

Aviation Financing and Leasing

By Conyers Dill and Pearman's Aviation team:
Julie McLean, Bermuda,
Robert Briant, British Virgin Islands,
Kevin Butler, Cayman Islands
and Nicolas Richard, Mauritius

When an airline decides it needs to add a plane to its fleet it usually looks to financiers or a leasing company. The airline will discuss with such financiers or leasing company the most cost efficient way to structure the transaction. At this stage, legal counsel will often suggest the use of offshore vehicles. Operating in tax neutral jurisdictions, such vehicles add benefit to the finance/lease structure. In addition, if a private or corporate aircraft is to be purchased by an operator using finance supplied by an international lender, or leased from an international lessor, the 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. However, 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 the jurisdiction do not meet the acceptable minimum risk standards of the financiers and lessors, a practical option is to use one of the offshore jurisdictions which are usually viewed as neutral by all parties and as providing an acceptable and clearly understood standard of legal rights. This article will set out the benefits and procedures of aviation finance and registration in each of these jurisdictions.

Structure

Generally, in Bermuda, the Cayman Islands (Cayman), the British Virgin Islands (BVI) and Mauritius, companies are incorporated as special purpose vehicles (SPVs) in order to own or

lease the aircraft and be instrumental in the financing or leasing transaction.

Each jurisdiction offers political and economic stability and the application of structural bankruptcy remoteness techniques. Each jurisdiction also offers a respected judicial system with the UK Privy Council being the highest court of appeal for Bermuda, Cayman, BVI and Mauritius, and there are no exchange control or currency restrictions. There are also no corporate taxes in each of Bermuda, Cayman and BVI, which may also be the case in Mauritius depending on the type of entity formed. Mauritius' legal system is a mixture of English common law and French Civil law borrowing legal concepts from both systems.

A Mauritius SPV set up to conduct business outside Mauritius may apply to the Financial Services Commission for a Category 1 Global Business Licence (GBC1) or a Category 2 Global Business Licence (GBC2). A GBC1 is resident in Mauritius for tax purposes and is liable to taxes at a rate of 15%. However, such companies benefit from a deemed foreign tax credit which results in an effective tax rate of only 3%. The GBC1 can benefit from the 34 double taxation avoidance treaties (tax treaties) to which Mauritius is a party. Mauritius does not impose tax on capital gains derived by a Mauritius GBC1 or levy any withholding tax on any gains, dividends or interest derived by an investor from a GBC1. A GBC2 is not subject to any tax in Mauritius but, unlike the GBC1, it cannot benefit from the Mauritius tax treaties. The GBC2 is similar in various aspects to the SPVs established in the other jurisdictions.

SPVs in each jurisdiction can be structured to establish bankruptcy remoteness. Only in specific cases (for

the most part, where there is evidence of fraud) will the separate corporate personality of an SPV be ignored so as to allow creditors of an SPV to commence proceedings against its shareholders or to allow creditors of shareholders to proceed against an SPV.

Use of Trusts

In the typical financing structure, an 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 SPV 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. A solution is to establish a trust pursuant to which a trustee holds the shares of the SPV.

In each jurisdiction, a variety of trusts can be established. These include charitable trusts and purpose trusts. In the Cayman Islands, charitable trusts are most often used, although other options include a bespoke trust called a "STAR" trust and discretionary trusts. In Bermuda and Mauritius, 'special purpose trusts' are preferred over charitable trusts. In BVI, the VISTA regime can also apply to British Virgin Islands purpose trusts. A purpose trust is normally established by way of a declaration of trust (i.e. there is no stated settlor) to carry out stated purposes. There are no beneficiaries and in Bermuda there is no requirement for a protector or enforcer. The Cayman Islands do require an enforcer for a STAR trust, which is similar to a purpose trust in that it can be established for the benefit of certain individuals and/or for a specified purpose. The British Virgin Islands and Mauritius also require an enforcer of a purpose trust.

Security

A security interest may be granted over the assets of the SPV. Generally, the security interest is governed by onshore laws and supported by the offshore opinion as to enforceability. In Mauritius, the common law fixed and floating charges, lien and pledges are available as well as the civil law sureties such as the “hypothèque” (mortgage). In addition, in all four jurisdictions, the shares of the SPV may be pledged in favour of the financiers. Other than in the Cayman Islands, such a pledge may then also be filed on a public register.

Bermuda also has the Mortgaging of Aircraft and Aircraft Engines Act 1999 and related regulation. Under such legislation, a Register of Aircraft Mortgages and a Register of Aircraft Engine Mortgages is maintained by the Bermuda Department of Civil Aviation (BDCA) to assist in the registration of security interests in both aircraft and aircraft engines that are owned by, or otherwise in the lawful possession of, a company incorporated in Bermuda.

The Cayman Islands are a British Overseas Territory with limited constitutional powers to enter into international treaties independently of the United Kingdom. However, certain provisions of the Cape Town Convention on International Interests in Mobile Equipment as modified by the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (the Convention) have been given domestic effect in the Cayman Islands by virtue of the Cape Town Convention Law 2009, which recently came into force. As such, the applicability of the Convention in Cayman will be achieved by domestic legislation which imports certain provisions of the Convention, rather than by a UK order extending its application into the territory.

The law of Mauritius provides that in the case of a mortgaged aircraft, the mortgage will extend to the airframe, engines, propellers and onboard instruments as well as other spare parts which are destined to be continually used to service the aircraft, even if those spare parts are temporarily separated from the aircraft. Registration of the mortgage will secure priority for the mortgagee from the date of inscription of the mortgage with the Conservator of Mortgages. Once inscribed, the mortgage will be valid for ten years from the date of inscription and the inscription must be renewed for the charge to remain effective thereafter.

Registration of Aircraft

An aircraft may only be registered in Bermuda, Cayman and BVI in compliance with the Air Navigation (Overseas Territories) Order 2007 (the Order). The Order provides that the following persons are qualified to hold a legal or beneficial interest by way of ownership in an aircraft registered in such jurisdictions:

- (a) the Crown in right of Her Majesty's Government in the United Kingdom or the government of the Cayman Islands;
- (b) Commonwealth citizens;
- (c) British protected persons; and
- (d) bodies incorporated in some part of the Commonwealth and having their principal place of business in any part of the Commonwealth.

Bermuda

There are presently more than 460 aircrafts registered on the Bermuda Register (the Register) and the majority of these are low age assets with significant value. Aircrafts are registered in either the private or commercial categories. As of May 2009 there were 284 registered aircrafts in the commercial category, with the bulk of these being western-built but operated by Russian carriers. The Bermuda Department of Civil Aviation is rated as a Category I Aviation Regulatory Authority by the US Federal Aviation Administration and is prepared to accept more than one internationally recognised set of airworthiness requirements, various flight crew licences for validation, and provides a “low-profile” registration mark which is valuable when operating in areas of the world subject to security risks or political instability. The Bermuda registration mark VP-B with two subsequent letters is seen as a neutral mark of high standard which is internationally accepted and its registered aircraft are accepted for operations worldwide. Due to the success of the mark, an additional designation, VQ-B, was introduced for the first time in May 2008.

If an aircraft has already been type-certificated by any of the US FAA, Canadian TC or European EASA, Bermuda will recognise that type-certification without further investigation.

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 other registers.

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.

British Virgin Islands

Currently, there are no aircrafts registered in the British Virgin Islands. The aircraft register is in the process of being established by Air Safety Support International (ASSI), a not-for-profit, wholly owned subsidiary of the United Kingdom Civil Aviation Authority. ASSI has been retained by the governor of BVI for the purposes of establishing an aircraft register in BVI. It is anticipated that the register will be available for both private and commercial aircraft. The registration mark of the British Virgin Islands is VP-L***. It is anticipated that all aircrafts registered in BVI will need to be owned either by a company incorporated in the British Virgin Islands (a BVI business company SPV) or by individuals resident in BVI.

Cayman Islands

Presently there are more than 170 aircrafts registered on the Cayman Islands Register. The registration process is generally for aircrafts operated within the definition of “Private Category”. Private Category is defined as being “any purpose other than public transport or aerial work”, and therefore, an aircraft registered in the Private Category may not be used for the purposes of “hire and reward”.

Mauritius

The Mauritius Register is currently open for private aircrafts on a case to case basis and is expected to re-open shortly for commercial aircrafts.

The Department of Civil Aviation (DCA) accepts all aircrafts with Type Certificates from major Airworthiness Authorities (EASA, FAA, French DGAC) and will also validate foreign flight crew licences subject to such licences being issued according to International Civil Aviation Organisation standards. The Mauritius registration mark (3B followed by 3 letters) is considered neutral.

Given its time zone (GMT +4) Mauritius is considered beneficial for Asian, Middle Eastern and African clients, especially if any intervention by the DCA is required.