

DEBT CAPITAL MARKETS FINANCING OF AIRCRAFT EQUIPMENT [March 2016]**EXECUTIVE SUMMARY**

Owners and operators of aircraft equipment are increasingly looking to the debt capital markets for a substantial portion of their overall financing requirements. Since 2009, there has also been a steady increase in investor interest in bonds secured on aircraft equipment, resulting in a strong market offering favourable financing terms to owners and operators of aircraft equipment. A number of these investors are looking for longer tenor investments which are well aligned to the needs of owners and operators of aircraft equipment, whose businesses require intensive capital investment in high value assets with lengthy expected useful lives.

This paper will focus on debt capital markets products secured on aircraft equipment. It includes (i) an overview of the debt capital markets financing in the aviation sector and its benefits, (ii) discussion of the general principles and features of debt capital markets financing of aircraft equipment (including financing structures, assessment of risk and ratings) and (iii) discussion of the requirement, in secured debt capital markets transactions, for prompt investor recourse to aircraft equipment in the event of insolvency or default of the operator or airline and the importance of predictable insolvency laws and the Cape Town Convention.¹

Prompt and predictable recourse to aircraft equipment is important, in equal measure, to investors and owners and operators that originate secured debt capital markets transactions. In the case of investors, it circumscribes and minimises their risk in such transactions. In the case of owners and operators, it has a positive impact on availability of financing, the rating and pricing of the transaction, and can reduce other transaction costs such as liquidity facilities in ABS and EETC transactions.

While there are a number of well-established products used to finance aircraft equipment in the debt capital markets, the Cape Town Convention has lent support to the growth of the market for these products offered by issuers / originators situated outside of the United States, particularly in jurisdictions with insolvency laws which differ substantively from the protections provided by Section 1110 of the U.S. Bankruptcy Code, with which investors and rating agencies are familiar.

[March 2016]

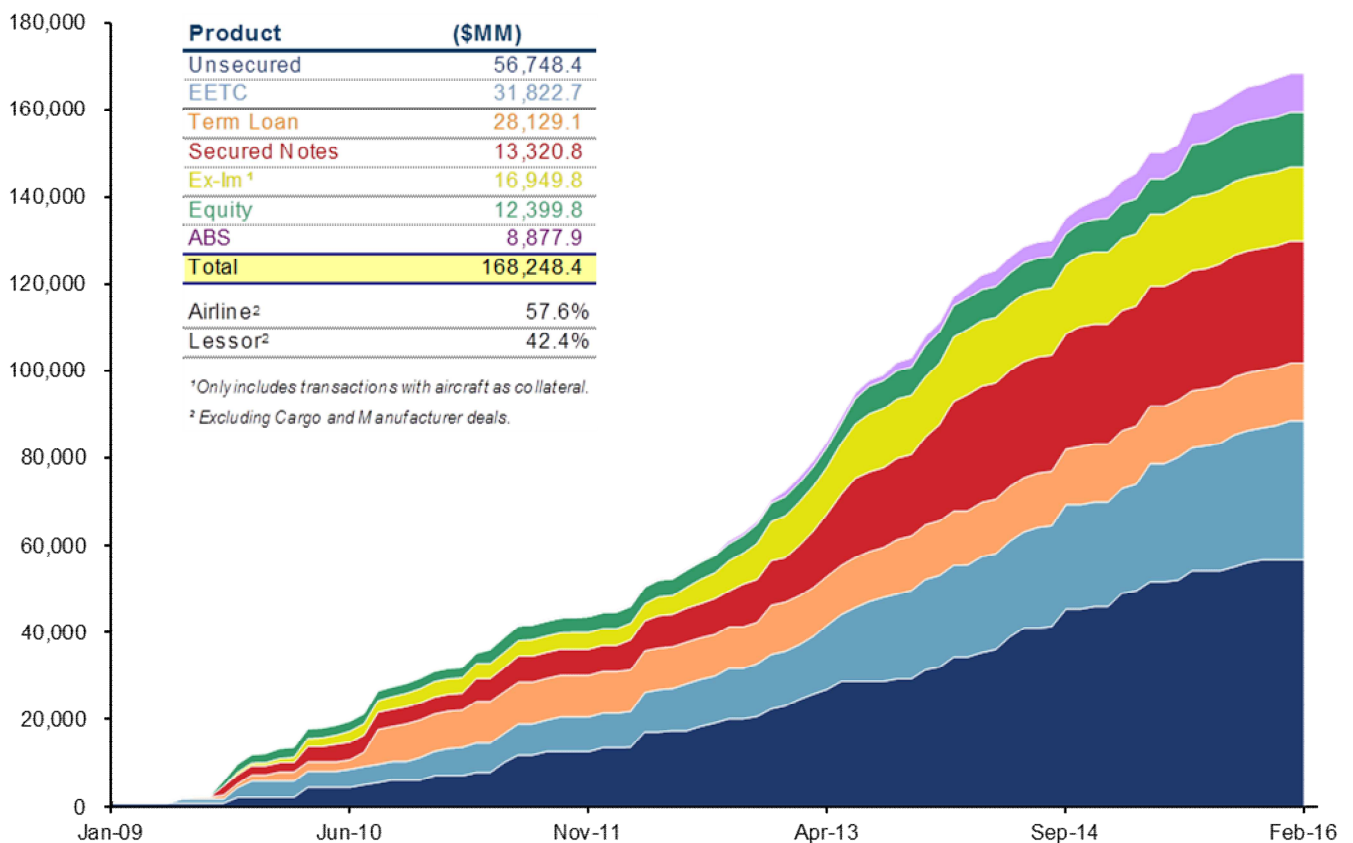
¹ References to the Cape Town Convention are references to *The Convention on International Interests in Mobile Equipment* and an associated Protocol to the Convention on Matters Specific to Aircraft Equipment, each dated 16 November 2001.

PART I: INTRODUCTION

An overview of debt capital markets financing in the aviation sector

1 The use of the debt capital markets as a funding source in the aviation sector has developed from the early 1990s but has seen significant growth since 2009, including the development of a market for the funding of aircraft operating lessors, who own and lease a portfolio of aircraft. The table below illustrates this growth.

Cumulative Aviation Issuance (2009 – February 2016)



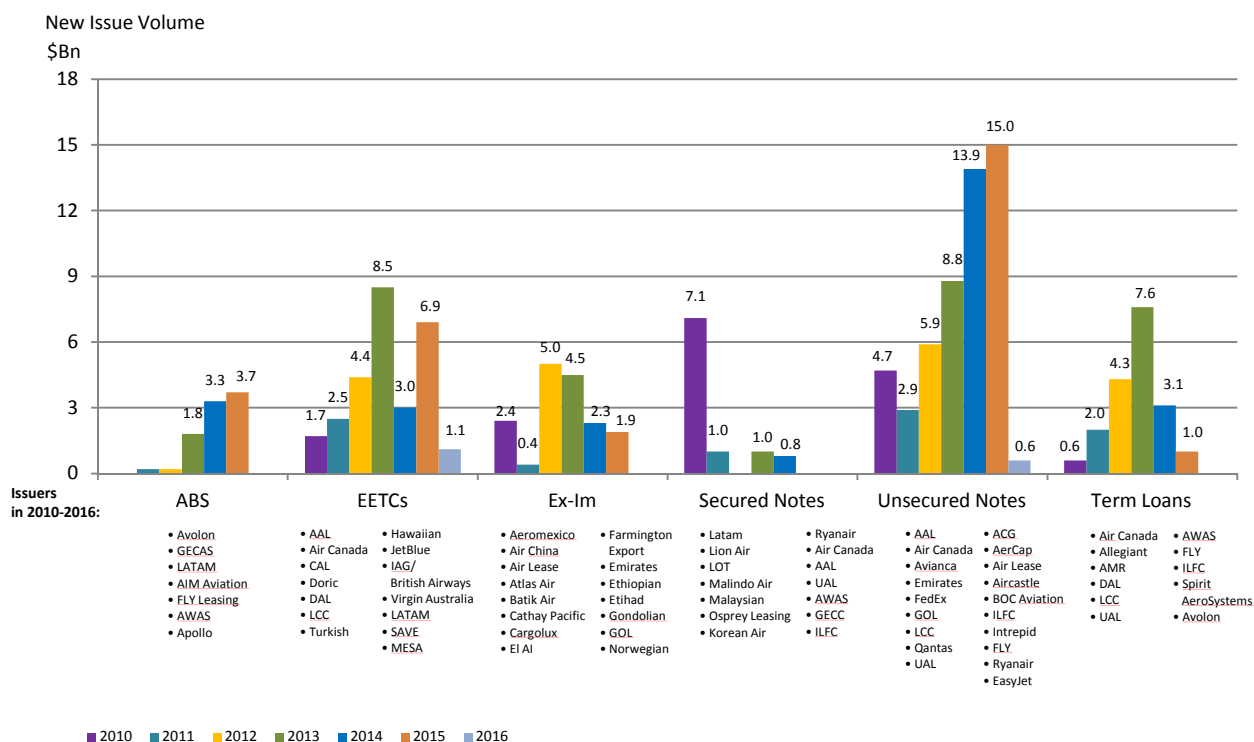
(Data provided by Goldman Sachs Structured Finance Trade and Transportation team, as of February 26, 2016.)

2 Since the start of the financial crisis in 2008, increased capital adequacy requirements and other regulatory reforms have put pressure on bank balance sheets, and this has affected the availability and terms of debt financing offerings from banks in the aviation sector. In addition, the introduction of revised minimum premium rates under the OECD's 2011 Aircraft Sector Understanding (**2011 ASU**)² has increased the cost of export credit agency supported financing for a number of airlines and operating lessors. As a result, the importance of debt capital markets financing has substantially increased.

² The 2011 ASU is a continuation of the concepts introduced by its predecessor, the OECD's 2007 Aircraft Sector Understanding and seeks to equalise competitive financial conditions between participating states offering export credit supported financing and also avoid distortion of competition between export credit supported financing and other sources of financing.

- 3 The size of the aircraft financing market as a whole was estimated to be worth approximately US\$122 billion in 2015, of which issuance in the debt capital markets equated to approximately US\$41.5 billion (or 34%). The table below illustrates the growing importance of the debt capital markets in the financing of aircraft equipment since 2010.

Aircraft Debt Environment



(Data provided by Morgan Stanley, Global Capital Markets, as of February 11, 2016.)

- 4 There is a wide range of debt capital markets products used to meet the funding requirements of the aviation sector. These include: (a) products which are not directly secured on aircraft equipment, such as unsecured corporate bonds, bonds which have the benefit of a sovereign guarantee or insurance policy issued through an export credit agency and bonds which are secured on non-aircraft assets; and (b) products which are secured on aircraft equipment, such as secured corporate bonds, asset-backed securities (ABS)³ and enhanced equipment trust certificates (EETCs) structures. Debt capital markets products secured on aircraft equipment are of most relevance to the subject matter of this paper.
- 5 In the past six years, many aircraft operating lessors have issued secured and unsecured bonds in the capital markets. Bonds issued by operating lessors and secured on aircraft equipment are typically secured on a pool of aircraft equipment comprising different aircraft types on lease to a range of airlines, diversifying the risk to investors and thereby improving the credit assessment of the transaction. Operating lessors are especially well-placed to offer such bonds given the diversified nature of their own aircraft leasing portfolios. These are typically issued as secured

³ Asset-backed securities typically include an assignment of lease cashflows and a negative pledge on disposal of the aircraft. However, aircraft mortgages (giving the investor a right to foreclose and sell the aircraft following a default) are not typically included.

corporate bonds by the operating lessor itself or as asset-backed securities (ABS) by a bankruptcy remote issuer.⁴

- 6 U.S. airlines have long used the U.S. debt capital markets to finance large aircraft orders through the well established EETC structure.⁵ The EETC funding structure is designed to offer airlines a competitive source of secured financing while offering investors strong protections and prompt access to collateral in the event of airline insolvency or default using fairly standardised documentation.
- 7 In the past four years, EETC funding structures have been successfully employed by non-U.S. airlines such as Doric Alpha/Emirates, Air Canada, British Airways, Virgin Australia and, most recently, Turkish Airlines and LATAM Airlines.⁶ Some of these issuances were modelled very closely on EETC issuances by U.S. airlines while others included variations, notably the British Airways EETC issuance and the Turkish Airlines Yen-denominated EETC issuance, both of which were combined with a Japanese operating lease structure. The success of these transactions has demonstrated investor interest in EETC issuances by non-U.S. airlines in jurisdictions that offer substantially similar strong protections and prompt access to collateral as is offered by U.S. airline EETC issuances.⁷

Benefits of debt capital markets financing

- 8 Financing transactions in the debt capital markets can have a number of potential benefits for both originators and investors alike in comparison to other funding sources, including:
- (i) *Access to capital:* Originators are able to access a wide and diverse pool of investors through the capital markets. An originator can attract fixed income institutional investors such as pension funds and insurers, investment funds and debt funds, as well as banks and high net worth individuals. The breadth of potential investors means that originators can structure a transaction to target high-yield or “ratings constrained” investors, or both.
 - (ii) *Increased liquidity/favourable pricing:* Investors can subscribe smaller minimum participations than for example syndicated lending usually permits which increases the liquidity of the capital markets. Transferability of bonds in established secondary markets further increases the liquidity and attractiveness to investors and should, therefore, result in more favourable pricing for the originator.
 - (iii) *Longer tenor:* Bonds are generally available for long tenors (up to 10-12 years). Institutional investors are more willing to lend for the long term on secured assets which match their own repayment or annuity profile. A longer tenor reduces the need to refinance as frequently, makes cash flow management easier, and is more suitable to companies with long term capital expenditure requirements (such as airlines and operating lessors).
 - (iv) *Efficiency:* If the frequency of issuance by airlines and leasing companies in the capital markets is maintained or continues to increase in line with current trends, originator and investor experience and expertise will continue to develop. This should increase efficiency in primary and secondary markets and, in turn, increase demand and liquidity.

⁴ For further detail on these structures, see paragraph 12 below.

⁵ For further detail on the EETC structure, see paragraph 13 below.

⁶ In the late 1990s and early 2000s, both Iberia and Air France issued bonds secured on aircraft equipment and related lease rental payments. These were adaptations of the EETC structure used by U.S. airlines.

⁷ For further discussion, see Part III below.

- (v) *Ratings*: The originator has the ability to have a bond rated which can improve pricing and liquidity.⁸
- (vi) *Favourable terms*: Typical terms of a capital markets debt financing offer a balance between investor protection and originator flexibility. Bonds often have more favourable terms for the originator than other financing sources, most notably in respect of covenants given by the originator / issuer.
- (vii) *Upfront bond programme*: Originators have the option of establishing upfront a bond issuance programme. Once such a programme is established, originators can access the capital markets as and when required at lower cost and without delay.

⁸ See Part II below for further discussion of ratings.

PART II: GENERAL PRINCIPLES AND FEATURES OF DEBT CAPITAL MARKETS FINANCING

- 9 There is a wide range of investors in the debt capital markets and, as a result, there is interest in investments with a wide range of risk profiles. Investments which typically provide higher returns to investors are structurally straightforward and place more importance on the performance of the originator / issuer than on recourse to its assets. Investments which typically provide lower returns to investors are structured in a manner which provides recourse to certain assets of the originator / issuer. The reliability, efficiency and priority of such recourse are key factors in the assessment of risk and, therefore, the pricing of such an investment. What follows is a brief summary of debt capital markets financing structures commonly used to finance aircraft equipment, ranging from unsecured bonds through to enhanced secured financing structures such as EETCs, and how investors and ratings agencies approach the assessment of the risks of investment in those structures.

Debt capital markets – financing structures

- 10 Unsecured corporate bonds are structurally the most straightforward type of debt issuance. Issuers are typically subject to few restrictive covenants. However, the financing structure is not isolated from the risk of issuer insolvency, nor are investors provided with security over the issuer's assets. Therefore, investors will look to the creditworthiness of the issuer in assessing default risk.
- 11 Secured corporate bonds are backed by security held by a trustee on behalf of investors. Typical security includes aircraft mortgages and a security assignment of associated lease rights (including lease rental streams). Although the investor remains exposed to the risk of insolvency of the originator, the security granted over certain assets of the originator offers greater protection to the investors and, therefore, pricing tends to be more attractive than for unsecured corporate bonds.
- 12 Asset-backed securities (ABS) are similar to secured corporate bonds but, importantly, are designed to provide enhanced security to investors by isolating the aircraft equipment and related lease rights on which the investor is secured from the risk of the underlying originator's insolvency. The aircraft equipment is owned by a special purpose vehicle which (directly or indirectly) issues bonds to investors secured on cashflows generated by that aircraft equipment. While the ABS structure mitigates insolvency risk in respect of the owner of the aircraft equipment, it would not mitigate potential difficulties or delays in recovery of the aircraft equipment following insolvency of the airline operating the equipment.⁹ ABS issued by operating lessors are typically enhanced by virtue of diversification across different aircraft types and airline credits, the strength of the servicer to remarket the assets and through the use of liquidity facility support and different tranches of securities.¹⁰
- 13 Enhanced equipment trust certificates (EETCs) are also issued (directly or indirectly) to investors by a special purpose vehicle which owns the aircraft equipment and, like the ABS structure, this mitigates insolvency risk in respect of the owner of the aircraft equipment. The aircraft equipment which secures payments due under the EETCs is leased to or owned by a single airline. EETC structures have a number of structural enhancements which provide a greater level of protection to investors and tend to result in attractive pricing for originators due to rating uplifts (as high as 9

⁹ Where security over the aircraft equipment is provided – see footnote 3 above.

¹⁰ For further discussion, see paragraph 13 below.

notches for the senior tranche of securities). The following structural enhancements have become customary features of EETC transactions:¹¹

- (i) *Prompt access to collateral*: in respect of issuances originated by U.S. airlines, the EETC structure is enhanced by Section 1110 of the U.S. Bankruptcy Code which offers investors predictable access to aircraft equipment within 60 days in the event of a U.S. airline bankruptcy. Successful EETC transactions originated by non-U.S. airlines have relied on alternate means to permit speedy access to aircraft equipment following airline insolvency, most notably Alternative A of Article XI of the Protocol to the Cape Town Convention (*CTC Alternative A*);¹²
- (ii) *Liquidity Facility*: availability of an undrawn bank revolver covering all interest due on the EETCs in the event of a default by the airline / issuer for a specified period. The term will be linked to the expected period for repossession in the relevant jurisdiction and orderly liquidation of the aircraft equipment following an airline insolvency. The liquidity facility allows investors to continue to receive coupon payments in the period between default and recovery of principal from the aircraft equipment collateral;
- (iii) *Over collateralisation*: the value of the aircraft equipment collateral is typically in excess of the payment obligations under the EETCs (i.e. the transaction provides a loan-to-value ratio (LTV) of less than 1). The excess collateral can absorb any reductions in asset value and recovery costs reducing the risk that investors will be unable to recover all payments due on the EETCs;
- (iv) *Cross default and cross collateralisation*: a default by the airline on any payment obligations related to the aircraft equipment will trigger a default with respect to all aircraft that secure a particular EETC issuance, and all proceeds of aircraft equipment collateral are available to all investors, subject to subordination arrangements between investors (see paragraph (v) below);
- (v) *Tranching*: the issue of separate classes or tranches of securities with different payment priority creates lower LTVs for senior investors and pushes first loss risk down to the most subordinated investors upon originator / issuer payment default. Accordingly, the notes of different tranches will receive different ratings and will offer a different coupon, allowing the originator to access both the investment grade and high-yield investor markets. This can create a high overall LTV tolerance, typically around 85% on a EETC transaction and 92.5% for the Virgin Australia EETC transaction.

Assessment of risk and ratings

- 14 For some investors, a credit rating is a pre-requisite to considering an investment in any debt capital markets transaction. Unsecured transactions derive their rating from the credit of the issuer, because repayment depends upon the financial performance of the issuer. Secured transactions such as secured corporate bonds, ABS and EETCs have a transaction specific rating as they derive their rating from both transaction specific factors and the ability of the operator(s) of the aircraft equipment to service the issuer's payment obligations (i.e. corporate default risk).
- 15 Typically, ratings for corporate bonds secured on aircraft equipment (without further structural enhancement) are one or two notches above the credit rating of the originator. By comparison, ABS and EETC transactions can achieve ratings of between approximately six and nine notches

¹¹ Some of these enhancements are equally applicable to ABS and secured corporate bond structures. However, they are included here as they have become customary features of EETC transactions.

¹² For further discussion, see Part III below.

above the credit ratings of their airline originators for the senior most tranche of securities issued. In each case, the transaction rating achieved will depend on consideration of a number of factors and, in particular, the level of insolvency protection and structural enhancement offered by the transaction.

- 16 The assessment of risk in connection with a secured transaction will be more straightforward where the airline or operator that ultimately services the issuer's payment obligations has its own corporate credit rating. As the level of investor protection provided by a secured transaction structure increases, the importance of the creditworthiness of the party servicing the issuer's payments decreases (though it will remain an important factor in the overall assessment of the transaction) relative to other factors such as the value of the assets on which the transaction is secured and investor recourse thereto in the event of insolvency or default. For example, corporate ratings were not publicly available for EETC issuances originated by Doric Alpha/Emirates and Virgin Australia and rating agencies based their transaction ratings on an assessment of the credit quality and business of the airlines alongside usual transaction specific considerations.
- 17 With the current levels of growth of debt capital markets financing in the aviation sector, it is expected that many more owners and operators of aircraft equipment will seek corporate ratings in order to facilitate access to the debt capital markets and to increase their attractiveness to investors.
- 18 Rating agencies consider a number of factors when providing a corporate rating. Moody's Investors Service, Standard & Poor's, Fitch Ratings and Kroll Bond Ratings have corporate ratings methodologies for the airline industry, many of which are published. The key factors considered include asset quality, business risk, diversity (both geographic and revenue), operating efficiency, leverage, management and financial policy.
- 19 Rating agency methodology for determining transaction specific ratings examines a wide range of factors. While these factors will vary on a case by case basis, and not all factors are essential to a marketable transaction, they include an assessment of the transaction structure (including bankruptcy remoteness), asset quality and resale value, collateral coverage (including cross-default and cross collateralisation), diversity of asset types and underlying credits, availability of liquidity facilities or other credit support and the speed and reliability of investor recourse to collateral in the event of insolvency or default (including jurisdictional analysis). When analysing ABS issued by operating lessors, rating agencies use a slightly different methodology, focussing more on the ability of the operating lessor to manage their portfolio (including capability to repossess, maintain, remarket and redeploy the aircraft equipment) than the credit of the underlying airlines and jurisdictional insolvency analysis, as such factors are expected to change from time to time over the term of the transaction.
- 20 The ability of non-U.S. airlines to issue secured debt in the international capital markets has been sharply limited where the insolvency laws relating to aircraft equipment in the state in which the airline is situated are not substantially similar to Section 1110 of the U.S. Bankruptcy Code. A lower degree of clarity and predictability around the legal protections afforded to investors and the timelines for repossession of aircraft equipment following an airline insolvency has a material adverse impact on the risk assessment and rating of transactions. Firstly, the increased risk can impact on terms and conditions; for example, a requirement for larger liquidity facilities, lower LTVs and/or higher coupons. Secondly, more in-depth and time consuming analysis, which then implies that any secondary liquidity of the bond will be limited since any secondary purchaser would likely need to do the same detailed analysis. However, there is evidence to suggest that the ratification and effective implementation of the Cape Town Convention¹³ assists investors and rating agencies in their analysis of repossession risk following insolvency of non-U.S. airlines. The

¹³ Effective implementation of the Cape Town Convention includes the implementation of CTC Alternative A and the other "qualifying declarations" which are required to be implemented for a state to qualify for the so-called 'Cape Town Discount' under the 2011 ASU. For further discussion, see paragraph 23 below.

Cape Town Convention provides a standardised model, which should also lower transaction costs. See Appendix A for rating agency commentary on repossession and insolvency risk in respect of EETC transactions originated by non-U.S. airlines.

PART III: INSOLVENCY, REPOSSESSION AND THE CAPE TOWN CONVENTION

The effect of insolvency on investor protections

- 21 In debt capital markets transactions secured on aircraft equipment, investors and rating agencies alike are concerned with the predictability of the legal process upon enforcement of the security to ensure that the aircraft equipment can be repossessed in a timely fashion and the value of the aircraft equipment realised. Investors and rating agencies will give particular focus to whether the legal system in the jurisdiction in which the operator or airline is situated will recognise the rights of the creditors to repossess the aircraft equipment in a timely manner in the event of an operator or airline insolvency and how predictable and prompt the repossession process has been and will be.
- 22 In the United States, where the debtor holds an air carrier operating licence, Section 1110 of the Bankruptcy Code limits the moratorium on enforcement of security applicable upon commencement of bankruptcy in relation to aircraft equipment. If the debtor does not cure all defaults during an initial 60 day moratorium, and no court-approved agreement is in place, then the creditor can repossess the aircraft equipment. As there is a well developed market for EETC transactions and other secured debt issuances by U.S. airlines, the protections afforded by Section 1110 of the Bankruptcy Code are well understood by experienced investors.
- 23 The Cape Town Convention provides similar, if not enhanced,¹⁴ protections to investors as compared with Section 1110 of the U.S. Bankruptcy Code. This assumes that the debtor (the operator or airline) is situated in a state that has ratified the Cape Town Convention and that such state: has made certain “qualifying declarations” in connection therewith; has implemented the Cape Town Convention and such qualifying declarations in such a way that they are appropriately translated into national law; and complies with the Cape Town Convention. The qualifying declarations under the Cape Town Convention are designed to allow prompt recovery of aircraft equipment following default or insolvency of the debtor. Chief among the qualifying declarations is the adoption of CTC Alternative A, an insolvency regime applicable to aircraft equipment which is analogous to Section 1110 of the U.S. Bankruptcy Code, and a limit on any insolvency related moratorium on enforcement (i.e. repossession of aircraft equipment) by a creditor to no more than 60 calendar days. However, the other qualifying declarations also provide protections that are important to investors secured on aircraft equipment relating to: expeditious de-registration and export of aircraft equipment; confirmation of choice of contractual governing law; preservation of asset value; and speedy advance relief and non-insolvency remedies.¹⁵ The term “**effective implementation**” is intended to refer to the adoption of the Cape Town Convention and the qualifying declarations and their primacy of conflicting national law of the relevant state.¹⁶
- 24 In jurisdictions that have not ratified the Cape Town Convention or that have not effectively implemented the full protections afforded to creditors by the Cape Town Convention, investors must look to the legal system in the jurisdiction in which the operator or airline would be subject to bankruptcy proceedings to determine their rights in the insolvency of an airline and the

¹⁴ The Cape Town Convention allows the possibility for the moratorium on enforcement to be limited to less than 60 calendar days, requires that the asset be maintained in accordance with the lease/agreement during the moratorium, and addresses the de-registration and export of aircraft.

¹⁵ For a full list of qualifying declarations, see Annex 1 of Appendix II to the OECD’s 2011 Aircraft Sector Understanding.

¹⁶ Effective implementation of the Cape Town Convention was a significant factor in the determination of the rating assigned to the Turkish Airlines EETC transaction and the level of protection offered to investors in an emerging market (see rating agency commentary in Appendix A). Turkey has made the requisite qualifying declarations to be eligible for the Cape Town Discount (see paragraph 26 below) and the Cape Town Convention prevails over conflicting national laws in Turkey by means of express legislation to that effect.

predictability and speed of the process for repossession of aircraft equipment. This may be less problematic in jurisdictions which offer substantially similar protections to those available under Section 1110 of the U.S. Bankruptcy Code or under the Cape Town Convention. However, diligence by rating agencies and investors may reveal that insolvency laws in particular jurisdictions have features which are unfavourable to creditors and may lead to unpredictable outcomes; this in turn provides a less standardised model which is likely to increase transaction costs. Such features may deter more risk averse investors and negatively impact demand for, and pricing of, debt capital markets transactions originated by airlines in such jurisdictions.

Effective implementation of, and compliance with, the Cape Town Convention

- 25 Where the Cape Town Convention, and in particular the adoption of the CTC Alternative A insolvency regime thereunder, is being relied upon by investors for protection against the risks associated with insolvency of an operator or airline, the effective implementation of, and compliance with, the Cape Town Convention is of the upmost importance. Effective implementation and compliance deliver to creditors predictable outcomes and prompt recovery of aircraft equipment in the event of operator or airline insolvency. In turn, it is expected to deliver, and has delivered,¹⁷ a positive impact on the cost and availability of finance for aircraft equipment to airlines and operators.
- 26 The 2011 ASU provides a further and substantial financial incentive to states for effective implementation of, and compliance with, the Cape Town Convention. It allows for a flat 10% discount, the so-called ‘Cape Town Discount’, on the minimum premium rates required to be charged for officially supported export credit financing from ASU participant states. The discount is only available where the relevant contracting state has made all of the qualifying declarations, including the adoption of the CTC Alternative A insolvency regime, and has effectively implemented the Cape Town Convention in such a way that its Cape Town Convention commitments are appropriately translated into national law. As of 27 October 2015, 24 contracting states had been added to the OECD list of states who qualify for the ‘Cape Town Discount’.¹⁸
- 27 The OECD is the body responsible for determining whether a contracting state has fulfilled the conditions for the ‘Cape Town Discount’ and whether a contracting state ceases to meet such conditions. Where a contracting state has ceased to comply with its Cape Town Convention and qualifying declaration commitments, the OECD may determine that such contracting state is no longer eligible for the ‘Cape Town Discount’. This means that the incentive provided under the 2011 ASU is not limited to effective implementation but extends to continuing compliance with Cape Town Convention commitments.

¹⁷ See rating agency commentary on EETCs offered by non-U.S. airlines in Appendix A.

¹⁸ The list of qualifying states is available at: <http://www.oecd.org/tad/xcred/ctc.htm>

28 Effective implementation of the Cape Town Convention can be demonstrated objectively and is somewhat easier to monitor than compliance with Cape Town Convention commitments.¹⁹ As with law generally, and aviation related treaty law in particular, there is a presumption that countries will comply with their treaty obligations.²⁰ This presumption of compliance is the reasonable starting point for contracting states that have effectively implemented the Cape Town Convention. This approach is in line with the 2011 ASU criteria for the ‘Cape Town Discount’ and is supported by the general record of compliance with the Cape Town Convention and other international treaties relating to the aviation and financial sectors and the sanctions for non-compliance with the Cape Town Convention. Sanctions for non-compliance with the Cape Town Convention include: loss of the ‘Cape Town Discount’; reputational costs in aviation, legal and investment sectors; and the resulting upward revision of risk and financing rates.

¹⁹ But a system is being developed under the University of Oxford – University of Washington Cape Town Convention Academic Project that contemplates compliance reporting on a public database.

²⁰ Where countries fail to comply with their treaty obligations, there is also practical experience, in the aviation market and in other markets, of participants reacting in a way that incentivises compliance.

Appendix A²¹
Rating Agency commentary on non U.S. EETC transactions²²

Virgin Australia (*Cape Town Convention applicable to New Zealand registered aircraft only*):²³ Fitch’s legal analysis focused on the Australian insolvency regime for the Australian registered aircraft which did not benefit from the protection afforded by the Cape Town Convention.²⁴ In contrast, the analysis focused on the Cape Town Convention for the New Zealand registered aircraft which did benefit from such protections. Fitch was of the view that “the Australian insolvency regime is slightly less beneficial to note holders than Section 1110 or the Cape Town Convention, although the ratings in the transaction were not affected. The Australian regime is not aircraft-specific, unlike Section 1110 and the Cape Town Convention.” Fitch also noted that exercise of rights under such transactions had not been tested in the Australian courts (in contrast with Section 1110 in the U.S.). Fitch also noted that the “Australian insolvency regime does not have a cure requirement, unlike Section 1110/Cape Town Convention” and went on to say that “this type of structure would not likely work in other countries with less proven, more debtor-friendly legal systems.” In contrast, Fitch viewed “the creditor approach provided by Cape Town Convention as ratified in New Zealand to be similar to the legal protection provided by Section 1110 in the U.S.”, adding that they did not have a significant concern with the Cape Town Convention being untested in the New Zealand courts given the reliability of the legal system.

British Airways (*Cape Town Convention not applicable*):²⁵ Moody’s stated “We believe that UK courts typically respect ownership rights in leasing transactions, which implies that under a payment default scenario by British Airways, the Trustee would likely be able to repossess in a timely manner.” Moody’s also stated that “the creditor-orientated character of UK insolvency law provides a sufficient level of protection relative to that of Section 1110, notwithstanding that the former does not define a specific time-frame for which the Administrator must decide whether to affirm a secured debt obligation or a lease or return the collateral to creditors once an administration commences.”²⁶

Doric Alpha / Emirates (*Cape Town Convention applicable*):²⁷ Moody’s stated that the UAE adopted the Cape Town Convention “in a manner that is intended to be favorable to creditors” as it adopted Alternative

²¹ Current as of March 2016.

²² For commentary of non-U.S. EETC transactions more generally, see: (a) ‘Ratings Direct: Credit FAQ: Standard & Poor’s Approach to Enhanced Equipment Trust Certificates Issued by Non-U.S. Airlines’ February 27, 2014, which states that “[the Cape Town Convention] is facilitating the issuance of EETCs to non-U.S. airlines’ (p.2) and “[w]e believe that the ratification of the Cape Town Convention – especially if its statutes are highly integrated into local laws – and a reliable and predictable legal regime benefit our analysis of EETCs’ (p.3); (b) Moody’s ‘Enhanced Equipment Trust and Equipment Trust Certificates’ December 28, 2010, which states that “significant work has been done to create a common framework for equipment financings among signatory nations to the Cape Town Convention ... We see the potential for Cape Town provisions to reduce the expected loss of equipment financings for some non-U.S. aircraft financings” (p. 8); and (c) Fitch Ratings’ ‘Rating Aircraft Enhanced Equipment Trust Certificates’ September 12, 2013, which states that “While most countries have ratified the treaty in the recommended manner, some have not, which could cause delays for creditors in airline bankruptcies.” (p. 23).

²³ See Fitch ratings report: RPT – Fitch rates VAH’s proposed 2013-1 EEN class A certs ‘A’, class B certs ‘BB+’, class C certs ‘B+’, October 7, 2013.

²⁴ Australia has since ratified the Cape Town Convention. The Cape Town Convention came into force in Australia on 1 September 2015. Australia appears on the OECD’s list of states qualifying for the Cape Town Discount.

²⁵ See Moody’s ratings report: British Airways, Plc Series 2013 – 1 Enhanced Equipment Trust Certificates, June 25, 2013.

²⁶ The UK has since ratified the Cape Town Convention. The Cape Town Convention came into force in the UK on 1 November 2015. The UK has adopted, *inter alia*, the Alternative A insolvency regime with a waiting period of sixty days.

²⁷ See Moody’s ratings report: Doric Nimrod Air Finance Alpha Limited Series 2012-1 Enhanced Equipment Trust Certificates, June 21, 2012. Doric Alpha issued its second EETC transaction in June 2013 - see Moody’s ratings

A, the use of IDERAs and Choice of Law.²⁸ Moody's noted that there was no apparent record of enforcement of the Cape Town Convention in the UAE which left "no case history from which to infer future outcomes" but were of the view that Dubai law seemed to support the rights of property owners "which implies that, under an event of default by Emirates, Doric Alpha...should be able to recover its aircraft."

Air Canada (*Cape Town Convention applicable*):²⁹ Standard & Poor's noted that there was no precedent on how the Cape Town Convention would be enforced by the Canadian courts. Nevertheless, based on the "generally positive view of the Canadian legal system" the report "assumes that Canadian courts will interpret the statutory provisions that implement the Cape Town Convention in a manner that will give effect to the protections afforded by the Cape Town Convention and its related protocol" and anticipates that in the case of an insolvency-related event in respect of Air Canada, the legal protections afforded by the Cape Town Convention will be available.

Turkish Airlines (*Cape Town Convention applicable*):³⁰ Standard & Poor's noted that Turkey has made declarations under the Cape Town Convention that are "most favorable for aircraft creditors" and stated that the OECD "has classified Turkey as eligible for the maximum discount". In relation to such declarations, S&P stated that "Turkey has chosen to implement Article XI, Alternative A, which is similar to the Section 1110 of the U.S. Bankruptcy Code". The report also noted that the Cape Town Convention prevails over national insolvency laws in Turkey. Therefore, while S&P noted that there was no precedent on how the Cape Town Convention would be enforced by the Turkish courts, "based on our review of the legal system, the way Turkey has adopted the Cape Town Convention and its track record in abiding with international treaties...it is very likely that Turkish courts will interpret the statutory provisions that implement the Cape Town Convention in a manner that will give effect to the protections afforded by the Cape Town Convention and the related protocol" and anticipated that in the case of an insolvency-related event in respect of Turkish Airlines, the legal protections afforded by the Cape Town Convention would be available.

LATAM Airlines (*Cape Town Convention applicable to Brazilian registered aircraft only*):³¹ Standard & Poor's legal analysis focused on the Cape Town Convention for the Brazilian registered aircraft. Standard & Poor's stated that "there are legal and structural protections available to the pass-through certificate holders such as...Brazil's ratification of the Cape Town Convention..." S&P also stated that Brazil had adopted CTC Alternative A. While S&P noted that "Brazil also has little track record of applying the Convention's rules so there's very limited precedent to how Brazilian courts would enforce them", S&P believed that "despite some uncertainties regarding how long these processes would take, the enforcement of the repossession through the leases would still happen."

END

report: Doric Nimrod Air Finance Alpha Limited Series 2013-1 Enhanced Equipment Trust Certificates, June 24, 2013.

²⁸ See discussion of "qualifying declarations" in Part III above.

²⁹ See S&P ratings report: Air Canada 2013-1 Pass-Through Certificates Rated Preliminary 'A-' (sf) (Class A) And Preliminary 'BB' (sf) (Class B), April 24, 2013. Air Canada issued its second EETC transaction in March 2015 – see S&P ratings report: Air Canada 2015-1 Pass-Through Certificates Rated 'A (sf)' (Class A) And 'BBB (sf)' (Class B) And 'BB- (sf)' (Class C), March 25, 2015. Air Canada issued its third EETC transaction in December 2015 – see Moody's ratings report: Air Canada 2015-2 Enhanced Equipment Trust Certificates, 1 December 2015.

³⁰ See S&P ratings report: Turkish Airlines Bosphorus Pass-Through Certificates Series 2015-1A Rated 'A- (sf)', March 19, 2015. Turkish Airlines issued its second EETC transaction in September 2015. It was the first ever Yen-denominated EETC issuance totalling JPY 11.9 billion (approximately USD 99 million).

³¹ See S&P ratings report: LATAM Airlines Group S.A. Pass-Through Certificates Series 2015-1 Rated Preliminary 'A- (sf)' (Class A) And Preliminary 'BBB- (sf)' (Class B), May 14, 2015.