

Aviation Finance Update: Canada

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Blakes
CANADIAN LAWYERS

The Canadian EETC Trilogy

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The Blakes Aviation group, representing the underwriters led by Morgan Stanley and Credit Suisse, is pleased to have assisted in the closing of the third Air Canada enhanced equipment trust certificate (EETC) transaction.

In April 2013, we assisted in the structuring and closing of **Air Canada EETC 2013-1** for five new Boeing 777 300ERs, which was a historic transaction, including the following features:

- Canada's first EETC
- World's first EETC to enjoy full Cape Town Convention benefits on an unqualified basis
- World's first EETC issued by non-U.S. airline to receive "pure" EETC pricing and terms
- 4.66 per cent blended rate effectively priced better than U.S. benchmarks (significant NPV savings over next best alternative)
- Liquidity Facility — 18 months
- Very high effective LTVs

U.S. rating agencies gave the Air Canada transaction notching upgrades equivalent to U.S. 1110 protection without the need for additional enhancements (such as Air France/Iberia/Emirates, extended Liquidity Facility and/or Repossession Facility or pricing premium such as for British Airways or Virgin Australia).

Heavy investor demand resulted in high oversubscription on all three tranches.

This transaction received both *Airfinance Journal* and *Airline Economics* "Deal of the Year" awards in 2014.

In March 2015, representing the underwriters led by Morgan Stanley and Credit Suisse, we assisted in the closing of **Air Canada EETC 2015-1** for one Boeing 787-8 (previously delivered) and eight new Boeing 787-9 aircraft, including the following features:

- Class A, Class B and Class C Certificates — same as 2013
- 3.81 per cent blended rate
- Liquidity Facility — 18 months

Structurally, this was a much simpler transaction and it resembled more closely a typical U.S. airline EETC (2013-1 included a separate special purpose entity as issuer, which issued the Equipment Notes and entered into a conditional sale agreement with Air Canada at delivery of each aircraft, and issued mortgages to the loan trustee — required due to certain negative covenants in then existing financing).

In 2015-1, Air Canada granted security over the aircraft through a Trust Indenture and Mortgage. Air Canada also granted security through a separate Deed of Hypothec. This was required under Quebec law as Air Canada's domicile (registered office) is in Quebec. There was no difference in the manner that the transaction was rated.

In December 2015, representing the underwriters led by Morgan Stanley, we assisted in the closing of **Air Canada EETC 2015-2** for three new Boeing 787-9 and two new Boeing 777 aircraft to be delivered in April and May 2016, including the following features:

- Liquidity Facility — 18 months
- 4.044 per cent blended rate
- Certificates offered: Class AA, Class A and Class B Certificates — different than 2013 and 2015-1. Only one or two U.S. airlines had issued with Class AA Certificates prior to Air Canada.

Air Canada's structure with Class AA Certificates was the first prefunded EETC with Class AA Certificates. Introduction of Class AA Certificates required certain changes to liquidity facility and deposit arrangements, but overall, substantially the same documentation as EETC 2015-1.

Cape Town in Canada: Happy 3rd Birthday!

Auriol Marasco
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While the CTC (defined below) has had the force of law in the majority of Canada since 2013, on July 1, 2016, the CTC will be in force across Canada.

Background

After much anticipation, the *Convention on International Interests in Mobile Equipment* and the *Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment* (collectively, the CTC) became law in Canada on April 1, 2013. Canada is a federal state consisting of a central federal government and 13 provincial

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and territorial governments. Under Canada's constitution, international and interprovincial transportation, aeronautics and bankruptcy and insolvency matters fall within federal jurisdiction, while property and civil rights matters remain the responsibility of the provinces. Given that the subject matter of the CTC straddles both provincial and federal jurisdictions, it was necessary for the CTC to be implemented by the federal government and by each province and territory. Given the various levels of government involved, the implementation of the CTC in Canada took a somewhat staggered approach.

Canada deposited its ratification instruments for the CTC, including declarations incorporating all Organisation for Economic Co-operation and Development (OECD) and Aircraft Sector Understandings (ASU) qualifying declarations, with UNIDROIT in December 2012 in respect of each province and territory except Prince Edward Island, Yukon and New Brunswick. Accordingly, the CTC has become federal law in Canada and has become provincial law in Ontario, Quebec, Alberta, Saskatchewan, Nova Scotia, British Columbia, Newfoundland and Labrador, Manitoba, the Northwest Territories and Nunavut as of April 1, 2013 (except that it has had the force of law in Newfoundland and Labrador since May 3, 2013). Canada deposited supplemental declarations in respect of Yukon and Prince Edward Island on March 28, 2014, and in accordance with Article 57(2) of the CTC, it took effect on October 1, 2014. On December 23, 2015, the federal government again submitted subsequent declarations to UNIDROIT in respect of New Brunswick. These declarations will take effect on July 1, 2016. As such, appropriately, on Canada Day, 2016, the CTC will have the force of law in all jurisdictions in Canada.

(War) Risky Business in Canada

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Existing Aviation War Risk Liability Program

Canadian aircraft operators are required by law to maintain certain levels of insurance. In addition to these legal minimums, financiers and lessors normally have their own prescribed coverage requirements, which include war risk liability and hull coverage. War risk coverage is now usually only available for an additional premium. Prior to 9/11, war risk insurance was readily available at commercially reasonable rates, but after 9/11, private war risk insurance was temporarily cancelled. When such insurance was reinstated, it was done so at reduced indemnity coverage and, for most airlines, became prohibitively expensive. As a result, Canada created the Aviation War Risk Liability Program (Program) in 2001 to fill this gap. The aim of the Program was to provide war risk indemnity to the Canadian air industry in an amount equal to the amount of general insurance coverage carried by the entity. The Program is required to be periodically renewed.

All Good Things Come to an End

The 2014 Undertaking by the Government of Canada to provide war risk indemnity under the Program came to an end on December 31, 2015, but was extended for another six months, by the Undertaking issued on November 16, 2015, by the Government of Canada, until June 30, 2016. Initially, it had provided coverage for "risks listed in the clause headed 'War, Hi jacking [sic] and Other Perils Exclusion Clause' in the standard

aviation insurance policy, to the extent that such risks have been included in a standard write-back endorsement to a policy, and any other such risk that is not included in the standard write-back endorsement that the Minister of Transport may, from time to time, in his sole discretion, declare in writing to be subject to the Undertaking, to the limit of the amount covered for aviation liability under the insurance policy, less whatever coverage is commercially available during the subject period." Coverage was provided to "any person covered under an insurance policy held by an airline, an airport operator, NAV Canada, or any supplier of goods or services to an airport operator, an airline in Canada or NAV Canada who is insured against general liability under an insurance policy."¹ This effectively meant that financiers and lessors, who are generally named as additional assureds in the insurance policy of the aircraft operator, could benefit from the government's coverage.

However, the wording of the extended 2015 Undertaking on its face appears to only indemnify aviation industry participants, which are defined by the *Aviation Industry Indemnity Act* (Act) as:

- a. An air carrier
- b. NAV Canada
- c. An owner or operator of an airport
- d. A supplier of goods or services that directly support the operation of aircraft from an airport, including with respect to (1) the preparation of an aircraft for departure or on its arrival, including maintenance and cleaning of the aircraft and the loading and unloading of passengers, baggage and cargo, (2) freight forwarding, (3) air navigation, or (4) airport security services, or
- e. An entity that is prescribed by regulation or a member of a class of entity that is prescribed by regulation

New Commercial Practice

This meant that financiers and lessors are not able to benefit from the Program coverage, and, therefore, that aircraft operators, in order to satisfy their insurance obligations under their respective leases and financing documents, have had to obtain war risk insurance from the commercial markets.

While the Minister of Transport issued a letter to the National Airlines Council of Canada to clarify that the scope of the extended indemnity was meant to cover the same entities as under previous undertakings, the wording of the 2015 Undertaking itself was not amended.

As a result, all the major Canadian airlines have obtained war risk coverage on the private market since the 2014 Undertaking period ended on December 31, 2015. In any event, the extension of the entire Program will terminate on June 30, 2016, unless there is a further extension, and all aircraft operators will have to obtain private war risk coverage if required to do so under their leases and/or financing documents.

¹ Undertaking with respect to Aviation War Risk Liability (2014-01-01)

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Droning on in Canada

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Operating in Canada

Transport Canada Aviation (TCA) is responsible for aeronautical safety in Canada. As such, it regulates the conduct of civil unmanned aerial vehicles (UAVs) for both commercial and private use. In Canada, UAVs must meet the equivalent levels of safety as exist for manned aircraft.

In general, Canadian aviation regulations apply to UAVs that have a total weight in excess of 35 kilograms (77.2 pounds) or to UAVs driven or launched into flight for purposes other than recreational use. In respect of UAVs meeting these criteria, unless the UAV operations qualify for another exemption, a Special Flight Operation Certificate (SFOC) must be obtained from TCA. An SFOC must be obtained for each and every flight, although a "blanket SFOC" can be obtained for certain operations, especially when a safety track record has been established with TCA. While there is no formal application for an SFOC, in general, it should contain information pertaining to the qualification and experience of the operator, detailed specifications about the UAV, including drawings where applicable, the proposed operation plan and, most importantly, the applicable safety precautions and emergency plan.

Regulatory Quick Fix

In late 2014, TCA issued a staff instruction (SI) in respect of UAV operations in Canada. A staff instruction does not have the force of law but does provide TCA officials with guidance as to how to implement the law. In addition, TCA issued an advisory circular (AC) also in respect of UAV operations in Canada. Similar to the SI, an advisory circular does not have the force of law. Instead, an advisory circular serves to provide general guidance and explanatory information to the general public.

The goal of the SI and AC was to ensure that the SFOC process was more in line with the changing technology of UAVs and the type of operations being conducted with UAVs. The SI eliminates the need for SFOCs in respect of small UAVs in certain circumstances. The exemptions for UAV operations are in respect of UAVs with (1) a maximum take-off weight not exceeding two kilograms (4.6 pounds) (Light Exemption) or (2) a maximum take-off weight exceeding two kilograms (4.6 pounds) but not exceeding 25 kilograms (55.1 pounds) (Heavy Exemption).

Keeping Up with Technology

While the exemptions created under the SI and AC have assisted in processing the backlog of SFOC applications, the current regulatory regime is incompatible with the rapidly evolving UAV industry. Fortunately, the government agrees. In 2015, the Canadian Aviation Regulations Advisory Council issued a notice of proposed amendment (NPA) in respect of UAVs. The NPA announced that TCA intended to revise the regulatory regime as it relates to UAVs 25 kilograms or less that are operated within visual line-of-sight. There are two main changes: (1) the requirement for such UAVs to be marked and registered with TCA and (2) the requirement for UAV pilots to obtain a pilot permit from TCA. This is consistent with the SI which notes that, while TCA does not currently

issue air operator certificates for UAV operations, such certificates will likely be the subject of future regulatory developments. While these proposed changes do not address all of the regulatory issues in operating UAVs in Canada, they are a step in the right direction.

Canadian Aviation in the News

HEADLINES

- In February 2016, Bombardier and Air Canada entered into a letter of intent for the purchase of 45 CS300 aircraft with options for an additional 30 CS300 aircraft, including conversion rights to CS100 aircraft.
- In October 2015, the Quebec government pledged C\$1.3-billion to aid Bombardier's C-Series line. The pension fund, Caisse de dépôt et placement du Québec, purchased 30 per cent of Bombardier's train business, though it will be used to help the C-Series line, for US\$1.5-billion. Bombardier requested further aid from the federal government in the amount of US\$1-billion.
- In February 2016, WestJet began talks with Boeing and Airbus regarding replacements for its fleet of Boeing 767-300ER aircraft.
- The federal government confirmed that it will likely be renewing its payment this spring to remain part of the F-35 consortium of countries, notwithstanding its election promise not to purchase the F-35 Joint Strike Fighter. The federal government has promised to hold a new RFP process for the replacement of its existing CF-18 fleet, but it is not clear whether the F-35 will continue to be a candidate.
- The 27th Annual Canadian Airline Investment Forum 2016 will be held June 14-15, 2016, in Toronto (www.insightaircraft.com). President and CEO of Air Canada, Calin Rovinescu, will be the key note speaker.

DELIVERIES AND ORDERS

2015

- Bombardier delivered 275 aircraft and received 27 orders net of cancellations
- Air Canada accepted delivery of the first of 29 firm Boeing 787-9 aircraft
- WestJet Airlines Ltd. accepted delivery of the first of four Boeing 767-300ER aircraft
- WestJet Encore placed a firm order for six additional Bombardier Q400 aircraft

2016

- Air Canada entered into a letter of intent to purchase 45 firm CS300 aircraft and options for 30 more CS300 aircraft

For more information about any of the above, please contact any member of our Aviation/Aerospace group.

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