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Statement of Karan Bhatia Assistant Secretary Aviation and International Affairs

Accompanied by: Ms. Clare Donelan Senior Attorney, Legislative Staff Office of the Chief Counsel Federal Aviation Administration

House Transportation and Infrastructure Committee Subcommittee on Aviation

April 29, 2004

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to testify this morning in strong support of the Cape Town Convention and the Protocol on Matters Specific to Aircraft Equipment, commonly known as the Cape Town Treaty, and its implementing legislation, which addresses certain responsibilities of the Federal Aviation Administration (FAA) relating to the Treaty. I would like to provide a short overview of the Treaty itself and then briefly describe the pending legislation and why the Department recommends this Committee's favorable action. With me today is Clare Donelan from the FAA's Chief Counsel's Office.

The Cape Town Convention and Aircraft Protocol, when fully implemented, will bring significant economic benefits to a variety of U.S. constituencies while helping to facilitate the modernization of airline fleets around the world. For countries that manufacture aircraft there likely will be increased exports as the number of aircraft orders increases. Increased exports also could mean more jobs for exporter countries such as the United States. Moreover, developing countries and their airlines will be able to upgrade their fleets at reduced financing costs-- based on reduced

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costs to creditors. As a result, the world's skies will be safer and cleaner as newer, state-of-the-art aircraft are acquired and brought into service. As such, the Treaty is a very practical and useful way of promoting aviation safety in partnership with countries across the globe.

The Cape Town Convention and Aircraft Protocol were negotiated under the auspices of the International Institute for the Unification of Private Law (UNIDROIT), an intergovernmental organization focused on harmonizing the commercial law of nations, and the International Civil Aviation Organization (ICAO), the United Nations body responsible for international aviation. It was concluded in November 2001 at a Diplomatic Conference at Cape Town, South Africa, and has been signed by 28 states, including the United States. The President transmitted the Convention and Aircraft Protocol to the Senate on November 5, 2003, where it is now pending before the Senate Foreign Relations Committee. I should note that both the State Department and the Department of Transportation testified before that Committee earlier this month in strong support of the Treaty.

The Convention entered into force on the day of that earlier Senate hearing--April 1st--and we expect that the Aircraft Protocol will come into force late this year. The Convention is designed flexibly to be able to operate in conjunction with protocols covering different types of high value mobile equipment. The Convention itself sets out the basic terms and provisions that underlie the regime. However, it is not equipment-specific and in fact needs a protocol particular to a given type of equipment in order to operate. The Protocol before you today applies to airframes, aircraft engines and helicopters above a minimum size or power threshold. In addition to this Aircraft Protocol, the Convention specifically contemplates that there will also be protocols governing railway rolling stock and space assets. Negotiations are at an advanced stage with respect to a protocol on railroad equipment and it is anticipated that a diplomatic conference will be held in 2005 to adopt such a protocol. Negotiations are at an earlier stage with respect to space assets. Left open is the possibility that additional protocols covering other types of high value mobile equipment may be negotiated in the future.

The rights and enforceable remedies created by the Convention and Aircraft Protocol are designed to reduce the risk assumed by creditors in financing transactions in many parts of the world. In many countries, the risk factor is significant because local laws either do not protect lenders in the event of default or bankruptcy, or are highly unpredictable. With respect to aircraft, this uncertainty is compounded by the fact that aircraft are by their nature highly mobile equipment. They can and do move readily between countries. It is this uncertainty that drives up the cost of aircraft financing in many countries, which is reflected in the interest rate the financier charges the debtor, or whether financing is available at all.

The Convention seeks to reduce this risk in a number of ways. For example, it provides financiers with a number of key rights with respect to an aircraft financed to an airline of a country that has ratified this Convention and Protocol. These include the right, upon default of a debtor, to deregister the aircraft and procure its export; to take possession or control of the aircraft, or sell or grant a lease in the aircraft; and to collect or receive income or profits arising from the management or use of the aircraft. The extent of these rights and the speed with which they can be exercised will be a function of the declarations a country files at the time it deposits its instrument of ratification. These declarations adjust which remedies that the country will allow and the means by which the remedies can be implemented. It can be expected that the greater the remedies a country chooses to recognize in its declarations, the greater its benefits will be.

These benefits are likely to take the form of lower financing charges and fresh sources of capital for aircraft financing. This will particularly benefit developing countries whose carriers have had to pay high interest rates or who have not been able to access the commercial credit markets at all because of their credit risk. For those countries that have historically financed aircraft acquisitions through the use of sovereign guarantees, the ability to make use of asset-based financing will allow such guarantees to instead be used for other national purposes. "Asset-based financing" simply means that a lender has assurance under law that, if a debtor defaults, the lender can very quickly recover the "asset" that served as the collateral for the loan.

A core part of the Treaty is its creation of an "international interest", which is a secured credit or leasing interest

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with defined rights in a piece of equipment--e.g. an aircraft. These rights consist primarily of 1) the holding of a clearly defined finance priority in the equipment, and 2) the ability of the holder of such an interest to repossess or sell or lease the equipment in case of a default. Priority will be established when a creditor files, on a first-in-time basis, a notice of its security interest, in a new, electronic International Registry that will be established under the Treaty. Once an international interest has been filed by a creditor and becomes searchable at the International Registry, that creditor's interest will have priority over all subsequently registered interests and all unregistered interests, with a few exceptions.

The FAA currently operates an aircraft registry, located in Oklahoma City, for U.S. civil aircraft. It is a comprehensive registry that functions not only as the entity that establishes the nationality of a U.S. aircraft (via the assignment of a registration number); it also operates a system for the recording and full documentation of certain security interests in U.S. civil aircraft, engines and spare parts. The system is well established and is a very useful tool for the aviation sector. One of the U.S. goals for the Cape Town negotiations was to ensure that the functions of FAA registry remained undisturbed by the new Treaty.

Accordingly, a declaration to the Treaty expected to be made by the U.S. will provide that the FAA will serve as the authorized entry point into the International Registry. This will allow the aircraft financing practices in the United States, among the most efficient in the world, to continue intact by permitting searches of documents on the FAA Registry.

The International Registry will be searchable on a 24 hour, 7 day a week basis. Fees will be charged for registering a financial interest in the International Registry and for other services connected to use of the International Registry. Such fees are expected to be very small because of the electronic nature of the registry.

ICAO will supervise the International Registry. A Preparatory Commission, established by the ICAO diplomatic conference and comprising 20 countries including the United States, has been doing the groundwork needed to get a registry system in place. In particular, working with ICAO, the Preparatory Commission prepared a request for proposals from which to select an entity to administer the registry. The request went out earlier this year, and a selection by the Preparatory Commission of a Registrar is on track to be made at the end of May. It is expected that the International Registry will be operational in the latter part of 2004.

The financing provisions on secured interests under the Treaty do not require any implementing legislation here in the U. S. In this respect, the Treaty is self-executing. However, certain technical amendments to aviation law are required to fully integrate filings with the new the International Registry with the existing FAA registry functions. Last fall, following transmittal of the Cape Town Treaty to the Senate by the President, Secretary Mineta sent Congress a set of proposed technical amendments to the FAA's authorities to accomplish this end. Although the Committee's legislation is somewhat different from the Administration's original proposal, it accomplishes essentially the same goal--implementation of the Treaty. We support the bill and look forward to working with the Committee to ensure that the bill does not result in any delay in implementation of the Cape Town Treaty and the important economic benefits to be derived therefrom. The bill would:

\* designate the FAA as the "entry point" for authorizing filings relating to U.S. civil aircraft and aircraft engines to the new International Registry while maintaining the full documentation system of the FAA registry; \* make necessary conforming changes to chapter 441 of title 49, United States Code by adding references to the new Treaty, and making changes to registration eligibility to reflect provisions of the Cape Town Treaty relating to engine size and the treatment of prospective interests in aircraft and aircraft engines; \* provide for expedited rulemaking so that the necessary implementing processes for registration and deregistration of aircraft and for prospective interests are in place when the Treaty comes into force in the U.S.; and \* clarify that, during the rulemaking process, the Treaty's provisions, which once ratified have the force of Federal statute, would supercede inconsistent FAA regulations--which is important to provide legal clarity for aviation practitioners in this country during the implementation of the Treaty.

Mr. Chairman, in conclusion, I wish to note that the leadership role the United States played in the development of

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the Cape Town Treaty will continue and will be supported by the action of your Committee today. The Committee's legislation will speed the entry into force of these agreements and hasten the realization of benefits to our economy, our exporters, the economic recovery of international aviation, the developing world, and the safety of aviation. I thank the Committee for its interest and attention to these matters and would be pleased to answer any questions you may have.

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