



CARBON PRICE CLARITY: HOW THE UK ETS WILL AFFECT AVIATION

As we reported in our first two briefings, the UK Government has confirmed plans to introduce a new UK Emissions Trading System ("ETS") from the start of 2021. The Government announced the proposal in its [Response to its Consultation on The Future of UK Carbon Pricing](#) published in June 2020 ("**Consultation Response**"). In this final briefing, we look at the design elements of the UK ETS which are specifically relevant to the aviation sector and how the UK ETS might interact with the new Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA).

Key issues

- UK ETS design elements relevant to aviation: routes and phases, free-allocation, exemptions and reporting
- Interaction with CORSIA

DESIGN OF THE UK ETS

At the outset, the design of the UK ETS will be very similar to the EU ETS, with only limited differences such as the initial emissions cap, the aviation routes covered and the phases of the scheme. This similarity will make the transition between the regimes smoother for existing EU ETS participants and enable the two systems to be linked if the UK and EU agree to pursue that option. There are, however, indications that things may change from 2024 following targeted reviews of certain aspects of the scheme including, in particular, how free allowances are allocated and the emissions cap trajectory. We expand on these below.

The extent of any changes is likely to depend in large part on whether the UK ETS is linked with the EU ETS – something yet to be decided (see our [second briefing](#) for more detail).

Routes and phases

When the UK ETS commences, it will apply to the following routes:

- UK domestic flights;
- flights between the UK and Gibraltar;
- flights departing from the UK to aerodromes within the European Economic Area ("EEA") states; and
- flights to offshore installations.

Flights arriving in the UK from the EEA will be covered by the EU ETS, assuming agreement on this is reached between the UK and EU as part of the ongoing Brexit negotiations. This route allocation is intended to apply in both a standalone and a linked UK ETS. If an agreement is reached to link up the UK ETS and Swiss ETS, it is expected that flights departing from the UK to aerodromes in Switzerland would be subject to the UK ETS and flights from Switzerland to the UK would be covered by the Swiss ETS.

A UK ETS will not cover:

- flights to/from the Isle of Man, Jersey and Guernsey; or
- flights to/from the nine EU Outermost Regions (French Guiana, Guadeloupe, Martinique, Mayotte, Réunion, Saint-Martin, Azores, Madeira and the Canary Islands).

The aviation sector will have the same overall phase length as the other sectors covered by the UK ETS, namely a 10-year first phase from 1 January 2021 to 31 December 2030. However, it will also have two sub-phases (mirroring the EU ETS aviation review periods):

- Phase I(a): 2021-2023 (mirroring CORSIA's pilot phase); and
- Phase I(b): 2024-2030.

Changes necessary for a UK ETS to accommodate CORSIA are set to be implemented by the end of Phase I(a) at the latest (see more on this below).

Free allocation of allowances

Aircraft operators will be allocated free allowances in line with the UK cap which, similarly to the EU ETS, will reduce annually. As we noted in our [first briefing](#), the UK ETS cap will, at least initially, remain 5% below the UK's notional share of the Phase IV EU ETS cap but the free allocation will not be affected by the 5% cap reduction as the reduction will be taken from auctioned allowances only. Also in line with Phase IV of the EU ETS, all UK allowances will be tradable between participating sectors (subject to interaction with CORSIA (see below)). This means that participants in the stationary sector (e.g. power plants) will be able to use aviation allowances to meet their compliance obligations, and vice versa. This tradability is helpful to operators as it broadens their market for purchasing (and selling) allowances.

The UK ETS will use the same free allocation approach as Phase IV of the EU ETS. Under this approach, an aircraft operator's free allocation will be calculated based on its verified 2010 tonne-kilometre data (and 2010-2014 if it is currently benefiting from the EU ETS Special Reserve). However, within the UK ETS, the allocations will be based on data for UK ETS routes only. Further details on the process for submitting this data will be announced later this year. As with Phase IV of the EU ETS, there will be no special reserve of allowances for new entrants but the Phase III Special Reserve will be honoured.

Some respondents to the Consultation thought that the free allocation for aviation should be reduced immediately under the UK ETS but the Government chose to keep the EU ETS approach, at least initially, in order to ensure a smoother transition – hardly surprising given the new scheme is set to commence in less than six months' time. Free allocation will however be reviewed in light of the UK's domestic and international climate commitments, with any changes likely to be implemented from the start of Phase I(b) (2024) at the latest. Among the possible changes, the Consultation Response indicates that the activity data and benchmark calculation may be updated so that free allocation is more reflective of current activity rather than being based on the older data and benchmark.

Exemptions and reporting

The exemptions under the UK ETS for small emitters will be the same as under the EU ETS. Under the UK ETS, full scope activity (on which the exemption threshold is based) will cover all flights that either arrive or depart from an aerodrome in the UK, Gibraltar or EEA, regardless of where the aircraft operator is registered, but aircraft operators will only be required to surrender allowances for emissions from flights on routes covered by the UK ETS.

Some small emitters will be able to use a simplified monitoring approach to estimate their fuel consumption and others will be eligible for simplified

reporting. The eligibility thresholds are set out in the Consultation Response but will be reviewed during the first few years of the scheme. Any changes (including to address known inconsistencies with CORSIA rules) would likely be implemented at the start of Phase I(b).

The UK ETS Monitoring, Reporting and Verification ("**MRV**") rules will mirror those of the EU ETS MRV to ensure a smooth transition for operators (see further on this below).

Interaction with CORSIA

One of the big questions with the UK ETS (as with the EU ETS) is how it will interact with CORSIA. The Government has committed to full implementation of CORSIA and to ensuring aircraft operators participating in the UK ETS are compliant with CORSIA rules. However, in order to fulfil the UK's more ambitious climate change targets, certain international flights (i.e. those to the EEA and potentially Switzerland) will be within scope of the UK ETS. This creates a risk of participating aircraft operators facing overlapping obligations between the UK ETS and CORSIA, given that CORSIA's scope covers interstate civil aviation.

The Government is currently reviewing the mechanics of integrating the UK ETS and CORSIA to ensure full compatibility between the schemes, with a view to implementing any changes to the UK ETS by 2024 (i.e. the start of Phase 1(b)). The Government has made it clear that it wants to avoid a scenario in which participating aircraft operators would incur double liability for the same tonne of CO₂ emissions. The Consultation Response identifies a couple of potential changes to deal with the CORSIA/UK ETS overlap including, for example, implementing simplified administration processes to reduce the administrative burden of having to comply with two regimes. Another possible option is making adjustments to the aviation-related design elements of the UK ETS, such as the aviation cap component and trajectory, to take into account any inconsistencies with CORSIA's Standards and Recommended Practices (SARPs).

In addition, the UK Government aims in 2021 to provide a full legislative basis for CORSIA MRV rules, which addresses remaining technical inconsistencies between CORSIA rules and the MRV rules for the EU ETS (the latter being largely adopted by the UK ETS). It is expected that this legislative basis will cover, among others, the following issues:

- harmonising MRV rules for small emitters to become CORSIA-compatible;
- including all five CORSIA monitoring methods within the UK ETS MRV; and
- expanding the MRV requirements of the UK ETS to make flight reporting mandatory for all domestic and international flight routes for UK operators to enable compliance with CORSIA rules.

While we continue to await further details on interaction between the UK ETS and CORSIA, the options for integration on the EU side, particularly in relation to potential double counting, also remain an open issue. In its Council Decision of 25 June 2020, which sets out the EU position on notifying the ICAO of the voluntary participation of EU Member States in CORSIA from 1 January 2021, the European Council noted that the European Commission has not yet presented the formal report considering ways to implement 'relevant ICAO instruments' through a revision of the EU ETS Directive. The Council urged the Commission to present the report "as soon as possible and before the end of 2020".

The progress so far to align EU legislation with CORSIA rules has been limited to monitoring and reporting (Regulation (EU) 2018/2066) and verification and accreditation of verifiers (Regulation (EU) 2018/2067), which was supported by

the Commission Delegated Regulation that came into force on 20 October 2019. However, some technical inconsistencies remain between the amended EU ETS MRV rules and CORSIA and it is expected that these will be addressed by the EU following a review in 2020.

It is likely that any proposal by the UK Government to integrate the UK ETS and CORSIA rules will be informed by the option the EU decides to take, especially if the two systems are ultimately linked. As such, the UK will be closely monitoring EU developments in this area. In the absence of a formal proposal to align the EU ETS with CORSIA, the options for integration remain speculative, but there are a few options the EU could take to avoid double counting liability. One option is implementing CORSIA as planned and continuing the EU ETS for domestic flights only but this seems unlikely given it would undermine the EU's ability to meet its greenhouse gas reduction targets (as CORSIA is less ambitious than the EU ETS). A second option could involve applying CORSIA only to flights partly or fully outside the EEA and continuing the intra-EEA scope of the EU ETS. This option seems more realistic as it would enable the EU to pursue its more ambitious climate targets at an EU level but also comply with its international commitments under CORSIA. How this would be achieved in practice remains to be seen.

Concluding comments

The aviation industry is already in a state of flux and severely affected by the global pandemic so the lack of clarity on exactly how it will be impacted by these two new regulatory regimes – the UK ETS and CORSIA – is unhelpful. The picture should hopefully become clearer over the coming months as legislation for the UK ETS is laid before Parliament and further thought is given to how the UK ETS, EU ETS and CORSIA will interact.

Postscript (August 2020): Kirsty Souter, one of the authors of this briefing, was extensively quoted in an article published by the Futures Industry Association which further analyses the proposals, in particular on issues relating to linkage and market liquidity. The article can be viewed by clicking [here](#).

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