

# EU ETS and ICAO CORSIA Update

Since 2012, greenhouse gas emissions from all flights operating in the European Economic Area ("EEA") (domestic and international) have been subject to EU rules. Under the EU Emissions Trading System ("EU ETS"), airlines are required to monitor, report and verify their emissions and to surrender allowances against those emissions. Airlines receive annual tradable allowances covering a certain level of emissions. Any shortfall between the allocated sum of free emissions allowances and their actual emissions require the purchase of additional allowances.

In order to support the development of a global Carbon Offsetting and Reduction Scheme for International Aviation ("CORSIA") by the International Civil Aviation Organisation ("ICAO"), however, the EU has since limited the scope of EU ETS to flights within the EEA only until 2023.

Contrary to EU ETS, which is a 'cap and trade' scheme that sets an upper limit for the total amount of emissions, CORSIA is an 'offsetting scheme', implying that emissions can grow but must be compensated by offsets. CORSIA aims to stabilise emissions at 2020 levels by requiring airlines to offset the growth of their emissions after 2020 albeit this only applies to international (not domestic) flights.

## State of Play

In June 2016, ICAO agreed to adopt CORSIA. The First Edition of Annex 16, Volume IV was adopted by ICAO in June 2018 and sets out the scheme's Standards and Recommended Practices ("SARPs") for CORSIA. SARPs impose compliance obligations on airlines and,

in turn, raise a number of potential risks for aircraft lessors and financiers.

Currently there are 192 countries that have signed up to CORSIA (each a "Contracting State"). Each Contracting State is responsible for implementing SARPs into its domestic law, however it currently remains unclear as to how, when or if each Contracting State will do so. Concerns remain due to differences between EU Directive 2003/87/EC and certain European Commission rules and CORSIA, in particular on monitoring, reporting, verification and offsetting requirements. This questions the certainty of achieving universal adoption and full and consistent implementation of SARPs by Contracting States.

Notwithstanding such uncertainty, as of 1 January 2019, all aircraft operators (not exempt from CORSIA) with annual emissions exceeding 10,000 metric tons of carbon dioxide must record and report annual emissions data for their international flights. Such operators were required to submit an emissions monitoring plan by 28 February 2019 and have an obligation to report their 2019 and 2020 emissions data to their ICAO state regulator by 31 May 2020 and 31 May 2021 respectively. Although participation in CORSIA is voluntary during the current pilot and first phase (2021-2026), and will become mandatory for all states in the second phase (from 2027), annual emissions reports and monitoring plans were required to be submitted by an airline operator to its ICAO Contracting State regulator even where a Contracting State had opted not to participate in the voluntary phases. Such reported data will form the base for calculating compliance requirements during

the voluntary and compulsory phases of the CORSIA scheme.

## **CORSIA Compliance Risks**

The principal potential commercial and legal risks for aircraft operators, owners, lessors, lenders and investors alike, arising from CORSIA compliance requirements are as follows:

### **(a) Owners' potential liability**

Where the aircraft operator has not been identified, the ICAO designator will be the first line of inquiry in terms of responsibility for compliance with the scheme, followed by the holder of the applicable Aircraft Operator Certificate. However, should an operator fail to submit an emissions monitoring plan and annual emissions report; and its CORSIA Contracting State is unable to identify the relevant aircraft operator or the party responsible for the emissions, the CORSIA compliance obligations will rest with the aircraft owner (as identified in the aircraft registration documentation).

### **(b) Potential CORSIA liens**

Individual Contracting States are responsible for transcribing CORSIA and SARPs into domestic law. This means that certain Contracting States may pass laws that permit the imposition of a lien on, and allow for the right to seize and potentially sell, an aircraft where the operator fails to comply with CORSIA obligations with respect to such aircraft or any other aircraft within the operator's fleet. Similar to a Eurocontrol fleet lien, any such lien imposed would apply notwithstanding the rights of an aircraft owner or mortgagee.

### **(c) Risk mitigation in lease and loan documents**

Lease and loan documentation practices should be considered in light of certain compliance

differences between EU ETS and CORSIA. For example, while EU-ETS runs on an annual emissions reporting cycle, from 2020 CORSIA will have a three year compliance cycle. Such a long period may cause aircraft owners to accumulate a greater credit risk exposure. Given the way the scheme operates, CORSIA will not be able to confirm the level of operator compliance until the end of the three year compliance cycle and thus the level of potential outstanding liability will not be known until that time.

## **What Next?**

Aviation carbon emissions are expected to keep growing. For operators that do not operate flights inside the EU, CORSIA is a significant change as they begin to start monitoring their emissions levels against regulatory standards.

Aircraft owners, lessors, lenders and investors alike need to be aware of potential CORSIA compliance risks that could be attributable to the owner as well as the relevance of on-going developments and implementation of SARPs by Contracting States for lease, loan and offering memoranda.

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## Further Information

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