

BERMUDA: “AIR FORCE ONE” IN THE OFFSHORE WORLD

Julie McLean – August 2009

When it comes to offshore aircraft finance and aircraft registration, Bermuda flies high

When an airline decides it needs to add one or more aircraft to its fleet it usually looks to financiers or a leasing company. They will discuss with such financiers or leasing company the most cost efficient way to structure the transaction. At this stage legal counsel for such entities will often suggest the use of offshore vehicles. Operating in a tax neutral jurisdiction like Bermuda, such vehicles add benefit to the finance/lease structure. If a private or corporate aircraft is to be purchased by a foreign operator using finance supplied by an international lender, or leased from an international lessor, the foreign operator may understandably wish to register the aircraft in its own jurisdiction where the aircraft will be based and operated, using its own pilots who are licensed by the aviation authority of that jurisdiction. This assumes that the operator's aviation authority will be of a standard acceptable to the financiers and/or lessors in relation to war risk, insurrection, forced requisitioning and bureaucratic difficulties in relation to registration and deregistration, lease term recovery and repossession upon default. If the home register and the laws of its jurisdiction do not meet the acceptable minimum risk standards of the financiers and lessors, a practical option is to use an offshore jurisdiction like Bermuda which is usually viewed as neutral by all parties and as providing an acceptable and clearly understood standard of legal rights. In addition, the Bermuda Department of Civil Aviation (“BDCA”) is internationally respected as a safe and solid regulator.

There are numerous benefits in establishing a special purpose vehicle (“SPV”) in Bermuda. It is a tax neutral jurisdiction (meaning there are no additional taxes in Bermuda that would effect or be harmful to the transaction) with appropriate, but not overly burdensome regulation. The legal framework of Bermuda is based on common law principles with English common law having a persuasive role. In addition, Bermuda is a British Overseas Territory and offers a stable political environment which provides consistency and certainty. The involvement of a Bermuda SPV can act as a counterbalance to operator jurisdictions where such stability might be less evident.

In the typical financing structure, a Bermuda SPV is formed to act as owner and lessor or as lessee and sub-lessor of the aircraft. The location of the SPV in Bermuda may offer certain protections against the bankruptcy of other involved parties and facilitates innovative and cost-effective methods of asset finance, often utilising cross-back tax benefits.

Use of Special Purpose Trusts

Bermuda is unique in that a “special purpose trust” can be utilised in financing structures. In the typical financing structure, a Bermuda SPV is incorporated to act as owner and lessor or as lessee and sub-lessor of the aircraft. The issue that then arises is how the shares of the Bermuda exempted company should be held. It is often the case that it is not possible or desirable for any of the parties to the transaction to own the SPV or include the SPV as a balance sheet asset. In the past, one solution was to use a charitable trust as the shareholder and this is still commonly done in the Cayman Islands. The Bermuda purpose trust, however, provides distinct advantages.

www.conyersdillandpearman.com

With a charitable trust, the duties of the trustees are to invest the trust funds so that the return for charities is maximised and to make appropriate distributions. These duties can conflict with the requirements of the parties to the transaction. With the purpose trust, the duties are to fulfil the stated purposes which accord with the intentions of the parties. These purposes are normally to (a) promote the incorporation of the Bermuda exempted company; (b) subscribe for the shares of the company; (c) hold those shares; (d) support the company in pursuing the activity of the particular transaction in question; and (e) enter into any agreements that may be appropriate in connection with the transaction.

Security

The shares of the SPV may be pledged in favour of the financiers and such charge can be registered with the Bermuda Registrar of Companies. In addition, Bermuda is unique in that the BDCA also maintains a separate aircraft and engines mortgage register pursuant to the Mortgage of Aircraft and Aircraft Engines Act 1999.

Aircraft Registration in Bermuda

There are approximately 490 aircraft registered on the Bermuda Register (the "Register") and the majority of these are low age assets with significant value. Aircraft are registered in either the private or commercial categories. As of May 2009 there were 284 registered aircraft in the commercial category, with the bulk of these being western-built but operated by Russian carriers. The BDCA is rated as a Category 1 Aviation Regulatory Authority by the US Federal Aviation Administration and provides "low-profile" registration marks which are valuable when operating in areas of the world subject to security risks or political instability. The Bermuda registration marks VP-B and VQ-B with two subsequent letters are seen as neutral marks of high standard which are internationally accepted and Bermuda's registered aircraft are accepted for operations worldwide.

Bermuda retains airworthiness oversight, an attractive position for lessors as they receive the asset on return with a complete maintenance history, in English, to a very high standard. Financiers also like the Register because of the quality of regulatory oversight on assets in terms of the upkeep and maintenance. As such, the asset value holds up well over time compared to registers in other jurisdictions.

In recent years the BDCA has entered into several agreements with foreign jurisdictions regarding the transfer to operator states of certain regulatory oversight functions and duties under Article 83 *bis* of the Convention on International Civil Aviation (Chicago, 1944) to which the United Kingdom (representing Bermuda) is a party. In this way, certain functions and duties normally carried out by a state of registry are transferred, under strict guidelines, to an operator's state. Presently an active *bis* agreement is in place with the government of Russia and additional agreements are in place with Uzbekistan, Azerbaijan and Austria.

Aviation Working Group

Bermuda is the jurisdiction of choice for the Aviation Working Group ("AWG"), the representative body for manufacturers, key operating lessors and key financiers in the aviation field. AWG began work in 1994, at the request of the International Institute for the Unification of Private Law ("UNIDROIT"), as an ad hoc industry group to contribute to the development of the Cape Town Convention. Since that time, its scope of activity has significantly expanded and now addresses a wide range of topics affecting international aviation financing. In 2002, it formalised itself as a not-for-profit legal entity. For more information see www.awg.aero.

Julie McLean, 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 is a multi-jurisdictional law firm that advises on the laws of the Cayman Islands, British Virgin Islands, Bermuda and Mauritius. The firm specialises in company and commercial law, commercial litigation and private client matters. Conyers' structure, culture and expertise enables the firm to consistently deliver on its promise of responsive, timely and thorough service. Conyers provides clients with the highest quality legal advice from 11 global locations including offices in the world's leading financial centres in Europe, Asia, the Middle East and South America. Founded in 1928, Conyers comprises 600 staff including more than 150 lawyers. Affiliated companies (Codan) provide a range of trust, corporate secretarial, accounting and management services.

For further information please contact:

Julie McLean

+1 441 299 4925

julie.mclean@conyersdillandpearman.com

www.conyersdillandpearman.com