THE INTERNATIONAL AVIATION FINANCE & LEASING REVIEW 2024 / 25

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The International Aviation Finance and Leasing Review 2024/25

Contents

FOREWORD

Airline profitability outlook strengthens despite challenging global economic environment

IATA

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BIO

Marie joined IATA in 2022 as Chief Economist. In January 2023 Marie added responsibility for IATA's Environment and Sustainability activities to her role.

Marie joined IATA from Lombard Odier where she was Head of Global Trends and Sustainability. Her 30-year professional life includes roles for both investment banks and private banks, including HSBC in London, Merrill Lynch in Paris, and Indosuez in Geneva. Outside of the financial sector Marie worked for IKEA, and she also founded and managed her own company in the equine industry. Marie holds an MBA from the University of Gothenburg in Sweden, and a PhD in International Economics from the Graduate Institute in Geneva, Switzerland. She speaks Swedish, English, and French fluently.

Airline profitability outlook strengthens despite challenging global economic environment

Airline Industry Outlook Improves for 2024

2024 is a historic year in terms of national elections around the world. More than 70 countries will go or have gone to the polls, involving 4.2 billion people, and hence a majority of the world's population for the first time ever. Together, the countries concerned represent around 60% of global GDP and around 75% of passenger air traffic.

Labor Market Dynamics

The labor market is notably active, with global employment at record highs and unemployment rates at historic lows in many countries, showing no signs of reversing. This robust employment has shielded many economies from recession threats in 2023 and will continue to do so in 2024. The global economy's steady 3% growth does not fully explain the widespread low unemployment, which typically increases with higher growth. Additionally, employment rises usually coincide with rising inflation, yet inflation is currently decelerating.

Airline Industry Financial Outlook

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> Fuel, specifically kerosene, is the largest expense for airlines, accounting for over 30% of total costs.

In this economic context, the International Air Transport Association (IATA) has revised its financial forecasts for the global airline industry upwards. In 2024, airlines are expected to achieve record revenues nearing $1 trillion, with expenses also at a record high of $936 billion. The net profit is anticipated to be $30.5 billion, representing a modest 3% net margin. Despite not being a record, this is a significant achievement considering the industry's recent history.

Flying remains cost-effective, with 77% of 6,500 travellers in 15 markets recently poled by IATA agreeing. That's not surprising considering that the real cost of air travel has fallen 34% over the last decade. Airlines' projected net profit per passenger in 2024 is $6.14, roughly the price of a large coffee in Geneva. Profits vary significantly by region: Middle Eastern airlines lead with $15 per passenger, while African airlines earn just $1. North America sees $13 per passenger, Europe $7, and Latin America and Asia between $1 and $2.

Fuel Costs and Regional Variations

Fuel, specifically kerosene, is the largest expense for airlines, accounting for over 30% of total costs. Ideally, kerosene prices would be uniform globally, but they are not. Currently, prices are higher in Europe due to shipping industry issues caused by Panama Canal disruptions and the Middle East conflict. Supply, distribution, and taxes also affect prices.

Sustainable Aviation Fuel (SAF) and Decarbonisation

Sustainable Aviation Fuel (SAF), made from renewable, non-fossil materials, is significantly more expensive than fossil-based kerosene, costing two to five times more. This poses a challenge for airlines with slim margins, projected at 3% net in 2024. Rapidly increasing SAF production is crucial for both securing supply and reducing costs through economies of scale. Despite high demand, SAF's anticipated 2024 supply will be around 0.5% of total aviation fuel.

Airlines lack the financial strength to tackle decarbonisation alone. SAF is expected to account for 65% of aviation's decarbonisation by 2050. Achieving this energy transition necessitates a significant increase in SAF production to lower prices through scale effects.

The Role of Oil and Gas Sector in Renewable Energy
Replacing the majority of fossil fuel consumption with renewable energy is a monumental challenge requiring collective effort, including from the oil and gas sector, given their expertise and infrastructure. Unfortunately, oil industry profits remain predominantly in the fossil fuel sector, with oil and gas producers contributing only 1% to global clean energy investments.

Aviation's Dual Challenge

The major risk facing the global economy and the airline industry is climate change, a systemic issue impacting all human activities for decades to come. The unprecedented challenge is reducing the global economy's dependence on fossil fuels. While alternative energies exist, they are not yet available at the necessary scale. Air transportation, essential for its unmatched speed and reach, has no viable alternative. Therefore, ensuring access to SAF must be a global priority to achieve better economic and environmental outcomes.

Financial and environmental sustainability in air transport are intertwined, and achieving one without the other is not realistic. This represents aviation's greatest challenge moving forward.

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BIO

Dr. Martin R. Geiger, LL.M., CSE, completed postgraduate studies at the University of Amsterdam after studying law at the University of Salzburg. He was admitted to the Austrian Bar in 2002. Before being one of the founding attorneys of GHP in 2024 he was a partner in national Austrian law firms and in an international law firm in Vienna.

Martin Geiger is inter alia a specialist in aviation law, including sales and financing transactions as well as regulatory issues, operating and CAMO issues, and also litigation and arbitration.

His legal know-how and long-standing practical experience in the aviation sector is valued by national and international aircraft carriers and operators, banks, financial institutions as well as technical and service enterprises of the aviation industry.

He is a member of the ABAA and EBAA and regularly publishes in international publications in the field of aviation.

Status of the Austrian aviation industry and recommendations of AIA for the Austrian legislative period 2024 – 2029

The aviation industry in Austria, a central hub in Europe, has seen significant developments in recent years, driven by advancements in technology, evolving regulatory frameworks, and the increasing need for sustainable practices. This article delves into the latest trends and legal developments shaping Austrian aviation, highlighting how these changes are influencing the industry's future.

1. Importance of the air transport industry for Austria's economy

The Austrian Aviation Association ("**AIA**") represents over 100 member companies, associations and universities from all over Austria, over 100,000 highly qualified jobs (around 29,000 direct, 20,000 indirect, 56,000 induced employees), around EUR 8 billion (over 2%) direct contribution to GDP, more than EUR 6 billion turnover, EUR 2.1 billion largely direct tax revenue, the Austrian aviation industry is among the 10 largest supplier nations for Airbus worldwide.

> "One of the most prominent trends in Austrian aviation is the push towards sustainability.

However, the overall economic significance of air transport goes far beyond these figures. Almost EUR 20 billion in spending by foreign tourists in Austria, EUR 171 billion in foreign direct investments in Austria and EUR 207 billion in exports would hardly be possible, or at least only to a much lesser extent, without air transport.

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It is the clear mission of the Aviation Umbrella Organisation to strengthen Austria as a business location and its global competitiveness by maintaining and increasing the innovative strength of the Austrian aviation industry through targeted research funding and promoting Austria as a business location in general through aviation connectivity. The connectivity required by all sides can only be achieved with a functioning air transport hub in Vienna, demand-orientated connections to the federal provinces and a sensible addition of business aviation activities. This will not only secure qualified jobs in air transport, but in all sectors of the economy, so that prosperity in Austria is maintained.

2. Sustainable Aviation and Environmental Regulations

One of the most prominent trends in Austrian aviation is the push towards sustainability. This aligns with the European Union's ambitious targets for reducing carbon emissions. The EU Green Deal and the European Climate Law, which aims to make Europe the first climate-neutral continent by 2050, heavily influence Austria's aviation policies.

3. Digitalisation and Innovation in Air Traffic Management

The integration of digital technologies into air traffic management (ATM) is transforming Austrian aviation. These advancements aim to enhance efficiency, safety, and reduce environmental impact.

Austrian stakeholders participating in SESAR and Single European Sky (SES) are as a whole convinced that SESAR is the most important European research initiative for air traffic management, and essential for the successful implementation of SES. During the SESAR 1 and SESAR 2020 programme execution, stakeholders met regularly and exchanged relevant information in order to both understand, align and find synergies between European and Austrian ATM research activities. Following the establishment of the SESAR 3 JU States Representatives Group (SRG), Austrian stakeholders agreed to set up a more formalised SESAR networking initiative coordinated through the Innovation and Transport Directorates General of the Federal Ministry for Climate Action.

The Austrian SESAR Networking Initiative is designed as an open platform for all Austrian public and private organisations engaged in SESAR. Participants include those responsible for research and innovation at the ministry and from the Directorate for Aviation (also members of the Single Sky Committee), as well as all Austrian founding members of the SESAR 3 JU, namely Austro Control, EasyJet Europe, Frequentis AG. The Austrian Research Promotion Agency alongside other research and private organisations interested in SESAR, complete the group of participants in this networking initiative.

The agenda of those participating is to openly and transparently share SESAR-related information, focusing on alignment between European and Austrian aviation research and innovation agendas. The hope is to prevent duplication of research activities and ensure research projects are cohesive. Ultimately, stakeholders create a better and joint understanding of administrative, governance, and process topics related to the SESAR 3 JU's Digital European Sky research and innovation programme. Topics shared include information about in-kind contributions to additional activities (IKAA) and best practices in project execution. Furthermore, members' changing priorities in the SESAR 3 JU's multi-annual work programme are addressed within the initiative.

4. Expansion of Air Connectivity and Infrastructure Development

Austria's strategic location in Europe makes it a key player in enhancing air connectivity. Significant investments are being made in airport infrastructure and the expansion of air routes.

Vienna International Airport, Austria's largest, is undergoing extensive expansion to accommodate increasing passenger traffic and larger aircraft. The expansion includes the development of new terminals, runways, and state-of-the-art facilities.

Legal frameworks governing these developments ensure compliance with environmental impact assessments (EIA) and local zoning laws. Public consultations and stakeholder engagement are integral parts of the approval process.

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> The Austrian SESAR Networking Initiative is designed as an open platform for all Austrian public and private organisations engaged in SESAR.

5. Recommendations of the Austrian aviation industry - AIA - for the Austrian legislative period 2024 - 2029

Air transport and the aviation supply industry are key prerequisites for a prosperous economy and a catalyst for innovation and technology leadership, but according to AIA aviation needs: avoidance of competition-distorting measures and "gold plating" of EU regulations, broad social and political recognition of the economic importance of scheduled, demand and cargo air traffic as well as business jet operations, and a significant increase in research funding for the domestic aviation industry, because in hardly any other economic sector does a euro of funding generate such a high return as in aviation; furthermore, appropriate resources from the transformation fund to make the industry fit for the future, also in terms of the challenges in relation to climate protection. Consequently, aviation needs more political support in Austria in the future in the following areas:

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Strengthening the aviation centre:

- Strengthening the hub function of Vienna Airport, its hub carrier Austrian Airlines and the regional economic importance of the provincial airports by ensuring their connectivity.

- Supporting air freight in terms of its overall economic importance for the location and Austria's resilience through practical further development of the physical transport infrastructure and legal framework conditions, reduction of regulatory hurdles, promotion of measures that reduce the costs or time required for air freight (e.g. optimised customs procedures with sufficient personnel, digitalisation of processes, documents and interfaces, international cooperation, etc.).

- No restriction of business aviation as a key factor for Austria as a business location and for regional development.

- Creating the conditions for successful intermodality by rail and bus by using funds for the expansion of the railway infrastructure.

- Competitive organisation of the paraffin stockpiling obligation

- Prioritisation of unbureaucratic access to funding for research and pilot plants for the development of competitive lightweight construction solutions for aviation.

- Full utilisation of support for the aviation supply industry in accordance with state aid legislation in order to create a level playing field with other countries.

- Commitment to a significant increase in research funding for domestic aviation.

Specialised personnel:

- Participation in the costs of pilot training by the public sector.

- Expansion and extension of endowed professorships in the field of aviation technology.

- Prioritising the training of specialists in aviation technology and creating suitable training facilities and research infrastructure for this purpose.

- Creation of a national legal framework for a mandatory technology share / industrial cooperation in the procurement of goods for national defence.

- Demanding a mandatory share of technology / industrial cooperation in the procurement of goods for national defence.

Avoidance of further multiple burdens on air traffic:

- Promotion of already established international and European emission reduction regimes, such as CORSIA, instead of multiple burdens and competition-distorting solo efforts in tax matters, which only lead to evasive traffic and additional CO2 emissions.

Strengthening innovative strength in competition:

- Significant increase in research funding for domestic air transport and at least 2.2% (corresponding to the GDP share of air transport) from the transformation fund.

- Focused promotion of the development of lighter aircraft and eVTOLs, as well as recyclable lightweight construction technology as the backbone of sustainable material use.

Decarbonisation of aviation through the establishment of Sustainable Aviation Fuel (SAF) production and research into fuels of the future:

- Revenues from aviation environmental levies such as the EU ETS or the aviation levy must be earmarked in favour of research, development and use of sustainable fuels to ensure competitive prices.

- Utilisation of resources from the transformation fund for the ramp-up of sustainable fuels for aviation.

- Provision of small quantities of SAF by the public sector as part of research and development programmes.

- European level, to prioritise the implementation of the Single European Sky for the saving flight time and fuel consumption in European airspace.

- Commitment at European level to ensure that the current competitive disadvantages for the European aviation industry are corrected in the planned revision of the European regulation on the blending obligation for sustainable aviation fuels (ReFuelEU) in 2027 (preferably with a target-based SAF levy).

- Targeted support for the establishment of a research infrastructure for the development of hydrogen drives and hydrogen technologies.

- Prioritisation of research funding - for example as part of the FFG Take Off programme - in the field of hydrogen applications for aviation in close coordination with the initiatives of the European Clean Aviation & Clean Hydrogen partnerships.

Safety of air traffic:

- Modern and practical further development of the Aviation Safety Act in close consultation with the aviation industry.

- Provision of sufficient police personnel resources to ensure the continued smooth operation of international air traffic.

- Creating modern, technologically effective responses to the massively increased danger posed by drones to critical infrastructures and facilities requiring special protection.

- Reasonable legal design of the background check in the Austrian Aviation Act, which aims to determine whether the person to be checked can actually be considered a threat to aviation in the individual case.

- Tightening of civil and criminal law provisions for obstructing and damaging critical aviation infrastructure (airports, aircraft, etc.).

Air transport of the future:

- Practical further development of the legal framework and targeted public funding to enable innovations in the passenger journey in air transport.

6. Legal Challenges and Future Outlook

The dynamic nature of aviation poses several legal challenges. Ensuring compliance with evolving regulations, addressing environmental concerns, and integrating new technologies require continuous legal oversight and adaptation.

Data Protection and Privacy:

The General Data Protection Regulation (GDPR) impacts how Austrian aviation stakeholders handle passenger data. Ensuring data privacy and security while leveraging digital innovations is a legal imperative.

International Cooperation:

Austria's aviation policies are closely aligned with EU regulations and international standards set by ICAO. Collaborative efforts at the European and global levels are crucial for addressing cross-border aviation challenges and enhancing safety and efficiency.

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> The Austrian aviation sector is undergoing significant transformation driven by sustainability goals, technological advancements, and regulatory changes.

Future Outlook:

The future of Austrian aviation looks promising with ongoing innovations and investments. Legal frameworks will continue to evolve to support sustainable growth, technological advancements, and enhanced connectivity. Stakeholder collaboration and proactive regulatory measures will be key to navigating the complexities of this dynamic industry.

In conclusion, the Austrian aviation sector is undergoing significant transformation driven by sustainability goals, technological advancements, and regulatory changes. Legal frameworks are adapting to support these developments, ensuring that Austria remains at the forefront of aviation innovation and safety. As the industry continues to evolve, ongoing collaboration and robust legal oversight will be essential in shaping the future of Austrian aviation.

CAYMAN

Aviation in the Cayman Islands: More than White Sandy Beaches

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BIO

Edward is a partner in our Corporate Department and advises on matters of Cayman Islands and British Virgin Islands law. He has a broad range of experience in asset and structured finance (including CLOs) and advises on all types of structures for commercial shipping and aviation assets as well as for superyachts and private jets. Ed is also regularly engaged to provide Cayman and BVI advice on general banking, capital markets and M&A transactions across a wide range of industry areas.

Ed has been based in Asia, Europe and the Americas and acts for banks, multinational corporates, lessors, funds, private equity, family offices and vessel/aircraft owners.

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Paul is a partner in the Corporate Department of our Hong Kong office. He advises on all forms of debt finance, structured finance and capital market transactions. Paul has more than 15 years' experience in the Asia-Pacific region and advises leading onshore law firms, regulated financial institutions, investment funds, listed companies and private corporations on a range of debt related transactions and structured products.

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Innovation in the industry

Despite a number of challenges in the market, IATA recently noted that total global passenger demand for May 2024, measured in revenue passenger kilometers (RPKs), was up 10.7 per cent compared to May 2023 and total capacity, measured in available seat kilometers (ASK), was up 8.5 per cent year-on-year. Having faced significant headwinds over the last several years, the aviation industry has proved itself to be both resilient and innovative in its endurance. Underpinning this performance has been a combination of multiple factors including an expansion in the range of financing transactions and structures in which Cayman Islands entities are deployed. That flexibility is attractive to participants at all levels from investors to operators.

> "The business in which a Cayman Islands entity can be involved is generally unrestricted provided it falls within what is permitted by law.

6 answers to 'Why Cayman?'

The Cayman Islands' strength in financial services is borne out of its ability to provide institutionally focused services to a global network of clients and this has seen it mature into one of the largest international financial centres in the world. The global financial industry can rely on the Cayman Islands' well developed and predictable company and partnership laws and put its trust in effective, cost-efficient and tax-neutral transaction structuring. We will focus on the key advantages here.

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1. Sophisticated Legal System and Political Stability: The Cayman Islands is a self-governing British Overseas Territory with an independent legal and judicial system grounded in English common law with well-developed local legislation. This predictability and stability is attractive when combined with a widely known and accepted corporate governance framework.

2. Tax Neutrality: The Cayman Islands has no direct taxation and a structure involving a Cayman Islands entity has the advantage of minimising potential tax leakage. It is free from any form of income, capital gains or corporation tax and no Cayman Islands' withholding tax is imposed on an entity's cash flows. Certain Cayman Islands entities with exempted status may also apply for a government undertaking confirming that such entity will not be subject to any taxation in the Cayman Islands for a period of 20 to 50 years (depending on the type of entity). The tax transparency of Cayman Islands exempted companies and partnerships can enable efficient raising of capital.

3. Flexibility: The business in which a Cayman Islands entity can be involved is generally unrestricted provided it falls within what is permitted by law. Combined with the ability to incorporate a new entity within as little as 24 hours, the flexibility allows parties to move quickly and efficiently. The Cayman Islands remains a relatively inexpensive jurisdiction in comparison to its competitors with government fees being assessed on a scale linked to the authorised share capital of the SPV. There are no exchange control restrictions allowing money and securities in any currency to be freely transferred to and from the Cayman Islands.

4. Creditor Friendly: The Cayman Islands' insolvency regime is recognised as creditor friendly. Contractual rights including subordination, netting and set-off are recognised by express statutory provisions. The effective use of bankruptcy remoteness structures is a key aspect of asset and structured financing in the Cayman Islands and recognised as robust by rating agencies and financiers.

5. Regulation: There is a well-established regulatory framework encompassing international standards around anti-money laundering and counter terrorism, data protection, economic substance and the Common Reporting Standard (to name a few). Regulatory and financial transparency are core values embodied by the Cayman Islands Monetary Authority which is an independent regulator charged with consistent application of regulatory requirements for financial institutions.

6. International Connectivity: It is well known that Ireland is a key global hub for the aviation industry not least due to its enviable treaty network. There is a well-established route for Cayman Islands entities to be established as Irish tax resident and that can be a powerful structuring tool in a variety of transactions.

Entity types

One of the most commonly chosen entities for asset and structured finance deals is the exempted company incorporated with limited liability (an 'SPV'). Exempted Companies have their registered offices in the Cayman Islands and carry on business outside of the Cayman Islands. SPVs are distinct from segregated portfolio companies ('SPCs') and limited liability companies ('LLCs') in the jurisdiction. At an investor level, an exempted limited partnership is likely to be the entity of choice and the Cayman Islands is the premier jurisdiction for investment funds with an estimated 80% of all new offshore funds domiciled in the country. Incorporation can be as quick as 24 hours.

Off-balance sheet financing

In an aviation context, an SPV is typically incorporated to act as a borrower and owner/lessor of an aircraft and its shares will be held on trust by a professional trust company such as Campbells Corporate Services Limited or its controlled subsidiary. This effectively separates the legal and beneficial ownership of the SPV and creates the 'orphan' structure taking the SPV off the balance sheet of the relevant parties and isolating the underlying assets from the corporate credit(s) in the deal. The trust will generally be a charitable or purpose trust maintained for the life of the deal. The other key feature for an orphan SPV deal is that all documentation is entered into on a limited recourse and non-petition basis. This ring-fences the assets and preserves bankruptcy remoteness by limiting the chance of claims against the SPV.

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Transactional diversity

Aviation itself is a multi-billion dollar industry, from commercial passengers to freighters, private aircraft, the vast network of regulators and technical service providers, the manufacturers and the infrastructure required to support it all. It is no surprise then that there are so many ways to transact. We have already touched on some of the kinds of transactions we see but below is a (non-exhaustive) list of where the Cayman Islands can feature in deals.

Funds and investment – as we have mentioned, the Cayman Islands is the jurisdiction of choice for the formation of investment funds. In recent years we have seen new investors with capital to deploy becoming new entrants into the aviation sector.

Alternative lending, joint ventures, new leasing platforms – once the investment is identified, those funds need to be put to use and we have seen Cayman incorporated entities being used in the establishment of alternative lending platforms, joint ventures with established industry players and the founding\of new leasing platforms. The flexibility of Cayman entities is particularly attractive to alternative lenders who can deploy capital quickly and fulfill a need where traditional lenders have retreated.

Debt financing – traditional debt financing for new and used aircraft also favours the use of bankruptcy remote SPVs. From pre-delivery payment financing, to delivery financing at the point of delivery from the manufacturers (including export credit guarantee and insurance backed products), to warehouse financing of portfolios, all lend themselves to an SPV borrower. As production lines continue to ramp up, we also expect to see carbon-neutral and de-carbonisation projects increasingly highlighted across the industry. Improvement in fuel efficiency, innovations in aircraft technology and a growing focus on what ESG means for aviation financing will be put into practice in debt documentation and elsewhere as pre-delivery payments fall due and new aircraft are delivered.

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> A Cayman incorporated but Irish tax resident issuer is a tried and tested structure in aircraft asset backed securitisations ('ABS')

Capital markets – a Cayman incorporated but Irish tax resident issuer is a tried and tested structure in aircraft asset backed securitisations ('**ABS**'). Where we also see the use of Cayman entities in capital markets and rated deals are in connection with note of bond issuances (secured or unsecured) and in non-US enhanced equipment trust certificate ('**EETC**') transactions. At the time of writing access to the ABS market is heavily restricted due to, among other things, interest rate volatility and the disconnect between lease rates and cost of funds. With this said, there have recently been two major aircraft ABS transactions in 2024 with one of these being structured through a Cayman issuer.

Loyalty financing – these highly structured hybrid capital market/securitisation type transactions entered into by several major US airlines following the deep impact of the global pandemic is an excellent example of the innovative approach the industry takes to self-preservation. The valuation of frequent flyer programmes has long been a closely guarded secret (and protected asset) but the first of-its-kind United Mileage Plus financing changed that. The bankruptcy remoteness protections afforded to the financiers and investors by using Cayman Islands SPVs were integral to the highly structured nature of these transactions. We have seen continued interest in this transaction structure.

Listing services – many of the transactions already described are likely to have a requirement for notes to be listed. The Cayman Islands Stock Exchange ('**CSX**') was the first offshore stock exchange to be granted approved organisation status by the London Stock Exchange. In addition, the UK HMRC also recognises the CSX under section 1005 of the Income Tax Act (ITA) 2007 regards the CSX as a 'recognised stock exchange'. The CSX is a specialised exchange which prides itself on being user friendly and offering an efficient and competitively priced listing service. A CSX listing is commonly utilised by entities (whether Cayman incorporated or otherwise) for the purpose of the "Quoted Eurobond Exemption" on withholding tax. Notes issued pursuant to structured finance transactions are sometimes listed with the CSX but also intra-group debt is commonly CSX listed.

Aircraft registration – a summary of the involvement of the Cayman Islands in aviation is not complete without a word on the Cayman Islands Civil Aviation Authority ('**CAACI**'). The aircraft registry maintained by the CAACI is an internationally respected registry with strategic values and a desire to strengthen the reputation of the jurisdiction as a safe, effective and innovative registry of choice. It is predominantly a private aircraft register but can also handle commercial aircraft (including those of the national flag carrier, Cayman Airways). It has an Article 83b Agreement in accordance with the International Civil Aviation Organisation ('**ICAO**') with the Kingdom of Saudi Arabia and, in more recent times, a transitional register for commercial aircraft. The transitional registration programme developed significantly throughout 2020 with an increase in demand from the commercial aviation community for reliable registry services resulting from the effects of the global pandemic. It should also be noted that the Cayman Islands benefits from the Convention on International Interest in Mobile Equipment (the '**Cape Town Convention**') following the United Kingdom's ratification. It affords entities structuring their asset financing transactions with a Cayman Islands SPV the added protection, certainty and uniformity that the Cape Town Convention and its Protocols afford.

Management and professional services

Regardless of the type of transaction, a Cayman Islands SPV still requires directors. Cayman Islands fiduciary service providers such as Campbells Corporate Services Limited can be engaged to provide administration and management services for SPVs and other kinds of Cayman entities including the provision of directors and officers, and importantly ensuring provision is made to assist the SPV meets its regulatory obligations. Ongoing monitoring and testing can be implemented to maintain required compliance procedures and ensure that the relevant entities remain in good standing with the appropriate authorities including the Registrar of Companies CIMA and the Department for International Tax Cooperation.

Looking to the future

The present macro-economic headwinds resulting from a number of factors including the continuing conflict within Ukraine has not dampened optimism. Further, with interest rates beginning to plateau and indications of potential rate cuts have been positive. There is an inherent industry cycle within the asset and structured finance space but with ABS transactions back underway continued softening of the market in the short term seems possible. The fundamentals remain strong in respect of both the industry itself, and the reasons why the Cayman Islands is an effective jurisdiction to support it.

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The Cayman Islands is a leading offshore financial centre and Campbells LLP and Campbells Corporate Services Limited are right at its heart. The Campbells team provides innovative solutions, unmatched flexibility and the strength to deliver results on all types of asset and structured finance transactions. For further information or advice, please reach out to the authors or your usual Campbells contact.

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HONG KONG
Hong Kong further enhanced its preferential tax regime: The city strives to become an international aircraft leasing hub

DELOITTE

BIO

Ka Yan is a Tax Partner of Deloitte China currently based in Hong Kong office. Ka Yan advises a wide range of her clients on both Hong Kong domestic and international tax matters, covering topics such as IPO, tax structuring, international tax planning, tax incentives planning, supply chain model design, complex investment and financing transactions, cross-border acquisitions, due diligence work, tax compliance and tax controversy. Ka Yan is also a frequent speaker on Hong Kong and international tax topics with various institutions and business chambers.

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Hong Kong further enhanced its preferential tax regime: The city strives to become an international aircraft leasing hub

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Under the global immense development of the aircraft leasing industry over the years, Hong Kong, located at the heart of Asia and serving as the southern gateway of mainland China, is full of opportunities in the future aviation business of the Asia-Pacific region. A trade forecast in 2023 suggested that global air traffic will grow by 6.1% per year in the next 20 years, with China alone experiencing an impressive yearly growth rate of 11.4%. By 2042, it is projected that approximately 42,600 new commercial jets will be delivered worldwide, 17,000 of these new jets will be delivered to the Asia-Pacific markets, and 8,560 of them will be destined for China. The Hong Kong Special Administrative Region Government ("the HKSAR Government") anticipates that around 3,100 aircraft will be leased through Hong Kong platforms in the next 20 years, creating over 1,000 direct employment positions and around 20,000 indirect jobs, contributing over HK$400 billion to the local gross domestic product.

> "Tax competitiveness is a key factor for developing the aircraft leasing industry as aircraft leasing is a global business without geographical limitations.

Tax competitiveness is a key factor for developing the aircraft leasing industry as aircraft leasing is a global business without geographical limitations. With a view to strengthen Hong Kong's competitiveness, effective from the year of assessment beginning on 1 April 2023, Hong Kong further enhanced its Aircraft Leasing preferential tax regime in February 2024 under the Inland Revenue (Amendment) (Aircraft Leasing Tax Concessions) Ordinance 2024 ("the 2024 Amendment").

As a background, in 2017, Hong Kong introduced the aircraft leasing preferential tax regime. Under the regime, qualifying aircraft lessors and qualifying aircraft leasing managers can enjoy concessionary tax rate of 8.25% (i.e., half of the prevailing profits tax rate of 16.5%) on profits derived from qualifying aircraft leasing activities (only dry lease, exclude funding lease, wet lease, etc.) and qualifying aircraft leasing management activities, subject to certain conditions. On the other hand, qualifying aircraft lessors can enjoy a 20% tax base concession as compensation for the lack of depreciation allowance. Effectively, the qualifying profits are only taxed at 1.65%.

Since then, there are noticeable market changes in the aircraft leasing industry in terms of leasing arrangements, lessees, source of finance, etc. In addition, the upcoming implementation of the Base Erosion and Profit Shifting ("BEPS") 2.0 global minimum tax regime introduced by Organisation for Economic Co-operation and Development (OECD) will also diminish the competitiveness of the then existing regime.

Against the above background, the 2024 Amendment introduced enhancements to the aircraft leasing preferential tax regime with a view to maintaining and improving Hong Kong's competitiveness. Below are the key features of enhancement introduced under the 2024 Amendment:

> "Against the above background, the 2024 Amendment introduced enhancements to the aircraft leasing preferential tax regime with a view to maintaining and improving Hong Kong's competitiveness.

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	The former tax regime	New tax regime introduced by the 2024 Amendment
1. Acquisition cost of aircraft	No deduction / depreciation allowance (compensated by a 20% tax base concession)	Full tax deduction
2. Covered lease	Dry lease only (applicable to operating lease for a term exceeding one year)	Dry lease[1], wet lease[2] and funding lease[3] (applicable to all regardless of the lease term)
3. Scope of aircraft leasing activity	Leasing an aircraft to an aircraft operator	Leasing an aircraft to any person
4. Interest expense to overseas non-financial institution / associate for acquisition of aircraft	Non-deductible	Deductible (subject to anti-avoidance provision if the lender is an associate)
5. Prescribed threshold requirements	Not specified	Specific requirements on no. of full-time qualified employees and amount of operating expenditure in Hong Kong

The 2024 Amendment's enhancement measures are discussed in detail below:

1. New deduction of the acquisition cost of aircraft

Qualifying aircraft lessor would be allowed to deduct the capital expenditure incurred in relation to an aircraft that is used for an operating lease in that year of assessment to replace the current 20% tax base concession.

As a transitional arrangement, qualifying aircraft lessor who acquired an aircraft before the year of assessment 2023/24 may opt to continue enjoying the current 20% tax base concession or switch to the new tax deduction. If the aircraft lessor opted to claim depreciation allowances on the aircraft, a notional allowance for the years of assessment for which the 20% tax base concession was allowed would be excluded for deduction and its assessable profits would be computed on an actual basis. Once the election is made, it is irrevocable.

The purpose of introducing the new deduction to replace the 20% tax base is to tackle the potential issue arising from the upcoming BEPS 2.0 global minimum tax regime for large multinational enterprises.

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Upon the disposal of aircraft, the deduction or concession (for the year of assessment 2023/24 and onwards) would be clawed back and the sale proceeds, not exceeding the amount of concession or deduction allowed, would be deemed as trading receipts chargeable to profits tax.

On the other hand, under the former tax regime, the 20% tax base concession would not apply if capital allowance has been granted to a qualifying aircraft lessor or its connected person in respect of the aircraft. The 2024 Amendment amends that the same anti-avoidance provisions would apply to the new tax deduction with some carve outs where no tax avoidance is involved. For example, deduction would still be allowed where the lessor or its connected person is subject to tax outside Hong Kong and where capital allowances on an aircraft granted to the lessor's connected person outside Hong Kong have been fully clawed back.

1. A dry lease generally means a lease of aircraft, not including crew, insurance and maintenance.
2. A wet lease is typically a short-term lease for seasonal needs including the aircraft, crew, maintenance and insurance during the period of the lease.
3. A funding lease is a financing arrangement under which the lessee is transferred the risks and rewards incidental to the ownership of the aircraft and the aircraft lessor is the financier. The lessee is usually provide with an option to purchase the aircraft at the end of the lease term.

Deloitte.

2. Expansion of the scope of lease and removal of the one-year lease term restriction

Under the former tax regime, only the leasing of an aircraft under a dry lease that is an operating lease for a term exceeding one year is allowed.

In view of the market changes, e.g. shifting of leasing arrangements from dry leases to wet leases, increased use of funding leases to acquire aircraft and shortening of lease terms, the 2024 Amendment expands the scope of lease to include both operating leases (i.e., dry and wet leases) and funding leases and remove the one-year lease term restriction.

3. Expansion of the scope of leasing activities

Under the former tax regime, the scope of "aircraft leasing activity" covers leasing of an aircraft only to an aircraft operator.

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In view of the market changes, e.g. shifting of leasing arrangements from dry leases to wet leases, increased use of funding leases to acquire aircraft and shortening of lease terms, the 2024 Amendment expands the scope of lease to include both operating leases (i.e., dry and wet leases) and funding leases and remove the one-year lease term restriction.

Given that aircraft lessors now also lease aircrafts to other types of entities, including private companies, public organizations or even individuals, the 2024 Amendment provides a more general meaning of "aircraft leasing activity", which will cover leasing of an aircraft to any other person.

4. New deduction of interest expense to overseas non-financial institution or associate for acquisition of aircraft

Under the former tax regime, interest expense incurred by an aircraft lessor is allowable for deduction if the money is borrowed from a lender whose interest income is chargeable to profits tax or a financial institution, or the money borrowed is wholly or exclusively used for financing the acquisition of machinery or plant which qualifies for depreciation allowance and the lender is not an associate of the borrower. In other words, the deduction is quite restrictive.

To accommodate different financing means for the acquisition of aircraft, the 2024 Amendment allows deduction of interest payable on money borrowed wholly and exclusively to finance the acquisition of an aircraft used by a qualifying aircraft lessor for producing qualifying profits.

If the lender is an overseas associate of the aircraft lessor, such interest deduction will be subject to certain anti-avoidance provisions[4], including subject-to-tax condition.

If a loan is partly used for financing the acquisition cost of an aircraft and partly used for other purposes, interest expenses would be allowed on an apportionment basis. Interest expenses attributable to that part of the loan used for financing the acquisition cost of the aircraft would be allowed for deduction, provided that the other relevant conditions are met.

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To accommodate different financing means for the acquisition of aircraft, the 2024 Amendment allows deduction of interest payable on money borrowed wholly and exclusively to finance the acquisition of an aircraft used by a qualifying aircraft lessor for producing qualifying profits.

Interest expenses on a subsequent loan obtained to wholly or exclusively refinance the outstanding balance of the previous loan obtained for financing the provision of aircraft would be allowed for deduction, provided that the other conditions are met.

5. Prescribed threshold requirements

Under the former tax regime, although there is substantial activity requirement for aircraft lessors and aircraft leasing managers, there is no specific threshold.

The 2024 Amendment prescribes the following threshold requirements for aircraft lessors and aircraft leasing managers:

4. The interest income received by the associate must be subject to similar tax outside Hong Kong at a rate not lower than the reference rate (i.e., tax concession rate of 8.25%). The associate's right to the interest would not pass to any other person, unless under an arm's length transaction and the capital expenditure qualifies for a deduction under Section 14IC of the IRO.

Deloitte.

	Full-time qualified employees in Hong Kong	Annual operating expenditure in Hong Kong
Aircraft lessors	Not less than 1	Not less than HK$ 2 million
Aircraft leasing managers	Not less than 2	Not less than HK$ 1 million

A director that possesses the required qualification and carries out the core income generating activities ("CIGAs") in Hong Kong can be counted as a full-time employee.

In case an employee serves multiple aircraft lessors or other non-aircraft leasing group companies, the Hong Kong Inland Revenue Department ("IRD") would allow the splitting of the employee by reference to the amount of time spent by the employee in carrying out the CIGAs for each aircraft lessor for the purpose of counting the number of full-time employees as long as there is no double counting.

> The HKSAR Government has also committed to continue its work in actively expanding Hong Kong's Comprehensive Double Taxation Agreement network.

Other enhancements

In addition to the above enhancement measures introduced under the 2024 Amendment, the following enhancement measures have also been implemented via administrative means in the first half of 2023:

- **Recognition of the Irish Stock Exchange**

To facilitate the financing of aircraft lessors through bonds or notes in asset backed securitisation structures listed in Ireland, the Irish Stock Exchange has been recognised by the IRD for the purpose of interest deduction under Section 16(2)(f) of the Hong Kong Inland Revenue Ordinance ("IRO")[5] starting from 1 April 2023.

- **Specification of leasing model involving bare trust**

In June 2023, the IRD updated its guidance on taxation of aircraft leasing activities[6] to clarify that a beneficial owner of an aircraft under a bare trust arrangement[7] would be entitled to the tax concessions under the regime and provide further guidance in this regard.

Further in April 2024, the HKSAR government also marked new milestone for Hong Kong's aircraft leasing market by signing a Memorandum of Understanding with the Tianjin Dongjiang Free Trade Port Zone to deepen cooperation in the development of the aircraft leasing and financing industries. The Tianjin Dongjiang Free Trade Port Zone is the largest aircraft leasing hub in China and the second-largest in the world after Ireland. Relying on the advantages of Hong Kong as an international financial centre and those of Dongjiang in the clustering of players of the aircraft leasing industry, the two sides will forge deeper co-operation in different areas, including financing, business, international competition, publicity, and the promotion of talent exchanges and training. Together, the two cities aim to build a regionally linked and complementary aircraft leasing and financing platform to promote co-operation between enterprises from both regions.

> We see Hong Kong's current tax regime to be competitive amongst its major competitors in the global market, such as Ireland and Singapore.

5. Under Section 16(2)(f)(i) of the IRO, interest can be allowed for deduction if it is payable on debentures listed on a stock exchange of Hong Kong or on any other stock exchange recognised by the Commissioner of Inland Revenue.
6. Departmental Interpretation and Practice Notes No. 54
7. Under a bare trust arrangement, a bare trustee holds the bare legal ownership of an aircraft while the lessor acts as the beneficial owner of aircraft and carries on the qualifying aircraft leasing activities in Hong Kong.

The HKSAR Government has also committed to continue its work in actively expanding Hong Kong's Comprehensive Double Taxation Agreement network.

In recent years, the aircraft leasing business has evolved significantly. We are pleased to see the HKSAR Government has taken the above active steps in multiple aspects to strengthen Hong Kong's aircraft leasing hub position. The enhancements brought by the 2024 Amendment are comprehensive and have catered for the market changes and international tax developments.

We believe the enhancement measures will strengthen Hong Kong's competitiveness in the global aircraft leasing industry. We see Hong Kong's current tax regime to be competitive amongst its major competitors in the global market, such as Ireland and Singapore. With its proximity and close relationship with mainland China and the favourable withholding tax rate on aircraft lease rental offered by mainland China, Hong Kong maintains a competitive advantage over its major competitors in this regard and we hope to see Hong Kong will be able to seize the business opportunities arising from the fast-growing civil aviation market in mainland China in the years to come.

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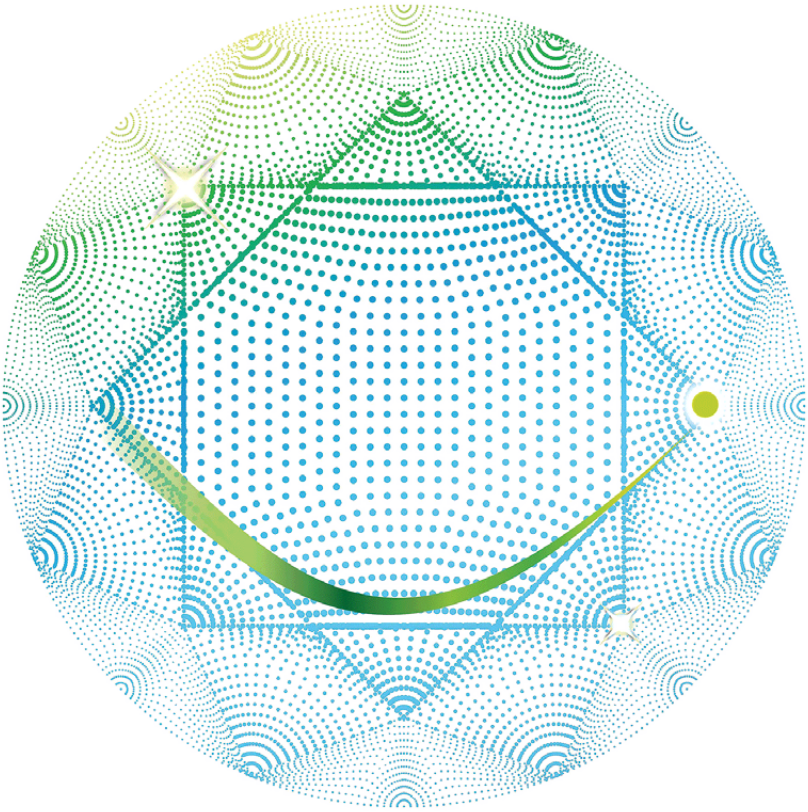
The enhancements brought by the 2024 Amendment are comprehensive and have catered for the market changes and international tax developments.



IRELAND

Global leader in aircraft leasing housing approximately 70% of the top 20 leasing firms.

KPMG IN IRELAND

BIO

Joe is a tax partner and is the Head of Aviation Finance in KPMG who advises a broad range of clients on both domestic and international tax matters. He has extensive experience in tax structuring, international tax planning, complex financing transactions and cross-border acquisitions. He has regularly led multi-country teams in delivering tax advice to his clients on large scale projects. Joe has experience in advising companies in the aviation financing, leasing, insurance and banking sectors. Joe has spoken at numerous international conferences on tax issues impacting the aviation and insurance sectors.

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Kieran is a partner in Management Consulting and is the lead advisory partner in the Aviation Finance & Leasing practice. Kieran has 18 years' experience of providing advisory services to the world's leading Aviation companies in the areas of performance improvement and optimisation, finance efficiency, post deal integration / separation and setting up leasing platforms. Kieran also provides Financial Management services to our clients across a number of industries leading the transformation of finance functions in reporting, controls and providing management insight.

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Geoff is a Director in Aviation Advisory at KPMG. Geoff has 25 years' experience in aviation, transport and logistics sectors. He specialises in airline transformation, strategy and finance. Previous to joining KMPG, Geoff was Director of Strategy for British Airways with responsibility for strategy, business planning and the transformation across all departments including commercial, engineering and operations. He is a qualified commercial pilot with multi-engine type rating.

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KPMG

Ireland is the global leader in aircraft leasing housing approximately 70% of the top 20 leasing firms.

Introduction

Ireland is a major centre for aircraft leasing, with approximately 50 percent of the world's leased commercial aircraft managed in Ireland and 70% of the top 20 leasing firms operating in the country. This article delves into why Ireland is preferred for leasing and the opportunities that lie ahead.

Ireland's success in leasing

Though Ireland's success in leasing can be attributed to several factors, the major ones are:

- favourable tax policies focussed on leasing
- access to EU capital markets
- a strong services industry focussed on the leasing sector
- a skilled workforce and English-speaking country
- a business-friendly regulatory environment
- a strong infrastructure supporting the aviation industry
- geographic proximity to either side of the world.

1. Favourable Tax Policies – There are two key policies that underpin Ireland's growth in the aviation sector:

a. Double tax treaties: Ireland has a wide network of double tax treaties with countries worldwide. As of May 2023, Ireland has signed double tax treaties with over 76 countries (74 of which are in effect), including many of the world's largest economies. These treaties generally follow the model tax convention developed by the Organisation for Economic Co-operation and Development ("OECD") and provide for reduced tax rates or exemptions for residents of the treaty partner countries. The treaties also include provisions for the exchange of information between tax authorities to prevent tax evasion.

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> Ireland is a major centre for aircraft leasing, with approximately 50 percent of the world's leased commercial aircraft managed in Ireland.

KPMG

b. Low tax rate: In particular, from 1 January 2003, the Irish government reduced its general level of corporate tax from 32% to just 12.5%, which has helped to attract a large number of leasing companies to the country. This tax rate is significantly lower than in many other countries, making Ireland an attractive destination for airlines looking to minimise their tax burden. However, the benefit of a lower tax rate extends to a range of industries beyond aircraft leasing firms, thus encouraging many to set-up offices in Ireland. Now, with a range of industries to cater to, a natural opportunity exists for financial firms to fund such ventures within Ireland, leading to a well-developed financial industry giving access to global capital.

It's a combination of these two ingredients, double tax treaties and lower tax rates, that is encouraging Sale and Leaseback ("SLB") transactions in Ireland. SLB is a financial transaction in which an airline or other aircraft operator sells one or more of its aircraft to a third-party leasing company, and then immediately leases the same aircraft back from the leasing company, thus allowing it to free up capital while retaining the use of the aircraft for its operation. Ireland promotes tax-efficient planning of SLB transactions by encouraging airlines companies to:

- Form an Irish leasing company of substance: By setting up an Irish leasing company of substance in Ireland, airlines can benefit from the lower tax rates in these countries, helping them reduce the overall tax burden of the transaction. However, these entities are required to have employees and business offerings in Ireland.

- Structure a lease as an operating lease: Operating leases are generally considered more tax-efficient than finance leases, as the lease payments are treated as operating expenses for tax purposes.

- Optimise your tax structuring: Ireland offers tax incentives for leasing companies, such as accelerated depreciation. By working with a leasing company that qualifies for these incentives, the airline can benefit from lower lease payments and improved tax planning.

2. Access to EU Capital Markets – On the demand side, airline companies are looking to benefit from a favourable tax regime in Ireland. However, on the supply side, leasing companies are able to access capital from European Union (EU) capital markets to fund such transactions. Being a member of the European single market, Ireland can leverage the free movement of goods, services, capital, and people within the EU, facilitating cross-border investment and business activity.

Moreover, many financial institutions such as international banks and investment firms have set-up their base in Ireland for European operations due to Ireland's favourable business and tax policies making it easier for lessors to access services from such institutions. Membership of the EU also grants Ireland a certain degree of political stability, thus giving leasing companies a sense of protection and security on the assets they hold.

3. A strong services industry focussed on the leasing sector – Apart from core leasing, there are a basket of services that Ireland offers to support the aircraft leasing sector, a few of them being accounting, tax advisory, and technology. These additional services give leasing companies the optionality to conduct business in Ireland from an end-to end perspective as well as scale up quickly. E.g., a growing leasing firm could conveniently migrate from the use of Excel to an Enterprise Performance Management ("EPM") tool to better manage their finance or contract management function as there are multiple firms within Ireland offering such services. Right from setting up an entity, managing the affairs of business, to winding up - all such services are available to the leasing sector.

4. A skilled workforce and English-speaking country – A vital factor supporting any nation thrive in a specific industry is the availability of a skilled workforce pertaining to that industry. Ireland has a well-developed education system, which has helped to produce a large pool of educated workers with expertise in general finance, law, and transfer pricing. Further, many Irish universities offer specialised courses in aviation finance, aircraft leasing and related subjects, helping Ireland develop a workforce well-equipped for the industry. To complement this, with many aviation finance consulting firms based in Ireland, universities bundle a series of guest speakers along with courses to ensure students get first-hand perspectives from industry leaders.

In addition, Ireland is an English-speaking country making it an attractive location for foreign companies looking to set up operations in a country where they can communicate easily with the local workforce and customers. It's also an incentive for talent to move to Ireland as they don't need to learn a new language for communication.

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> On the demand side, airline companies are looking to benefit from a favourable tax regime in Ireland.

Coupling this advantage with friendly immigration laws help candidates willing to move to Ireland. Many companies sponsor visas under the 'critical skill permit' route, allowing candidates can get two years of work employment to reside in Ireland.

5. A business-friendly regulatory environment – Ireland's well developed regulatory environment offers the following advantages:
    a. Easy Company Formation: It is relatively straightforward to set up a company in Ireland, with most of the processes being done online. The Irish government also provides support to start-ups and small businesses.
    b. Flexible Employment Laws: Ireland's flexible employment laws are designed to promote job creation and support businesses. This includes a range of employment incentives such as tax credits for hiring new employees and reduced social insurance contributions for certain categories of workers.
    c. Support for Innovation and Programmes: Ireland has a strong culture of innovation and supports research and development through tax incentives, grants, and other programmes. For example, the Irish government offers a tax credit for companies engaged in R&D activities. In addition, the government promotes entrepreneurship and supports business growth through programs such as Enterprise Ireland and the Industrial Development Agency ("IDA") Ireland.

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> Ireland has a set-up multiple authorities and institutes to support the sector for various purposes.

6. Infrastructure supporting the aviation industry – Ireland has a set-up multiple authorities and institutes to support the sector for various purposes. The main authority from a regulatory purpose is the Irish Aviation Authority ("IAA"). The IAA, with a strong reputation for professionalism and responsiveness, is the national aviation authority responsible for the regulation of Irish aviation. Additionally, the government has established the Irish Aviation Research Institute ("IARI"), the Shannon Aviation Cluster, the International Aviation Services Centre ("IASC"), and Aircraft leasing Ireland ("ALI"). ALI represents the aircraft leasing industry in Ireland and is dedicated to the continued development and success of Ireland's aircraft leasing industry.

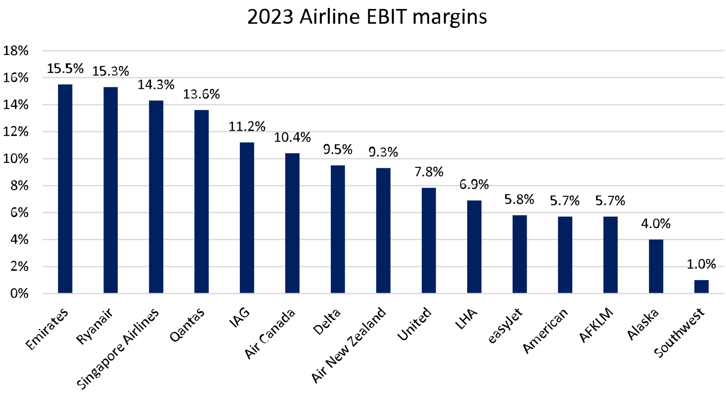
All these institutes are set up to support the aviation industry not only though a commercial lens but also through a sustainability one, especially in areas of sustainable aviation fuels, zero-carbon propulsion systems, and noise mapping. Additionally, there are generous donations from leading Irish Universities to support such innovation allowing both the industry and students to benefit.

7. Geographic proximity to either side of the world – Being strategically located and with modern airport infrastructure connecting Ireland to most global cities, Ireland has been a preferred choice by all three business regions – Americas, EMEA and APAC. The country has several modern, state-of-the-art airports that are well-connected to the rest of the world making it possible to reach major cities like New York and London with direct flights. Amongst the airports in Ireland, the Dublin Airport is one of the busiest airports in Europe, and it serves as a major hub for transatlantic flights. Additionally, Shannon Airport and Cork Airport are also important hubs for the aviation industry as a few leasing companies and aviation services providers located in these regions. Further, the Irish government continues to invest heavily in the development of the country's transport infrastructure, encouraging international companies to begin operations in the country.

Global aviation sector key themes

The aviation sector is in many respects in good health but there are some key challenges that are facing the industry including the rising cost of ownership, aircraft shortages and higher labour costs.

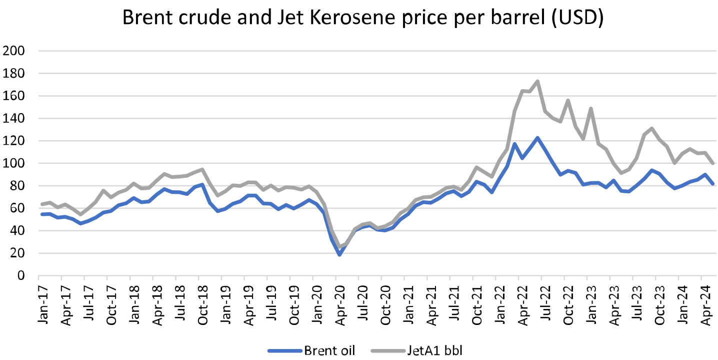
Airlines reporting strong profitability: Most major airline groups in the world returned to respectable levels of operating margin in 2023 as illustrated by the chart below, mainly driven by strong revenue. Strong passenger demand combined with a global shortage of aircraft has limited the supply of seats and kept pricing firm. In 2024 we expect to see a normalisation of passenger yields (against a very strong 2023 base) as capacity constraints ease a little but we continue see a strong revenue environment.



<u>Supply chain issues continue to affect aircraft and engine supply</u>: Airbus recently trimmed its full-year delivery forecast guiding to a figure of 770 aircraft this year, down from 800 previously, and the production target of 75 A320neos monthly has been pushed back from 2026 to 2027. The OEM says it is facing "persistent" and "specific" supply-chain issues, primarily affecting engines, aerostructures and cabin equipment. Boeing has faced production quality issues most notably with its key supplier Spirit AeroSystems which manufacturers the fuselage of the 737 Max. In Boeing's Q1 results statement, the company stated that "Our first quarter results reflect the immediate actions we've taken to slow down 737 production to drive improvements in quality". Meanwhile the Pratt & Whitney's Geared Turbofan (GTF) engine issues continue to ground a significant proportion of Airbus A320 neo and Airbus A220 aircraft. Airlines are reporting that worldwide repair capacity is too low leading to many months of engines off wing.

<u>Rising cost of ownership</u>: Rising interest rates mean that the cost of borrowing is clearly much higher than it has been over the last fifteen years when interest rates were held low following the global financial crisis. This combined with the shortage of aircraft means that aircraft lease rates have risen substantially over the past 12 months. New aircraft lease rates for the A320-200N and B737 Max 8 for example were below USD300,000 a month in January 2022 but are now around USD400,000.

<u>Jet crack spread moderates but labour costs structurally higher</u>: Brent crude has been fairly stable at around US$80/bbl over the past year which is perhaps surprising given the amount of geopolitical instability. However, the key issue for the industry in recent years has been the unusually high cost of refining with crack spreads averaging USD40/bbl in 2022 compared to historical averages below USD20/bbl. The good news is that the crack spread has returned to around USD20/bbl as illustrated by the chart below.



However, labour costs are structurally higher than historically especially in the US mainly driven by pilot wages. For example in 2013, American, United and Delta all had employee costs of between 20 and 23% of sales. In 2023 they reported employee costs at 28% of sales.

KPMG IN AVIATION

KPMG offers a broad range of professional services in aviation including tax advisory, capital markets and management consultancy covering airline business planning, cost benchmarking, project management and transaction due-diligence.

Japan
Key Developments & the Latest Trends in Japan from a Legal Perspective

MORI HAMADA & MATSUMOTO

BIO

Hiromi Hayashi is a partner at Mori Hamada & Matsumoto. Hiromi is a member of the Logistics Subcommittee of the Study Group on the Flying of Unmanned Aircraft (Drones) Beyond Visual Line of Sight and Over Third Parties, established jointly by the Ministry of Land, Infrastructure, Transport and Tourism and the Ministry of Economy, Trade and Industry (2017).

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Mori Hamada & Matsumoto

MORI HAMADA & MATSUMOTO

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MORI HAMADA & MATSUMOTO

Key Developments & the Latest Trends in Japan from a Legal Perspective

MORI HAMADA & MATSUMOTO

Introduction

Although the Japanese aviation industry, including airlines and the aviation finance industry, was significantly harmed by the COVID-19 pandemic, fortunately no airline in Japan has gone bankrupt due to the pandemic, and the industry is now recovering thanks to the rapid recovery of passenger demand as well as the general global trend of recovery. The recovery trend in Japan is expected to continue, but there are some challenges such as the rising price of oil. From the legal perspective, there have not been any remarkable updates or developments in aviation finance and leasing in recent years.

Legal Framework for Aviation Finance & Leasing

Aviation Finance & Leasing Regulatory Framework In Japan, there is no single, comprehensive piece of legislation regulating aviation finance and leasing. The following two laws (including the orders and regulations thereunder) are relevant to aviation finance and leasing on top of Japanese Civil Code and the Commercial Code. Please note that citations to relevant articles and provisions of the laws below refer to the law in each respective section title unless noted otherwise.

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> Under the Civil Aeronautics Act, MLIT registers an aircraft in the Aircraft Register (Koukuuki Tourokugenbo) by application of an owner of the aircraft (Article 3, Article 5)

A) The Civil Aeronautics Act *(Koukuu Hou)*
The Civil Aeronautics Act governs civil aeronautics activities in Japan based on the Convention on International Civil Aviation (the Chicago Convention) and its Annexes. For treaties related to aviation finance and leasing, in addition to the Chicago Convention, Japan has ratified the Convention for the Unification of Certain Rules for International Carriage by Air (the Montreal Convention). On the other hand, Japan has not ratified the Convention on Damage Caused by Foreign Aircraft to Third Parties on the Surface (the Rome Convention), the Convention on the International Recognition of Rights in Aircraft (the Geneva Convention), and the Convention on International Interest in Mobile Equipment (the Cape Town Convention) and the Protocol to the Convention on International Interest in Mobile Equipment on Matters Specific to Aircraft Equipment.

Under the Civil Aeronautics Act, the Ministry of Land, Infrastructure, Transport and Tourism (“**MLIT**”) is the principal regulator of aviation matters. In addition, the act defines “aircraft” as any aeroplane, rotorcraft, glider and airship that can be used for air navigation with a person on board and any other apparatus used for air navigation as may be specified by a cabinet order related to the act.

Aircraft in the context of aviation finance and leasing would fall under “aeroplane” *(hikouki)* in the definition above.

Under the Civil Aeronautics Act, MLIT registers an aircraft in the Aircraft Register *(Koukuuki Tourokugenbo)* by application of an owner of the aircraft (Article 3, Article 5). This Aircraft Register is a registry of owners of aircraft. As it currently stands, there is no registration system for engines of aircraft, lease interests in aircraft and lease agreements over aircraft in Japan, and lessees of leased aircraft cannot be registered in the Aircraft Register. By completing registration in the Aircraft Register, the registered aircraft acquires a Japanese nationality. In principle, any aircraft which does not have this registration cannot be operated in Japan with exceptions for foreign-registered aircraft (Chapter 8). Under this law, any registration in the Aircraft Register cannot be made regarding any aircraft owned by (i) any person who does not have a Japanese nationality, (ii) any foreign state or public entity or its equivalent in any foreign state, (iii) any juridical person or body established in accordance with the laws and regulations of any foreign state, or (iv) any juridical person of which the representative is any one of those listed in the preceding three items or of which one-third or more of the officers are those persons or one-third or more of voting rights are held by those persons (Article 4, Paragraph 1). In the context of aviation finance and leasing, in order for a foreign owner to lease aircraft that are or will be registered in the Aircraft Register to a Japanese airline, in practice, the owner nominates an SPC that does not fall under any of the requirements above to own the registered aircraft.

Under the laws of Japan, any transfers of aircraft ownership take effect upon execution of an agreement between the seller and the purchaser, and no formalities are required, but the new owner of the registered aircraft is required to apply for a transfer of registration within a period not exceeding 15 days (Article 7-2). However, the act stipulates that no acquisition or loss or change of ownership of any registered aircraft (more precisely, limited to aeroplanes and rotorcraft) may be duly asserted against a third party unless the aircraft has been registered. That is, registration in the Aircraft Register also functions as a means of perfect ownership. However, it should be noted that if the registration is false and there is a true owner who is not registered in the Aircraft Register, the buyer cannot acquire ownership of the aircraft. In this sense, the Aircraft Register acts as a crucial piece of evidence to prove ownership, but it does not per se protect a person who relies on a false registration.

B) The Aircraft Mortgage Act *(Koukuuki Teitou Hou)*

The Aircraft Mortgage Act clearly stipulates that aircraft can be the subject matter of a mortgage (*teitouken*; Article 3) though the act explicitly provides that the registered aircraft cannot be the subject matter of a pledge (*shichiken*; Article 23). The types of mortgages when it comes to aircraft include revolving mortgages (*neteitouken*), which secure unspecified claims of a certain scope, up to the limit of a maximum amount on top of ordinary mortgages as well as ones stipulated in the Civil Code. The Aircraft Mortgage Act does not stipulate a mortgage over engines or other spare parts of aircraft, but those parts may be subject to security assignments (*jototanpo*; note that pledges are practically not used for those parts since the Civil Code stipulates that a pledgee may not allow a pledgor to possess the thing pledged on behalf of the pledgee (Article 345 of the Civil Code)).

Although creation of aircraft mortgages takes effect without any registration, a registration of an aircraft mortgage in the Aircraft Register in which ownership of the aircraft is registered is necessary for its perfection against any third party (Article 5 of the Aircraft Mortgage Act). To register an aircraft mortgage, the mortgagee and the mortgagor must jointly apply for registration and submit a document verifying the existence of the mortgage, such as the mortgage agreement, and other necessary documents. The aircraft mortgage registration tax is JPY 0.003 multiplied by the loan amount or the maximum secured amount. Since the amount of tax tends to be high, it is customary to make a provisional registration (*karitouroku*) for the mortgage and pay only JPY 2,000 as a registration tax per aircraft.

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> Under the laws of Japan, any transfers of aircraft ownership take effect upon execution of an agreement between the seller and the purchaser.

In addition, for the priority of aircraft mortgages, the Aircraft Mortgage Act stipulates that an aircraft mortgage has the same priority as a first-rank lien (sakidoritokken; Article 11). First-rank liens include liens for leases of immovables, lodging at hotels and transportation (Article 330, Paragraph 1, item 1 of the Civil Code).

Repossession and Enforcement of Security

A) Repossession Procedures

Under the laws of Japan, in principle, self-help is illegal. Thus, even if a lessee does not voluntarily return leased aircraft to a lessor after the termination of a lease agreement, if the lessor repossesses the aircraft from the lessor by itself, the repossession can be judged as a tort (Article 709 of the Civil Code). Thus, in the case above, the lessor needs to file a petition for compulsory execution and, if necessary, an execution of provisional seizure of the aircraft to a competent district court in order to retrieve the aircraft from the lessee. More specifically, under the Civil Aeronautics Act, the compulsory execution and the execution of provisional seizure of a registered aircraft are governed by rules issued by the Supreme Court (Article 8–4, Paragraph 2 of the Civil Aeronautics Act), and the Civil Execution Rules (*Minji Shikkou Kisoku*) and the Civil Provisional Remedies Rules (*Minji Hozen Kisoku*) apply to the compulsory execution and execution of provisional seizure of the registered aircraft (Article 84 of the Civil Execution Rules and Article 34 of the Civil Provisional Remedies Rules).

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> Under the laws of Japan, in principle, self-help is illegal.

If the court decides to commence the procedures for compulsory execution, it must order a public auction of the aircraft, obtain the documents which are necessary to fly the aircraft, including verification of the aircraft's nationality, and prohibit the aircraft's departure (Article 84 of the Civil Execution Rules and Article 114 of the Civil Execution Act). In addition, the execution of a provisional seizure is carried out by (i) making an entry of the provisional seizure in the register, or (ii) obtaining the documentation necessary to fly the aircraft, including the verification of the aircraft's nationality (Article 34 of the Civil Provisional Remedies Rules and Article 48 of the Civil Provisional Remedies Act). Since aircraft without any registration certification cannot be used for aviation under the laws of Japan, aircraft subject to the court's orders will be detained through the procedures for compulsory execution and execution of provisional seizure. On top of that, if it is likely that a compulsory execution will become significantly unfeasible unless the aircraft is in detention, the lessor may file a petition with the district court with jurisdiction over the aircraft's home base (*teichijyo*) before commencing the compulsory execution procedures to request that the court order for the delivery of the registration certification. Furthermore, if there are pressing circumstances, the lessor may file the petition with the district court with jurisdiction over where the aircraft is located (Article 84 of the Civil Execution Rules and Article 115 of the Civil Execution Act). Even if the certification of registration is delivered, the possession of the aircraft is not deemed delivered to the lessor or the court. The lessor may file a petition to appoint a custodian to maintain the aircraft until the compulsory execution starts (Article 84 of the Civil Execution Rules and Article 116 of the Civil Execution Act).

For the compulsory execution, it shall be carried out based on "title of obligation" (Saimumeigi), which includes, among others, (i) a final and binding judgment, (ii) a judgment of a foreign court for which an execution judgment has become final and binding and (iii) an arbitral award for which an execution order has become final and binding (Article 22 of the Civil Execution Act). For (ii), in order to obtain an execution order from a court, it must satisfy the following requirements (Article 118 of the Code of Civil Procedure):

(a) the jurisdiction of the foreign court is recognised pursuant to laws and regulations, conventions, or treaties;
(b) the defeated defendant has been served (excluding service by publication or any other service similar thereto) with the requisite summons or order for the commencement of litigation, or has appeared without being so served;
(c) the content of the judgment and the litigation proceedings are not contrary to public policy in Japan; and
(d) there is a guarantee of reciprocity in the country of the foreign court.

In terms of (iii) above, Japan has ratified the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention). The Arbitration Act stipulates that an arbitral award (irrespective of whether or not the place of arbitration is in Japan) shall have the same effect as a final and binding judgment; provided, however, that a civil execution based on said arbitral award requires an execution order (*Shikkoukettei*; Article 45, Paragraph 1 of the Arbitration Act). However, this provision is not applied in some exceptional cases such as if the petition filed in the arbitration procedure is concerned with a dispute that may not be subject to an arbitration agreement pursuant to provisions of the laws and regulations of Japan or the content of the arbitral award is contrary to public policy in Japan.

B) Procedures for Enforcement of Security

As mentioned above, under the laws of Japan, in principle, self-help is not permitted. Thus, even if an owner of an aircraft declines to cooperate with a mortgagee to conduct a voluntary sale other than a disposal agreed under a security agreement between the mortgagee and the owner, the mortgagee needs to file a petition for compulsory execution to a competent court. The compulsory execution is the same as the one for repossession mentioned above (Article 175 of the Civil Execution Rules).

Choice of Law

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> Japan has ratified the Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

The Act on General Rules for Application of Laws stipulates that (i) a real right to movables or immovables and any other right requiring registration are governed by the law of the place where the subject property of the right is situated and (ii) acquisition or loss of the right is governed by the law of the place where the subject property of the right is situated at the time when the facts constituting the cause of the acquisition or loss were completed regardless of (i) (Article 13 of the Act on General Rules for Application of Laws). Although it is not expressly provided for in the act, the law of the registration is usually considered as the governing law of real rights regarding aircraft.

Taxation

If a business provider transfers or lends any property or provides services to a third party for consideration within Japan, a consumption tax will be levied on the transaction (the current rate is 10%). However, if the transaction is considered an export under the Consumption Tax Law and the business provider has an export permit, the transaction may be exempt from consumption tax. In the case of an aircraft that delivers passengers or cargo outside Japan, the transfer of the aircraft may be exempted if certain requirements under the Consumption Tax Law are satisfied. Furthermore, the Stamp Tax Law requires that stamps be affixed to certain documents, including an agreement to sell and purchase an aircraft. The amount of the stamp depends on the purchase price. For example, if the price is more than JPY 100,000,000 but not more than JPY 500,000,000, the stamp amount is JPY 100,000; and if the price is more than JPY 5,000,000,000, the stamp amount is JPY 600,000.

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When an aircraft is registered in the Aviation Register, a registration tax is imposed.

In addition to the above, annual property tax is imposed on the owner of an aircraft. On top of that, withholding tax may be imposed on rent paid by a Japanese lessee to a foreign lessor.

Furthermore, as mentioned above, when an aircraft is registered in the Aviation Register, a registration tax is imposed.

Exchange Control

Under the Foreign Exchange and Foreign Trade Act, except in the event of certain exceptional cases such as payment to a person subject to economic sanctions, payments in relation to aviation financing and leasing are not subject to any approval requirements. However, it should be noted that a post-closing report on certain payments or receipt of payment is required if the payment amount is equal to or greater than JPY 30,000,000.

LITHUANIA

Latest Aviation Trends and General Overview of Aviation Regulation in Lithuania

COBALT

BIO

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Introduction

Although Lithuania no longer has a national airline, charter companies are popular in the market, especially during holiday periods. Although the Lithuanian aviation industry was heavily affected by the COVID-19 pandemic, no charter company has gone bankrupt. In fact, just recently in spring 2024, one charter company undergoing restructuring finished restructuring procedures earlier than planned and successfully continues its operations from Lithuania.

Lithuanian Airports, a company operating three airports in Lithuania, has just recently presented a long-term master plan for the development of the entire network until 2052, aiming to develop a competitive model for Lithuanian airports, improve efficiency and clearly map out the infrastructure development steps for Vilnius, Kaunas, and Palanga airports in order to be able to seamlessly handle 17 million passengers a year in the future.[1] It is noteworthy that approx. €180 million in investments is planned for Vilnius airport (Lithuania's main capital airport), an additional €50 million for Kaunas airport (in Lithuania's second largest city), and €50 million for Palanga airport (in a busy Baltic Sea coast summer resort).[2]

> "Although Lithuania no longer has a national airline, charter companies are popular in the market, especially during holiday periods.

From the legal perspective, there have not been any remarkable updates or developments in aviation finance and leasing in recent years, save that Lithuania has just recently ratified the Cape Town Convention on International Interests in Mobile Equipment (2001).

Lithuanian Legal Framework for Aviation Finance and Leasing – General Overview

General Legal Framework

In Lithuania, there is no single regulation covering all aspects of aviation finance and leasing. The primary regulation governing the aviation industry in general is the Aviation Law, establishing the main rules regarding administration of aviation, use of airspace, aircraft and other facilities in aviation, airport operations, carriage, search and rescue, and pecuniary liability and insurance of entities related to aviation. A number of secondary laws implementing the Aviation Law, such as orders, decrees, etc., have been adopted by the Lithuanian Government, the Lithuanian Ministry of Transport and Communications, the Lithuanian Transport Competence Agency, the Lithuanian Transport Safety Administration, State Enterprise Oro navigacija (Air Navigation), and others.

As to financing transactions, the general rules are established by the Civil Code (governing the creation and perfection of pledges/mortgages under local law) and the Code of Civil Procedure (governing enforcement of pledges/mortgages). If financing is provided by Lithuanian lenders, other local laws may also be relevant (e.g. the Law on Financial Institutions, the Law on Banks, and other laws and secondary legislation of the Republic of Lithuania and of the European Union).

1. More information: https://www.vilnius-airport.lt/en/news/the-changes-in-lithuanian-aviation-until-2052-lithuanian-airports-present-a-long-term-master-plan
2. Op. cit.

Aviation Authorities

Pursuant to the Aviation Law, the Government, the Ministry of National Defence, the Ministry of Transport and Communications, the Chief of Defence of the Republic of Lithuania, the Lithuanian Transport Safety Administration, and the Lithuanian Transport Competence Agency implement national management of the aviation sector in the country within the scope of their competence. As regards civil aviation, the core functions are vested in the Lithuanian Transport Safety Administration and the Lithuanian Transport Competence Agency, which took over the functions of the Lithuanian Civil Aviation Administration after its restructuring in 2019.

Registration of Aircraft in Lithuania

Requirements for aircraft registration in Lithuania are established in the Aviation Law, the Regulations of the Register of Civil Aircraft, the Rules for Registration of the Objects of the Register of Civil Aircraft, and the Rules for Issuing of Registration Marks and Marking of Civil Aircraft.

An aircraft is eligible for registration with the Register of Civil Aircraft if: (a) it has a certificate of airworthiness; (b) it is not registered in a foreign aircraft register; (c) the aircraft owner is: (i) a citizen of the Republic of Lithuania or another member state of the European Union; or (ii) another natural person who makes use of the right of free movement in the member states of the European Union provided to him by the legislation of the European Union; or (iii) a legal entity registered in the Republic of Lithuania; or (iv) the State of Lithuania or a municipality; or (v) the owner of the aircraft is not a person specified in items (i), (ii) and (iii) above, but the aircraft performs more than half of the flights from an airport of the Republic of Lithuania; or (vi) the operator of the aircraft is a person specified in items (i), (ii) or (iii) above; (d) the aircraft is not registered in the Register of Military Aircraft of the Republic of Lithuania.

The requirement specified in item (a) above does not apply in the case of test flights to obtain a certificate of airworthiness.

The minimum set of documents required for aircraft registration with the Register of Civil Aircraft is the following: (a) application to the Transport Competence Agency; (b) documents evidencing the owner's legal title to the aircraft; (c) document evidencing the transfer and acceptance of the aircraft (for example, a transfer and acceptance deed); (d) if the aircraft was registered in a foreign aircraft register – the original certificate issued by that register, evidencing deregistration of the aircraft; if the aircraft was not registered in a foreign aircraft register, then the original certificate issued by the aircraft register of the country from which the aircraft is imported, evidencing that the aircraft was not registered there (if the original certificate cannot be provided, an exemption may be requested, with reasons why the original certificate cannot be provided); (e) registration (if legal entity) or personal identity (if natural person) documents of the owner and/or operator of the aircraft; (f) documents evidencing the right to manage and/or operate the aircraft (for example, lease agreement) if not the owner of the aircraft (if the document is in a foreign language, the Transport Competence Agency may request its translation into Lithuanian); (g) power of attorney issued by the aircraft owner to the person submitting the documents to the Transport Competence Agency; (h) documents evidencing payment of the registration fee (which depends on the aircraft specifications and whether registration is regular or expedited).

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> As regards civil aviation, the core functions are vested in the Lithuanian Transport Safety Administration and the Lithuanian Transport Competence Agency

When copies of documents are provided, these have to be certified by a public notary and, where applicable, certified with an Apostille or legalised and translated into the Lithuanian language (unless otherwise agreed with the aviation authority).

Title Transfers

Lithuanian laws provide that title and other rights in rem to real estate are governed by the laws of the country in which the real estate is located (*lex rei sitae*). Under Lithuanian laws, aircraft registered in Lithuania are considered real estate; therefore, title and other rights in rem in registered aircraft are governed by the laws of the country of aircraft registration (*lex registri*).

The agreement for the sale and purchase of an aircraft registered with the Lithuanian Civil Aircraft Register is governed by Lithuanian law and requires certification by a notary in Lithuania. Aircraft sale and purchase agreements concluded in breach of the notarisation requirements are null and void. Therefore, if the agreement for the sale and purchase of a Lithuania-registered aircraft is governed by foreign law, the Transport Competence Agency may refuse to register the change of the owner with the Lithuanian Civil Aircraft Register, and in case of a dispute Lithuanian courts may refuse to apply foreign law in respect of the transaction.

"Lithuanian laws provide that title and other rights in rem to real estate are governed by the laws of the country in which the real estate is located.

Nonetheless, in respect of aircraft registered in a foreign Civil Aircraft Register, the rules of Lithuanian law would not apply. Thus, application of foreign law would be recognised in Lithuania, unless doing so conflicts with the public order and Lithuanian mandatory statutory provisions.

Registration of Lease Interests in Lithuania

There is a requirement when applying for aircraft registration with the Lithuanian Civil Aircraft Register to provide the aircraft lease agreement to the Transport Competence Agency to substantiate the nexus with Lithuania (i.e. that the requirements for aircraft registration listed above are met). The respective aircraft is indicated in the aircraft registration certificate issued by the Transport Competence Agency and usually also in the operations specifications of the aircraft operator.

Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 September 2008 entitles an air carrier (lessee) to take on lease aircraft registered in both EU and non-EU countries. A Lithuanian air carrier may be required to obtain prior approval of the Transport Competence Agency subject to the requirements contained in the Regulation.

Aircraft Mortgage

In Lithuania, security for obligations can be established over aircraft. This is usually done by creating a mortgage over the aircraft. Security can also be established over other types of collateral (e.g. over movable items or rights, such as funds in bank accounts). The security interest is effective upon creation, but may be invoked against third parties, with certain exceptions, only if registered in the Register of Contracts and Liens (for aircraft mortgages and pledges of movables and rights) or in the Real Estate Register (for real estate mortgages). Aircraft mortgage (even though legally treated as real estate) is subject to registration with the Register of Contracts and Liens.

The pledge/mortgage agreement can be signed in a free form and may be structured in a way acceptable to the parties (however, it must contain certain mandatory prerequisites (requirement as to substance), as established by the Lithuanian Civil Code).

The aircraft mortgage agreement must be certified by a notary in Lithuania. The notary certifying the transaction will require the mortgage agreement to be drafted in the Lithuanian language. A bilingual version of the mortgage agreement can be used, but the Lithuanian version would have to prevail. In certain cases, for instance, the English language can be chosen as the prevailing language, but notaries will then require that, along with the other parties, the agreement is signed by the translator confirming that the translation is correct. The notary notifies details of the notarised mortgage agreement to the Register of Contracts and Liens for registration. Registration normally takes 1 to 2 business days from the date of receipt of such notification from the notary.

To discharge or cancel a mortgage and/or pledge, a relevant request has to be submitted to the notary by the creditor, or by the collateral owner, in the latter case together with evidence showing the proper fulfilment of the secured obligation. Upon receipt of such request, the notary notifies the Real Estate Register and/or the Register of Contracts and Liens that the mortgage and/or pledge should be deregistered. The mortgage and/or pledge is removed from the respective register usually within one business day after receipt of such notification from the notary.

Status of Cape Town Convention: Ratification and Case Law

The Cape Town Convention on International Interests in Mobile Equipment (2001) has been ratified in Lithuania just recently (on 14 June 2024). The law on ratification of the Cape Town Convention will enter into force and the implementing acts should be adopted by mid next year.

It is noteworthy that there are already some case law developments concerning the Cape Town Convention (although it has been ratified by Lithuania recently). In particular, in 2022 the Lithuanian Supreme Court ruled that the provisions of the Cape Town Convention concerning enforcement actions (protecting the rights of the holder of the collateral or international interest) would not be applicable without Lithuania's independent accession to this international treaty.

Repossession of Aircraft and Enforcement of Security

Repossession Following Lease Termination or Bankruptcy of the Lessee

Under Lithuanian law, the use of self-help remedies is essentially prohibited or very strictly limited to the cases clearly prescribed under applicable laws. This means that the aircraft should be repossessed in a normal business-like manner, under the terms of the lease agreement. In case of a dispute, the parties should bring the matter to court. Once the court issues a judgment, the same is submitted to the bailiff for enforcement.

If the lessee is undergoing bankruptcy, unless stated otherwise in the lease agreement, the lease is valid and enforceable until terminated by the decision of the bankruptcy administrator, i.e. the lessee undergoing bankruptcy is eligible to carry on its business activities. Upon termination of the lease, the aircraft may be repossessed in a normal business-like manner, i.e. the bankruptcy administrator cannot exercise and assume more rights than the entity undergoing bankruptcy had.

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The aircraft mortgage agreement must be certified by a notary in Lithuania.

Enforcement of Security

Mortgage and pledge enforcement procedures are practically the same. Enforcement is carried out through a notary and a bailiff. If the enforcement grounds established under the secured obligation and/or the applicable law exist, a creditor may apply to a notary for an enforcement record, based on which a bailiff starts the forced enforcement procedure. When a creditor (pledgee) applies for an enforcement record, the notary, having received the pledgee's request for an enforcement record, must firstly verify whether: (i) the person submitting the request is the pledgee; (ii) the data provided in the pledgee's request (pledge/mortgage identification code, claim amount, details of the debtor, pledgor/mortgagor and their addresses) conforms to the data provided in the relevant public register; (iii) whether the maturity date of the secured obligation has expired or, if the pledgee wishes to enforce the pledge before the maturity date, whether other grounds for enforcement exist. Having verified such data, the notary sends a notice to the debtor, proposing that the debtor repay the debt within 20 days from the date of the notice or submit evidence that the creditor's claim is invalid.

> "An enforcement record issued by a notary must be submitted to a bailiff for enforcement.

The notary will make or refuse to make an enforcement record based on the information provided by the creditor and the debtor. If the notary makes an enforcement record, the notary promptly notifies the relevant public register accordingly. From the date of registration of the enforcement record, the debtor has no right to dispose of the collateral without the creditor's consent.

An enforcement record issued by a notary must be submitted to a bailiff for enforcement. Usually, a creditor may choose from the following enforcement options: (a) to sell the collateral in a forced auction; or (b) to request transferring the collateral to the creditor for administration (in such case the creditor is entitled to cover its claim from the proceeds received during the administration). If the proceeds of sale of the collateral do not entirely cover the creditor's claim, the creditor is entitled to initiate general debt recovery proceedings.

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L A T A M

Overview

The Mexican aviation industry has shown resilience and growth post-pandemic, marked by increased passenger traffic, significant investments, and regulatory changes aimed at enhancing safety and competitiveness. Key players like Aeroméxico, Volaris, and Viva Aerobus continue to expand their fleets and routes.

Following a significant downturn due to the COVID-19 pandemic, the Mexican aviation industry has seen a robust recovery. By mid-2024, passenger traffic had returned to pre-pandemic levels, with domestic travel rebounding more quickly than international travel. This recovery is driven by increased demand for leisure travel and a resurgence in business travel.

> "Arguably the biggest issue Mexico faced are the reckless policy decisions made by the Federal administration that have impacted the Mexican Aviation market as a whole.

Arguably the biggest issue Mexico faced are the reckless policy decisions made by the Federal administration that have impacted the Mexican Aviation market as a whole. First, with regards to the decision to scrap the construction—on a political basis-- of the much-needed New Mexico City mega airport; and the lack of policies and regulations that resulted in the downgrade of Mexico's FAA assessment.

Below, we will assess these developments from a factual and legal standpoint. Finally, we will note how despite these challenges, the Mexican Aviation market trends are positive, favourable, and ever-growing.

Latest Developments
The Mexico City Airport Dilemma

It's no secret that the Mexico City Airport (AICM) has been saturated for years. Given this saturation, which has been evident for several years, there was an urgent need to find a viable alternative for the connectivity and infrastructure in Mexico City. Therefore, the previous administration began construction of the New Mexico City International Airport (NAICM), a project that represented the largest infrastructure project in Latin America and the second largest airport in the world. However, the new administration formally announced the cancellation of the NAICM.

Instead, to fix the saturation of the current Mexico City Airport, the government would allow and encourage simultaneous operations of three different airports: AICM, the Felipe Angeles International Airport (AIFA), and the Toluca International Airport (TLC). This was done with a backdrop where there was already existing infrastructure associated with the Metropolitan Airport System, which includes the AICM and TLC. Having 30% of the original NAICM project completed, the Federal Administration decided that the construction of the AIFA airport, rather than continuing with the construction of the NAICM, was the way forward. This political assessment provided the Secretary of National Defense with the construction of the project and cost Mexican taxpayers and investors around 13 billion dollars in cancellation liability, lost infrastructure, and the cost of the new AIFA airport from scratch.

As of June 2024, the AIFA airport is operational, but it has faced challenges in attracting significant airline traffic due to its distance from Mexico City and the preference of airlines and passengers for the more centrally located AICM. Efforts are ongoing to increase the utilisation of AIFA, including improving transportation links and offering incentives to airlines.

The Mexican Airline Situation

The next development in this series of events in the Mexican aviation market was the global stress that the pandemic had on aviation travel. This resulted in financial difficulties that the Aviation Finance market suffered globally. The situation was particularly difficult for two out of the four main carriers in the Mexican market.

The loss of the third-largest airline caused connectivity in Mexico to become extremely reduced. What followed was the repossession of the leased aircraft, with the substantive majority of aircraft being repossessed in a timely manner prior to bankruptcy. The successful repossession of aircraft is testament to the strong and reliable legal system that Mexico provides by assuring creditors property and repossession rights. Compliance with the Cape Town Convention's declaration in accordance with the Mexican declarations allows expedited remedies, assuring creditors that their rights and property are protected and respected. The legal framework for Aviation Finance in Mexico is not only reliable but has also been stress-tested on multiple occasions.

The death of one of the four major Mexican airlines covering the market was not an isolated incident. Aeromexico, the largest airline in Mexico, had to seek restructuring under Chapter 11 proceedings in June 2020. Aeromexico was able to exit their restructuring process and secure $5 billion for a 5-year fleet expansion plan in March 2022. The property-secured transactions and restructuring regulations in Mexico have granted lessors and financiers the security and trust to recognise their rights in these procedures.

The FAA Category Conundrum

The last piece of the trifecta for a perfect storm of the Mexican aviation industry was the downgrade by the Federal Aviation Administration (FAA) from Category 1 to Category 2. The FAA conducted an excruciating audit on the Mexican Civil Aviation Authority between October 2020 and February 2021. The result of such an audit was devastating, as the U.S. Department of Transportation determined that Mexico had several infractions identified by the International Aviation Safety Assessment process regarding Annexes 17 and 18 of the Convention on International Civil Aviation. Therefore, Mexico's safety rating according to the FAA was downgraded from category 1 to category 2.

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> The next development in this series of events in the Mexican aviation market was the global stress that the pandemic had on aviation travel.

The aviation industry moved swiftly in ensuring open conversations with the government so that they treat this downgrade as a priority; however, the government's response was practically non-existent. This meant that the industry stakeholders had to deal with the consequences of the downgrade by themselves. Among these consequences are (i) the prohibition for Mexican airlines to add or initiate new services, aircraft, or routes to the US, (ii) maintenance and repair facilities are only authorised to provide services to Mexican-registered aircraft (unless they have a separate FAA certification), and (iii) increased scrutiny on Mexican operators' flights to the US.

It has been two years since the downgrade, and as a result, US airlines have gained at least 10% of market share due to an increased number of flights and routes to Mexico as Mexican airlines cannot operate more or new flights to meet the demand. Since the downgrade, and in an effort to regain its Category 1, Mexico has been working endlessly in the training of air traffic controllers and aeronautical personnel, as this was one of the reasons for the downgrading, which is caused mainly by the lack of budget by the government. As of June 2024, Mexico has finally regained its Category 1 rating, bringing relief and renewed opportunities for growth in the aviation sector.

Newly Elected President and Aviation Policy Trends[1]

In June 2024, Mexico elected a new president, Claudia Sheinbaum. While her policies on the matter are yet to be known, she has vaguely outlined the following initiatives that, if enforced, may support the aviation industry:

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> Domestic passenger traffic has increased by 23% compared to pre-pandemic levels.

1. **Infrastructure Development:** President González has committed to revisiting the feasibility of expanding AICM and enhancing the connectivity between AIFA and central Mexico City. This includes potential investments in high-speed rail and improved road networks to facilitate access to AIFA.
2. **Regulatory Reforms:** The new administration plans to streamline aviation regulations to make them more investor-friendly. This includes simplifying the processes for obtaining operational licenses and reducing bureaucratic hurdles for new entrants in the market.
3. **Support for Domestic Airlines:** President González has promised financial support and incentives for Mexican airlines to help them expand their fleets and routes. This includes subsidies for new aircraft purchases and tax breaks for airlines that increase their domestic and international flight offerings.
4. **Environmental Initiatives:** Recognising the growing importance of sustainability, the new administration aims to implement policies that encourage the adoption of greener technologies in aviation. This includes incentives for airlines to invest in more fuel-efficient aircraft and the development of biofuel infrastructure.
5. **International Collaboration:** The new president has expressed a strong interest in enhancing Mexico's aviation ties with international partners, particularly the United States and Canada. This includes negotiating new bilateral agreements to expand market access and improve operational efficiencies.

Trends and Future

Despite the terrible trifecta discussed above, the Mexican aviation industry is growing significantly and is already exceeding pre-COVID traffic and aircraft order numbers as of the date of this article. The Mexican aviation industry currently has the largest commercial fleet it has had since 2018, with Aeromexico having just over 40% of the fleet, followed by Volaris and Viva Aerobus.

Domestic passenger traffic has increased by 23% compared to pre-pandemic levels. Nonetheless, it is important to note that Aeromar, a domestic carrier, ceased operations in February 2023, which was a blow for the Mexican aviation industry but also highlighted the effective repossession mechanisms that are in place for lessors and financiers. This further emphasises Mexican courts' willingness to honour contracts and the international remedies of the creditors.

1. https://expansion.mx/empresas/2024/03/01/sheinbaum-100-puntos-trenes-de-pasajeros

Creditors in Mexico can be assured that their leasing and property rights are and have remained secured and will continue to do so even beyond national carriers and Mexican-registered aircraft. The Mexican Civil Aviation Authorities and the Judges have truly honoured the Cape Town Convention obligations and the Mexican law in enforcing remedies in light of the detention of Russian-operated aircraft in Mexican territory. This was highlighted with the repossession of Russian aircraft in Mexico as a result of the imposed sanctions and cancellation of the registration mark. This was a unison effort with international authorities and other governments. The turbulent landscape that Mexico has confronted in the past few years provides certainty for creditors and financiers that their rights will be respected and efficiently enforced.

According to Boeing's 2023 Commercial Market Outlook (CMO), the Latin American and Caribbean region will need 2,240 new airplanes by 2041, with Mexico being the second-largest market in the region. Seat and passenger growth has seen a 31.8% growth versus 2022 levels and a 14% growth versus 2019 levels prior to the COVID-19 pandemic. Specifically, Mexico is expected to need approximately 480 new aircraft to meet its growing demand over the next two decades.

Mexico is and continues to be a resilient market, and Aircraft Finance will continue to grow strongly.

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Creditors in Mexico can be assured that their leasing and property rights are and have remained secured and will continue to do so.

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BIO

Amna Al Jalaf is recognized internationally as one of the Middle East's leading aviation law experts. She began her career as the first and only Emirati and Arabic speaking in-house legal counsel at Emirates before establishing the first specialist aviation firm in the UAE, Al Jallaf Advocates. Amna's clients include major airlines, international law firms, multinational banks and corporations, and industry leaders. Her practice encompasses all aspects of commercial litigation and aviation law. Amna has been appointed to a number of prestigious positions, she is proudly one of the few notable legal professionals appointed to the Legal Advisory Panel of the Aviation Working Group (AWG), a UN endorsed international industry group. Amna was also elected as a Member of the Board of the Dubai Chamber of Commerce; an office she served for over fifteen years. Her expertise is often sought after, she is regularly invited to attend key events globally to give speeches and presentations on the aviation sector.

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BIO

Ihab is an Italian attorney-at-law and expert in the aviation sector.

He has extensive experience in high-profile litigation, aircraft financing and leasing, aviation regulation, aircraft accident investigations and policy & business aviation issues.

Ihab has addressed numerous conferences on aviation law and aircraft financing & leasing in the Middle East, Europe and Canada, and published on a variety of issues, including commercial aviation developments, environmental regulation impacting the aviation sector and the Cape Town Convention and its Aircraft Protocol.

He is a member of ICAO's Commission of Experts of the Supervisory Authority of the International Registry (CESAIR) for the purposes of the Cape Town Convention (CTC) and the Aircraft Protocol.

Key developments & the latest trends in the United Arab Emirates – from a legal perspective

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Introduction

Within the complex landscape of global aviation, the United Arab Emirates (UAE) stands as a pivotal figure, marked by significant legal developments and strategic initiatives that shape the industry's trajectory. Over recent years, the UAE has demonstrated a steadfast commitment to fostering international cooperation through the negotiation and implementation of the Open Skies agreements, facilitating unrestricted air travel between nations.

Simultaneously, the nation has embarked on ambitious endeavours to expand and modernize its aviation infrastructure, underpinned by a robust legal framework that ensures regulatory compliance and fosters sustainable growth. Moreover, the UAE's ventures into space exploration have raised legal considerations regarding international space law and domestic regulations, reflecting the nation's proactive stance in navigating the legal complexities of space activities. Anchored by a dedication to legal excellence and regulatory innovation, these developments underscore the UAE's role as a trailblazer in shaping the legal landscape of aviation and space exploration.

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This article aims to explore and provide an overview for those significant developments, and an insight into what the future holds, for not just the UAE and the MENA region, but the whole world.

Open Skies Agreements:

Throughout the years, the UAE has expanded its network of Open Skies agreements, fostering international cooperation and liberalising air travel regulations. The UAE proudly remains as the country with the most signed open skies agreements, with over 187 agreements made with various countries worldwide. These agreements enable airlines from both countries to operate flights with minimal restrictions on routes, frequencies, and capacity. They have the ability to open up new opportunities for air connectivity and tourism between nations.

The benefits of these agreements range from promoting economic growth and job creation, to the enhancement of consumer choice and competition in the aviation market. When reviewing one of the most prominent and established Open Skies agreement for the UAE, which is with the United States of America, the longstanding appreciation and commitment of both nations to the free movement of goods and people has fostered numerous benefits and immensely strengthened their commercial relationship. This was confirmed in April of 2020, when Sir Tim Clark of Emirates Airline and Mr. Tony Douglas of Etihad Airways were hosted by the United States and United Arab Emirates Business Council for a joint briefing, discussing the significance of the Open Skies agreement.

Investment in Infrastructure:

The UAE's commitment to investing in aviation infrastructure is evident in major expansion projects at key airports. For example, the Zayed International Airport Expansion occurring in Abu Dhabi, represents a significant investment in state-of-the-art facilities to accommodate growing passenger traffic and enhance the airport's competitiveness as a global aviation hub. The Midfield Terminal Complex at Abu Dhabi International Airport is part of an approximately AED40 billion airport expansion plan, which features advanced technology and passenger amenities to provide a world-class travel experience. The 700,000-square metre terminal building can be expected to not only completely change the method of managing passenger traffic, but increase airline activity and create a global transportation hub as well.

Additionally, the Al Maktoum International Airport expansion plan is set to accommodate 260 million passengers a year, which is larger than any airport operation in the world. Accommodating 400 aircraft gates, and five parallel runways, it is said to be, as Sheikh Mohammed bin Rashid Al Maktoum, the ruler of Dubai, said, "five times the size of the current Dubai International Airport, and all operations at Dubai International Airport will be transferred to it in the coming years".

Space Exploration:

The UAE's ambitious space exploration program has garnered international attention, culminating in the successful launch of the "Hope" Mars probe in 2020. The program is designed to provide insight into the habitability conditions of the planet when the atmosphere had the capability to support life. This is performed through studying Mars climate change through time, which would in turn show a deeper understand of past conditions of the planet and whether it, in fact, was able to support life at a moment in time. This program also has the capability of providing insight into our own planet, and show us how climate change could impact Earth. Therefore, the global significance of this program and its potential are evident in its goals and ambitions.

Building on this achievement, the UAE has announced plans to establish a Mars colony by 2117, demonstrating its long-term commitment to space exploration and the potential for colonization. By embarking on the journey to establish a Mars colony, the UAE not only propels itself into the forefront of space exploration but also champions the collaborative spirit necessary for humanity's collective advancement beyond Earth's bounds. In addition to government-led initiatives, the UAE's private sector is also actively involved in space-related activities, with companies like Virgin Galactic and SpaceX exploring commercial space tourism and satellite launch services. The introduction of Federal Decree No.46 of 2023 to govern the space sector displays the solid legal approach of the UAE to attentively manage and organise space activity. The aim of this law is to construct a regulatory environment that provides support to achieve the objectives of the National Space Policy of the UAE, while also encouraging the participation of the private sector and increasing investment.

These developments are immensely thrilling, and we eagerly anticipate the remarkable trajectory it will take.

Sustainability Initiatives:

The UAE is actively promoting sustainability in the aviation industry through various initiatives and partnerships. Emirates Airlines continues to invest in fuel-efficient aircraft like the Boeing 777X and Airbus A350 which offer significant reductions in fuel consumption and carbon emissions compared to the previous models. Additionally, the UAE government is intending to develop its local capacity for 'Sustainable Aviation Fuel' (SAF), with plans of producing 700 million litres annually, in the aims of reducing the environmental impact of aviation through decarbonising the aviation sector and working towards low-carbon aviation fuel.

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The introduction of Ministerial Decree No.27 of 2023, concerning the Carbon Offsetting Reduction Scheme in International Aviation (CORSIA), marks the first of its kind in the Arab region. CORSIA is designed to align with the international standards set forth by the International Civil Aviation Organisation (ICAO), and provides clarity regarding the relationship between the legislator and the operator through discussing their roles and responsibilities towards annually monitoring and reporting emissions. Notably, the legislation underscores the pivotal role of the GCAA in overseeing CORSIA implementation in the UAE.

Legal actions such as CORSIA underscore the vital synergy between legal frameworks and sustainability goals, showcasing how law can drive positive environmental change in the aviation sector. Such measures not only ensure accountability but also foster innovation and collective action, ultimately contributing to a healthier planet for current and future generations.

Technology Integration:

The UAE is embracing cutting-edge technologies to enhance efficiency, safety, and passenger experience in aviation. For instance, Dubai International Airport has deployed advanced biometric authentication systems, allowing passengers to undergo seamless identity verification at various touchpoints throughout the airport. Similarly, the UAE's air navigation service provider, the Sheikh Zayed Air Navigation Center, has implemented state-of-the-art air traffic management systems, including satellite-based navigation and surveillance technologies, to improve airspace efficiency and enhance safety.

The recent AED 700 million allocation from the GCAA towards technological integration and updating air navigation services is based on employing the most recent technologies, such as AI and blockchain, in order to insure the highest possible levels of efficiency, safety, development and expansion.

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Legal and Regulatory Frameworks in Response to Technological Advancements:

In recent years, the UAE has enacted several laws and regulations to strengthen its legal framework for the aviation industry. The UAE introduced the UAE Space Law, governed by Federal Decree Law No. 46 of 2023, which provides a comprehensive legal framework for regulating space activities, including permits, safety, and liability issues. These legislative developments demonstrate the UAE's commitment to maintaining a robust legal framework that supports the growth and development of its aviation and space sectors.

Recently, the GCAA issued new regulations governing the operation of unmanned aerial vehicles (UAVs) or drones, addressing concerns related to airspace safety and security. Federal Decree-Law No.26 of 2022 is a clear demonstrator of the UAE's constant actions to ensure the regulation and control of constantly evolving technologies in the aims of minimising risk and guaranteeing competencies.

Conclusion

Looking ahead, the United Arab Emirates emerges as a beacon of legal innovation and foresight within the global aviation industry. As the nation continues to aim for growth and commitment in international cooperation, infrastructure expansion, and space exploration, its commitment to legal excellence serves as a cornerstone for future progress. With each legal development and strategic initiative, the UAE charts a course towards a future where regulatory precision and innovation converge to shape the trajectory of aviation and space exploration. As the industry evolves and new frontiers beckon, the UAE's proactive stance towards legal challenges positions it as a trailblazer, inspiring a future where legal frameworks not only uphold safety and efficiency but also foster a culture of exploration and discovery. In this dynamic landscape, the UAE's commitment to legal excellence ensures that it remains at the forefront of shaping the future of aviation and space exploration for generations to come.

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