



## RECOGNITION OF OWNERSHIP RIGHTS OF ENGINES AND AIRFRAMES

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**ABSTRACT:** A lender's right to repossession is established by the underlying loan documents and applicable state law: generally, the state's version of the Uniform Commercial Code (UCC). Poorly drafted loan documents can slow down, or even prevent, the lawful seizure of the aircraft. A careful review of the loan documents is the first step to a successful repossession. A stringent auditing and follow up on the lessee's compliance to agreement and ability of operation of the asset is equally important.

**KEY WORDS:** Repossession, Ownership Rights, Commercial Code, Aircrafts.

**RESUMEN:** El derecho de recuperación se establece por los documentos del préstamo subyacentes así como la ley estatal aplicable que, por lo general, se enmarca en el Código de Comercio. Documentos de préstamos mal redactados pueden retrasar o incluso evitar, la recuperación legal de la aeronave. Un estudio de los documentos del préstamo supone el primer paso para una recuperación satisfactoria y con éxito. Una verificación del cumplimiento por parte del arrendatario a un acuerdo y la capacidad de funcionamiento del activo muy importante.

**PALABRAS CLAVE:** Recuperación, Derecho de la Propiedad, Código de Comercio, Aeronaves.

### 1. Introduction

Seizing a jet from a delinquent borrower is no simple task. A lender's right to repossession is established by the underlying loan documents and applicable state law (generally, the state's version of the Uniform Commercial Code or UCC). Poorly drafted loan documents can slow down, or even prevent, the lawful seizure of the aircraft. A careful review of the loan documents is the first step to a successful repossession. A stringent auditing and follow up on the lessee's compliance to agreement and ability of operation of the asset is equally important, the core question for financier and/or Lessors will however remain: How can I secure my asset?

### 2. Objective

Repossession of an aircraft is a process that becomes effective when lessees of an aircraft fail to respect their contractual obligations as set forth in the Aircraft Lease Agreement. Subject to the contents of the 'Default' clauses agreed between the parties, an event may occur that such a default arises. When actions to enforce performance of the agreement or to recover the damages for the breach of the agreement fail, the lessor (or rightful owner of the Aircraft) may take possession of the aircraft.

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For mobile assets it is particularly difficult to enforce the repossession for the obvious reason related to its location. It is being assumed that the lessee of the mobile asset continues the operation of its network whilst the lessor will undertake to enforce repossession of its aircraft. Consequently it will be uncertain where and when an asset can be repossessed, in particular when the Lessee becomes inoperative in relation with the default clause, E.g. Bankruptcy, Loss of Operating License or similar.

Consequently a Universal Convention to facilitate repossession and more over the process with regards to the clarification of the rightful owner forms a solid legal foundation to reassure that pledged assets would remain under the control of the rightful owner.

This document will explore to what extent ownership securitization, in terms of the application to the Cape Town convention, will favour the industry.

### 3. *The Lease Agreement*

The underlying document to which both parties have concluded the terms of their cooperation is referred to as the "Lease Agreement"<sup>1</sup>. Obviously the Lease Agreement will contain all elements on technical specification, and set forth the commercial terms of the Agreement. The scope of this document will relate the terms and conditions on how the parties have concluded their liability relation with regards to the leasing of an Aircraft of Aircraft Engines. In particular the agreement regulates the obligation(s) of the Lessee how to compensate the Lessor for the assets leased, however equally important is the protection of the asset itself and the recognition of who is the rightful owner of the asset; or who has what pledge on the asset.

#### 3.1. Default to Agreement

A default situation occurs when one of the parties does not comply with its obligations stipulated in the Lease Agreement. One may incline that focus is set on the non-payment of the monthly rent instalments, however due to the important value of Aircrafts and their related Engines or Parts, the Lessor generally undertakes a much more rigid surveillance on adherence to the terms. In particular the Lessor is taking a much more precautious position, by assessing already in advance the financial and operational ability of Lessee. This procedure is being repeated by regular 'Lease Audits' to which the Lessor is entitled by agreement.

The most common reasons of defaults are the following: Non Payment: Lessee fails to pay the agreed value; Material Covenants: Lessee fails to rectify non-compliance; Breach: Lessee fails to comply with provisions; Representation: Lessee becomes incorrect in any material respect (e.g. certificates, Operative Documents); Cross Default: financial indebtedness, conditional sale, termination of enforcement of securities; Approvals: revocation of air transport license, permit, concessions, AOC; Insolvency: Lessee falls insolvent / unable to pay debts; Disposal: Lessee disposes or threatens to dispose of all material parts of its assets to a surviving entity; Rights: Lessee fails to assign, validate, enforce or prioritize the rights of the Lessor<sup>2</sup>

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<sup>1</sup> Lease Agreement - Appendix I.

<sup>2</sup> Lease Agreement – Appendix 1.

From the above listing it becomes visible that Lessors (Aircraft Owners) do equally focus on the ability to repossess their asset as to the financial viability of their Lessees (Operator).

### 3.2. Registry of Ownership

As reviewed here afore, the ultimate option for Lessors to anticipate on serious and/or repetitive default on the Agreement is to facilitate the repossession of the asset. In order to undertake repossession, the owner will have to demonstrate to be eligible to claim the asset in question. In Luxembourg this process is regulated by the inscription of ownership rights at the Ministry of Finance; "Bureau de la conservation des hypothèques aériennes".

*Example: Aircraft having Serial Nbr 2037, constructed by British Aerospace ATP and registered in Luxembourg under LX-WAE, has been purchase by Trident Aviation Leasing Services, Jersey. Means of ownership is proven by the presentation of the 'Bill of Sale' as an entitlement of ownership. The latter is certified by the 'Registry of Civil Acts' and inserted by the 'Bureau des hypothèques aériennes' in Luxembourg<sup>3</sup>.*

*Upon completion of the registry a certificate of inscription is issued and remains in custody of the Aircraft owner<sup>4</sup>.*

Upon deregistration of an Aircraft from the national registry, a certificate of radiation is being issues in the same form as the aforesaid example, duly certifying that the asset has been removed from its ownership entitlement in Luxembourg.

## 4. Process of repossession

What legal or other proceedings that can be taken or are necessary to repossess an Aircraft? In fact more than one kind of proceeding is possible, such as summary proceedings, bankruptcy proceedings, arrest or application to a governmental or regulatory agency. The purpose of this assignment is to briefly describe each of these, as well as to elaborate on the implications; and consequently assess the importance of 'Recognition of Ownership Rights of Engines and Airframes', in particular as covered under the 'Cape Town Convention'.

### 4.1. Court Proceedings for Repossessions

In the event of uncorrected defaults as stipulated in the respective Lease Agreement the rightful owner (Lessor) may undertake to repossess an aircraft. In that case the Lessor will have to instigate a legal proceeding at the competent court if the Lessee is unwilling to cooperate and to yield possession of the aircraft or engine. The Lessor will have to demonstrate in such proceedings that it has a contractual right or a right in rem to claim repossession the court will order the Lessee to return the aircraft to the Lessor. Given the case that the court will order the execution of repossessing the asset, such a

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<sup>3</sup> Bill of Sale – Appendix II

<sup>4</sup> Certificat d'Inscription – Appendix III

court order can be executed with the help of a bailiff against a Lessee that is unwilling to comply with the court order.

Premier bureau des hypothèques Luxembourg		GRAND-DUCHE DE LUXEMBOURG MINISTÈRE DES FINANCES Bureau de la conservation des hypothèques aériennes	VOL NO 11 2/179
<b>CERTIFICAT D'INSCRIPTION</b> dans le registre des droits sur aéronef			
1. Marques de nationalité et d'immatriculation LX - WAE	2. Constructeur et désignation de l'aéronef donnée par le constructeur BRITISH AEROSPACE BAe ATP - F	3. N° de série de l'aéronef 2037	
4. Nom du propriétaire TRIDENT AVIATION LEASING SERVICES (JERSEY) LIMITED			
5. Adresse du propriétaire PO. Box. 727, St. Pauls Gate New Street, St. Helier, JE4 8ZB JERSEY			
6. Il est certifié par les présentes que l'aéronef ci-dessus désigné a été dûment inscrit dans le registre des droits sur aéronef conformément à la loi du 8 décembre 08, concernant la reconnaissance des droits sur aéronef.			
Luxembourg, le 9 DEC. 2011		Le Conservateur des hypothèques aériennes, Guillaume KERGER	
73321			

Premier bureau des hypothèques Luxembourg		GRAND-DUCHE DE LUXEMBOURG MINISTÈRE DES FINANCES Bureau de la conservation des hypothèques aériennes	VOL NO 5 293
<b>CERTIFICAT DE RADIATION D'INSCRIPTION</b> dans le registre des droits sur aéronef			
1. Marques de nationalité et d'immatriculation LX - WAE	2. Constructeur et désignation de l'aéronef donnée par le constructeur BRITISH AEROSPACE ATP	3. N° de série de l'aéronef 2037	
4. Nom du propriétaire TRIDENT AVIATION LEASING SERVICES (JERSEY) LIMITED			
5. Adresse du propriétaire PO. Box. 727, St. Pauls Gate New Street, St. Helier, JE4 8ZB JERSEY			
6. Il est certifié par les présentes que l'inscription portant sur l'aéronef ci-dessus désigné a été rayée dans le registre des droits sur aéronef. Le certificat d'inscription (duplicata) a été dûment remis au soussigné en exécution de l'article 10 de la loi du 8 décembre 08, concernant la reconnaissance des droits sur aéronef.			
Luxembourg, le 5 SEP. 2013		Le Conservateur f.f. des hypothèques aériennes, Marc SCHREINER	
73322			

Figure 1 Certificate of Inscription / Radiation

Interim relief may be available in the form of a preliminary injunction under the Code of Civil Procedure, provided that the respective prerequisites are met, such as urgency and the likelihood of a deterioration of the aircraft or engine resulting from excessive use. An order in such proceedings can be obtained much more rapidly than a judgment in ordinary proceedings referred to above, because under the applicable *prima facie* standard full evidence of disputed facts is not required and even affidavits are admissible as evidence. Orders in such proceedings can be granted *ex parte*, too, that is, without the need to hear the defendant, if the particular urgency of the matter so requires<sup>5</sup>.

It is to be remarked that summary proceedings are not subject of a repossession undertaking and cannot be used to repossess an aircraft or its engines, they are available only in cases involving cheques and promissory notes and if the plaintiff pursues a monetary claim.

There is no automatic termination of the lease resulting from the commencement of insolvency proceedings. It appears to be the majority view that a contractual termination right of the lessor or an automatic termination of the lease in case of an insolvency of the lessor in case of an insolvency of the law. The lessor can only repossess the aircraft under his ownership title in very limited circumstances, for example, if the lessor terminates the Lease because of unpaid rentals due after the filing for insolvency.<sup>6</sup>

#### 4.2. Documentation to be filed.

Before a repossession of the aircraft or engines can be undertaken the legal proceedings will have to be complied with. It will be the plaintiff that will have to adhere the following steps: 1. Filing a complaint at the competent court. 2. Deliver evidence of right to repossess the aircraft under lease. 3. Notice of termination of lease and notice of default

In order to repossess the aircraft the lessor has to commence the legal process. Normally, the lease will have to be submitted, the notice of termination/declaration of default and possibly evidence for the plaintiff's ownership in the aircraft. Depending on the defendant's reply, the court will determine how to proceed with the matter, for example, by setting deadlines for submitting additional written briefs and by scheduling in an oral hearing, taking evidence if once it is final with the help of a bailiff if the judgment is in favour of the Lessor. The owner of the aircraft will *generally* be permitted to sell the aircraft irrespective of who has possession of the aircraft unless there are contractual stipulations prohibiting the sale. A security interest holder under common EU countries' law cannot sell the mortgaged aircraft, as a mortgaged aircraft must be sold by way of a public auction.

#### 4.3. Security Interest Holder

Enforcement procedures for a Security Interest Holder are different from those of a lessor for the purpose of taking repossession. The Security Interest Holder must obtain a judgment first or can proceed to enforce its rights under an authentic deed or another enforceable instrument. The enforcement of the mortgage will ordinarily be carried out by public auction as provided for by the National Aircraft Mortgage. (in Luxembourg: Bureau de la conservation des hypothèques aériennes).

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<sup>5</sup> strongly inspired by Kluwer Law intl 'Aircraft Repossession and Enforcement Vol2'

<sup>6</sup> strongly inspired by Kluwer Law intl 'Aircraft Repossession and Enforcement Vol2'



*An example of an enforcement, but later non-compliant public auction can be found in the English commercial court judgement:*

*Alpstream AG & Ors –v- PK Airfinance Luxembourg s.à.r.l  
[2013] EWHC 2370 (Comm) (July 2013)*

*One of the more notable judicial decisions in the aviation sector in 2013 is the recent decision of the English Commercial Court in the Alpstream Case. This case highlighted the duties of financiers in the context of aircraft repossessions; the powers and remedies available to financiers following breach and default, and the duties accountability of financiers in the event of a distressed sale and remarketing.<sup>7</sup>*

##### *5. Cape Town Convention (CTC)*

The Cape Town Convention is an international instrument purpose designed to achieve a commercial objective: to facilitate efficient forms of asset based financing. The latter will be enabling airlines to be financed in much less restrictive manor as it has been done before. One of the main issues with financing mobile assets is the fact that the asset is uncontrollable in terms of its location. Moreover aircraft parts or engines are today even subject to removal from the airframe and are today being stored and even added to certain spare part pools. The most important characteristics of the Cape Town Convention are the ability to give providers of finance a much greater confidence in the decision to grant a credit, enhance the credit rating of aircraft receivables and thereby reducing the costs of air finance of an airline.

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<sup>7</sup> Vedder Price - Lessons for Financiers and Lessors Bulletin December 2013



The most fundamental characteristic is the possibility to anticipate on a much more differentiated manner to insolvency of airlines and the related property rights of the aircrafts and its related parts. The Cape Town Treaty other main characteristic includes providing the creditor with effective and prompt remedies in case of default or insolvency of the debtor, mainly in terms of a time definite process to repossess the asset and the clearly stipulated terms of the final determination of a claim.

#### 5.1. Out-dated Convention from 1948

The Cape Town Convention replaces in fact a previous Convention: "Convention on the International Recognition of Rights in Aircrafts"<sup>8</sup>.

Main obstacles for the application of this convention was the fact that the aforesaid convention regulated the right of ownership of entire Aircraft and did not consider Spares like 'Landing Gears' or 'Aircraft Engines' as removable commodities of the airframe. The increasing trend in the industry to separately lease or purchase engines, this as a consequence of an increased variety of engines models, created an obstacles in the financing of the those components. In particular if these were to be financed by separate vehicles.

#### 5.2. The Cape Town is Different

The Cape Town Convention has formed a much more advanced environment on the recognition of the ownership rights, main differences are: 1. International Interest which is recognized in all Contracting States. 2. An electronic international register of interests; and 3. Standard rights for creditors on defaults.

The convention was established on March 1<sup>st</sup> 2006, in the meantime some sixty states have signed or acceded to the convention. However, as it is ratification and signature or accession that brings the Convention into force in the relevant state, the convention was put into force mostly several years after the establishment. In the case of Luxembourg June 19<sup>th</sup> 2009<sup>9</sup>.

The international Registry of Mobile Assets is maintained by a company named Aviareto Ltd. in Ireland, last is under the supervision of ICAO

<sup>8</sup> ICAO [http://www.icao.int/secretariat/legal/List%20of%20Parties/Geneva\\_EN.pdf](http://www.icao.int/secretariat/legal/List%20of%20Parties/Geneva_EN.pdf).

<sup>9</sup> Memorial du GDL A-159 of July 3rd 2009.

(International Civil Aviation Organization). Nowadays the registry operates on an entirely electronic system; registrations, searches and certificates are made and issued electronically. Registration onto aforesaid Registry may only be affected by approved users, these users are mainly National Civil Aviation Authorities or their designated subcontracting agencies.

Having registered an interest is mainly effective in bankruptcy proceedings against the debtor prior to the commencement of the proceedings. “Effective” means that the priority interest will be recognised and the creditor will have a claim against the asset for obligations to be discharged. Nothing in the Cape Town Convention will undermine the effectiveness of an international interest which is in any event effective under national law. Another benefit of the Convention is that even if an interest has not been registered under national law, or for any reasons has been voided, it will nonetheless be enforceable under International Registry provided it is properly registered.

### *Conclusion*

The aviation industry fosters mainly high valuable commodities, not simply the entire airframe is subject to financing and/or leasing but nowadays the individual parts and elements of the aircraft are being purchased and sourced separately. Taking into consideration the macro economic impact that the industry contains in general, the globalization of the world requires equal access and ability to financing. Especially less developed economies take advantage of instruments that the Cape Town Convention contains. Of all the contracting states which have ratified the Cape Town Convention, the majority consist of developing countries, to name a few: Afghanistan, Angola, Bangladesh, China, Colombia, Jordan, Mexico etc. whilst many developed countries such as United Kingdom and Germany have not yet ratified the Convention by their governments. Main obstacles for the latter named governments are that national law already regulates repossession and the harmonizing process to the convention is a lengthy one. There against developing countries are much more eager to implement a well constructed convention in absence of any own regulation, in particular if it facilitates financing to their local airline industry.

Nevertheless the backside of the prompt ratifying of the Cape Town Convention by underdeveloped countries is the absence, or inability, of these governments to adhering to the Convention. In the case of Indian Kingfisher Airline's suspension of operation<sup>10</sup>, Investors and Leasing Companies alike have been raising concerns regarding the regulatory safeguards of investments and questioned the credibility of the Indian Government's will to adhere to the application of the ratified Cape Town Convention.

Overall it can be concluded that the establishment of the Cape Town Convention did and will contribute to a safer financial environment in the airline and aviation industry. Regardless of various set back and low credibility of the adherence of some of the Contracting States, the access to finance appears to have increased for some actors of the industry. In particular the separation of aircraft components has significantly facilitated the leasing of aircraft engines and, albeit to a lower degree, the financing of aircraft parts.

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<sup>10</sup> CAPA Centre for Aviation Appendix iv

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