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# Aviation

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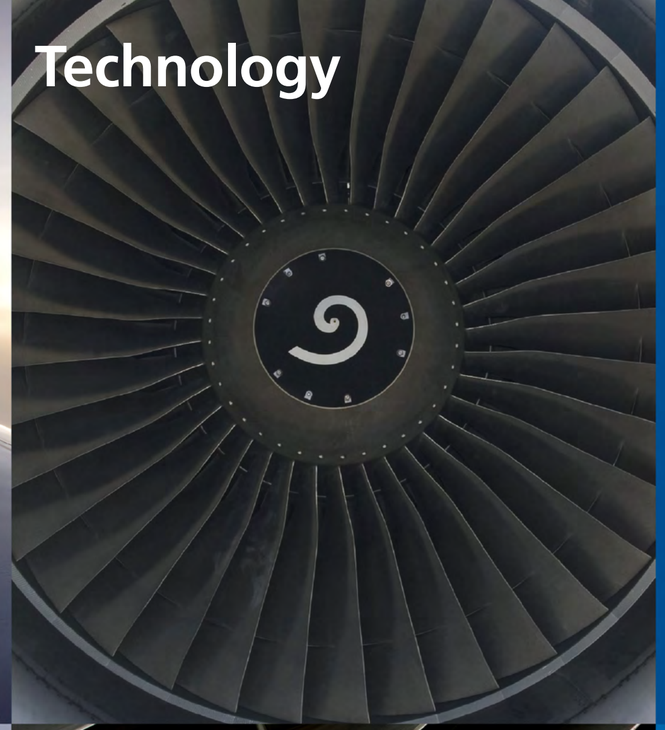


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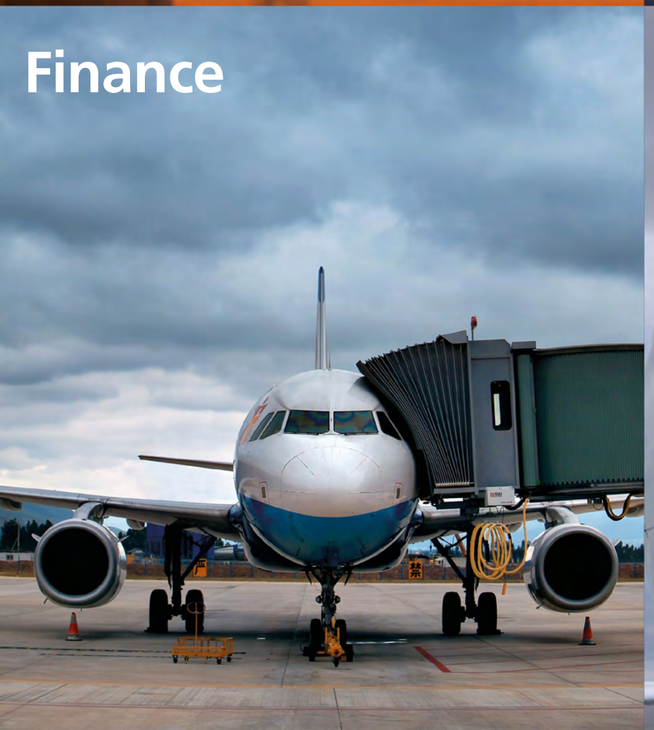



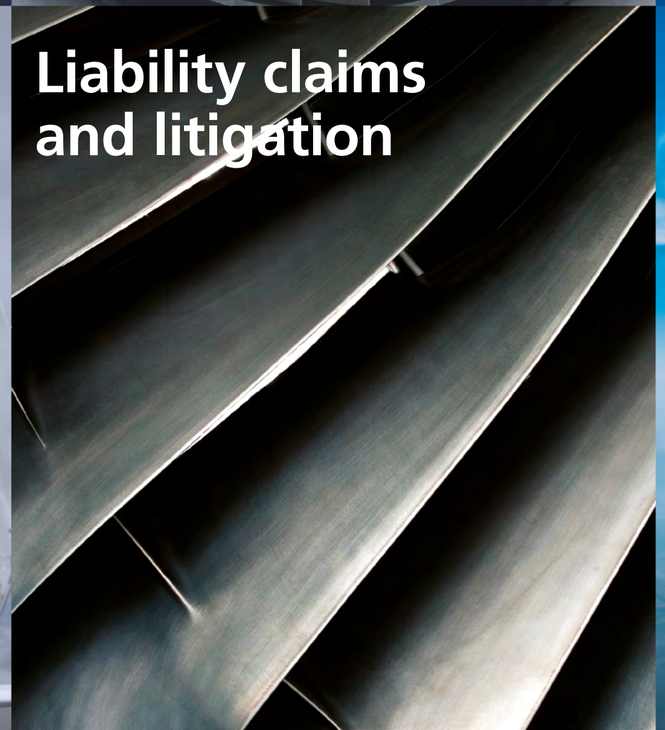


# Introduction

The aviation industry is emerging from an unprecedented period in its history brought about by the global pandemic.

The eyes of the world are also increasingly focussed on climate and sustainability. Arguably COP26 puts further pressure on the aviation industry to make positive changes in support of the goals of the Paris Agreement. This unique situation has prompted industry participants to question the status quo and wonder what happens next. How can the industry recover and what does the future look like for aviation? What could and should the industry be doing to address climate change and who should drive the agenda? What are the challenges that airlines, financiers, manufacturers and other market participants are facing and what opportunities will arise? Who will be the winners and losers?

In this report, CMS aviation experts share their insights across a range of issues, many of which cannot be separated from the ESG agenda which most industry players would agree has to be front and centre of any strategy for future success in aviation.

We look at the latest regulatory framework and future developments that will shape the manner and pace of decarbonisation in aviation, including the use of sustainable aviation fuels (SAFs) and carbon off-setting, combined with new developments in technology such as unmanned aviation vehicles and a new generation of supersonic aircraft.

Keith Wilson takes us through financing and leasing trends that have emerged during, and coming out of, the pandemic as travel recommences on a greater scale – some such trends seemingly at odds with the levels of financial distress that market analysts might have forecast.

Focusing on solutions to distress in the industry, Glen Flannery considers the path to recovery and gives an overview of restructuring tools, including the use of the UK's new "Restructuring Plan" one year on from its introduction in 2020.

Finally, we finish the report with a voice from the leasing world, Angus von Schoenberg of TrueNoord, who shares his valuable experience from a long career in aviation and his insights as to market recovery, key trends, and the impact of technological innovation.

We hope you enjoy reading this report and we would love to take the conversation further with you, to hear your views and ideas and to share more of ours. Please reach out to your regular CMS aviation contact if you would like to discuss any of the topics raised in this report in more detail.

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# & REBOUND & REMODEL

**Legal Flightpath – CMS Aviation** is a multidisciplinary team comprising over 70 Partners across the firm, providing client solutions for every part of the aviation industry, including airlines, airport operators and service providers, air traffic control operators, banks, aircraft lessors, equipment manufacturers, aircraft maintenance services and aviation tech.

# Decarbonisation

## Hot air? How regulation can help decarbonise aviation

The aviation sector is one of the fastest-growing sources of greenhouse gas emissions.

Under current predictions, the sector could be emitting 56 gigatonnes over the period 2016-2050, or one-quarter of the total remaining carbon budget that can be allowed in order to stay within the target set pursuant to the Paris Agreement. While a number of options such as use of sustainable aviation fuels (SAFs) or hydrogen fuel, greenhouse gas offsetting schemes and more efficient flight paths are being explored, the role of regulation and legal requirements cannot be underestimated if zero/low carbon aviation is to become technological and commercial reality. Here we briefly consider 2 of these: SAFs and carbon offsetting.

### The Paris Agreement

While the Paris Agreement makes no explicit reference to emissions from international aviation, it did put in place an ambitious and legally binding long-term global goal to achieve which requires changes to the existing practices in the aviation sector. This goal would see all signatories to the Paris Agreement pursue a limit in global temperature increase to 1.5 °C compared to 1990 levels.

Given that flights worldwide produced 915 million tonnes of $CO_2$ in 2019 and the number of countries adopting commitments to achieve net-zero by 2050 in line with Paris Agreement aims, aviation has long been indirectly enveloped under the Paris Agreement remit.

Developments at COP26 have increased the pressure on the aviation industry to support the goals of the Paris Agreement. On 10th November 2021, a declaration was made by members of the International Aviation Climate Ambition Coalition of their aim to reduce aviation $CO_2$ emissions at a rate consistent to achieving net zero carbon emissions by 2050. This is done with the intention of helping limit the increase of global average temperatures to below 1.5°C, a key pillar of the Paris Agreement. The declaration recognised the ICAO as the appropriate forum in which to address emissions from international aviation as well as supporting the deployment of sustainable aviation fuel and the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA).

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### Changing the fuel mix – Sustainable Aviation Fuels

SAFs, produced from sources such as waste oils from a biological origin, agricultural-residues, or sustainably-produced biomass, which can be blended with petroleum based jet fuels are attractive in that they require no major infrastructure or equipment changes. However, to ensure that SAFs meet the standards required of traditional fossil jet fuel, SAFs remain subject to the same certifications (such as ASTM D1655/ DEFSTAN 91-91).

The way SAFs are being introduced into the aviation sector is through mandates pursuant to which fuel suppliers are required to reduce their carbon content by using SAF. The EU, for example, included plans for a SAF mandate as part of its ReFuelEU Aviation initiative and published draft regulations in July 2021, a part of Fit for 55 package. This includes provisions for hefty fines on non-complying fuel suppliers.

However, while there are nearly 20 SAF mandates in place globally, thus far these have only been adopted by countries such as Norway and Indonesia and details about how they will operate remain unclear. Consequentially SAF mandates are not yet making a measurable impact.

According to the European Commission, SAF currently accounts for just 0.05% of jet fuel use in the EU and without any further change in regulation this percentage is expected to increase to just 2.8% by 2050. Clearly further incentives, whether by regulation or otherwise, are needed to stimulate further uptake of SAFs. However, with SAF production currently only accounting for ~0.01% of annual aviation fuel demand and SAFs being currently two to five times more expensive than kerosene, key industry leaders are quick to claim that its usage is being held back by a lack of production and high cost. Moreover, since most SAFs require biological feedstocks (e.g. sugar cane or algae), there are concerns that SAFs may compete with food crops, or exacerbate global water shortages.

This is where the alternative of using liquid hydrogen or batteries comes in which may be better suited for shorter-haul and smaller aircraft. For example, easyJet has expressed optimism about providing regular flights by electric, hydrogen or hybrid planes by the mid to late-2030s. Similarly, Airbus has announced its aim to develop a hydrogen-fuelled commercial airliner by 2035.

Although hydrogen fuel would provide 3 times more energy per unit of mass compared to traditional jet fuel, a number of challenges must be addressed before widespread adoption becomes feasible. This includes the need to redesign aircraft to have bigger fuel tanks in order to accommodate the space needs of hydrogen fuel, as well as developing the large-scale transport and infrastructure solutions required to supply airports with the necessary quantities of hydrogen. For these challenges to be overcome greater coordination within the industry is required so that market participants can make the most of shared learnings to provide solutions.

### Greenhouse gas offsetting schemes and the role for EU ETS and other emissions trading schemes

As there is currently no practical alternative to aviation for long distance travel, carbon offsetting is often seen as an immediate and pragmatic way to encourage flyers to address their impact on greenhouse gas emissions, at least in the short-term. Carbon offsetting is the term for the process whereby individuals and organisations can offset a proportion of a flight's greenhouse gas emissions by investing in carbon reduction projects. For example, ICAO has a global market-based offsetting measure – the Carbon Offsetting and Reduction Scheme for International Aviation (CORISA). CORISA comprises of three implementation phases: the first two phases (pilot phase (2021-2023) and first phase (2024-2026)) are voluntary, whilst all ICAO member-states will participate in the second phase (2027-2035).

### ICAO

The International Civil Aviation Organisation (ICAO), a United Nations organisation formed of 193 countries, has been one of the main drivers of change in aviation climate change policy. In October 2016, ICAO passed a resolution for a global market-based measure to address $CO_2$ emissions from international aviation as of 2021. The resolution sets out the objective and key design elements of the global scheme, as well as a roadmap for the completion of the work on implementing modalities.

Furthermore, the ICAO Council adopted an aircraft $CO_2$ emissions standard for new aircraft. The $CO_2$ standard will apply to aircraft type designs already in-production as of 2023. Those in-production aircraft that do not meet the standard by 2028 will have to change their designs sufficiently before they can be produced.

# Decarbonisation

## Hot air? How regulation can help decarbonise aviation

It obliges airlines to monitor and report their emissions and to purchase emission reduction units generated by projects in other sectors to cover any growth in $CO_2$ emissions from international flights above 2020 levels.

However, over the last 2 decades carbon offsetting has received some scrutiny over issues of accountability and transparency. As governments and industry groups galvanise to address the challenges of "greenwashing" and new regulatory reforms, like those under the UN's clean development mechanism, and higher standards (such as the Gold Standard) which require companies seeking carbon credit for their activities to register and satisfy certain criteria before their offset is certified are brought in, the effectiveness of carbon offsetting will surely increase.

Separately, since 2009, (though subject to a temporary derogation until the end of 2023 for flights to and from airports in non-EEA countries) aviation activities have been included in the EU Emissions Trading Scheme (EU ETS) and greenhouse gas emissions from aviation have been incorporated into the EU's domestic greenhouse gas emission reduction targets.

This means that all flights to and from airports in the European Economic Area (EEA) must buy allowances in order to comply with the EU ETS scheme. As one of the largest carbon trading markets in the world, the EU ETS scheme is a clear and important example of regulation impacting the way the aviation industry addresses its contribution to climate change. As the EU ETS scheme, and other schemes, become more comprehensive and tighten the scope of excluded activities, these add a financial incentive for the aviation sector to take steps to decarbonise.

### Conclusion

The aviation industry, governments, international institutions and civil society are all considering steps to decarbonise the activities of and reduce the impacts of greenhouse gas emissions from the aviation sector. A recent example of this being that, in early October 2021 IATA member airlines passed a resolution to commit themselves to achieve net-zero carbon emissions by 2050. Some of this new focus, at least in part, is a result of societal pressures and the cultural changes catalysed by the COVID-19 pandemic but market-based approaches and regulation will also play a key part in helping the aviation sector to achieve the goals of the Paris Agreement.

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# Technology

## Latest developments and innovation in aviation

We live in a time of great innovation in the aviation sector, both in terms of technology and in reducing environmental impact.

### Commercial unmanned aerial vehicles

Due to the need for logistics support during the pandemic, coupled with constantly changing restrictions impacting delivery, servicing remote communities became a challenge.

Innovation in aviation, and associated regulation, helped solve these challenges. During the pandemic we saw the first autonomous delivery by Royal Mail via an unmanned aerial vehicle (UAV) to the Scottish islands. Royal Mail, further innovating during the uncertain times, used a drone to deliver parcels to remote communities (including PPE).

To achieve this the CAA had to be certain of the safety of the UAV and also clear a section of airspace for the flight trials, notified via a NOTAM restriction. Due to the reduced use of the usually busy airspace over the UK during the pandemic slowdown, the ability of the CAA to provide temporary dedicated UAV airspace has facilitated advancement in the testing and understanding of how autonomous or unmanned drones and manned aircraft can happily co-exist in airspace in the future. This will be essential for the safe deployment of drone deliveries in our cities (or even flying cars), and future usage of this new technology.

### Electric power

We have recently seen an increase in investment into environmentally friendly propulsion. We have witnessed the exciting first flights of electric powered general aviation aircraft, replacing the single engine piston propulsion that pilots have trained on, known and trusted for over 100 years. In 2015 Airbus claimed the E-Fan demonstrator had made history with the first electric crossing of the channel, whilst a rival independent French pilot Hugues Duval claimed he had actually pulled off the same feat the night before in the home built Cri Cri E-Christaline. This is a great example of the breadth of innovation in this space, from start-up pioneers to the largest and most established players in the aviation sector.

However, it is the legal certification of the first electric engine by the European Union Aviation Safety Agency (EASA), again during the pandemic, that is the most significant step in green aviation propulsion. EASA has certified the Velis Electro, a two seater electric powered training aircraft made by Pipstrel. This is the first fully electric aircraft in the world to receive certification.

In the UK we have recently seen Rolls-Royce's all electric "Spirit of Innovation" aircraft take flight. The future for electric aircraft appears bright. Regulators will surely continue to certify more aircraft types and innovate around the associated ancillary aviation support. Pilots will soon be changing their checklists from mixture rich and carb heat to battery levels and energy flow. A great development for pilots, passengers, and the environment.

### Civilian supersonic 2.0

Now is also a very exciting time in the area of supersonic flight. New technology will, for the first time since the demise of the Concorde, make faster than sound (mach 1) flight viable for civilian use. This technology promises to reduce sonic boom and sound vibrations which could potentially allow regulators to consider permitting mach 1 flights over land (this was not possible with the Concorde which was restricted to flying at mach 1 only over water). This technology will likely reduce flight and therefore engine running times and this, combined with cleaner engines, could help reduce environmental impact.

The industry and regulators are also in discussions on supersonic-specific environmental standards for this new sector to ensure that the environment remains a key concern in the second age of civilian supersonic travel.

### Safety innovation

Recently, we have seen increased development of technology designed to improve safety. Avionics providers have created products that will autonomously land a manned aircraft at the nearest airport in the event of pilot incapacity. This is a new final line of defence for manned aircraft in the rare, but often deadly, scenario of a serious pilot incapacity, and has the potential to save many lives in these rare circumstances.

The system, once activated, will identify the nearest suitable airstrip, perform emergency communications with the tower (via AI) and then land the aircraft on the runway allowing emergency services to reach the aircraft and help the crew and passengers to safely disembark.

Following extensive testing, regulatory approval was given by the FAA in the US for such technology in defined emergency circumstances, and also by EASA for use on certain certified aircraft in the EU.

The role of lawyers in aviation technology has never been more important. Lawyers help regulators understand and document guidelines for the safe deployment of these new technologies into society, ensure sustainability and a responsible approach to the environment, help parties safely contract for these new technologies, and ensure that when things do go wrong there is an appropriate recourse and insurance protection available for any affected persons.

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# Finance

## The limited impact of COVID-19

Questions have been raised regarding whether the impact of the pandemic on the aviation industry will result in lasting and fundamental changes to the model and availability of financing for the industry from traditional lenders and/or alternative sources. In short, the answer appears to be no.

Something counter intuitive is happening. The blackest of black swans has occurred in respect of the aviation industry and yet investors are lining up to provide funding. This is not a consequence of emergency state aid from COVID propping up airlines and therefore attracting investors with a possible safety net of state protection. Indeed, many investors feel that states did too much to protect individual airlines to prevent market forces regulating the industry and allowing the stronger, more liquid and arguably, more efficient, airlines to succeed ahead of weaker competitors. This may be a slightly extreme view in light of COVID being effectively an "Act of God". Instead, the extraordinary appetite for aviation assets has to be explained by the attractiveness of aviation as an asset class when compared to other alternative investments. As a consequence, while there are still many aircraft parked, manufacturers have yet to return to the production levels for new equipment seen before COVID, and certain countries remain almost "closed" to flying, the banks, leasing companies and private equity firms continue to pursue aircraft financing and leasing opportunities with enthusiasm and significant liquidity. Pricing for new sale and leaseback transactions, anecdotally, remains virtually at pre-COVID competitivity levels.

Looking a little deeper one can perhaps detect some trends which may signal some structural market changes likely to continue post-COVID. One example would be that the percentage of the world fleet that is now owned by aircraft operating lessors and leased to airlines has passed 50% and is estimated by some sources to be closer to 65%. While airlines may seek to rebuild their balance sheets by issuing equity and then acquiring new fuel-efficient aircraft so that they have asset reserves against future possible downturns, it is unlikely that this percentage figure will fall below 50% again. The age of the aircraft operating lessor as the dominant method of either acquiring or funding aircraft has now arrived. It has been coming for a long time.

> "The age of the operating lessor has now arrived"

The relative success of operating lessors in navigating the difficulties that COVID has presented, including successfully negotiating with airlines to restructure finance or leasing obligations, is held up as a demonstration of the resilience of the aircraft leasing model and as proof that the asset class is mature and ripe for continued investment. At a recent industry conference, a CEO from a well-known lessor referred to the industry coming together and putting its arms around each other by navigating though challenges with rent deferrals, lease extensions and other accommodations. There have been well publicised airlines under-going more formal restructuring processes, but a vast amount has been achieved – at lower cost – by reasonable negotiation between parties. Lessors were able to negotiate from a position of strength because of the quality of legal documentation so that where investors might once have had doubts as to the strength of their position, in the darkest hour it all worked as planned and concessions made were for commercial rather than legal reasons. Behaviour indicative of a mature asset class?

Another structural change is that the largescale grounding of aircraft has accelerated a shift from older equipment to the newer more fuel-efficient aircraft. Transatlantic routes are likely to be dominated not by Boeing 747 jumbos but by the long-range variant of the Airbus A321 – a single aisle aircraft. Investors want to finance or lease new generation aircraft. Some mid-age aircraft that in previous down turns might have suffered a drop in demand, followed by a recovery as demand for flights recovered, will not be as lucky this time due to their lower fuel efficiency and larger carbon footprint.

# Finance

## The limited impact of COVID-19

While the finance industry has not yet reached any real consensus as to how to ensure greener credentials on their deals, they are sure that modern fuel-efficient aircraft are part of the way forward.

Another outcome of the world-wide grounding is that it gave Boeing breathing space to resolve the issues affecting the 737-MAX and to obtain regulatory approval first in the US from the FAA and now gradually elsewhere. The cloud that the two tragedies involving this aircraft model cast over Boeing's products gave Airbus a short term but significant competitive advantage. That will now gradually dissipate as the most stringently reviewed aircraft in history is rehabilitated and allowed to demonstrate its highly fuel-efficient, long-range capabilities.

Another trend that may have longevity is the return of funding from export credit agencies. UKEF has been notable in providing funding to British Airways and easyJet (both publicly announced deals) when historically providing funding to UK airlines was not part of the export credit agreement.

UKEF has significant plans to continue providing funding into the aviation industry and will no doubt form one of many diverse sources of funding available.

It does not seem then that COVID is likely to have a significant effect on liquidity available to the aircraft industry. However, as explored above, it has accelerated trends that were already in play, many of which now look to be here to stay.

> "The pandemic has accelerated the shift to newer more fuel-efficient aircraft"

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# Distress

## Current outlook and role of restructuring tools

### Trends since the onset of the pandemic

The aviation industry has been one of the hardest hit by the COVID-19 pandemic. As travel restrictions took hold and aircraft were grounded, revenue streams evaporated, not just for airlines but for other market participants such as aircraft and engine lessors, airports, catering suppliers and baggage handlers.

Intense cash-flow management and stakeholder management have been critical to the survival of these businesses in the short term. Liquidity measures have included availing of government support such as the UK's furlough scheme for employees, agreeing payment deferrals with suppliers and credit providers, through to raising fresh funds from debt providers and shareholders.

For some participants more radical measures have been required and formal restructuring tools have been used to restructure their affairs. For example, LATAM Airlines entered into a US Chapter 11 proceeding, Virgin Atlantic used the UK's new restructuring plan procedure (see further below), and Norwegian Air deployed an Irish examinership process.

### The recovery path

Although large parts of the world appear to be emerging from the worst of the pandemic so far and flight traffic is picking up again, the global outlook remains challenging and the aviation industry remains susceptible to further disruption from pandemic related events.

With some consumers understandably apprehensive about flying again and businesses' travel policies remaining conservative, the path to a full recovery is predicted to be a long haul, with fresh headwinds along the way. The latest to hit the industry are the rapid increase in global energy prices and the Omicron variant of COVID-19.

As air traffic and revenues pick up, airlines and other industry participants can begin to unwind some of the credit positions built up since the pandemic began, but this will not be without its challenges.

### Continued cash-flow challenges

Managing cash-flow during a "restart" is arguably even more difficult than when aircraft were grounded. Operational (and to some extent, capital) expenditure must resume and be carefully balanced with revenue generation from sales, but at a time when sales revenue is not as predicable or as guaranteed as in normal times.

Cash-flows will also suffer from customers cashing in vouchers given to them in place of cancelled flights, rather than making "new money" purchases. While this should ultimately improve an airline's balance sheet position, in the short term it impacts cash-flow.

One can also expect credit card acquirers to be increasingly cautious about the credit they extend and the amount of hold-backs they retain from card payments as security for the credit card "charge-backs" they have to absorb when an airline fails.

A sustained negative cash-flow position for any industry participant is likely to trigger a need for a financial restructuring, potentially using a formal restructuring process or a formal insolvency process.

### Right-sizing over-indebted balance sheets

As deferral periods end and business models are adjusted to align with lower medium-term levels of demand, we anticipate renewed focus on balance sheet restructurings in the sector. In some cases this will be worked out between the debtor and its existing stakeholders, but we also expect to see opportunistic alternative investment funds taking over and leveraging some of the positions of those looking to exit the market.

Where stakeholders do not agree restructuring proposals consensually, formal restructuring tools can play an important role in forcing the compromises necessary to restore business viability.

### Choice of restructuring forum

In any particular case, the choice of restructuring venue and tool will depend on a wide range of factors, including the jurisdiction(s) of the debtor(s) and the stakeholders, where assets are located, the governing law of the debt to be compromised and levels of stakeholder support. Ideally proceedings are anchored in one key jurisdiction and recognition of this is sought in relevant overseas jurisdictions, although in more complex group structures multiple proceedings may be required.

The US Chapter 11 proceeding is a well-trodden and favoured path for South American airlines as well as North American airlines, often because US law governed debt is in play. The debtor benefits from the ability to reject existing leases and return aircraft to lessors, the possibility of debtor-in-possession financing, and a worldwide stay on enforcement action while restructuring proposals are drawn up and implemented. The proposals can be given effect with the support of a majority in number and two-thirds in amount of those voting in each affected class of stakeholder.

European airlines are more likely to avail of a European proceeding. As well as more established procedures such as the Irish examinership process used by Norwegian Air Shuttle, in recent years a raft of new restructuring procedures have been introduced in key European jurisdictions in response to the EU's directive on "preventative" restructuring. These include new Dutch and German scheme procedures, which can be used to impose debt compromises. It will be interesting to see the extent to which these new procedures are used in the aviation sector.

# Distress

## Current outlook and role of restructuring tools

### The UK's restructuring tools

The UK has one of the most advanced formal restructuring toolkits in the world. The available processes include administration, the company voluntary arrangement, the scheme of arrangement and the restructuring plan, as well as a standalone moratorium process that can be used to provide a breathing space from certain enforcement actions while restructuring proposals are being drawn up.

The most mature of these processes is the scheme of arrangement. This can be used to impose a compromise on stakeholders with the support of a majority in number and at least 75% by value of those voting in each affected class of stakeholders.

The UK's restructuring plan process was introduced in June 2020 as part of the government's response to the pandemic. It is closely modelled on the scheme of arrangement process, but is even more powerful from a debtor's perspective. The English court has been given discretion to sanction a restructuring plan even where one or more affected classes has rejected it when voting (a feature known as a "cross-class" cram down). This is possible where it can be shown that: (a) each dissenting class will not be in a worse position than in the "relevant alternative", i.e. the most likely outcome for the debtor if the plan is not approved; and (b) at least one approving class would receive a payment or have a genuine economic interest in the debtor company in the event of the "relevant alternative".

Virgin Atlantic was the first UK company to avail of the restructuring plan, not long after it was enacted. It used the process to facilitate a £1.2bn solvent recapitalisation, which was sanctioned by the High Court on 3 September 2020. Among other things, the plan gave effect to changes to the terms of a secured revolving credit facility, deferrals of operating lease payments and a 20% reduction in trade debts.

### Using the UK's restructuring tools for foreign debtors

The UK's scheme of arrangement is also a popular choice of restructuring tool for overseas debtors incorporated in jurisdictions with less developed or effective restructuring tools. Those using it value its flexibility and the certainty of outcome that comes from it having been tried and tested in numerous cases over multiple decades.

A UK scheme can be used by a foreign debtor where: (a) it has a "sufficient connection" to the UK (which need only be a thin connection to the UK, such as the debtor having some English law governed debt); and (b) the English court is satisfied that the scheme will be recognised in the relevant overseas jurisdictions. A recent example of this is the Malaysian Airlines scheme of arrangement.

The UK's new restructuring plan procedure is also accessible to foreign debtors and we expect to see it used by foreign debtors in the future, particularly where there is significant English law debt to be restructured since it remains a principle of English law that English law governed debt can only be extinguished using English law.

### The Cape Town Convention and the Aircraft Protocol

The Cape Town Convention and its Aircraft Protocol (which has been widely adopted globally) aims to provide certain and uniform rules for the buying, selling, leasing, and financing of aircraft objects. Among other things, it affords special rights to creditors who have international interests registered under it on an international register, in the event of an aircraft becoming subject to an insolvency related event. This includes an ability for aircraft lessors to retake possession of their aircraft where defaults are not cured and a prohibition on modifying their rights without their express consent. Where this applies it is a potential impediment to the effectiveness of a scheme of arrangement or restructuring plan that seeks to use creditor majorities and/or court approval to affect the rights of creditors with such international interests.

There is an ongoing academic debate as to whether or not a UK scheme of arrangement or restructuring plan would constitute an insolvency related event for the purpose of the Cape Town Convention. The weight of current opinion appears to be that a restructuring plan would constitute an insolvency related event and that a scheme of arrangement would too where it is used in an insolvency context. To help avoid potential issues, restructuring professionals have been incorporating qualifications into scheme and plan documents, respecting rights under the Convention.

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# Liability claims and litigation

## Emerging risks due to the pandemic

With the aviation industry currently experiencing some of the most turbulent times in its history, it is facing a number of emerging risks that could lead to liability claims and litigation. A combination of the pandemic, travel restrictions and Brexit have led to aviation market players exploring new options and facing new exposures, leading to claims and litigation.

While in theory the grounding of a large number of flights should have led to a reduction in the risk exposure faced by airlines, airports and other aviation market players, in fact the risk profile has simply changed. For example, while the more routine passenger liability claims for slips and trips, personal injury, lost baggage and the like have reduced significantly, new areas of liability risk have arisen including:

**Grounding** – with a large number of aircraft parked, we have seen an increase in the number of ground collisions and hull claims caused by environmental conditions such as hurricanes, as well as maintenance and engineering issues with aircraft not being intended to remain parked for long periods of time.

**Skills deficit** – allied to the above, given the reduction in flights there is a skills deficit with pilots having to maintain their flying hours on simulators (often at considerably reduced hours than they would ordinarily have been flying) and a large number of employees in the aviation space having been furloughed or having left the industry. We anticipate that, in the short term, this will lead to an increased number of claims caused by human error and lack of knowledge.

**COVID safety** – with obligations on both airports and airlines to remain COVID-secure, alongside heightened expectations around hygiene and cleanliness, we would not be surprised to see allegations from passengers that they were exposed to COVID in the airport or onboard. In addition, there may be increased employer's liability claims alleging exposure to the virus. While there may be causation issues with those claims, they can still be costly to deal with from a financial, time and reputational perspective.

**Transportation of vaccines and pharma risk** – vaccines may lose their effectiveness if they become too hot or too cold during transportation. Should this happen, vaccines will be unable to create the desired immune response and so provide poor protection against the disease they are aimed at preventing (such as COVID). Disruption of the so-called 'cold chain' could therefore have significant consequences and thereby carry additional risks for carriers and their supply chain – including freight forwarders, ground-handlers and airports as well as airlines. While there are a number of experienced 'cold cargo' carriers that have the specialist infrastructure required to safely transport vaccines and other pharmaceutical products, the scale of the logistical challenge required to distribute COVID vaccines globally (including, going forward, vaccines designed to deal with future variants) comes with enhanced risk, particularly for those less experienced in this area.

**Class actions** – the US has seen multiple class actions surrounding flight cancellations and passenger refunds over the pandemic. The windfall incentives for bringing actions in the UK and Europe are far less, but regulators have been bending over backwards to "protect" consumers (to the detriment of businesses dealing with unprecedented challenge) seeking to pile on the pressure (both on a state-by-state basis, and across the EU through the beefed-up Consumer Protection Cooperation Network). Airlines will continue to face challenges in this area given the tight timeframes for refunds and addressing peaks in demand following changes in national policies on travel. Any determination of breach of consumer law may well be a trigger for follow-on claims or regulator-imposed redress schemes.

Further, with ever more scrutiny on the actions taken by boards, it is possible that directors and officers may be subject to class actions seeking to challenge their decisions during the pandemic. Again, these are likely to be more prevalent in the US.

**Litigation concerning lease arrangements** – while there have been fewer disputes relating to lease arrangements arising out of COVID than might have been expected, this is generally due to the symbiotic relationship between lessees and lessors in the current climate. Nevertheless, there have been some recent cases (Salam Air SAOC v Latam Airlines Group SA, in the English High Court and Wilmington Trust SP Services (Dublin) Limited & Others v SpiceJet Limited) in which the lessees sought to argue that performance of the leases was frustrated. Although these cases considered different points and neither sets a formal precedent, both appear to confirm the intention that lessees will not be able

# Liability claims and litigation

## Emerging risks due to the pandemic

to use the English law doctrine of frustration, as a result of conditions brought about by COVID, to escape their obligation to make lease payments. That said and despite the slow start, we anticipate further disputes will arise in respect of lease arrangements.

Further, it is worth confirming that the insurance arrangements in place provide the appropriate level of comfort regarding lease arrangements, for example if, as is commonplace, the policy follows the local law of the carrier, does that local law recognise loss payee provisions.

While the risk profiles of aviation market players have changed in light of COVID there are some small signs of light at the end of the tunnel. Despite high profile pressure on the Government from the early days of the traffic light system governing international travel (including a judicial review led by Manchester Airport Group), it was not until 4 October 2021 that the Government decided to scrap the traffic light system and implement simplified travel measures. Given that this easing is still in its infancy, it remains to be seen what impact winter and the ongoing vaccine roll-out will have on COVID case numbers and the aviation industry but we remain hopeful that there are some small seeds of recovery for a less turbulent future.

> “The risk profiles for the aviation industry have changed”


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REBOUND & REMODEL

# Industry insight

## Angus von Schoenberg of TrueNoord

### What is your role at TrueNoord?

My primary role at TrueNoord is a strategic one both in support of the management team, and also critically our investors who need to be kept up to date regarding the reasons behind our portfolio development decisions. These might include the mix of aircraft we are investing in and their likely future value performance, the liquidity of the particular asset class in the marketplace, and the associated risks. In the regional aircraft sector these dynamics are usually very different from the larger aircraft market.

### Please could you tell us about your background in the aviation industry?

I have worked in the aviation world since the early 1990s, initially for a French Bank in an asset-based lending role. In the late 90s I moved into an asset management and aircraft remarketing role where I got involved with regional aircraft as opposed to the wider aircraft market. I have specialised in that specific market ever since.

Jump forward to 2012 and I was acting for the European Regions' Airline Association (ERA), looking at why there were relatively few financing participants, specifically, lessors. At that time there were already many global lessors but only two with any scale, Nordic Aviation Capital and GECAS, operating in the regional aircraft space. The reasons behind this included the perception that it was a small market, and the asset sizes were smaller too. For most, doing the same amount of work on the commercial and legal aspects for lower value assets did not seem to add up. Our findings were published as "The case for investing in regional aircraft". This report turned out to be one of the drivers behind the formation of TrueNoord in 2016, and I have been involved ever since.

### How does the pandemic compare to previous periods of downturn and distress in the aviation industry that you have experienced?

At the beginning of the pandemic the situation was very serious, whole swathes of the air transport system were shut down for an indeterminate period. This happened after 9/11 but only for a short time. We have never experienced a situation before where approximately 75% of aircraft traffic disappeared over the course of a couple of months. In previous economic downturns these percentage reductions might have been in single digits. However, it has not been totally bad news. There have been remarkably few airline failures. You would have thought that with the huge decline in traffic many airlines would have collapsed. But that did not happen. This is partly due to the fact that governments all over the world stepped up to support the industry, not just for flag carriers or state-owned entities, but for the wider industry as well. However, it is also true that the regional carriers have, though not necessarily deliberately, received less state support than their larger aircraft peers.

### Would you say that the impact of the pandemic has been different across the aviation industry?

Indeed. Regional airlines, including those that operate as subsidiaries of major airlines, fly shorter domestic routes unconstrained by international restrictions. Whereas long-haul carriers suffered declines in traffic of 80%-90%, regional operators suffered lower percentage declines. Furthermore, domestic travel has recovered far faster with the US domestic market now almost back to a pre-pandemic position.

Carriers with regional fleets have been able to use regional aircraft on routes where they would have previously deployed a A320 or B737. If an airline has, for example, an E190 with 100 seats which they can fill instead of flying an A320 at 60% load then they will use it in a depressed demand environment.

A rare advantage that network airlines have over low-cost carriers during the pandemic is that the latter only operate single type fleets. For low cost-carriers you either fly or you do not. Passenger loads are managed through your revenue management system; that is the only tool you've got. A network carrier can also manage by flexing capacity up and down. At TrueNoord one of our biggest customers is KLM Cityhopper. During the pandemic they continued flying all their Embraer aircraft often in place of 737s.

### Has TrueNoord had to make strategic changes in light of the challenges raised by the pandemic?

In the short term, yes, we have had to adapt. Initially we had to ensure the safety and working environment of our colleagues, and the way we manage our assets and customers without the ability to travel. For certain customers we provided support. It was common for airlines to request deferral agreements and of course that had legal implications regarding documentation. In some cases, this has meant deferring lease rentals in return for extended lease terms.

In a small number of cases, we have agreed to early returns voluntarily. Ultimately there is no gain to be made from forcing aircraft on customers that they cannot operate in the longer term and just drain their cash-flow even further.

# Industry insight

## Angus von Schoenberg of TrueNoord

Assuming we have a suitable home for an aircraft, we can and have provided such alternative solutions to help some customers thus maintaining and even enhancing long term relationships. In respect of investors, the key is to keep them informed, including of our risk mitigation strategies.

Overall, our record throughout the pandemic tells its own story. CH-Aviation regularly reviews the active fleets of the world's lessors. TrueNoord has consistently performed in the Top 10 lessors with over 50 aircraft.

### What are some of the opportunities you have seen as a result of the pandemic?

Unsurprisingly, one of the short-term developments was highly constrained capital expenditure. There have been some well publicised cancellations of orders across the industry, although less in the regional aircraft world. This is creating some opportunities in relation to aircraft that were in production and causing the OEM considerable concern knowing that their customer wouldn't be able to take them.

Such an example would be TrueNoord's recent transaction with SKY express which CMS advised on. Those were aircraft which were previously destined for other carriers and if the pandemic had not taken place, SKY express would not have been able to access those aircraft. It was a win-win, it helped both ATR and SKY express and gave us a new customer with wide and diversified business interests. Had it not been for the pandemic, opportunities like this would not have arisen.

### What does recovery look like and how might this be achieved in the regional aircraft market?

We were expecting a much bigger economic recessionary impact. Economies seem to have proved remarkably resilient and there are now shortages of materials and services which we would never have predicted.

There are future challenges some of which might have more of an impact on regional carriers. While aircraft were grounded crews left the industry and many of these will not return. Once you make a career move you may not come back especially with costs and training implications. In the medium- term a big conversation is going to be around pilot shortages which I would have never expected a year ago. However, I do think recovery, particularly in the regional sector, is likely to be a little bit faster than we thought at the start of the pandemic.

### What will be the key trends in aviation medium to long term?

The other big challenge to the aviation industry is the environment. Both in the short and longer term there is a likelihood that with things like the EU taxonomy and other regulatory changes, the cost of travel for the passenger may increase. That may have a dampening effect, however, the more interesting aspect from a regional aviation perspective, is the potential for newer technologies. Whether that is the uptake of sustainable aviation fuel or new propulsion technologies such as hydrogen, electric or hybrid, these will reach the regional sector far faster than long-haul aircraft simply because we fly smaller aircraft shorter distances. That is the big change that we're going to see in the medium term and beyond.

A further point on this topic is that in the future, travellers will increasingly scrutinise the best way of getting from A to B. Should I drive, take a train or fly? It's vital to provide the general public with the right tools to make that decision because it is not always necessarily better to go somewhere by an alternate mode if, for example, the distance covered becomes much longer due to geographical obstacles or if the traveller is a single occupant in a car. Without accurate comparative data to account for the footprint of all modes of transport between two points, there is a risk that substitution to alternatives may simply shift emissions from one place to another or, at worst, increase them. Our industry has a duty to ensure accuracy of comparisons.

Another area where we might see change is within the "hub and spoke" operations of large network carriers. In many cases these are highly environmentally inefficient. It is fine for a long-haul connection and for the big Middle East carriers, that is their business model. But if, for example, you are a US carrier and you fly between two states, you may have to fly first to a hub airport and then get on another flight and fly the second side of a triangle. From an environmental perspective this makes no sense. Two take-offs and two landings clearly have a larger carbon footprint. A move towards point-to-point services would utilise more smaller capacity aircraft and present an opportunity for regional carriers.

### Which technological innovations for aviation will have the biggest medium to long-term impact?

In the short to medium term the only feasible technology is sustainable aviation fuels but that has its own challenges. Producing SAFs has a CO2 cost so we need to make sure we have the sustainable energy resources to support that production. We also need to ensure we are producing proportionately more of the synthetic variety so that we do not end up creating other problems such as reducing the amount of agricultural produce that can be used for food. The danger is that you solve a particular environmental problem in one industry and end up creating comparable issues in others.

### Finally, can you tell us where you are flying to next, Angus?

I have not been able to travel to our office in Amsterdam for over a year so I am looking forward to that being my next flight.

# TrueNoord

TrueNoord
Regional Aircraft Leasing

TrueNoord is a specialist regional aircraft leasing company with offices in Amsterdam, Dublin, London, and Singapore. It provides leasing and lease management services strengthened by extensive knowledge of aircraft finance to operators and investors worldwide in the regional aircraft sector. TrueNoord exclusively invests in latest technology turboprops and regional jet aircraft, understanding the important role of these lower seating capacity aircraft in linking remote locations to larger conurbations, providing a feeder service to major hubs, and fulfilling carriers' lower demand off-peak services in a growing global market.

TrueNoord is supported by cornerstone investors – Freshstream, BlackRock, Aberdeen Standard and others. TrueNoord's fleet of over fifty new and young in-production aircraft covers eight different models in the 50 – 150 seat class, including: Embraer, ATR, Airbus, MHI-RJ and De Havilland Canada.

See **truenoord.com** for more information.

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