

GATS: BUSINESS AVIATION PARTICIPANTS SHOULD PROCEED WITH CAUTION


On Friday, March 29, 2019, the Aviation Working Group (AWG) published FAQs, e-terms, and draft contracts relating to its Global Aircraft Trading System (GATS). Those documents and other materials published by fixed-wing commercial aircraft financiers suggest that GATS is really designed for that market. The FAQs are, however, drafted expansively, and the GATS e-terms expressly contemplate that business aviation participants could use GATS.

Perhaps GATS will work well for fixed-wing commercial aviation market participants. Business aviation participants should proceed with caution for these reasons:

The value that GATS purports to add is unapparent

1. Facially, it is hard to see how obtaining aircraft syndications data through a centralized portal to record it on a decentralized system of record owned and maintained by that portal adds value to current market practices. That data is already recorded in a decentralized manner by each market participant in its own system of record.
2. The focus by the AWG on no increased obligations for obligors is a red herring. Financiers require syndication rights in order to manage (among other things) their: exposure to equipment and credits; and costs of funds. In other words, the benefits of syndication are one-sided, so an obligor should never incur increased obligations as a result of a syndication.

The AWG appears to be an opaque special interest group

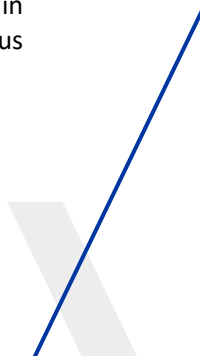
1. According to its website, the AWG is a private non-profit legal entity based in Bermuda whose members are manufacturers and financiers of primarily fixed wing commercial aircraft and engines. Whatever its projects, it is unclear that the AWG represents the interests of any other aviation market participants, or that it could do so effectively.
 2. The members of the AWG may have transparency into its finances and governance, but the AWG does not publish that information on its website, unlike the International Registry and Aviareto. Both publish some financial information and the regulations that govern the International Registry.
 3. The AWG will charge fees for access to GATS. Once those fees are received, the AWG is a black box. Neither the AWG's website nor the GATS e-terms gives GATS participants any right to an accounting of how those fees will be allocated once collected. On the contrary, the GATS e-terms give the AWG the ability to handle that money in its sole discretion.
 4. The FAQs to GATS state that AWG will take advice from Aviareto, an owner and operator of the International Registry, "with a view to advancing best practices on electronic systems and practices for the aviation leasing and financing sector." Are these institutions sufficiently independent from one another so that this reliance is credible?
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GATS increases concentration risk

1. GATS is a single network that could be used by a number of market participants. The network effect will amplify for those market participants the negative impacts of technical outages. The GATS e-terms give the AWG flexibility to declare *force majeure* events and exempt itself from liability relating thereto. Each financier currently should manage its own records and technical issues, so the potential impact of technological failure is limited.
2. The global business aviation market could become dependent upon, and subservient to, AWG. Is that an appropriate outcome?
3. For example, the FAQs published by the AWG both state that the AWG will admit trustees and express a bias in favor of regulated financial institutions acting as trustees. Holding title to aircraft, even as a trustee, is an important activity, but it raises significant legal liability and reputational issues that may become incompatible with the business of a regulated financial institution, whether the end-use is commercial or private. End-users and financiers will be taking performance risk on the trustees who may, over time, develop interests or implement policies that run counter to the interests of end-users and financiers. One may expect that any changes required by the owner trustees, including the outright sale of their business, will be charged ultimately to the end-users on the basis of the indemnities set out in the trust and lease documents.
4. How many trustees will there be? Is each geographical market deep enough to support multiple trustees, or will a monopoly exist?
5. Finally, where proposed trustees are not regulated financial institutions, the AWG proposes to evaluate them for initial admission and review them annually. What expertise does the AWG have to conduct these evaluations? What will the criteria be?

GATS increases litigation risk

1. One may expect trustees to register contracts of sale with the International Registry in order to perfect their ownership interests. To the extent that litigation arises in connection with those interests, one may expect to have to sue before the Irish courts, which have exclusive jurisdiction over the International Registry.
2. If, in addition to that litigation, there is a concurrent issue with GATS, the GATS e-terms require its users to submit to English law and mediation followed by arbitration, both in London. Mediation and arbitration tend to be expensive compared to using local courts (with a jury trial waiver, if applicable). One can typically access the courts for little more than filing fees; mediators and arbitrators charge by the hour, in addition to the legal fees charged by counsel, also by the hour. If the transaction parties to a trust are located in the United States, Singapore, or elsewhere, litigating in England adds logistical complexity and corresponding additional expense.
3. If the litigation impacts the finance and trust documents themselves, then there will be a third set of concurrent litigation, subject to whatever laws the parties to those documents chose to govern them.
4. This dispute resolution structure makes it impossible for the litigants to consolidate their claims in a single tribunal to manage the litigation holistically. What happens if the judgments in the various jurisdictions are inconsistent?



GATS does not overcome sovereignty issues

1. GATS relies on the Cape Town Convention to cause contracting states to recognize the existence of trusts. In some of those contracting states, other than in connection with the Cape Town Convention, trusts may not exist in domestic law or, if they do, their use tends to be highly circumscribed. How does the AWG propose to cause those contracting states to understand and incorporate a concept, whether common law or statutory, that may be alien to their institutions and legal cultures? One should expect resistance from the institutions in those contracting states. How could that resistance impact the registration of aircraft? More importantly, how could that resistance impact distressed situations? Who should incur the risk that the first GATS transactions encounter difficulties that need to be resolved?
2. This risk is not unlikely: there is evidence that contracting states do not relinquish their sovereignty. Instead, the institutions of those contracting states (even in those contracting states that are eligible for the OECD discount) have not enforced the remedies available under the Cape Town Convention, such as the IDERA, as they should. This is highly worrisome; the IDERA is a much simpler concept than is a trust.

Market participants must scrutinize GATS

Transactions, once executed, are difficult and costly to restructure or unwind. This is why GATS should continue to be scrutinized both conceptually and in granular detail to determine if it is fit for purpose.

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