



Commentary, April 2012
www.canada-europe-dialogue

EU Emissions Trading Scheme: Problems presented to Canada

by Armand de Mestral* and Md. Tanveer Ahmad[†]

From January 1, 2012, Canadian civil aircraft have been subject to the European Union's Emissions Trading Scheme (EU ETS). The EU ETS was launched in 2005 in accordance with *Directive 2003/87*,¹ and international civil aviation has been included within the scheme from January 1, 2012 pursuant to *Directive 2008/101*.² The EU ETS is one of the three market-based mechanisms introduced in the *Kyoto Protocol*,³ and it works on the cap-and-trade principle under which "there is a "cap", or limit, on the total amount of certain greenhouse gases that can be emitted"⁴ by different types of companies including airline companies.⁵ Within this cap, "companies receive emission allowances which they can sell to or buy from one another as needed."⁶ Each company is required to surrender enough allowances to cover all its emissions at the end of each year to avoid paying a fine of 100 EUROS per tonne of carbon emitted over the

*Emeritus Professor, Jean Monnet Professor of Law, McGill University; [†] DCL candidate, McGill University

¹ EC, *Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC*, [2003] O.J. L 275/32 [*Directive 2003/87*].

² EC, *Directive 2008/101/EC of the European Parliament and of the Council of 19 November 2008 amending Directive 2003/87/EC so as to include aviation activities in the scheme for greenhouse gas emission allowance trading within the Community*, [2009] O.J. L 8/3 at 6, 8 – 9 [*Directive 2008/101*].

³ *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, 16 March 1998, 2303 U.N.T.S. 148 (entered into force 16 February 2005) [*Kyoto Protocol*]. "[T]he Kyoto Protocol introduced three market-based mechanisms, thereby creating what is now known as the "carbon market."

The Kyoto mechanisms are:

- [Emissions Trading](#)
- [The Clean Development Mechanism \(CDM\)](#)
- [Joint Implementation \(JI\)](#)

Online: Mechanisms under the Kyoto Protocol, United Nations Framework Convention on Climate Change <http://unfccc.int/kyoto_protocol/mechanisms/items/1673.php>. The Court of Justice of the European Union classified the trading system as a market-based mechanism different from a duty, tax, fee, charge, levy, etc. on the fuel load in a recent decision concerning the inclusion of aviation within the European scheme. See *Air Transport Association of America and others v. Secretary of State for Energy and Climate Change*, C-366/10, online: InfoCuria – Case-law of the Court of Justice <<http://curia.europa.eu/juris/document/document.jsf?text=emissions%2Btrading&docid=117193&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=574404#ctx1>>.

⁴ Online: Emissions Trading System (EU ETS), Policies, Climate Action, European Commission <http://ec.europa.eu/clima/policies/ets/index_en.htm>.

⁵ *Ibid.*

⁶ *Ibid.*

limit set by the *Directive*.⁷ If a company reduces its emissions, it can keep the spare allowances to cover its future needs or else sell them to another company that is short of allowance.⁸ Failure to comply with the scheme may lead to an operating ban on the respective airline company.⁹

All flights performed by aircraft with a certified maximum take-off mass of more than 5700 kg arriving into or departing from an aerodrome situated in the territory of an EU Member State are included within the scheme unless exempted by satisfying any of the exemption criteria under the scheme.¹⁰ Each airline company is administered by a single Member State for all of its aviation activities under the scheme.¹¹ Under the scheme, in the first year, emissions allowances are issued free to participating airlines while, in the second year, 15% of allowances must be obtained by auction.¹² In the first and subsequent years, emissions must be reduced by 3% in relation to the previous year's emissions.¹³ Although *Directive 2008/101* provides guidelines regarding the use to be made of the proceeds from the auction, EU Member States are accorded discretion regarding the use of such revenues.¹⁴

The implementation of the EU ETS poses a variety of difficulties to Canada and its air carriers. First and foremost, the EU ETS has been adopted unilaterally neither in accordance with the *Chicago Convention* nor with the *Kyoto Protocol*.¹⁵ The EU ETS is imposed on all airline companies from third countries including Canada. Second, the EU ETS is calculated on the basis of emissions occurring beyond the airspace above the territory of EU. Arguably, this is incompatible with the *Chicago Convention*,¹⁶ the "Constitution"¹⁷ of international civil aviation,¹⁸ and customary international law, since extra-territorial application of any domestic regulation is not accepted by other states.¹⁹ Third, by complying with the EU ETS, Canadian airlines may be

⁷ *Ibid.*; *Directive 2008/101*, *supra* note 2; *Directive 2003/87*, *supra* note 1.

⁸ *Ibid.*

⁹ *Directive 2008/101*, *supra* note 2 at 7, 13.

¹⁰ *Ibid.* at 17.

¹¹ *Ibid.* at 7. For the latest list of operators bound to comply with the emissions trading system and their administering Member States see EC, *Commission Regulation (EU) No 100/2012 of 3 February 2012 amending Regulation (EC) No 748/2009 on the list of aircraft operators that performed an aviation activity listed in Annex I to Directive 2003/87/EC of the European Parliament and of the Council on or after 1 January 2006 specifying the administering Member State for each aircraft operator also taking into consideration the expansion of the Union emission trading scheme to EEA-EFTA countries*, [2012] O.J. L 39/1.

¹² See *Directive 2008/101*, *supra* note 2 at 6 – 9.

¹³ *Ibid.*

¹⁴ See *ibid.* at 6, 8 – 9.

¹⁵ According to article 2, paragraph 2 of *Kyoto Protocol*, *supra* note 3, developed countries listed in Annex I to the Protocol must work through the International Civil Aviation Organization while pursuing any limitation or reduction of greenhouse gas emissions in the field of aviation. See *Kyoto Protocol*, *supra* note 3, art. 2(2).

¹⁶ *Convention on International Civil Aviation*, 7 December 1944, 61 STAT. 1180, T.I.A.S. No. 1591, 15 U.N.T.S. 295, Can. T.S. 1944 No. 36, ICAO Doc. 7300/9 [*Chicago Convention*].

¹⁷ See Paul Stephen Dempsey, *Public International Air Law* (Montreal: McGill University, Institute and Center for Research in Air & Space Law, 2008) at 69.

¹⁸ *Ibid.*

¹⁹ See *Chicago Convention*, *supra* note 16, arts. 1, 2, 12, Preamble; *Inclusion of International Civil Aviation in the European Union Emissions Trading Scheme (EU ETS) and Its Impact*, ICAO Council, 194th Sess., Working Paper, Subject No. 50, ICAO Doc. C-WP/13790 (2011). The three principles of customary international law which forbid extra-territorial application of domestic regulations are: (a) each State has complete and exclusive sovereignty over the airspace above its territory; (b) no State may validly purport to subject any part of the high seas to its sovereignty;

indirectly sponsoring unidentified national projects of the administering EU Member State. Fourth, as a result of the EU ETS, Canadian airlines must increase air fares to cover the costs associated with complying with the scheme and suffer loss of profits due to reduced traffic. It should be noted that compliance with the EU ETS involves considerable administrative costs on the part of the airlines in addition to the need to purchase emissions allowances at the auction or from other companies. Fifth, application of the EU ETS may well not comply with the Canada-EU Air Services Agreement,²⁰ signed in December 17/18, 2009 and provisionally in force since that date.²¹ The Agreement does not specifically provide for the application of EU ETS,²² and, arguably, several provisions of the Agreement conflict with the EU ETS.²³

The latest Canada-EU Air Services Agreement: important provisions affecting environmental issues

The Canada-EU Air Services Agreement contains several provisions concerning environmental issues. The Agreement places considerable emphasis on the protection of the environment by specifying that it is one of the important factors to be considered by both parties while developing and implementing international civil aviation policy.²⁴ Article 18 of the Agreement is especially devoted to environmental matters.²⁵

According to article 18, paragraph 2, the Agreement authorizes both parties to take and apply environmental measures within their own sovereign jurisdiction so long as they do not prejudice the rights and obligation of the parties under international law and the *Chicago Convention*.²⁶ Arguably, the extraterritorial dimension of the EU ETS infringes this provision.²⁷ EU Member States are not only exceeding their jurisdiction but also prejudicing the rights and obligations of Canada under both international law and the *Chicago Convention*.²⁸

(c) freedom to fly over the high seas. These principles of customary international law were also recognized by the Court of Justice of the European Union. See *ATA v. Secretary of State*, *supra* note 3, paras. 103 – 111.

²⁰ *Agreement on Air Transport between Canada and the European Community and its Member States*, Canada and European Union, 17/18 December 2009, online: Transport, European Commission <http://ec.europa.eu/transport/air/international_aviation/country_index/doc/canada_final_text_agreement.pdf> (not yet in force) [*Canada-EU Air Services Agreement*].

²¹ See EC, Press Release, IP/09/1963, “EU and Canada sign Air Transport Agreement” (17 December 2009), online: Press Releases RAPID, Europa

<<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1963&format=HTML&language=en>>; EC, Press Release, Memo/09/218, “The EU-Canada aviation agreements – Q&A” (6 May 2009), online: Press Releases RAPID,

Europa <<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/218&format=HTML&aged=0&language=en&guiLanguage=en>>.

²² See *Canada-EU Air Services Agreement*, *supra* note 20.

²³ See below.

²⁴ *Canada-EU Air Services Agreement*, *supra* note 20, art. 18(1), Preamble.

²⁵ *Ibid.*, art. 18.

²⁶ *Ibid.*, art. 18(2).

²⁷ See *Chicago Convention*, *supra* note 16, arts. 1, 2, 11, 12. Article 1 of *Chicago Convention* codifies the relevant principle of customary international law, namely, each State has complete and exclusive sovereignty over the airspace above its territory. See *ATA v. Secretary of State*, *supra* note 3, para. 104.

²⁸ “The mandatory nature of the [Chicago] Convention is underlined by Article 82 in which contracting states committed themselves to abrogate any inconsistent obligations and understandings and not to enter into any such obligations or understanding.” Michael Milde, “International Air Law and ICAO” in Marietta Benkö, ed., *Essential Air and Space Law*, vol. 4 (Utrecht, Netherlands: Eleven International Publishing, 2008) at 18 [footnote omitted].

Article 13, paragraph 2 of the Canada-EU Air Services Agreement authorizes both parties to unilaterally limit the volume of traffic, frequency or regularity of service, or the aircraft type(s) operated by the airlines of the other party and to require the filing of schedules, programmes for charter flights, or operations plans by the airlines of the other party on environmental reasons limited to two issues: noise and local air quality. The EU ETS is not a noise regulation. It can also be argued that it is not essentially a local air quality regulation.²⁹ Since the EU ETS has the potential to unilaterally limit the volume of traffic of the other party, and is neither a noise regulation nor a local air quality regulation, it can be submitted that *Directive 2008/101* infringes the Agreement.³⁰

Article 18, paragraph 5 of the Canada-EU Air Services Agreement provides that any environmental measures adopted by either party must comply with the international standards adopted by International Civil Aviation Organization (hereinafter ICAO) in Annexes to the *Chicago Convention* unless differences have been filed.³¹ It has to be stated that the EU ETS complies with this provision since the EU Member States have already filed differences by placing reservation on ICAO Assembly Resolution A36-22 which requests the Contracting States to the *Chicago Convention* not to implement any unilateral market-based mechanism.³² Nevertheless, whether or not the EU ETS is consistent with the guidelines for market-based mechanisms set out in Annex to the ICAO Assembly Resolution A37-19,³³ which supersedes Resolution A36-22 in conjunction with Resolution A37-18,³⁴ cannot be guaranteed.³⁵ Arguably, the EU ETS does not satisfy the requirements of transparency, administrative simplicity and a “not an inappropriate” economic burden on international aviation.³⁶

²⁹ See *Directive 2008/101*, *supra* note 2 at 17; *ATA v. Secretary of State*, *supra* note 3, para. 117.

³⁰ One may argue that the EU ETS does not violate article 13(2) of *Canada-EU Air Services Agreement*, *supra* note 20, since the Court of Justice of the European Union has recently declared that unilaterally limiting the volume of traffic, etc., by the EU ETS are permitted according to a similarly worded provision, namely, article 3(4), of *Air Transport Agreement*, United States and European Union, 25 and 30 April 2007, E.U. Series 005/2011: Cm 8137, [2007] O.J. L 134/4. See *ATA v. Secretary of State*, *supra* note 3, paras. 95 – 100. In this context, it can be counter-argued that both provisions are distinguishable since article 13(2) is limited to noise and local air quality regulations while article 3(4) covers all environmental measures. *Canada-EU Air Services Agreement*, *supra* note 20, art. 13(2); *Air Transport Agreement*, *ibid.*, art. 3(4).

³¹ *Canada-EU Air Services Agreement*, *supra* note 20, art. 18(5).

³² *Consolidated statement of continuing ICAO policies and practices related to environmental protection*, ICAO Assembly Res. A36-22, 36th Sess., ICAO Doc. 9902, I-54, online: ICAO <http://www.icao.int/publications/Documents/9902_en.pdf>.

³³ *Consolidated statement of continuing ICAO policies and practices related to environmental protection — Climate change*, ICAO Assembly Res. A37-19, 37th Sess., ICAO Doc. 9958, I-67, online: ICAO <http://www.icao.int/publications/Documents/9958_en.pdf> [*ICAO Res. A37-19*].

³⁴ *Consolidated statement of continuing ICAO policies and practices related to environmental protection — General provisions, noise and local air quality*, ICAO Assembly Res. A37-18, 37th Sess., ICAO Doc. 9958, I-54, online: ICAO <http://www.icao.int/publications/Documents/9958_en.pdf>.

³⁵ See *Inclusion of International Civil Aviation*, *supra* note 19.

³⁶ See *ICAO Res. A37-19*, *supra* note 33, Annex.

Canada's current activity concerning aviation emissions

Canada has not initiated any specific response to the EU ETS. To date, some environmental actions have been initiated at the federal government level to reduce greenhouse gas emissions.³⁷ There exists no market-based mechanism in Canada,³⁸ and, most recently, Canada has withdrawn from the *Kyoto Protocol* effective December 15, 2012,³⁹ which introduced three market-based mechanisms.⁴⁰ Transport Canada, the Canadian government department responsible for transportation policies and programs,⁴¹ supports the work of and cooperates with the ICAO and its Committee on Aviation Environmental Protection in the development of international environmental standards.⁴² Canada's civil aviation policy, namely the Blue Sky Policy, which governs Canada's approach to bilateral air services agreements, does not include anything with regard to the protection and improvement of environment.⁴³

What should Canada do in response: the available avenues

Although ICAO now plans to have an emissions proposal by the end of 2012,⁴⁴ it may not be prudent for Canada to remain inactive and wait for a global solution while Canadian air carriers are being compelled to pay for their carbon emissions by the EU. Some countries have already commenced responding in various ways. For example, the United States House of Representatives has passed and the Congress appears ready to pass a bill opposing the EU ETS,⁴⁵ China has suspended aircraft orders from Airbus and asked its air carriers not to participate in the EU ETS without government approval,⁴⁶ India is poised to order its aircraft operators to ignore the EU ETS.⁴⁷ Therefore, some more concrete action on the part of Canada is warranted.

³⁷ See online: Aviation Emissions, Emissions, Transport Canada <<http://www.tc.gc.ca/eng/programs/page-2624.htm#air>>.

³⁸ See e.g. National Round Table on the Environment and the Economy, "ECC – International Advisory Note - The International Policy Elements of a Long-term Energy and Climate Change Strategy for Canada - Advisory Note to the Minister of the Environment" online: National Round Table on the Environment and the Economy <<http://nrtee-trnee.ca/ecc-interim-report-index/ecc-international-advisory-note>>.

³⁹ "In accordance with article 27 (1) of the Kyoto Protocol to the United Nations Framework Convention on Climate Change, the Government of Canada notified the Secretary-General of the United Nations that it had decided to withdraw from the Kyoto Protocol. The action will become effective for Canada on 15 December 2012 in accordance with article 27 (2)." Online: Status of Ratification of the Kyoto Protocol, United Nations Framework Convention on Climate Change <http://unfccc.int/kyoto_protocol/background/items/6603.php>.

⁴⁰ *Kyoto Protocol*, *supra* note 3; Online: Mechanisms under the Kyoto Protocol, United Nations Framework Convention on Climate Change <http://unfccc.int/kyoto_protocol/mechanisms/items/1673.php>.

⁴¹ Online: About Transport Canada, Transport Canada <<http://www.tc.gc.ca/eng/aboutus-menu.htm>>.

⁴² See online: Transport Canada <<http://www.tc.gc.ca/eng/programs/environment-air-index.htm>>.

⁴³ Online: Blue Sky: Canada's New International Air Policy, Transport Canada <<http://www.tc.gc.ca/eng/policy/acc-consultations-blueskypolicy-749.htm>>.

⁴⁴ See "UPDATE 2-UN aviation body says emissions proposal by year-end" *Reuters [US]* (2 March 2012), online: Reuters <<http://www.reuters.com/article/2012/03/02/airlines-emissions-idUSL2E8E2B9720120302>>.

⁴⁵ See "Congress to oppose EU law on aircraft emissions" *Reuters [US]* (31 January 2012), online: Reuters <<http://www.reuters.com/article/2012/02/01/us-usa-airlines-eu-idUSTRE81003Y20120201>>.

⁴⁶ See Anurag Kotoky, "EXCLUSIVE - India to ask airlines to shun EU carbon law" *Reuters [India]* (19 March 2012), online: Reuters <<http://in.reuters.com/article/2012/03/19/india-eu-emission-idINDEE82I0CZ20120319>>.

⁴⁷ See *ibid.*

First, Canada might try to persuade the EU to cease the application of EU ETS to international civil aviation in favor of a global solution, which the EU claims to favor.⁴⁸ Canada may also consider the dispute resolution mechanisms available under both the *Chicago Convention* and the Canada-EU Air Services Agreement,⁴⁹ or the Joint Committee instrument available under the Agreement.⁵⁰

Second, Canada might join the 26 states opposing the EU ETS and participate actively in their discussions.⁵¹

Third, Canada might introduce an emissions trading scheme applicable only to Canadian aircraft. Such a scheme would contribute to the reduction of carbon emissions from Canadian aircraft and should qualify for an exemption under the EU *Directive*. This scheme should be based on the guidelines for market-based mechanisms set out in Annex to the ICAO Resolution A37-19.⁵² During the planning process, Canada should endeavor to consult with its EU counterparts using the Joint Committee instrument in accordance with article 18, paragraphs 4 and 6 of the Agreement.⁵³ After launching the scheme, Canada should apply for exemption from the EU ETS and,⁵⁴ if granted exemption, should exclude EU aircraft from the Canadian scheme to avoid duplication of regulation in accordance with guidelines for market-based mechanisms.⁵⁵

⁴⁸ *Directive 2008/101*, *supra* note 2 at 5, 15.

⁴⁹ On dispute resolution, see *Chicago Convention*, *supra* note 16, arts. 84 – 88; *Canada-EU Air Services Agreement*, *supra* note 20, art. 21.

⁵⁰ *Canada-EU Air Services Agreement*, *supra* note 20, arts. 17, 18(6), 20.

⁵¹ See e.g. Barbara Lewis, “Moscow air talks to debate measures against EU” *Reuters [US]* (17 February 2012), online: Reuters <<http://www.reuters.com/article/2012/02/17/uk-eu-airlines-idUSLNE81G01T20120217>>.

⁵² See *ICAO Res. A37-19*, *supra* note 33, Annex.

⁵³ *Ibid.*, art. 18(6).

⁵⁴ See *Directive 2008/101*, *supra* note 2 at 5, 7, 14 – 15.

⁵⁵ See *ICAO Res. A37-19*, *supra* note 33, Annex.