

Membership of the EU Emissions Trading Scheme will be a big administrative task for airlines. ERA's director of industry affairs, Simon McNamara, gives Bernie Baldwin a tutorial on the requirements.

ETS - preparation starts **now!**

Aviation joins the European Union's Emissions Trading Scheme (ETS) in 2012. The scheme has many facets, and some airlines could be about to discover that they are not as well placed as they think in understanding the demands placed upon them.

So what is the ETS, and what are the requirements for operators? Simon McNamara, director of industry affairs, European Regions Airline Association (ERA), has been integral to the Association's ETS work on behalf of its members and has many of the answers. The starting point is understanding that ETS is a cap-and-trade scheme – airlines have a limit to the emissions they can put into the atmosphere.

"The EU is doing two things," McNamara begins. "First of all, they're capping the emissions of industry at, effectively, 2005 levels – it's actually the annual average of 2004, 2005 and 2006. That's where the cap is.

"In simple terms for the cap-and-trade, any emissions above that 2005 level you have to

buy, and any emissions below that you can sell. So if the industry as a whole [gets its emissions below the cap], it's going to have a surplus of emissions to sell, and if it [goes above the 2005 cap level], it's going to have to buy some emissions from somewhere else. That's the first key thing."

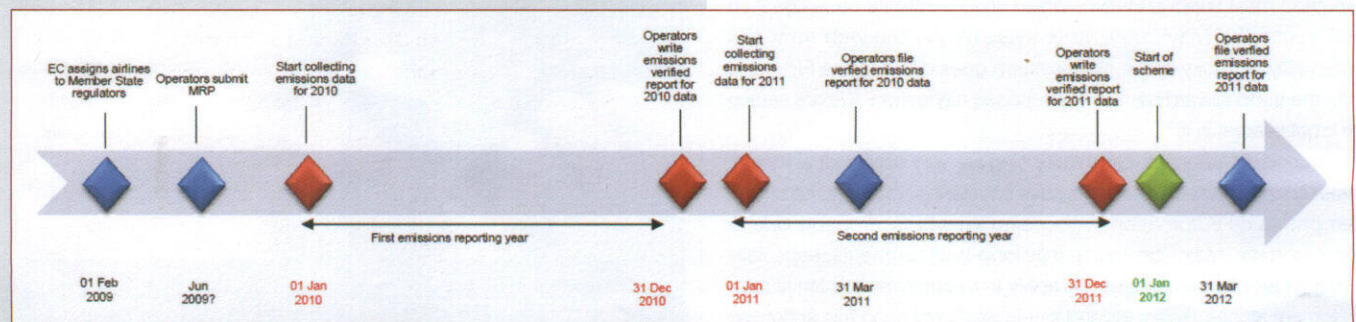
■ PLANNING FOR PERMITS

Aviation will be given a certain amount of valuable free emissions permits, so each airline needs to know how to get its allocation. "It's a bureaucratic process that will start in August this year. If you're operating in Europe, you'll be assigned to a particular country, which will be your competent authority and they will regulate you. For example, if you're a French carrier, you'll be assigned to France. It only gets a bit more complicated if you're a non-EU carrier," McNamara notes. And there are plenty of regional and low-fare airlines from outside the EU operating into it.

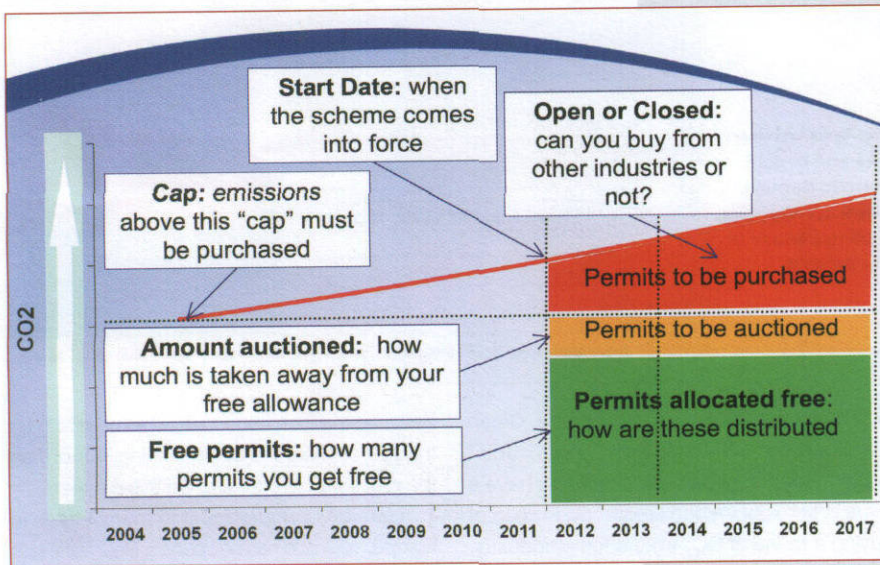
"They will be assigned to the EU state in which they produce the most emissions," he continues. The European Commission's (EC's) list of states and the airlines they will regulate was scheduled to be issued in February of this year.

"By August 2009, if you're an operator, you have to submit, to your competent authority, a plan which says two things – how you are going to monitor and report your emissions, and how you're going to monitor and report your tonne-kilometres, which is what you will need to apply for free permits. If you don't submit a plan by August, you risk two things: one, potentially a fine – one member state has already indicated that it will fine operators that are late with submissions; two, missing the opportunity to apply for free permits when the scheme comes into full force.

"In 2012, you have to start trading. But you have to do a number of other things between now and 2012. So the first obligation is the plan



The emissions trading timeline through the pre-trading period of 2010-2011. (All illustrations courtesy of ERA)



The ETS issues that have been, and continue to be, under discussion.

One part of the regulatory battle in 2008 related to the number of free permits available. There was outrage amongst industry over proposals by the European Commission to progressively increase the proportion of permits auctioned to 100% by 2020.

"Thankfully, member states saw sense, and that threat has now gone," McNamara reports. "If the 2005 cap is equivalent to 100% [of emissions allowed for the industry], the amount of free allocation is determined by reducing this first to 97% in 2012, and then to 95% thereafter. A further 15% is then taken off and auctioned by member states to generate revenue to fund the administration of the scheme. The discussions about auctioning were whether the 15% figure should progressively increase to 100% by 2020.

"Now, 100% auctioning means no free allowances at all. So any carbon emissions you produce, you have to buy a permit for. The challenge the industry had was to push for the auctioning figure to be kept as low as possible. The final agreement between the European Parliament and member states was to keep it at 15% through to 2020."

Airlines will discover that buying carbon is not done at a fixed price, but as part of a free market. So the price of carbon goes up and down depending on factors such as supply and demand, or other economic conditions.

The need to buy carbon in an open market has perplexed some, who note that the point of ETS is not about people making money, but about the environmental effects of emissions on the planet. Yet the free market will reign rather than, for example, the European Union setting a price each year. →

by August this year. The next serious obligation is to start monitoring both fuel burn and tonne-kilometres – beginning on 1 January 2010. That's when a 'pre-trading period' over 2010 and 2011 starts. During those years, operators will have to behave as if they were part of ETS, which means monitoring their emissions, reporting their emissions to their competent authority and getting those reports verified. So they have to go through the whole process. It's just that at the end of the process, they don't have to surrender permits to cover their emissions. They don't have to do that until 2012."

This ought to enable airlines to see how they are progressing in order to keep to their free allocation. But McNamara points out that, under the timetable, carriers will not know how many free allowances they will have until 2011.

Returning to the process that airlines will need to learn, he says there are two main obligations from ETS. One is the process for applying for free permits – that's one half of the monitoring and reporting; the other half is the actual monitoring and reporting of emissions.

"In applying for free permits, an operator has to monitor its tonne-kilometres in the calendar year 2010, converting passengers' weights to tonnes using a pre-defined passenger weight. That number will be used as a benchmark to allocate free permits. All carriers report their data for the calendar year 2010, and the pot of free allowances is carved up according to each carrier's tonne-kilometres."

Airlines will also need to know immediately how to buy carbon permits – for a very good reason. "Our view is that a large majority of carriers will have to buy from day one, simply because of the gap between when the cap was set and when the scheme comes into force," McNamara explains. "You've got a gap of seven years, from 2005 to 2012, where the industry has gone through sustained growth. We're in a downturn at the moment, which may help as the industry slows a little, but as an industry we are likely to be a net buyer from the word go.

ALLOCATIONS AND AUCTIONS

"At an individual operator level, it will depend on how you've changed your fleet and operation, as to whether you will be a buyer from day one or whether, indeed, you might have some free permits that you can trade.

"The other important message this year is that the time for discussing if ETS is a good or bad thing is now over. The reality is that you have to do something. The opportunity for challenging the legislation was last year. Now our focus is on what you have to do to comply."

MUST ATTEND

ERA is holding a workshop on the implementation of the European Union's Emissions Trading Scheme. The event will be held in Brussels on 29 April 2009.

Spaces are strictly limited, so to register your interest and secure a place at the workshop, please contact jacqueline.tierney@eraa.org

"The thing to remember is that aviation is joining an existing scheme," McNamara observes. "The EU ETS has been around for some years, so the original set-up was a whole different discussion. And the cap-and-trade concept has always been viewed, right from its origins, as a free market system, where governments don't interfere. Governments interfere in setting the cap, but how people and companies behave is up to them."

"The idea behind not having a controlled market is much like any other commodity – and carbon is just another commodity – leave it to the markets to deal with. It isn't ideal, as prices go up and down as a result. Last year, the price was down at less than €1 per tonne because of over-allocation of CO₂ to the industries already in ETS, so nobody needed permits, so the price dropped. Obviously, as supplies become scarcer, the price will go up as well."

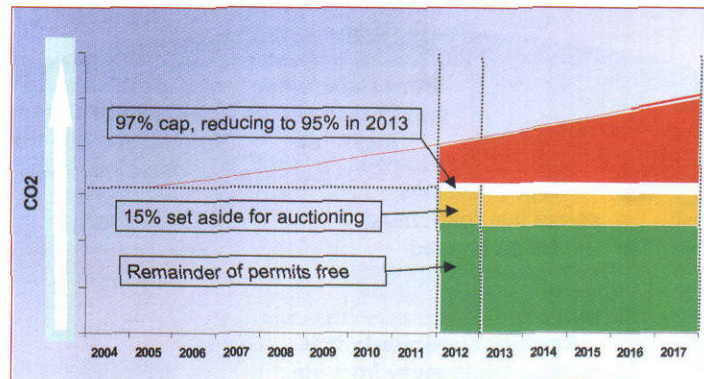
■ GETTING CREDIT

When it comes time for an airline to buy extra carbon credits, there are a number of options available. "You can get involved in several ways. You can obviously take it upon yourself to buy permits on the open market. You can go through a broker, for example, to some of the city banks that trade and hold carbon inventories. But ERA is not getting into the business of recommending individual companies. What we are saying to carriers is that operators have to start planning strategically even now to look at that kind of issue."

"If you go, for example, to some city banks, they already have products that they are keen to sell. For example, one major bank has a fuel-and-carbon hedging product that it is developing. ERA is holding a workshop in April (see box), the theme of which is to take operators through every step of ETS, including the final step, which is the actual trading."

Much publicity has been given to programmes in, say, the Far East or South America, where money goes to eco-projects and the company spending that money gets carbon credits. McNamara explains how these fit into carbon trading.

The split between free and bought permits through aviation's first two trading periods in the EU ETS.



"These are CDM/JIs, which are Clean Development Mechanisms and Joint Implementation, where such projects have a value in terms of carbon credits. So instead of buying a tonne of CO₂ from another industry, you can earn credits from these projects and you can gain a benefit from those instead of buying your CO₂. Now aviation is going to be very limited in terms of how much benefit it can get from CDM/JI. The regulation stipulates that 1.5% is the minimum proportion of the CO₂ required by an operator which can come from CDM/JIs. Most of it has to be purchased CO₂ from other industries. So it's not going to be a big area of trading."

On the administrative and strategic side, airlines are fairly well placed, as they are always looking at strategic planning with regard to purchasing fuel. The airline staff who do that, and follow market trends, just have to track another commodity.

Given McNamara's explanation of ETS, the preparation scenario is just as important for airlines coming in from non-EU countries. They may not, however, be aware of it. "It's possible they're not. There are only a few states in Europe advising airlines on what they have to do – mainly because the legislation is so late. The legislation was only finished in November last year."

"The actual legislation lays the framework. The Commission then has to develop what it calls monitoring and reporting guidelines, and it's working on those at the moment. The final version of those will not be available until June this year. And that gives the real nuts and bolts of what an airline has to do to comply."

"So it's actually quite difficult for national legislators to start advising carriers what to do, because they don't fully know themselves."

Because there's a huge rush, which is driven by the political desire to do something, rather than the practical 'Let's try and do this properly'.

"I can be confident that in many states in Europe, very little has happened. So awareness is very important for our members, but I think for non-EU carriers, that state of awareness is going to be even worse."

Another key aspect of ETS is getting data verified and audited. Examples of verifiers would be organisations such as accountants. "Yes, for example, Ernst & Young offer verification services for the EU ETS," McNamara comments. "And although they have already been doing it for other industries in the ETS, they'll have to be accredited for aviation, so that they understand about the business."

■ FLIGHT OWNERSHIP

Airlines also need to pay careful attention to aircraft leasing and emissions. "Depending on how you define who is the operator of a flight, it starts getting very complicated, identifying who is actually responsible for a flight and responsible for complying with the legislation."

"A lot of our members are ACMI operators. The advice we're giving to members is that you have to actually look at your leasing contracts – current and future – and build in something on emissions trading before 1 January 2010. Sitting down with your lawyers and saying, 'We need an article in our contracts on emissions trading,' is necessary, to decide who is responsible for complying, who holds the free permits, who will surrender permits, and so on. Carriers have to start working on that, or they could lose out."

Thus endeth the lesson and the conclusion could not be clearer. Airlines must act on ETS now! ■