Reports of Cases

JUDGMENT OF THE COURT (Fifth Chamber)

17 October 2013 *

(Request for a preliminary ruling — Protection of the ozone layer — Scheme for greenhouse gas emission allowance trading within the Community — Method of allocating allowances — Allocation of allowances free of charge)

In Joined Cases C-566/11, C-567/11, C-580/11, C-591/11, C-620/11 and C-640/11,

REQUEST for a preliminary ruling under Article 267 TFEU from the Tribunal Supremo (Spain), made by decisions of 19, 20, 24 and 28 October 2011 and of 18 November 2011, received at the Court on 14, 21 and 25 November 2011 and on 2 and 14 December 2011, in the proceedings

Iberdrola SA,

Gas Natural SDG SA,

intervening parties:

Administración del Estado and Others (C-566/11),

Gas Natural SDG SA,

intervening parties:

Endesa SA and Others (C-567/11),

Tarragona Power SL,

intervening parties:

Gas Natural SDG SA and Others (C-580/11),

Gas Natural SDG SA,

Bizcaia Energía SL,

intervening parties:

Administración del Estado and Others (C-591/11),

Bahía de Bizcaia Electricidad SL,

intervening parties:

* Language of the case: Spanish.

Gas Natural SDG SA and Others (C-620/11),

and

E.ON Generación SL and Others (C-640/11),

THE COURT (Fifth Chamber),

composed of T. von Danwitz, President of the Chamber, K. Lenaerts, Vice-President of the Court, acting as Judge of the Fifth Chamber, A. Rosas, D. Šváby (Rapporteur) and C. Vajda, Judges,

Advocate General: J. Kokott,

Registrar: C. Strömholm, Administrator,

having regard to the written procedure and further to the hearing on 7 February 2013,

after considering the observations submitted on behalf of:

— Iberdrola SA and Tarragona Power SL, by J. Folguera Crespo, L. Moscoso del Prado González and E. Peinado Iríbar, abogados,

— Gas Natural SDG SA, by Á. Martín-Rico Sanz, procuradora, and by A. Morales Plaza and R. Espín Martí, abogados,

— Endesa SA, by F. De Borja Acha Besga and J.J. Lavilla Rubira, abogados, and by M. Merola, avvocato,

— Bizcaia Energía SL, by J. Briones Méndez, procurador, and by J. García Sanz, abogado,

— Bahía de Bizcaia Electricidad SL, by F. González Ruiz, procuradora, and by J. Abril Martínez, abogado,

— E.ON Generación SL, by J. Gutiérrez Aceves, procuradora, and by J.C. Hernanz Junquero, abogado,

— the Spanish Government, by S. Centeno Huerta, acting as Agent,

— the European Commission, by L. Banciella, E. White and K. Mifsud-Bonnici, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 21 March 2013,

gives the following

Judgment

1 These requests for a preliminary ruling concern the interpretation of Article 10 of 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).

2 The requests have been made in proceedings between a number of electricity producers and the Administración del Estado (the national administration) concerning the reduction in the remuneration for electricity production.

Legal context

European Union ('EU') law

3 The aim of Directive 2003/87, according to Recital 5 in the preamble thereto, is to contribute to fulfilling the commitments of the European Community and its Member States to reduce anthropogenic greenhouse gas emissions effectively, in accordance with 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), through an efficient European market in greenhouse gas emission allowances ('emission allowances'), with the least possible diminution of economic development and employment.

4 Recital 7 of Directive 2003/87 is worded as follows:

'Community provisions relating to allocation of allowances by the Member States are necessary to contribute to preserving the integrity of the internal market and to avoid distortions of competition.'

5 Article 1 of the directive defines its objectives as follows:

'This Directive establishes a scheme for [emission allowance] trading within the Community ... in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner.'

6 Article 10 of Directive 2003/87, entitled 'Method of allocation', provides:

'For the three-year period beginning 1 January 2005 Member States shall allocate at least 95% of the allowances free of charge. For the five-year period beginning 1 January 2008, Member States shall allocate at least 90% of the allowances free of charge.'

7 In accordance with Article 12(1) of the directive, allowances are transferable and may be traded between persons within the Community and, under certain conditions, between persons within the Community and persons in third countries.

8 Article 12(3) of Directive 2003/87 provides:

'Member States shall ensure that, by 30 April each year at the latest, the operator of each installation surrenders a number of allowances equal to the total emissions from that installation during the preceding calendar year as verified in accordance with Article 15, and that these are subsequently cancelled.'

9 In the Communication of 29 November 2006 from the Commission to the Council and to the European Parliament on the assessment of national allocation plans for the allocation of greenhouse gas emission allowances in the second period of the EU Emissions Trading Scheme accompanying Commission Decisions of 29 November 2006 on the national allocation plans of Germany, Greece, Ireland, Latvia, Lithuania, Luxembourg, Malta, Slovakia, Sweden and the United Kingdom in accordance with Directive 2003/87 (COM(2006) 725 final), it is stated that:

'As noted by the High-Level Group on Competitiveness, Energy and the Environment insufficient maturity of energy markets is alleged to have led to insufficient competitive pressure to reduce the pass-through of the value of allowances in electricity prices and hence to so-called windfall profits for electricity producers. The Group has furthermore recommended that Member States consider differentiated allocation between sectors in the second allocation period ...'

10 Recitals 15 and 19 to Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community (OJ 2009 L 140, p. 3), state that:

'(15) The additional effort to be made by the Community economy requires, inter alia, that the revised Community scheme operate with the highest possible degree of economic efficiency and on the basis of fully harmonised conditions of allocation within the Community. Auctioning should therefore be the basic principle for allocation, as it is the simplest, and generally considered to be the most economically efficient, system. This should also eliminate windfall profits and put new entrants and economies growing faster than average on the same competitive footing as existing installations.

...

(19) Consequently, full auctioning should be the rule from 2013 onwards for the power sector, taking into account its ability to pass on the increased cost of CO_2 ...'

Spanish law

11 Directive 2003/87 was transposed into Spanish law by Law 1/2005 regulating the greenhouse gas emissions trading scheme (Ley 1/2005 por la que se establece un régimen para el comercio de derechos de emisión de gases de efecto invernadero) of 9 March 2005 (BOE No 59 of 10 March 2005, p. 8405; 'Law 1/2005'). That law imposes an obligation on every operator of a production unit with a rated thermal input exceeding 20 MW to surrender, by 30 April each calendar year, a number of emission allowances equal to the total verified emissions of greenhouse gases from that installation during the preceding calendar year. For the purposes of the surrender, the operators may use both the allowances which were allocated to them for each installation under the national allocation plan and those bought on the emission allowances market. Article 16 of Law 1/2005 provides that the allocation of allowances under the national allocation plan 'is to be free' during the period from 2005 to 2008.

12 Following the adoption of Law 54/1997 on the Electricity Sector (Ley 54/1997 del sector eléctrico) of 27 November 1997 (BOE No 285 of 28 November 1997, p. 35097) transposing into Spanish law the European directives on the internal electricity market, the activity of electricity production in Spain is open to all operators who meet the technical and financial conditions laid down.

13 A wholesale electricity market was set up in accordance with Law 54/1997. It is supervised by the Compañía Operadora del Mercado de Electricidad SA, a private entity entrusted with impartially ensuring market transparency and the independence of market participants. The market operates in accordance with a balancing mechanism which matches the energy demand for each programming period with the offers received for the same period. The energy is sold at the price offered by the producer which was last to be admitted to the system and whose admission was necessary if electricity demand was to be met. It is a 'marginalist' market in which all producers whose offers are accepted receive the same 'marginal' price, which corresponds to the offer made by the operator of the last production unit to be admitted. That price is set at the intersection of the curves of energy supply and demand.

14 In 2006, the Spanish Government regulated by royal decree the electricity tariffs applicable to consumers in such a way that they cover, inter alia, the electricity prices set on the on-the-day market. A growing tariff deficit emerged because subsequent royal decrees failed to take fully into account the costs arising in relation to electricity production on the open market.

15 On 24 February 2006, the Consejo de Ministros (Council of Ministers) adopted Royal Decree-Law 3/2006 (Real Decreto-Ley 3/2006, BOE No 50 of 28 February 2006, p. 8015, and corrigendum, BOE No 53 of 3 March 2006, p. 8659; 'Royal Decree-Law 3/2006'), which entered into force on 1 March 2006 and the main aim of which is to amend the mechanism used in Spain for matching the offers to sell electricity and the bids to purchase it, submitted simultaneously on the on-the-day and intraday electricity generation markets by operators from the same entrepreneurial group.

16 Article 2 of Royal Decree-Law 3/2006, entitled 'Greenhouse gas emission allowances under the 2006-2007 National Allocation Plan', provides for the remuneration of electricity production to be reduced by an amount equivalent to the value of the emission allowances allocated free of charge to electricity producers in accordance with the 2005-2007 National Allocation Plan, during the corresponding periods.

17 As justification for that reduction, the explanatory memorandum for Royal Decree-Law 3/2006 refers to the fact that electricity producers opted for 'integration of the value of the [emission allowances] in the formation of prices in the wholesale electricity market'. It also provides the following explanation:

'In addition, the taking into account of the value of the [emission allowances] in the formation of prices in the wholesale electricity market is intended to reflect [that integration] by reducing, by equivalent amounts, the remuneration payable to the generating units concerned. Furthermore, the sharp increase in tariff deficit during 2006 makes it advisable to deduct the value of the emission allowances for the purposes of determining the amount of that deficit. The existing risk of high prices in the electricity-generation market, with their immediate and irreversible negative effects on end-consumers, justifies the urgent adoption of the provisions laid down in the present measure and the exceptional nature of those provisions.'

18 On 15 November 2007, the Ministro de Industria, Turismo y Comercio (Ministry of Industry, Tourism and Commerce) adopted, pursuant to Article 2(3) of Royal Decree-Law 3/2006, Ministerial Order ITC/3315/2007 regulating, for 2006, the reduction of remuneration for electricity production by an amount equivalent to the value of the greenhouse gas emission allowances allocated free of charge (Orden ministerial ITC/3315/2007 sobre la regulación para el año 2006 de la minoración de la retribución de la actividad de producción de energía eléctrica en el importe equivalente al valor de los derechos de emisión de gases de efecto invernadero asignados gratuitamente, BOE No 275 of 16 November 2007, p. 46991, 'Ministerial Order ITC/3315/2007'). In that connection, it is specified in the preamble to that ministerial order that 'the sum by which the remuneration for production plants is to be reduced shall be equivalent to the surplus income obtained through the incorporation in sale offers of the cost of emission allowances allocated free of charge'.

The disputes in the main proceedings and the question referred for a preliminary ruling

19 The applicants in the main proceedings – electricity producers in Spain – brought actions before the Chamber for Contentious Administrative Proceedings of the Audiencia Nacional (High Court) for annulment of Ministerial Order ITC/3315/2007, claiming, inter alia, that the order is contrary to Directive 2003/87 in so far as it neutralises the 'free of charge' nature of emission allowances.

20 Those actions were dismissed by the Audiencia Nacional, which held that the Order did not neutralise the 'free of charge' nature of emission allowances.

21 The applicants in the main proceedings brought appeals before the Tribunal Supremo (the Supreme Court) against the judgments of the Audiencia Nacional. The Tribunal Supremo has doubts regarding the concept of 'allocation free of charge' as used in Directive 2003/87.

22 First, it is arguable that Directive 2003/87 does nothing to stop Member States from precluding electricity producers from passing on in the wholesale price for electricity the cost of emission allowances allocated to them free of charge.

23 Secondly, according to the Tribunal Supremo, those measures could have the effect of neutralising the 'free of charge' nature of the initial allocation of emission allowances and undermining the very purpose of the scheme established by Directive 2003/87, which is to reduce greenhouse gas emissions by means of an economic incentive mechanism.

24 In those circumstances, the Tribunal Supremo decided to stay the proceedings and to refer the following question, which is framed in the same terms in Cases C-566/11, C-567/11, C-580/11, C-591/11, C-620/11 and C-640/11, to the Court of Justice for a preliminary ruling:

'May Article 10 of Directive [2003/87] be interpreted as not preventing application of national legislative measures of the kind under review in these proceedings, the purpose and effect of which are to reduce remuneration for electricity production by an amount equivalent to the value of the [emission allowances] allocated free of charge during the relevant period?'

25 By Order of the President of the Court of 18 January 2012, Cases C-566/11, C-567/11, C-580/11, C-591/11, C-620/11 and C-640/11 were joined for the purposes of the written and oral procedure and of the judgment.

Consideration of the question referred

26 By its question, the referring court asks, in essence, whether Article 10 of Directive 2003/87 must be interpreted as precluding application of national legislative measures, such as those at issue in the main proceedings, the purpose and effect of which are to reduce remuneration for electricity production by an amount equal to the increase in such remuneration brought about through the incorporation, as an additional production cost, in the selling prices offered on the wholesale electricity market, the value of the emission allowances allocated free of charge.

27 As is apparent from its wording – according to which, during the period at issue, Member States are to allocate at least 95% of the emission allowances free of charge – Article 10 of Directive 2003/87 precludes charges imposed in respect of the allocation of allowances.

28 On the other hand, neither Article 10 nor any other provision of the directive concerns the use of emission allowances or expressly restricts the right of Member States to adopt measures which may affect the economic implications of using emission allowances.

29 Consequently, Member States are free, as a rule, to adopt economic policy measures, such as price controls on the markets for certain goods or essential resources, determining the manner in which the value of the emission allowances allocated free of charge to producers is to be passed on to consumers.

30 Nevertheless, the adoption of such measures must not neutralise the principle that emission allowances are allocated free of charge; nor may it undermine the objectives pursued by Directive 2003/87.

31 As regards the first aspect, it should be noted that the allocation 'free of charge' under Article 10 of Directive 2003/87 precludes not only the direct fixing of a price for the allocation of emission allowances but also the subsequent levying of a charge in respect of their allocation.

32 In the present case, as is apparent from the recitals to Royal Decree-Law 3/2006 and from Ministerial Order ITC/3315/2007, the rules at issue in the main proceedings are designed to ensure that the consumer does not bear the effects of the incorporation, in the selling prices offered on the electricity market, of the value of emission allowances allocated free of charge.

33 The Spanish electricity producers in question have incorporated, in the selling prices that they offer on the wholesale electricity market, the value of the emission allowances, in the same way as any other production cost, even though those allowances had been allocated to them free of charge.

34 As the referring court explains, that practice is undoubtedly cogent from an economic point of view, in so far as an undertaking's use of emission allowances allocated to it represents an implied cost, known as an 'opportunity cost', which consists in the income that the undertaking has forgone by not selling those allowances on the emission allowances market. However, the combination of that practice with the pricing system on the electricity generation market in Spain results in windfall profits for electricity producers.

35 It should be noted that the on-the-day electricity trading market in Spain is a 'marginalist' market in which all producers whose offers have been accepted receive the same price, that is, the price offered by the operator of the last production unit to be admitted to the system. Since, during the period concerned, that marginal price was determined by the offers from operators of combined gas and steam power plants – technology attracting free emission allowances – the incorporation of the value of the allowances into the selling prices offered is passed on in the overall market price for electricity.

36 Accordingly, the reduction in remuneration provided for in Ministerial Order ITC/3315/2007 applies not only to undertakings that have received emission allowances free of charge, but also to power plants that do not need allowances, such as hydroelectric and nuclear power plants, as the emission allowance value incorporated in the costs structure is passed on in the price for electricity, which is received by every producer active on the wholesale electricity market in Spain.

37 Furthermore, as can be seen from the documents before the Court, the rules at issue in the main proceedings take into account factors other than the quantity of allowances allocated: in particular, the type of power plant and its emission factor. The reduction in remuneration for electricity production provided for under those rules is calculated in such a way that it absorbs only the extra charged as a result of the opportunity costs relating to emission allowances being incorporated in the price. This is confirmed by the fact that the levy is not incurred where power plant operators sell allowances allocated free of charge on the secondary market.

38 Accordingly, the aim of the rules at issue in the main proceedings is not subsequently to impose a fee for the allocation of emission allowances, but to mitigate the effects of the windfall profits accrued through the allocation of emission allowances free of charge on the Spanish electricity market.

39 It should be noted, in that regard, that the allocation of emission allowances free of charge under Article 10 of Directive 2003/87 was not intended as a way of granting subsidies to the producers concerned, but of reducing the economic impact of the immediate and unilateral introduction by the European Union of an emission allowances market, by preventing a loss of competitiveness in certain production sectors covered by that directive.

40 As was stated in paragraph 9 above, insufficient competitive pressure to limit the extent to which the value of emission allowances is passed on in electricity prices has led electricity producers to make windfall profits. As can be seen from recitals 15 and 19 to Directive 2009/29, it is in order to eliminate windfall profits that, with effect from 2013, emission allowances are to be allocated by means of a full auctioning mechanism.

41 It follows that the mechanism established by Directive 2003/87 for the allocation of emission allowances free of charge does not require electricity producers to be able to pass on the value of those allowances in electricity prices and thus make windfall profits.

42 Consequently, the concept of 'free of charge' allowances as used in Article 10 of Directive 2003/87 does not preclude rules such as those at issue in the main proceedings, under which the remuneration for electricity producers is to be reduced in order to counterbalance windfall profits resulting from the allocation of emission allowances free of charge, provided that – as was pointed out in paragraph 30 above – they do not undermine the objectives pursued by that directive.

43 As regards that second aspect, it should be noted that the principal objective of Directive 2003/87 is to reduce greenhouse gas emissions substantially. That objective must be attained in compliance with a series of sub-objectives and through recourse to certain instruments. The principal instrument for that purpose is the EU scheme for greenhouse gas emissions trading. As indicated in recitals 5 and 7 to Directive 2003/87, among the other sub-objectives to be fulfilled by the scheme are the safeguarding of economic development and employment and the preservation of the integrity of the internal market and of conditions of competition (see, Case C-505/09 P *Commission* v *Estonia* [2012] ECR, paragraph 79).

44 Consequently, the question that arises in the present case is, more specifically, whether, by counterbalancing the windfall profits accrued as a result of the allocation of allowances free of charge, the rules at issue in the main proceedings undermine the purpose of the system established by Directive 2003/87 for reducing emissions, based on the incorporation of environmental costs into the product price.

45 It should be noted, in the first place, that the allocation of emission allowances free of charge was a transitional measure intended to prevent undertakings from losing competitiveness as a result of the scheme for emission allowance trading. Accordingly, it is not directly related to the environmental objective of reducing emissions.

46 In the second place, it should be noted that the rules at issue in the main proceedings do not affect the emission allowances market, but rather the windfall profits made by all electricity producers in Spain as a result of the value of those allowances being incorporated into the price quoted in the offers accepted for the purposes of setting prices on the wholesale electricity market, in light of the fact that it is a 'marginalist' market.

47 Undertakings may use their free emission allowances for their electricity production activities or they may sell them on the emission allowances market, depending on the value of those allowances on the market and the profits that they could accordingly yield.

48 It should be stated, in the third place, that the rules at issue in the main proceedings do not compromise the environmental objective of Directive 2003/87, which is to encourage the reduction of emissions.

49 First, in order to reduce greenhouse gas emissions, Directive 2003/87 introduced an emissions trading scheme. As provided in Article 1 of that directive, the incentive to reduce emissions is to be cost-effective and economically efficient, it being understood that the producer may decide to invest in more efficient technologies emitting less greenhouse gas, or to use more emission allowances, or even to scale back production, choosing the most economically advantageous option. In view of the fact that, under the rules at issue in the main proceedings, the value of emission allowances can be converted into money by selling them, it is clear that the rules do not have the effect of deterring electricity producers from reducing greenhouse gas emissions.

50 Second, the costs relating to greenhouse gas emissions have been incorporated into the selling prices offered by producers on the wholesale electricity market. As higher production costs weaken their position on that market, electricity producers have an incentive to reduce the emissions associated with their activities.

51 Lastly, Law 1/2005 requires electricity producers to surrender each year a number of emission allowances equal to the total verified emissions from the production plant during the preceding calendar year and to ensure that those allowances are subsequently cancelled, in accordance with Article 12(3) of Directive 2003/87.

52 However, a number of producers have claimed, in observations submitted to the Court, that the reduction in the remuneration for electricity production, at issue in the main proceedings, is designed in such a way that it negates the incentive to reduce greenhouse gas emissions.

53 It is true that, according to the replies to the written questions put by the Court, the formula laid down in Ministerial Order ITC/3315/2007 for calculating that reduction could cause the operator of an electrical power plant which has reduced its greenhouse gas emissions to have to pay a higher amount by way of levy.

54 However, the Spanish Government stated that that additional cost does not cancel out the profit generated from involvement in emission allowance trading.

55 In that regard, it should be noted that the incentive to reduce the emissions of each power plant lies in the advantage to be gained by reducing its need for emission allowances, which have a financial value that can be converted into money through their sale, whether or not they have been allocated free of charge.

56 Moreover, in order for Directive 2003/87 to attain its objective of reducing greenhouse gas emissions in a cost-effective and economically efficient manner, it is not necessary, as was noted in paragraph 41 above, for undertakings to pass on in consumer prices the costs relating to emission allowances allocated to them free of charge.

57 Additionally, since, on the Spanish electricity generation market, a single price is paid to all producers and the end consumer has no knowledge of the technology used to generate the electricity that he consumes and the tariff for which is set by the State, the extent to which electricity producers may pass on in prices the costs associated with the use of emission allowances has no impact on the reduction of emissions.

58 It follows that, although a levy lowering the remuneration for electricity production, such as that imposed by the rules at issue in the main proceedings, may diminish the incentive to reduce greenhouse gas emissions, it does not remove that incentive entirely.

59 In the light of all the foregoing considerations, the answer to the question is that Article 10 of Directive 2003/87 must be interpreted as not precluding application of national legislative measures, such as those at issue in the main proceedings, the purpose and effect of which are to reduce remuneration for electricity production by an amount equal to the increase in such remuneration brought about through the incorporation, in the selling prices offered on the wholesale electricity market, of the value of the emission allowances allocated free of charge.

Costs

60 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the referring court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Fifth Chamber) hereby rules:

Article 10 of 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 must be interpreted as not precluding application of national legislative measures, such as those at issue in the main proceedings, the purpose and effect of which are to reduce remuneration for electricity production by an amount equal to the increase in such remuneration brought about through the incorporation, in the selling prices offered on the wholesale electricity market, of the value of the emission allowances allocated free of charge.

[Signatures]