2, penultimate paragraph), such unlawfulness affects only ex-post adjustments applicable to installations whose operation began after 1 January 2003 and not those applicable to new entrants. In response to a

written question from the Court, the Commission confirmed this interpretation, but stated that the Commission Communication of 7 July 2004 incorrectly limited the unlawfulness to ex-post adjustments applicable to installations whose operation began after 1 January 2003 and that the contested decision accordingly also covered those applicable to installations whose operation began before that date.

89 The Commission also finds, in the second case in Article 1(c), and recital 6, of the contested decision, as rectified at the hearing (see paragraph 40 above), that the downward ex-post adjustments provided for when the installation's annual emissions are less than 60% of base-period emissions are unlawful ('de facto closure').

90 In the final case in Article 1(c), and recital 6, of the contested decision, the Commission finds, lastly, that the ex-post adjustments of the special allocation of allowances to cogeneration installations when the volume of electricity produced by them is below the base-period quantity are unlawful.

91 More generally, it is apparent from recitals 4 and 5 of the contested decision and from the first paragraph of point 3.2 of the Commission Communication of 7 July 2004 (see paragraph 41 above) that the Commission is of the view that in an NAP the amount of allowances to be allocated to each installation must be determined in advance for the first allocation period and, in any event, can no longer be altered after the Member State has adopted the decision under Article 11(1) of Directive 2003/87. On the other hand, the applicant essentially contends that criterion 10 of Annex III to the directive contains only a procedural condition requiring the Member State to annex to the NAP a list of the installations with the projected quantity of allowances which it intends to allocate to them and that the amount of these individually allocated allowances is liable to change in a subsequent phase of implementation of the allocation decision adopted under Article 11(1) of Directive 2003/87.

92 In order to examine the merits of the arguments put forward by the parties, the Court considers it necessary to provide a literal, historical, contextual and teleological interpretation of criterion 10 of Annex III to Directive 2003/87 (see, as regards the methodology, Case T-251/00 *Lagardère and Canal+* v *Commission* [2002] ECR II-4825, paragraph 72 et seq., and Joined Cases T-22/02 and T-23/02 *Sumitomo Chemical and Sumika Fine Chemicals* v *Commission* [2005] ECR II-4065, paragraph 41 et seq.).

(b) Literal interpretation of criterion 10 of Annex III to Directive 2003/87

93 It is to be determined first of all, by means of a literal interpretation, whether the wording of criterion 10 of Annex III to Directive 2003/87 precludes the measures for ex-post adjustment provided for by the German NAP.

94 Criterion 10 of Annex III to Directive 2003/87 states that 'the [NAP] shall contain a list of the installations covered by this Directive with the quantities of allowances intended to be allocated to each'. Thus, it is apparent from the terms in which the criterion is couched, first, that the NAP must contain a list of the installations falling within the scope of Directive 2003/87 and, second, that the list must indicate the amount of allowances 'intended to be allocated' to each of those installations. It is accordingly necessary to consider more specifically the meaning of the phrase 'intended to be allocated'.

95 For the purposes of a literal interpretation, it must be borne in mind that Community legislation is drafted in various languages and that the different language versions are all equally authentic; an interpretation of a provision of Community law thus involves a comparison of the different language versions (Case 283/81 *Cilfit* [1982] ECR 3415, paragraph 18). The phrase 'que l'on souhaite ...

allouer' in the French version is reproduced in the Spanish and Portuguese versions, namely 'que se prevé asignar' and 'que se pretende de atribuir' respectively, all these versions thus expressing the same subjective character — involving a certain degree of independent will — of the individual allocation of emission allowances to the various installations. This character is toned down and becomes a simple intention in the versions drafted in English ('intended to be allocated'), Danish ('hensigten'), Finnish ('aiotaan myöntää') and Swedish ('som avses'), where the phrase has been reproduced with a slightly different sense, namely as meaning 'which the Member State would intend to allocate'. Moreover, in the German version ('zugeteilt werden sollen') and the Dutch version ('bestemd om te worden toegewezen'), meaning 'are to be allocated', the individual allocation of emission allowances to the various installations has an increasingly neutral and objective character. This neutral and objective character is again accentuated slightly further in the Greek version ('pou prokitai na diatethoun') and the Italian version ('saranno assegnate'), which present the individual allocation of emission allowances simply as a future act ('will be allocated').

96 In light of the foregoing, significant nuances exist between the various language versions of criterion 10 of Annex III to Directive 2003/87, each of which is authentic; depending on the words used, those versions confer upon the individual allocation of emission allowances a character which is, rather, subjective and intentional or, on the other hand, a more or less objective and neutral character. Consequently, those language versions, taken as a whole, cannot lead to acceptance either of the position of the Commission, according to which the NAP and the allocation decision must contain the definitive amount of allowances to be allocated in respect of each of the installations listed, or of that of the applicant which, essentially, argues that the Member State has a wide discretion in this regard. However, the formulations referred to above also do not preclude that the Community legislature sought to grant some flexibility, indeed some discretion for the Member State, by allowing it the possibility of altering the amount of allowances, as envisaged in the list of installations annexed to the NAP, in a subsequent phase of the implementation of Directive 2003/87.

97 Accordingly, this literal interpretation and this comparative reading of the various language versions of criterion 10 of Annex III to Directive 2003/87 should be supplemented by a historical interpretation.

(c) Historical interpretation of criterion 10 of Annex III to Directive 2003/87

98 In retracing the legislative process which led to the adoption of Directive 2003/87, the Court notes that criterion 10 of Annex III did not appear in the draft directive until a relatively late stage, that is to say in Common Position (EC) No 28/2003 of 18 March 2003 adopted by the Council with a view to adopting the directive (OJ 2003 C 125E, p. 72). As the applicant states, this criterion was included in the draft directive following an amendment, proposed on 13 September 2002 by the European Parliament Committee on the Environment, Public Health and Consumer Policy, the justification for which was that 'data which enable the state of emissions allowances trading to be gauged must be made available' (Session document A5-0303/2002, I, p. 46, Amendment 73).

99 Consequently, a historical interpretation does not supply additional factors capable of altering the conclusion drawn in paragraph 96 above.

100 It is accordingly necessary to provide a contextual interpretation of criterion 10 of Annex III to Directive 2003/87.

(d) Contextual interpretation of criterion 10 of Annex III to Directive 2003/87

The relevant provisions of Directive 2003/87 and Regulation No 2216/2004

(i) Articles 9 and 11 of Directive 2003/87

101 In interpreting criterion 10 of Annex III to Directive 2003/87 contextually, it is appropriate to refer, first of all, to Article 9(1) of the directive, which forms the legal basis for the drawing up of NAPs by the Member States. This provision states, in particular, that 'each Member State shall develop [an NAP] stating the total quantity of allowances that it intends to allocate for that period and how it proposes to allocate them' and that 'the [NAP] shall be based on objective and transparent criteria, including those listed in Annex III, taking due account of comments from the public'.

102 With regard to whether the allocation of allowances by a Member State that is envisaged by the NAP is definitive or, on the other hand, only provisional in nature, the Court finds that the words used in Article 9(1) of Directive 2003/87 ('intends to allocate') essentially correspond, in each of the language versions examined in paragraph 95 above, to those used in criterion 10 of Annex III to the directive ('intended to be allocated'). These formulations do not, however, necessarily mean that the Member State has wide freedom of action with regard to implementation. They may also be understood as being the consequence of the fact that the NAP will be reviewed by the Commission, pursuant to Article 9(3) of the directive, and that accordingly any allocation of allowances envisaged in the list of installations annexed to the NAP — and therefore 'intended' by the Member State — is only provisional until the Commission ratifies it or rejects it with a request for amendments.

103 It is appropriate to refer, next, to Article 9(3) of Directive 2003/87, according to which 'the Commission may reject [the NAP], or any aspect thereof, on the basis that it is incompatible with the criteria listed in Annex III or with Article 10' and 'the Member State shall only take a decision under Article 11(1) ... if proposed amendments are accepted by the Commission'. The wording of Article 11(1) should also be recalled, according to which 'each Member State shall decide upon the total quantity of allowances it will allocate ... and the allocation of those allowances to the operator of each installation'. Article 11(1) also makes it clear that 'this decision shall be ... based on its [NAP] ..., taking due account of comments from the public'.

104 In this context, it is useful to recall the various stages of the procedure set out in Article 9(1) and (3) of Directive 2003/87, read in conjunction with Article 11(1). Article 9(3) envisages a number of stages corresponding, respectively, to notification and finalisation of the NAP and adoption by the Member State of the allocation decision. It also envisages at least two opportunities for the Commission to review and reject the NAP. The first, essential, stage consists in the initial notification by the Member State of the NAP in accordance with Article 9(1) and examination of the NAP by the Commission. This first stage is supplemented, in some cases, by a second stage. The latter gives rise to possible amendments of the NAP, either at the Commission's request or following a proposal by the Member State, and to the acceptance or rejection of those amendments by the Commission. It is only when the first and — if necessary — the second stage have been completed that the Member State is entitled to adopt, in a third stage and on the basis of its NAP, its decision allocating allowances pursuant to Article 11(1) of Directive 2003/87 (Case T-178/05 *United Kingdom* v *Commission* [2005] ECR II-4807, paragraph 56). In addition, Article 9(1) and Article 11(1) of the directive oblige the Member State to '[take] due account of comments from the public', both in the NAP, that is to say following an initial public consultation, and in the allocation decision, adopted following a second public consultation. In this connection, criterion 9 of Annex III

to Directive 2003/87 states that 'the [NAP] shall include provisions for comments to be expressed by the public, and contain information on the arrangements by which due account will be taken of these comments before a decision on the allocation of allowances is taken'.

105 In light of the foregoing, the Court observes, first, that the allocation decision by the Member State which is provided for in Article 11(1) of Directive 2003/87 is not subject, under the directive, to a specific examination by the Commission like the review provided for in Article 9 of the directive concerning the NAP. However, the fact that Article 11(1) obliges the Member State to base its allocation decision on its NAP, as examined by the Commission under Article 9 and possibly amended at its request, does not necessarily mean that a subsequent modification of the individual allocations of allowances is no longer possible. In accordance with the final words of the second sentence of Article 11(1), read in conjunction with criterion 9 of Annex III, the content of the allocation decision also depends on the second public consultation. This second public consultation does not take place until after the Commission has examined the notified NAP, and it must be capable of leading to amendment of the allocation which the Member State proposes to lay down by its allocation decision, if that consultation is not to be deprived of its effectiveness and the comments of the public are not to be rendered purely academic (*United Kingdom* v *Commission*, cited in paragraph 104 above, paragraph 57). It follows that while, in principle, any amendment of the NAP's fundamental framework following the conclusion of the examination procedure provided for in Article 9(3) of Directive 2003/87 is liable to neutralise the system of preventive review which it establishes, an absolute prohibition on amending the individual allocations laid down in the NAP would compromise the practical effect of the second public consultation as provided for by the final words of the second sentence of Article 11(1), read in conjunction with criterion 9 of Annex III (see, to this effect, *United Kingdom* v *Commission*, cited in paragraph 104 above, paragraph 58). It should be added that, as is apparent from paragraphs 93, 95 and 96 of the Commission guidance, the Commission itself seems to take as its starting point that, given the mandatory nature of the public participation, any amendments that have proved necessary after the second public consultation can be incorporated into the allocation decision, provided that the Member State informs the Commission thereof before adopting that decision.

106 It should be observed, second, that in the relevant passage ('each Member State shall decide upon the total quantity of allowances it will allocate ... and the allocation of those allowances to the operator of each installation'), Article 11(1) of Directive 2003/87 is worded in a rather open manner and is directed towards the future, and that that provision does not expressly prohibit a subsequent amendment of the amount of allowances allocated individually according to the list annexed to the NAP and according to the allocation decision. Also, Article 9(1) of the directive, which lays down the conditions governing an NAP's legality, does not refer exclusively to the criteria listed in Annex III to the directive, but allows the NAP to be founded on other allocation criteria, provided that they are 'objective and transparent'. It follows, first, that, in the absence of an express prohibition in Article 11(1) of subsequent amendment of the individual allocation of allowances, the NAP and the allocation decision may expressly provide for such a possibility of amendment, provided that the criteria for exercise of that power are laid down in an objective and transparent manner. It follows, second, that, since those additional criteria do not constitute criteria defined in Annex III to Directive 2003/87, the Commission's power of review under Article 9(3) of that directive is necessarily restricted and is limited to the question whether the additional criteria — introduced by the Member State in the exercise of the discretion which it is allowed for transposition of the directive — fulfil the conditions of objectivity and transparency. It should be added that any subsequent amendment of the individual allocations of allowances, occurring after the allocation decision under Article 11(1) of Directive 2003/87, does not result in the Commission losing all possibility of review, given the permanent supervision which it exercises as a result of the instruments for management and verification that are provided for by Regulation No 2216/2004, and the general supervisory power with which it is vested under Articles 211 EC and 226 EC and which permits it to act at any time if Community law is infringed.

(ii) Article 29 of Directive 2003/87

107 Article 29 of Directive 2003/87 permits, as an exception and in derogation from the total quantity of allowances that is laid down, a subsequent increase in the amount

of individually allocated allowances. This bears out the proposition that a Member State is not, in principle, permitted to allocate additional allowances. However, the directive contains no express provision limiting the Member State's freedom of action in managing the individual allocation of allowances when that does not result in such an increase but only in downward ex-post corrections. In the latter case, there is no risk of an allocation exceeding the total amount of allowances that is provided for in the NAP, an allocation which would be contrary to the obligation owed by the Member State to reduce emissions. In this connection, it should also be noted that, in reply to a questionnaire from the Commission during the administrative procedure, the applicant pointed out that, contrary to what appeared from the NAP as originally notified, the allocation decision adopted pursuant to Article 11(1) of Directive 2003/87 contained only downward ex-post adjustments and not measures increasing individual allocations (see paragraph 34 above).

(iii) Article 38(2) of Regulation No 2216/2004

108 As the Commission submits, Article 38(2) of Regulation No 2216/2004 is merely a procedural rule of a technical nature for the proper management and centralised, European-level, management of the standard and secured system of registries, which contains, inter alia, the NAP tables presenting the data of the various NAPs as notified by the Member States. That rule establishes the conditions in accordance with which corrections may be notified and made to the NAP table, but the corrections are contingent upon compliance with the procedure of notification and review by the Commission under Article 9(3) of Directive 2003/87. It follows that these possibilities of amendment are entirely without prejudice to whether the corrections in question are lawful or well founded and that they are not in any event capable of altering the effect of the various relevant provisions of Directive 2003/87. On the other hand, the wording used in the second sentence of Article 38(2) of Regulation No 2216/2004, namely 'that correction is in accordance with methodologies set out in that [NAP]', confirms, at least indirectly, that subsequent correction of the amount of allowances allocated is possible, provided that the NAP

as such expressly lays down the methodology applicable to such a correction. That rule thus presupposes that the Member State may lay down correction mechanisms in the NAP, provided that they are objective and transparent within the meaning of Article 9(1) of Directive 2003/87.

Effect of the Commission guidance

(i) Self-limiting effect of the Commission guidance

109 In so far as the Commission guidance is capable of forming part of the relevant legal framework, it is necessary to assess its effect and to analyse those of its provisions that are relevant to interpreting criterion 10 of Annex III to Directive 2003/87.

110 With regard to the legal nature of the guidance, it is to be noted that, while it is founded on an express legal basis laid down in the final sentence of the first subparagraph of Article 9(1) of Directive 2003/87, according to which 'the Commission shall ... develop guidance on the implementation of the criteria listed in Annex III', it does not correspond to any of the measures of secondary Community law that are provided for in Article 249 EC (see, by analogy, Case C-443/97 *Spain* v *Commission* [2000] ECR I-2415, paragraph 28 et seq.; *Pfizer Animal Health* v *Council*, cited in paragraph 81 above, paragraph 119; and *Alpharma* v *Council*, cited in paragraph 81 above, paragraph 140). The Commission is nevertheless thereby empowered to set out and to make public in advance, in the form of this guidance, its own understanding of the meaning and effect of the criteria which are included in Annex III to the directive, and the way in which it intends to perform its review, pursuant to Article 9(3) of the directive, of whether

the implementing action taken by the Member State is compatible with those criteria. Accordingly, the guidance falls within the category of rules which, as such, do not, in principle, have independent binding effect vis-à-vis third parties and of which the Commission makes extensive use in its administrative practice in order to structure, and increase the transparency of, the exercise of its discretion and supervisory power.

111 In this regard, the case-law should be recalled according to which, by adopting rules of administrative conduct designed to produce external effects and announcing by publishing them that it will henceforth apply them to the cases to which they relate, the institution in question imposes a limit on the exercise of its own discretion and cannot depart from those rules, if it is not to be found, in some circumstances, to be in breach of general principles of law, such as the principles of equal treatment, of legal certainty or of the protection of legitimate expectations. It cannot therefore be precluded that, on certain conditions and depending on their content, such rules of conduct of general application may produce legal effects and that, in particular, the administration may not depart from them in an individual case without giving reasons that are compatible with the principle of equal treatment (see, with regard to the Commission guidelines on the method of setting fines in competition matters, Joined Cases C-189/02 P, C-202/02 P, C-205/02 P, C-208/02 P and C-213/02 P *Dansk Rørindustri and Others* v *Commission* [2005] ECR I-5425, paragraphs 209 to 211; see also, with regard to guidelines adopted by the Commission on State aid, Case T-16/96 *Cityflyer Express* v *Commission* [1998] ECR II-757, paragraph 57), provided that such an approach is not contrary to other superior rules of Community law. Specifically in the fields of agriculture, health and the environment, the Court has recognised that the Community institutions may lay down for themselves guidelines for the exercise of their discretion by way of measures not provided for in Article 249 EC, in particular by communications, provided that they contain an indication as to the approach to be followed by those Community institutions and do not depart from the Treaty rules (see *Pfizer Animal Health* v *Council*, cited in paragraph 81 above, paragraph 119, *Alpharma* v *Council*, cited in paragraph 81 above, paragraph 140, and the case-law cited).

112 It follows that, in connection with the exercise of its power of review under Article 9 of Directive 2003/87, the Commission has, by its guidance, imposed a limit on itself such that it cannot depart from the guidance, if it is not to infringe, in some circumstances, certain general principles of Community law, such as the principles of equal treatment, of the protection of legitimate expectations and of legal certainty. Consequently, the Commission is liable to have its guidance raised against it, in particular by the Member States to which it is addressed, when it adopts measures running counter to that guidance.

(ii) Interpretation of criterion 10 of Annex III to Directive 2003/87 in the light of the Commission guidance

113 It may be recalled that, with regard to criterion 10 of Annex III to Directive 2003/87, the Commission stated as follows in paragraphs 97 to 100 of its guidance:

'97. This criterion provides for the transparency of the [NAP]. It implies that the quantities of allowances per installation are indicated, and therefore visible to the general public, when the [NAP] is submitted to the Commission and other Member States ...

...

98. This criterion will be deemed as fulfilled if a Member State has respected its obligation to list all the installations covered by [Directive 2003/87] ...

...

100. A Member State has to indicate the total quantity of allowances intended to be allocated to each installation and should indicate the quantity issued in each year to each installation following Article 11(4) [of Directive 2003/87] ...'

114 Paragraph 97 of the Commission guidance reflects the same ratio legis as that underlying the justification given by the Parliament Committee which proposed that criterion 10 be included in Directive 2003/87 (see paragraph 98 above). That justification is essentially concerned with guaranteeing the public and the authorities involved in management of the allowance trading scheme that the quantity of allowances allocated per installation will be transparent in the NAP. Likewise, the words 'this criterion will be deemed as fulfilled', used in paragraph 98 of the Commission guidance, indicate that the Commission itself wished to convey that the scope of the obligation contained in criterion 10 of Annex III to Directive 2003/87 is limited to a formal obligation to give notice of a 'list [of] all the installations covered by [Directive 2003/87]'. Furthermore, paragraph 100 of the Commission guidance merely requires, like the wording of criterion 10, that the Member State 'indicate the total quantity of allowances intended to be allocated to each installation'. The wording chosen to express the freedom of action available to the Member State for allocation of the allowances ('intended to be allocated') is therefore hardly different from the wording used in criterion 10 (also 'intended to be allocated') and the other relevant provisions of Directive 2003/87 (see paragraphs 101 to 106 above).

115 The Court concludes that, in its guidance, the Commission does not provide any additional explanation beyond the wording of the relevant provisions of Directive 2003/87, with regard to the effect of criterion 10 of Annex III to Directive 2003/87, explanation which would be capable of supporting the validity of its interpretation

that the ex-post measures of adjustment at issue are contrary to that criterion. Nor does the Commission guidance contain anything that helps to determine whether the Member State is able to change the individual allocation of the allowances after the adoption of its NAP or of the allocation decision under Article 11(1) of Directive 2003/87.

116 However, given that the Commission guidance is supposed to specify the Commission's administrative practice and its practice in conducting reviews, and to set out the extent of the freedom of action available to the Member State when transposing the criteria laid down in Annex III to Directive 2003/87, the Commission is required to establish that guidance, in particular as regards the most essential aspects, with the greatest possible clarity and precision. That is all the more so because the power to review and reject NAPs, exercised by the Commission pursuant to Article 9(3) of Directive 2003/87, is very circumscribed, being limited to examining whether they are compatible with the criteria in Annex III and Article 10 alone. Accordingly, in the absence of any reference in the Commission guidance to the question of the lawfulness of downward ex-post adjustments to the amount of individually allocated allowances and the question of the Member State's freedom of action for that purpose, the Commission cannot legitimately raise against the Member State the objection that those adjustments are prohibited, if it is not to infringe the principles of legal certainty and of the protection of legitimate expectations, but must, conversely, have this lack of reference raised against it by the Member State, unless that is contrary to other provisions of Community law, in particular higher-ranking provisions of Community law.

(iii) Effect of the Commission Communication of 7 July 2004

117 The Commission Communication of 7 July 2004, which repeats and supplements the grounds of the contested decision adopted on the same day, in particular the reasons why the Commission considers the ex-post adjustments at issue to be

incompatible with criterion 10 of Annex III to Directive 2003/87, cannot alter the interpretation of the Commission guidance in paragraphs 114 and 116 above. It is true that that communication constitutes an important element falling within the immediate context in which the contested decision was adopted and, therefore, a statement of reasons additional to the grounds contained in that decision, which the Community judicature is required to take into consideration in conducting its judicial review (see, to this effect, Case T-374/00 *Verband der freien Rohrwerke and Others* v *Commission* [2003] ECR II-2275, paragraphs 122 to 124). However, the communication neither pre-dates the drawing up of the German NAP, when it could have helped the Federal Republic of Germany to observe the criteria set out in Annex III, nor is founded on the final sentence of the first subparagraph of Article 9(1) of Directive 2003/87 and accordingly cannot alter the effect of the Commission guidance drawn up pursuant to that provision.

Conclusion on the contextual interpretation of criterion 10 of Annex III to Directive 2003/87

118 Having regard to all the foregoing, the Court concludes that a contextual interpretation of criterion 10 of Annex III to Directive 2003/87 in the light of the directive's other provisions and the Commission guidance cannot provide a clear and precise answer to the question whether or not it is open to a Member State, following approval of its NAP by the Commission and adoption of the allocation decision, to adjust the individual allocation of allowances to the installations downwards.

(e) Teleological interpretation of criterion 10 of Annex III to Directive 2003/87

Introductory remark

119 As regards the teleological interpretation of criterion 10 of Annex III to Directive 2003/87, reference should be made especially to the directive's objectives and

general system, to whose accomplishment and operation the criteria in Annex III are supposed to contribute. In this context, it should be asked in particular whether actual implementation of the directive's objectives and, therefore, the effectiveness of the relevant provisions that are designed to achieve those objectives, which include the criteria laid down in Annex III, preclude accepting that downward ex-post adjustments of the allowances allocated are lawful (see paragraphs 93 to 118 above).

120 Accordingly, it is appropriate to begin by defining the objectives pursued by Directive 2003/87 the implementation of which might be impeded by acceptance that the ex-post adjustments at issue are lawful.

Objectives of Directive 2003/87

121 According to Article 1 of Directive 2003/87, the directive's principal objective is to '[establish] a scheme for greenhouse gas emission allowance trading within the Community ... in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner'. In this connection, criterion 1 of Annex III to the directive concludes by stating that the total quantity of allowances to be allocated for the relevant period 'shall not be more than is likely to be needed for the strict application of the criteria of this Annex' and, 'prior to 2008, ... shall be consistent with a path towards achieving or over-achieving each Member State's target under Decision 2002/358 ... and the Kyoto Protocol'. Also, recital 4 in the preamble to the directive refers to the commitments which the Community and the Member States have entered into under the Kyoto Protocol to reduce their anthropogenic greenhouse gas emissions.

122 Recital 5 in the preamble to Directive 2003/87 states that 'this Directive aims to contribute to fulfilling the commitments of the European Community 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'. In addition, recital 7 refers to the need for 'Community provisions relating to allocation of allowances by the Member States ... to contribute to preserving the integrity of the internal market and to avoid distortions of competition'.

123 Recital 20 notes that 'this Directive will encourage the use of more energy-efficient technologies, including combined heat and power technology, producing less emissions per unit of output'. Also recital 25 states that 'policies and measures should be implemented at Member State and Community level across all sectors of the ... economy ... in order to generate substantial emissions reductions'.

124 It follows that the principal declared objective of Directive 2003/87 is to reduce greenhouse gas emissions substantially in order to be able to fulfil the commitments of the Community and its Member States under the Kyoto Protocol. This objective must be achieved in compliance with a series of 'sub-objectives' and through recourse to certain instruments. The principal instrument for this purpose is constituted by the Community scheme for greenhouse gas emissions trading (Article 1 of Directive 2003/87 and recital 2 in its preamble), the functioning of which is determined by certain 'sub-objectives', namely the maintenance of cost-effective and economically efficient conditions, the safeguarding of economic development and employment, and the preservation of the integrity of the internal market and of conditions of competition (Article 1 and recitals 5 and 7). Directive 2003/87 also encourages utilisation of a particular type of instrument, that is to say use of more energy-efficient technologies enabling emissions per unit of output to be reduced (recital 20).

125 It should be added that criterion 10 of Annex III to Directive 2003/87, which refers to the allocation of allowances to the installations listed in the NAP, indeed constitutes a Community provision relating to allocation of allowances by the Member States within the meaning of recital 7 in the preamble to the directive and is thus intended 'to contribute to preserving the integrity of the internal market and to avoid distortions of competition'. Accordingly, when interpreting criterion 10 teleologically and, therefore, in reviewing the legality of the contested decision, the 'sub-objectives' which preservation of the integrity of the internal market and preservation of conditions of competition represent are of particular importance.

126 It is therefore in the light of those 'sub-objectives' that a teleological interpretation of criterion 10 of Annex III to Directive 2003/87 should be provided.

Interpretation of criterion 10 of Annex III to Directive 2003/87 in the light of the directive's objectives

(i) Principal arguments of the parties

127 In this regard, and in the course of its arguments relating to criterion 5, the Commission submits that ex-post adjustments affect the incentive for operators to behave in accordance with the objectives of Directive 2003/87 and to reduce, ultimately, their emission rates. In support of its view, it contends essentially that this reduction in emissions could be achieved, according to operators' preferences, either by investment in more energy-efficient technologies resulting in a lower emission rate per unit of output or by a simple reduction in production, which would lead to a proportionate reduction in emissions. On the other hand, ex-post

adjustments create uncertainty, indeed deter operators from investing, with the consequence that improvements in production technologies and reductions in production are less substantial than they would be in the absence of adjustments.

128 The applicant counters that an ex-post adjustment mechanism, which deters operators from over-assessing their need for allowances and, therefore, which avoids 'over-allocations', is an essential precondition for achieving the objectives of Directive 2003/87, namely the substantial reduction of greenhouse gas emissions in a cost-effective and economically efficient manner. The fact that application of the ex-post adjustments is linked to differences recorded between actual production and predicted production, and not to the reduction of emission rates, has specifically the consequence that the operator's economic decisions as to the purchase or the sale of allowances depend on the efficiency of his installation. Accordingly, neither the incentive for operators to reduce their emissions nor certainty in respect of investments made for this purpose is affected by the ex-post adjustments, quite the reverse.

(ii) The relevant analytical criteria

129 For the purposes of the teleological interpretation of criterion 10 of Annex III to Directive 2003/87 and of its application to the ex-post adjustments at issue, account should be taken in particular of the following relevant analytical criteria: (i) the relation existing between production volume and the emission rate in light of the objective of reducing emissions, (ii) the relation existing between that objective and the objective of maintaining cost-effective and economically efficient conditions (Article 1 of Directive 2003/87), (iii) the objective of reducing emissions through improvements in technologies (recital 20 in the preamble to the directive) and (iv) the objective of safeguarding the internal market and maintaining conditions of competition (recital 7).

— The relation existing between production volume and the emission rate in light of the objective of reducing emissions

130 A preliminary point to note is that it is common ground between the parties that the ex-post adjustments at issue are linked, primarily, to changes in production volume, that is to say to changes in the number of units of output, and not to a change in an installation's emission rate. As the applicant has explained in response to a written question from the Court, without being contradicted by the Commission, the same is true of the 'de facto closure' rule provided for in the German NAP (see the first indent of paragraph 31 above), as transposed in the first sentence of Paragraph 7(9) of the Zuteilungsgesetz, the substantive application of which depends on a reduction in production volume, as the reduction in the installation's emissions to a rate below 10% or 60% of average annual emissions during the base period is relevant only to the triggering of a specific examination in this connection by the authorities.

131 In light of the matters put forward by the Commission in the contested decision, it is therefore sufficient to examine, in the teleological interpretation of criterion 10 of Annex III to Directive 2003/87, whether that criterion precludes measures for the ex-post adjustment of the allowances allocated that are linked to a reduction in production volume.

132 As the Commission has explained in response to a written question from the Court, in the event of a reduction in production volume the installation's emissions fall and, consequently, the operator has allowances available which he can either place on the trading market or keep in so far as they do not have to be surrendered and cancelled. On the other hand, in such a case the emission rate does not fall per unit of output but only in absolute terms, in proportion to the reduction in production volume. It also follows that, after such a fall in production, the overall emission rate of the industrial sectors covered by Annex I to Directive 2003/87 does not necessarily drop, given that the allowances freed up can be used subsequently either by the

operator himself or by other operators who have purchased them on the trading market. Accordingly, while reducing production volume is an essential means of feeding the emission allowance trading market, it does not ensure, in itself, that the principal and ultimate objective of Directive 2003/87, which is to reduce substantially Community greenhouse gas emissions as a whole, is achieved.

133 However, as the Commission submits, when the operator is aware that any fall in production diverging from his own forecasts will be penalised by the application of ex-post adjustments, his incentive to reduce production in order to free up allowances is affected, not to say removed, even where there is an increase in demand on the trading market from other operators wishing to obtain additional allowances. Assuming that, if the allowance trading scheme is to function properly, satisfying that demand must be possible, it appears important to safeguard the operator's ability freely to choose to lower his production volume and place on the trading market the allowances thereby freed up, so as to permit him to respond, in the short term, to such an increase in demand from other operators. Finally, while ex-post adjustments whose application presupposes a very substantial fall in production, such as in the case of 'de facto closure' (see the first indent of paragraph 31 above), are not likely to affect appreciably the incentive for occasional and limited reductions in production volume in response to variations in demand on the trading market, that is not true of the ex-post adjustments that are applicable once a relatively small fall in production occurs, as is the case with installations in operation since 2003 and new entrants (see the third and fourth indents of paragraph 31 above).

134 Consequently, the Commission has demonstrated that certain of the ex-post adjustments at issue, inasmuch as they deter operators from reducing their installations' production volume, are liable to compromise achievement of the objective of efficient functioning of the trading market in accordance with Article 1 and recital 5 of Directive 2003/87. However, the Commission has not put forward evidence or arguments capable of establishing that those adjustments harm the principal objective of Directive 2003/87, namely the reduction of greenhouse gas emissions as a whole in accordance with that provision.

135 It should therefore be determined whether the ex-post adjustments at issue are compatible with the 'sub-objectives' of Directive 2003/87 referred to in paragraphs 124 to 126 above, with which achievement of the principal objective of reducing greenhouse gas emissions as a whole must be reconciled.

— Reconciliation of the objective of reducing emissions with the objective of maintaining cost-effective and economically efficient conditions

136 In accordance with Article 1, Directive 2003/87 is intended to promote the objective of reducing emissions, by means of an allowance trading scheme and in a cost-effective and economically efficient manner. As the Commission accepted at the hearing, the criteria of cost-effectiveness and economic efficiency do not apply solely to the functioning of the trading market as such, but also to the sectors of activity referred to in Annex I to Directive 2003/87, which are subject to the objective of reducing emissions, such as the steel-production sector or the energy sector. This finding is confirmed, at least indirectly, first, by the concluding words of recital 5 in the preamble to Directive 2003/87, according to which the trading market must cause the least possible diminution of economic development and employment and, second, by recital 7, which calls for the adoption of Community provisions relating to the allocation of allowances by the Member States in order to contribute to preserving the integrity of the internal market and to avoid distortions of competition.

137 It should be recalled that, while a fall in production volume may enable the trading market to be supplied with emission allowances, it does not necessarily lead to a reduction in the overall emission rate (see paragraph 132 above). Furthermore, that fall in production volume could result in the relevant market for goods being undersupplied in so far as production is no longer sufficient to satisfy demand on those markets, a situation which is liable to arise in particular where there is a structural deficit in the supply of allowances on the trading market and the price of allowances exceeds by a considerable margin the profit which the operator could

derive from selling goods produced by using up the allowances available to him. While such a situation results from the economic logic of the trading market, it appears difficult to reconcile with the objective of maintaining cost-effective and economically efficient conditions with regard to the sectors of activity and markets for goods in question, as referred to in Annex I to Directive 2003/87. Accordingly, contrary to the Commission's view, given the positive effects which they entail for the functioning of the markets for goods concerned, ex-post adjustments cannot be considered to be contrary to the objective referred to in Article 1 of Directive 2003/87 in so far as they deter operators from reducing their production volume.

138 It follows that the Commission has not demonstrated that the deterrent effect of ex-post adjustments linked to falls in production volume is contrary to the objective of maintaining cost-effective and economically efficient conditions as regards the sectors of activity and markets for goods in question covered by Annex I to Directive 2003/87.

— The objective of reducing emissions through improvements in technologies

139 It should also be determined whether the ex-post adjustments at issue are compatible with the 'sub-objective' referred to in recital 20 in the preamble to Directive 2003/87, according to which the directive 'will encourage the use of more energy-efficient technologies ... producing less emissions per unit of output'. In this connection, the Commission was wrong in asserting at the hearing that this recital did no more than 'record' a desirable future effect of implementing Directive 2003/87 and that, in any event, it was only a 'subordinate objective'. Although the recital is expressed in the future tense ('will encourage') and in the form of a statement of fact, the use of new, more environmentally-efficient, production technologies, in that they reduce emissions per unit of output, is none the less liable, first, to make a substantial contribution to the principal objective of reducing

emissions and, second, to safeguard cost-effective and economically efficient conditions, both on the trading market and on the markets for goods in question, since it does not lead to a reduction in production volume that might be harmful to their proper functioning (see paragraph 137 above). This also shows that investment in more energy-efficient technologies constitutes an instrument at least equivalent, if not superior, to that of reducing production volume, for the purpose of successfully reconciling the objective of substantially reducing emissions and that of safeguarding cost-effective and economically efficient conditions both on the trading market and on the market for goods in question.

140 Furthermore, while it is true that the ex-post adjustments at issue are liable to deter operators from reducing their production volume in order to reduce emissions, they do not, contrary to the Commission's view, compromise either the objective of encouraging operators to invest in the development of more energy-efficient technologies or the certainty of such investments. On the contrary, in so far as the ex-post adjustments at issue deter operators from reducing their production in conflict with their own forecasts, those adjustments are liable, having regard to the limited quantity of emission allowances available, to reinforce the incentive to reduce emissions by means of investments in improving the energy efficiency of production technology.

141 In this respect, the Commission cannot legitimately submit that the ex-post adjustments at issue are not capable of promoting the objective of reducing emissions, since the allowances freed up are not cancelled immediately but transferred to the reserve to remain available to new entrants, with the consequence that the total amount of available allowances remains unchanged. First, this contention fails to take account of the fact that the result would not necessarily be any different in the event of allowances being freed up following a reduction in production volume to enable unused emission allowances to be sold (see paragraph 132 above). Second, it is precisely in the latter situation that the incentive to invest in the development of more efficient technology is, at the very least, weakened, because another path to emission reductions that is less costly in the short term would open

up for operators. Accordingly, the Commission's argument that ex-post adjustments are environmentally neutral or even harmful is not well founded. Moreover, the Commission appears to contradict its own statements in this regard set out in the Commission Communication of 7 July 2004 (pp. 7 and 8), where it is stated that downward ex-post adjustments 'might be argued' to have 'a beneficial environmental effect'. It should nevertheless be pointed out that the positive effect of ex-post adjustments with regard to the objective of substantially reducing emissions would be decidedly greater if, instead of being transferred to the reserve, the allowances withdrawn were immediately cancelled.

142 Consequently, contrary to the Commission's assertions, the ex-post adjustments at issue are not contrary to the objective of reducing emissions by means of investment in more energy-efficient technologies within the meaning of recital 20 in the preamble to Directive 2003/87.

— The objective of preserving the integrity of the internal market and maintaining conditions of competition

143 It is also necessary to consider whether or not the ex-post adjustments at issue contribute to preserving the integrity of the internal market and to avoiding distortions of competition within the meaning of recital 7 in the preamble to Directive 2003/87, objectives which are of particular importance to the interpretation of criterion 10 of Annex III to the directive (see paragraph 125 above).

144 As the applicant observes, there is a natural tendency for operators to seek to obtain the greatest possible quantity of allowances, which means that there is a significant stimulus for them to overestimate — even if only through negligence — their own

needs for emission allowances. A risk of 'over-allocation' in favour of certain operators results, particularly in the case of operators in whose regard objective verification on the basis of historic production data proves difficult or impossible (see the third and fourth indents of paragraph 31 above). Apart from its general postulate regarding the need to determine the amount of allowances in advance, the Commission does not put forward any specific evidence or argument to contradict the applicant's argument that ex-post adjustments help specifically to maintain and re-establish conditions of competition by preventing certain operators from obtaining, through an 'over-allocation of allowances', unjustified advantages over other operators.

145 Moreover, the Commission itself seems to start from the principle, as referred to in its letter of 17 March 2004 to the Member States relating to application of the Community aid rules to NAPs, that such 'over-allocations' are liable to infringe Article 87(1) EC and distort or threaten to distort competition seriously. In those circumstances, the Commission's contention, supported by very little detail, that the allowance trading scheme is based on forecasts and involves self-correction mechanisms ensuring equality of chance for operators, thereby immediately excluding distortions of competition, is not comprehensible and, therefore, cannot be upheld.

146 Nor did the Commission put forward, during the administrative procedure, in the contested decision, in its Communication of 7 July 2004 or even in the course of the written procedure before the Court, sufficient evidence or arguments to call into question the legality of the ex-post adjustments at issue in light of the objective of preserving the integrity of the internal market. As the Commission itself acknowledges, its observations, put forward only at the hearing in response to a specific question in this regard from the Court, regarding an impermissible restriction on the free trading of emission allowances within the Community — because allowances are withdrawn from the trading market and transferred to the reserve which is accessible only to operators of installations located in Germany — are not in any way reflected in the grounds of the contested decision or in the

documents in the case that relate to the carrying out of the administrative procedure. In any event, the very general references made, in paragraph 2 of the defence, to the possibility of transferring emission allowances within the Community under Article 12(1) of Directive 2003/87 and, in paragraphs 5 and 6 of the rejoinder, to the need to safeguard the effectiveness of the emission trading scheme cannot be considered sufficient objection in this regard. This determination is, none the less, without prejudice to any examination of the ex-post adjustments at issue in light of the fundamental freedoms laid down in the Treaty, in particular in light of the free movement of goods and freedom of establishment under Articles 28 EC and 43 EC, but such an examination is entirely lacking both in the contested decision and in the Commission Communication of 7 July 2004. In view of the fact that the Commission did not put forward a clear and precise ground of defence in this regard and that it is necessary to safeguard the division of functions and the institutional balance between the administration and the judiciary, the Court cannot in the circumstances assume the role of the Commission as regards verification, at the administrative stage, that the relevant rules of the German NAP are consistent with the fundamental freedoms in the Treaty.

147 Accordingly, the Commission has not proved to the requisite legal standard that the ex-post adjustments at issue are contrary to the objectives of preserving the integrity of the internal market and maintaining conditions of competition.

Conclusion on the teleological interpretation of criterion 10 of Annex III to Directive 2003/87

148 In light of all the foregoing, the Court holds that the Commission misconstrued the effect of criterion 10 of Annex III to Directive 2003/87, as read in the light of the objectives of that directive, in particular those in recital 7 in its preamble, in that it treated the ex-post adjustments at issue as measures contrary to the directive's scheme and general system. The mere fact that the ex-post adjustments at issue are liable to deter operators from reducing their production volume and, therefore, their emission rates is not sufficient to call into question the adjustments' legality in light of the directive's objectives as a whole. Furthermore, it follows from the self-limiting

effect created by the Commission guidance that the Commission must accept having the applicant raise against it the lack of clarity and precision of that guidance as regards any prohibition of the ex-post adjustments at issue in light of the directive's objectives (see paragraphs 112 and 116 above).

(f) Conclusion on the legality of the contested decision with regard to criterion 10 of Annex III to Directive 2003/87

149 It must therefore be concluded, in light of a literal, historical, contextual and teleological interpretation, that the Commission has not demonstrated that criterion 10 of Annex III to Directive 2003/87 reduced the Member States' freedom of action as to the forms and methods for transposing the directive into national law so as to prohibit application of the ex-post adjustments at issue. In this regard, therefore, the contested decision is vitiated by an error of law.

150 It follows that the Commission committed an error of law in the application of criterion 10 of Annex III to Directive 2003/87 and that the first part of the applicant's first plea must be upheld.

3. The legality of the contested decision with regard to criterion 5 of Annex III to Directive 2003/87

(a) General points

151 In recital 4 of the contested decision, the Commission states, essentially, that the ex-post adjustments relating to the amount of allowances allocated to new entrants are

contrary to criterion 5 of Annex III to Directive 2003/87, since new entrants are unjustifiably favoured compared with operators of installations who are already covered by the German NAP, who do not benefit from such adjustments. Also, in its Communication of 7 July 2004, the Commission explains that 'the intention of [the applicant] to ... adjust the allocation of allowances to new entrants contravenes criterion 5 which requires non-discrimination in accordance with the Treaty, because the application of such ex-post adjustments would discriminate new entrants compared to the operators of other installations in respect of which no ex-post adjustments to their allocation are permitted by [Directive 2003/87]'.

152 It is to be recalled that criterion 5 of Annex III to Directive 2003/87 states that 'the [NAP] shall not discriminate between companies or sectors in such a way as to unduly favour certain undertakings or activities in accordance with the requirements of the Treaty, in particular Articles 87 [EC] and 88 [EC]'. As regards the prohibition of discrimination, paragraph 51 of the Commission guidance, concerning criterion 6 which relates specifically to new entrants, adds that the principle of equal treatment is the guiding principle relating to new entrants' access to allowances. Finally, paragraph 61 of the Commission guidance specifies that, 'in order to respect the principle of equal treatment, the methodology that a Member State uses in order to allocate allowances to new entrants should as far as possible be the same as the one used for comparable incumbents', while acknowledging, however, that 'adaptations may be made for justified reasons'.

153 It follows from the foregoing that the Commission correctly considers criterion 5, whose wording expressly refers to the concept of discrimination, to be the specific application of the general principle of equal treatment in the context of implementation by the Member States of Directive 2003/87 and, more specifically, in the context of the allocation of allowances effected on the basis of the NAPs. Furthermore, the Commission also correctly refers in the guidance to the conditions, as recognised by the case-law, governing application of the principle of equal treatment, that is to say, in particular, the need to compare the situation of

the persons concerned ('comparable incumbents') and the possibility of objectively justifying discrimination ('adaptations ... for justified reasons'). Indeed, according to that case-law, the principle of equal treatment requires that comparable situations must not be treated differently and that different situations must not be treated in the same way unless such treatment is objectively justified (see Joined Cases C-154/04 and C-155/04 *Alliance for Natural Health and Others* [2005] ECR I-6451, paragraph 115, and the case-law cited).

(b) Comparison of the respective situations of the operators concerned

154 In determining whether the Commission applied the principle of equal treatment correctly to the case in point, it is appropriate to begin by considering whether it duly verified whether or not new entrants are in an analogous situation to that of other operators of installations as regards the application of ex-post adjustments.

155 It is to be pointed out that, contrary to what the Commission appears to think, the German NAP provides for the application of ex-post adjustments in respect not only of new entrants but also of certain operators of installations who are already present on the market and covered by the German NAP.

156 First, the German NAP allows ex-post adjustments to be applied in respect of all operators in the case of a substantial reduction in production or 'de facto closure'

(see the first indent of paragraph 31 and paragraph 89 above). In this regard therefore, the Commission cannot, without having examined whether those various operators, who are also subject to the ex-post adjustment rules, are in an analogous or separate situation, properly submit in such a general manner that the German NAP provides for unequal treatment of other operators compared with new entrants.

157 Second, the German NAP provides for the application of ex-post adjustments similar to those which are applicable to new entrants in the specific case of installations whose operation began in 2003 or 2004 (see the third indent of paragraph 31 and paragraph 88 above). That is confirmed by the Zuteilungsgesetz which establishes identical revocation mechanisms for new entrants and operators who have commenced production after 2002 (see, first, Paragraph 8(4) of the Zuteilungsgesetz and, second, Paragraph 11(5), read in conjunction with Paragraph 8(4), of that Law). It is to be noted that, like the explanation given for the ex-post adjustments applicable to new entrants, the reason proffered by the applicant for the application of the adjustments concerning installations whose operation began in 2003 or 2004 is essentially a risk of 'over-allocation' resulting from the fact that the operators concerned could be prompted to provide overestimated production forecasts in the course of the allocation procedure based on the method of calculation known as 'benchmarking'. According to the applicant, no such risk exists in the case of installations in operation since at least 2002, in respect of which the method of calculation known as 'grandfathering' is applied, since this method enables relatively reliable data concerning past production volumes to be generated.

158 Having regard to the foregoing, the arguments put forward by the Commission in support of its general conclusion, in recital 4 of the contested decision, that the ex-post adjustments applicable to new entrants are contrary to criterion 5 in that they are liable to favour new entrants compared to other operators, who are not subject to the ex-post adjustment rules, are neither factually substantiated nor legally well founded.

159 First of all, neither the contested decision nor the Commission communications disclose why and to what extent new entrants would be in an analogous or a different situation compared with other operators as regards application of the ex-post adjustments. On the contrary, the contested decision clearly fails to take account of the fact that similar, or even identical, adjustments to those concerning new entrants are applicable in the case of operators of installations which commenced production after 2002.

160 In addition, as the applicant states in its third plea, the argument put forward by the Commission in the course of the present proceedings that it is advantageous for new entrants to have a possibility of subsequent correction of the amount of allowances allocated, because that allows them to overestimate production volume when submitting the application for an allocation and gives rise to laxer checks on the part of the German authorities, is manifestly contradictory and erroneous in a number of respects.

161 First, the argument that a subsequent downward correction of the allowances granted to an operator — that is to say a measure withdrawing allowances, to the detriment of the operator concerned because it deprives him of 'property' having commercial value — is liable to constitute an 'advantage' for him compared with other operators who are not subject to such a correction mechanism is contradictory. Second, that argument implies that other operators — on the assumption that they are in an analogous situation — do not have the same 'advantage', which, in any event, is not true of operators who entered the market after 2002, who are subject to the same correction mechanism.

162 Also, the contention that the incentive for new entrants to overestimate is greater where there is a possibility of ex-post adjustment than in the absence of such a

mechanism is highly speculative and also contradictory. Indeed, the contrary conclusion is called for, given the fact that every operator who is aware, when submitting his application, of the risk of an ex-post adjustment is, rather, inclined to seek to guard against it. Finally, the argument that the competent authorities are less diligent when they have a possibility of ex-post correction is not convincing either, since it is in the interest of every effective administration to avoid at the outset any subsequent complication and in particular measures of withdrawal that are time-consuming and involve the investment of significant administrative resources.

163 In light of the foregoing, recital 4 of the contested decision is manifestly contradictory and erroneous and fails manifestly to apply the conditions governing the application of the principle of equal treatment. It should be added that when the Commission reviews, under Article 9 of Directive 2003/87, the Member State's observance of criterion 5, it cannot merely assert that there is unequal treatment without having first considered, with all necessary diligence, the factors relevant in this regard, as specified by the case-law cited in paragraph 153 above, and without having taken due account of them in justifying its conclusion.

164 It follows that the Commission committed an error of law in the application of criterion 5 of Annex III to Directive 2003/87 and that the second part of the first plea must also be upheld.

165 It is nevertheless appropriate to examine the third plea given that it is closely connected with the first plea.

III — *The third plea: breach of the obligation under Article 253 EC to state reasons*

A — *Arguments of the parties*

166 The applicant states that Articles 1(a) and 2(a) of the contested decision are founded on a breach of the obligation under Article 253 EC to state reasons inasmuch as in recital 4 of that decision it is found, manifestly erroneously, on the basis of criterion 5 of Annex III to Directive 2003/87 that the ex-post adjustments unduly favour new entrants compared to the operators of other installations. In the applicant's submission, the Commission fails to have regard to the fact that, first, the NAP does not provide that new entrants may obtain additional allowances, but only that they are subject to downward ex-post adjustments, and second, the revocation of the allowances following such an adjustment constitutes a burden and not an advantage. Nor does the applicant see any advantage in the fact that, contrary to the case of existing installations, the allocation for new entrants is made on the basis of production forecasts, since that is specifically balanced by the possibility of downward ex-post adjustments. Accordingly, Articles 1(a) and 2(a) of the contested decision must be annulled for this reason too.

167 The Commission refers to its submissions that the complaint alleging infringement of criterion 5 of Annex III to Directive 2003/87 is unfounded, and concludes that the contested decision does not infringe Article 253 EC.

B — *Findings of the Court*

168 It should be observed at the outset that compliance with the obligation under Article 253 EC to state reasons, as reaffirmed in the final sentence of Article 9(3) of Directive 2003/87, which concerns decisions adopted by the Commission rejecting the whole or part of an NAP, is of particularly fundamental importance because here exercise of the Commission's power of review under Article 9(3) of the directive entails complex economic and ecological assessments and review by the Community judicature of the legality and merits of those assessments is restricted (see, to this effect, Case C-269/90 *Technische Universität München* [1991] ECR I-5469, paragraph 14).

169 The arguments put forward by the applicant in support of this plea concern, rather, the substantive legality of the contested decision as regards the application of criterion 5 of Annex III to Directive 2003/87. However, given that a plea alleging breach of the obligation to state reasons may, in any event, be raised by the Community judicature of its own motion (Case C-166/95 P *Commission* v *Daffix* [1997] ECR I-983, paragraph 24, and Case C-457/00 *Belgium* v *Commission* [2003] ECR I-6931, paragraph 102), the plea's merits should be determined.

170 In light of the findings set out in paragraphs 158 to 164 above, the Court holds that the Commission breached its duty under Article 253 EC to state reasons by failing to provide the slightest explanation regarding the application of the principle of equal treatment in the contested decision, in the Commission Communication of 7 July 2004 or in the context of the adoption of those measures. This failure to state reasons concerns in particular the ground of the contested decision according to which new entrants are in a favourable position distinct from that of the other operators as regards application of the ex-post adjustments, the lack of a comparison in the contested decision of the situation of new entrants with that of operators

subject to similar, or even identical, ex-post adjustments and the lack of an assessment by the Commission as to whether any difference in treatment might be objectively justified.

171 Consequently, the present plea must be upheld and Articles 1(a) and 2(a) of the contested decision must also be annulled on this basis.

IV — *Conclusion*

172 Given that the first and third pleas are well founded and suffice for the applicant's claims for annulment to be upheld, there is no need to rule on the second plea alleging infringement of Article 176 EC.

Costs

173 Under Article 87(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has been unsuccessful, it must be ordered to pay the costs, as applied for by the applicant.

On those grounds,

THE COURT OF FIRST INSTANCE
(Third Chamber, Extended Composition)

hereby:

1. **Annuls Article 1 of Commission Decision C(2004) 2515/2 final of 7 July 2004 concerning the national allocation plan for the allocation of greenhouse gas emission allowances notified by the Federal Republic of Germany in accordance with Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC;**

2. **Annuls Article 2(a) to (c) of that decision in so far as it directs the Federal Republic of Germany, first, to omit the measures for ex-post adjustment which are referred to therein and, second, to notify the Commission of their omission;**

3. Orders the Commission to pay the costs.

Jaeger Tiili Azizi

Cremona Czúcz

Delivered in open court in Luxembourg on 7 November 2007.

E. Coulon M. Jaeger

Registrar President

Table of contents

Legal context ..... II - 4442

Facts, procedure and forms of order sought ..... II - 4452

Law ..... II - 4463

I — Preliminary observation ..... II - 4463

II — The first plea: infringement of Article 9(3) of Directive 2003/87, read in conjunction with Annex III thereto ..... II - 4463

A — Arguments of the parties ..... II - 4463

1. Arguments of the applicant ..... II - 4463

(a) Preliminary observation ..... II - 4463

(b) Observance of criterion 10 of Annex III to Directive 2003/87 II - 4464

(c) Observance of criterion 5 of Annex III to Directive 2003/87 .. II - 4466

(d) The extent of the Commission's power of review under Article 9(3) of Directive 2003/87, read in conjunction with Annex III thereto, and the freedom of action left to the Member States by the directive ..... II - 4467

(e) The economic arguments put forward by the Commission ... II - 4469

2. Arguments of the Commission ..... II - 4471

(a) Decisiveness of the effect of the criteria in Annex III to Directive 2003/87 in the review carried out by the Commission under Article 9(3) of the directive ..... II - 4471

(b) Consistency of the German NAP with criterion 10 of Annex III to Directive 2003/87 ..... II - 4471

(c) Consistency of the German NAP with criterion 5 of Annex III to Directive 2003/87 ..... II - 4473

B — Findings of the Court ..... II - 4476

1. The allocation of tasks and powers between the Commission and the Member States and the extent of judicial review ..... II - 4476

2. The legality of the contested decision with regard to criterion 10 of Annex III to Directive 2003/87 ..... II - 4479

(a) The ex-post adjustments at issue ..... II - 4479

(b) Literal interpretation of criterion 10 of Annex III to Directive 2003/87 ..... II - 4482

(c) Historical interpretation of criterion 10 of Annex III to Directive 2003/87 ..... II - 4484

(d) Contextual interpretation of criterion 10 of Annex III to Directive 2003/87 ..... II - 4485

The relevant provisions of Directive 2003/87 and Regulation No 2216/2004 ..... II - 4485

(i) Articles 9 and 11 of Directive 2003/87 ..... II - 4485

(ii) Article 29 of Directive 2003/87 ..... II - 4488

(iii) Article 38(2) of Regulation No 2216/2004 ..... II - 4489

Effect of the Commission guidance ..... II - 4490

(i) Self-limiting effect of the Commission guidance ..... II - 4490

(ii) Interpretation of criterion 10 of Annex III to Directive 2003/87 in the light of the Commission guidance ..... II - 4492

(iii) Effect of the Commission Communication of 7 July 2004 ..... II - 4494

Conclusion on the contextual interpretation of criterion 10 of Annex III to Directive 2003/87 ..... II - 4495

(e) Teleological interpretation of criterion 10 of Annex III to Directive 2003/87 ..... II - 4495

Introductory remark ..... II - 4495

Objectives of Directive 2003/87 ..... II - 4496

Interpretation of criterion 10 of Annex III to Directive 2003/87 in the light of the directive's objectives ..... II - 4498

(i) Principal arguments of the parties ..... II - 4498

(ii) The relevant analytical criteria ..... II - 4499

— The relation existing between production volume and the emission rate in light of the objective of reducing emissions ..... II - 4500

— Reconciliation of the objective of reducing emissions with the objective of maintaining cost-effective and economically efficient conditions ..... II - 4502

— The objective of reducing emissions through improvements in technologies ..... II - 4503

— The objective of preserving the integrity of the internal market and maintaining conditions of competition ..... II - 4505

Conclusion on the teleological interpretation of criterion 10 of Annex III to Directive 2003/87 ..... II - 4507

(f) Conclusion on the legality of the contested decision with regard to criterion 10 of Annex III to Directive 2003/87 ..... II - 4508

3. The legality of the contested decision with regard to criterion 5 of Annex III to Directive 2003/87 ..... II - 4508

(a) General points ..... II - 4508

(b) Comparison of the respective situations of the operators concerned ..... II - 4510

III — The third plea: breach of the obligation under Article 253 EC to state reasons II - 4514

A — Arguments of the parties ..... II - 4514

B — Findings of the Court ..... II - 4515

IV — Conclusion ..... II - 4516

Costs ..... II - 4516