

LEGAL ISSUES IN AIRCRAFT LEASING

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PART I

Legal Due Diligence

Lease Due Diligence

- Why Do We Do Due Diligence?
 - Portfolio analysis
 - Purchase price confirmation
 - Portfolio integration
 - Financing
- Long Form, ABS-style (see Attachment 1)
- Short Form, Equity-style (see Attachment 2)

PART II

Purchase and Sale Agreements

AIRCRAFT SALE AGREEMENT

among

[]

as Buyer

and

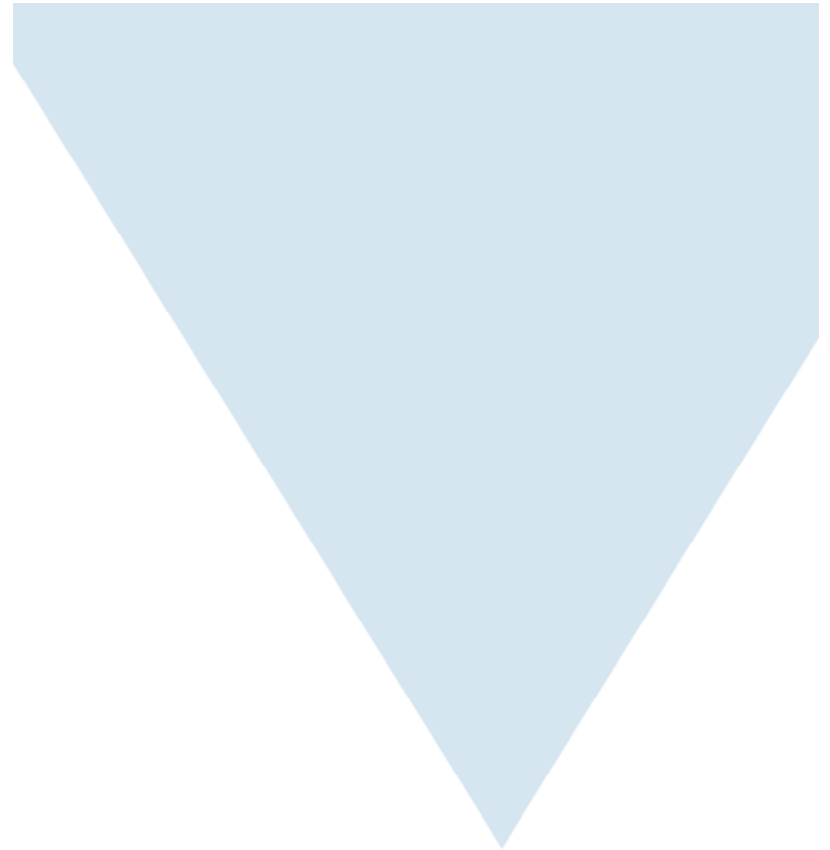
[]

as Seller

Dated as of []

Purchase and sale of []

Model [] Aircraft



AIRCRAFT SALE AGREEMENT

among
[]
as Buyer
and
[]
as Seller



Who is the Buyer?

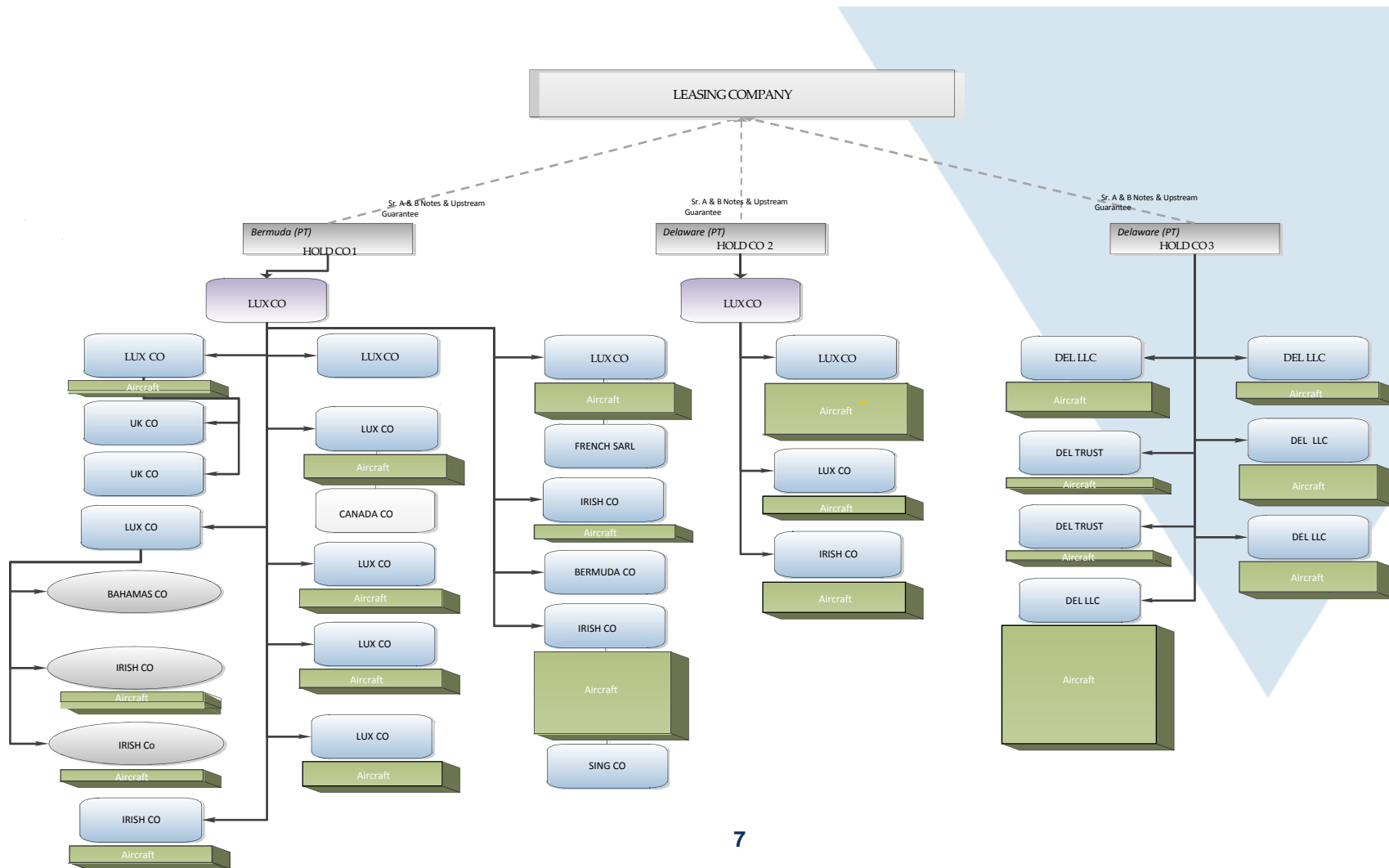
Dated as of [_____]

Purchase and sale of [_____]

Model [_____] Aircraft

Issues Related to the Buyer Entity

- What Is My Ownership Structure?
- What Jurisdiction Am I Based In?
- Do I Meet the Transfer Restrictions?
- Do I Need Financing?



AIRCRAFT SALE AGREEMENT

among

[]

as Buyer

and

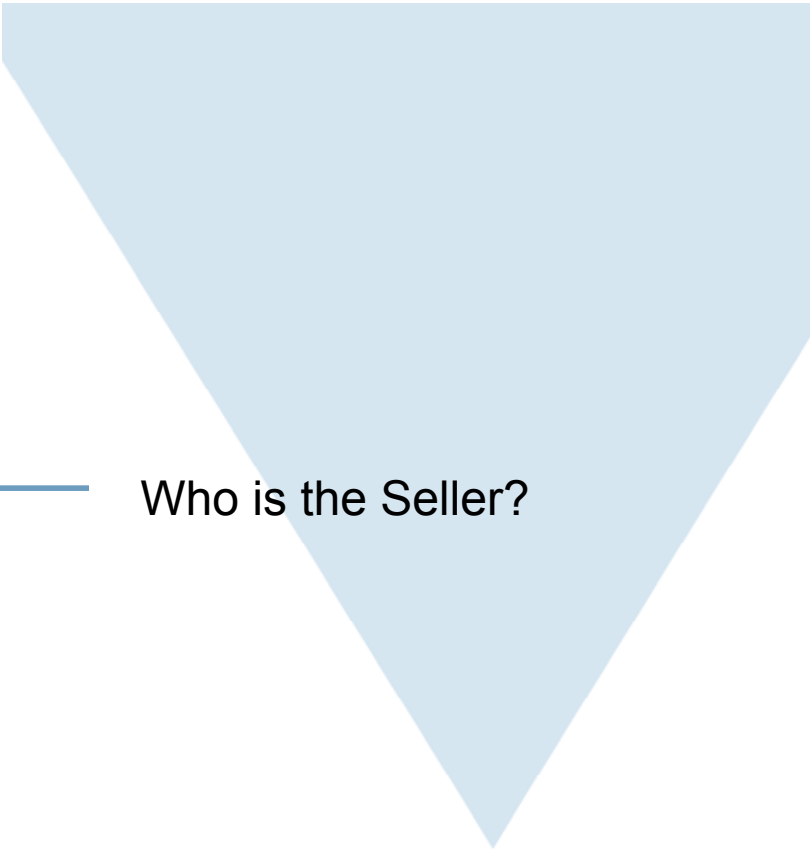
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as Seller

Dated as of []

Purchase and sale of []

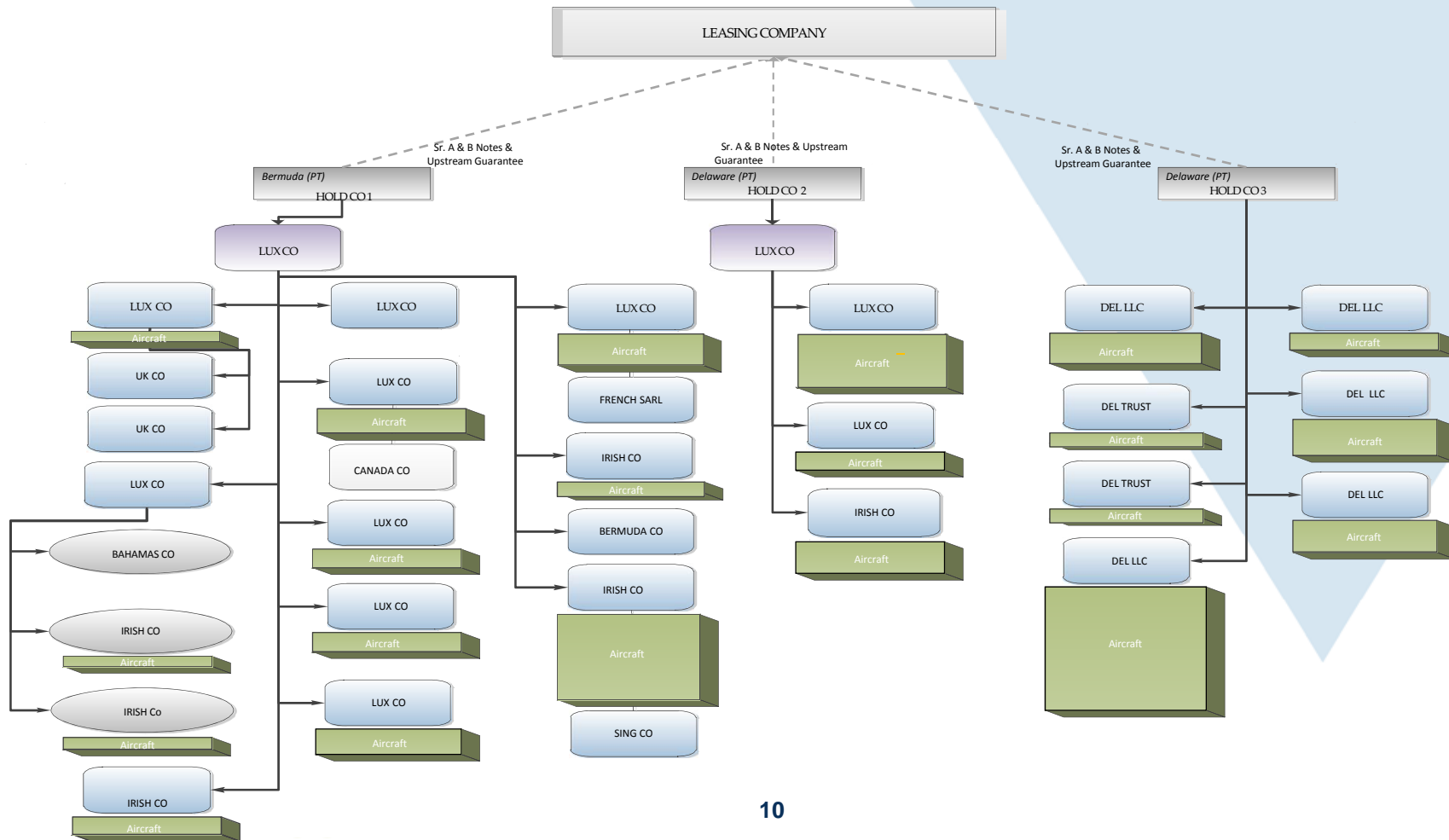
Model [] Aircraft



Who is the Seller?

Issues Related to the Selling Entity

- Who Owns the Aircraft?
- Is the Seller Creditworthy?
- What Is the Leasing Structure?
- Is There Financing?




AIRCRAFT SALE AGREEMENT

among
[]
as Buyer
and
[]
as Seller

Dated as of []

Purchase and sale of []
Model [] Aircraft



What am I buying?

Issues Related to the Asset

- Am I Buying an Aircraft or an Asset Owning Entity?
- Aircraft vs. Entity Purchases
 - Due diligence issues
 - Liability issues
 - Tax issues
 - Novation issues

or party; (3) includes any judicial or administrative interpretation or application thereof; and (4) is a reference to that provision as amended, substituted or re-enacted; and

(iv) an Article, a Section, an Exhibit or a Schedule is a reference to a clause of or an exhibit or a schedule to this Agreement.

(b) The headings in this Agreement are to be ignored in construing this Agreement.

ARTICLE II
SALE OF AIRCRAFT

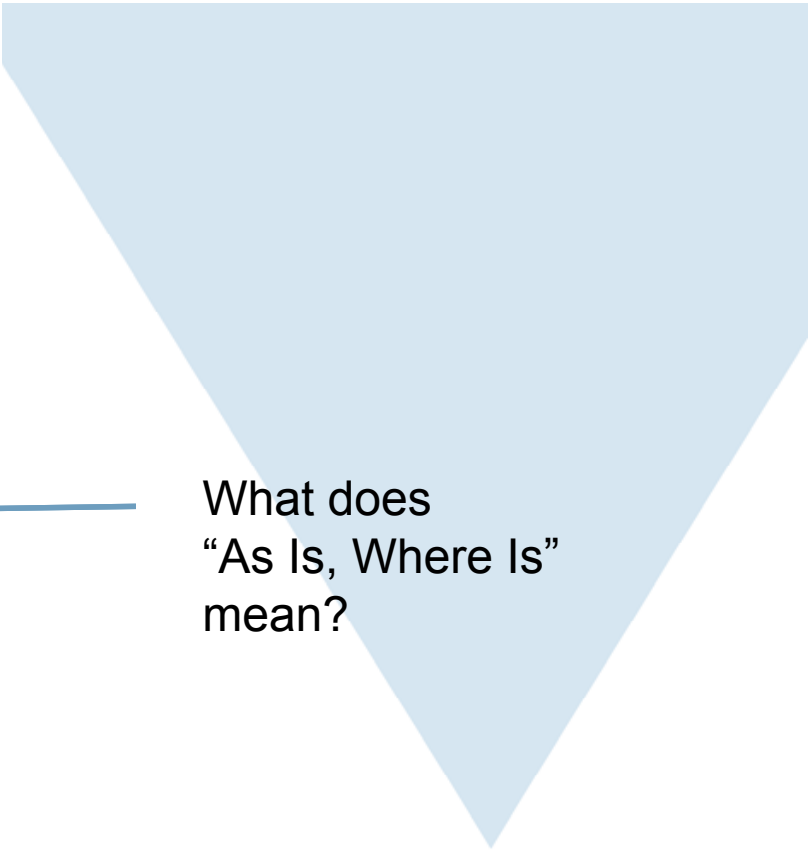
Section 2.1 **Sale.** Subject to the terms and conditions set forth in this Agreement, Seller as owner of the Aircraft agrees to sell, transfer, convey, assign and deliver to Buyer, and Buyer agrees to purchase, on the applicable Delivery Date, Aircraft 1 and Aircraft 2, in each case free from any Liens except for Permitted Liens.

Section 2.2 **Disclaimer.**

BUYER UNCONDITIONALLY AGREES THAT AS BETWEEN THE BUYER AND THE SELLERS EACH AIRCRAFT AND EACH PART THEREOF IS TO BE SOLD AND PURCHASED IN AN "AS IS, WHERE IS", CONDITION AS AT THE DELIVERY DATE FOR THAT AIRCRAFT, AND (SAVE AS SET OUT IN ARTICLE 6 AND, AS APPLICABLE, THE RELEVANT BILL OF SALE) NO TERM, CONDITION, WARRANTY, REPRESENTATION OR COVENANT OF ANY KIND HAS BEEN MADE OR IS GIVEN BY ANY SELLER OR ITS SERVANTS OR AGENTS IN RESPECT OF THE AIRWORTHINESS, VALUE, QUALITY, DURABILITY, CONDITION, DESIGN, OPERATION, DESCRIPTION, MERCHANTABILITY OR FITNESS FOR USE OR PURPOSE OF ANY OF THE AIRCRAFT OR ANY PART THEREOF, AS TO THE ABSENCE OF LATENT, INHERENT OR OTHER DEFECTS (WHETHER OR NOT DISCOVERABLE), AS TO THE COMPLETENESS OR CONDITION OF ANY OF THE AIRCRAFT DOCUMENTATION, OR AS TO THE ABSENCE OF ANY INFRINGEMENT OF ANY PATENT, COPYRIGHT, DESIGN, OR OTHER PROPRIETARY RIGHTS AND (SAVE AS SET OUT IN ARTICLE 6 AND, AS APPLICABLE, THE RELEVANT BILL OF SALE) ALL CONDITIONS, WARRANTIES AND REPRESENTATIONS (OR OBLIGATION OR LIABILITY, IN CONTRACT OR IN TORT) IN RELATION TO ANY OF THOSE MATTERS, EXPRESSED OR IMPLIED, STATUTORY OR OTHERWISE, ARE EXPRESSLY EXCLUDED.

ARTICLE III
PURCHASE PRICE

Section 3.1 **Transfer of Title and Payment of Net Purchase Price.** Subject to the terms and conditions of this Agreement, on the Delivery Date for each Aircraft, Buyer will pay the Purchase Price to Seller of such Aircraft by means of a cash payment in an amount of the Net Purchase Price. Immediately prior to and as a condition to Delivery of an Aircraft, Buyer shall



What does
"As Is, Where Is"
mean?

ARTICLE IV
DELIVERY

Section 4.1 Inspection. Seller shall arrange for the inspection of each Aircraft with Lessee in accordance with and as may be permitted by the terms of the Lease, including each Engine associated with the Aircraft, and inspection of all Aircraft Documents pertaining to the Aircraft (the "Inspection"). To the extent such an inspection is permitted under the Lease, it shall: (a) take place at such times and locations as Lessee shall agree and at such times and locations which do not otherwise interfere with Lessee's operation of the Aircraft, or place undue strain on Lessee's resources; (b) not involve any requirement to withdraw the Aircraft from operational service; (c) consist of a visual walk-around inspection of the Aircraft that may include going on board the Aircraft and examining the contents of any open panels, bays or other components of such Aircraft (but shall not include the opening of any unopened panels, bays or other components) and an inspection of the Aircraft Documents of Lessee relating to that Aircraft. Within five (5) days of completing the Inspection of an Aircraft, Buyer shall notify Seller in writing of its decision of whether the results of such Inspection are satisfactory to Buyer. If Buyer determines the result of the Inspection were satisfactory or fails to notify Seller of its decision within the time period set forth above, the Parties shall proceed to Delivery. If Buyer notifies Seller that the results of the Inspection are not satisfactory, all of the respective obligations of the Parties under this Agreement in relation to the affected Aircraft, other than the obligations under Section 13.11, shall thereupon automatically terminate.

Section 4.2 Delivery condition. Without prejudice to Sections 5.1(e) and 5.1(f), each Aircraft shall be in "as is, where is" condition at Delivery of such Aircraft and Buyer acknowledges that it has no rights or claims whatsoever against any Seller in respect of the physical and technical condition, airworthiness or suitability of any of the Aircraft or any of the Aircraft Documentation.

Section 4.3 Delivery Date and Delivery Location. Subject to the terms and conditions of this Agreement, the Delivery shall take place on a Business Day that falls on or before the Final Delivery Date at the Delivery Location for the relevant Aircraft. The Delivery of an Aircraft shall occur at the same time as the Closing of the Shares (as defined in the Shares Sale Agreement) related to such Aircraft. Seller and Buyer shall co-operate with a view to ensuring that each Delivery Location is in a jurisdiction where no Transfer Taxes are imposed on Seller and/or Buyer as a result of the sale of the Aircraft related to an Aircraft pursuant to this Agreement and taking into account the operating schedules of Lessee for that Aircraft.

Section 4.4 Acceptance. Delivery of each Aircraft shall be conclusive proof, as between the relevant Seller and the Buyer, that the Buyer has examined and investigated the Aircraft and that it is in all respects satisfactory to Buyer.

Section 4.5 Possession. It is acknowledged by the Parties that the Lessee is in possession of the Aircraft and that no physical delivery of any Aircraft to the Buyer under this Agreement is required or shall take place.

Section 4.6 Risk. As between each Seller and Buyer, but without prejudice to the Leases and the other Lease Documents in relation to each of the Aircraft, all risk of loss or

And how does my inspection fit with an "as-is, where-is" sale?

Issues Related to Inspection

- “As-Is, Where-Is”
- Inspection
 - Physical
 - Records
 - On-lease vs. Off-lease

destruction of an Aircraft or damage to that Aircraft shall pass from that Seller to Buyer at Delivery of that Aircraft.

Section 4.7 Effective Time. The relevant Seller and Buyer agree with respect to each Aircraft that the Effective Time for that Aircraft shall be the time at which Delivery of that Aircraft occurs and that, immediately after Delivery of that Aircraft, they shall notify the Lessee of that Aircraft by delivering an Effective Time Notice that the Effective Time has occurred.

Section 4.8 Cape Town registrations. Until title to an Aircraft has passed to the Buyer pursuant to this Agreement, Buyer shall not seek or be entitled to register any interest in this Agreement, the relevant Aircraft or any Engine for that Aircraft with the International Registry established pursuant to the Cape Town Convention. To the extent that such co-operation is necessary, the Seller of an Aircraft will, at the request and cost of the Buyer, co-operate with Buyer in connection with any such registrations to be effected by Buyer after title to that Aircraft has passed to Buyer pursuant to this Agreement.

ARTICLE V
CONDITIONS PRECEDENT

Section 5.1 Conditions Precedent of Buyer

The obligation of Buyer to buy an Aircraft under and subject to the terms and conditions of this Agreement is subject to the satisfaction or waiver of the following express conditions precedent on or prior to the Delivery Date for such Aircraft:

(a) Buyer shall have received a certification from a duly authorized officer of Seller to the effect that the representations and warranties of Seller set forth herein are true and correct in all material respects as of such Delivery Date.

(b) All conditions precedent to the Buyer's obligations under the Shares Sale Agreement with respect to such Aircraft shall have been satisfied or waived by Buyer.

(c) The relevant Aircraft shall be free and clear of Liens (other than Permitted Liens).

(d) Buyer shall be satisfied that no Tax will be imposed on Buyer in connection with any of the Sale Documents or any of the transactions contemplated by the Sale Documents in any jurisdiction.

(e) The relevant Aircraft shall have not sustained any Material Damage after the inspection of that Aircraft referred to in Section 4.1.

(f) An Event of Loss of the relevant Aircraft shall have not occurred.

(g) The relevant Aircraft shall be at the Delivery Location.

(h) The Lease for the Aircraft shall be in full force and effect, and shall not have been amended, rescinded, terminated or cancelled since the date of this Agreement.

(i) appropriate resolutions approving the transactions contemplated by the Sale Documents to which it is or is to be a party and authorizing a person or persons to sign and deliver on its behalf those Sale Documents and any related notices or other documents; and

(ii) specimen signatures of each of the authorized signatories referred to above.

(h) Seller shall have received all information required under applicable “know your customer” rules and regulations and in accordance with Seller’s internal “know your customer” policy requirements.

ARTICLE VI
REPRESENTATIONS AND WARRANTIES

Section 6.1 Seller’s Representations and Warranties

Seller represents and warrants to Buyer as of the Delivery Date of an Aircraft that:

(a) Each Seller is an entity duly formed, validly existing and, in the case of those jurisdictions where such concept is known, in good standing under the laws of its jurisdiction of formation and has all organizational powers and all governmental licenses, authorizations, permits, consents and approvals required to carry on its business as now conducted.

(b) The transactions contemplated by this Agreement are within Seller’s powers and have been duly authorized by all necessary corporate or other legal entity action. This Agreement has been duly executed and delivered by Seller and constitutes a legal, valid and binding obligation of Seller, enforceable against Seller in accordance with its terms, except as such enforceability may be limited by (a) bankruptcy, insolvency, reorganization, moratorium or similar laws of general applicability affecting the enforcement of creditors’ rights and (b) the application of general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

(c) The entry into and performance by Seller of, and the transactions contemplated by, this Agreement do not and will not (i) conflict with any laws binding on Seller or (ii) result in any breach of, or constitute a default under the constitutional documents of Seller.

(d) There are no actions, suits, claims or proceedings by or before any arbitrator or Governmental Authority now pending against or, to Seller’s knowledge, threatened against Seller, that, would have a material adverse effect on its ability to perform its obligations under, or to carry out the transactions contemplated by, this Agreement or any other Sale Document or affect its right, title or interest in the Aircraft.

(e) All authorizations, consents, registrations and notifications required in connection with Seller’s entry into, performance, validity and enforceability of, this Agreement and the consummation of the transactions contemplated by this Agreement have been obtained or effected (as appropriate) and are in full force and effect.

Representations and Warranties

- What Are the Purposes of Representations and Warranties?
 - Due diligence – What does the Seller know?
 - Risk allocation – What should the Seller be responsible for?
 - (see Attachments 3 and 4)
 - Entity representations and warranties
 - (see Attachment 5)

continued

Representations and Warranties

- What is a “knowledge qualifier,” and when is it appropriate?
- Conditions precedent vs. representations

Ukraine (or to an entity located in one of those countries or regions, as the case may be) is prohibited without first obtaining a license from BIS's Export Administration Regulations. Further, any export, sale, lease or brokering of an Aircraft or Part related thereto or component that is regulated pursuant to the DDTC's International Traffic in Arms Regulations will require a license or other authorization from DDTC. Buyer further acknowledges that United States economic sanctions programs prohibit the resale or leasing of an aircraft and its engines or other parts (i) to the government of, or for operation in or to, certain countries or territories presently including Cuba, Libya, Iran, North Korea, Sudan, and the Crimea Region of Ukraine or (ii) the persons listed on OFAC's Specially Designated Nationals and Blocked Persons List ("SDN List") at the time of sale or at any time during the term of a lease. The SDN List can be viewed at: <http://www.treas.gov/offices/enforcement/ofac/sdn/index.html>. Buyer represents that it will comply with all applicable requirements administered by BIS, DDTC and OFAC and all other applicable law in its use or disposition of the Aircraft and the parts related thereto.

(f) There are no actions, suits, claims or proceedings by or before any arbitrator or Governmental Authority now pending against or, to Buyer's knowledge, threatened against Buyer that would have a material adverse effect on its ability to perform its obligations under, or to carry out the transactions contemplated by, this Agreement or any other Sale Document.

Section 6.3 Survival of Representations and Warranties. The representations and warranties set forth in this Article VI shall survive the sale of the Aircraft to Buyer.

ARTICLE VII COVENANTS OF BUYER

Section 7.1 Buyer's Covenants.

(a) Buyer agrees to defend, indemnify and hold harmless Seller Indemnitees in the absence of Seller's own gross negligence or willful misconduct from and against any and all costs, losses, liabilities, claims, damages or expenses (including, without limitation, reasonable fees and disbursements of counsel for Seller) that may be imposed on, incurred by, or asserted against any Seller Indemnitee as a result of or arising out of (i) Buyer's breach of any of its representations, warranties, covenants or agreements in this Agreement, (ii) any claim made by any Lessee Entity or other Person in connection with maintenance, servicing and/or repair of the relevant Aircraft, (iii) any Aircraft Activity occurring on or after Delivery or (iv) any claim arising after Delivery that any design, article or material in the Aircraft or that any Aircraft Activity after Delivery constitutes an infringement of a patent, trademark, copyright infringement, design or other proprietary right.

ARTICLE VIII TERMINATION

Section 8.1 Material Damage If (i) an Aircraft sustains any Material Damage after the inspection referred to in Section 4.1 and before Delivery of the relevant Aircraft and (ii) that Material Damage is not repaired in accordance with the terms of the Lease Documents before the Final Delivery Date, Buyer may at its option issue a written notice to Seller terminating all

obligations of all Parties under this Agreement in relation to such Aircraft, other than the obligations under Section 13.11, and upon receipt by Seller of any such notice those obligations shall automatically terminate. For the avoidance of doubt, the occurrence of any Material Damage with respect to an Aircraft shall not require Seller to repair such Material Damage and the sole remedy of Buyer in such case shall be termination of this Agreement as contemplated by the preceding sentence

Section 8.2 Optional termination - Buyer

If before Delivery of all of the Aircraft:

(a) (subject always to Section 8.4) it becomes unlawful in any applicable jurisdiction for Buyer to perform any of its obligations under this Agreement or any other Sale Document or any Operative Document;

(b) Seller becomes subject to any insolvency proceedings or equivalent in any relevant jurisdiction and those insolvency proceedings or equivalent in any relevant jurisdiction materially adversely affects its ability to perform and discharge its obligations under the Sale Documents (as determined by Buyer acting reasonably); or

(c) Buyer terminates the Shares Sale Agreement pursuant to Section 8.2 thereof,

then Buyer may at its option issue a written notice to Seller terminating all obligations of all Parties under this Agreement in relation to all Aircraft which have not, as at that time, been transferred to Buyer under this Agreement, other than the obligations under Section 13.11, and upon receipt by Seller of any such notice those obligations shall automatically terminate.

Section 8.3 Optional termination - Seller

If before Delivery of all of the Aircraft:

(a) (subject always to Section 8.4) it becomes unlawful in any applicable jurisdiction for Seller to perform any of its obligations under this Agreement or any other Sale Document;

(b) Buyer becomes subject to any insolvency proceedings or equivalent in any relevant jurisdiction and those insolvency proceedings or equivalent in any relevant jurisdiction materially adversely affects its ability to perform and discharge its obligations under the Sale Documents (as determined by Seller acting reasonably); or

(c) Seller terminates the Shares Sale Agreement pursuant to Section 8.3 thereof,

Termination Events

- Damages
 - Threshold
 - Repair?
- Other Customary Circumstances
 - Drop dead dates/Lessee issues
 - Defaults

then Seller may at its sole option issue a written notice to Buyer terminating all obligations of all Parties under this Agreement in relation to all Aircraft which have not, as at that time, been transferred to Buyer under this Agreement, other than the obligations under Section 13.11, and upon receipt by Buyer of any such notice those obligations shall automatically terminate.

Section 8.4 Illegality – mitigation.

Each Party shall, in consultation with the other Party, take all reasonable steps to mitigate any circumstances which arise and which would otherwise result in this Agreement being terminated pursuant to Section 8.2(a) or Section 8.3(a), including restructuring the transaction contemplated by this Agreement so as to avoid such illegality if it is possible to do so. All costs and expenses of each Party in connection with any such consultation and mitigation shall be borne by the Party to whom the relevant unlawfulness applies.

Section 8.5 Final Delivery Date.

If, as at 16:00 New York time on the Final Delivery Date, Closing (as defined in the Aircraft Sale Agreement) of the sale and purchase of any of the Shares related to an Aircraft and the Delivery of any of the Aircraft has not occurred, Seller (unless it is in breach of any of its material obligations under the Sale Documents) and Buyer (unless it is in breach of any of its material obligations under the Sale Documents) may at its option issue a written notice to the other Party terminating all obligations of all Parties under this Agreement in relation to such Aircraft, other than the obligations under Section 13.11 and upon receipt by the other of any such notice those obligations shall automatically terminate.

Section 8.6 Automatic termination.

If, before Delivery of all of the Aircraft, an Event of Loss of any Airframe occurs, all of the respective obligations of the Parties under this Agreement in relation to the affected Aircraft, other than the obligations under Section 13.11, shall thereupon automatically terminate.

Section 8.7 No Seller Liability.

No Seller shall be responsible for any Losses (including any loss of profit) arising from any delay in the delivery of, or failure to deliver, any of the Aircraft to Buyer under this Agreement.

**ARTICLE IX
DEPOSIT**

Section 9.1 Deposits. The Parties acknowledge and agree that Buyer has paid the full amount of all of the Deposits to Seller. Following the occurrence of a Deposit Return Event with respect to an Aircraft, Seller shall within five (5) Business Days pay to Buyer an amount equal to the Deposit for such Aircraft.

Issues with Deposits

- Who Holds the Deposit?
- When Is the Deposit Refundable?

ARTICLE X
TAXES

Section 10.1 Transfer Taxes. Seller and Buyer shall cooperate and use reasonable efforts in selecting a jurisdiction in which each Delivery can occur to lawfully minimize any and all sales, capital gains, stamp, use, transfer, value-added, goods and services, conveyance, gross receipts or other similar Tax or duty imposed on the assignment and sale of each of the Aircraft to Buyer by Seller or otherwise imposed on each Aircraft or on transactions contemplated by the Sale Documents and any claims, penalties, fine, interests, damages, fees, costs and expenses arising or resulting therefrom (such taxes and duties, "**Transfer Taxes**"). For the avoidance of doubt, Transfer Taxes shall not include (i) any corporation, franchise and other similar Taxes or any Tax imposed in Seller's respective jurisdiction of residence with respect to, or measured by Seller's profit, income or capital gain) or (ii) any Taxes attributable to Seller's gross negligence or willful misconduct. Notwithstanding the foregoing, Buyer shall be responsible for, and shall indemnify Seller and Seller's affiliates against the payment of any and all Transfer Taxes imposed in connection with the transactions contemplated by this Agreement and the other Sale Documents.

Section 10.2 Taxes. Except for any Transfer Taxes for which Seller is liable hereunder, Buyer shall be liable for all other Taxes required to be paid in connection with the transactions contemplated by this Agreement.

ARTICLE XI
INSURANCE REQUIREMENTS

Section 11.1 Insurance.

Beginning on the Delivery Date for each Aircraft and continuing until the earlier of (i) two (2) years from the Delivery Date for such Aircraft and (ii) the date of the next major Airframe check in relation to such Aircraft after the Delivery Date (the "**Insurance Period**"), Buyer will, at no expense to Seller, maintain, or procure that Lessee for such Aircraft or any follow-on operator or purchaser of such Aircraft maintains, with recognized insurers comprehensive aircraft liability insurance in respect of such Aircraft of at least the applicable minimum liability limit set forth in the respective Lease each and every loss (but in the aggregate in respect of products and personal injury liability), it being agreed that the insurances currently carried by Lessee under the respective Leases shall be deemed to satisfy any such insurance obligation under this Section. Buyer covenants that any insurance policies carried in accordance with this Section and any policies taken out in substitution or replacement for any of such policies during the Insurance Period shall: (a) be endorsed to name the Insured Parties as additional insureds in accordance with the terms of the respective Leases (hereinafter each an "**Additional Insured**" and collectively the "**Additional Insureds**"); (b) contain a reference to this Agreement as required; (c) contain a waiver of subrogation in favor of such Additional Insureds; (d) provide for thirty (30) days (seven (7) days, or such other period as may be customarily available, in the case of any war and allied perils liability coverage) advance written notice of any cancellation, termination or adverse change with respect to such insurance policy; and (e) be otherwise in accordance with customary terms and conditions then available in the leading international insurers markets.

Insurance and Indemnities (in Purchase Agreements)

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PART III

Issues in Aircraft Leases

Issues in Aircraft Leases

- Maintenance Reserves
- Insurance
- Transferability
- Tax Structuring

Maintenance Reserves

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Maintenance Reserves

- What Are Maintenance Reserves?
 - Are they “reserves” or “rent”?
 - Why does it matter?
 - Tax/accounting
 - Bankruptcy
- Reasons for Reserves
 - Lessee vs. Lessor
 - Preservation of Value

Maintenance Reserves

- Elements of Reserve Provisions
 - Rates and terms of payment
 - Criteria for reimbursements
 - Annual adjustments
- Maintenance Events (see Attachment 6)
 - Airframe heavy check(s)
 - Annual (C) Check
 - High-level Checks

Maintenance Reserves

- Landing gear overhaul
 - APU overhaul
 - Engine performance restorations
 - Module breakdown
 - Engine LLPs
- Calculation
- Rates based on event cost divided by interval (as dictated by maintenance program and manufacturers)

Maintenance Reserves

- Event cost loosely based on industry standard (except for LLPs, catalog cost)
 - Paid monthly in arrears based on utilization (hours, cycles, calendar) for previous month
 - Adjustment for variation from specified flight hour/cycle ratio—usually engines only (see Attachment 7)
- Reimbursing the Lessee
- Paid on proven completion (and payment) or Qualifying Event
 - What is a Qualifying Event? (see Attachment 8)

Maintenance Reserves

- What is excluded from reimbursement?
- Lessee must provide full work package and invoices to support request
- Negotiating Issues
 - Lessor approval process
 - Excess reserves and cost overruns
 - Loss distributions

Maintenance Reserves

- Interest and where reserves are held
 - Lender issues
- Betterment with non-reimbursable events
- Adjustments (see Attachment 7)
 - Fixed annual percentage is preferred
 - Mixture of consumer price indices acceptable
 - Engine manufacturer's catalog price for LLPs

Maintenance Reserves

- Other Considerations
 - New vs. used Aircraft
 - Use of letter of credit (see Attachment 7)
 - Adjusting amounts
 - Common mistakes
 - Bankruptcy considerations (see Attachment 9)

Maintenance Reserves

- Additional Issues
 - “Power by the hour” contracts
 - What are they?
 - How are the contracts priced?
 - Early exits/terminations
 - Assignments to Lessor
 - Termination payments
 - Transitions between operators

continued

Maintenance Reserves

- Used aircraft
 - “Upsy-downsy”
 - Lessor cost contributions
 - up front
 - shared cost
 - at redelivery
 - caps

Aviation Insurance

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Aviation Insurance

- Why Is Insurance Important?
 - Potential loss to aircraft – hull insurance
 - Exposure to tort liability – liability insurance

Aviation Insurance

■ Some Basics

- Insurable interest – the party receiving the monetary benefits from insurance coverage must have an “insurable interest” in the aircraft
 - An insurable interest exists where the party will gain some benefit through the existence of the aircraft or suffer some loss from its destruction (includes “any lawful and substantial economic interest in the safety or preservation of property from loss, destruction or pecuniary damage”)

Aviation Insurance

- Not necessary for a party to have title to the aircraft being insured in order to have an insurable interest
- Declarations – sets forth information including the identity of the named insured, policy number, the insurers, the effective dates, description of the named insured's business, the type of coverage purchased, amount of coverage purchased, the premium charged and a list of endorsements

Aviation Insurance

- Endorsements are specific changes or amendments to the terms and conditions of the standard-form policy language
- Named insured is the person or organization to whom the policy is sold
- Who Is Insured?
 - “Named insureds” under the policy is usually the airline/operator (automatic qualification)

Aviation Insurance

- An “additional insured” is a party who is not automatically an insured under the policy, but to whom the named insured wishes or is obligated to extend a measure of protection under its policy
- Limits of insurance – set a ceiling on the amount of money the insurer will pay, regardless of the number of insureds covered by the policy, the number of losses, the number of claims made or the number of persons or organizations making claims

Aviation Insurance

- Deductibles – many policies contain deductible clauses requiring payment by the named insured of a specified portion of the loss before the insurer's obligation is triggered
 - Lessors or financiers should ensure that the named insured has adequate financial resources to pay the deductible
 - Hull v. Liability
 - Deductible = Self-insurance (credit risk)

Aviation Insurance

- Cancellation and changes – under standard insurance policy, the insurer owes no duties to provide notice of cancellation, non-renewal or changes to additional insureds or loss payees; rather, it owes such duties only to the named insured
 - Lessors and financiers should insist that the insurance policy contain a clause giving interested parties advance notice of any cancellation, non-renewal or material changes in the policy

Aviation Insurance

- Normal hull and liability policy may not contain any cancellation clause at all (policy intended to be a fixed contract for 12 months) – if it does contain a cancellation clause the notice period will normally vary from 10 to 30 days
- For a “war and allied perils” policy the situation is different – there are specific (short period) cancellation provisions which can give rise to an aircraft or a specific geographical area being excluded from cover at relatively short notice

Aviation Insurance

- For hull policies, the usual cancellation provisions may include:
 - Automatic termination in the event of the excluded perils
 - Seven days at any time to review the rate of premium and/or the geographical limits

Aviation Insurance

- For liability policies, the usual cancellation provision may include:
 - Automatic termination in the event of a war between the five great powers
 - Automatic termination of liability war coverage (not the allied perils) in the event of the detonation of a nuclear weapon
 - Seven days at any time to review the rate of premium and/or the geographical limits

Aviation Insurance

- Subrogation – most insurance policies permit the insurer the right to subrogation, or the right to “take over” the rights of a party receiving an insurance payment
- Geographical limits – traditionally insurances have been worldwide containing effectively no geographically limits (it has always been understood that if the named insured departs from its “normal” operations it will (i) act as if not insured and (ii) notify his insurers)
 - Exceptions

Aviation Insurance

- Premiums – lessors and financiers should not be liable for any premiums (insurers will typically agree to this, but will seek to deduct any premium due in respect of the aircraft from any claim in respect of such aircraft)
- Loss Payee Clause
 - A loss payee clause is an insurance policy provision that names a person to whom the hull insurance proceeds are to be paid if a loss occurs

Aviation Insurance

- Lessors and financiers can arrange to be named as loss payees under the policy – such status does not entitle them to any rights under the policy except to be paid the proceeds after the loss
- Breach of Warranty
 - Most airline policies contain warranties which provide something like the following: the assured shall take all reasonable precautions to ensure that: (i) at the commencement of each flight, the aircraft shall have a

Aviation Insurance

- (cont.) current and valid Certificate of Airworthiness or other permit to fly issued by a competent authority and shall be airworthy and in every way fit to fly; (ii) all government regulations and instructions for civil aviation are complied with; (iii) the aircraft shall operate in accordance with the weight restriction imposed by such aircraft's Certificate of Airworthiness
 - Failure to comply with these warranties could invalidate the insurance

Aviation Insurance

- Breach of warranty endorsement provides that the insurance maintained by a lessee or a borrower shall not be invalidated as to a lender or lessor by reason of any act or neglect of the named insured
- Insurer will require that if it has a defense against the insured, its payment obligation to the creditor shall not exceed the indebtedness due the creditor and it shall be subrogated to the rights of the creditor against the insured

Aviation Insurance

■ Aircraft Hull Insurance

- Hull insurance protects against physical loss or damage to the aircraft
- Generally the obligations under a hull policy expressly cover “all risk” except those that are specifically excluded
- Generally a hull policy provides for a deductible – deductibles should not apply in the case of a total loss
 - Deductibles dependent on the type and size of the aircraft

Aviation Insurance

- Deductibles can be reduced by means of a separately placed “deductible insurance” policy
- Generally lease documentation provides that an event of loss with respect to the airframe constitutes an event of loss with respect to the entire aircraft (including the engines)
- For damaged property, insurance policies generally provide the cost of repair/replacement

Aviation Insurance

- For destroyed property, insurance policy may obligate the insurer to pay on the basis of actual cash value of the property, replacement cost or agreed value (generally require “agreed value”)
- Hull insurance will not cover loss of use, delay, grounding or any other consequential loss nor will it pay for wear, tear and gradual deterioration
- War and allied perils are excluded (AVN 48B)

Aviation Insurance

- Passenger and Third-Party Liability Insurance
 - Liability insurance covers the legal liability of the named insured and additional insureds for bodily injury to passengers and damage to persons (other than passengers) or property resulting from the operation of the aircraft
 - Liability can be divided into three categories: (i) liability in respect of passengers, baggage, cargo and mail carried on the aircraft (these liabilities result from the operations of the

Aviation Insurance

- (cont.) carrier), (ii) aircraft third party liability (liability for damage done to property or person outside the aircraft itself) and (iii) “general third party” (liability for damage done to property or people arising other than from the use of the aircraft (these are the “ground operations” risks comprising premises, hangarkeepers and products liability))
- In certain jurisdictions, lessors and financiers may be held responsible for injury or property damage stemming from the use of an aircraft simply because of their interests in the aircraft (“strict liability” concerns)

Aviation Insurance

- Overall concern is due to their perceived “deep pockets” – target in any litigation resulting from the operation of aircraft
- Liability insurance is generally capped at a specified amount for claims arising from a single “occurrence” (however it is defined) – an “occurrence” is defined generally to be an “accident” or a series of related conditions collectively constituting an accident

Aviation Insurance

- War and Allied Perils Coverage
 - Hull and liability insurers will usually exclude from their respective coverages certain war and associated risks including invasion, rebellion, insurrection, hostile detonation of atomic weapons, strikes, riots, civil commotion, acts of political and terrorist nature, sabotage, confiscation, nationalization, and hijacking (AVN 48B) (see Attachment 10)

Aviation Insurance

- Certain of these risks are often written back into the hull and liability policies by virtue of supplemental endorsements to the policies
 - Hull coverage
 - The hull “war risks” policy will cover those claims for physical loss of, or damage to, the aircraft which have been excluded from the named insured’s hull “all risks” policy either by (i) the application of the AVN 48B or (ii) when the aircraft is outside the control of the operator by reason of any of these “war” perils

Aviation Insurance

- LSW 555B (see Attachment 11)
- AVN 51 (see Attachment 12)
- Most hull “war risk” policy are subject to an aggregate limit
- Liability coverage
 - All of the risks excluded can be written back except for the hostile detonation or explosion of a nuclear weapon
 - AVN 52E (see Attachment 13)

Aviation Insurance

- A separate policy is not necessary – the risks excluded by AVN 48B can be reinstated by an endorsement known as Extended Coverage Endorsement (AVN 52E) which, subject to its terms and conditions, provides coverage in respect of liability war and allied risk
- Normally no deductibles applied to hull “war and allied perils” policy

Aviation Insurance

- AVN 67B / 67C (see Attachment 14)
 - AVN 67 consists of two separate policy endorsements – one for ‘all risks’ policy and one for the ‘hull war’ policy (the two endorsements are almost identical)
 - AVN 67 is not a policy, but rather evidence of the inclusion of insurance coverage for the specific protection of the identified contract parties, and it allows them to be endorsed directly onto the operator’s policy as additional insureds

Aviation Insurance

- Underwriters in the United States do not follow AVN 67B unless they are participating in transactions involving London-led underwritings
- Major Differences
 - No Loss Payee
 - Contracts and Contract Parties

Aviation Insurance

- 50/50 Clause

- 50/50 clause is a devise intended to deal with those claims where the circumstances of the loss are such that it is not clear whether they will be covered by the “all risk” policy or the “war and allied perils” policy (AVS 103A) (see Attachment 15)

Aviation Insurance

■ Reinsurance/Cut-Through Clause

- In many jurisdictions, local law may require that all insurances is placed with a domestic insurer, who will often reinsure into the international markets
- The ratings of such domestic insurer are often lower than would normally be acceptable – lessors and financiers may require reinsurances due to creditworthiness concerns of the domestic insurer

Aviation Insurance

- “Cut through” clause is a device by which it is required that the reinsurers make direct payment of a claim to the loss payee nominated in the original policy
- See Attachment 16
- **Political Risk**
 - Political risk insurance (repossession insurance, repatriation insurance and collateral deprivation insurance) is utilized to protect financiers who are unable to recover possession of their aircraft as a result of action

Aviation Insurance

- (cont.) or inaction of the government or governmental authority of the state in which the lessee or operator of the aircraft is located (LSW 147) (see Attachment 17)
- Tail Coverage
 - Extension of liability coverage for lessor or lenders for an agreed period (typically 2 years) after the earlier of a transfer or the lease/loan expiry

Transferability

- See attachment 18

