BIS | Department for Business Innovation & Skills

CALL FOR EVIDENCE: FULL LIST OF RESPONSES

Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment

Contents

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BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

Reply submitted by AIRBUS S.A.S on October 6, 2010

Dear Ms. Onikosi

This is a response to the above-identified Call for Evidence (the "**CE**") in connection with the government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment (the "**Convention**" or "**C**") and the Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**" or "**P**"). The Convention and the Protocol will be referred to together as the "**Cape Town Treaty**" or "**Treaty**").

We have cut into this response the questions contained in Part III of the CE, and have set out our replies thereto below each such question.

To be clear at the outset, and as noted in reply to question 3.9, ***we strongly support ratification of the Cape Town Treaty and urge the government to do so as promptly as possible and with a high level of priority***.

The Cape Town Treaty reflects, enhances, and internationally promotes basic concepts found in English law. That should be expected given the central role played by the UK in negotiating and drafting the instruments. In fact, the drafting committee at every intergovernmental meeting that negotiated, and at the diplomatic conference that adopted, the Cape Town Treaty was chaired by a UK representative (either Sir Roy Goode (Oxford) or Bryan Welch (BIS)). The Treaty will reduce legal risk. It will produce economic benefit.

Importance of Protocol, art XI (Remedies on Insolvency) – Alternative A

The CE does not ask a question about the economically most important provision, P, art XI (remedies on insolvency). It is necessary to draw out the significance of applying Alternative A of this article ("**Alternative A**"). Most of the economic benefits and transaction risk reduction under the Treaty are predicated on the applicability of Alternative A (with a sixty (60) day waiting period). See *Economic Benefits of the Cape Town Treaty*, 2009, by Professor Vadim Linetsky, a leading authority on the financial modeling of secured transactions.

Regarding the basis for this provision in emerging legal thinking, see "Cape Town Treaty in the European Context: the case for Alternative A, Article XI of the Aircraft Protocol", by Jeffrey Wool / Andrew Littlejohns. These materials can be downloaded at www.awg.aero . Thus, it is essential that Alternative A apply in the UK though its inclusion in the UK's implementing legislation (that mode of application is required given agreements relating to EU competence). See Unidroit, "The European Union and the Cape Town Convention", DC9 / DEP, Doc. 8, June 2010 at Annex III.

We note the Department's willingness to meet to discuss these matters. We would like to do that.

QUESTIONS POSED AND REPLIES

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;
b) the predictability of legal outcomes;
c) the availability of finance or leasing facilities; or
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Reply: The internationality of aircraft financing and leasing, and the consequent applicability of several non-harmonised laws, undoubtedly produce complex transactions. Legal outcomes are less predictable than they could and should be. As mentioned in CE, para 1.11, there is a particular level of uncertainty in English law due to the application of the *lex situs* rule regarding property rights in aircraft. The recent Blue Sky case has brought that problem into sharp focus.

All else equal, greater complexity and less predictability result in higher transaction costs than would otherwise by the case. At some point on the continuum, these factors impact the availability of financing. The foregoing is axiomatic. It is a basic tenet of law and economic theory, which is now widely-accepted in policy-making relating to secured transactions.

A prime example of such conflict of laws issues relates to rights in aircraft engines. Laws differ significantly regarding the legal effect of installing or removing engines, which, given operational requirements, could happen in any jurisdiction. In some jurisdictions, these actions impact core property rights.

Beyond conflicts, the cost and availability of financing are significantly impacted by the underlying substantive law, more specifically, any impediments caused by it affect the timely access to collateral value. Timely access to valuable collateral is the basis of secured transactions and defines the leasing model. In financial terms, timely access to valuable collateral offsets loss (that is, reduces the risk of loss (to a creditor) notwithstanding the risk of default (by a debtor)), thus producing efficiencies.

A prime example of such substantive law issues – as noted in CE para 1.11 – is delay occasioned by insolvency law. Beyond that delay, such laws may qualify or restrict contractual (and non-insolvency law) enforcement rights or impact property rights. These prospects are directly inconsistent with the core principles underlying asset-based financing and leasing.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

a) the rating of aircraft receivables,
b) the cost of export credit insurance, and/or
c) the cost of financing or leasing aircraft?

Reply: Sub-question 3.2(a) and (b) may be answered with reference to objective and publicly available information. Sub-question (c) raises methodological and confidentiality issues, and, thus, needs to be addressed based on general principles.

Re 3.2(a): "Aircraft receivables", in the context of the Treaty (which excludes general receivables financing), must refer to the rating of aircraft-backed securities. The only source of publicly available information regarding their cost is public, capital markets. In the aviation industry, these securities / transactions are known as "enhanced equipment trust certificates"

("**EETCs**"). There have been few EETCs in Europe and none in the UK, given uncertainties caused by applicable underlying insolvency law. In those transactions, two major European airlines paid materially higher rates, and had materially more restrictive terms, than less creditworthy airlines (closing transactions in the same time frame) in the US. The sole reason for such preferential US financing terms was the existence and application of section 1110 of the US bankruptcy code, a functional equivalent to Alternative A. This follows from the policies of international rating agencies, which have, based on years of data, used a system of "enhanced" rating (rating upgrades) where timely recourse to valuable aircraft collateral can be safely assumed. Based on underlying law, including insolvency law, that has been the case in the US but not in Europe.

Thus, the ratification of the Cape Town Treaty will provide UK airlines with enhanced access to international capital markets, thus diversifying their sources of funding. In particular, it will open public debt markets, providing UK airlines with another important option (in addition to bank debt and leasing, their traditional options) to help fund their capital-intensive aircraft acquisition requirements. For discussion of other commercial transactions, please see below.

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Re 3.2(c): This question raises the general topic of the relationship between harmonised and (see reply to 3.1 above, more importantly) commercially-oriented secured financing and leasing law, on the one hand, and the cost (and terms) of such transactions, on the other. It is not possible to provide definitive and precise information on this question, for two reasons. First, many factors go into transaction pricing (and the availability of financing). These include – in addition to credit and legal risk – more general and macro considerations, such as (i) general liquidity in the financial sector and the liquidity position of a particular financial institution, (ii) the impact of regulatory capital, (iii) comparative returns from other forms of lending, (iv) competitive issues that may lead a bank to consider longer-term and relationship issues in setting price, and (v) other sources of fees payable to a bank directly or indirectly linked to that transaction or related transactions. Secondly, confidentiality (and, possibly, competition law) considerations prevent the disclosure of terms in private financing transactions.

That said, and as noted above, the direct link between reduced transactional risk and improved pricing and other terms – all else equal – is a foundation of law and economics. It is now taken as an established fact. Elements of this thinking are seen (beyond the positions of the

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[1] The UK, France, Germany, Spain and the US currently follow the "home market rule", which prevents export credit into these countries. The ASU is currently under review. A number of home market airlines, including some in the UK, are seeking to have this restriction eased or removed. To the extent that is agreed, the points above will apply in respect of UK carriers.

international rating agencies and the OECD countries, noted above) in the terms of BIS II (rules for regulatory capital) and daily decisions made by credit committees of financial institutions.

Finally, a specific word on the Treaty and "proof" of economic benefit. The extensive economic assessment and related academic work on the Cape Town Treaty has been without precedent in the field of commercial law reform. Two major studies were undertaken (see www.awg.aero), each of which took into account available information and research. The authors were of the highest possible caliber (in addition to Professor Linetsky, Northwestern University, they are Professors Anthony Saunders and Ingo Walters (INSEAD and NYU)). These academics are applied economists and finance specialists. If a higher standard than that undertaken in connection with the Treaty needs to be met, then question whether (i) any prior commercial treaty (or national law reform in this field) should ever have been adopted, or (ii) any future commercial law treaty (or national law reform in this field) will ever be adopted.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

Reply: The terms of the Cape Town Treaty will significantly address all of the issues noted in 3.1 above. First, it will sweep away the problems associated with the *lex situs* rule. Secondly, with Alternative A, it will sweep away problems associated with insolvency delay and impairment. That, in turn, will provide UK airlines with enhanced access to international capital markets, thus diversifying and increasing their sources of funding. Thirdly, it will eliminate the above-noted legal issues associated with engine financing, though that depends on adoption by many countries. On that last point, while the Treaty is rapidly being adopted internationally, there is no doubt that UK ratification would provide a leading example to and justification for others to ratify. That would also serve the objective of the UK export community. See reply to question 3.9 below.

The Cape Town Treaty, unlike most other international legal instruments, was purposefully designed to facilitate a transaction type, thereby producing benefits to the industry sector. The core role that the aviation sector – IATA (airlines) and AWG (financiers and manufacturers) – played in the process ensures that result. The Treaty elegantly solves the current legal issues in this field, and does so in a manner consistent with leading legal thought. There are no losers: the problems solved equally benefit debtors, creditors, and manufacturers.

3.4 Do you:

a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Reply: Re 3.4(a): The International Registry under the Treaty ("**IR**") is already recognised as both ground-breaking and well-established. Approximately half of the world's new aircraft transactions are registered in the IR. The system has run with virtually no problems since inception. There is strong supervision by ICAO. Users have direct input through an International Advisory Board.

The IR (and the above-noted priority rules) is a significant improvement over current law and practice. First, the system is electronic and low cost. It is simple and effective. Closings are made easier. Interests may be registered in advance ("prospective interests"), which takes pressure off of (expensive) closing logistics. In international (and national) law reform circles, the starting point for any discussion about registries systems is the IR. Secondly, the priority rules are clear and objective. In the context of aviation financing, clarity equals fairness. Parties can search the IR and determine exactly where they stand. Litigation relating to "knowledge" will be avoided. There will be no need for legal gymnastics (such as priority notices), which seek to address the issues handled directly by the Treaty. Thirdly, the IR (through the Treaty) establishes priorities on an international basis. Any other system would be limited to national priorities. That is inherently inefficient, and leaves risks in transactions which can be reduced only at significant expense. In short, the Treaty, through the IR and the priority rules, puts an efficient international system in place to deal with international transactions and fact patterns.

Re 3.4(b): The treatment of engines as separate property – and, correspondingly, the ability to separately register against them – is extremely useful. As noted in reply to question 3.1, the law applicable to rights in engines varies widely, and, in some jurisdictions, is potentially prejudicial to the right of property holders. That is exacerbated by the *lex situs* problem in the engine context.

Engines are highly valuable equipment. They consistently maintain their value. They should therefore serve as excellent collateral, if the underlying law so permits. In addition, they are often separately financed (spare engines) and pooled and interchanged. From a commercial perspective, they are often hired out on a short-term basis, where strong property rights are particularly important. For all these reasons, the treatment of engines under the Cape Town Treaty – as separate property to which the Treaty's clear rules apply – is a vast improvement to current law around the world. It will support advanced engine financing and use.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

Reply: As mentioned above, this is a significant advantage without any corresponding disadvantage. The absence of a required time period, and the ability to make a prospective registration, takes pressure off of closing logistics. While the priority "relates back", there is no unfairness to any party – since the registration only has priority from the time it is searchable. There are no secret interests. Any searching party can easily self-protect: all it needs to do is search the IR. It is then on notice that an interest, actual or prospective, might have a higher priority. That searching party would not close its financing transaction until the IR is cleared of any registration that could prevail over its interest.

The priority notice concept under English law aims at the same objective, but achieves it using a heavier two-step, paper-based process. The Treaty simplifies and improves the process.

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details.

Reply: We do not understand the relevance of this question – unless it is driving at providing an example and justification for other countries to ratify. See response to question 3.9. This question – what is the position (of a UK-registered aircraft) under foreign (substantive and

procedural) law would not be addressed by UK ratification. It would only be addressed by ratification by foreign countries (where the aircraft is located). And, if that is the optic, why limit the question to UK-registered aircraft. What about the position of a UK financier with a non-UK registered aircraft located elsewhere. Or a UK manufacturer who has problems financing sales given foreign law. These are all analytically the same: what is the position under foreign law. (N.B.: In many jurisdictions, there are significant repossession and enforcement problems.) UK ratification will not address these problems, save to the extent others are thereby encouraged to ratify. That encouragement, however, is important, given the wide range of material UK interests in international aviation.

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

Reply: This provision C, art 13 ("**Relief Pending**"), on which an opt-out is permitted (see C, art 55), and which is strengthened by an opt-in permitted under P, art X (see P, art XXX(2), was designed to provided countries opposed to non-judicial remedies with a court-based function equivalent thereof.

The UK is not such a country. English law on non-judicial remedies is well-established and effective. The international financing community is comfortable with it.

Thus, since the UK, reflecting its law, would be expected to permit non-judicial remedies through the mandatory declaration required by C, art 54(2)(permitting action "without leave of the court"), the Relief Pending provision is not necessary to reduce transactional risk or increase economic benefit in the context of the UK. The aviation community should be largely indifferent as to whether the UK, when ratifying, makes these particular declarations.

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export.. How useful do you consider these additional remedies to be?

Reply: These remedies are essential. In light of the terms of the Chicago Convention of 1944, to effectively exercise remedies against an aircraft, a creditor must be able to de-register that aircraft. The Treaty not only provides these remedies, but adds the extremely useful IDERA clause ("irrevocable deregistration and export authorization"), P, art XIII. Most countries have opted into the IDERA clause (see P, art XXX(1)). An international standard is rapidly developing in favor of the use of IDERAs. (Even countries with very efficient de-registration systems (like the US) have made the IDERA election.) Underscoring its importance, the IDERA clause is an ASU qualifying declaration. Importantly, the use of an IDERA is expressly without prejudice to safety laws and regulations.

3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so

b) what impact do you consider these instruments will have on your sector of the aviation industry?

c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

Reply:

Re 3.9(a): ***We strongly support ratification of the Cape Town Treaty.***

In connection with that ratification, it is essential that the UK implement the economically must important provision, P, art XI (remedies on insolvency) – **Alternative A** (with a sixty (60) day waiting period). Most of the economic benefits and transaction risk reduction effected by the Cape Town Treaty is predicated on the applicability that provision. See materials by Linetsky and Wool / Littlejohns referred to above. See also reply to question 3.10 re ASU qualifying declarations.

Re 3.9(b): Ratification of the Cape Town Treaty (with P, art XI, Alternative A implemented through legislation) will reduce legal and transactional risk. It will produce economic benefit to airlines (by reducing cost and providing additional sources of financing), manufacturers (including through its impact on ratification by others, by promoting exports), and financial institutions (by reducing risk). Such direct benefits have important indirect benefits, including (from export enhancement) job creation and (from airline benefits) pass-through benefits to passengers.

UK ratification will ensure that English law remains a preferred governing law of choice in aviation finance and leasing, and that London remains central in the aviation financing and leasing industry.

Re 3.9(c): ***We urge the government to do so as promptly as possible and with a high level of priority***. The ratification by the UK has been delayed for a long time, given two matters unrelated to the core objectives of the Cape Town Treaty: EU competence issue and the Gibraltar-hold. These two items have finally been addressed. UK companies should start to benefit from the Treaty as promptly as possible. In addition, the recent strains on the financing sector coupled with demand for modern, environmentally friendly aircraft argue for swift action to help in these areas. Finally, while the UK has not yet ratified, many UK companies still need to comply with the Cape Town Treaty (e.g., register with the IR if they (i) buy aircraft equipment from a party located in a contracting state, or (ii) lease an aircraft from a financed lessor located in a Contracting State). In other words, aspects of compliance are already required; ratification will permit the corresponding benefit.

3.10 Do you have any other comments you would like to make?

Reply: We make following additional comments:

(i) The UK should make a set of "qualifying declarations" under the ASU. That would be as follows: (1) non-judicial remedies, C, art 54(2), (2) IDERA, P, art XIII, and (3) Alternative A (60 calendar day waiting period, implemented through legislation).

(ii) With respect to non-consensual rights and interests, the UK should align such rights with those customary in the international community. The UK "fleet lien" is seen as out-of-line with international norms, over-reaching, and potentially harmful to airlines (restricting credit) and financiers (increasing risk). The recent GKL litigation has drawn greater attention to the problem of the UK fleet lien. Thus, a tailored declaration under C, art 39 should be agreed after a policy assessment on this matter.

(iii) We note the Department's current intent to have a second consultation on the declarations to be made and the content of the implementing legislation. We think that such is not necessary, given the clarity on what is needed to ensure the benefits of the Treaty, and the consistency thereof with leading legal thought. If it is necessary, we encourage the government to undertake and complete that second step as promptly as possible.

END

AIRCASTLE

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Rachel Onikosi
Deputy Head, Legislative and International Policy Unit
Department for Business, Innovation & Skills
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October 6th, 2010

Re: BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)
Reply submitted by: Aircastle Advisor LLC
Date: October 6th, 2010

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Aircastle Limited ("Aircastle") is a global company that acquires and leases high-utility commercial jet aircraft to passenger and cargo airlines throughout the world. As of 30 July 2010, Aircastle had acquired 130 aircraft. While Aircastle does not have an office in the United Kingdom, it does business in the United Kingdom and currently leases aircraft to airlines incorporated and existing in England. Aircastle is listed on the New York Stock Exchange (AYR). Aircastle is sending this response in connection with the response sent on 16 August 2010 by the Aircraft Working Group (AWG), of which Aircastle is a member. This response is intended to be for information purposes only and reflects the opinion of Aircastle and is not intended to be interpreted as a statement of fact.

We have cut into this response the questions contained in Part III of the CE, and have set out our replies thereto below each such question.

To be clear at the outset, and as noted in reply to question 3.9, ***we strongly support ratification of the Cape Town Treaty and urge the government to do so as promptly as possible and with a high level of priority***.

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Finally, a specific word on the Treaty and "proof" of economic benefit. The extensive economic assessment and related academic work on the Cape Town Treaty has been without precedent in the field of commercial law reform. Two major studies were undertaken (see www.awg.aero), each of which took into account available information and research. The authors were of the highest possible caliber (in addition to Professor Linetsky, Northwestern University, they are Professors Anthony Saunders and Ingo Walters (INSEAD and NYU)). These academics are applied economists and finance specialists. If a higher standard than that undertaken in connection with the Treaty needs to be met, then question whether (i) any prior commercial treaty (or national law reform in this field) should ever have been adopted, or (ii) any future commercial law treaty (or national law reform in this field) will ever be adopted.

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Reply: The terms of the Cape Town Treaty will significantly address all of the issues noted in 3.1 above. First, it will sweep away the problems associated with the *lex situs* rule. Secondly, with Alternative A, it will sweep away problems associated with insolvency delay and impairment. That, in turn, will provide UK airlines with enhanced access to international capital markets, thus diversifying and increasing their sources of funding. Thirdly, it will eliminate the above-noted legal issues associated with engine financing, though that depends on adoption by many countries. On that last point, while the Treaty is rapidly being adopted internationally, there is no doubt that UK ratification would provide a leading example to and justification for others to ratify. That would also serve the objective of the UK export community. See reply to question 3.9 below.

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b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Reply: Re 3.4(a): The International Registry under the Treaty ("**IR**") is already recognised as both ground-breaking and well-established. Approximately half of the world's new aircraft transactions are registered in the IR. The system has run with virtually no problems since inception. There is strong supervision by ICAO. Users have direct input through an International Advisory Board.

The IR (and the above-noted priority rules) is a significant improvement over current law and practice. First, the system is electronic and low cost. It is simple and effective. Closings are made easier. Interests may be registered in advance ("prospective interests"), which takes pressure off of (expensive) closing logistics. In international (and national) law reform circles, the starting point for any discussion about registries systems is the IR. Secondly, the priority rules are clear and objective. In the context of aviation financing, clarity equals fairness. Parties can search the IR and determine exactly where they stand. Litigation relating to "knowledge" will be avoided. There will be no need for legal gymnastics (such as priority notices), which seek to address the issues handled directly by the Treaty. Thirdly, the IR (through the Treaty) establishes priorities on an international basis. Any other system would be limited to national priorities. That is inherently inefficient, and leaves risks in transactions which can be reduced only at significant expense. In short, the Treaty, through the IR and the priority rules, puts an efficient international system in place to deal with international transactions and fact patterns.

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3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

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Thus, since the UK, reflecting its law, would be expected to permit non-judicial remedies through the mandatory declaration required by C, art 54(2)(permitting action "without leave of the court"), the Relief Pending provision is not necessary to reduce transactional risk or increase economic benefit in the context of the UK. The aviation community should be largely indifferent as to whether the UK, when ratifying, makes these particular declarations.

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Reply: These remedies are essential. In light of the terms of the Chicago Convention of 1944, to effectively exercise remedies against an aircraft, a creditor must be able to de-register that aircraft. The Treaty not only provides these remedies, but adds the extremely useful IDERA clause ("irrevocable deregistration and export authorization"), P, art XIII. Most countries have opted into the IDERA clause (see P, art XXX(1)). An international standard is rapidly developing in favor of the use of IDERAs. (Even countries with very efficient de-registration systems (like the US) have made the IDERA election.) Underscoring its importance, the IDERA clause is an ASU qualifying declaration. Importantly, the use of an IDERA is expressly without prejudice to safety laws and regulations.

3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so

b) what impact do you consider these instruments will have on your sector of the aviation industry?

c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

Reply:

Re 3.9(a): ***We strongly support ratification of the Cape Town Treaty.***

In connection with that ratification, it is essential that the UK implement the economically must important provision, P, art XI (remedies on insolvency) – **Alternative** A (with a sixty (60) day waiting period). Most of the economic benefits and transaction risk reduction effected by the Cape Town Treaty is predicated on the applicability of that provision. See materials by Linetsky and Wool / Littlejohns referred to above. See also reply to question 3.10 re ASU qualifying declarations.

Re 3.9(b): Ratification of the Cape Town Treaty (with P, art XI, Alternative A implemented through legislation) will reduce legal and transactional risk. It will produce economic benefit to airlines (by reducing cost and providing additional sources of financing), manufacturers (including through its impact on ratification by others, by promoting exports), and financial institutions (by reducing risk). Such direct benefits have important indirect benefits, including (from export enhancement) job creation and (from airline benefits) pass-through benefits to passengers.

UK ratification will ensure that English law remains a preferred governing law of choice in aviation finance and leasing, and that London remains central in the aviation financing and leasing industry.

Re 3.9(c): ***We urge the government to do so as promptly as possible and with a high level of priority.*** The ratification by the UK has been delayed for a long time, given two matters unrelated to the core objectives of the Cape Town Treaty: EU competence issue and the Gibraltar-hold. These two items have finally been addressed. UK companies should start to benefit from the Treaty as promptly as possible. In addition, the recent strains on the financing sector coupled with demand for modern, environmentally friendly aircraft argue for swift action to help in these areas. Finally, while the UK has not yet ratified, many UK companies still need to comply with the Cape Town Treaty (e.g., register with the IR if they (i) buy aircraft equipment from a party located in a contracting state, or (ii) lease an aircraft from a financed lessor located in a Contracting State). In other words, aspects of compliance are already required; ratification will permit the corresponding benefit.

3.10 Do you have any other comments you would like to make?

Reply: We make following additional comments:

(i) The UK should make a set of "qualifying declarations" under the ASU. That would be as follows: (1) non-judicial remedies, C, art 54(2), (2) IDERA, P, art XIII, and (3) Alternative A (60 calendar day waiting period, implemented through legislation).

(ii) With respect to non-consensual rights and interests, the UK should align such rights with those customary in the international community. The UK "fleet lien" is seen as out-of-line with international norms, over-reaching, and potentially harmful to airlines (restricting credit) and financiers (increasing risk). The recent GKL litigation has drawn greater attention to the problem of the UK fleet lien. Thus, a tailored declaration under C, art 39 should be agreed after a policy assessment on this matter.

(iii) We note the Department's current intent to have a second consultation on the declarations to be made and the content of the implementing legislation. We think that such is not necessary, given the clarity on what is needed to ensure the benefits of the Treaty, and the consistency thereof with leading legal thought. If it is necessary, we encourage the government to undertake and complete that second step as promptly as possible.

Yours faithfully,

David Walton
Chief Operating Officer
Aircastle Advisor LLC

AVIATION CAPITAL GROUP
A Pacific LifeCorp Company

20 August 2010

Ms Rachel Onikosi
Deputy Head, Legislative and International Policy Unit
Department for Business, Innovation & Skills
1 Victoria Street, London SW1H OET

Re: **BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)**

Dear Ms. Onikosi,

Attached is the response of the Aviation Capital Group Corp. ("**ACG**") in connection with your government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment.

ACG is a global jet aircraft leasing and asset management company. Founded in 1989, we are actively engaged in aircraft acquisition and leasing to international airlines, and are a provider of advisory services for aircraft investors and institutional clients worldwide.

ACG is a member of the Aviation Working Group ("AWG"), which is comprised of major aviation manufacturers, financial institutions, and leasing companies. Its members manufacture most of the world's large aircraft and engines, and lease and finance a substantial majority of them.

We thank you for giving us this opportunity to comment.

Yours sincerely,

Donal Hanley

Donal Hanley
Vice President, Legal
Aviation Capital Group Corp.

BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

Reply submitted by: Aviation Capital Group Corp.

Date: 20 August 2010

This is a response to the above-identified Call for Evidence (the "**CE**") in connection with the government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment (the "**Convention**" or "**C**") and the Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**" or "**P**"). The Convention and the Protocol will be referred to together as the "**Cape Town Treaty**" or "**Treaty**").

We have cut into this response the questions contained in Part III of the CE, and have set out our replies thereto below each such question.

To be clear at the outset, and as noted in reply to question 3.9, ***we strongly support ratification of the Cape Town Treaty and urge the government to do so as promptly as possible and with a high level of priority.***

The Cape Town Treaty reflects, enhances, and internationally promotes basic concepts found in English law. That should be expected given the central role played by the UK in negotiating and drafting the instruments. In fact, the drafting committee at every intergovernmental meeting that negotiated, and at the diplomatic conference that adopted, the Cape Town Treaty was chaired by a UK representative (either Sir Roy Goode (Oxford) or Bryan Welch (BIS)). The Treaty will reduce legal risk. It will produce economic benefit.

Importance of Protocol, art XI (Remedies on Insolvency) – Alternative A

The CE does not ask a question about the economically most important provision, P, art XI (remedies on insolvency). It is necessary to draw out the significance of applying Alternative A of this article ("**Alternative A**"). Most of the economic benefits and transaction risk reduction under the Treaty are predicated on the applicability of Alternative A (with a sixty (60) day waiting period). See *Economic Benefits of the Cape Town Treaty*, 2009, by Professor Vadim Linetsky, a leading authority on the financial modeling of secured transactions. Regarding the basis for this provision in emerging legal thinking, see "Cape Town Treaty in the European Context: the case for Alternative A, Article XI of the Aircraft Protocol", by Jeffrey Wool / Andrew Littlejohns. These materials can be downloaded at www.awg.aero . Thus, it is essential that Alternative A apply in the UK though its inclusion in the UK's implementing legislation (that mode of application is required given agreements relating to EU competence). See Unidroit, "The European Union and the Cape Town Convention", DC9 / DEP, Doc. 8, June 2010 at Annex III.

We note the Department's willingness to meet to discuss these matters. We would like to do that.

QUESTIONS POSED AND REPLIES

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;
b) the predictability of legal outcomes;
c) the availability of finance or leasing facilities; or
d) the cost?

Reply: The internationality of aircraft financing and leasing, and the consequent applicability of several non-harmonised laws, undoubtedly produce complex transactions. Legal outcomes are less predictable than they could and should be. As mentioned in CE, para 1.11, there is a particular level of uncertainty in English law due to the application of the *lex situs* rule regarding property rights in aircraft. The recent Blue Sky case has brought that problem into sharp focus.

All else equal, greater complexity and less predictability result in higher transaction costs than would otherwise by the case. At some point on the continuum, these factors impact the availability of financing. The foregoing is axiomatic. It is a basic tenet of law and economic theory, which is now widely-accepted in policy-making relating to secured transactions.

A prime example of such conflict of laws issues relates to rights in aircraft engines. Laws differ significantly regarding the legal effect of installing or removing engines, which, given operational requirements, could happen in any jurisdiction. In some jurisdictions, these actions impact core property rights.

Beyond conflicts, the cost and availability of financing are significantly impacted by the underlying substantive law, more specifically, any impediments caused by it affect the timely access to collateral value. Timely access to valuable collateral is the basis of secured transactions and defines the leasing model. In financial terms, timely access to valuable collateral offsets loss (that is, reduces the risk of loss (to a creditor) notwithstanding the risk of default (by a debtor)), thus producing efficiencies.

A prime example of such substantive law issues – as noted in CE para 1.11 – is delay occasioned by insolvency law. Beyond that delay, such laws may qualify or restrict contractual (and non-insolvency law) enforcement rights or impact property rights. These prospects are directly inconsistent with the core principles underlying asset-based financing and leasing.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

a) the rating of aircraft receivables,
b) the cost of export credit insurance, and/or
c) the cost of financing or leasing aircraft?

Reply: Sub-question 3.2(a) and (b) may be answered with reference to objective and publicly available information. Sub-question (c) raises methodological and confidentiality issues, and, thus, needs to be addressed based on general principles.

Re 3.2(a): "Aircraft receivables", in the context of the Treaty (which excludes general receivables financing), must refer to the rating of aircraft-backed securities. The only source of publicly available information regarding their cost is public, capital markets. In the aviation industry, these securities / transactions are known as "enhanced equipment trust certificates" ("**EETCs**"). There have been few EETCs in Europe and none in the UK, given uncertainties caused by applicable underlying insolvency

law. In those transactions, two major European airlines paid materially higher rates, and had materially more restrictive terms, than less creditworthy airlines (closing transactions in the same time frame) in the US. The sole reason for such preferential US financing terms was the existence and application of section 1110 of the US bankruptcy code, a functional equivalent to Alternative A. This follows from the policies of international rating agencies, which have, based on years of data, used a system of "enhanced" rating (rating upgrades) where timely recourse to valuable aircraft collateral can be safely assumed. Based on underlying law, including insolvency law, that has been the case in the US but not in Europe.

Thus, the ratification of the Cape Town Treaty will provide UK airlines with enhanced access to international capital markets, thus diversifying their sources of funding. In particular, it will open public debt markets, providing UK airlines with another important option (in addition to bank debt and leasing, their traditional options) to help fund their capital-intensive aircraft acquisition requirements. For discussion of other commercial transactions, please see below.

Re 3.2(b): The cost of export credit is governed by the OECD's aircraft sector understanding (the "**ASU**"). Under the ASU, all OECD countries (the UK included) plus Brazil have agreed that ratification of the Treaty – with a set of "qualifying declarations" (see reply to question 3.10) – justifies a material reduction in the fee charged.[1] That decision supports the proposition that transactions in legal systems that provide higher levels of predictability and reflect the principles underlying asset based financing should be priced lower than those systems that do not. As to quantification, the size of the "Cape Town Discount" depends on the credit standing of the borrower; the weaker the credit standing (the higher the risk of default), the larger the fee reduction. Under the current terms of the ASU, the range (for large aircraft) is 20 to 150 basis points on the upfront fee charged. To give an example, a 100 basis point reduction (a "B" rated airline would receive a 94 basis point reduction) on a USD 100m aircraft financing equals USD 1m. It is noteworthy that under the ASU the terms of export credit are not attractive for spare aircraft engines. That reflects concerns about the point noted above regarding the law applicable to rights in engines.

Re 3.2(c): This question raises the general topic of the relationship between harmonised and (see reply to 3.1 above, more importantly) commercially-oriented secured financing and leasing law, on the one hand, and the cost (and terms) of such transactions, on the other. It is not possible to provide definitive and precise information on this question, for two reasons. First, many factors go into transaction pricing (and the availability of financing). These include – in addition to credit and legal risk – more general and macro considerations, such as (i) general liquidity in the financial sector and the liquidity position of a particular financial institution, (ii) the impact of regulatory capital, (iii) comparative returns from other forms of lending, (iv) competitive issues that may lead a bank to consider longer-term and relationship issues in setting price, and (v) other sources of fees payable to a bank directly or indirectly linked to that transaction or related transactions. Secondly, confidentiality (and, possibly, competition law) considerations prevent the disclosure of terms in private financing transactions.

That said, and as noted above, the direct link between reduced transactional risk and improved pricing and other terms – all else equal – is a foundation of law and economics. It is now taken as an established fact. Elements of this thinking are seen (beyond the positions of the international rating agencies and the

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[1] The UK, France, Germany, Spain and the US currently follow the "home market rule", which prevents export credit into these countries. The ASU is currently under review. A number of home market airlines, including some in the UK, are seeking to have this restriction eased or removed. To the extent that is agreed, the points above will apply in respect of UK carriers.

OECD countries, noted above) in the terms of BIS II (rules for regulatory capital) and daily decisions made by credit committees of financial institutions.

Finally, a specific word on the Treaty and "proof" of economic benefit. The extensive economic assessment and related academic work on the Cape Town Treaty has been without precedent in the field of commercial law reform. Two major studies were undertaken (see www.awg.aero), each of which took into account available information and research. The authors were of the highest possible caliber (in addition to Professor Linetsky, Northwestern University, they are Professors Anthony Saunders and Ingo Walters (INSEAD and NYU)). These academics are applied economists and finance specialists. If a higher standard than that undertaken in connection with the Treaty needs to be met, then question whether (i) any prior commercial treaty (or national law reform in this field) should ever have been adopted, or (ii) any future commercial law treaty (or national law reform in this field) will ever be adopted.

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Re 3.9(b): Ratification of the Cape Town Treaty (with P, art XI, Alternative A implemented through legislation) will reduce legal and transactional risk. It will produce economic benefit to airlines (by reducing cost and providing additional sources of financing), manufacturers (including through its impact on ratification by others, by promoting exports), and financial institutions (by reducing risk). Such direct benefits have important indirect benefits, including (from export enhancement) job creation and (from airline benefits) pass-through benefits to passengers.

UK ratification will ensure that English law remains a preferred governing law of choice in aviation finance and leasing, and that London remains central in the aviation financing and leasing industry.

Re 3.9(c): ***We urge the government to do so as promptly as possible and with a high level of priority.*** The ratification by the UK has been delayed for a long time, given two matters unrelated to the core objectives of the Cape Town Treaty: EU competence issue and the Gibraltar-hold. These two items have finally been addressed. UK companies should start to benefit from the Treaty as promptly as possible. In addition, the recent strains on the financing sector coupled with demand for modern, environmentally friendly aircraft argue for swift action to help in these areas. Finally, while the UK has not yet ratified, many UK companies still need to comply with the Cape Town Treaty (e.g., register with the IR if they (i) buy aircraft equipment from a party located in a contracting state, or (ii) lease an aircraft from a financed lessor located in a Contracting State). In other words, aspects of compliance are already required; ratification will permit the corresponding benefit.

3.10 Do you have any other comments you would like to make?

Reply: We make following additional comments:

(i) The UK should make a set of "qualifying declarations" under the ASU. That would be as follows: (1) non-judicial remedies, C, art 54(2), (2) IDERA, P, art XIII, and (3) Alternative A (60 calendar day waiting period, implemented through legislation).

(ii) With respect to non-consensual rights and interests, the UK should align such rights with those customary in the international community. The UK "fleet lien" is seen as out-of-line with international norms, over-reaching, and potentially harmful to airlines (restricting credit) and financiers (increasing risk). The recent GKL litigation has drawn greater attention to the problem of the UK fleet lien. Thus, a tailored declaration under C, art 39 should be agreed after a policy assessment on this matter.

(iii) We note the Department's current intent to have a second consultation on the declarations to be made and the content of the implementing legislation. We think that such is not necessary, given the clarity on what is needed to ensure the benefits of the Treaty, and the consistency thereof with leading legal thought. If it is necessary, we encourage the government to undertake and complete that second step as promptly as possible.

END

A·W·G AVIATION WORKING GROUP

16 August 2010

Rachel Onikosi
Deputy Head, Legislative and International Policy Unit
Department for Business, Innovation & Skills
1 Victoria Street, London SW1H OET

Re: **BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)**

Dear Ms. Onikosi,

This is a response of the Aviation Working Group (the "**AWG**") to the above-identified Call for Evidence (the "**CE**") in connection with the government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment (the "**Convention**" or "**C**") and the Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**" or "**P**"). The Convention and the Protocol will be referred to together as the "**Cape Town Treaty**" or "**Treaty**").

The AWG is comprised of major aviation manufacturers, financial institutions, and leasing company. Its members manufacturer most of the world's large aircraft and engines, and lease and finance a substantial majority of them. AWG works closely with the world's airlines, and, in particular, has taken joint positions on the Treaty with IATA, a representative of the world's airlines. AWG includes several UK-based members, and most AWG members do a substantial amount of business in the UK.

We have cut into this response the questions contained in Part III of the CE, and have set out our replies thereto below each such question.

To be clear at the outset, and as noted in reply to question 3.9, ***we strongly support ratification of the Cape Town Treaty and urge the government to do so as promptly as possible and with a high level of priority.***

The Cape Town Treaty reflects, enhances, and internationally promotes basic concepts found in English law. That should be expected given the central role played by the UK in negotiating and drafting the instruments. In fact, the drafting committee at every intergovernmental meeting that negotiated, and at the diplomatic conference that adopted, the Cape Town Treaty was chaired by a UK representative (either Sir Roy Goode (Oxford) or Bryan Welch (BIS)). The Treaty will reduce legal risk. It will produce economic benefit.

Importance of Protocol, art XI (Remedies on Insolvency) – Alternative A

The CE does not ask a question about the economically most important provision, P, art XI (remedies on insolvency). It is necessary to draw out the significance of applying Alternative A of this article ("**Alternative A**"). Most of the economic benefits and transaction risk reduction under the Treaty are predicated on the applicability of Alternative A (with a sixty (60) day waiting period). See *Economic Benefits of the Cape Town Treaty*, 2009, by Professor Vadim Linetsky, a leading authority on the financial modeling of secured transactions. Regarding the basis for this provision in emerging legal thinking, see "Cape Town Treaty in the European Context: the case for Alternative A, Article XI of the Aircraft Protocol", by Jeffrey Wool / Andrew Littlejohns. These materials can be downloaded at www.awg.aero . Thus, it is essential that Alternative A

apply in the UK though its inclusion in the UK's implementing legislation (that mode of application is required given agreements relating to EU competence). See Unidroit, "The European Union and the Cape Town Convention", DC9 / DEP, Doc. 8, June 2010 at Annex III.

We note the Department's willingness to meet to discuss these matters. We would like to do that.

QUESTIONS POSED AND REPLIES

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;
b) the predictability of legal outcomes;
c) the availability of finance or leasing facilities; or
d) the cost?

Reply: The internationality of aircraft financing and leasing, and the consequent applicability of several non-harmonised laws, undoubtedly produce complex transactions. Legal outcomes are less predictable than they could and should be. As mentioned in CE, para 1.11, there is a particular level of uncertainty in English law due to the application of the *lex situs* rule regarding property rights in aircraft. The recent Blue Sky case has brought that problem into sharp focus.

All else equal, greater complexity and less predictability result in higher transaction costs than would otherwise by the case. At some point on the continuum, these factors impact the availability of financing. The foregoing is axiomatic. It is a basic tenet of law and economic theory, which is now widely-accepted in policy-making relating to secured transactions.

A prime example of such conflict of laws issues relates to rights in aircraft engines. Laws differ significantly regarding the legal effect of installing or removing engines, which, given operational requirements, could happen in any jurisdiction. In some jurisdictions, these actions impact core property rights.

Beyond conflicts, the cost and availability of financing are significantly impacted by the underlying substantive law, more specifically, any impediments caused by it affect the timely access to collateral value. Timely access to valuable collateral is the basis of secured transactions and defines the leasing model. In financial terms, timely access to valuable collateral offsets loss (that is, reduces the risk of loss (to a creditor) notwithstanding the risk of default (by a debtor)), thus producing efficiencies.

A prime example of such substantive law issues – as noted in CE para 1.11 – is delay occasioned by insolvency law. Beyond that delay, such laws may qualify or restrict contractual (and non-insolvency law) enforcement rights or impact property rights. These prospects are directly inconsistent with the core principles underlying asset-based financing and leasing.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

a) the rating of aircraft receivables,
b) the cost of export credit insurance, and/or
c) the cost of financing or leasing aircraft?

Reply: Sub-question 3.2(a) and (b) may be answered with reference to objective and publicly available information. Sub-question (c) raises methodological and confidentiality issues, and, thus, needs to be addressed based on general principles.

Re 3.2(a): "Aircraft receivables", in the context of the Treaty (which excludes general receivables financing), must refer to the rating of aircraft-backed securities. The only source of publicly available information regarding their cost is public, capital markets. In the aviation industry, these securities / transactions are known as "enhanced equipment trust certificates" ("EETCs"). There have been few EETCs in Europe and none in the UK, given uncertainties caused by applicable underlying insolvency law. In those transactions,

two major European airlines paid materially higher rates, and had materially more restrictive terms, than less creditworthy airlines (closing transactions in the same time frame) in the US. The sole reason for such preferential US financing terms was the existence and application of section 1110 of the US bankruptcy code, a functional equivalent to Alternative A. This follows from the policies of international rating agencies, which have, based on years of data, used a system of "enhanced" rating (rating upgrades) where timely recourse to valuable aircraft collateral can be safely assumed. Based on underlying law, including insolvency law, that has been the case in the US but not in Europe.

Thus, the ratification of the Cape Town Treaty will provide UK airlines with enhanced access to international capital markets, thus diversifying their sources of funding. In particular, it will open public debt markets, providing UK airlines with another important option (in addition to bank debt and leasing, their traditional options) to help fund their capital-intensive aircraft acquisition requirements. For discussion of other commercial transactions, please see below.

Re 3.2(b): The cost of export credit is governed by the OECD's aircraft sector understanding (the "**ASU**"). Under the ASU, all OECD countries (the UK included) plus Brazil have agreed that ratification of the Treaty – with a set of "qualifying declarations" (see reply to question 3.10) – justifies a material reduction in the fee charged.[1] That decision supports the proposition that transactions in legal systems that provide higher levels of predictability and reflect the principles underlying asset based financing should be priced lower than those systems that do not. As to quantification, the size of the "Cape Town Discount" depends on the credit standing of the borrower; the weaker the credit standing (the higher the risk of default), the larger the fee reduction. Under the current terms of the ASU, the range (for large aircraft) is 20 to 150 basis points on the upfront fee charged. To give an example, a 100 basis point reduction (a "B" rated airline would receive a 94 basis point reduction) on a USD 100m aircraft financing equals USD 1m. It is noteworthy that under the ASU the terms of export credit are not attractive for spare aircraft engines. That reflects concerns about the point noted above regarding the law applicable to rights in engines.

Re 3.2(c): This question raises the general topic of the relationship between harmonised and (see reply to 3.1 above, more importantly) commercially-oriented secured financing and leasing law, on the one hand, and the cost (and terms) of such transactions, on the other. It is not possible to provide definitive and precise information on this question, for two reasons. First, many factors go into transaction pricing (and the availability of financing). These include – in addition to credit and legal risk – more general and macro considerations, such as (i) general liquidity in the financial sector and the liquidity position of a particular financial institution, (ii) the impact of regulatory capital, (iii) comparative returns from other forms of lending, (iv) competitive issues that may lead a bank to consider longer-term and relationship issues in setting price, and (v) other sources of fees payable to a bank directly or indirectly linked to that transaction or related transactions. Secondly, confidentiality (and, possibly, competition law) considerations prevent the disclosure of terms in private financing transactions.

That said, and as noted above, the direct link between reduced transactional risk and improved pricing and other terms – all else equal – is a foundation of law and economics. It is now taken as an established fact. Elements of this thinking are seen (beyond the positions of the international rating agencies and the OECD countries, noted above) in the terms of BIS II (rules for regulatory capital) and daily decisions made by credit committees of financial institutions.

Finally, a specific word on the Treaty and "proof" of economic benefit. The extensive economic assessment and related academic work on the Cape Town Treaty has been without precedent in the field of commercial law reform. Two major studies were undertaken (see www.awg.aero), each of which took into account available information and research. The authors were of the highest possible caliber (in addition to Professor Linetsky, Northwestern University, they are Professors Anthony Saunders and Ingo Walters (INSEAD and

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[1] The UK, France, Germany, Spain and the US currently follow the "home market rule", which prevents export credit into these countries. The ASU is currently under review. A number of home market airlines, including some in the UK, are seeking to have this restriction eased or removed. To the extent that is agreed, the points above will apply in respect of UK carriers.

NYU)). These academics are applied economists and finance specialists. If a higher standard than that undertaken in connection with the Treaty needs to be met, then question whether (i) any prior commercial treaty (or national law reform in this field) should ever have been adopted, or (ii) any future commercial law treaty (or national law reform in this field) will ever be adopted.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

Reply: The terms of the Cape Town Treaty will significantly address all of the issues noted in 3.1 above. First, it will sweep away the problems associated with the *lex situs* rule. Secondly, with Alternative A, it will sweep away problems associated with insolvency delay and impairment. That, in turn, will provide UK airlines with enhanced access to international capital markets, thus diversifying and increasing their sources of funding. Thirdly, it will eliminate the above-noted legal issues associated with engine financing, though that depends on adoption by many countries. On that last point, while the Treaty is rapidly being adopted internationally, there is no doubt that UK ratification would provide a leading example to and justification for others to ratify. That would also serve the objective of the UK export community. See reply to question 3.9 below.

The Cape Town Treaty, unlike most other international legal instruments, was purposefully designed to facilitate a transaction type, thereby producing benefits to the industry sector. The core role that the aviation sector – IATA (airlines) and AWG (financiers and manufacturers) – played in the process ensures that result. The Treaty elegantly solves the current legal issues in this field, and does so in a manner consistent with leading legal thought. There are no losers: the problems solved equally benefit debtors, creditors, and manufacturers.

3.4 Do you:

a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Reply: Re 3.4(a): The International Registry under the Treaty ("**IR**") is already recognised as both ground-breaking and well-established. Approximately half of the world's new aircraft transactions are registered in the IR. The system has run with virtually no problems since inception. There is strong supervision by ICAO. Users have direct input through an International Advisory Board.

The IR (and the above-noted priority rules) is a significant improvement over current law and practice. First, the system is electronic and low cost. It is simple and effective. Closings are made easier. Interests may be registered in advance ("prospective interests"), which takes pressure off of (expensive) closing logistics. In international (and national) law reform circles, the starting point for any discussion about registries systems is the IR. Secondly, the priority rules are clear and objective. In the context of aviation financing, clarity equals fairness. Parties can search the IR and determine exactly where they stand. Litigation relating to "knowledge" will be avoided. There will be no need for legal gymnastics (such as priority notices), which seek to address the issues handled directly by the Treaty. Thirdly, the IR (through the Treaty) establishes priorities on an international basis. Any other system would be limited to national priorities. That is inherently inefficient, and leaves risks in transactions which can be reduced only at significant expense. In short, the Treaty, through the IR and the priority rules, puts an efficient international system in place to deal with international transactions and fact patterns.

Re 3.4(b): The treatment of engines as separate property – and, correspondingly, the ability to separately register against them – is extremely useful. As noted in reply to question 3.1, the law applicable to rights in

engines varies widely, and, in some jurisdictions, is potentially prejudicial to the right of property holders. That is exacerbated by the *lex situs* problem in the engine context.

Engines are highly valuable equipment. They consistently maintain their value. They should therefore serve as excellent collateral, if the underlying law so permits. In addition, they are often separately financed (spare engines) and pooled and interchanged. From a commercial perspective, they are often hired out on a short-term basis, where strong property rights are particularly important. For all these reasons, the treatment of engines under the Cape Town Treaty – as separate property to which the Treaty's clear rules apply – is a vast improvement to current law around the world. It will support advanced engine financing and use.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

Reply: As mentioned above, this is a significant advantage without any corresponding disadvantage. The absence of a required time period, and the ability to make a prospective registration, takes pressure off of closing logistics. While the priority "relates back", there is no unfairness to any party – since the registration only has priority from the time it is searchable. There are no secret interests. Any searching party can easily self-protect: all it needs to do is search the IR. It is then on notice that an interest, actual or prospective, might have a higher priority. That searching party would not close its financing transaction until the IR is cleared of any registration that could prevail over its interest.

The priority notice concept under English law aims at the same objective, but achieves it using a heavier two-step, paper-based process. The Treaty simplifies and improves the process.

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details.

Reply: We do not understand the relevance of this question – unless it is driving at providing an example and justification for other countries to ratify. See response to question 3.9. This question – what is the position (of a UK-registered aircraft) under foreign (substantive and procedural) law would not be addressed by UK ratification. It would only be addressed by ratification by foreign countries (where the aircraft is located). And, if that is the optic, why limit the question to UK-registered aircraft. What about the position of a UK financier with a non-UK registered aircraft located elsewhere. Or a UK manufacturer who has problems financing sales given foreign law. These are all analytically the same: what is the position under foreign law. (N.B.: In many jurisdictions, there are significant repossession and enforcement problems.) UK ratification will not address these problems, save to the extent others are thereby encouraged to ratify. That encouragement, however, is important, given the wide range of material UK interests in international aviation.

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

Reply: This provision C, art 13 ("**Relief Pending**"), on which an opt-out is permitted (see C, art 55), and which is strengthened by an opt-in permitted under P, art X (see P, art XXX(2), was designed to provided countries opposed to non-judicial remedies with a court-based function equivalent thereof.

The UK is not such a country. English law on non-judicial remedies is well-established and effective. The international financing community is comfortable with it.

Thus, since the UK, reflecting its law, would be expected to permit non-judicial remedies through the mandatory declaration required by C, art 54(2)(permitting action "without leave of the court"), the Relief Pending provision is not necessary to reduce transactional risk or increase economic benefit in the context of

the UK. The aviation community should be largely indifferent as to whether the UK, when ratifying, makes these particular declarations.

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be?

Reply: These remedies are essential. In light of the terms of the Chicago Convention of 1944, to effectively exercise remedies against an aircraft, a creditor must be able to de-register that aircraft. The Treaty not only provides these remedies, but adds the extremely useful IDERA clause ("irrevocable deregistration and export authorization"), P, art XIII. Most countries have opted into the IDERA clause (see P, art XXX(1)). An international standard is rapidly developing in favor of the use of IDERAs. (Even countries with very efficient de-registration systems (like the US) have made the IDERA election.) Underscoring its importance, the IDERA clause is an ASU qualifying declaration. Importantly, the use of an IDERA is expressly without prejudice to safety laws and regulations.

3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so

b) what impact do you consider these instruments will have on your sector of the aviation industry?

c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

Reply:

Re 3.9(a): ***We strongly support ratification of the Cape Town Treaty.***

In connection with that ratification, it is essential that the UK implement the economically most important provision, P, art XI (remedies on insolvency) – **Alternative A** (with a sixty (60) day waiting period). Most of the economic benefits and transaction risk reduction effected by the Cape Town Treaty is predicated on the applicability that provision. See materials by Linetsky and Wool / Littlejohns referred to above. See also reply to question 3.10 re ASU qualifying declarations.

Re 3.9(b): Ratification of the Cape Town Treaty (with P, art XI, Alternative A implemented through legislation) will reduce legal and transactional risk. It will produce economic benefit to airlines (by reducing cost and providing additional sources of financing), manufacturers (including through its impact on ratification by others, by promoting exports), and financial institutions (by reducing risk). Such direct benefits have important indirect benefits, including (from export enhancement) job creation and (from airline benefits) pass-through benefits to passengers.

UK ratification will ensure that English law remains a preferred governing law of choice in aviation finance and leasing, and that London remains central in the aviation financing and leasing industry.

Re 3.9(c): ***We urge the government to do so as promptly as possible and with a high level of priority.*** The ratification by the UK has been delayed for a long time, given two matters unrelated to the core objectives of the Cape Town Treaty: EU competence issue and the Gibraltar-hold. These two items have finally been addressed. UK companies should start to benefit from the Treaty as promptly as possible. In addition, the recent strains on the financing sector coupled with demand for modern, environmentally friendly aircraft argue for swift action to help in these areas. Finally, while the UK has not yet ratified, many UK companies still need to comply with the Cape Town Treaty (e.g., register with the IR if they (i) buy aircraft equipment from a party located in a contracting state, or (ii) lease an aircraft from a financed lessor located in a Contracting State). In other words, aspects of compliance are already required; ratification will permit the corresponding benefit.

3.10 Do you have any other comments you would like to make?

Reply: We make following additional comments:

(i) The UK should make a set of "qualifying declarations" under the ASU. That would be as follows: (1) non-judicial remedies, C, art 54(2), (2) IDERA, P, art XIII, and (3) Alternative A (60 calendar day waiting period, implemented through legislation).

(ii) With respect to non-consensual rights and interests, the UK should align such rights with those customary in the international community. The UK "fleet lien" is seen as out-of-line with international norms, over-reaching, and potentially harmful to airlines (restricting credit) and financiers (increasing risk). The recent GKL litigation has drawn greater attention to the problem of the UK fleet lien. Thus, a tailored declaration under C, art 39 should be agreed after a policy assessment on this matter.

(iii) We note the Department's current intent to have a second consultation on the declarations to be made and the content of the implementing legislation. We think that such is not necessary, given the clarity on what is needed to ensure the benefits of the Treaty, and the consistency thereof with leading legal thought. If it is necessary, we encourage the government to undertake and complete that second step as promptly as possible.

Thank you for considering these comments.

Finally, as noted above, representatives of AWG would welcome the opportunity to meet with the Department to discuss these matters.

Sincerely yours,

Jeffrey Wool

Secretary General
Aviation Working Group

CC: Claude BRANDES, Co-Chairman, AWG

CC: Scott SCHERER, Co-Chairman, AWG

BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

Reply submitted by: **Bermuda Department of Civil Aviation ("BDCA")**
Conyers Dill & Pearman Limited
Appleby

Date: 7 October, 2010

This is a response to the above-identified Call for Evidence in connection with the UK government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment (the "**Convention**") and the Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**"). The Convention and the Protocol will be referred to together as the "**Cape Town Treaty**" or "**Treaty**").

The Call for Evidence was also forwarded by the Aviation Working Group ("AWG") to Conyers Dill & Pearman Limited with a request to respond. The AWG has a long history with Bermuda and recognises that Bermuda plays an important role in international aircraft financing transactions, especially those involving Russian operators. This response is provided on behalf of the BDCA, Conyers Dill & Pearman Limited and Appleby, the latter two named being the two largest law firms in Bermuda which, on a combined basis, are involved in a significant majority of aircraft transactions involving Bermuda registered aircraft and/or Bermuda registered companies.

We have included in this response the questions contained in Part III of the Call for Evidence, and have set out our replies thereto below each such question.

QUESTIONS POSED AND REPLIES

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;
b) the predictability of legal outcomes;
c) the availability of finance or leasing facilities; or
d) the cost?

Reply:

(a) Aircraft financing by its nature results in numerous international legal systems being involved. The parties are usually located in a multitude of jurisdictions and the physical location of the aircraft itself, as a tangible moveable asset, together with the jurisdiction of the aircraft's registration, serve to create complex legal issues surrounding the creation, validity and priority of security over aircraft. As a result, the parties need to take into consideration and draft documents under appropriate proper law (often, more than one) after taking into account different legal concepts and consequences, especially as regards the eventual enforcement of security. If there is a default and enforcement of the security is sought, additional complexities then arise from this multi-jurisdictional component as to re-possession and de-registration of the aircraft.

(b) These issues were highlighted in the recent Blue Sky One (*Blue Sky One Ltd. v Mahan [2010] All E.R. (D) 02*) decision and the *lex situs* issues discussed therein; such decision will be considered as being persuasive by a Bermuda court. The decision has highlighted areas of potential difficulty relating to the validity of mortgages granted over aircraft due to such *lex situs* issues. The resulting

lack of certainty and predictability (centred on whether the security granted will be recognised by the courts) will result in lenders having to reflect this additional risk in the cost of borrowing.

(c) With the recent banking and financial crisis, there has already been less private bank financing available. Borrowers have been looking to export credit agencies such Eximbank and the ECAs for financing. Operators from poorer countries may not be able to afford the higher rates charged by such export credit agencies. However, please see 3.2(b) below where such export credit agencies offer discounted fees for borrowers who are in jurisdictions signed up to the Treaty.

(d) Quite simply, the complexity of international financing structures and lack of predictability of effectiveness of security taken equates to much greater transaction cost. Being able to rely on the Treaty will significantly reduce the complexities while at the same time increase the predictability of outcome. This in turn should significantly reduce the costs.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

a) the rating of aircraft receivables,

b) the cost of export credit insurance, and/or

c) the cost of financing or leasing aircraft?

Reply:

(a) By "aircraft receivables" we refer to the rating of aircraft-backed security. Such capital market instruments are "enhanced equipment trust certificates" or "EETCs" which are rated on the value of the aircraft itself rather than the credit of the issuer. These have traditionally been used by US airlines rather than UK airlines due to the price differential arising from the uncertainty caused by applicable underlying insolvency laws. In the US, there is more predictability under section 1110 of the US Bankruptcy Code. Adopting the Treaty with Alternative A would remove such uncertainty for the UK and the Overseas Territories and permit borrowers in such jurisdictions to access more affordable funding.

(b) Under the OECD's aircraft sector understanding ("ASU"), we understand that all OECD countries (including the UK) plus Brazil have agreed that ratification of the Treaty with certain "qualifying declarations" justifies a material reduction of the fees charged by export credit agencies. This can result in huge savings to the borrowers. The size of such "Cape Town Reduction" varies depending on the credit standing of the borrower but under the current terms of the ASU, the range of discount (for large aircrafts) is 20 – 150 basis points on the upfront fee charged. The required "qualifying declarations" are set out in the attached Extract from the Sector Understanding on Export Credits for Civil Aircraft July 2007 (taken from http://www.awg.aero/pdf/extractasu.pdf). Please note that these are conditional upon the contracting state declaring that it will apply the entirety of Alternative A under Article XI of the Protocol.

As such, we would only request having the Treaty extended to Bermuda on the basis that the UK also make such "qualifying declarations" for Bermuda even if the UK decides not to make any or only some of such declarations for itself.

(c) As many factors go into transaction pricing (including the availability of credit in the market), this is difficult to quantify. However, as a matter of natural consequence, it is reasonable to conclude that, if the complexity of a transaction is reduced and the predictability of outcome and right to repossess increased (as discussed in 3.1 above), overall costs of financing and leasing of aircraft can be expected to decrease.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at

all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

Reply:

The terms of the Treaty would resolve the "*lex situs*" issues as discussed in 3.1 above and would also, provided that Alternative A is elected, eliminate (or at least, significantly reduce) the uncertainty associated with local insolvency laws in multiple jurisdictions, in the context of the enforcement of security over aircraft.

3.4 Do yon:

a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Reply:

(a) We consider the registration system and subsequent priority afforded by the International Registry ("IR") to offer a range of practical, commercial and legal advantages in aircraft transactions, for the following reasons:

(i) Legal advantages: The priority rules are clear and objective and establish priority on an international basis. This removes the need to rely on and plan for national priority rules. In the event of litigation, there would be no question of notice or knowledge as priority is based on first to register, regardless of actual notice.

(ii) Practical and commercial advantages: These appear to be widely recognised on the basis of the high volume of aircraft transactions which have already been registered in the IR and include the following:

- the entry system is electronic and low cost;
- interests can be registered in advance, making closings less complex and less expensive to arrange;
- the IR is available and accessible 24 hours a day, 7 days a week.

It should be noted that the Bermuda Department of Civil Aviation currently maintains a Register of Aircraft Mortgages and a Register of Aircraft Engine Mortgages. The Mortgaging of Aircraft and Aircraft Engines Act 1999 and related regulations have been in place since 1 July 1999. Under this legislation, a Register of Aircraft Mortgages and a Register of Aircraft Engine Mortgages is maintained to assist in the registration of security interests in both aircraft and aircraft engines (with certain minimum thrust or horsepower levels) and owned by or otherwise in the lawful possession of a company incorporated in Bermuda. In both instances, the priority of a mortgage can be fixed by filing of a priority notice at the BDCA pursuant to which the priority of a yet to be executed mortgage can be fixed for a 14 day renewable period. Fees relating to the filing of mortgages are presently set on a sliding scale up to a maximum of US$800. The Register of Aircraft Mortgages can be searched by lodging with the BDCA a request for a Transcript of the Register of Aircraft Mortgages as against a particular aircraft (citing the name of the Bermuda registrant and/or MSN and/or registration mark.)

In the event that the Convention is ratified by the UK government, our view, based on our understanding of the practice in jurisdictions that have so far ratified the Treaty[1], is that lenders will continue to require that local mortgage filings are made. However, such a filing will only grant priority to the mortgagee to the extent that Bermuda law governs the priority, unlike an IR registration which would be deemed to be an international interest. The principal reasons for continuing to make local filings, based on our understanding, include the following:

- lenders may perceive there to be a benefit to have local filings made where the aircraft is owned and/or registered in a Contracting State, but operated in a non-Contracting State;
- as above, in some circumstances there may be doubt as to whether or not a particular transaction is within the scope of the Convention, notwithstanding that a Contracting State is involved;
- IR registrations are relatively new and it may take time for lenders to rely solely on a new system;
- local filings are relatively inexpensive and lenders habitually take all available steps to protect their security interests.

(b) As the law and treatment applicable to aircraft engines varies significantly between jurisdictions – particularly where engines are separated from the airframe or used on a different airframe - a number of advantages flow from providing the certainty afforded by the ability to register an aircraft engine separately from the airframe, including the following:

- provides certainty of retaining secure property rights in aircraft engines, even when removed from an airframe;
- lowers the risk (and costs) of financing or leasing structures which involve aircraft engines only;
- simplifies the structure of such transactions and removes the need to attempt to ensure recovery of aircraft engines through complex contractual arrangements and other devices;
- removes uncertainty and disadvantages currently in place through engine financiers/lessors having to resort to contractual arrangements (as opposed to reliance on statutory law) in order to attempt to preserve security – often in the face of conflicting local/national laws which may or may not consider an engine attached to an airframe to be indistinguishable from the airframe.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

Reply:

As many aircraft transactions are multi-jurisdictional, spanning a number of time zones, we consider this to be very helpful in providing flexibility and in relation to facilitating closings and reducing cost. As interests only have priority from such time as they are searchable no party is disadvantaged.

Both Bermuda and English law recognizes the need for some type of protection of prospective interests through the utilization of priority notices for mortgages over aircraft; which are registered in each respective jurisdiction. However, in Bermuda at least, this involves a two-step, paper-based approach rather than the simpler process that the Treaty establishes.

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[1] For example, we note that the practice in the US is to make FAA filings, in conjunction with IR registrations.

The absence of any prescribed time limits within which registration may be made, combined with an ability to make registrations with respect to prospective international interests, allows any interested person to search the International Registry in order to determine if an aircraft object is subject to a filing.

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details.

Reply:

We cannot speak to difficulties in connection with repossessing UK registered aircraft. Although the Bermuda law firms have received enquiries recently as to repossession of Bermuda registered aircraft, to date none of such enquiries has progressed to the state where repossession needed to be effected, or has not been realized on a consensual basis. Practically speaking though, although the lender could obtain a Bermuda court order, there are still potential issues with having the jurisdiction in which such aircraft is located actually enforce the Bermuda order.

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

Reply:

We understand from other commentators that this provision was included in the Convention in order to provide countries opposed to non-judicial remedies with a court based, functional equivalent thereof.

Neither Bermuda nor the U.K. is such a country and English and Bermuda law (which closely follows English law), on non-judicial remedies is well-established and effective; therefore the aviation community should be largely indifferent as to whether the U.K., when ratifying, makes these particular declarations. We would however expect that the declaration required by the Convention, part 54(2) (permitting action "without leave of the court"), would be applied to the Treaty as extended to Bermuda.

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be?

Reply:

The ability to de-register the aircraft is an essential remedy for creditors. The Chicago Convention of 1944, requires that in order to effectively exercise remedies against an aircraft, a creditor must be able to de-register that aircraft. We would also support the IDERA clause in Part XIII of the Treaty: "irrevocable deregistration and export authorization". Most countries have opted into the IDERA clause (see P, art XXX(1)). We understand that even countries with very efficient de-registration systems (like the US) have made the IDERA election and that the IDERA clause is a further ASU qualifying declaration with respect to obtaining the Cape Town Discount.

3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so

b) **what impact do you consider these instruments will have on your sector of the aviation industry?**

c) **if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.**

Reply:

(a) We are strongly in favour of the UK ratifying both the Convention and the Protocol and in addition strongly urge that ratification and extension of the Treaty to Bermuda include the "qualifying declarations" as set out in the ASU (see 3.2(b) above). Without such qualifying declarations, Bermuda entities would not be able to enjoy the "Cape Town Discount" which is an important positive factor in achieving the full benefits of signing up to the Treaty.

Should the UK decide not to ratify for itself, we would nonetheless urge HM Government to agree to ratify for Bermuda and other Overseas Territories who wish to be party to the Treaty, similar to what we understand the Netherlands has done in relation to Aruba.

(b) Bermuda's main pillar of economy is the use of Bermuda incorporated exempted companies in the use of international business. The use of Bermuda special purpose companies ("SPCs") in aviation finance structures is well known and being party to the Treaty would make Bermuda more attractive as a jurisdiction for borrowers wishing to arrange aircraft financing. As an overseas territory, Bermuda is dependent on the UK ratifying the Treaty before Bermuda can be a party to it.

(c) We would strongly urge ratification and extension of the Treaty to Bermuda as soon as possible. Ratification will support the use of English law and Bermuda SPCs in aviation finance structures. A number of potential clients have been approaching us for some time wanting to know when the Treaty would apply to Bermuda and have advised they would need to seek a Treaty compliant jurisdiction if this issue continues to stall. Not being party to the Treaty puts Bermuda at a competitive disadvantage to other jurisdictions such as Ireland and Delaware.

3.10 Do you have any other comments you would like to make?

Reply:

Ratification and extension of the Treaty to Bermuda can increasingly be viewed as an essential development to keeping Bermuda competitive with those other jurisdictions which have already ratified the Treaty and adopted it as law. As with all such legal developments, it is important to stay abreast of legal developments – the number of countries which have now ratified the Treaty demonstrates that it is no longer considered favourably by only a marginal few; it is rapidly becoming the international norm by which aircraft financing transactions are measured and absence of an ability to be party to the Treaty will increasingly become a competitive disadvantage for the jurisdiction..

If you wish to discuss any of the above, please do not hesitate to contact any one of us as follows:

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Extract from the Sector Understanding on Export Credits for Civil Aircraft
July 2007

ANNEX 1: QUALIFYING DECLARATIONS

1. The term "qualifying declarations" for the purpose of Section 2 of Appendix III, and all other references thereto in this Sector Understanding, means that a Contracting party to the Cape Town Convention (Contracting Party):

a) has made the declarations in Article 2 of this Annex, and

b) has not made the declarations in Article 3 of this Annex.

2. The declarations referred to in Article 1 a) of this Annex are the following, provided that, while both of the declarations specified in Article 2 d) and e) of this Annex shall be encouraged, the making of either one of them (together with the making of the declarations in Article 2 a) to c) of this Annex and the non-declarations under Article 3 of this Annex) may permit application of the Cape Town Convention discount:

a) Insolvency: State Party declares that it will apply the entirety of Alternative A under Article XI of the Aircraft Protocol to all types of insolvency proceeding and that the waiting period for the purposes of Article XI (3) of that Alternative shall be no more than 60 calendar days.

b) Deregistration: State Party declares that it will apply Article XIII of the Aircraft Protocol.

c) Choice of Law: State Party declares that it will apply Article VIII of the Aircraft Protocol.

d) Method for Exercising Remedies: State Party declares under Convention Article 54 (2) that any remedies available to the creditor under any provision of the Convention which are not expressed under the relevant provisions thereof to require application to a court may be exercised without leave of the court (the insertion "without court action and" to be recommended (but not required) before the words "leave of the court").

e) Timely Remedies: State Party declares that it will apply Article X of the Aircraft Protocol in its entirety and that the number of working days to be used for the purposes of the time-limit laid down in Article X (2) of the Aircraft Protocol shall be in respect of:

1) the remedies specified in Articles 13 (1) (a), (b) and (c) of the Convention (preservation of the aircraft objects and their value; possession, control or custody of the aircraft objects; and immobilisation of the aircraft objects), not more than that equal to ten calendar days, and

2) the remedies specified in Articles 13 (1) (d) and (e) of the Convention (lease or management of the aircraft objects and the income thereof and sale and application of proceeds from the aircraft equipment), not more than that equal to 30 calendar days.

3. The declarations referred to in Article 1 b) of this Annex are the following:

a) Relief Pending Final Determination: State Party shall not have made a declaration under Article 55 of the Convention opting out of Article 13 or Article 43 of the Convention; provided, however, that, if State Party made the declarations set out under Article 2 d) of this Annex, the making of a declaration under Article 55 of the Convention shall not prevent application of the Cape Town Convention discount.

b) Rome Convention: State Party shall not have made a declaration under Article XXXII of the Aircraft Protocol opting out of Article XXIV of the Aircraft Protocol.

c) Lease Remedy: State Party shall not have made a declaration under Article 54 (1) of the Convention preventing lease as a remedy.

4. Regarding Article XI of the Aircraft Protocol, for Member States of the European Community, the qualifying declaration set out in Article 2 a) of this Annex shall be deemed made by a Member State, for purposes hereof, if the national law of such Member State was amended to reflect the terms of Alternative A under Article XI of the Aircraft Protocol (with a maximum 60 calendar days waiting period). As regards the qualifying declarations set out in Article 2 c) and d) of this Annex, these shall be deemed satisfied, for the purpose of this Sector Understanding, if the laws of the European Community or the relevant Member States are substantially similar to that set out in such Articles of this Annex.

BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

Reply submitted by: Bombardier, Inc.

Date: October 8, 2010

This is a response to the above-identified Call for Evidence (the "**CE**") in connection with the government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment (the "**Convention**" or "**C**") and the Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**" or "**P**"). The Convention and the Protocol will be referred to together as the "**Cape Town Treaty**" or "**Treaty**").

We have cut into this response the questions contained in Part III of the CE, and have set out our replies thereto below each such question.

To be clear at the outset, and as noted in reply to question 3.9, ***we strongly support ratification of the Cape Town Treaty and urge the government to do so as promptly as possible and with a high level of priority***.

The Cape Town Treaty reflects, enhances, and internationally promotes basic concepts found in English law. That should be expected given the central role played by the UK in negotiating and drafting the instruments. In fact, the drafting committee at every intergovernmental meeting that negotiated, and at the diplomatic conference that adopted, the Cape Town Treaty was chaired by a UK representative (either Sir Roy Goode (Oxford) or Bryan Welch (BIS)). The Treaty will reduce legal risk. It will produce economic benefit.

Importance of Protocol, art XI (Remedies on Insolvency) – Alternative A

The CE does not ask a question about the economically most important provision, P, art XI (remedies on insolvency). It is necessary to draw out the significance of applying Alternative A of this article ("**Alternative A**"). Most of the economic benefits and transaction risk reduction under the Treaty are predicated on the applicability of Alternative A (with a sixty (60) day waiting period). See *Economic Benefits of the Cape Town Treaty*, 2009, by Professor Vadim Linetsky, a leading authority on the financial modeling of secured transactions. Regarding the basis for this provision in emerging legal thinking, see "Cape Town Treaty in the European Context: the case for Alternative A, Article XI of the Aircraft Protocol", by Jeffrey Wool / Andrew Littlejohns. These materials can be downloaded at www.awg.aero . Thus, it is essential that Alternative A apply in the UK through its inclusion in the UK's implementing legislation (that mode of application is required given agreements relating to EU competence). See Unidroit, "The European Union and the Cape Town Convention", DC9 / DEP, Doc. 8, June 2010 at Annex III.

We note the Department's willingness to meet to discuss these matters. We would like to do that.

QUESTIONS POSED AND REPLIES

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;
b) the predictability of legal outcomes;
c) the availability of finance or leasing facilities; or
d) the cost?

Reply: The internationality of aircraft financing and leasing, and the consequent applicability of several non-harmonised laws, undoubtedly produce complex transactions. Legal outcomes are less predictable than they could and should be. As mentioned in CE, para 1.11, there is a particular level of uncertainty in English law due to the application of the *lex situs* rule regarding property rights in aircraft. The recent Blue Sky case has brought that problem into sharp focus.

All else equal, greater complexity and less predictability result in higher transaction costs than would otherwise be the case. At some point on the continuum, these factors impact the availability of financing. The foregoing is axiomatic. It is a basic tenet of law and economic theory, which is now widely-accepted in policy-making relating to secured transactions.

A prime example of such conflict of laws issues relates to rights in aircraft engines. Laws differ significantly regarding the legal effect of installing or removing engines, which, given operational requirements, could happen in any jurisdiction. In some jurisdictions, these actions impact core property rights.

Beyond conflicts, the cost and availability of financing are significantly impacted by the underlying substantive law, more specifically, any impediments caused by it affect the timely access to collateral value. Timely access to valuable collateral is the basis of secured transactions and defines the leasing model. In financial terms, timely access to valuable collateral offsets loss (that is, reduces the risk of loss (to a creditor) notwithstanding the risk of default (by a debtor)), thus producing efficiencies.

A prime example of such substantive law issues – as noted in CE para 1.11 – is delay occasioned by insolvency law. Beyond that delay, such laws may qualify or restrict contractual (and non-insolvency law) enforcement rights or impact property rights. These prospects are directly inconsistent with the core principles underlying asset-based financing and leasing.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

a) the rating of aircraft receivables,
b) the cost of export credit insurance, and/or
c) the cost of financing or leasing aircraft?

Reply: Sub-question 3.2(a) and (b) may be answered with reference to objective and publicly available information. Sub-question (c) raises methodological and confidentiality issues, and, thus, needs to be addressed based on general principles.

Re 3.2(a): "Aircraft receivables", in the context of the Treaty (which excludes general receivables financing), must refer to the rating of aircraft-backed securities. The only source of publicly available information regarding their cost is public, capital markets. In the aviation industry, these securities / transactions are known as "enhanced equipment trust certificates"

("**EETCs**"). There have been few EETCs in Europe and none in the UK, given uncertainties caused by applicable underlying insolvency law. In those transactions, two major European airlines paid materially higher rates, and had materially more restrictive terms, than less creditworthy airlines (closing transactions in the same time frame) in the US. The sole reason for such preferential US financing terms was the existence and application of section 1110 of the US bankruptcy code, a functional equivalent to Alternative A. This follows from the policies of international rating agencies, which have, based on years of data, used a system of "enhanced" rating (rating upgrades) where timely recourse to valuable aircraft collateral can be safely assumed. Based on underlying law, including insolvency law, that has been the case in the US but not in Europe.

Thus, the ratification of the Cape Town Treaty will provide UK airlines with enhanced access to international capital markets, thus diversifying their sources of funding. In particular, it will open public debt markets, providing UK airlines with another important option (in addition to bank debt and leasing, their traditional options) to help fund their capital-intensive aircraft acquisition requirements. For discussion of other commercial transactions, please see below.

Re 3.2(b): The cost of export credit is governed by the OECD's aircraft sector understanding (the "**ASU**"). Under the ASU, all OECD countries (the UK included) plus Brazil have agreed that ratification of the Treaty – with a set of "qualifying declarations" (see reply to question 3.10) – justifies a material reduction in the fee charged.[1] That decision supports the proposition that transactions in legal systems that provide higher levels of predictability and reflect the principles underlying asset based financing should be priced lower than those systems that do not. As to quantification, the size of the "Cape Town Discount" depends on the credit standing of the borrower; the weaker the credit standing (the higher the risk of default), the larger the fee reduction. Under the current terms of the ASU, the range (for large aircraft) is 20 to 150 basis points on the upfront fee charged. To give an example, a 100 basis point reduction (a "B" rated airline would receive a 94 basis point reduction) on a USD 100m aircraft financing equals USD 1m. It is noteworthy that under the ASU the terms of export credit are not attractive for spare aircraft engines. That reflects concerns about the point noted above regarding the law applicable to rights in engines.

Re 3.2(c): This question raises the general topic of the relationship between harmonised and (see reply to 3.1 above, more importantly) commercially-oriented secured financing and leasing law, on the one hand, and the cost (and terms) of such transactions, on the other. It is not possible to provide definitive and precise information on this question, for two reasons. First, many factors go into transaction pricing (and the availability of financing). These include – in addition to credit and legal risk – more general and macro considerations, such as (i) general liquidity in the financial sector and the liquidity position of a particular financial institution, (ii) the impact of regulatory capital, (iii) comparative returns from other forms of lending, (iv) competitive issues that may lead a bank to consider longer-term and relationship issues in setting price, and (v) other sources of fees payable to a bank directly or indirectly linked to that transaction or related transactions. Secondly, confidentiality (and, possibly, competition law) considerations prevent the disclosure of terms in private financing transactions.

That said, and as noted above, the direct link between reduced transactional risk and improved pricing and other terms – all else equal – is a foundation of law and economics. It is now taken as an established fact. Elements of this thinking are seen (beyond the positions of the

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[1] The UK, France, Germany, Spain and the US currently follow the "home market rule", which prevents export credit into these countries. The ASU is currently under review. A number of home market airlines, including some in the UK, are seeking to have this restriction eased or removed. To the extent that is agreed, the points above will apply in respect of UK carriers.

international rating agencies and the OECD countries, noted above) in the terms of BIS II (rules for regulatory capital) and daily decisions made by credit committees of financial institutions.

Finally, a specific word on the Treaty and "proof" of economic benefit. The extensive economic assessment and related academic work on the Cape Town Treaty has been without precedent in the field of commercial law reform. Two major studies were undertaken (see www.awg.aero), each of which took into account available information and research. The authors were of the highest possible caliber (in addition to Professor Linetsky, Northwestern University, they are Professors Anthony Saunders and Ingo Walters (INSEAD and NYU)). These academics are applied economists and finance specialists. If a higher standard than that undertaken in connection with the Treaty needs to be met, then question whether (i) any prior commercial treaty (or national law reform in this field) should ever have been adopted, or (ii) any future commercial law treaty (or national law reform in this field) will ever be adopted.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

Reply: The terms of the Cape Town Treaty will significantly address all of the issues noted in 3.1 above. First, it will sweep away the problems associated with the *lex situs* rule. Secondly, with Alternative A, it will sweep away problems associated with insolvency delay and impairment. That, in turn, will provide UK airlines with enhanced access to international capital markets, thus diversifying and increasing their sources of funding. Thirdly, it will eliminate the above-noted legal issues associated with engine financing, though that depends on adoption by many countries. On that last point, while the Treaty is rapidly being adopted internationally, there is no doubt that UK ratification would provide a leading example to and justification for others to ratify. That would also serve the objective of the UK export community. See reply to question 3.9 below.

The Cape Town Treaty, unlike most other international legal instruments, was purposefully designed to facilitate a transaction type, thereby producing benefits to the industry sector. The core role that the aviation sector – IATA (airlines) and AWG (financiers and manufacturers) – played in the process ensures that result. The Treaty elegantly solves the current legal issues in this field, and does so in a manner consistent with leading legal thought. There are no losers: the problems solved equally benefit debtors, creditors, and manufacturers.

3.4 Do you:

a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Reply: Re 3.4(a): The International Registry under the Treaty ("**IR**") is already recognised as both ground-breaking and well-established. Approximately half of the world's new aircraft transactions are registered in the IR. The system has run with virtually no problems since inception. There is strong supervision by ICAO. Users have direct input through an International Advisory Board.

The IR (and the above-noted priority rules) is a significant improvement over current law and practice. First, the system is electronic and low cost. It is simple and effective. Closings are made easier. Interests may be registered in advance ("prospective interests"), which takes pressure off of (expensive) closing logistics. In international (and national) law reform circles, the starting point for any discussion about registries systems is the IR. Secondly, the priority rules are clear and objective. In the context of aviation financing, clarity equals fairness. Parties can search the IR and determine exactly where they stand. Litigation relating to "knowledge" will be avoided. There will be no need for legal gymnastics (such as priority notices), which seek to address the issues handled directly by the Treaty. Thirdly, the IR (through the Treaty) establishes priorities on an international basis. Any other system would be limited to national priorities. That is inherently inefficient, and leaves risks in transactions which can be reduced only at significant expense. In short, the Treaty, through the IR and the priority rules, puts an efficient international system in place to deal with international transactions and fact patterns.

Re 3.4(b): The treatment of engines as separate property – and, correspondingly, the ability to separately register against them – is extremely useful. As noted in reply to question 3.1, the law applicable to rights in engines varies widely, and, in some jurisdictions, is potentially prejudicial to the right of property holders. That is exacerbated by the *lex situs* problem in the engine context.

Engines are highly valuable equipment. They consistently maintain their value. They should therefore serve as excellent collateral, if the underlying law so permits. In addition, they are often separately financed (spare engines) and pooled and interchanged. From a commercial perspective, they are often hired out on a short-term basis, where strong property rights are particularly important. For all these reasons, the treatment of engines under the Cape Town Treaty – as separate property to which the Treaty's clear rules apply – is a vast improvement to current law around the world. It will support advanced engine financing and use.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

Reply: As mentioned above, this is a significant advantage without any corresponding disadvantage. The absence of a required time period, and the ability to make a prospective registration, takes pressure off of closing logistics. While the priority "relates back", there is no unfairness to any party – since the registration only has priority from the time it is searchable. There are no secret interests. Any searching party can easily self-protect: all it needs to do is search the IR. It is then on notice that an interest, actual or prospective, might have a higher priority. That searching party would not close its financing transaction until the IR is cleared of any registration that could prevail over its interest.

The priority notice concept under English law aims at the same objective, but achieves it using a heavier two-step, paper-based process. The Treaty simplifies and improves the process.

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details.

Reply: We do not understand the relevance of this question – unless it is driving at providing an example and justification for other countries to ratify. See response to question 3.9. This question – what is the position (of a UK-registered aircraft) under foreign (substantive and

procedural) law would not be addressed by UK ratification. It would only be addressed by ratification by foreign countries (where the aircraft is located). And, if that is the optic, why limit the question to UK-registered aircraft. What about the position of a UK financier with a non-UK registered aircraft located elsewhere. Or a UK manufacturer who has problems financing sales given foreign law. These are all analytically the same: what is the position under foreign law. (N.B.: In many jurisdictions, there are significant repossession and enforcement problems.) UK ratification will not address these problems, save to the extent others are thereby encouraged to ratify. That encouragement, however, is important, given the wide range of material UK interests in international aviation.

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

Reply: This provision C, art 13 ("**Relief Pending**"), on which an opt-out is permitted (see C, art 55), and which is strengthened by an opt-in permitted under P, art X (see P, art XXX(2), was designed to provided countries opposed to non-judicial remedies with a court-based function equivalent thereof.

The UK is not such a country. English law on non-judicial remedies is well-established and effective. The international financing community is comfortable with it.

Thus, since the UK, reflecting its law, would be expected to permit non-judicial remedies through the mandatory declaration required by C, art 54(2)(permitting action "without leave of the court"), the Relief Pending provision is not necessary to reduce transactional risk or increase economic benefit in the context of the UK. The aviation community should be largely indifferent as to whether the UK, when ratifying, makes these particular declarations.

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be?

Reply: These remedies are essential. In light of the terms of the Chicago Convention of 1944, to effectively exercise remedies against an aircraft, a creditor must be able to de-register that aircraft. The Treaty not only provides these remedies, but adds the extremely useful IDERA clause ("irrevocable deregistration and export authorization"), P, art XIII. Most countries have opted into the IDERA clause (see P, art XXX(1)). An international standard is rapidly developing in favor of the use of IDERAs. (Even countries with very efficient de-registration systems (like the US) have made the IDERA election.) Underscoring its importance, the IDERA clause is an ASU qualifying declaration. Importantly, the use of an IDERA is expressly without prejudice to safety laws and regulations.

3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so

b) what impact do you consider these instruments will have on your sector of the aviation industry?

c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

Reply:

Re 3.9(a): ***We strongly support ratification of the Cape Town Treaty.***

In connection with that ratification, it is essential that the UK implement the economically must important provision, P, art XI (remedies on insolvency) – **Alternative A** (with a sixty (60) day waiting period). Most of the economic benefits and transaction risk reduction effected by the Cape Town Treaty is predicated on the applicability that provision. See materials by Linetsky and Wool / Littlejohns referred to above. See also reply to question 3.10 re ASU qualifying declarations.

Re 3.9(b): Ratification of the Cape Town Treaty (with P, art XI, Alternative A implemented through legislation) will reduce legal and transactional risk. It will produce economic benefit to airlines (by reducing cost and providing additional sources of financing), manufacturers (including through its impact on ratification by others, by promoting exports), and financial institutions (by reducing risk). Such direct benefits have important indirect benefits, including (from export enhancement) job creation and (from airline benefits) pass-through benefits to passengers.

UK ratification will ensure that English law remains a preferred governing law of choice in aviation finance and leasing, and that London remains central in the aviation financing and leasing industry.

Re 3.9(c): ***We urge the government to do so as promptly as possible and with a high level of priority***. The ratification by the UK has been delayed for a long time, given two matters unrelated to the core objectives of the Cape Town Treaty: EU competence issue and the Gibraltar-hold. These two items have finally been addressed. UK companies should start to benefit from the Treaty as promptly as possible. In addition, the recent strains on the financing sector coupled with demand for modern, environmentally friendly aircraft argue for swift action to help in these areas. Finally, while the UK has not yet ratified, many UK companies still need to comply with the Cape Town Treaty (e.g., register with the IR if they (i) buy aircraft equipment from a party located in a contracting state, or (ii) lease an aircraft from a financed lessor located in a Contracting State). In other words, aspects of compliance are already required; ratification will permit the corresponding benefit.

3.10 Do you have any other comments you would like to make?

Reply: We make following additional comments:

(i) The UK should make a set of "qualifying declarations" under the ASU. That would be as follows: (1) non-judicial remedies, C, art 54(2), (2) IDERA, P, art XIII, and (3) Alternative A (60 calendar day waiting period, implemented through legislation).

(ii) With respect to non-consensual rights and interests, the UK should align such rights with those customary in the international community. The UK "fleet lien" is seen as out-of-line with international norms, over-reaching, and potentially harmful to airlines (restricting credit) and financiers (increasing risk). The recent GKL litigation has drawn greater attention to the problem of the UK fleet lien. Thus, a tailored declaration under C, art 39 should be agreed after a policy assessment on this matter.

(iii) We note the Department's current intent to have a second consultation on the declarations to be made and the content of the implementing legislation. We think that such is not necessary, given the clarity on what is needed to ensure the benefits of the Treaty, and the consistency thereof with leading legal thought. If it is necessary, we encourage the government to undertake and complete that second step as promptly as possible.

END

BRITISH AIRWAYS

Our Ref: NG/am/NGL11

7 October 2010

Ms Rachel Onikosi
6th Floor, Abbey 2
Legislation and International Policy Unit
Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET

Dear Rachel

Call For Evidence - Treaty On International Interests In Mobile Equipment and Protocol Thereto On Matters Specific To Aircraft Equipment

Thank you for the opportunity to comment on the UK adoption of the Treaty On International Interests In Mobile Equipment and Protocol Thereto On Matters Specific To Aircraft Equipment (Cape Town Treaty). I hope you find our responses to the questionnaire useful, we have tried to comment only on the areas directly impacting British Airways.

British Airways' largest source of debt financing is secured aircraft financing which is achieved through a variety of structures from simple mortgages over the aircraft through to more complex cross border finance leases. British Airways also has a number of aircraft under operating leases. Financiers and operating lessors find the English legal system, in particular their security over the aircraft asset, to be strong and as a result can generally offer us competitive rates that fully reflect the value of the security offered. British Airways is also a lessor of surplus aircraft, generally to foreign airlines in lessor friendly jurisdictions.

Summary

British Airways supports the UK ratification of the Cape Town Treaty as:

- the harmonisation of UK and US law on aircraft security will support British Airways' access to the US EETC debt financing market
- Export Credit Agencies (ECAs) offer discounts to airlines based in countries that have ratified the Cape Town Treaty

- UK ratification will promote worldwide adoption which would significantly enhance our ability to lease surplus aircraft

- worldwide harmonisation of the legal framework will, over time, attract banks to the aircraft financing market and reduce transaction fees in cross border transactions

There is an additional administrative burden in adoption of the Cape Town Treaty and it is important that this is kept to a minimum by the scope of the CAA register being reduced to eliminate duplication. Given that the advantages set out above, we believe that the Cape Town Treaty should be ratified as soon as possible.

Questionnaire

3.1a There are well established cross border transactions where the financing providers and airlines have become used to operating under each other's legal framework. As such we do not see a "day one" reduction in the complexity of transactions but, over time, the introduction of new sources of financing and new structures will be simplified. As a lessor we see substantial benefits in other countries ratifying the Cape Town Treaty as it simplifies the risk analysis that we carry out when leasing out surplus aircraft.

3.1b No additional comment.

3.1c Following ratification of the Cape Town Treaty by the USA, we predict that financial markets will increasingly consider the Cape Town Treaty to be the market standard legal framework and will add a risk premium to other countries even where the local legal system is lender / lessor friendly. This will be particularly true when we try to access new markets previously untapped by British Airways such as the EETC market which is a substantial aircraft financing bond market in the USA.

3.1d Ratification of the Cape Town Treaty will lead to a lower cost of financing. The most direct impact will be through ECA financing where British Airways has access to financing on non European and non US manufactured aircraft. The OECD aircraft sector understanding encourages ECAs to charge higher premiums to countries that have not ratified the Cape Town Treaty.

3.2 Any initiatives that encourage finance into the market and simplify the execution of transactions will reduce financing costs.

3.3 No additional comments.

3.4a The CAA register in the UK works perfectly well so we are indifferent to replacing it with the international registry for UK registered aircraft other then the simplicity brought about by worldwide harmonization set out in 3.1a. It is however essential that charges and legal ownership are only recorded on one register.

3.4b Spare aircraft engines can cost over $25 million so are often subject to separate financing transactions. As such we see the ability to register charges over individual engines as an advantage.

3.5 British Airways acts primarily as a borrower or lessee and does not have a preference here.

3.6 British Airways, as an airline, has no experience of repossessing assets.

3.7 British Airways is largely indifferent here.

3.8 British Airways acts primarily as a borrower or lessee and does not have a preference here.

3.9 Please see Summary above.

Please do not hesitate to call me on 020 8738 6797 should you have any questions on our responses.

Yours sincerely

Nick Goddard
TREASURER

Tel: +44 20 8738 6797
Fax: +44 20 8738 9618

BRITISH EXPORTERS ASSOCIATION

Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment
BIS CALL FOR EVIDENCE JULY 2010

Response to: Rachel Onikosi 6th Floor, Abbey 2 Legislation and International Policy Unit Department for Business, Innovation and Skills 1 Victoria Street London SW1H 0ET rachel.onikosi@bis.gsi.gov.uk

BExA is responding to the Business Innovation and Skills consultation concerning the Convention on International Interests in Mobile Equipment, known as the Cape Town Convention.
http://www.bis.gov.uk/assets/biscore/corporate/docs/c/10-1032-call-for-evidence-mobile-aircraft-equipment.pdf

BExA members are drawn from the exporting community including exporters and their advisors, financiers and insurers. Aerospace, including aero engines and components including wings, is a key export for the UK. Airbus reports that its export of wings supports 10,000 jobs at Airbus UK and 135,000 in the supply chain. This is a very competitive market and the demand for aircraft finance is increasing, as can be seen from ECGD's most recent (2009-10) results.

Commercial aircraft sales almost invariably involve careful financial engineering to enable payments to be made according to the expected cash-flow generated by the investment in the asset. The Cape Town Convention provides a legal framework that allows a financier to rely on the security of an aircraft and repossession in a timely manner in the event of default.

Without it, financiers take a larger risk on the credit worthiness of the customer because the value of their security may be eroded without certainty of repossession. The certainty given by the Cape Town Convention will increase the availability of funding and reduce costs.

The UK should ratify the Convention on International Interests in Mobile Equipment and its Aircraft Protocol (the Cape Town Convention) without delay since it will show leadership to other nations and, once the Convention is widely ratified, lead to increased availability of financing for aircraft and engines. This will benefit the main UK suppliers and have a knock-on effect of increased sales for component manufacturers. Ratification will not result in any increase in cost to the UK taxpayer.

BExA Council
October 2010

GOVERNMENT ADMINISTRATION BUILDING
GRAND CAYMAN, KY1-9000, CAYMAN ISLANDS
TEL: (345) 949-7900, EXT. 2458
FAX: (345) 945-1746

Cayman Islands Government

Ministry of
Finance, Tourism and Development

VIA ELECTRONIC MAIL to: rachel.onikosi@bis.gsi.gov.uk

8 October 2010

Rachel Onikosi
6th Floor, Abbey 2
Legislation and International Policy Unit
Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET

Dear Ms. Onikosi;

Re: Call for Evidence on the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

The Cayman Islands Government welcomes the opportunity to formally respond to the Call for Evidence on the Convention on International Interests in Mobile Equipment (the "**Convention**") and Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**") issued by the Department for Business, Innovation and Skills ("**BIS**").

We are especially grateful for your written confirmation that BIS had intended for this Call for Evidence to be extended to all Overseas Territories.

This letter of response, therefore, is intended to serve the dual purposes of outlining the position of the Cayman Islands Government and endorsing the letter of reply submitted to BIS by Maples and Calder (*see attachment*), a Cayman Islands law firm, on 17 September 2010. Given that the letter of reply from Maples and Calder is written from the perspective of Cayman Islands legal practitioners, the Cayman Islands Government considers them better placed to complete the Questionnaire attached to Part III of the Call for Evidence.

The Cayman Islands Government strongly supports the ratification of the Convention and the Protocol. We also entreat H.M. Government to extend the Convention and Protocol to the Cayman Islands as it is our desire to become a Contracting State to both.

The Convention and Protocol have long been viewed as essential to the Cayman Islands. This is exemplified by the fact that last year a law was passed in the Cayman Islands entitled "The Cape Town Convention Law, 2009" which sought to give domestic effect to the relevant provisions of the actual Convention.

Cayman Islands vehicles are often utilised for aircraft financing structures. This is therefore a matter of particular commercial and economic importance for the Cayman Islands. However, because of our political status as an Overseas Territory, we are wholly dependent on H.M. Government's intervention regarding this matter.

There is clear evidence to demonstrate that a precedent has been established for our request to have this Convention and Protocol ratified then extended to the Cayman Islands. It is worthy highlighting that the Netherlands on 17 May 2010 acceded to this Convention on behalf of the Netherlands Antilles and Aruba, thereby establishing the Netherlands Antilles and Aruba as Contracting States and placing both at a significant advantage over competing jurisdictions such as the Cayman Islands.

We have sought views on this matter from a panel of leading Cayman Islands law firms who specialise in aircraft and asset financing transactions. They have unanimously and unequivocally supported the position outlined by Maples and Calder in their reply to BIS and share the concern that this ratification occur as promptly as possible and with a high level of priority.

There is only one further recommendation which was not contained in the response from Maples and Calder. For the purposes of Article 1 and Chapter XII of the Convention, the Cayman Islands would seek to declare that all courts with competent jurisdiction under the laws of the Cayman Islands are the relevant courts.

This additional recommendation has the support of the Cayman Islands Government and the panel of law firms polled on the subject (which includes Maples and Calder).

In closing, the Cayman Islands Government would welcome the opportunity to enter into further dialogue with BIS with regards to this Convention and Protocol. It is recognised that prior to any extension of the Convention, the Cayman Islands will be required to demonstrate the ability to meet all terms and obligations which it contains. Again, we put forward that there is a clear commitment on our part to put in place any enacting legislation that may be required.

Should you have any questions or comments please do not hesitate to contact Samuel Rose, Deputy Chief Officer in the Ministry of Finance, Tourism & Development at samuel.rose@gov.ky who is assigned to this matter.

I thank you for this opportunity to respond to this Call for Evidence on behalf of the Cayman Islands Government.

Sincerely,

Kenneth Jefferson JP
Financial Secretary

cc: His Exellency, Mr. Duncan J.R. Taylor CBE
Hon. W. McKeeva Bush OBE, JP - Premier and Minister for Finance, Tourism & Development

(Attachment)

Corporate Centre
Aircraft Registration

Civil Aviation Authority

Rachel Onikosi
6th Floor, Abbey 2
Legislation and International Policy Unit
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

14 October 2010
Ref

Dear Rachel

CAPE TOWN CONVENTION CALL FOR EVIDENCE

Thank you for your letter of 30 July and the Call for Evidence in relation to the Convention on International Interests in Mobile Equipment and Protocol on Matters Specific to the Aircraft Equipment.

The CAA is the UK's specialist aviation regulator responsible for air safety, economic regulation, airspace regulation, and consumer protection. In the context of this call for Evidence, the CAA is responsible for maintaining the UK Register of Civil Aircraft and the UK Register of Aircraft Mortgages.

The questions from part 3 of the Call for Evidence and the CAA responses are as follows:

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;

No comment.

b) the predictability of legal outcomes;

No comment.

c) the availability of finance or leasing facilities; or
d) the cost?

No comment.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

Civil Aviation Authority
Aircraft Registration CAA House 45-59 Kingsway London WC2B 6TE www.caa.co.uk/aircraftregister
Telephone (020) 7453 6666 Fax (020) 7453 6670 aircraft.reg@caa.co.uk

a) the rating of aircraft receivables,
b) the cost of export credit insurance, and/or
c) the cost of financing or leasing aircraft?

Not applicable

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

Not applicable

3.4 Do you:

a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

The CAA generally supported the aims of the Convention and Protocol at the time of signing, and therefore we consider that the proposal to utilise the International Registry System would be advantageous. The method of recording interests on the International Registry under the Convention has been reported as working satisfactorily for those countries that have already ratified the convention. Additionally, the International Registry is available 24 hours a day and 7 days a week, which makes searching and filing interests more efficient than being required to deal with various different National Aviation Authorities.

However, the existing method of recording mortgages on the UK Register of Aircraft Mortgages offers the lender the protection that an aircraft cannot be removed from the UK Register of Civil Aircraft without the lenders written consent. In practical terms, this is currently one of the most powerful protections provided to the lender, since without this consent the aircraft cannot be re-registered to another owner within the UK or removed from the UK Register and thus be re-registered anywhere else. The International Registry system does not offer this specific protection to lenders.

b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

There is currently no provision to register an engine separately from the airframe on the UK Register of Aircraft Mortgages. Although not possible under current UK law, the ability to register an interest against an engine separately from an aircraft has been requested from time to time. Therefore it would appear that the ability to do so would be helpful to prospective lenders.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

No comment.

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details.

No comment.

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

No comment.

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be?

This could be considered useful by creditors, but in practice creditors with a mortgage entered on the UK Register of Aircraft Mortgages are able to effect prompt de-registration from the UK Register of Civil Aircraft in cases of default.

3.9 In light of your answers to the above questions:
a) do you favour ratification of the Convention and Protocol; if so

As we noted in our original response to the consultation in 2001, the CAA generally supports the aims of the Convention and Protocol; therefore we favour ratification subject to an analysis of the various implementation options and the points raised below in 3.10.

b) what impact do you consider these instruments will have on your sector of the aviation industry?

Depending on the approach taken at ratification, changes may result in the way mortgages are registered on the UK Register of Aircraft Mortgages in order to accommodate the legislative changes required by ratification. This could have an impact on those lenders that specialise in lending over aircraft that are not covered by the Convention and Protocol.

Similarly, depending on the approach taken at ratification, changes to the current method of recording mortgages in the UK would also have a detrimental impact upon the income of the CAA.

c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

Given that the UK was a signatory to the Convention and that 40 states have now ratified there is a danger that the UK may be perceived as uncommitted unless ratification occurs within the next five years.

3.10 Do you have any other comments you would like to make?

The CAA has previously raised concerns regarding its powers of detention and sale of aircraft following ratification; these concerns and the other potential implications require a fuller analysis in due course.

I would be happy to discuss any of these matters in more depth if that would be helpful.

Yours Sincerely

Robert Ferris
Head of Aircraft Registration

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By email
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5 October 2010

Dear Rachel

BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment

In reply to the above Call for Evidence, we should be grateful if you would note that, while we have reviewed the paper with great interest, at this stage, we shall not be submitting a response to the questions posed in Part III of the Call for Evidence.

However, we understand that if the decision is made to move towards ratification by the UK of the Convention and Protocol, BIS expects a further consultation to take place on the detail of the legal options and changes that would be required to UK law. We respectfully request that you keep this firm on your contact list for any such consultation or further communications, if this matter proceeds.

Many thanks.

Yours sincerely

Marisa Chan

Deutsche Bank

Deutsche Bank AG London
Winchester House
1 Great Winchester Street
London EC2N 2DB
Tel +44 20 7545 8000

8. October, 2010

Rachel Onikosi
Deputy Head, Legislative and International Policy Unit
Department for Business, Innovation & Skills
1 Victoria Street
London SW1H OET

Re: **BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)**

Dear Ms. Onikosi,

This is a response to the above-identified Call for Evidence (the "**CE**") in connection with the government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment (the "**Convention**" or "**C**") and the Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**" or "**P**"). The Convention and the Protocol will be referred to together as the "**Cape Town Treaty**" or "**Treaty**").

I am writing on behalf of Deutsche Bank AG ("Deutsche Bank"). Deutsche Bank is a leading global investment bank with over 70,000 employees in 72 countries. Deutsche Bank has been a leader in providing both financing and advisory services to airlines and aircraft leasing companies around the world. We currently hold an aircraft-backed loan book of over $1.5 billion. Furthermore, Deutsche Bank provides active trading markets in a wide range of aircraft-backed securities as part of its global credit trading activities for institutional investors.

We have cut into this response the questions contained in Part III of the CE, and have set out our replies thereto below each such question.

To be clear at the outset, and as noted in reply to question 3.9, ***we strongly support ratification of the Cape Town Treaty and urge the government to do so as promptly as possible and with a high level of priority.***

The Cape Town Treaty reflects, enhances, and internationally promotes basic concepts found in English law. That should be expected given the central role played by the UK in

negotiating and drafting the instruments. In fact, the drafting committee at every intergovernmental meeting that negotiated, and at the diplomatic conference that adopted, the Cape Town Treaty was chaired by a UK representative (either Sir Roy Goode (Oxford) or Bryan Welch (BIS)). The Treaty will reduce legal risk. It will produce economic benefit.

Importance of Protocol, art XI (Remedies on Insolvency) – Alternative A
The CE does not ask a question about the economically most important provision, P, art XI (remedies on insolvency). It is necessary to draw out the significance of applying Alternative A of this article ("**Alternative A**"). Most of the economic benefits and transaction risk reduction under the Treaty are predicated on the applicability of Alternative A (with a sixty (60) day waiting period). See *Economic Benefits of the Cape Town Treaty*, 2009, by Professor Vadim Linetsky, a leading authority on the financial modeling of secured transactions. Regarding the basis for this provision in emerging legal thinking, see "Cape Town Treaty in the European Context: the case for Alternative A, Article XI of the Aircraft Protocol", by Jeffrey Wool / Andrew Littlejohns. These materials can be downloaded at www.awg.aero . Thus, it is essential that Alternative A apply in the UK through its inclusion in the UK's implementing legislation (that mode of application is required given agreements relating to EU competence). See Unidroit, "The European Union and the Cape Town Convention", DC9 / DEP, Doc. 8, June 2010 at Annex III.

QUESTIONS POSED AND REPLIES

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:
- a) the complexity of the transactions;
- b) the predictability of legal outcomes;
- c) the availability of finance or leasing facilities; or
- d) the cost?

Reply: The internationality of aircraft financing and leasing, and the consequent applicability of several non-harmonised laws, undoubtedly produce complex transactions. Legal outcomes are less predictable than they could and should be. As mentioned in CE, para 1.11, there is a particular level of uncertainty in English law due to the application of the *lex situs* rule regarding property rights in aircraft. The recent Blue Sky case has brought that problem into sharp focus.

All else equal, greater complexity and less predictability result in higher transaction costs than would otherwise by the case. At some point on the continuum, these factors impact the availability of financing. The foregoing is axiomatic. It is a basic tenet of law and economic theory, which is now widely accepted in policy-making relating to secured transactions.

A prime example of such conflict of laws issues relates to rights in aircraft engines. Laws differ significantly regarding the legal effect of installing or removing engines, which, given operational requirements, could happen in any jurisdiction. In some jurisdictions, these actions impact core property rights.

Beyond conflicts, the cost and availability of financing are significantly impacted by the underlying substantive law, more specifically, any impediments caused by it affect the timely access to collateral value. Timely access to valuable collateral is the basis of secured

transactions and defines the leasing model. In financial terms, timely access to valuable collateral offsets loss (that is, reduces the risk of loss (to a creditor) notwithstanding the risk of default (by a debtor)), thus producing efficiencies.

A prime example of such substantive law issues – as noted in CE para 1.11 – is delay occasioned by insolvency law. Beyond that delay, such laws may qualify or restrict contractual (and non-insolvency law) enforcement rights or impact property rights. These prospects are directly inconsistent with the core principles underlying asset-based financing and leasing.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

a) the rating of aircraft receivables,
b) the cost of export credit insurance, and/or
c) the cost of financing or leasing aircraft?

Reply: Sub-question 3.2(a) and (b) may be answered with reference to objective and publicly available information. Sub-question (c) raises methodological and confidentiality issues, and, thus, needs to be addressed based on general principles.

Re 3.2(a): "Aircraft receivables", in the context of the Treaty (which excludes general receivables financing), must refer to the rating of aircraft-backed securities. The only source of publicly available information regarding their cost is public capital markets. In the aviation industry, these securities / transactions are known as "enhanced equipment trust certificates" ("**EETCs**"). There have been few EETCs in Europe and none in the UK, given uncertainties caused by applicable underlying insolvency law. In those transactions, two major European airlines paid materially higher rates, and had materially more restrictive terms, than less creditworthy airlines (closing transactions in the same time frame) in the US. The sole reason for such preferential US financing terms was the existence and application of section 1110 of the US bankruptcy code, a functional equivalent to Alternative A. This follows from the policies of international rating agencies, which have, based on years of data, used a system of "enhanced" rating (rating upgrades) where timely recourse to valuable aircraft collateral can be safely assumed. Based on underlying law, including insolvency law, that has been the case in the US but not in Europe.

In our regular discussions with major institutional investors who have actively invested in EETCs during the past 15 years, it has become clear that the presence of Section 1110 protection for EETCs issued by US airlines is a key element in their investment decision. The value of Section 1110 to secured lenders was borne out during a series of bankruptcies of US airlines in the past decade, including those of major carriers such as Delta Air Lines, Northwest Airlines, United Airlines and US Airways, in which these investors were able to recover all or substantially all of their invested principal in a timely manner. Conversely, the absence of Section 1110 or its functional equivalent has been a major hurdle to these same investors investing in EETCs from non-US airlines, including UK-based airlines. Pricing indications provided by these investors demonstrate that there would be a measurable economic benefit to issuing airlines in countries that have ratified the Cape Town Treaty.

Thus, the ratification of the Cape Town Treaty will provide UK airlines with enhanced access to international capital markets, thus diversifying their sources of funding. In particular, it will open public debt markets, providing UK airlines with another important option (in addition to bank debt and leasing, their traditional options) to help fund their capital-

intensive aircraft acquisition requirements. For discussion of other commercial transactions, please see below.

Re 3.2(b): The cost of export credit is governed by the OECD's aircraft sector understanding (the "**ASU**"). Under the ASU, all OECD countries (the UK included) plus Brazil have agreed that ratification of the Treaty – with a set of "qualifying declarations" (see reply to question 3.10) – justifies a material reduction in the fee charged.[1] That decision supports the proposition that transactions in legal systems that provide higher levels of predictability and reflect the principles underlying asset based financing should be priced lower than those systems that do not. As to quantification, the size of the "Cape Town Discount" depends on the credit standing of the borrower; the weaker the credit standing (the higher the risk of default), the larger the fee reduction. Under the current terms of the ASU, the range (for large aircraft) is 20 to 150 basis points on the upfront fee charged. To give an example, a 100 basis point reduction (a "B" rated airline would receive a 94 basis point reduction) on a USD 100m aircraft financing equals USD 1m. It is noteworthy that under the ASU the terms of export credit are not attractive for spare aircraft engines. That reflects concerns about the point noted above regarding the law applicable to rights in engines.

Re 3.2(c): This question raises the general topic of the relationship between harmonised and (see reply to 3.1 above, more importantly) commercially-oriented secured financing and leasing law, on the one hand, and the cost (and terms) of such transactions, on the other. It is not possible to provide definitive and precise information on this question, for two reasons. First, many factors go into transaction pricing (and the availability of financing). These include – in addition to credit and legal risk – more general and macro considerations, such as (i) general liquidity in the financial sector and the liquidity position of a particular financial institution, (ii) the impact of regulatory capital, (iii) comparative returns from other forms of lending, (iv) competitive issues that may lead a bank to consider longer-term and relationship issues in setting price, and (v) other sources of fees payable to a bank directly or indirectly linked to that transaction or related transactions. Secondly, confidentiality (and, possibly, competition law) considerations prevent the disclosure of terms in private financing transactions.

That said, and as noted above, the direct link between reduced transactional risk and improved pricing and other terms – all else equal – is a foundation of law and economics. It is now taken as an established fact. Elements of this thinking are seen (beyond the positions of the international rating agencies and the OECD countries, noted above) in the terms of BIS II (rules for regulatory capital) and daily decisions made by credit committees of financial institutions.

Finally, a specific word on the Treaty and "proof" of economic benefit. The extensive economic assessment and related academic work on the Cape Town Treaty has been without precedent in the field of commercial law reform. Two major studies were undertaken (see www.awg.aero), each of which took into account available information and research. The authors were of the highest possible caliber (in addition to Professor Linetsky, Northwestern University, they are Professors Anthony Saunders and Ingo Walters (INSEAD and NYU)). These academics are applied economists and finance specialists. If a higher

[1] The UK, France, Germany, Spain and the US currently follow the "home market rule", which prevents export credit into these countries. The ASU is currently under review. A number of home market airlines, including some in the UK, are seeking to have this restriction eased or removed. To the extent that is agreed, the points above will apply in respect of UK carriers.

standard than that undertaken in connection with the Treaty needs to be met, then question whether (i) any prior commercial treaty (or national law reform in this field) should ever have been adopted, or (ii) any future commercial law treaty (or national law reform in this field) will ever be adopted.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

Reply: The terms of the Cape Town Treaty will significantly address all of the issues noted in 3.1 above. First, it will sweep away the problems associated with the *lex situs* rule. Secondly, with Alternative A, it will sweep away problems associated with insolvency delay and impairment. That, in turn, will provide UK airlines with enhanced access to international capital markets, thus diversifying and increasing their sources of funding. Thirdly, it will eliminate the above-noted legal issues associated with engine financing, though that depends on adoption by many countries. On that last point, while the Treaty is rapidly being adopted internationally, there is no doubt that UK ratification would provide a leading example to and justification for others to ratify. That would also serve the objective of the UK export community. See reply to question 3.9 below.

The Cape Town Treaty, unlike most other international legal instruments, was purposefully designed to facilitate a transaction type, thereby producing benefits to the industry sector. The core role that the aviation sector – IATA (airlines) and AWG (financiers and manufacturers) – played in the process ensures that result. The Treaty elegantly solves the current legal issues in this field, and does so in a manner consistent with leading legal thought. There are no losers: the problems solved equally benefit debtors, creditors, and manufacturers.

3.4 Do you:

a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Reply: Re 3.4(a): The International Registry under the Treaty ("IR") is already recognised as both ground-breaking and well-established. Approximately half of the world's new aircraft transactions are registered in the IR. The system has run with virtually no problems since inception. There is strong supervision by ICAO. Users have direct input through an International Advisory Board.

The IR (and the above-noted priority rules) is a significant improvement over current law and practice. First, the system is electronic and low cost. It is simple and effective. Closings are made easier. Interests may be registered in advance ("prospective interests"), which takes pressure off of (expensive) closing logistics. In international (and national) law reform circles, the starting point for any discussion about registries systems is the IR. Secondly, the priority rules are clear and objective. In the context of aviation financing, clarity equals fairness. Parties can search the IR and determine exactly where they stand. Litigation relating to "knowledge" will be avoided. There will be no need for legal gymnastics (such as priority

notices), which seek to address the issues handled directly by the Treaty. Thirdly, the IR (through the Treaty) establishes priorities on an international basis. Any other system would be limited to national priorities. That is inherently inefficient, and leaves risks in transactions which can be reduced only at significant expense. In short, the Treaty, through the IR and the priority rules, puts an efficient international system in place to deal with international transactions and fact patterns.

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Engines are highly valuable equipment. They consistently maintain their value. They should therefore serve as excellent collateral, if the underlying law so permits. In addition, they are often separately financed (spare engines) and pooled and interchanged. From a commercial perspective, they are often hired out on a short-term basis, where strong property rights are particularly important. For all these reasons, the treatment of engines under the Cape Town Treaty – as separate property to which the Treaty's clear rules apply – is a vast improvement to current law around the world. It will support advanced engine financing and use.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

Reply: As mentioned above, this is a significant advantage without any corresponding disadvantage. The absence of a required time period, and the ability to make a prospective registration, takes pressure off of closing logistics. While the priority "relates back", there is no unfairness to any party – since the registration only has priority from the time it is searchable. There are no secret interests. Any searching party can easily self-protect: all it needs to do is search the IR. It is then on notice that an interest, actual or prospective, might have a higher priority. That searching party would not close its financing transaction until the IR is cleared of any registration that could prevail over its interest.

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3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details.

Reply: We do not understand the relevance of this question – unless it is driving at providing an example and justification for other countries to ratify. See response to question 3.9. This question – what is the position (of a UK-registered aircraft) under foreign (substantive and procedural) law would not be addressed by UK ratification. It would only be addressed by ratification by foreign countries (where the aircraft is located). And, if that is the optic, why limit the question to UK-registered aircraft. What about the position of a UK financier with a non-UK registered aircraft located elsewhere. Or a UK manufacturer who has problems financing sales given foreign law. These are all analytically the same: what is

the position under foreign law. (N.B.: In many jurisdictions, there are significant repossession and enforcement problems.) UK ratification will not address these problems, save to the extent others are thereby encouraged to ratify. That encouragement, however, is important, given the wide range of material UK interests in international aviation.

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

Reply: This provision C, art 13 ("Relief Pending"), on which an opt-out is permitted (see C, art 55), and which is strengthened by an opt-in permitted under P, art X (see P, art XXX(2), was designed to provide countries opposed to non-judicial remedies with a court-based function equivalent thereof.

The UK is not such a country. English law on non-judicial remedies is well-established and effective. The international financing community is comfortable with it.

Thus, since the UK, reflecting its law, would be expected to permit non-judicial remedies through the mandatory declaration required by C, art 54(2)(permitting action "without leave of the court"), the Relief Pending provision is not necessary to reduce transactional risk or increase economic benefit in the context of the UK. The aviation community should be largely indifferent as to whether the UK, when ratifying, makes these particular declarations.

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be?

Reply: These remedies are essential. In light of the terms of the Chicago Convention of 1944, to effectively exercise remedies against an aircraft, a creditor must be able to de-register that aircraft. The Treaty not only provides these remedies, but adds the extremely useful IDERA clause ("irrevocable deregistration and export authorization"), P, art XIII. Most countries have opted into the IDERA clause (see P, art XXX(1)). An international standard is rapidly developing in favor of the use of IDERAs. (Even countries with very efficient de-registration systems (like the US) have made the IDERA election.) Underscoring its importance, the IDERA clause is an ASU qualifying declaration. Importantly, the use of an IDERA is expressly without prejudice to safety laws and regulations.

3.9 In light of your answers to the above questions:
- a) do you favour ratification of the Convention and Protocol; if so
- b) what impact do you consider these instruments will have on your sector of the aviation industry?
- c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

Reply:

Re 3.9(a): ***We strongly support ratification of the Cape Town Treaty.***

In connection with that ratification, it is essential that the UK implement the economically must important provision, P, art XI (remedies on insolvency) – **Alternative A** (with a sixty (60) day waiting period). Most of the economic benefits and transaction risk reduction effected

by the Cape Town Treaty is predicated on the applicability that provision. See materials by Linetsky and Wool / Littlejohns referred to above. See also reply to question 3.10 re ASU qualifying declarations.

Re 3.9(b): Ratification of the Cape Town Treaty (with P, art XI, Alternative A implemented through legislation) will reduce legal and transactional risk. It will produce economic benefit to airlines (by reducing cost and providing additional sources of financing), manufacturers (including through its impact on ratification by others, by promoting exports), and financial institutions (by reducing risk). Such direct benefits have important indirect benefits, including (from export enhancement) job creation and (from airline benefits) pass-through benefits to passengers.

UK ratification will ensure that English law remains a preferred governing law of choice in aviation finance and leasing, and that London remains central in the aviation financing and leasing industry.

Re 3.9(c): ***We urge the government to do so as promptly as possible and with a high level of priority***. The ratification by the UK has been delayed for a long time, given two matters unrelated to the core objectives of the Cape Town Treaty: EU competence issue and the Gibraltar-hold. These two items have finally been addressed. UK companies should start to benefit from the Treaty as promptly as possible. In addition, the recent strains on the financing sector coupled with demand for modern, environmentally friendly aircraft argue for swift action to help in these areas. Finally, while the UK has not yet ratified, many UK companies still need to comply with the Cape Town Treaty (e.g., register with the IR if they (i) buy aircraft equipment from a party located in a contracting state, or (ii) lease an aircraft from a financed lessor located in a Contracting State). In other words, aspects of compliance are already required; ratification will permit the corresponding benefit.

3.10 Do you have any other comments you would like to make?

Reply: We make following additional comments:

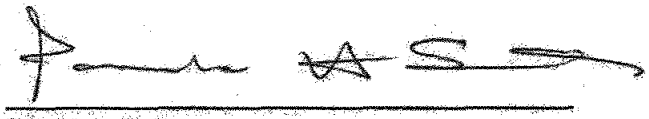
(i) The UK should make a set of "qualifying declarations" under the ASU. That would be as follows: (1) non-judicial remedies, C, art 54(2), (2) IDERA, P, art XIII, and (3) Alternative A (60 calendar day waiting period, implemented through legislation).

(ii) With respect to non-consensual rights and interests, the UK should align such rights with those customary in the international community. The UK "fleet lien" is seen as out-of-line with international norms, over-reaching, and potentially harmful to airlines (restricting credit) and financiers (increasing risk). The recent GKL litigation has drawn greater attention to the problem of the UK fleet lien. Thus, a tailored declaration under C, art 39 should be agreed after a policy assessment on this matter.

(iii) We note the Department's current intent to have a second consultation on the declarations to be made and the content of the implementing legislation. We think that such is not necessary, given the clarity on what is needed to ensure the benefits of the Treaty, and the consistency thereof with leading legal thought. If it is necessary, we encourage the government to undertake and complete that second step as promptly as possible.

Thank you for considering these comments.

Sincerely yours,



Pamela Smith
Managing Director
Deutsche Bank AG

CC: Patrick Käufer, Managing Director, Deutsche Bank Securities Inc.
CC: Richard Moody, Director, Deutsche Bank AG

EMBRAER

BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

Reply submitted by: **Embraer – Empresa Brasileira de Aeronáutica S.A.**

Date: **October, 6th 2010**

This is a response to the above-identified Call for Evidence (the "**CE**") in connection with the government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment (the "**Convention**" or "**C**") and the Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**" or "**P**"). The Convention and the Protocol will be referred to together as the "**Cape Town Treaty**" or "**Treaty**").

We have cut into this response the questions contained in Part III of the CE, and have set out our replies thereto below each such question.

To be clear at the outset, and as noted in reply to question 3.9, ***we strongly support ratification of the Cape Town Treaty and urge the government to do so as promptly as possible and with a high level of priority***.

The Cape Town Treaty reflects, enhances, and internationally promotes basic concepts found in English law. That should be expected given the central role played by the UK in negotiating and drafting the instruments. In fact, the drafting committee at every intergovernmental meeting that negotiated, and at the diplomatic conference that adopted, the Cape Town Treaty was chaired by a UK representative (either Sir Roy Goode (Oxford) or Bryan Welch (BIS)). The Treaty will reduce legal risk. It will produce economic benefit.

Importance of Protocol, art XI (Remedies on Insolvency) – Alternative A

The CE does not ask a question about the economically most important provision, P, art XI (remedies on insolvency). It is necessary to draw out the significance of applying Alternative A of this article ("**Alternative A**"). Most of the economic benefits and transaction risk reduction under the Treaty are predicated on the applicability of Alternative A (with a sixty (60) day waiting period). See *Economic Benefits of the Cape Town Treaty*, 2009, by Professor Vadim Linetsky, a leading authority on the financial modeling of secured transactions. Regarding the basis for this provision in emerging legal thinking, see "Cape Town Treaty in the European Context: the case for Alternative A, Article XI of the Aircraft Protocol", by Jeffrey Wool / Andrew Littlejohns. These materials can be downloaded at www.awg.aero . Thus, it is essential that Alternative A apply in the UK though its inclusion in the UK's implementing legislation (that mode of application is required given agreements relating to EU competence). See Unidroit, "The European Union and the Cape Town Convention", DC9 / DEP, Doc. 8, June 2010 at Annex III.

We note the Department's willingness to meet to discuss these matters. We would like to do that.

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QUESTIONS POSED AND REPLIES

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;
b) the predictability of legal outcomes;
c) the availability of finance or leasing facilities; or
d) the cost?

Reply: The internationality of aircraft financing and leasing, and the consequent applicability of several non-harmonised laws, undoubtedly produce complex transactions. Legal outcomes are less predictable than they could and should be. As mentioned in CE, para 1.11, there is a particular level of uncertainty in English law due to the application of the *lex situs* rule regarding property rights in aircraft. The recent Blue Sky case has brought that problem into sharp focus.

All else equal, greater complexity and less predictability result in higher transaction costs than would otherwise by the case. At some point on the continuum, these factors impact the availability of financing. The foregoing is axiomatic. It is a basic tenet of law and economic theory, which is now widely-accepted in policy-making relating to secured transactions.

A prime example of such conflict of laws issues relates to rights in aircraft engines. Laws differ significantly regarding the legal effect of installing or removing engines, which, given operational requirements, could happen in any jurisdiction. In some jurisdictions, these actions impact core property rights.

Beyond conflicts, the cost and availability of financing are significantly impacted by the underlying substantive law, more specifically, any impediments caused by it affect the timely access to collateral value. Timely access to valuable collateral is the basis of secured transactions and defines the leasing model. In financial terms, timely access to valuable collateral offsets loss (that is, reduces the risk of loss (to a creditor) notwithstanding the risk of default (by a debtor)), thus producing efficiencies.

A prime example of such substantive law issues – as noted in CE para 1.11 – is delay occasioned by insolvency law. Beyond that delay, such laws may qualify or restrict contractual (and non-insolvency law) enforcement rights or impact property rights. These prospects are directly inconsistent with the core principles underlying asset-based financing and leasing.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

a) the rating of aircraft receivables,
b) the cost of export credit insurance, and/or
c) the cost of financing or leasing aircraft?

Reply: Sub-question 3.2(a) and (b) may be answered with reference to objective and publicly available information. Sub-question (c) raises methodological and confidentiality issues, and, thus, needs to be addressed based on general principles.

Re 3.2(a): "Aircraft receivables", in the context of the Treaty (which excludes general receivables financing), must refer to the rating of aircraft-backed securities. The only source of publicly available information regarding their cost is public, capital markets. In the aviation

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industry, these securities / transactions are known as "enhanced equipment trust certificates" ("**EETCs**"). There have been few EETCs in Europe and none in the UK, given uncertainties caused by applicable underlying insolvency law. In those transactions, two major European airlines paid materially higher rates, and had materially more restrictive terms, than less creditworthy airlines (closing transactions in the same time frame) in the US. The sole reason for such preferential US financing terms was the existence and application of section 1110 of the US bankruptcy code, a functional equivalent to Alternative A. This follows from the policies of international rating agencies, which have, based on years of data, used a system of "enhanced" rating (rating upgrades) where timely recourse to valuable aircraft collateral can be safely assumed. Based on underlying law, including insolvency law, that has been the case in the US but not in Europe.

Thus, the ratification of the Cape Town Treaty will provide UK airlines with enhanced access to international capital markets, thus diversifying their sources of funding. In particular, it will open public debt markets, providing UK airlines with another important option (in addition to bank debt and leasing, their traditional options) to help fund their capital-intensive aircraft acquisition requirements. For discussion of other commercial transactions, please see below.

Re 3.2(b): The cost of export credit is governed by the OECD's aircraft sector understanding (the "**ASU**"). Under the ASU, all OECD countries (the UK included) plus Brazil have agreed that ratification of the Treaty – with a set of "qualifying declarations" (see reply to question 3.10) – justifies a material reduction in the fee charged.[1] That decision supports the proposition that transactions in legal systems that provide higher levels of predictability and reflect the principles underlying asset based financing should be priced lower than those systems that do not. As to quantification, the size of the "Cape Town Discount" depends on the credit standing of the borrower; the weaker the credit standing (the higher the risk of default), the larger the fee reduction. Under the current terms of the ASU, the range (for large aircraft) is 20 to 150 basis points on the upfront fee charged. To give an example, a 100 basis point reduction (a "B" rated airline would receive a 94 basis point reduction) on a USD 100m aircraft financing equals USD 1m. It is noteworthy that under the ASU the terms of export credit are not attractive for spare aircraft engines. That reflects concerns about the point noted above regarding the law applicable to rights in engines.

Re 3.2(c): This question raises the general topic of the relationship between harmonised and (see reply to 3.1 above, more importantly) commercially-oriented secured financing and leasing law, on the one hand, and the cost (and terms) of such transactions, on the other. It is not possible to provide definitive and precise information on this question, for two reasons. First, many factors go into transaction pricing (and the availability of financing). These include – in addition to credit and legal risk – more general and macro considerations, such as (i) general liquidity in the financial sector and the liquidity position of a particular financial institution, (ii) the impact of regulatory capital, (iii) comparative returns from other forms of lending, (iv) competitive issues that may lead a bank to consider longer-term and relationship issues in setting price, and (v) other sources of fees payable to a bank directly or indirectly linked to that transaction or

[1] The UK, France, Germany, Spain and the US currently follow the "home market rule", which prevents export credit into these countries. The ASU is currently under review. A number of home market airlines, including some in the UK, are seeking to have this restriction eased or removed. To the extent that is agreed, the points above will apply in respect of UK carriers.

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related transactions. Secondly, confidentiality (and, possibly, competition law) considerations prevent the disclosure of terms in private financing transactions.

That said, and as noted above, the direct link between reduced transactional risk and improved pricing and other terms – all else equal – is a foundation of law and economics. It is now taken as an established fact. Elements of this thinking are seen (beyond the positions of the international rating agencies and the OECD countries, noted above) in the terms of BIS II (rules for regulatory capital) and daily decisions made by credit committees of financial institutions.

Finally, a specific word on the Treaty and "proof" of economic benefit. The extensive economic assessment and related academic work on the Cape Town Treaty has been without precedent in the field of commercial law reform. Two major studies were undertaken (see www.awg.aero), each of which took into account available information and research. The authors were of the highest possible caliber (in addition to Professor Linetsky, Northwestern University, they are Professors Anthony Saunders and Ingo Walters (INSEAD and NYU)). These academics are applied economists and finance specialists. If a higher standard than that undertaken in connection with the Treaty needs to be met, then question whether (i) any prior commercial treaty (or national law reform in this field) should ever have been adopted, or (ii) any future commercial law treaty (or national law reform in this field) will ever be adopted.

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EMBRAER LEGAL DEPARTMENT

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3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so

b) what impact do you consider these instruments will have on your sector of the aviation industry?

c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

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Reply: We make following additional comments:

(i) The UK should make a set of "qualifying declarations" under the ASU. That would be as follows: (1) non-judicial remedies, C, art 54(2), (2) IDERA, P, art XIII, and (3) Alternative A (60 calendar day waiting period, implemented through legislation).

(ii) With respect to non-consensual rights and interests, the UK should align such rights with those customary in the international community. The UK "fleet lien" is seen as out-of-line with international norms, over-reaching, and potentially harmful to airlines (restricting credit) and financiers (increasing risk). The recent GKL litigation has drawn greater attention to the problem of the UK fleet lien. Thus, a tailored declaration under C, art 39 should be agreed after a policy assessment on this matter.

(iii) We note the Department's current intent to have a second consultation on the declarations to be made and the content of the implementing legislation. We think that such is not necessary, given the clarity on what is needed to ensure the benefits of the Treaty, and the consistency thereof with leading legal thought. If it is necessary, we encourage the government to undertake and complete that second step as promptly as possible.

END

EMBRAER LEGAL DEPARTMENT

BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

Reply submitted by: **Engine Lease Finance Corporation**

Date: 08 October 2010

This is a response to the above-identified Call for Evidence (the "**CE**") in connection with the government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment (the "**Convention**" or "**C**") and the Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**" or "**P**"). The Convention and the Protocol will be referred to together as the "**Cape Town Treaty**" or "**Treaty**").

We have cut into this response the questions contained in Part III of the CE, and have set out our replies thereto below each such question.

Engine Lease Finance Corporation ("**ELFC**") is one of the world's leading large commercial aircraft engine lessors / financiers and is a wholly owned subsidiary of BTMU Capital Corporation which is itself owned by Bank of Tokyo Mitsubishi UFJ. ELFC is headquartered in Shannon, Ireland and also has personnel based in Massachusetts and Oklahoma, USA, Dublin, Ireland, the UK, Spain, Singapore and Hong Kong.

With an owned / managed portfolio of over 200 large commercial jet aircraft engines, ELFC currently leases or manages the leases of 26 such engines to 6 of the UK's leading airlines, representing more than 10% of ELFC's total portfolio.

QUESTIONS POSED AND REPLIES

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;
b) the predictability of legal outcomes;
c) the availability of finance or leasing facilities; or
d) the cost?

Reply: The internationality of aircraft and aircraft engine financing and leasing, and the consequent applicability of several non-harmonised laws, undoubtedly produce complex transactions. Legal outcomes are less predictable than they could and should be. As mentioned in CE, para 1.11, there is a particular level of uncertainty in English law due to the application of the *lex situs* rule regarding property rights in aircraft. The recent High Court judgment in *Blue Sky One Limited & O'rs v Mahan Air & Ano'r [2010] EWHC 631 (Comm)* has brought that problem into sharp focus.

All else equal, greater complexity and less predictability result in higher transaction costs than would otherwise by the case. At some point on the continuum, these factors impact the availability of financing. The foregoing is axiomatic. It is a basic tenet of law and economic theory, which is now widely-accepted in policy-making relating to secured transactions.

A prime example of such conflict of laws issues relates to rights in aircraft engines. Laws differ significantly regarding the legal effect of installing or removing engines, which, given operational requirements, could happen in any jurisdiction. In some jurisdictions, these actions impact core property rights.

Beyond conflicts, the cost and availability of financing are significantly impacted by the underlying substantive law, more specifically, any impediments caused by it affect the timely access to collateral value. Timely access to valuable collateral is the basis of secured transactions and defines the leasing model. In financial terms, timely access to valuable collateral offsets loss (that is, reduces the risk of loss (to a creditor) notwithstanding the risk of default (by a debtor)), thus producing efficiencies.

A prime example of such substantive law issues – as noted in CE para 1.11 – is delay occasioned by insolvency law. Beyond that delay, such laws may qualify or restrict contractual (and non-insolvency law) enforcement rights or impact property rights. These prospects are directly inconsistent with the core principles underlying asset-based financing and leasing.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:
- a) the rating of aircraft receivables,
- b) the cost of export credit insurance, and/or
- c) the cost of financing or leasing aircraft?

Reply: Sub-question 3.2(a) and (b) may be answered with reference to objective and publicly available information. Sub-question (c) raises methodological and confidentiality issues, and, thus, needs to be addressed based on general principles.

Re 3.2(a): "Aircraft receivables", in the context of the Treaty (which excludes general receivables financing), must refer to the rating of aircraft / aircraft engine-backed securities. The only source of publicly available information regarding their cost is public, capital markets. In the aviation industry, these securities / transactions are known as "enhanced equipment trust certificates" ("**EETCs**"). There have been few EETCs in Europe and none in the UK, given uncertainties caused by applicable underlying insolvency law. In those transactions, two major European airlines paid materially higher rates, and had materially more restrictive terms, than less creditworthy airlines (closing transactions in the same time frame) in the US. The sole reason for such preferential US financing terms was the existence and application of section 1110 of the US bankruptcy code, a functional equivalent to P, art XI (remedies on insolvency) – Alternative A (with a sixty (60) day waiting period) ("**Alternative A**"). This follows from the policies of international rating agencies, which have, based on years of data, used a system of "enhanced" rating (rating upgrades) where timely recourse to valuable aircraft collateral can be safely assumed. Based on underlying law, including insolvency law, that has been the case in the US but not in Europe.

Thus, the ratification of the Cape Town Treaty will provide UK airlines with enhanced access to international capital markets, thus diversifying their sources of funding. In particular, it will open public debt markets, providing UK airlines with another important option (in addition to bank debt and leasing, their traditional options) to help fund their capital-intensive aircraft acquisition requirements. For discussion of other commercial transactions, please see below.

Re 3.2(b): The cost of export credit is governed by the OECD's aircraft sector understanding (the "**ASU**"). Under the ASU, all OECD countries (the UK included) plus Brazil have agreed that ratification of the Treaty – with a set of "qualifying declarations" (see reply to question

3.10) – justifies a material reduction in the fee charged.[1] That decision supports the proposition that transactions in legal systems that provide higher levels of predictability and reflect the principles underlying asset based financing should be priced lower than those systems that do not. As to quantification, the size of the "Cape Town Discount" depends on the credit standing of the borrower; the weaker the credit standing (the higher the risk of default), the larger the fee reduction. It is noteworthy that under the ASU the terms of export credit are not attractive for spare aircraft engines. That reflects concerns about the point noted above regarding the law applicable to rights in engines.

Re 3.2(c): This question raises the general topic of the relationship between harmonised and (see reply to 3.1 above, more importantly) commercially-oriented secured financing and leasing law, on the one hand, and the cost (and terms) of such transactions, on the other. It is not possible to provide definitive and precise information on this question, for two reasons. First, many factors go into transaction pricing (and the availability of financing). These include – in addition to credit and legal risk – more general and macro considerations, such as (i) general liquidity in the financial sector and the liquidity position of a particular financial institution, (ii) the impact of regulatory capital, (iii) comparative returns from other forms of lending, (iv) competitive issues that may lead a bank to consider longer-term and relationship issues in setting price, and (v) other sources of fees payable to a bank directly or indirectly linked to that transaction or related transactions. Secondly, confidentiality (and, possibly, competition law) considerations prevent the disclosure of terms in private financing transactions.

That said, and as noted above, the direct link between reduced transactional risk and improved pricing and other terms – all else equal – is a foundation of law and economics. It is now taken as an established fact. Elements of this thinking are seen (beyond the positions of the international rating agencies and the OECD countries, noted above) in the terms of BIS II (rules for regulatory capital) and daily decisions made by credit committees of financial institutions.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

Reply: The terms of the Cape Town Treaty will significantly address all of the issues noted in 3.1 above. First, it will sweep away the problems associated with the *lex situs* rule. Secondly, with Alternative A, it will sweep away problems associated with insolvency delay and impairment. That, in turn, will provide UK airlines with enhanced access to international capital markets, thus diversifying and increasing their sources of funding. Thirdly, it will eliminate the above-noted legal issues associated with engine financing, though that depends on adoption by many countries. On that last point, while the Treaty is rapidly being adopted internationally, there is no doubt that UK ratification would provide a leading example to and justification for others to ratify. That would also serve the objective of the UK export community. See reply to question 3.9 below.

The Cape Town Treaty, unlike most other international legal instruments, was purposefully designed to facilitate a transaction type, thereby producing benefits to the industry sector. The core role that the aviation sector – IATA (airlines) and AWG (financiers and manufacturers) –

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[1] The UK, France, Germany, Spain and the US currently follow the "home market rule", which prevents export credit into these countries. The ASU is currently under review. A number of home market airlines, including some in the UK, are seeking to have this restriction eased or removed. To the extent that is agreed, the points above will apply in respect of UK carriers.

played in the process ensures that result. The Treaty elegantly solves the current legal issues in this field, and does so in a manner consistent with leading legal thought. There are no losers: the problems solved equally benefit debtors, creditors, and manufacturers.

3.4 Do you:

a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Reply: Re 3.4(a): The International Registry under the Treaty ("**IR**") is already recognised as both ground-breaking and well-established. Approximately half of the world's new aircraft transactions are registered in the IR. The system has run with virtually no problems since inception. There is strong supervision by ICAO. Users have direct input through an International Advisory Board.

The IR (and the above-noted priority rules) is a significant improvement over current law and practice. First, the system is electronic and low cost. It is simple and effective. Closings are made easier. Interests may be registered in advance ("prospective interests"), which takes pressure off of (expensive) closing logistics. Secondly, the priority rules are clear and objective. In the context of aviation financing, clarity equals fairness. Parties can search the IR and determine exactly where they stand. Litigation relating to "knowledge" will be avoided. There will be no need for legal gymnastics (such as priority notices), which seek to address the issues handled directly by the Treaty. Thirdly, the IR (through the Treaty) establishes priorities on an international basis. Any other system would be limited to national priorities. That is inherently inefficient, and leaves risks in transactions which can be reduced only at significant expense. In short, the Treaty, through the IR and the priority rules, puts an efficient international system in place to deal with international transactions and fact patterns.

Re 3.4(b): The treatment of engines as separate property – and, correspondingly, the ability to separately register against them – is extremely useful. In most jurisdictions, it is not possible to register interests in engines separately from interests in aircraft. As noted in reply to question 3.1, the law applicable to rights in engines varies widely, and, in some jurisdictions, is potentially prejudicial to the right of property holders. That is exacerbated by the *lex situs* problem in the engine context.

Engines are highly valuable equipment. They consistently maintain their value. They should therefore serve as excellent collateral, if the underlying law so permits. In addition, they are often separately financed (spare engines) and pooled and interchanged. From a commercial perspective, they are often hired out on a short-term basis, where strong property rights are particularly important in the absence of comprehensive contractual protections. For all these reasons, the treatment of engines under the Cape Town Treaty – as separate property to which the Treaty's clear rules apply – is a vast improvement to current law around the world. It will support advanced engine financing and use.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

Reply: As mentioned above, this is a significant advantage without any corresponding disadvantage. The absence of a required time period, and the ability to make a prospective registration, takes pressure off of closing logistics. While the priority "relates back", there is no unfairness to any party – since the registration only has priority from the time it is searchable. There are no secret interests. Any searching party can easily self-protect: all it needs to do is search the IR. It is then on notice that an interest, actual or prospective, might have a higher priority. That searching party would not close its financing transaction until the IR is cleared of any registration that could prevail over its interest.

The priority notice concept under English law aims at the same objective, but achieves it using a heavier two-step, paper-based process. The Treaty simplifies and improves the process.

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details.

Reply: We do not understand the relevance of this question – unless it is driving at providing an example and justification for other countries to ratify. See response to question 3.9. This question – what is the position (of a UK-registered aircraft) under foreign (substantive and procedural) law - would not be addressed by UK ratification. It would only be addressed by ratification by foreign countries (where the aircraft is located). And, if that is the optic, why limit the question to UK-registered aircraft? What about the position of a UK financier with a non-UK registered aircraft located elsewhere or a UK manufacturer who has problems financing sales given foreign law? These are all analytically the same: what is the position under foreign law (N.B.: In many jurisdictions, there are significant repossession and enforcement problems.)? UK ratification will not address these problems, save to the extent others are thereby encouraged to ratify. That encouragement, however, is important, given the wide range of material UK interests in international aviation.

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

Reply: This provision C, art 13 (**"Relief Pending"**), on which an opt-out is permitted (see C, art 55), and which is strengthened by an opt-in permitted under P, art X (see P, art XXX(2), was designed to provide countries opposed to non-judicial remedies with a court-based function equivalent thereof.

The UK is not such a country. English law on non-judicial remedies is well-established and effective. The international financing community is comfortable with it.

Thus, since the UK, reflecting its law, would be expected to permit non-judicial remedies through the mandatory declaration required by C, art 54(2) (permitting action "without leave of the court"), the Relief Pending provision is not necessary to reduce transactional risk or increase economic benefit in the context of the UK. The aviation community should be largely indifferent as to whether the UK, when ratifying, makes these particular declarations.

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be?

Reply: These remedies are essential. In light of the terms of the Chicago Convention of 1944, to effectively exercise remedies against an aircraft, a creditor must be able to de-register that

aircraft. The Treaty not only provides these remedies, but adds the extremely useful IDERA clause ("irrevocable deregistration and export authorization"), P, art XIII. Most countries have opted into the IDERA clause (see P, art XXX(1)). An international standard is rapidly developing in favor of the use of IDERAs. (Even countries with very efficient de-registration systems (like the US) have made the IDERA election.) Underscoring its importance, the IDERA clause is an ASU qualifying declaration. Importantly, the use of an IDERA is expressly without prejudice to safety laws and regulations.

3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so

b) what impact do you consider these instruments will have on your sector of the aviation industry?

c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

Reply:

Re 3.9(a):

The Cape Town Treaty reflects, enhances, and internationally promotes basic concepts found in English law and the UK played a central role in negotiating and drafting the instruments. The Treaty will reduce legal risk and produce economic benefit. We strongly support ratification of the Cape Town Treaty.

In connection with that ratification, it is essential that the UK implement the economically must important provision, Alternative A. Most of the economic benefits and transaction risk reduction effected by the Cape Town Treaty is predicated on the applicability that provision. See also reply to question 3.10 re ASU qualifying declarations.

Re 3.9(b): Ratification of the Cape Town Treaty (with Alternative A implemented through legislation) will reduce legal and transactional risk. It will produce economic benefit to airlines (by reducing cost and providing additional sources of financing), manufacturers (including through its impact on ratification by others, by promoting exports), and financial institutions (by reducing risk). Such direct benefits have important indirect benefits, including (from export enhancement) job creation and (from airline benefits) pass-through benefits to passengers.

UK ratification will ensure that English law remains a preferred governing law of choice in aviation finance and leasing, and that London remains central in the aviation financing and leasing industry.

Re 3.9(c): We would encourage the government to ratify the Cape Town Treaty as promptly as possible and with a high level of priority. Ratification by the UK has been delayed for a long time, given two matters unrelated to the core objectives of the Cape Town Treaty: EU competence issue and the Gibraltar-hold. These two items have finally been addressed. UK companies should start to benefit from the Treaty as promptly as possible. In addition, the recent strains on the financing sector coupled with demand for modern, environmentally friendly aircraft and aircraft engines argue for swift action to help in these areas. Finally, while the UK has not yet ratified, many UK companies still need to comply with the Cape Town Treaty (e.g., register with the IR if they (i) buy aircraft equipment from a party located in a contracting state, or (ii) lease an aircraft from a financed lessor located in a Contracting

State). In other words, aspects of compliance are already required; ratification will permit the corresponding benefit.

3.10 Do you have any other comments you would like to make?

Reply: We make following additional comments:

(i) The UK should make a set of "qualifying declarations" under the ASU. That would be as follows: (1) non-judicial remedies, C, art 54(2), (2) IDERA, P, art XIII, and (3) Alternative A, implemented through legislation).

(ii) With respect to non-consensual rights and interests, the UK should align such rights with those customary in the international community. The UK "fleet lien" is seen as out-of-line with international norms, over-reaching, and potentially harmful to airlines (restricting credit) and financiers (increasing risk). The recent case *R (on the application of Global Knafaim Leasing Ltd and another) v Civil Aviation Authority and another* has drawn greater attention to the problem of the UK fleet lien. Thus, a tailored declaration under C, art 39 should be agreed after a policy assessment on this matter.

(iii) We note the Department's current intent to have a second consultation on the declarations to be made and the content of the implementing legislation. We think that such is not necessary, given the clarity on what is needed to ensure the benefits of the Treaty, and the consistency thereof with leading legal thought. If it is necessary, we encourage the government to undertake and complete that second step as promptly as possible.

END

European Bank
for Reconstruction and Development

Mrs. Rachel Onikosi
Department of Business Innovation and Skills
Legal Services Group, Legislation & International Policy Unit
1 Victoria Street
London SW1V OET

rachel.onikosi@bis.gsi.gov.uk

London, 8 October 2010

Dear Mrs Onikosi,

Re: BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

We are writing to you in response to the letter you addressed to Frederique Dahan on 30 July 2010 requesting views in connection with the UK government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment (thereafter "Cape Town Treaty" or "Treaty"). We have been working with the Aviation Working Group for many years to disseminate the importance of the Cape Town Treaty in a number of jurisdictions and provide assistance, whenever requested, to them in the process of accession/ratification. This is in this capacity, respectively as EBRD Senior Banker responsible for aviation matters and Lead Counsel for financial law reform, that we are expressing views.

The European Bank for Reconstruction and Development (EBRD) was established in 1991 with a mandate to promote the transition from command to market economy in the countries of Central and Eastern Europe. The shareholders of the EBRD are 61 countries, including the UK, the European Union and the European Investment Bank. Since its establishment in 1991, the EBRD has become the largest financial investor in Central and Eastern Europe.

The EBRD is committed to undertaking operations throughout the region and has signed projects in each of its countries of operations. The EBRD is also committed to the promotion of transparent and efficient legal systems and has developed an important legal transition programme, with a dedicated team working on legal reforms. Through its involvement in the aviation sector, and in particular in support of Russian aircraft manufacturing, the EBRD has recognised the importance of establishing a level field for financing organisations. EBRD legal documentation is, by convention, subject to English law but for all the aspects that are likely to be subject to the *lex situs*, the EBRD obtains local law advice and prepares the documentation in compliance with local law. This applies in particular to all security rights that we would want to obtain (or that we would want our partners to have) to secure the financing. Often, the most valuable asset available is the aircraft itself.

In this respect, the EBRD has become familiar with the Cape Town Treaty since the time where it was developed and negotiated, and aknowledged that the Treaty could have a major positive impact on the conditions of financing in the aviation sector, specially in the EBRD region where the questions of existence, validity, priority and enforcement of security rights remain largely untested.

In close cooperation with the Aviation Working Group, the EBRD is currently providing technical assistance to the Russian Federation on its accession to the Treaty and have experienced first hand the importance and influence that other jurisdictions have in the process. There can be no doubt that Western countries are watched very closely by countries like Russia as a guide to the approach, including on the Treaty's declarations.

We therefore would like to express the importance of the UK decision to ratify the Treaty with all the set of "qualifying declarations" contained in the OECD's aircraft sector understanding.

We hope that these views, albeit limited, are of use to the BIS.

We remain available for any other query that you may have.

Sincerely yours,

Florence Bachelard-Bakal
Senior Banker
Banking Department

Frederique Dahan
Lead Counsel
Office of the General Counsel

GE Capital Aviation Services and its affiliated companies lease around 1,800 commercial aircraft to airlines in over 75 different countries, including the UK.

Our affiliated company, PK AirFinance, headquartered in Luxembourg and whose legal affairs I also supervise, has financed a further 400 or so commercial aircraft, again operated by airlines in the UK and worldwide.

GE Engine Leasing supplies aircraft engines to various airlines and GE Capital's Equipment Finance arm provides funding for general aviation, corporate jets and helicopters, including for example those used in the North Sea oil industry.

The Cape Town Convention and its Aircraft Equipment Protocol have therefore major significance to us.

GECAS is a member of the Aviation Working Group and the evidence, views and submissions put forward by the AWG on this subject have my full endorsement.

There are just a few extra points to add or stress:

There is considerable focus in the call for evidence document on mortgages but it is important to understand that the Convention affects leasing of aircraft too and (whilst statistics on the subject vary) there is no doubt that the vast majority of commercial airliners are subject to lease, more than mortgage and indeed in many cases, the same aircraft may be subject to mortgages and leases.

Whilst a view is sometimes expressed that the Convention / Protocol are really aimed at and will have the most impact, in developing / emerging market countries, rather than those like the UK , this overlooks and underestimates (1) the UK's leadership role, which other countries will follow and (2) the importance to the UK economy of being a centre for international dispute resolution in England under English law.

1. **Leadership**: There is no doubt that the UK's decision on ratification and its subsequent choice of declarations under the Convention and Protocol will send a signal and influence other countries, particularly those in the Commonwealth, in their own consideration of the topic. Some of those countries desperately need foreign investment in their aviation industry to update to more modern, safer and more fuel efficient aircraft. Attracting that investment will be made harder without the Cape Town Convention and its Protocol.

By way of background, last year I was asked by the Tanzanian CAA to assist it with the country's adoption of the Convention and Protocol. I was pleased and able to do that. This week I have been discussing the same point with a member of the Ugandan Ministry of Justice and Foreign Affairs. There is interest in such countries but guidance is needed and the UK has a real opportunity to help give a lead here. Conversely if the UK were to decide not to ratify, that would send a very unhelpful message, as well as incidentally leaving the UK behind other EU states like Ireland, Luxembourg and (this week) Malta who have adopted the Convention and Protocol.

2. C**hoice of English law and jurisdiction**: GECAS and PK AirFinance are not English companies but have in recent years chosen English law to govern their contracts (for transactions outside of the United States) and provided for dispute resolution before the English courts in London. This brings legal work to England. However the recent Blue Sky case, which you rightly feature strongly in the call for evidence document, demonstrates a weakness which has caused concern in the aviation finance industry and a reassessment of whether English law is really the most appropriate choice.

Blue Sky is a case in which PK AirFinance's English law mortgage over a UK registered aircraft was challenged on *lex situs* grounds in the English courts by an Iranian party who had used forged bills of sale to re-register the aircraft elsewhere. The decision that PK's English

law mortgage over an English registered aircraft, created by an English incorporated owner and registered both on the UK aircraft mortgage register and at English Companies House was invalid because the aircraft happened to be in The Netherlands at the time the mortgage was created, has caused widespread comment. At the International Bar Association Annual Conference in Vancouver this week several Dutch lawyers expressed their bemusement at the English decision; if the Dutch courts had been asked to decide on the validity of the English mortgage, the Dutch courts would have upheld the validity of the mortgage. For the English court to say it was applying Dutch law to deny the mortgage effect was seen as illogical. This is an unsatisfactory and highly non-commercial result, which adversely affects the view of the suitability of English law to determine rights over aircraft, one of the most moveable and high value of assets. The judge gave leave to appeal this point but that means more cost and as some legal commentators have already noted, had PK selected New York law and jurisdiction for example the *lex situs* would not have been relevant at all.

It would therefore be a big step in the right direction to promote certainty of English law and help support a continued choice by foreign parties for English law and jurisdiction, if the UK now ratifies the Cape Town Convention and allows for international registration of interests where the borrower, operator, lessee is an English entity.

I would be happy to discuss these points and our experience of the Convention to date with you if that would be helpful.

Yours sincerely

David Bartlett

GE
Capital Aviation Services / PK AirFinance S.a.r.l
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5 October, 2010

Rachel Onikosi
Deputy Head, Legislative and International Policy Unit
Department for Business, Innovation & Skills
1 Victoria Street
London SW1H OET

Dear Ms. Onikosi,

BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

This is a response of Goldman Sachs International to the Call for Evidence in connection with the government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment and the Protocol thereto on Matters Specific to Aircraft Equipment.

As a leading global bank, we have a keen interest in the development of international capital markets and encouraging the widest possible access to issuers and investors.

The ratification of the Cape Town Treaty will provide UK airlines with enhanced access to international capital markets, thus diversifying their sources of funding. In particular, it will open public debt markets, providing UK airlines with another important option (in addition to bank debt and leasing, their traditional options) to help fund their capital-intensive aircraft acquisition requirements.

We strongly support ratification of the Cape Town Treaty and urge the government to do so as promptly as possible and with a high level of priority. We strongly endorse the response of the Aviation Working Group dated 16 August 2010.

Yours sincerely,

James Wardlaw

cc: Jeffrey Wool, Secretary General, Aviation Working Group

Helaba Landesbank Hessen-Thüringen

The questions below have been specifically designed so that you can provide us with the necessary evidence to help us identify whether the UK should move towards ratifying the Convention and Protocol. We require this information to help inform our decisions, and for this reason ask that you answer the questions fully as possible providing any additional information that you think would be helpful.

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions; *quite highly*
b) the predictability of legal outcomes; *creates uncertainty*
c) the availability of finance or leasing facilities; or *either unavailable or more expensive*
d) the cost?

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

a) the rating of aircraft receivables, *significant effect*
b) the cost of export credit insurance, and/or *N/A*
c) the cost of financing or leasing aircraft? *Significant effect*

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1? *Very helpful.*

3.4 Do you:

a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer. *Advantage. A common system engenders confidence amongst financiers and lawyers.*

b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your

answer. *Yes. As Aircraft Engines are highly interchangeable amongst airframes such that the respective assets can be in several jurisdictions concurrently.*

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous? *No. A certain time frame would be preferable.*

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details. *No.*

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer. *Yes. It provides a financier with greater certainty in establishing his rights.*

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of deregistration
(removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be? *Very. An alternative user of the asset may need immediate use of the equipment. It also limits physical deterioration of the asset.*

3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so *Yes.*
b) what impact do you consider these instruments will have on your sector of the aviation industry? *Quite beneficial.*
c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer. *As soon as possible to provide good example to other nations considering ratification.*

3.10 Do you have any other comments you would like to make? *No.*

PARTNERS D R Baggott R A J Bedford
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E A Oldham N D O'Callaghan
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Our Ref: DB/aes

8th October 2010

By email: Rachel.onikosi@bis.gisi.gov.uk

Dear Madam

Re: Call for evidence in respect of the Convention on International Interests in mobile equipment and protocol thereto and matters specific to aircraft equipment

This response is submitted by David Baggott, solicitor, as an individual.

Background

David Baggott has specialised specifically in Aviation related matters for more than 30 years and during that period of time has acted in various transactions involving the purchase of both new and used Boeing and Airbus commercial aircraft; the sale of various commercial aircraft; the purchase and sale of both new and used Business Jets; the purchase and sale of both new and used Helicopters.

David Baggott also has extensive experience of financing and leasing (both tax based leases and operating leases) for commercial airliners, business jets and helicopters.

Response

By way of response to this call for evidence, and in answer to the questionnaire, I would say as follows:-

3.1 When transactions involving Aircraft which can and do involve businesses from different jurisdictions, whether it be way of financing or leasing, one of the fundamental aspects of the transaction which is inevitably agreed early in the

discussions or negotiations, is the law that is to apply to this particular transaction. In most transactions involving UK registered aircraft, the legal system that is held to apply is usually English law and with the English courts as having the jurisdiction in any disputes. That is because English law has become recognised as reputable and reliable and English courts are considered to be equally reputable, reliable consistent and honest, coupled with the ability to act quickly if required. In addition, English is considered to be the language of the Aviation Industry and, therefore, disputes resolved in England, using English and the English system, is felt to be an acceptable position.

This is inevitably the case even when monies are being borrowed from foreign jurisdictions, e.g. US banks; Germany banks and even in the case of leasing companies, when they lease on an operating lease basis aircraft into the United Kingdom inevitably UK law is the law that they are perfectly happy to rely upon. I would, therefore, disagree with your fundamental proposition that cross border aircraft financing and leasing potentially attract the laws of different countries with differing rules and creditors rights and the protection of security interest. The Aviation Industry is an extremely knowledgeable and sophisticated industry in which knowledgeable and experienced individuals work, both on a commercial basis and on a legal basis, and they fully appreciate the benefits of identifying the legal system and the Courts under which any disputes should be resolved.

Therefore, complexity of the transactions is irrelevant, as is the predictability of legal outcomes, the availability of finance or leasing and cost. One further point on predictability of legal outcomes is the necessity to avoid any suggestion that this Convention could prefer owners or banks to the detriment of airlines or other aircraft users.

3.2 As I do not consider any of the factors referred to in clause 3.1 apply, for the reasons stated, it follows that because English law is recognised as a stable and benign legal system that no difficulties should be experienced by people dealing with the UK on the rating of aircraft receivables; the cost of export credit insurance and/or the cost of financing or leasing aircraft.

3.3 Bearing in mind the current system that we have within the UK, and particularly with the Register of Aircraft mortgages that can also be registered at Companies House and the assistance that the CAA provides in noting interests on the aircraft register when specifically requested, I do not consider that it is necessary for the UK to move towards ratifying the Convention and Protocol. I certainly do not consider that the Convention and Protocol would help to reduce any problems (if such problems exist) where UK registered aircraft are concerned.

3.4 (a) We already have a system that recognises the registration of aircraft mortgages and the fact that interests can be acknowledged by the CAA and, therefore, I would not consider that there was any advantage in their being an international register system applicable to UK registered aircraft.

3.4 (b) There may well be benefit in a registration system for an aircraft engine separate from the airframe, but that is something that could easily be adapted and adopted by the CAA for the purpose of providing protection.

3.5 Time limits for the completion of registration of any transaction are always sensible. I, therefore, do not consider it advantageous for the Cape Town Convention to set no time limit. That merely creates uncertainty and confusion for those who might have different interests in the aircraft and with no impetus to register those interests as quickly as possible.

3.6 I have not experienced any difficulty in repossessing UK registered aircraft in a foreign country, and would go further to say that I have not experienced any difficulties whenever British aircraft that have changed registry in a country and then had to be repossessed. Previous actions on my part have proved successful, but occasionally lengthy for the purpose of securing the release and return of the aircraft.

3.7 I am not sure that this provides any benefit and believe that similar rights exist in the UK courts when, for example, seeking an interim injunction in the process of grounding an aircraft and following that with an application to recover possession.

3.8 The normal procedure when dealing with aircraft financing and leasing is for deregistration power of attorney to be provided to enable the deregistration and export of the aircraft and, therefore, the Aircraft Protocol as such is merely following the procedure and practice that already prevails within the English aviation system.

3.9 (a) No

(b) I consider that if ratification took place it would create unnecessary red tape and administrative burden on those selling, purchasing, financing and leasing aircraft in the UK and for no real purpose or benefit.

3.10 Discussing the Convention with others in, for example, the United States who now have to operate under the Convention, they find that the Convention burdens them unnecessarily and is considered a general nuisance. Please have regard for the fact that in the United Kingdom there is a sophisticated and well experienced aviation industry that has operated without in the main difficulty, certainly over the last 30 years, without the need for this Convention. I have no doubt that in other parts of the world where the industry is not as so well sophisticated and experienced that this Convention may well prove useful, but that is not sufficient reason to impose this unnecessarily burdensome Convention on the United Kingdom at a time when the present Government has pledged to reduce red tape.

Airlines have come and gone in the United Kingdom over the last 30 years or more and aircraft owners throughout that period have been able, with the benefit of the UK legal system, the registrar of aircraft mortgages, register of mortgage at Companies House and the general edict of English law, to recover possession of their assets when required.

Isolated cases no doubt cause difficulty from time to time, but they must be treated in isolation and such isolated cases should not be sufficient reason to impose on the UK aviation industry a further additional and unnecessary administrative burden.

In addition to all this, there will, of course, be cost and that cost of the registration will involve inevitably the use of lawyers or agents who themselves will make a charge. This is an unreasonable further burden to impose on airlines; those that own or operate business jets and those that own and operate helicopters.

I have heard this Convention described as a lot of hassle; the information on the system is not very helpful and apparently international interests are not considered to be mortgages.

There is even a school of thought that this Convention is anti trust as at the present time United States is a signatory to the Convention and for the people who buy Boeing aircraft with the benefit of ExIm Finance, one of the ancillary effects of registration under the Convention is that it reduces the fee that is paid or charged by ExIm Finance. I am inclined to say I do not have any personal information on that; it is merely a comment that has been made to me as I have prepared for this response.

Hopefully you find this helpful and if you require any further information or comment, please do not hesitate to get in touch.

Yours faithfully

David Baggott.

David Baggott

BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

Reply submitted by: Maples and Calder

(contact Mark Western – mark.western@maplesandcalder.com)

Date: 17th September 2010

Introduction

This is a response to the above-identified Call for Evidence (the "**CE**") in connection with HM Government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment (the "**Convention**") and the Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**"). The Convention and the Protocol will be referred to together as the "**Cape Town Treaty**" or "**Treaty**".

We have set out in this response the questions contained in Part III of the CE, and, below each such question, our reply.

The CE was forwarded to us by the Aviation Working Group ("**AWG**") which recognises the important role that Cayman Islands' entities have in international aircraft financing transactions.

Our response is given from the perspective of Cayman Islands lawyers - the Cayman Islands have a particular interest in the U.K. ratifying the Treaty and extending it to the Cayman Islands for the following reasons:

1) numerous aircraft financing transactions utilise a Cayman Islands entity ("**C.I. SPV**") in the ownership structure in order, amongst other things, to ring-fence the asset and liabilities and enhance the financiers' security position; in particular many transactions guaranteed by the European Export Credit Agencies ("**ECAs**") in support of exports of Airbus aircraft use a C.I. SPV owner of the aircraft (the ECAs comprise of the United Kingdom's Exports Credits Guarantee Department, France's Compagnie Francaise d. Assurance pour le Commerce Exterieur and Germany's Hermes Kreditversicherungs-AG) as do traditional commercial based lending in airfinance transactions;

2) Exports of Boeing aircraft supported by the Export-Import Bank of the United States ("**EXIM**") have also traditionally utilised C.I. SPVs;

3) the use of C.I. SPVs in EXIM backed financings has been reduced as a direct result of the Cayman Islands not being a party to the Treaty and the majority of that work (including the incorporation of the owner) has gone to either Delaware or Ireland;

4) as an Overseas Territory the Cayman Islands is dependent on the United Kingdom ratifying the Treaty before it can become a party to it.

The importance of implementation of the Treaty for the Cayman Islands is illustrated by the fact that a law was passed in the Cayman Islands (the "**Cape Town Law**") to recognise the Treaty as if the Cayman Islands had ratified it; however the international finance community (and especially EXIM) do not view the Cape Town Law as having similar standing to ratification of the Treaty and its extension to the Cayman Islands.

We strongly support ratification of the Cape Town Treaty and urge H.M Government to do so as promptly as possible and with a high level of priority and to extend the Treaty to the Cayman Islands with the provisions discussed below.

The Treaty as extended to the Cayman Islands should include Article XI (remedies on insolvency) applying Alternative A of this article ("**Alternative A**") as well as the other declarations highlighted in our response to 3.9 below. The aircraft financing market perceives the economic benefits and transaction risk reduction under the Treaty as being predicated on the applicability of Alternative A (with a sixty (60) day waiting period). Thus, it is essential that Alternative A apply in the Cayman Islands through its inclusion in the U.K.'s implementing legislation as extended to the Cayman Islands.

Responses

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;
b) the predictability of legal outcomes;
c) the availability of finance or leasing facilities; or
d) the cost?

Response:

a) Having to deal with conflict of law issues does make aircraft financing and leasing transactions very complex as the parties will often have to try and draft documents to deal with differing legal concepts and formalities - For example there are often differing rules for establishing priority or perfection of security granted in support of the financing; in addition financiers and lessors have to deal with the differing regimes that apply in relation to the ability to actually repossess and de-register aircraft ;

b) whenever conflict of laws issues apply they lead to unpredictability. As mentioned in CE, para 1.11, there is a particular level of uncertainty in English law (which would be highly persuasive in the Cayman Islands) due to the application of the *lex situs* rule regarding property rights in aircraft. The recent Blue Sky case highlights the problems associated with *lex situs* issues and we want to highlight the predictability (or lack thereof) issues that can arise by pointing out the following:

In the Blue Sky the case the judge (Beaton J) described one of the issues as giving:

"... rise to questions of the validity of the mortgage which in turn involves determining their applicable law and whether the English choice of law rule as to the determination of title to moveables refers to the domestic law of the relevant country or also to its private international law and its choice of law rules (the "*renvoi*" issue)."

In deciding the above issue Mr Justice Beaton stated that:

"As a matter of English law both mortgages are valid and effective. It is common ground between the Armenian experts, Messrs Babadjanian, Khzmalyan, and Mouradin, that the mortgages are valid according to Armenian law. It is also common ground between the Dutch experts, Messrs Crans Falkena and Janssen, that a Dutch court would hold that the mortgage of the third aircraft is valid because it would apply English law as the *lex registrii* at the time of the mortgage. A comment in the table setting out the different positions and the joint view of the Dutch experts states "the experts are in full agreement that a Dutch court would use the substantive law of the country where the aircraft was registered as to nationality at the time of the creation of the relevant security interest". In the case of the third aircraft this would be English law. However, they also agree that "where Dutch domestic law would apply the mortgage as contemplated in the mortgage and security assignment dated 21 December

2006 would not create a valid mortgage (hypoteck) under Dutch law." The issue is thus whether the English choice of law rule on this issue refers to the Dutch conflict of laws rules and permits the *"renvoi"* of the issue, or whether it refers to domestic Dutch law."

Beaton J then goes on to state that in Berlitz International Inc. Millett J observed ([1995] 1 WLR 978 at 1008) that the doctrine of *renvoi* has only been applied in the field of succession and to legitimation by subsequent marriage. He stated:

"It has not been applied in contract or other commercial situations. It has often been criticised, and it is probably right to describe it as largely discredited. It owes its origin to a laudable endeavour to ensure that like cases should be decided alike wherever they are decided, but it should now be recognised that this cannot be achieved by judicial mental gymnastics ***but only by international conventions***." (at 1008) (Emphasis added).

So Blue Sky itself illustrates that English law (and Cayman Islands law) needs instruments such as the Treaty in order to achieve uniformity and predictability.

c) and d) The aircraft finance and leasing markets have had to spend a tremendous amount of time and resources dealing with complex cross border legal issues; in some circumstances this has meant that airlines in often poorer jurisdictions have not been able to avail themselves of leasing or finance products without paying more for them. In all circumstances, greater complexity and less predictability results in higher transaction costs than would otherwise by the case.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

a) the rating of aircraft receivables,

b) the cost of export credit insurance, and/or

c) the cost of financing or leasing aircraft?

Response:

a) Unlike operators in the U.S., European/U.K. airlines have not been able to easily avail themselves of access to capital market instruments such as "enhanced equipment trust certificates" (**"EETCs"**) which are largely issued and rated on the value of the aircraft secured rather than the credit of the issuer. The few European airlines (and it should be noted no U.K. airline has done so) that have successfully issued EETCs (and they have often used C.I. SPVs in the structures) have had to pay far more and accept more restrictions than U.S. airlines do; the price differential reflects the uncertainty that a financier to a European/U.K. Airline has that it will be able to access the relevant aircraft as security for the debt when compared with the greater protections available in the U.S. (as a result of the protections offered under section 1110 of the U.S. Bankruptcy code). Ratification of the Treaty with Alternative A will greatly enhance the ability of airlines in the U.K. and the Overseas Territories to access cheaper funding;

b) It is relatively easy to ascertain the market view of what the difficulties referred to in 3.1 cost in respect of export credit insurance and how ratification of the Treaty will reduce those costs. In the OECD's aircraft sector understanding (the **"ASU"**) all OECD countries (the U.K. included) plus Brazil have agreed that ratification of the Treaty – with a set of "qualifying declarations" (see reply to question 3.9) – justifies a material reduction in the fee charged for obtaining export credit support. The size of the so called "Cape Town Discount" depends on the credit standing of the borrower; the weaker the credit standing (and therefore the higher of the risk of default), the larger the fee reduction. Under the current terms of the ASU, the range of discount (for large aircraft) is 20 to 150 basis points on the upfront fee charged.

c) This is a more difficult amount to actually quantify as transaction costs for these products are affected by a number of issues including the overall availability of credit in the market,

capital adequacy requirements and aircraft values; in addition very little information is publicly available about financing/lease costs - however any actions taken that reduce a financiers'/lessors' risk in relation to repossession must have a reductive effect on the costs of financing.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

Response

The terms of the Cape Town Treaty will significantly reduce the problems identified in 3.1 as it will: (i) address the problems associated with the *lex situs* rule and (ii) (if ratified incorporating Alternative A) remove insolvency delay and impairment issues.

3.4 Do you:

a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Response:

a) In evaluating the International Registry ("**IR**") we have the benefit of the fact that it is already in operation and that approximately half of the world's new aircraft transactions are registered in the IR.

The IR (and the relevant priority rules) provides a significant advantage to the alternative of national registers as it is electronic, low cost and available 24 hours a day. Utilisation of the IR has made closing aircraft transactions easier. The fact that interests may be registered in advance ("prospective interests"), allows the parties flexibility (and cost savings) in relation to closing logistics. The priority rules are clear and the objective is that all parties to an aircraft transaction can search the IR at any time and determine exactly what their rights will be. The fact that the IR (through the Treaty) establishes priorities on an international basis is a significant advantage as it is far more efficient that relying on national priority rules.

b) By allowing international interests to be registered separately against engines the Treaty very helpfully addressees a particularly thorny issue for engine financiers/lessors (be they financiers of a whole aircraft whose engines are then used on a different airframe as a result of pooling or specialists in the field of engines).

Engines are a valuable asset that are often financed/leased separately from the airframe they may be used on from time to time (for operational reasons airlines want to pool their engines or need to access spares). The financing of engines has been overly complicated by the fact that in some jurisdictions they are treated as part of the airframe to which they are attached - this has often meant that financiers/lessors of engines lose their property rights in the asset they are financing or leasing which is inequitable and leads to higher risk and hence costs for airlines.

Allowing for separate registrations in respect of Engines means that engine financiers/lessors will no longer have to try and utilise artificial devices such as "recognition of rights

agreements" ("**RORAs**") to try and protect themselves. RORAs are a series of undertakings between persons interested in engines used by an airline to respect each other rights to specific engines. The main problem with RORAs is that they may only equate to a contractual obligation that may be frustrated by the insolvency of a counterparty and so they are very inferior to the rights that the Treaty would establish in respect of engines.

3.5 *The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?*

Response

This is very advantageous as the absence of a stipulated time period and the ability to make a prospective registration allows the parties much needed flexibility in relation to closings. It should be remembered that aircraft transactions often span multiple jurisdictions and time zones and so anything that allows for the time at which a closing may occur to be as great as possible open-ended helps the transaction and reduces cost. As an interest only has priority from the time it is searchable no party is disadvantaged because all someone needs to do is to search the IR to ascertain if something is registered; if the search reveals an entry that may have a higher priority then the searching party would have then it will not close its transaction until the IR is cleared of any registration that could prevail over its interest.

Both Cayman Islands and English law recognises the need for some type of protection of prospective interests through the utilisation of priority notices for mortgages over aircraft; which are registered in each respective jurisdiction. However, both countries currently use a two-step, paper-based approach rather than the simpler process that the Treaty establishes.

3.6 *Do you know of difficulties experienced in (a) repossessing U.K. registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details.*

Response:

We leave it to English law practitioners to respond to this issue.

3.7 *The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.*

Response:

We understand from other commentators that this provision was included in the Convention in order to provide countries opposed to non-judicial remedies with a court-based, functional equivalent thereof.

Neither the Cayman Islands nor the U.K. is such a country and English and Cayman Islands law (which closely follows English law), on non-judicial remedies is well-established and effective; therefore the aviation community should be largely indifferent as to whether the U.K., when ratifying, makes these particular declarations. We would however expect that the declaration required by the Convention, part 54(2)(permitting action "without leave of the court"), would be applied to the Treaty as extended to the Cayman Islands.

3.8 *The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be?*

Response :

A financier/lessor would view the ability to de-register as essential because of the terms of the Chicago Convention of 1944, which means that to effectively exercise remedies against an aircraft, a creditor must be able to de-register that aircraft before being able to deploy and register it elsewhere. If the aircraft is not deregistered it is effectively worthless as it will lose the associated airworthiness certificate and therefore it is unlikely that it can be operated. We would also support the use of the provisions set out in Part XIII of the Treaty in respect of IDERAs or "irrevocable deregistration and export authorization". It should be noted that most countries which have ratified the Convention (including the United States which already has an efficient de-registration system) have opted into using IDERAs and that utilisation of IDERAs is a prerequisite to obtaining the Cape Town Discount under the ASU.

3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so

b) what impact do you consider these instruments will have on your sector of the aviation industry?

c) if the answer to question 3.9(a) is yes, within what time scale should the U.K. proceed to ratification? Please give reasons for your answer.

Response:

a) ***We strongly support ratification of the Cape Town Treaty and its extension to the Cayman Islands.***

As stated in the introduction, the Treaty as extended to the Cayman Islands must include the economically most important provision, Part XI (remedies on insolvency) – **Alternative A** (with a sixty (60) day waiting period) as most of the economic benefits and transaction risk reduction effected by the Cape Town Treaty are predicated on the applicability of that provision.

b) Ratification of the Cape Town Treaty (with Part XI, Alternative A implemented through legislation) will reduce legal and transactional risk and therefore will produce economic benefit to airlines (by reducing cost and providing more availability of financing), manufacturers (including through its impact on ratification by others, and by promoting exports), and financial institutions (by reducing risk). These interests, including export interests, also have the job creation benefits. Extension of the Treaty to the Cayman Islands will allow C.I. SPVs to continue to be used in relation to aircraft financings and to support the aircraft industry.

c) ***We would urge the government to ratify as promptly as possible and extend the Treaty to the Cayman Islands.***

Ratification will support the continued use of both English law as the governing law of the transaction and C.I. SPVs in international airfinance transactions. The use of C.I. SPVs in EXIM transactions has been seriously effected by the fact that the Cayman Islands is not a party to the Treaty.

Even if the U.K. is not willing to ratify promptly we would strongly urge them to engage with the Cayman Islands Government in order to put in place a mechanism by which the Cayman Islands can be made a party to the Treaty as soon as possible.

3.10 Do you have any other comments you would like to make?

Response:

The Treaty is earning global appeal for the reasons outlined above. Countries which do not ratify are likely to be (and indeed are already finding themselves) at a competitive disadvantage, with negative knock on effects to their economy and business community.

Moreover, it is essential that the Treaty as extended to the Cayman Islands includes the "qualifying declarations" set out in the ASU which are as follows:

(1) non-judicial remedies, Part 54(2),

(2) IDERA, Part XIII; and

(3) Alternative A (60 calendar day waiting period, implemented through legislation).

If you wish to discuss the above please do not hesitate to contact Mark Western who is based in our Hong Kong office and whose contact details are below:

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Natixis Transport Finance

I am answering this on behalf of Natixis Transport Finance, French Bank dedicated to aircraft financing.

Question 3.1: This affects a), b) and d): Lending to an entity - or for the final benefit of an airline - which is based in a country were the Cape Town Convention has been ratified can enable the bank to look at a financing that it could not have looked at without Cape Town Convention: for instance in countries where the jurisdiction is not favourable to creditors if a repossession process needs to be set up, following a default payment of the airline.

Question 3.2: b) Export Credit Insurance can thus be more expensive: the more complicated and the less favourable the jurisdiction, the most expensive the up front premium of the ECAs

c) As for ECAs, the more complicated and the less favourable the jurisdiction, the more expensive the commercial debt available to the airlines and the less aircraft financing proposals they will receive.

Question 3.3: Please see 3.1

Question 3.4: a) It is an advantage for both the airline and the bank because it enables the airline to get better financing conditions and the banks better securities and the insurance that their securities will be better recognized

b) It is helpful because banks sometimes only finance engines and engines are movable parts. So it is helpful to separate the different movable parts of the aircraft, all the more since, at the end of the economic life of an aircraft, the engine represent the most important value the aircraft contains.

Question 3.5 NA

Question 3.6 Yes, we know that some operating lessors and banks might have had issues to repossess in the past (especially in non cooperative jurisdiction) and thus we think the Cape Town Convention is a good thing in the aircraft financing industry (recognized by the ECAs since their up front premium are lower when the state in which the aircraft are registered has ratified Cape Town). Cape Town will certainly favour British airlines which wish to get financings for their aircraft both in terms of volume and pricing.

Question 3.7 Yes this is useful. On a bank's perspective, if your client (the airline) is in default, you will want to have access to your security (the airframe + engines) as soon as possible. If the Cape Town Convention enables you to shorten the timing during which you cannot exercise your securities, it is obviously very useful.

Question 3.8 NA

Question 3.9 a) Yes indeed

b) Positive impact enabling (1) certain airlines to have access to financings (for airline based in difficult jurisdiction where a local law mortgage is difficultly enforceable) and (2) other airlines to benefit from better funding sources (for instance, lower ECA premium). Also, the more securities banks have on the assets they finance, the less equity they will have to mobilize in their Balance Sheet to comply with the local regulations (Basel II, III...) and thus the more competitive their pricing will be which will lead for the airline to better margins and advance levels on their loans.

c) As soon as practicable

Question 3.10 We thank you for having asked us our opinion. We remain at your disposal should you have any additional question.

NORTON ROSE

9 September 2010

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By courier
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Your reference

Our reference
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Direct line
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Email
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Dear Rachel

I am replying on behalf of Norton Rose LLP to the DBIS's Call for Evidence (**CE**) in relation to the possible ratification by the United Kingdom of the Convention on International Interests in Mobile Equipment and the Protocol on Matters Specific to Aircraft Equipment (together the Convention).

Norton Rose LLP is an international law firm and a market leader in aviation finance. We represent a large number of airlines (including easyJet and Flybe), lessors and banks. We are also on the panel of law firms that represent the Export Credits Guarantee Department (ECGD) in aviation finance matters. However the views expressed below are our own and not necessarily those of our clients. This reply has been prepared following consultation with the partners in the firm who are active in this field.

We are members of the Legal Advisory Panel to the Aviation Working Group (**AWG**). The AWG has replied to you separately and we have indicated below where we agree with their views.

As lawyers, we do not believe that we are qualified to comment on the possible effect of the Convention's ratification by the United Kingdom on overall finance costs for airlines or on lease rates actually made available to airlines in this country.

We note that the CE does not request our views on the desirability or otherwise of the United Kingdom adopting Alternative A. The AWG has, however, covered this issue at length in their reply and we therefore make a short comment on this issue. We are not aware of any empirical evidence as to the effect that the ratification of the Convention with Alternative A has had on overall finance costs for airlines or on lease rates for airlines in countries that have done so. Any such benefits would need to be weighed against the loss of the benefits to airlines in the United Kingdom of the administration process.

However, we do believe that the ratification by the United Kingdom of the Convention, even without Alternative A (if that is what the Government were to decide to do), would bring significant benefits for the reasons described below.

Replying to the questions raised in the CE:

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;
b) the predictability of legal outcomes;
c) the availability of finance or leasing facilities; or
d) the cost?

Deputy Head, Legislative and International Policy Unit

9 September 2010

We agree with the replies of the AWG.

We would add that, under the provisions of the Basel 2 Accord on the International Convergence of Capital Measurement and Capital Standards and its enabling legislation in the United Kingdom, banks wishing to rely on the availability of security over aircraft to reduce the capital charge for any financing loan need to establish that they have legally effective and enforceable security over the aircraft in every relevant jurisdiction. That different jurisdictions have different rules as to how such security can be created makes this difficult, if not impossible, to establish in certain transactions.

If banks cannot claim appropriate capital relief for aircraft security, it is inevitable that the costs of the financing will rise.

The CE mentions the Blue Sky case. Another recent case decided by the High Court (Celestial Aviation Trading 71 Ltd v Paramount Airways Private Ltd [2010] All ER (D) 146) held (obiter) that relief from forfeiture might be a defence available to airline lessees under finance leases. This adds to the unpredictability of legal outcomes. Finance leases, negotiated between airlines and banks, by their terms permit lessors to terminate leases and repossess aircraft following the occurrence of an event of default. It will add to the uncertainty as to the effectiveness of finance leases as instruments of quasi-security if these contractual rights can be overridden by the court's equitable discretion. This is a problem that would be resolved by the Convention's ratification.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:
a) the rating of aircraft receivables,
b) the cost of export credit insurance, and/or
c) the cost of financing or leasing aircraft?

Paragraph (a): we have no comment. We would recommend consultation with a ratings agency on this issue.

Paragraph (b): we agree with the reply of the AWG but note that the "Cape Town Discount" applies to the minimum guarantee fee chargeable by an export credit agency. Whether that discount is actually applied depends on the identity of the agency. We also note that currently export credit financing for Airbus and Boeing aircraft is not available to UK airlines under the so-called Home Countries rule (though we understand that this is currently being discussed by the export credit agencies). We would recommend consultation with ECGD on this issue.

Paragraph (c): we agree with the reply of the AWG and also refer to our comments on Basel 2 set out at 3.1 above.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

We agree with the reply of the AWG save that we make no comment as to the desirability or otherwise of Alternative A.

3.4 Do you:
a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.
b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

We agree with the reply of the AWG.

In addition we would emphasise the benefit of separate registration of engines for those parties involved in the financing of spare engines, both lessors and lessees. Because of the property rights issues affecting title to engines identified by the AWG in their reply, this type of financing has historically been treated as effectively unsecured. To the extent that the Convention applies and lessors/financiers can track their interests in specific equipment, this enables these transactions to be properly secured and treated as such for Basel 2 purposes for the benefit of financiers and airlines alike.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

We agree with the reply of the AWG.

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details.

We have extensive experience of repossessing aircraft in many jurisdictions. Whatever problems we have encountered tend to be caused by the jurisdiction where the aircraft is located at the relevant time rather than by the state where it is registered.

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

We agree with the reply of the AWG.

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be?

We believe that these are valuable remedies although we are unaware of any situation in which lessors or financiers have actually needed to avail themselves of these in the United Kingdom.

3.9 In light of your answers to the above questions:
a) do you favour ratification of the Convention and Protocol; if so
b) what impact do you consider these instruments will have on your sector of the aviation industry?
c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

We support the ratification of the Convention by the United Kingdom but, as explained above, make no comment on the importance or otherwise of Alternative A.

We make the additional comment that, given the frequency with which English law is used to govern contracts in the field of aircraft finance, it would be highly desirable for it to conform with prevailing international practice which we believe would be consistent with its ratification.

We agree with the AWG in their replies to paragraphs (b) and (c).

3.10 Do you have any other comments you would like to make?

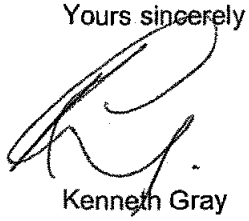
No.

Deputy Head, Legislative and International Policy Unit

9 September 2010

We are grateful for the opportunity to reply to the Call for Evidence and remain available to discuss any of the issues raised in this letter with you if you so wish.

Yours sincerely



Kenneth Gray

Response by Rolls-Royce plc (*Rolls-Royce*) to Department for Business Innovation and Skills Call for Evidence on the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment dated July 2010

Rolls-Royce sets out its views below on the questions posed by the Department for Business, Innovation and Skills (**BIS**) in its Call for Evidence on the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (referred to in this note as the **Convention** and the **Protocol** and together as the **Cape Town Convention**). We strongly support ratification of the Cape Town Convention and urge the government to do so as promptly as possible and with a high level of priority. We are happy to provide any further information or participate in discussions with BIS on these matters.

It is helpful to set out details of our business as background to our responses. Rolls-Royce is a world-leading provider of power systems, gas turbines and services for use on land, at sea and in the air, operating in four global markets – Civil Aerospace, Defence Aerospace, Marine and Energy. Rolls-Royce has four roles in the aircraft industry where ratification of the Cape Town Convention would be beneficial: as manufacturer; as financier, as lessor and as borrower.

As manufacturer Rolls-Royce civil aerospace engines power over 30 different types of major commercial aircraft, with a fleet of over 13,000 engines in service and a market share of over 30%. Rolls-Royce is a significant exporter of UK manufactured products and a key employer in the UK economy.

As financier Rolls-Royce frequently agrees to provide backstop financing for airlines whereby Rolls-Royce finances the purchase of aircraft and engines by airlines if they are unable to locate funding in the commercial 7market.

As lessor Rolls-Royce has a 50% shareholding in the world's second largest engine lessor, Rolls-Royce Partners Finance Limited (**RRPF**). RRPF has a portfolio of approximately 300 aircraft engines with a combined value in excess of US$1.5 billion. Rolls-Royce also has shareholdings in other engine leasing joint ventures.

As borrower, both RRPF and other engine leasing joint ventures source bank and capital markets funding, using engines as security collateral.

Our responses to the questions posed by BIS in its Call for Evidence reflect our experience in the aircraft industry as manufacturer, financier, lessor and borrower.

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

(a) the complexity of the transactions
(b) the predictability of legal outcomes
(c) the availability of finance or leasing facilities
(d) the cost?

In our experience the ability of cross border aircraft financing and leasing to potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests significantly affects the complexity of transactions, predictability of legal outcomes, the availability of finance or leasing facilities and the cost involved. There are three issues in this respect: the lex situs rule; recovery in insolvency; and accession of title to engines.

Aircraft and engine repossession rights are governed by the law of the jurisdiction in which the aircraft object is situated (lex situs) at the time of repossession. Aircraft are highly moveable assets and legal rights and remedies, and the time period and costs involved in repossessing an aircraft object vary considerably between different legal systems. It is

therefore difficult for financiers and lessors to be certain as to the legal rights and remedies available, or the time period for recovery of aircraft objects, following default by an airline, resulting in uncertainty and unpredictability of outcomes.

Financiers' and lessors' rights and ability to recover financed or leased aircraft objects on insolvency of an airline vary from jurisdiction to jurisdiction. In the majority of jurisdictions financiers and lessors can not be clear as to the time period for repossession of aircraft objects. This uncertainty results in increased financing and leasing costs as financiers and lessors seek to price this risk into transactions. This risk is addressed in a few jurisdictions, such as the US, where section 1110 of the US bankruptcy code requires the insolvency administrator, by the end of a sixty day waiting period, to either give possession of aircraft or aircraft engines to the secured party with a security interest over that aircraft or aircraft engine, or to cure all defaults and to agree to perform all future obligations under the relevant agreement. Such legislation gives certainty as to the time period for repossession of aircraft and aircraft engines. However, the vast majority of jurisdictions, including the UK, do not have such protections for financiers and lessors of aircraft, giving rise to uncertainty and unpredictability of outcomes.

In addition, in certain jurisdictions (for example, the Netherlands), title to engines installed on an airframe becomes vested in the owner and/or mortgagee of the airframe merely by the fact of installation of those engines on the host airframe. Financiers and lessors of spare engines (or aircraft from which the original engines are removed and installed on another airframe) may therefore lose title to engines installed on airframes. Engines are frequently installed on different airframes and there is a significant risk that title to an engine accede to another owner or mortgagee, thereby preventing or delaying repossession. Financiers and lessors seek to mitigate these risks by obtaining recognition of rights agreements (RORAs) from the owners and mortgagees of host airframes; however, the need to obtain RORAs, potentially from many owners and mortgagees, adds complexity, delay and costs to transactions.

Aircraft financiers and lessors therefore face uncertainty as to their ability to protect their legal rights and interests and the time period for recovery of collateral. Legal outcomes are unpredictable. The unpredictability of legal outcomes leads to greater complexity in transactions as parties seek to minimise that risk – for example by implementing complicated and costly financing structures. This uncertainty and unpredictability reduces the availability of financing, particularly from the capital markets. Pricing of aircraft financing and leasing reflects this uncertainty, resulting in increased costs for borrowers.

Of these three issues, the lex situs rule and accession of title to engines issues are more acute in engine financing. In many jurisdictions it is not possible to register interests such as leases of or mortgages over aircraft engines with the aviation authority, meaning it is impossible or very difficult to grant effective security over aircraft engines. This results in higher funding costs, as banks seek to reflect the increased risk in their ability to repossess aircraft assets by increased pricing. The recovery in insolvency issue is identical in respect of engines as for aircraft. The accession of title to engines issue is a significant issue in respect of engine financing and leasing: an engine lessor or financier risks losing his entire collateral through accession of title to engines.

The Cape Town Convention solves the lex situs rule, recovery in insolvency rule and accession of title to engines issues and it is important that the UK ratifies the Cape Town Convention in order to address these issues, thereby reducing the complexity and unpredictability of outcomes in aircraft finance transactions, increasing availability of finance and leasing facilities and reducing cost.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

(a) the rating of aircraft receivables;
(b) the cost of export credit insurance; and
(c) the cost of financing or leasing aircraft.

We are not personally familiar with the rating of aircraft receivables. However, the rating of aircraft-backed securities (enhanced equipment trust certificates or EETCs) is publicly available. These indicate that pricing of EETCs issued by European airlines has been higher than those issued by lower rated US airlines. This is thought to be as a result of enhanced creditor protection through section 1110 of the US bankruptcy code, which addresses the recovery in insolvency issue identified above.

The difficulties identified in our response to question 3.1 clearly affect the cost of export credit insurance. This is reflected in the discounts given by export credit agencies where these difficulties are addressed through ratification by the relevant country of the Cape Town Convention. Under the Aircraft Sector Understanding (ASU) export credit agencies in the OECD and Brazil offer significantly lower priced credit insurance (between 20-150 bps, depending on the creditworthiness of the airline) where an airline is situated in a country which has ratified the Cape Town Convention.

We consider that the difficulties identified in our response to question 3.1 significantly increase the cost of financing or leasing aircraft. The cost of aircraft finance and leasing reflects the risks involved, and the uncertainties in aircraft finance and leasing are reflected by increased pricing.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

We consider that the Convention and Protocol would reduce to a significant extent the three issues (lex situs rule, recovery in insolvency and accession of title to engines) identified in our answer to question 3.1.

The Convention and Protocol create a simple and inexpensive way to register mortgages and leases of aircraft objects. Mortgages and leases registered with the International Registry are recognised by banks and financial institutions as creating fully perfected security, resulting in greater availability and cheaper funding. International interests registered with the International Registry are recognised by other jurisdictions which have ratified the Cape Town Convention, thereby removing the uncertainties arising from the lex situs rule.

The Cape Town Convention allows Contracting States to address the recovery in insolvency issue by opting for a special insolvency regime in relation to aircraft objects. Under Article XI of the Protocol Contracting States may choose Alternative A or Alternative B as regards remedies on insolvency, or alternatively Contracting States may make no declaration under Article XI, in which case national insolvency law applies.

Alternative A requires the insolvency administrator, by the end of a waiting period specified by the Contracting State in its declaration, where a creditor has a international interest over an aircraft object registered with the International Registry, to either cure all defaults and agree to perform all future obligations under the relevant agreement or to give possession of the aircraft object to the creditor. This is functionally equivalent to the protections given by section 1110 of the US bankruptcy code. Alternative A gives creditors certainty by ensuring that within a specified and binding time-limit the creditor either secures recovery of the aircraft object or obtains a curing of all past defaults and a commitment to perform the debtor's future obligations. The debtor and other creditors are not disadvantaged by the rights of aircraft financiers and lessors under Alternative A provided the waiting period is sufficient to allow the debtor or insolvency practitioner to consider restructuring options for an insolvent airline or lessor.

Alternative B requires the insolvency administrator, by the end of a waiting period specified by the Contracting State in its declaration, where a creditors has a international interest over an aircraft object registered with the International Registry, to either cure all defaults and to agree to perform all future obligations under the relevant agreement or to give possession of the aircraft object to the creditor subject to any additional step or the provision of any additional

guarantee that the court may require as permitted by applicable law. Under Alternative B recovery of aircraft objects by a creditor may depend upon a discretion exercised by the national court in accordance with applicable domestic law. English law imposes moratoria in insolvency procedures, including liquidations and administration, such that an aircraft financier or lessor would require court or insolvency practitioner consent in order to repossess an aircraft object. There is no time limit under Alternative B for assumption of the agreement or return of the aircraft object. Alternative B does not resolve the recovery in insolvency issue.

A Contracting State may opt to apply Alternative A or Alternative B to all types of insolvency proceeding or only to some, and it may apply Alternative A to some types of insolvency proceeding and Alternative B to others, or apply one of these alternatives to all or only some types of insolvency proceeding and make no declaration to others (in which case national insolvency law will apply). The majority of Contracting States have applied Alternative A to all types of insolvency proceeding. We recommend that the UK apply Alternative A though alignment of national law with Alternative A to all types of insolvency declaration, with a sixty day waiting period, which is consistent with that adopted by the majority of other Contracting States.

The Cape Town Convention removes the accession of title to engines issue by allowing aircraft lessors and financiers to register international interests with the International Registry, evidencing title to and security interests over engines. Registration of international interests with the International Registry overrides local law as to title preservation, thereby protecting the interest of engine lessors and financiers against the risk of accession of title to engines.

Ratification of the Cape Town Convention by the UK will not only assist in resolving these issues where there is a direct link to the UK, but will also set an example to other countries. Both ratification of the Cape Town Convention by the UK and global ratification will have significant benefits for our business, the aircraft industry and the economy generally. Cheaper and more available funding allows airlines to purchase more and newer aircraft equipment, encouraging the manufacture and export of UK manufactured aircraft assets such as Rolls-Royce engines. Cheaper and more available funding reduces operating costs for UK-based airlines and lessors and therefore greater competitiveness of UK-based airlines and lessors in the global marketplace.

3.4 Do you:

(a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

We consider that the International Registry system is an advantage. The International Registry is easy and cheap to use. The International Registry is available online and filings can be made, and searches carried out, simply and quickly, 24/7. International interests registered on the International Registry are recognised by financiers and lessors as creating effective security interests, resulting in greater availability of funding and cheaper financing. Interested parties can quickly and easily check international interests registered against aircraft objects and parties can be certain as to interests over aircraft objects.

The International Registry has significant advantages over local aircraft registries. Aircraft registers tend to be open only during business hours in the relevant jurisdiction, potentially requiring expensive and inconvenient closing processes to ensure that aircraft transactions occur during the opening hours of the relevant aircraft register. Prospective interests can be registered in advance which further facilitates closing of transactions.

(b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Yes, we find this very helpful. As noted in our response to question 3.1, the lex situs rule; recovery in insolvency; and accession of title to engines issues are problematic for aircraft, and even more so for engines. Registration of international interests against an aircraft engine enables a financier/lessor to protect its interests by registration of an international interest with the International Registry and to protect against the risk of accession of title to engines. Adoption of Alternative A enables financiers and lessors to have clear legal rights within a specified time period.

Ratification of the Cape Town Convention would result in lower pricing and increased availability of funding for aircraft engine financing. We would quantify this in the region of 50-150 bps, a significant differential. Engine lessors based in jurisdictions which have ratified the Cape Town Convention have a competitive advantage through access to more available and cheaper funding, a significant disincentive for engine lessors to be based in the UK.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

We believe that this offers an advantage; however in our experience of engine financings and leasing filings with the International Registry are made simultaneously with creation of the relevant interest.

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b) exercising other default remedies over such assets in a foreign country. If so, please give details.

Repossession of UK registered aircraft or exercise of other default remedies over UK registered aircraft outside the UK is rare. Aircraft registered on the UK aircraft register are likely to return regularly to the UK. As the UK is a country where repossession is relatively easy, quick and inexpensive, creditors generally tend to favour repossession of UK registered aircraft and exercise of other default remedies over UK registered aircraft in the UK. We are not aware of any specific examples of repossession of UK registered aircraft situated in a foreign country.

This question is also largely irrelevant to the question of whether the UK should ratify the Cape Town Convention. The value in the UK ratifying the Cape Town Convention is the ability for creditors to register interests on the International Registry, which are then recognised by other Contracting States. This is only indirectly affected by UK ratification of the Cape Town Convention through the fact that ratification of the Cape Town Convention by the UK may influence other countries in deciding to ratify the Cape Town Convention. Ratification of the Cape Town Convention by other countries then protects title to and security interests over aircraft objects and greatly facilitates repossession of aircraft objects located in those countries at the time of repossession.

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

In a number of jurisdictions it is necessary to repossess aircraft via court procedures. In the UK it is possible to exercise self-help remedies outside insolvency and it is not necessary to obtain a court declaration to repossess aircraft. The ability of creditors to obtain early judicial relief is therefore of limited benefit in the UK.

3.8. The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register) and export. How useful do you consider these additional remedies to be?

We consider that the remedies of de-registration and export are essential. In repossessing an aircraft or engine it is important for the creditor to redeploy the asset as quickly and easily as possible. De-registration and export of the aircraft or engine allows a sale or lease of the aircraft or engine to occur – without these remedies the creditor simply has an asset which it is unable to deploy and therefore has limited value.

3.9. In light of your answers to the above questions:

(a) do you favour ratification of the Convention and Protocol; if so
(b) what impact do you consider these instruments will have on your sector of the aviation industry.
(c) If the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

We strongly favour ratification of the Cape Town Convention. We consider that ratification of the Cape Town Convention will have a significant positive impact on availability and pricing of financing, particularly in relation to engine leasing and financing, with no drawbacks. Accordingly we believe the Cape Town Convention should be ratified as promptly as possible by the United Kingdom. We consider that the UK should adopt national law equivalent to Alternative A of Article XI of the Protocol thereto on Matters Specific to Aircraft Equipment, with a sixty day waiting period.

We consider that ratification of the Cape Town Convention will benefit all participants in the aircraft and engine industry, and will assist in encouraging UK exports and making the UK an attractive location for airlines and lessors.

Failure to ratify the Cape Town Convention, including Alternative A, will result in serious disadvantages for airlines and lessors based in the UK and a loss of competitiveness of UK PLC in the global marketplace.

3.10 Do you have any other comments you would like to make?

We would also like to add that we do not believe that a second consultation on the details of legal opinions and the changes required to UK law is necessary.

We are happy to provide any further information or participate in discussions with BIS on these matters.

RBS
The Royal Bank of Scotland

8 October 2010

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BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

Dear Ms. Onikosi,

This is a response to the above Call for Evidence (**"CE"**) in connection with the UK government's assessment of whether to ratify the Convention on International Interests in Mobile Equipment (the **"Convention"**) and the Protocol thereto on Matters Specific to Aircraft Equipment (the **"Protocol"**, and together with the Convention, the **"Cape Town Treaty"**).

RBS Aviation Capital ("RBS AC")

RBS AC is the division within RBS Group plc that is responsible for the secured financing and operating leasing of commercial jet aircraft. Currently, RBS AC owns an operating lease portfolio of 214 aircraft (primarily through its Irish incorporated subsidiary, RBS Aerospace Limited) and has a debt portfolio secured against over 300 aircraft. The combined debt and operating lease book is STG£7.8 bn. RBS AC is the third largest aircraft lessor in the world by fleet value.

RBS AC leases aircraft to, or is involved, as a lender, in transactions with over 100 airlines in 40 different jurisdictions across the world. Our business operations and transaction experience mean that we have significant knowledge of the issues related to complex, high-value cross-border transactions involving aircraft and engines. For example, in 2007, RBS AC closed a transaction whereby it sold 36 aircraft on lease to 23 lessees based in 16 jurisdictions to a securitisation vehicle, which issued US$1.1bn in asset-backed notes, in a limited (144A) offering and US$280m equity notes in a private placement.

RBS AC is a member of the Aviation Working Group (**"AWG"**) and this letter is in support of the response of the AWG to the CE, dated 16 August 2010 (the **"AWG Response"**).

As per the AWG Response, we strongly support ratification of the Cape Town Treaty and urge the UK government to do so as promptly as possible, with a high level of priority. In addition to the arguments raised in the AWG response, our separate response also outlines matters which we encourage you to consider in your assessment.

We note BIS' willingness to meet to discuss these matters. We would like to do so, either through the AWG or separately.

Yours faithfully,

Peter Barrett
Chief Executive Officer,
RBS Aviation Capital

RBS AC Response to Part III of CE (Questionnaire)

For ease of review, we set out the relevant question in Part III of the CE prior to our reply to each question.

3.1. *Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:*

a) the complexity of the transactions;

b) the predictability of legal outcomes;

c) the availability of finance or leasing facilities; or

d) the cost?

Aircraft transactions are undoubtedly more complex than pure "domestic" transactions, in respect of the number of different legal regimes which could apply at any time during the transaction term. For example, the most straightforward aircraft lease financing transaction may involve the following regimes:

A lessor/financier (the **"creditor"**) located in State A may lease/advance a loan to an airline based in State B. The parties may choose the laws of State C to govern the transaction documents (and submit to the jurisdiction of the courts of State C).

Although aircraft will typically be registered in the jurisdiction of the airline, i.e. State B[1], for various reasons, including concerns about the creditor's ability to de-register and export the aircraft from such jurisdiction, the parties may seek to register the aircraft in another jurisdiction (e.g. State D).

On closing of the transaction, when title to the aircraft transfers to the owner and security is granted to the creditor for its lease investment/loan (which will often include a mortgage or similar security interest over the aircraft), the aircraft may be located in any state (State X). Depending on the airline's operations, the aircraft may be located in or over any number of jurisdictions at any time during the transaction, including temporarily located in a particular jurisdiction for maintenance or registered there under a sub-lease (State Y).

To a greater or lesser extent, the laws and jurisdictional rules and procedures of each of these states will be relevant in determining the rights and remedies of the parties, including third party interests, at any given time.

For example, on a default, depending on the specific fact pattern at the time, the creditor will need to decide (very quickly, as experience shows that speed is of the essence in possessing the aircraft and preserving the collateral value) on its options, in respect of trying to enforce its security and/or to issue proceedings, whether in State Y (where the aircraft is located at the time of default), State B (as the jurisdiction of incorporation of the airline, or possibly another state[2]), State B/D (as the jurisdiction of the aircraft's registration, particularly as it will need to de-register the aircraft from there in order to sell or re-lease it) or State C (as the governing jurisdiction for disputes under the transaction documents; e.g. by obtaining judgment from State C courts and

[1] National registration of commercial passenger aircraft is a requirement under the Chicago Convention on International Civil Aviation.

[2] Proceedings may need to be taken in a state other than the airline's state of incorporation, depending on the airline's residence or domicile (or, in the language of the EU insolvency rules, its centre of main interests ("COMI")) and where the aircraft is located or registered at the onset of insolvency, the laws of any number of states may be relevant.

then seeking to have such judgment recognised in State B/D or Y). If the airline is insolvent, the creditor's options will be dictated by the insolvency rules of the jurisdiction in which insolvency proceedings have arisen and all this must be analysed by the creditor (again, very quickly).

With regard to Questions 3 (a) and (b), it is fairly clear from the above example, that an increase in the number of different laws and jurisdictions that may be involved in a specific transaction will usually mean a corresponding increase in the transaction complexity and a decrease in the predictability of legal outcomes. While the parties can identify, analyse and mitigate against certain of the legal regimes above, e.g. State A, State B, State C, State D, and State X, this process is often complicated and therefore adds to the overall transaction cost, whether in terms of initial due diligence (associated time and expense) or the risk assumed by the parties.

With regard to Questions 3.1 (c) and (d), timely access to valuable collateral is the basis of secured transactions and defines the leasing model. In financial terms timely access to the collateral enables the creditor to protect its value and offset loss by redeploying the aircraft without delay. A reduction in the risk of loss to the creditor (notwithstanding the risk of default of the debtor) produces efficiencies that can impact the cost and availability of financing or leasing facilities.

Restrictions on the creditor's options on a default, delays caused by insolvency law and/or by laws that qualify and restrict contractual (and non-insolvency) enforcement rights drive up the economic cost of financing or leasing aircraft. These costs will be passed down to an extent to the airlines and other operators, by way of increased lease rates and loan pricing. In some cases the potential risks will be unacceptable to the creditor and, as a result, the creditor will not make the financing or leasing facility available.

Aircraft engine transactions have a further level of complexity as an engine, while a valuable asset in its own right, in order to be of operational use and value, clearly needs to be affixed to an airframe. Under the laws of certain jurisdictions, the attachment of an engine to an airframe is enough to transfer title in that engine to the airframe owner, and, vice-versa, the removal of an engine from an airframe where one party owns both assets may be enough for the owner to lose title to the engine. Further, unlike aircraft, there is no established international regime of asset registration for individual engines. This means that engine financiers assume greater risk in engine transactions, as they cannot track the asset or manage their collateral position to the same extent.

3.2. *If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:*

a) the rating of aircraft receivables;

b) the cost of export credit insurance, and/or

c) the cost of financing and leasing aircraft.

With regard to Question 3.2 (a), we assume by aircraft receivables transactions you are referring to aircraft lease or loan portfolio securitisations or other asset-backed securities issuances. The structure of such transactions, if subject to a credit rating analysis, will need to satisfy the relevant rating agency, amongst other things, that there will be "timely payment" of the rated notes or other securities. The rating agencies' assessment of this requirement typically includes a consideration of the speed and certainty with which the collateral (the aircraft) can be realised upon an insolvency or other default leading to non- payment of the notes. This will depend on the different laws and jurisdictions, including their insolvency systems, involved in the transaction (e.g. if the portfolio involves lease receivables from 10 airlines in 10 different countries and if the notes are secured against aircraft registered in 10 different states).

With regard to Question 3.2 (b), in respect of export credit supported aircraft financings, these transactions are largely governed by the OECD's Arrangement on Officially Supported Export Credits, and specifically the rules under the Arrangement's Aircraft Sector Understanding ("**ASU**"). While the cost of export credit support (whether by way of guarantee or insurance) depends on the pricing of the loans from banks in participating OECD states (or more recently, the pricing of bonds issued on the basis of a sovereign export credit guarantee from particular states), the cost is also affected by the fee or other charge imposed by the relevant export credit agency providing the support to the transaction.

As banks offering export credit backed financing analyse these transactions by reference to the nature and quality of the export credit agency support (as the ultimate credit in the transaction), rather than by reference to the creditworthiness of the underlying airline, the issues discussed in our response to Question 3.1 are probably less relevant than for a bank offering a commercial, non-export credit supported loan, or an operating lessor leasing an aircraft to the subject airline.

However, the level of the export credit agency's fee is affected by such issues, under the ASU, and furthermore, a discount on such fee is available on transactions where the underlying operator is based in a country which has adopted the Cape Town Treaty (or the aircraft is registered in such country).

In relation to Question 3.2(c), please see our response to Question 3.1 (c)/(d) above.

3.3. *The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to Question 3.1?*

If properly adopted by a "critical mass" of countries worldwide, the Cape Town Treaty will contribute significantly towards the harmonisation of the legal systems of such countries in relation to aircraft leasing and financing, including the substantial mitigation of key risks relating to the ability of lessors and lenders to re-possess and de-register aircraft (particularly on a debtor insolvency, if Alternative A of Article XI is adopted by such countries – see further below).

For example, the concept of an international interest seeks to neutralise many conflict of laws issues.

Further, a crucial tenet of the treaty is the provision of a separate insolvency regime for aircraft, under Article XI, and particularly, "Alternative A". The remedies under Alternative A, which include a speedy and certain process by which the creditor can obtain its asset on a debtor insolvency, are clearly set out in the treaty and address key concerns of creditors, as do the treaty rules on interim relief and de-registration and export powers. If a creditor had certainty that the aircraft would be returned (or the lease/loan assumed) at the end of a set time period (as contemplated by Alternative A) in debtor jurisdictions (e.g. the UK) into which they are leasing aircraft or providing financing, then the transactional and risk costs discussed above should be reduced. Similarly, rating agencies' concerns on timely payment should be mitigated by the insolvency process, which will enhance the availability of capital markets funding in those jurisdictions which have adopted the treaty and specifically these provisions.

The above-noted legal issues associated with engine financing are also addressed by the treaty, which provides for the same remedies discussed above for such assets, as well as introducing an international system of asset registration for engines.

While the treaty is rapidly being adopted internationally, there is no doubt that UK ratification would provide a leading example to and justification for others to ratify.

3.4 *Do you:*

a) *consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.*

b) *Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or note helpful? Please explain your answer.*

The International Registry system establishes a priority regime, based on electronic notice-filing, for registrable interests. This is useful for creditors to search against leased or financed assets to (i) establish prior closing whether there are any international interests with a higher priority and (ii) register their own interests, from a priority perspective and to give notice to other parties who may search the register. In addition the International Registry establishes priorities on an international basis – other systems are limited to national priorities.

With Regard to Question 3.4 (b), please see our earlier responses explaining the issues relating to engine financing (or any aircraft lease or financing transaction which allows engine pooling or swapping). An international registration system which allows individual engines to be tracked and interests in such engines to be recorded is of significant benefit to engine financiers.

3.5. *The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?*

There is no need for a time limit for completion of registration, as attainment of priority will incentivise timely registrations. Late filings may result in a loss of a potential priority position, but do not result in an extinguishment of the interest.

This is because registration does not affect validity of the relevant interest, only priority, although it should be noted that if the relevant contracting state has adopted the Article XI insolvency rules, then a registered interest will give the creditor the remedies under those rules, against a liquidator or other insolvency officer and any other creditors.

3.6 *Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b) exercising other default remedies over such assets in a foreign country? If so, please give details.*

Firstly, it should be recalled that ratification by the UK of the Cape Town Treaty will not provide a solution to any such difficulties, in and of itself.

For the purpose of this response we assume that the airline is a UK entity. If the UK ratified and implemented the treaty, including Alternative A, and the UK airline was insolvent, then as a

matter of English law, the domesticated treaty would allow the creditor to repossess within 60 days of the insolvency and de-register the aircraft from the UK CAA register.[3]

However, the extent to which the creditor could take possession of the aircraft in the foreign jurisdiction of location or exercise any other default remedies provided under the transaction documents (on an insolvency or otherwise) would depend on the applicable laws of that jurisdiction. For example, the rules relating to recognition of foreign judgments in that country, or if any insolvency or other rules prevent enforcement of security by the creditor (e.g. if another interest-holder in that jurisdiction asserts a claim on the aircraft, such as under a possessory lien). If the foreign country has adopted the treaty, some of these issues may not arise, however, if the treaty is subject to national laws, then such issues may still be relevant.

This is a key example of the importance of "full" harmonisation, as UK ratification of the treaty will not address issues under the laws of the foreign country. However, ratification by the UK may result in the intangible benefit of encouraging other states to ratify (and to follow the UK's model of implementation).

3.7 *The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.*

As a lessor/lender, RBS AC is of the view that this is of enormous financial benefit, as it allows the owner/mortgagee to preserve the value of the asset in case of default and/or insolvency. It prevents a further deterioration in condition of the aircraft and prevents the removal of valuable engines and parts which can impact the value and marketability of the collateral. However, as UK law already permits such non-judicial remedies, this is not an issue.

3.8 *The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register) and export. How useful do you consider these additional remedies to be?*

We refer to our responses above, in which we explain that the ability to obtain speedy and certain re-possession and re-deployment of an aircraft is crucial to a creditor, as recovery costs are minimised, the creditor's economic loss from the operator's default is mitigated by re-marketing the aircraft to another user and the aircraft's value and marketability is preserved. An aircraft cannot be registered on any nationality register and therefore cannot be operated, if it is still registered in the original state of registration and/or against the defaulting operator. The creditor needs to export the aircraft to anywhere in the world, whether for immediate maintenance, repair and valuation, or because the new operator is in another jurisdiction. These remedies must be available on an insolvency of the operator, which will depend on the operator's state of incorporation and the state of registration also adopting the treaty.

[3] (Note that the relationship between the treaty's insolvency rules for aircraft and the EU Insolvency Regulation would need to be considered, e.g. if the aircraft was located in another EU member state and/or if secondary proceedings were brought in another member state and/or if another party asserted a competing *right in rem* under EUIR, confirmation that the Treaty rules would prevail as a matter of EU harmonised insolvency rules?)

3.9 *In light of your answers to the above questions:*

a) do you favour ratification of the Convention and Protocol; if so,

b) what impact do you consider these instruments will have on your sector of the aviation industry?

c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

Yes, RBS AC strongly favours ratification of the Convention and Protocol as swiftly as possible, for the reasons discussed above. RBS also considers it essential that the UK implement the economically most important provision, being Article XI of the Protocol – Alternative A, with a 60 day waiting period.

3.10 *Do you have any other comments you would like to make?*

The UK should make a set of "qualifying declarations" under the ASU. That would be as follows: (1) non-judicial remedies, C, art 54(2), (2) IDERA, P, art XIII, and (3) Alternative A (60 calendar day waiting period, implemented through legislation).

With respect to non-consensual rights and interests, the UK should align such rights with those customary in the international community. The UK "fleet lien" is seen as out-of-line with international norms, over-reaching, and potentially harmful to airlines (restricting credit) and financiers (increasing risk). The recent GKL litigation has drawn greater attention to the problem of the UK fleet lien. Thus, a tailored declaration under C, art 39 should be agreed after a policy assessment on this matter.

END

DEPARTMENT FOR BUSINESS INNOVATION & SKILLS

CALL FOR EVIDENCE

QUESTIONAIRE ANSWERS PREPARED BY TOBY CRAMPTON & AILEEN MARSHALL SINGERS CORPORATE ASSET FINANCE LIMITED

Questions

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors rights and the protection of security interests..
To what extent do you consider that this affects.

(a) The complexity of the transactions

Answer: Each cross border transaction would definitely be more time consuming, complex and expensive however to date Singers Corporate Asset Finance Ltd have not entered into any cross border deals.

(b)The predictability of the transactions:

Answer: Unpredictability reduces our ability to assess the risk and is to be avoided whenever possible.

(c) the availability of finance or leasing facilities or

Answer: We do not offer cross border finance because of the complexity, cost and perceived risk.

(d) the cost?

Answer: If we were to enter this market we would pass the Legal Fees and Registration Costs onto our customer.

3.2

If any of the factors in question 3.1 apply to what extent do you consider that the difficulties you have identified effect.

(a) the rating of aircraft receivables.

Answer: No experience

(b) the cost of export credit insurance and /or

Answer: No experience

(c) the cost of financing or leasing aircraft

Answer: Yes this would have a large bearing but only on the customer's side.

3.3 The convention and protocol embody and international legal regime for the creation perfection and priority of international interests and outright sales . To what extent, if at all do you consider

such a regime would help to reduce any problems you have identified in your answer to question 3.1

Answer: Reducing risk would be extremely helpful and reassuring for us.

3.4 Do you.

(a) consider that the international registry system, which provides for registration of international interest in and sales of airframe, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

Answer: We consider that our interests in the General Aviation market are currently well protected by the UK CAA and US FAA Registers. We also recognize that an International Register could protect our interests if an aircraft was distained abroad.

(b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful?

Answer : We can envisage that it would be helpful in the Business Jet and Commercial sector.

3.5 The Cape Town convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous.

Answer: We are ambivalent on the time limit as we would always register our interest immediately. The question of giving priority to the International Register over interests registered on other national registers would cause concern to us.

3.6 Do you know of difficulties experienced in (a) repossessing uk registered aircraft or engines situated in a foreign country or (b) exercising other default remedies over such assets in a foreign country? If so please give details.

Answer: Some years ago a Spanish company blocked our repossession of our UK Registered aircraft they were renting from a UK company. If the aircraft had been registered on the International Register we may have had a better chance of forcing the Spanish authorities to assist us rather than hindering it's collection.

3.7 The cape Town convention confers on the creditor the right, on adducing evidence of default to obtain early judicial relief pending final determination of the case . Do you consider this useful? Please explain your answer

Answer: We can envisage that the possibility of obtaining early judicial relief could be helpful and reassuring when dealing with a business or individual that had sought Court protection from creditors.

3.8 The aircraft protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register) and export . How useful do you consider these additional remedies to be

Answer: Although our documentation includes the right to 'de-registration' in the event of default we recognize that any additional rights to remove an aircraft and export would be helpful.

3.9 In light your answers to the above questions

(a) Do you favour ratification of the convention and protocol: if so

Answer: Yes, although we would require assurance that our registered UK CAA interest could never be overtaken by an International Register interest registered at a later date. We consider that all applications to the International Register must be ratified by the UK CAA or relevant national Register. If this assurance is not available we do not recommend ratification.

(b) What impact do you consider instruments will have on your sector of the aviation industry?

Answer: We are financing aircraft in the General Aviation market and it is unusual for the aircraft to be used abroad therefore it would be unusual for the instruments to have any impact. If we extended our activities into the Business Jet and Commercial aircraft market then the International Register would be essential for us.

© If the answer to question 3.9 (a) is yes within what time scale should the UK proceed to ratification? Please give reasons for your answers

Answer: Subject to the comments above, we consider that ratification is required now.

Prepared by Aileen Marshall & Toby Crampton

BIS Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

Reply submitted by: The Boeing Company

Date: October 7, 2010

This is The Boeing Company's response to the above-identified Call for Evidence (the "CE") in connection with the UK government's assessment of whether to ratify the *Convention on International Interests in Mobile Equipment* (the "Convention" or "C") and the *Protocol thereto on Matters Specific to Aircraft Equipment* (the "Protocol" or "P"). The Convention and the Protocol will be referred to together hereinafter as the "Cape Town Treaty" or "Treaty").

Our replies to the questions contained in Part III of the CE appear below the inserted text of each such question below.

As indicated in our reply to question 3.9, ***we strongly support the UK's ratification of the Cape Town Treaty and urge the government to do so as swiftly as possible and with a high level of priority***.

The UK played a central role in negotiating and drafting the Cape Town Treaty, and it should come as no surprise that the instruments reflect, enhance and promote basic concepts found in English law. In fact, the drafting committee at every intergovernmental meeting that negotiated, and at the diplomatic conference that adopted, the Cape Town Treaty was chaired by a UK representative (either Sir Roy Goode (Oxford) or Bryan Welch (BIS)). The Cape Town Treaty will reduce legal risk and produce significant economic benefit.

Importance of Protocol, art XI (Remedies on Insolvency) – Alternative A

Most of the economic benefits and transaction risk reduction under the Cape Town Treaty are predicated on the applicability of Alternative A ("Alternative A") of P, art XI (remedies on insolvency) (with a sixty (60) day waiting period). See *Economic Benefits of the Cape Town Treaty*, 2009, by Professor Vadim Linetsky, a leading authority on the financial modeling of secured transactions. See also "Cape Town Treaty in the European Context: the case for Alternative A, Article XI of the Aircraft Protocol", by Jeffrey Wool / Andrew Littlejohns. These materials can be downloaded at www.awg.aero. Curiously, the CE does not ask a question about what is undoubtedly the single most important provision of the Treaty economically. It is therefore essential that Alternative A apply in the UK though its inclusion in the UK's implementing legislation (that mode of application is required given agreements relating to EU competence). See Unidroit, "The European Union and the Cape Town Convention", DC9 / DEP, Doc. 8, June 2010 at Annex III.

We note the Department's willingness to meet to discuss these matters, and The Boeing Company welcomes that opportunity.

QUESTIONS POSED AND REPLIES

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects:

a) the complexity of the transactions;
b) the predictability of legal outcomes;
c) the availability of finance or leasing facilities; or
d) the cost?

Reply: The cross-border nature of aircraft financing and leasing, and the consequent applicability of several non-harmonised laws, combine to produce complex transactions. Legal outcomes are less predictable than they could and should be. As mentioned in CE, para 1.11, there is a particular level of uncertainty in English law due to the application of the *lex situs* rule regarding property rights in aircraft.

It is axiomatic that greater complexity and less predictability result in higher transaction costs than would otherwise by the case, all else being equal. These factors eventually impact the availability of financing.

One of the best examples of such conflict of laws issues relates to rights in aircraft engines. Laws differ significantly regarding the legal effect of installing or removing engines, which, given operational requirements, could (and do) happen in any jurisdiction. In some jurisdictions, these actions impact core property rights.

Apart from conflicts, the cost and availability of financing are dramatically impacted by the underlying substantive law, and more specifically, any impediments caused by it affect the timely access to collateral. Timely access to high value collateral forms the basis of asset-based financing and leasing. Timely access to such collateral reduces the risk of loss (to a creditor) notwithstanding the risk of default (by a debtor), thus producing efficiencies.

The delay occasioned by insolvency law is a good example of such substantive issues. Furthermore, such laws may qualify or restrict contractual (and non-insolvency law) enforcement rights or impact property rights. These prospects are directly inconsistent with the core principles underlying asset-based financing and leasing.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

a) the rating of aircraft receivables,
b) the cost of export credit insurance, and/or
c) the cost of financing or leasing aircraft?

Reply: Re 3.2(a): "Aircraft receivables", in the context of the Cape Town Treaty must refer to the rating of aircraft-backed securities. The capital markets are the only source of publicly available information regarding their cost. In the aviation industry, these securities / transactions are known as "enhanced equipment trust certificates" ("EETCs"). Given uncertainties caused by applicable underlying insolvency law, there have been few EETCs in Europe and none in the UK. In those transactions, two major European airlines paid materially higher rates and had materially more restrictive terms, than less creditworthy airlines (closing transactions in the same time frame) in the US. The existence and application of §1110 of the US Bankruptcy Code, a functional equivalent to P, art XI, Alternative A, is the sole reason for such preferential US financing terms. This follows from the policies of international rating agencies, which have, based on years of data, used a system of "enhanced" rating (rating upgrades) where timely recourse to high value aircraft collateral

can be safely assumed. Based on underlying law, including insolvency law, that has been the case in the US but not in Europe.

The ratification of the Cape Town Treaty will provide UK airlines with increased access to international capital markets, thereby diversifying their sources of funding. In particular, it will open public debt markets, availing UK airlines of another important financing option (in addition to bank debt and leasing, their traditional options) to help fund their capital-intensive aircraft acquisition requirements. For discussion of other commercial transactions, please see below.

Re 3.2(b): The OECD's aircraft sector understanding (the "ASU") governs the cost of export credit. Under the ASU, all OECD countries (the UK included) plus Brazil have agreed that ratification of the Treaty – with a set of "qualifying declarations" (see reply to question 3.10) – justifies a material reduction in the fee charged.[1] That decision supports the proposition that transactions in legal systems that provide higher levels of predictability and reflect the principles underlying asset-based financing and leasing should be priced lower than those systems that do not. The size of the "Cape Town Discount" depends on the credit standing of the borrower; the weaker the credit standing (the higher the risk of default), the larger the fee reduction. Under the current terms of the ASU, the range (for large aircraft) is 20 to 150 basis points on the upfront fee charged. To give an example, a 100 basis point reduction (a "B" rated airline would receive a 94 basis point reduction) on a USD 100m aircraft financing equals USD 1m. That the terms of export credit under the ASU are not attractive for spare aircraft engines underscores the point noted above regarding concerns over the law applicable to rights in engines.

Re 3.2(c): This question raises the general topic of the relationship between commercially-oriented secured financing and leasing law, on the one hand, and the cost (and terms) of such transactions, on the other. For two reasons, it is not possible to provide concrete information on this question. First, in addition to credit and legal risk, several factors go into the pricing of transactions and the availability of financing. These include more general considerations, such as (i) general liquidity in the financial sector and the liquidity position of a particular financial institution, (ii) the impact of regulatory capital, (iii) comparative returns from other forms of lending, (iv) competitive issues that may lead a bank to consider longer-term and relationship issues in setting price and (v) other sources of fees payable to a bank directly or indirectly linked to that transaction or related transactions. Second, confidentiality (and, possibly, competition law) considerations prevent the disclosure of terms in private financing transactions.

Nevertheless, it is well established that improved pricing and other terms are directly related to reduced transactional risk, all else being equal. In fact, this is a foundation of law and economics.

Finally, The economic assessment and related academic work on the Cape Town Treaty is extensive. We direct your attention to two major studies (see www.awg.aero), each of which took into account available information and research. The authors, applied economists and finance specialists, were of the highest possible caliber (in addition to Professor Linetsky, Northwestern University, they are Professors Anthony Saunders and Ingo Walters (INSEAD and NYU)).

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[1] The UK, France, Germany, Spain and the US currently follow the "home market rule", which prevents export credit into these countries. The ASU is currently under review. A number of home market airlines, including some in the UK, are seeking to have this restriction eased or removed. To the extent that is agreed, the points above will apply in respect of UK carriers.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

Reply: The terms of the Cape Town Treaty will address all of the issues noted in question 3.1 above. First, it will solve the problems associated with the *lex situs* rule. Second, with (with P, art XI, Alternative A implemented through legislation, it will solve problems associated with insolvency delay and impairment. That, in turn, will provide UK airlines with enhanced access to international capital markets, thereby diversifying and increasing their sources of funding. Third, it will eliminate the above-noted legal issues associated with engine financing, though that depends on adoption by many countries. In this connection, while the Treaty is being adopted internationally at a rapid pace, there is no question that ratification by the UK would provide a leading example to and justification for others to ratify. That would also serve the objective of the UK export community. See reply to question 3.9 below.

Unlike most other international legal instruments, the Cape Town Treaty was deliberately designed to facilitate a transaction type, thereby producing benefits to the aviation sector. The core role that the aviation sector – IATA (airlines) and AWG (financiers and manufacturers) – played in the process ensures that result. The Treaty solves the current legal issues in this field and does so in a manner entirely consistent with leading legal thought. There are no losers here: the problems solved equally benefit debtors, creditors and manufacturers.

3.4 Do you:

a) consider that the International Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Reply: Re 3.4(a): Approximately half of the world's new aircraft transactions are registered in the International Registry under the Cape Town Treaty ("IR"). Since its inception, the IR has run with virtually no problems. There is strong supervision by ICAO. An International Registry Advisory Board gives users direct input.

The IR (and the above-noted priority rules) is a significant improvement over current law and practice. First, the system is electronic, notice-based and low cost. It is very simple and effective. Closings are made more convenient. Interests may be registered in advance ("prospective interests"), which takes pressure off of closing logistics, which tend to be very expensive. In international (and national) law reform circles, the starting point for any discussion about registries systems is the IR, which is viewed as ground breaking and well-established. Second, the priority rules are clear and objective. In the context of aviation financing, clarity equals fairness. Parties can search the IR and determine exactly where they stand. Litigation relating to "knowledge" will be avoided. There will be no need for legal gymnastics (such as priority notices), which seek to address the issues handled directly by the Treaty. Third, the IR (through the Treaty) establishes priorities on an international basis. Any other system would be limited to national priorities. That is inherently inefficient and leaves risks in transactions which can be reduced only at significant expense. In short, the Cape Town Treaty, through the IR and the priority rules, puts an efficient international system in place to deal with international transactions and fact patterns.

Re 3.4(b): The ability to separately register against engines under the Treaty (as separate property) is extremely useful. As noted in reply to question 3.1, the law applicable to rights in engines varies dramatically, and, in certain jurisdictions, is potentially prejudicial to the right of property holders.

Engines are high value assets that consistently maintain their value. If the underlying law so permits, they should serve as excellent collateral. Increasingly, engines are separately financed (as spare engines) and both pooled and interchanged. Of necessity (e.g., AOG events), they are routinely hired out on a short-term basis, making strong property rights all the more important. For all these reasons, the treatment of engines under the Cape Town Treaty – as separate property to which the Treaty's clear rules apply – is a considerable improvement over current law around the world. The Cape Town Treaty is designed to support advanced engine financing and use.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

Reply: As mentioned above, this is a distinct advantage without any corresponding disadvantage. The ability to make a prospective registration takes pressure off of closing logistics. While the priority "relates back", there is no unfairness to any party, since the registration only has priority from the time it is searchable. There are no hidden interests. Any searching party can easily protect itself by searching the IR. It is then on notice that an interest, actual or prospective, might have a higher priority. That searching party would not close its financing transaction until the IR is cleared of any registration that could prevail over its interest.

The Cape Town Treaty is an improvement over (and a simplification of) the priority notice concept under English law, which is aimed at the same objective but achieves it using a more cumbersome two-step, paper-based process.

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b), exercising other default remedies over such assets in a foreign country? If so, please give details.

Reply: Unless this question is directed at providing an example and rationale for other countries to ratify the Cape Town Convention, we question its relevance. See response to question 3.9. This question – what is the position (of a UK-registered aircraft) under foreign (substantive and procedural) law would not be addressed by UK ratification. It would only be addressed by ratification by foreign countries (where the aircraft is located). And, if that is the point, why limit the question to UK-registered aircraft? What about the position of a UK financier with a non-UK registered aircraft located elsewhere or a UK manufacturer who has problems financing sales given foreign law? Analytically, these are all the same: what is the position under foreign law. (N.B.: In many jurisdictions, there are significant repossession and enforcement problems.) UK ratification will not address these problems, save to the extent other countries are thereby encouraged to ratify. That encouragement, however, cannot be overstated, given the wide range of material UK interests in international aviation.

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

Reply: This provision C, art 13 ("Relief Pending"), on which an opt-out is permitted (see C, art 55), and which is strengthened by an opt-in permitted under P, art X (see P, art XXX(2), was designed to provide countries opposed to non-judicial remedies with a court-based functional equivalent thereof.

The UK is not such a country. English law on non-judicial remedies is well-established and effective.

It is anticipated that the UK would elect to permit non-judicial remedies through the mandatory declaration required by C, art 54(2)(permitting action "without leave of the court"), reflecting its law, and consequently, the Relief Pending provision would not be necessary to reduce transactional risk or increase economic benefit in the context of the UK. The aviation community should be largely indifferent as to whether the UK, when ratifying, makes these particular declarations.

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be?

Reply: These remedies are critical. Under the terms of the *Chicago Convention of 1944*, in order to effectively exercise remedies against an aircraft, a creditor must be able to de-register that aircraft. The Cape Town Treaty not only provides these remedies but adds the extremely useful IDERA clause ("irrevocable deregistration and export request authorization"), P, art XIII. Most countries have opted into the IDERA clause (see P, art XXX(1)). An international standard is rapidly developing in favor of the use of IDERAs (even countries (like the US) with very efficient de-registration systems have made the IDERA election.) Underscoring its importance, the IDERA clause is an ASU qualifying declaration. Importantly, the use of an IDERA is expressly without prejudice to safety laws and regulations.

3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so

b) what impact do you consider these instruments will have on your sector of the aviation industry?

c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

Reply:

Re 3.9(a): ***We strongly support ratification of the Cape Town Treaty.***

In connection with such ratification, it is paramount that the UK implement the economically most important provision, P, art XI (remedies on insolvency) – **Alternative A** (with a sixty (60) day waiting period). Most of the economic benefits and transaction risk reduction effected by the Cape Town Treaty depends on the applicability that provision. See materials by Linetsky and Wool / Littlejohns referred to above. See also reply to question 3.10 re ASU qualifying declarations.

Re 3.9(b): Ratification of the Cape Town Treaty (with P, art XI, Alternative A implemented through legislation) will reduce legal and transactional risk. Airlines will benefit from reduced financing costs and access to additional sources of financing, manufacturers will benefit from increased exports and financial institutions will benefit from reduced risk. Such

direct economic benefits invite indirect benefits, including job creation (as a result of enhanced exports) and pass-through benefits to passengers (as a result of airline benefits).

UK ratification will ensure that English law remains a governing law of choice in aviation finance and leasing and that London remains central in the aviation financing and leasing industry.

Re 3.9(c): ***We strongly urge the government to proceed to ratification as swiftly as possible and with a high level of priority***. The ratification by the UK has been delayed for a long time, given EU competence issue and the Gibraltar-hold, two matters which are unrelated to the core objectives of the Cape Town Treaty. These two matters have now been addressed, and UK companies should begin to benefit from the Treaty as promptly as possible. In addition, the recent strains on the financing sector coupled with demand for modern, environmentally friendly aircraft argue for decisive action to help in these areas. Finally, while the UK has not yet ratified, many UK companies still need to comply with the Cape Town Treaty (e.g., register with the IR if they (i) buy aircraft equipment from a party located in a contracting state, or (ii) lease an aircraft from a financed lessor located in a Contracting State). In other words, aspects of compliance are already required; ratification will permit the corresponding benefit.

3.10 Do you have any other comments you would like to make?

Reply: We make following additional comments:

(i) We encourage the UK to make a set of "qualifying declarations" under the ASU. That would be as follows: (1) non-judicial remedies, C, art 54(2), (2) IDERA, P, art XIII, and (3) Alternative A (60 calendar day waiting period, implemented through legislation).

(ii) With respect to non-consensual rights and interests, the UK should align such rights with those customary in the international community. The UK "fleet lien" is seen as out-of-line with international norms, over-reaching and potentially harmful to airlines by restricting credit and to financiers by dramatically increasing risk. The recent GKL litigation has focused greater attention to the problem of the UK fleet lien. Thus, a tailored declaration under C, art 39 should be agreed after a policy assessment on this matter.

(iii) Given the clarity on what is needed to ensure the benefits of the Cape Town Treaty, we see no need to have a second consultation on the declarations to be made and the content of the implementing legislation. If the Department is intent on having such a consultation, we encourage the government to undertake and complete that second step as promptly as possible.

(iv) Major UK-based airlines, like most other major European airlines, have historically relied heavily on the commercial bank markets to provide the majority of financing for new aircraft acquisitions. The financial market crisis of 2008 and the severe contraction of the international bank markets resulted in a much diminished supply of equipment financing for even the top quality airline credits. US airlines on the other hand have long had access to the deep US capital markets. This was not because of their credit quality, which is arguably lower overall than the major European airlines. Rather, US airlines' access to the US capital markets has largely been due to the existence of §1110 of the US Bankruptcy Code, which provides assurance that in the event of a bankruptcy, creditors will have the ability to quickly repossess aircraft collateral. UK ratification of the Cape Town Treaty (with P, art XI, Alternative A implemented through legislation) would make the US capital markets open to the top tier UK airline credits and provide them with a valuable financing alternative to relying only on the commercial bank markets.

The Falkland Islands Government

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Ref: AIR/13/2

22 October 2010

Rachel Onikosi
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Legislation and International Policy Unit
Department for Business, Innovation and Skills
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London SW1H 0ET

Dear Ms Onikosi

Call for Evidence on the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment (July 2010)

The Falkland Islands Government welcomes the opportunity to formally respond to the Call for Evidence on the Convention on International Interests in Mobile Equipment (the "**Convention**") and Protocol thereto on Matters Specific to Aircraft Equipment (the "**Protocol**") issued by the Department for Business, Innovation and Skills ("**BIS**").

We are especially grateful for your written confirmation that BIS had intended for this Call for Evidence to be extended to all Overseas Territories.

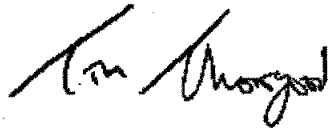
Therefore this letter of response is intended to serve the purpose of outlining the position of the Falkland Islands Government in the knowledge that you have received detailed responses from legal and financial firms in Cayman and Bermuda.

The Falkland Islands Government supports the ratification of the Convention and the Protocol. We do so on the condition that HMG agree to assist and advise in relation to the most appropriate method of its implementation, preferably by the production of model legislation for implementation by the OTs.

For the purposes of Article 1 and Chapter XII of the Cape Town Convention, the Falkland Islands would seek to declare that all courts with competent jurisdiction under the laws of the Falkland Islands are the relevant courts.

The Falkland Islands are currently not utilised for aircraft financing structures. This is therefore a matter of preparation for possible future development within our aviation and business sectors. However, because of our political status as an Overseas Territory, we are wholly dependent on H.M. Government's intervention regarding this matter.

Yours sincerely



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TUI Travel PLC

More than a smile

The TUI Travel PLC response to the Department for Business Innovation & Skills call for evidence on the Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment:

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TUI Travel PLC is the world's leading international leisure travel group operating in approximately 180 countries worldwide. It serves more than 30 million customers in over 27 source markets. Headquartered in the UK, the Group employs approximately 50,000 people and operates a pan-European airline consisting of 143 aircraft. The company is organised and managed through four business Sectors: Mainstream, Specialist & Activity, Accommodation & Destinations and Emerging Markets. In the financial year ended 30 September 2009 TUI Travel had revenues of £13.9bn and an underlying profit before tax of £366m. The TUI Travel European airlines are: Thomson Airways – UK; TUIFly – Germany; TUIFly Nordic – Sweden; Arkefly – Netherlands; Jetairfly – Belgium; Corsairfly – France and Jet4you – Morocco:

General Comments:

The TUI Travel approach to sourcing aircraft is to acquire aircraft through purchase (for purchased aircraft we either hold the aircraft ownership in, or execute a sale and leaseback financing transaction) or lease the aircraft into an in house leasing company and then sub-lease the aircraft to one of our seven airlines. We often seek to move aircraft between airlines either from one of our owned airlines to another or sub-leasing excess capacity to a third party carrier.. Under the current regime the transactional costs of changing leases and securing the appropriate securities and rights very high, thus any changes to the legal regime that will both simplify the process and reduce costs is welcomed by TUI Travel.

Our airlines operate on behalf of the TUI Travel Tour Operators in a highly competitive marketplace and one that requires the utmost fleet flexibility, especially between our operating carriers where we may move aircraft between our own airline fleets to meet such market demands. This is typically achieved between Winter and Summer seasons. Such switching of registration creates additional burdens and costs, with the inherent legal uncertainties that are outlined in the introduction paragraphs of the call for evidence, thus we are supportive of the creation of an international registry to enable us to register our interests.

One significant part of our business model is that we wet lease or aircraft into non-EU aviation markets during the European winter period, our off-peak season, to areas such as North America and Canada where their 'peak season' requires additional aircraft capacity to Caribbean destinations. We have suffered over the years with the collapse of our airline partners, most recently Skyservice in 2009, and delays in getting aircraft released back to our airlines due to the regulatory and legal process involved. It therefore appears to us that the default remedies for creditors of security arrangements would be highly beneficial to our operations.

Responses to specific questions:

We do not propose to respond in detail to each question but will identify those that we believe would have a significant positive impact if the convention were to be ratified by the UK.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

We believe that the terms of the Cape Town Treaty will address many of the issues and concerns that we have. In particular it will remove the problems associated with the *lex situs* rule. Were Alternative A to be adopted it would remove problems associated with insolvency delay and impairment. That, in turn, will provide TUI Travel PLC with enhanced access to international capital markets, thus diversifying and increasing our sources of funding.

We also believe that it would eliminate the legal issues associated with engine financing, though that depends on adoption by many countries. The Cape Town Treaty, unlike most other international legal instruments, was purposefully designed to facilitate a transaction type, thereby producing benefits to the industry sector.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

TUI Travel believes that setting no time limit is a significant advantage without any corresponding disadvantage. The priority notice concept under English law aims at the same objective, but achieves it using a heavier two-step, paper-based process. The Treaty simplifies and improves the process.

3.8 The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register), and export. How useful do you consider these additional remedies to be?

In light of the difficulties TUI airlines have faced when attempting to recover an aircraft in circumstances of the lessee carrier insolvency we believe that these remedies are essential.

3.9 In light of your answers to the above questions:

a) do you favour ratification of the Convention and Protocol; if so

c) if the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

TUI travel PLC supports the ratification of the Cape Town Treaty as soon as practically possible to enable our continued aircraft acquisition strategy to proceed with more legal certainty and reduced costs.

Conclusion:

TUI Travel and its UK airline Thomson believes that ratification of the Cape Town Treaty should be done within the UK utilising alternative A in order to remove problems associated with insolvency delay and impairment. We will be encouraging other member states also to ratify the Treaty.

TUI Airlines are grateful for the opportunity to comment and would be pleased to respond to any questions or clarifications that may be required.

Submitted on behalf of the TUI Travel PLC and Thomson Airways by:

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Unite the Union response to DBIS call for evidence on the Cape Town Convention

This response is submitted by Unite the union. Unite is the UK's largest trade union with over 1.5 million members across the private and public sectors. The union's members work in a range of industries including manufacturing, financial services, print, energy, construction, transport, local government, education, health and not for profit sectors.

Introduction

Unite recognises that there are legal impediments in certain countries that restrict the availability, or increase the cost, of aircraft finance. The Cape Town Convention creates an international legal framework that solves many of these problems. It gives predictable rules that facilitate the financing and leasing of aircraft and engines by reducing risk and legal uncertainty, particularly in bankruptcy.

This legal predictability is crucial as it allows lenders to rely on access to, and the value of, the aircraft on an airline default. Financiers wanting to lend to airlines in legal systems without the Cape Town (or equivalent) legal framework are forced to make lending decisions based largely on the credit of the airline. This is a problem for airlines that do not have a strong credit, particularly those in developing countries.

The Cape Town Convention was signed by a number of countries, including the United Kingdom, in 2001. To date, nearly 30 countries have ratified the Cape Town Convention, including China, India and the United States. The UK has yet to ratify this Convention. Ratification by the UK will accelerate the widespread adoption of the Cape Town Convention, which will lead to increased availability of financing to overseas airlines thereby increasing sales of aircraft and engines manufactured in the UK.

The Cape Town Convention is a mixed treaty in which legal competence is shared between the European Community and the European Member States. In April 2009, The European Community acceded to the Cape Town

Convention. Accession by the European Community has cleared the way for ratification by the European Member States.

3.1 Cross-border aircraft financing and leasing potentially attract the laws of different countries with differing rules on creditors' rights and the protection of security interests. To what extent do you consider that this affects

(a) the complexity of the transactions;
(b) the predictability of legal outcomes;
(c) the availability of finance or leasing facilities;
(d) the cost?

Unite understands that the need to analyse differing creditors' rights and security interests in cross-border transactions affect all of the issues raised in (a) to (d) above.

Unite also understands that (i) greater complexity and cost in structuring a transaction; and (ii) less predictability and availability of financing, all create an environment whereby it is unnecessarily difficult to achieve sales/export – hitting the bottom line for UK companies, leading to inevitable additional concerns for Unite members in the current economic climate.

3.2 If any of the factors in question 3.1 apply, to what extent do you consider that the difficulties you have identified affect:

(a) the rating of aircraft receivables;
(b) the cost of export credit insurance;
(c) the cost of financing or leasing aircraft?

Unite understands that the difficulties outlined in 3.1 above have a detrimental effect on financing costs; making it more difficult to finance the purchase of aircraft and aircraft engines in an environment where the UK administration should be doing all it can to promote the success of UK exporters and airlines.

3.3 The Convention and Protocol embody an international legal regime for the creation, perfection and priority of international interests and outright sales. To what extent, if at all, do you consider such a regime would help to reduce any problems you have identified in your answer to question 3.1?

The Convention and Protocol creates a regime which has the effect of mitigating, to a very great extent, the issues raised in 3.1 above; whilst having no corresponding disadvantages. Given the potential benefits, Unite members are very firmly in favour of prompt UK ratification.

3.4 Do you:

(a) consider that the international Registry system, which provides for registration of international interests in and sales of airframes, aircraft engines and helicopters, with priority

over unregistered national interests, is an advantage or a disadvantage? Please explain your answer.

(b) Do you find the ability to register an international interest against an aircraft engine separately from the airframe helpful or not helpful? Please explain your answer.

Unite has no experience of the International Registry and therefore cannot pass comment.

3.5 The Cape Town Convention sets no time limit for the completion and registration of transactions, and completion gives priority to the registered international interest as from the time of registration of the prospective international interest without the need for any additional registration. Do you consider this to be advantageous?

Unite has no experience of registering international interests and therefore cannot pass comment.

3.6 Do you know of difficulties experienced in (a) repossessing UK registered aircraft or engines situated in a foreign country or (b) exercising other default remedies over such assets in a foreign country. If so, please give details.

Unite understands that the difficulties highlighted in this question are aspects which do exist and must be taken into account when structuring an aircraft or engine financing. To the extent that the Convention and Protocol has the effect of mitigating the issues which have a direct effect on UK exporters and airlines, Unite members consider this to be a compelling reason for prompt UK ratification. Even if mitigation is only partial, with no downside to ratification, why would the UK government not take advantage of the potential?

3.7 The Cape Town Convention confers on the creditor the right, on adducing evidence of default, to obtain early judicial relief pending final determination of the case. Do you consider this useful? Please explain your answer.

Unite does not feel suitably qualified to provide substantive comments on this, but understand that this specific right is of limited value in the UK.

3.8. The Aircraft Protocol confers on the creditor the additional default remedies of de-registration (removal of an aircraft from a nationality register) and export. How useful do you consider these additional remedies to be?

Unite has no direct experience of the matters referred to in this question; but does understand that providers of asset backed leasing or financing place considerable value in the remedies.

3.9. In light of your answers to the above questions:

a) Do you favour ratification of the Convention and Protocol; if so b) what impact do you consider these instruments will have on your sector of the aviation industry.
c)If the answer to question 3.9(a) is yes, within what time scale should the UK proceed to ratification? Please give reasons for your answer.

Unite members that work in the aviation industry favour ratification; and Unite therefore strongly favours ratification.

At a time when the economy has been subject to the worst recession in recent history, ratification by the UK of these instruments would show to our members that all measures are being taken to provide the best possible chance for the industry to recover and grow further in the UK.

To the extent that ratification would provide a level playing field for UK airlines and manufacturers in the industry (as against countries that have already ratified the convention) through, amongst other things, financing from an increased number of sources, we believe that ratification must be completed as soon as possible by the United Kingdom.

3.10 Do you have any other comments you would like to make?

Unite has no further comments, but would welcome the ability to meet with BIS officials to discuss the timeline for ratification.

Bernie Hamilton
Unite National Officer
Aerospace & Shipbuilding

29th September 2010.

Rachel Onikosi
Legislation & International Policy Unit
BIS
1 Victoria Street
London
SW1H 0ET

Deadline 8th October 2010.

BIS - Call for Evidence – Convention on International Interests in Mobile Equipment and Protocol thereto on Matters Specific to Aircraft Equipment

REPLIES BY VIRGIN ATLANTIC AIRWAYS

3.1

(a) The complexity of transactions does increase where the laws in different countries conflict. However, this is seldom the case as it depends on the countries involved in the transaction. In the majority of cases, especially where the UK and its laws apply, there is little or no complexity involved.

(b) The predictability of the legal outcome is usually quite clear under UK law. Problems are more likely when the legal system used is not English or a mature and comparable regime. An example often given of such conflict of laws issues relates to title of aircraft engines. Laws can differ regarding the legal effect of installing or removing engines. Under English Law there are ways to overcome such issues such as the use of a Recognition of Rights Agreement for the asset owners.

(c) The availability of financing and leasing facilities is not generally a problem for UK airlines because the UK Register and legal system is probably the most highly respected in the world. There are far bigger issues such as the state of the financial markets and the availability of capital. The "Home Country Rule" is a much bigger obstacle than anything related to cross-border financing.

(d) The cost for UK airlines is not a problem. There are some challenges when airlines lease out aircraft to an overseas airline in less mature jurisdictions. The adoption of The Convention in these countries is important as it brings the legal system to a standard closer to the UK. The cost for financiers is optional, more a function of which countries they choose to carry out their business.

3.2

(a) Aircraft receivables are affected by a huge range of issues. Somewhere on the list is the risks of the aviation registry and law of the habitual base of the operator. The reality is that VAA is a UK airline has never been an issue raised by any financing party that has been involved in any aircraft or engine transaction. So this is not a issue for lessors and financiers doing business in the UK.

(b) Purely being able to access Export Credit would remove a severe competitive disadvantage for UK airlines (and others in Germany, France, Spain and the USA). The fact that the export credit agencies choose to differentiate their pricing to those airlines in certain jurisdictions could be considered an act of bribery. However, in the event that the Home Country Rule disappears, it is unlikely that the UK would suffer discriminatory pricing, with or without CTC.

(c) There are undoubtedly risks and costs associated with the differing legal practices in various countries. This is not a problem being based in the UK as the law is one of the most supportive for an asset or security holder. Therefore once can conclude that the costs of financing or leasing in this respect are zero or certainly lower than almost anywhere else in the world.

3.3

The CTC will bring many benefits and solve many issues if adopted in many other countries. Ratification by the UK is almost immaterial in this respect.

3.4

(a) The CAA register in the UK works perfectly well and we never have any issues with lessors or financiers regarding its use. The International Registry is on balance a disadvantage for a UK airline. It introduces yet another level of unnecessary bureaucracy and duplicity with all of the costs and inefficient administration.

(b) See 3.4(a). There are other methods available to protect engine title as described previously.

3.5

It is beneficial by reducing the pressure on closing logistics to have no time limit for the completion and registration of transactions. The same goes for the ability to make a prospective registration.

The priority notice concept already applies under English law.

3.6

Recent examples are difficult to find. The subject of UK ratification is unlikely to have any bearing on these situations regardless?

3.7

It is difficult to determine the relevance as English law on non-judicial remedies is established and is considered effective.

3.8

These deregistration remedies are important to a title of security holder. To effectively exercise remedies against an aircraft, a creditor must be able to de-register an aircraft. In our view UK law in this respect is already sufficient.

3.9

(a) We cannot identify enough positive reasons to support the ratification of the Convention and Protocol in the UK. The law is already highly protective of the rights of investors, lessors and financiers in respect of aircraft assets.

(b) These instruments will burden airlines with extra costs, duplication, bureaucracy and administration with very little, if any, benefit. What will effectively happen is that there will be a levelling down effect at great cost to the UK. By its ratification, the UK economy will therefore effectively end up subsidising the implementation of the Convention across the world.

(c) Although our response is "no", it is important to realise that there are other major issues facing the industry, not least the implementation of ETS. If The Convention is to be enforced, a sensible timeframe is requested to ensure the resources are available to manage the massive amount of administration that the introduction would bring about.

3.10

In the situation where the Home Country Rule is no longer effective, there could be a slightly different view taken to a few of the questions.

English law is already the most highly favoured by all parties in respect of aircraft financing and leasing transactions. Careful consideration needs to be given to ratifying a treaty that could compromise this situation.

The UK has established and well-regarded methods of registering security interests over aircraft and aircraft assets both at Companies House and via the CAA Register of Mortgages. The CTC is of greatest benefit to jurisdictions where registration of security is difficult or impossible.

Similarly, English law and the English courts already provide for a relatively rapid and effective means for creditors to enforce their security in a default situation - a situation which is recognised across the aviation and aviation finance industries. Again, the provisions of the CTC are of greatest benefit in jurisdictions where the status of creditors is uncertain and the enforcement of security is difficult or slow, and in a UK context add an additional level of legislative complexity.

Given the relatively recent adoption of the CTC in those countries that have implemented it, how effective is the CTC in practice and is it being applied uniformly across jurisdictions that have acceded to it? Or is it still something of an unknown quantity, in which case why should the UK rush to implement it and instead not adopt a wait and see approach?

The International Registry website is the main portal for registration of international interests and prospective international interests but from experience it is not a user friendly website and its rules and procedures are not in keeping with its supposed status and purpose.

Fees for registration of interests are high, as is the cost of registering and maintaining a registration as a transacting user entity. Lenders, creditors and lessors usually expect airlines to meet these fees themselves. These are additional costs the UK aviation industry simply does not need.

In summary, from the perspective of a UK airline, there is little evidence to suggest that the implementation of the CTC in the UK form a priority for the current government.