

**CALL FOR EVIDENCE: SUMMARY
OF RESPONSES**

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

FEBRUARY 2010

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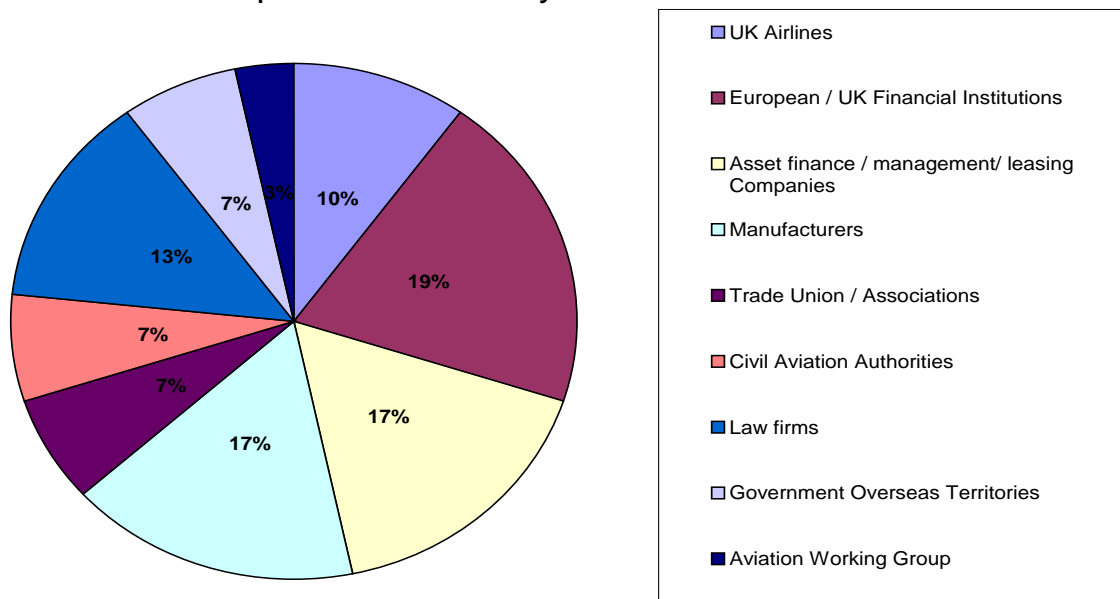
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Introduction

1. The Department for Business, Innovation and Skills published a Call for Evidence on 30 July 2010 in relation to the Convention on International Interests in Mobile Equipment (“the Convention”) and the Protocol thereto on Matters Specific to Aircraft Equipment (“the Aircraft Protocol”).
2. The Call for Evidence posed a number of questions aimed at seeking views from those within the aviation industry on whether it would benefit the UK to move towards ratification of the Convention and Aircraft Protocol or take no further action at this time.
3. The Call for Evidence closed on 8 October 2010. Thirty responses were received from a variety of interested parties. Meetings were also held with the Aviation Working Group (AWG) and RBS Aviation Capital.

Responses divided by source



4. Part 2 of the paper contains the Summary of Responses. Full copies of the responses are available at the [full responses paper](#).

Please note:

- (a) The views expressed are those of the respondents only, and should NOT be taken as the views of the Government.
- (b) The Department is still evaluating the responses and conducting further discussions with respondees. A formal Government Response to the Call for Evidence will be published by April 2011.
- (c) Where points have been raised without a full explanation by the respondents, we have provided further clarification shown in italics.

We would like to thank everyone who responded to the Call for Evidence, and to those who met with us. A full list of respondees can be found on page 16.

Summary of Responses

CALL FOR EVIDENCE 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 the:

(a) complexity of the transactions?

- The majority of those that responded said that cross-border aircraft financing and leasing affects and increases the complexity of aircraft transactions giving rise to conflict of laws issues. This often resulted in new legal documents being drafted to encompass the different jurisdictional legal rules and procedures. On occasions, one transaction may involve several jurisdictions, resulting in a multitude of legal documents being produced. The complexity of such transactions increases when repossession, deregistration and engine rights came into the equation.

"The internationality of aircraft financing and leasing, and the consequent applicability of several non-harmonised laws, undoubtedly produce complex transactions." **Aircastle Advisor LLC**

"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." **British Airways**

- A minority of those who responded did not agree that cross-border financing and leasing increased the complexity of transactions. These respondents thought that, generally, parties involved in cross-border transactions agree at the outset which law will apply. In these circumstances, UK law is normally the applicable law, and as such few problems exist as UK law is reliable and robust.

(b) predictability of legal outcomes

- The majority of respondents argued that legal outcomes are less predictable when cross-border finance and leasing transactions are concerned, and this is the case whenever there is conflict of law.
- A number of respondents referred to a recent High Court judgement - *Blue Sky One Ltd v Mahan* [2010] All E.R. (D) 02 to emphasise the unpredictability of legal outcomes due to an uncertainty in English law regarding the *lex situs* rule (the law of the jurisdiction where the relevant asset is situated at the time that the interest is created).

The facts of the case involved a UK registered aircraft, owned by an English company. The aircraft was leased to an Armenian company, Blue Airways, and then subsequently chartered to an Iranian Company. The English company secured a mortgage over the aircraft on behalf of a US company, at a time when the aircraft was located in the Netherlands. The case was decided against the English company, and the mortgage was deemed invalid as the aircraft was situated in another jurisdiction when the mortgage was created.

- A minority of respondents said that the predictability of legal outcomes is usually quite clear when UK law is applied to transactions. Issues of unpredictability arose when less mature or non UK laws are applied.

(c) availability of finance or leasing facilities?

- Overall respondees said that the complexity and unpredictability of cross-border transactions had a negative impact on the availability of finance and leasing facilities. **British Airways** predicated that following the ratification of Cape Town by the USA, financial markets will increasingly consider it to be the market standard legal framework, and will add a risk premium to other countries. In their view this would happen even where the local system was lender/lessor friendly and would have a direct impact on them when they try to access new markets previously untapped such as the Enhanced Equipment Trust Certificate (EETC) market in the USA.
- **Virgin Atlantic Airlines**, however, didn't see the availability of financing and leasing as a general problem for UK airlines because the UK Register and legal system was probably the most highly respected in the world.

(d) cost?

- Many respondents said that the ratification of the Cape Town Convention would lower the cost of financing. The main reasons were:
 - It would lead to lower financing costs as the OECD Aircraft Sector Understanding (ASU) allows Export Credit Agencies (ECA's) to charge lower premiums to countries that have ratified the Treaty.
 - The financial crisis has led to less private bank financing, and borrowers have been seeking help from ECA's.
 - It would significantly reduce the complexities of transactions while at the same time increase the predictability of transactional outcomes, resulting in a significant reduction in costs. The cost reduction would come as a direct result of financiers no longer needing to charge higher rates to borrowers as the risk of losing capital would be reduced.
 - Owners often use the Recognition of Rights Agreements (RORA) to mitigate the risks of losing title to engines installed on another airframe. This method adds to the cost of transactions as aircraft/engine owners incur costs with the use of RORA's. Under the Cape Town Convention engines are treated as separate security interests from the airframe and as such, engine owners would no longer need to use RORA's to protect their interests as Cape Town would automatically do this.

- A minority of respondents said the cost for cross-border transactions is not a problem for the UK airlines, but recognised that some challenges are faced when dealing with less mature jurisdictions. Less mature legal systems which adopted the Convention would get closer to the standard of the UK but this would not have a knock on effect in terms of cost implications in the UK.

CALL FOR EVIDENCE QUESTION

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?
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(a) the rating of aircraft receivables?

- The majority of respondees said that the factors raised in question 3.1 affect the rating of aircraft receivables. Many respondents refer to the rating of aircraft backed securities known as Enhanced Equipment Trust Certificates. These are capital market instruments largely issued and rated on the value of the aircraft secured rather than the creditworthiness of the borrower. Only a few have been issued in Europe and none in the UK. This is due to the uncertainties caused by the underlying insolvency law. As a result, two major European airlines paid higher rates, and on more restrictive terms, than less creditworthy US airlines. Preferential US financing terms are available due to the existence and application of section 1110 of the US Bankruptcy Code. Alternative A of the Insolvency provisions of Cape Town is the functional equivalent of section 1110. Ratification of Cape Town with Alternative A would provide UK airlines with enhanced access to international capital markets.

“Since 1996, U.S. airlines have raised nearly USD 55 billion for the issue of over 110 EETC.....[and] in stark contrast to U.S. airlines, European airlines have had virtually no access to capital markets, despite significantly higher corporate credit ratings [and have raised] only \$2 billion via 4 [EETC] issues to date.” **Aviation Working Group**

- A minority of respondees said that English law was recognised as a stable and benign legal system, and as a result no difficulties were experienced when dealing with UK aircraft and financing transactions.

(b) the cost of export credit insurance?

- The majority of respondents said that the ratification of the Treaty with a set of qualifying declarations would reduce the cost of export credit, as under ASU all OECD countries have agreed that ratification would lead to a material reduction in the fee charged. It was noted by these respondents that:
 - The 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 at lower rates than those systems that do not, and that under the current terms of ASU the range for large aircraft is 20 – 150 basis points on the upfront fee charged.

“Any initiatives that encourage finance into the market and simplify the execution of transactions will reduce financing costs.” **British Airways**

- However, it should be noted that the UK, France, Germany, Spain and the US follow the “home market rule”, which prevents the use of export credit financing to promote exports into each others home markets.

“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)...However, in the event the Home Country Rule disappears, it is unlikely that the UK would suffer discriminatory pricing, with or without CTC.” **Virgin Atlantic Airways**

- A minority of respondents said that they had not experienced any difficulties.

(c) the cost of financing or leasing aircraft?

- Respondents said that they were not able to provide any definitive or precise information for two reasons:
 - Many factors are involved in transaction pricing and the availability of financing e.g. general liquidity in the financial sector/institution, general competitive issues.
 - Confidentiality and, possibly, competition law considerations prevent the disclosure of terms in private financing transactions.

However the **Aviation Working Group** said that “UK based airlines are expected to save between 534 million pounds and 2.7 billion pounds (best estimate 1.195 billion pounds) in funding costs on the estimated 98 billion pounds of financing relating to aircraft deliveries over the next 20 years.”

- A minority of respondents do not share the view that the factors identified in question 3.1 apply to the cost of financing and leasing an aircraft in regard to the UK.

CALL FOR EVIDENCE QUESTION

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
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- The majority of those who responded said that the Convention and Protocol would address all the issues identified in question 3.1. In particular it would take away the problems caused by the lex situs rule as referred to in the Blue Sky case with the adoption of Alternative A insolvency provisions. Alternative A would eliminate the problems associated with insolvency delay and impairment. As a result, UK airlines would have enhanced access to international capital markets, thus diversifying and increasing their sources of funding.

“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.” **Royal Bank of Scotland Aviation Group**

- A minority of respondents said that:
 - The Treaty would provide many benefits and should be adopted by many countries, although UK ratification is almost immaterial in this respect.
 - They do not consider that the Convention and Protocol would help to reduce any problems (if such problems exist) where UK registered aircraft were concerned.

CALL FOR EVIDENCE QUESTION

3.4a	Do you 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.
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- A vast majority of respondees said that the International Registry (IR) system would be extremely advantageous. The reasons for this were:
 - The IR system is easy to use, it is electronic and available online allowing access 24 hours a day.
 - Many new aircraft transactions are already registered with the Registry.
 - Interests may be registered in advance which takes the pressure off expensive closing logistics.
 - Priority rules are clear and objective. Parties can therefore search the system and determine exactly where they stand in terms of registered interests.
- Other respondees noted that:
 - The General Aviation market is currently well protected by the UK Civil Aviation Authority and the US FAA Registers, but recognised that the Registry could protect their interests if an aircraft was detained abroad.
 - The Registry is not an advantage to UK registered aircrafts, and it introduces yet another level of unnecessary bureaucracy and duplicity, with costs and inefficient administration.

“The CAA 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.....however the existing method of 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 lender’s written consent,....The International Registry system does not offer this specific protection to its lenders.” **Civil Aviation Authority**

CALL FOR EVIDENCE QUESTION

3.4b	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
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- The majority of respondees said that it was helpful to register an international interest against an engine separately from the airframe. This was because:
 - Engines are highly valuable equipment and consistently maintain their value, and should serve as excellent collateral if the underlying law permits.
 - Engines are often financed separately and/or hired out on a short term basis, so strong property rights are particularly important.

“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.” **British Airways**

- 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.
- A minority of respondees suggested that there are other methods of protecting engine titles such as the Recognition of Rights Agreements, and that the Civil Aviation Authority can easily adapt their processes to provide such protection.

CALL FOR EVIDENCE QUESTION

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?
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- The vast majority of responses said that it was an advantage that the Cape Town Convention did not set a time limit on the completion and registration of transactions. The priority notice concept under the current English law aims to achieve the same objective,

but does so using a heavier two-step, paper-based process. The advantages of the Cape Town system were:

- No required time period, and the ability to make prospective registration took the pressure off closing logistics.
- No secret registrations. Any searching party can self-protect by simply searching the Registry, and will then be on notice that an interest, actual or prospective, might have a higher priority.
- The system is fair as the registration only has priority from the time it is searchable: in this way a searching party would not close its transaction until the Registry is cleared of any registration that could prevail over its interest.
- One respondee did not agree, and believed that the setting of time limits was sensible. The lack of time limits created uncertainty and confusion for those who might have different interests in the aircraft as there would be no impetus to register interests as soon as possible.

CALL FOR EVIDENCE QUESTION

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
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- There was no consensus on this question with responses evenly spread between those who did not know of any difficulties, those that had encountered some difficulties, and those who did not understand the relevance of the question.
- **Do not know of any difficulties:**
 - **Rolls Royce** state that “repossession of UK registered aircraft or exercise of other default remedies over UK registered aircraft outside the UK is rare.We are not aware of any specific examples of repossession of UK registered aircraft situated in a foreign country.”
 - **David Baggott, Machins Solicitors** said “I have not experienced any difficulty in repossessing UK registered aircraft in a foreign country and.....I have not experienced any difficulties whenever [a] British aircraft that has changed registry in a country, and that 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.”
- **Some difficulties experienced:**
 - **Singers Corporate Asset Finance Limited** said “some years ago a Spanish company blocked our repossession of a UK Registered aircraft that we 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 its collection.”

- **Norton Rose** said “we have extensive experience of repossessing aircraft[s] in many jurisdictions. Whatever problems 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,”
- **Do not understand the relevance of the question:**
 - **Aviation Working Group** state “We do not understand the relevance of this question – unless it is driving at providing an example and justification for other countries to ratify. 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).”

CALL FOR EVIDENCE QUESTION

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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- The majority of respondents said that the UK had a well established system of non-judicial remedies which the international financing system was comfortable with.

CALL FOR EVIDENCE QUESTION

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?
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- The vast majority of respondees said that it was essential to have the additional default remedies of deregistration and export. The following reasons were given:
 - To effectively exercise remedies against an aircraft a creditor must be able to deregister the aircraft.
 - The Treaty includes the irrevocable deregistration and export authorisation (IDERA) clause in which an international standard is rapidly developing for their use, and IDERA's are an ASU qualifying declaration.
- A minority of respondees said that additional default remedies of deregistration and export were useful but in their views the current UK law was sufficient.

“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.” **Civil Aviation Authority**

CALL FOR EVIDENCE QUESTION

3.9a	In light of the above questions do you favour ratification of the Convention and Protocol?
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- The majority of respondents were in favour of UK ratification. The following points were made:
 - Ratification would have significant positive impact on the availability and pricing of financing, particularly in relation to engine leasing and financing, with no drawbacks.
 - Important that ratification included Alternative A ‘remedies on Insolvency’ with a sixty day waiting period.
 - Failure to ratify 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.
 - Should be done as soon as practically possible to enable our continued aircraft acquisition strategy to proceed with more legal certainty and reduced costs.
 - It would assist in encouraging UK exports, and make the UK an attractive location for airlines and lessors.
- A minority of respondees did not favour ratification on the basis that they could not identify enough positive reasons to support the ratification, and that the law was already highly protective of the rights of investors, lessors and financiers in respect of aircraft assets.

CALL FOR EVIDENCE QUESTION

3.9b	In light of the above questions What impact do you consider these instruments will have on your sector of the aviation industry?
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- The vast majority of respondees said that the ratification of the instruments would have a positive effect on the aviation sector generally. It would:
 - Reduce legal and transactional risks thus reduce transactional costs.
 - Produce economic benefit to airlines, manufacturers and financial institutions
 - Enhance export and create jobs.

- Help to ensure English law remains a preferred governing law of choice in aviation finance and leasing industry, and make the UK an attractive place for airlines and lessors.
- Would show that all measures were being taken by Government to provide the best possible chance for the industry to recover and grow further in the UK.

“Ratification will provide UK airlines with enhanced access to international capital markets.....open public debt markets, providing UK airlines with another important option...to help fund their capital intensive aircraft acquisition requirements.” **Goldman Sachs**

“Accession to the CTC ratification offers special benefits to UK based engine manufacturers..... We estimate that over a 20 year period, the expected benefits of this category of savings would fall in the range of £10 – 100 million.” **Aviation Working Group**

- A small number of respondees took the opposite view and said that ratification 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.
- Another respondent said that ratification could have an impact on those lenders that specialise in lending on aircrafts that are not covered by the Convention and Protocol.

“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 end up subsidising the implementation of the Convention across the world.” **Virgin Atlantic Airlines**

CALL FOR EVIDENCE QUESTION

3.9c	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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- Those respondents that supported ratification said it should take place as a matter of priority. They also noted that some UK companies already comply with aspects of the Treaty by registering aircraft equipment from parties located in a contracting state, or lease an aircraft from a financed lessor located in another state.
- A respondee that did not support ratification said that if the UK were to do so, it should be done within a sensible timeframe to ensure resources are available to manage the massive amount of administration that introduction would bring.

CALL FOR EVIDENCE QUESTION

3.10	Do you have any other comments you would like to make?
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- The following comments were made:
 - When ratifying the UK should make a set of qualifying declarations implemented through legislation on: non-judicial remedies, Article 54(2) of the Convention, the IDERA clauses contained in Part XIII and Alternative A, 60 calendar day waiting period.
 - Align non-consensual rights and interests with those customary in the international community.
 - A tailored declaration under C, Article 39 should be agreed after a policy assessment on issues related to UK fleet lien.
 - Countries which do not ratify are likely to be, and indeed are already finding themselves at a competitive disadvantage, having a negative effect on the economy and business community.
 - English law and courts provide for 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. Provisions of the Treaty are of greatest benefit to jurisdictions where the status of creditors is uncertain and the enforcement of security is difficult or slow.

“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.” **Virgin Atlantic Airlines**

“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 Travel**

Next Steps

1. Our intention is to publish a formal Government Response by April 2011 on the responses to the Call for Evidence. As mentioned in the introduction to this paper, this document is a summary of the responses received and the full responses can be viewed at the [full responses paper](#).
2. Please be aware that the views represent that of the respondents only, and should **NOT** be taken as a representation of HM Government's position, or taken as an assurance that the UK will ratify the Convention and Aircraft Protocol at this time.

List of Respondents

1. [Airbus S.A.S](#)
2. [Aircastle Advisor LLC](#)
3. [Aviation Capital Group](#)
4. [Aviation Working Group](#)
5. [Bermuda Department of Civil Aviation](#)
6. [Bombardier, Inc.](#)
7. [British Airways](#)
8. [British Exporters Association](#)
9. [Cayman Islands Government](#)
10. [Civil Aviation Authority](#)
11. [Clifford Chance LLP](#)
12. [Deutsche Bank AG London](#)
13. [Embrarer – Empresa Brasileira de Aeronautica S.A.](#)
14. [Engine Lease Finance Corporation](#)
15. [European Bank for Reconstruction and Development](#)
16. [GE Capital Aviation Services](#)
17. [Goldman Sachs](#)
18. [Helaba Landesbank Hessen-Thüringen](#)
19. [Machins Solicitors](#)
20. [Maples and Calder](#)
21. [Natixis Transport Finance](#)
22. [Norton Rose LLP](#)
23. [Rolls Royce plc](#)
24. [Royal Bank of Scotland Aviation Capital](#)
25. [Singers Corporate Asset Finance](#)
26. [The Boeing Company](#)
27. [The Falkland Island Government](#)
28. [TUI Travel PLC](#)
29. [Unite the Union](#)
30. [Virgin Atlantic Airlines](#)

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