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Aviation Financing & Leasing

USA
Pillsbury Winthrop Shaw Pittman LLP

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2019

Law and Practice

Contributed by Pillsbury Winthrop Shaw Pittman LLP

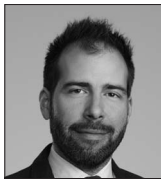
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Pillsbury Winthrop Shaw Pittman LLP is powered by a team of dedicated aviation finance lawyers in the US, Europe and Asia. The 30-member global aviation finance team has ranked consistently as one of the world's finest over decades. Over the last five years alone, the firm has helped a diverse range of market participants get or keep more than 1,500 commercial aircraft flying, reflecting an aggregate asset value of more than USD75 billion. The firm serves as a trusted adviser to the most established names in aviation as well as emerging players, including airlines, lessors, fi-

nancial institutions and other investors. Whichever side is represented, the firm understands the unique dynamics between, and interests of, the parties involved. Clients and counterparties know the firm for its in-depth substantive knowledge, commercial awareness, user-friendly service and ability to power the efficient execution of transactions. In addition, members of the team are also known as a long-range capable force to be reckoned with when it comes to the prosecution (and defence) of related enforcement actions and disputes.

Authors



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1. Aircraft and Engine Purchase and Sale

1.1 Sales Agreements

1.1.1 Taxes/Duties Payable Upon Execution of the Sales Agreement

There are no stamp, registration or similar taxes payable under federal law of the United States of America (“US”) or the laws of New York, Delaware or most other states in connection with the execution and delivery of an aircraft engine or sale agreement. See answer to **1.2.5 Tax/Duties Payable upon Execution of a Bill of Sale** with respect to taxes which might arise on the transfer of title rather than execution of the sale agreement.

1.1.2 Enforceability Against Domestic Parties

The sale agreement should be in the English language (or translated into English) but need not be certified, notarised or legalised to be enforceable against a domestic party.

1.2 Transfer of Ownership

1.2.1 Transferring Title

Transferring title to an aircraft or engine is effected by a bill of sale or contract of sale or physical delivery, or both. The transfer will apply to all installed parts, including an auxiliary power unit (APU). The goods must be existing and identifiable at the time of transfer as any interest in goods may not pass under a contract of sale before the goods are existing and identified to the contract.

The sale of the ownership interest in an owner trust or other pass-through entity that owns an aircraft or engine will not generally be recognised as a sale of that aircraft or engine itself, but as a sale of a beneficial interest in that asset.

1.2.2 Sales Governed by English or New York Law

Subject to the requirements of the Geneva Convention (discussed below), the transfer of title to an aircraft or engine physically delivered in the US would be recognised if the bill of sale is governed by either English or New York law. There are no minimum substantive requirements for such a bill of sale to be recognised, subject in each case to (i) the particular requirements for the US Federal Aviation Administration (“FAA”) bill of sale required for aircraft registered in the US (see **1.2.4 Registration, Filing and/or Consent from Government Entities**), (ii) applicable bankruptcy, fraudulent conveyance and other laws affecting and relating to the rights of creditors generally, (iii) general equitable principles and (iv) requirements of reasonableness, good faith and fair dealing.

1.2.3 Enforceability Against Domestic Parties

A bill of sale should be in the English language (or translated into English) but need not be certified, notarised or legal-

ised to be enforceable against a domestic party. Typically, parties will deliver two bills of sale in connection with US registered aircraft: a warranty bill of sale governed by New York law, which has the legal effect of warranting title to the aircraft free and clear of all liens (other than permitted liens as agreed); and an FAA bill of sale which is an evidentiary instrument used to record a title transfer on the FAA registry. The bill of sale registered with the FAA must be in a prescribed form (see **1.2.4 Registration, Filing and/or Consent from Government Entities**).

1.2.4 Registration, Filing and/or Consent from, Government Entities

Save for any requirement for a written contract arising as a result of the applicable statute of frauds of a particular state, a written transfer document is not even necessary as title could transfer by physical delivery alone as between the buyer and seller. In the case of an aircraft registered with the FAA, however, 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.

FAA aircraft may only be registered 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 US (see discussion on registration below).

To qualify as a US citizen, the owner must be (i) an individual citizen of the US; (ii) a partnership, each of whose partners is an individual citizen of the US; or (iii) 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% of the voting interest is owned or controlled by US citizens.

The FAA also generally permits other ownership structures, including limited liability companies (which are treated as associations), voting trusts and non-citizen 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% 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 which in its discretion are necessary to protect the interests of the US, without interference from the beneficiaries, in which case the beneficiaries need not qualify as US citizens (a ‘non-citizen trust’).

The formalities for recording an instrument affecting title to, or any interest in, an aircraft are set forth in the relevant FAA regulations and can be summarised as follows:

- the instrument must be in a form acceptable to the FAA, which has provided AC Form 8050-2 as an acceptable conveyancing form;
- 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 in ink and must also have the typed or legibly printed name of each signer in the signature block or otherwise provided in compliance with electronic signature procedures;
- the instrument must be accompanied by a filing fee of USD5 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 for such application;
- if the seller is not shown as owner on the FAA records, the instrument must be accompanied by copies of bills of sale or similar documents showing consecutive transfers from the last registered owner, through each intervening owner, to the seller; 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.

No notarisation or other authentication of the signatures submitted to the FAA is necessary unless required by applicable state law. New York and most other states do not require any such authentication.

1.2.5 Taxes/Duties Payable upon Execution of a Bill of Sale
With respect to the sale of an aircraft when physically located in a particular US state that has a sales or use tax applicable to commercial aircraft, generally the state will require that the seller collect from the buyer and remit to the state's tax authorities a sales tax on the gross sale proceeds. Many states do not impose any sales taxes, and in other states there are often exemptions available, including for sales of aircraft to air carriers for use in foreign or interstate commerce. States would not assert sales tax over sales of aircraft that occur over international waters or in another state or jurisdiction that does not impose a sales tax. Many states also impose a use tax for aircraft that are purchased outside the state without sales tax but are subsequently imported and habitually based in that state.

The particular facts and circumstances of the transaction must be examined closely with respect to US federal tax con-

sequences on income or a gain from sales proceeds, but there is no US federal sales tax.

2. Aircraft and Engine Leasing

2.1 Overview

2.1.1 Non-Permissible Leases

We are not aware of any types of operating/wet/finance leases or leases concerning only engines or parts which are not permissible or recognised, but would note that prohibitions on leases of aircraft to certain persons or entities on sanctioned lists, or those located in certain countries, would apply equally to leases of engines or parts.

2.1.2 Application of Foreign Laws

A lease involving either a domestic party or an asset situated in this jurisdiction can be governed by a foreign law.

2.1.3 Restrictions Concerning Payments in US Dollars

There are no material restrictions imposed on domestic lessees making rent payments to foreign lessors in US dollars.

2.1.4 Exchange Controls

There are no foreign exchange controls and no restrictions on international payments other than ordinary course bank reporting requirements and certain restrictions on dealing with sanctioned or controlled countries, persons or entities.

2.1.5 Taxes/Duties Payable for Physical Execution of a Lease

There are no stamp, registration or similar taxes payable under US federal law or the laws of New York, Delaware or most other states in connection with the execution and delivery of a lease. In the case of a finance or capital lease, care should be given to determining whether such a lease might be treated as a sale, triggering potential sales and use tax consequences, as discussed above.

2.1.6 Licensing/Qualification of Lessors

A lessor does not have to be licensed or otherwise qualified in the US to do business with a domestic lessee. A finance lessor that is in the business of providing commercial loans to residents of certain states, including in some cases California, may need to register and/or comply with state lending laws. Regulated financial institutions are typically exempt from such laws.

2.2 Lease Terms

2.2.1 Mandatory Terms for Leases Governed by English or New York Law

Leases that are governed by New York law are generally subject to Article 2A of the UCC, except as pre-empted with respect to certain matters by the Transportation Code, the

Cape Town Convention and the Geneva Convention. Article 2A contains general rules on matters that include the valid formation of lease contracts, as well as a number of implied warranties and remedies. Parties are generally free to exclude, modify or derogate from such warranties and remedies in their contractual arrangements.

2.2.2 Tax and Withholding Gross-up Provisions

Tax and other withholding gross-up provisions are generally permissible and enforceable, subject to general limitations on the enforceability of contracts.

2.2.3 Parts Installed or Replaced After a Lease's Execution

The terms of the contract will govern the extent to which replacement parts are made subject to the lease. Generally, parties provide in their leases that parts removed will remain subject to the lease until replacement parts are affixed to the aircraft, at which point title to the replacement parts will vest with the owner and they will become subject to the lease. It is prudent to include a reference to parts installed or replaced at a later date in the definitions of the airframe and engine.

2.2.4 Risk of Title Annexation

Pursuant to the Uniform Commercial Code (the "UCC"), title to an engine installed on an airframe would not automatically annex to the owner of that airframe upon its installation on the airframe, provided that the identity of the engine is not lost. In addition, the Cape Town Convention, which is in effect in the US, expressly rejects the principle of accession for aircraft engines.

2.2.5 Recognition of the Concepts of Trust/Trustee

The concept of a trust and the role of an owner trustee under a lease is recognised. US law facilitates the use of trusts for the ownership of aircraft and for registration of aircraft at the FAA. Trusts are convenient for many other purposes as well, including the flexibility to transfer the beneficial interest in a trust so that neither the lessor of an aircraft under a lease nor the registration of the aircraft in the FAA Registry needs to be changed.

2.3 Lease Registration

2.3.1 Notation of Owner's/Lessor's Interests on Aircraft Register

An ownership interest in an aircraft must be registered with the FAA. Only US citizens may register their ownership in a US registered aircraft (see discussion above).

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 not conclusive evidence in a proceeding in which ownership is an issue.

A lease can be filed for recording with the FAA Registry and the Transportation Code (Title 49 of the US Code, the

"Transportation Code"), which provides that it must be filed for recording with the FAA in order to be valid against third parties without notice.

2.3.2 Registration if Owner is Different from Operator

The aircraft may only be registered domestically in the name of the owner. In the case of a finance or capital lease (generally a lease which places all or substantially all of the benefits and burdens of ownership with the lessee, such as a lease which provides for payments equal to the capital cost of the asset amortised over its entire useful life), the lessee will be treated as the owner of the aircraft and it will be registered in the lessee's name.

2.3.3 Aircraft/Engine-specific Registers

There is no separate register for leases concerning aircraft or engines, but leases can be registered with the FAA Registry (see **2.3.1 Notation of Owner's/Lessor's Interests on Aircraft Register**). There is no separate engine registry in the US and as such, the interests of the owner, operator and lessee in aircraft engines cannot be registered with the FAA.

2.3.4 Registration of Leases with Domestic Aircraft Registry

Leases are not subject to consent from any government entity or any related formalities. A lease is not required to be filed with the FAA but 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. Certain lessors ensure that their leases contain chattel paper language in order to assist with perfection under the UCC. Chattel paper is the tangible counterpart of a finance lease or operating lease designated as the original for perfection purposes. However, many practitioners take the view that the provisions of the Cape Town Convention, and the registration of lease international interest (and assignment of associated rights) obviates the need to create and retain chattel paper originals.

For leases governed by New York law, parties will typically file a precautionary UCC-1 financing statement to cover the scenario where a true lease might be re-characterised as secured financing.

The formalities described in **1.2.4 Registration, Filing and/or Consent from Government Entities** for the recording of an instrument affecting title to, or any interest in, an aircraft with the FAA must be met for a lease and the filing fee is USD5. As a practical matter, the FAA will allow certain commercial terms of the lease to be redacted or set forth in a schedule and for that schedule to be redacted from the lease filed with the FAA.

2.3.5 Requirements for a Lease to be Valid and Registrable
Save for the formalities described in **1.2.4 Registration, Filing and/or Consent from Government Entities**, there is no required form of lease, but the lease should constitute a true lease under applicable state law (ie, a lease that is not a finance or capital lease, as described above).

2.3.6 Taxes/Duties Payable for Registering a Lease

See **2.3.5 Requirements for a Lease to be Valid and Registrable** above.

2.3.7 Registration of Aircraft in Alternative Countries

Aircraft habitually based in this jurisdiction are not typically registered in alternative countries.

2.3.8 Requirements for Documents Concerning Registration

Save for the formalities described in **1.2.4 Registration, Filing and/or Consent from Government Entities**, there is no requirement.

2.4 Lessor's Liabilities

2.4.1 Tax Requirements for a Foreign Lessor

In the absence of an exemption, in general, a foreign lessor is subject to 30% US federal withholding tax with respect to rent attributable to flights that begin and end in the US and a 4% US-source gross transportation tax with respect to rent attributable to flights that begin or end in the US. The lessee should collect the 30% withholding tax (if applicable) and remit the tax to the US Treasury Department. However, if the lessee fails to collect the tax, the foreign lessor is liable for the tax. The 4% gross transportation tax (if applicable) is self-assessed by the foreign lessor.

2.4.2 Effects of Leasing on the Residence of a Foreign Lessor

For US federal income tax purposes, merely being a party to a typical aircraft lease generally does not cause the foreign lessor to be engaged in a US trade or business and does not cause the foreign lessor to be deemed to be resident or domiciled in the US. Enforcement of the lease also should not generally cause the foreign lessor to be engaged in a US trade or business and does not cause the foreign lessor to be deemed to be resident or domiciled in the US.

2.4.3 Engine Maintenance and Operations

Pursuant to the Transportation Code, Section 44112(b), a lessor (foreign or not) 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 such equipment was in the actual control of the lessor. 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 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, such as tort claims for negligent entrustment of property. As such, it is recommended that a lessor obtain broad indemnification from the operator covering all operational risks, and that broad liability insurance covering any such risks be required.

2.4.4 Damage or Loss Caused by an Asset

This will be a matter of state law in the state where the damage or loss occurs, or where the defendant is located, or where the legal proceeding is held. However, as discussed above, it is unlikely that a passive owner or financier would be held liable if it was not in control of the equipment, let alone strictly liable.

2.4.5 Attachment by Creditors

Creditors of a domestic lessee cannot attach and sell property which is not owned by that lessee.

2.4.6 Priority of Third Parties' Rights

The following third-party rights may have priority over a lessor's rights under an aircraft or engine lease, whether or not such lease/lessor is registered in the FAA Registry:

- right of the US Customs Service to seize an aircraft for transporting drugs (save for airlines involved in common carriage);
- right of US government to requisition all or any part of a US airline transportation system for government use during times of war, in which case, the US government would be required to compensate for any such taking under the US Constitution;
- US federal tax liens, which are filed with the relevant state or county and cannot be filed with the FAA Registry or registered with the International Registry;
- airport and air navigation authorities' charges;
- possessory mechanic's or fuel supplier's liens to the extent provided under applicable state law;
- non-possessory mechanic's or fuel supplier's 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 in favour of a lender, which allows a lender to repossess property financed with its loan or demand repayment in cash if the borrower defaults and such interest may be filed before the borrower receives possession or up to 20 days thereafter and will take priority over any intervening creditors' claims; and
- buyers purchasing goods in the ordinary course in good faith from a person in the business of selling goods of that kind.

2.5 Insurance and Reinsurance

2.5.1 Requirement to Engage Domestic Insurance Companies

There is no legal requirement that aviation insurances in relation to aircraft registered in the US be placed with any domestic US insurance company. Insurance for aircraft registered in the US are often placed in the Lloyd's of London insurance market.

2.5.2 Mandatory Insurance Coverage Requirements

The FAA imposes different minimum liability insurance requirements on different types of aircraft. For example, air carriers operating small aircraft (60 or fewer passenger seats or a maximum payload capacity of 18,000 pounds or less) generally must maintain combined or separate insurance coverages for (i) Combined Bodily Injury (Excluding Passengers other than cargo attendants) and Property Damage Liability of not less than USD300,000 per person and USD2,000,000 per occurrence and (ii) Passenger Bodily Injury of not less than USD300,000 per person and USD300,000 x 75% of total number of passenger seats installed in aircraft. Air carriers operating large aircraft (more than 60 passenger seats or a maximum payload capacity of more than 18,000 pounds) must generally maintain combined or separate insurance coverages for (i) Combined Bodily Injury (Excluding Passengers other than cargo attendants) and Property Damage Liability of not less than USD300,000 per person and USD20,000,000 per occurrence and (ii) Passenger Bodily Injury of not less than USD300,000 per person and USD300,000 x 75% of total number of passenger seats installed in aircraft.

2.5.3 Placement of Insurances Outside of Jurisdiction

Reinsurances can be placed outside of the jurisdiction up to 100% coverage.

2.5.4 Enforceability of 'Cut-through' Clauses

The treatment of cut-through clauses, which provide for direct payment of reinsurance proceeds to the primary insured or contract party(ies) rather than to the insurer, varies in the US depending on the state law applicable to the insurer. Laws in California, New York and certain other states support the enforcement of cut-through clauses.

2.5.5 Assignment of Insurance/Reinsurance

Assignments of insurances/reinsurances are permitted. However, these are not typically used in the US because secured parties entitled to receive hull loss proceeds in the event of a loss are typically endorsed as 'contract parties' or 'sole loss payees' in the relevant insurance certificate(s) and parties entitled to third-party liability coverage are commonly endorsed as 'additional insureds' in the relevant insurance certificate(s).

2.6 Lease Enforcement

2.6.1 Restrictions on Lessors' Abilities

Outside of bankruptcy and subject to other applicable laws and the quiet enjoyment terms applicable under each specific lease, there are no specific limitations on the ability to exercise remedies. The aircraft need not be physically located in the US; however, if it is located in a third country, the procedural local laws of that country will typically govern the exercise of remedies.

2.6.2 Lessor Taking Possession of Aircraft

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' to take possession of an aircraft without a court order if it can do so without breach of the peace and subject to any limitations under the terms of the lease. If the lessee physically opposes the lessor's repossession efforts, the lessor cannot forcibly take the aircraft and would likely have to seek a court order through a judicial proceeding.

If a bankruptcy proceeding is commenced by or against a US lessee, an automatic stay under the US Bankruptcy Code (the "Bankruptcy Code") would bar any efforts by the lessor to repossess the aircraft in the absence of an order from the bankruptcy court, except in respect of an aircraft lease involving certain aircraft that are subject to Section 1110 of the Bankruptcy Code (see **5.2 Other Effects of Lessee's Insolvency**).

2.6.3 Specific Courts for Aviation Disputes

There are no specific courts for deciding aviation disputes.

2.6.4 Summary Judgment or Other Relief

A lessor can obtain a summary judgment, equitable or other injunctive relief pending final resolution of judicial proceedings to enforce an aircraft lease. Many jurisdictions permit a highly accelerated process but such processes generally require that the plaintiff post large security (in New York for example, twice the value of the asset), to secure the defendant against damage that it might suffer if the seizure is found to have been unfounded.

2.6.5 Domestic Courts' Approach to Foreign Laws and Judgments

A domestic court will (i) uphold a foreign law as the governing law of an aircraft lease, (ii) generally uphold the submission to a foreign jurisdiction and (iii) generally uphold a waiver of immunity by the parties of that lease.

2.6.6 Domestic Courts' Recognition of Foreign Judgments/Awards

Generally, domestic courts will recognise and enforce a final judgment of a foreign court or an arbitral award without re-examination of the matter, even if it is not governed by

treaty, but the US court has to be persuaded that the foreign proceeding was fair.

2.6.7 Judgments in Foreign Currencies

A lessor under an aircraft lease cannot obtain a judgment in a foreign currency.

2.6.8 Limitations on Lessors' Actions Following Termination

Generally, parties are free to agree on contractual terms without limitation, and usury limits may not restrict the amount of interest that may be paid following a default on a lease payment if they are not determined as payments for borrowed money. General UCC principles will apply to recovery of losses.

2.6.9 Lessor's Requirement to Pay Taxes/Fees

There are no US federal taxes required to be paid in connection with the enforcement of a lease.

2.6.10 Mandatory Notice Periods

There are no mandatory notice periods with which a lessor must comply if it terminates an aircraft lease which (i) relates to an aircraft operated domestically; or (ii) is leased by a domestic operator.

2.6.11 Lessees' Entitlement to Claim Immunity

Sovereign immunity can generally be waived and may not even be applicable in relation to purely commercial activity.

2.6.12 Enforcement of Foreign Arbitral Decisions

The US has adopted the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and domestic courts will recognise and enforce an arbitral decision.

2.6.13 Other Relevant Issues

US courts generally look to substance over form; for example, a lease that is in economic substance a secured loan is likely to be treated as such.

2.7 Lease Assignment / Novation

2.7.1 Recognition of the Concepts of Contractual Assignment and Novation

In general, this jurisdiction recognises the concepts of contractual assignment and novation. Outright transfers of a lessor's interest in a lease are far more likely to be effected by way of agreement described as an assignment and assumption agreement under US law than a novation. The typical assignment and assumption agreement replaces the existing lessor with a new lessor while aiming to preserve the continuity of the lease. This is in contrast to a typical English law novation which creates a new agreement between the new lessor and lessee on substantially the same terms. Certain agreements which purport to be merely contractual

assignment and assumption agreements in the US, however, may be construed under the laws of certain states in the US (including California and Washington, but less likely for New York) as novations. This has important implications for analysing whether new international interests and/or assignment of international interest registrations are required to be made under the Cape Town Convention in respect of the assigned/novated lease, because whether a transaction is an assignment or a novation is to be determined from its nature as a matter of interpretation of the Cape Town Convention without reference to applicable law.

2.7.2 Assignment/Novation of Leases Under Foreign Laws

The agreement (or deed) would be held valid by a domestic court and the lessee's consent to an assignment would not be required as a matter of law, it being understood that consent would be required as a matter of contract if the lease so stated. Notice to the lessee would be required to perfect the assignment. A typical novation, however, would by its terms require a lessee to be a party. In practice, a lessor will need some form of co-operation from the lessee to provide certain items related to title transfer/novation (for example, updated insurances, tax certifications or changes to indemnified parties) which means that a transfer is rarely completed without the lessee's consent.

2.7.3 Enforceability of Lease Assignments/Novations

The lease assignment should be in the English language (or translated into English) but need not be certified, notarised or legalised to be enforceable against a domestic party.

2.7.4 Filing/Registration of Lease Assignments/Novations

A lease assignment can be registered with the FAA and, to the extent that it relates to a lease which is registered with the FAA, it is advisable to do so. The same formalities apply to the lease assignment as to the filing of a lease. No government consent is necessary.

2.7.5 Taxes/Duties Payable on Assignment/Novation

On the US federal tax side, generally, there are no taxes or duties payable, but the lessor should determine whether it will be entitled to an exemption from US withholding and the 4% gross transportation tax (see **2.4.1 Tax Requirements for a Foreign Lessor**) and whether it will be required to provide any US withholding tax forms to the lessee.

2.7.6 Recognition of Transfer of Ownership Interests

In general, where there is no assignment of the actual lease it would not require lessee consent or participation. In practice, however, new insurance, tax certifications and financing consents are required. A transfer of a beneficial interest in a US trust that owns an FAA-registered aircraft is not legally required for effectiveness, but as a matter of practice an instrument of beneficial interest transfer is typically filed with the FAA to put parties on notice and to provide evidence of continued US citizenship, where applicable.

2.8 Aircraft Deregistration and Export

2.8.1 Deregistering Aircraft in this Jurisdiction

Either the owner as named in the Certificate of Registration must initiate the deregistration of the aircraft subject to the rights of the party authorised under the Irrevocable Deregistration and Export Request Authorisation (“IDERA”) (if any) or a creditor of the owner which has been granted the authority to deregister the aircraft. If an IDERA has been filed with the FAA, the FAA Registry will honour a cancellation request only from the person authorised under the IDERA or its designee.

In addition, following an event of default and successful repossession or foreclosure, an aircraft owner may unilaterally file a Certificate of Repossession with the FAA, certifying that it has validly repossessed the aircraft in accordance with applicable state law, which will be honoured by the FAA.

The person authorised in the Certificate of Registration or IDERA (to the extent an IDERA has been filed for recordation with the FAA) must submit the following to the FAA Registry in order to deregister the aircraft:

- a signed request for cancellation of the registration with a complete description of the aircraft, including manufacturer name, model designation, serial number and registration number, along with the reason for cancellation (ie, export to another country) and the name of the country to which the aircraft is being exported;
- documentary evidence satisfactory to the FAA that all senior recorded interests have been discharged or that the holders of such interests have consented to the cancellation; and
- written certification that all registered interests ranking in priority to that of the requestor have been discharged or that the holders of such interests have consented to the cancellation for export purposes.

If the aircraft is subject to the Cape Town Convention and an IDERA is on file then the IDERA authorised party must also include with its request a copy of the International Registry Search Certificate.

Following the provision of the above to the FAA Registry and the cancellation of the registration, the FAA Registry shall notify that cancellation to the aviation authority of the country to which the aircraft is to be exported.

2.8.2 Lessee’s/Operator’s Consent

If an IDERA has been issued, the operator should not be able to block the deregistration by the holder of the IDERA. In addition, following an event of default and successful repossession or foreclosure, an aircraft owner may file a Certificate of Repossession unilaterally with the FAA, certifying that it

has validly repossessed the aircraft in accordance with applicable state law, which will be honoured by the FAA.

2.8.3 Required Documentation

See **2.8.2 Lessee’s/Operator’s Consent** above.

2.8.4 Duration of Deregistration Process

Deregistration and export requests are handled by the FAA on a priority basis and it is recommended that “Export” be indicated in red ink on the envelope and the request. Upon receipt of the required documentation and authority to proceed, deregistration would typically take one to two business days.

2.8.5 Aviation Authority’s Assurances

No advance assurances are given on timing for deregistration of the aircraft.

2.8.6 Costs, Fees and Taxes Relating to Deregistration

There are no US federal taxes chargeable in respect of the deregistration of an aircraft.

2.8.7 Deregistration Power of Attorney

An IDERA is often used by secured parties in the US to provide an extra layer of protection to deregister an aircraft from the FAA. Note, however, that major air carriers in the US do not typically agree to provide IDERAs or other FAA powers of attorney.

The FAA also permits parties to file powers of attorney as a means of supporting other filings at the FAA in respect of an aircraft. The default expiry date of a power of attorney under FAA regulations is three years, in the absence of an alternative period designated in the operative documents.

The deregistration power of attorney should be in the English language (or translated into English) but need not be certified, notarised or legalised to be enforceable against a domestic party.

2.8.8 Documents Required to Enforce Deregistration Power of Attorney

A deregistration power of attorney is not commonly provided on the basis that an aircraft owner or person authorised in an IDERA can follow the procedure outlined in **2.8.1 Deregistering Aircraft in this Jurisdiction** and **2.8.2 Lessee’s/Operator’s Consent**, including, in the case of the aircraft owner, the unilateral filing of a Certificate of Repossession with the FAA.

2.8.9 Choice of Laws Governing Deregistration Power of Attorney

A deregistration power of attorney would not have to be governed by the laws of this jurisdiction, but see **2.8.8 Documents Required to Enforce Deregistration Power of Attorney** above.

2.8.10 Revocation of Deregistration Power of Attorney

An irrevocable deregistration power of attorney could not be revoked in practice and, furthermore, the owner or authorised person under an IDERA can follow the procedure outlined in **2.8.1 Deregistering Aircraft in this Jurisdiction** and **2.8.2 Lessee's/Operator's Consent** above, including, in the case of the aircraft owner, the unilateral filing of a Certificate of Repossession with the FAA.

2.8.11 Owner's/Lessor's Consent

Please see **2.8.1 Deregistering Aircraft in this Jurisdiction** and **2.8.2 Lessee's/Operator's Consent** above.

2.8.12 Aircraft Export Permits/Licences

The export of commercial aircraft from the US, and the sale or transfer of a US-origin aircraft outside the US, 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 sanctioned countries;
- of aircraft incorporating certain military or technologically advanced components; and
- to certain persons or entities on sanctioned lists, or those located in certain countries.

If an aircraft is being permanently exported from the US, there are required formalities and paperwork.

2.8.13 Costs, Fees and Taxes Concerning Export of Aircraft

The US does not have any such export duties.

2.8.14 Practical Issues Related to Deregistration of Aircraft

Please see **2.8.1 Deregistering Aircraft in this Jurisdiction** and **2.8.2 Lessee's/Operator's Consent** above.

2.9 Insolvency Proceedings**2.9.1 Effect of Lessee's Insolvency on Deregistration Power of Attorney**

Section 1110 of the Bankruptcy Code only provides protection to a financier or lessor in a Chapter 11 reorganisation scenario; in a Chapter 7 liquidation scenario, the normal bankruptcy rules applicable to non-aircraft leased equipment would apply and the automatic-stay provisions of the Bankruptcy Code would prevent a lessor or financier from exercising any relevant powers granted under a deregistration power of attorney or an IDERA.

2.9.2 Other Effects of Lessee's Insolvency

Potentially, the lease can be set aside. Under Section 365 of the Bankruptcy Code, the lessee has the option of reject-

ing (terminating) or assuming any unexpired lease. Under these provisions, a lessee in possession may (unless the court orders otherwise) defer the decision on whether to reject or assume a lease of personal property, but must resume performance of its obligations (including payment of rent) 60 days after the initial order of relief in the proceeding. Rejection of a lease under Section 365 would require return of the aircraft and is treated as a material breach of contract (and may entitle the lessor to unsecured damages from the bankruptcy estate, albeit not necessarily equal to any termination or stipulated loss value).

Special provisions apply to aircraft equipment (including engines and spare parts and related records) in Chapter 11 proceeding under Section 1110 of the Bankruptcy Code if the lessee holds a US air carrier operating certificate for the operation of aircraft capable of carrying ten or more individuals or 6,000 or more pounds of cargo (with certain additional limitations for aircraft first placed in service before October 1994). If Section 1110 applies, the lessee must, within 60 days of the order of relief, either elect to cure all defaults (including payment defaults) other than certain ipso facto defaults and agree to perform its contractual obligations under the unmodified lease or enter into an agreement with the lessor (which may modify the lease terms) to extend the 60-day period. If the lessee does not make any such election or enter into such an agreement, the lessee is required to surrender and return the aircraft equipment at the lessor's request and the lessor may enforce its contractual remedies without regard to the automatic stay. The lessee may revoke its Section 1110 election or terminate a Section 1110 agreement at any time. If the lessee ceases to perform its contractual obligations after an election or under an agreement with the lessor, the lessor may also demand surrender and return of the aircraft and equipment. Case law holds that the obligation to "surrender and return" does not require compliance with contractual return conditions, for example, with respect to maintenance condition.

The automatic stay will limit repossession as long as it applies, and the lessor would have to petition the bankruptcy court to lift the stay at its discretion.

The lessee's contractual rights under the lease will be viewed as part of the bankruptcy estate of the debtor but the aircraft itself will not be viewed as the property of the lessee unless the lease is re-characterised as a financing arrangement.

Potentially, the liquidator/administrator could impose the rights of other creditors in priority to those of the lessor. If the lease is assumed by the lessee, payment of rent under the lease and any post-petition damages will be treated as priority administrative claims, as will payments of lease rent after 60 days if Section 1110 does not apply or upon a Section 1110 election or agreement. Other amounts payable with respect to the lease may be subject to the Bankruptcy

Code's order of priority and the rights of other creditors. An agreement to cure defaults and perform going forward is not the same as permanent assumption of a lease that is the subject of the Section 1110(a) agreement; the lease can later be rejected.

2.9.3 Risks for a Lender if a Borrower, Guarantor or Security Provider Becomes Insolvent

In addition to the limits of the automatic stay regarding the leased property, a lease may be re-characterised by a bankruptcy court as a secured loan, particularly if it has a nominal repurchase right, which would affect the ability to repossess the aircraft. Payments made by the lessee to a non-insider 90 days prior to the bankruptcy filing may (subject to defences, including ordinary course) be viewed as preferences and avoided, and assets transferred or liens granted with an intent to defraud or for less than equivalent value when the debtor was insolvent may also be avoided. Claims against a lease guarantor subject to its own bankruptcy proceeding will generally be viewed as unsecured claims and enforcement will be subject to the automatic stay.

2.9.4 Imposition of Moratoria in Connection with Insolvency Proceedings

Filing of a voluntary or involuntary petition triggers the automatic stay under Section 362 of the Bankruptcy Code and prevents action by creditors to collect pre-petition debts, terminate contracts or attempt to recover or seize collateral. The automatic stay will apply until the proceeding is completed, although a lessor may petition to have the stay lifted for cause (which may include inadequate protection of a lessor's interest). Section 1110 of the Bankruptcy Code will terminate the automatic stay under certain circumstances.

2.9.5 Liquidation of Domestic Lessees

Bankruptcy proceedings are initiated by a petition filed with a federal bankruptcy court and may be filed voluntarily by a debtor or (under certain conditions) involuntarily by creditors. A determination of actual insolvency is not required. Domestic entities (and, under certain circumstances, foreign entities) are eligible for liquidation by a trustee (Chapter 7) or for reorganisation or liquidation by the debtor in possession (Chapter 11) proceedings. Filing of a petition triggers the automatic stay, but if there is an involuntary petition which is challenged, the bankruptcy court must then determine that the debtor is generally not paying its debts as those debts become due.

2.9.6 Ipso Facto Defaults

Ipsa facto defaults are generally not given effect under the Bankruptcy Code; they are specifically carved out of Section 365 and Section 1110 and will not, standing alone, allow repossession. They may, at the discretion of the court, be given limited effect to allow default interest to be charged or to prevent a voluntary make-whole premium to apply.

2.9.7 Impact of Domestic Lessees' Winding-up

If a domestic lessee is wound up by a court or administration proceeding the aircraft would remain the property of the lessor unless re-characterised, subject to the lessee's rights under a fully assumed lease or under a Section 1110 election or agreement. The lessor would have a claim against the estate for pre-petition or pre-election or assumption lease rentals, and lease rentals after 60 days or after an assumption would be a priority administrative claim, but such rentals do not necessarily have to be paid on a current basis. The lease security deposit would be part of the bankruptcy estate, but courts would generally recognise the lessor's interest in the deposit. Payments already made to the lessor couched as supplemental rent on an unconditional basis should not be part of the bankruptcy estate, but escrowed maintenance reserves might be subject to limitations.

2.10 Cape Town Convention and Others

2.10.1 Conventions in Force

The US is a party to the Cape Town Convention. In order to register an international interest with the International Registry, the relevant party must first obtain authorised entry point codes from the FAA by filing FAA form AC Form 8050-135 with original copies of the relevant documents to be filed (digitally executed copies may be provided only if in compliance with FAA procedures). Typically, the FAA will be able to issue the authorised entry point codes on the same day. Any party may submit the form and underlying documents (only the initial aircraft registration with the FAA must be completed by a domestic entity or person with limited exceptions).

2.10.2 Declarations Made Concerning Conventions

The US has made the following declarations under the Cape Town Convention and the Protocol:

- (a) Cape Town Convention Article 39(1)(a)-(b);
- (b) Cape Town Convention Article 54(2);
- (c) Article XXX(1) of the Protocol; and
- (d) Article XIX of the Protocol.

2.10.3 Application of Article XIII of the Protocol on Matters Specific to Aircraft Equipment

By virtue of the US making declaration of Article XXX(1) of the Protocol, Article XIII of the Protocol is also applicable in the US. The FAA will accept an IDERA for filing and recordation as long as it is associated with a recordable encumbrance and is in the proper form for filing.

2.10.4 Enforcement of Conventions

There is limited case law in the US with respect to the enforcement of the Cape Town Convention or the Protocol.

2.10.5 Other Conventions

The US is a party to the 1948 Geneva Convention on the International Recognition of Rights in Aircraft (which is superseded by the Cape Town Convention wherever inconsistent), but is not a party to the 1933 Rome Convention on the Unification of Certain Rules relating to the Precautionary Arrest of Aircraft.

3. Aircraft Debt Finance

3.1 Structuring

3.1.1 Restrictions on Lending and Borrowing

There are no restrictions on foreign lenders financing an aircraft locally; however, federal withholding taxes may apply in the absence of an available exemption under an applicable international tax treaty. Local borrowers are subject to all applicable US laws, but no additional restrictions apply to the use of loan proceeds from foreign lenders. See the reference to lending laws above.

3.1.2 Effect of Exchange Controls or Government Consents

There are no exchange controls or government consents that would be material to any financing or repatriation of realisation proceeds under a loan, guarantee or security document.

3.1.3 Granting of Security to Foreign Lenders

Borrowers are permitted to grant security to foreign lenders.

3.1.4 Downstream, Upstream and Cross-stream Guarantees

All such guarantees are permitted, and adequate consideration is a requirement for all such guarantees. As guarantees are typically provided by the parent or another party related to the borrower, the benefit of the loan being disbursed to the borrower is typically the consideration referenced in the guarantee. Particular care should be given to consideration for upstream guarantees, as courts will look to see what benefit the subsidiary received in guaranteeing its parent's debt, such as the amount of debt proceeds which were contributed to the subsidiary. If a bankruptcy court determines that the guarantor did not receive adequate consideration for its guarantee, the court may void the guarantee as a fraudulent conveyance.

There are no registration requirements for guarantees, unless the borrower is a public company in the US, in which case it would be required to disclose any material contingent liability created by the guarantee pursuant to its reporting obligations under the Securities Act of 1933.

3.1.5 Lenders' Share in Security over Domestic SPVs

It is advisable for a lender to take share security over a domestic special-purpose vehicle which owns the financed aircraft. A pledge of shares in a corporation is recognised, as

is a pledge of the membership interests of a limited liability company and a pledge of the beneficial interest in an owner trust.

3.1.6 Negative Pledges

Negative pledges are contractual covenants which would be recognised as enforceable obligations by the relevant courts.

3.1.7 Intercreditor Arrangements

There are no specific material restrictions imposed on intercreditor agreements; however, there are many cases dealing with intercreditor dynamics.

3.1.8 Syndicated Loans

The concept of agency and the role of an agent under a syndicated loan is recognised.

3.1.9 Debt Subordination

There are four principal ways to subordinate debt:

- subordination to secured debt, whereby the claims of unsecured creditors are subordinated to those of secured creditors;
- lien subordination, whereby two or more liens are placed on an item of collateral (a senior lien and junior lien(s)) but rights among the relevant creditors are governed by an intercreditor agreement;
- structural subordination, resulting from the structure of a transaction rather than by contractual agreement between the parties. When debt is incurred by a parent company, the claims of the parent's creditors to the assets of a subsidiary of the parent are structurally subordinated to the creditors of the subsidiary. If the parent and its subsidiary become insolvent, the creditors of the subsidiary are paid before any distribution is made to the parent company or its creditors;
- contractual subordination, whereby a company's creditors set forth in a written agreement the relevant subordination terms among the relevant creditors. For example, such agreements might take the form of subordination as to right of payment, which is a stronger form of subordination, as any proceeds from unsecured deficiency claims of the subordinated creditor would be made available to satisfy the senior creditor's claims first. Contractual subordination may alternatively be limited rights in the collateral which give the senior credit a first right to all collateral proceeds, but leaves the subordinated creditor in control of its deficiency claims.

Additionally, US bankruptcy courts have broad equitable subordination powers and have the right to disallow completely or subordinate a creditor's claim.

3.1.10 Transfer/Assignment of Debts Under Foreign Laws

Subject to any restrictions on transfer or assignment in the underlying debt instrument, applicable bankruptcy, fraudu-

lent conveyance and other laws affecting and relating to the rights of creditors generally, general equitable principles and requirements of reasonableness, good faith and fair dealing.

3.1.11 Usury/Interest-limitation Laws

There are usury or interest limitation laws, which vary by state. For example, charging interest in excess of 16% is civil usury in the State of New York, and charging interest in excess of 25% is criminal usury in the State of New York. However, each state law also includes various exceptions to the civil and criminal usury laws.

3.2 Security

3.2.1 Typical Forms of Security and Recourse

The typical forms of security granted in an aviation finance transaction domestically are:

- an aircraft mortgage and security agreement entered into by the aircraft owner and the borrower under the financing (if different), which aircraft mortgage and security agreement typically includes a granting clause in favour of the secured party, setting forth a security interest in the airframe, the engines, parts, manuals and technical records, any lease agreement and the mortgagor's rights thereunder and rent paid thereunder, manufacturer warranties, insurance proceeds, accounts, and all proceeds of the foregoing;
- a share, beneficial interest or membership interest pledge in the equity of the aircraft owner and borrower (if different);
- airframe and engine warranty assignments; and
- account pledges.

Recourse varies from deal to deal, and transactions can be non-recourse, limited recourse or full recourse to the true economic beneficiary of the financing, depending on the asset being financed and the creditworthiness of the borrower.

3.2.2 Types of Security Not Available

Security can be taken over engines, warranties and insurances and there are no material categories of collateral which cannot be made subject to the lender's security interest. However, as a matter of practice, the mortgagor's rights to indemnity payments and to proceeds of liability insurance are typically excluded from the collateral.

3.2.3 Trust/Trustee Concepts

The concept of a trust and the role of a security trustee is recognised.

3.2.4 Assignment of Rights to an Aircraft by a Borrower to a Security Trustee

The borrower's rights to the aircraft or under a lease (including in relation to insurances) can be assigned under a security agreement or mortgage.

3.2.5 Assignment of Rights and Benefits Without Attendant Obligations

As a matter of contract law, it is possible to assign the rights and benefits only, without also assigning the attendant obligations of the lessor under an aircraft lease if the parties so agree. However, in practice, leases will typically require that a secured party assume the obligations of the lessor under the lease agreement if the secured party forecloses on its security interest in the lease.

3.2.6 Choice of Foreign Law

A security assignment or guarantee can be governed by New York or English law. Typically, where an English law lease security assignment is entered into, the lease agreement is also assigned pursuant to the New York law security agreement.

3.2.7 Formalities/Mandatory Terms to Create and Perfect Security Assignments

Creation of Security Interest

A New York law security agreement must satisfy the following requirements in order for the creation of the security interest thereunder to be enforceable:

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

The security agreement should also include a "granting clause", which provides a description of the collateral subject to the security agreement.

Perfection of a Security Interest

In order to perfect a security interest in an aircraft registered in the US, the relevant security agreement or mortgage must be registered with the FAA. Additionally, where the Cape Town Convention applies, international interests created by

the security agreement or mortgage must be registered with the International Registry. Finally, a UCC-1 financing statement must also be recorded in the state where the applicable debtor is “located” for purposes of Article 9 of the UCC as in effect in the relevant state.

With respect to aircraft that are not registered in the US, if (i) the Cape Town Convention does not apply, (ii) the country of registry has a central filing system and (iii) the security agreement or mortgage is duly constituted under its laws and duly recorded under its filing system, the effect of that recording and rights under the security agreement or mortgage under the laws of the country of registry will be recognised in the US.

If the country of registry does not provide for perfection by filing in a public filing system, perfection can be accomplished in the US by filing a UCC-1 financing statement identifying, among other things, the debtor, the secured party, and a description of the collateral. A UCC-1 financing statement should be filed in the state in which the debtor is located under the UCC as in effect in the State of New York for every New York law security agreement or mortgage, whether or not the aircraft is registered in the US, in order to perfect the security interest created under the applicable security document under New York law. UCC-1 filings in relation to non-US debtors are required to be made with the Recorder of Deeds in the District of Columbia.

A UCC-1 financing statement is valid for a five-year period, after which time it will expire if not “continued” for another five-year period by the filing of a UCC-3 continuation statement.

Consequences of failure to comply with security interest creation and perfection requirements

If the requirements in relation to the creation of a valid security interest are not met, the security agreement or mortgage will not be valid between the parties or against third parties. If the security agreement or mortgage validly creates a security interest, but the security interest is not validly perfected, then the security agreement or mortgage will be valid as between the debtor and the secured party, but will not be valid against third parties without notice. In bankruptcy in general, an unperfected lien is tantamount to no lien at all due to the debtor’s “strong-arm” powers which treat the debtor as if it were in the same position as a hypothetical lien creditor, thus outranking (for the benefit of unsecured creditors) the unperfected pre-petition lien. Additionally, under the UCC, the general rule is that the priority of a security interest is determined by the order of filing of a UCC-1 financing statement, subject to certain exceptions. Similarly, under the Cape Town Convention, which pre-empted the US federal Transportation Code and state laws, a registered interest in an airframe or engine has priority over

a subsequently registered interest or an unregistered interest, subject to certain exceptions.

Translation, Certification, Notarisation or Legalisation Requirements

New York law security agreements and any document filed with the FAA should be in the English language. An affidavit as to the US citizenship of the owner, along with any evidence required to establish that status, is required in order to register an aircraft with the FAA. With the exception of the US citizenship affidavit, which is required to be notarised, documents filed with the FAA are not typically required to be notarised or legalised.

3.2.8 Domestic-law Security Instruments

If an English law security assignment has been taken, the financier should also take a New York law mortgage over the collateral and arrange to have a UCC-1 financing statement covering the collateral filed in the jurisdiction that is the location of the debtor under Article 9 of the UCC and have the New York law mortgage filed with the FAA. If a New York law security agreement has been entered into, no additional domestic law documentation is required. In order to make Cape Town filings, the underlying security agreement must have been previously filed with the FAA who will issue an authorisation code to allow for the registration of the international interest created by the security agreement with the International Registry. Filing an instrument with the FAA costs USD5, plus the cost of the legal fees of the law firm making the filings. The cost of filing a UCC-1 is the sum of the applicable state filing fee and the fee charged by the service company making the filing. Costs vary from state to state but are typically under USD150.

3.2.9 Domestic Registration of Security Assignments Governed by Foreign Laws

See **3.2.8 Domestic-law Security Instruments** above. English law-governed security assignments cannot be registered in the US. Only US law-governed security agreements can be registered with the FAA.

3.2.10 Transfer of Security Interests Over Aircraft/Engines

The transfer of security interests over an aircraft and/or engines is recognised, provided that the transfer is in accordance with the transfer conditions set forth in the security instrument. Also, see **3.2.11 Effect of Changes in the Identity of Secured Parties** below.

3.2.11 Effect of Changes in the Identity of Secured Parties

In order for the security interest to remain effective against third parties, the instrument assigning the security interest must be filed with the FAA for recordation and a UCC-3 financing statement amendment noting the change in the secured party must be filed in the relevant state. Under the Cape Town Convention, an assignment of each relevant international interest would also need to be filed with the

International Registry in order to be effective against third parties. Notice of the security interest assignment must also be given to the grantor of the security interest.

3.2.12 'Parallel Debt' Structures

"Parallel debt" structures are not typically used in the US.

3.2.13 Effect of Security Assignments on Residence of Secured Parties

A secured party would not be treated as being resident or domiciled in the US for US federal tax purposes merely as a result of its being a party to or enforcement of its security assignment or, generally under a typical aircraft lease, be treated as engaged in a US trade or business. However, if the aircraft is foreclosed upon, there may be tax consequences to the secured party that will depend upon its particular facts and circumstances.

A secured party under a security assignment will not be deemed to be resident, domiciled, carrying on business or subject to any taxes solely as a result of its being a party to, or its enforcement of, any such security assignment. However, as noted in **3.2.1 Typical Forms of Security and Recourse** above, amounts payable to a foreign secured party may be subject to withholding tax.

3.2.14 Perfection of Domestic-law Mortgages

See **3.2.7 Formalities/Mandatory Terms to Create and Perfect Security Assignments** above.

3.2.15 Differences Between Security Over Aircraft and Spare Engines

There is no difference between the form of security (or perfection) taken over an aircraft and that taken over spare engines except that (1) FAA filings are not applicable or required for the perfection of a security interest in aircraft engines having less than 550 rated take-off horsepower or the equivalent of that horsepower and (2) Cape Town Convention filings are not applicable or required for the perfection of a security interest in aircraft engines having less than 1,750 pounds of thrust or its equivalent (in the case of jet propulsion engines) or 550 rated take-off shaft horsepower or its equivalent (in the case of turbine or piston engines). Perfection of security interests in such engines should be made by filing a UCC-1 financing statement.

3.2.16 Form and Perfection of Security Over Bank Accounts

Security over a bank account is perfected by the secured party obtaining "control" over the relevant account. In practice, this is typically done in two ways. First, by having the secured party be the bank with which the bank account is maintained and including appropriate provisions in relation to the account in the security agreement. Second, by entering into a tripartite account pledge agreement or account control agreement among the account bank, the borrower/account holder and the secured party, pursuant to which the

account bank agrees to grant the secured party control over the account following notification of the occurrence of an event of default under the related security agreement.

3.3 Liens

3.3.1 Third-party Liens

A third party can take or register a lien over an aircraft or engine, but the applicable governing law is the state in which the relevant airport, repairer or mechanic is located, and the laws in relation to these matters vary from state to state.

State law governs repairers' and similar liens. Whether the lien covers the contract price or the actual value of the work will vary from state to state. A repairer's lien will typically only cover the work done on the relevant asset and not other assets; however, some states recognise floating mechanics' liens on aircraft equipment other than the relevant asset. Where permitted under state law, and subject to applicable state-law requirements, a floating mechanics' lien can attach to equipment owned by the debtor but not repaired by the relevant mechanic, where that mechanic has not been paid for work previously performed on other property of the debtor.

A fleet lien is generally not recognised in the US; however, the federal government of the US can obtain a lien against all property of a debtor for unpaid taxes.

The available remedies vary from state to state. The third party may be entitled to retain possession of the aircraft until amounts owed to it are paid. The third party may also be entitled to a non-possessory lien on the relevant aircraft, although these may be subordinate to any perfected security interest and may need to be filed with the FAA. A lien claimant may also initiate a foreclosure proceeding to foreclose on the aircraft subject to the lien.

3.3.2 Timeframe to Discharge a Lien or Mortgage

Once the required documentation has been finalised and submitted to the FAA, this is typically effected within a single day.

3.3.3 Register of Mortgages and Charges

Aircraft and engine mortgages are recorded with the FAA, and UCC-1 financing statements are filed in the jurisdiction that is the location of the debtor under Article 9 of the UCC. The interests of an aircraft mortgagee or security trustee may be registered with the FAA by filing the relevant mortgage or security agreement with the FAA. Once the security document is registered with the FAA, the secured party will have a perfected security interest in the aircraft and the aircraft cannot be deregistered or sold without the consent of the secured party.

3.3.4 Statutory Rights of Detention or Non-consensual Preferential Liens

There are no statutory rights of detention in the US. However, the effect of some federal and state statutory provisions may amount to detention of an aircraft, such as when an aircraft operator fails to pay airport landing fees or through the enforcement of unpaid tax liens. Non-consensual preferential liens, such as mechanic's or fuel supplier's liens, are permitted in the US and are governed by state law and may arise over an aircraft fleet.

3.3.5 Verification of an Aircraft's Freedom from Encumbrances

A potential purchaser of an aircraft could search the FAA and International Registry records to verify that an aircraft is free of encumbrances.

3.4 Enforcement

3.4.1 Differences Between Enforcing Security Assignments, Loans and Guarantees

One important difference in enforcing a security assignment as opposed to a loan or a guarantee is that, to enforce a loan or guarantee against a party who is unwilling to pay, it may be necessary to file a lawsuit or arbitration against that party. By contrast, in some states, a security agreement can be enforced by selling the collateral at a non-judicial foreclosure.

3.4.2 Security Trustees' Enforcement of their Rights

A security trustee can enforce its rights under the security assignment pursuant only to a notice and acknowledgement executed by that lessor and the relevant lessee respectively in connection with the security assignment, provided that the security assignment of the lease was also previously recorded at the FAA and an assignment of the international interest with respect to the lease, from the lessor to the security trustee, was recorded with the International Registry. Notice of the enforcement of the assignment would also need to be provided to the lessee, in accordance with the notice and acknowledgement. In connection with an involuntary foreclosure a certificate of repossession and, if applicable, an FAA bill of sale and lease assignment and assumption agreement will also need to be signed and filed with the FAA by the secured party in order to complete the foreclosure process. See also **3.4.4 Secured Parties' Right to Take Possession of Aircraft** below.

3.4.3 Application of Foreign Laws

Domestic courts in the US will generally uphold a choice-of-law clause in a finance or security document, subject to certain exceptions (eg, the clause is contrary to public policy, pre-emption). US domestic courts will also generally not interfere if parties choose to submit certain issues to foreign jurisdictions, although the parties themselves may choose

to ask the court to block submission to foreign jurisdictions (eg, by applying to a US court for an anti-suit injunction).

3.4.4 Secured Parties' Right to Take Possession of Aircraft

Whether a secured party can take physical possession of the aircraft to enforce a security agreement/aircraft mortgage without the lessee's or operator's consent depends on whether the lease or operating agreement is subject and subordinate to the security agreement/aircraft mortgage. If the lease or operating agreement is subject and subordinate to the security agreement/aircraft mortgage, then the secured party can do so, subject to applicable state laws in relation to 'self help'. As a general matter, under Article 9 of the UCC, a secured party may repossess an aircraft without a court order if it may do so without breach of the peace. If a lessee or operator physically challenges the repossession, then the secured party, if it nonetheless proceeds with its efforts to repossess the aircraft, will typically be considered to have breached the peace. In a scenario where the lessee or operator does not consent to the repossession, the secured party often therefore must seek a court order from the state or federal courts located in the state in which the aircraft is physically located.

If the lease or operating agreement is not subject and subordinate, and the lessor and secured party have provided the lessee with a covenant of quiet enjoyment, then the secured party will not be permitted to take physical possession of the aircraft unless there has been an event of default under the lease or operating agreement.

3.4.5 Domestic Courts Competent to Decide on Enforcement Actions

A federal court or state court can decide an enforcement action regarding a security agreement or an aircraft mortgage if the court has jurisdiction over the case and over the parties. The fact that a case involves a security agreement or aircraft mortgage will not necessarily determine whether a court has jurisdiction. Many other considerations can come into play.

3.4.6 Summary Judgments or Other Relief

Summary judgment is one way of obtaining a final resolution of a judicial proceeding. To obtain summary judgment, the movant must show that a trial is unnecessary because there is no genuine dispute of material fact and because the movant is entitled to judgment as a matter of law. It is possible to seek summary judgment in an action involving a security agreement or aircraft mortgage. There is no requirement to post a bond or provide a guarantee to move for summary judgment. Pending the final resolution of a judicial proceeding, including in cases involving security agreements and aircraft mortgages, a party may seek equitable relief or other injunctive relief. A court will decide whether such relief is proper under the circumstances and will decide whether the

movant should be required to post bond as a condition of entering such relief.

3.4.7 Judgments in Foreign Currencies

It varies state to state; however, typically the secured party can obtain a judgment in a foreign currency but the court will allow the debtor to convert the foreign currency judgment into US dollars.

3.4.8 Taxes/Fees Payable

There are no US federal taxes payable in connection with the enforcement of a security agreement or aircraft mortgage. However, if the aircraft is foreclosed upon, there may be tax consequences to the secured parties that will depend upon their particular facts and circumstances.

A secured party is not required to pay taxes or fees in a non-nominal amount in connection with the enforcement of a security agreement/aircraft mortgage. However, if a secured party seeks a court order in order to repossess an aircraft it may have to post a bond with the court equivalent to twice the value of the property to be repossessed or the amount of the debt outstanding.

3.4.9 Other Relevant Issues

Section 1110 of the Bankruptcy Code provides special protections to lenders that finance eligible aircraft equipment. If a US debtor air carrier files for bankruptcy, they are required to surrender possession of the relevant aircraft equipment to the secured party within 60 days of filing, unless the airline cures all defaults and agrees to assume and perform all of its obligations under the loan and security documents.

4. Other Issues of Note

4.1 Issues Relevant to Domestic Purchase, Sale, Lease or Debt Finance of Aircraft

The factual, tax and legal background of each transaction needs to be assessed on a case-by-case basis in order to be able to render conclusive advice on the specific legal issues that may arise in connection with a purchase, sale, lease or debt financing of an aircraft registered with the FAA or involving a US party.

4.2 Current Legislative Proposals

We are not aware of any proposed legislation specifically addressing transactions concerning a purchase, sale, lease or debt financing of an aircraft registered with the FAA or involving a US party.

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