CORSIA – It's (almost) crunch time

As part of the global UN-led effort to tackle climate change, the aviation sector has agreed a basket of measures to decarbonize the industry and achieve net zero carbon emissions by 2050. One of those measures is the Carbon Offset and Reduction Scheme for International Aviation ("**CORSIA**"), the first market-based carbon reduction scheme to cover an entire industry sector. Managed by the International Civil Aviation Organization ("**ICAO**"), CORSIA commits the industry to purchase Eligible Emissions Units ("**EEUs**") to offset any growth in sector emissions against a pre-agreed baseline.

As the Pilot Phase draws to a close in 2023, the next cycle, the First Phase, operational between 2024-2026, is expected to generate a significant requirement for EEUs: the global aviation sector has recovered strongly from the COVID-19 pandemic and ICAO has set a baseline for CORSIA for the First Phase of 85% of 2019 sector emissions, which could require industry participants to purchase 100-200 million EEUs for offsetting emissions over the First Phase[1].

Here comes the crunch

In March, the Technical Advisory Board ("**TAB**"), which is the body responsible for determining the eligibility criteria for EEUs, updated its rules for the First Phase which contain some key differences and clarifications from the Pilot Phase:

> First, the American Carbon Registry and Architecture for REDD+ Transactions standards were approved to supply EEUs for the First Phase. Additionally, Verra's VCS programme, The Gold Standard, Climate Action Reserve and the Global Carbon Council were conditionally approved for the First Phase. It is broadly expected that they will be fully approved later this year. TAB is in the process of assessing other crediting schemes and will make further recommendations in Q3/Q4 of 2023.
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> Second, only EEUs created from 2021 onwards will be eligible for use and cancellation by operators in the First Phase.
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> Finally, and most significantly, EEUs used for First Phase compliance will require a "Corresponding Adjustment"[2]. Corresponding Adjustments are a mechanism to avoid the double-counting of emission reductions or removals. A Corresponding Adjustment must be granted by the government of the country in which the emission reduction or removal occurs.

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[1] Source: Trove Research

[2] These updates are set out in "Clarifications of TAB's Criteria Interpretations Contained in TAB Reports".

Although many countries are engaging in developing their strategies and the required architecture to manage accounting and effect Corresponding Adjustments, this process is still in its relative infancy and there are currently ***no*** EEUs available in the market that will satisfy the First Phase criteria.

TAB's recommendations do not yet constitute formal requirements but are expected to be confirmed by ICAO later this year. In this context, it is vital to establish the supply of EEUs that the aviation industry requires in the First Phase *now*.

Surviving the crunch: can the aircraft leasing and financing industry support the airlines?

Given there are currently no EEUs with a Corresponding Adjustment in the market, it is expected that demand is likely to outstrip supply for many years to come – as well as demand for First Phase CORSIA compliance there will be other areas of demand, including (a) governments seeking to use carbon credits towards their national targets and (b) corporates sourcing "best-in-class" UN-grade emissions reductions/removals who will have these units in their sights. As a result, there will likely be a material effect on pricing as well as availability.

If the sector invests in projects *now*, participants can help to ensure a supply of EEUs for airlines. The EEU cancellation deadline for airlines for the First Phase of CORSIA is 31 January 2028 – this means that airlines will need to have acquired and cancelled a volume of EEUs with a Corresponding Adjustment that is sufficient to match their excess emissions under CORSIA's rules by that date. Projects normally take several years to be funded, developed, registered and verified before issuing units – this makes it important for investment to be made *now* to establish a supply to meet the considerable airline needs in a few years' time.

Consideration is being given at ICAO to the legal and financial consequences for airlines that fail to cancel a sufficient quantity of EEUs to cover their obligations – it is reasonable to think that the enforceability of CORSIA will depend on there being meaningful penalties.

How to support airline customers

The aircraft leasing and financing industry can act today to join in the carbon markets – there are many different activity types for the industry to invest in, ranging from nature-based solutions to sustainable aviation fuel production[3]. Projects of different scale, location and profile help to reduce risk – be it legal, geopolitical or environmental – whilst a clear regulatory requirement provides demand for EEUs.

Participation may seem novel but aircraft lessors are already starting to participate in the carbon markets. Establishing solo projects may suit some but options exist for clubbing together to invest in a variety of projects to produce EEUs.

Investing now would ensure security of supply and give price certainty, could provide a differentiator from a competitor for a customer, providing a competitive advantage in discussions with airline customers, as well as contributing to the transition to net zero.

[3] The latter has, for example, made India's list of Article 6 project activities.

Climate Impact Partners is a market-leading company specializing in carbon project development and finance with its headquarters in London and a significant presence in the US.

Vedder Price LLP is an international law firm with a market-leading reputation in the aviation community with offices in London, Singapore and across the US.

Philip Lee LLP is a law firm with a specialist practice in carbon and climate finance with offices in Dublin, London and San Francisco.