

AVIATION & RESTRUCTURING LAW BULLETIN

July 2006

LIABILITY FOR AIR NAVIGATION AND AIRPORT SERVICE CHARGES

Aircraft lessors and financiers may be held liable for Canadian air navigation and airport service charges incurred by airlines operating the aircraft as a result of a recent decision by the Supreme Court of Canada.

The Court recently released its decision in two controversial cases regarding the extent of the rights of NAV Canada (the privatized Canadian civil air navigation service provider) and various Canadian airports to seize and detain aircraft for the non-payment of air navigation and airport service charges incurred by an airline operating the aircraft.

The cases involved the 1999 collapse of Inter-Canadien Airlines, a Quebec regional airline and the 2001 collapse of Canada 3000, then Canada's second largest airline. In each case, Nav Canada and certain airports obtained court-ordered seizures of aircraft operated by the insolvent airline pursuant to certain statutory rights created by the *Civil Air Navigation Services Commercialization Act* ("CANSCA") and the *Airport Transfer (Miscellaneous Matters) Act* ("Airports Act"). In order to obtain possession of the aircraft, the aircraft lessors and financiers were required to post cash or equivalent security for the unpaid navigation and airport service charges.

The central question for the courts in each case was whether the ownership interests and rights of the aircraft lessors and financiers took priority over the rights of NAV Canada and the airports to seize and detain the aircraft.

In a unanimous decision that overturned decisions of the Quebec Court of Appeal and the Ontario Court of Appeal, the Supreme Court concluded that the lessors and legal title holders of aircraft are not jointly and severally liable with the aircraft operators for civil air navigation and airport service charges. However, the Court ruled that seizure and detention remedies of NAV Canada and the airports effectively take priority over the rights of the aircraft lessors and title holders to repossess the aircraft by finding that the authorities were entitled to detain the aircraft seized until the charges had been paid.

Accordingly, the aircraft lessors and financiers to Inter-Canadien and Canada 3000 will be required to satisfy the outstanding amounts owing to NAV Canada and the airports out of the security posted at the time the aircraft were repossessed.

The Supreme Court returned the seizure and detention applications to the lower courts to determine the obligations of each lessor and title holder in a "fair" and "proportionate" manner.

The Supreme Court also referred the issue of interest on the outstanding charges back to the lower courts for consideration. The Court observed that there may have been an issue about the lessors having received proper notice of the interest charges. In any event, the Court noted that interest can be charged until the date of payment, the posting of security or the bankruptcy of the airline.

In reaching its decision, the Court noted that aircraft lessors and financiers "are sophisticated corporate players well versed in the industry in which they have chosen to invest" and "are in a better position to protect themselves against this type of loss than are the airport authorities and NAV Canada." In the Court's view, "the legal titleholders can select which airlines they are prepared to deal with and negotiate appropriate security arrangements as part of their lease transactions with the airlines." In contrast, the Court noted that NAV Canada and the airports "cannot withhold services even from an obviously failing airline."

The Court recognized the potential unfairness resulting from the fact that an aircraft may be “held hostage” for all of the unpaid user charges incurred by the airline that operated the aircraft. In the Court’s view, such potential unfairness can be addressed by the motions judge who presides over the issuance and release of the seizure and detention orders “provided the result is that the authority is paid in full”.

Lessors and financiers of aircraft operated in Canada (whether by Canadian or international operators) should consider carefully the nature and extent of the reporting obligations and security they will require in respect of the potential obligations of the operator on account of Canadian navigation and airport service charges. Because a lessor may be required to satisfy all such charges incurred by an operator in order to repossess an aircraft seized by NAV Canada and/or the airports (and not only the charges relating specifically to the lessor’s aircraft), the security requirements may be substantial.

ABOUT THE AVIATION AND RESTRUCTURING GROUPS

The aviation group at McMillan Binch Mendelsohn has extensive experience in all aspects of aircraft and airline ownership, finance, operation and regulatory matters.

We have particular expertise in relation to commercial and private aircraft and engine finance matters, acting for equipment manufacturers, financial institutions, aircraft lessors, engine lessors, investors, investors and aircraft operators. Our expertise in aircraft finance is levered by our finance group’s recognized standing as one of Canada’s leading commercial finance advisors with a broad practice in both the development and implementation of domestic and cross-border leasing, project financing, and balance sheet enhancement products. We also have expertise in aviation and airline regulatory matters in both the commercial aviation and corporate ownership contexts.

Our restructuring group has considerable depth and extensive expertise in all aspects of business, insolvency and reorganization matters and has been actively engaged with significant mandates in major airline restructuring cases in Canada over the past several years.

McMillan Binch Mendelsohn acted for the lessors of a number of aircraft operated by Inter-Canadien and for the trustee in bankruptcy in the Canada 3000 matter.

ABOUT McMILLAN BINCH MENDELSON LLP

McMillan Binch Mendelsohn is a leading Canadian business law firm. Based in Toronto and Montreal, the firm is at the forefront in serving the financial sector, domestic and international corporations and governments. Key to the firm’s success is a depth of expertise in core areas, an emphasis on collaborating on fresh ideas and a multi-disciplinary approach to handling complex transactions efficiently. McMillan Binch Mendelsohn has an operational philosophy based on its core values of respect, teamwork, commitment, client service and professional excellence.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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