

## AIRCRAFT FINANCE, LEASING AND SECURITIZATION IN THE CAYMAN ISLANDS

*Kevin Butler, February 2009*

The Cayman Islands continues to be the offshore leader for aircraft financing, leasing and securitization. By using a Cayman Islands' special purpose vehicle ("SPV") funding and leasing arrangements may obtain certain tax, regulatory and capital restriction relief.

There are numerous benefits in establishing the SPV in the Cayman Islands. The Cayman Islands is a tax neutral jurisdiction (meaning there are no additional taxes in the Cayman Islands that will effect or be harmful to the transaction) with appropriate but not over burdensome regulation. Investors, lenders, rating agencies and various service providers are familiar with the Cayman Islands' legal system and are thus willing to participate in such a structure with little added due diligence. The legal framework of the Cayman Islands is based on common law principles with English common law being persuasive authority with the court of ultimate appeal being the Privy Council. In addition, the Cayman Islands is a British Overseas Territory and has a stable political system. In some cases the airline is based in a country without a similar stable political and legal system and as such it is beneficial to the structure to establish the SPV in the Cayman Islands. Add to this the high number of qualified legal and other service providers located in the Cayman Islands and it is easy to see why the Cayman Islands remains the offshore leader.

Although generally the documents are drafted by UK or US counsel and governed by such laws, another advantage to setting up the SPV in a neutral jurisdiction such as the Cayman Islands allows for the use of Cayman Islands law as the governing law of the documentation. If, for instance, the airline is located in China but a large number of investors are from the United States or Europe, the parties involved may take comfort in using the laws of a neutral jurisdiction such as the Cayman Islands.

### **Forming the SPV**

In a typical structure the SPV is incorporated as a Cayman Islands exempted company. The voting shares are issued to a Cayman Islands trustee pursuant to a charitable or purpose trust. The SPV will also usually contract with an administrator or management company (often the share trustee) to provide directors and officers to the SPV and provide the day to day administration of the SPV to ensure that it remains compliant with Cayman Islands laws and regulations. The SPV issues notes to investors and uses the proceeds of such notes to purchase the aircraft. The aircraft is then leased to the airline.

It is important to establish the SPV as a bankruptcy remote vehicle. The SPV is incorporated with restrictions in its charter documents to only raise funds by the issuance of the notes and enter into the transactions related to the purchase and lease of the aircraft. The SPV will be a clean company with no operating history and various contractual restrictions that reduce the risk of bankruptcy. The investors are attracted to the deal as they do not have to worry about the credit worthiness of the airline.

Typically the airline will contract with the aircraft manufacturer to purchase one or more aircraft. Prior to delivery of the aircraft the airline will assign that purchase agreement to one or more SPVs pursuant to which the SPV will purchase the aircraft. The airline does not have to look to traditional means of borrowing money in order to have use of the aircraft. By using the SPV structure, lending costs are less with the issuance of notes compared to traditional borrowing. In addition, the airline does not need to consolidate the aircraft (and related debt) into its balance sheet. The SPV will then enter into a lease directly or indirectly (in some cases an intermediary SPV set up offshore is for the head lease of the aircraft in order to obtain certain structural benefits) with the airline.

### **Transactions**

The transactions that the SPV will enter into will contractually bind the SPV from the closing date throughout the life of the SPV. There will be little or no discretion for the directors and officers of the SPV to amend the transactions or enter into new transactions. This too adds to the bankruptcy remoteness of the structure.

On the closing date, the SPV will generally enter into a Note Purchase Agreement with the investors, an Indenture with an indenture trustee and various related agreements with service providers. The SPV will take an assignment of the aircraft purchase agreement and enter into a lease with the airlines. As part of the structure, the noteholders (through the indenture trustee) will want to ensure security is granted over the aircraft and the lease payments. In some cases the shares of the SPV are also charged.

The transaction documents will include certain negative covenants by the share trustee, administrator and other parties contracting with the SPV whereby all contracting parties agree not to petition the SPV into bankruptcy or winding up or, as applicable, not to take any action to amend the corporate structure of the SPV or allow the SPV to enter into any unrelated agreements.

### **Security**

The SPV will assign all of its right, title and interest under the lease of the aircraft and other documents to the indenture trustee. This assures that the noteholders will, through an indenture trustee, have an income stream (the lease payments) and be able to enforce the rights of the SPV against the airline under the terms of the lease.

In addition, the indenture trustee will be granted a security interest (in the form of a mortgage) over the aircraft.

Finally, it is sometimes desired to take a charge over the shares of the SPV. In most cases the indenture trustee does not want to have the shares registered in its name (as in the case of a legal mortgage) but would prefer to have a charge granted over the shares. If a default occurs, the indenture trustee would then have the shares transferred to itself or its nominee. In order to ensure this happens, special provisions can be added to the charter documents of the SPV, blank share transfer forms can be executed and held by the indenture trustee and undertakings given by the directors of the SPV to transfer the shares (by updating the register of members of the SPV) upon demand of the indenture trustee. In such a case where the indenture trustee becomes the shareholder of the SPV, usually all of the existing directors and officers would resign and their signed, undated resignations should be obtained at the time the share charge is entered into.

The Cayman Islands does not have a public register of mortgages and charges. Instead, each company must maintain its own register. The details of the security interests would be maintained by the SPV in such register.

### **Cape Town Convention**

It should be noted that the provisions of the Convention on International Interests in Mobile Equipment and corresponding Protocol on matters specific to Aircraft Equipment (the “Cape Town Convention”) can only apply to the Cayman Islands by extension by the UK, once the UK itself has signed up to the Cape Town Convention (which it has) and ratified it (which it has not). However, most industry insiders are not overly concerned because of Cayman’s creditor friendly legal system. In addition, the airline itself and the governing law of the documents may be under a jurisdiction for which the provisions of the Cape Town Convention apply.

### **Conclusion**

The use of an SPV in the structure is dependent upon the financing, legal and regulatory requirements in the home jurisdiction of the airline and as such, each transaction may be structured differently. This paper deals with some of the usual structuring aspects of an aircraft leasing and securitization structure. The Cayman Islands continues to offer the aircraft industry a commercially flexible approach and with its depth of expertise the Cayman Islands continues to lead the field in offshore aircraft leasing and securitization.

### **Kevin Butler, Conyers Dill & Pearman**

*This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.*

### **Notes to Editors**

Conyers Dill & Pearman has pioneered the field of offshore law since its establishment in 1928. It is the first law firm to have established an office outside of its home jurisdiction, setting up shop in Guernsey in 1982 as a base for servicing European clients (superceded by the London office in 1998). It is also the first to have expanded into Asia, with the opening of its Hong Kong office in 1985, and the first to establish a presence in Singapore in 2001. The firm continued in this vein in 2008, becoming the first offshore law firm to have a Russian presence with the launch of its Moscow office in March, and the first offshore law firm to have a physical presence in Brazil with the establishment of its São Paulo office.

With a current complement in excess of 550 staff, with over 150 lawyers, Conyers Dill & Pearman advises on the laws of Anguilla, Bermuda, British Virgin Islands, Cayman Islands and Mauritius from those islands and from Dubai, Hong Kong, London, Moscow, and Singapore. The firm has earned clients’ trust, loyalty and respect by consistently providing responsive, timely and thorough advice on all aspects of offshore corporate, company and commercial law, commercial litigation and private client matters.

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