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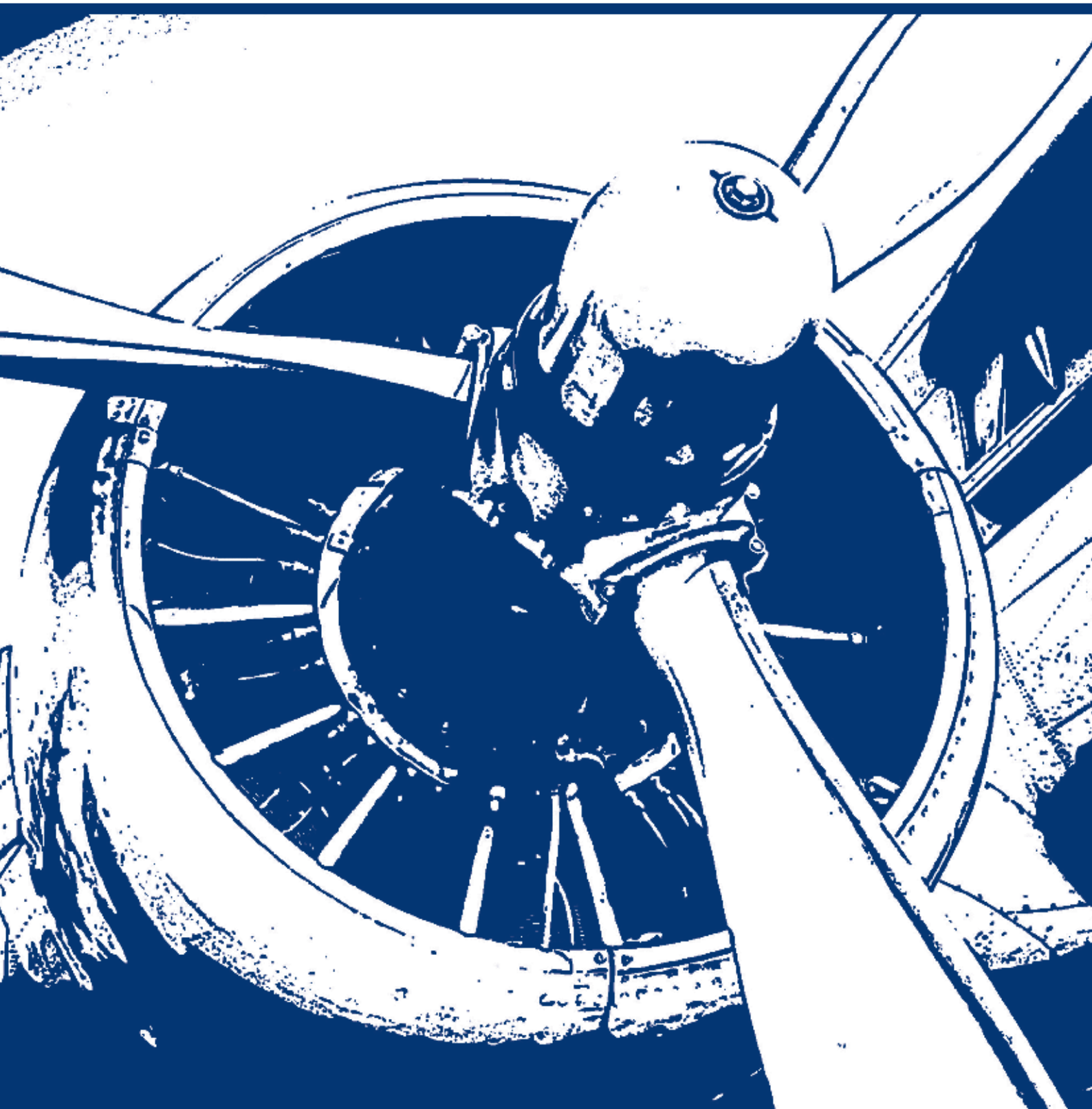

> economic tool designed to analyse the particular asserted anti-competitive conduct, a market definition must nonetheless be based on findings of fact... The premise... is that it has economic and commercial reality. It must accordingly not be artificial or contrived... A court should be loath to accept or act on a market definition which is an artificial construct that does not accurately or realistically describe and reflect the interactions between, and perceptions and actions of, the relevant actors or participants in the alleged market, that is, the commercial community involved.'

The decisions reinforce the fact that, while economics are central to competition analysis, in the end it is commercial reality that takes precedence over economic theory.

The initial *Flight Centre* decision caused confusion among airlines and others involved in the sale and distribution of products such as travel, accommodation and financial services. The appeal decision has clarified the law in Australia.

The key is to understand the nature of the services being offered by each of the parties to the distribution arrangement. For example, when an airline markets its products direct to the public as well as via travel agents, the airline is not supplying a separate booking or distribution service. Booking and distribution is an essential and inseparable component of the airline's product. Travel agents, on the other hand, provide services both to the airline and to the customer, but they are different services – 'facilitation services'. In that circumstance airlines are not in competition with the travel agents who supply those facilitation services.

Flight Centre and the airlines were all parties to the IATA Passenger Agency Agreement. The existence of that agency relationship is relevant, but not essential; a genuine agency relationship supports a conclusion that the principal and agent are not in competition with one another, but each case depends on its particular facts.

As to next steps, the ACCC appealed to the High Court of Australia, but only in the Flight Centre case. The case will be heard towards the end of this year.

EUROPEAN UNION

Jordan R Labkon, Barry L Moss and Andrew Pozniak[2]

EU ETS UPDATE: Aviation emissions making headlines ahead of another important political crossroads[1]

Carbon emissions from the aviation sector have a highly emotive and clearly visible profile compared to many other industries. During 2015, the aviation sector emitted approximately 757 million tons of carbon dioxide,[3] representing between two and three per cent of the world's anthropogenic carbon emissions,[4] just slightly less than the entire carbon footprint of major industrialised countries such as Canada, South Korea and Germany. The International Energy Agency has reported that oil demand for aviation is set to grow faster than for any other sector through 2040, leaving little hope for the industry to achieve its goal of carbon-neutral growth after 2020 without offsets from other sectors.[5]

The White House has estimated the 'social cost' of carbon emissions at $36 per metric ton. Based on this calculation, the annual cost to society resulting from current aviation CO_2 emissions is approximately $27bn.[6] Presently, very little of this societal cost is paid for by the air transport industry. To date, only the European Union has enforced stringent compliance requirements under its Emissions Trading Scheme (EU ETS),[7] whereby aircraft operators are legally required to account for their intra-European CO_2 emissions. Even under EU ETS, up to 82 per cent of

compliance costs are currently subsidised by the EU through free carbon allowances. Most other carbon-intensive industries regulated under EU ETS receive no such financial support or social relief. As a result, aviation emissions have become a highly charged global issue, with a critical crossroads approaching later this year.

Evolution of a global controversy

In order to meet its commitments under the Kyoto Protocol to the United Nations Framework Convention on Climate Change,[8] the EU decided in 2008 to expand its flagship emissions trading scheme to include aviation activities.[9] This triggered considerable international backlash against the EU for unilaterally regulating emissions occurring within other sovereign territories and within international air space. In response, the United States enacted the European Union Emissions Trading Scheme Prohibition Act of 2011 (similar to prohibitions by India and China against their airlines participating in EU ETS) and also led to the formation of a 'Coalition of the Unwilling' comprised of over 20 countries that initially refused to comply with EU ETS and considered several potential countermeasures ranging from airspace overflight restrictions to Airbus order cancellations and boycotts.

EU bureaucrats failed to see the signs of such a backlash brewing, and by November 2012 were forced to hastily back down by enacting a temporary 12-month measure to 'Stop the Clock' on international emissions until after the ICAO Triennial Assembly held in Autumn 2013. 'Stop the Clock' reduced aviation emissions for flights commencing or terminating in Europe from a 100 per cent compliance target to 40 per cent compliance figure overnight. However, EU ETS remained in full force and effect for all intra-European flights, even for operators based outside the EU. Most European airlines, particularly low-cost carriers, saw this measure as penalizing European airlines by increasing their compliance costs relative to those of their international competitors.

The EU's intended plan was to give ICAO time to devise a global aviation emissions reduction and trading scheme that was equivalent to EU ETS measures and ready for implementation by 2020. If ICAO was unable to do so, the EU planned to revert to 'full scope' EU ETS as originally enacted prior to the 2012 'Stop the Clock' decision. However, rather than create an alternative scheme to EU ETS, ICAO members used the 2013 Assembly to admonish the EU ETS and to give themselves another three years to decide what a global aviation emissions reduction scheme might look like, a process that at that stage had already taken 16 years.[10] The EU once again was forced to concede, and in April 2014, the European Parliament voted to extend the 'Stop the Clock' derogation to the next ICAO Triennial Assembly in Autumn 2016. The EU also enacted amendments to EU ETS to increase compliance thresholds and exclude many small aircraft operator emitters where the cost of enforcement vastly outweighed any potential noncompliance penalty recoveries.

EU ETS compliance and enforcement

The framework of EU ETS was based on a bureaucratic European scheme designed for stationary installations such as power plants and steel mills. As such, many contend that it was not the best starting place for an aviation emissions scheme. EU ETS is politically complicated and technically cumbersome, only being fully understood in most parts by civil servants and a few accredited verifiers and specialist commodity traders. Unlike Eurocontrol, which is centrally administered and regulated, EU ETS compliance is delegated among the 28 EU member states plus Iceland, Norway and Lichtenstein (collectively, the 'EEA 31 States'). Each EEA 31 State has transcribed the EU ETS Directives into its local laws differently, effectively creating 31 different variations of the emissions trading scheme. Administration under the scheme mostly has been delegated to non-aviation entities such as environmental agencies and even ministries for agriculture, fishing and forestry. Each EEA 31 State has different administration requirements and local laws concerning enforcement. Many international airlines face confusion as to which regulatory authority is assigned to regulate them, with some authorities being far more helpful, organised and pragmatic than others. Non-EU aircraft operators are generally assigned to the regulator in the EU country to where they historically have had the greatest number of scheduled flights.

The three basic common denominators of compliance and enforcement under EU ETS are that: (1) covered operators must report their annual CO_2 emissions by March 31 of the following year, (2) sufficient allowances commensurate with each year's emissions must

be surrendered by April 30 of the following year and (3) a statutory penalty of €100 per ton (or the local currency equivalent) is enforced for non-compliance. Each EEA 31 State also has the right to enforce local civil penalties for non-compliance in addition to EU ETS statutory penalties. Local penalties, if applicable, vary from state to state. For example, local penalties in the UK are capped at around £63,000, while in Spain each potential offense carries a maximum penalty of €2,000,000, which could have crippling financial implications for a single aircraft operator. As indicated above, there also are different levels of enforcement codified under the various EEA 31 States' domestic laws. For example, under the UK's Greenhouse Gas Emissions Trading Regulations, the Civil Aviation Authority has the right of seizure, detention and sale of aircraft in the event of persistent EU ETS aviation non-compliance, whereas the authorities in most other EEA 31 States do not.

Covered aircraft operators were effectively given a two-year compliance holiday after 2012, but were required to submit 2013 and 2014 emissions reports by 31 March 2015 and surrender sufficient emissions allowances by 30 April 2015. Aircraft operators failing to meet these deadlines are to be sent enforcement notices and penalty calculations (based on Eurocontrol flight data) by the relevant regulatory authority. Each EEA 31 State has its own appeal procedures, and in some countries it can take years to determine and adjudicate non-compliance.

EU Governments begin cracking the whip

The UK, Germany, Belgium, Sweden and the Netherlands proactively have issued penalty notices against European and international aircraft operators since 2014, and currently are pursuing enforcement measures. Civil penalty appeals brought by Jet Airways against the UK regulator, which could be considered a potential test case of EU ETS enforcement against international carriers, were dismissed in March and October 2015. In the latter appeal, Jet Airways unsuccessfully argued that *force majeure* compelled it to follow the Indian Government's mandate against EU ETS participation. It was found that Jet Airways was not bound under Indian law not to comply with EU ETS, political motivations notwithstanding, and that there was no external force compelling Jet Airways to make intra-EU flights. Jet Airways has since paid the statutory penalty. While all Chinese international airlines now appear to be compliant under EU ETS according to the European Union Transaction Log (EUTL), it remains unclear whether the EEA 31 States have been instructed not to enforce statutory penalties against Chinese carriers in order to encourage compliance. Belgium recently levied a fine of €1,400,000 against Saudia[11] for non-compliance in 2012, and while the penalty may have been paid, the airline appears to be absent from the EUTL, thus potentially calling its compliance into question. The UK, Belgium and the Netherlands have published lists of non-compliant operators; however, it is understood that these lists are incomplete in that the names of a number of offenders have yet to be published due to ongoing investigations and appeals. In April 2014, the German authorities ordered 61 operators from Russia, the United States and other countries to pay fines totalling €2,700,000[12] for breaching EU ETS regulations; however, the authorities declined to name the non-compliant operators.

Aircraft lessors and financiers should be concerned if their airline customers do not comply with EU ETS, and could feel compelled to repossess aircraft rather than risk being dragged into EU ETS enforcement proceedings (which could significantly jeopardise lessor and lender rights) and face exposure to fleet-wide liens that could give rise to aircraft detention and sale similar to the manner in which Eurocontrol liens may be enforced. While it is possible that EEA 31 States may continue to administer a light touch so as not to antagonise the ICAO process toward a potential global emissions trading scheme, it also is unlikely that the increasingly strident political forces at work within the EU will allow this situation to continue indefinitely. In fact, aircraft operators constitute the only delinquent participants in EU ETS. According to a recent EU report, over 10 percent of all aircraft operators covered under EU ETS are currently non-compliant with the scheme, but most of those delinquent operators are 'small emitters' and not commercial airlines.[13] The European Commission's Director-General for Climate Action has intimated that once diplomatic avenues to bring delinquent flag carriers into compliance are exhausted, then legal proceedings would commence.

To call the proposals being discussed in ICAO a 'global' scheme is somewhat misleading, as the scheme will, if

implemented, only cover emissions from international flights and not domestic flights. For example, fully 60 per cent of all flights departing and arriving in the United States are domestic flights, and therefore would not be covered under the proposed ICAO scheme. The recent proposed endangerment finding by the United States Environmental Protection Agency (EPA) concerning aviation emissions has triggered a rulemaking process that ultimately could fill this gap, though it is too early to tell who will be bound by the EPA's final regulations (ie, only US domestic or also international operators), which aircraft models will be covered, and whether the EPA rules will be promulgated in time to dovetail with the ICAO process, or stand on their own as yet another layer of complexity for operators forced to comply with differing standards around the globe.

Many industry insiders believe it is unlikely that a workable global emissions reduction scheme can be devised by the time the next ICAO Assembly convenes in late September 2016. The biggest hurdle is conflict between developed and developing nations over who should bear the greater proportion of compliance cost. It will be quite difficult to resolve the tension between the UN's principle of 'Combined but Differentiating Responsibilities and Respective Capabilities' and the Chicago Convention's guiding principle of creating a level playing field regardless of State of domicile. Any proposals to operate a phased-in route-based system may antagonise the US while potentially benefitting other countries, particularly those in the Middle East and Asia, which are rapidly making significant economic inroads into markets historically governed by bilateral aviation agreements.

The 21st Convention of the Parties of the United Nations Framework Committee on Climate Change ('COP21') was held in Paris during November and December 2015. While COP21 resulted in what many consider a historic agreement to cap average global temperature increases to no more than 1.5°C above pre-industrial levels, many stakeholders were surprised by the removal of aviation (and shipping) from the final text of the Paris agreement. This means that there is no binding requirement on countries to include aviation emissions within their respective self-determined emissions reduction commitments (known as Nationally Determined Contributions or NDCs). A recent study undertaken by the EU concluded that the combined emissions from aviation and shipping could reach 39 per cent of all anthropogenic emissions by 2050.[14] Many climate change experts therefore believe that the 1.5°C cap will be impossible to achieve unless emissions from international aviation are capped by ICAO, as the Paris agreement does not require them to be included in the NDCs. This has led to growing concern within the aviation industry that time is rapidly running out and that ICAO needs to redouble its efforts to find unity and an agreement that will lead to aviation carbon neutrality from 2020 onwards. ICAO global emissions reduction scheme will not be ambitious enough to contribute to limiting global temperature increases to within 2°C,[15] particularly considering the meteoric increase in aviation activities and the current low price of oil.

What aircraft lessors and financiers should be doing now

Lessors and financiers of aircraft operated by customers covered under EU ETS should be taking a proactive interest in EU ETS monitoring and reporting and ensuring contractual covenant compliance. If no agreement on a global emissions reduction scheme is reached at ICAO's next Assembly in autumn 2016, then the EU may feel emboldened and also legally obligated to reintroduce 'full scope' EU ETS covering all flights within, to and from the EU, regardless of origin, end point, operator domicile or aircraft registry. This could have wide-ranging consequences for aircraft operators and owners, including heightened risks of lease and loan defaults, imposition of significant monetary penalties and (in extreme cases) crippling operating bans and (of even graver concern) threats to possession and ownership. Absent clear and practical EU ETS compliance covenants in lease and loan agreements, aircraft lessors and financiers may find themselves in a difficult recovery position should the EU reintroduce full scope EU ETS as threatened. Aircraft lessors and financiers therefore should be closely following developments over the next 12 months, as a reversion to 'full scope' EU ETS likely will result in further airline defaults. Proactive risk management is therefore advisable.

Vedder Price and Avocet can provide valuable assistance to reduce EU ETS non-compliance risk and threats to possessory, ownership and secured creditor rights. Vedder

Price can assist by drafting and reviewing EU ETS compliance covenants in lease and loan agreements and advising aircraft owners and financiers on enforcement issues. Avocet can provide proactive risk advisory and mitigation measures to aircraft lessors and financiers, including the issuance of EU ETS compliance reports prior to closing and at each subsequent EU ETS compliance date during the lease or loan term.

Notes

1 A modified version of this article appeared in Vedder Price's Global Transportation Finance client newsletter in December 2015.
2 Jordan R Labkon is a Shareholder in the Chicago office of Vedder Price P.C. and has been a member of its Global Transportation Finance team since 1999. His practice concentrates primarily on the leasing, finance and trading of commercial and private aircraft. Barry L Moss is founder and CEO of Avocet Risk Management Ltd., a London-based risk consultancy. He advises on aviation insurance and EU ETS compliance risks for aircraft owners, lessors and financiers. Prior to founding Avocet in 2007, Barry was Managing Director of the Asset Finance and Political Risk Division of HSBC Insurance. Andrew Pozniak is a Director of Avocet, where he specialises in technical EU ETS advisory to commercial and private aircraft clients. He is also a biofuels specialist and previously worked for IATA and British Airways.
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14 See European Parliament Report, 'Emission Reduction Targets for Aviation and Shipping', available at www.europarl.europa.eu/RegData/etudes/STUD/2015/569964/IPOL_STU(2015)569964_EN.pdf
15 From pre-industrial times, this being the UNFCCC consensus target. 'We must limit global temperature rise to 2 degrees', UN Secretary-General Ban Ki-moon, Remarks at the Council on Foreign Relations, February 2013, www.un.org/en/globalissues/climatechange/

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Developments in ground handling services at Frankfurt Airport

The final decision whether a new tender procedure for ground handling services at Europe's third-largest airport will be required is still pending. Meanwhile, a global player in the ground services market acquired a majority interest in a Frankfurt cargo handler. Fraport AG sold a 51 per cent stake in its Frankfurt-based Fraport Cargo Services GmbH subsidiary to Worldwide Flight Services (WFS). Fraport's new partner is allegedly the world's largest cargo handler and a global provider of ground handling and technical services.

The acquisition occurred against a backdrop of some uncertainty whether new players may be given a chance to provide ground handling services in Frankfurt. In 2014, the Hesse Administrative Court ruled that a new tender procedure for ground handling services was required. In the tender concerned, the Hesse Ministry of Traffic had accepted the bid of a second handler, Acciona Airport Services. Acciona Airport Services had previously held a licence for ground handling services at Frankfurt airport for several years.

Wisag Aviation (another contender for this key site licence) filed an official complaint against the award decision, which resulted in the ruling by the Hesse Administrative Court. Wisag argued that the award criteria during the tender process, in particular the economic efficiency, did not carry an