

Applying the EU ETS to aviation has been controversial from the start. The EU has met worldwide opposition on the ETS being applied to the entirety of flights to and from the EU. Challenges have been made to the EU both in court and through trade and other sanctions. This article analyses why and how this is occurring, and the possible resolutions being considered.

ETS developments: legal challenges

The European Union's (EU) emissions trading scheme (ETS) was launched in 2005, and is the EU's flagship climate change policy.

The aim of the scheme is to reduce carbon emissions from aviation to 97% of 2004-2006 levels by 2012, and to 95% from 2013.

The ETS is a cap-and-trade system, designed to use market-based measures to achieve these reductions. In 2008, the EU passed legislation to include aviation within the ETS, beginning in 2012. Each operator will be allocated allowances for their carbon emissions, based on fuel consumption during the base year of 2010. One allowance represents one tonne of carbon dioxide emitted.

In 2012, 85% of operators' allowances will be free, while the remaining 15% will have to be acquired through auctions. This means that each operator must pay for all allowances used beyond their free allowances. From 2013 to 2020, the free allowance will reduce to 82% of 2010 emissions, with the other 15% acquired through auctions. The remaining 3% from 2013 to 2020 are kept by the EU as a special reserve for new airlines and others experiencing high growth rates.

The EU ETS applies to all flights arriving at, and departing from, an EU airport, regardless of their origin or final destination. This means that even long-haul flights departing from the Americas, Africa or Asia are subject to pay for their emissions for the entirety of the flight, even though only a small portion of it is over EU airspace. Herein lies the controversy of the EU ETS. There has been almost unanimous opposition to the ETS from both operators and governments worldwide. Airlines, both EU- and non-EU-based are opposed to

having to pay for emissions produced outside the EU. Many countries oppose the EU ETS on grounds of sovereignty and jurisdiction. This article analyses the legal challenges to the EU ETS, possible retaliatory measures, and possible resolutions.

Legal challenges

Despite worldwide opposition to the inclusion of aviation in the EU ETS, to date only two legal challenges have been brought to court. The first was a joint case by American Airlines (AA), United Airlines (UA), Continental Airlines (now merged with United) and the Air Transport Association (ATA) of America (now Airlines for America (A4A)), referred to as 'the ATA Lawsuit'.

This challenge was initially filed in the High Court of the United Kingdom (UK) It was then referred to the European Court of Justice (ECJ), which rejected it in December 2011.

The second case to be brought to court is by Air Algérie in the Council of State in France (France's highest court). This case is on hold as of April 2012, pending further hearings.

Both of these cases centre on sovereignty issues and the ability of the EU to charge for, and have jurisdiction over, carbon emissions produced beyond EU territory.

The ATA lawsuit had three primary arguments. First, the plaintiffs argued that the EU ETS contravened the Chicago Convention (the Convention on International Civil Aviation, which established rules and regulations for international air travel). Article 1 of the Chicago Convention states that "every state has complete and exclusive sovereignty over airspace above its territory." The ATA argued that by

charging non-EU airlines for their emissions in locations other than the EU, the EU ETS is violating the Chicago Convention.

Second, the ATA argued that the EU ETS was another tax on fuel, and that the EU-US Open Skies Agreement does not allow for further fuel taxes. The plaintiffs argued, therefore, that the EU ETS was in contravention of the EU-US Open Skies Agreement, and therefore unlawful.

The third argument made by the ATA was that the Kyoto Protocol recognises that the International Civil Aviation Organization (ICAO) is the proper venue for tackling emissions from aviation. The plaintiffs argued that the EU was taking global aviation emissions into its own hands, when it is not its place to do so, and should be carried out through ICAO.

The ECJ rejected these arguments. It rejected the first argument on the Chicago Convention on the grounds that the EU itself is not a signatory to the Convention (although all EU member states are), and therefore the EU does not have to comply.

Second, the ECJ said that the EU ETS is not a tax on fuel, because it is not based on fuel dispensed. Instead, the EU ETS is based on emissions, where fuel dispensed is just one parameter used.

Finally, although the ECJ recognised that the Kyoto Protocol states that ICAO is the venue for addressing global aviation emissions, it does not mean that individual countries, communities or organisations cannot address aviation emissions. The ETS was therefore found not to be in contravention of the Kyoto Protocol by the ECJ.

Concerning the second court case, to be held in France with Air Algérie opposing the EU ETS, arguments have not been officially held yet. It is likely, however, that a similar stance will be

Besides legal challenges to the EU, some countries are finding political and economic ways to oppose the EU. China is understood to have blocked the sale of A380s and A330s to Chinese carriers.

taken with these issues of sovereignty, and EU jurisdiction over emissions in other countries, taking centre stage.

Currently, only individual operators or operators grouping together have taken legal proceedings against the EU ETS. There are other avenues of opposition to the EU ETS, however.

Guido Harling, chief executive officer and lead auditor at ETS Verification, explains, "Opposition to the EU ETS is two-fold. There can be opposition from operators, since they are the ones complying, or from state governments, which are more politically motivated.

"Although the ATA lawsuit from the US failed, they could raise a case with an international trade organisation. The US government is also proposing sanctions against the EU ETS in US Congress. China, Russia and India are also opposed to the EU ETS, and are considering their own sanctions," continues Harling.

Sanctions from opposition governments are therefore more likely at this stage, since they can be passed internally, without a legal battle against the EU.

US

US Congress is currently deliberating a bill that will make it illegal for US carriers to comply with the EU ETS. If this is passed, US airlines operating to the EU will be forced to make a decision between complying with the EU ETS, and breaking US law, or breaking EU law to comply with US law.

"Were such a law to be passed, it would create an enormous legal quandary, requiring a US airline to choose which set of laws to obey," says Aaron Robinson, senior implementation consultant at OSyS. Robinson believes, however, that the intention of this bill is not to harm US airlines. "The intent was not really to force a choice for US airlines, but rather to continue reinforcing the opposition that the US and other countries have been communicating to the EU," says Robinson.

"It is possible that such a bill could pass," continues Robinson, "but keep in mind that it is an election year, where traditionally little happens in Congress. Furthermore, Congress has already spent a great deal of time on aviation in this session, passing a multi-year Federal Aviation Administration (FAA) spending



bill for the first time in five years." This means, therefore, that it is unlikely that US airlines will be forced to choose between US and EU law before financial obligations come into force in 2013.

China

The Chinese government also opposes the EU ETS, and has made targeted retaliatory measures to show its opposition. "China is different to other countries in its opposition to the ETS. Opposition is centrally organised, with strong, measurable sanctions being taken against the EU," says Harling.

"China is preventing EU carriers from obtaining more landing slots at major Chinese airports," continues Harling. "For example, Lufthansa was not granted permission for new landing slots at Shanghai (PVG), nor to fly its A380 to PVG. China has also barred certain Airbus deliveries to Chinese airlines."

China is also adding roadblocks for Chinese carriers to comply. "China has effectively prohibited compliance with the ETS for Chinese carriers," says Sue Barham, partner at Holman Fenwick Willan. "Chinese carriers must first gain their government's approval before complying with ETS."

China is likely to maintain its strong opposition to the ETS until a compromise between the EU and China can be found. Despite this, China cannot afford to shun the EU altogether. In terms of stopping certain Airbus orders, it is understood that the sales of 10 A380s and 30 A330s were blocked by China, but that major Chinese airlines still have a backlog of over 200 aircraft on order from Airbus, which have not been stopped as of April

2012. It is not in China's interest to block all of these orders, because that will slow aviation growth in its internal market.

"In addition, Airbus's Tianjin final assembly line is an important part of China's long-term aerospace strategy," says Robinson. "China can afford to pressure the EU through Airbus, but it cannot afford to lose Airbus as an industrial partner."

Others

Apart from the US and China, several other countries, as well as airlines and aviation organisations, have voiced their opposition to the EU ETS. None has gone so far as the US and China yet, however. In October 2011 26 countries met in Delhi to declare their opposition to the EU ETS, and again in Moscow in February 2012 to agree on potential retaliatory measures.

Both India and Russia have been at the forefront of these discussions and as well as agreeing on measures with other countries, they also plan to take their own steps in opposition to the EU ETS.

India has threatened withholding rights for EU airlines to land in India on certain days, disrupting their schedules, and is considering asking airlines in India to cancel Airbus orders. India has also urged Indian carriers not to participate in the EU ETS, but it has not made official statements about a ban. India is also considering suspending overflying rights to EU airlines.

Russia is considering very similar measures to India, with particular emphasis on withholding overflying rights to EU airlines, which would severely lengthen and disrupt flights for



EU airlines between the EU and the Asia Pacific.

Other worldwide opposition to the EU ETS was voiced at the meetings in Delhi and Moscow. Apart from the US, China, India, and Russia, other countries that attended were Argentina, Brazil, Canada, Chile, Colombia, Cuba, Egypt, Japan, South Korea, Malaysia, Mexico, Nigeria, Paraguay, Peru, Philippines, Qatar, Saudi Arabia, Singapore, South Africa, Thailand, Turkey and the United Arab Emirates.

Retaliatory measures discussed by these countries and declared to the EU in the Moscow Declaration are: filing an application under Article 84 of the Chicago Convention for resolution of the dispute according to ICAO rules; using state legislation to prohibit compliance by airlines from that state with the EU ETS; mandating EU carriers to submit extra flight details for overflying rights; assessing the EU ETS for consistency against World Trade Organisation (WTO) agreements; reviewing bilateral air service agreements, including Open Skies; suspending current and future discussions and/or negotiations to enhance operating rights for EU airlines; and imposing additional levies/charges on EU carriers.

The measures listed above, however, have yet to be implemented by many of the signatories and are instead a list of measures being contemplated, to send a message to the EU about the seriousness of global opposition to the EU ETS.

Resolutions

It is clear, therefore, that there is significant worldwide opposition to the EU ETS. There is the possibility that this

could further escalate into a trade war between the EU and other countries. A trade war, however, is an undesirable outcome for all parties, and a political compromise is more likely.

There are several possible scenarios, therefore, for how the EU ETS is to move forward. First, the ETS can stay as it is, with no changes. This means the financial side of ETS, including fines for non-compliance of €100 (\$130) per tonne of emitted carbon dioxide, will come into force from 31 March 2013. After this date, all eligible airlines must pay for extra allowances they use beyond their free allocation, and will be fined for non-compliance. This scenario is likely to provoke further retaliatory action, as described above.

Second, the rules and regulations of the EU ETS could be changed according to political compromises that are found. There are a number of compromises available. "In a broader context, a comprehensive global approach to reducing aviation emissions should be the ultimate objective," explains Andy Kershaw, manager environmental policy at British Airways. "In transitioning to this, possible compromises are: to only account for emissions above EU airspace; remove the EU ETS application on inbound flights to the EU, and only charge for outbound flights; or to only apply the EU ETS to intra-European flights."

One option, therefore, is to only apply the EU ETS to emissions that occur in the airspace of EU countries. "There is consensus among airlines that this is a fairer and more practical solution," says Harling. Under this compromise, the rules, regulations, fines, and financial implications of the ETS would remain the

Non-EU airlines are objecting to the entirety of flights being subject to ETS legislation. One theory is that the increased cost of flying long distance flights into the EU could favour those carriers geographically located close to Europe.

same, but only apply within EU airspace. This means that both politically and geographically, the EU would only be enforcing EU ETS laws over its physical area of jurisdiction.

The second compromise is to only apply the EU ETS to outbound flights, so that airlines will only pay for their emissions once they depart an EU airport. This would approximately halve the cost for those non-EU airlines operating to and from the EU, and therefore may be a more desirable outcome.

Third, the EU ETS could only apply to intra-European flights, ensuring that no non-EU airlines would have to comply, unless they operated intra-EU flights. This would keep the system strictly in EU territory and would not impinge on the sovereignty of non-EU nations.

Another possible resolution is for the EU to replace the ETS with a global solution to aviation emissions agreed through ICAO. Airlines, both EU and non-EU are fairly unanimous in their support for a global solution through ICAO. "A global solution to reducing carbon emissions should be the main focus," says Kershaw. "Dealing with climate change is a new and complicated challenge, but we believe a comprehensive global approach to reducing emissions is the best way to address this."

This is echoed by Andrzej Rode, head of environmental affairs at LOT Polish Airlines. "Although it will be difficult, a global system for reducing emissions should be established. An agreement through ICAO is the best way for this to be achieved."

Due to the amount of complications and differing national interests of countries on a global scale, a global solution will be difficult before the financial implications of the EU ETS come into force. "Time has proved that it is difficult to achieve a global solution," says Lucas Bobes, group environmental officer at Amadeus. "We are 15 years past Kyoto and a global solution for addressing civil aviation emissions has not been reached. This is despite article 2.2 of the Kyoto Protocol indicating that countries included in Annex I (Organisation for Economic Co-operation and Development (OECD) countries plus those in transition to the

market system at the time, that is ex-Soviet Union countries) should pursue limitation or reduction of emissions of greenhouse gases from aviation.

“ICAO received a specific mandate to work with the parties of Annex I to achieve such objectives. Although article 2.2 of the Kyoto Protocol has probably been the major regulatory driver of any aviation emissions commitment for many years, it faced at least two critical challenges: first, there was no timeframe in which aviation emissions reductions should be achieved; and second, there was no quantification of such commitments. Climate change has been a lower priority due to the recent economic downturn, but the EU ETS has forced attention to the issue. It will be a better outcome for all if reducing emissions can be agreed on a global scale; especially since, as things now stand, implementing the EU ETS for aviation might ignite more political conflicts than environmental solutions, at least in the short term,” explains Bobes.

A final scenario could be that the EU ETS stays as is, while countries such as the US and China implement their own individual emissions reduction schemes. If this happens, the EU has made allowances so that airlines do not double-pay for their emissions. For example, if the US implements its own scheme, EU

airlines would not have to pay for emissions for both arrival and departure from both areas. “Provisions are included in the EU ETS if other countries have their own schemes. The EU ETS legislation states that the other countries’ schemes must be ‘equivalent measures’ to the EU ETS,” says Barham. “In such cases, EU airlines would only pay for their departures from the EU. However, the problem is that there is no guidance for what the ‘equivalent measures’ might be, which may create further complications if this were to arise.”

Summary

With so many possible, and plausible, scenarios facing the EU ETS, it is difficult to predict at this point where the EU ETS will go next. With so much worldwide opposition from both operators and state governments alike, it seems unlikely that it can stay as it is. As the EU, however, has spent considerable time and resources on forcing the scheme through, it may choose not back down, despite worldwide opposition.

It is possible that the beginning of financial obligations from 31 March 2013 will force the EU’s hand, and that the EU ETS may be postponed in light of opposition. If many non-EU airlines, particularly from China and India, do not

comply after this time, it raises questions about the integrity and sustainability of the system.

What is important to note, however, is that most opposition is not against the nature of the scheme itself, nor against the goal of reducing emissions - it is against the ETS being enforced outside EU territory. Most airlines in fact agree that a cap-and-trade market-based system is the best way to reduce emissions. Rudolf Christen, chief executive officer at Aviaso, summarises: “The strength of the EU ETS system is that it is market-based. It gives incentives to reduce fuel consumption and emissions. The main problem with the EU ETS is that the EU has tried to do too much.”

If the EU can find a compromise with worldwide governments and organisations, there is no reason why the ETS cannot succeed in reducing carbon emissions. Ideally, a worldwide system would be best, but given the political complications involved, this may not be possible in the short to medium term. A successful EU ETS may provide a benchmark, however, for how a worldwide system can operate in the longer term. [AC](#)

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