

## Insights

# CARBON PRICING IN THE UK/EUROPE: ETS AND CORSIA DEVELOPMENTS

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## SUMMARY

Operators in the aviation sector and the 'stationary sectors' (power generation, energy intensive industries, etc.) should note that the environmental regulatory framework for carbon pricing and emissions trading in the UK/Europe changed in 2020, and will continue to change.

In this blog, we provide a high-level summary of three recent key UK/European developments that impact operators: Brexit/UK ETS, the Swiss ETS-EU ETS link and CORSIA implementation.

## BREXIT/UK ETS

Throughout 2020, as the UK moved towards the end of the Brexit transition period, there was much discussion regarding what new carbon pricing mechanism the UK would deploy upon leaving the EU Emissions Trading System (EU ETS) on 1 January 2021. It looked likely that a new UK ETS (broadly a like-for-like replacement for the EU ETS) was the preferred option, rather than the main alternative – a carbon tax.

However, uncertainty remained due to mixed messages from the UK Government – for example, in November, the creation of a legislative framework for the UK ETS (the Greenhouse Gas Emissions Trading Scheme Order 2020) and simultaneous comments from Government that the carbon tax alternative had not been taken off the table.

Then, in mid-December 2020, the Energy White Paper confirmed that the Government would establish the new UK ETS – noting that:

“the UK is open to linking the UK ETS internationally in principle and we are considering a range of options, but no decision on our preferred linking partners has yet been made”

As mentioned in our blog on the Energy White Paper, the assumption at the time of the white paper was that this comment was implying a possible link with the EU ETS.

Shortly after the white paper's publication, the EU-UK trade and cooperation agreement (TCA) was agreed – including a specific carbon pricing article (Article 7.3) in the 'Environment and climate'

level playing field chapter (Chapter seven). This article crystallised the above assumption by stating:

“The Parties shall cooperate on carbon pricing. They shall give serious consideration to linking their respective carbon pricing systems in a way that preserves the integrity of these systems and provides for the possibility to increase their effectiveness.”

There is no link yet, however, so, from 1 January 2021, operators now need to grapple with two parallel neighbouring ETS regulatory regimes – the EU ETS and the UK ETS.

Greenhouse gas emissions permits for UK stationary installations have now moved over from the EU ETS to the UK ETS (subject to certain rules for Northern Ireland). Operators need to start thinking about compliance with permitting, monitoring, reporting, etc. requirements under the UK ETS going forward (albeit with some residual compliance requirements under their final EU ETS obligations for the 2020 scheme year).

On the other hand, aircraft operators (especially those flying to and from multiple UK and EU airports) are likely to find themselves in a more complex position. They will have new UK ETS obligations for UK domestic flights and flights from the UK to the EEA (with such flights now carved out from existing EU ETS obligations – again, except for some residual EU ETS compliance for the 2020 scheme year). This will mean dealing simultaneously with two regimes rather than one (although the principles/processes of the two systems are similar).

Looking forward (bearing in mind the above comments in the white paper/TCA and the natural compatibility of the two systems), could the linking of the UK ETS and EU ETS occur in the future and what might this look like?

## **THE SWISS ETS-EU ETS LINK**

The idea of linking ETSs has long been discussed as a means of expanding international carbon markets (with potential benefits related to cost effectiveness, liquidity, compliance and carbon leakage). The importance of ETS linking arrangements in the arsenal of climate change measures is illustrated by the Paris Agreement’s reference (in Article 6) to such international cooperation on carbon markets.

In 2020, there was a big moment in this area – The ETS linking agreement between the EU and Switzerland entered into force. This is the first such linking agreement (with the Swiss ETS being the first to link with the EU ETS). The European Commission commented:

“[This agreement] demonstrates that emissions trading systems can pave the way to broader international carbon markets”

As a result of the link, emission allowances used for compliance under the EU ETS are recognised for compliance under the Swiss ETS (and vice versa) and the transfer of these allowances is

enabled between the EU and Swiss trading registries. A provisional electronic link between the registries was launched in September 2020 so that inter-ETS allowance transactions could be executed.

The link covers both stationary installations and aviation – setting out “essential criteria” in both areas. This means that the EU and Switzerland must ensure that their respective ETSs meet at least the “essential criteria” so that their regulatory regimes for stationary installations/aviation maintain compatibility.

This EU-Swiss ETS linking agreement may well be the starting point for discussions between the EU and the UK in their “serious consideration” under the TCA regarding the linking of the EU and UK ETSs – there is clear precedent for the way this can work. Stakeholders will be watching closely how the EU-Swiss link operates in practice to get a sense of what may also be coming in an EU-UK context.

## **CORSIA IMPLEMENTATION**

For aircraft operators, as well as thinking about compliance with multiple ETSs, the Carbon Offsetting and Reduction Scheme for International Aviation (“CORSIA”) comes into play.

Developed by the UN’s International Civil Aviation Organisation (“ICAO”), CORSIA is a global market-based scheme designed to mitigate carbon dioxide emissions from international civil aviation by requiring operators to offset any increase in their emissions above a specific baseline.

Although dealing with the same thing, i.e. aviation greenhouse gas emissions, the mechanism of CORSIA is very different to the EU and UK ETSs, and its geographical scope is international rather than just European.

The UK and EU have both been consulting on the approach to implementing CORSIA alongside their ETSs. The EU consultation has already closed, and the UK consultation closes shortly on 28 February 2021.

The UK’s consultation includes a draft instrument on CORSIA MRV (monitoring, reporting and verification of emissions) which is intended to come into force by spring 2021. The most contentious part of the consultation, however, relates to the interaction of the offsetting of emissions under CORSIA and the surrendering of allowances under the UK ETS - taking into account the possibility that each regime may bite on the same tonne of emissions. The UK’s consultation has set out six options for CORSIA-UK ETS interaction – with Option 2 (Supply-Adjusted Hybrid) singled out as the preferred option.

In short, Option 2 would involve aircraft operators claiming reductions in their UK ETS obligation to surrender allowances equivalent to their CORSIA obligations on certain flights – with the UK ETS

allowances cap then adjusted to account for emissions covered by CORSIA. This approach would maintain the supply-demand balance.

A second UK consultation is expected later this year to consider the approach to CORSIA-UK ETS interaction in greater technical detail (possibly focussing in on Option 2 if this preferred option is selected as the way forward).

## **Concluding thoughts**

UK and European regulation surrounding the reduction of greenhouse gas emissions in the principal emitting sectors is changing and developing. This is particularly so in relation to the aviation sector, where there is an additional international angle to the regulation. Given the zero carbon commitments made by many developed nations, this area of regulation can also be expected to tighten over the coming years. Aviation and 'stationary sectors' operators will need to be agile to respond to the regulatory changes that are expected in the coming years.

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### **Sam Levy**

Co-Author, London

[sam.levy@bclplaw.com](mailto:sam.levy@bclplaw.com)

[+44 \(0\) 20 3400 3082](tel:+442034003082)

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