

# **ENDS** *Europe* **Breakfast Seminar**

**‘International aviation in the EU ETS:  
has the EU overstepped the mark?’**

**21 October, 8.30am, The Carbon Show,  
Business Design Centre, London.**

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## **BRIEFING NOTE: AVIATION AND THE EU ETS**

Carbon dioxide emissions from flights into and out of European airports will be included in the EU Emissions Trading Scheme (ETS) from 1 January 2012.

The plan was agreed by EU member states and the European Parliament in 2008 but with the start of the scheme looming some airlines and foreign governments are fighting back.

### **The basics**

Aviation is one of the fastest growing sources of greenhouse gas emissions. Its CO<sub>2</sub> emissions currently account for around 2% of the global total, but could quadruple by 2050 if left unchecked. European emissions from the sector have doubled since 1990.

Frustrated at the lack of international action, the European Commission began work on including aviation in the ETS in 2004. To ignore aviation emissions would be unfair to other sectors covered by the ETS, it argued.

The move was also consistent with a resolution agreed that year by the UN's International Civil Aviation Authority (ICAO). This ruled out plans for a global aviation emissions trading scheme but promised support for countries wanting to incorporate aviation into their own schemes.

Parties to the convention have since reopened the debate on common market-based mechanisms.

The EU's aviation directive, adopted in 2008, extended the ETS to include the total CO<sub>2</sub> emissions of all flights entering and leaving EU airports. This was done to ensure equal treatment of operators, irrespective of their nationality, and because most CO<sub>2</sub> is emitted during take-off and landing.

But the move has also led to accusations that the EU is acting beyond its jurisdiction and will effectively be regulating foreign airlines as they fly through non-EU airspace.

Participants in the EU ETS have to surrender enough allowances each year to cover their emissions in the preceding year. They also have to comply with a range of monitoring and reporting requirements – for airlines, these entered force in 2009.

When the scheme begins in earnest next year, CO<sub>2</sub> emissions from aviation will be capped at 97% of their 2004-06 level, falling to 95% for 2013-20. This amounts to 212.9 million tonnes of CO<sub>2</sub> in 2012 and represents an increase in the total EU ETS cap of around 10%.

## **Free allocations and the cost to airlines**

The European Commission will give away 85% of the EU allowances created for airlines in 2012 for free, distributing them based on airlines' past activity levels. Another 15% will be auctioned, with member states forced to spend the revenues on tackling climate change. From 2013, some of the free allowances will be retained for new entrants and rapidly growing airlines.

To qualify for free allowances, airlines had to submit figures on the passenger-tonne-kilometres they flew into and out of EU airports in 2010 to regulators by 31 March. Some appear to have been late submitting these figures, but it was not a mandatory requirement.

The European Commission used the data to compile a benchmark for allocation, released in September, and member state regulators must publish their full allocation plans, based on this benchmark, by 26 December. The sector will receive its free allowances next February.

The use of past activity levels to allocate free EUAs, rather than historical emissions, ensures airlines with more efficient fleets are not penalised. But there are some concerns over the relative treatment of short-haul and long-haul flights. Airlines with more long-haul routes carry out fewer fuel-hungry take-off and landings per kilometre and will therefore do better than predominantly short-haul airlines.

Operators with more fuel-efficient fleets and the fullest aircraft will also receive a higher proportion of their allowances for free.

Carbon market analyst Point Carbon believes the rise in aviation emissions since the 2004-06 baseline year will force the sector to buy 88 million allowances in 2012 on top of the 176 million it gets for free. At today's ETS price, this would cost the industry around €1.1bn.

The average scheduled passenger carrier will receive 56% of its allowances free, and dedicated freight carriers, 52%, Point Carbon says. But Air France/KLM, British Airways and Lufthansa will all be given 81% of their EUAs.

The total cost of including aviation in the ETS was fiercely debated during the directive's adoption, with European airline associations claiming it would cut passenger numbers and lose them €45bn over ten years.

However, the Commission believes the impact on both the industry and passengers will be minimal. Buying allowances should add less than €2 to the ticket price for a transatlantic flight at current prices, it suggests. It admits other sectors have passed on the value of free EU ETS allowances to their customers in the past, but even this would increase ticket prices by only around €12.

## **Legal challenge by US airlines**

The US Air Transport Association of America (ATA) and American, Continental and United Airlines challenged their inclusion in the ETS through a British court in 2009. The case was referred to the European court last year and a hearing held over the summer.

The airlines believe the EU is breaching several international laws and treaties, plus "customary" international law, by effectively requiring non-EU airlines to have a licence to operate in areas outside European jurisdiction.

In particular, they claim the 1944 Chicago Convention forbids national governments from imposing taxes, duties and charges on airline operators, and that the EU is breaching the 1997 Kyoto Protocol, requiring aviation emissions to be addressed through ICAO, and the US-EU Open Skies Agreement.

A lawyer speaking on behalf of the ATA at the hearing said it was not opposed to emissions cuts but "unilateral and piecemeal measures can only result in chaos". The ETS counts as a tax because operators will be charged for each missing allowance, he said.

The International Air Transport Association (IATA) and National Airlines Council of Canada supported the US position at the Luxembourg hearing, suggesting that the EU's actions could slow international action on climate change.

Putting its case, the European Commission said participation in the ETS was a requirement placed on airlines flying into and out of European airports rather than an extra-territorial regulation. It cannot be a tax, charge or levy because allowances have no fixed price, are distributed for free, and will not need to be bought if airlines cut their emissions, it says.

The Commission also believes the airlines were wrong to assume they could use international laws to contest its legislation. It is not a signatory to the Chicago Convention and even if it were, case law suggests this should not be used as grounds for appeal, it claims.

Opinions on the case vary within the EU's aviation industry. Some organisations want the scheme reformed or delayed to ensure they do not suffer as a result of the international opprobrium it has stirred up, others support the European Commission position.

The latter group includes the low-cost airlines, which considered entering the legal case on the Commission's side. Although short-haul flights suffer in the free allocation of allowances, they tend to have newer and more efficient fleets than traditional airlines and more flights within EU borders.

## **The advocate general's opinion**

The European court's advocate general Juliane Kokott gave her opinion on the case on 6 October. She strongly backed the EU position, suggesting the airlines' arguments were based on a misinterpretation of the rules and treaties they invoke and an "erroneous and highly superficial reading of the [2008] directive".

There is insufficient evidence to prove the principle of customary international law cited by the airlines actually exists, Ms Kokott believes. And the Chicago Convention is not legally binding for the EU and cannot be interpreted as prohibiting fees or charges for entering, leaving or transiting through national or regional airspace.

In reality, the convention merely prohibits differential access to airports for airlines of different nationalities, she says. In any case, EU ETS cannot be seen as a tax and does not discriminate between airlines.

Ms Kokott also dismisses the airlines' suggestion that the Kyoto Protocol only permits action on CO<sub>2</sub> through ICAO. "There is no reference to any kind of exclusivity in the actual wording," she says.

The court is expected to deliver its ruling in early 2012, but its judges rarely deviate from the advice given by advocate generals. While the ruling is technically a preliminary one, to be passed back to the UK court, the national court is unlikely to ignore the EU judge's advice.

## **Political challenges**

Even if the EU wins its legal battle with the airlines, the war is not over. The inclusion of foreign airlines in the ETS has also become a major political issue.

The US government raised a formal complaint about its airlines' inclusion at a meeting with the EU in June, and a cross-party bill introduced to the House of Representatives on 20 July would ban US airlines from the scheme altogether. What position the US government will adopt on this law remains to be seen.

Since then, a number of the governments opposed to the EU's plans have met in India to agree a declaration urging the EU to drop international flights from the ETS.

The 21 signatories to the New Delhi agreement, which include Brazil, China, India, Japan, Russia and the US, promise to “continue to work together to oppose the imposition of the EU ETS on our operators”.

As yet, no foreign government has launched a legal challenge to the scheme, but India has threatened action through the World Trade Organization and China suggested in May that an order from European aircraft maker Airbus might be cancelled in retaliation. The Chinese threat prompted considerable concern among the EU industry.

## **Equivalent measures?**

The European Commission has been discussing the ETS with opposing governments over the summer, pinning hopes of a compromise on a provision in the 2008 directive on “equivalent measures”. This allows incoming flights from a particular country to be exempted from the ETS providing the country has policies with “an environmental effect at least equivalent to that of [the directive]”.

The whole section is only three paragraphs long and says nothing about judging or approving equivalent measures proposed by third-country governments, or how their performance would be tracked. The Commission says this is deliberate; it does not want to dictate what other countries come up with and will consider any suggestions.

But the US government, MEPs, and airline associations have all said the lack of detail is unhelpful. Some commentators also fear the provision could create further fragmentation of global aviation climate policies and complexity.

The potential success of the equivalent measures approach depends to some extent on the country in question. The EU appears to have some hope of reaching an agreement with China which is already aiming to reduce carbon emissions from its airlines by 20% by 2020 and has the advantage of a relatively new and efficient fleet.

However, the US is not expected to follow this route. It would be hard for any measures to win approval when the House of Representatives is expected to vote in favour of an anti-EU ETS bill. American airlines, like IATA, also remain wedded to an international approach.

## **What now?**

Despite foreign airlines’ complaints, the European Commission says the main players have been complying with the 2008 directive so far.

They effectively have until April 2013 before they have to pay out for allowances, but any further legal challenges will take much longer than that to resolve. Some supporters of the ETS hope opposition will fade once the scheme beds down.

The number of flights within the ETS is also due to expand with Croatia’s accession to the EU and a plan by Switzerland to link its emissions trading scheme to the EU’s. The Commission has also talked about expanding the ETS to including other aviation gases.

In the meantime, and whatever the outcome of the political and legal wrangles, the threat of inclusion in the ETS has undoubtedly forced airlines to look more closely at their emissions – and what they can do to cut them.