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Sauter, W.; Vedder, H.B.B.

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By

Wolf Sauter and Hans Vedder

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State Aid and Selectivity in the Context of Emissions Trading: Comment on the *NOx* Case

Wolf Sauter
Tilburg University

Hans Vedder*
University of Groningen

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Abstract

Article 107(1) TFEU only applies to State measures that favour certain undertakings or productions. This concept of selectivity features prominently in a number of recent cases and plays a controversial role in Commission and Court practice in the application of art.107(1) to seemingly general schemes. In this recent appeal from a judgment of the General Court, the highest EU Court examined the Netherlands scheme for NOx emissions trading from a State aid perspective and, notably, the selectivity criterion. The ECJ found for the Commission on the ground that the measure was selective because only the largest polluters had been granted (tradable, and hence valuable) emission rights free of charge. However, the largest polluters were also the only ones caught by the scheme and it would have been impossible to determine the value of the rights up-front in a dynamic cap scheme. The approach chosen by the Court casts doubt on the ability of Member States to design national schemes that avoid the State aid rules even if they are in line with EU environmental policy. This comment also addresses the wider implications of the Court's interpretation of selectivity in the light of recent case law where the Commission and EU Courts are restricting national tax sovereignty.

Introduction

The *NOx* case[1] concerned the implementation in the Netherlands of Directive 2001/81 on emission ceilings (NEC Directive) with regard to nitrogen oxides, for which the Directive sets a cap to be achieved by 2010.[2] The Dutch had introduced a so-called "dynamic cap system" assigning tradable emission rights to each of the 250 largest polluters starting in 2004, based on a thermal installation capacity greater than 20 MWth. This scheme was notified to, and cleared by, the European Commission as Treaty-compatible State aid. The Netherlands appealed this decision, however, essentially in order to avoid the applicability of the procedural regime that attaches to State aid measures. Thus the Netherlands contested whether aid was involved before the General Court, which ruled in favour of the Netherlands on the argument that the measure concerned was not selective.[3] The Court of Justice found for the Commission on the issue of selectivity and overturned the judgment of the General Court, with the result that the Commission Decision was reinstated in full force. It also resolved a significant procedural point by ruling that a decision classifying a measure as State aid, even if it declares it compatible with the internal market, constitutes a challengeable

* We are grateful to Leigh Hancher and Stefan Weishaar for their comments.
[1] *European Commission v Kingdom of the Netherlands* (C-279/08 P) September 8, 2011 (*NOx*).
[2] Directive 2001/81 on national emission ceilings for certain atmospheric pollutants [2001] OJ L309/22.
[3] *Netherlands v Commission* (T-233/04) [2008] E.C.R. II-591; [2008] Env. L.R. 42.

act under art.263 of the Treaty on the Functioning of the European Union (TFEU). In this comment, we first discuss the factual background, prior stages and main elements of the *NOx* case itself, followed by our analysis and conclusions.

Factual background

The above-mentioned NEC Directive lays down national emissions ceilings. In practice this means that emissions of NOx in the Netherlands could not exceed 260 kilotonnes in 2010. The Directive does not specify the design of this scheme. To comply with the obligation, the Netherlands developed, alongside generally applicable measures on pollution control, a national NOx trading regime for the approximately 250 large industrial companies that were responsible for the bulk of NOx emissions in that Member State. This trading regime was put in place partly to reduce the compliance costs of the scheme for large emitters. These undertakings did not belong to any particular sector of production or share any commonality apart from emitting NOx and having an installed thermal capacity above a certain threshold, i.e. above 20 MWth. The standard used was a so-called relative emission standard or a "dynamic cap system" because it reflected the maximum allowable NOx content per unit of energy consumed.[4]

This system may be contrasted with a "cap and trade" system, where there is a fixed cap corresponding to the maximum allowed emissions and there are tradable emission rights corresponding to this cap. In both systems, there are a certain number of tradable rights available to all polluters that fall under the system. This quantity of rights corresponds to the emissions of these polluters (i.e. one tradable right corresponds to 1 tonne of emissions). The number of available rights is then reduced over the years and a polluter that has reduced emissions to a level below the number of rights available to him will be able to sell or bank these rights. Another polluter unable or unwilling to reduce emissions will then have to buy or borrow rights because, at the end of the year, a number of rights corresponding to the actual emissions will have to be surrendered. The trading takes place in a stock market-like environment.

The environmental effect of both trading schemes thus comes from a progressive reduction of the number of rights available. In a cap and trade scheme, the number of available allowances is reduced over the years. In a dynamic cap system, the environmental benefit is achieved by means of a progressively tighter emissions performance standard (i.e NOx-efficiency) in relative terms. Both schemes aim to ensure that emissions are reduced efficiently, i.e. first by those undertakings who could do so most cost-effectively.

The impact on competition of these two types of emissions trading schemes is different. An advantage of the dynamic cap system is that entrants do not have to acquire emissions rights before they can enter the market. Under a cap and trade system, this problem is solved by creating a reserve for entrants. Furthermore, in a cap and trade system emissions rights must be capped and distributed over the parties engaged in trading. This may occur several times. In the EU emissions trading scheme (ETS), for example, we are currently in the second trading period, meaning that initial allocation through so-called national allocation plans has now taken place twice.[5] Emission rights may be allocated either free of charge (a practice often referred to as grandfathering), or at a charge, for example through an auction. In a dynamic cap system this initial distribution is not necessary. In terms of environmental effectiveness, a dynamic cap system has one main disadvantage compared with a cap and trade scheme, which is that in a dynamic cap system there is no absolute maximum to the emissions. Even tighter emissions standards in relation to increased energy use (i.e. in relative terms) may still result in more overall emissions if more energy is

[4] This is also referred to as the performance standard rate (PSR) system; cf. S. Weishaar, *Towards Auctioning: The Transformation of the European Greenhouse Gas Emissions Trading System* (Austin: Wolters Kluwer, 2009), p.58.

[5] See *http://ec.europa.eu/clima/policies/ets/allocation/2005/index_en.htm* and *http://ec.europa.eu/clima/policies/ets/allocation/2008/index_en.htm* [Both accessed April 26, 2012].

used (e.g. as a result of economic growth). This is one of the primary reasons why the EU ETS for greenhouse gases that was launched in 2003 is based on the cap and trade model.[6]

Both schemes may provide for some flexibility; for example, because emissions rights may be set aside for later use (banking) or indeed taken from future emissions (borrowing). In the Dutch NOx scheme, undertakings were allowed a certain margin for excess emissions to be compensated for in the following year. However, this was discouraged by the fact that a more than full eventual compensation in emission reductions was required (by an additional 25 per cent), and by financial penalties where undertakings failed to meet their required emission targets altogether.

The Commission Decision

The Dutch NOx scheme as described above was notified to the Commission in January 2003, which took its clearance Decision in June of that same year.[7] In the view of the Dutch authorities, the NOx scheme did not form an aid within the meaning of art.107(1) TFEU primarily because no State resources were involved and the authorities did not allocate NOx emissions allowances.

With reference to prior decisions concerning environmental standards, the Commission distinguished two types of schemes: (1) those where a tradable document is considered to be an intangible asset (of a financial instrument) representing a market value that the authorities could have sold or auctioned[8]; or (2) systems where such a document is considered to be a non-transferable proof of a certain production.[9] In this context, the Commission noted the emergence of a market in, and considerable value of, tradable emission or pollution documents in the Netherlands. The Commission considered the emissions trade system as comparable to a direct allowance allocation, and noted that the tradable NOx emission documents would represent a value to their recipient. Finally, because the Dutch State did not collect revenues by means of a permit or auction system, the Commission held that State resources were granted implicitly to the beneficiary undertakings. As these benefits would accrue to a specific group of undertakings, their position with relation to their competitors would thereby be strengthened, and trade between the Member States would be affected. Hence the Commission decided that the notified scheme constituted aid within the meaning of art.107(1) TFEU.

However, taking into account the absence of EU rules on the type of market organisation involved, given that the scheme was in compliance with such EU legislation on pollution caps as did exist, and since the Dutch scheme took a multi-sectoral approach as well as because emission trading is a competition-oriented instrument to achieve emission targets, the Commission found the aid concerned to be compatible with art.107(3)c TFEU (and art.61(3)c of the EEA Agreement). The Commission did, however, impose a reporting obligation on the Dutch authorities.

[6] Directive 2003/87 establishing a scheme for greenhouse gas emission allowance trading within the Community [2003] OJ L275/32, as amended by Directive 2009/29 [2009] OJ L140/63. For a discussion of this scheme, see J.H. Jans and H.H.B. Vedder, *European Environmental Law* (Groningen: Europa Law Publishing, 2012), pp.434–440.

[7] Commission Decision of June 24, 2003, State Aid No.N 35/2003, the Netherlands—NOx emission trading scheme [2003] OJ C227/8.

[8] Commission Decision of March 29, 2000, State Aid No.N 653/1999, Denmark—CO2-quota system [2000] OJ C322/9; Commission Decision of November 28, 2001, State Aid No.N 416/2001, United Kingdom—Emission trading scheme [2002] OJ C88/16.

[9] Commission Decision of July 25, 2001, State Aid No.N 550/2000, Belgium—Green electricity certificates [2001] OJ C330/3.

The General Court's Decision

The Netherlands subsequently appealed the Commission Decision to the General Court, arguing that this Decision should be annulled insofar as it held that the contested measure constituted an aid.[10] The Commission in turn argued that an action against a Decision approving aid had no legal effects capable of affecting the interests of the Netherlands and should therefore be declared inadmissible. The General Court decided the case in 2008. It first pointed out that, based on art.263(2) TFEU, the Netherlands as a Member State alongside the Community institutions is a privileged party that does not have to demonstrate a legal interest in bringing proceedings for annulment of acts of the Commission. Secondly, because the Decision triggered reporting obligations[11] and the classification of the scheme as aid could affect the grant of new aid,[12] it was held to give rise to binding legal effects. Finally, the Netherlands had called into question the operative part of the Decision concerning the classification of the contested scheme as State aid. Hence the General Court found the action to be admissible. The substantive arguments centred on the (lack of) advantage financed through State resources and on the (lack of) selectivity.

Lack of advantage

According to the Netherlands, the scheme formed a burden on the undertakings concerned and did not constitute an advantage. It claimed that, as in *PreussenElektra*, there had been no transfer of State resources.[13] The Commission, by contrast, emphasised that emission allowances were made available free of charge and could have been sold or auctioned at a market price. In addition, it pointed out that by trading emission allowances undertakings could avoid fines.

The General Court agreed that by making allowances tradable, the Netherlands conferred a market value on them as intangible assets. This tradability of NOx emission allowances then constituted an advantage for the undertakings concerned. At the same time these assets were conferred on the undertakings free of charge, forgoing State resources. The General Court did not find the precedent of *PreussenElektra* raised by the Netherlands to be relevant: that scheme imposed an obligation to purchase among the relevant operators but was not based on emission or pollution allowances. Consequently, an advantage granted through State resources was found to exist in the context of the NOx scheme.

Lack of selectivity

The standard to be applied according to the General Court was whether, under a particular statutory scheme, a State measure favours certain undertakings or the production of goods within the meaning of art.107(1) TFEU in comparison with other undertakings which are in a comparable legal and factual situation, in the light of the aim of the measure concerned.[14] In this regard it found, first, that the application of the measure in question was objective, by targeting the largest polluters without any geographic or sectoral connotation and, secondly, that only those undertakings were constrained by the emissions cap under the scheme. The General Court held that,

[10] *Netherlands v Commission* (T-233/04) [2008] E.C.R. II-591.

[11] With reference to Council Regulation 659/1999 laying down detailed rules for the application of art.93 of the EC Treaty (now art.108) [1999] OJ L83/1 arts 17–19 and 21.

[12] Community guidelines on state aid for environmental protection [2008] OJ C82/1, point 8.

[13] *PreussenElektra AG v Schleswag AG, in the presence of Windpark Reußenköge III GmbH and Land Schleswig-Holstein* (C-379/98) [2001] E.C.R. I-2099; [2001] 2 C.M.L.R. 36.

[14] With reference to *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirektion für Kärnten* (C-143/99) [2001] E.C.R. I-8365; [2002] 1 C.M.L.R. 38 at [41].

> "that objective criterion is furthermore in conformity with the goal of the measure, that is, the protection of the environment and with the internal logic of the system."[15]

The Commission had produced no evidence that other producers who found themselves in a comparable legal or factual situation were subject to stricter requirements. Hence the measure in question did not derogate from a general scheme. The use of a 20MWth energy consumption threshold and the limitation of the number of undertakings under the scheme were held insufficient to establish the selectivity of the measure. In sum, the General Court held that the measure in question was not selective.

It added (in the alternative) that even if the measure were in principle to be regarded as selective, this differentiation arose from the nature or general scheme of the system of which it was part, which meant that it did not fulfil the selectivity condition.[16] That is to say, the NOx scheme was acceptable as jointly beneficial to the environment and justified by the overall structure of which it was part. Hence the General Court concluded that the NOx scheme could not be classified as State aid and annulled the Commission's 2003 Decision.

The Opinion of the Advocate General

A.G. Mengozzi concluded in favour of upholding the appeal filed by the Commission and annulling the judgment of the General Court, and dismissing the cross-appeals (see further below) as well as the action at first instance. As subsequently quoted by the Court, the Advocate General noted that a mistaken classification of a measure as State aid has legal consequences for the notifying State in the form of monitoring and periodic checks which reduce its freedom of manoeuvre.[17] As regards the issue of selectivity, he argued that a differentiation of undertakings based on a quantitative criterion, such as the thermal capacity threshold of 20 MWth in the *NOx* case, could not be regarded as inherent to a scheme intended to reduce industrial pollution and could therefore be justified only on environmental grounds.[18] With regard to the issue of State resources, the Advocate General reasoned that by turning emission allowances into tradable tangible assets and making them available free of charge, instead of selling them or putting them up for auction, the Member State concerned forgoes public resources. This could not, in his view, be seen as inherent in an emission allowance trading scheme, as the Member State concerned has a choice between allocating these allowances free of charge or charging for them.[19]

The Court of Justice

Like the General Court, the Court of Justice had to address the ground of admissibility as well as selectivity. In addition, there were cross-appeals by the Netherlands and Germany concerning the findings on advantage and the use of State resources by the General Court. The admissibility of an appeal against a Decision classifying a measure as State aid as compatible with the internal market was quickly accepted by the ECJ based on the same reasoning as the General Court.

Selectivity

The selectivity argument raised by the Commission concerned both (1) the General Court's finding that there was no issue of the NOx scheme favouring certain undertakings, and (2) that even if there was

[15] *Netherlands v Commission* (T-233/04) [2008] E.C.R. II-591 at [88].
[16] Cf. *Adria Wien* (C-143/99) [2001] E.C.R. I-8365 at [42].
[17] Opinion of A.G. Mengozzi December 22, 2010 in *NOx* (C-279/08 P) at [24] and [27].
[18] Opinion of A.G. Mengozzi in *NOx* (C-279/08 P) at [55].
[19] Opinion of A.G. Mengozzi in *NOx* (C-279/08 P) at [87] and [92].

selectivity, this was compensated for by the environmental benefit and justified by the nature and the overall structure of the scheme.

Not favouring certain undertakings

The ECJ found that the application of an objective criterion to establish the number of undertakings able to claim an entitlement did not call into question its selective character—proving only that it is part of an aid scheme and not an individual aid.[20] The ECJ also found that the General Court had held that the measure applied to large undertakings without any further geographic or sectoral distinction. Contrary to what the Commission argued, the General Court had therefore not simply ruled that there was no selectivity on the ground that the measure was governed by an objective criterion.

However, the ECJ next turned to the question of the burden of proof on the Commission to demonstrate the selective nature of the contested measure. Here it found that the Commission must prove that the measure in question produces differences between undertakings that, taking into account the measure's objective, are in a comparable factual and legal situation. The Member State, in turn, must show that any differentiation is justified by the nature and general scheme of the system concerned.[21] In that respect, the ECJ found that it was sufficient for the Commission to have established the fact that the undertakings concerned enjoyed an advantage that was not available to other undertakings:

> "Those undertakings enjoy the advantage of being able to monetise the economic value of the emission reductions they achieve, by converting them into tradable emission allowances or, as the case may be, avoiding the risk of having to pay fines when they exceed the NOx emission limit per unit of energy laid down by the national authorities by buying such emission allowance from other undertakings falling within the measure in question … whereas the other undertakings do not have those possibilities, that being sufficient, in principle, to establish that the Kingdom of the Netherlands has created a differentiation between undertakings … ."[22]

At the same time, every undertaking in the Netherlands must comply with general obligations regarding the reduction of NOx emissions—whether or not it falls under the scheme. Consequently the Commission was not required to go into further detail on this point in its Decision and its appeal in this respect was upheld by the Court of Justice. In other words, having established the existence of an advantage, as in identifying a general obligation of NOx emissions controls and a selective group with trading privileges in this regard, it was not charged with an additional burden of proof as regards selectivity.

Beneficial and justified in context

The second branch of the appeal concerning selectivity concerned the question whether the aims or the effects of the scheme were decisive, as well as the role of the nature or overall structure of the scheme of which the contested measure was part. The ECJ stated that, according to settled case law, art.107(1) TFEU did not distinguish between objectives or causes but defined State measures in relation to their effects.[23] An objective such as environmental protection that was one of the essential aims of the European Union could be taken into account when assessing the compatibility of the measure pursuant to art.107(3) TFEU—but not to exclude selective measures from the scope of the prohibition in art.107(1) TFEU.[24]

[20] With reference to *Spain v Commission* (C-409/00) [2003] E.C.R. I-1487; [2003] 2 C.M.L.R. 24 at [48]–[49].
[21] With reference to *Netherlands v Commission* (C-159/01) [2004] E.C.R. I-4461 at [42]–[43].
[22] *NOx* (C-279/08 P) September 8, 2011 at [63].
[23] With reference to *Spain v Commission* (C-409/00) [2003] E.C.R. I-1487 at [46]; and *British Aggregates Association v Commission and United Kingdom* (C-487/06 P) [2008] E.C.R. I-10505; [2009] 2 C.M.L.R. 10 at [92].
[24] A point also made in the context of *British Aggregates* (C-487/06 P) [2008] E.C.R. I-10505 at [92].

Moreover the emissions covered by the NOx scheme were not sufficient to avoid classification of the scheme as a selective measure, as the quantitative differentiation involved could not be regarded as inherent to a scheme to reduce industrial pollution. Because it was the Member State that had introduced this distinction between undertakings, it was up to that Member State to justify that the differentiation concerned was required by the nature and general scheme of the system in question. Hence the distinction based on a thermal installation capacity greater than 20 MWth was not justified.

The cross-appeals

The Netherlands and Germany had lodged a cross-appeal contesting the findings of the General Court concerning advantage and regarding the concept of financing through State resources.

Advantage revisited

Concerning advantage, the Netherlands argued that the amount of traded allowances was not laid down in advance and depended entirely on the additional reductions achieved by the undertakings in relation to the standard. Germany argued that the financial advantage obtained constituted consideration for the efforts made by the undertakings concerned. Here, the ECJ held that the NOx scheme constituted the creation of a market by the State by means of authorising the sale and acquisition of emission allowances, making them tradable. Concerning the issue of consideration, it pointed out that the costs concerned were charges to which the budget of an undertaking is normally subject. The difference between the costs of acquiring emission allowances for undertakings and the costs needed to reduce NOx emissions were, according to the Court, an advantage to them. Consequently it established the existence of an advantage that could not have been obtained by the recipient undertaking under normal market conditions.

State resources

The Netherlands argued that the General Court had wrongly distinguished the *NOx* case from *PreussenElektra*, since there was no direct or indirect transfer of State resources as the result of the distribution of an additional financial burden by means of the NOx scheme. According to Germany, the undertakings themselves created their own assets under the scheme: the State did not invest subject to the private market investor test, but created a normative framework. The Court of Justice held that, in the first place, it was not necessary to establish in every case that there had been a transfer of State resources for the advantage granted to be capable of being regarded as a State aid.[25] Secondly, the tradability of NOx allowances could lead to the avoidance of the payment of fines, and the creation of emission rights without consideration paid to the State meant that it has forgone income which could have been made from their sale or auction.

As regards *PreussenElektra*, the ECJ held that the General Court had correctly distinguished that judgment from the *NOx* case because, in the former case, the negative financial repercussions of the scheme at issue and the resultant reduction of tax receipts were unavoidable, and producers of renewable energy were not placed at a particular advantage. In the present case, however, the State had a choice between allocating the allowances free of charge, or selling or auctioning them. This meant that there was a direct link between benefits accrued and revenue forgone that did not exist in *PreussenElektra*.

[25] Cf. *France v Commission* (C-482/99) [2002] E.C.R. I-4397; [2002] 2 C.M.L.R. 41 at [36].

The obligation to state reasons

The Netherlands claimed that the Commission had failed to state reasons for the Decision and erred in fact on the question whether undertakings that fail to meet their NOx emission standard can nevertheless receive NOx credits. The Commission replied that this was so because every producer emitting NOx receives emission credits free of charge. The ECJ held that this concerned more an error of fact than a failure to state reasons with regard to a finding of State aid and must therefore be dismissed.[26]

Outcome

The outcome of the case was therefore that the position of the General Court on the existence of advantage was confirmed, but otherwise its judgment was set aside insofar as it annulled the contested Commission Decision. Hence the Commission was confirmed in its conclusion that the advantage derived from the contested measure was applied selectively. As a procedural point, the right of Member States to appeal against Commission Decisions that had declared aid to be compatible with the internal market was confirmed.

Comment

This judgment is significant because it sheds further light on the selectivity criterion in art.107(1) TFEU. We find that the widely different interpretations of this criterion produce a degree of legal uncertainty that is unacceptable in view of the impact of the State aid rules on Member State sovereignty.

Admissibility

As the above summary has shown, the two judgments in the *NOx* case dealt succinctly with the admissibility of an appeal against a decision declaring a measure to be aid while finding it compatible with the internal market. However, this does not mean that it was a moot point. Admissibility requires that the contested decision results in a distinct change in the legal position of the applicant, and this is why the objective of the notification matters. Member States seeking a declaration that a certain measure does not constitute State aid are therefore well advised to notify explicitly with a view to obtaining an art.4(2) decision that requires the Commission to issue a decision finding that the measure does not constitute State aid.[27] An art.4(3) decision where the Commission finds that the measure constitutes State aid that is compatible with the internal market is less attractive. Because the latter triggers a reporting duty and ongoing Commission supervision, the Member State's room for manoeuvre in implementing the notified measure is restricted.[28]

This brings us to an apparent trend in the case law of the Court concerning similar negative clearance decisions in other areas of EU competition law. The term "negative clearance decision" refers to the Commission's appraisal of restrictive agreements under art.101 TFEU at the time when Regulation 17 of

[26] On three other points raised by the Netherlands, i.e. (1) the question whether the emission credits were offered free of charge; (2) whether "dynamic cap" schemes are to be preferred over "cap and trade" schemes; and (3) the effect on trade which was found to be inherent in the involvement of the largest industrial producers of NOx emissions, the ECJ similarly found that the Commission's reasoning was not defective.

[27] This refers to art.4(2) of Regulation 659/1999.

[28] *NOx* (C-279/08 P) September 8, 2011 at [41]. For a comparable case concerning art.101(1) and 101(3) TFEU, cf. *O2 (Germany) GmbH & Co OHG v Commission* (T-328/03) [2006] E.C.R. II-1231; [2006] 5 C.M.L.R. 5.

1962 was still in force.[29] The Commission then occupied a similarly central position with respect to the enforcement of art.101 TFEU as it does today regarding art.107 TFEU. The applicability of art.101(1) TFEU (the finding of an infringement) and the nullity sanction in art.101(2) TFEU applied objectively, i.e. independently of a Commission finding. Awarding exemptions based on art.101(3) TFEU was, however, the Commission's exclusive domain. This situation resembles the application of art.107(1) TFEU for a finding of aid in contrast to the Commission's monopoly in applying art.107(2) and (3) TFEU in applying exemptions. As a rule, the Commission, in both general competition law and the State aid system, has preferred to find an infringement and then grant an exemption (negative clearance) to carrying out a balancing test as regards the initial finding of an infringement (sometimes called a rule of reason).

In this context, the Commission's apparent desire to place the clearance part of an exemption decision outside the scope of judicial review under art.263 TFEU essentially means removing its balancing of the interests involved from scrutiny. Incidentally the Commission has shown the same inclination in relation to art.102 TFEU, regarding dominance abuse, on two occasions: first, in *Deutsche Telekom*, where the application of national sector-specific regulation did not rule out the applicability of art.102 TFEU, thus enabling Commission enforcement[30]; and, secondly, in the more recent *Tele2 Polska* case, where the Court held that art.5 of Regulation 1/2003 precluded a national competition authority from adopting a negative clearance decision on art.102 TFEU so as not to "undermine the power of the Commission".[31]

The common trait of the latter two cases and the *NOx* case is that the Commission seeks to ensure that the concurrent application of (national) competition law and/or sector-specific rules by national authorities does not limit the Commission in its own application of the various competition prohibitions in the Treaty. In *Deutsche Telekom* and *Tele2 Polska*, the Court was susceptible to the Commission's arguments concerning concurrent application to such an extent that it effectively blocked access to review by the European Courts. Hence, in our view, the admissibility discussion in the *NOx* case concerns both the Commission's position in the interpretation of art.107(1) TFEU and the pre-emption of judicial review. The finding in favour of admissibility is thus a clear step in the right direction.

Selectivity

The most contentious part of the judgment relates to the selectivity of the Dutch NOx scheme. The Court's approach is pragmatic and functional: whether or not a measure constitutes State aid depends on the effects.[32] Selectivity essentially involves the equality principle because one undertaking may not be favoured compared with another undertaking in a comparable situation.[33] However, comparability is determined in the light of the objective pursued by the measure in question. This means that the equality test that would make a measure non-selective is not an absolute one. On the contrary, this equality is to be determined in the light of the objectives of the measure. With respect to the NOx scheme at issue, this would require taking account of the objectives of the scheme. These objectives are not just related to achieving

[29] This Regulation has now been replaced with Regulation 1/2003 [2003] OJ L1/1. Under Regulation 17, negative clearance referred to decisions on the non-applicability of art.101(1) TFEU, whereas exemption was the terminology used for decisions where art.101(3) TFEU was applied.

[30] *Deutsche Telekom AG v Commission* (T-271/03) [2008] E.C.R. II-477; [2008] 5 C.M.L.R. 9, confirmed by *Deutsche Telekom AG v Commission* (C-280/08 P) [2010] 5 C.M.L.R. 27.

[31] *Prezes Urzedu Ochrony Konkurencji i Konsumentów v Tele2 Polska sp. z o.o., devenue Netia SA (Tele2 Polska)* (C-375/09) May 3, 2011 at [19]–[30].

[32] *NOx* (C-279/08 P) September 8, 2011 at [51].

[33] *NOx* (C-279/08 P) September 8, 2011 at [52]. See further on this point *Commission v Gibraltar and UK* (C-106/09 P and C-107/09 P) (Gibraltar Tax Reform) [2012] 1 C.M.L.R. 44 at [101], where the Court refers to discrimination between companies in a comparable situation with regard to the objective of the measure.

environmental protection, however, but also aim to minimise the compliance and administrative costs involved.[34]

The latter two objectives are important for all types of regulation and essentially result from the fact that the compliance and administrative costs involved generally increase with the number of entities regulated. Moreover, the Dutch Government explicitly argued that its choice for an emissions trading scheme was motivated by a desire to reduce compliance costs for the industry in line with the justification for choosing trading instruments generally.[35] In this situation, the central question is whether the 250 large emitters are in a comparable situation to that in which the other emitters of NOx in the Netherlands find themselves. Here the General Court found that there was no comparability on two grounds. First, the criterion based on amount of pollution meant the measure was aimed exclusively at the largest NOx emitters. Secondly, the fact that these large emitters were the only ones to which the performance standard rate applied meant that only they could sell credits or would have to buy them in order to comply with the scheme and avoid penalties.[36]

In the absence of a comparable situation, the group of undertakings within the scheme and the group outside of it could be treated differently without the advantage given to one group being selective. This reasoning was not accepted by the ECJ, which held that all undertakings emitting NOx are under emissions regulations and thus in a comparable situation.[37] This is also connected to the idea that the Commission is not under a burden of proof to go beyond determining whether a scheme gives "an appreciable advantage to recipients in relation to their *competitors*".[38] Here, the Court of Justice appears to equate *comparability* arising from the fact that NOx emissions regulations apply with the concept of *competition.* It should be obvious that competition was not at stake here as the 20MWth criterion selected was based on thermal capacity, not by sector or activity, i.e. meant adopting a cross-sectoral approach to undertakings that otherwise have little in common.

The ECJ's narrow interpretation of the possibility to objectively justify differentiated treatment of undertakings that are not comparable in view of the objective pursued by the measure prompts the following critical observations.[39] In the first place, environmental measures such as the NOx trading scheme rarely pursue exclusively environmental objectives. Environmental objectives are invariably balanced with those related to competitiveness and limiting the administrative burdens on the undertakings involved. Generally this balancing reduces the environmental effectiveness of the measure concerned, as higher levels of environmental protection also mean greater internalisation of external costs and therefore potentially compromise the competitiveness of the industry compared with competitors located in other jurisdictions. Hence observing the environmental objective in isolation does not allow an accurate assessment of comparability. In relation to the Dutch NOx emissions trading scheme, compliance costs and administrative costs should have been taken into account as well, as minimising these costs was always a part of the

[34] In this regard, we point to the opt-out possibility for smaller installations (with a thermal capacity up to 30 MW) in view of the disproportionate administration costs. This opt-out would concern approximately 40 installations of the 250 installations covered by the trading scheme whereas the NOx emitted by these installations accounts for only 1.5%: TK 2004-2005 29766, No.13, at p.2, *https://zoek.officielebekendmakingen.nl/kst-29766-13.html* [Accessed April 26, 2012]. See further Commission Decision of June 24, 2003, State Aid No.N 35/2003, the Netherlands—NOx emission trading scheme [2003] OJ C227/8, p.6, where the Commission refers to the Netherlands' intention to broaden the scope after experience has been gathered.

[35] Commission Decision of June 24, 2003, State Aid No. N 35/2003, the Netherlands—NOx emission trading scheme [2003] OJ C227/8, p.2.

[36] *Netherlands v Commission* (T-233/04) [2008] E.C.R. II-591 at [88]–[90].

[37] *NOx* (C-279/08 P) September 8, 2011 at [63], [64].

[38] *NOx* (C-279/08 P) September 8, 2011 at [65] (emphasis added).

[39] Cf. B. Kurcz and D. Vallindas, "Can General Measures Be … Selective? Some Thoughts on the Interpretation of a State Aid Definition" (2008) 45 C.M.L. Rev. 159, who, at 172, qualify this possibility as purely theoretical.

scheme's objective.[40] This was not taken into account at EU level by the Commission, the General Court or the Court of Justice. Yet, at the same time, non-environmental objectives are taken into account in legislation at EU level: in fact, the EU ETS is all about a combined environmental/efficiency objective.[41]

Secondly, this failure to acknowledge that environmental measures are rarely restricted to environmental protection touches upon the discretion necessary to set the environmental thresholds. In connection with the EU ETS, the Court had to deal with this question in *Arcelor*.[42] Arcelor, a producer of steel and thus within the scope of the EU ETS, argued that the fact that plastics and aluminium manufacturers remained outside the scope of the EU ETS distorted competition on the broader market for packaging materials.[43] Here the Court not only accepted the dual environmental and efficiency objectives of the EU ETS,[44] it also acknowledged that a restriction in scope that results in unequal treatment may nevertheless be objectively justified in view of the administrative costs and the step-by-step approach chosen by the EU legislature.[45] Hence the fact that the producers of other materials remained outside the scope of the EU scheme on efficiency grounds was considered to be justifiable. Therefore it appears that the ECJ applies a double standard of review when evaluating administrative cost-related arguments by the Member States and the EU legislature respectively.

This becomes all the more relevant when the ECJ's strict attitude towards competitiveness arguments as part of state aid supervision is taken into account. In both *Adria-Wien* and the more recent *British Aggregates*, the ECJ found against the national eco-taxation schemes at issue essentially because the exemptions created from the eco-tax were designed to protect the competitiveness of the industry.[46] Yet competitiveness concerns feature very prominently in the EU ETS scheme in the shape of the carbon leakage regime and the possibility to deal with indirect carbon leakage as a result of high electricity prices.[47] These double standards and much of the reluctance to decide things differently on the part of the ECJ can probably be explained by the fact that the effect of allowing such a justification on the basis of a combined environmental and competitiveness objective would be that a Member State could then exclude an entire category of measures from the scope of art.107(1) TFEU simply by redefining their objective.[48]

The boundaries to State aid supervision: efficiencies and Article 107 TFEU

However, we wonder whether the Commission and ECJ did not overstretch the concept of aid in order to exercise influence on the Dutch scheme. This relates to a more general criticism in relation to the application of the selectivity criterion to tax schemes, such as those in the *Adria-Wien* and *British Aggregates* cases already mentioned. Moreover, the NOx emissions trading scheme has an effect similar to an ecotax, in

[40] See the opt-out possibility for smaller installations (with a thermal capacity up to 30 MW), and the explanatory memorandum to the proposal, TK 2004-2005 29766, No.3, at pp.4 and 40, *https://zoek.officielebekendmakingen.nl /kst-29766-3.html* [Accessed April 26, 2012].

[41] Directive 2003/87 establishing a scheme for greenhouse gas emission allowance trading within the Community [2003] OJ L275/32 as amended by Directive 2009/29 [2009] OJ L140/63 art.1; and *Société Arcelor Atlantique et Lorraine v Premier ministre, Ministre de l'Écologie et du Développement durable and Ministre de l'Économie, des Finances et de l'Industrie* (C-127/07) [2008] E.C.R. I-9895; [2009] Env. L.R. D10 at [28]–[32].

[42] *Arcelor* (C-127/07) [2008] E.C.R. I-9895 at [28]–[32].

[43] *Arcelor* (C-127/07) at [21].

[44] *Arcelor* (C-127/07) at [31]–[33].

[45] *Arcelor* (C-127/07) at [60], [61].

[46] *Adria-Wien* (C-143/99) [2001] E.C.R. I-8365 at [52]–[54]; and *British Aggregates* (C-487/06 P) [2008] E.C.R. I-10505 at [65] and [88].

[47] Directive 2003/87 establishing a scheme for greenhouse gas emission allowance trading within the Community [2003] OJ L275/32 as amended by Directive 2009/29 [2009] OJ L140/63 arts 10a and 10b. See further: H.H.B. Vedder, "The Climate Challenge to Competition" in M.M. Roggenkamp and U. Hammer (eds), *European Energy Law Report VII* (Antwerp: Intersentia 2011), pp.3–20.

[48] This is a risk explicitly pointed out by the Commission: *NOx* (C-279/08 P) September 8, 2011 at [70].

that the government imposes a measure that is designed to attach a cost to environmental pollution and thus create an incentive to invest in emissions abatement. The only difference is that the incentive is not fixed by the government, but by the market.

The Commission Decision, in particular, clearly demonstrates the doubts the Commission has on the environmental effectiveness, complexity and administration costs of the dynamic cap trading scheme.[49] Differences of opinion on the realism of the Commission's doubts aside,[50] the fact remains that these touch upon a Member State's sovereignty to decide upon a certain method to implement a Directive that does not specify the methods allowed to reach the required emissions ceilings. Given the Commission and ECJ stance on the possibility to sell or auction the tradable credits, this becomes even more problematic. It can be taken to indicate a poor understanding of this type of emissions trading.

Hence the ECJ in its judgment in *NOx* starts from the assumption that the "emission allowances"[51] have an economic value for the undertaking participating in the trading scheme and could have been sold or auctioned "if [the Member State] had structured that scheme differently."[52] However, the introduction of a sales or auctioning mechanism would have been virtually impossible and quite possibly inefficient in the context of a dynamic cap scheme. In such a scheme, credits are acquired based on actual performance over any given year and then traded: they are thus more closely linked to performance than to tradable rights created ex ante in the abstract as in a cap and trade system. Forcing the creation of ex ante trading rights in a dynamic cap context distorts the incentives to lower emissions cost-effectively because instead of focusing on reducing emissions and thus creating facts, it requires second-guessing the actions of the other undertakings involved, which does not contribute to an effective functioning of the market in trading rights.[53]

Apart from the mix-up of cap and trade with credit trading that we see here,[54] effectively imposing an auction obligation seems to overstep the limits to the powers that the Commission and the EU Courts exercise when supervising State aid controls. The exclusive purpose of that supervision is to examine whether the conditions of art.107(1) TFEU are met in relation to an actually existing scheme. It is not to argue that alternative versions of a scheme would have been conceivable, in particular where the NEC Directive left considerable discretion to the Member States as to the method by which they wanted to achieve the agreed emission reductions. Doubts about the efficiency of a scheme should not result in unduly classifying it as a measure caught by art.107(1) TFEU. However, once a measure is caught on the merits, it makes sense that subsequently the efficiency of the scheme can play a role in determining the nature of the conditions attached to the art.107(3) TFEU decision. These two separate parts of the test should not be mixed up.

Conclusions

The *NOx* case warrants three principal conclusions in our opinion. First, the applicability of judicial review to art.108(3) TFEU decisions finding aid compatible with the internal market is to be welcomed. Secondly, as regards selectivity, the level of legal uncertainty perpetuated by the present case is no longer workable. In connection with the *NOx* case, the Dutch Government considered that it was free in its choice of

[49] Commission Decision of June 24, 2003, State Aid No. N 35/2003, the Netherlands—NOx emission trading scheme [2003] OJ C227/8, p.5.

[50] While cap and trade schemes are indeed less complex in theory, anyone familiar with the current EU ETS in practice would find it difficult to argue that is an uncomplicated system.

[51] *NOx* (C-279/08 P) September 8, 2011 at [102], [106].

[52] *NOx* (C-279/08 P) September 8, 2011 at [106].

[53] Cf. Weishaar, *Towards Auctioning* (2009), p.179.

[54] Emissions allowances are the tradable units used in the EU ETS, which is a cap and trade scheme. Using this terminology in connection with credit trading shows a poor understanding of emissions trading.

instrument so long as it would attain the emissions ceilings prescribed in Directive 2001/81, which imposed only partial harmonisation in this respect. In practice, however, the shared environmental competence (art.4(2)e TFEU) appears to be severely restricted by means of State aid supervision. Yet selectivity is the dividing line between Member State tax sovereignty and EU State aid supervision, giving rise to the constitutional question as to whether tax sovereignty is in danger in the European Union.[55] Also, it is difficult to see how an instrumental interpretation of selectivity could not be anything but counter-productive by opening up the floodgates of EU State aid supervision for cases where this is not warranted. This increased power for the Commission seems, however, to be a recent trend in the ECJ's case law.[56]

Thirdly, efficiencies appear to have found their way into the application of art.107(1) TFEU, just as they have been introduced into art.101(1) TFEU, often referred to as a rule of reason.[57] This is remarkable because the Commission itself has long opposed this trend with regard to art.101(1) TFEU. In itself this trend may be welcome. However, the absurd effect of the *NOx* case would be that the Dutch Government could have escaped State aid supervision by opting for what is arguably the less efficient instrument. The efficiency test applied could therefore have been more tolerant of national preferences, and more effective, at the same time.

[55] The judgment in *Gibraltar Tax Reform* (C-106/09P and C-107/09P) [2012] 1 C.M.L.R. 44 suggests that this tax sovereignty is limited. *Banco Bilbao Vizcaya Argentaria v Commission* (T-429/11) [2011] OJ C282/46, is one of a number of cases dealing with the selectivity of a Spanish fiscal scheme that was found to entail State aid: see Decision C (2010) 9566, concerning C45/2007.

[56] As is also evidenced by *Gibraltar Tax Reform* (C-106/09P and C-107/09P) [2012] 1 C.M.L.R. 44.

[57] See recently, *Pierre Fabre Dermo-Cosmetique SAS v President de l'Autorite de la Concurrence* (C-439/09) [2011] 5 C.M.L.R. 31 at [40].