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The third annual *Airline Economics* Aviation Law Yearbook, produced in conjunction with L2B Aviation Lawyers, delves into some of the most pressing legal issues affecting aviation today. A truly global industry like aviation is beset by many legal jurisdictional issues, many of which are touched on within these pages. From aircraft registration to repossession and tax, this guide provides commentary on legal issues affecting our industry as well as those enduring aspects of aviation law – such as the continued prominence of EETCs and the continuing allure of the market for investors – as well as touching on the future of the industry with an illuminating article on how the application of blockchain could benefit the industry.

We hope you find this guide informative and useful. Please do get in touch with your comments on this new guide from the publishers of *Airline Economics*. Likewise, if you would like to contribute to the 2019 law guide, please do get in touch.

Best wishes,

Victoria

Victoria Tozer-Pennington

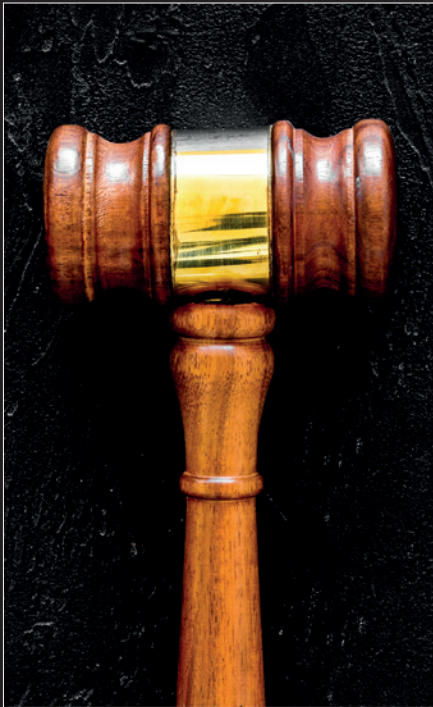
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the AVIATION lawyers

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The allure of investing in aviation

By Richard Hakes, Partner, and Ashleigh Standen, Associate,
from Reed Smith's aviation finance team in London



We always try to keep an eye on the markets and bond spreads, and on how these might be affecting the current positions and future strategies of our clients.

We say “keep an eye on” the markets because lately they seem to have been deliberately eluding the usual analysis – can anyone really understand them at the moment? Repeated record highs for S&P, and record lows for VIX volatility. Diminishing oil price risks and

a flattening yield curve as a by-product of quantitative easing. Interest rates are still very low. Most major economies are now in recovery with positive output gaps and declining deficits, and are moving back to full employment. We saw a strong Q3 2017 in most parts, together with signs of wage inflation. These all offer good indications of strengthening global growth.

All of these factors mean that the bulls amongst you may very well be in “buy mode”. However if you have a slightly more cautious outlook, but think

that given the current readings on the barometer you can't afford to sit this half out, our message to you is don't worry about a thing!

THE APPEAL OF ALTERNATIVE INVESTMENTS

In a sustained low-yield environment and with a demanding regulatory framework to navigate (particularly for highly-regulated investors such as insurance companies and pension schemes), the last few years have seen many investors



looking at less liquid alternative investments that offer a higher risk adjusted return. The uncorrelated alternative of aviation investments in particular may offer a safe harbour of strong returns, somewhat independent from the madness of markets.

The latest stats are encouraging. Global revenue passenger kilometres (RPKs) grew by 7.4% in 2016, and again by 7.9% in the first half of 2017 which, according to IATA, is the fastest H1 seen since 2005. The average passenger load factor reached a record high of over

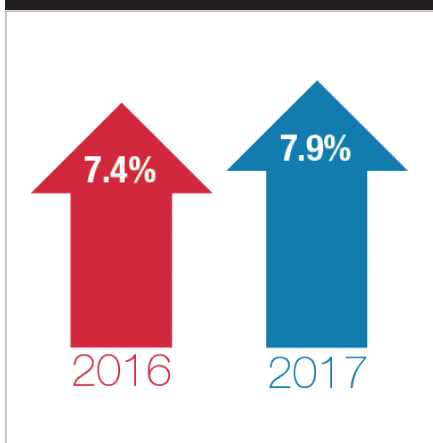
80%. The International Monetary Fund estimates that the world's GDP rose by 3.1% in 2016. At the time of writing, it looks like GDP for 2017 is going to exceed this and will be in the region of 3.5%. So, RPKs beat GDP by more than double and there are no obvious outward signs that cyclical factors are constraining the medium to longer term prospects for growth in the industry.

Aircraft typically have an economic life of 25 to 30 years, but the push for ever more fuel-efficient options has only served to increase the demand for new

aircraft. The upcoming introductions of 'next generation' aircraft will have an appreciable market impact in terms of fleet composition – they account for somewhere in the region of 80% of the current order book, with the A320neo and the Boeing 737 leading the pack.

As new technology becomes increasingly important, the pace of change is accelerating. Air traffic has historically doubled every 15 years and is, according to research by The Airline Monitor, projected to have an average annual growth rate of close to

GLOBAL REVENUE PASSENGER KILOMETERS



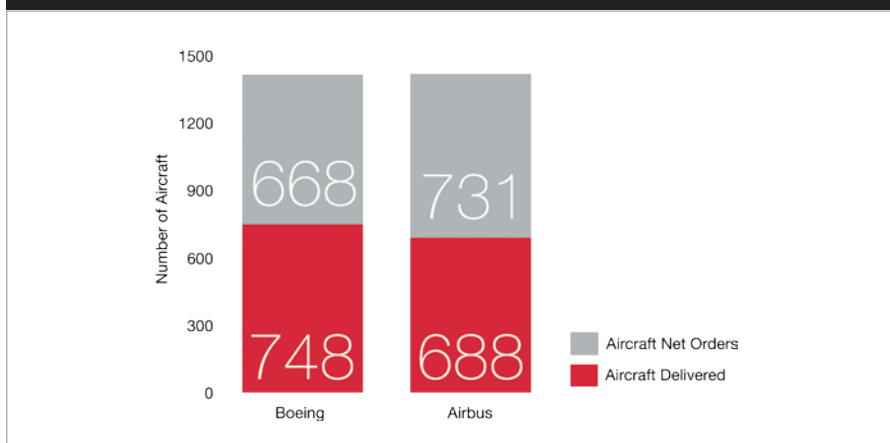
5% percent for the next 20 years. This will double traffic again over the next 15 years. The latest Airbus and Boeing forecasts show that the commercial fleet (currently around 20,000 aircraft) is expected to more than double over the next two decades.

Boeing's announcement in November 2017 of a \$37 billion, 300 aircraft order for the Chinese is worth noting. On the one hand, this was key to President Trump's plans to develop \$200 billion of new business during his trip to Asia. The numbers look big! But actually, Boeing is forecasting that China will require more than 7,000 aircraft over the next 20 years – or to put it another way, more than Trump's order every single year. Record breaking orders were also placed at the 2017 Dubai Airshow, including Indigo Partners' \$49.5 billion Airbus order and Flydubai's \$27 billion Boeing order.

It's not hard to see why: globalisation, the success of the low cost model and growing urban, "middle class", populations have all led to many more people flying much more often, which translates into rising demand for aircraft capacity. The financing of new deliveries is already estimated to be worth in excess of \$100 billion a year. This is before we even factor in the secondary market, corporate jets or spare engine transactions. This expansion requires a pool of financing both wide and deep to sustain it, which will inevitably require tapping into new sources of capital and innovative structures.

At this point I should add that because of print-deadlines, we have written this article in November 2017; so

AIRCRAFT ORDERS AND DELIVERIES



if the markets have experienced a bump in the road between then and now, this only serves to underline the importance of investing in real assets (and to demonstrate the power of the Reed Smith aviation team's newly-purchased crystal ball). And if this hasn't yet come to pass, just watch this space.

HATCHES AND MATCHES: THE ROLE OF FUNDS AND PRIVATE EQUITY

As the financing requirements grow, the role of fund finance and private equity in the aviation sector is also becoming more prominent.

This is not a new phenomenon. Private equity players have been excited by operating lessors for years. Aircraftle was founded by Fortress in 2004. Cerberus Capital had an investment in AerCap until its exit in 2012, by which time AerCap had grown to be one of the largest lessors in the world. Falko was formed in July 2011 when funds managed by Fortress purchased the BAE Systems aircraft portfolio. Terra Firma acquired AWAS from Morgan Stanley in 2006 and Pegasus from Oaktree Capital, combining the two to create the new and enlarged AWAS (at the time, the third largest lessor in the world). AWAS hit the news again earlier in 2017 after it was bought by DAE, so the movement continues. Avolon was founded in 2010 with private equity backing, and bought CIT's aircraft leasing business last year for \$10 billion.

In addition to these corporate-level acquisitions, many investors are looking at asset-specific plays. For example, the last 12 months have seen Doric

partner with Floreat to launch an ABS transaction for A330s, and World Star Aviation establish a joint venture with Oaktree Capital to issue series of notes for 21 aircraft. Castlelake ran its fourth ABS programme in August for in excess of 40 aircraft and Aergo recently established its first ABS programme worth \$585 million.

There is a relatively high bar to entry for investors looking to become aircraft financiers (which is why so many of these transactions arise as the result of partnerships and ad hoc joint ventures). While the opportunity to access investment grade debt secured against a long-term asset with a stable cash flow profile is of course attractive, these businesses are very capital intensive and acceptable returns can usually only be generated on a highly levered basis.

Perhaps contrary to expectation, the high capital requirements are attractive for investors rather than daunting. The expensive nature of aircraft is a great fit for the private equity world. Investors benefit from the economies of scale. Capital can be deployed quickly and efficiently, which enables tried and tested investment strategies to be imported from other sectors, such as real estate. In contrast to real estate, however, aircraft afford the added comfort of not being bound to a particular city or jurisdiction in an enforcement scenario and can be relatively easily repossessed, relocated and refurbished, whether in scheduled or unscheduled circumstances.

There are also operational challenges for investors to overcome, whether in terms of sector-specific experience (such as aircraft valuations) or the

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AIRCRAFT ORDERS AND DELIVERIES

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Cash	25%	26%	25%	24%	23%	28%	25%
Capital Markets	15%	18%	19%	28%	34%	30%	30%
Bank Debt	27%	23%	30%	33%	30%	33%	33%
Export Credit	33%	33%	26%	15%	13%	8%	10%
Manufacturer	0%	0%	0%	0%	0%	1%	2%
Total Volume (US\$ billions)	\$77	\$98	\$104	\$115	\$122	\$122	\$126

Source: Boeing Current Aircraft Finance Market Outlook 2017

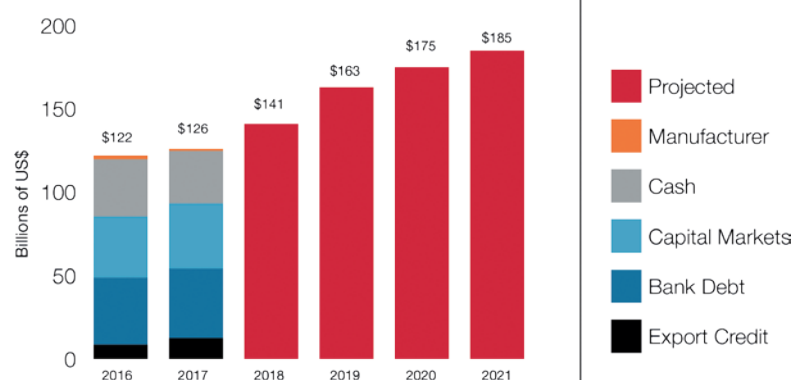
various applicable regulatory regimes. And whilst aircraft are highly fungible, they do have finite economic lives. The extent of the operational challenges varies – for example, in default management for an ABS structure, the leasing company will have to manage repossession and resale upon a default, whereas in an EETC structure, this is the investor's responsibility. This might entail obtaining asset valuations, renegotiating the underlying debt or taking enforcement action.

However, the happiness of the marriage between private equity and funds with aviation is only emphasised by their existing familiarity with structured products, different leverage plays and diversified funding options. Many of our fund clients tell us they have also been drawn to this industry by relatively predictable asset values, supported by solid fundamentals around the supply and demand dynamic and manufacturing output. There are also useful real world mitigating factors against this volatility when pure aircraft value risk is viewed through the lens of lease rentals and residual values.

AN EYE TO THE FUTURE

Increased investor appetite has led to a reduced yield on more traditional loans and a search for new sources of finance – and next year is therefore likely to see a continued diversity of financiers. However, we expect ongoing stable performance from the existing primary investors in the sector. The commercial banks in particular face regulatory obstacles, not least around the Basel

AVIATION FINANCE OUTLOOK



Source: Boeing Current Aircraft Finance Market Outlook 2017

IV approach to the asset finance sector. This can be offset against the pace of growth in China (where bank debt is the primary source of finance) which means that it will still be the prevalent method of aviation finance and indeed will probably grow. The continued importance of the capital markets (including in secured structures such as EETCs, and particularly in the growth of non-US investors) should also not be underestimated.

Whilst equity funds attract more interest and will continue to do so, the role of aviation debt funds will increase and some banks will look to partner with funds managers in this space. German investment manager KGAL, which already has several aviation funds established, is expected to set up more in 2018.

We also expect that the high levels of interest in ABS structures (and in particular in e-note dispositions) will

continue. Lessors will increasingly construct their portfolios with tradability and future access to sources of funding in mind, as demonstrated by the growing trend for owner-trust structures enabling faster lease novations. We also expect the lessors to carry on with their rapid portfolio trading, allowing for fleet growth and for portfolios to be refreshed.

All of these factors combine to create a sustained competitive pricing environment, particularly when relatively new funding sources such as the Korean institutional investors and the Taiwanese banks are considered. Some of these new sources will inevitably see tailored debt in alternate currencies and a number of borrowers have also indicated a willingness to tailor profiles to fit the investors' needs. However, aviation offers a niche investment opportunity – and prospective financiers will continue to pick and choose their opportunities carefully.



Global Leaders in Aviation Finance

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New kids on the block?

A step-by-step guide to blockchain and its potential application to the aviation industry By Richard Hakes, Partner, Reed Smith



There is abundant anecdotal evidence indicating that the financial services industry is increasingly embracing financial technology (“fintech”). Digitisation and automation means that banks can more

efficiently meet customer demands, while at the same time meeting their regulatory obligations. In May 2018 the Financial Times reported that HSBC completed a trade finance transaction using blockchain to process a letter of credit. Billed as the world’s first

commercially viable deal of this nature and size, it looks set to forge a path for increasing adoption of this technology in the financial services arena. However, the fintech impact in the world of aircraft leasing and finance has been less pronounced.

For a fast growing and capital intensive industry, this is interesting. The world of aviation has been at the forefront of adopting a host of different technologies, including digitisation more generally. Lessors have invested heavily in updates to their information technology platforms, to good effect. Many readers will be aware, for example, of the progress made in digitising maintenance records. Our clients and other industry participants tell us that this has been directly value accreting, not least because the accuracy and integrity of these records goes directly to the residual value of aircraft.

However, data outputs are only as good as their inputs. If systems can communicate directly (that is, if data inputs can themselves be digitised and automated) then the outputs will be more reliable. As a consequence, decision-making by businesses will be better informed. This is where blockchain has the ability to be transformative for the aviation industry.

There have been some forays into the world of blockchain by the aviation community. Airlines such as Airbaltic in Latvia and Peach in Japan have accepted payments made in a virtual currency. According to the Financial Times in May 2018, IAG is of the view that blockchain is a “key priority”, and Lufthansa has started a “blockchain for aviation” initiative. However, selling airfares or cataloguing passenger preferences is some distance from settling aircraft sale and purchase transactions through this medium – and it offers appreciably less value as well.

There are numerous applications of blockchain technology across a variety of industries. One of these is of course the rapidly developing cryptocurrency and digital token sector, including Bitcoin. As a result of these developments, we are faced with an interesting and rapidly evolving legal and regulatory landscape. More generally, a huge amount of data is produced by, and required for, every transaction from the sale and purchase of an aircraft, its financing, its leasing, its management and its operation. With this in mind, we will take a look at some of the potential uses for, and benefits of, blockchain technology in the aircraft leasing and financing industry.

“In May 2018, HSBC completed a trade finance transaction using blockchain to process a letter of credit... However, the fintech impact in the world of aircraft leasing and finance has been less pronounced.”

WHAT IS IT?

People use the term “blockchain” to mean different things. It can be confusing! Essentially it is technology that provides a secure ledger that any authorised party can view, but no one can retrospectively amend. Most of the time when we are talking about blockchain, we are talking about what is known as a “distributed ledger technology”. Bitcoin, on the other hand, is both a digital currency and a blockchain platform – or to put it another way, a platform that uses the blockchain distributed ledger technology.

Imagine, if you will, that you have a paper ledger, a book recording a list of all your transactions with your counterparties, with each new transaction listed on a new ledger row. Blockchain is similar in many respects. It is a ledger, but it is digitised and cryptographically secured and each row is instead a block.

However, one of the most fundamental differences is that blockchain is also “distributed”. This means that it is shared by all parties who participate in the relevant network. The ledger is replicated (“distributed”) across a number of computers – stored collectively by each network participant rather than on a central server. The parties to the relevant network do not

need to know who the others are but are able to transfer digital assets between themselves (peer-to-peer) without the need for third party validation. Each user is identified only by its public key. This is what is referred to as “pseudonymity”.

Blockchain is further set apart from other computerised databases by its ability to add a new row in that database, validate that row (and ensure that it meets certain requirements) and then broadcast the addition of the row to all other users of the database. This means that all participants have the same information, but also confidence in the accuracy and integrity of that information.

Each transaction on the ledger is stored in a unit of data called a “block”. As the name suggests, each block of data is linked together in a chain with each other block. New blocks are added in real time for all users. Participation in a particular blockchain will require the operation of the relevant software, allowing the participant (known as a “node”) to both connect to the blockchain and, crucially, lend its computing power to the network. This power is used to build the new blocks of records.

Participants build blocks of records by investing computer time to solve complex mathematical problems, effectively in competition with each other. Finding a solution to the problem provides the successful participant (whether a transacting participant or a network peer) with a key and a reward, for example a number of Bitcoin. This is called mining, which is something of a misnomer: to discover this key, participants’ computers make millions and millions of guesses. Discovery of a key, by mining, enables the creation of the new block, which is then double-checked by other members of the network. Each new block is only then added to the ledger when a majority of participants have approved the work of the participant who wants to add it. This means that blockchain is in fact “trustless” – that is, it does not rely on trust. It relies on consensus, thereby generating rather than relying on the trust of its participants.

When a new block of records is added to the blockchain, which typically takes about ten minutes, it is considered final.

To alter it (fraudulently or otherwise) would mean that the key that enabled not just that block of records but each subsequent block of records would have to be mined (and approved) again. Over time, more and more blocks of records are added to the blockchain. Each one securely references the previous block.

This means that to change a transaction on the ledger would require both re-solving the mathematical problem (so as to create the fraudulent block) but also re-solving each and every subsequent block in the chain. Even then, this would not be enough. Any would-be fraudster would also need to convince each other network participant to accept these fake blocks. And the fraudster would have to do so before another legitimate participant added the next (legitimate) block.

It is therefore considered that, statistically, it is almost impossible to retrospectively alter blocks. Indeed, many blockchains are capable of defending against any possibility of this happening. For example, the Bitcoin network adjusts the difficulty (both up and down) of discovering a key by mining, depending on the amount of computing power in the network at any one time. On a mathematical level the computational difficulty of mining for keys means that most Bitcoin transactions are considered verified after six blocks are added to the network, which typically takes less than an hour.

On a practical level this means that participants can take comfort both that any transaction is final, and that the integrity of the ledger is maintained. And this means that trust can be established between participants who do not necessarily know or trust one another in the “real world”.

OPEN OR CLOSED?

There are two principal types of blockchain – an open ledger, or a closed one. These are also known as “permissionless” (open) and “permissioned” (closed).

Open blockchains are pseudonymous (which means that the users are identified, but only by their public keys and not by their real names) whereas closed blockchains have identified participants. Bitcoin, for example, works



on two fundamental premises. Firstly, that anyone should be able to access the Bitcoin blockchain on an anonymised basis. Secondly, that there should be no centralised control of this blockchain. This has indelibly shaped the operation and perception of Bitcoin, but is not something that is a requirement of all blockchains.

An open or permissionless ledger is available for anyone to use – it is a public network. Fellow users may choose to remain anonymous to each other. Again, Bitcoin is one such open ledger. Anyone may mine Bitcoin and view the records of all Bitcoin transactions. Despite the primary anonymity, this actually serves to guarantee accessibility and transparency, but it also means that there is a possibility of security breaches of sensitive material or indeed the use of blockchain for the exchange of illicit activity.

On the other hand, a permissioned blockchain is a closed network. The participants are known to or trusted by each other. It is “permissioned” because permission needs to be granted in order for certain functions to be performed. For example, permission may be required to read the ledger, it may serve to limit who participants can deal with, and it may also restrict (or apply criteria to) who can add or validate new blocks in the blockchain.

SMART CONTRACTS

A key blockchain capability (and one that we see as having real potential for the aviation leasing world) is that of “smart contracts”.

In essence, a smart contract is a programme that facilitates, concludes, executes and verifies agreements between parties. It is “smart” in the sense that it is automated and, on many levels, self-executing subject only to certain pre-determined parameters. As such, unlike the classic method of contract creation (offer and acceptance), smart contracts work by way of an input/output structure. This means that an offer by one party has the potential to be accepted automatically by its counterparty’s performance. This performance will mean that consequentially the terms of the offer have been met.

In this context we note that smart contract frameworks exist already outside blockchain – without the need for a distributed ledger. It is therefore fair to ask whether implementing the same smart contracts on a blockchain would give rise to any tangible benefits – especially given there would of course be a cost to moving a contract into a blockchain.

However, in our view the enhanced automation available through blockchain offers the possibility of a substantial practical benefit for adopters

“By executing a smart contract in a blockchain the conditionals are encoded into a neutral ledger. This means that the relevant outputs will be triggered automatically once the corresponding conditionality is met, reducing transaction costs...”

of this technology. By executing a smart contract in a blockchain the conditionals (the “if you pay the bill, then we will provide the service” provisions) are encoded into a neutral ledger. This means that the relevant outputs will be triggered automatically once the corresponding conditionality is met, reducing transaction costs by cutting fees associated with processing and third party intermediaries. For example, when a certain number of flight hours or engine cycles have elapsed, a smart contract could automatically contact the most physically proximate maintenance provider with availability and schedule the requisite maintenance based on the predicted geographical location of the aircraft and engines at the required time.

SMART LAW FOR SMART CONTRACTS?

One of the principal legal issues identified for the adoption of blockchain in aviation transactions is the pan-jurisdictional nature of the underlying transactions in our industry. Using decentralised ledger technology means that, even if it can be ascertained that there has been a breach, it may be hard to determine whether the contract is enforceable and, if it is, in which jurisdiction and with which enforcement options. Blockchain remains largely unregulated and virtual currencies are subject to exchange rate volatility. There also remains an

education deficit and there is a real sense that a lot of us are “playing catch-up”.

Lawmakers and regulators will therefore need to give real thought to the amendments that are required to be made to the contractual concepts that underpin many of the world’s leading legal systems. Work has started – for example, Arizona recently passed a law clarifying that “smart contracts” made on a blockchain are enforceable. Delaware has passed legislation allowing companies to maintain their stock ledgers via distributed ledger technology. The US Office of Comptroller of Currency has released a white paper proposing oversight of the increasing number of banks looking to introduce fintech solutions. In addition to the United States, the likes of India and the European Union are now developing regulations for transactions using virtual currencies. In certain countries, such as Israel, some regulation has already been passed. However some countries have taken a more circumspect approach. The Central Bank of Nigeria, for example, has banned all banks and other financial institutions from making transactions in virtual currencies.

However, legal uncertainty persists and it remains to be seen how regulators will treat it. For example, support and guidance for the aviation world will be required from the likes of EASA in Europe and the FAA in the United States.

BLOCKCHAIN’S APPLICATION TO AVIATION

Having, we hope, explained the basics of blockchain, the remainder of this article will focus on some of the potential benefits to the aviation industry – and in particular to the world of leasing and finance. There are of course many wider potential benefits that are not within the scope of this article, such as passenger data, security and flight handling.

(1) Sale and purchase

In our view it would be helpful for participants in aircraft sale and purchase transactions to establish a blockchain-based trading platform for the sale and purchase of aircraft. Aircraft sale and purchase transactions could be concluded on the basis of smart

contracts. This would be effected by what is referred to as “tokenising” the asset – that is, creating a digital token to represent each individual aircraft in a lessor’s fleet. This token could then be traded in exchange for payment in a virtual currency.

As noted above, virtual currencies are already being used for airline ticketing, but this is still some way from reaching the level of acceptance required to be used to finance the sale and purchase of an aircraft. However, there are anecdotal examples of large asset transactions already being closed using Bitcoin, especially in the real estate sector. For example, we understand that last year Sotheby’s facilitated the sale of a significant house in the US with consideration payable in Bitcoin.

The sale of an aircraft could also be effected automatically at a time and when the aircraft is in a location determined by the relevant blockchain to minimise sales or transfer taxes. We envisage that the blockchain would operate to only release the relevant “signatures” (whether digital or otherwise) to the corresponding smart contracts (or other digital title transfer documents) at the time when the aircraft automatically confirms to the blockchain that it is in a suitable jurisdiction.

In addition, the value of a used aircraft is of course in no small measure contingent on its condition and its maintenance history. A purchaser will need to be comfortable that the aircraft’s history has been properly and completely documented and those records will need to be made available to the purchaser in a way that it can rely on them. Blockchain could be used to provide an instant and practically incorruptible record of parts fitted to an aircraft and the integrity of their maintenance. It could in theory be as instant and simple as scanning a barcode on the side of an engine with a smart phone, revealing that engine’s comprehensive history.

This would greatly facilitate technical due diligence (and increase the accuracy of that due diligence), speeding up sale and purchase transactions by making the evaluation of each asset more straightforward. In this scenario, it should not matter how many previous owners an aircraft has had – it would

still be possible to identify the age and provenance of each part. The increased efficiency of blockchain in this area could offer significant time and cost savings, and would likely also contribute to the industry's safety.

(2) Financing

We recognise this may seem far-fetched in 2018, but we do not think that the day aviation financiers are ready and willing to lend in a virtual currency is far away. The rise of Bitcoin in particular has demonstrated the potential in this space and, as discussed above, some airlines are already transacting with their customers for virtual currencies.

The ability to purchase an aircraft for a virtual currency will be inextricably linked to the ability to raise finance in virtual currencies. However, pricing virtual debt is difficult. Further, aircraft are of course capital intensive and there is a relatively low level of virtual liquidity. It is also somewhat volatile when compared to traditional currencies. The first movers are therefore likely to be the leading manufacturers, for whom a key advantage will be the ability to peg the purchase price for a new aircraft to their airline customer's "real" domestic currency, thus mitigating any foreign exchange exposure.

Foreign exchange risk is also a particular issue for airlines who often raise finance (and pay lease rentals) in US Dollars, but generate their income in their "home" currency. Using virtual currencies to meet these payments would enable greater foreign exchange mitigation for them as well.

Notwithstanding the issues that remain to be resolved around virtual debt, it strikes us that while statistically most aircraft are financed by bank debt (and we anticipate that this will continue to be the leading source of funding) it is systemically not the best option for either lenders or borrowers. Existing methods of financing aircraft are document heavy and rely on negotiating provisions that could and arguably should be harmonised to all parties' benefit. There is a necessary level of rigour and bureaucracy from all participants that, although important, could perhaps be better accomplished through greater automation in a

blockchain environment. Smart contracts, for example, could greatly streamline transaction management and the execution of significant numbers of transaction documents, even if certain bespoke provisions still remained to be negotiated.

Further, security interests and their relative priority could also be recorded as an immutable and trans-national public record of the interests of each owner and investor or financier in an aircraft – as well as providing the ability for liens of third parties to be publically recorded if and when they arise. All of this could be used in conjunction with existing public databases and, in particular, the International Registry operated pursuant to the Cape Town Convention.

(3) Aircraft leasing, management and maintenance

Because of the relative length of the aircraft lifespan and the frequency with which critical component parts are replaced, we are of the view that maintenance databases maintained by airlines, aircraft operators and maintenance facilities would be ideally suited to management in a blockchain environment, giving greater levels of traceability and trust. This in turn would serve to increase the liquidity available to the industry.

All of the millions of component parts of aircraft are managed by different and often uncoordinated systems. These records may be incomplete and some are still paper-based. This lack of standardisation leads to challenges in traceability and compliance. It would in our view be more efficient if all relevant stakeholders submitted transaction details to a private blockchain established by, for example, a manufacturer. Every action in relation to the component parts of an aircraft throughout its lifespan could then be recorded, timestamped and would be able to be relied upon. This would benefit the manufacturers, MROs, lessors and airlines alike.

Much of the underlying infrastructure already exists. In particular, each major component part of an aircraft will already have a unique identifying serial number and a lot of work has been done to establish digitised databases. However, not only is there a lack of

“Maintenance databases maintained by airlines, aircraft operators and maintenance facilities would be ideally suited to management in a blockchain environment, giving greater levels of traceability and trust.”

standardisation, but these databases are heavily reliant on input by human operators. By its nature, any database with inputs provided by a human is subject to the risk of both fraudulent and negligent misstatement, which is mitigated by blockchain. Our expectation is that it could be automated such that the requirement for manual data entry is minimised, which would be particularly valuable for engines. However, there is a need for an industry-wide consensus to be reached for this to succeed – the majority of market participants would need to join a common platform to realise the value and potential in such a system.

Implementing a blockchain system could also be used to track the use of the individual aircraft (for example, take-offs and landings, flight hours, engine cycles etc.) which could identify when replacement or maintenance is required. These inputs would yield real-time outputs and improved data quality. More than just tracking the replacement or maintenance of parts, a blockchain could also be used to take data directly from the aircraft's sensors and record the occurrence of damage events leading to the replacement of parts (or at least, the requirement to do so).

To make this work, data ownership and privacy issues will need to be resolved, as will security concerns – both commercial and operational. In



addition to the airframe and engine manufacturer, each component supplier would ideally have the ability to input as appropriate. Payment for the replacement or service of parts could also be automated through the system. However, we anticipate that principally because of the cost and “unknowns” inevitably borne by first adopters, any approach is likely to be driven initially by the principal airframe and engine manufacturers and will then evolve over time to become more comprehensive.

Further, as noted above in the context of sale and purchase transactions, our view is that leasing transactions could helpfully be concluded on the basis of smart contracts. This could include the use of ancillary chains to the primary blockchain, enabling each individual aircraft asset to be given its own ancillary chain. This would provide greater opportunity for analysis at a fleet level, as well as a more granular asset level.

We anticipate that lessors adopting blockchain technology first will gain a competitive advantage because their business will be able to run more efficiently. It may also mean that they can attract investment from a wider variety of funding sources who will be attracted by the accurate, timely and comprehensive reporting – especially where those investors may not be native English speakers. If English was the language of the industrial revolution,

code is the new language of the cyber revolution.

(4) Documentation

We have briefly discussed the merits and uses of smart contracts.

In particular, blockchain would provide a platform for transaction documents of any nature to be stored on a single, immutable and shareable database. This would help mitigate against fraud and would enable largely paperless and totally accurate transactions, free of human error. Even if certain paper documents are still required, transacting by blockchain would greatly assist with the processing and (where applicable) transfer of any originals. For example, parties may be able to dispense with the need for multiple duplicate documents, whether in original “hard copy” format or indeed soft (electronic) copies on other databases.

Blockchain transactions would provide for all transaction details to be logged and stored, free from documentary fraud and visible to all applicable stakeholders, replacing systems that are susceptible to both forgeries and simple clerical errors.

LETTERS OF CREDIT

We see a number of immediate applications in this regard. The first is for maintenance and security letters

of credit. In the trade finance world some work has already been done in relation to the operation of trading letters of credit.

A significant amount of time is unnecessarily spent circulating documents between all involved parties – issuing and confirming banks, airlines, lessors, financiers and lawyers. Instead, these could be executed automatically through digitised smart contracts. This means that each transaction participant could access the relevant data almost immediately after that data has been added or modified. It would also make it clear what, if any, further steps need to be taken. Indeed, any drawing under the letter of credit could be made through (or even triggered automatically by) the corresponding blockchain. Not only is this administratively less burdensome, but it would give greater comfort for those parties placing reliance on the letter of credit.

AIRCRAFT INSURANCE

In the insurance space, it is necessary to ensure in particular that appropriate liability policies are in place – not just at the outset of the transaction but on an ongoing basis. Renewals could be effected automatically within a blockchain and the appropriate parties (lessors and lenders as well as airlines) would be informed that this had happened. For a lessor or lender, this removes the risk of failing to notice that a renewal has not happened. It also reduces the need for active diarising and monitoring by individual employees who may leave a business, or be away from the office at the crucial time of renewal.

TITLE REGISTRATION AND BILLS OF SALE

Establishing title to an asset is paramount – especially in the event that it is sold. Much time is spent and cost incurred in storing and cataloguing, and then retrieving and delivering, each bill of sale from each transaction to which that aircraft has been subject from its initial delivery by the manufacturer. Many readers will be only too familiar with the scenario of missing original bills of sale and the need for sellers to provide additional title warranties as a consequence.

We are of the view that any global blockchain registry or title database is an unlikely innovation because of the level of change this would require to underlying legal frameworks. However, a distributed ledger means that the ownership of any particular digital asset is much more certain, making its identification more akin to a property title search. This could therefore serve to replace the need for paper bills of sale. Blockchain offers a particular advantage in this regard as its integrity and resistance to fraud are ideally suited to such uses.

Various stakeholders in other industries have already explored similar capabilities, particularly in the world of real estate. The Swedish land registry has been trialling blockchain-based solutions since 2016. Their research has apparently indicated that eliminating paperwork could save taxpayers millions of Euros every year and reports this year suggest that a test transaction is imminent. Last October, Amaravati, a city in India, created a land registry based on blockchain and Dubai made the decision to migrate its land registry to a real estate blockchain – including for lease transactions. Dubai has also gone one stage further, aiming to link its real estate registrations with its public utility provisions thus ensuring that all property-related accounts are settled immediately and automatically. These states are not alone in taking the plunge.

Legal obstacles, such as the validity of digital signatures, will need to be resolved and any progress will not work in technological or jurisdictional isolation – needing significant international consensus akin to (if not greater than) that achieved with the Cape Town Convention.

CONCLUSIONS

This review is by no means exhaustive, but there is enough to indicate that the characteristics of the airline industry align very well with the capabilities of blockchain. We note also that there are many other applications of blockchain in particular that are outside the scope of this article, such as:

- passenger services, like paperless ticketing;

- flight planning (air traffic control and the associated flight charges e.g. Eurocontrol); and
- loyalty programmes.

It will take time for law and market practice around blockchain and smart contracts to become clear and capable of reliance, but the application of blockchain will eventually go far beyond our current expectations for it.

We are aware that some airlines are already active users of the technology (principally at a consumer level, as discussed above). The leading manufacturers have also made some forays into the development and testing of potential solutions. However, it appears to us that, on a simplistic view of the number of pilot projects announced by market participants, the aviation industry is behind the curve. Ultimately blockchain is not just about digitising what the industry does today, but it also gives us a fantastic opportunity to do more – and to do it more cost efficiently. A balance will of course need to be struck between “first movers” who may suffer the teething issues, but who as early adopters will take value away from their competitors.

ACTION POINTS

At this stage in development, we recommend that industry participants take the following steps to ensure that they are positioned to take advantage of this technology as it involves:

1. Watch – the adoption of technology this ground-breaking requires an industry-wide approach. What are your competitors doing and what opportunities exist for collaboration with them? What uses are most immediately appropriate or valuable to your business?
2. Learn – develop and test the technology, including by providing an opportunity for the training staff in appropriate functions. Will these software solutions be best developed in-house or by external vendors?
3. Listen – what are your customers’ and clients’ priorities in this environment?

Whilst no one party yet has all the



answers and much remains to be learned about blockchain and its capabilities and possibilities, we hope that in some way this article may have helped you become interested in (or even enthusiastic about!) its possibilities.

It seems clear to us that the technology is likely to have far-reaching and transformative capabilities and could be a “revolution” as big as the dawn of the internet. Many remained sceptical, even fifteen years ago, about the idea of e-commerce or internet based financial transactions. Today many of us could not live without its capabilities.

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Reed Smith is a global law firm with more than 1,700 lawyers in 27 offices across Europe, the Middle East, Asia and the United States. For more details, please feel free to contact any of the Reed Smith aviation finance teams in London, New York or Paris. Alternatively, on 5 March 2018 Reed Smith released an extensive white paper on the global legal landscape impacting blockchain technology and copies of this are available on reedsmith.com



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Guarding Your Standard

Some comfort and word of caution to lenders (and lessors) using precedent/standard form documents. By Pillsbury Winthrop Shaw Pittman's Paul Jebely, Managing Partner, Hong Kong; Deborah Ruff, Partner, London, and Julia Kalinina Belcher, Counsel, London

The English Court of Appeal recently considered whether the use of model form agreements could constitute dealing “on written standard terms of business”, which could have potentially given a defaulting borrower an “unfair contract” defense against a group of lenders seeking to enforce.

The decision gives comfort to lenders (and lessors) who use precedents or model form agreements, so long as substantial negotiations and extensive changes to a draft agreement suggested

by the borrower (or lessee) indicate that the borrower (or lessee) was not dealing on the lender's (or lessor's) standard terms.

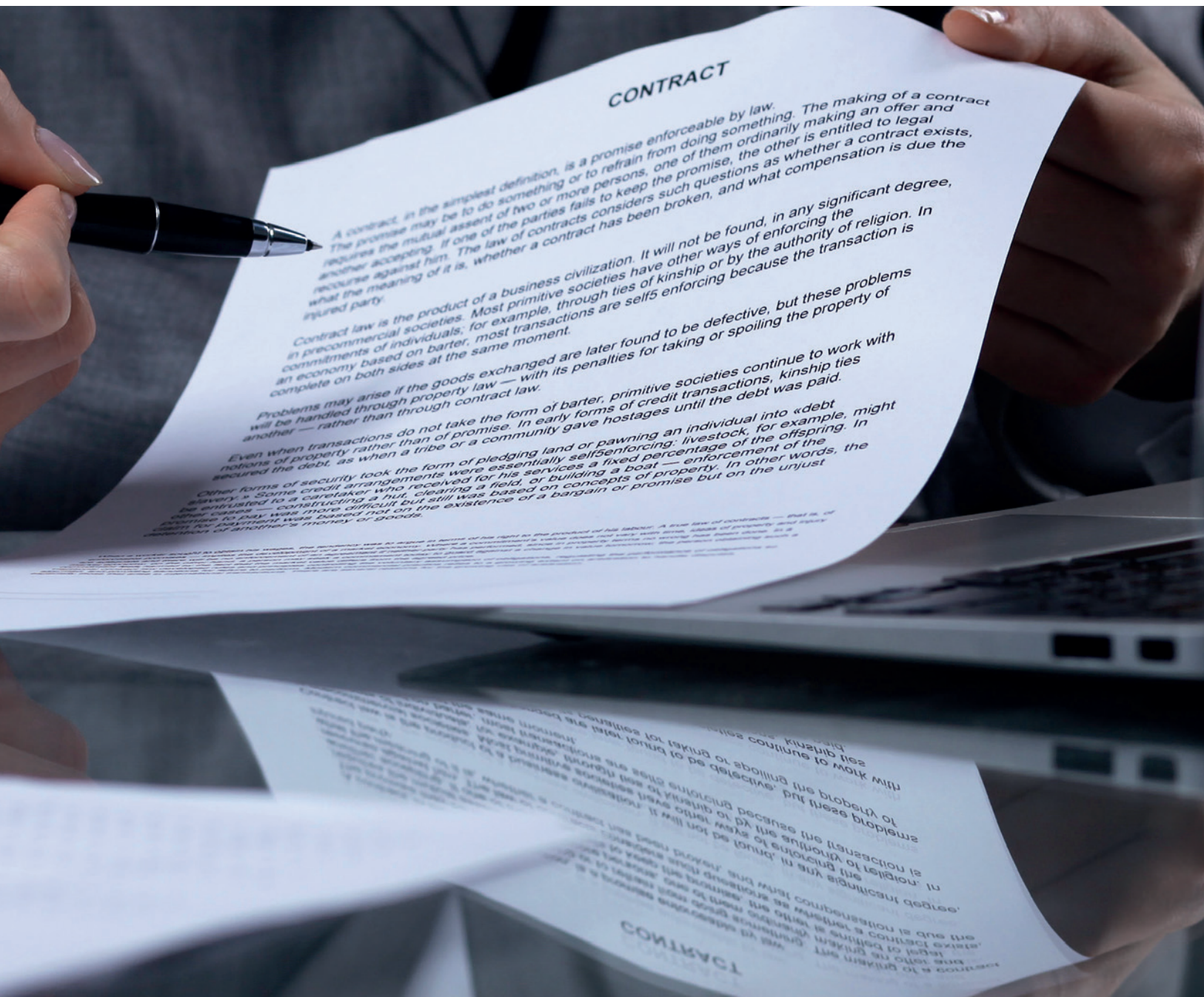
INTRODUCTION

In the recent case of *African Export-Import Bank & Ors v Shebah Exploration & Production Company Limited & Ors* [2017] EWCA Civ 845, the English Court of Appeal considered the question of whether the use of model form agreements (in this case, Loan Market Association (LMA) form of syndicated facility agreement) by

lending banks could constitute dealing “on written standard terms of business”, which would be subject to the Unfair Contract Terms Act 1977 (UCTA) reasonableness requirement.

As amended by Consumer Rights Act 2015, Section 3 of UCTA provides:

1. This section applies as between contracting parties where one of them deals on the other's written standard terms of business.
2. As against that party, the other cannot by reference to any contract term —



- (a) when himself in breach of contract, exclude or restrict any liability of his in respect of the breach; or
- (b) claim to be entitled—
 - (i) to render a contractual performance substantially different from that which was reasonably expected of him, or
 - (ii) in respect of the whole or any part of his contractual obligation, to render no performance at all, except

in so far as (in any of the cases mentioned above in this subsection) the contract term satisfies the requirement of reasonableness.

The decision of the Court of Appeal signals that it would not be easy for a defaulting party to assert as a defence that it was dealing on its counterparty's standard terms where a) substantial negotiations preceded the conclusion of the agreement, and b) the defaulting party was able to introduce meaningful

changes to the terms of the other party. While it provides useful judicial guidance, the decision does not change the law relating to exclusion clauses.

The Court of Appeal, perhaps unsurprisingly, rejected the proposition that a contract based on an LMA form could never be made on standard business terms. Whether or not it is would depend on the extent of the negotiations and amendments made to the form of agreement. This is one of the unusual situations where evidence of pre-contractual negotiations is admissible under English law.



“The decision gives comfort to lenders (and lessors) who use precedents or model form agreements, so long as substantial negotiations and extensive changes to a draft agreement suggested by the borrower (or lessee) indicate that the borrower (or lessee) was not dealing on the lender’s (or lessor’s) standard terms.”

This decision will give comfort to lenders who use precedents or model form agreements, making it more difficult for borrowers to argue that they contract on the lenders’ standard terms in circumstances where extensive negotiations preceded the conclusion of an agreement and substantive changes suggested by borrowers.

BACKGROUND FACTS

Shebah Exploration & Production Company Limited (“Shebah”) entered into a pre-export finance facility agreement with three banks (the “Lending Banks”), to refinance its pre-existing debt and obtain working capital to fund an oil production programme. Shebah’s obligations were guaranteed by two other parties (together with Shebah, the Defendants). The Lending Banks advanced US\$50 million each to Shebah. The facility agreement was based on the Loan Market Association (LMA) form of syndicated facility agreement, which was used as a starting point for negotiation.

Shebah defaulted on its capital repayment obligations, and the Lending Banks accelerated Shebah’s entire debt, as was their right under the facility agreement. When no payment was made by Shebah, the Lending Banks started proceedings to recover the debt.

The Defendants advanced counterclaims in the sum of US\$1 billion

and argued that they were entitled to set off the alleged counterclaims against their accepted liabilities under the facility agreement.

The Lending Banks relied on the following “no set off” clause in the facility agreement:

All payments to be made by an Obligor under the Finance Documents shall be calculated and be made without (and free and clear of any deduction for) set-off or counterclaim.

The Defendants argued that they were dealing on the Lending Banks’ “written standard terms of business” under section 3 of UCTA, so that the Lending Banks could only rely on the no set-off clause if it were “reasonable”.

At first instance, Phillips J granted summary judgment against the Defendants. The Defendants appealed.

COURT OF APPEAL

The Court of Appeal agreed with the first instance judge and held that the Defendants did not deal on the Lending Banks’ “written standard terms of business”, and made the following observations:

Model form agreements. The party alleging that it was dealing on another party’s standard terms must show “that the other party habitually uses those terms of business”. Showing only that terms are sometimes used and

sometimes not used is not enough.

Insofar as model forms are concerned, for UCTA to apply, it is essential that such form be “invariably, or at least usually” used by the party in question, and that a party has adopted a model form as its standard terms of business “either by practice or by express statement”. Demonstrating that a model form has been used “on the particular occasion” would not suffice.

The Shebah decision confirms that the Court will look at all the circumstances of the transaction. Here, the Defendants were dealing with three different lending banks (one Egyptian, two Nigerian) in a syndicated loan transaction, and could not have believed that they were doing so on “standard terms”. The Court stressed that the Defendants had to evidence their assertion that they were contracting on the Lending Banks’ standard business terms: “It cannot be right that any defaulting borrower can just assert that business is being done on standard terms and that the lender then has to disclose the terms of other (how many other?) transactions he has entered into [...]”.

Pre-contractual negotiations. Consistently with the previous authorities, the Court of Appeal rejected the proposition that any negotiations of any kind would automatically bar UCTA from applying. The relevant question was “whether there have been more than insubstantial variations to the terms which may otherwise have been habitually used by the other party to the transaction”. Substantial variations would be less likely to engage UCTA.

In Shebah, detailed negotiations preceded the entry into the facility agreement, and substantial amendments (evidenced by copious “redlines”) were made by the Defendants. This made hopeless the Defendants’ argument that the LMA model form was, or the terms ultimately agreed were, the Lending Banks’ standard terms of business.

The Court of Appeal stressed that it is not necessary for the negotiations to relate to the exclusion terms in order to displace the application of UCTA: the Court will look at all the surrounding circumstances to determine whether the terms ultimately agreed were or were not standard terms.

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The prominence of aviation EETCs

By Serap Zuvin and Can Yilmaz of Serap Zuvin Law Offices, Istanbul, Turkey.



From sociology to the economy, and from politics to technology, the world has greatly changed in many respects in the last decade. Recent political developments around the globe have particularly increased unpredictability. The economy, with changes happening in a blink, is one of the most affected areas, if not the most. The global economy had started recovering after the hit it took in 2008, but after a couple of promising years, it faced further struggles, with the result that many businesses across all industries are currently standing still and implementing a “wait and see” policy. The aviation finance industry, however, is anything but pausing or shrinking; on

the contrary the sector’s strong growth has pushed it to the forefront in the global economy. This analysis is borne out by the facts: 2016 saw airlines and lessors take delivery of new aircraft worth approximately US\$122 billion, and the size of the market as a whole is expected to grow to nearly US\$185 billion over the next five years. As we draw closer to the crux of this article, it should be noted that capital markets, and debt capital markets in particular, are the main source of aircraft financing – in 2016 they accounted for 35% of the total volume. This share is expected to continue growing over the coming years. The preference for debt capital financing is a direct consequence of investor-friendly instruments, such

as Asset Backed Securities (ABSs), Equipment Trust Certificates (ETCs) and Enhanced Equipment Trust Certificates (EETCs), which will be the main focus of this article. In order to explain the growing interest in EETCs and debt capital markets in general, we will briefly describe the structure of EETCs, comparing it to other methods where relevant. We will then discuss the “enhancements” that make credit notes more attractive, and the assessment methods applied by rating agencies. Finally, we will deal with the most crucial aspect of EETCs: the protection available to investors in the event of the issuer’s insolvency, under Section 1110 of the U.S. Bankruptcy Code on the one hand, and under the Cape Town



Convention Alternative A on the other hand, with illustrations taken from recent EETC offerings by major airlines.

DEBT CAPITAL MARKET FINANCING IN THE AVIATION SECTOR

Notwithstanding the availability of different aircraft financing routes for airlines, lessors, operators and others in the sector, the debt capital market remains the most popular choice. Recourse to this market has been growing over the last 20 years, due to its flexibility and wide availability to most airlines. Although debt market instruments vary significantly, they may be classed in two separate categories: (i) unsecured debt instruments, such as unsecured corporate bonds, and (ii)

bonds secured on aircraft equipment, such as secured corporate bonds, Asset Backed Securities (ABSs), Equipment Trust Certificates (ETCs) and Enhanced Equipment Trust Certificates (EETCs)

For corporate stakeholders - mostly airlines and operators in this context - the deciding factors when electing either secured or unsecured debt instruments, are linked to a variety of features of the debtor itself, such as its size, credit, operational strategies, financial position and so on. While some airlines prefer to finance their operations using a wide range of debt market instruments, some rely on their own assets. This mostly occurs when they suffer from a low credit rating, and as a result find themselves unable to attract investors

without committing their assets (aircraft equipment) as security. In other words, “The stronger an airline’s financial condition, the broader the range of debt market it can access and better the terms it can negotiate”

However, despite the wealth of financing options available, most airlines turn to the secured debt market, regardless of whether or not they could finance their aircraft without using their assets as security. This market in turn is the subject of constant improvements and introductions of new incentives, becoming always more attractive for investors.

The following sections gives a brief explanation of debt market products compared to EETCs.

A BRIEF COMPARISON BETWEEN EETCS AND OTHER SECURED AIRCRAFT DEBT FINANCING METHODS

Before explaining “secured aircraft financing”, the meaning of “bonds”, “secured bonds” and “trusts” need to be clarified, since these are at the heart of the structure of instruments such as ABSs, ETCs, EETCs and Pass Through Certificates (PTCs), which will be explained further on.

In essence, a bond is a debt security instrument, issued by companies or governments in order to raise funds for their operational needs. It creates a debt owed to those individuals or companies who buy these bonds, which can be either secured over an asset or not. Issuers take on an obligation to make fixed payments (coupon payments) over a set term ranging from six months to 10 years or longer, depending on the maturity date of the relevant bonds. Bonds issued by a single company or government are often held by different investors, in which case they are issued through a “Trust Deed” agreed between a trust company and the issuer. Under such an agreement, both bondholders and the issuer only deal with the trustee as regards those payments still owing, and in the event of a default, the trustee is entitled to act on the bondholders’ behalf to take action against the issuer. For instance, when bonds are secured over an asset, the trustee initiates steps towards enforcement and foreclosure in order to ensure the discharge of the obligations owed to the debtholders.

Turning to the structure of instruments such as secured corporate bonds, ABSs, PTCs and EETCs, we can see that it always involves a trust deed and provides some form of security over aircraft equipment - such as mortgages or security assignments of associated lease rights and so on - in order to allow attractive pricings on bond issuances.

With secured corporate bonds, the security is held by a trustee on behalf of investors, and it is provided over the issuer’s assets in order to pay the investors should the issuer become insolvent.

Despite some similarities with secured bonds, ABSs differ from the latter in several significant respects, one of them being their security feature. ABSs



are designed to enhance the security enjoyed by investors by insulating aircraft equipment and related rights in the event of the issuer’s insolvency.

The growth of the ABS market is due to the benefits it has brought to both investors and issuers. From the issuer’s perspective, like the other secured debt instruments, ABSs make for cheaper and more efficient financing. From the investor’s perspective, they represent a wider alternative range of steady fixed-income products carrying a lower risk and, as a result, higher credit ratings.

The main difference between ABSs and ETCs is that with ABSs security is typically granted over the cash flow generated by operating the aircraft equipment held by a trustee, whereas in the context of ETCs, the aircraft itself is directly committed as security. This also has a direct impact on the assessment methods adopted by credit agencies, which we will explain in detail below.

Another debt financing instrument secured over aircraft equipment is the PTC. In the aviation sector, PTCs were developed as an answer to the significant demand for financing and a lack of liquidity among issuers. In the early 1990s, issuers facilitated meeting their financing requirements by granting security over multiple aircraft portfolios rather than individual aircraft, which helped creating a more liquid security.

Nonetheless, the poor performance of airlines reflected on their earnings

which, combined with the downgrading of credit notes even below investment grade, forced investors to sell their holdings; this spelled the death of PTCs. As the saying goes: “every end is a new beginning”. Although issuers and investors alike experienced a poorly performing debt market product, growing aircraft financing requirements led to the creation of EETCs [as a new instrument that would meet the needs of both sides in the aircraft finance market, and to which the next section is devoted.]

THE STRUCTURE OF EETCS

The complex structure of EETCs is explained below to gain a better understanding of the “enhancements” which distinguish them from traditional ETCs. The methods used by credit agencies to assess EETCs will also be explained briefly.

DIFFERENCES BETWEEN EETCS, TRADITIONAL ETCs AND AIRCRAFT SECURITISATIONS

EETCs can be described as a combination of ETCs and aircraft securitisations. A clear understanding of the mechanisms of conventional ETCs and aircraft securitisations is required for an in-depth discussion of EETCs.

ETCs find their origin primarily in the railway industry, arising from that sector’s specific financing needs. What distinguished them from traditional

“Since the first EETC offering, closed in 1994 by Northwest Airlines, the leading U.S. airlines have raised billions of dollars of aircraft capital via the now well-trodden EETC route.”

mortgage liens was the structure of the security over railway assets. With ETCs, the title collateral, granted to investors as security for the payments owed to them at regular intervals, is not held by the issuing company; instead that title vests in a trustee. The collateral is leased back to the issuer, and the cash flow generated from the lease is dedicated to the payment of principal and interest on the certificates.

Even though the structure of ETCs is beneficial for investors from a legal point of view, those in the airline industry were at first sceptical when it came to ETC financing, because companies sought to raise amounts significantly larger than those in the railway sector. It is the introduction of Section 1110 protection in the U.S. Bankruptcy Code in 1979 that led the airline industry to embrace ETCs. The benefits of Section 1110 protection will be detailed below.

Aircraft securitisation is the other aircraft debt financing method that paved the way for EETCs was aircraft securitisation. In the case of aircraft securitisations as in that of PTCs, the instrument is backed by a large pool of aircraft and geographically diversified leases. However, unlike securitisations in other markets, the performance of aircraft securitisations is not wholly independent of the issuer's business performance and default risk. This correlation between the performance of aircraft securitisations and that of their

issuers has, from the outset, entailed constraints in terms of credit ratings, which have put investors off.

EETCS IN A NUTSHELL

Having described different debt financing securities, we see that all of them share certain similarities, such as the type of security granted, even though their respective structures may otherwise differ significantly. Looking at them in chronological order, we can see that their basic structure has been developed, updated and modified over time better to meet the fast changing requirements of the aviation sector. New features have kept appearing to make the latest instrument more attractive than the last, and it is through this process that EETCs were created to appeal to both investors and issuers.

An “Enhanced Equipment Trust Certificate” widely known as “double ETC” is a publicly - but sometimes privately - issued, rated security that relies on the credit of a single corporate issuer and secured by aircraft asset as collateral.” These certificates are usually issued by a special purpose company (“SPC”) or special purpose vehicle (“SPV”), the sole purpose of which is to hold the title to the asset(s) over which the EETCs are secured. The use of a “bankruptcy-remote” trust as an intermediary between investors and the issuer substantially lowers the risk posed by the issuer's insolvency, as it does in the ABS structure discussed earlier. Furthermore and as also mentioned earlier, this instrument adds the protection afforded by Section 1110 as well as other structural enhancements, such as further liquidity facilities, tranches, cross-collateralisations, call features, among others. This greatly increased the credibility of EETCs; by up to almost 10 notches for senior tranches.

The direct impact of these enhancements on the loan-to-value ratio (LTV) explains why investors' interest in EETCs soared. Since the first EETC offering, closed in 1994 by Northwest Airlines, the leading U.S. airlines have raised billions of dollars of aircraft capital via the now well-trodden EETC route.

Data from the last 7 years shows EETCs are the second most preferred

debt financing method, right behind unsecured debt financing, with relevant offerings amounting to nearly US\$32 billion dollars.

MOST SIGNIFICANT ENHANCEMENTS IN EETCS

As previously stated, the enhancements embodied in EETCs give them the edge over other debt market instruments. As is obvious from their name, EETCs offer a wide range of enhancements in terms of protection for investors in the market.

TRANCHES

EETCs are often issued in tranches ranked in alphabetical order as A, B, C and so on. Each tranche is rated separately by credit agencies and held by a stand-alone trust: a single trust for the A tranche equipment notes, another trust for the B tranche and so on. EETCs are issued in tranches to exploit the residual value of the relevant aircraft equipment after payment of the senior tranches, and to attract different types of investors (investment grade, high yield investors) by diversifying, the credit ratings on offer at the issuer's end.

From the investor's point of view, EETCs provide the senior investor with lower LTVs by granting them priority and allocating the first loss risk to the most subordinated investor. In addition, EETCs generally feature a strict subordination payment waterfall, by virtue of which both principal and interest on senior tranches are paid before any payments on junior tranches. All in all, “the financings are structured either to minimise risk or reward investors accordingly and this is done by layering different tranches of debt risk into the deal.”

LIQUIDITY FACILITY

In addition to tranches, EETCs also include a liquidity facility. In the event of a default by the airline, interest payments to mostly investors in the senior tranches are assured over the length of time - up to 18 months - required to repossess and remarket the aircraft equipment security. This liquidity cushion is deposited at a bank, prior to the issuance, and to be withdrawn when required; the aim of providing investors with this facility being higher credit ratings.

CROSS-DEFAULT AND CROSS-COLLATERALISATION

Back in 2005, a further enhancement was added to the structure of EETCs: cross-default and cross-collateralisation enable issuers to combine separate pools of aircraft equipment collateral, mixing new and old aircraft for example, which ultimately balance each other. The weaker assets are supported by the stronger ones. In the event of the issuer's default on any obligation relating to any aircraft equipment, all aircraft equipment securing the relevant EETC issuance is eligible for repossession. The proceeds of the repossession are then available to all investors, and any excess proceeds received from the sale of more valuable aircraft are available to offset shortfalls resulting from the sale of other aircraft involved in the deal.

METHODS USED BY CREDIT AGENCIES TO ASSESS EETCS

Nearly all investors active in the debt capital market set their strategies and expenditures on the basis of the issuer's creditworthiness and the detailed structure of any security issued by the issuer is arranged accordingly. The same is true for aircraft debt financing.

All the features, developments and enhancements of the aircraft debt finance market instruments reviewed so far have been used - and their potential is still being explored - with a view to obtaining a higher rating from credit rating agencies, which has had a significant impact on investors' decisions.

Before turning to the rating agencies' assessment methods, it should be noted that, while unsecured offerings are rated on the basis of the issuer's own credit, the assessment of secured corporate bonds such as EETCs and ABSs also takes into consideration the specifics of the transaction, independently from their issuer's creditworthiness. Furthermore, because of the enhancements included in their structure, corporate bonds secured over aircraft equipment generally receive a rating that is on average 1 to 2 notches above that of their issuer, and sometimes even higher than that of the issuing airline's existing secured debt.

On the other hand, however, because the majority of airlines have their



own credit rating, meaning that their default risk has already been quantified, assessing the EETCs they issue is a rather straightforward process, and the rating agencies only cover a narrow range of credit questions. Even when a credit rating is not available for an airline, as was the case for Doric Alpha/Emirates at the time of their EETCs offering, the assessment is made on the basis of the business quality and transaction-specific considerations of the relevant airline.

The various credit agencies, Moody's, Standard & Poor's, Fitch Ratings, Kroll Bond Ratings, apply different methods. Although the factors they take into account vary on a case-by-case basis, some critical factors have been applied to nearly all issuances.

These factors are as follows:

- structure of the transaction in general,
- asset quality and resale value, collateral coverage (including cross-default and cross-collateralisation);
- issuer's business risk (the airline's creditworthiness);
- diversity (both geographic and revenue);
- operating efficiency;
- leverage, management and financial policy;
- expected collateral values and

amount of support for each class of EETCs;

- availability of liquidity facilities or other credit support (credit agencies require this to be sufficient to cover a term of 18 months); and
- the effect of Section 1110, the implementation of the Cape Town Convention and applicable insolvency provisions in the jurisdiction of the issuer (recourse to collateral in the event of insolvency or default, including jurisdictional analysis).

Although each single factor has of course a critical impact on the rating, some carry more weight than others. Provisions governing the "recourse to collateral in the event of insolvency" are unequivocally at the heart of any discussions about EETCs. It is for this reason that the next section is devoted to an analysis of EETCs from an insolvency perspective.

EETCS FROM AN INSOLVENCY PERSPECTIVE

We have discussed above various features and enhancements in relation to specific aircraft debt capital instruments, leaving to the end the protection afforded to investors under relevant insolvency provisions. We made this choice because that protection is essential in relation

to such instruments, and in order to conclude this article with the most critical enhancement.

Until recently, the EETC market has been deemed suitable only for issuers originating from the U.S., the reason for this being the investor-friendly bankruptcy laws of the U.S., especially since the enactment of Section 1110, which will be explained below. Since the adoption of the Cape Town Convention and relevant protocols, which provide for a “Section 1110- like” process, non-U.S. airlines have been testing the EETC market and closing successful transactions.

The main concern of investors and credit agencies with respect to “repossession” is the legal provisions in force in the jurisdiction in which the issuer is incorporated. The crucial question is whether that jurisdiction has investor-friendly insolvency rules, under which investors are able to repossess the aircraft equipment reasonably swiftly in the event of the issuer’s insolvency.

In addition to the speed of repossession of the subject asset(s), rating agencies also take into consideration the predictability of a successful outcome for the repossession process. In other words, investor-friendly insolvency legislation does not, of itself, guarantee an enhanced credit rating. Agencies also assess the application of the rule of law in a country, and whether that country is reliable.

The bottom line is that a swift and predictable recourse to aircraft equipment is important not only for investors, but also for issuers as it enables them to obtain a higher credit rating in line with the level of protection granted to investors.

STRUCTURING EETCS IN THE U.S. UNDER SECTION 1110 AND IN NON-U.S. JURISDICTIONS

In EETC issuances, a distinction is traditionally made between U.S. and non-U.S. issuers.

EETCs have been used as a U.S. financing product for a relatively long time because of the pioneering additional protection Section 1110 provides to investors in the event of the issuer’s default.

The aircraft finance market is not,

however, limited to U.S. airlines and operators; airlines from other parts of the world have also shown interest in this alternative financing method. Unfortunately, since Section 1110 only applies to U.S. certified air carriers, other air carriers were unable to obtain favourable credit ratings; but that changed with the adoption of the Cape Town Convention (“CTC”).

The CTC has enabled non-U.S. air carriers (e.g. recently, Air Canada, British Airways and Virgin Australia) to take advantage of the EETC structure when they are incorporated in countries which have ratified the CTC and implemented it. Nevertheless, while the CTC provides investors with a protection similar to that set out in Section 1110, the process under the U.S. and CTC provisions differ in a number of respects. We will now explain how these provisions operate, in order to highlight their distinctive features.

PROTECTION UNDER SECTION 1110 OF THE U.S. BANKRUPTCY CODE

The U.S. Bankruptcy Code has always been investor-friendly, and the introduction of Section 1110 strengthened that protection even further.

The amendments which introduced Section 1110 have considerably widened the scope of the protection provided, in terms of both the type of aircraft and the nature of the transactions covered. Nearly all operators of commercial aircraft, such as commuter carriers, cargo carriers and charter operators, as well as all transactions involving qualifying aircraft and airlines, whether it be a lease, a conditional sale, a purchase money transaction, a financing or a refinancing, now fall within the scope of Section 1110, as long as they carry a U.S. air-carrier certificate.

As regards proceedings under Section 1110, the moratorium on the enforcement of aircraft collateral, which runs from the declaration of bankruptcy, is limited to 60 days. Unless the insolvent debtor cures all defaults or strikes a court-approved agreement within those 60 days, the creditor is entitled to repossess the aircraft equipment.

This protection, combined with the liquidity facility explained above,

is the reason why a typical EETC structure entitles investors to a much faster recourse to collateral than usual bankruptcy proceedings, while those same investors keep receiving payment of the interest they are owed, even if the issuer is in default, thanks to a liquidity facility.

It is in the light of that structural protection that credit agencies revised their assessment criteria for EETC notes where Section 1110 applies, with ratings boosted up to 2 notches above that of the same issuer’s unsecured debt.

PROTECTION UNDER THE CAPE TOWN CONVENTION

Article XI of the Cape Town Convention, which as of February 2017, has been ratified by 73 countries, deals with bankruptcy and insolvency.

The CTC offers two alternative sets of provisions for signatories to adopt, in the form of the Aircraft Protocol, Alternative A and Alternative B. “A contracting state may elect either A in its entirety or B in its entirety or neither.”

With Alternative A, in the event of insolvency, the issuer must either cure all defaults or deliver the aircraft to the creditor (investor) within a reasonable set timeframe. As is obvious, Alternative A is rather similar to the provisions of Section 1110, which also grants investors recourse to the aircraft collateral within a reasonable time. The only difference is that the moratorium that must elapse before a recourse to the aircraft is either one set by the contracting state in the declaration it has made, or, if shorter, that which would have applied in the absence of Article XI.

The process under Alternative B is relatively different from those under Alternative A and Section 1110. No time limit is set for returning the aircraft to the investor; rather, it is the investor who starts the time running by notice to the insolvent party. On receiving this notice, the insolvent party’s only obligation is to inform the investor whether it opts to cure all defaults or to return the aircraft. Of the 73 signatories to the CTC, only Mexico has adopted the more “debtor-friendly” Alternative B.

The CTC provides a standardised model that is, if not an improvement on Section 1110, at least similar to

these provisions; this model has reduced the costs of issuing EETCs for non-U.S. airlines.

However, to achieve a favourable rating, it is not enough merely to ratify the CTC and opt for Alternative A. An important distinction must also be drawn between those countries which have ratified the CTC, made certain “qualifying declarations” and amended their domestic law in order duly to implement the CTC, and those countries which have ratified the CTC but have not implemented the protection it provides for creditors in an insolvency context.

The assessment of airlines from those states which have not implemented such measures despite ratifying the CTC, will take into account the domestic insolvency laws, analysed in terms of the speed of the repossession process and the predictability of its outcome.

The strict assessment carried out by rating agencies continues even after a state has made qualifying declarations and amended its domestic law. The main two questions asked by rating agencies are:

1. Has the relevant state adopted the ‘right’ (i.e. “qualifying”) Cape Town Declarations?
2. Is significant regard paid to the rule of law in that particular jurisdiction?

Appendix II of the Aircraft Sector Understanding (“ASU”) 2011 included some guidelines to achieve effective implementation, right declarations, and compliance with the CTC. Signatory countries, when they meet the requirements for qualifying declarations and implementation measures set out in the ASU list (e.g. Alternative A, choice of law, IDERA, self-help, and so on), are entitled to enjoy a discount from the minimum premium rate in respect of export financing support. The assessment of the implementation of the declarations is conducted by the Organisation of Economic Co-Operation and Development (“OECD”); at the date of publication, only 25 contracting states have qualified for this discount.

Airlines from those countries which have carried out all the required qualifying CTC declarations, reforms

and implementations, have received comments and assessments from credit agencies which have almost been at the same level as those received by U.S. airlines. Turkish Airlines, for example, one of the major European airlines, has successfully completed its second EETCs offering with a 4.25% interest on A tranche, totalling approximately US\$99 million. Investors knew this transaction was bound to succeed after Standard & Poor’s comments highlighted that, Turkey having made the most favourable declarations for aircraft creditors, Turkish Airlines had qualified for the maximum discount.

Standard & Poor’s comments also emphasised that although there had not yet been any Turkish precedent of enforcement in accordance with the CTC Alternative A rules, Turkish Courts were very likely duly to implement the CTC in a manner that would supersede domestic rules, meaning that investors would benefit from the protection afforded by Alternative A.

Many non-U.S. airlines besides Turkish Airlines have issued EETCs in recent years, including Doric Alpha/Emirates, Air Canada, British Airways, Virgin Australia, to name but a few.

There is no doubt that the CTC has greatly improved the market for non-U.S. issuers, and especially for those from jurisdictions where insolvency laws are substantially different from the protection provided by Section 1110.

CONCLUSION

Looking back on EETCs offerings to date, we can see that although nearly all issuing airlines have been struggling financially and have filed for bankruptcy, they have been extremely true to their word as regards their EETC liabilities. For instance, according to a KBRA research, “A” tranche recovery in EETCs issued between 2001 and 2005 represented an incredible 99.8%, with 98.5% of the same unimpaired. The main underlying reason for this reliability is the strong protection provided to investors in relation to the repossession of aircraft equipment. Faced with the threat of losing the aircraft, airlines opt to repay all their EETC debts, no matter what. Furthermore, having become fully aware that EETCs give them a unique

“EETCs are providing issuers with a competitive source for aircraft financing and a large and diverse pool of investors, affording strong protection and rapid access to aircraft equipment in the event of a default.”

access to very diverse investment grade and high yield investors, and that they allow cheaper, efficient and balance-sheet flexible prices, issuers do not want to impair their relationship with investors, and their credit rating on EETC issuances, by failing to satisfy their investors. At the other end of the market, investors show relatively little hesitation in committing to EETCs, thanks to the swiftness of reliability of their structure when it comes to repayment in the event of insolvency.


In the light of the protections provided and the different type of features of the transaction in favour of both the investors and the issuers, the EETC funding structure, without any doubts, was designed for the benefit of both sides of the transaction. EETCs are providing issuers with a competitive source for aircraft financing and a large and diverse pool of investors, affording strong protection and rapid access to aircraft equipment in the event of a default. In other words, EETCs have a positive impact on both the availability of financing and its rating and pricing.

As a consequence, the EETC structure is a highly valuable financing method, designed for the purpose of meeting the increasing financing needs of the fast-growing aviation sector. More airlines will be making the most of EETCs in the near future.

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Tracing the impact of Spain's ratification of the Cape Town Convention

By Sergi Giménez, AUGUSTA ABOGADOS, Barcelona



More than two years have now elapsed since 1 March 2016, when the Aircraft Protocol of the 2001 Cape Town Convention entered into force in Spain. Back then we wrote a note in this very publication (“Spain About To Ratify Aircraft Protocol of Cape Town Convention”, *Airline Economics Aviation Law Yearbook 2016*, page 38 <http://viewer.zmags.com/publication/d483f038#/9556ccaa/40>) that attempted to anticipate some of the challenges the ratification posed to the Spanish legal system. With the benefit of the practical experience gained during

this period, it seems appropriate to review the subject and analyse which aspects are working well and identify those areas where improvement is still needed. To that end, it seems useful to follow the same order as in our initial article.

1. Ratification of the Aircraft Protocol – Spanish declarations

On 27 November 2015 the Kingdom of Spain formally submitted to UNIDROIT its accession to the Aircraft Protocol, which therefore entered into force in Spain on 1 March 2016. Together with its ratification, Spain made a number of

declarations to both the Aircraft Protocol and the Cape Town Convention, two of which are worth noting: (i) in accordance with Article 18.5 of the Convention, the Spanish Movable Assets Registry was designated as the only authorizing entry point for the purposes of transmitting information to the International Registry relating to Spanish-registered airframes and helicopters, and (ii) while Spain generally rejected all self-help remedies contemplated in the Aircraft Protocol and in the Convention, it expressly accepted the validity and use of IDERAs as per Article XIII of the Aircraft Protocol.

Spain's ratification instrument was



complemented by a Resolution of the Directorate General of Registries and Notaries dated 29 February 2016 whereby certain procedural rules were approved (namely, the official forms to be used for the purposes of applying for entry codes to the International Registry and the official IDERA form in Spanish). So far, no further development legislation has been approved, which is causing some practical difficulties as we shall see.

2. Dual registry system

As explained in our previous article, since the late 60's Spain has a dual-

registry system for aircraft: Spanish-registered aircraft historically had to be recorded at the Aircraft Matriculation Registry ("Registro de Matrícula de Aeronaves", a body which depends of the Spanish Air Safety Agency) and, only under certain circumstances, also at the Movable Assets Registry ("Registro de Bienes Muebles", a body which depends of the Ministry of Justice). In 2015 new Regulations for the Aircraft Matriculation Registry were passed, and on that occasion the Government lost a perfect opportunity to simplify the Spanish registration system and adapt it to the models of the more advanced –and neighbouring– jurisdictions: instead of establishing a single-registry system, it reinforced the dual-registry system and forced that all aircraft transactions be recorded at the Movable Assets Registry first. Until then, most transactions involving commercial aircraft were exempt from such registration, but this changed under the new Regulations and is causing some heavy additional bureaucracy and costs on operators and practitioners.

- (a) Firstly, since the Movable Assets Registry has been designated as the sole authorizing entry point for international interests relating to Spanish-registered aircraft and helicopters, operators must apply for an "Authorizing Entry Point Code" ("AEP Code") before they can submit any international interests to the International Registry. In general terms, the procedure to obtain such AEP Codes is easy and inexpensive, but nevertheless a waiting period of up to 48 hours should be accounted for. This can sometimes impact the timing of transactions, particularly when last-minute changes are to be implemented.
- (b) Secondly, under the 2015 Regulations it has become mandatory to record aircraft-related transactions such as leases, sales, novations, charges, etc. first with the Movable Assets Registry and then with the Aircraft Matriculation Registry. This can significantly impact the timing of the recordation of an international interest under the Cape Town Convention:

- (i) Upon receipt of the documents which evidence the international interest (e.g., an aircraft operating lease along with the relevant certificate of acceptance, IDERA, etc.), the Movable Assets Registry analyses such documents to ensure their validity and conformity. This analysis is obviously conducted from the perspective of applicable Spanish law, which is quite formalistic in many aspects. After the first year of operation under this new system, it can be said that it happens quite frequently that the Movable Assets Registry rejects documents on the grounds of an alleged lack of formalities or even lack of clarity, due to it not being familiar with the complexity of these types of documents. Foreign lessors and financiers are often confused by this.
- (ii) For so long as the transaction documents have not been recorded at the Movable Assets Registry, the Aircraft Matriculation Registry cannot issue the final registration marks for the aircraft. While it is of course possible to operate under the provisional registration marks given by the Aircraft Matriculation Registry, such marks expire after three months. Occasionally this period of time has been exceeded due to the pace of work at the Movable Assets Registry, which has obliged the parties to ask for extensions and engage in additional explanatory work. Although the Movable Assets Registry is becoming more and more familiar with aircraft transactions, and as a consequence the times for the review procedure are being shortened, this is not a situation that financiers, owners or lessors of aircraft objects look at favourably. What is clear nowadays is that operators are forced to face additional costs, because all documents submitted to the Movable Assets Registry require an official translation into Spanish and the fees of the Registry itself are calculated on the basis of the value of the transaction (which are usually high figures where commercial aircraft are involved).

- (iii) The recordation of IDERAs is probably one of the most problematic areas. The interest of owners, financiers, lessors and the like mandates that IDERAs be recorded with the relevant national authority almost immediately, and this interest is clearly reflected in the Aircraft Protocol. However, the system imposed under the new Spanish rules requires that IDERAs are submitted firstly to the Movable Assets Registry; only after successful review of all the transaction documents will the Registrar allow the Aircraft Matriculation Registry to proceed with its part of the work, which includes the IDERA recordation. Since such review process can take weeks, it is clear that during the interim period between closing of the transaction and notice to the Aircraft Matriculation Registry, an IDERA will remain unregistered and hence unenforceable should the need arise. This seems to be in clear contradiction with the terms of the Convention and the Aircraft Protocol, and conversations are underway to find suitable alternatives.
- (iv) A secondary issue affecting IDERAs relates to the formality requirements which the Movable Assets Registry attempts to impose. There is international consensus that an IDERA should be valid and enforceable as long as it meets the formalities foreseen in the Aircraft Protocol (essentially, written form and conformity to the template attached to the Aircraft Protocol). However, the Spanish registry has occasionally requested that the signatures on an IDERA be legalised by a Notary Public, a requirement that is not contemplated by the Convention or the Aircraft Protocol. From an international perspective, therefore, such requests should be rejected, although in practice operators often chose to oblige in the interest of speeding up the process.
- (v) Finally, some doubts have arisen in connection with the “certified designees” foreseen under Article



XIII.2 of the Aircraft Protocol. IDERAs are, according to this provision, transferrable by their beneficiary in favour of third parties. So far, applications to record this type of transfers have been rejected, mostly on the grounds that this type of legal institution is alien to Spanish law. It seems clear that some educational work will have to be undertaken in this connection.

3. Some pending legal challenges

In our initial paper we stated that Spain's legal system was facing a number of challenges before the terms of the Convention and the Aircraft Protocol could be fully implemented and accepted without reservations by the Courts. Some of these have been summarised above, but there are some further aspects which require development work.

- (a) In addition to IDERAs, the Convention contemplates a number of self-help remedies that are available to owners and financiers of assets. However, under Spanish law self-help measures are strictly forbidden and may even be considered as a criminal offence; parties should seek their remedies in Court. This contradiction was solved through the Spanish accession instrument of October 2013, whereby it was declared that all remedies foreseen under the Convention can only be exercised with the prior authorisation of

a judge. Spain does not allow creditors to use the self-help remedies of the Convention without first getting a judge's approval. The only exception to this prohibition is the acceptance of IDERAs, which have not been tested yet in practice.

- (b) As happens with other jurisdictions, the remedies foreseen by the Convention for situations of bankruptcy must also be carefully analysed in the light of existing Spanish bankruptcy law, which is aligned with the European Insolvency Regulation. So far, Spain has made no declaration as to whether it chooses Alternative “A” or “B” as foreseen in the Convention. However, there are presently some ongoing works to amend the Spanish Insolvency Act 2003, and this would be a perfect opportunity to make such choice from a domestic law viewpoint. It is clear that choosing Alternative A would be the preferred course of action for the international aviation community, but some legal scholars argue that the super-privilege that the Convention attempts to give to creditors in insolvency situations may face resistance given the present political and social trend of reducing the privileges of secured creditors.

Hopefully some of the doubts and challenges described in this note will be clarified in the near future. Without a doubt, we will continue monitoring the situation and reporting on it.



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The Mexican Aviation Industry

By Juan Carlos Machorro G of Santamarina + Steta



Mexico is ranked 14th within Aerospace industry countries. The industry contributes 2.9% of the country's GDP and creates more than 1 million jobs in Mexico. There are more than 300 aerospace companies operating in Mexico, most of which hold NADCAP certifications (National Aerospace and Defense Contractors Accreditation Programs). The majority of those companies integrate the Mexican Federation of Aerospace Industries

(Federación Mexicana de la Industria Aeroespacial, A.C., FEMIA), a non-profit agency established to promote the development of the industry.

In 2017, the industry experienced an increase of almost 11% in the first four months of the year, compared to the same period of 2016.

It is estimated that exports will be reaching around US \$8,000 million at the end of 2017.

Government agencies continue in the effort of expanding the creation of industry clusters offering incentives

and support for companies investing in Mexico and willing to form or expand the creation of supply chains.

According to KPMG, Mexico currently has an average cost advantage of 22.5% (over 19 industries), compared to the US, higher than at any point in this decade. The Index of Technological Sophistication of Mexican export products (3.25), is the highest in Latin America and above India and Brazil (OECD). KPMG's 2016 study of Competitive Alternatives ratified Mexico as one of the most



competitive countries in terms of fees in aerospace manufacturing (9% below the US, 7.4% below France, 8.9% below Germany, 6.9% below Australia and 8.9% below Japan), having Mexico City and Monterrey as the two main manufacturers in the country.

It has been estimated by Goldman Sachs that Mexico will be the fifth largest economy by 2050.

Mexico's free trade agreements give privileged access to 2/3 of the world's GDP. Mexico is part of the world's largest economic block (NAFTA = 18 trillion

USD) and, with 12 trade agreements, it has access to 44 countries (1.2 billion people).

The so-called MIST economies (Mexico, Indonesia, South Korea and Turkey) more than doubled in size in the past decade. In Mexico, Latin America's second largest economy, record auto exports are helping growth outpace Brazil's for a second year amid waning Chinese demand for the South American nation's commodities. These four countries are all members of the prestigious G-20 group of the world's

top economies. Each of them represents more than 1% of global GDP.

Boeing and Airbus announced more than US \$114 billion in new business during the 2017 edition of the Paris Air Show. The show also witnessed the launch of new narrow body aircraft from Mitsubishi, ANTONOV, COMAC and UAC manufacturers, making the busiest air show since 2013. Boeing and Airbus also announced the 737 MAX 10 and the A380plus, respectively.

Narrowing to Mexico, AeroMéxico continues to renew its fleet with a multi-



“A new segment of people has started to fly in Mexico and commercial airline players (both domestic and international) are certainly taking advantage of these opportunities”

million dollar investment announced in 2012 to acquire 100 new Boeing aircraft in a period of 10 years. During 2017, AeroMéxico replaced all of its B767 fleet and will replace all of its B777 during early 2018 with the B787. The airline's B737s will be replaced with new B737 MAX to attend short and medium haul flights. As of October 2017, AeroMéxico's fleet is integrated by 129 aircraft: 55 B737s, 3 B777s, 14 B787s and 57 EMBs.

Interjet received during 2017 brand new A320neos and was America's launch customer for the Russian manufactured aircraft Sukhoi Superjet 100.

VivaAerobus recently completed a fully fleet renovation, replacing all of its B737s with brand new A320s and A320neos.

A new segment of people has started to fly in Mexico and commercial airline players (both domestic and international) are certainly taking advantage of these opportunities. New international non-stop routes from and to Mexico include Rome, Tokyo, Guangzhou, Zurich, Copenhagen, Oslo and Helsinki. With a commercial fleet of over 330 aircraft, it has been estimated that Mexico has the potential to operate 500 commercial aircraft to attend domestic and international routes.

Calculations show transportation of 290 to 315 Million passengers per year for the year 2040 in Mexico, with some dependency on the operation of a new airport in Mexico City in the next decade. It is estimated that Mexico will account for 90 million transported passengers in 2017. Palenque Airport, in Chiapas, and Ixtapetec Airport, in Oaxaca were recently

inaugurated, expanding air connectivity in Mexico's Southern region. Cancun Airport also inaugurated its brand new Terminal 4, making it the first terminal 4 for an airport operating in Mexico, which will increase the airport passenger's capacity up to 40%.

Mexico City International Airport (AICM) has experienced a considerable increase in passenger traffic (with a capacity exceeding 30 million annually), making it the largest in Latin America. Still, a new airport was required for Mexico City, as the AICM has been officially declared saturated, both for passenger and merchandise transportation, resulting in delays and diversions of flights, reduced quality of service, and loss of competitiveness from small airlines. During 2016, AICM transported over 41 Million passengers (an 8% increase from 2015).

New Mexico City Airport has officially reported a 10% construction advance, which continues to represent the main infrastructure project of this administration, and one of the main infrastructure projects worldwide, competing with Heathrow, Dubai, Istanbul, Beijing and Berlin airports. It will have an initial cost (initial phase) of MX\$180 Billion Pesos with an initial phase of one terminal building and three runways for triple simultaneous operations, in an area of around 4,430 hectares and a capacity for 50 Million passengers (with an average of 137 thousand per day) and 550,000 operations per year (with an average of 1,500 per day), and a subsequent phase of two terminal buildings and

two satellites, six runways for triple simultaneous operations, and a capacity for 120 Million passengers (with an average of 342 thousand per day) and one Million operations per year (with an average of 2,750 per day). It has been officially announced that this new airport is expected to be completed and in the first stages of operation by the year 2020.

After the DOT (US Department of Transportation) authorization in May 2017, AeroMéxico and Delta started a joint venture, tying-up Sky Team Alliance's presence in the Mexico-US market and the Americas. This will include growth in hub-to-hub markets, Mexican cities to the US and US cities to Mexican destinations. AeroMexico and Delta together fly nearly 22% of the capacity in the US-Mexico market, Innovata FlightMaps Analytics shows. Their closest competitor, American Airlines, flies 18.7% of the capacity in the market and United Airlines 16.7%.

Mexico's air connectivity expansion and passenger flow has experienced Mexico's antitrust authority proposing a new slot distribution system, which may directly affect frequencies operated by AeroMexico, Interjet, Delta, Southwest, among others.

Finally, amendments to Civil Aviation Law and Federal Consumer Protection Law were implemented mid-2017, focusing on passenger protections. Amendments include the increase of passenger rights, airline sanctions and minimum standards for airlines to indemnify passengers in case of flight delays, cancellations or deviations.

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Registration of aircraft in Romania

Comments on legislative changes by Dr Crenguta Leaua
and Gina Gheorghe, Leaua & Asociatii



Romania is well connected to international aviation, e.g. Romania is a member of the European Civil Aviation Conference and of the European Aviation Safety Agency.

The certifications (e.g. airworthiness) required for obtaining registration of aircrafts in Romania are subject to special legislation in line with EASA Rules. The Romanian Civil Aeronautical Authority (“RCAA”) is the authority that deals with registration/deregistration, airworthiness and operation of aircrafts in Romania.

At the end of 2016 (RACR -IA), a new regulation on aircraft registration came in force in Romania, replacing the one of 2007 (RACR 47). The new regulation brings certain changes with respect to the conditions of registration, the aircraft subject to registration, the deregistration, or as novel the temporary registration of an aircraft or aspects related to the registration of encumbrances over an aircraft or the documents filing procedure with RCAA. Without attempting to provide a full comparison of the two regulations, there are mentioned here only certain aspects which were more or less amended by the new legislation.

AIRCRAFT REGISTRIES KEPT BY RCAA AND INFORMATION THEREOF

According to the regulation RCAA keeps the Romanian Sole Civil Aircraft Registration Registry, the Encumbrances Registry and the Deregistration Registry. The Romanian Sole Civil Aircraft Registration Registry consists of registry books with unique numbers and is structured in two sections (i.e. registration and temporary registration).

The registry books contain details concerning the aircraft (e.g. nationality and mark, certificate of registration, manufacturer, manufacturer’s mark, class and type of aircraft, the manufacturing number given by the manufacturer, the certificate of airworthiness, insignia, colour, operation base), the holder, its title on the aircraft and its address (whenever the aircraft is not held by the owner), the owner and its address, and special information on any liens on the

aircraft. There is also room left for registering details after registration of the aircraft with respect to any change of owner or holder, deregistration, liens, duplicates of the aircraft registration certificate, or other.

The registry book for temporary registration contains details with respect to the certificate of registration of the aircraft, national insignia and mark, class and type of the aircraft, manufacturer's name and number of fabrication, owner, and deregistration.

The Encumbrances Registry contains information with respect to the aircraft registration certificate, type of aircraft, registration mark, owner and its address, the type of encumbrance (e.g. mortgage, movable mortgage), holder, information with respect to other components under lien, the beneficiary of the encumbrances, and the amount or duration for which the encumbrance was set up.

The Deregistration Registry contains information with respect to the deregistration certificate, national insignia and mark, the aircraft type and fabrication number, the manufacturer, and the requesting party

Excerpts with the information contained in the registries kept by RCAA may be obtained by any person who proves to have a legitimate interest in receiving such information, upon request and against payment of insignificant fee. For instance, an owner who leased an aircraft registered in Romania may request from time to time certain information on the aircraft.

By registration with the Romanian Sole Civil Aircraft Registration Registry the aircraft will have the Romanian nationality.

It is expressly provided in the Romanian law that the registration of an aircraft in the Romanian Sole Civil Aircraft Registration Registry and the certificate of registration do not represent the proof of any legal title or ownership on the aircraft.

EXCEPTIONS FROM REGISTRATION REQUIREMENT

The new regulation amends the exceptions from the registration requirement of certain aircrafts, by introducing a new exempted category



and modifying certain limits to another category. Thus, the ultralight aircrafts, as defined by law, are exempted from registration, as well as the aircrafts with no human pilot on board and with a maximum weight at take-off of 150 kg (previously the weight requirement was of only 25 Kg). The other exemptions from registration are the balloons for meteorological use, free balloons with no pilot and no cargo on board, aircrafts for military service, customs or police.

AIRCRAFT REGISTRATION CONDITIONS

One particular change reflects the condition of registration in the Romanian Sole Civil Aircraft Registration Registry regarding the owner/holder of the aircraft. Thus, while the previous regulation provided that an aircraft might have been registered if, among others, (i) the aircraft belonged to a Romanian body (natural or legal person) or to a foreign citizen living in Romania or to a foreign body whose economic activity is developed according to the Romanian legislation, and the civil aircraft had its main operation base in Romania; or (ii) the aircraft belonged to a foreign body of a state (natural or legal person) that concluded with Romania a convention

for mutual national treatment regarding the registration of the aircrafts, the new regulation provides in this respect that an aircraft may be registered in Romania when its owner or holder is either a natural or juridical person with its domicile or headquarters in one of the European Union states.

The other registration conditions are: (i) the aircraft is not registered in another state, (ii) the aircraft complies with the national regulations regarding the noise level and hazardous emissions, (iii) the aircraft is airworthy, and (iv) the aircraft is not exempted from registration. For aircrafts which were previously registered in another state it is required that they are deregistered prior to registering them with RCAA. An Export Airworthiness Certificate is required from the former state of registration.

The registration of the aircraft can be requested by the owner or by the holder with the written approval of the owner, either directly or by attorney in fact.

The documentation required for aircraft registration in Romania was also amended in the new regulation by supplementing it with the following: (i) the copy of the registration certificate and a full certificate with the status of

“The new regulation brings certain changes with respect to the conditions of registration, the aircraft subject to registration, the deregistration, or as novel the temporary registration of an aircraft or aspects related to the registration of encumbrances over an aircraft or the documents filing procedure with RCAA.”

the Romanian juridical persons, while for foreign juridical persons there are required the equivalent documents issued by the relevant authorities in the respective countries, (ii) a copy of the identification card or proof of being a resident in Romania for the natural persons and, respectively, the equivalent documents issued by the relevant authorities for the foreign natural persons, and (iii) the copy of the airworthiness certificate valid at the date when the request for registration was filed (for this last one, the previous regulation required for the airworthiness certificate or a document attesting airworthiness).

The rest of the documents required for registration are similar to the previous regulation: (i) the standard registration form filled-up (full name, nationality, domicile/headquarters, registration number with the Trade Register and fiscal registration number of the owner and of the holder, if the holder differs from the owner, the aircraft class and type, as well as the destination of the aircraft, the name of the manufacturer and the manufacturer's designation number, the serial mark reserved prior to the registration request, the colour of the aircraft and the colour of the registration

marks, the name of the main operation base); (ii) the proof of the ownership or possession of the aircraft (copy of the contracts and, if drafted in a foreign language, the authorized translation in Romanian) accompanied by the owner's consent, if the case may be; (iii) the document regarding the previous status of the aircraft as regards the registration (which may be (1) for a new serial aircraft which was not previously registered in Romania or in another country: (a) in the case of the aircrafts manufactured in Romania, a statement of the manufacturer regarding how the aircraft was identified for the factory flights, or (b) in the case of imported aircrafts, a document, issued by the competent civil aeronautical authority based in the manufacturer's country, from which to confirm that the aircraft is not registered in the registration registry of that country, (2) for the aircraft which was last registered in the Romanian Sole Civil Aircraft Registration Registry and not deregistered, the certificate of registration, and (3) for the aircraft which was registered in another country, the certificate of deregistration or a document legally issued by the civil aeronautical authority from that country attesting that the aircraft is no longer registered there); (iv) the scheme of the registration marks display and (v) the proof of the legal fees payment.

RCAA may require supplementary documents, as it deems necessary, for the registration of the aircraft.

TEMPORARY REGISTRATION FOR CERTAIN AIRCRAFTS

As novel, the new regulation introduces the temporary registration of aircrafts in Romania. This includes provisions on (i) the categories of aircrafts which may fly in the Romanian air space with temporary registration, (ii) the documents required for temporary registration, (iii) the use of registration marks in case of temporary registration, (iv) the use of easily removable material for inscribing registration marks, (v) the obligation to remove the registration marks at the expiry of the duration of the temporary registration, (vi) the deregistration from the Romanian Sole Civil Aircraft Registration Registry of an aircraft registered temporarily at the

expiry of the respective duration.

The aircrafts that may be temporarily registered in Romania are the prototypes, the new serial aircrafts, the aircrafts de-registered in other states if subject to flights for airworthiness verification. According to the previous registration these aircrafts could have performed flights without registration requirement (although certain rules on identification were in place). Different from the regular registration of aircrafts, in case of temporary registration the request may be filed only by the manufacturer, the management organisation for continuing airworthiness, or the maintenance organization.

The documentation required for temporary registration consists of the following: (i) request for temporary registration, (ii) the consent of the owner, should the case be, (iii) the document regarding the previous status of the aircraft as regards the registration or identification, as the case may be, (iv) the scheme of the registration marks display, (v) the registration certificate or the full certificate with the status of the juridical persons requesting the temporary registration, and (iv) the fee payment proof.

AMENDMENT OF REGISTRATIONS WITH THE ROMANIAN SOLE CIVIL AIRCRAFT REGISTRATION REGISTRY

Whenever a piece of information registered in the Romanian Sole Civil Aircraft Registration Registry changes, then the owner or the holder (depending on the rights transferred by the owner), directly or through an attorney in fact, have to request for the registration of the respective change.

However, the amendments generated by the change of the exterior characteristics of the aircraft, the change of the main operation base, the change of the holder or of the owner of the aircraft or their addresses, as well as the change of the colours of the aircraft or of the registration marks are required to be sent to RCAA within 10 days. Otherwise, RCAA may suspend the certificate of registration for a period of maximum 6 (six) months. If, within 6 (six) months the cause that led to suspension is not removed, then the certificate of registration may be revoked by RCAA.



REMOVAL OF REGISTRATION MARKS WHEN DEREGISTRATION

Another change in legislation regards the removal of the registration marks when de-registration occurs. Thus, while under previous regulation the registration marks were to be removed immediately after the RCAA's confirmation of the deregistration, the new regulation sets forth that the registration marks shall be removed at the latest prior to the issuance of the deregistration certificate.

ENCUMBRANCES ON AIRCRAFT OR CERTAIN PARTS OF AN AIRCRAFT

The new regulation provides for certain aspects on encumbrances which were not regulated by the previous one, e.g. the registration in the Encumbrances Registry, the documentation required to register an encumbrance, and amendment of the Encumbrances Registry.

The beneficiary or the debtor of an encumbrance may register it in the Encumbrances Registry upon request and proof of the respective encumbrance, namely the original title or a legalized copy and payment of the required fee. Unless otherwise specified, an encumbrance is validly registered for a period of 5 years from the date of its initial registration in the Encumbrance Registry for the aircrafts that have a registration certificate or for the

duration of the temporary registration, as the case may be. The beneficiary or the debtor itself may, based on relevant evidence, renew the registration of an encumbrance before its expiry, or, otherwise, the respective registration shall become obsolete. Any registration in the Encumbrance Registry may be amended by the beneficiary based on relevant evidence that the respective amendment is legally valid.

Any encumbrance on Encumbrances Registry kept by RCAA, is then mentioned in the Romanian Sole Civil Aircraft Registration Registry as well.

COMMON REQUEST FILING PROCEDURE WITH RCAA

The new regulation provides for a common procedure for the requests filed with RCAA on filing of documents, resolution and challenge of the requests.

All documents filed with RCAA must be in original or legalized copy, and, should the case be, must be accompanied with a certified translation into Romanian. The documents issued by a foreign authority need to be apostilled or over legalized, upon applicable international conventions with the state of the respective authority. Any person who files a request with RCAA is liable toward RCAA on authenticity, completeness, correctness, validity, accuracy and true character of the filed documentation, as well as for

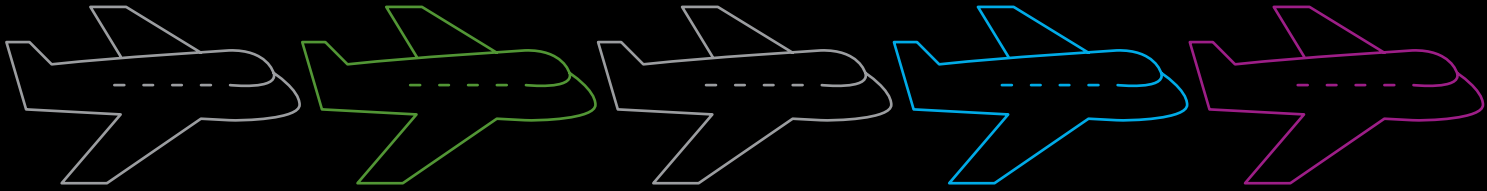
“Another change in legislation regards the removal of the registration marks when de-registration occurs.”

the compliance with the applicable legal requirements with respect to the form and content of the respective documents.

RCAA has to answer any request within 30 days from the receipt of all documents and information required. RCAA's answer may be challenged either with RCAA or Ministry of Transportation within 30 days from its receipt. Such challenge does not suspend RCAA's decision.

Decision of RCAA and/or Ministry of Transportation may be challenged in court within 6 months from the receipt of the respective decision. Also, if the decision is not received within 30 days then a party may file a claim in court.

Overall, the new regulation clarifies several matters and is in line with the modern trend of Romanian legislation and, more specifically, aviation law which is harmonized with international regulations (e.g. EASA rules) and best practices.



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Passenger compensation – just claims or avoidable major airline costs?

By Katja H. Brecke, LL.M., a senior associate with Arnecke Sibeth in Frankfurt, and partner Ulrich Steppeler, LL.M, who co-heads the transportation, aviation and logistics group at Arnecke Siebeth.

There are currently more than 60 countries worldwide that have enacted passenger protection of some kind. For example, in the U.S., new tarmac delay rules came into effect in 2010; Turkey recently copied the EU Regulation on passenger rights; and even Saudi Arabia published Executive Regulations for Consumers' Rights Protection in 2017. The number of regulations around the world is growing at an extremely fast pace, while simultaneously existing rules are being tightened.

In the European Union, notorious Regulation (EC) No 261/2004 on passenger rights ('the EU Regulation') has been the cause of a myriad of

disputes. It was attempted in a series of rulings to clarify the interpretation of the relevant provisions. However, most judgments of the Court of Justice of the European Union (CJEU) seem tailored only to allow the most favorable outcome for consumers, rendering the EU Regulation at the same time even more inconsistent and self-contradictory from a legal point of view. In consequence, we do not look at uniform jurisprudence throughout the European Union or even on the level of a single Member State. On the contrary, case law is of a fragmented nature, which adds to the burden of an airline operating internationally and trying to stay in control of various jurisdictions from a legal perspective.

The amounts of compensation for

denied boarding, cancellation and long delays under the EU Regulation are prescribed. Passengers do not have to demonstrate or even prove damages; rather compensation simply depends on the flight distance, i.e. EUR 250, EUR 400 or EUR 600 for short haul, mid haul and long haul flights respectively. Furthermore, air carriers are required to provide unlimited care to passengers affected by a flight irregularity even if the cause of the irregularity is beyond the airlines' control. The statute of limitation for claims under the EU Regulation depends on the respective national law. In Germany, for instance, the limitation period is as long as three years. Airlines therefore have to be able to access data for flights that were



operated sometimes a few years back to be in the position to actually assess and evaluate the entitlement of a passenger to receive compensation. It is all about the data for an airline; whether or not you can defend an unjustified claim successfully or can take the decision quickly to process payment if the disruption of the carrier's operations calls for it.

2. U 261 – QUO VADIS?

The prospects for a change are dim. The revision of the EU Regulation that was proposed by the EU Commission in 2013 was put on hold due to political issues, e.g. the conflict between Spain and the United Kingdom on Gibraltar Airport. With the Brexit on the political agenda, millions of refugees coming to

Europe and various Member States still recovering from the Euro crisis, it seems there are not enough hours in a day to carefully review the passenger rights' regime and to establish a level playing field between the stakeholders. Even if the political deadlock can be resolved and a revision of the EU Regulation would be pursued further, it is unlikely that it will turn back the clock.

3. EMERGENCE OF CLAIM AGENCIES

Due to the high amounts involved, an entire industry has been established around passenger claims. Claims agencies try to take advantage of the situation offering digitalized easy and fast solutions for passengers. These agencies, or claim farms, either demand compensation on behalf of the passenger or buy the passenger's claim and push forward the claim against the air carrier. Airlines therefore pay roughly 30 per cent of the compensation to claim agencies. Claim farms are clearly not the most effective way for passengers and airlines to handle compensation claims. Flightright, a claim agency founded in 2010, has collected more than EUR 100 million in compensation payments until today. Thus, air carriers paid roughly 30 million in compensation directly into Flightright's pockets. AirHelp, another international claim farm, advertises that it has had 5 million customers since it was established in 2013. If one would assume the lowest compensation of EUR 250 per passenger, compensation collected by AirHelp would amount to EUR 1.25 billion. Moreover, these are only two claim companies in the shark pool. In the last years more and more claim farms have appeared on the market. Those companies are well aware of the fact that right now we are only looking at the tip of the iceberg, i.e. there is a huge potential of so far unclaimed compensation probably in the billions of Euro on an annual basis. A study initiated by the European Commission indicates that 5 to 10 per cent of passengers entitled to compensation in cases of cancellation or long delay do actually claim it. To increase that number the EU Commission started an awareness campaign and is actively promoting air passenger rights with videos, posters, leaflets and an app.

That goes hand in hand with the already well established industry of claim farmers that are aiming at facilitating the claims handling process. They want to make it just as easy to file for compensation as it is to book a ticket online. And it seems they are almost there. At least the growing number of passenger claims processed by claim agencies shows a clear development towards more customer awareness and thus a trend to even more claims.

The claims agency EUclaim states in a press release that in the first six months of 2016 it had received 6,444 claims in Germany against AirBerlin, 4,425 claims against Condor and 3,212 claims against Lufthansa. In the first half year of 2017 there were 8,217 flights cancelled in Germany and 2,224 flights delayed. Compared to the first half year of 2016 the irregularities increased by 10 per cent.

Given the high amount of passengers per flight, e. g. an Airbus A320 with 170 passengers on board, a Boeing 777 with 350 passengers, or even an Airbus A380 or Boeing 747 with 450 passengers on board, a delayed flight can easily cost several hundred thousand Euros. Moreover, reactionary delays can aggravate the situation. The delay caused by late arrival of one aircraft causes subsequent flights to suffer a delay as well. Finally, even small delays can trigger compensation payments albeit the fact that the threshold of three hours established by the Court of Justice of the European Union was not met. If the passenger suffers a minor delay on the feeder flight and subsequently misses the connecting flight due to a minor delay of the feeder flight.

On top of that social media is taking its toll. Passengers on the same flight are exchanging information on the status of their compensation claim and how it is handled by an individual carrier.

On the next level of passenger compensation the individual claims handling will not be processed by human beings but through the use of artificial intelligence (AI) bots. Again, the claim agency AirHelp seems to be on the forefront of this. Almost a year ago they announced the launch of the first AI bot called Herman. For the programming of Herman he has been fed with thousands

PASSENGER COMPENSATION

of court cases and decisions which enable him to suggest the appropriate option for legal actions within seconds.

The claim agencies use a high degree of digitalization and automation in order to keep their business profitable. Airlines still pay enormous amounts for the claims handling process itself using clunky CRM systems and are still not able to compete with claim agencies with regard to reaction and pay out times. Although the customer will receive only around 70 per cent of the compensation amount, he still chooses to engage a claim agency.

4. COSTS AND COST REDUCTION

'At the end of the day EU 261 has added costs to airline operations.'

Chaitan Jain, IATA Assistant Director, Government and Industry Affairs.

Do passenger claims provoke negligible costs for an airline or is it worth taking a closer look at those costs and the cost saving potential? In order to answer that question it is vital to know what kind of costs do occur with regard to a passenger claim.

The above-mentioned numbers concerning claim agencies already indicate the high volume and enormous size of this market. However, compensation itself is not the only cost factor that has to be considered when dealing with passenger claims handling. There are numerous types of costs triggered by a passenger claim – direct costs as well as hidden costs, which can easily multiply the original compensation costs.

Direct costs associated with passenger claims are for instance:

- a. Compensation - The costs for compensation for one delayed flight can amount to several hundred thousand Euros. On average the profits of 250 flights are required to cover the costs of paying compensation to the passengers of 1 disrupted flight.
- b. Costs for services not provided - Additionally, the EU Regulation foresees that air carriers have to provide unlimited care to their passengers when an operating carrier reasonably expects a

flight to be delayed beyond its scheduled time of departure by two hours, three hours or four hours for short, mid and long haul flights. The right to care includes meals and refreshments in a reasonable relation to the waiting time, hotel accommodation in cases where a stay of one or more nights becomes necessary, or where a stay additional to that intended by the passenger becomes necessary, as well as transport between the airport and place of accommodation (hotel or other). In addition, passengers shall be offered free of charge two telephone calls, telex or fax messages, or e-mails. In case such services cannot be offered the affected passengers are entitled to claim damages from the airline. Hotel accommodation, taxi cost as well as telephone costs are the most common claims in this regard and can cost easily a couple of hundred Euros.

- c. Costs for alternative flights - Moreover, in case of a flight irregularity the passenger can choose between reimbursement and re-routing to the final destination under comparable transport conditions according to the EU Regulation. In case the air carrier cannot offer an alternative flight, the passenger can request the reimbursement of the ticket price for the alternative flight.
- d. Interest - Generally, passengers, lawyers and claim agencies set relatively short deadlines with regard to the desired payment, e.g. 7, 10 or 14 days. Often these deadlines cannot be met by the air carriers. Either the airline's customer service center is snowed under with work and cannot respond in time or the payment process is too slow. Under German law as well as under most EU legal regimes late payments cause interest – completely avoidable costs that come on top of the compensation payment.



- e. Out of court legal fees for the passenger's counsel - Similarly, if an airline cannot respond to the passenger's claim in time, the customer can involve a lawyer in order to get his/her demand accepted. In such case, the air carrier has to pay for the passenger's lawyer. In Germany, fees for representation by a lawyer are calculated on the basis of the value of the claim. For an out-of-court advisement, the passenger's counsel can charge e.g. EUR 147.56 for a EUR 600 compensation claim of one passenger and EUR 201.71 for a EUR 1,200 compensation claim of two passengers. Thus the lawyer's fees increase the compensation amount by approximately 20 - 25 per cent. These are often costs that arise



due to the airline's default and would thus often be avoidable.

- f. Court costs - Usually, the court receives a court fee, calculated according to the value of the claim. Germany implemented a 'losers-pay-principle', i.e. if an air carrier loses a case, it will have to reimburse the passenger for all costs, in particular court costs and the costs for the passenger's attorney.

If court proceedings are initiated before the German courts, the court costs for a claim with a disputed amount of EUR 600 will amount to EUR 159. Additionally, the passenger can claim legal fees for the representation in court in the amount of EUR 261.80. Furthermore, the opposing

counsel may claim travel expenses etc. Depending on the specific case, translation costs, costs for witnesses and for expert opinions can arise.

The claim agency AirHelp alone has lodged about 30,000 legal actions in the last 4 years in Europe. Many German customers have legal protection insurance, i.e. the insurance covers policyholders against the potential costs of a legal action brought by the policyholder. This system significantly lowers the threshold for passengers to quickly lodge a claim before the German courts as there is no financial risk.

- g. Legal fees and expenses for hiring external counsel - Often the air carrier has to engage external counsel for its representation in court.
- h. Costs for enforcement - In case a decision, e.g. a default judgment, was handed down by the court and the defendant does not pay the awarded amount to the plaintiff on time, the plaintiff may instruct a bailiff to enforce the decision. The costs incurred through this procedure will have to be borne by the defendant. Depending on the instructions given by the plaintiff to the bailiff, the costs for the enforcement will generally be in the vicinity of EUR 25 to EUR 100.
- i. Costs for other damages - Moreover, there are numerous other claims from passengers concerning other irregularities, e.g. related to baggage, injuries etc., that may be claimed in addition to compensation under the EU Regulation.

As if this was not enough, one has to take into account that also hidden costs will occur for maintaining the appropriate infrastructure, e.g. labor costs for claims handlers and the accounting department, rent for building(s) and office space, implementing costs and maintenance costs for a CRM system, costs for witnesses that spend working

time appearing before the courts, such as pilots being taken off a live roster, and costs for the management for external legal representation across the EU or even worldwide.

5. DIGITAL CUSTOMER EXPERIENCE

Digitalization offers a sporting chance. On 1 June 2008, the airline industry moved to 100 per cent electronic ticketing. Apart from substantial cost savings for the industry of up to USD 3 billion per year, electronic ticketing is also more convenient for passengers who no longer have to worry about losing tickets and can make changes to itineraries more easily. The electronic ticket paved the way for digitalization in the aviation sector.

Nowadays, many passengers book their flights via their smartphones, use electronic boarding passes and – quite naturally – communicate online through various channels with the airline. Airlines have so far primarily focused on customer experience during the booking process, at the airport or inflight. However, customer experience does not end if the passenger leaves the aircraft. Good communication with the passenger is especially important if a flight irregularity occurs as customer experience is not only based on perceptions, but largely on emotions. The customer expects an easy, simple and fast solution.

The most successful innovative business ideas in the airline and travel industry in the last decade are based on digital products, such as the meta search engines Kayak or Google flights, the online travel agencies Expedia or booking.com, vacation rentals like Airbnb as well as review portals such as Tripadvisor. Those products show the clear trend for further automation and digitalization. Today's world is real-time. In order to meet customers' expectations, airlines should strive for real time solutions. Further digitalization is inexorable. Being on the forefront of digital customer experience in the aviation sector provides a competitive edge.

Furthermore, digitalization not only benefits the customer and provides cost saving opportunities, but also improves work experience for airline employees.

6. CONCLUSION

Given the enormous costs associated with passenger claims handling it is all the more astonishing that air carriers still work with a patchwork of clunky software solutions that are slow and not adapted to their needs, and which cannot provide the airline's decision-makers with the necessary reports and statistics they require for informed decisions. Due to poor or complicated reporting tools it is also very difficult to get reliable numbers on the question of the average costs for one passenger claim. Studies that have been published are either not up to date or rely themselves on estimates. Many airlines simply do not know the exact costs for a specific claim or an average passenger claim. They rely on claims reports provided by external counsel that are prepared on a quarterly basis and cannot capture the entire picture.

The above-mentioned list of cost items shows that a fast reply to the customer is essential in order to avoid unnecessary legal fees, interest and court costs. The financial burden implied by the compensation payment itself can easily double or triple through ancillary costs as described above.

The number of passengers is growing and digitalization shortcomings will have an even bigger impact in the future. At the moment few passengers are claiming compensation, however the potential is huge. A study initiated by the European Commission indicates that 5 to 10 per cent of passengers entitled to compensation in cases of cancellation or long delay do actually claim it. There are therefore still billions of dollars of unclaimed compensation every year.

The claims agency EUclaim states in a press release that in the first six months of 2016 it had received 6,444 claims in Germany against Airberlin, 4,425 claims against Condor and 3,212 claims against Lufthansa. In the first half year of 2017 there were 8,217 flights cancelled in Germany and 2,224 flights delayed. Compared to the first half year of 2016 the irregularities increased by 10 per cent.

The potential for cost savings is huge and it seems that not many airlines are making adequate use of it. Airlines should catch up on digital and



automated solutions in order to ensure fast and efficient claims handling.

Many default cases could be avoided preventing out of court legal fees, interests and court costs. Moreover, digitalization will offer better cost spending control, allow for an easy implementation of tactical considerations, enable the centralization or the outsourcing of the claims handling process, offer a better control over legal spending, promote customer loyalty, and will allow airlines to master peaks and avoid delays in claims handling causing unnecessary costs and customer dissatisfaction.

In order to be cost-effective an airline must be in the position to handle and pay out claims that are beyond dispute in a simple and fast way using the highest possible degree of automation. This mini-mizes not only internal administrative cost, but avoids unnecessary default cases and thus reduces legal costs and interest payments. Finally, paying out undisputed compensation will bind the customer closer to the airline and will promote customer loyalty. A high degree of automation will also allow the airline to balance out peaks more easily, especially if a high number of customers are being affected by a flight irregularity at the same time, e.g. volcanic ash crises, IT system outage, airport closure, etc. Similarly, the airline must be able to refuse claims that are clearly unfounded in an effective manner using a high degree of automation, e.g. the EU Regulation is not applicable, the airline is not the operating carrier, etc.

Claims, on the other hand, that can arguably be disputed, need to be handled with care. If such claims are paid out albeit the air carrier could defend them, the number of claims will likely increase significantly for that carrier. Depending on the case, the evidence base and the cost-benefit ratio, an airline may opt for a settlement offer or refuse to pay completely.

In the light of fast spreading and increasingly stringent passenger rights regulations worldwide and passengers becoming more and more aware of their rights, it is crucial for air carriers to take up the challenge. According to IATA's forecast, passenger travel will nearly double within the next twenty years. With increasing limitations in capacity of airports and in air traffic control delays, cancellations will remain inevitable in the future and thus costs for passenger claims are likely to increase much further. Significantly lower costs for passenger claims can bring a competitive advantage to an airline, while simultaneously, an enhanced digital customer experience will promote customer loyalty.

An end-to-end digital customer experience will be key in the future in order to create speed and agility. The airline industry is at an important crossroad, specifically in the field of customer service and claims handling. Airlines have to decide if they will continue losing passengers to Flightright & Co or if they will provide a comparably simple and fast solution to their passengers.

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A status check on India's new Aviation Policy

by Ramesh Vaidyanathan (Partner) & Mansi Singh (Associate)
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India's booming economy and growing middle class have helped to make it the world's fastest-growing air travel market. India is the ninth-largest civil aviation market in the world and has a market size of US\$16 billion. The industry is poised to become the third-largest civil aviation market by 2020 and the largest by 2030. More than 86 international airlines operate in India, and five Indian carriers offer service to over 40 countries. The passengers carried by scheduled domestic airlines have increased by 29% from 148 million in April 2012 - March 2014 to 190 million in April 2014 - March 2016.

Because the development of the Indian aviation sector can have a multiplier effect on the nation's economy in terms of investments, tourism, and employment, the Government of India (GoI) has developed an aggressive plan to promote the sector. As the first significant step in implementing this plan, the GoI on June 15, 2016 unveiled

the much-awaited Civil Aviation Policy (policy). This is the first time since India's independence that the GoI's Ministry of Civil Aviation (MoCA) has propounded an integrated civil aviation policy. The policy reflects an intent to migrate to a more liberal administrative and regulatory regime for the aviation sector in India. It also seeks to relax rules for airlines to fly overseas and substantially increase regional air connectivity.

The policy's fundamental objectives are affordability and connectivity of air services and facilitation of doing business in India. With the policy, the GoI plans to create an ecosystem that will facilitate an increase in air travel. It hopes to stimulate 300 million air ticket sales per year in the domestic sector by 2022 and 500 million by 2027, while for international travel, the target is 200 million annual ticket sales by 2027.

This article first describes the recent history of Indian civil aviation and the current state of the aviation sector and its regulatory framework. The article also

briefly deals with the recently amended Civil Aviation Requirements for handling of unruly passengers (Unruly Passengers CAR) and the draft CAR on the 'Requirements for Operation of Civil Remotely Piloted Aircraft System' (draft UAV CAR). The article concludes that the recent initiatives provide a roadmap for substantial growth and modernization of the aviation sector.

RECENT EXPERIENCE OF INDIAN AVIATION

India's aviation sector has not always been so vibrant. For many years, air travel was the purview of the rich as high fares deterred many from traveling by air. Over the last two decades, however, the air travel market has expanded due to rapid economic growth, an expanding middle class, higher disposable incomes, the emergence of low-cost carriers, modern airports, increased Foreign Direct Investment (FDI), sophisticated information technology, and a growing emphasis on regional connectivity. A



huge tide of first-time air passengers has emerged, attracted by the services of popular domestic low-cost carriers.

LARGEST INDIAN AIRLINES

The Indian air transport market has become highly competitive over recent years. While many airlines have suffered from escalating operating costs, flawed strategies, and inelastic pricing, consistent levels of traffic growth have kept them solvent. India's largest domestic airlines are listed in table 1.

INDIAN AIRPORTS

India has about 449 airports and airstrips, of which around 125 airports are owned and managed by GoI-owned and controlled Airports Authority of India (AAI). Until recently, AAI was the only major player involved in developing and operating airports in India. Like most GoI-controlled enterprises, AAI suffered from a lack of resources and talent, governmental/bureaucratic interference, and a paucity

TABLE 1

Airline	Market Share (September 2017)	Remarks
Indigo	38.2%	A publicly listed company whose principal shareholder is InterGlobe Enterprises.
Jet Airways	15.4%	A publicly listed company substantially owned by Naresh Goyal and Etihad Airways recently acquired a 24% ownership interest.
Air India	13.5%	Owned by the GoI.
SpiceJet	13.8%	Substantially owned by Ajay Singh.
GoAir	8.4%	A wholly owned subsidiary of the Wadia Group, which has interests in textiles, real estate, and other industries.
Vistara	3.8%	A joint venture of the Tata Group (51%) and Singapore Airlines (49%).
AirAsia India	4.1%	A joint venture of the Tata group (51%) and AirAsia Berhad (49%).

TABLE 2

Airport location	Number of passengers (in Millions FY 2016-17)	Joint Venture Partners
Delhi	57.7	The Bengaluru-based GMR Group holds 64%, with AAI holding 26% and Fraport holding 10%.
Mumbai	45.2	A Hyderabad-based, GVK-led consortium holds 74% stake (after acquiring the interest of Airports Company of South Africa), with AAI holding 26%.
Bengaluru	22.18	GVK Group holds 43%, Siemens Project Ventures holds 26%, KSIIDC holds 13%, AAI holds 13% and Flughafen Zurich AG holds 5%.
Hyderabad	15.2	The GMR Group holds 63%, the GoI holds 13%, the Government of Telangana holds 13% and Malaysia Airports Holdings Berhad holds 11%.

TABLE 3

Sr. No.	Airport Location
1.	Dholera, Gujarat
2.	Bhugapuram, Vizianagaram, Andhra Pradesh
3.	Dagadarthi, Nellore, Andhra Pradesh
4.	Oravakal, Kurnool, Andhra Pradesh
5.	Bhiwadi, Rajasthan
6.	Kothagudem, Telangana

of professional management. The GoI, recognizing the need for reform, decided to invite private investment into India's civil aviation infrastructure.

The private sector, including foreign investors, was attracted to participate in the operation, management, and development of Indian airports through various public-private partnership (PPP) models, with substantial state support in terms of financing, concessionary land allotments, tax, and other incentives.

This has helped to produce world-class airports at Mumbai, Delhi, Kochi, Hyderabad, and Bengaluru, which together account for over 60 percent of the nation's air traffic. The largest PPP airports in India are listed in table 2.

Presently, one hundred and sixty airports in India are being revived and operationalized in an attempt to boost regional and remote air connectivity. The following new greenfield airports have been approved:

INDIA'S CIVIL AVIATION REGULATORY FRAMEWORK

Aviation is a subject included in the Union List of the Constitution of India. Accordingly, the national parliament has exclusive power to legislate with respect to aviation. The current legal and regulatory framework for the aviation sector is as follows:

- The Ministry of Civil Aviation (MoCA) is responsible for the formulation of national policies and programs for the development and regulation of civil aviation, and for devising and implementing schemes for the orderly growth and expansion of civil air transport.
- The Airports Authority of India (AAI) functions under the control and supervision of MoCA and is responsible for building and managing civil aviation infrastructure in India. Air navigation services are under AAI's exclusive control.
- The Airports Economic Regulatory Authority of India (AERA) is a statutory body entrusted with setting tariffs for aeronautical services and establishing the amount of development and passenger service fees, as well as establishing and monitoring performance standards relating to quality, continuity, and reliability of aviation services.
- The Directorate General of Civil Aviation (DGCA) is the regulatory body primarily responsible for the regulation of domestic and international air transport services and enforcement of civil aviation regulations, air safety, and airworthiness standards. It also coordinates all regulatory functions with the International Civil Aviation Organization (ICAO).

LIBERALIZING FDI IN CIVIL AVIATION

FDI inflows in India witnessed an exponential growth of 605% from USD 61.84 million during April 2012 to March 2014 to USD 435.81 million during April 2014 to March 2016. In a significant reform initiative, the GoI now allows 100 percent FDI in scheduled air transport service/domestic scheduled passenger airline and regional air transport service. However, only

TABLE 4

Sector/Activity	FDI Permitted	Governmental Review Requirements
Airports		
Greenfield Airport Projects	100%	None
Brownfield Airport Projects	100%	None
Air Transport Services		
Scheduled Air Transport Service/ Domestic Scheduled Passenger Airline and Regional Air Transport Service	100%	Prior GoI approval required if investment exceeds 49% None for Non-Resident Indians
Nonscheduled Air Transport Service	100%	None
Helicopter/Seaplane services Requiring DGCA Approval	100%	None
Other Services under Civil Aviation Sector		
Ground Handling Services subject to sectoral regulations and security clearance	100%	None
Maintenance, Repair, and Overhaul Organizations (MROs); Flight Training Institutes; Technical Training Institutions	100%	None

nonairline foreign investors are allowed to acquire a 100 percent ownership interest in an Indian carrier. Under this regime, foreign investors may acquire up to a 49 percent interest but FDI exceeding that threshold will require prior government approval. Investments by foreign airlines in Indian airlines are limited to a minority (49 percent) interest. The new FDI regime for the aviation sector is summarized in table 4.

Relaxation of FDI restrictions will provide a much-needed boost to the Indian aviation sector at a time when some airlines were struggling to remain solvent and many were reporting losses. By allowing up to 100 percent FDI subject to certain limitations, the GoI will enable Indian airlines to access new sources of capital, which will stimulate investments in expansion and consolidation. As a policy matter, however, it is unclear why airports, cargo, MROs, and general aviation have been opened up to 100 percent FDI, yet airlines remain subject to a 49 percent limit on FDI.

AMENDED CIVIL AVIATION REQUIREMENTS FOR HANDLING OF UNRULY PASSENGERS

An incident that caused a huge uproar in recent times in India is when a member of parliament assaulted an Air India staffer. In an unprecedented move, most of the airlines banned the unruly legislator from flying on their aircraft. This brought the issue of legality of no-

fly lists in India to the forefront. It was realised that the present regulations were silent on the legality of no-fly lists. Accordingly, the CAR on 'Handling of unruly/disruptive passengers' was amended by the DGCA to establish a national no-fly list.

The Unruly Passengers CAR aims at creating a central database of unruly passengers. If an airline decides to ban a passenger for unruly behaviour, it will inform the DGCA and other airlines and the passenger will become a part of the national no-fly list.

The Unruly Passengers CAR appears to be a step in the right direction towards better safety of passengers, crew and the aircraft.

Draft CAR to prescribe the Requirements for Operation of Civil Remotely Piloted Aircraft System (RPAS)

DGCA had, in October 2014, released a public notice banning the use of UAV in the Indian civil airspace by any person, corporate or organization other than those related to the Government of India. While most countries had enacted laws regulating the usage of drones, India continued to deliberate on the regulations for licensing and operation of UAVs.

Finally, on November 1, 2017, DGCA released draft UAV CAR for India. Draft UAV CAR classifies RPA for civil purposes into five categories: (i) Nano (less than or equal to 250 grams); (ii) Micro (greater than 250 grams and less



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than or equal to 2 kg.); (iii) Mini (greater than 2 kg and less than or equal to 25 kg.); (iv) Small (greater than 25 kg and less than or equal to 150 kg); and (v) Large (greater than 150 kg).

Draft UAV CAR lays down the eligibility for obtaining a Unique Identification Number (UIN) from the DGCA for the RPAS. This will be a one-time process, and the UIN will be provided only for an RPAS that is either wholly owned by an Indian citizen or a company, or to an RPAS that will be leased to an Indian citizen or company. Draft UAV CAR also lays down that RPAs under all the weight categories must maintain a 500 m visual line-of-sight and must operate during daylight. Further, the use of RPAs would be banned within a certain distance from airports, the country's borders and some other excluded areas.

DGCA is expected to release the final CAR in early 2018. Legal recognition of UAVs in India is expected to encourage domestic and foreign investors to fund UAV related startups in the country. Until now, investors were reluctant to pump money into such startups due to the lack of regulatory clarity.

THE CIVIL AVIATION POLICY

The policy sets forth plans for an ambitious over-haul of the aviation sector with an eye on the future. The cornerstones of the policy are competition, consumers, connectivity (within India and internationally), and investment—from both domestic and foreign investors. The GoI is convinced that this will be the key to realizing its target of becoming the third-largest aviation market by 2020 and the largest by 2030. Following are the key elements of the policy.

LIBERALIZED “OPEN SKIES” AND CODESHARE AGREEMENTS

The policy allows Indian carriers to enter into codeshare agreements with foreign carriers to any point in India and abroad consistent with the applicable bilateral air service agreement (ASA), with no prior MoCA approval required. Indian designated carriers will only have to inform MoCA 30 days prior to starting the codeshare flights. The liberalization of codeshare agreements and bilateral

rights will lead to greater ease of doing business, increased competition, and wider choice for passengers. The policy allows India to have an “open skies” policy with all countries beyond a 5,000 km radius from Delhi based on principles of reciprocity. This will enable airlines of such countries to have unlimited access in terms of number of flights and seats to Indian airports. This is expected to increase flight frequencies with these countries. Unlimited flights above the existing ASA limitations will be allowed directly to and from major international airports within the country as notified by MoCA from time to time. In September 2016, India signed an open skies agreement with Greece, making Greece the first country to have an open sky agreement with India under the new policy. In the International Civil Aviation Negotiations 2016 held in Nassau, India signed open skies agreements with Jamaica, Guyana, Czech Republic, Finland, Spain and Sri Lanka. India has also recently signed an open skies agreement with Japan. All these agreements will encourage connectivity and passenger travel between India and these countries.

MAINTENANCE, REPAIR, AND OVERHAUL (MRO)

The policy recognizes the critical role of the MRO sector in the development of the aviation industry. Today, most Indian airlines send their aircraft overseas for maintenance and repair. As the MRO business of Indian carriers is valued at around \$1 billion, 90 percent of which is currently spent outside India, the GoI is keen to develop India as an MRO hub in Asia as part of the “Make in India” initiative, which in turn will attract business from foreign airlines. MoCA will persuade state governments to make value added tax (VAT) zero-rated on MRO activities. Airport royalty and other charges will not be levied on MRO service providers for a period of five years from the date of approval of the policy. Foreign aircraft brought to India for MRO work will be allowed to stay for the entire period of maintenance or up to six months (whichever is less), provided the aircraft does not operate any commercial flights during that period. The aircraft, however, may carry

passengers on flights at the beginning and end of a stay period in India. The DGCA's permission is required for a stay exceeding six months. The policy also promises steps to ensure that foreign MRO experts are provided visas promptly, and in cases of an aircraft-on-ground situation, temporary landing permits will be issued, subject to certain conditions. Foreign pilots operating an aircraft to and from India for the purpose of servicing at an Indian MRO entity will be issued temporary landing permits, subject to certain conditions.

Airport Infrastructure Augmentation

Airport infrastructure is an area that needs immediate attention because the existing infrastructure is inadequate to meet the sector's anticipated rate of growth. India plans to increase the number of operational airports to 250 by 2020. The policy aims at the development and modernization of airports and upgrading of quality of services. The policy encourages the development of airports by state governments and the private sector (including via PPPs), with greater regulatory certainty. Future greenfield and brownfield airports will have cost-efficient functionality, with no compromise on safety and security. To ensure uniformity and a level playing field across various operators, future tariffs at all airports in India will be calculated on a “hybrid till” basis, unless otherwise specified for any project being bid out. A total of 30 percent of nonaeronautical revenue will be used to cross-subsidize aeronautical charges. If the tariff in a particular year or contractual period proves to be excessive, the airport operator and regulator will explore ways to keep the tariff reasonable, and spread the excess amount over future years.

CARGO

India has tremendous potential for air cargo growth on domestic as well as international routes. Currently, the primary beneficiaries of the Indian cargo market are Indian Railways, road transporters, and foreign airlines. Development of regional cargo hubs is one of the GoI's top priorities. Revenue from air cargo helps airlines to subsidize the cost of passenger tickets, thereby facilitating the development of a mass market for air transportation. The policy

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aims to increase air cargo volumes to 10 million tons by 2027. The policy further recognizes express delivery services as a separate segment within air cargo owing to their distinctive nature and process. The express industry is turning out to be a pivotal segment for enhancing exports, especially in the small and medium-sized enterprises segment, in view of the expansion of e-commerce and other new age industries. The policy aims at encouraging airport operators to provide space for at least 10 years via lease to operators of express cargo freighters, which may then develop dedicated infrastructure to improve their operational efficiency. The policy also aims to establish free trade and warehousing zones to facilitate transshipment cargo. With the GoI's emphasis on "Make in India," "ease of doing business," and enhancement of exports, it is extremely important to enhance infrastructure to stimulate growth of the air cargo sector.

5/20 RULE REPLACED

International operations are lucrative for airlines because they generate higher yields, enable better utilization of aircraft, and permit airlines to purchase cheaper jet fuel overseas. Under the 5/20 rule, only Indian airlines that had at least five years of operational experience and a minimum fleet of 20 aircraft were allowed to fly internationally. Over time, however, the increasingly prevalent view was that this restriction, which is unique to India, needed to be replaced by a scheme that would provide a level playing field and allow airlines, both new and old, to introduce international operations provided they continued to meet some obligation regarding domestic operations. The aviation ministry faced aggressive opposition to elimination of the 5/20 rule by older airlines such as Jet Airways, IndiGo, SpiceJet, and GoAir, while new entrants such as Vistara and AirAsia advocated for the rule's abolition. The policy discarded the controversial 5/20 rule, and now any domestic airline may fly overseas provided it deploys 20 planes or 20 percent of its total capacity for domestic operations. The GoI does not want airlines to focus on international operations to the detriment of domestic

service; rather it wants airlines that are allowed to fly internationally to ensure that their domestic flights account for at least 20 percent of their total seats.

GROUND HANDLING POLICY

Domestic airlines are now permitted to self-handle at all airports to ensure competition as well as cost savings. In addition, airport operators must ensure that there will be at least three ground handling companies, including Air India's subsidiary/joint venture partner, in competition with each other at all major airports. At nonmajor airports, the airport operator will determine the number of ground handling companies, based on traffic output and airside/terminal building capacity. All domestic scheduled airline operators, including helicopter operators, will be free to self-handle at all airports.

HELICOPTERS

Helicopters play a key role in ensuring remote area connectivity, intra-city movement, tourism, law enforcement, disaster relief, search and rescue, and emergency medical evacuation. India currently has fewer than 300 civilian helicopters, which is abysmally low compared to other developing nations. The policy aims at encouraging helicopter usage by facilitating the development of at least four heli-hubs initially across the country to promote regional connectivity. Airport charges for helicopter operations will be reduced, and a separate helicopter department will be created within the DGCA.

REGIONAL CONNECTIVITY SCHEME

India's Regional Connectivity Scheme (RCS) was introduced as part of the policy in June 2016 and was formally launched in October 2016. As part of RCS, the GoI aims to connect unserved and underserved destinations for which fares will be capped at INR 2,500 (approximately US\$35) for a one-hour flight. 31 currently served airports, 12 underserved airports, and 27 unserved airports will connect 128 RCS routes. Various airlines including Air India, Air Deccan, SpiceJet, Air Odisha and Turbo Megha have been awarded the right to fly to these 128 routes across

India, requiring them to offer half the seats at nearly 50 percent discount. Airlines will be allowed to self-handle for operations under RCS at all airports. RCS will take "flying to the masses" by connecting India's remote, unserved, or underserved regions, thereby increasing tourism and generating employment. RCS will require a huge number of small aircraft to cater to regional service, thereby creating a new opportunity to invest in the flourishing Indian aviation sector.

CONCLUSION

While India's Civil Aviation Policy has its flaws, its overall roadmap for reform and liberalization is clear and ambitious. The policy aims to foster a more conducive investment climate, which should improve the Indian aviation sector's access to capital, thereby stimulating growth. In conjunction with the liberalized FDI rules, the policy is expected to pave the way for the launch of new airlines and increase the number of flights, lower prices, and elevate demand for skilled workers, while also fostering aviation leasing and financing activities. The real challenge will be the management of the exponential growth of Indian air traffic without compromising on safety.

As regards UAVs, once the final CAR for the operation of UAVs is released by the DGCA, it will pave way for the usage of UAVs for myriad functions like news gathering, commercial surveillance, power line inspection, commercial filming, advertising, law enforcement, disaster relief, agriculture, search and rescue, and mineral, gas and oil exploration. In the future, UAVs may also be deployed for carriage of donated organs, border patrolling, and delivery of parcels from e-commerce websites.

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Airline Economics

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Colombia's Tax Structure

A short review of the main taxes in Colombia that may be applicable for aviation-related transactions.



To understand the Colombian tax structure, it is important to keep in mind that this country is organized as a unitary, but decentralized republic. This implies

that there is a national Congress, but municipalities or cities and departments (similar to “provinces”) have this prerogative too, not to create taxes, but to set some policies regarding them.

Thus, it is possible to have taxes of the national order, such as Value Added Tax (hereinafter “VAT”), or income tax, or municipal or district tax, as is the Industry and Commerce Tax (hereinafter “ICA”).

#####			
Tax	National/Local	Rate	Withholding
Corporate income tax	National	Since 2017, annual corporate income tax is set at 34%.	<p>It is not a tax, but it is the advance payment of the tax made by taxpayers.</p> <p>Withholding rates to be applied to payments to residents vary between 1% and 11%.</p> <p>Withholding rates to be applied to payments to nonresidents vary between 1% and 34%.</p>
Value Added Tax (VAT) on services, goods and imports	National	The VAT is the indirect national tax par excellence, which, in principle, imposes the added value in each of the different stages of the production chain, providing the possibility, in certain cases, to proceed to deduct part of the tax paid. The general rate is 19% since January 1st, 2017.	<p>It is not a tax, but it is the advance payment of the tax made by taxpayers.</p> <p>Withholding agents are as follows:</p> <ul style="list-style-type: none"> • Big tax payers • Those companies or individuals responsible for the ordinary tax regime when they acquire goods or services from companies or individuals responsible for the simplified regime • Others
Transfer prices	National	<p>Transactions between companies under the same owner or controller must be made at open market prices, for which a study will be made to support this purpose.</p> <p>This obligation is fulfilled providing the respective study and submitting the declarations to the tax administration.</p>	
Financial Transactions Tax	National	0.4% (or 4x1000) applicable on amounts transferred through the Colombian financial system.	The central bank and other entities subject to surveillance of the Finance Superintendence.
Industry and Commerce Tax	Local	<p>Rates may vary from 0.2% to 1% applicable to gross income.</p> <p>Municipalities have the authority to establish different rates according to the limits established by Law.</p>	<p>As a general rule, the payer must apply the withholding tax.</p> <p>However, municipalities have the authority to determine the entity in charge of applying the withholding tax.</p>
Tax on real estate	Local	Rates may vary between 0.1% and 2% on officially appraised or self-appraised (the latter acceptable in certain municipalities) value of land and buildings.	
Registration Tax	Local	Rates may vary between 0.3% and 3.0% on the value of the document to be registered before the Chamber of Commerce or the Registration Office of Public Deeds.	Registration Offices of Public Deeds and Chambers of Commerce are in charge of collecting this tax.
Financial Transactions Tax	National	0.4% applicable on amounts transferred through the Colombian financial system.	The central bank and other entities subject to surveillance of the Finance Superintendence.



Switzerland's aviation industry

Contributed by Philippe Wenker, LL.M., Michael Eitle, LL.M.
and Shawn Richard Gregory, Blum&Grob Attorneys at Law, Zurich, Switzerland

As a highly export-oriented country and famous tourist destination, host of the United Nations and headquarter to many multinational organisations and NGOs, Switzerland attaches a great importance to its connections around the world. Aviation is thus an important sector for Switzerland's economy, integrating airlines, business jet operators, airports, maintenance and completion centres but also highly professional and experienced financial institutions rendering worldwide services from their Swiss base. In summary, due to its geographical position in the heart of Europe, its strong and healthy economy, its sophisticated financial markets and high-quality standards, and its reliable and efficient legal system, Switzerland

has been and still is, one of the leading jurisdictions for aviation worldwide.

INFRASTRUCTURE

International air carriers operating to or from Switzerland do not face any limitations as air-port concession holders are obliged to grant access to all aircraft flying on international routes. The five international airports of Switzerland are located nearby the cities of Zurich, Geneva, Basel, Berne and Lugano whereby the latter two airports have a reduced role compared to the other three.

The airport of Zurich, Switzerland's financial hub, is the largest international airport with the highest passenger volume. In 2016, the airport of Zurich was host to 27.7 million passengers – which represents a year-on-year

increase in growth to 5.3% compared to a growth of 3.2% in the year 2015. Especially during the annual World Economic Forum held in Davos, the airport of Zurich is host to numerous personalities from the worlds of business and politics and an increased number of up to 1,000 movements during that certain week due to business jets and helicopters. To the enjoyment of travellers and plane spotters alike, there are three daily movements of an Airbus A380 at Zurich airport, which is the biggest civil passenger aircraft of its time produced in series manufacturing. Zurich Airport has been awarded the "Skytrax World Airport Award for passengers of 20-30 million 2017", the "Air Cargo Excellence Award 2016" and, most importantly, the renowned "World Travel Award 2017 as Europe's Leading



Airport”, which it now holds for the fourteenth consecutive time. With this in mind, it is not surprising that Zurich Airport has this fall introduced a state-of-the-art auto-matic passport control in order to increase its capacity but also the traveller’s experience.

Basel-Mulhouse Airport, Switzerland’s third largest airport which is divided into a Swiss and a French sector, AMAC Aerospace, has experienced steady growth over the past years and the local Air Service Basel as well as Jet Aviation are competing to provide international VIP customers with high quality handling, maintenance and completion services for corporate aircraft. Last but not least, Switzerland’s second largest airport, Geneva International Air-port, also known as home of EBAA’s annual

European Business Aviation Convention & Exhibition (EBACE), regularly ranks within the top five of the most popular business aviation departure airports in Europe.

CARRIERS

In 1998 the internal Swiss market has been deregulated by the fall of the monopoly of Swissair and the Swiss Confederation ceased its support of the national airline. The crisis of the Swiss aviation sector ended with the fall of the Swissair group and the grounding of the airline in early 2002. The Swiss government provided financial aid and got involved in the creation of a new international airline – SWISS. After years of struggling, Switzerland’s “na-tional” carrier, being since 2007 entirely part of the Lufthansa Group, is doing well com-pared to its European competitors and its affiliates and lost its biggest competitor at Zurich Airport with this year’s insolvency of Air Berlin. However, and like its legacy competitors in Europe, SWISS is faced with a strong competition, especially by the Middle East carriers. Carriers from the gulf region benefit from better surrounding conditions, such as the geo-strategic location of their home bases and the financial power of the states, which partly or comprehensively own them. They may also exploit mostly unrestricted operating hours and favourable fuel prices, which results in very competitive ticket prices. Furthermore, they acquire minority stakes in regional airlines based in Switzerland which shall act as distributors in Europe for such Mid East carriers. Etihad and the other investors of Lugano-based Darwin Airlines (formerly operating as Etihad Regional) sold their stake in the latter to the Pri-vate Equity Fund 4K invest, which is controlling Adria Airways. As a result, Darwin Airlines is now a subsidiary of Ljubljana-based Adria Airways operating under Adria Airways Switzer-land.

SWISS is operating a fleet of currently 84 aircraft; 29 for long haul and 55 for medium- and short haul routes. The thirty orders of the all new Bombardier C-Series (CS100s and CS300s) have replaced SWISS’ Avro RJ100 Aircraft. So far eight CS100 and two CS300

have been delivered. Also, the Airbus A340 fleet has started to be replaced by the nine ordered Boeing 777-300ER, eight of which are already in operation. With regard to the Bombardier aircraft, SWISS predicts savings of at least 25% per seat, also due to a reduc-tion in fuel consumption of 20%. Another national carrier is Helvetic Airways, which currently operates seven Embraer 190s and five Fokker 100s (partly operated under a wet-lease arrangement for SWISS). Edelweiss Air (since 2008 a subsidiary of SWISS) is operating a fleet of currently ten aircraft, consisting of one Airbus A340 and two Airbus A330s for long-haul routes and six Airbus A320s for short and medium haul routes. It remains to be a suc-cess story as it plans to extend its fleet up to twelve aircraft in 2018.

MANUFACTURERS

Swiss aircraft manufacturer, Pilatus, is known best for its single turboprop engine-powered aircraft such as the PC-12, of which close to 1500 aircraft have been delivered so far. In 2013, Pilatus’ first twin-engine business jet PC-24 was revealed to the public, which has been developed entirely in Switzerland. According to the manufacturer, the aircraft is capa-ble of operation from unpaved runways as well as runways as short as 2,690 feet (820m). These unique capabilities for a business jet give it access to almost 10,000 additional air-ports worldwide, which other business jets cannot use. During the 2014 European Business Aviation Convention & Exhibition (EBACE), Pilatus sold 84 PC-24s, which covers its planned production volume. Since then, Pilatus has not accepted any further orders and is currently sold out until the end of 2019. One aircraft has been ordered by the Swiss Air Force with the intention to use the jet as executive transport for the Swiss Federal Council. The PC-24 is expected to be certified by the EASA and the FAA in December 2017 and the first deliv-eries shall occur before the end of the year 2017.

In 2016, the Swiss helicopter manufacturer Marenco tested its prototype of the first helicop-ter built in Switzerland. Launch customers include Brazil’s Helisul Táxi Aéreo, clients in

South Africa and Swiss Air Zermatt, with which it collaborates closely in developing its SKYe SH09, so that it will meet the expectations not only regarding in and out of cabin transport flights but also regarding rescue missions. The helicopter is expected to gain EASA certification in 2018.

BUSINESS AVIATION

Business aviation is seen by many people outside the industry as a luxury. However, the advantages for business purposes are evident when it comes to scheduling a flight on short notice, the flexibility when trying to reach a remote airport and the discretion it offers to its client, allowing for confidential conversations aboard. Over the last couple of years, the demand in Switzerland for the charter of and ownership in business aircraft could not match the boom of the former years. Still, Swiss business aviation is of global importance and a significant pillar of its economy. In order to meet the needs of business aviation, the Swiss Federal Council intends to transform the former military airport of Dübendorf in the suburb of Zurich into an additional civil airport and is looking for similar opportunities around Geneva. There are currently around 3344 aircraft of all kind registered in the Swiss aircraft registry, many of them corporate and private jets. Switzerland is home base of around 50 high quality business and private jet operators, such as Jet Aviation, Comlux Aviation, ExecuJet (a subsidiary of Luxaviation, Luxemburg), Premium Jet, DC Aviation Switzerland AG, Cat Aviation and PrivatAir – just to mention a few. However, contemplating the competitive environment and the density of regulation, a trend towards consolidation is emerging. Surf Air, a private air travel club with its roots in California started its operation of weekly flights between Zurich and London (Luton) offering an all-you-can-fly service for a monthly fee.

FINANCING

The financing situation in Switzerland and across the world has changed in the past decade. The deterioration of aircraft values over the last years has had significant impact on financiers worldwide. As a result, it can be

observed that purely asset-based aircraft financing has almost disappeared. Financiers today require additional securities in form of guarantees and other assets, because aircraft values have proven not to be sustainable and reliable collateral. As a further consequence, borrowers or lessees sometimes find themselves unable to pay back their lenders or lessors in case of margin calls due to the deterioration of the aircraft's value, leading to default scenarios and recoveries. However, even in these circumstances Swiss based financiers such as UBS, Credit Suisse, SG Equipment Finance, JPMorgan (Suisse) and others remain strong players and reliable partners, even if faced with new competitors.

LEGAL FRAMEWORK

The Swiss Federal Office of Civil Aviation (FOCA), as regulating authority, is responsible for the safety and general aviation matters in Switzerland. The FOCA provides for a well proven, reliable and efficient civil aviation authority, which was attested by the last ICAO audit report to provide for an appropriate organisation, well-operating procedures, and well-qualified personnel to secure supervision of safety.

With regards to aviation's legal aspect, even though Switzerland is not a member of the European Union, aviation legislation derives from two sources: on the one hand, Swiss national law and on the other hand, the EU legislation according to the bilateral treaty between the European Community and the Swiss Confederation on Air Transport. The latter provides for the formal adoption of the regulation which shall be binding for Switzerland. As a result, Swiss law offers significant advantages, not only from a corporate, contractual or aviation law perspective, but also regarding tax law. The administrative registration of aircraft (certificates of registration etc.) is effected in the Aircraft Register (Luftfahrzeugregister). Furthermore, Swiss law does not only recognise foreign mortgages (as Switzerland is a member state of the Geneva Convention on the Recognition of Rights in Aircraft) but also allows the registration and protection of ownership, mortgages, certain leases

and other encumbrances in the Swiss Aircraft Record (Luftfahrzeugbuch). As a result, a registered right can only be altered or deleted by amending the respective registration in the Aircraft Record. Further, the promoted self-help remedies allowed under common law jurisdictions have repeatedly proven not to be as reliable as advocated. Recent recovery cases revealed that enforcing rights privately in most cases leads rather to more liability than offering fast relief to creditors. In comparison, the well-established and straight forward enforcement regime under the Swiss legal system covers not only the needs of aviation financiers but also addresses debtor's and operator's concerns, which results in a more efficient enforcement than in many other jurisdictions.

With regard to tax, Switzerland, with an import VAT of only 7.7% as of 2018 (formerly 8%), has become a viable option in the centre of Europe. Furthermore, Switzerland has not (yet) joined the European Emissions Trading System (EU ETS), which covers all aviation activities with take-off and landings within the European Union, and may therewith be considered as a white spot for intercontinental flights. However, the Federal Council pursues the signing of an agreement to link the Swiss and the EU emissions trading schemes. If ratified by the competent legislator, such agreement would provide for a more liquid market for Swiss companies. Finally, the Swiss Federal Council has granted a mandate to enter into negotiations with the EU on an extension of air traffic rights to so-called cabotage flights which may pave the way for Swiss commercial aircraft operators to freely serve destinations within any EU country.

BOTTOM LINE

The aviation sector in Switzerland has been experiencing steady growth within the last years and passenger frequencies in the largest Swiss airports are rising. Being located in the centre of Europe and home to several well-known aircraft financiers and a stable political and legal environment, Switzerland provides for various advantages and a level playing field for many participants involved in the aviation industry.



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The extraordinary administration procedure of Alitalia

By decree dated 2 May 2017, the Ministry for the Economic Development admitted Alitalia to the extraordinary administration procedure (pursuant Law 39/2004) and appointed three commissioners to lead the company throughout the procedure (the Ministry Decree).

The extraordinary administration is an insolvency procedure provided for large insolvent companies having more than 500 employees (over the last year) and an overall indebtedness equal to, or higher than, €300 million. The main purpose of this procedure is to preserve the employment levels by way of three alternative plans: (1) the financial restructuring of the company; (2) the sale of the business as a whole; (3) the sale of the assets and contracts part by part.

Following the Ministry Decree, on 11 May 2017, the Court of Civitavecchia (having jurisdiction as the legal seat of the airline is located near FCO Airport) issued the so called “declaration of insolvency” of Alitalia. The main effects of the said declaration are that: (i) creditors cannot start individual judicial actions against the airline, and any actions pending at the time of the declaration are interrupted (i.e. “automatic stay”); (ii) no enforcement

and precautionary measures can be commenced nor continued against the airline’s assets; (iii) the commissioners took charge of the airline’s going concern in order to collect all receivables, credits and properties.

Besides the above, the Italian Government has granted Alitalia a loan facility of €600 million, at a market interest rate and to be repaid within six months. The facility is intended to face the daily financial needs and guarantee the continuation of the flight operations during the implementation of the plan (for the restructuring or sale of the assets, see above) to be carried out by the commissioners.

From a commercial perspective, the consequence of the extraordinary administration on the agreements entered into by Alitalia are the following:

(a) They continue in full force and effect, but the commissioners are entitled to early terminate the same. After the authorisation to implement the plan (see above) the other party will

be entitled to assign the commissioners a term not exceeding 30 days to make a decision as to whether to continue or terminate the agreement. If the commissioners do not respond then the agreement(s) are deemed as terminated.

(b) Credits, if any, accrued towards the airline prior to the date of the Ministry Decree, shall have to be admitted to the overall insolvency liabilities and, at a later stage, will be repaid on a “par condicio creditorum” basis according to the arrangement prepared by the commissioners for the satisfaction of the creditors.

(c) The agreements still in force and effect are binding for the airline, which is so committed to regularly perform its payment obligations accrued after the Ministry Decree (including lease rents and bills for MRO services).

On 17 May 2017, the commissioners published a call for the expressions of interest from any prospective bidders, who at first must comply with specific financial and honourability requirements to be eligible for the



acquisition of Alitalia's business. The commissioners have received more than 30 expressions of interest, either for the entire aviation business or for a portion thereof (e.g. specific aircraft, contracts, slots etc.). Following a detailed evaluation of the various expressions of interest – with a main focus on the economic offer and the proposed preservation of the employment levels – the commissioners have selected 15 entities eligible to take part in the next phase of the procedure. Accordingly, from 26 June to 21 July 2017, the selected entities have been granted access to a data room of the airline, in order to carry out the necessary due diligence and then decide as to whether a potential purchase may be of interest. The data room did not contain sensitive and confidential information that could bring undue advantages to competitors within the aviation sector.

On 21 July 2017, the first part of the due diligence process concluded. Thereafter, on 1 August 2017, the commissioners have issued a call

for the submission of non-binding offers relating to either: (a) the entire business of Alitalia (including aviation, maintenance and handling); or (b) the aviation business (including maintenance activities); or (c) the airport ground handling business. The call has also clarified that in case of a certain degree of equality between the conditions offered by the bidders, the commissioners would prefer those offers relating to the entire business of Alitalia. The deadline to submit non-binding offers expired on 15 September 2017. Afterwards, the commissioners have admitted the selected bidders to the second part of the due diligence and then collected a number of binding offers from them.

From this point in time onward no official information has been disclosed by the commissioners and any update regarding the evaluation of the offers and the status of the negotiations with the bidders is being provided by the national media. It seems that most of the bidders are interested in purchasing

only a portion of Alitalia's assets (the aviation or the handling activities) rather than the entire business. It also appears that seven binding offers have been considered to be reliable by the commissioners, and they come, among others, from the leading German carrier Lufthansa, the US private investment firm Cerberus, and an Italian handling company belonging to the DNATA Group based in Dubai.

Meanwhile, by way of a fiscal decree dated 13 October 2017, the Italian Government has extended the term for the completion of the sale of Alitalia – and for the repayment of the loan of €600 million – from 5 November 2017 to 30 April 2018. The Government has also granted an additional loan of €300 million that should allow the airline to overcome the challenging winter season. This further loan shall be repaid by 30 April 2018 as well, and it is still subject to the investigation by the European Commission in order to assess its compliance with the EU rules on state aid.

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