



EU ETS & CORSIA

Position Revision EU Emission Trading System 2003/87/EC

Management summary

The revision of the EU Emission Trading System Directive 2003/87/EC must solve important policy design issues between EU ETS and CORSIA, including the changed world post-COVID-19. An intelligent coexistence of both systems is of utmost importance. Europe should not undermine the credibility of CORSIA. Moreover, airlines should not pay twice for the same single ton of CO₂.

It is essential that the revision ensures a level-playing field between EEA- and non-EEA airlines. For EEA airlines, intra-EEA feeder services into their respective hubs *are* subject to the EU-ETS. In contrast, non-EEA airlines feeding their non-EEA hubs from within the EEA are *not* subject to the EU-ETS. This leads to a clear distortion of competition, reduced employment for European citizens, less economic activity, less intra-EEA connectivity and carbon leakage. The EU must therefore introduce flanking measures, like a carbon border adjustment mechanism for aviation, an exemption from EU ETS for intra-EEA feeder flights and the integration of environmental compliance in air transport agreements.

In the view of Lufthansa Group, the revision must address six core requirements:

- prevent and remove market distortion between EEA and third country carriers
- prevent double regulation of emissions
- ensure long-term regulatory stability by preventing international opposition
- minimize deviation from CORSIA or EU ETS principles
- limit the increase in administrative burden
- limit the increase in cost (especially regarding the impact of COVID-19)

It should also address free allowances of insolvent airlines, transferring free allowances inside an airline group, simplifying the SAF-accounting methodology and a financing cycle, which uses ETS-revenues for dedicated research and development of sustainable aviation fuels (SAFs).

As regards whether and how to implement CORSIA and EU ETS, none of the described options fully comply with our six core requirements. Options 1, 2 and 6 are unacceptable, as they neither consider nor apply CORSIA, leading to significant market distortion. Options 3 and 4 could be conceivable, but at the expense of either ETS or CORSIA. Option 5 is the least unfavourable alternative; however, it must be adapted to prevent double regulation and market distortion.

Regarding free allowances, it is essential to acknowledge their purpose: balancing an uneven global level-playing field. Any increase of the auctioning share, increases the market distortion to the disadvantage of EEA carriers. Moreover, any reduction should start only after the COVID-19 crisis, since it will otherwise endanger the recovery plans and environmental investments.

We call for a re-evaluation of the policy options and urge the European Commission to integrate the abovementioned, necessary requirements.



Core requirements for EU ETS Revision

The revision of the EU Emission Trading System Directive 2003/87/EC will be a cornerstone of environmental policy of aviation industry. It will determine the future coexistence of the two climate action frameworks: EU ETS and CORSIA. At the same time, this revision will define the future auctioning share of ETS allowances. By doing so, it will shape the environmental legislation for European and global aviation for at least the next decade.

The revision provides the unique opportunity to resolve policy design issues of the EU-ETS in its current layout – especially the inherent market distortion. It is equally important that the revision takes into account the changed circumstances for aviation post-COVID-19.

In the view of Lufthansa Group, the revision must address six core requirements:

- prevent and remove market distortion between EEA and third country carriers
- prevent double regulation of emissions
- ensure long-term regulatory stability by preventing international opposition
- minimize deviation from CORSIA or EU ETS principles
- limit the increase in administrative burden
- limit the increase in cost (especially regarding the impact of COVID-19)

The revision should also clarify important unregulated aspects and boost environmental developments by:

- deciding on how to deal with free allowances of operators in insolvency
- introducing a transfer mechanism for free allowances from one AOC to another AOC
- simplifying the accounting methodology for SAF in the EU-ETS
- using ETS revenues from aviation to decarbonize the aviation industry (e.g. a financial circuit to finance the scale-up of SAF production capacity)

Background and relevance of EU ETS and CORSIA

To date, the EU ETS is the most important policy instrument to mitigate aviation carbon emissions in Europe. The introduction of the Emission Trading Scheme (ETS) in its original scope (i.e. including international flights departing the EEA) led to severe international resistance. Consequentially, the ETS scope was temporarily limited to intra-EEA traffic only, also known as “stop-the-clock”.

Due to global competition, a global framework is preferred. We therefore support the global policy instrument, developed by ICAO: CORSIA. At least 88 states, representing 77% of international aviation, will be covered by the scheme, as from 2021. No other industry has a comparable framework, which addresses CO₂-emissions on a global scale.



Both EU ETS and CORSIA address environmental externalities. However, their underlying principles are fundamentally different. The EU ETS reduces total allowable emissions in line with a pre-defined mitigation path. Airlines and other industries purchase allowances for their individual emissions. In contrast, CORSIA aims for carbon neutral growth from international flights. Airlines must purchase offsets to compensate¹ collective sectoral emission growth² (instead of individual airline growth). These different principles make harmonization complex, especially as double regulation must be avoided. The European aviation industry should not pay twice for the same single ton of CO₂.

On the one hand, the EU must not undermine the credibility of CORSIA. Instead, it should strengthen CORSIA by aiming at as many participating states as possible. On the other hand, the EU ETS is the established key instrument to reduce emissions across European industries in line with climate targets. A carve-out of the aviation sector is not conceivable. However, a smooth coexistence is of the utmost importance.

Market distortion in the EU ETS

Apart from harmonizing EU ETS and CORSIA, the revision must prevent and remove existing market distortion. It is particularly bothersome that there is no level playing field in particular between EEA airlines and non-EEA airlines, which operate from hubs close the EEA-border (e.g. Istanbul, Dubai, Abu Dhabi, Doha, Moscow and due to Brexit even London). For EEA airlines, intra-EEA feeder services into their respective hubs *are* subject to the EU-ETS. In contrast, non-EEA airlines feeding their non-EEA hubs from within the EEA are *not* subject to the EU-ETS. At the same time, these non-EEA airlines benefit from a practically unlimited access to the EEA market, which is a clear distortion of competition.

Non-EEA airlines do have a clear financial advantage, as they are not subject to the financial burden of the ETS in their home markets. Moreover, many non-EEA airlines do have lower social protection for their employees and do receive significant state subsidies (unrelated to COVID-19). Both increase their financial advantage over EEA airlines even more.

Next to reduced employment for European citizens, less economic activity and less intra-EEA connectivity, this competitive distortion also results in carbon leakage. Due to the ability to offer significantly lower ticket prices, non-EEA airlines steer traffic via their hubs. By doing so, non-EEA airlines incentivize detours, leading to an unnecessary increase of emissions.

It is essential that the revision of the EU ETS ensures a global level playing field. There are three conceivable regulative options:

¹ The principle implies that CO₂ reductions in other sectors are financed and claimed by aviation, i.e. each ton of CO₂ emitted by aviation is avoided or removed elsewhere. Thus, there is a direct link between monetary expenses and associated CO₂-reductions. In the EU-ETS there is no direct appropriation, however compensation certificates (offsets, such as ERU/CER) may be credited to some degree in the ETS.

² This will slowly change from 2029 onwards.



- Establish a carbon border adjustment mechanism for aviation, comparable to policy instruments, which protect other industries (e.g. steel production)
- Exempt intra-EEA feeder flights from the ETS proportionally to the share of connecting passengers with a final destination outside of the EEA
- Integrate environmental compliance in EU comprehensive air transport agreements with third countries

Besides these necessary accompanying policies, it is important to take into account the “bigger picture”. Without a global level playing field, any reduction in free allowances further increases this market distortion to the disadvantage of EEA carriers.

Harmonization of EU-ETS and CORSIA

The inception impact assessment, supporting the revision of the EU Emission Trading System Directive, describes six different policy options:

- **Option 1 – EU ETS full legal scope:** In case no amendment is adopted by the European Parliament and Council by December 2023, the EU ETS for aviation would cover flights departing from airports in the EU/EFTA and arriving to other airports in EU/EFTA or to third countries and, if not exempted through delegated legislation, incoming flights to airports in the EU/EFTA from third countries.
- **Option 2 – Intra-EU/EFTA ETS only:** Maintaining the status quo, the EU ETS would be applied exclusively and confined to the scope of the system as currently applied: allowance surrendering obligations for aircraft operators would be based solely on emissions from flights between aerodromes located in the EU/EFTA, with the exception of flights between EU outermost regions and other regions of the EU/EFTA (including other outermost regions), while including flights within any given outermost region.
- **Option 3 – CORSIA only:** Only CORSIA would be applied to international flights, non-domestic intra-EU/EFTA flights, flights to and from the EU/EFTA States (including their outermost regions) and third countries.
- **Option 4 – ETS-CORSIA “clean cut”:** The EU ETS would continue to apply to the current intra-EU/EFTA scope, as in option 2 above, and CORSIA would be introduced for extra-EU/EFTA flights, i.e. flights to and from EU/EFTA States (including their outermost regions) and third countries. In other words, the EU ETS would be applied as at present and CORSIA would be applied to all other flights (to the extent that CORSIA is applicable to them).
- **Option 5 – ETS-CORSIA “mix”:** Regarding non-domestic intra-EU/EFTA flights, the EU ETS would apply up to each operator’s 2020 emissions. Above the 2020 emissions, CORSIA would apply. Regarding flights between EU/EFTA States (including their outermost regions) and third countries, CORSIA would apply on emissions above 2020 levels. This option would cover domestic flights.



- **Option 6 – ETS-CORSIA “mix” according to licence of aircraft operators:** The EU ETS would apply to non-domestic, intra-EU/EFTA flights, operated by operators with licences issued by Member States. For operators with licences issued by third countries, only CORSIA would apply on those non-domestic intra-EU/EFTA flights and flights between EU/EFTA States (including their outermost regions) and third countries. This option would not cover domestic flights.

The following table summarizes these options:

Table 1: Description of the six policy options in the inception impact assessment

	Option 1: EU ETS full legal scope	Option 2: Intra-EU/EFTA ETS only	Option 3: CORSIA only	Option 4: ETS/CORSIA “clean cut”	Option 5: ETS CORSIA Mix	Option 6: ETS CORSIA Mix acc. to AOC
Int. extra EEA:	ETS	No regulation	CORSIA	CORSIA	CORSIA	CORSIA
Int. intra EEA:	ETS	ETS	CORSIA	ETS	ETS<2019>CORSIA	ETS or CORSIA
Domestic:	ETS	ETS	ETS	ETS	ETS	ETS
Implication	Max. absolute cost	No cost change	Least cost increase	Max. cost increase	Medium cost increase	Distortion of competition
	Total emissions ultimately limited	Intra-EEA emissions ultimately limited	Domestic emissions ultimately limited	Intra-EEA emissions ultimately limited	Domestic emissions ultimately limited	
Remarks	Undermines CORSIA	Undermines CORSIA	Major loss of relevance for ETS	EEA considered as one country	Adaption required to avoid double regulation	Airline license nationality defines applicable scheme
	Int. opposition			Int. opposition		

In order to rate these options, it is important to assess them against the six core requirements and the four unregulated aspects:

- prevent and remove market distortion between EEA and third country carriers
- prevent double regulation of emissions
- ensure long-term regulatory stability by preventing international opposition
- minimize deviation from CORSIA or EU ETS principles
- limit the increase in administrative burden
- limit the increase in cost (especially regarding the impact of COVID-19)
- no reduction of free allowances of operators in case of an insolvency
- transfer free allowances from one AOC to another
- simplify the accounting methodology for SAF in the EU-ETS
- use ETS revenues from aviation to decarbonize the aviation industry (e.g. a financial circuit to finance the scale-up of SAF production capacity)



Table 2: Lufthansa Group's assessment of the six policy options in the inception impact assessment

	1	2	3	4	5	6
No distortion of competition with non-EEA	+	-	-	-	-	-
No double-regulation	+	+	+	+	?	+
No international opposition & long-term stability	-	-	+	-	+	?
No or minor deviation from CORSIA principles	-	-	+	-	+	-
No or minor deviation from ETS principles	+	+	-	+	?	-
No increase of administrative burden	+	+	+	+	?	+
Decision on EUAs of liquidated operators	-	-	-	-	-	-
Transfer of free allowances from AOC to AOC	-	-	-	-	-	-
Improved SAF accounting methodology	-	-	-	-	-	-
Financial circuit for ETS revenues	-	-	-	-	-	-

Based on the requirements defined above, **option 5** reflects the necessary improvements the most. It separates CORSIA and EU ETS based on a reference year. It applies CORSIA in its full scope and modifies the EU ETS for intra-EEA flights. Thereby, all emissions from European aviation will be subject to regulation and international opposition avoided. However, to prevent double regulation, a fundamental modification of this option is necessary. Under CORSIA, airlines do compensate the sectoral (instead of their individual) emission growth. This implies that an airline with unchanged emissions will still need to purchase offsets. For such cases, option five must permit the deduction of CORSIA compensation from the ETS obligation. This also implies that the ETS applies to all emissions not governed by CORSIA. Moreover, this option should also reflect the adaptation of the reference year for CORSIA to 2019. The ETS would then apply up to an operator's 2019 emissions. Emission growth beyond the level of 2019 would be subject to CORSIA.

Option 3 does also tick some core requirements. This option implements CORSIA in its full scope, but the ETS is subject to a major adaption. The suggested carve-out of international intra-EEA aviation moves the associated emissions from a regional (ETS) to a global regulation (CORSIA). As a result, the emissions remain governed under an equally effective compensation scheme.

Option 4 proposes a clear cut, but a major adaption to CORSIA. In this option, the ETS for aviation remains in its current intra-EEA scope and CORSIA only applies to flights between the EEA and third countries. As international intra-EEA flights are taken out of CORSIA, this option represents a significant reduction of its scope and would certainly provoke international opposition.

Option 6 has to be excluded. Linking the carbon pricing mechanism to the nationality of the AOC would enhance the distortion of competition. Furthermore, **options 1 and 2** are unacceptable, as they neither consider nor apply CORSIA at all.

➔ **Conclusion:** none of the options fully comply with all six core requirements. We therefore, cannot fully support any of the proposed policy options. We call for an evaluation of the policy options and urge the European Commission to come up with feasible option, which respects the abovementioned requirements, e.g. a modification of option 5.



Future auctioning share in the EU-ETS

The free allowances represent a pre-crisis value of nearly 800m EUR per year. It is a design principle of the ETS that the share of allowances being auctioned among the industries is gradually increased. This implies that the total number of free allowances decreases over time. The Lufthansa Group, however, urges the European institutions to take into account the current extraordinary circumstances.

It is our opinion that the revision of the EU ETS must take into account the fact that European aviation presently faces the most severe crisis in its history. An accelerated reduction will increase the financial burden on the industry significantly. This will endanger the industry's post-COVID recovery plans and puts environmental investments, such as the deployment of new aircraft, at risk.

Any reduction of allowances should therefore start only after the crisis, e.g. when airlines have been able to repay their temporary aid. Furthermore, it should anticipate the additional environmental cost imposed by CORSIA – that affects slow growing European airlines over-proportionately³. Finally, as long as there is no level playing field between EEA and non-EEA airlines, any increase of the auctioning share increases the market distortion described above to the disadvantage of EEA carriers.

The status quo and four policy options are ranked in the table below:

- **Option 0** – Status quo: The current legally situation is perpetuated until 2030, i.e. the 15% auctioning share.
- **Option 1** – Immediate phase-out: 100% auctioning from the entry into force of the revision.
- **Option 2** – Swift phase-out: Full auctioning by 2025, starting with an auctioning share of 60% in 2023, and a share of 80% in 2024.
- **Option 3** – Slow phase-out: A linear increase year-by-year to full auctioning by 2030 starting from 20% in 2023.
- **Option 4** – Slow reduction: A linear increase year-by-year starting with an auctioning share of 20% in 2023 and ending at 55% in 2030.

³ In CORSIA the sectoral growth of aviation emissions is collectively compensated by all airlines. If the sector grows faster than an individual airline, this airline will compensate more emissions than required for its own carbon neutral growth.



Table 3: Assessment of different policy options regarding allowances

	Status Quo	100% phase-out	Swift phase-out	Slow phase-out	Slow reduction
No distortion of competition	-	-	-	-	-
No double-regulation	n/a	n/a	n/a	n/a	n/a
No (int.) opposition & long-term regul. stability	+	+	+	+	+
No or minor deviation from CORSIA principles	n/a	n/a	n/a	n/a	n/a
No or minor deviation from ETS principles	+	-	-	-	-
No increase of administrative burden	+	+	+	+	+
Decision on EUAAs of liquidated operators	-	-	-	-	-
Transfer of free allowances from AOC to AOC	-	-	-	-	-
Improved SAF accounting methodology	-	-	-	-	-
Financial circuit for ETS revenues	-	-	-	-	-

→ **Conclusion:** Regarding free allowances, it is essential to acknowledge their purpose: balancing an uneven global level-playing field. Any increase of the auctioning share, increases the market distortion to the disadvantage of EEA carriers. Moreover, any reduction should start only after the COVID-19 crisis, since it will otherwise endanger the recovery plans and environmental investments. Besides the allocation share, a transfer mechanism for free allocation should also be introduced.

Other necessary regulatory improvements

Apart from the future auctioning share, the revision of the ETS should also address the free allocation to former operators. These are airlines that have been liquidated or were fully or partially acquired by other airlines in the last years (regardless of a share or asset deal). These allocations should be transferred to the purchasing airlines – similar to airport slots. Instead, they currently remain out of the market.

To date, the free allocation is linked to the AOC. Within an airline group, the AOC structure is subject to change for economic reasons. In order to prevent the loss of free allowances, the revision of the Directive should foresee a procedure to transfer the free allocation from one AOC to another AOC (within the same airline group).

An additional regulative improvement concerns the methodology to account for the use of sustainable aviation fuel in the EU ETS. A more practicable methodology is necessary that does not require designated fuel logistics (unnecessary transports) and increases availability across the EEA. In comparable circumstances (e.g. when marketing green electricity), the “book and claim” principle proved successful. Analysis shows that this principle could be adapted accordingly⁴.

⁴ Pechstein et al (2020): A “book and claim”-approach to account for sustainable aviation fuel in the EU-ETS – development of a basic concept, Energy Policy (136)



In terms of contributing to decarbonization of aviation, ETS revenues from aviation should be reinvested in technologies that help reducing the carbon footprint of aviation. Sustainable aviation fuel is the most important lever to mitigate emissions in the mid- to long-term. Introducing a financial cycle could accelerate their market introduction, e.g. by funding the demonstration and scale-up of SAF supply concepts. Furthermore, the revision should anticipate the additional use of sustainable fuels that are not derived from biomass – so called “Power-to-Liquid”, “electrofuels” or “renewable fuels of non-biogenic origin, RFNBO”.