

Aviation Finance & Leasing

Contributing editor
Mark Bisset

VedderPrice



2017

GETTING THE
DEAL THROUGH 

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Aviation Finance & Leasing 2017

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CONTENTS

Global overview	5	Japan	87
Mark Bisset Clyde & Co LLP		Katsu Sengoku and Kentaro Miyagi Nishimura & Asahi	
Aircraft operating leases – New York law or English law?	9	Kenya	93
Thomas A Zimmer and Neil Poland Vedder Price		Suzanne Muthaura, Christopher Kiragu and Kenneth Kimachia MMAN Advocates	
Australia	12	Lithuania	99
Matthew Bode and Kate Craig Colin Biggers & Paisley		Gintautas Šulija Šulija Partners Law Firm Vilnius	
Austria	17	Malta	106
Martin Geiger Benn-Ibler Rechtsanwälte GmbH		Malcolm Falzon and Steven Decesare Camilleri Preziosi	
Belgium	22	Mexico	114
Dimitri de Bournonville and Cyril-Igor Grigorieff Kennedys		Javier Alegre and Carlos Campillo Alegre, Calderón y Márquez Abogados	
Bermuda	26	New Zealand	119
Jeremy Leese MJM Limited		Frank Porter and Rishalat Khan Buddle Findlay Lawyers	
Brazil	31	Panama	124
Renata Iezzi Basch & Rameh		Maria de Lourdes Marengo Patton, Moreno & Asvat	
Cayman Islands	38	Philippines	129
Matthew Stocker Conyers Dill & Pearman		Imelda A Manguiat, Carina C Laforteza, Bhong Paulo A Macasaet, Aldous Benjamin C Camiso and Maricar G Ramos SyCip Salazar Hernandez & Gatmaitan	
Dominican Republic	43	Portugal	135
Maria Esther Fernandez A de Pou Russin Vecchi & Heredia Bonetti		Luis Soares de Sousa Cuatrecasas	
England & Wales	49	Russia	142
Mark Bisset Clyde & Co LLP		Victoria Bortkevicha and Anna Nikulina Clifford Chance CIS Limited	
France	56	South Africa	148
Edward Campbell Stephenson Harwood AARPI		Sean Craig Lederman ENSafrica	
Germany	63	Sweden	153
Ulrich Stepler and Katja Helen Brecke Arnecke Sibeth		Fredrik Wilkens, Emma Stuart-Beck and Henrik Schön Advokatfirman Vinge	
India	70	Switzerland	159
Ashwin Ramanathan, Akansha Aggarwal and Maitreye Parashar AZB & Partners		Frédéric Meyer, Raphaël Baeriswyl and Antoine Labaume Meyer Avocats	
Israel	76	United Arab Emirates	165
Charles B Gottlieb and Assi Talmor Gottlieb, Gera, Engel & Co Advocates		Shyamal Jeewoolall Holman Fenwick Willan Middle East LLP	
Italy	81	United States	172
Laura Pierallini and Francesco Grassetto Studio Pierallini		Thomas A Zimmer and Laura J Bond Vedder Price	

Preface

Aviation Finance & Leasing 2017

Fourth edition

Getting the Deal Through is delighted to publish the fourth edition of *Aviation Finance & Leasing*, which is available in print, as an e-book and online at www.gettingthedealthrough.com.

Getting the Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique **Getting the Deal Through** format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Israel, Japan, Kenya, Lithuania, South Africa and United Arab Emirates.

Getting the Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.gettingthedealthrough.com.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Mark Bisset of Clyde & Co LLP, for his continued assistance with this volume.

GETTING THE
DEAL THROUGH 

London
June 2017

Aircraft operating leases – New York law or English law?

Thomas A Zimmer and Neil Poland

Vedder Price

Aircraft operating leases – choice of law

It is common for leases of commercial and business aircraft to select either New York law or English law as the governing law. Most lenders, investors and lessors of aircraft are comfortable with leases governed by either New York or English law.

While the similarities between New York and English law-governed aircraft leases far outweigh the differences, lessors and lessees should understand the differences and use a lease tailored for the chosen governing law that takes into account these differences.

Similarities between New York law and English law

The key similarities between the New York and English legal systems include the following:

- Freedom of contract – Both systems recognise the fundamental principles of freedom of contract. Generally, the courts in both jurisdictions will uphold the terms of a contract freely entered into between commercial parties, although there are certain public policy exceptions in both jurisdictions.
- Common law – Both jurisdictions are common law legal systems, with the courts bound by legal precedent. With well-established precedents on many of the issues presented by leases, each system provides a high level of stability and certainty when it comes to enforcing the terms of an aircraft lease.
- Security interests against aircraft and lease rentals – Both New York and English law allow a lessor to grant a security interest in the rent receivable payable under the lease and the ownership rights of the lessor in the aircraft which is subject to the lease. Such rights can be perfected as against third-party claims against the lessor or the lessee although there are differences in the validity and perfection requirements under the two legal systems that are noted under ‘Filing requirements for aircraft leases and security assignments’.
- Enforcement rights – Both legal systems provide ‘self-help’ remedies of enforcement of certain contractual or security rights and relatively speedy procedures for pursuing legal redress in the event of a default by the lessee either through the courts or other alternative disputes procedures subject to the dispute resolution process provided for in the lease.
- Ratification of Cape Town Convention – Both the United States and the United Kingdom have ratified the Convention on International Interests in Mobile Equipment (2001) and the Protocol to the Convention on Matters Specific to Aircraft Equipment (together, CTC), although there are some differences in the implementation of the CTC.

Some key differences between aircraft leases governed by New York law and English law

There are a number of differences between aircraft leases governed by New York and English law that should be taken into account when choosing the governing law for an aircraft lease. The following is a brief description of some of the differences that we would advise parties to consider.

Recharacterisation risk

Under New York law and in certain circumstances, an instrument that purports to be a lease may be recharacterised as a security agreement

(a security interest disguised as a lease) and not a ‘true lease’. This can happen if the economic substance of the transaction is such that the lessee, and not the lessor, is deemed the economic owner of the aircraft. If an aircraft lease is recharacterised as a security interest, the lessor must take steps to perfect its security interest. Further, the remedies available to the titular lessor following a default by the lessee would be those of a secured creditor, and not those of an owner or lessor. Any excess proceeds resulting from a foreclosure sale of the aircraft beyond the secured amount would have to be paid over to the lessee.

In contrast, under English law there is no risk of recharacterisation of an aircraft lease as a security interest. There is no general legal definition of a finance lease or an operating lease, although the distinction is relevant for accounting and tax purposes.¹ If an instrument is structured as a lease under English law, a lessor may exercise its rights as owner as against the lessee regardless of the economic substance of the transaction. English law permits a lender or lessor to use ‘finance lease’ arrangements with the owner or lessor retaining ownership rights as against the lessee even if the transaction would not be deemed a ‘true lease’ under New York law.

Enforceability of foreign judgments

English or New York law-governed aircraft leases will typically provide that courts located in that jurisdiction shall have jurisdiction to resolve disputes under the lease, and that a judgment entered by those courts can be enforced in the jurisdiction where the lessee is based or where the aircraft is registered. However, the enforceability of a judgment entered by the courts of a foreign jurisdiction (for example, in the jurisdiction where the lessee is based or where the aircraft is registered) will require an examination of the laws of such jurisdiction and its position with respect to the enforcement of foreign judgments. This will include analysing any bilateral or multilateral treaties governing the enforcement of foreign judgments to which such foreign jurisdiction may be a signatory.

The United States has not ratified any treaty with the recognition and enforcement of foreign judicial judgments as a principal focus. Therefore, the recognition and enforcement of a judgment entered by a court in New York with respect to an aircraft lease would be subject to a case-by-case analysis, with input from foreign counsel being of critical importance. The courts of many jurisdictions outside the United States will recognise judgments issued by the courts in New York and it is customary for local counsel to provide a legal opinion to that effect.

In contrast with this position, as a member state of the EU,² the United Kingdom benefits from a number of instruments that regulate jurisdiction and the recognition and enforcement of judgments as between EU member states. The Brussels Regulation (Recast),³ for example, applies to the enforcement of judgments across the EU in proceedings instituted on or after 10 January 2015 and is directly effective in the United Kingdom and all other member states.⁴ Similarly, the 2007 Lugano Convention extends the recognition and enforcement of English judgments to certain European Free Trade Association countries, those being Denmark, Iceland, Norway and Switzerland.

The United Kingdom also benefits from a number of bilateral arrangements for the enforcement of judgments with certain non-EU countries (including members of the Commonwealth, the British Overseas Territories and a number of former British colonies). Importantly for a lessor, these arrangements extend to jurisdictions

often experienced in aircraft leasing transactions such as the Cayman Islands, Bermuda and the British Virgin Islands.⁵

To the extent that the parties cannot satisfy themselves that a judgment on the lease entered by a New York court or English court would be recognised and enforced in the courts of a foreign jurisdiction, the parties might consider providing for the arbitration of disputes if the foreign jurisdiction has adopted the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). Under the New York Convention, to which both the United States and the United Kingdom are a party, an arbitral award determined by a New York arbitration tribunal on a New York law-governed lease or English arbitration tribunal on an English law-governed lease should be recognised by the courts of a foreign jurisdiction that has also adopted the New York Convention (subject to any requirements of the New York Convention).

Filing requirements for aircraft leases and security assignments

Under English law, there are no filing requirements for an aircraft lease per se, although, given that the United Kingdom aircraft register is an operator registry, a domestic operator would be responsible for aircraft registration as charterer by demise under the lease. Since the ratification of the CTC in the United Kingdom, a lease may be, and in practice often is, registered at the International Registry as an international interest.

Similarly, under English law, there is no requirement to make any filings with respect to such an assignment at Companies House (other than with respect to an assignor incorporated in the United Kingdom, in which case a filing at Companies House in the United Kingdom will need to be made to ensure that the security is enforceable). The only formality to perfect an assignment by way of security of a lessor's rights under an English law-governed lease is to serve notice of the assignment on the debtor. Again, since the ratification of the CTC in the United Kingdom, an English law-governed security assignment will typically be registered at the International Registry as an international interest.

Under New York law, while there is no filing requirement in respect to a 'true lease' under the Uniform Commercial Code (UCC), it is customary for a precautionary financing statement to be filed. In the case of aircraft registered with the Federal Aviation Administration (FAA), an aircraft lease must be filed for recording with the FAA in order to be valid against third parties without notice of the aircraft lease. If the CTC applies to the lease, the international interest created under the lease must be registered with the International Registry in order to have priority over subsequently registered international interests or unregistered interests, except for certain unregistered interests that are given priority over even registered interests.

Under New York law, a titular lessor whose lease is recharacterised as a security interest will be treated as a secured party and not as a lessor, and must take steps to perfect the security interest in order to be effective against third parties. These steps include the filing of appropriate financing statements under the UCC, the filing of the lease with the FAA in the case of FAA-registered aircraft and, if the CTC applies, registering the international interest created under the lease with the International Registry. If an aircraft lease is perceived to have a substantial risk of being recharacterised, the lease should include language expressly granting to the lessor a security interest in the aircraft along with appropriate remedies in the event that the lease is recharacterised as a security interest.

Under New York law, a lender who takes an assignment of the lessor's rights under an aircraft lease also must take steps to perfect the security assignment in order to be effective against third parties. These steps include taking possession of the chattel paper original of the lease, the filing of appropriate financing statements under the UCC, the filing of the security assignment with the FAA in the case of FAA-registered aircraft and, if the CTC applies, registering the international interests created under the lease and the security assignment with the International Registry.

Mitigation of damages (common law)

English common law establishes that the purpose of damages is to compensate the injured party for loss, so as to put the innocent party in the position in which it would have been had the relevant contract not been breached.⁶ To quantify the damages to be awarded, English courts

must be satisfied that, after the breach of contract that gave rise to the loss, a claimant has taken reasonable steps to mitigate (ie, avoid or reduce) the loss. This 'duty to mitigate',⁷ is framed by three principles:

- (i) a claimant cannot recover damages for any loss that could have been avoided by taking reasonable steps;
- (ii) if a claimant in fact avoids or mitigates his or her loss resulting from a defendant's breach, he or she cannot recover for such avoided loss, even though the steps he or she took were more than could reasonably be required under (i); and
- (iii) where a claimant incurs loss or expense in the course of taking reasonable steps to mitigate the loss resulting from a defendant's breach, a claimant may recover any expenses incurred in taking such steps, even if these prove to be greater than the loss thereby avoided.

Importantly, the English courts have confirmed that the burden of proving that a claimant failed to take reasonable steps to mitigate its loss falls on a defendant and that a lessor claiming damages against a lessee in default, for example, would not be 'under any obligation to do anything other than in the ordinary course of business' to mitigate its loss.

During negotiation of an English law-governed lease, lessees commonly request that the lessor agree to a contractual duty to mitigate losses. Lessors need to consider carefully whether it is in their commercial (and legal) interest to agree to a contractual obligation that is likely to impose a greater burden on the lessor than would be imposed by common law if the lease were otherwise silent on mitigation of loss.

While New York law recognises a general duty to mitigate damages, this is subject to the parties' freedom to contract with respect to remedies and other rights under the UCC. The statutory remedies granted to a lessor under the UCC, upon a default by the lessee, provide for a statutory mitigation mechanism. However, the UCC allows the parties to override the statutory remedies provided that the obligations of good faith, diligence, reasonableness and care may not be disclaimed by agreement. The obligations of good faith, diligence, reasonableness and care might be construed in specific circumstances to impose a mitigation obligation on a lessor whether or not one is imposed expressly. One advantage of the parties setting forth a specific contractual mitigation measure is that the UCC allows the parties to determine by agreement what standards should be applied in measuring performance as long as such standards are not manifestly unreasonable. This is often set forth in a non-exclusive liquidated damages provision setting forth an agreed formula for determining lessor's damages following a lessee default.

Remoteness of damage in the context of aircraft leasing (common law)

English common law places a further check on the ability of an injured party to recover contractual damages, where a loss results from a breach of contract that is deemed to be too remote. In order for damages to be recoverable, the loss claimed must either arise 'in the usual course of things' or 'may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract as the probable result of the breach of it'. In *Pindell Limited and BBAM Aircraft Holdings 98 (Labuan) Limited v AirAsia Berhad* [2010] EWHC 2516, the English courts examined the 'second limb' test for remoteness in the context of an aircraft leasing transaction. The court held that the loss of an onward sale of a 20-year-old Boeing 737-300 aircraft, owing to the late re-delivery of the aircraft by the lessee to the lessor, was not something which 'reasonable contracting parties in the shoes of [the parties] would, when making this contract, have had it in mind'. The court also highlighted that, on the proper interpretation of the contract against its commercial background, the loss of the onward sale was not something that the lessee had assumed responsibility for and, as such, the lessor was precluded from claiming damages for the loss of the future onward sale.

To offset risks as to a reduction in damages payable to a lessor as a result of a failure to mitigate loss or losses being deemed too remote, lessors may seek to draft express provisions in their lease that specifically address these points at the outset.

Under English law, one way this may be achieved is for a lessor to stipulate in its lease a predetermined amount of damages ('liquidated damages') that will be payable by the lessee upon the breach of certain

of the lessee's obligations under a lease.⁸ Similarly, to address claims that a loss suffered may be too remote, a lessor may seek to include broad indemnification provisions that contemplate, at the outset, potential losses that may occur throughout the lease term or as a result of the leasing of an aircraft or both. It should be noted, of course, that the ability of a lessor to incorporate such terms will depend on the relative bargaining power it has as regards a potential lessee and will ultimately be a matter for commercial negotiation.

Under New York law and the UCC, the parties to a lease may include rights and remedies for default in addition to or in substitution for those provided for under the UCC, subject to the obligations of good faith, diligence, reasonableness and care mentioned previously, which cannot be disclaimed by agreement. In the case of liquidated damages clauses, these are permissible but only in an amount that is reasonable in light of the then-anticipated harm caused by default. If the parties to a lease desire to allow for the recovery of certain losses, such as loss profit on an onward sale or lease of an aircraft, they would be well advised to expressly provide for such recovery in the lease.

Conclusion

While there are some differences in the treatment of aircraft leases governed by New York law and English law, if due care is taken in the drafting of the lease and attending to all actions required to perfect and protect the interests created under the lease, it should be possible to accomplish the commercial and other objectives of the parties in an aircraft lease whether it is governed by New York law or English law.

Notes

- 1 The International Accounting Standards Board's 'IFRS16 Leases' takes effect in January 2019, which will change the basis for reporting of leases, including the requirement for lessees to report leases on balance sheets.
- 2 As a result of the United Kingdom's referendum result on its continued EU membership and the commencement of its exit from the EU, the future applicability of relevant conventions is not currently clear.
- 3 Council Regulation (EU) No. 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast).
- 4 Other than Denmark, however, note that the 2001 Brussels Regulation (Council Regulation (EC) No. 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters) is directly effective in Denmark.
- 5 Such bilateral reciprocal enforcement treaties are implemented into English law by the Administration of Justice Act 1920, Part II, and the Foreign Judgement (Reciprocal Enforcement) Act 1933.
- 6 *Robinson v Harman* (1848) 1 Ex 850.
- 7 R Goode, *Commercial Law* (4th edn 2010) notes that 'this is not a positive duty at all, merely a factor limiting the recoverability of damages.'
- 8 Such liquidated damages must not be 'penal in nature'. *Cavendish Square Holding BV v El Makdessi and ParkingEye Ltd v Beavis* [2015] UKSC 67.

United States

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Overview

1 Conventions

To which major air law treaties is your state a party? Is your state a party to the New York Convention of 1958?

The United States is a party to the following major conventions affecting aviation finance and leasing:

- the 1944 Convention on International Civil Aviation (Chicago Convention), effective April 1947, providing that aircraft shall adopt the nationality of the state in which they are registered and cannot be registered in more than one state at any given time;
- the 1948 Convention on the International Recognition of Rights in Aircraft (Geneva Convention), effective 17 September 1953, providing for mutual recognition of rights in aircraft among contracting nations;
- the 2001 Convention on International Interests in Mobile Equipment (Convention) and the 2001 Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Protocol), effective 1 March 2006 (collectively, the Cape Town Convention) establishing a uniform set of rules regarding the creation, enforcement and registration of interests held by certain parties in mobile equipment, including aircraft certified to transport at least eight persons (including crew) or goods in excess of 2,750kg (CTC airframe), all engines of at least 550 horsepower or the equivalent (1,750 pounds of thrust for jet engines) (CTC engine), and all helicopters certified to transport at least five persons (including crew) or goods in excess of 450kg (CTC helicopter and together with the CTC airframe and the CTC engine, the Aircraft Objects); and
- the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) providing common legislative standards for the recognition of arbitration agreements, and court recognition and enforcement of foreign and non-domestic arbitral awards.

The United States is not a party to the 1933 Convention for the Unification of Certain Rules relating to the Precautionary Attachment of Aircraft.

For the purposes of this chapter we will assume that the laws of the state of New York have been chosen as the governing law of the principal legal documents and that the aircraft and engines have been registered in a jurisdiction that either has or has not adopted the Cape Town Convention.

Where the Cape Town Convention does not apply either because the jurisdiction in question has not ratified it or because the equipment falls outside the definition of an Aircraft Object, the Geneva Convention will govern the rights in the airframe, engine or helicopter for those countries that have ratified it. Although the Geneva Convention successfully addresses the rules or priority over property rights in aircraft, it presents some perfection and enforcement issues requiring careful assessment of the laws of the jurisdiction where the aircraft is registered, as well as the laws of the jurisdiction where the aircraft is located at the time of delivery. The Geneva Convention is not discussed in detail in this chapter, but should be kept in mind in circumstances in which the Cape Town Convention does not apply.

For a list of contracting states to the Cape Town Convention see www.unidroit.org/status-2001capetown.

2 Domestic legislation

What is the principal domestic legislation applicable to aviation finance and leasing?

The legal framework applicable to the regulation of aviation finance and leasing transactions in the United States is a blend of state, federal and international law.

State law

Article 9 of the Uniform Commercial Code (UCC) governs transactions involving security interests in personal property such as aircraft, engines and helicopters. All 50 states have adopted a version of article 9 and these rules govern the validity and priority of security interests unless pre-empted by federal or international law (see below).

Federal law

Federal Aviation Act

State laws permitting undocumented or unrecorded transfers of interests in aircraft are typically pre-empted by the Federal Aviation Act. The Federal Aviation Act provides that the Federal Aviation Administration (FAA) shall maintain a system for the registration of aircraft and recording conveyances, leases and security interests. The FAA, to the exclusion of the states, regulates the registration of any device used or intended to be used for flight, airworthiness, safety and maintenance issues involving civil aviation, the issuance of operating certificates and licences for civil aviation and the recording of agreements and instruments conveying interests in aircraft registered with the FAA and certain aircraft engines, components and parts. Once a filing has been made with the FAA such filing acts as notice to third parties and thereby perfects an interest over the equipment.

Transportation Code

Title 49 of the US Code (Transportation Code) also pre-emptes state law, including the UCC, as to certain matters relevant to aviation finance and leasing transactions.

Title 11 of the United States Code (Bankruptcy Code)

Title 11 of the US Bankruptcy Code sets forth the rules and procedures governing bankruptcy in the United States. Although there are a number of statutory provisions protecting the rights and interests of financing parties, the most relevant is section 1110, which provides a special insolvency regime to govern a creditor's rights with respect to an aircraft, aircraft engine, propeller or spare part that is subject to a security interest granted by, leased to or conditionally sold to an airline that holds an FAA operating certificate for aircraft capable of carrying 10 or more individuals or 6,000 pounds or more of cargo when the airline becomes subject to insolvency proceedings.

International law

The Cape Town Convention and the other aviation treaties to which the United States is a party (see question 1) pre-empt federal and state laws as to certain matters relevant to aviation finance and leasing transactions.

3 Governing law

Are there any restrictions on choice-of-law clauses in contracts to the transfer of interests in or creation of security over aircraft? If parties are not free to specify the applicable law, is the law of the place where the aircraft is located or where it is registered the relevant applicable law?

As a general rule, there are no such restrictions on choice-of-law clauses. The Cape Town Convention allows the parties to an aircraft conveyancing agreement to agree on the law to govern their contractual rights and duties whether or not a 'reasonable relationship' exists to that jurisdiction (thus pre-empting any such requirement under state law). With certain exceptions, the parties to a contract that is subject to the UCC are free to choose, subject to pre-emption by federal or international law, the governing law for their contractual relationship as long as the transaction bears a 'reasonable relationship' to the chosen jurisdiction; however, there are variations in choice-of-law rules from state to state. Therefore, it is important to examine the state law chosen to govern a transaction.

In the state of New York, New York General Obligations Law section 5-1401 allows the parties to a non-consumer contract, notwithstanding the general 'reasonable relationship' choice-of-law rule in the UCC, to choose New York law to govern their contractual relationship without regard to whether a reasonable relationship exists to the state of New York provided that the obligations arising out of the transaction governed by the contract are not less than US\$250,000. Most aircraft finance and leasing transactions would fall within this statute.

Where the Cape Town Convention does not apply, the United States would recognise and enforce a conveyance under an aircraft conveyancing agreement affecting the airframe if such aircraft conveyancing agreement:

- was constituted in accordance with the law of the country where the airframe is registered (the country of registry); and
- was regularly recorded in a public record in the country of registry.

In the case of an aircraft conveyancing agreement, the laws of the country of registry would need to be examined to determine:

- whether those laws would recognise the aircraft conveyancing agreement as a valid conveyancing agreement; and
- whether the aircraft conveyancing agreement is required to be recorded in a public record.

Title transfer

4 Transfer of aircraft

How is title in an aircraft transferred?

Title to an aircraft is transferred through a bill of sale or contract of sale or physical delivery, or both. Generally, the purchaser will expect to see evidence of chain of title in the form of 'back-to-birth' bills of sale so as to trace ownership of the aircraft back to the original equipment manufacturer. Title to goods cannot pass under a contract of sale prior to the time the goods are identified to the contract; that is, the goods must be existing and identifiable at the time title is transferred.

For US-registered aircraft and engines, the practice is to complete a bill of sale in the FAA's prescribed form and file the bill of sale for recording with the FAA Registry and also to obtain a warranty bill of sale that is not recorded with the FAA.

Under the Cape Town Convention, in order to have priority over subsequently registered interests or unregistered interests in the equipment, an interest transferred pursuant to a contract of sale must be registered with the International Registry.

5 Transfer document requirements

What are the formalities for creating an enforceable transfer document for an aircraft?

The formalities required for an aircraft transfer agreement are determined by applicable state law (see question 4). As between a seller and a buyer, while the applicable statute of frauds may require a written contract for the transaction, a written transfer document is not necessary, and title could transfer by physical delivery alone; however, in the case of an FAA-registered aircraft, a conveyancing instrument must be filed for recording with the FAA Registry in order for the transfer to be

effective against third parties without notice. Further, where the Cape Town Convention applies, the interest transferred must be registered with the International Registry in order to have priority against subsequently registered interests and unregistered interests.

In the United States, the formalities for recording an instrument affecting title to, or any interest in, an aircraft are set out in Part 49 of the Federal Aviation Regulations (14 CFR Part 49), which can be found at www.ecfr.gov.

Typically, a separate warranty bill of sale under state law is issued with an AC Form 8050-2 filed with the FAA. The formal requirements for filing a conveyance instrument for an aircraft with the FAA are:

- the instrument must be in a form acceptable to the FAA, which has provided AC Form 8050-2 as an acceptable conveyancing form (www.faa.gov/documentLibrary/media/form/ac8050-2.pdf);
- the instrument must describe the aircraft by make and model, manufacturer's serial number and FAA registration number or other identifying details;
- the instrument must be an original document, or a duplicate original document, or if neither is available, a true copy of an original document. The signatures on the instrument must be ink originals. No notarisation or other authentication of the signatures is required unless requested by applicable state law. Most states, including New York, do not require authentication;
- the instrument must be accompanied by a filing fee of US\$5 for each aircraft listed. No fee is charged for recording a bill of sale that accompanies an application for aircraft registration and the proper registration fee under Part 47.17 of the Federal Aviation Regulations;
- if the seller is not shown as owner on the FAA records, the instrument must be accompanied by bills of sale or similar documents showing the chain of title; and
- if the conveyance is made by a person or entity doing business under a trade name, or by an agent, corporation, partnership, co-owner or unincorporated association, there are additional formal requirements to evidence the authority of the signer.

Registration of aircraft ownership and lease interests

6 Aircraft registry

Identify and describe the aircraft registry.

The FAA maintains a registry for civil aircraft in Oklahoma City, Oklahoma (the FAA Registry). The FAA Registry is an owner registry, and an aircraft may be registered only in the name of the owner, which must be:

- a US citizen;
- a US-resident alien;
- a US corporation that does not qualify as a US citizen, but only if the aircraft is based in and primarily used in the US; or
- the US government or a state or territory or possession of the United States.

To qualify as a US citizen, the owner must be:

- an individual citizen of the United States;
- a partnership each of whose partners is an individual citizen of the United States; or
- a US corporation or association of which the president and at least two-thirds of the board of directors and other managing officers are US citizens, which is under the actual control of US citizens, and in which at least 75 per cent of the voting interest is owned or controlled by US citizens.

The FAA has also permitted other ownership structures, including limited liability companies (LLCs) (which are treated as associations) and owner trusts, provided that the ownership entity qualifies as a US citizen or US resident alien. In the case of owner trusts, the trustee must qualify as a US citizen or US resident alien and either:

- beneficiaries who qualify as US citizens must hold at least 75 per cent of the power and authority to influence, direct or remove the trustee; or
- the trustee must have the power and authority in respect of the ownership and operation of the aircraft to take actions that in its discretion are necessary to protect the interests of the United States, without interference from the beneficiaries, in which case the beneficiaries need not qualify as US citizens (a non-citizen trust).

In connection with the registration of an aircraft in the name of an owner trustee, the trust agreement and each document affecting a relationship under the trust agreement (such as an operating agreement with the beneficiary) must be submitted along with the application for registration of the aircraft and the proper fee.

There is no separate engine registry in the United States.

7 Registrability of ownership of aircraft and lease interests

Can an ownership or lease interest in, or lease agreement over, aircraft be registered with the aircraft registry? Are there limitations on who can be recorded as owner? Can an ownership interest be registered with any other registry? Can owners', operators' and lessees' interests in aircraft engines be registered?

An ownership interest in an aircraft can and must be registered with the FAA. The interest of a lessee under a true lease cannot be registered with the FAA. A true lease is a lease of the aircraft from a lessor to the lessee, where the lessor is considered the aircraft owner for FAA, tax and accounting purposes. If the lease does not qualify as a true lease and, instead, is treated as a conditional sale agreement or a security interest, the lessee may be characterised as the owner.

See question 6 as to FAA aircraft ownership restrictions.

The owners', operators' and lessees' interests in aircraft engines cannot be registered with the FAA.

8 Registration of ownership interests

Summarise the process to register an ownership interest.

In order to register an aircraft in the name of the owner with the FAA, the following must be filed with the FAA Registry:

- an aircraft registration application using AC Form 8050-1, signed in ink. In the case of a corporate owner, the application must be signed by an officer or by an authorised person who presents a certified copy of an authorisation from any officer or manager. In the case of a partnership, the application must be signed by a general partner with the names of all general partners listed. In the case of an LLC, the application must include a statement of Support of Registration demonstrating the US citizenship status of the LLC. It is best practice to submit the application in advance to the Aeronautical Counsel at the FAA for an opinion as to the eligibility of an aircraft owned by an LLC for registration because proving LLC citizenship can be an uncertain process;
- evidence of the ownership of the aircraft by the applicant, which can take various forms:
 - if the aircraft has not previously been registered in the United States or any other country, the applicant must submit a bill of sale using Form 8050-2 signed by the seller, or an equivalent conveyancing instrument or other evidence of ownership authorised by the Federal Aviation Regulations;
 - if the aircraft was most recently registered with the FAA and was purchased from the last registered owner, the applicant must submit a bill of sale using AC Form 8050-2 signed by the seller, or an equivalent conveyance instrument or other evidence of ownership authorised by the Federal Aviation Regulations;
 - if the aircraft was most recently registered with the FAA but was not purchased from the last registered owner, the applicant must produce evidence of ownership, such as the chain of title from the last registered owner with the FAA, satisfactory to the FAA; and
 - if the aircraft was registered in a foreign country, the applicant must submit the following:
 - evidence that the foreign registration has ended (normally evidenced by notice from the foreign registry to the FAA);
 - a bill of sale using Form 8050-2 signed by the foreign seller; or
 - other evidence satisfactory to the FAA that the applicant owns the aircraft; as well as the following:
 - if the foreign country has not ratified the Geneva Convention or the Cape Town Convention, evidence that the foreign registration has ended or is invalid;
 - if the foreign country has ratified the Geneva Convention but not the Cape Town Convention, evidence that the

foreign registration has ended or is invalid, and that each recorded interest in the aircraft has been discharged or that each holder of such an interest has consented to the transfer; or

- if the foreign country has ratified the Cape Town Convention, evidence that the foreign registration has ended or is invalid and that all recorded interests ranking in priority have been discharged or the holders of such interests have consented to the deregistration and export of the aircraft;
- certification as to the US citizenship or US residency status of the owner, along with any required evidence to establish that status; and
- the fee for a Certificate of Registration of an aircraft – US\$5.

Pursuant to the UCC, title to an engine installed on an aircraft would not automatically vest in the owner of the aircraft upon its installation on the aircraft as long as the identity of the engine is not lost.

9 Title and third parties

What is the effect of registration of an ownership interest as to proof of title and third parties?

The registration of title to the aircraft and the issuance of a Certificate of Registration constitutes prima facie evidence of ownership of the aircraft, but it is not conclusive evidence of ownership of an aircraft in a proceeding in which ownership is an issue.

The Transportation Code provides that any conveyance, lease or instrument executed for security purposes that may be recorded with the FAA, affecting an aircraft or an engine, must be filed for recording with the FAA in order to be valid against third parties without notice.

Under the Cape Town Convention, in order to have priority against subsequently registered interests or unregistered interests, it is necessary to register an interest in an Aircraft Object with the International Registry. The International Registry is an electronic, web-based system that is located in Dublin, Ireland, and is operated by the Registrar, Aviareto Limited. The International Registry provides a mechanism to determine the priority of registrations made against specific equipment. For Cape Town Convention purposes an interest will be valid if it relates to an Aircraft Object and is an international interest; namely, it is (i) granted by a chargor under a security agreement; (ii) vested in a person who is a conditional seller under a title reservation agreement; or (iii) vested in a person who is a lessor under a leasing agreement. Failure to register an international interest on the International Registry renders such interest junior to competing registered interests and a purchaser would take title subject to all interests on record with the International Registry.

10 Registration of lease interests

Summarise the process to register a lease interest.

There is no registration of the interest of a lessee under a lease of an aircraft or engine registered with the FAA; however, a lease involving an aircraft or engine registered with the FAA can be filed for recording with the FAA Registry, and it must be filed for recording with the FAA in order to be valid against third parties without notice.

In order to file a lease of an aircraft or engine for recording with the FAA, a signed copy of the lease must be submitted to the FAA. The lease should contain chattel paper language which will assist with perfection under the UCC. Chattel paper is the tangible counterpart of a finance lease or operating lease designated the original for perfection purposes.

Under established procedures, the FAA will allow certain economic terms of the lease to be set forth in a schedule and for such schedule to be redacted from the lease filed with the FAA. There is no prescribed form of lease, but the lease should constitute a true lease under applicable state law (see question 7). The same signing procedures for the filing of a transfer document for an aircraft described in question 5 must be met for a lease. The filing fee is US\$5.

Where the Cape Town Convention applies, the international interest pursuant to a lease must be registered with the International Registry in order to have priority over subsequently registered interests or unregistered interests (see question 9).

11 Certificate of registration

What is the regime for certification of registered aviation interests in your jurisdiction?

Certificates of Registration for aircraft are issued by the FAA. A Certificate of Registration, in the form of AC Form 8050-03, identifies an aircraft by registration mark (commencing with the letter N), the manufacturer's serial number, the manufacturer and manufacturer's designation of the aircraft by model number, the name and address of the party to whom the Certificate of Registration is issued (the person who appears to be the owner based on the evidence of ownership submitted to the FAA), the date of issuance of such certificate and its expiry date. A Certificate of Registration issued from or after 1 October 2010 expires three years after the last day of the month in which it is issued, unless it is renewed during the six months preceding its expiry date. The Certificate of Registration does not list the owner, operator or any holder of any interest in the aircraft and expressly states that it is not a certificate of title. There is no separate engine certificate of registration.

12 Deregistration and export

Is an owner or mortgagee required to consent to any deregistration or export of the aircraft? Must the aviation authority give notice? Can the operator block any proposed deregistration or export by an owner or mortgagee?

As the holder of the Certificate of Registration, the owner (not the operator under a lease) is the party who must initiate the deregistration of the aircraft for export, subject to the rights of the holder of the Irrevocable Deregistration and Export Request Authorisation (IDERA), or a creditor of the owner that has been granted the authority to deregister and export the aircraft.

IDERA is the name given to the power of attorney granted by an airline or lessor (in the case of an owner registry) to a financing party which enables that financing party to re-register a financed aircraft. If an IDERA has been issued, the operator should not be able to block the deregistration or export by the holder of the IDERA.

The holder of the Certificate of Registration or IDERA (if one has been filed for recordation with the FAA), must submit to the FAA Registry the following in order to deregister and export the aircraft:

- a written request for cancellation describing the aircraft by make, model, manufacturer's serial number and FAA registration mark and the country to which the aircraft is to be exported;
- evidence satisfactory to the FAA that all senior recorded interests have been discharged or the holders thereof have consented to the cancellation; and
- a written certification that all senior recorded interests have been discharged or the holders thereof have consented to the cancellation.

Upon cancellation of registration of an aircraft, the FAA Registry notifies the country to which the aircraft is to be exported of such cancellation.

13 Powers of attorney

What are the principal characteristics of deregistration and export powers of attorney?

As ratified by the United States, the Cape Town Convention allows for the issuance of an IDERA (as further described in question 12) by an owner of an aircraft in the form prescribed by the Cape Town Convention.

14 Cape Town Convention and IDERA

If the Cape Town Convention is in effect in the jurisdiction, describe any notable features of the irrevocable deregistration and export request authorisation (IDERA) process.

IDERAs must be in the form attached to the Protocol to the Cape Town Convention. The IDERA must be signed by the owner that holds the Certificate of Registration. It need not be countersigned by the FAA, but must be filed for recording with the FAA Registry. The IDERA must be linked to a security instrument that is filed for recording with the FAA Registry. When seeking to deregister and export an aircraft using an IDERA, the holder must submit to the FAA Registry a search certificate from the International Registry and evidence of the discharge of any senior registered interest or the consent of the holders thereof to the cancellation.

Where the Cape Town Convention applies, the United States will recognise the holder of an IDERA as the sole person who may procure the deregistration and export of the aircraft. If an IDERA has been filed with the FAA with respect to an aircraft, the FAA Registry will honour a cancellation request only from the authorised party under the IDERA or its designee.

Security

15 Security document (mortgage) form and content

What is the typical form of a security document over the aircraft and what must it contain?

The typical form of aircraft security agreement is an English language agreement, normally called a security agreement, mortgage or trust indenture, which creates a security interest in the airframe or engines. In order to be valid against the grantor granting the security interest, the following requirements must be satisfied:

- the grantor must have rights in the collateral or power to transfer rights in the collateral to a secured party;
- value must be given; and
- one of the following conditions must be satisfied:
 - the debtor has authenticated the security agreement that provides a description of the collateral;
 - the collateral is not a certificated security and is in the possession of the secured party;
 - the collateral is a certificated security in registered form and the security certificate has been delivered to the secured party; or
 - the collateral is deposit accounts, electronic chattel paper investment property, or letter of credit rights, and the secured party has control thereof.

An aircraft security agreement need not be in any specified form as long as it creates a valid security interest under applicable state law. It need not state a maximum secured amount. The economic terms of the transaction do not need to be set out in a public record.

16 Security documentary requirements and costs

What are the documentary formalities for creation of an enforceable security over an aircraft? What are the documentary costs?

The documentary formalities will be determined by applicable state law. If the aircraft security agreement is governed by New York law, there are no documentary formalities besides it being duly signed by an authorised signatory. The only document expenses would be in connection with the filing or perfection of the security interest.

17 Security registration requirements

Must the security document be filed with the aviation authority or any other registry as a condition to its effective creation or perfection against the debtor and third parties? Summarise the process to register a mortgagee interest.

An aircraft security agreement creating a security interest in an aircraft which is registered with the FAA need not be filed or registered to be valid between the grantor and the grantee, however, in order to be valid against third parties without notice, the aircraft security agreement must be filed for recording with the FAA. This is accomplished by submitting a signed original of the mortgage or security agreement to the FAA Registry, along with evidence of the authorisation of the signing party, and a filing fee of US\$5.

Where the Cape Town Convention applies, the FAA will issue an authorising code to allow for the registration of the international interest created by the aircraft security agreement with the International Registry in order to be valid against third parties without notice.

If (i) the Cape Town Convention does not apply, (ii) the country of registry has a central filing system and (iii) the aircraft security agreement is duly constituted under its laws and duly recorded under its filing system, the effect of such recording and rights under the aircraft security agreement under the laws of the country of registry will be recognised in the United States.

If the foreign jurisdiction does not provide for perfection by filing in a public filing system, perfection can be accomplished by filing a

UCC-1 financing statement with the Recorder of Deeds in the District of Columbia. The purpose of the UCC-1 is to perfect a security interest. The cost of filing a UCC-1 is the sum of the filing fee and the fee charged by the service company performing the filing (typically between US\$80 and \$150). UCC-1 financing statements expire on the fifth anniversary of their recordation date.

It is customary to also file a precautionary UCC-1 financing statement with the Recorder of Deeds in the jurisdiction in which the debtor is organised (and if not US-organised, in the District of Columbia) for the security interest granted by the grantor, even in respect to an aircraft registered with the FAA.

18 Registration of security

How is registration of a security interest certified?

After an aircraft security agreement is recorded with the FAA Registry, the FAA sends a Conveyance Recordation Notice, AC Form 8050-41, to the grantee, identifying the recorded conveyance document by its date, the parties, the FAA recording number, the date of recordation and a description of the aircraft. The Conveyance Recordation Notice does not state the rank or priority of the security interest created by the recorded conveyance document. Registered interests appear in a searchable database maintained by the FAA.

Where the Cape Town Convention applies, the registered interest will appear on the International Registry's searchable database upon the registration of an international interest in an aircraft with the International Registry.

19 Effect of registration of a security interest

What is the effect of registration as to third parties?

Pursuant to the Transportation Code, in order to be valid against third parties without actual notice, a security agreement against an aircraft must be filed for recording with the FAA. The validity and priority of the security interest in an aircraft created by an aircraft security agreement is determined by applicable state law and, in particular, article 9 of the UCC. Under article 9, and subject to certain exceptions, the general rule is that the priority of a security interest in personal property is determined by the order of filing of a UCC-1 financing statement (valid for five years from the date of recordation) or security agreement in the appropriate location, subject to certain exceptions (see question 24).

The Cape Town Convention pre-empts the Transportation Code and state law. Under the Cape Town Convention, a registered interest in an airframe or engine has priority over a subsequent registered interest or an unregistered interest, subject to certain exceptions (see question 24).

20 Security structure and alteration

How is security over aircraft and leases typically structured? What are the consequences of changes to the security or its beneficiaries?

Security over aircraft in the United States is created by the grant of a security interest against the aircraft, pursuant to article 9 of the UCC as adopted in the applicable state. The document by which the security interest is granted is typically called a security agreement or mortgage. Security over an aircraft lease is created by the grant of an assignment of or security interest in the lease pursuant to article 9. A security interest may be granted to a trustee or agent on behalf of a group of beneficiaries, however, in such a case, the secured party would be the trustee or agent, not the beneficiaries.

If a security interest is granted to a lender to secure the loan from such lender and the lender transfers the loan to a new lender, the security agreement under which the security interest was granted would have to be transferred to the new lender. As among the grantor of the security interest, the original lender that was granted the security interest and the new lender, no filing or registration in respect to the assignment would be necessary in order for the assignment to be effective, although notice of the assignment would have to be given to the grantor, however, in order for the assignment to have priority over third parties, the assignment would need to be perfected.

Under the Transportation Code, in order to be effective against third parties without notice, an assignment of a security interest with

respect to an aircraft or engine would need to be filed for recordation with the FAA Registry. Under the Cape Town Convention, in order to be effective against third parties (whether or not they have notice), the assignment of associated rights in respect to the international interest would have to be registered with the International Registry.

21 Security over spare engines

What form does security over spare engines typically take and how does it operate?

The form of security over spare engines in the United States is the same as that for aircraft – a security interest granted pursuant to article 9 of the UCC, with the typical document being a security agreement or mortgage (see question 20). In the case of engines that are installed on an airframe, a single aircraft security agreement covering the airframe and its installed engines is most commonly used. In the case of spare engines that are not installed, an aircraft security agreement covering that engine or other uninstalled engines may be used.

Engines are typically treated separately from the airframe and, therefore, an aircraft security agreement covering both an airframe and its installed engines should separately identify the engines by manufacturer, model and serial number. An engine need not be installed on the airframe in order to be covered by an aircraft security agreement that appropriately identifies that engine. Subject to the terms of the aircraft security agreement, the engine should remain encumbered by the aircraft security agreement if it is removed from the airframe.

While an engine encumbered by an aircraft security agreement that is installed on another airframe should not cease to be encumbered under the UCC, this could depend upon applicable law of the jurisdiction of where the engine is located when it was installed on the other airframe.

Enforcement measures

22 Repossession following lease termination

Outline the basic repossession procedures following lease termination. How may the lessee lawfully impede the owner's rights to exercise default remedies?

Subject to any limitations under the aircraft lease, upon termination of the aircraft lease following the expiry of its term or an event of default by the lessee, the lessor may exercise self-help measures to repossess an aircraft without judicial intervention if it can do so without breach of the peace. If the lessee physically opposes the lessor's repossession efforts, the lessor cannot forcibly take the aircraft and would likely have to seek assistance from a court through a judicial proceeding. The typical procedure for repossessing an aircraft in the United States is to pursue an action in state or federal court where the aircraft is situated under state law procedures. In the same proceeding, the lessor could seek to recover damages under the aircraft lease. In such court proceeding, the lessee could seek to resist the repossession of the aircraft by the lessor or countersue the lessor – actions that could interfere or delay the lessor's attempts to repossess.

If a bankruptcy proceeding is commenced by or against a US lessee, an automatic stay under the Bankruptcy Code would bar any efforts by the lessor to repossess the aircraft absent an order from the bankruptcy court except in respect to an aircraft lease involving certain aircraft that are subject to section 1110 of the Bankruptcy Code. Section 1110 gives special protection to financiers in circumstances in which an air carrier becomes a debtor under Chapter 11 of the Bankruptcy Code. Specifically, it provides that, with respect to aircraft, aircraft engines and certain other items subject to a security interest granted by, leased to or conditionally sold to a grantor that is an FAA-certified air carrier for aircraft capable of carrying 10 or more individuals or 6,000 pounds or more of cargo, the automatic stay is lifted unless the bankruptcy trustee cures all defaults and agrees to assume all obligations under the security agreement, lease or conditional sale contract within 60 days of the commencement of the bankruptcy proceeding (subject to extension by agreement of the parties).

Alternatively, a financier may opt to:

- obtain an ex-parte court order to seize the aircraft while it is on the ground but must be prepared to post a bond in case the financier is seizing the aircraft in error; or

- engage a 'repo team' to take control of the aircraft and fly it to a favourable jurisdiction, if such team can repossess without breaching the peace.

23 Enforcement of security

Outline the basic measures to enforce a security interest.

How may the owner lawfully impede the mortgagee's right to enforce?

Similar to the rights of a lessor under an aircraft lease described in question 22, upon a default under an aircraft security agreement covering an aircraft, pursuant to article 9 of the UCC, the grantee may exercise self-help measures to repossess the aircraft or render the aircraft unusable by the grantor without judicial intervention if it may do so without breach of the peace. If the grantor physically resists the grantor's repossession efforts, the grantor will likely not be able to proceed without breaching the peace, in which case the grantor would need to seek a court order to repossess the aircraft. The typical procedure for repossessing an aircraft in the United States is to pursue an action under state law procedures in state or federal court where the aircraft is situated. In the same proceeding, the lessor could seek a deficiency claim against the grantor if the value of the aircraft is less than the amount secured and other damages. In such a court proceeding, the lessee could seek to resist the repossession of the aircraft by the lessor or counter-sue the lessor – actions that could interfere with or delay the lessor's attempts to repossess.

If the grantee under an aircraft security agreement is able to repossess the aircraft, either through the exercise of self-help or pursuant to a court order, under the UCC, the grantee would be able to dispose of the aircraft either through a public or private sale in accordance with the UCC and the aircraft security agreement, with the net proceeds from the sale, after payment of expenses, being applied against the secured debt, with any surplus proceeds going to the grantor.

Similar to an aircraft lease agreement, if a bankruptcy proceeding is commenced by or against a US grantor of an aircraft agreement, the automatic stay under the Bankruptcy Code would bar any efforts by the grantee to repossess or dispose of the aircraft absent an order from the bankruptcy court, except in respect to an aircraft security agreement involving certain aircraft that are subject to section 1110 of the Bankruptcy Code (see question 22).

24 Priority liens and rights

Which liens and rights will have priority over aircraft ownership or an aircraft security interest? If an aircraft can be taken, seized or detained, is any form of compensation available to an owner or mortgagee?

The following liens or rights could have priority over a security interest created under an aircraft security agreement:

- US federal tax liens, which are filed with the relevant state and cannot be filed with the FAA Registry or registered with the International Registry;
- possessory mechanics and warehouse liens to the extent provided under applicable state law;
- non-possessory mechanics liens to the extent provided under applicable state law, although these may be subordinate to any perfected security interest and may need to be filed for recordation with the FAA Registry;
- purchase money security interests (being a security interest in favour of a lender that is created in an asset at the time the buyer of that asset uses the lender's loan proceeds to make the purchase), which may be filed up to 20 days after the grantor receives possession and will take priority over any intervening security interests;
- buyers purchasing goods in the ordinary course from persons in the business of selling that type of goods; and
- airport and air navigation charges.

The US Customs Service may seize an aircraft for transporting drugs (except for airlines involved in common carriage).

The US government has the power to require all or any part of the US airline transportation system to be turned over to the government for its use during times of war. The US government would be obligated to provide compensation for any such taking under the US Constitution.

Taxes and payment restrictions

25 Taxes

What taxes may apply to aviation-related lease payments, loan repayments and transfers of aircraft? How may tax liability be lawfully minimised?

Aviation finance and leasing transactions in the US give rise to a significant number of tax issues, and before entering into such a transaction the parties should thoroughly examine the US and foreign tax consequences and factor them into the structuring and pricing of the transaction. The following is a brief discussion of a few selected tax issues that are commonly addressed in the case of foreign corporation selling, financing or leasing an aircraft to a US resident.

Sales and use taxes

Upon the sale of an aircraft when physically located in a state, or the lease of an aircraft that will be based or used in a state, generally the state will require that the seller or lessor collect from the buyer or lessee and remit to the state's tax authorities a sales tax on the gross sale proceeds or use tax on the gross rentals under a lease when based or operated in such state. State sales taxes are typically around 8.5 per cent of gross sales proceeds. There are often exemptions available, including in many states an exemption for sales or leases of aircraft to air carriers for use in foreign or interstate commerce. Delivering an aircraft when it is located either over international airspace or in another state or jurisdiction that does not impose a sales tax or has an exemption can be an effective way to eliminate sales taxes, but not use taxes. The seller or lessor should require that the buyer or lessee deliver a tax exemption certificate to evidence the availability of any tax exemption. There are no federal sales or use taxes, although there are both federal and state income taxes that could be imposed with respect to income or gain from sale proceeds or rentals.

Federal withholding tax on aircraft lease rentals

Without an exemption or reduction under an international tax treaty or federal tax laws, gross rentals payable by a US lessee to a foreign lessor that is not engaged in the leasing business in the United States are generally subject to US federal withholding tax at the rate of 30 per cent, to the extent that the rentals are attributable to periods of time when the aircraft is located or operated within the United States. The United States is a party to numerous treaties with other countries that either exempt or reduce the withholding tax on gross rentals.

Federal corporation income tax on aircraft lease rentals

A foreign corporate lessor that is engaged in the leasing business through a permanent establishment in the United States is subject to US federal income tax at the graduated rate applicable to US domestic corporations. However, all or part of the lessor's leasing income may be exempt from US federal income taxation under an international treaty or a reciprocal exemption under the US federal income tax statute.

A foreign corporate lessor that is engaged in the leasing business in the United States that does not have a permanent establishment in the United States will be subject to a US federal gross transportation income tax at the rate of 4 per cent on one-half of its rental income for the period when the aircraft is operated between a place within the United States and a place outside the United States. However, all or part of the lessor's leasing income may be exempt from US federal income taxation under an international treaty or a reciprocal exemption under the US federal income tax statute.

State income tax on aircraft lease rentals

A foreign corporate lessor that carries on the business of leasing at a place of business within a state will be subject to income taxation by the state. A foreign corporate lessor that does not have a place of business within a state may nonetheless be subject to income taxation by the state if aircraft leased by the lessor are based or operated within the state.

Property taxes

Certain states and local taxing authorities impose a property tax on the owner of tangible property located within a state during all or a portion of a tax year. Such taxes are usually based on the value of the property.

Update and trends

According to Boeing's Current Aircraft Finance Market Outlook 2017, it is anticipated that this year commercial banks will provide the greatest share of funding for the first time since 2014. The primary factor driving this latest trend is the rising share of deliveries to China, where bank debt is the most prevalent source of financing. Contributions from capital markets and cash are expected to remain steady throughout 2017 and non-US investor participation in enhanced equipment trust certificates is likely to continue to accelerate. This trend is not surprising given the momentum behind the Cape Town Convention and an expanding global investor base.

The number of commercial aircraft deliveries will also continue to build upon 2016 levels. This upward trend is expected to continue through the end of 2017 and, according to the IATA, airlines are expected to take delivery of some 1,700 new aircraft this year, around half of which will replace older and less fuel-efficient aircraft.

Federal withholding tax on interest payments

Absent an exemption or reduction under an international tax treaty, interest payments by a US resident to a foreign lender that is not effectively connected to a US business of the lender are generally subject to US federal withholding tax at the rate of 30 per cent. If the interest payments are effectively connected to a US business of the lender, the lender would be subject to US federal income tax at the graduated rate applicable to US domestic corporations. The United States is a party to numerous treaties with other countries that either exempt or reduce the withholding tax on gross rentals.

26 Exchange control

Are there any restrictions on international payments and exchange controls in effect in your jurisdiction?

The United States does not have restrictions on international payments or foreign exchange controls other than certain bank reporting requirements and certain restrictions on dealing with barred or listed countries, persons or entities.

27 Default interest

Are there any limitations on the amount of default interest that can be charged on lease or loan payments?

Pursuant to state usury laws, there are limits on interest payments that may be charged on borrowed money. In New York, the maximum amount of interest that may be charged is 16 per cent, although certain exemptions may apply. Usury limits may not restrict the amount of interest that may be paid following a default on a loan or lease payment if they are not determined to be payments for borrowed money.

28 Customs, import and export

Are there any costs to bring the aircraft into the jurisdiction or take it out of the jurisdiction? Does the liability attach to the owner or mortgagee?

The export of commercial aircraft from the United States, and sale or transfer of a US-origin aircraft outside the United States, are subject to US export laws. Most commercial aircraft are considered US origin aircraft.

Generally, the export of a US aircraft does not have any restricted parts or avionics and does not require a special licence, although certain transfers are prohibited including transfers:

- to certain embargoed countries;
- of aircraft incorporating certain military or technologically advanced components; and
- to certain persons or entities on barred lists, or those located in certain countries.

If an aircraft is being permanently exported from the United States, there is certain paperwork required in connection with the export.

Insurance and reinsurance

29 Captive insurance

Summarise any captive insurance regime in your jurisdiction as applicable to aviation.

There are no captive insurance regimes applicable to commercial aircraft and insurance coverage in the United States; aviation insurance is normally placed through commercial aviation markets.

30 Cut-through clauses

Are cut-through clauses under the insurance and reinsurance documentation legally effective?

A cut-through clause (or endorsement) in an underlying primary insurance policy allows the insured to seek payment directly from the reinsurer in the case of insolvency or similar events affecting the primary insurer policy. The enforceability of cut-through clauses is determined by the governing law for both the primary insurance policy and the reinsurance policy. For the primary insurance policy, the main issue is whether, under the state law applicable to the primary insurer, the proceeds from reinsurance can be paid to the insured, rather than to the primary insurer or a conservator or administrator of the insolvent insurer. While results vary from state to state, many states, including New York and California, permit cut-through endorsements. Among the issues affecting the enforceability of a cut-through endorsement against the reinsurer is whether there needs to be privity between the reinsurer and the insured. Generally, such privity should not be required in the United States, however, the safest approach is to include a cut-through endorsement in the reinsurance policy and to have the insured named as an additional insured and loss payee under the reinsurance policy, so that the insured has a direct claim against the reinsurer.

31 Reinsurance

Are assignments of reinsurance (by domestic or captive insurers) legally effective? Are assignments of reinsurance typically provided on aviation leasing and finance transactions?

With the exception of California and Louisiana, assignments of insurance policies (including reinsurance policies), other than healthcare insurance, are excluded from coverage under article 9 of the UCC. There is no uniformity from state to state regarding the process of obtaining priority in an assignment of aviation insurance or reinsurance over competing assignments. As a consequence, assignments of insurance and reinsurance policies are not customary for aviation finance and leasing transactions in the United States. The normal approach is for the financier or lessor to be named as an additional insured and loss payee under the insurance and reinsurance policies, and then include cut-through endorsements in the policies, rather than assignments.

32 Liability

Can an owner, lessor or financier be liable for the operation of the aircraft or the activities of the operator?

Liability for passenger injuries and death

If an accident or incident involving an aircraft registered with the FAA causes death, injury or damage to third parties, it is not clear under what circumstances an owner, lessor or secured party without any operational control or authority over the aircraft would be liable to such third parties. Pursuant to the Transportation Code, 49 USC, section 44112(b), a lessor, owner or secured party of an aircraft registered with the FAA can be liable for personal injury, death, or property loss or damage on land or water caused by a civil aircraft, engine or propeller only if it was in the actual control of the lessor, owner or secured party. The majority of courts that have considered the federal exclusion from liability under section 44112(b) have construed it broadly to pre-empt state statutes and common law claims that impose liabilities on owners or lessors not in actual possession or control. However, there is a minority view that would narrowly construe the exclusion from liability and allow certain claims under state law. In *Vreeland v Ferrer*, 28 So. 3d 906 (2010), the Florida Supreme Court construed section 44112 narrowly to exclude liability for loss or damage only to

people or property on the ground and, therefore, looked to applicable state law as to whether liability should be imposed on a passive owner.

If the majority view is followed, section 44112(b) would pre-empt state law and owners and lessors not in actual control of an aircraft would avoid liability for accidents or incidents involving FAA-registered aircraft. However, if the minority view represented by the *Vreeland* decision is followed, then the liability of an owner, lessor or financier could depend upon the applicable law in the jurisdiction where a lawsuit is filed. There is no uniform standard under state laws for imposing liability for aircraft accidents upon an owner, lessor or secured party that does not have operation control over the aircraft. Some states impose strict liability upon an owner. Other states impose liability if an owner, lessor or secured party is found to be negligent either on its own or vicariously through its selection of an operator. Although there is very little authority actually holding an owner, lessor or financier liable for aircraft accidents or incidents, the standard practice is to obtain broad indemnification from the operator covering all operational risks, and to require broad liability insurance covering those risks.

33 **Strict liability**

Does the jurisdiction adopt a regime of strict liability for owners, lessors, financiers or others with no operational interest in the aircraft?

This is a matter of state law, possibly where the accident occurs, or where the defendant is located, or where the legal proceeding is held.

34 **Third-party liability insurance**

Are there minimum requirements for the amount of third-party liability cover that must be in place?

Generally, air carriers are required to have US\$300,000 coverage for any one person in any one occurrence and a total of US\$20 million per involved aircraft for each occurrence, except that for aircraft of not more than 60 seats or 18,000 pounds maximum payload capacity, carriers need maintain coverage of only US\$2 million per involved aircraft for each occurrence.

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