

## EU ETS, UK ETS AND CH ETS: UNDUE FEARS FOR LESSORS OVER LIENS AND AIRCRAFT DETENTION RIGHTS

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Flyr, a Norwegian airline, filed for bankruptcy on 1 February 2023 after failing to raise NOK330m (US\$31m) to pay for EU ETS charges that fall due on 30 April 2023. Given the airline's exposure to potential EU ETS non-compliance penalties, there is some concern as to whether the enforcement of such penalties could directly impact Flyr's lessors. Primarily, there are questions (notably, following articles in the trade press) as to whether such enforcement could involve the imposition of liens on, or the detention of, Flyr's leased aircraft or the aircraft owner's wider fleet.

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While the initial panic around Flyr's inability to pay the charges caused concern for lessors, there is no basis in either the text of the EU ETS Directive (as defined below) or Norwegian law for such liens and detention rights over Flyr's aircraft. Indeed, as further explored herein, there is no basis in the EU ETS Directive or, in most cases, local law for the imposition of such liens or detention rights in other jurisdictions where the EU ETS scheme applies. In this article, we explore the workings of the EU, UK and Swiss (CH) ETS schemes (including their enforcement mechanics) and the risk that an aircraft operator's non-compliance with them poses to lessors across those jurisdictions which fall within these schemes.

### THE EU ETS SCHEME: TACKLING THE AVIATION INDUSTRY'S CO2 EMISSIONS

The EU ETS scheme was established in 2005 pursuant to Directive 2003/87/EC (the "2003 Directive"), it applies to all 27 member states, as well as Iceland, Liechtenstein, and Norway (each an "ETS State") and also previously applied to the UK prior to Brexit. Its scope was expanded in 2008 to capture aviation activities within the European Economic Area ("EEA") pursuant to Directive 2008/101/EC (the "2008 Directive", together with the 2003 Directive, the "EU ETS Directive"). The scheme implements a cap on the level of emissions that may be incurred by aircraft operators, requiring these entities to monitor their aviation emissions and report on the same by 31 March each year.

Each aircraft operator is then responsible for offsetting their reported emissions by 30 April of the same year. Offsets can be made using tradeable carbon credits, which can be obtained via auctions or the secondary markets. There are also limited free allowances granted to aircraft operators annually. However, we note that the European Commission is phasing out free allowances for the aviation sector by 2026 in pursuit of the implementation of the ‘polluter pays’ principle.

## Defining an ‘aircraft operator’

First, it is worth exploring what the EU ETS scheme considers to be an ‘aircraft operator’ as the scheme looks to such entities for monitoring, reporting and offsetting.

Under the EU ETS Directive, an ‘aircraft operator’ is “*the person who operates an aircraft at the time it performs an aviation activity*”.<sup>1</sup> This is determined by reference to the call sign used for air traffic control purposes for each flight. Where the aircraft operator “*is not known or is not identified by the owner of the aircraft*”,<sup>2</sup> the scheme will instead look to the aircraft owner in respect of the emissions for each flight.

It is this language that has prompted concerns regarding the enforcement of penalties under the scheme against lessors. However, it is clear that in order for the owner itself to be captured directly within the EU ETS scheme (rather than as a result of a lien or detention right, for which see discussion below), the relevant authority would have to fail to identify the lessee as the ‘aircraft operator’. In Flyr’s case, it is helpful that it appears on the official list of aircraft operators maintained by the Commission (Commission Regulation (EC) No 748/2009 (the “Aircraft Operator List”)). (although this is not definitive, as aircraft operators are identified for each relevant flight).

## Penalties for non-compliance

The penalties under the EU ETS scheme for offending aircraft operators are implemented at two levels: the EU level and the ETS State level. Each aircraft operator is assigned an ETS State (which is specified in the Aircraft Operator List) that is responsible for the imposition of penalties on it. The relevant ETS State is determined by reference to the operating licence or the ETS State in which the aircraft operator’s emissions were mostly attributable in 2006 or, if later, its first year of operation. Subject to the operating ban exception mentioned below, only one ETS State is responsible for enforcement against an aircraft operator. Each ETS State appoints a competent authority to implement the EU ETS scheme.

At the EU level, the scheme imposes penalties of €100 for each tonne of CO<sub>2</sub> emitted in respect of which no allowance is surrendered by the aircraft operator. Additionally, the Commission may impose an operating ban on the offending aircraft operator (at the request of its ETS State). Once implemented, an operating ban must be recognised and enforced by all ETS States.

At a local level, each ETS State is responsible for determining further penalties to ensure compliance with the scheme. Whether or not liens can be imposed on aircraft, or aircraft can be detained, is a matter for each ETS State to determine as the EU ETS Directive does not contemplate, or provide for, such methods of enforcement.

## ETS STATES AND THE EU ETS: ENFORCEMENT AT A LOCAL LEVEL

As noted above, enforcement methods under the EU ETS scheme ultimately fall to each ETS State to determine. The methods employed by each ETS State vary, but they tend to focus on administrative actions taken against the operators. Although in some cases the local authorities do seek to impose liens on, or detain, the operator's aircraft, it is rare that lessor's aircraft may be affected (such rare cases being Greece, Poland and Portugal). We have set out further detail on all relevant ETS States (excluding Liechtenstein) below. Importantly, in Flyr's case, there is no Norwegian law which would allow the imposition of liens or detainment of aircraft.

## THE UK ETS SCHEME: CHANGES FOLLOWING THE BREXIT FALLOUT

The UK ETS scheme came into force pursuant to the Greenhouse Gas Emissions Trading Scheme Order 2020 after the Brexit transition period ended on 1 January 2021. Broadly, the UK ETS scheme is aligned with the EU ETS scheme and adopts the same definition of an 'aircraft operator'. Its scope, however, is limited to UK domestic flights, flights between the UK and Gibraltar or Switzerland, and flights departing the UK to EEA states conducted by aircraft operators, regardless of nationality (subject to certain minimum thresholds).

When the UK was a part of the EU ETS scheme, UK regulators had the statutory right to detain and, with the leave of the courts, sell aircraft (on a fleet-wide basis) operated by the aircraft operators who were regulated by the UK for EU ETS purposes. However, following the implementation of the UK ETS scheme, these statutory powers of detention and sale have been removed, bringing the position in line with the general EU ETS position (as set out below in the table).

## THE SWISS (CH) ETS SCHEME: LINKING UP WITH THE EU ETS SCHEME

Switzerland's ETS scheme, the CH ETS, largely follows the same rules as the EU ETS scheme (including the definition of aircraft operators). On 1 January 2020, the CH ETS was linked with the EU ETS because of the agreement between the European Union and the Swiss Confederation on the linking of their greenhouse gas emissions trading systems (the "Linking Agreement"). Domestic Switzerland flights and flights from Switzerland to EEA countries fall within the CH ETS scheme. Whereas flights from EEA countries to Switzerland fall within the EU ETS scheme. However, aircraft operators who are subject to both schemes will only be regulated by one ETS State and allowances allocated pursuant to either scheme can be used to meet the obligations under both schemes.

Akin to the treatment of the other ETS States under the EU ETS Directive, the Linking Agreement does not affect Switzerland's right to amend its local law to adopt stricter enforcement measures. However, as of April 2023, Switzerland does not grant the right for liens to be imposed or aircraft to be detained or seized in relation to the enforcement of unpaid CH ETS or EU ETS charges.

## THE CAPE TOWN CONVENTION: IMPLICATIONS FOR LIENS AND DETENTION RIGHTS

Liens and detention rights are rights which are created by law and not by the agreement of parties. The Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment (the “Cape Town Convention”) provides for the protection of these types of rights and interests (being non-consensual rights and interests) where the relevant Contracting State has made a declaration either (a) under Article 39(1)(a) to preserve the priority that its national law gives to such rights without having to make a registration of such right (“Article 39(1)(a) Rights and Interests”), or (b) under Article 40 to replace its national law priority for such rights with the Cape Town Convention’s registration and priority scheme (“Article 40 Rights and Interests”). Contractual arrest or detention rights given to a state, state entities, intergovernmental organisations or private providers of public services may also be preserved under Article 39(1)(b), to the extent that a Contracting State has made a declaration to such effect.

In respect of Article 39(1)(a) Rights and Interests, the relevant declaration does not have to specifically list the types of interests included in this category – a generic statement saying that all non-consensual rights and interests which under the law of that state would have priority over security interests will have priority, without registration, over international interests that are security interests under the Cape Town Convention. Any declaration made in respect of Article 39(1)(a) Rights and Interests will only preserve the existing priority of such rights and interests under national law – it may not expand such rights. For Article 40 Rights and Interests, the categories of rights and interests must be specifically identified.

Based on the information in the table below, the only jurisdictions which provide for liens or detention rights against aircraft leased by aircraft operators are not countries that have ratified the Cape Town Convention. Therefore, the Cape Town Convention countries comply with their obligations under the Cape Town Convention in this respect.

**"The methods employed by each ETS State vary, but they tend to focus on administrative actions taken against the operators."**

## LOCAL ENFORCEMENT: A SUMMARY ANALYSIS

We have sought clarification on the enforcement mechanisms of the relevant schemes for the UK, Switzerland and each ETS State (excluding Liechtenstein) from our Watson Farley & Williams network and correspondent counsel (as noted in the table below). In each case, we have sought confirmation on the following questions and have detailed the responses in the table below:

1. when an aircraft operator has not complied with the EU ETS, UK ETS or CH ETS scheme (as applicable), or failed to pay penalties imposed on it, can liens be imposed on the aircraft operator’s leased aircraft (or can such aircraft be otherwise detained)?
2. if the answer to question 1 is yes, can such lien/detention right extend to all of the aircraft operated by the offending aircraft operator?
3. if the answer to question 1 is yes, can such lien or detention right extend to any of the owner’s aircraft (including its wider fleet, not just those operated by the offending aircraft operator)? and
4. can charges and penalties incurred by an aircraft operator under the EU ETS, UK ETS or CH ETS scheme (as applicable) be passed on to the owner from the offending aircraft operator (excluding circumstances where the aircraft operator cannot be identified)?

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Of course, local counsel should be consulted in respect of specific fact patterns as the law in some ETS States lacks clarity (which is unsurprising given the lack of precedent surrounding enforcement under the EU ETS scheme).

Country	Q1	Q2	Q3	Q4	CTC Country?	Law firm advising	Lawyer notes
Austria	No	N/A	N/A	No	No	Klemm Rewchtsanwalts- GmbH	None
Belgium	No	N/A	N/A	No	No	Goemans, De Scheemaecker & De Wit	None
Bulgaria	No	N/A	N/A	No	No	Boyanov & Co.	None
Croatia	No	N/A	N/A	No	No	Kovačević Prpić Simeunović	None
Cyprus	No*	N/A	N/A	No	No	Montanios & Montanios LLC	*The law in Cyprus states that the authorities may apply to the courts for “the detention of any aircraft owned by an aircraft operator”. If interpreted literally, only aircraft owned by an aircraft operator may be detained. However, if, on the basis of Cypriot rules of interpretation and construction, the Cypriot courts determine that the word "owned" may be substituted for the term "operated", then the answers to questions 1, 2 and 3 would be yes, yes, and no, respectively.
Czech Republic	No	No	No	No	No	Kocián Šolc Balaščík	None
Denmark	No	N/A	N/A	No	Yes	Kromann Reumert	None
Estonia	No	N/A	N/A	No	No	Wallace	None
Finland	No	N/A	N/A	No	No	Castrén & Snellman Attorneys Ltd	None

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Country	Q1	Q2	Q3	Q4	CTC Country?	Law firm advising	Lawyer notes
France	No	N/A	N/A	No	No±	Watson Farley & Williams	None
Germany	No	N/A	N/A	No	No±	Watson Farley & Williams	None
Greece	Yes*	No	No	No	No	Watson Farley & Williams	*Any detainment of an aircraft would have to be authorised by the Greek courts. It should be noted that (a) there is no precedent for the detainment of an aircraft in Greece for the non-payment of EU ETS charges or penalties and (b) the detainment of aircraft for non-compliance with the EU ETS scheme in Greece takes a significant amount of time as this may only occur after monetary fines for non-compliance remain unpaid for one year.
Hungary	No	N/A	N/A	No	No	Lakatos, Köves és Társai Ügyvédi Iroda	None
Iceland	No	N/A	N/A	No	Yes	BBA//Fjeldco	None
Ireland	No	N/A	N/A	No	Yes	A&L Goodbody LLP	None
Italy	No	N/A	N/A	No	No±	Watson Farley & Williams	None
Latvia	No	N/A	N/A	No	Yes	Walless	None
Lituania	No	N/A	N/A	No	No	Walless	None
Luxemborg	No	N/A	N/A	No	Yes	NautaDutilh	None
Malta	No	N/A	N/A	No	Yes	Ganado Advocates	None
Netherlands	No	N/A	N/A	No	Yes	NautaDutilh	None
Norway	No	N/A	N/A	No	Yes	Kvale Advokatfirma DA	None

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Country	Q1	Q2	Q3	Q4	CTC Country?	Law firm advising	Lawyer notes
Poland	Yes*	Yes	No	No	No	SSW Pragmatic Solutions	*If an aircraft is detained or seized, the owner of such aircraft has 14 days to object to this and provide evidence of its ownership – at which point the authorities should release the aircraft. It should be noted that, as of April 2023, there is no existing case law on this matter.
Portugal	Yes	Yes*	No	No	Yes	CS'Associados	*The Portuguese authorities may, in the case of serious or very serious offences under the EU ETS scheme, detain aircraft (even when such aircraft are leased to the offending aircraft operator). However, the extension of such detainment to other aircraft only occurs when the penalties imposed by the Portuguese authorities impact the aircraft operator's whole operation (such as the suspension of its operating licence).
Romania	No*	N/A	N/A	No	No	Volciuc-Ionescu	*Generally, under Romanian law, liens can only be imposed on a debtor's assets. However, it may be argued that an aircraft leased to an aircraft operator can be deemed to be its asset and thus captured by such lien. Volciuc-Ionescu are not aware of any such liens being carried out in practice.
Slovakia	No	N/A	N/A	No	No	Barger Prekop	None
Slovenia	No	N/A	N/A	No	No	Odvetniki Šelih & partnerji	None
Spain	No	N/A	N/A	No	Yes	Watson Farley & Williams	None

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Country	Q1	Q2	Q3	Q4	CTC Country?	Law firm advising	Lawyer notes
Sweden	No	N/A	N/A	No	Yes	Mannheimer Swartling Advokatbyrå AB	None
Switzerland	No	N/A	N/A	No	No±	MLL Meyerlustenberger Lachenal Froriep LLP	None
United Kingdom	No	N/A	N/A	No	Yes	Watson Farley & Williams	None

± indicates that the country has signed, but has not ratified, the Cape Town Convention.

## CONCLUSION: INITIAL PANIC AND UNDERSTANDING

Although the initial heightened concern around the risk of Flyr's non-compliance with the EU ETS scheme is understandable, it is ultimately unwarranted. Importantly, each of the EU ETS, UK ETS and CH ETS schemes look to the aircraft operators to enforce penalties. Further, neither the Commission, the UK regulators, nor the Swiss authorities require, or even recommend, the imposition of liens or the detainment of aircraft as enforcement mechanisms. When looking at this from a local law perspective, the position is the same in the vast majority of jurisdictions that are part of such schemes. Overall, the risk of liens being imposed on, or the detainment of, aircraft is minimal and we view the picture as a positive one for lessors.

## FOOTNOTES

[1] Article 3(o), EU ETS Directive.

[2] Article 3(o), EU ETS Directive.



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