

WORLDWIDE AIR TRANSPORT CONFERENCE: CHALLENGES AND OPPORTUNITIES OF LIBERALIZATION

Montreal, 24 to 29 March 2003

Agenda Item 2: Examination of key regulatory issues in liberalization 2.2: Market access

AIRCRAFT LEASING IN INTERNATIONAL AIR TRANSPORT

(Presented by the Secretariat)

SUMMARY

This paper documents the increasing importance of aircraft leasing in the use of market access, describes State's regulatory approaches to the practice, notes potential safety issues and means to address them and proposes a regulatory arrangement on the subject.

Action by the Conference is in paragraph 7.1.

REFERENCES

State letter EC2/82, LE 4/55-99 dated 14 May 1999
Circ 295, Guidance on the Implementation of Article 83 *bis* of the Convention on International Civil Aviation

1. INTRODUCTION

1.1 During the past decade, there has been a growing increase in the practice of aircraft leasing in international air transport, where an air carrier rents (rather than purchases) an aircraft from another carrier or other entities to provide commercial air transport. Leases generally take the form of "dry" lease (lease of an aircraft without crew) and "wet" lease (lease of an aircraft with crew). The practice of leasing can raise potential safety and economic issues in a situation where the leased aircraft is registered in a State other than that of the operator using it in international commercial services. Consequently there has been increasing attention given by States to the regulatory treatment of leased aircraft, particularly in the context of the use of market access, from both a safety and an economic perspective. This paper reviews these developments and concerns, and proposes a regulatory arrangement for possible use by States at their discretion in their air services agreements.

2. PREVIOUS ICAO WORK

2.1 To address some of the issues and in response to requests from States for assistance in dealing with the economic and safety aspects of the use of leased aircraft, ICAO prepared a study on aircraft leasing which examined the economic, regulatory and safety implications of aircraft leasing and set out some widely shared principles to assist States in developing transparent and effective policies with respect to this growing practice. The study was disseminated to Contracting States in May 1999, together with guidance material on the implementation of Article 83 *bis* of the Chicago Convention on aircraft lease, charter and interchange (State letter EC 2/82, LE 4/55-99/54 dated 14 May 1999).

2.2 Article 83 *bis*, an amendment to the Chicago Convention, entered into force on 20 June 1997. The Amendment provides for certain responsibilities of the State of Registry under the Convention for leased aircraft to be transferred to the State of the operator. As of June 2002, the number of States ratifying Article 83 *bis* has increased to 133. Seventeen States have concluded 24 agreements under the Article. The agreements were predominantly for dry leases of aircraft involving leasing companies or financial entities as lessors. ICAO's initial guidance material on the implementation of Article 83 *bis* has been reviewed and enhanced in light of the experience in the application of Article 83 *bis* since 1997 and will be available by early 2003 as an ICAO Circular "Guidance on the Implementation of Article 83 *bis* of the Convention on International Civil Aviation" (Circ 295).

3. RECENT DEVELOPMENTS

3.1 The use of leased aircraft continues to play a significant role for airlines in the provision of international air services. During the last five years, the number of international scheduled airlines which used leased aircraft has increased by 20 per cent. In 2001, 84 per cent of the 532 international scheduled airlines in operation worldwide used leased aircraft, and over 45 percent of all transport category aircraft in service with such airlines were leased. As regards the sources of leased aircraft for international scheduled service airlines, between 1996 and 2001 the number of aircraft leased from other airlines increased by 33 per cent, from leasing companies by 43 per cent, and from others (a category including, for example, banks) by 44 per cent. Thus, the trend towards the increasing use of leased aircraft has continued, reflecting in particular the economics and flexibility of leasing over purchasing. In a liberalized environment leasing of aircraft facilitates the entry of new carriers into the market place.

3.2 As regards the regulatory response at bilateral and other levels, at the time of the ICAO study on aircraft leasing (1999), there were 41 bilateral air service agreements (involving 38 States) which contained aircraft leasing clauses. Since then, an additional 25 bilateral agreements with leasing provisions have been concluded (involving 28 States, 22 of which were not included in the earlier group of 38). The first leasing provision in other than a bilateral air services agreement was contained in an "open skies" plurilateral agreement signed in May 2001 by five members of the Asia-Pacific Economic Cooperation (APEC). The leasing provision in this agreement broadened the potential number of States whose airlines could provide leased aircraft to airlines of any of signatory States to include other APEC members not Parties to the agreement. At the regional level, the European Union (EU) has two Council Regulations (No. 3991/91 of 16 December 1991 and No. 2407/92 of 23 July 1992) and one Resolution (19 June 1995) dealing with the use of leased aircraft by community air carriers; the European Civil Aviation Conference (ECAC) has a Recommendation on Aircraft Leasing (ECAC/21-1, 2-3 July 1997) for its members.

4. DISCUSSION

4.1 As the 1999 ICAO study indicated, potential safety problems arise where a leased aircraft is registered in a State other than that of the operator using it in international commercial services. The approval of dry and wet leases should clearly establish the scope of responsibilities with respect to safety standards undertaken by each of the parties to the agreement in their respective areas of competence.

4.2 From an economic perspective, States either approve or do not regulate leases where the lessor is not an air carrier nor is controlled by an air carrier. In other words, financial and long-term operating leases where the lessor is a leasing company, bank or other entity are generally permitted in international air transport. From a bilateral perspective, States generally permit aircraft leases between airlines of the two parties, while restricting or not allowing leases, particularly wet leases, from airlines of third countries. For leases involving airlines of States not parties to the relevant agreement or arrangement, States either require that such airlines have the necessary traffic rights, or prohibit leases where such airlines do not have such rights.

4.3 Although the specific approaches of the provisions being inserted in bilateral agreements vary, they generally address two fundamental aspects of the use of leased aircraft: economics and safety. The economic issue reflects a specific concern that aircraft, leased from airlines of States not parties to the relevant agreement or arrangement, are not used to exercise traffic rights to which the lessor airline is not entitled. The safety concern is a more general one, that leased aircraft not compromise safety.

4.4 In certain situations (long-term dry leases, for example) the potential safety problems of operators using leased aircraft registered in States other than the one which has designated/authorized the operators for international commercial services has been ameliorated by agreements pursuant to Article 83 *bis*, as described in paragraph 2.2 above. However, for other situations where such agreements are not appropriate, States have either required that minimum safety standards be met or mutually agreed on a case by case basis as to the respective safety responsibilities with respect to leased aircraft.

5. CONCLUSIONS

5.1 The Conference is invited to conclude that:

- a) leasing (both wet and dry) offers considerable benefits to air carriers, enables expanded and more flexible air services and provides opportunities for the establishment of new carriers. However, it also raises economic and safety regulatory issues which need to be addressed; and
- b) States should, where necessary, review their regulatory responses to the use of leased aircraft in international services to and from their territory, and should ensure clear responsibility for compliance with minimum safety standards, whether through the inclusion of appropriate provisions in their air services arrangements or by the establishment of agreements pursuant to Article 83 *bis* of the Chicago Convention. In this regard, ICAO guidance in Circ 295 may be used.

6. RECOMMENDED REGULATORY ARRANGEMENT

6.1 In 1999, the ICAO study on aircraft leasing concluded that, although there were some widely shared principles from the economic regulatory perspective concerning, for example, the use of dry-leased aircraft, there did not appear to be at that time a sufficient consensus on approaches to the approval or disapproval of aircraft leasing to attempt to develop a single approach or model clause for air services agreements in this rapidly changing area. Moreover, the study noted that, from the safety perspective, the complex and varied situations presented by different leasing arrangements as well as the need to gain experience with the use of agreements under Article 83 *bis* were not conducive to establishing a single uniform worldwide policy which would meet all safety situations posed by leased aircraft.

6.2 Since the time of the study, bilateral clauses have continued to evolve and some States are using standard language for their clauses dealing with aircraft leasing, leading to a measure of uniformity. Moreover, there has been some experience with the use of agreements under Article 83 *bis*. In view of the trend towards liberalization and this recent experience, there would seem to be merit for ICAO to formulate a regulatory arrangement on leasing for optional use by States. This regulatory arrangement could take the form of a model leasing article for insertion in air services agreements.

6.3 Bearing in mind the different approaches to the safety and economic aspects for the use of leased aircraft in existing agreements and practices, as well as the wide variety in leasing arrangements, the proposed model uses a general safety paragraph linked to the existing safety article found in many air services agreements and a choice of two clauses dealing with the economic aspects of the use of leased aircraft. The safety paragraph puts the operation of leased aircraft on the same basis with respect to safety requirements as other aircraft operated by designated airlines under the relevant agreement. However, where a safety clause does not exist, this provision would not apply and the parties should consider concluding an agreement on the transfer of relevant safety responsibilities under Article 83 *bis* of the Chicago Convention. Furthermore, it should be noted that ICAO has produced a model clause on aviation safety for States to use, as necessary, in their air services agreements (see State letter AN 6/42-01/84 dated 14 September 2001). The economic paragraphs reflect the two basic approaches to aircraft leased from airlines not parties to the agreement: requiring underlying traffic rights or prohibiting leases where the airline does not have them. Both options recognize (by omission) that from an economic perspective, States generally permit aircraft leases by non-airline entities.

6.4 The following regulatory arrangement, in the form of a draft model clause, is proposed for consideration by the Conference for Contracting States to use at their discretion in bilateral, regional or plurilateral air services agreements. This provision has also been inserted in the Template Air Services Agreements (in ATConf/5-WP/17)

LEASE OF AIRCRAFT

1. *A Party may prevent the use of leased aircraft to operate services under this agreement when such operation would not meet the safety standards and procedures in Article _____ (Safety)*

2. First Option

Subject to paragraph 1 above, the designated airlines of each Party may use aircraft leased from other airlines to provide services under this agreement, provided all airlines

participating in such arrangements hold the appropriate authority and meet the requirements applied to such arrangements.

OR

Second Option

Subject to paragraph 1 above, the designated airlines of each Party may use leased aircraft to provide services under this agreement, provided that this would not result in a lessor airline exercising traffic rights it does not have.

7. ACTION BY THE CONFERENCE

7.1 The Conference is invited to:

- a) review and adopt the conclusions in paragraph 5.1; and
- b) recommend the adoption of the model clause on lease of aircraft in paragraph 6.4.

— END —