Aviation

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

This publication is uniquely devoted to offering a legal perspective on the full spectrum of the global GA sector, from finance to insurance, corporate/commercial to operations and regulatory to risk. The HFW Aerospace team has been advising this sector for over 30 years. With the global team positioned in key locations, this quarterly bulletin aims to provide a concise analysis of the important legal developments and trends and how we can assist you.

In sheer numbers GA is impressive: nearly 400,000 aircraft and over 1.3 million pilots compared with 40,000 aircraft and 600,000 pilots in commercial operations. The significance of GA becomes greater when it is realised that every airline/military pilot must begin their journey to professional competence in a GA aircraft. It is also a sector that is experiencing considerable growth in new markets in spite of the economic downturn. Indeed, it is often considered to be a catalyst for economic growth.

In this, our inaugural edition, Sue Barham and Victoria Cooper address the thorny issue of the EU emissions trading scheme (ETS) and what it means for the GA sector. Peter Coles then goes on to highlight the importance of maintaining a valid medical certificate for reasons of insurance before Zohar Zik reports upon some recent and much welcomed amendments to aircraft taxation levies in Italy. The oil and gas sector accounts for a significantly higher aircraft accident rate than that of commercial airline operations. In elaborating upon this, Peter Coles explores some fundamental principles of aviation loss mitigation set against the context of recent OGP guidelines. Finally, as part of a regular Country Focus feature, Charlie Cockrell examines some of the challenges and opportunities affecting the rapidly growing GA sector in India.

This bulletin includes contact details for a number of our Global GA team. For further information about any of these articles, or aviation and aerospace issues in general, please contact one of the team or your usual contact at HFW.



The EU ETS: simplified procedure for small emitters - not so simple?

Introduction

The EU's Emissions Trading System (or Emissions Trading Scheme, as it is more commonly known) ("EU ETS" or "the Scheme") was extended to include the aviation industry from 1 January 2012. Although the subject of intense scrutiny and attack, a legal challenge against the EU ETS by the Air Transport Association of America, supported by the International Air Transport Association and the National Airlines Council of Canada, was dismissed by the European Court of Justice in December 2011. Although this is by no means the end of the story, the EU ETS has now come into effect for the aviation industry and is likely to remain so notwithstanding ongoing legal and political challenges to its validity.

This article considers the effect of the Scheme on 'small emitters', with a particular focus on the problems already being experienced by business aircraft operators.

Background

The EU ETS is a market-based "cap and trade" scheme for environmental improvement that allows participants to buy and sell emissions allowances i.e. the right to emit a fixed amount of emissions each year. At the end of each trading year, operators must "surrender" allowances which correspond to their actual emissions for that year. A certain number of free allowances are allocated to each operator based on a benchmark figure set by the European Commission ("the Commission") and tonne-kilometre data provided by that operator for the year 2010. Unused allowances can be sold to other operators but additional allowances must be purchased if extra emissions are made, or serious penalties may be applied. The Scheme places obligations on operators to monitor, report and verify ("MRV") their emissions data.

In essence, an aircraft operator falls under the EU ETS if it performs flights to, within or from the EU. However, if an operator only operates exempt flights (set out in Annex I of Directive 2003/87/EC) or is a commercial air transport operator falling below the de minimis threshold (see below), the operator is not caught by the Scheme. Important Annex 1 exemptions for the GA market include military flights, search and rescue flights, flights performed exclusively under visual flight rules, flights departing/arriving at the same aerodrome (where no intermediate landing has been made), training flights performed exclusively for the purpose of obtaining a licence, and flights performed by aircraft with a certified take-off mass of less than 5,700kg.

The *de minimis* threshold: "small emitters"

A commercial aircraft operator is defined in the relevant EU legislation as an operator with an Air Operator's Certificate under Part I of Annex 6 to the Chicago Convention. If a noncommercial operator operates fewer than 243 flights per period for three consecutive four-month periods (Jan-April, May-Aug, Sep-Dec) or operates flights with total annual emissions of less than 10,000 tonnes CO₂ per year (the *de minimis* threshold), it is considered to be a "small emitter" for EU ETS purposes. Commercial operators who operate below the *de minimis* threshold are exempt from EU ETS altogether. Small emitters are permitted to use a simplified procedure for calculating their annual emissions, which is designed to ease the administrative burden of compliance with some aspects of the Scheme.

Although many business aircraft operators fall below the *de minimis* threshold, the European Business Aviation Association (EBAA) has intensively lobbied the Commission regarding the arbitrarily low limit of 10,000t of emissions. We understand that, in December 2011, the Commission agreed to increase the threshold to 25,000t (EBAA wanted a higher limit of 50,000t), although this is not expected to come into play until 2013.

The simplified procedure: is it really that simple?

Eurocontrol has produced a 'small emitters tool' ("SET"), which has been approved by the European Commission and can be used by small emitters to determine their fuel consumption for EU ETS monitoring and reporting purposes. The SET provides an estimate of fuel consumption based on the actual flight distance and a representative fuel burn model for the aircraft type. It uses the standard density for jet kerosene of $3.15 \text{ tCO}_2/\text{tfuel to provide}$ an estimate of the amount of CO₂ produced per flight.

Although the SET is free to use, small emitters are still required to adhere to the formal standard reporting and verification requirements set down by the Commission. Unsurprisingly,



many smaller business aircraft operators do not have the resources to dedicate to the time-consuming standard MRV requirements. Recent research carried out suggests that 80% of smaller businesses have already struggled with the administrative burden of compliance and could also face annual verification costs of around €1,000. However, the EBAA estimates that verification costs could, in fact, be much higher.

In addition to the SET, Eurocontrol offers (at a cost of €400 per access) an ETS Support Facility which incorporates the SET and produces a draft annual emissions report for small emitters generated from the best available data and flight information. The form of draft report is compliant with the Commission's reporting requirements but does still require formal verification before it can be submitted. Although some providers (such as VerifAvia) offer a simplified verification procedure for small emitters (which can be conducted remotely by email), small emitters are not relieved of the compliance burden entirely.

Free allowances: why it pays to be heavy

Another criticism of EU ETS from the business aviation community is that the benchmarking process for calculating free allowances discriminates against business aircraft operators. 85% of the total emissions cap for 2012 has been allocated to qualifying operators (i.e. those who submitted a verified benchmarking report for 2010) for free. The total number of free allowances available will be reduced to 83% from 2013. Allocation of free allowances is based on the operator's tonne-kilometre data as a proportion of the total tonne-kilometre data of all operators caught by the Scheme in the benchmark year 2010. Tonnekilometre data is calculated using the formula: distance (km) x payload (t). So, the heavier an operator's payload (i.e. total mass of freight, mail and passengers carried), the higher the tonne-kilometre calculation and the greater the number of free allowances granted.

The consequence for business aircraft operators, whose payloads are on a completely different scale compared to commercial airlines, is that they are expected to have to acquire some 96% of their historical CO_2 emissions in permits, whereas busy commercial airlines may need to acquire only 15%. As a result, it is thought that some business aircraft operators are choosing to purchase permits for 100% of their emissions, rather than spending time and money calculating how far their free allowances will go.

The future

While non-EU countries (such as America and China) legislate to prohibit compliance with EU ETS, and organisations (such as the EBAA) continue to lobby the Commission intensively, the latter remains firm in its stance that EU ETS is legally valid, fully in force and must be complied with. Although many business aircraft operators are not against the premise of EU ETS, it is the timing and execution of the "one-size-fits-all" approach that has been criticised. Pressure continues to grow for an international agreement on carbon emissions from aviation which might resolve

the current "stand off" between the EU and those countries threatening non-compliance, but the Scheme is in full swing for now and cannot be ignored. For those business aircraft operators who are not in a position to retrofit newer engines, install winglets, or conduct aerodynamic paint-jobs, it may simply be a case of biting the compliance bullet for now and awaiting developments at an international level. However, the business aviation community will wish to ensure that its legitimate concerns are not overlooked in the event of any adjustment to the application of EU ETS to reflect any international compromise reached in the near future.

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"Although many business aircraft operators are not against the premise of EU ETS, it is the timing and execution of the "one-size-fits-all" approach that has been criticised."

Insurance Coverage: is your medical certificate still valid?

In 2006 a Canadian pilot lost control of his Cessna 177B aircraft after making a slow-speed pass at low altitude. He obtained his private pilot license in 1993, but his most recent medical certificate expired in 2005.

His estate submitted a \$60,000 insurance claim for damage to the aircraft. However, the aviation insurer denied the claim on the ground that the policy "applies only if your aircraft is flown by an approved pilot...who has the required license...to fly". Subsequently, the estate issued legal proceedings against the Insurer.

At first instance the estate succeeded in its claim, with the Master of the Alberta Court of Queen's Bench finding that the language of the policy was ambiguous and that the policy only required that the pilot had a license to fly an aircraft without additional requirements. This decision was then overturned on appeal, the judge ruling that a "required license" under the policy meant a license that was valid. It found that it would stretch "the bounds of common sense to find that an invalid license is still a license and that insurance coverage is valid". Finally, in January 2012, after hearing an appeal by the estate, the Alberta Court of Appeal held that the policy was not ambiguous and that the insurer was entitled to denv coverage. The Court ruled that reference to a license means a license in force and since the pilot did not have an up-to-date medical certificate his license had also expired.

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The Italian government appears to have heeded industry concerns and has modified a new tax on private aircraft

The latest Italian "luxury tax", approved in December 2011, was to be levied on a sliding scale from €1.5 per kilogram per year for aircraft under 1,000 kgs, to €7.55 per kg for aircraft over 10,000 kg. Helicopters were to pay double these rates. What concerned the international aviation community however was that the new levy was originally proposed to be applied to *any* private aircraft, regardless of nationality, which remained on Italian territory for 48 hours or more.

In response to these concerns, amendments to the legislation, passed this April, extend the period in which non-Italian registered aircraft can spend in the country to 45 consecutive days¹. Any time spent in maintenance facilities on Italian soil will not count towards the 45 day allowance. After the 45 day period the tax will be applied on a pro-rated monthly basis.

Other amendments made to the new tax include a 50 per cent reduction in the rates for aircraft below 6000 kg and in those applying to helicopters. The new rates are as follows:

Aircraft Maximum Takeoff Weight (MTOW)	Tax Rate (€)
Up to 1,000 kg (2,200 lb)	0.75 per kg
Up to 2,000 kg (4,400 lb)	1.25 per kg
Up to 4,000 kg (8,800 lb)	4.00 per kg
Up to 6,000 kg (13,220 lb)	5.00 per kg
Up to 8,000 kg (17,600 lb)	6.65 per kg
Up to 10,000 kg (22,000 lb)	7.10 per kg
Up to 22,000 kg (22,000 lb)	7.55 per kg

1. The amended tax regime has a retroactive effective date of 6 December 2011 for Italian registered aircraft and 28 December 2011 for non-Italian registered aircraft. The amendments also created a new "user fee" tax on chartered flights at the rate of €100 per passenger for flights of less that 1500km and €200 on all longer flights. This tax is payable by the charter operators and is likely erode their profitability whether they decide to pass it on to their passengers or not.

The recent changes to the scheme seem to meet industry concerns but only half way. Whilst they do away with the most controversial aspect of this tax, namely the exposure of persons with no connection to Italy to significant tax bills in circumstances that are out of their control - e.g. weather delay, a mechanical problem, or industrial action by ATC - key aspects of the tax, such as whether it should be levied progressively, remain unclear. It is also unclear if this form of "tax of the rich" will be emulated by other European Governments as the Eurozone crisis deepens, and, if so, in what form.

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Oil and gas exploration and production aviation loss mitigation

Anyone who has read the International Association of Oil and Gas Producers (OGP) aviation transport accident statistics, will know that it makes for grim reading. The sector's accident rate is much higher than that of commercial airline operations. Even considering many of the special characteristics of oil and gas operations (frequently operating in dangerous conditions, flying low to the ground etc) it is far from being an acceptable level.

The OGP has 71 member companies. They operate/utilise a fleet of 1,383 aircraft. On average they operate 2,881 flights per year and carry 9,386 passengers. Between 1998-2010 there were 425 accidents (317 helicopters, 54 fixed wing), 133 were fatal losses (107 in helicopters, 26 fixed wing) with 541 fatalities (414 in helicopters, 127 fixed wing). Since OGP members aviation activities comprise only 46% of the reported oil and gas aviation operations, the accident rate and fatalities is clearly much higher.

In January 2011 the OGP estimated that there were 0.8 and 3.0 fatal accidents per million flight hours on commercial and commuter airlines respectively. Among OGP members there are 4.5 fatal accidents per million flight hours in offshore helicopter transportation. By far the highest exposure is pipeline surveillance at 30 fatal accidents per million flight hours. 18.1 is the figure for seismic (land and heli-rig) operations.

The oil and gas industry and the aircraft operators whom they

contract with should comply with applicable national safety regulations as these relate to aircraft operators and associated air operations infrastructure.

In spite of the obvious importance of this industry to national and global economies, national aviation authorities have at best laid down only minimum requirements and safety standards. In most cases these are based on ICAO requirements: Annex 6 (Operation of aircraft), 11 (Air Traffic Services), 14 (Aerodrome Design and Operations) to name but a few. EASA/JAA, the UK CAA, Australia's CASA and the FAA have all introduced guidance to operators on appropriate safety management systems.

However, many authorities lack the teeth which are needed to ensure compliance. Consider the global location of many rigs and wells and one can quickly draw up a rather long list. The inevitable result – responsibility for air safety lies with the aircraft operators and the oil and gas industry.

It is just as well then that the OGP has produced aircraft management guidelines to assist those responsible for managing aviation operations in planning, developing and controlling safe and efficient air operations; and developing proper aviation policies. In August 2011, the guidelines were revised including the incorporation of a dedicated chapter on safety management systems. This includes a list of SMS elements and relationships which OGP members are asked to implement within their own and contracted aircraft operators: leadership commitment; a defined HSE policy based on a just culture; documented procedures; appointment of key safety personnel with defined competence requirements; a range and hierarchy of safety communication processes; safety reporting and investigation; a defined procedure to manage the risks associated with significant change to aircraft operations, hazard/risk management; quality assurance so as to ensure that risk controls specified through regulation, company operating procedures and the risk management process are effective within all flight operations, maintenance and ground operations activities; and a senior management review process that gives managers visibility of the SMS activity, in particular safety reporting, hazard management and QA issues.

Most contracts should oblige parties to establish appropriate safety management systems and comply with all applicable laws and regulations. As with other codes of practice, the OGP guidelines can be incorporated into contracts by reference. If they are breached, then party "B" may have a right to make a claim for breach of contract or enforce an indemnity given by party "A" which protects it from claims of third parties.

Even where the guidelines are not expressly incorporated into a contract, their use by the industry over time may be enough for them to become a customary practice which national health and safety laws may refer to. Consequently, a party may be liable if an accident has occurred causing loss and damage and a practice was not followed. Failure to follow the practice may not constitute a breach of the law justifying prosecution. However, the breach could result in a claim for breach of a customary law and breach of contract.



Customary law is defined as resulting from a "general and consistent practice of parties followed by them from a sense of legal obligation".

It is also possible for terms to be implied into a contract according to the custom of the market in which the contracting parties are operating. In common law jurisdictions (Australia, Malaysia, New Zealand, Singapore etc), the rule is that the custom must be "certain, notorious, reasonable, recognized as legally binding and consistent with the express terms of the contract". There must be proof that a custom is generally accepted by those who work or trade with the oil and gas and aviation industries. Moreover, the custom must be so generally known that an outsider who makes reasonable enquiries could not fail to be made aware of it. Case law suggests that the size of the market or the extent of the trade affected is neither here nor there.

Like all terms implied by courts, parties can seek to exclude customs by express terms in a contract. However, not all attempts to do this succeed because of the technicalities of local law and public policy. Legal advice should be obtained.

It is clearly in the interests of the oil and gas and aviation industries to significantly reduce the accident rate. Whilst the allocation of risk is an acceptable practice, ignore safety requirements at your peril!

HFW represents companies in the energy sector, including oil and gas exploration and production companies, and owners and operators of terminals, ships and aircraft. With our in-depth knowledge of handling large scale disputes and catastrophic losses for these industries we can offer an unparalleled approach to managing your risks.

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Country focus: India

Despite the well publicised financial crisis affecting its major carriers, India's aerospace industry remains one of the fastest growing in the world. The general aviation (GA) market is particularly buoyant and expected to develop into the third largest market for business aviation in the world by 2020. According to a report published by the Centre for Asia Pacific Aviation (CAPA) last year, the Indian GA industry could see new aircraft sales (business jets, helicopters, turboprops and piston engines) of up to US\$12 billion over the next decade with a contribution of some US\$4 billion per annum to the Indian economy by 2020.

Whilst the potential for growth in the GA industry is undoubtedly huge, there are significant hurdles to overcome for this to be realised. This article explores some of these hurdles and looks ahead to possible solutions.

Challenges

Lack of infrastructure

As the Indian economy booms and its corporations expand, demand for business jets and helicopters has significantly increased. A large number of high net-worth individuals and a fast growing tourism industry have contributed to this trend. At present India does not have sufficient infrastructure in place to adequately cater for its GA fleet and considerable investment is necessary to address this.

According to a report published by PWC in March 2012 (General Aviation: Unfolding Horizons), India has only one airport for every 4.6 million people. By contrast, the US has one airport for every 60,000 persons.

Approximately 150 airports in India are capable of handling business aviation aircraft. The Indian Business Aviation Operators Association (BAOA) estimates that a further 100 airports and as many as 700 heliports need to be built during the next seven years to provide for the expected increase in GA traffic movement.

Facilities at the vast majority of the airports capable of handling business aviation aircraft are substandard. Common problems include limited hangar and parking space (particularly at airports located at or near to major cities), non-existent ground handling facilities, a lack of basic navigation aids and inadequate equipment for night landings. There are also no heliports of any consequence in the entire country.

A related problem is the shortage of Fixed Base Operators (FBOs) and Maintenance and Repair Organisations (MROs) to service business aircraft. Facilities that do exist are more geared towards commercial aviation and India does not currently have a sufficient pool of skilled engineers with the required training to carry out maintenance on business jets and helicopters. A shortage of pilots is an additional concern.

Competition for slots is intense,



particularly at the major airports, some of which (including Mumbai) actively discourage GA aircraft by imposing landing curfews during peak hours.

Complex regulatory regime

Regulations governing the operation of business jets in India have long been perceived as overly cumbersome and bureaucratic. There are numerous government bodies involved in the regulatory process, including the Ministry of Civil Aviation (MOCA), the Directorate General of Civil Aviation (DGCA) and the Directorate General of Foreign Trade (DGFT). Whilst each body has a designated role, the complexity and weight of the procedures they have created undoubtedly stifles growth in the GA sector.

An example is the process for importing and registering an aircraft, which is complicated and time consuming. Permission of the Central Government is required before any person can operate an air transport service (scheduled or non-scheduled) to, within or from India. The DGCA is responsible for issuing Air Operator's Permits, which will only be granted to an Indian citizen or company. The operator must first obtain an initial No Objection Certificate ("NOC") from the Ministry of Civil Aviation in Delhi before it can obtain an Air Operator's Permit. This requires the disclosure of a considerable volume of information, including details of the proposed operations and the financial structure of the applicant.

If foreign investment is envisaged, the Foreign Investment Promotion Board must give its approval and the Directors and Chairman of the applicant must obtain security clearance. Foreign financial institutions and other entities who seek to hold equity should not be associated with foreign airlines, have foreign airlines as their shareholders, or have any office of a foreign airline involved in their management. If the Ministry of Civil Aviation grants an initial NOC, it will normally be valid for a period of 18 months.

The next step is for the applicant to apply to the DGCA for an NOC for import and submit detailed information relating to the aircraft, including the type certification and proof that stipulated equipment and accessories are fitted. The DGCA will grant permission for import based on the recommendations of the Ministry and its standing committee. The NOC for import given by the DGCA will be valid for one year or until the date of expiry of the initial NOC given by the Ministry.

An import license from the DGFT is then required. Aircraft can only be imported for personal use by companies and individuals and cannot be utilised for hire and reward unless specifically permitted by the Ministry.

Once imported, an aircraft must be registered in India before it can be flown and there are regulatory hurdles here also.

Tax implications must also be considered. These can be significant, particularly for private operators who are required to pay customs duty of 25% of the value of the imported aircraft.

For business aircraft not registered in India, each flight within the country must be specifically sanctioned and it can take up to seven days to get a permit to land. An added consideration is that customs duty will become payable if the aircraft remains in the country for a period of sixty days or more.

It will be apparent from the above that the regulations governing the operation of business aircraft in India are far from straightforward and likely to inhibit the growth of the GA sector unless action is taken to cut away unnecessary red tape.

Opportunities

Industry bodies, most notably the recently formed BAOA, are lobbying the government hard for the challenges identified above (among others) to be addressed. Progress is certainly being made and an integrated plan for business and general aviation in India (covering helicopters, sea planes and fixed-wing operations) is being worked on by a team that includes representatives from ICAO and the Indian Ministry of Civil Aviation. It is hoped that the plan will be worked into the new draft Civil Aviation Policy, expected to be released later this year.

Meanwhile the Government has plans in place to build a number of greenfield airports and upgrade various existing ones across the country to ease the burden on those that are capable of handling business aviation aircraft. Mumbai's Chhatrapati Shivaji International Airport recently became the first airport in India to commence international operations from a dedicated GA terminal. Others are expected to follow.

The growth of the Indian aerospace industry and the relative lack of MRO support presents opportunities that some companies are already capitalising on. The best example is



Airworks Indian Engineering which recently became the first independent general aviation MRO to obtain European Aviation Safety Agency Part 145 approval for its facility in Delhi, meaning that it can now carry out maintenance on European registered aircraft. The company has other major facilities in Mumbai and Hosur capable of handling business aircraft and maintenance centres at nine locations around the country, with plans to expand further.

Meanwhile, Boeing is in the process of setting up a US\$100 million MRO facility in Delhi and Dassault Aviation is reported to be planning the development of an MRO sector in Hyderabad to service its business jets in the region.

Indocopters Private Limited, the distributor for Eurocopter helicopters in India, is also reported to be developing a helicopter MRO facility in Bhubaneswar.

A major factor that has traditionally hindered the creation and expansion of MROs in India is the high rate of tax imposed for importing parts and servicing aircraft. Encouragingly, the Government offered some relief for general aviation MROs in its March 2012 budget by exempting aircraft spares, new and retreaded tyres and training equipment from customs duty. Taxes still apply for servicing an aircraft but this development has been welcomed by the industry and is likely to stimulate growth, particularly in the GA sector.

The biggest impediment to the development of the GA sector remains the overly complex and bureaucratic regulatory regime outlined earlier in this article. Procedures for importing and operating aircraft must be simplified. The development of a draft Civil Aviation Policy addressing these issues signals an intention on the part of the Government to legislate in this area; something that is urgently required if the GA sector is to realise its vast potential.

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Conferences & Events

HKBAC - Opening of third hangar Hong Kong (21 May 2012) Ashleigh Williamson

Isle of Man Aviation conference Isle of Man (21 June 2012) Adam Shire and Jonathan Russell

LABACE 2012

São Paulo (15-17 August 2012) Adam Shire

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