

# Global Transportation Finance Newsletter

## United Kingdom: Aircraft Repossession and Recovery

Recent European airline bankruptcies have highlighted the need to take care when formulating aircraft repossession and recovery strategies. An owner or financier will want to ensure that a successful recovery of its aircraft from the defaulting airline is not followed by the detention and/or loss of its aircraft because of the rules that apply at the fly-out destination or the location chosen for the maintenance and/or storage of the aircraft.

The risk of detention and sale is present in one guise or another in most jurisdictions – in the United Kingdom (UK), the risk is most commonly associated with unpaid Eurocontrol navigation charges (including the notorious “fleet-wide lien”) and, more recently, unpaid civil penalties under the European Union’s Emissions Trading Scheme insofar as it relates to aircraft (EU ETS).

This article summarizes the detention and sale regime in the UK, explains how the risk of the Eurocontrol fleet-wide lien can be handled and highlights the available protection for owners and financiers in the context of the EU ETS legislation. This article does not discuss other detention rights that might be exercised against an aircraft in the UK.

### *Airport and Air Navigation Charges*

*Overview* – First, a recap on the power of the United Kingdom Civil Aviation Authority (UK CAA) to detain and sell aircraft. The power applies in relation to the non-payment of airport charges (i.e., charges payable for the use of various UK airport facilities)<sup>1</sup> or air navigation charges (i.e., charges payable for the supply of services by the UK National Air Traffic

Services, the Danish and Icelandic authorities and Eurocontrol).<sup>2</sup> The detention and sale regime with respect to aircraft is effectively the same for both airport charges and air navigation charges.

*Detention Right*—The applicable legislative provisions grant a detention right over an aircraft in favor of the UK CAA in two situations:

- 1 Where it is the aircraft in respect of which charges were incurred, which charges remain unpaid (whether or not incurred by the person who is the operator at the time when the detention begins; i.e., when an owner or financier is exposed to the risk of prior operators); and
- 2 Where it is one aircraft in the fleet of aircraft, in relation to which the person in default is the operator at the time the detention begins (this being the so-called “fleet-wide lien”).

Any person repossessing an aircraft is therefore not liable to have it detained in the UK (a) if the

<sup>2</sup> Reg. 4 Civil Aviation (Chargeable Air Services Detention and Sale of Aircraft for Eurocontrol) Regulations 2001 (the Eurocontrol Regulations).

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<sup>1</sup> S. 88 Civil Aviation Act 1982 (the Act).

aircraft itself has not incurred any charges that are unpaid and (b) if the person in default is no longer the operator of the aircraft.

*Managing the Fleet-Wide Risk* – An owner or financier can effectively deal with the fleet-wide risk by terminating the lease agreement before its aircraft enters the UK. This was affirmed in a 2010 English court case relating to the now-defunct operator Zoom Airlines,<sup>3</sup> which stated that the election to terminate must be made before the aircraft is detained. Any such termination should be effected before the aircraft reaches the UK, as the detention right may be exercised upon arrival in the UK and (notwithstanding a subsequent termination of the lease agreement) cannot be removed until such time as the unpaid sums are paid or the UK CAA elects to sell the aircraft.

*Airport Coverage* – The UK CAA's power to detain aircraft is restricted to so-called designated airports, many of which were listed in an order of the Secretary of State for Transport in 2009 and include aerodromes from Bournemouth to Blackpool, Cambridge to Carlisle and Liverpool to Lydd.<sup>4</sup>

The Secretary of State is able to supplement the list of designated airports by Amendment Order.<sup>5</sup> Prior to an Amendment Order being made, the Department of Transport enters into consultation with the aerodrome concerned, the UK CAA and other interested consultees.

The effect of the 2009 and subsequent legislation has greatly increased the number of airports covered, and as a result has made it very difficult for the owner or financier of a commercial aircraft to position its aircraft beyond the reach of the UK CAA.

<sup>3</sup> *Global Knafaim Leasing Limited v. The Civil Aviation Authority* [2010] EWHC 1348 (Admin).

<sup>4</sup> Sch. 1 Aerodromes (Designation) (Detention and Sale of Aircraft) (England and Wales) Order 2009 lists Bembridge, Biggin Hill, Birmingham, Blackpool, Bournemouth, Bristol, Bristol (Filton), Cambridge, Cardiff, Carlisle, Coventry, Cranfield, Doncaster/Sheffield, Durham Tees Valley, Exeter, Farnborough, Gloucestershire, Humberside, Leeds/Bradford, Liverpool, London City, London (Gatwick), London (Heathrow), London (Luton), London (Stansted), Lydd, Manchester, Manston, Newcastle, Norwich, Nottingham East Midlands, Oxford, Redhill, Southampton, Southend, Wolverhampton.

<sup>5</sup> At the time of writing, only Cotswold Airport has been so designated by Amendment Order.

*Sale Right* – The right to sell an aircraft is consequent upon the aircraft's detention. Pursuant to the provisions of – in relation to unpaid airport fees – the Act and, in relation to unpaid air navigation charges, the Eurocontrol Regulations, the UK CAA has the power, with the leave of the court, to sell the aircraft if due amounts are not settled within 56 days of the date on which the aircraft was detained.

## EU ETS

*Overview* – The provisions in relation to the EU ETS<sup>6</sup> impose the same ultimate sanction as those for unpaid airport fees and unpaid air navigation charges. However, the procedure is different, and there is (probably) increased protection for owners and financiers.

*Detention Right* – The power to detain an aircraft rests, in England and Wales, with the UK Environment Agency (and not with the UK CAA). The power may be exercised in two circumstances:

- 1 In relation to UK-administered aircraft operators who have failed to pay any civil penalty within six months of the due date. Civil penalties generally result from failure to comply with ETS regulations (including reporting requirements) or a failure to surrender allowances; and are generally due within one month of the date on which notice to pay is served; and
- 2 In relation to European Union (EU) operators who are subject to an operating ban under Article 16(10) of the EU ETS Directive.<sup>7</sup>

The detention right operates on a fleet-wide basis, since its reference point is necessarily the operator and not the aircraft.

The first limb applies only to any operator that is specified as administered, for the purposes of the EU ETS, by the UK under Commission Regulation (EC) No. 748/2009, which covers the majority of UK operators plus those international carriers for

<sup>6</sup> Generally, the Aviation Greenhouse Gas Emissions Trading Scheme Regulations 2010, as amended from time to time (the ETS Regulations).

<sup>7</sup> Directive 2003/87/EC, as amended from time to time.

which the UK has been allocated administrative responsibility.

Under the second limb, any aircraft operator operating within the EU may have its aircraft detained if a Member State applies for an operating ban under Article 16(10) of the EU ETS Directive. In this way, if an airline fails to comply with implementation of the EU ETS in Malta, for example, its aircraft may still be detained in the UK by the UK Environment Agency, provided that Malta has filed an application for an operating ban under Article 16(10) of the EU ETS Directive.

*Protections Against Detention* – An aircraft cannot be detained, continue to be detained or be sold if (i) following detention, the UK Environment Agency no longer has reason to believe the defaulting operator is the operator of the aircraft or (ii) the defaulting operator or any other person claiming an interest in the aircraft demonstrates to the UK Environment Agency's satisfaction that the defaulting operator is no longer entitled to possession of the aircraft, in particular by virtue of the termination of any lease with respect to the aircraft.<sup>8</sup>

The legislative provisions do not state whether the operator must have ceased to be the operator, or whether the lease must have been terminated, before the exercise of the detention right. The fact that the provisions are written in relatively broad terms suggests that lease termination after detention should be effective to cause the release of an aircraft.

Assuming that the transaction includes a lease to the operator, a mortgagee (as "a person claiming an interest in the aircraft") should not rely solely on its enforcement of the aircraft mortgage as a trigger to release the aircraft. A mortgagee would need to be able to demonstrate that the lease has also been terminated to be confident of securing the release of the aircraft.

*Geographical Coverage* – The geographical scope of the UK Environment Agency's detention power is

greater than that of the UK CAA. Rather than using a list of "designated airports," the EU ETS Regulations encompass "any area or space . . . for the landing and departure of aircraft."<sup>9</sup> Every aerodrome operator must provide assistance to the UK Environment Agency in detaining the relevant aircraft.

*Sale Right* – An aircraft may be sold, with the leave of the court, if sums due are not settled within 56 days of the date on which the aircraft was detained. Where the UK Environment Agency has detained an aircraft under the first limb, it must give at least 21 days' notice to any relevant party (which includes the owner and/or mortgagee) before proceeding with any sale.

### Summary

To summarize:

- An owner or financier must carefully select its fly-out destination and maintenance/storage location.
- The (perhaps overstated) Eurocontrol fleet-wide risk in the UK can be effectively addressed by timely lease termination.
- Timely lease termination should also protect against ETS detention and sale risk.
- Recovering mortgagees should not rely on repossession as mortgagee alone.
- It will be more than difficult to find a recovery location in the UK that is outside the reach of the UK CAA and the UK Environment Agency.

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<sup>8</sup> Reg. 43 of the ETS Regulations (which provision includes further circumstances in which an aircraft is to be released).

<sup>9</sup> "Aerodrome" means any area of land or water that is designed, equipped, set apart or commonly used for affording facilities for the landing and departure of aircraft and includes any area or space, whether on the ground, on the roof of a building or elsewhere, that is designed, equipped or set apart for affording facilities for the landing and departure of aircraft capable of descending or climbing vertically. Reg. 48 ETS Regulations/s. 105 Civil Aviation Act 1982.

## Trading Aircraft Loans Utilizing LSTA Trade Forms

As many single-investor or club deal loans secured by commercial aircraft (Aircraft Loans) became distressed during the economic downturn that followed 9/11, secondary trading increased dramatically. The Aircraft Loan financing community reacted by morphing from a primary base of commercial banks to a diversified group of commercial banks, investment banks, hedge funds, leasing companies and other aircraft investors. Many of these participants had high-volume syndicated debt-trading desks that were accustomed to trading corporate syndicated bank debt on forms published by the Loan Syndication and Trading Association (LSTA).<sup>1</sup> Because of this familiarity, certain participants began to utilize LSTA trade forms for Aircraft Loan transfers as a means to increase certainty of transaction execution and to reduce transaction costs. While these two goals are key reasons the LSTA forms have attained nearly universal acceptance as the documentation standard in the US syndicated corporate bank debt trading market, the LSTA forms do present a number of issues that require careful attention when they are utilized to close an Aircraft Loan transfer.<sup>2</sup>

The most important issues when using LSTA forms are: (i) an LSTA trade confirmation creates a legally binding obligation and, depending on the nature of the transaction, the binding obligation may have been created prior to execution of the trade confirmation; (ii) unless specifically modified by the parties, the LSTA forms do not contain very

basic representations and conditions precedent that are customary in Aircraft Loan transfers completed using traditional negotiated Aircraft Loan purchase agreements; and (iii) unless specifically modified by the parties, LSTA forms incorporate a very specific and pre-agreed purchase price calculation.

### *Timing of Binding Obligation*

An LSTA trade confirmation is typically the first agreement entered into when executing a trade utilizing LSTA forms. The confirmation has many of the hallmarks of a nonbinding letter of intent in a typical Aircraft Loan purchase transaction. An LSTA confirmation is a very short document that includes the basic terms of the transaction: (i) the purchase price, (ii) a description of the debt being purchased and (iii) any special terms related to the transaction.<sup>3</sup> However, as its name suggests, when used in a typical corporate syndicated bank debt trade, an LSTA trade confirmation is *not* a nonbinding indication of intent, but rather a *confirmation* of a binding trade that has already occurred, and the documentation of the trade using LSTA forms is in many respects an administrative exercise. In fact, in the syndicated corporate debt market, the custom is to verbally agree to the principal terms of the trade over the phone on a recorded line, with the binding obligation being created during the phone call.<sup>4</sup> If the parties to a trade expect there to be any substantive deviations from the LSTA Standard Terms and Conditions, the deviations are typically discussed and agreed to during the phone call. As a result, when utilizing LSTA forms to trade Aircraft

<sup>1</sup> The Loan Syndication and Trading Association is an industry trade group created in 1995, which is currently comprised of more than 320 banks, brokers, investment funds, law firms and other parties interested in the corporate syndicated bank debt market. See <http://www.lsta.org>.

<sup>2</sup> The LSTA publishes two sets of trade forms – one for *par* trades and one for *distressed* trades. The documentation for *par* trades consists of an LSTA trade confirmation. The *par* documents are typically used for trades of performing loans where the expectation is that the loans will pay out in full in accordance with the underlying credit agreement. The documentation for *distressed* trades consists of an LSTA trade confirmation as well as a long-form LSTA purchase agreement. The *distressed* documents are typically used for trades of non-performing loans or loans that are at some stage of restructuring (or expected restructuring). Both the *par* documents and *distressed* documents incorporate by reference the LSTA Standard Terms and Conditions, which apply to every trade completed on LSTA forms, unless the parties specifically modify those terms in the trade confirmation and/or purchase agreement.

<sup>3</sup> The special terms are set forth in the “Trade-Specific Other Terms of Trade” section of the LSTA confirmation and contain terms agreed to by the purchaser and seller that are (i) outside the scope of what is contained in the LSTA Standard Terms and Conditions or (ii) intended to modify the LSTA Standard Terms and Conditions.

<sup>4</sup> Further amplifying the binding nature of an LSTA trade, the LSTA Standard Terms and Conditions provide that if, for any reason, the trade cannot be settled by a legal assignment (*e.g.*, if required Borrower/Agent consent is not obtained), the parties will settle the trade by means of participation, and if a participation cannot be effected, the parties will settle the trade by an alternative means to give the parties the economic benefit of the agreed trade. Given the unique nature of Aircraft Loans and the relative effect that the specific aircraft forming the collateral can have on the pricing of, and return that can be realized on, an Aircraft Loan, a forced agreement to settle a trade by means of a participation or the specter of alternative settlement means may present an untenable position for a purchaser of an Aircraft Loan, both from a counterparty risk perspective and an ROI perspective.



Loans, in discussing the terms of the trade during the predocumentation phase, it is important that (i) the parties have a clear understanding and agreement as to if, and when, a binding obligation will be created; and (ii) the parties agree to any additional terms or modifications to the LSTA Standard Terms and Conditions at the time the binding obligation is created, particularly if a binding obligation is intended to arise prior to execution of a trade confirmation.<sup>5</sup>

### *Lack of Basic Representations, Warranties and Conditions Precedent*

LSTA forms do not contain basic representations, warranties and conditions precedent that many aviation industry participants are accustomed to seeing in Aircraft Loan transfers completed using negotiated Aircraft Loan purchase agreements. Below are a few examples:

- No Aircraft Documents Representation. LSTA forms do not contain a representation specifically identifying a definitive set of loan documents that include all the obligations that the purchaser will be assuming in connection with the purchased Aircraft Loans.<sup>6</sup>
- No Consent Rights over Amendments. LSTA forms do not provide a purchaser with any consent rights over amendments that may be effected after the trade date (i.e., date of trade specified in the LSTA confirmation) and prior to the settlement date (i.e., the closing date of the trade).<sup>7</sup>

<sup>5</sup> Because of the varying transaction practices between the syndicated corporate debt market (for which the LSTA forms were created) and the traditional aircraft secondary loan market, some parties enter into a non-binding letter of intent (rather than an LSTA trade confirmation) as a prelude to executing a trade on LSTA forms.

<sup>6</sup> While the LSTA distressed purchase agreement contains representations that partially address this point, the form representations are more limited than a purchaser would typically receive in an Aircraft Loan trade completed in a negotiated Aircraft Loan purchase agreement.

<sup>7</sup> While this would be virtually unheard of in the context of a negotiated Aircraft Loan purchase agreement of a "controlling position" in a loan transaction, it is the LSTA standard because the LSTA forms are primarily intended to be used in the context of widely syndicated debt, where a seller typically does not have a controlling position that would be necessary to effect, or prevent, an amendment to the underlying credit agreement.

- No Borrower/Collateral Conditions Precedent. LSTA forms do not contain any conditions precedent regarding the borrower or the collateral (e.g., no default under a credit agreement or lease (in case of a leveraged lease), no loss or damage to the Aircraft, no other liens on the Aircraft, etc.).
- No Documentary Conditions Precedent. LSTA forms do not contain any documentary conditions precedent to speak of (e.g., no opinions, no corporate authority deliverables, etc.).

Any of these terms and conditions may be incorporated into a transaction completed utilizing LSTA forms by including the desired terms, as agreed, in the "Trade Specific Other Terms of Trade" section of the LSTA confirmation.

### *Pre-agreed Purchase Price Calculation*

LSTA forms set forth an agreed Purchase Rate expressed as a percentage that, when multiplied by the outstanding principal amount of loans being purchased, forms the purchase price for the loans. The purchase price is adjusted based on a Target Settlement Date (which is analogous to an Economic Closing Date in typical aviation transactions). For trades completed on LSTA par documents, the Target Settlement Date is seven business days after the trade date and for trades completed on LSTA distressed documents, the Target Settlement Date is 20 business days after the trade date. Generally, the adjustment results in the purchaser receiving a credit for all interest accrued after the Target Settlement Date and the seller receiving a cost-of-carry adjustment on the purchase price from and after the Target Settlement Date calculated on the basis of one month's LIBOR.<sup>8</sup> While this purchase price calculation methodology is not intrinsically unfair or unworkable, and in many respects is very similar to purchase price adjustments often agreed to in negotiated

<sup>8</sup> While this is a general description of the default purchase price calculation mechanism contained in the LSTA Standard Terms and Conditions, the LSTA Standard Terms and Conditions do contain other "pre-agreed" purchase price calculation options that can be specifically selected.

Aircraft Loan purchase agreements, it is important that parties understand how the calculations work.

LSTA forms were primarily intended to be utilized for transfers of widely syndicated “cash flow” loans. Investors in this asset class do not, as a matter of practice, need to rely on a seller for information regarding loans being sold. This information is typically provided by the administrative agent of the underlying loan facility to both lenders and prospective lenders via a secure data site. Furthermore, widely syndicated cash flow loans derive their value from the cash flows of the underlying business and the credit quality of the borrower. Aircraft Loan investors, on the other hand, are forced to rely on sellers to provide information regarding the underlying loan documents and related aircraft collateral, and the value of an Aircraft Loan is often highly (or solely) dependent on the value of the underlying collateral. This information and valuation dichotomy gives rise to many of the issues discussed above. While the presence of these issues, in and of themselves, should not deter parties from utilizing the LSTA forms for transfers of Aircraft Loans, it is important that transaction parties understand these issues and modify the LSTA trade forms to fit the specific transaction.

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## The European Union’s Emissions Trading Scheme: From Environmental Initiative to Geopolitical Flashpoint

Since its establishment in 2003,<sup>1</sup> and in particular its expansion to aviation in 2008,<sup>2</sup> the European Union’s Emission Trading Scheme (ETS) has

<sup>1</sup> Directive 2003/87/EC (October 13, 2003) (establishing a scheme for greenhouse gas (GHG) emission allowance trading within the EU and amending Council Directive 96/61/EC) (the 2003 Directive).

<sup>2</sup> Directive 2008/101/EC (November 19, 2008) (amending the 2003 Directive to include aviation activities in the scheme for GHG emission allowance trading within the Community) (the 2008 Directive).

attracted controversy. In the past year, with impending, and now effective, implementation, dissatisfaction, controversy and protest have grown exponentially.

By far the most controversial aspect of ETS is its extraterritorial reach, with covered operators required to monitor and surrender (and pay for, if necessary) allowances corresponding to CO<sub>2</sub> emissions from every point of their flights to, from or within the European Union (EU) – whether on the ground in, or over, non-EU territory or international water. Moreover, there is no requirement that the monies expended for compliance (or as a result of noncompliance) with ETS be reinvested in environmental causes or toward advancement of more ecofriendly technology. The potentially disproportionate burden on non-EU operators has provoked vociferous opposition from non-EU airlines and governments, who have decried ETS as an illegal tax, designed merely to line government coffers in the economically troubled Eurozone.<sup>3</sup> The most prominent challenge to the ETS has been the lawsuit brought in December 2009 by United Airlines, American Airlines, Airlines For America, the National Airlines Council of Canada and the International Air Transport Association (IATA).<sup>4</sup>

On December 21, 2011, the European Court of Justice (ECJ), following the non-binding opinion issued in October 2011 by its advocate-general, upheld the validity of ETS and effectively struck down the lawsuit. Brought originally in the United Kingdom (UK) High Court and referred to the ECJ for interpretation of EU-wide treaty law, the lawsuit challenged the applicability of ETS to non-EU airlines on the grounds that it improperly infringes on the sovereignty of non-EU nations over their airspace and constitutes an unlawful charge or tax

<sup>3</sup> Estimates of the economic impact of ETS on the airline industry vary widely, ranging from €300 million to more than €500 million (according to one publication, IATA estimated the cost to be as high as \$1.35 billion) for 2012 alone, and as much as \$4.2 billion by 2020. See, e.g., “Airlines Face CO<sub>2</sub> Bill of 300 Million Euros in 2012: Barcap,” Reuters.com, February 17, 2012; “Airlines Can Profit from EU Carbon Tax,” USAToday.com, February 21, 2012; “Airlines Shouldn’t Crater to the E.U. Carbon Caper,” Forbes.com, February 28, 2012.

<sup>4</sup> Case C-366/10, *Air Transport Association of America and Others v. Secretary of State for Energy and Climate Change* (Judgment of the Court dated 21 December 2011).

on fuel, in violation of the Chicago Convention and other aviation treaties. The ECJ held that the EU is not bound by the requirements of the Chicago Convention since it is not a party to the treaty, even though the member states comprising the EU are parties to the treaty.<sup>5</sup> Nevertheless, the ECJ found no improper infringement of sovereignty (despite the fact that covered operators must account and pay for emissions during all points of flights to, from or within the EU) because the scheme applies to operators only when their aircraft are voluntarily in EU territory by having landed at, or taken off from, an EU airport.<sup>6</sup> The ECJ also found that ETS was not an impermissible tax on fuel in breach of the US-EU Open Skies Agreement (the “Open Skies Agreement”) because there was (in the ECJ’s estimation) no direct link between the quantity of fuel consumed by an aircraft and the financial burden of its operator.<sup>7</sup> Moreover, the ECJ held that the EU was not required to satisfy its Kyoto Protocol obligations exclusively through the International Civil Aviation Organization (ICAO).<sup>8</sup> The EU has consistently justified the inclusion of airlines worldwide in ETS because a decade of talks at ICAO failed to produce a global solution to address the environmental harms posed by airline emissions. Lastly, the ECJ held that ETS did not improperly discriminate in violation of the Open Skies Agreement.<sup>9</sup> While the case has been remanded to the UK High Court for final disposition, airlines from countries opposed to ETS are complying under protest, as the action shifts out of the courtroom and into the political arena.

The rallying cry of the ETS opposition is that emissions are a global environmental issue to be tackled globally through ICAO rather than unilaterally imposed by one market against the rest of the world. In response, the EU has consistently maintained that flights by operators from countries that have enacted “equivalent measures” to ETS within their own domestic systems would be exempt from ETS requirements. However, the EU Commission has never specified exactly what

constitutes an “equivalent measure.”<sup>10</sup> Though the issue has been debated in ICAO for more than a decade, the 191-member organization has not yet readied an agreed position. ICAO is said to be considering several options, including a worldwide emissions trading system and levies assessed on airlines (likely to be passed along to consumers) based on fuel intake, passenger numbers and cargo weight.<sup>11</sup> Some consideration has been given to initiating proceedings under ICAO’s dispute resolution mechanisms under Article 84 of the Chicago Convention; however, such actions rarely have been invoked, and on all but one occasion a mediated compromise was achieved without the need to resort to the full resolution process. The Secretary-General of ICAO has promised to have a proposed framework on the table by the end of 2012 for consideration and decision by ICAO in 2013, but at this point that is little more than an aspiration.

In light of the EU’s intractability, ICAO’s inactivity and the EJC’s decision, representatives of 26 countries (all of whom are ICAO members)<sup>12</sup> have met twice, most recently in Moscow late last month. The Moscow meeting resulted in a “basket of measures” with each country free to adopt the measure(s) it deems necessary and most effective to counteract ETS.<sup>13</sup> In the United States, Secretary of State Clinton and Transportation Secretary LaHood have written to the EU Commission and their counterparts in various EU member states, urging them to reconsider, delay or suspend the

<sup>5</sup> *Id.*, at ¶¶ 52, 60, 63, 69 and 71.

<sup>6</sup> *Id.*, at ¶¶ 116-118, 124-130 and 131-135.

<sup>7</sup> *Id.*, at ¶¶ 137-147.

<sup>8</sup> *Id.*, at ¶¶ 76-78.

<sup>9</sup> *Id.*, at ¶¶ 152-157.

<sup>10</sup> South Korea and Australia are at varying stages of development and implementation of emissions trading schemes for internal flights by their domestic carriers, but no official pronouncement has been made that these systems are sufficiently equivalent to pass muster.

<sup>11</sup> “UN Aviation Body Says Emissions Proposal by Year-End,” Reuters.com, March 2, 2012.

<sup>12</sup> Argentina, Brazil, Burkina Faso, Cameroon, Chile, China, Colombia, Cuba, Egypt, India, Japan, Malaysia, Mexico, Nigeria, Paraguay, Peru, Qatar, Russia, Saudi Arabia, Singapore, South Africa, South Korea, Swaziland, Uganda, the United Arab Emirates and the United States of America.

<sup>13</sup> These measures include the option for each country to bar its airlines from participating in ETS (which China has done and the US and Russia are considering or drafting legislation with similar impact) and submitting requested emissions data (as India has done), imposing retaliatory levies on EU-based airlines, renegotiating existing bilateral aviation treaties and ceasing talks about new routes with EU-based airlines (as India has threatened), initiating proceedings under Article 84 of the Chicago Convention, and reinstating territorial overflight restrictions on EU-based airlines (as Russia has threatened to do, despite previously agreeing to rescind such restrictions as a condition of its World Trade Organization accession).

application of ETS and to engage with ICAO to address the aviation emissions issue. The FAA re-authorization bill signed into law last month reaffirms the US opposition to ETS, favors a global consensus approach to greenhouse-gas emissions under ICAO auspices and calls for the federal government to use all political, diplomatic and legal means available to ensure that American aircraft operators are not subjected to ETS. Meanwhile, legislation prohibiting American aircraft operators from participating in ETS and authorizing the federal government to take any action necessary to keep American aircraft operators harmless from ETS was passed by the House in October 2011 and is now pending, with bipartisan support, in the Senate.<sup>14</sup> If ETS is signed into law, American aircraft operators would be placed in the untenable position of violating either US or EU law every time they fly to, from or within the EU.

On February 6, 2012, the Civil Aviation Administration of China (CAAC) took the most significant action to date against ETS, banning Chinese airlines (absent formal CAAC approval) from participating in the scheme and from raising fares or passenger charges to recover the cost of taking part in ETS. Absent participation by the world's fastest-growing aviation market, and especially if Congress bans American operators from participating, it is very difficult to envision a sustainable system in its present form. Adding further tension to the situation is the Chinese government's withholding of approval for new Airbus deliveries to Chinese airlines (presumably in favor of the competing Boeing models) as retaliation against ETS. Currently, Chinese airlines have as many as 45 A330 and A380 aircraft on order from Airbus (with a catalog value upwards of \$12 billion), many of which are slated for delivery in 2013 and 2014. According to Airbus, the threat of losing these orders has temporarily halted plans to increase A330 production rates in order to meet customer

<sup>14</sup> See H.R. 2594 (an Act to prohibit operators of civil aircraft of the United States from participating in the European Union's emissions trading scheme, and for other purposes); S.1956 (European Union Emissions Trading Scheme Prohibition Act of 2011).

demand, and it could result in billions of dollars and thousands of jobs being lost.<sup>15</sup>

As evidence of just how seriously this threat is being taken, European aviation leaders have written their own political leaders, calling for a change in course. In recent days, the chief executive officers of Airbus and eight major European airlines and engine manufacturers<sup>16</sup> have written to European Commission President Barroso, British Prime Minister Cameron, German Chancellor Merkel, French Prime Minister Fillon and Spanish Prime Minister Rajoy, urging EU governments to delay enforcement of ETS until a global scheme can be implemented under ICAO, in the face of an "intolerable threat" of retaliatory trade measures jeopardizing all European aviation.<sup>17</sup> Nevertheless, the EU has given no indication of backing down from ETS in its present form.

### Conclusion

China's response seems to be bringing the divisive matter of ETS to a political and economic head. Although covered operators are not required to surrender allocated or purchased allowances for 2012 emissions until April 30, 2013, the pressures being created by ETS have already risen to the highest levels of leadership worldwide. Many questions remain unanswered at this point. Will European operators cooperate even if their non-EU counterparts do not? How quickly can a global system be implemented (if at all)? How will rising jet fuel prices affect demand for tradable emissions allowances? Will airlines scale back (or discontinue) intercontinental routes to Europe? How will this affect traffic at airports in close proximity to Europe? Will an increase in traffic outside the EU actually cause an increase in global emissions? To what extent will EU economies be impacted as international traffic to and from the EU recedes and new hubs arise? Clearly, this issue will remain on

<sup>15</sup> See, e.g., "EADS Says A330 Boost Is Hostage to China Views on Carbon Tax," Bloomberg.com, March 8, 2012; "European Airlines Rally Against EU Carbon Tax: Source," ASDNews.com, March 12, 2012.

<sup>16</sup> British Airways, Virgin Atlantic, Lufthansa, Air France, Air Berlin, Iberia, Safran and MTU Aero Engines.

<sup>17</sup> See, e.g., "Aviation Chiefs Ask EU Leaders to Halt Carbon Row," Reuters.com, March 12, 2012; "Delay EU Carbon Levy, Says Air Industry," FT.com, March 12, 2012.



the aviation industry's front burner in the months (and years) to come.

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## FAA NCT Update

On February 9, 2012, the FAA published a Proposed Policy Clarification (PPC) regarding the use of Non-Citizenship Trusts (NCTs) by non-US citizen owners of US/FAA-registered aircraft. In the PPC, the FAA requested comments by March 31, 2012.<sup>1</sup>

On March 14, 2012, the FAA, responding to initial reactions to its PPC, published a notice scheduling a public meeting regarding the PPC on June 6, 2012 and extending the deadline for public comment to the same date.

After analyzing the PPC, many industry representatives made clear to the FAA that, although certain changes to the NCT process might enhance the FAA's information-gathering efforts when investigating an accident, the PPC comments and proposed clarifications were troublesome for many reasons. Commentators raised various concerns regarding the responsibility of registered owners for matters pertaining to the operation and condition of registered aircraft, impractical requirements imposed on owner trustees if and when demanded by an FAA representative, and invoking new procedural requirements without following proper rule-making protocols.

By scheduling the meeting, and extending the time for comment after the meeting, the FAA appears to be acknowledging that further exchanges among the FAA and industry members are necessary so that with policy clarification and valid rule making, consistent with industry input, the FAA may accomplish its purpose without wreaking havoc on accepted and benevolent industry practices. The continuing collaborative efforts by industry members and the FAA should result in

certain NCT procedural changes, but the scope and effective date will be better determined this summer after the meeting and written submissions.

If you have any questions about this article, please contact **Edward K. Gross** at +1 (202) 312-3330. ■

<sup>1</sup> See, "FAA Publishes Proposed Policy Clarification Regarding Non-Citizen Trusts: Permitted, but Conditioned," *Global Transportation Finance Bulletin* (Feb. 2012).

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