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Case No: 2010-1043

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 11/05/2012

Before :

MR JUSTICE ANDREW SMITH

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Between :

	Deutsche Bank AG	**Claimant**
	- and -	
	Total Global Steel Ltd	**Defendant**

- -
- -

Orlando Gledhill (instructed by **Norton Rose LLP**) for the **Claimant**
Claire Staddon (instructed by **Millbank**) for the **Defendant**

Hearing dates: 23, 24, 25 & 26 January 2012

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Judgment

Mr Justice Andrew Smith:

1. The claimant, Deutsche Bank AG ("DB"), claims damages of €5,781,000 from the defendant, Total Global Steel Ltd ("TGS"), for breach of four contracts made on 10, 11 and 12 March 2010 by which DB acquired from TGS through the European Union Emissions Trading System ("EUETS") for €5,737,440 a total of 492,000 Certified Emissions Reductions ("CERs"), which are instruments created under the Kyoto Protocol to the United Nations Framework Convention on Climate Change ("UNFCCC"). DB's claim is that the contracts provided that the CERs "may be used for determining compliance with emissions limitation commitments pursuant to and in accordance with the [EUETS]". They complain that the CERs that they acquired from TGS did not meet that requirement (i) because they had previously been "surrendered" under the EUETS, that is to say exchanged for allowances, and the European Commission, as regulator of the EUETS, had introduced and published in December 2009 and January 2010 a check that prevented surrendered CERs from being used for compliance purposes under it, and (ii) in any case, they argue, surrendered CERs could not legally have been so used. (I shall adopt the expression "surrendered CERs" as a convenient label, and I shall refer to CERs that have not been surrendered as "conventional CERs". I shall later have to examine what it means for a CER to be "surrendered" and in particular whether, once surrendered, it can again be so used under the EUETS.) DB's claim for damages is made on the basis that the instruments that

they acquired were valueless as at 22 March 2010 (when they say damages should be assessed) or at any relevant time.

2. TGS deny that they were in breach of the contracts, although they accept that they supplied surrendered CERs. They dispute that they were obliged to deliver CERs that could be used under the EUETS for determining compliance with commitments. They also say that, if the contracts did provide that the instruments should be such as "may be used for determining compliance with emission limitation commitments pursuant and in accordance with the EUETS", then:

   i) On the true construction of the contracts their obligation was to provide instruments that met the *legal* requirements of the EUETS for such use, and the surrendered CERs did so; and it is irrelevant that *in fact* the European Commission had introduced procedures that prevented or hampered their use; and
   ii) In any case, DB have not shown that steps taken by the regulator in fact prevented such use.

3. With regard to DB's claim for damages, TGS:

   i) dispute that the CERs were valueless at the proper date for assessment of DB's damages, which TGS submit is 15 March 2010; and

   ii) contend that DB did not mitigate their loss, in particular in that DB did not move the CERs out of their account which was subject to the EUETS before 19 April 2010, when new regulations prevented them from doing so, and therefore they were unable to sell or dispose of the CERs thereafter.

4. The main issues between the parties are therefore these:

<u>Liability</u>

   i) Were TGS obliged to deliver to DB under the contracts CERs that "may be used for determining compliance with emissions limitations commitments pursuant to and in accordance with" the EUETS?

   ii) If so, does that term mean only that TGS were obliged to deliver CERs that met the legal requirements for such use, or were they also in breach of their obligations if procedures such as the check introduced by the European Commission in fact prevented such use?

   iii) If TGS were obliged to deliver CERs that could in fact be used as specified, did the procedures introduced by the European Commission prevent this?

   iv) Did the surrendered CERs delivered by TGS meet the legal requirements for the specified use under the EUETS?

Quantum of damages

v) At what date are damages to be assessed?

vi) Did the surrendered CERs have any value at the material date?

vii) Did DB fail to act reasonably because they did not move the CERs out of the EUETS before 19 April 2010?

viii) If so, did this prevent DB from reducing their loss?

The Kyoto Protocol

5. CERs are a creature of the Kyoto Protocol to the UNFCCC. Article 3 of the Kyoto Protocol obliges countries listed in Annex I (which are, characteristically, developed countries who have agreed to be bound by the Protocol) to ensure that their "aggregate anthropogenic carbon dioxide equivalent emissions of [specified] greenhouse gases" do not exceed their "assigned amounts" calculated in accordance with their emissions limitation and reduction commitments. The six specified gases include carbon dioxide, nitrous oxide and hydrofluorocarbons ("HFCs"). The commitments are intended to reduce overall emissions of the specified gases by at least 5% below 1990 levels in the first commitment period, which is 2008-2012.

6. The basic unit for measuring compliance under the Kyoto Protocol with emissions commitments is the Assigned Amount Unit (or "AAU"). Countries which have entered into commitments need AAUs corresponding with their emissions, and, if their emissions exceed their allocations of AAUs, they need to acquire from elsewhere AAUs or (as I shall explain) units equivalent to AAUs in order to meet their obligations.

7. Several eastern European countries, including Hungary, have large surpluses of AAUs, largely because their industries that emitted greenhouse gas have been in decline since the early 1990's, if not before. These surplus units are known as "hot air" AAUs, an expression which reflects the belief of some that the emissions of these countries will not exceed the levels to which they are committed whether or not they take action to protect the environment of the kind that the Kyoto Protocol was intended to achieve.

8. I have referred to units equivalent to AAUs. Article 12 of the Kyoto Protocol establishes the Clean Development Mechanism ("CDM"), under which projects may be undertaken in developing countries that reduce greenhouse emissions produced there. The reductions achieved from these projects are certified by way, in particular, of CERs. The purpose is to encourage projects to reduce greenhouse gas emissions in developing countries, where, it is thought, reductions may be achieved more readily than in the developed world. Developed countries that have entered into emissions reduction commitments meet the costs of reducing emissions generated in the developing world and thereby acquire CERs that count towards their own commitments. In effect developed countries that so acquire CERs take credit under the Kyoto Protocol system for emissions reductions elsewhere, and thereby can meet their commitments without themselves reducing emissions of greenhouse gas as they would have to do otherwise.

9. Another unit that can, subject to specified limitations, be deployed under the Kyoto Protocol as an equivalent to an AAU is an Emissions Reductions Unit ("ERU"), which is a creature of the so-called Joint Implementation Mechanism. (CERs and ERUs are sometimes referred to as "Joint Implementation Credits".) This provides for credits for emissions reduction projects in developed countries with Kyoto Protocol commitments.

10. Most of the CERs that DB acquired from TGS (some 94%) derived from projects in India, China and Korea for reducing emissions of HFC-23, a powerful greenhouse gas. However, for reasons which are immaterial for present purposes, the supposed environmental benefits from projects to reduce HFC-23 emissions are controversial, some emissions reduction schemes do not recognise units relating to HFC-23, and the European Commission announced a decision in November 2010 that from May 2013 it will not recognise HFC-23 units under the EUETS. A small number of the units acquired by DB from TGS (some 4%) derived from nitrous oxide decomposition projects in Korea and China: the European Commission, for similar reasons, also decided not to recognise such units from May 2013.

EUETS

11. The EUETS is one of the primary mechanisms by which the European Union and its member states seek to meet their obligations under the Kyoto Protocol. It is a "cap-and-trade" system, that is to say a system under which the relevant authorities set an overall "cap" on emissions and require those covered by the policy to keep their overall emissions within the cap and to surrender allowances corresponding to their emissions. Allowances are transferrable and may be bought by those whose emissions exceed the allowances that they have. Thus, allowances are traded, not only by those who are obliged to limit their emissions but by brokers and other intermediaries.

12. The EUETS is designed to work in conjunction with the system established by the Kyoto Protocol, but it is a separate trading system. The Kyoto Protocol system binds states to keep emissions of specified gases emanating within their borders within agreed limits. On the other hand, the EUETS requires "operators" which themselves emit the gas, typically large industrial concerns, to keep within limits emissions of specified kinds. Until 2013 the EUETS is concerned with only carbon dioxide, although thereafter it will be directed also to nitrous oxide and perfluorocarbons.

13. Mr Daniel Radov and Ms Elizabeth Bossley, who gave expert evidence for DB and TGS respectively, agreed that the EUETS is the largest market for emissions credits, measured both by volume of trading and by value, and it accounts for the majority of trade in emissions allowances and credits. I refer to Mr Radov's evidence to give the general picture: in terms of volumes the EUETS accounted for 82% of emissions units traded in 2010, and in terms of value they accounted for 85%.

14. The basic units for measuring compliance under the EUETS are "EU Allowances", or "EUAs". The first phase, phase 1, of the EUETS was from 2005–2007, and phase 2 is from 2008-2012, coinciding with the first Kyoto Protocol commitment period. EUAs are simply AAUs held in a national registry that had been "tagged" to identify them as subject to the EUETS, and so transactions in them are subject to checks both for compliance with the Kyoto Protocol and also under the EUETS (although from 2013

EUAs are to be separate allowances from AAUs).

15. The EUETS was established under the EU Scheme Directive, directive 2003/87/EC (the "Directive"). The recitals to the Directive include these:

> "3. The ultimate objective of the [UNFCCC] is to achieve stabilisation of greenhouse gas concentrations in the atmosphere at a level which prevents dangerous anthropogenic interference with the climate system."
>
> "4. Once it enters into force the Kyoto Protocol … will commit the Community and its Member States to reducing their aggregate anthropogenic emissions of greenhouse gasses listed in Annex A to the Protocol by 8% compared to 1990 levels in the period 2008 to 2012."
>
> "5. The Community and its Member States have agreed to fulfil their commitments to reduce anthropogenic greenhouse gas emissions under the Kyoto Protocol jointly, … . 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."
>
> "11. Member States should ensure that the operators of certain specified activities hold a greenhouse gas emissions permit and that they monitor and report their emissions of greenhouse gases specified in relation to those activities…."
>
> "19. Project-based mechanisms including Joint Implementation (JI) and the [CDM] are important to achieve the goals of both reducing global greenhouse gas emissions and increasing the cost-effective functioning to the Community scheme. In accordance with the relevant provisions of the Kyoto Protocol and the Marrakech Accords, the use of the mechanisms should be supplemental to domestic action and domestic actions will thus constitute a significant element of the effort made."
>
> "26. Notwithstanding the multifaceted potential of market-based mechanisms, the European Union strategy for climate change mitigation should be built on a balance between the Community scheme and other types of Community, domestic and international action."

16. Article 4 of the Directive provides that, "Member States shall ensure that, from 1 January 2005, no installation undertakes any [specified] activity resulting in [specified] emissions unless its operator holds a permit" issued by a national authority (or the operator's installation is temporarily excluded from the EUETS). By article 16 Member States are to lay down rules on penalties applicable for infringements of national provisions adopted under the Directive. By article 19 the European Commission is to adopt a regulation "for a standardised and secured system of registries in the form of

standardised electronic databases containing common data elements to track the issue, holding, transfer and cancellation of allowances … and to ensure that there are no transfers which are incompatible with the obligations resulting with the Kyoto Protocol". By article 20 the Directive provides for a central administrator, which has been established under the name Communities Independent Transaction Log, or "CITL":

> "1. The Commission shall designate a Central Administrator to maintain an independent transaction log recording the issue, transfer and cancellation of allowances.
>
> 2. The Central Administrator shall conduct an automated check on each transaction in registries through the independent transaction log to ensure there are no irregularities in the issue, transfer and cancellation of allowances.
>
> 3. If irregularities are identified through the automated check, the Central Administrator shall inform the Member State or Member States concerned who shall not register the transactions in question or any further transactions relating to the allowances concerned until the irregularities have been resolved".

17. The EUETS did not at first permit the use of CERs or ERUs to meet commitments. However by Directive 2004/101/EC (the "Linking Directive") the scheme was amended to allow them to be used (as well as EUAs). Recital 5 to the Linking Directive stated:

> "Member States may allow operators to use, in the Community scheme, certified emission reductions (CERs) from 2005 and emission reduction units (ERUs) from 2008. The use of CERs and ERUs by operators from 2008 may be allowed up to a percentage of the allocation to each installation, to be specified by each Member State in its national allocation plan. The use will take place through the issue and immediate surrender of one allowance in exchange for one CER or ERU. An allowance issued in exchange for a CER or ERU will correspond to that CER or ERU."

Thus CERs, created as instruments under the Kyoto Protocol, are permitted units under the EUETS. In the years between 2008 and 2010 CERs represented some 5% of the 5.6 billion tonnes of emissions rights submitted for compliance with the EUETS. However their use is subject to some restrictions (in addition to the limit on how many CERs an operator can deploy): for example, the EUETS prohibits the use of CERs generated by nuclear facilities and from land use, land use change and forestry activities; and it requires member states to ensure that specified criteria and guidelines are observed for CERs generated from hydro-electric power production activities.

18. This last requirement is reflected in references to "non-hydro" CERs or "non-large hydro" CERs in the discussions between DB and TGS around the time that the disputed contracts were made. "Hydro" CERs are from large hydroelectric power production activities (that is, activities with a generating capacity of more than 20 MW), and states are obliged, when approving such project activities, to ensure that internationally recognised criteria will be respected during the development. There has been

inconsistency between states about the interpretation of these criteria, and trading in hydro CERs is not straightforward, major exchanges have been reluctant to deal in them and they are less valuable than other CERs. Accordingly, purchasers sometimes seek confirmation from their counterparty that they are buying "non-hydro" CERs or "non-large hydro" CERs.

19. When the scheme was amended so as to permit the use of CERs and ERUs, the Linking Directive introduced article 11a of the Directive which concerned "Use of CERs and ERUs from project activities in the Community scheme". The Directive defines a CER as "a unit issued pursuant to Article 12 of the Kyoto Protocol and the decisions adopted pursuant to the UNFCCC or the Kyoto Protocol". Article 11a provides as follows:

> "1. Subject to paragraph 3, during [phase 2 and each five year period thereafter], Member States may allow operators to use CERs and ERUs from project activities in the Community scheme up to a percentage of the allocation of allowances to each installation, to be specified by each Member State in its national allocation plan for that period. This shall take place through the issue and immediate surrender of one allowance by the Member State in exchange for one CER or ERU held by the operator in the national registry of its Member State.
>
> …
>
> 2. Subject to paragraph 3, during [phase 1] Member States may allow operators to use CERs from project activities in the Community scheme. This shall take place through the issue and immediate surrender of one allowance by the Member State in exchange for one CER. Member States shall cancel CERs that had been used by operators during [phase 1].
>
> 3. All CERs and ERUs that are issued and may be used in accordance with the UNFCCC and the Kyoto Protocol and subsequent decisions adopted thereunder may be used in the Community scheme;
>
> (a) except that, in recognition of the fact that, in accordance with the UNFCCC and the Kyoto Protocol and subsequent decisions adopted thereunder, Member States are to refrain from using CERs and ERUs generated from nuclear facilities to meet their commitments pursuant to Article 3(1) of the Kyoto Protocol and in accordance with Decision 2002/358/EC, operators are to refrain from using CERs and ERUs generated from such facilities in the Community scheme during [phases 1 and 2];
>
> and
>
> (b) except for CERs and ERUs from land use, land use change and forestry activities."

20. The expression "allowance" is defined in the Directive as:

> "… an allowance to emit one tonne of carbon dioxide equivalent during a specified period, which shall be valid only for the purposes of meeting the requirements of this Directive and shall be transferable in accordance with the provisions of this Directive."

21. I should also refer to article 21a of the Directive, another article introduced by the Linking Directive, that provides that,

> "In accordance with the UNFCCC, the Kyoto Protocol and any subsequent decision adopted for their implementation, the Commission and the Member States shall endeavour to support capacity-building activities in developing countries and countries with economies in transition in order to help them take full advantage of [joint implementation] and [CDM] in a manner that supports their sustainable development strategies and to facilitate the engagement of entities in [joint implementation] and [CDM] project development and implementation."

22. The Regulation adopted by the Commission under article 19 of the Directive is Commission Regulation, number 2216/2004, of 21 December 2004 (the "Regulation"). Article 5 of the Regulation provides for the establishment of the CITL. It states that the Central Administrator shall "operate and maintain the [CITL] in accordance with the provisions of this Regulation", and that "The Central Administrator shall only perform processes concerning allowances, verified emissions, accounts or Kyoto units where necessary to carry out its functions as Central Administrator". With regard to CERs and ERUs, article 53 of the Regulation (as amended) provided at the relevant time as follows:

> "The use of CERs and ERUs by an operator in accordance with Article 11a of Directive 2003/87/EC in respect of an installation shall take place through an operator requesting the registry administrator to:
>
> (a) transfer a specified number of CERs or ERUs for a specified year from the relevant operator holding account into the Party [i.e. Member State] holding account of that registry;
>
> (b) enter the number transferred CERs and ERUs into the section of the surrendered allowance table designated for that installation for that year.
>
> From 1 January 2008 onwards, the registry administrator shall only accept requests to use CERs and ERUs up to a percentage of the allocation made to each installation, as specified by that administrator's Member State in its national allocation plan for that period.

> The transfer and entry shall take place in accordance with the allowance surrender process set out under Annex IX."

The processes to be followed by CITL for different processes are set out in annexes to the Regulation, and annex IX, which is concerned with "Processes concerning transactions with response codes", specifies primary, secondary and tertiary checks that are to be carried out in the process. They did not include any checks about whether CERs had been surrendered.

Other Markets

23. As well as the Kyoto Protocol compliance market (by which I mean the market among countries and companies trading in emissions units for compliance with commitments under the Kyoto Protocol) and the EUETS, there are emissions trading schemes in Norway, Iceland, Lichtenstein, Switzerland, New Zealand and the United States (a scheme in the north-eastern states known as the Regional Greenhouse Gas Initiative or "RGGI). These other mandatory systems are typically, like the EUETS, "cap-and-trade" schemes, and under them compliance buyers are required by law to surrender emissions units to off-set their emissions or otherwise to face penalties. They are all much smaller and less commercially significant than the EUETS.

24. A further market in carbon emissions (the "voluntary market") has developed for entities who wish voluntarily to off-set their greenhouse gas emissions by purchasing emissions credits because of concern for the environment or in order to enhance their reputation. For example some airlines invite passengers to pay a surcharge upon tickets to be used for this purpose. DB have a voluntary carbon neutrality commitment in respect of their own "carbon footprint", which is a worldwide commitment and independent of their emissions trading desk in London. However, the voluntary market is very much smaller than the mandatory compliance markets, in terms both of value and volume traded. By way of illustration, Mr Radov thought that the mandatory markets accounted for more than 98% of trading in terms of volume and more than 99% in terms of value, and I accept that this gives the broad picture, although Ms Bossley thought that the voluntary market was somewhat larger in 2010.

25. There are a number of exchanges through which CERs and other units are traded. One of the largest is the BlueNext Exchange, which was established in Paris in December 2007. Those engaged in the transactions relevant to this litigation both at DB and at TGS consulted the BlueNext online prices when dealing in CERs. Other exchanges are the European Energy Exchange (or "EXE" based in Germany); Climex (based in the Netherlands); the Nord Pool Exchange (based in Scandinavia); and the European Climate Exchange (or "ECX", formerly a subsidiary of the Chicago Climate Exchange).

The surrendered CERs

26. During the first phase of the EUETS, between 2005 and 2007, because there was no contemporaneous Kyoto commitment period, article 11(a)(2) of the EUETS required Member States to cancel CERs surrendered to them. However during phase 2 of the EUETS, when there was a concurrent Kyoto commitment period, the EUETS Directive did not require that CERs be cancelled when surrendered by member states, so that they would be available for use by member states in order to meet their commitments under

the Kyoto Protocol. This meant, however, that member states could sell CERs that had been surrendered to them if they had enough AAUs and did not need the CERs for Kyoto Protocol purposes. As far as the evidence before me goes, the only EU member state who actually did so was Hungary, although Lithuania apparently considered such a plan: on 27 January 2010, Carbon Point, a trade newspaper, reported "concerns that [Lithuania] was trying to sell used …[CER] credits which had already been surrendered for compliance". (Ms Bossley indicated in cross-examination that Latvia too might have considered it, but I have no real information about that).

27. A scheme for selling surrendered CERs was recommended to the Hungarian government by DB through their Budapest branch, but in fact DB withdrew from the proposed scheme in late 2009, apparently because of concern that the scheme might compromise the EUETS and damage DB's reputation. In early 2010 the Hungarian government were contemplating a sale of 1,743,894 CERs surrendered under the EUETS, because, as I infer, they had more allowances (including CERs and possibly ERUs) than they needed to meet their Kyoto Protocol commitment, and CERs commanded a higher price than AAUs (and were apparently easier to sell).

28. In the event, the Hungarian government sold only 793,000 such CERs, and they were sold during the period between 3 and 12 March 2010 to a Hungarian company, Hungarian Energy Power KFT ("HEP"). HEP were reported to have paid €9 or between €9 and €9.50 each. According to a report published on 14 May 2010 by the Hungarian government, they were initially sold subject to contractual stipulations that they would not re-used in the EUETS. The CERs sold by the Hungarian government were sold by HEP to Microdyne UK Ltd, by Microdyne UK Ltd to Mourinio Ltd ("Mourinio"), and by Mourinio to TGS. Although, as I conclude, this was the contractual chain, in fact the CERs were transferred directly from HEP to TGS. TGS delivered 492,000 surrendered CERs to DB under the transactions that give rise to this dispute, and also sold 301,000 of them to MF Global Energy in three tranches of 1,000mt (presumably by way of a test sale), 150,000mt and 150,000mt on or about 8, 11 and 12 March 2010 respectively.

29. News that the Hungarian government had sold surrendered CERs was soon reported. Late on 11 March 2010 Point Carbon reported it under the headline, "Hungary sells "recycled" CERs". On 12 March 2010 it reported that "More EU nations are set to follow Hungary's lead and sell offsets surrendered by ETS companies", referring to "a total of almost 62 million surrendered CERs on [the] national accounts" of Hungary, the Czech Republic, Germany, Italy, Lithuania, Liechtenstein, Luxembourg, the Netherlands, Poland, Slovakia and Spain.

30. Market participants and others interested in the trade in emissions units therefore became aware on 11 March 2010 that CERs that had already been surrendered to a member state under the EUETS were being "recycled". Mr Radov and Ms Bossley agreed in the joint memorandum that they prepared and signed on 18 November 2011 (and I accept) that "The recycling of CERs was unexpected by most market participants and government authorities. The reaction by market participants to the actions of the Hungarian Government was one of surprise, alarm, and generally of disapproval". On 15 March 2010 the International Emissions Trading Association ("IETA"), a leading industry association representing participants in the market, issued a press release calling for decisive action to protect participants through full disclosure about the nature of recycled credits, and on 24 March 2010 they called on members to "abstain from trading" in

surrendered CERs. Trading in CER contracts was suspended for a time on the main exchanges: BlueNext, for example, suspended spot trading from 17 to 22 March 2010. The European Commission temporarily suspended from 18 March 2010 the machinery whereby CERs (or ERUs) could be surrendered under the EUETS, apart from during a period from 19 April 2010 to 1 May 2010. On 18 March 2010, the Times reported "chaos" and mounting scandal, on 22 March 2010 the Financial Times wrote of "market fears … after the latest blow to the credibility of [the EUETS]", and on 25 March 2010 the Economist wrote of "all hell [breaking] loose".

31. The European Commission considered that dealings in what became characterised as "recycled" CERs were both objectionable and in breach of the rules of the EUETS. On 18 December 2009 the Commission had imposed a check in the CITL, check no 7368, designed to prevent any CER that had already been surrendered for EUETS compliance purposes from being surrendered again under it. Ms Yvonne Slingenberg, the head of a unit in the European Commission's Directorate for Environment - General Climate Action, wrote as follows to the administrators of the registries of Member States:

> "I would like to inform you that the Central Administrator has introduced today a check in the CITL which will prevent operators from surrendering CERs and ERUs that were already surrendered once. The introduction of this check will prevent market participants from using the same CER multiple times in the EUETS, by buying CERs that have already been surrendered by companies from governments before these credits are retired. Such surrenders are contrary to the rules of the EUETS, and in particular Article 11a of the EUETS Directive which states that the use of CER or ERUs shall take place "through the issue and immediate surrender of one allowance by the Member State in exchange for one CER or ERU held by the operator in the national registry of its Member State". In addition, recital 6 of the [Linking Directive], states that "[A]n allowance issued in exchange for a CER or ERU will correspond to that a CER or ERU." While the check introduced now is not explicitly mentioned in the Registries Regulation, the surrender of CERs or ERUs that were already surrendered once cannot be allowed in the Community registry system, as the multiple use of CERs or ERUs would seriously undermine the credibility of the EUETS. Furthermore, it is imperative to prevent illegal transactions in the registry system, not least to avoid uncertainty for individuals about the possible uses of CERs and ERUs."

The reference to recital 6 to the Linking Directive was an error: it should have been to recital 5 (see para 17 above). The reference to the check not being explicitly referred to the "Registries Regulation" was apparently a reference in particular to the primary, secondary and tertiary checks referred to in annex IX (see para 22 above).

32. On 26 January 2010 the Commission announced on the CITL website that, under the rules governing the EUETS, surrendered CERs could not lawfully be used again for compliance purposes. The announcement stated, under the heading "Emissions Trading", that "Article 11(a) of EUETS Directive prohibits the multiple use of CERs and ERUs for compliance purposes in the EUETS. Check number 7368 applies in the CITL

to prevent the re-surrender of CERs or ERUs that were surrendered since 2008." According to Point Carbon, the European Commission presented the note as being "an advisory note [that] was just for clarity".

33. Ms Bossley explained in cross-examination how this check would have been carried out. If an account holder wishes to transfer CERs, it applies to its national registry at which it has an account for a transfer to be made. This occasions first a check at the "International Transaction Log" (or ITL) that the transfer would be in accordance with the rules about transfers under the Kyoto Protocol. If the proposed transfer meets those requirements, it proceeds to the CITL, which checks that it would comply with the rules of the EUETS. The transfer can be effected only if responses confirm that it would not breach either rules. These checks are required both when a CER is simply transferred between account holders at the registries for trading purposes and when an operator requests that it be transferred from its holding account to a member state's holding account at the registry in order for it to be surrendered.

34. Changes were brought into effect at CITL, which were effective from 19 April 2010, to prevent surrendered CERs from being transferred to or from EUETS accounts except to a retirement account. Thus, surrendered CERs held in the EUETS could not be transferred out of the EUETS for sale so as to be used for compliance with Kyoto Protocol commitments or on other mandatory markets (although, as I shall explain at para 164, it would not necessarily have prevented them being used in the voluntary market).

35. Article 53 of the Regulation was amended from 7 October 2010 so as to provide by its second paragraph that, "The CITL shall reject any request … that would result in surrendering CERs or ERUs that are barred from surrendering in accordance with Article 11a of [the Directive]". Further paragraphs were added to article 53: "A CER or ERU that was already surrendered may not be surrendered again or transferred to an operator or person holding account in the EUETS"; and "Surrendered CERs and ERUs shall only be transferred into a retirement account".

36. It was only by this amendment that the language of a CER being "surrendered" was introduced into the legislation governing the EUETS: there was reference in article 11a to the surrender of allowances, but not of CERs, which were simply said to be "used".

The parties

37. DB are a large international investment and retail bank. They are a market maker in emissions-related financial products, including ERUs and CERs, and a leading participant in the international emissions trading market. DB have an Environmental Financial Products desk in London through which emissions related units are traded. The desk's counterparties include other banks, trading houses and intermediaries who have no use themselves for emissions instruments for compliance purposes, as well as market participants who do have such a requirement.

38. At the relevant time DB's Environmental Financial Products desk was headed by Mr Martin Lawless, the Global Head of Environment Financial Products. Secondary market trading of emissions credits such as CERs was conducted by the secondary market team, including Mr Lawless. Among the sales people on the team were Ms Chloe Desmonet,

Mr Hector Freitas and Mr Andreas Dreier. They cultivated trading relationships with customers and they negotiated and concluded deals over the telephone. They operated in conjunction with traders, who decided what transactions DB should be prepared to make and at what price. Ms Evdokia Karra was a trader on the team: she ran a secondary markets trading book and advised the sales people of the prices at which they might contract. She provided the prices for all the transactions that give rise to this litigation. She did not usually deal with clients on the telephone, but she happened to speak with TGS before the last of the four controversial transactions with TGS.

39. TGS are a small commodity trading house, their main business being steel and other metals trading. They are a member of the London Metal Exchange and they specialise, among other things, in trading carbon emissions. TGS were at the relevant time a member of the BlueNext exchange and also the ECX. TGS became a member of the International Swaps and Derivatives Association Inc ("ISDA") in September 2009.

40. Mr Martin Lonergan is TGS's managing director and majority shareholder. As I shall explain, in July 2009 Mr Oliver Temple of TGS initiated a relationship with DB to conduct emissions trading. He dealt mainly with Ms Desmonet. Mr Temple left TGS in August 2009. Thereafter the trading relationship between DB and TGS was primarily one between Ms Desmonet and Mr Lonergan, although written confirmations of deals were sent out and returned by administrative staff.

41. Mr Ian Ellis was another of TGS's traders. He had formerly worked as a trader at MF Global. He concluded with Ms Desmonet one of the four controversial deals, and he also apparently was involved in selling the 301,000 surrendered CERs to MF Global. He no longer works for TGS and did not give evidence.

42. Mr Darren Barrows was a director of TGS between May 2010 and January 2011. He had no involvement in the controversial transactions but was involved in trying to find on behalf of TGS a buyer for the surrendered CERs in the Far East. He too has now left TGS.

The trial

43. The trial was conducted with proper cooperation on both sides. Both parties conceded unarguable points, cross-examination was focused and conducted without unwarranted aggression and the submissions were careful and economical. This is much to the credit both of the parties and their advisors.

44. There was little dispute about the primary facts. All the important telephone calls between the parties were recorded and transcripts of them were agreed. The parties also agreed a schedule of the telephone calls that had taken place between them over the relevant period. There was a minor issue about whether this schedule was comprehensive, including every telephone contact, because, as I shall explain, Mr Lonergan was convinced that he had spoken to Ms Desmonet on at least one other occasion. Although I have concluded that Mr Lonergan was mistaken about this, it was an honest error that does not discredit his evidence generally.

45. As far as evidence of fact is concerned, DB presented witness statements from Ms Desmonet, Mr Lawless, Mr Dreier and Ms Karra. TGS did not require Mr Dreier or Ms Karra to give oral evidence or to be cross-examined. Ms Desmonet and Mr Lawless gave oral evidence. DB's factual evidence also included a letter from Ms Slingenberg dated 20 December 2011, and TGS waived any requirement for notice under the Civil Evidence Act 1995 in respect of this.

46. TGS served witness statements of Mr Lonergan, Mr Temple and Mr Barrows. Mr Lonergan gave oral evidence and was cross-examined. DB did not wish to cross-examine Mr Temple and did not object to Mr Barrows' witness statement being received in evidence although he did not attend for cross-examination. TGS's factual evidence also included two documents adduced under the Civil Evidence Act 1995: a document dated 5 February 2010 entitled "Official Notification" and signed by Dr Jozsef Molnar, a Hungarian government official, which referred to an annexe that listed 159 CERs and the date of their surrender; and the annexe together with a table that lists, by number, CERs that had been surrendered. It includes all the CERs that are the subject of this litigation.

47. All the witnesses of fact were honest in their evidence, and indeed neither party suggested otherwise. I so conclude although Mr Lonergan acknowledged that in the course of his dealings with DB he had on occasion told them untruths. Specifically he claimed in a conversation with Ms Desmonet on 10 March 2010 that he had sold 33 lots of CERs (a lot being 1,000 CERs) to another client when he had not done so. On 15 March 2011 he told DB that he had been supplied with the controversial CERs by "a UK supplier" whereas he had in fact obtained them from the Far East; and, when asked whether TGS had obtained them all from the same client, he said that TGS "had a couple of different CER deals", whereas all were supplied from the same source. Mr Orlando Gledhill, who represented DB, realistically described the untruth on 10 March 2010 as "trading banter", and, whereas perhaps those on 15 March 2011 would not be of that category, I do not consider that they detract from the credibility of Mr Lonergan's evidence at the trial.

48. DB called as an expert witness Mr Daniel Radov who is an associate director of NERA Economic Consulting, a firm specialising in micro-economic analysis. His work has focused on analysis of policies designed to engage with climate change and air quality, including emissions trading. TGS called as an expert witness Ms Elizabeth Bossley who has had more than 30 years' experience in the energy markets, and in 1999 founded a trading consultancy practice, the Consilience Energy Advisory Group Ltd, that specialises (among other areas) in markets associated with emissions and their derivatives.

49. Both experts were detached and impartial. Mr Radov had a most impressive knowledge of the markets for trading in instruments of the kind with which this litigation is concerned, but acknowledged that he has no practical experience of emissions trading. Ms Bossley's knowledge of the markets comes from a close involvement with them over many years and she has a full understanding of how they operate in practice. The evidence of each therefore complemented that of the other and much assisted me.

<u>The trading relationship between TGS and DB</u>

50. DB's first business relationship with TGS was in July 2009 after Mr Temple telephoned

Ms Desmonet on 1 July 2009 with a view to trading metals and carbon products. After DB had carried out some due diligence and "know your customer" checks, on 2 July 2009 Ms Desmonet told Mr Temple by an email that she would provide DB's "standard delivery and settlement terms as soon as credit department has finished its review", and she continued, "As for futures trades, we will need to have an ISDA in place (with an emissions annexe), unless we can clear via exchange (ECX)". In her email Ms Desmonet also said, "Since we do not have any legal documentation in place at the moment, we would use a Standard Short Spot Confirmation", and promised to send the template for TGS's review. On 3 July 2009 Ms Desmonet sent a further email to Mr Temple stating that DB would use a "Short Spot Confirmation", but by 8 July 2009 DB had decided instead to use a "Long Form Confirmation". Ms Desmonet's email of that date stated "Please find attached a copy of the ISDA Emissions Annexe for reference purposes as well as a tailored Long Form Confirmation we would be using to confirm Spot trades". (She explained in her evidence that DB's "credit team" had decided that this form was more appropriate because it gave them more protection for same day trades than the shorter form.) In his reply, Mr Temple did not object to this or question it.

51. Between 13 October 2009 and 29 January 2010 DB, through Ms Desmonet, and TGS, through Mr Lonergan, entered into seven spot transactions in CERs, and Ms Desmonet sent confirmations in the form contemplated in her email of 8 July 2008. They also entered into 97 over the counter spot EUA transactions. These were on materially similar terms (except for volume and price). In November and December 2009 they entered into four futures transactions that were cleared through the ECX and were therefore not on ISDA terms.

The contracts

52. The four contracts with which this litigation is concerned are these:

i) On 10 March 2010 in a telephone conversation at about 7.53am between Ms Desmonet and Mr Lonergan DB agreed to buy and TGS agreed to sell 117,000 CERs at €11.82 each, giving a total price of €1,382,940.

ii) On 10 March 2010 in a telephone conversation at about 11.41am between Ms Desmonet and Mr Lonergan DB agreed to buy and TGS agreed to sell 125,000 CERs at €11.84 each, giving a total price of €1,480,000.

iii) On 11 March 2010 in a telephone conversation at about 9.02am between Ms Desmonet and Mr Ellis DB agreed to buy and TGS agreed to sell 100,000 CERs at €11.75 each, giving a total price of €1,175,000.

iv) On 12 March 2010 in a telephone conversation at about 1.03pm between Mr Dreier and Mr Lonergan DB agreed to buy and TGS agreed to sell 150,000 CERs at €11.33 per CER, giving a total price of €1,699,500.

53. The background to the contracts was this. In late November 2009 or thereabouts, TGS

established a trading relationship with Mourinio, who were based in Hong Kong, and they traded in EUAs. On 4 March 2010, one of Mourinio's traders asked Mr Lonergan whether he could sell instruments that Mourinio had been offered, and said that they had been offered a large number of AAUs and also some "surrendered CERs", which, as Mr Lonergan explained what he was told, had been "surrendered but then swapped against or offset by AAUs". Mr Lonergan asked whether the CERs were "large hydro", but the trader did not know, and Mr Lonergan asked him to send such information as Mourinio had. That day Mourinio sent him 1,000 CERs.

54. On 5 March 2010 at 9.26am Mr. Lonergan told Ms Desmonet that he had "got a murmur that someone wants to sell some CERs", and when Ms. Desmonet expressed enthusiasm to buy, he said that TGS would go back to the sellers and say that they were "definitely interested". Later on 5 March 2010 Mourinio enquired of Mr Lonergan whether there was any interest in the CERs which they had discussed, and he reported that DB were apparently interested. He said that on Monday 8 March 2010 he would provide DB with details of the CERs and report back to Mourinio.

55. On 8 March 2010 Ms. Desmonet and Mr. Lonergan spoke again on the telephone. Mr. Lonergan said that he had "no one in the market for buying anything", but that he had been offered "CERs, a couple of hundred lots of them, but they're telling me that they are for … the Far East region, because they've been swapped against AAUs". Ms. Desmonet queried this, and Mr. Lonergan confirmed, "Yeah, they've been surrendered, but they've been offset against AAUs". Mr. Lonergan told her that it did not make sense to him, and that he had just said to his contact, "Look, if their first commitment period starts and, you know, I can give you a bid on them". Ms. Desmonet replied, "Yeah", but then commented that, "Swapping against AAUs doesn't make any sense to me either" and that she did not know "who would do that". Their conversation turned to other matters: to the scale of DB's business and an enquiry that Mr Lonergan had received about buying "non-hydro" CERs. Ms Desmonet began to explain to Mr Lonergan how it was possible to check on the UNFCCC website from its serial number whether a CER was "non-hydro", and agreed to send him a "link" to the website. She did so, and later that morning left Mr Lonergan a message offering to explain how to use the website.

56. After speaking with Ms Desmonet, Mr Lonergan reported to Mourinio on his conversation and Mourinio agreed to send some CERs the next day, with the prospect of more if DB were happy with them. On the same day, TGS, through Mr Ellis, sold to MF Global 1,000 surrendered CERs that Mourinio had already supplied.

57. Ms Desmonet and Mr Lonergan had another telephone conversation that afternoon at 3.13pm. They went through the procedure for using the website to find whether a CER was "large hydro", using the serial number of one of the surrendered CERs that Mourinio had delivered to TGS. The website showed that the CER derived from a HFC23 project (and so was "non-hydro"), but not whether it had been surrendered. Mr Lonergan commented that they (his suppliers) were not "trying to bulk me up with stuff that's not worth the money", and that he would like to take them and "do business with you". He said that he had a buyer for the CERs who had stipulated that they should be "non-hydro", and told Ms Desmonet, "I promise to give you all my business, okay?". Ms Desmonet responded, "Okay". Their exchange continued as follows:

> Mr Lonergan: "No I couldn't – a guy specified non-hydro and I didn't know how to check, Chloe, and if someone sends me in 100 lots of CERs, I've got a guy that will buy 35 lots of stuff off me if I give him a good price. If I give him halfway between the bid and the offer, he'll probably buy 35 lots off me, and I'd give you the other 65."
>
> Ms Desmonet: "Okay."
>
> Mr Lonergan: "But obviously I don't want to get a customer come back to me and say, "Oh, you've sold me –oh, you know I only buy non-large hydro and you've sold me 35 lots that are" then obviously – and I didn't know how to know that, but now I know that. Thanks for your help, and I've definitely got a deal on the table and I've got some stuff coming in to me. I've got far more coming in to me, I believe, than what I can sell to my little guy that buys non-hydro, but you'll get the other – you'll get some of them as well, and especially now I know that then – now I know I can check to make sure I'm not giving him non-hydros."

58. On 9 March 2010 Ms Desmonet telephoned Mr Lonergan at 3.26pm and asked him, "What about those CERs?". Mr Lonergan replied that he was about to telephone the supplier and "see what he could do". After that conversation on 9 March 2010 Mourinio supplied TGS with 242,894 surrendered CERs, and they supplied further tranches of 250,000 and 300,000 such instruments on 10 and 12 March 2010 respectively.

59. On 10 March 2010 Ms Desmonet and Mr Lonergan concluded the first deal. Mr. Lonergan told Ms. Desmonet that he had available 117 lots of "non-large hydro" CERs, and invited her bid for them. She offered a price of €11.82 and Mr. Lonergan accepted it, commenting that his sellers "reckon that they have quite a bit more stock that they want to move".

60. Ms Desmonet sent TGS an email by way of a "recap" of the terms of the deal, describing the instruments simply as CERs, and TGS delivered the CERs. They invoiced DB and were immediately paid.

61. Later that morning Mr Lonergan telephoned Ms Desmonet to tell her that he had available 125 more lots of CERs from the same seller. Ms Desmonet enquired whether they were "non-hydro" and Mr Lonergan told her that they were "non-large hydros". After some exchanges, they concluded the second contract, under which TGS sold to DB 125,000 CERs at a price of €11.84. Ms Desmonet sent a "recap" email, again referring simply to CERs, and delivery and payment were made promptly.

62. On 11 March 2010 Mr Ellis concluded the third of the controversial sales with Ms Desmonet, the sale of 100 lots of CERs at a price of €11.75. Again Ms Desmonet asked whether they were "non-large hydro" and Mr Ellis confirmed that they were. Ms Desmonet's "recap" email referred to "CERs, non large Hydro". The invoice was sent, delivery made and payment received by TGS that same day.

63. On 12 March 2010 at 12.32pm Mr Lonergan telephoned to invite BD to bid for a further 150 lots. His call was answered by Ms Karra. She said that the market had been "rocked … a bit" by news of CERs that had been "actually used, swapped for a use and sold back into the market as CERs"; and that as a result it was "really difficult to find any bids for spot CERs". Half an hour later at 1.03pm Mr. Lonergan spoke to Mr. Dreier, who described the market in CERs as "super illiquid at the moment". They concluded that fourth contract, the sale by TGS of 150,000 CERs at a price of €11.33. Mr. Dreier sent a "recap" email, in which he stated, "As for our previous CER transactions, these non-large hydro ETS compliant". This reference to the EUETS did not reflect anything said in Mr. Lonergan's conversation with Mr. Dreier, nor indeed anything said in his earlier conversations with Ms. Karra and Ms. Desmonet, and (as I have said) this had not been stated in the recap emails sent by DB after the previous transactions.

Exchanges after the contracts

64. Late on 12 March 2010 DB became aware that some of the CERs delivered by TGS had already been surrendered. By mid-afternoon on Monday 15 March 2010 they had learned that all the CERs delivered by TGS were surrendered instruments.

65. In the evening of 15 March 2010 (the first trading day after 12 March 2010) Mr Freitas telephoned Mr Lonergan. He referred to the sales by "the Hungarians" of "recycled CERs to the Japanese" and told Mr. Lonergan that the CERs delivered by TGS on 12 March 2010 were all on a published list of the "recycled" (or surrendered) CERs. Apparently there were (false) rumours in the market that the surrendered CERs had been sold to Japan. Presumably for this reason, Mr. Freitas asked Mr. Lonergan whether his "client", that is to say his seller, was in Europe or not, and Mr. Lonergan replied, "My supplier's a UK supplier". Mr. Lonergan acknowledged (rather reluctantly) in cross-examination that he was "probably being slightly evasive" and was "probably … trying to put [DB] off any scent", because he had become involved with the surrendered CERs. He was being untruthful.

66. On 16 March 2010 at 7.53am Mr. Freitas again telephoned Mr. Lonergan about the CERs. Mr. Lonergan gave this account of his discussions with Ms. Desmonet:

> Mr Lonergan: "When I first had offers of stock from them about three weeks ago they offered me AAU, which I offered to Chloe [Ms Desmonet] (CD) and we spoke about them and I didn't really understand what AAUs were. It's something I've not traded in here before and we did speak about them and CD explained that they were traded between sovereign states generally but Deutsche Bank had had some knowledge of them, but that deal never went any further. I then spoke to CD and said I'd been offered some CERs which had been surrendered against AAUs. She didn't really understand that, nor did I and the only concern between us was that they were non-large hydros. So we looked at how to do that. CD actually gave me the link to – it's the UN site, I believe, and I looked at some of the stock and obviously there were non-large hydros and I made some offers."

He continued, "So I've sold you a couple of tranches of this product – of CERs from this source. I don't know that they're Hungarian. The ones I looked at were from an Indian project, some power station, they certainly weren't large hydros".

67. On 17 March 2010 DB's Legal Counsel wrote to TGS, stating that they did not believe that TGS had performed the contracts in accordance with their terms because the CERs that were delivered could not be used for compliance purposes under the EUETS. They requested that TGS "immediately" replace them with CERs that could be so used, threatening otherwise to issue a notice of failure to deliver in accordance with the contracts.

68. On 18 March 2010 DB formally demanded of TGS that by the close of business on 19 March 2010 they deliver CERs in accordance with their obligations under the contracts, but TGS did not deliver any further CERs.

69. DB have kept most of the CERs in their UK registry account under the EUETS ever since they first received them from TGS. However, on 10 March 2010 DB made a routine transfer of 250,000 CERs to their Swiss account with BlueNext in order to maintain their trading "float", and 86,932 of the surrendered CERs delivered by TGS happened to be included in that transfer. On 12 March 2010 DB made three sales of a total of 210,000 CERs to the same counterparty (whose identity DB have understandably declined to disclose), and DB delivered the 86,932 CERs to the counterparty through BlueNext under one or more of those sales. On 17 March 2010 the counterparty informed DB that they had been delivered surrendered CERs, and on 18 March 2010 DB agreed to replace them. On 19 March 2010 DB delivered replacement (conventional) CERs to their counterparty and received back into their UK registry account under the EUETS the 86,932 surrendered CERs. Accordingly, on 19 March 2010 DB took back into their EUETS account 86,932 surrendered CERs that had been held in an account outside the EUETS since 10 March 2010.

The terms of the Contracts

70. After the agreements in March 2010, DB sent to TGS confirmation letters in the "long form" and terms similar to those sent after their previous spot transactions. TGS countersigned and returned to DB the confirmations relating to the first three contracts on 15 March 2010, 16 March 2010 and 15 March 2010 respectively. They did not countersign the confirmation relating to the fourth contract, presumably because before they did so DB had raised their concern about the surrendered CERs. However, it is admitted by TGS, and so common ground between the parties, that each of the contracts incorporated the corresponding confirmation letter, as well as the ISDA form, the Allowance Annex and the Commodity Definitions (all as defined in the confirmation letters as set out below).

71. The confirmation letters were headed "EU Emissions Allowance Transaction". They stated that the "Allowance Type" was CER, and also that:

> "The definitions and provisions contained in the 2005 ISDA Commodity Definitions (the "Commodity Definitions"), as published by the International Swaps and Derivatives

> Association, Inc ("ISDA"), are incorporated into this Confirmation. In the event of any inconsistency between the Commodity Definitions and this Confirmation, this Confirmation will govern.
>
> The Confirmation evidences a complete and binding agreement between you and us as to the terms of the Transactions to which this Confirmation relates. This Confirmation shall supplement, form a part of, and be subject to an agreement in the form of the ISDA 2002 Master Agreement (the "ISDA Form") as published by ISDA as if we had executed an agreement on the Trade Date in such form with the Schedule thereto (i) specifying only that (a) the governing law is English law and (b) the Termination Currency is Euro (ii) incorporating the addition to the definition of "Indemnifiable Tax" … and (iii) incorporating any other modifications to the ISDA Form specified below.
>
> For the purposes of this Confirmation, the Schedule to the Agreement will be deemed to have been amended by the addition of a new Part 6 in the Form of Part [6] to the Schedule to an ISDA Master Agreement for EU Emissions Allowance Transactions (Version 4), modified for Phase 2 delivery, as published by ISDA in February 2008 and in the form attached hereto as Schedule 1 (the "Allowance Annex") … ."

72. The Allowance Annex was headed "EU Emissions Allowance Transfers", and paragraph (a) stated that its provisions applied solely in respect of "Transactions that are identified in the related Confirmation as EU Emissions Allowance Transactions". As I have said, the relevant confirmation letters did so identify the transactions.

73. The Allowance Annex included this definition of an Allowance: "In respect of an EU Emissions Allowance Transaction, an allowance of the specified Allowance Type and of the Specified Compliance Period". Allowance Types were defined as "In respect of an EU Emissions Allowance Transaction, any of an EU Allowance, an EU Credit or an Alterative Allowance as specified in the related Confirmation". The expression "Confirmation" derived from the main operative clause of the ISDA form, that is to say the form of the ISDA 2002 Master Agreement, which was also incorporated into the contracts. This provided that the agreement included "the documents and other confirming evidence (each a "Confirmation") exchanged between the parties or otherwise effective for the purpose of confirming or evidencing" the transaction or transactions.

74. An "EU Allowance" was defined as:

> "An "allowance" as defined in the Directive that has been issued by a competent authority pursuant to Article 11(4) of the Directive."

75. An "EU Credit" was defined as:

> "A Certified Emissions Reduction or an Emissions Reduction

> Unit as defined in the Directive that may be used for determining compliance with emissions limitation commitments pursuant to and in accordance with the Scheme."

76. The Scheme was defined as:

> "The scheme for transferring Allowances established pursuant to the Directive and the Registry Regulation, and as implemented by the national laws of Member States."

That is to say, the Scheme was the EUETS.

77. Thus, a CER was a type of EU Credit and therefore an Allowance Type within the meaning of the Allowance Annex. All Allowance Types (EU Allowances, EU Credits and Alternative Allowances) were instruments that may be used under the EUETS, and the definitions so stipulated.

78. DB contend that each of the contracts provided that TGS were to deliver CERs such as could "be used for determining compliance with emissions limitations commitments pursuant to and in accordance with" the EUETS. Mr. Gledhill advanced three arguments in support of this contention based upon:

i) The circumstances in which the contracts were made that were known to the parties or that the parties are to be taken to have known.

ii) The headings of the confirmation letters.

iii) The definition in the Allowance Annex of an "EU Credit".

79. By the time of the contracts in March 2010, the European Commission had made the announcement on 26 January 2010 about surrendered CERs, and made it clear that in their opinion surrendered CERs did not comply with the requirements of the EUETS, which was by far the largest market for CERs. These matters are not relevant to interpreting the contracts only if the contracting parties actually knew them. It suffices that the information was reasonably available to the parties at the time of the contracts (per Lord Hoffmann in Investors Compensation Scheme Ltd v West Bromwich Building Society, [1997] UKHL 28), and I conclude that this information was reasonably available to DB and TGS at the relevant time. This is clear from the evidence of Ms Bossley, reinforced by that of Mr Lawless, and in any case I would have so inferred. Mr. Gledhill submitted that therefore DB and TGS should not be understood to have intended to deal in CERs which had been (or might have been) surrendered when they referred simply to CERs in their exchanges and said nothing (or nothing significant) about any possibility that the CERs might have been surrendered.

80. Mr. Gledhill's second argument relied upon the confirmation letters being headed "EU Emissions Allowance Transactions", an expression repeatedly used in the letters themselves. This in itself, he argued, connotes that the instruments being traded had

some connection with the EU and that they were of a type approved by or compliant with an EU standard or programme relating to allowances for emissions. Accordingly, it is said, the natural inference is that this was a reference to the EUETS and that the transactions involved instruments that complied with the EUETS.

81. The precise wording of the term that DB allege (set out in para 78 above) derives from the definition of "EU Credit" in the Allowance Annex, which, as I have said, both parties accept was incorporated into the contracts. The Annex provided that when "Allowances" were sold, they should be one of the "Allowance Types", according to the parties' "Confirmation", that is to say, in this case, the confirmation letters.

82. In fact the parties did not strictly specify any of the three "Allowance Types" stated in the Annex's definition of the expression, but stipulated more precisely for CERs, a sub-type of EU Credit. But they are not to be taken therefore to have dispensed with the part of the definition of an EU Credit that, if the "Allowances" that were being traded were EU Credits, they should be such as might be used for determining compliance with emissions limitation commitments pursuant to and in accordance with the EUETS. I would understand the letters simply to mean that the instruments should be "EU Credits" as contemplated in the Allowance Annex but of a specific kind.

83. I therefore accept DB's submission that the contract included a term that the instruments should be such as might be used for determining compliance with emissions commitments pursuant to and in accordance with the EUETS. I would have so concluded on the basis of the definition of an EU Credit alone: it is, to my mind, farfetched to suppose that, when they describe the instruments as CERs, the parties did not intend them also to comply with the definition. Mr. Gledhill's other two arguments about the factual matrix and the headings to the confirmation letters reinforce this conclusion.

84. I reach this conclusion:

i) Although, as observed by Ms Claire Staddon, who represented TGS, the Allowance Annex is largely directed to sales of futures and options rather than spot trades of instruments such as CERs.

ii) Despite Mr. Lonergan's evidence about a telephone call which was not (apparently) recorded by DB.

iii) Despite what was said on 8 March 2010 about "surrendered" CERs.

I should say something about these three points.

85. TGS plead that that the terms of the Allowance Annex "concern forward transactions and option transactions, rather than spot transactions", and that the terms of the Allowance Annex "applied … only if and in so far as they were capable on a true construction of applying to the parties' spot trading". Undoubtedly the Allowance Annex is largely directed to trading in futures and options, and much of it has no

possible application to spot deals. However, as TGS's pleading recognises, that is no reason to disregard those parts of the Annex that do have application, and they include the definition of EU Credit and the other provisions on which DB rely. Indeed, the reference in the confirmation letters to "Allowance Type" to my mind contemplates that the definition of Allowance Type and hence the definition of the three types of allowance, including "EU Credit", should apply to the contracts.

86. I have described the telephone calls in the first half of March 2010 between Ms Desmonet and Mr Lonergan which were recorded and of which there were transcripts in evidence at the trial. Mr Lonergan's evidence was that on about 5 March 2010, apparently after the call at 9.26am, he had a further telephone conversation with Ms Desmonet: that he had "a strong recollection that on 5 March 2010, after TGS had received the sample of surrendered CERs, [he] spoke to [Ms Desmonet] about them…". Ms Desmonet denied this.

87. It became apparent that this difference is of no real significance because Mr. Lonergan accepted in cross-examination that, as far as he recalled, nothing was said in the conversation that was not repeated when he and Ms. Desmonet spoke on 8 March 2010. However, I should determine the issue.

88. There is in evidence an agreed list of the telephone calls during the period from 1 March 2010 to 25 March 2010 between DB's emissions desk and TGS or Mr. Lonergan. DB had one landline for their emissions sale desk, and calls might be made to the work stations of the sales people on this number. Incoming calls might be answered by any of the sales people, and the line was also used by them all for out-going calls. All calls to and from the emissions desk line were recorded. There was no relevant call after that made by Ms Desmonet at 9.26am on 5 March 2010 until she called TGS at 8.23am on 8 March 2010.

89. Mr. Lonergan, recognising this, said that the call that he recollected would have been made by mobile telephone and, since no such call appears on his mobile telephone bill, Ms. Desmonet would have been calling him. However, Ms. Desmonet's evidence is that, whilst she had a mobile telephone for work, it would have been contrary to DB's policy for her to have used it to conduct business and that she never did so, and that she never made a call to TGS from it. She added that she did not remember any occasion when Mr. Lonergan (or anyone else at TGS) called her on her mobile telephone. The bills from her service provider confirm that she made no call that corresponds to that described by Mr. Lonergan.

90. As I have already said, I accept that Mr. Lonergan was honest in his evidence about this matter, but I conclude that he is mistaken. There is simply no such call reflected in the evidence about telephone records, and this evidence is sufficiently complete to show that, had Mr. Lonergan's recollection been correct, there would have been a record corroborating it. I accept Ms. Desmonet's evidence that there was no such call.

91. TGS argue that nevertheless they told DB on 8 March 2010 that the CERs that they might be able to supply had been surrendered and that DB therefore agreed to buy surrendered CERs. This argument depends upon how the exchanges between TGS and DB are, objectively, to be understood. Otherwise it is beside the point what Mr.

Lonergan intended to convey or that Ms Desmonet and others at DB did not understand what Mr Lonergan intended.

92. TGS's contention is as follows: at 8.23am on 8 March 2010 Mr. Lonergan told Ms. Desmonet that TGS had been offered CERs that had already been surrendered, and Ms. Desmonet responded "Yeah" when Mr. Lonergan said that he could give a bid on them. The conversation moved on to how a trader might check from CERs' serial numbers whether they are "large hydro", and then broke off so that Ms. Desmonet could send Mr. Lonergan details of the relevant website. Ms. Desmonet did so, and she and Mr. Lonergan resumed their conversation at 3.13pm. Ms. Desmonet explained how to use the website, and together they checked on it one of the CERs that Mr Lonergan had been offered. He explained that he had a potential purchaser who would buy 35 lots of the 100 lots that he had been offered, provided that they were "non-large hydro", and said that he was willing to let Ms. Desmonet have the other 65 lots. He added that he had "some stuff coming in to [him] … far more coming in to him". On 9 March 2010 Ms. Desmonet telephoned Mr. Lonergan to ask about "those CERs", which, as TGS submit, was a reference to the CERs that they had been discussing both in the conversation at 3.13pm on 8 March 2010 and earlier that day at 8.23am. On 10 March 2010 Mr. Lonergan told Mr. Dreier, before speaking to Ms. Desmonet, that he and Ms. Desmonet had been "working on some CERs". Thus, as TGS argue, in this series of conversations on 8, 9 and 10 March 2010 Mr. Lonergan is naturally understood to be speaking of the CERs that he had told Ms Desmonet in their first conversation at 8.23am on 8 March 2010 had been swapped or surrendered. Further, the first contract was made in a conversation between Mr Lonergan and Ms Desmonet that they had a few minutes after Mr Lonergan had spoke to Mr Dreier, and is naturally understood to be about the same CERs. The later sales are naturally understood as being of similar instruments to those sold in the first one.

93. Crucially for this contention, TGS argued that in their conversation at 3.13pm on 8 March 2010, when Mr Lonergan referred to the "guy" who specified "non-large hydro", Ms Desmonet and Mr. Lonergan were returning to the discussion of the swapped or surrendered CERs of which they had spoken that morning, and that at that point he should be understood as referring to a possible deal to sell those same swapped or surrendered CERs. I accept Mr. Gledhill's submission that more naturally the afternoon conversation is to be understood to be about a hypothetical deal: to the position, "if someone sends me in 100 lots of CERs".

94. I am not persuaded that TGS's argument presents a natural interpretation of the exchanges, and do not accept that Ms. Desmonet agreed in the first contract on 10 March 2010 to buy the CERs that she and Mr Lonergan had briefly discussed at the start of their first conversation on 8 March 2010. After all, neither Ms Desmonet nor Mr Lonergan understood what "swapped" or "surrendered" CERs might be and it is inherently improbable that Ms Desmonet would have agreed to spend large sums on instruments that she did not understand. As Mr. Gledhill observed, although the trial examined in isolation and in detail the conversations between DB and TGS, the background against which they are to be considered is that both Ms. Desmonet and Mr. Lonergan spent their working days on the telephone discussing and making deals with various business contacts, and each of them knew, or is to be taken to have known, that this was the nature of the other's business. They both would, I infer, have had many trading discussions in the 48 hours or so between the conversation upon which TGS rely and the conclusion of the first contract, and I would not readily accept that the parties were to be understood to

recollect on 10 March 2010 their earlier discussions and to suppose that they were buying and selling the same instruments.

95. In my judgment, TGS's argument attaches significance to the exchange at the start of the conversation at 8.23am on 8 March 2010 that it simply will not bear. After the short discussion about the surrendered CERs, the conversation turned to how a trader could distinguish hydro and non-hydro CERs and never reverted to the surrendered CERs to which Mr. Lonergan had referred. I therefore reject the defendant's contention based upon this conversation that it was a term of each of the contracts that the CERs had been surrendered or that DB knew (or are to be taken to have known) that they were buying surrendered CERs.

96. DB advanced further arguments that, even if the first contract included a term such as that for which TGS contend because of the exchanges between Ms. Desmonet and Mr. Lonergan on 8 March 2010, nevertheless the later contracts did not do so. In view of the conclusion that I have reached, DB do not need to rely upon them, but I shall refer to them briefly. They are as follows:

i) Before each of the contracts DB asked whether the instruments were "non-large hydro" and was told that they were. This is said to demonstrate, and to have demonstrated to TGS, that DB did not suppose that the CERs that they were buying in the second, third and fourth contracts were necessarily similar to those that they had previously bought.

ii) In their exchanges before the second contract, Ms. Desmonet referred to "looking at the screen" with regard to market prices, most naturally, in my judgment, a reference to looking at the BlueNext index, and Mr. Lonergan said that he was "watching BlueNext". The prices shown in the BlueNext index were, as Mr. Radov explained, prices for conventional CERs. In fact, in the case of all four contracts the prices that DB bid for the CERs were close to and consistent with those quoted on BlueNext for conventional, non-hydro CERs that met the EUETS requirements. (The closing prices quoted by BlueNext for such instruments on 10, 11 and 12 March 2010 were €11.97, €11.73 and €11.45 respectively.)

iii) The third of these points concerns only the fourth contract. As I have said, at 12.32pm on 12 March 2010, about half an hour before the sale agreed between Mr. Dreier and Mr. Lonergan, Ms. Karra had told Mr. Lonergan that it was difficult to find bids for CERs on the spot market because surrendered CERs had been sold, and "that has rocked the market a bit". Mr Gledhill argued that, given that the market disquiet about trading in surrendered CERs was not only known to both DB and TGS but had also been the subject of this exchange between them, it cannot be inferred that DB were agreeing to buy such instruments.

There would, to my mind, have been a good deal of force in these three points had DB needed to rely upon them.

<u>The meaning of the requirement that the CERs "may be used for determining compliance with</u>

the emissions limitation commitments pursuant to and in accordance with" the EUETS.

97. I therefore conclude that the contracts provided that CERs should be such as "may be used for determining compliance with the emissions limitation commitments pursuant to and in accordance with" the EUETS, but there is an issue about what that requirement means. There is no dispute that an instrument is "used for determining compliance" when an operator has it brought into account in order to determine whether its emissions have been within its prescribed limit: that is to say, when the operator exchanges the CER for an allowance that is surrendered immediately upon issue in accordance with article 11a of the Directive. The issue is about what "*may* be used" means.

98. TGS plead that this requirement is met provided that the CERs "were permitted by and/ or eligible" under the Directive and the Regulation to be so used, and that checks introduced by CITL are irrelevant to the question, even if they in fact prevent surrendered CERs being again so used under the EUETS. DB submit that the requirement is that the CERs "may lawfully be used and may in practice be used by operators within the EUETS", and therefore the requirement would not have been met if the CITL check was effective to prevent this. Mr. Gledhill also submitted that the very announcement of the check on 26 January 2010 meant that surrendered CERs did not satisfy the requirement because realistically, once the announcement had been made, ordinary and reasonable traders would not have considered that the instruments could have been used for compliance purposes.

99. The first question, therefore, is whether the requirement concerns only a legal entitlement to exchange the CERs for allowances or whether it was also that in practice they could have been exchanged. The issue is easily stated but less easy to decide. The requirement is one that DB introduced into their contracts with TGS, and upon which DB rely in the litigation: therefore, if uncertainty about its meaning is to be determined contra proferentem, DB are both the proferens in contrahendo and the proferens coram iudice. However the court will not readily resort to either aspect of the principle that contracts are to be construed contra proferentem in order to interpret them, and in my judgment it is not necessary to do so in this case.

100. The argument that Mr. Gledhill advanced in support of DB's interpretation is simple and can hardly be elaborated. He submitted that it makes little or no business sense to suppose that those dealing in instruments such as these would have been concerned about whether the purchaser or holder of them would have a legal right to "surrender" them under the EUETS (or to exchange them for an allowance) if in reality the CITL would not allow the exchange. To my mind there is a great deal of force in this submission.

101. In response Ms. Staddon makes two points about the wording of the requirement, which derive from the definition in the Allowance Annex of "EU Credit". First, she submitted that the word "may" connotes that the use is "permissible" under a code or a set of rules or that the CERs were "eligible" for use under a scheme of that kind. Secondly, she observes that the requirement expressly states the criterion by which it is to be determined whether the CERs may be used because it stipulates that the use of the CERs is permitted, or the CERs are eligible for use, pursuant to and in accordance with "the scheme", that is to say, as far as is relevant for present purposes, the EUETS. Thus, it is

argued, the definitions in the Annex direct that the question whether a CER "may be used" is answered by reference to what Ms. Staddon called the "code", that is to say the legislative provisions governing the EUETS.

102. The most relevant provisions of the "code" are in article 11a and article 12 of the Directive. Paragraph 1 of article 11a is concerned with allowing CERs and ERUs to be used under the scheme during phase 2 and afterwards, and with providing for how they can be used. It is subject to paragraph 3, which is directed to which instruments are eligible for use under the EUETS, and provides that all CERs and ERUs may be used in the EUETS if they are issued and may be used in accordance with the Kyoto Protocol scheme, subject only to the two excepted categories stated in sub-paragraphs (a) and (b). The Directive defines a CER as "a unit issued pursuant to Article 12 of the Kyoto Protocol and the decisions adopted pursuant to the UNFCCC or the Kyoto Protocol", and nothing states that, because a CER has already been surrendered under the EUETS, it falls outside that definition or in either of the excepted categories.

103. I am unable to accept Ms. Staddon's submission. I agree that the expression "may be used" connotes that the specified use is permissible or that CERs are eligible for such use, but it does not follow that the use is necessarily permissible, or the CERs are necessarily eligible for use, provided only the terms of the legislative provisions governing the EUETS are satisfied, and whether or not the Central Administrator, who operates and controls CITL, allows the use. The fact that the definition of an EU Credit refers to the instrument being used "pursuant to and in accordance with the" EUETS does not, to my mind, assist TGS. The CITL was established under and in accordance with the Directive, and it is an inherent part of the EUETS.

104. In my judgment, nothing in the language of the requirement is inconsistent with DB's interpretation of it, and I do not accept that the more natural interpretation of it confines its application to what the "code" stipulates. The requirement must be given an interpretation that makes business sense and would accord with the reasonable expectations of those buying and selling such instruments on the spot market. They would not have been satisfied simply because the relevant law would have allowed it to be surrendered.

105. Although my conclusion about the proper interpretation of the requirement does not depend upon this, I add that that TGS's submission does not recognise that the requirement is not only that CERs may be used "in accordance with" the EUETS, but that they may be used "pursuant to" it. The CITL check, if it did not prevent surrendered CERs being used "in accordance with" the EUETS, would (if effective) have prevented them from being used "pursuant to" it. On TGS's interpretation the words "pursuant to" would apparently be surplusage.

106. I therefore uphold DB's submission on this point. I cannot however accept Mr Gledhill's secondary submission that TGS were in breach of the requirement even if the CITL check was not introduced or was not effective, because the very announcement of the check would have created such commercial risks that traders would not have expected to deal in surrendered CERs. I agree that the market would not have expected that traded CERs had been surrendered, but, I think, it strains too far the natural meaning of the requirement to conclude that therefore surrendered CERs were not such as "may be used

in accordance with and pursuant to the Scheme".

Did TGS deliver CERs that could in practice be used pursuant to and in accordance with the EUETS?

107. In support of their contention that the introduction and announcement of check no 7368 were effective to prevent "recycling" of surrendered CERs, DB relied upon the letter dated 20 December 2011 written to their solicitors, Norton Rose LLP, by Ms Slingenberg. In response to enquiries expressly made in the context and for the purposes of this litigation, Ms Slingenberg wrote that the check "was established to prevent the surrender of [CERs or ERUs] that had already been surrendered", and that it "was effective in the CITL when it was announced on the CITL public website on 26 January 2010". She continued that, "The effect of this introduction is that it prevents an operator from surrendering already surrendered CERs or ERUs for compliance purposes i.e. an attempt to surrender any already surrendered CERs or ERUs is blocked by the system".

108. I see no reason to doubt the evidence of Ms. Slingenberg that the check introduced by CITL had by 10 March 2010 effectively prevented an operator from exchanging for allowances CERs that had already been used for that purpose under the EUETS. I accept her evidence and conclude that in practice the surrendered CERs delivered by TGS could not have been used for determining compliance with commitments pursuant to and in accordance with the EUETS, and that TGS were therefore in breach of their four contracts with DB.

109. Ms Staddon suggested in her final submissions that the evidential value of Ms Slingenberg's letter was the less because, in enquiring about the checks, Norton Rose did not identify that their client was DB (whom, it was suggested, Ms Slingenberg would have associated with Hungary's decision to sell surrendered CERs) and described the CERs as "recycled" (which, she submitted, was not neutral language). In cross-examination Ms Bossley commented of Ms Slingenberg's letter, "They would say that, wouldn't they?". These submissions and this observation do not seem to me to provide any proper basis for rejecting what Ms Slingenberg wrote. Ms Bossley made the general comment that the "European registry system" does not always work as it should, but neither she nor Mr Radov had any reason to think that the check did not work in accordance with the announcement.

Was it prohibited under the relevant legislation to "re-surrender" CERs?

110. DB argued that the surrendered CERs that TGS sold and delivered to them could not lawfully be "re-surrendered". They advanced two submissions:

i) That the Directive properly interpreted so provides; and

ii) That the Central Administrator was entitled to prohibit such use through the CITL of surrendered CERs and lawfully prevented it.

If I have correctly interpreted the contracts, in my judgment DB do not need to rely upon this alternative argument, but I should consider the parties' submissions about it. (Had my decision turned upon these difficult issues of European law, I might have considered

whether a reference to the European Court of Justice would have been appropriate, although neither party wished this, but in view of my other conclusions this question does not arise.)

111. The starting point for DB's first argument is that European directives and regulations should be given a purposive or teleological construction, and, if necessary, this should prevail over a literal interpretation. Mr. Gledhill referred to the speech of Lord Steyn in Shanning International Ltd v Lloyds TSB Bank PLC, [2001] UKHL 31, who, at para 24, cited the observation of Prof Bennion in Statutory Interpretation (3rd ed.) that of the four methods of interpreting instruments of the European Communion – literal, historical, schematic and teleological – the literal approach is the least important and the teleological method the most important. I accept Mr. Gledhill's submission about the proper approach for interpreting the European legislation about the EUETS. Accordingly, due regard should be had to the recitals to the Linking Directive when interpreting it and determining the effect of introducing article 11a into the Directive. They include the following:

> "3. … The demand for CDM credits will also be stimulated [by linking the Kyoto project-based mechanisms to the EUETS] and thus developing countries hosting CDM projects will be assisted in achieving their sustainable development goals.
>
> 4. In addition to the use of the Kyoto project-based mechanisms by the Community and its Member States, and by companies and individuals outside the Community scheme, those mechanisms should be linked to the Community scheme in such a way as to ensure consistency with the [UNFCCC] and the Kyoto Protocol and subsequent decisions adopted thereunder as well as with the objectives and architecture of the Community scheme and provisions laid down by [the] Directive ….
>
> 13. In accordance with the UNFCCC, the Kyoto Protocol and subsequent decisions adopted for their implementation, the Commission and the Member States should support capacity building activities in developing countries and countries with economies in transition in order to help them take full advantage of … the CDM in a manner that supports their sustainable development strategies…."

I have already set out Article 21a of the Directive (at para 21 above), introduced by the Linking Directive. It reflects recital 13. The purpose of article 12 of the Kyoto Protocol, which established the CDM, was, among other things, to assist developing countries in achieving sustainable development. Article 12(3) provided that under the CDM developing countries "will benefit from project activities resulting in certified emission reductions".

112. Mr. Gledhill therefore submitted that:

i) The purpose of allowing CERs to be used under the EUETS, which would have operated perfectly well as a cap-and-trade scheme without allowing this, was to

support and promote projects in developing countries that could contribute to sustainable development and reduce carbon emissions.

ii) If the EUETS allowed CERs that have already been surrendered (exchanged for allowances) again to be so used, this would reduce the demand for new CERs and so reduce the incentive to generate new CERs from investment in projects to reduce carbon emissions in the developing world.

He therefore argued that an interpretation of the EUETS allowing surrendered CERs to be re-used under it (either in phase 1 or in phase 2) would be inconsistent with the purpose stated in the recitals to the Linking Directive.

113. The Directive and the Regulation do not explicitly state either that at the relevant time surrendered CERs might again be used under the EUETS or that they might not be. However both DB and TGS rely upon article 11a of the Directive.

114. I have already referred to Ms. Staddon's argument (at para 102 above): that article 11a allows CERs to be used during phase 2 and is subject only to the exceptions in paragraph 3 of the article, which are irrelevant for present purposes. A surrendered CER remains a CER, and its use under the EUETS remains permitted under article 11a. The argument is attractively simple, but I am not persuaded by it. The article does not state that the *only* CERs that may not be used are those excepted by paragraph 3, and the language of article 11a does not demand the interpretation that it is legitimate to re-use surrendered CERs even if this would be contrary to the structure and purpose of the Scheme.

115. I see more force in two of Mr. Gledhill's arguments. The first echoes the announcement of the European Commission on 26 January 2010, and it relies upon *how* CERs are used under the EUETS: that their use "shall take place through the issue and immediate surrender of one allowance by the Member State in exchange for one CER … held by the operator in the National Register of its Member State". This language suggests that, once a CER is so exchanged, it has been "used up" and cannot be used further. Similarly recital 5 to the Linking Directive states that "an allowance issued in exchange for a CER … will correspond to that CER", connoting that the allowance replaces the CER, which is then spent and has no further validity under the EUETS.

116. The second argument is this: paragraph 2 of article 11a of the Directive provides that, when CERs were surrendered by an operator during the three year period beginning on 1 January 2005 (that is, during phase 1 of the Scheme), Member States were to cancel them. There is no comparable provision in article 11a (or elsewhere in the Directive) about CERs surrendered by an operator during phase 2. This is readily understandable, and does not, as TGS submitted, detract from DB's interpretation of the Scheme, but, to my mind, provides some support for it.

117. As I have said, the first Kyoto Protocol compliance period began on 1 January 2008, and member states had no commitments under the Kyoto Protocol until after the end of phase 1 of the EUETS. In these circumstances there was good reason to prevent member states from using CERs that operators had surrendered to them between 2005 and 2007 to meet their commitments under the first Kyoto Protocol compliance period.

Otherwise, CERs could have been used both during phase 1 of the EUETS (as an allowance for emissions covered by the EUETS) and during the period between 2008 and 2012 (as an allowance for emissions not covered by the EUETS but covered by the Kyoto Protocol); and therefore, as a result of allowing CERs to be used for compliance in phase 1 of the EUETS, more global emissions would have been allowed over the period from 2005 to 2012, and so the purposes of the Kyoto Protocol and its effectiveness in its first phase would have been compromised. Thus, the purpose of requiring member states to cancel CERs surrendered during phase 1 of the EUETS was not in order to prevent operators from reusing them under the EUETS – it was never supposed that surrendered CERs could be so used – but in order to prevent *states* from using them under the Kyoto Protocol.

118. After 1 January 2008 the position was different. Member states then had commitments under the Kyoto Protocol, and they were entitled to use CERs to meet them. Mr. Radov gave this explanation of the position, with which Ms. Bosley agreed:

> "If Member States had been forced to cancel CERs that were used by installations complying with the EUETS, Member States would have faced a double compliance burden: despite having acquired the right to emit a tonne of CO2 (through the surrender of a CER by an EUETS installation), they would not have been able to use this emissions right to cover (under the Kyoto Protocol) the associated emissions from the surrendering installation. Member States would have been required to acquire *another* emissions right to comply with the Kyoto Protocol. Such a double compliance burden would have placed even greater environmental constraints on European countries than would have been required by the Kyoto Protocol and the EUETS as originally envisaged prior to the Linking Directive, and would therefore … not have been consistent with policy goals."

119. It was common ground between Mr. Radov and Ms. Bosley that there was no reason that the policy of the EUETS should have changed between phase 1 and phase 2 with regard to the permitted use that *operators* might make of CERs under the EUETS. More specifically, there was no reason that operators should be permitted to use surrendered CERs during phase 2 but prohibited or prevented from doing so during phase 1. The change between phase 1 and phase 2, reflected in the difference between paragraph 1 and paragraph 2 of article 11a, was about whether *states* should be allowed to use surrendered CERs under the Kyoto Protocol.

120. Mr. Gledhill found a further argument in favour of DB's interpretation of article 11a that I found less persuasive. He relied upon the reference (in the heading of the article as well as in the article itself) to the use of CERs "from project activities" in the EUETS, the project activities being CDM activities. The argument is that CERs could fairly be described as being from a project activity when they are first used, because they then represent a reduction of emissions by a project in the developing world. But subsequent use of the same (surrendered) CER does not represent a corresponding reduction in emissions achieved from a "project activity": so to regard it is double counting.

121. Of course, this reflects the argument that the policy of the EUETS would be

compromised if surrendered CERs were reused: that is, the argument that a purposive or teleological construction of the Directive requires DB's interpretation be adopted. But I do not think that this submission finds further support because the language of article 11a refers to instruments "from project activities". Surrendered CERs still derive from project activities, and remain instruments certified under the CDM.

122. I therefore accept Mr. Gledhill's argument that, when article 11a permitted the use of CERs, on its proper interpretation it should be understood to have permitted operators to exchange CERs under the EUETS once, and not to have allowed surrendered CERs to be so reused on a second and subsequent occasions.

123. I refer to a further submission of Mr. Gledhill in support of this. Amendments to article 53 of the Regulation made in October 2010 (by article 78(12) of Commission Regulation 920/2010 of 7 October 2010) made it explicit that surrendered CERs could not be exchanged for an allowance. The amendments refer to a bar on surrendering CERs "that are barred from surrendering in accordance with Article 11a of [the Directive]". This is not, I think, simply a reference to paragraph 3 of article 11a: had it been, that would have been made explicit. On DB's argument, that I have accepted, this did not represent a change, but reflects what had always been the legal position under article 11a.

124. Mr. Gledhill submitted that the amendment to the Regulation provides additional support for DB's interpretation because unofficial interpretations of legislation by EU institutions may confirm or strengthen an interpretation arrived at by other means: see Vaughan and Robertson, Law of the European Union, at para 3[95]. He points out that this view was adopted by the Court of Appeal in X v Mid-Sussex Citizen's Advice Bureau, [2011] EWCA Civ 28 at para 61. However, this simply reinforces the conclusion which I would have in any case have reached.

125. If this is correct, Mr. Gledhill does not need to rely upon his alternative argument that in any case the Central Administrator was entitled to prohibit the reuse of surrendered CERs, and so the CITL check introduced in December 2009 and announced in January 2010 was lawful. However, I should deal briefly with this alternative argument. I do so, of course, on the basis that, but for the check introduced by the Central Administrator, the use by operators of surrendered CERs would have been lawful under the EUETS.

126. Article 19(3) of the Directive provided for the Regulation to be adopted "to ensure that there are no transfers which are incompatible with the obligations resulting from the Kyoto Protocol". The Central Administrator was to conduct checks on transactions "to ensure there are no irregularities in the issue, transfer and cancellation of allowances": article 20(2) of the Directive. Mr. Gledhill argued that it would be an irregularity if an allowance (that is, an EUA) were issued in exchange for a surrendered CER, because a single CER, representing the reduction of a single tonne of emissions in a developing country, would be deployed to create allowances for more than one tonne. I am unable to accept that this would be an irregularity if, as is to be supposed for present purposes, such use of surrendered CERs were permitted under the Scheme.

127. Against this Ms. Staddon relied on article 5(3) of the Regulation: "The Central Administrator … shall operate and maintain the [CITL] in accordance with the provisions of this regulation", and observed that Regulation has no provisions relevant to

surrendered CERs. Article 5(5) provides, "The Central Administrator shall only perform processes concerning allowances, verified emissions, accounts or Kyoto units where necessary to carry out its functions as Central Administrators". Thus, Ms. Staddon argued, the central administrator, through the CITL, may only impose restrictions that are required and authorised by the Regulation. Article 32 of the Regulation provided that processes should be of the type set out in the annexes to the Regulation, and, as I have said, the relevant annex, annex IX, does not authorise checks for surrendered CERs.

128. I accept Ms. Staddon's argument on this point. If the Directive and the Regulation had allowed surrendered CERs to be exchanged for allowances, it would not have been lawful for the Central Administrator to prevent this through introducing a check at the CITL, the check would not have been lawful, and surrendered CERs could lawfully have been used notwithstanding the check. I therefore would reject Mr. Gledhill's alternative argument.

Quantum of damages

129. Although CERs are not "goods" within the meaning of the Sale of Goods Act, 1979, but some species of intangible property (see Armstrong DLW GMBH v Winnington Networks Ltd, [2012] EWHC 10 Ch at para 52), nevertheless the measure of DB's damages is prima facie that codified in section 53(3) of the Sale of Goods Act 1979 for breach of warranty by a seller of goods: it is the difference between the value of the CERs at the time of delivery to DB and the value that the surrendered CERs would have had if TGS had delivered CERs that complied with the contract. However, although generally damages are assessed as at the time of delivery, this is not an absolute rule, and it is displaced if logic or justice so requires: Johnson v Agnew, [1980] AC 367 at p.400 per Lord Wilberforce.

130. That much is common ground between the parties. Nor is there any dispute about what would have been the value of the CERs if they had complied with the contractual requirements: that is, if they had been conventional and not surrendered CERs. DB plead and TGS admit that the values of conventional CERs are the closing prices quoted by Point Carbon, a leading provider of data and information relating to the carbon markets, and were on different dates in March 2010 as follows:

10 March 2010: €11.95.
11 March 2010: €11.73.
12 March 2010: €11.42.
15 March 2010: €11.61.
22 March 2010: €11.75.

131. The issues between the parties about the application of the prima facie measure of damages are:

i) As at what date are damages to be assessed; and

ii) Whether the surrendered CERs had, as DB contend, no value at the relevant date or whether they had some, and if so what, value.

132. It is, however, convenient first to consider TGS's submission that DB's damages are to be reduced because they did not mitigate their loss. The burden of proving this is upon TGS: see Chitty on Contracts, (30th Ed, 2008) Vol 1 para 26-103. They do not say that in March or April 2010 DB should have sold the surrendered CERs through either the EUETS or another compliance market or elsewhere. TGS's main complaint is that DB kept the surrendered CERs within the EUETS until 19 April 2010, when, as I have said, measures were introduced that prevented them from selling the CERs later on other markets. This in turn raises these questions:

i) Whether, given the prima facie measure of damages, there is scope for reducing damages because of a failure to mitigate in this way;

ii) Whether it was unreasonable for DB to have kept the surrendered CERs in the EUETS until 19 April 2010; and

iii) Whether as a result DB did not sell the CERs (and if so at what price they could have been sold).

I shall consider them in reverse order.

Would DB have reduced their loss by selling them if they had moved them outside the EUETS?

133. According to Ms Bossley, the best opportunity for selling the surrendered CERs was "in the month running up to the United National Climate Change Conference held in Cancun for two weeks from 29 November 2010". She considered that potential buyers might have waited until the European Commission implemented their changes to the EUETS procedures in response to the sale of surrendered CERs, which they did in October 2010, and that thereafter, as prices for allowances fell before the conference, buyers who were short of allowances might, she thought, "have been tempted to buy". In her opinion, it was "highly likely that a sale of the CERs could have been achieved within the compliance market outside the EUETS after October 2010" had they not been registered in an EUETS account.

134. Mr Radov disagreed. Although after April 2010 there was less press coverage about surrendered CERs, he considered that the news reports had so tarnished surrendered CERs that potential buyers would not have risked their reputation by buying them. There was no shortage of AAUs available on the market for those who needed them, and, even if the offer price for the surrendered CERs had been relatively low, he considered it "highly unlikely" that a country with Kyoto Protocol commitments would have bought them.

135. It is therefore necessary to consider in more detail who might have bought the surrendered CERs. Clearly, participants in the EUETS would not have done so. The potential buyers fall into these categories:

i) Participants in other mandatory schemes;

ii) Countries with Kyoto Protocol commitments; and

iii) Participants in the voluntary markets.

136. There are mandatory emissions trading schemes in four European countries that do not belong to the European Community (and therefore the EUETS): Norway, Iceland, Liechtenstein and Switzerland. Mr Radov and Ms Bossley agreed that the surrendered CERs would not have been eligible under the trading schemes of Norway and Liechtenstein, which have rules similar to, if not the same as, the EUETS. Iceland's scheme was not significantly operational at the relevant time: in July 2010 it still did not have an operational registry, according to the registry reports of the UNFCCC, and as at the end of 2010 there were still no allowances (whether EAUs, CERs or ERUs) held in any of the accounts in Iceland's scheme.

137. I also conclude that the Swiss emissions trading scheme ("ETS") would not have provided a market for selling the surrendered CERs. Although in her reports Ms Bossley appeared to suggest otherwise, in the end this was common ground between her and Mr Radov.

138. The Swiss government allows companies that use large amounts of energy either to join the federal carbon trading scheme or to pay a carbon tax. In 2010, 431 companies had chosen to join the scheme and accepted limits on their emissions, but most of them did not need to buy allowances because their emissions were within their allocated limits. Only 131 companies needed to buy additional allowances through the trading scheme and in total they needed to buy only some 100,000 tonnes of allowances. Most companies had an excess of allowances that they were in a position to sell.

139. For this reason alone there was only a small potential market, but in any case I conclude that there would have been no real prospect that the surrendered CERs might have been used under the Swiss ETS. First, the foreign instruments could be used under the Swiss ETS only if their use had been specifically approved by the Federal Office for the Environment, and, in my judgment, there would have been no realistic prospect of them approving use of surrendered CERs. The intention was that the Swiss ETS should become linked to the EUETS – negotiations formally began in October 2010 and in December 2010 the Council of the EU had authorised the Commission to open negotiations in order for the schemes to be linked. I cannot accept that in these circumstances those administering the Swiss scheme would have decided to accept instruments that the EUETS had prohibited in the circumstances of the surrendered CERs. Secondly, the Swiss government had demonstrated hostility to CERs derived from HFC-23 projects and for this reason they would not have accepted the vast majority of the surrendered CERs. Moreover, the Swiss scheme allowed only 8% of operators' allowances to be foreign instruments, and this would have limited the potential market to about 25,000 tonnes (8% of the requirements of the 131 companies, that were in total for allowances for some 364,000 tonnes).

140. The mandatory trading schemes outside Europe for consideration are those of New

Zealand and Australia and Japan. Mr Radov and Ms Bossley agreed that the surrendered CERs would not have been eligible under the RGGI.

141. I can deal with the New Zealand ETS briefly because it is a very small market (although in the experts' joint memorandum the most relevant national ETSs were said to be those of Switzerland and New Zealand). The New Zealand ETS began in 2008 but until July 2010 it was only for the forestry sector, which accounts for a large proportion of New Zealand's emissions. Other industrial and energy sectors then came under the scheme. The scheme accepts CERs but not foreign AAUs, and according to Mr Radov's unchallenged evidence, which I accept, this reflects, first, concern about whether AAUs from Eastern European countries had "environmental integrity" (that is, represented any real contribution towards achieving environmental goals), and, secondly, the intention that the New Zealand ETS should become linked to larger schemes, including the EUETS. It would have been inconsistent with both these purposes if the administrators of the New Zealand scheme accepted surrendered CERs. Although the rules governing it did not make clear whether or not surrendered CERs could be used, they probably would not have been allowed. Both for this reason and because of the size of the market, the possibility of sales of the surrendered CERs in the New Zealand ETS is insignificant for present purposes.

142. The Australian ETS is to be created under the Australian Clean Energy Act, 2011 and is not to start until 2015, if not later. However, Ms Bossley considered that operators who are to be in the scheme might have been interested in acquiring allowances in preparation for when it comes into force. Even assuming that this is so, I am unable to accept that this would have provided a market in which the surrendered CERs could have been sold. It seems unlikely that surrendered CERs will be accepted under the scheme when it starts, and, although detailed arrangements for the scheme have not been finalised, I cannot accept that there was any significant prospect that an operator would have bought instruments in the hope that they could be used. Not only would it have been obvious that the controversial instruments will probably not be accepted by those drafting the terms of the new scheme, but more specifically the 2011 Act contemplates that the Australian scheme should become linked to other schemes such as the EUETS, and the Australian Government had indicated that it intended to prohibit the use of CERs derived from HFC23 and nitrous oxide projects.

143. I conclude that there would not have been a market for the surrendered CERs in the mandatory compliance trading schemes in Europe or outside Europe other than the EUETS.

144. I come to the possibility that the surrendered CERs might have been sold to countries with commitments under the Kyoto Protocol, the Kyoto Protocol market being by far the largest other than the EUETS. My purpose here is to identify potential purchasers of the surrendered CERs and to decide whether they would probably have been sold if DB had been free to sell them outside the EUETS after 19 April 2010; it is not to decide at what price they might have been sold if there was a potential market, or to assess more precisely the chance of a sale. However, it is relevant to observe at the outset that there was a buyers' market for units that could be used to meet Kyoto Protocol commitments because of the glut of AAUs.

145. The expert witnesses identified 9 countries whose actual emissions significantly exceeded their allocations, and seemed likely to need to buy allowances in order to meet their commitments: namely, Canada, Australia, Spain, Japan, Italy, Austria, New Zealand, Denmark and Switzerland.

146. Mr Radov and Ms Bossley agreed that there was no realistic possibility that countries in the EU would have been interested in buying the surrendered CERs. They would have had to do so through the EUETS, which would not have been possible. In cross-examination Ms Bossley also agreed with Mr Radov that there was no realistic prospect that Canada would have been interested in buying them because the Canadian government has stated that Canada will not comply with its Kyoto Protocol commitment for the first period, 2008 to 2012.

147. Mr Radov's evidence was that, in order to meet its Kyoto Protocol commitment, Switzerland has contracted with the Climate Cent foundation, a quasi-independent organisation, to bring about emissions reductions. The agreement stipulates that emissions reductions must not derive from specified projects, including the destruction of HFC-23. Mr Radov infers that the Swiss Government would not have accepted the majority of the CERs even if they had been conventional and not surrendered. I agree with Mr Gledhill that for practical purposes Switzerland can be ruled out as a potential purchaser. That leaves New Zealand, Australia and Japan.

148. In my judgment the evidence does not conclusively rule out New Zealand and Australia as potential purchasers, but I have explained in relation to their trading systems why it seems unlikely that these countries would have been interested in buying the surrendered CERs. I add only that New Zealand would have been the less likely to buy them because of their hostility to CERs derived from industrial gasses such as HFC-23 and nitrous oxide, reflected in a proposal from a government appointed panel that such instruments should be considered ineligible for compliance purposes.

149. In Japan the Government has created a nominally voluntary scheme under which about 1,000 large Japanese corporations are required to buy AAUs or emission credits (by way of CERs and ERUs) to enable the Japanese government to meet its Kyoto Protocol commitment. As a result, Japanese corporate buyers play a significant role in the AAU market and there is a close relationship between the interests of the Japanese government and Japanese corporations. As I have said, when news of the surrendered CERs was first reported, it was thought that they were destined for Japanese buyers: that Japanese corporations would buy the CERs in order to enable the government to meet its commitment.

150. Ms Bossley accepted that the Japanese market shared the disapproval of others for instruments from HFC-23 projects, but there is no evidence that this would have ruled out all possibility that there would be Japanese purchasers for the surrendered CERs. When DB explored the Japanese market in late March 2010, their broker reported that the Japanese Ministry of Economy, Trading and Industry said that at that time ("for now") no distinction was drawn between conventional and surrendered CERs, and a potential buyer had indicated that he considered the fact that the CERs were surrendered as a reason that their price should be discounted below that for "greened AAUs" (an expression that I explain below at para 172) rather than that he had no interest in them.

In the event, there was no sale. There would not, in my judgment, have been enthusiasm among Japanese corporations to buy the surrendered CERs in the autumn of 2010 if DB had been in a position to seek offers. DB could have attracted interest only if they had been willing to sell them at a much reduced price, far below the price of AAUs.

151. Finally, as far as the Kyoto Protocol market is concerned, it was suggested that Russia and Ukraine might have bought the surrendered CERs not because they were short of allowances to meet their Kyoto Protocol commitments - they had a considerable excess - but because Ms Bossley thought that they might have bought them for arbitrage purposes if the price of the surrendered CERs fell below that of AAUs. It was not explained why these countries would be interested in buying them for this purpose if others would not have been, or why Russia or Ukraine might have taken a more optimistic view of their potential value than others. I do not consider that this possibility significantly enhances the chance that DB would have sold the surrendered CERs if they had been free from the prohibition imposed by the European Community.

152. Finally, the voluntary market: as I explained at paragraph 24 above, this is very small compared with other markets, and those who participate in it do so because of their concern about the environment or to enhance their reputations or both. As Ms Bossley put it, "they are there because they want to be and therefore are likely to be pickier [about what they buy]". I cannot accept that these buyers would have been interested in CERs that had been surrendered and that were mostly derived from HFC 23 and nitrous oxide projects.

153. I conclude that the only realistically possible purchasers of the surrendered CERs would have been New Zealand, Australia or Japan, who might have bought them in the autumn of 2010 to go to meet their Kyoto Protocol commitments, but there is good reason to suppose that New Zealand and Australia would not have done so, and that Japanese buyers could only have been attracted, if at all, by DB offering them at a very low price.

154. I conclude that DB would not have sold the surrendered CERs in the autumn of 2010 even if they had not been held in their EUETS account. If they could have found a purchaser, they would have had to accept such a low price that it would have underlined the widespread disapproval of the instruments. DB could not reasonably have been expected to face the risk, indeed the likelihood, of the damaging publicity that such a sale would have attracted, and I do not believe that they would have sold them in such circumstances. This decision would not have been open to criticism as a failure properly to mitigate their loss.

<u>Should DB have moved the surrendered CERs out of the EUETS before 19 April 2010?</u>

155. Mr Lawless said that DB considered in "mid-April 2010" whether they should transfer the CERs to their account with the Swiss registry or elsewhere outside the EUETS when and because there were news reports suggesting that there was to be a complete ban on the movement of surrendered CERs within the EUETS. They did not do so for a number of reasons.

156. First, on 18 March 2010 DB had reported to the European Commission that they had taken delivery of the surrendered CERs (and that they had sold a small number of them, which they were negotiating to retrieve), and promised to "quarantine these CERs and [to] ensure that they do not re-enter the European market". They considered this necessary to maintain confidence in the EUETS, particularly because they were a leading participant in the market and concerned not to jeopardise their reputation. Mr Lawless reiterated DB's promise in a telephone conversation with Ms Slingenberg on 26 March 2010. DB have not been criticised for making these commitments. Although Ms Slingenberg was, as Mr Lawless put it, "essentially unsympathetic", DB did not want to do anything that might be perceived to be inconsistent with the assurance that they had given.

157. Secondly, and more generally, DB did not want to do anything that might, in Mr Lawless's words, "attract unnecessary negative attention". By this, as I understand it, he meant that, if they took the potentially controversial step of moving the surrendered CERs so that they were out of the control of the EUETS, the resultant discussion or publicity would further damage the market and DB's standing in it.

158. Further, DB thought that, as matters stood in the second half of March and the first half of April 2010, they had no real chance of selling the surrendered CERs, or at least of selling them on acceptable terms and in particular the basis that they would not re-enter the EUETS. On the other hand, DB thought that, once the European Commission had taken steps to prevent more surrendered CERs (re)entering the EUETS, they might have the opportunity to hold productive discussion about how to deal with those instruments that were already "in the system".

159. In principle, the question whether DB took reasonable steps to mitigate their loss is objective: it depends upon whether what they did or did not do was objectively reasonable (that is to say, whether their efforts to deal with the loss were objectively reasonable for someone in their position), and not upon DB's reason for acting as they did. This is implicit, for example, in the judgment of Visc. Haldane in the British Westinghouse Electric case: [1912] AC 613 at pp.689, 690. The reasons that DB did not move the surrendered CERs to their Swiss registry account, or otherwise outside the EUETS, seem to me cogent and to demonstrate that their decision was a reasonable one. Certainly it does not fall below the standard required as to mitigation of loss of an injured party, whose conduct is not judged by a particularly high standard (see Chitty on Contracts (30th Ed, 2008) Vol 1 para 26-104) and who is entitled to have due regard to his commercial reputation (see Banco de Portugal v Waterlow, [1932] AC 452).

Does the measure of damages answer TGS's complaint of failure to mitigate?

160. Mr Gledhill submitted that in any case the measure of damages, together with the identification of an appropriate date for assessment to ensure that justice is done, answers TGS's complaint because it assumes that the injured party has appropriately mitigated the loss. I agree with this submission. As Lord Brown said in Golden Strait Corpn v Nippon Yusen Kubishika Kaisha, [2007] 2 AC 353 at para 79, the explanation for the general principle in cases governed by section 51 of the Sale of Goods Act, 1979 (non-delivery of goods) is that the injured party should ordinarily go out into the market (if one is available) to make a substitute contract to mitigate (and generally thereby to

crystallise) his loss. So too in a case of delivery that does not comply with the contractual terms, the general principle is that the injured party, having received the delivery and not rejected it, should ordinarily go out into the market (if one is available) to mitigate his loss.

161. Further, as Mr Gledhill observed, citing Jamal v Moolla Dawood, Sons & Co, [1916] AC 175 at pp.179,180 and Slater v Hoyle & Smith, [1920] 2 KB 11, if DB had sold the CERs after the assessment date for more than their value at that date, the additional recovery would not have been brought into account when assessing their damages so as to reduce them (any more than DB's damages would have been increased if they had later sold the CERs for less than their value on the assessment date or, as in this case, not sold them at all). It is therefore irrelevant to the assessment of damages that DB might have mitigated their loss in this way.

162. It does not follow from Mr Gledhill's argument that damages measured as in this case will never be reduced because of a failure to mitigate. I need not, for example, consider the position where an injured party rejects an offer from the wrongdoer that would go to reduce the loss. It is sufficient to say that, in my judgment, Mr Gledhill's argument answers the complaint that DB should have mitigated their loss by transferring the CERs to Switzerland or elsewhere before 19 April 2010 and that then they could, in due course, have sold them.

Conclusion on mitigation

163. I therefore reject this contention of TGS about mitigation. TGS have suggested that DB should have mitigated their loss in two other ways. First, they pleaded that DB should have cancelled the CERs and brought them into account towards meeting their own voluntary environmental commitment. Although this course was considered internally within DB, Ms Staddon rightly abandoned this argument: it would not have advanced the purpose of DB's voluntary commitment to have used the CERs in this way.

164. TGS also suggested that the surrendered CERs could have been "sold" in the voluntary market, and this could have been done after 19 April 2010 because a buyer with a voluntary commitment would have been content for DB themselves to cancel the CERs rather than to deliver them to the "purchaser" for cancellation. I do not consider that there is anything in this suggestion. First, as I have explained (at para 152 above) I do not consider that the voluntary market would have bought the surrendered CERs (whether or not they were in the EUETS). In any case, any possibility of such a sale is brought into account in assessing the value of the surrendered CERs in the primary measure of damage: in other words, the argument is met by Mr Gledhill's submission that there is no scope for mitigation in these circumstances.

At what date should damages be assessed?

165. As I have said, the application to contracts of sale of the principle that damages are compensatory means that generally they are assessed as at the date of breach. In this case the contracts were breached when surrendered CERs were delivered on 10, 11 and 12 March 2010. Neither party argues that damages should be assessed as at that date.

TGS submit that they should be assessed as at 15 March 2010, the date when DB became aware that all the CERs delivered to them were surrendered. DB argue for assessment as at 22 March 2010, and I accept DB's submission.

166. The question whether some date other than the date of breach should be used to assess damages is closely associated with mitigation of damage: see, for example, Andrew et al, Contractual Duties: Performance, Breach, Termination and Remedies (2011) para 21-088. In Radford v De Froberville, [1977] 1 WLR 1262 at p.1285H Oliver J said that:

> "In contracts for the sale of goods … where there is an available market, the date of non-delivery is generally the appropriate date because it is open to the plaintiff to mitigate by going into the market immediately. Where there is no readily available market a later date may be appropriate."

22 March 2010 was the first working date after the expiry of the deadline of 19 March 2010 imposed by DB's letter of 18 March 2010. It was not suggested that DB were unreasonable to give TGS the opportunity to remedy their breach: they might have been open to criticism had they not done so. It would, I think, be unjust to reduce DB's damages by assessing them at an earlier date than 22 March 2010.

What value (if any) did the CERs have at the date for assessing damages?

167. DB claim damages of €5,781,000 on the basis that on 22 March 2010 492,000 conventional CERs would have been worth €5,781,000, whereas the surrendered CERs were worth nothing. Their primary submission was that by 22 March 2010 there was no market for the surrendered CERs and therefore they had no value. However, the assessment of damage in such cases as this is not concerned only with the market value of assets in the sense of their immediately realisable value, and assets may have values even if they cannot immediately be realised. As is stated in Tettenborn, The Law of Damages (2nd Ed) at para 22.99, "Where there is no ready market in the assets involved, … presumably the court must do its best, using whatever material is available to it, to construct a market value or otherwise compute what the claimant has lost". Gebruder Metelmann GmbH & Co KG v NBR (London) Ltd, [1984] 1 Ll Rep 614 is an example of a case where value was assessed in the absence of an available market by reference to the terminal or futures market. The assessment of the value of the surrendered CERs is a particularly difficult exercise:

i) Because no surrendered CERs, as I conclude, were sold after 12 March 2010 when the news about the sale of the surrendered Hungarian CERs broke and disrupted the market;

ii) Because at the relevant time there was no market even in conventional CERs; and

iii) Because, as Ms Bossley said, the market in instruments of this kind is new and,

in her words, "we're making it up as we go along".

But this does not excuse the court from making the best assessment that it can.

168. TGS's primary argument, based on Ms Bossley's evidence, was that the value of the surrendered CERs is best assessed as being 80% of the value of conventional CERs because the price paid to the Hungarian government by HEP was about 80% of the contemporaneous market price for conventional CERs. I cannot accept that approach. The difficulty is not that it involves assessing a value for conventional CERs: that can be done, if inexactly (see para 130 above). It is that the price paid by HEP for the surrendered CERs was agreed before the disruption brought to the market by the news of their sale, and that price and its relationship with the price of conventional CERs provide no guidance to their value afterwards.

169. Having rejected, therefore, the primary position of both the parties, either of which would have given a relatively straightforward answer to the assessment of quantum, I must engage with a more difficult and uncertain exercise. The market price of conventional CERs is higher than that of AAUs, and this reflects that they can be used in other trading schemes as well as the Kyoto Protocol market, and in particular in the EUETS. Because they had been surrendered, the CERs in this case could no longer be used under the EUETS (either practically or, as I have concluded, in accordance with the relevant legal provisions), and so lost this advantage over AAUs. However, they still could be used under the Kyoto Protocol, and they were equivalent to AAUs for those purposes. And, at least in theory, they could be used under some other markets, including the voluntary market.

170. There were therefore two reasons that surrendered CERs might be worth less than conventional ones: (i) simply because they were surrendered, and for that reason alone and because of the publicity surrounding them they were less attractive to market participants; and (ii) because the EUETS had prohibited their use. I must consider whether and how these two considerations affected their value on 22 March 2010.

171. Mr Radov considered that therefore there is no good reason that a surrendered CER should command a price higher than that of an AAU, and the market values of AAUs therefore provides a ceiling when assessing the value of surrendered CERs. This argument requires me to assess the value of AAUs at the relevant time, but a market value is not readily ascertained. As the experts agreed in their joint memorandum, the number of transactions in AAUs is very limited and, being typically between governments, they are not "transparent".

172. Mr Radov explained another difficulty in assessing their value. Countries buying AAUs often require the sellers to give a commitment to "Green Investment Schemes" (or "GISs"), the aim of which is to ensure that the proceeds from sales of AAUs should be used for purposes which bring environmental benefits. As the supply of AAUs has increased on the market and buyers therefore can be more demanding, they have increasingly required of sellers commitments that will benefit them, such as requiring sellers to undertake GIS projects from which companies of the buyer countries might profit. The demand for these "greened" AAUs (as they are called) can obscure the market value of the AAUs themselves, and mean that reported prices are an

unreliable indicator of it.

173. Despite these problems, the expert witnesses were able to form a view about the value of AAUs. Mr Radov's evidence was that in around March 2010 the market price charged in a "greened" AAU sale, that is a sale associated with a GIS acceptable to the purchaser, was around €6 to €8 per AAU. Ms Bossley said that prices for AAUs in 2010 were around €5 to €7. I accept Mr Radov's evidence, and, in view of that of Ms Bossley, I narrow his range for the value at the relevant time to €6 to €7.

174. Mr Radov's evidence went further: he considered that the value of surrendered CERs was lower than that of AAUs for three reasons:

i) There were few surrendered CERs relative to the volumes typically traded in AAU transactions, and countries with compliance commitments would generally have been interested in much larger volumes than they could have bought by way of surrendered CERs. The transaction costs that they would have incurred would have depressed the amount that buyers would have paid.

ii) If DB were selling surrendered CERs, they would not be able to offer incentives of the kind associated with GISs that governments selling AAUs could provide.

iii) Buyers of the surrendered CERs would risk unfavourable publicity, and Mr Radov thought that this would reduce the price that they might attract (assuming that they could have been sold at all).

175. Ms Bossley disputed all three points. She did not think that governments would have been deterred by the relatively small number of surrendered CERs available. I cannot accept this, given that purchasers would have been unused to buying surrendered CERs and, I infer, would have needed to research and be advised about what they were buying. This would inevitably have affected what they would pay.

176. Secondly, Ms Bossley did not dispute that government buyers of AAUs are attracted by GISs, and that there would not be comparable incentives upon a sale of the surrendered CERs. I infer that this too would have affected their value. Ms Bossley observed that CERs are "already greened", by which she meant that CERs have been verified as meeting the requirements of the CDM. That is so, but it does not answer Mr Radov's point that some purchaser governments would have been looking for GISs that brought their country collateral benefits.

177. Thirdly, Ms Bossley accepted that in the period between the contracts and 19 April 2010, if it be supposed that surrendered CERs could have been sold at all, the price would have been at a discount to the prices commanded by AAUs. However, she considered that by the autumn of 2010, when (in her opinion) the surrendered CERs could have been sold, they would have traded at a premium to AAUs: whereas CERs (whether surrendered or conventional) represented emission reductions that had been verified under the CDM, the AAU market was dominated by "hot air" allowances, particularly from Russia and Ukraine, and countries that needed more allowances to meet their Kyoto Protocol

commitments would have been reluctant to buy "hot air" AAUs unless enticed by an attractive GIS arrangement. Moreover, Ms Bossley thought that surrendered CERs would have attracted a higher price than AAUs because they could have been used under the Swiss, Japanese and New Zealand trading schemes and because they could have been sold in the voluntary market as "high quality offsets verified to the [CDM] standard". I do not find that reasoning convincing. If a country is reluctant to buy "hot air" allowances out of concern for its reputation (as New Zealand is: para 141 above), it will, as I see it, be the more concerned about the reputational risk associated with surrendered CERs.

178. Ms Bossley also observed that generally CERs can be traded more flexibly than AAUs and that the market for them is wider. I accept that that is generally the position with conventional CERs, but not that the flexible and wider market would have assisted the holders of surrendered CERs.

179. I conclude not only that the value of AAUs provides a ceiling for that of surrendered CERs, but that, for the reasons that Mr Radov explained, the value of surrendered CERs was less than that of AAUs.

180. How then did the EUETS restrictions upon trading in surrendered CERs affect their value? Given the common ground that there was no active or "available" market in surrendered CERs on 22 (or 15) March 2010, any value that they might have had reflected the possibility, or more precisely the perception of a possibility, that in the future they might be sold under the EUETS or that they might be sold elsewhere (or both). I have already explained the problems about selling them outside the EUETS. In fact, neither DB nor TGS were able to dispose of any of those which they held.

181. In order for the surrendered CERs to have been sold under the EUETS, it would have been necessary for the European community to have removed the obstacles to their sale, and specifically lifted the CITL check. Mr Gledhill submitted that at the relevant time it would have been wholly unrealistic to think that the check would be withdrawn. He identified three reasons:

i) It had been introduced in December 2009 and announced in January 2010. In the weeks following the announcement it had not, as I conclude, been challenged by any market participant, and any effective challenge to it would probably have been made before 22 March 2010.

ii) By 22 March 2010, trade bodies had expressed support for measures against surrendered CERs. I have referred to the press release of IETA (at para 30 above). Further on 12 March 2010, the Carbon Markets & Investors Association had issued a press release "call[ing] on all European Member States that are committed to addressing climate change to refrain from selling [CERs] that ha[d] been surrendered to them …". Given this reaction, the European Commission would have been encouraged to maintain their controls.

iii) The evidence indicates that Commission officials would have resisted any relaxations suggested by the market. Mr Lawless described Ms Slingenberg as

"a self-confessed environmental ethicist with no knowledge or understanding of how markets work".

182. However, I am to assess the value of the CERs as at 22 March 2010. Although, with hindsight, it can be seen that, once the news about the surrendered CERS had caused alarm in the market, the damage was permanent, at the time some thought that the European Commission would moderate their hostility at least to surrendered CERs being sold on other markets than the EUETS.

183. I set out Mr Lawless's evidence about his contemporaneous views as to whether the European Commission would resist proposals from the market to solve the problem caused by the surrendered CERs. He held a senior position in a leading participant in the market, there is no reason to think that others in the market did not share his views, and I infer that some would have done so:

> "At the time, I also expected that the proposed EU-wide solution of preventing the movement of all Surrendered CERs would be a temporary fix, to prevent more Surrendered CERs *entering* the EUETS. I thought that with that immediate risk having been brought under control, a technical solution would be conceived and put in place to enable Surrendered CERs to be tagged and automatically stopped from being transferred back into the EUETS. My expectation at the time was that once such a technical solution was in place, if we could put together a deal in principle to move Surrendered CERs *out of* the EUETS, we would be able to take that proposed deal to the Commission and get approval for it to take place. "

184. There is also evidence that some were optimistic that the surrendered CERs could in any case be sold outside the EUETS. For example, on 18 March 2010 there was a report in Point Carbon that "Japanese companies can reap a windfall by buying recycled CERs, sources said today". It suggested that because surrendered CERs could be used in the Japanese corporate emission trading system, Japanese companies had been presented with the opportunity for "an almost risk-free arbitrage". It referred to the possibility of an arbitrage "on paper" of €2.50 per CER (€11.50 being the market price for conventional CERs and €9 being the price for which the Hungarian government sold the surrendered CERs); and it reported the view of Mr Henrik Hasselknippe, the Head of Carbon Analysis at Point Carbon, as being that, "The CER holding by Japanese companies is likely to be more than sufficient to recycle all the used CERs currently available in the market".

185. This report was sent to Mr Lawless by Mr Theodore Backhouse, DB's Head of Environmental Financial Product Structuring Asia; and Mr Lawless responded, that because the surrendered CERs "represent real verified emissions reductions they should trade at a premium to AAUs … but obviously at a discount to [conventional] CERs…. Fair value probably in the 9.0-10.0 region". Mr Lawless said in his evidence that he now recognises that this estimate of the price for surrendered CERs was "overly optimistic", and that there was in fact no market at all at the time for surrendered CERs. I have rejected the view that surrendered CERs would (or should) trade at a premium over AAUs (see para 179 above). However, again there is no reason to think that Mr

Lawless alone among markets participants held this view at the time.

186. This being the sentiment of some market participants, I cannot accept that the surrendered CERs were entirely valueless, and some more optimistic market participants who were willing to speculate would, I infer, have bought the CERs if the price was low enough. The market had collapsed and the evidence of the experts makes it clear that there was little interest in the surrendered CERs. The question is how low a price would a seller have had to accept in order to attract a speculator.

187. How then am I to quantify DB's damages? I cannot *calculate* the value of the CERs. I can only *estimate* it as best I can, in light of the expert evidence, what loss DB have established on the balance of probabilities. They have not established that the surrendered CERs had no value. They have established that they were worth less than AAUs, that is that they were worth less than about €6.50 each. The reasons that Mr Radov gave in support of his opinion about this were, to my mind, powerful and cogent and they persuade me that the surrendered CERs were worth much less than AAUs. Looking at all the evidence, DB have persuaded me that the CERs were worth no more than half the value of AAUs, but I cannot accept that they have proved more than that.

188. I therefore attribute to the surrendered CERs a value as at 22 March 2010 of €3.25 each, and I calculate damages on that basis. (Had I accepted TGS's argument that the date of assessment should be 15 March 2010, I would still have assessed the CERs' value at €3.25 each.) On this basis, my calculation of DB's damages is that the loss on each CER was €8.50 (€11.75 less €3.25), and so their damages in respect of the 492,000 CERs are €4,182,000.

Conclusion

189. DB's claim succeeds, and I assess their damages at €4,182,000.

190. I shall invite submissions about the order that I should make in light of this judgment, including about whether DB are entitled to costs under section 11 of the ISDA Form, a question that Mr Gledhill raised in opening and consideration of which was deferred.