Aviation

February 2013

GLOBAL GA

Welcome to HFW's Global GA, a bulletin that is dedicated solely to General Aviation.

In this third edition of our bulletin, Daniella Cavendish and Zohar Zik look at the issues relating to the warranty bill of sale. Edward Spencer, Victoria Cooper and Kate Seaton then look at insurance coverage for Europe and beyond, whilst Fernando Albino looks at the growing problem of illegal air taxi operators in Brazil. Finally, James Jordan looks at the issues surrounding growth in GA in China and asks if it is capable of achieving its expansion objectives.

This bulletin also includes details of some upcoming events in the GA sector, plus contact information for a number of our Global GA team. For further information about any of these articles, or aviation in general, please contact any of the contributors to this bulletin, members of the team listed, or your usual contact at HFW.

Giles Kavanagh, Partner and Head of Aerospace.

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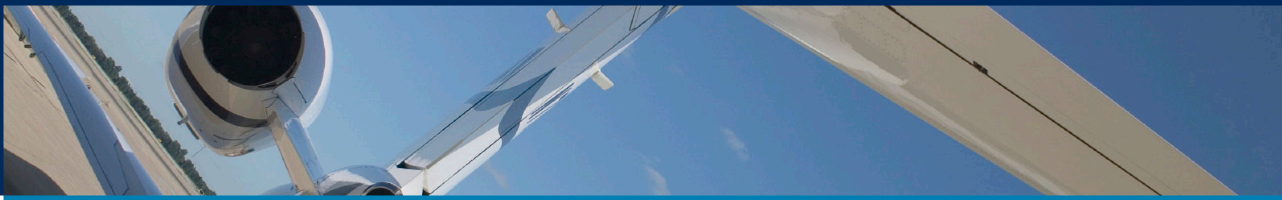

Is a warranty bill of sale really necessary?

Buyers are becoming more and more attached to these instruments, but do sellers really know what they are signing?

Warranty bills of sale are common practice today but this has not always been the case, particularly in the UK, due to the defunct requirement to pay stamp duty on such documents. The accepted practice in the past was to use an acceptance certificate from buyer to seller, resulting in no transfer of title document and therefore no stamp duty - a solution embraced by countless parties to sale agreements.

Since the stamp duty rule change, there is and has been, a tendency for buyers to demand a warranty bill of sale in addition to, or instead of, the standard FAA style bill of sale. But there are risks involved and sellers should be aware of these risks. Sellers should take care that, if a warranty bill of sale is to be signed, they are not giving warranties that are more extensive than those given in the sale agreement. In addition, the question of enforceability of an obligation that is to last "forever", as seen in some documents, arises. Does the seller realise what this means and how that sits with the Statue of Limitations? And what about the otherwise applicable doctrine of *caveat emptor,* which puts the onus on the buyer, not the seller, to ensure it is satisfied with the aircraft he is buying?

So, we have a situation where in the past, no bill of sale was acceptable in aircraft transactions, but now, the other end of the spectrum is favoured with the use of the warranty bill of sale.

Without care and attention to this aspect of a sale, this seemingly innocent wording can alter what the seller has bargained for under the sale agreement. Sellers beware.

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Mandatory insurance requirements - EU and beyond

Operators of aircraft within Europe have been faced with compulsory insurance obligations for a number of years. Here, we review the current requirements, with a particular focus on the GA sector.

Following the attacks of 9/11, the European Commission approached the subject of compulsory insurance with a renewed sense of vigour, with the aim of ensuring a harmonised approach throughout the European Community (now the European Union (EU)). This aim was achieved through "Regulation (EC) No 785/2004 of the European Parliament and of the Council of 21 April 2004 on insurance requirements for air carriers and aircraft operators" (the Insurance Regulation), which imposes minimum insurance requirements to cover the liabilities of those operating within European airspace.

As its name suggests, the Insurance Regulation requires almost all aircraft operating within European airspace to carry aviation-specific liability insurance in respect of:

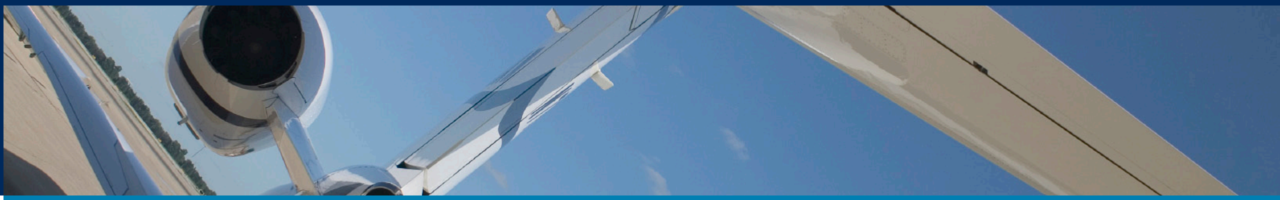
- Passenger, baggage and cargo liability.
- Third party liability - i.e. in respect of death, injury or damage to property on the ground, caused by accidents.

In addition to the usual "accidental" liabilities, the insured risks must include acts of war, terrorism, hijacking, acts of sabotage, unlawful seizure of aircraft and civil commotion (although some small aircraft, gliders and microlights are exempt from this type of war etc. cover).

Air carriers (broadly speaking, commercial airlines) and aircraft operators (largely, those who fly aircraft for non-commercial purposes) must ensure that insurance cover exists for each and every flight, regardless of whether the aircraft operated is at their disposal through ownership or any form of lease agreement, joint-franchise agreement, or other similar agreement. For many years, UK commercial air carriers had been required to provide the Civil Aviation Authority (CAA) with annual evidence of adequate insurance. However, for the first time, the Insurance Regulation placed a strict legal obligation of insurance upon non-public transport aircraft operators in the UK.

The only exceptions to the general scope are the following classes of aircraft:

- State aircraft - i.e. those used in military, customs and police services.



- Model aircraft with a maximum take off mass (MTOM) of 20kg.
- Foot-launched flying machines (including powered paragliders and hang gliders).
- Captive balloons.
- Kites.
- Parachutes.

With the exception of passenger limits (which were already adequate), the specified minimum coverage levels were increased on 6 April 2010 by Regulation (EU) 285/2010 to reflect the International Civil Aviation Organisation's decision (effective 30 December 2009) to increase carriers' liability limits established under MC99. Air carriers and aircraft operators are required to obtain the following cover:

- Passenger liability: 250,000 Special Drawing Rights (SDRs).
- Baggage: 1,131 SDRs per passenger in commercial operations.
- Cargo: 19 SDRs/kg for commercial operations.

Member States have the option of reducing passenger liability cover to a sum in excess of 100,000 SDRs per passenger for aircraft of 2,700kg or less MTOM in non-commercial operations. The UK, for instance, has set the minimum level at 100,000 SDRs.

Passenger, baggage and cargo cover does not have to be in place for mere "overflights" by operators from outside the European Union, where they do not take off or land within a Member State.

Minimum third-party liability cover in respect of death, injury or damage on the ground is on a per accident sliding scale by reference to the MTOM of an aircraft:

MTOM (kg)	Minimum third party cover (SDRs)
< 500	750,000
< 1,000	1,500,000
< 2,700	3,000,000
< 6,000	7,000,000
< 12,000	18,000,000
< 25,000	80,000,000
< 50,000	150,000,000
< 200,000	300,000,000
< 500,000	500,000,000
≥ 500,000	700,000,000

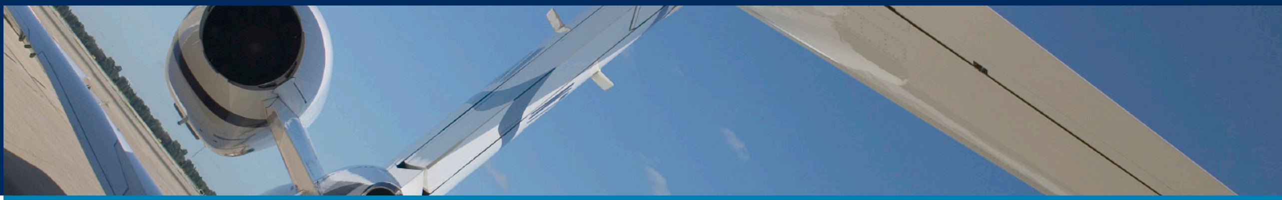
The above limits are mandatory for each and every aircraft on a per accident basis. However, if third party war or terrorism cover is not available on a per accident basis, insurance on an aggregate basis is permitted by the Insurance Regulation, provided such aggregate is at least equivalent to the relevant amount set out above.

Enforcement and penalties

Compliance with the Insurance Regulation is enforced by individual Member States - the relevant body in the UK is usually the CAA. The Insurance Regulation states that for aircraft operators using aircraft registered in the EU, depositing evidence of insurance in one Member State should be sufficient in all Member States. For overflights by aircraft registered outside the EU which do not involve take-off or landing in a Member State (or where such aircraft stop in Member states only for non-traffic purposes), the relevant Member State may decide whether to request evidence that the Insurance Regulation has been met.

Infringement of the Insurance Regulation may result in the withdrawal of an operating licence for EU air carriers, or the refusal of the right to land on the territory of a Member State for non-EU air carriers or aircraft operators using aircraft registered outside the community.

In the UK, the Civil Aviation (Insurance) Regulations 2005 permit the CAA to de-register UK registered aircraft where an aircraft operator fails to provide (when requested) evidence of adequate insurance, meaning the right to fly will be withdrawn. The CAA may also prevent the take-off of, and take steps to retain, any aircraft



which it has reason to believe is intended or likely to be flown without adequate insurance.

Crucially, in addition to the withdrawal of the right to fly, criminal penalties may also be imposed on aircraft operators who fail to provide insurance details when requested, or are found to have already flown aircraft without adequate insurance. The maximum penalty on conviction for failing to provide evidence of adequate insurance is a fine of £1,000. The latter offence is more serious and, on summary conviction, can lead to a maximum fine of £5,000, or on conviction on indictment, a fine and/or up to two years in prison.

However, it is possible for an aircraft to remain on the UK register without adequate insurance, provided a declaration is made in writing to the CAA that the aircraft will not be flown unless the CAA has first been provided with evidence of adequate insurance.

Beyond Europe

Increasingly, countries beyond the EU are choosing to put in place mandatory insurance criteria for air carriers and aircraft operators. Australia, Dubai, Hong Kong, Indonesia, Thailand, Turkey and the USA have all introduced minimum insurance criteria. How the criteria is set in each country varies:

1. In Thailand, for example, the requirements set by the Department of Civil Aviation do not apply to foreign carriers.

2. In some countries, the minimum insurance requirements are similar if not identical to those established under the Insurance Regulation. For example, in Dubai, minimum insurance requirements for aircraft operators have been established in an Information Bulletin 06/2010, issued by the UAE General Civil Aviation Authority, which broadly mirror those established under the EC Regulation, although the revised MC99 limits have not been reflected in the Bulletin.

3. The same can be said for Turkey, where a Turkish Regulation on insurance requirements for air carriers and airport operators in respect of passengers, baggage, cargo, war and terrorism was implemented on 15 November 2006.

4. In Hong Kong, the minimum requirements are set in USD currency and are on a sliding scale based on an aircraft’s maximum takeoff mass.

5. In the USA, air carriers are required to maintain third party aircraft accident liability cover for bodily injury to or death of persons (other than passengers) and for damage to property. In addition, they are required to maintain cover for bodily injury to or death of aircraft passengers. How the limits are set depends on the cover. For example, the limits of cover for liability to third parties are set at a minimum limit any one person any one occurrence up to a maximum amount per aircraft for each occurrence. For some aircraft, depending on the number of seats or maximum payload capacity, the minimum coverage requirements are lower. As would be expected, the minimum insurance cover required in respect of bodily injury in the USA is higher than the limits set under MC99, as is the case also under the Insurance Regulation.

6. In Indonesia, minimum levels of insurance have been established in respect of third party and passenger cover. However, the levels, set in Indonesian Rupiah, are much lower than those established under MC99.

In conclusion, the requirement for all aircraft operators to comply with minimum insurance criteria set by individual states is becoming increasingly prevalent. It is incumbent on aircraft operators, when purchasing their insurance cover, to ensure they are adequately protected for the routes being flown, particularly since the sanctions for failing to comply can be severe.

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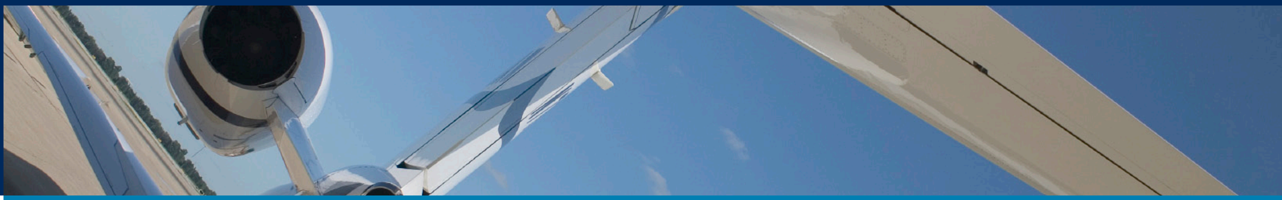

Brazilian air taxi operators fight back against illegal carriage of passengers by air

Forty air taxi companies, all members of ABTAER (Brazilian Air Taxi Association), recently sent a delegation to the Brazilian Senate to complain about the widespread practice of illegal carriage by air by private owners without the necessary licences, insurance, training, etc.

More than new rules and regulations, the representatives from this sector (which has an estimated annual turnover of R$8.4 billion) asked the members of the Senate's temporary sub-committee for civil aviation for stricter checks to be adopted to put an end to these kinds of illegal practices.

The Brazilian civil aviation authority (ANAC), charged with overseeing the sector, has powers to seize aircraft or cancel a pilot's licence, as well as levy fines. The criticism made is that ANAC is not doing enough, and more random checks and inspections need to be carried out to stamp out this practice.

According to a representative from the Senate's civil aviation sub-committee, quoted in the local press, the sector does need defending, because it invests heavily in pilot training and retention, aircraft maintenance and adequate insurance, and cannot compete with private operators who are exempt from similar restrictions.

As an example, whilst an air taxi operator will take as long as nine months legally to include an aircraft into its fleet, so that it is properly licensed to carry passengers by air, a private operator can start using its aircraft for illegal carriage by air immediately after acquiring it. This is usually seen by private owners as an easy way of reducing the costs of maintaining their aircraft.

In another example, an air taxi pilot who undergoes a four month training programme (usually paid for by the air taxi company) is subject to the same rules as a commercial pilot in an airline, whereas the illegal operator can operate anytime anywhere with little or no control or preparation.

Users of air taxi services in Brazil should watch out and check whether the carrier they have chosen is duly authorized or not.

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Regional focus: China

China is now the second largest economy in the world. Over the next 20 years, China's gross domestic product is forecast to grow at an average annual rate of 7%. There has been a consequent rapid development in air travel and much publicity surrounding China's development of its own commercial aircraft manufacturing industry, including the ARJ21, C919 and CJ-1000A programs.

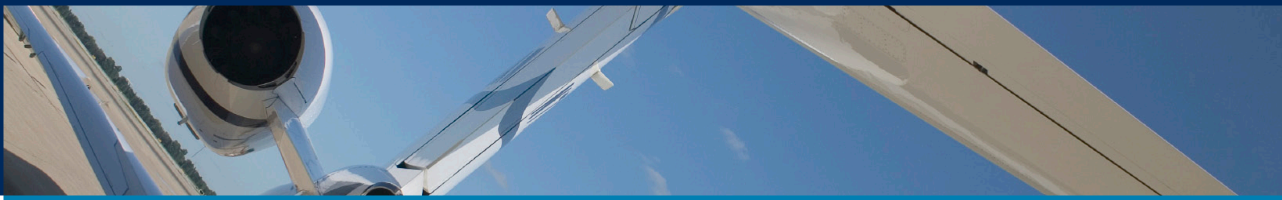
Although growth in the Chinese economy has slowed in recent months, this is not set to hamper an appetite for the General Aviation (GA) sector. Government rhetoric and announcements from private investors have made it clear that industry stakeholders see China as a key-player in the years to come. This article analyses what the future may hold for China's 'fledgling' GA industry and whether it will be able to overcome the regulatory, political and infrastructural challenges it faces to truly achieve its long-awaited take-off.

The industry

GA is not new to China, but it is one of the few sectors that has not experienced strong growth over the past three decades. The first post war GA operations can be traced back to the 1950s. Growth has, however, been slow since that period. Records from 2010 show that China had 1,010 GA aircraft, including 206 rotor-wing aircraft, 781 fixed-wing aircraft, and a number of hot-air balloons and airships. Federal Aviation Administration statistics from the same period show that there were 224,172 active GA aircraft in the United States. If the number of aircraft is taken as an indication of the maturity of the industry, China's GA has not developed significantly.

Government plans

The government recognizes that GA in China still falls far short of what is needed by the economy. In light of this, GA was named for the first time as a strategic industry by China's cabinet in the 12th Five-Year Plan (2011-15). Much of the change in the government's attitude has been down to the work of the Civil Aviation Administration of China (CAAC), who have worked hard to publicise the wider economic and social benefits of a developed GA industry. For example, the CAAC has pushed for and set out ambitious investment plans, which aim to trigger growth in the industry and has established a specific GA fund,



in conjunction with the Ministry of Finance, to subsidise GA operations, pilot training, and infrastructure and facility refurbishment. Both State-owned and private enterprises registered in China and holding GA operating licenses should be eligible to apply for the subsidy.

Local governments are also starting to gear up in anticipation of growth in the sector. Eight cities, including Chonquing, Xi'an and Zhuhai have already established State or provincial industrial parks, specially designed to attract interest from the GA industry, and should provide suitable bases for MROs and OEMs looking to establish themselves in the country. Such projects by local government should encourage growth in the support functions that are vital if the GA industry is to develop.

In addition to investment, the CAAC 'plans' to overhaul what many see in the industry as outdated and restrictive flying regulations. Opening up of the country's low altitude airspace is due to start in 2013. Recent statements from the National Air Traffic Management Committee have intimated that traffic guidance and air surveillance facilities will be promoted nationally from next year. A government circular, the "Opinion on Intensifying Reform of the Administration of Low-Altitude Airspace in China", states that airspace will be opened up below 1,000 metres for the use of GA in trial locations covering parts of Beijing, Changchun, Chengdu, Guangzhou, Lanzhou, Jinan, and Nanjing.

Potential for growth

China's GA industry clearly has huge potential for growth. In terms of private jets, the Hurun Chinese Luxury Consumer White Paper 2012 disclosed that 63,500 Chinese have minimum assets of 100 million yuan (c. US$16 million) and 13% plan to buy a business jet.

The CAAC expects GA flying will increase at an average rate of 15% p/a over the next ten years, which would require somewhere in the range of 10,000 to 12,000 GA aircraft to accommodate that level of activity, including 400 business jets!

The country is also in desperate need of helicopters to service rural communities for air ambulance and accident and emergency purposes. In addition, as more people move to urban areas, there will be a greater need for helicopters to provide traffic and policing support. The current fleet is clearly not sufficient to service a population of over one billion.

Investment is needed

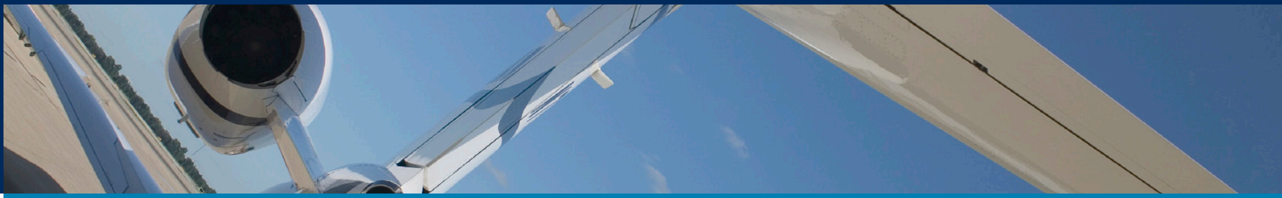
Private investment from both Chinese and overseas companies in GA is set to be significant and needed. Investment has already started to come from overseas companies, with several major aviation players signing joint ventures with Chinese based companies and the Chinese government. China's GA influence overseas also seems to be expanding, with the state backed purchase of the US helicopter manufacturer, Enstrom Helicopter Corporation, at the end of last year. Privately owned Chinese interests also came close to finalising a significant deal to purchase the GA arm of Hawker Beechcraft, but the deal broke down due to a dispute over pensions. Although only small steps into a huge market, it shows that Chinese GA ambitions are not confined by geographical boundaries.

Government plans versus reality

This is not the first time there have been ambitious plans for Chinese GA. In 1996 the CAAC published "The Decision by the CAAC on Issues Regarding the Development of General Aviation." This decision emphasised the need for coordinated development of the national economy, society and civil aviation; recognized the importance of GA; and outlined specific policies and measures to promote GA Growth in the industry, which has been modest since 1996. Even the current plans to open low altitude air space – seen by many as the biggest regulatory challenge to growth – are some way off, with reform of the regulations and implementation of the trial locations not expected to start until 2015, with the final aim of completing the project by 2020.

China does have a significant body of law relating to GA. There are more than 30 regulations containing rules relating to civil and GA, which focus on economic management, certification, security and operating standards. Amongst the most important are the "General Operating Flight Rules", "Regulations on General Aviation Business", "Approval Process for General Aviation", "General Aviation Business License Regulations" and the "General Aviation Regulations on Non-operating Registration". These rules are however, difficult to navigate and the current procedures for approval and registration are time consuming, and do not allow enough flexibility to meet the numerous functions of GA.

Whilst the CAAC clearly aim to achieve growth and development in the industry the development of GA is not up to the CAAC alone and this may have been part of the problem over



the preceding decades. Development involves fiscal and tax policies (e.g. taxation on small and mid-sized helicopters is very high), and needs coordination and support from the military and the wider Communist party. Getting all interested parties reading from the same song book may be the hardest challenge GA growth faces.

The challenges

Some 502,700 flight hours were recorded in China's GA market in 2011. It is expected that this number will rise to over two million hours by 2020, if planned reforms and the opening up of the industry continue and materialise as outlined above. There is little doubt that China has the buying power to purchase aircraft though state-owned initiatives, corporate investment and the growing wealth of the Chinese 'super-rich', but the real problems facing growth are likely to come from the lack of suitable infrastructure and trained personnel.

A recent CAAC report states that there were 70 airports and 216 landing points for GA in China. Industry commentators anticipate that as many as 3000 may be needed. Although the government is embarking on expansive airport investment plans to build 70 new airports and rebuild or expand 101 others over the next five years, it is unclear how many of these airports will be suitable for GA. In addition, MRO facilities for GA are currently lacking in Mainland China, with the country's first "4S" (sale, spare parts, service, and survey) facility for GA aircraft only opening in June 2007. Most work on GA aircraft - especially work on engines - is currently being performed in Hong Kong or overseas. Fixed Base Operators (FBOs) which provide fuel, hangar space, and airtaxi and flight training services for GA are also few and far between; in comparison the US has over 5000 . Until significant investment in the infrastructure needed to operate GA aircraft is realised it will be impractical to own or operate a private aircraft in China without incurring significant costs.

China also suffers from a lack of GA pilots. Part of the reason for this is the relative lack of financial rewards and poorer working conditions compared to the commercial airlines. In addition, pilot training costs in China are actually higher than in the US, with most GA pilots being military veterans, thus making the transfer process time consuming and costly.

Other issues surrounding investment and development also exist, because of the difficulty surrounding foreign owned companies investing in China. Unless a foreign owned company is able to find a suitable joint venture partner it can often make the process of establishing a business very difficult. Until the laws surrounding foreign investment in China are relaxed, there may be some reluctance for foreign companies to invest significant amounts of money. There are also well publicised issues with intellectual property and trade secrecy, with the laws in these areas needing significant reform. China needs to make investing in its GA project attractive for foreign investors or they risk losing out on the capital and industry expertise that could be the catalyst for growth

A significant cause for tension in China will be GA's relationship with the People's Liberation Army Air Force. Much of Chinese airspace is tightly controlled by the military; 42% of aerospace in eastern China is reserved for the air force, according to a recent military study. This significantly restricts areas in which GA aircraft can operate and until loosened will continue to hamper development. GA flights are given low priority and obtaining clearance to operate a specific flight might take days; this removes a significant amount of the attractiveness and convenience that GA operations often bring.

The future

The CAAC's plans are ambitious. GA spans aircraft manufacturing, flying operations, airport management, airspace usage, finance, insurance and third-party services, and significant investment from within China and overseas will be needed in all these areas. The purchase of GA aircraft alone will not be enough to trigger growth and the realisation of the CAAC plans, unless the relevant infrastructure is also improved. There are clearly significant challenges facing the GA industry in China; however, real reform does appear to be on the horizon.

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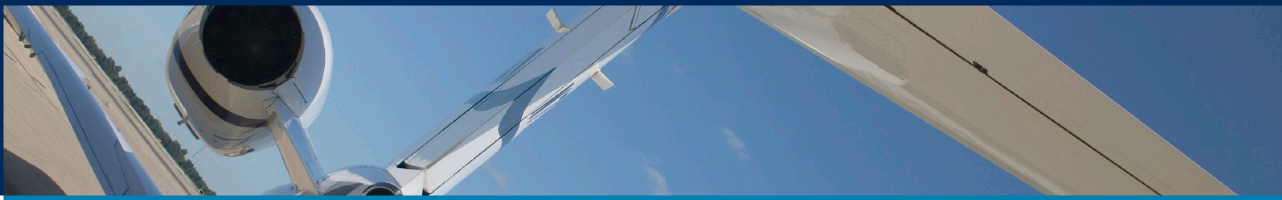
> "China also suffers from a lack of GA pilots."



Conferences & Events

International Corporate Jet & Helicopter Finance London 2013
London
(11-13 February 2013)
HFW Sponsoring
Attending: Adam Shire, Edward Spencer, Jonathan Russell, Anthea Agathou, Daniella Cavendish and Zohar Zik

Edward Spencer and Zohar Zik presenting

Abu Dhabi Air Expo
Abu Dhabi
(5-7 March 2013)
Attending: Richard Gimblett

GA Expo 2013
Ahmedabad, India
(7-10 March 2013)
Attending: Peter Coles

CHC Safety Summit
Vancouver
(18-20 March 2013)
HFW Sponsoring
Attending: Nick Hughes and Peter Coles

Asian Business Aviation Conference & Exhibition (ABACE)
Shanghai
(16-18 April 2013)
Attending: Peter Coles

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