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Some current challenges in aircraft finance and European aviation regulatory law

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Ladies and Gentlemen,

It is a great pleasure and honour to be part of this conference and I would like to thank you, President Olowski, for the invitation to this panel.

I. I am neither an academic nor a governmental lawyer and therefore I think I should contribute to this panel titled "Contemporary Challenges in Civil Aviation" by sharing some of the practical challenges I am dealing with in my legal practice.

I consider myself very lucky because ever since I have graduated from the McGill Institute of Air & Space Law, chaired today by Professor Dempsey, I have been able to practice aviation law almost exclusively. Aircraft finance transactions and regulatory matters are very important areas

of my practice and the issues I would like to discuss here have arisen in those areas.

II. Integration of regulatory framework for aircraft transactions

The field of international aircraft finance is very dynamic. Particularly transborder leasing transactions have enormously increased over the last 20 or 30 years, namely so-called operating leases. I remember that when I started to practice Lufthansa for example prided itself that it owned practically its entire fleet – as opposed to leasing aircraft. That has certainly changed, not only with Lufthansa, but generally with airlines and other aircraft operators around the world.

The respective leasing transactions are highly standardized. This means that the documentation looks pretty much the same depending on the particular type of lease transaction. The commercial terms of course differ and will be agreed in tough negotiations resulting in a term sheet listing those

commercial terms. But through the standardization of much of the documentation of a lease the next step, i. e. the production of the documentation based on the term sheet can e handled rather efficiently. The cost for the parties for this step, i. e. the legal fees is rather reasonable considering the complexity and the economic significance of the exercise.

But there are other factors over which the parties have no control that can complicate aircraft finance transactions and make them much more expensive than necessary. These factors sometimes are the result of an insufficiently integrated regulatory framework in the areas of registration of aircraft and recordation of aircraft mortgages in Europe.

Let me give you two examples from my practice: Operating leases are term leases. Once the lease term has expired the aircraft may be leased to another operator. Very frequently the next lessee is in another country. In this kind of situation it will facilitate the business significantly if the aircraft will not

have to be re-registered from one jurisdiction to the other merely because the aircraft changes its operational base. It is possible to retain the old registration if there is an agreement in place between the states concerned under Article 83 bis of the Chicago Convention transferring the functions and duties of the state of registry to the state where the aircraft operator is based.

This used to be handled quite liberally in Germany in the past until the German CAA, the LBA, introduced a new registration policy. Under this registration policy an aircraft owned by a non-EU lessor can only be registered in Germany if (i) the lessee is the holder of a German AOC and (ii) the aircraft is based in Germany. This of course means that an aircraft has to be re-registered every time it goes to a new lessee in another country.

This policy is much more restrictive than the policies in other EU member states. The price for this restrictive approach will

ultimately be borne by the consumer because one factor for pricing tickets is obviously the cost for financing aircraft.

Another example of such a costly special "German treatment" is the fee the German aircraft mortgage register charges for the recordation of an aircraft mortgage. To give you an idea: This fee used to be around € 6,000 for a mortgage in the amount of € 30m until this summer. On 1st August the fee was increased to around € 24,000. The job done by the mortgage registry for this fee is minimal: they review the mortgage deed and enter the most basic terms of the mortgage in their records. And the notary's fee for the required notarization of the mortgage deed comes on top of this: Another € 24,000. This means that for the creation of such a mortgage the parties incur almost € 50,000 in fees for the notary and the mortgage registry alone.

This is ridiculous in my view and many times higher than in other European countries where you may pay a few hundred Euros for the same job.

These are just two examples that show how the lack of regulatory integration in Europe creates hurdles that make aircraft finance transactions more difficult and more costly which is ultimately to the disadvantage of the consumer.

III. Challenges resulting from the EASA process

Another challenge I would like to briefly discuss this morning results from the strict civil aviation exclusivity of the EASA process.

Under the EASA Basic Regulation (Reg. 216/2008) EASA is in charge of civil aviation matters exclusively, while all military matters are left to the member states. There appears to be a fairly clear borderline between civil aviation and military

aviation. But in reality grey areas exist where the distinction is not so clear. These areas present a significant challenge to the parties concerned. In my example this was a helicopter manufacturer that design and manufactures helicopters both for civil and for military applications. The helicopters obviously need a lot of testing carried out by the manufacturer's test pilots. These test pilots are highly qualified and have the type ratings they need for their job. To the extent they pilot military helicopters they have the necessary military type ratings. These used to be entered into their civil pilot licenses under a provision of the former JAR-FCL rules. However, when the new European Flight Crew Licensing rules (Reg. 1178/2011) entered into force for Germany earlier this year, the German LBA had to stop entering military type ratings into civil licenses. This grounded those test pilots of our client when their licenses expired. As these pilots are not military personnel they cannot be granted military licenses, either. A solution was brought about after lengthy negotiations with the German authorities, when they

eventually accepted that pilots with a civil license can carry out those test flights even without the respective military type rating in their license as long as they have a special permit to be issued by the military.

This is quite remarkable because a civil license for a test pilot normally is valid only with the respective type rating in it.

The German civil aviation authority has been very flexible in this case, but the process to reach this flexibility was time-consuming and even nerve-racking for our client.

So judging from this experience another challenge in civil aviation is the impact that civil aviation rule making has on the grey area between civil aviation and military aviation. In my view this area has to be taken into consideration and needs to be analyzed carefully in the rule making process. Without that exercise there will be new challenges in this area in the future.

To sum up these challenges in civil aviation:

A. It is in the best interest of the consumer to facilitate aircraft transactions, to reduce bureaucratic hurdles and to make them less costly.

B. In the EASA process greater attention should be given to the grey area between civil aviation and military aviation.