

**Consultation on Transposition of EU directive  
(EC/2008/101) to include aviation in the European Union  
Emissions Trading Scheme (ETS)**

**Comments submitted by the Aviation Working Group  
(relating to detention and sale of aircraft)**

**13 May 2009**

## **A. INTRODUCTION**

1. The purpose of this submission is to set out the objections of the Aviation Working Group ('**AWG**') to the rights of detention and sale of aircraft granted to the UK regulators under the proposed regulations to implement the EU ETS Directive in the UK (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](http://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 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. Draft regulations to implement certain sections of the Aviation Directive in the UK have been published and the Department of Energy and Climate Change, together with the Department of Transport and the Devolved Administrations for Northern Ireland, Scotland and Wales have commissioned a consultation paper seeking input/commentary from various interested parties.

8. These regulations confer a right of detention on the appropriate regulator to detain and sell aircraft that are operated by an operator (Fleet Lien) who has failed to pay civil penalties imposed on it for either (i) failing to submit an emissions plan by 31 August 2009; (ii) failing to monitor and report its emissions on an annual basis from 1 January 2010; or (iii) failing to provide a regulator with any information specified in a notice from the regulator requesting such information. AWG contends that this right of sale and detention is unlawful and fails to adequately respect the rights of parties who hold property rights in the form of an ownership or security interest in an aircraft (or any part thereof) but do not act as operators of such aircraft.

9. A second set of draft regulations will be consulted on later in 2009 and these will transpose the terms of the Aviation Directive in full. AWG is concerned that these additional regulations may include further circumstances in which the regulators may seek to impose the Fleet Lien.

#### **D. DRAFT REGULATIONS AND THE DETENTION AND SALE OF THIRD PARTY OWNED AIRCRAFT**

10. 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 the 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 (pursuant to draft Regulation 16) is disproportionate to the problems that the regulations are designed to address. Consequently it is inconsistent with the Principles of Good Regulation. It also represents 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.

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

- (a) does 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) does not meet the requirements of lawfulness under Article 1 of Protocol No. 1.

*Fair balance/proportionality*

12. AWG contends that the exercise of the Fleet Lien 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.

13. As noted in paragraph 8 above it is proposed that the regulator may exercise the Fleet Lien in circumstances where an operator has failed to provide an emissions plan or information relating to its emissions. The Fleet Lien however is 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.

14. Such a draconian and disproportionate sanction is unnecessary to provide a deterrent against breach of obligations by an operator. The UK authorities have a range of regulatory tools to ensure compliance and can create others. See paragraph 26 below. Virtually all other European States use more tailored remedies, such as fines, discontinuation of air navigation services, or loss of operating permits to ensure compliance of similar obligations. They have proved effective.

- 15. (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) 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 the current proposal. 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 Fleet 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 Fleet Lien.

16. The Fleet 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.

17. As the term aircraft is undefined it appears that there is 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.

18. The regulations are not restricted to aircraft that are registered in the UK, thus if a Fleet Lien has been exercised in relation to an aircraft that has been registered in Bermuda. 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 other EU state that have decided to enforce ETS reporting requirements through more tailored means, as may be expected. More generally, this aspect of the regulations raises the possibility of treaty violations and retaliation by other jurisdictions.

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

### *Lawfulness*

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

21. Central to the AWG objection to the Fleet 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 the Fleet Lien. The Fleet Lien creates a significant financial

risk which is not susceptible to an ex ante calculation or risk mitigation through insurance.

22. The Fleet Lien is arbitrary and non-transparent in its application because:
- (a) 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 little that property rights holders can do to challenge the allegation that the operator is indebted for the sums claimed and it is unclear what the effect of Regulation 17(a) might be in this context.

23. The relevant regulator (either (i) the Environment Agency in the UK; (ii) the Scottish Environment Protection Agency in Scotland; or (iii) the chief inspector as appointed under regulation 8(3) of the Northern Ireland Regulations) does not have any published rules or guidance as to the circumstances in which they will exercise the Fleet Lien. They do not, for example, set a threshold amount above which the powers are to be exercised, nor do they set out the considerations to be taken into account in deciding when to exercise. Thus, property rights holders cannot reasonably foresee the circumstances in which one of their aircraft might be at risk of being subject to the power. In addition, because there is no requirement to provide such holders with precise, reliable information about the extent of charges owed by an operator with whom they have a contractual relationship, they cannot be assured in advance of the amount of any financial exposure.

24. Exercise of the Fleet Lien is not attended by procedural guarantees which are sufficient in the circumstances. Authorities are not obliged to give notice to property rights holders (or operators) of an intention to exercise their powers. Once such powers are exercised, there is no requirement to furnish property rights holders with details of the charges in respect of which the powers have been exercised. Thus although notified property rights holders are entitled to be joined in proceedings (note these provisions only apply to notified persons) seeking an order for sale of a detained aircraft, and they are entitled to any balance of the proceeds of sale after satisfaction of those charges and related expenses:

- (a) they are not given information which would enable them effectively to challenge compliance with one of the conditions precedent to an order for sale, namely the existence of a valid debt;
- (b) there is no basis prescribed to establish the extent of their entitlement to the balance of the proceeds of sale after payment of such debt and related charges;
- (c) the legal costs of participating in such proceedings may be far greater than the amount of unpaid civil penalties owed to the regulator and there is no right

under the regulations to be paid such an amount out of the sale proceeds and there are no guidelines as to how these are to be apportioned; and

- (d) it is probable that in detaining the aircraft, the regulator will amass significant storage and maintenance costs which may be applied against the proceeds of sale in priority to the claims of a property rights holder.

25. Pursuant to Regulation 24 the appropriate regulator may appoint any person as a delegate, who could be someone who may not possess the necessary knowledge or experience in what is a very specialised industry, to perform any of its functions including, selling the aircraft on its behalf. It is likely that a sale controlled by such a delegate would further reduce the value of the equity a property rights owner holds in an aircraft.

#### *Alternatives/Minimum Standards*

26. AWG have argued that the Fleet Lien 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. These actions would avoid the harms outlined in this submission, 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.

27. In all cases, and regardless of the sanctions set out in the final regulation, AWG contends that in order to alert third party property holders and minimise their potential exposure it is essential that emissions information and in particular penalties 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, and requests that questions or comments on this submission be directed to its Secretary at [jeffrey.wool@awg.aero](mailto:jeffrey.wool@awg.aero)

**END**

## **Consultation on second stage transposition of EU Directive (2008/101/EC) to include aviation in the EU Emissions Trading System (EU ETS)**

### **Response of the Aviation Working Group –5 March 2010**

#### **1. Introduction to Aviation Working Group**

- (a) 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.
- (b) 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](http://www.awg.aero).

#### **2. The AWG position on the detention of aircraft as a penalty for the non-payment by the operator of regulatory penalties.**

- (a) The AWG, on behalf of its members, has serious objections to the detention of third-party owned or financed aircraft as a tool of regulatory compliance.
- (b) AWG accepts and encourages practices and regulations 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 notes that 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. In a number of cases therefore, there will be third parties unconnected with an operator's regulatory compliance who have considerable economic interest in the asset.
- (c) AWG contends that any proposal to allow the appropriate regulator to detain and sell any third-party owned or financed aircraft for unpaid civil penalties incurred by the operator is disproportionate to the problems that the regulations are designed to address. It would also represent a serious breach of the rights of such third party owner or financier.
- (d) Further details of the AWG's position regarding the detention of aircraft are set out in the attached Position Paper which is also available on the AWG's Website.

#### **3. The Second Stage Consultation**

- (a) The AWG note that the draft regulations accompanying the second stage consultation paper continue to provide for the detention of aircraft where the relevant operator is in default, albeit with a 6-month grace period (regulation 43).

- (b) We also note that there is nothing in the draft regulations preventing the detention of a leased or third-party financed aircraft. The regulators have clearly indicated in communications with stakeholders that the intention of the regulations is not to detain such aircraft, but this is not reflected in the regulations.
- (c) The AWG would suggest that the final wording of regulation 43(1) be amended to read “the regulator may detain any aircraft of which the regulator has reason to believe the defaulting operator is the operator and owner, and no third party unconnected to the operator holds a significant economic interest in such aircraft”.
- (d) **Question 19** asks whether 56 days is an appropriate length of time to detain an aircraft before having the right to apply to the court for sale. The AWG is concerned that this amount of time may not be sufficient in the context of leased or financed aircraft, and we would request that the period be increased to 90 days in order to minimise the risk of aircraft being sold without the knowledge of an innocent third party rights holder.
- (e) **Question 20** of the consultation document refers to criteria for releasing detained aircraft. AWG believes that it is particularly important that any leased or financed aircraft detained in error by the regulator be released from detention without the lessor/financier suffering any harm. Again the regulators have stated in informal consultation that this is the intention. Regulation 44(a) however, by stating that aircraft will be released if they are no longer operated by the defaulting operator, does not go far enough. In order to demonstrate that the aircraft was no longer operated by the defaulting operator, the lessor would have to terminate the lease, or a financier would have to exercise its security, which in certain circumstances it may be prohibited from doing.
- (f) We would suggest that a new regulation 44(a) be inserted reading as follows:

“**44.** The regulator must not detain, or continue to detain, or sell any aircraft under regulation 43 if-

- (a) Such an aircraft is owned by a company controlled by a third party unconnected to the operator, or a third party unconnected to the operator holds a significant economic interest in such aircraft”

It should also be clear that such third party will not be liable for the payment of the penalties incurred by the operator under any circumstances, and such payment is not a requirement for the release of the aircraft. In terms of liability for payment penalties (and costs of recovery – see **Question 12**) we understand that the regulators do not consider that lessors or financiers should ever be liable, and we would request that this be made explicit in the regulations.

- (g) As well as provisions guarding against the detention of leased or financed aircraft, AWG would suggest provisions in the regulations binding the regulators to publish the details of operators who are not in compliance with their regulatory obligations, or at the very least allowing third parties with an interest in the assets to be provided, on request, with an operator’s compliance record. This can be catered for in the lease, in the same way as an operator’s compliance with airport charges and air navigation charges can be monitored at present. Such an increased transparency in the process would allow lessors and financiers to become involved, and help to prevent the detention of leased aircraft.

- (h) The consultation document makes reference to application to the European Commission for an operating ban (see **Question 23**). AWG notes that such a ban would be less harmful to the interests of third-party financiers or lessors than detention of aircraft and more appropriately and proportionally places responsibility for compliance on the operator as the entity responsible for compliance with the reporting and information obligations., and AWG would urge the regulators to use this sanction before resorting to detention, as opposed to viewing the operating ban as a “last resort”.
- (i) However, AWG would suggest that lessors and financiers are involved in the process of applying for an operating ban, or at the very least made aware of such application. Regulation 51 contains references to various notices of such application being provided. AWG would further suggest that notice also be provided to any holder of a registered interest in the aircraft, for example, on the CAA mortgage register or on the International Registry under the Cape Town Convention.

#### 4. Summary

- (a) AWG welcomes the representations made at stakeholder events that the regulator believes it will have no power to detain leased or financed aircraft and that any leased or financed aircraft can be released without the lease being terminated or the security enforced. However, the regulations make no reference to the treatment of leased aircraft or the treatment of third parties with an economic interest in the aircraft. AWG contends that this represents a significant proportion of commercial aviation, and such treatment can and should be easily clarified.