

GOT AN AIRCRAFT DEAL?

THE CAPE TOWN CONVENTION CAME INTO FORCE IN MANITOBA ON APRIL 1, 2013

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What is Cape Town? It is an International Convention which was formulated by the International Civil Aviation Organization (ICAO) legal committee and passed at a diplomatic conference at Cape Town, South Africa in 2001.

The Convention also applies to space and certain Railway objects, but it is Aircraft Protocol of the Convention that we are concerned with.

Cape Town was established to facilitate financing of aircraft. Unidroit, a UN organization that administers international treaties liked the idea, but had no money, so Cape Town's development was funded to a large extent by Boeing and Airbus - the Aviation Working Group - which now includes Bombardier, ATR and Embraer, a number of engine manufacturers and most of the larger aviation leasing and financing companies and Brokers/underwriters. The AWG has a legal advisory Panel that comprises the leading aviation finance practitioners globally, present company excepted.

To demonstrate the extent AWG is practically driven, it hosts a conference, at no cost to participants in each major country that adopts Cape Town, so that local counsel can get up to speed on its workings. The manufacturers and financiers want Cape Town to work and to work well.

Cape Town is loosely based on North American PPR/UCC models. Canada played an important role in its development, with Professor Ron Cuming of the U of Saskatchewan being a principal drafter - and Canada's representatives to ICAO keeping momentum for the project. Air Canada was a big proponent because it was paying higher rates than its US competitors for financing due to security registration and enforcement differences between the two countries.

Cape Town is founded on core asset-based financing principles - to reduce the risk of loss in transactions:

1. Prompt, predictable enforcement, even in insolvency;
2. Clear & objective priority rules; and
3. Party autonomy & freedom to contract, reducing the gap between contract and laws.

In 2005, Parliament passed the *International Interests in Mobile Equipment (Aircraft Equipment) Act*. It is Chapter I 19.6 of the consolidated federal statutes. Because of divided constitutional jurisdiction, both federal and provincial enactment is necessary. The Uniform Law Commission developed a standard provincial version of the Act. Manitoba passed Cape Town legislation in 2012 - C.C.S.M. c. I 63, thanks in large part to encouragement from Manitoba Bar Association...

Most other Provinces and Territories have also enacted Cape Town legislation. All were proclaimed in force on April 1, 2013 and those who lagged behind have a bill on the order paper or in the chute.

The Federal Government also amended Canada's bankruptcy laws and the *Bank Act* to accommodate the Convention and the priorities it creates.

The Convention provides for the establishment of an international registry for international interests in aircraft objects.

The Convention specifically defines "aircraft objects":

1. Airframes - fixed wing aircraft, certified to transport at least eight persons including crew or goods of over 2,750 kg. *[note: goods includes hopper capacity of AG aircraft - number of seats does not determine]*
2. Aircraft engines - turbo jets of at least 750 lbs. thrust and turbo props or piston engines of at least 550 take off shaft horsepower. *[engines are treated as separate objects, so there are no accession issues. Spare engines can be registered]; and*
3. Helicopters with at least five seats or able to transport 450 kg of freight. *[helicopter engines are NOT aircraft objects - this is a weakness of the scheme that may be fixed]*

[note: look to aircraft type certificate for capacity info - quere - STC? - may need to review logs]

[Cover Canadian Civil Aircraft Registry & limitations. c.f. FAA registry]

International "Interests" comprise security interests, leases and title reservation agreements (what we call conditional sales). Both operating and financial leases are included. An interest is "international" if it meets the convention's definitions of the interest and the object. By creating a new category of interests, unique to the Convention, differences in property interests in a variety of local legal systems are avoided.

That means a Manitoba credit union financing an aircraft of sufficient size owned by a Manitoba company and operated exclusively in Manitoba still has an "international interest" and will need to register under Cape Town.

The Convention applies when the debtor resides in a contracting state - a state that has ratified Cape Town - or when the aircraft or helicopter is registered in a contracting state. Cape Town is in force in 57 contracting states. It is the most successful international convention in terms of rate of adoption. It is an economic, not a political treaty.

Unidroit administers the Convention. Extensive Information can be found on its website: <http://www.unidroit.org/english/conventions/mobile-equipment/main.htm>. *[lists of contracting states, declarations, etc.]*

The convention permits a contracting state to make declarations that define the "rules" of implementation. While that dilutes uniformity, it allows most states to find a formula that fits the tolerances of its public policy and sovereignty interests. Cape Town's flexibility through different declarations allows implementation where a one-size-fits-all version would not have many takers.

Countries can have declarations that are viewed as strong, or weak, in terms of meeting the goals of enforcement, priority and party autonomy. The strength or weakness of the

declarations determines whether Cape Town enhances the creditworthiness of a lessee or borrower in a particular state.

Canada's declarations are viewed as very strong, as evidenced by Air Canada achieving ratings for its latest 777 financing comparable to or better than those granted to the highest-rated US carriers. Air Canada and WestJet will save millions of dollars on their aircraft financing with Cape Town. The benefits should trickle down to smaller deals, but the big winners are the big players.

[Ex-IM Bank; OECD Aircraft Sector Understanding]

Key among Canada's declarations are:

1. The Convention has the force of law and priority over conflicting legislation.
2. Self-help is allowed unless a court approval/order is specifically required. *[creditor can repossess]*
3. The parties can choose the law of the contract.
4. Rights (registrations) existing before enactment have priority, except for Bank Act security, which has a life of 5 years (likely no Bank Act registrations of aircraft as inventory in any event).
5. Alternative A of Article XI of the Protocol applies - KEY - in the case of an insolvency, the creditor/lessor will be given possession of the aircraft object within the period provided in the underlying agreement or 60 days, if earlier, and the debtor or trustee/receiver will be able to retain possession only if arrears are paid and all other obligations are assumed and complied with.
6. Non-consensual liens need not be registered and have priority - repair shop (possessory) liens, airport & NavCanada right of seizure, and certain super-priorities.
7. IDERA's (IRREVOCABLE DE-REGISTRATION AND EXPORT REQUEST AUTHORISATION) will be enforced *[explain]*.

There is an on-line system that allows registrations of international interests in aircraft objects and the recording of sales of aircraft objects, called the International Registry. It does not purport to be a title registry: www.internationalregistry.aero. The registry is located in Ireland. It is operated by an Irish corporation - Aviareto, which is a joint venture of the Irish Government and SITA - a non-profit IT provider whose members represent about 80% of the global aviation industry.

Priority is by the first to file rule. Unregistered international interests have no priority and do not survive a sale, even in the face of actual prior knowledge. Registration lists the parties and records manufacturer, model and serial number of the aircraft object. Fractional and joint interests can be recorded. Anyone can search an aircraft object on-line and get an electronic certificate of the results. Search guides are on the web site.

Registration is a complex procedure and requires that the parties to the transactions be registered as users. Lawyers and service companies can register as professional users to affect

registrations, but need the consent of the parties - who must also be registered as transactional users - to complete the registration.

User Registration - go to IR site & show. Also User Manual & Quick Guide.

Once a User is registered, you can make registrations. - User Manual & Quick Guide

You need authorization to work on (make registrations) on an aircraft object - see IR User manual pp. 35-36.

Once authorized, a registered user can initiate registration - See IR User Manual - page 37-38 - the 28 steps to initiate registration and then page 44 for consents. Note that ALL parties must consent.

The right to discharge is critical. Be careful determining who has authority to do that. Similarly, you can have only one IDERA and need to decide which is the appropriate party to control it - follow the money and decide who has greatest enforcement rights.

You can assign and subordinate and provide notice of sales to cut off the effect of late registrations against prior owners. The register also allows the registration of prospective international interests, so you can file before the deal is signed, but both parties will need to consent to the registration. You can also choose the life of the registration.

The Irish court has supervisory jurisdiction over the Registry. It has acted swiftly in the couple of cases where it has been called upon to discharge rogue registrations.

If your head is spinning by now, there is additional help - the Practitioner's Guide published by AWG. There will be a new edition this fall. There is also an "Official Commentary" on the Convention (Unidroit web site), but most experts refer to the Practitioner's guide as the best place for practical advice.

Even if you register in the IR, PPSA registration may still be advisable:

1. if the Debtor is located in a Province (or other jurisdiction) that has not adopted Cape Town;
2. Cape Town has a narrower definition of "proceeds" than do the PPSA statutes, so PPSA registration may be necessary to capture that additional collateral;
3. the Cape Town airframe definition limits accessories, parts and equipment to those that are "installed, incorporated or attached" and does not include spares or items removed temporarily, for example, out for overhaul. The registry does allow for spare engine registrations along with an airframe;
4. some aircraft, helicopters and engines are too small to register and helicopter engines are not covered at all;

5. your security or lease document may include collateral beyond the aircraft objects, for example assignments of leases and of warranties;
6. you may be financing equipment prior to installation, so a PPR filing may trump an IR registration when the equipment is installed (not certain on that, but that was an opinion expressed at the conference in Toronto.); and
7. the practical notoriety of having your security displayed on the local system.

Remember that aircraft are mobile chattels, so s. 7 applies:

Location of debtor

7(1) For the purpose of this section and section 7.1, a debtor is located at

- (a) any place of business of the debtor;
- (b) the executive office of the debtor, if the debtor has more than one place of business; and
- (c) the principal residence of the debtor, if the debtor has no place of business.

Applicable law for mobile goods, intangibles, etc.

7(2) The validity, perfection and effect of perfection or non-perfection of

- (a) a security interest in
 - (i) an intangible, or
 - (ii) goods that are of a type that are normally used in more than one jurisdiction, if the goods are equipment or inventory leased or held for lease by a debtor to others; and
- (b) a non-possessory security interest in an instrument, a negotiable document of title, money and chattel paper;

is governed by the law, including the conflict of law rules, of the jurisdiction in which the debtor is located when the security interest attaches.

In its simplest terms, if you have an aircraft deal, here are the steps:

1. PPR search - debtor name and "serial number"
2. IR search - airframes and engines serial numbers and search certificates
3. Documents reflecting Cape Town including IDERA
4. Parties registered transactional users in IR
5. Register PPR ("serial number", collateral description & PMSI if applicable)
6. Register IR - airframes and engines
7. Discharges as appropriate
8. File IDERA with TC and get acknowledgment (no priors) *[SI 200-001 not on web site yet]*