

**Position Paper Objecting to Liens to Securing Airline
Obligations under Rules Implementing the EU ETS**

AVIATION WORKING GROUP

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A. INTRODUCTION

1. The purpose of this note is to set out the objections of the Aviation Working Group ('AWG') to the rights of detention and sale of aircraft as may be granted to regulators under any proposed regulations to implement the EU ETS Directive in the various member states (for simplicity, 'Fleet Lien'). Such objections are based on (i) the effect of the Fleet Lien on the property rights of innocent parties that lease or finance aircraft equipment to aircraft operators ('property rights holders') and the related adverse impact on aviation financing and leasing (which facilitate the acquisition and use of newer, more environmentally-friendly aircraft), (ii) the disproportionate nature of the Fleet Lien and its inability to achieve the intent of the regulations, (iii) questions relating to compliance of the Fleet Lien with the rule of law (absence of arbitrariness and foreseeability), in general, and the European Convention on Human Rights, in particular, and (iv) the shift from the core responsibility of the aircraft operator, as defined in the ETS.

B. AVIATION WORKING GROUP

2. The AWG was formed 1994 at the request of the International Institute for the Unification of Private Law (UNIDROIT), an intergovernmental organisation whose purpose is the modernising, harmonising and co-ordinating of private and in particular commercial law between States and groups of States. AWG contributes to the development of laws and policies which facilitates the advancement of aviation financing and leasing, and addresses inefficiencies that constrain such transactions. AWG works regularly with governments and international organisations on matters within its scope. AWG has an active subgroup focusing on environmental regulation. That group has submitted two papers in connection with the EU ETS Directive.

3. AWG is co-chaired by Airbus and Boeing, and its members comprise the major aviation manufacturers and a number of leading financial institutions, including most of the world's largest leasing companies. AWG's members and their affiliates manufacture substantially all modern commercial aircraft and engines, and lease and finance a substantial majority of such new equipment. More information on the AWG may be found at www.awg.aero.

4. Asset based financing and leasing arrangements are core to the success of the aviation industry as the high costs associated with acquiring an aircraft can place a significant burden on an operator's balance sheet. These burdens may be ameliorated by financing arrangements which, to a large extent, include the leasing of aircraft, including engines and other equipment from owners to operators. Such financing arrangements are predicated on an established system of laws which govern the priority of property rights based on transparency (thought registration), to which the Fleet Lien, and indeed any regulatory lien, is contrary. It is estimated that leased aircraft currently represent approximately one-third of the world's fleet of modern commercial aircraft and if aircraft subject to other forms of asset-based financing are included, that fraction is significantly higher.

C. BACKGROUND TO LEGISLATION

5. In 2005, pursuant to EU Directive 2003/87/EC (**'EU ETS Directive'**), a system for greenhouse gas emission allowance trading was established within the EU.

6. Its purpose was to promote cost efficient reductions in greenhouse gases by introducing an emissions trading scheme. This trading scheme aims to determine a market price for carbon and places a cap on emissions in relation to each industry sector to which it applies. This scheme applies across a number of industry sectors, including aviation (pursuant to EU Directive 2008/101/EC (**'Aviation Directive'**)), and within the scheme operators are allocated tradable allowances which they may trade with other parties across applicable relevant industries.

7. The Aviation Directive is to be implemented with legislation in each member state. While approaches vary, it is clear that means other than a Fleet Lien or a lien on third party owned aircraft are being employed by several member states (e.g., Germany and France).

D. THE DETENTION AND SALE OF THIRD PARTY OWNED AIRCRAFT

8. AWG accepts and encourages practices and environmental regulation that reduce the environmental impact of aviation and do not create competitive distortions. We further accept that the efficient collection of emissions data is a legitimate aim in the public interest. However, AWG contends that any proposal to allow the appropriate regulator to detain and sell any third-party owned or financed aircraft, of which the relevant aircraft operator is the operator at the time, for unpaid civil penalties is disproportionate to the problems that the regulations are designed to address. Consequently it is inconsistent with the Principles of Good Regulation. It would also represent a breach of the right to peaceful enjoyment of possession guaranteed by Article 1 of Protocol No. 1 to the European Convention on Human Rights (**'Protocol No. 1'**) where such an aircraft is owned by, or mortgaged to, or leased through a party other than the operator.

9. AWG therefore submits that any such far reaching right to detain and sell any aircraft (including any on-board equipment, engines and aircraft documents carried in it):

- (a) would not address the problems identified by the regulations in a proportionate manner and does not strike a fair balance between the general interest and the fundamental rights of the property rights owner; and
- (b) would not meet the requirements of lawfulness under Article 1 of Protocol No. 1.

Fair balance/proportionality

10. AWG contends that the exercise of the Fleet Lien, or indeed any lien or detention right over third party owned aircraft is disproportionate, does not strike a fair balance between the general interest and the fundamental rights of property rights holders and places an individual and excessive burden on the latter. Indeed it should

be noted that Article 16.1 of the EU ETS Directive states that the penalties laid down by the Member States must be effective and proportionate.

11. It has been proposed in various member states that a regulator may exercise the Fleet Lien in circumstances where an operator has failed to provide an emissions plan or information relating to its emissions. Liens however are not an appropriate measure as the detention and sale of aircraft will not remedy the breach by the operator of its reporting and information obligations, nor will it help to regulate the emissions produced by the operator or the specific aircraft following sale.

12. Such a draconian and disproportionate sanction is unnecessary to provide a deterrent against breach of obligations by an operator. The authorities of the member states have a range of regulatory tools to ensure compliance and can create others. See paragraph 21 below.

13. (a) The possibility of the exercise of the Fleet Lien is a very considerable risk for property rights holders, who may find themselves required to meet the obligations of an operator, over which they have no control (because the operator is solely responsible for recording and reporting emissions data) in order to protect their own interests;
- (b) In theory, under current proposals, the Fleet Lien may be exercised for a debt of any amount. Thus an aircraft worth millions of Euros may be detained and sold for a minor debt arising under the regulation;
- (c) There is little that property rights holders can do to protect themselves effectively against default by the operator given the lack of transparency in some current proposals. Most property rights holders are financial institutions, which are merely extending credit, with aircraft as financial security for that credit. It is that very security - which is adequate in most commercial transactions - which the exercise of powers of Fleet Lien overrides;
- (d) Property rights holders cannot protect themselves by insurance as there is no such insurance available;
- (e) Once a lien is exercised, there is little that property rights holders can do as a legal matter effectively to challenge the allegation that the operator is indebted for the sums claimed.
- (f) The appropriate regulator has the sole control (and the property rights holder has no control) over allowing the operator to continue to increase its debt through continued operation after non-payment; the risks arising from the regulator's decision to allow the operator to increase its debt without payment should not be borne by a property rights holder through the Fleet Lien. By contrast with property rights holders, the regulator is much better placed to (i) know the amount of such charges (ii) take steps to minimise exposure to non-payment and (iii) enforce payment by means other than the imposition of liens. At the very least the regulators should confirm that they will share information on outstanding penalties incurred with property rights holders on request, given the consent (provided in advance) of the operator, as certain regulators (for example Eurocontrol) do at present.

14. Any aircraft lien, in the context of asset-based financing, has the potential to interfere with the property rights of property rights holders by virtue of the ability of others to take action against an aircraft in which they have no property interest. This can fundamentally undermine the financial structure under which the air transport industry is financed.

15. In some cases of regulation there may be no obligation on the regulator to notify the owners of the engines or any on board equipment in circumstances where they differ from the owner of the aircraft itself and in many cases the engines and in-flight entertainment equipment will be separately owned and financed. These are not necessarily interests that are recorded publicly so it is difficult to see how a regulator would identify them.

16. The regulations may not be restricted to aircraft that are registered in the relevant regulator's jurisdiction. For example, there is a possible conflict in relation to any rights afforded to a property rights holder or operator under such registry. Such conflicts may arise where an aircraft is registered in one EU state that has decided to enforce ETS reporting requirements through more tailored means, as may be expected, and penalties for breach are incurred in another. More generally, this aspect of the regulations raises the possibility of treaty violations and retaliation by other jurisdictions.

17. If the aircraft against which a lien is exercised is under a wet-lease from another operator the exercise of such a lien could deprive a compliant airline of an aircraft it either owns or leases.

Lawfulness

18. AWG submits that the draft regulations do not meet the requirements of compliance with the rule of law, absence of arbitrariness or foreseeability.

19. Central to the AWG objection to the imposition of a lien is that it imposes a de facto requirement on the property rights holder to pay a debt which it did not incur, the accrual of which it has no control over and which is not necessarily directly related to the aircraft in which that person has an interest. In aircraft financing the aircraft acts as security for the financiers, thus reducing the cost of credit and as a result lessors and financiers are in a position to offer more affordable commercial terms to operators. For this system to work, owners and financiers must have a reasonable degree of commercial certainty regarding the incidence and extent of third party interests in their aircraft as the provision of capital is priced to reflect standard asset-based financing risks. However, these arrangements are not designed to include operational risks, such as liens imposed by regulators. Such liens create a significant financial risk which is not susceptible to an ex ante calculation or risk mitigation through insurance.

20. The Fleet Lien is arbitrary and non-transparent in its application because:

- (a) In many cases there is no requirement for published rules of practice as to the particular circumstances in which, and the aircraft against which, it will be exercised;

- (b) there is therefore no way for property rights holders to establish the likelihood of its exercise, nor is there a requirement to provide such holders with information on compliance status and proposed penalties in respect of which it might be exercised; and
- (c) it contains no effective procedural safeguards: once the Fleet Lien is exercised, there is often little that property rights holders can do to challenge the allegation that the operator is indebted for the sums claimed.

Alternatives/Minimum Standards

21. AWG have argued that the Fleet Lien, or indeed any lien on third party owned aircraft imposed by a regulator, is disproportionate and does not address the issues for which ETS regulations are designed. There are however other sanctions, individually or collectively, that will ensure compliance in a more tailored manner. First, the fee and penalty structure will provide a significant initial incentive. That could be supplemented by injunctive relief to compel the operators to provide emissions information. A further sanction that would act as a deterrent, but fall short of a power of sale and thus would have much less unjust impact on third party property holders, would be the power to discontinue air navigation services. Finally, an operator's operating permits, either in respect of individual aircraft, a section of the operator's fleet, or in extreme circumstances the whole of such fleet, could be withdrawn.

22. The discontinuation of air navigation charges and eventual revocation of operating permits is a solution that the AWG actively supports on the basis that these actions would avoid the harms outlined in this submission (and must not affect any third party rights including the right to terminate leases), but would provide high compliance incentives to operators. Such an approach is consistent with placing the core responsibility for compliance with aircraft operator, as defined in the ETS.

23. In all cases, AWG contends that in order to alert third party property holders and minimise their potential exposure it is essential any enacting legislation makes provision that an operator's emissions planning, emissions compliance information and in particular penalties incurred or in danger of being incurred be freely and promptly available to such property holders, for example published on a website to which they have access.

AWG stands ready to consult further on these matters, in particular with governmental agencies, and requests that questions or comments on this submission be directed to its Secretary at jeffrey.wool@awg.aero

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