



Conyers Dill & Pearman

# BERMUDA AS A CENTRE FOR THE FINANCING AND REGISTRATION OF AIRCRAFT

## Foreword

This guide has been prepared for the assistance of those who are considering the registration of aircraft or financing an aircraft purchase in Bermuda.

We do not attempt to cover these subjects in detail but rather aim to deal in broad terms with the matters of significance.

Before proceeding with any matter discussed herein, persons are advised to consult with their legal, tax and other professional advisers in their respective jurisdictions.

This Memorandum has been prepared on the basis of the law and practice as at the date referred to below.

**Conyers Dill & Pearman**

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## 1. OWNERSHIP AND LEASING STRUCTURES OF ASSETS IN BERMUDA

### 1.1 Structures

Bermuda continues to play an important role in the creation of asset holding entities and, increasingly, the use of exempted company special purpose vehicles (“SPVs”) coupled with a purpose trust shareholder (“Bermuda SPV Structures”) in export credit financings. Political and economic stability, being a well regarded participant in international financial transparency and information exchange, as well as having a respected and consistent judicial system, a favourable legislative framework and tax regime, and the absence of exchange control and currency restrictions, make Bermuda the ideal jurisdiction to play a consistent and reliable role in ownership, financing and securitisation structures. When linked with a commercial aircraft registration capability, Bermuda is a leader in the international structuring and ongoing oversight of aviation linked transactions.

### 1.2 The Purpose Trust – A Neutral Ownership Vehicle

Historically, the most common form of trust has been that pursuant to which a trustee is given assets to manage and distribute amongst certain named or described beneficiaries. Trust law has, however, for some time recognised that a trust may be established in circumstances where assets are given to a trustee to manage and use in the fulfilment of a certain purpose rather than for the benefit of specific beneficiaries. Such purposes are generally required to be charitable, but there have also been certain limited instances where trusts have been upheld for non-charitable purposes.

The enactment of the Trusts (Special Provisions) Act 1989 in Bermuda enabled the creation of trusts for a broad range of non-charitable purposes (“purpose trusts”), and since that time the practice of establishing purpose trusts has become increasingly common in Bermuda.

With a charitable trust, the duties of the trustees include investing the trust funds to maximise the return for charities and making appropriate distributions. When a

charitable trust is used in a commercial transaction, these duties can conflict with the requirements/desires of the parties to the transaction. In comparison, when a purpose trust is used, the principal duties of the trustees are to fulfil the stated purposes, which are drafted to accord with the transactional requirements of the parties. Such purposes are often to: (i) promote the incorporation of a special purpose company; (ii) subscribe for the shares of that company; (iii) hold those shares; (iv) support the company in pursuing the activity of the transaction in question; and (v) enter into any agreements that may be appropriate in connection with the transaction. The purposes can, however, be tailored to cover specific requirements of a particular transaction.

The principal advantages of using a purpose trust in a commercial transaction are twofold, being:

- (i) The duties of the trustees of a purpose trust are clear, being to fulfil the stated purposes of the trust. Depending on circumstances, if a charitable trust is used in a commercial transaction, a conflict of interest may arise if for any reason it is in the interests of the parties to the transaction to minimise the profit of the trust's assets (e.g. so that the company only declares enough dividend to fund its ongoing expenses). The use of a purpose trust avoids such conflicts; and
- (ii) Bermuda law, like the laws of most jurisdictions that follow English common law principles, enables the Attorney-General of Bermuda (or some similar public official) to enforce a charitable trust that is not being properly administered for the benefit of charity. While we are not aware of an instance where the Attorney-General in Bermuda has sought to enforce a charitable trust that has been used in a commercial structure, the risk cannot be entirely dismissed in Bermuda or in any other jurisdiction where such enforcement powers exist. In the case of purpose trusts, the legislation expressly provides for the selection of a person to act as enforcer of the obligations under a purpose trust. This person may be a representative of a party to the transaction (most usually a representative of the secured parties) or an independent professional. The Attorney-General may only become involved to appoint an enforcer where the trustees are aware that the person designated

by the trust instrument to enforce the trusts is not able to do so. A well-drafted trust instrument will normally provide a mechanism to appoint successors to the original enforcer to ensure this problem never arises. In any event, the duty of anyone seeking to enforce the trust will be to ensure that the purposes are complied with, not that charitable benefits are maximised.

### **1.3 Bermuda SPV Structure and Corporate Control**

There may be circumstances where it is desirable to divide the shareholding of a Bermuda exempted company between non-voting shares that participate in profits and assets of the company and voting shares that do not so participate. This permits the exempted company to be controlled by an independent trustee who is bound to respect certain guidelines in the purposes of the trust as described in the trust deed. Those guidelines may or may not coincide with the interests of maximising the profits to the participating shareholders. Further, a small percentage of shares may be held in a purpose trust to provide a veto over major corporate actions or changes in the nature of the exempted company's operations.

### **1.4 The Tax Position**

There is presently no Bermuda income or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by a Bermuda company or its shareholders, other than shareholders ordinarily resident in Bermuda.

There is a government guarantee available in relation to the tax regime applicable to a Bermuda exempted company in the future. A Bermuda exempted company may apply for and is likely to receive from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act 1966, an assurance that in the event of there being enacted in Bermuda any legislation imposing tax computed on profits or income, or computed on any capital assets, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, such tax shall not be applicable to the company or to any of its operations or to the shares, debentures or other obligations of the company except insofar as such tax applies to persons ordinarily resident in

Bermuda and holding such shares, debentures or other obligations of the company or any land leased or let to the company. In accordance with the relevant legislation, such assurances are presently granted until the year 2035.

Stamp duties are not presently levied by the Bermuda government on documents to which an exempted Bermuda company is party other than if the subject property is located in Bermuda.

### **1.5 An Overview of the Bermuda Aircraft Register**

The registration of aircraft in Bermuda is sought for a number of purposes and Bermuda registered aircraft are based and operated throughout the world. Just under half of registered aircraft are corporate and private executive types. Increasingly, the majority of registered aircraft are leased to airlines where the state of the operator has agreed to accept a formal delegation of a substantial portion of their operational oversight. 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.

There are presently in excess of 500 aircraft on the Bermuda Register (which has been in existence since 1931) (the “Register”) and the majority of these are low age assets with significant value. Aircraft are registered in the private or commercial categories; the former presently numbering 179 and the latter 322. Many of the private registrations relate to large executive jets such as the Boeing 747 SP, Boeing Business Jet, Gulfstream GV, Falcon 900B, Bombardier Global Express and Airbus Corporate Jetliner or commercial type craft such as the Boeing 777, Boeing 757 and Boeing 737 registered for private use. Commercial craft operated by international airlines and presently registered in Bermuda include the full range of Airbus, Bombardier and Boeing aircraft.

There has been a growing use of the Register for commercially operated aircraft and this category has become the fastest growing for the Bermuda Department of Civil Aviation (“BDCA”) in recent years. The commercial operators of Bermuda registered

aircraft must maintain high levels of operational safety. If a commercial operator is not as yet operating a Bermuda registered aircraft, there is an operator linked application and approval procedure in place to ensure that only aircraft operated by accepted operators will be considered for registration.

## 1.6 Operational Oversight & Article 83 bis

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. The aim of this highly successful operational initiative is to ensure on the spot safety oversight and allow for greater efficiencies at both the government and operator level.

Presently an active bis agreement is in place with the government of Russia and additional agreements are in place with Uzbekistan, Azerbaijan and Austria. An update regarding the status of the non Russian bis agreements is expected in the near future.

## 2. AIRS

On 1 February 2008, the BDCA implemented the Aircraft Information and Records System (AIRS). AIRS is essentially an electronic filing and record keeping system to be used by authorised persons during the initial registration of the aircraft and to renew certificates and licences while an aircraft remains registered in Bermuda. The initial application for "approval in principle" in relation to a proposed registration must now be submitted by "authorised and certified users" which includes certain personnel of Bermuda law firms.

It is intended that mortgage filings and priority notice filings will also be done via AIRS and that once fully implemented, certificates of registration and certificates of

airworthiness, etc. will all be issued via the system with certificates having digital signatures and an imbedded document authentication certificate.

## **2.1 Benefits of Registration in Bermuda**

Owners and operators enjoy a Bermudian administration which is rated as a Category 1 Aviation Regulatory Authority by the US Federal Aviation Administration and which 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.

Owners and operators have expressed satisfaction with the high level of responsiveness of the BDCA when dealing with enquiries and requirements. This is made possible by the absence of the degree of administrative bureaucracy often encountered when dealing with other key aviation jurisdictions. Bermuda does, however, offer the full range of professional and administrative services necessary to ensure that all legal and other requirements are properly met and to ensure the BDCA and the Register retain a high level of international respect and confidence.

Registration in Bermuda is not subject to any requirements that demand the aircraft be based in or operate through Bermuda and Bermuda registered aircraft may be operated anywhere in the world, excluding war zones and the like or practically, areas restricted by its insurances. Other jurisdictions impose requirements that an aircraft registered in that jurisdiction must be based and primarily used in that jurisdiction, calculated upon the total number of flight hours during a designated measurement period.

Aircraft that meet the standards of the BDCA may be registered by a Bermuda exempted owning company or on a lease through basis to a Bermuda exempted company lessee and then onward. The latter form of registration does have implications as to the registration of related security in Bermuda.

## **2.2 Financing, Lessors and Bermuda Registration**

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 a jurisdiction such as Bermuda which is usually viewed as neutral by all parties and as providing an acceptable standard and clearly understood array of legal rights.

## **2.3 The Legal Framework**

Bermuda meets, and in most cases surpasses, the risk threshold for financing lessors in today's environment who want to hold assets in international well respected jurisdictions which clearly recognise their ownership rights based on common law principles. Financiers involved in asset based finance transactions require the possession rights of a borrower and security rights of a lender clearly and consistently applied. Financiers require that their rights in moveable equipment be registrable in a manner which is universally understood and recognised and wish to deal with a jurisdiction familiar with, and prepared for, sophisticated finance and leasing structures. Bermuda meets all of these needs.

The legal framework of Bermuda is known, stable, consistent and based upon the common law with the highest court of appeal in Bermuda being the Judicial Committee of the UK Privy Council.

## 2.4 The Mortgage & Priority Notice

In Bermuda the Mortgaging of Aircraft and Aircraft Engines Act 1999 and related regulations have been in place since 1 July 1999. Under this legislation, a Register of Aircraft Mortgages and a Register of Aircraft Engine Mortgages is maintained to assist in the registration of security interests in both aircraft and aircraft engines (with certain minimum thrust or horsepower levels matching those set in the Protocol) and owned by or otherwise in the lawful possession of a company incorporated in Bermuda. In both instances, the priority of a mortgage can be fixed by acceptance of a priority notice by the BDCA pursuant to which the priority of a yet to be executed mortgage can be fixed for a 14 day renewable period. Fees are reasonable and presently set on a sliding scale up to a maximum of US\$800.

## 2.5 The Security Package

To protect the security held in an aircraft the following documents and/or options are available, depending on the structure of the transaction and the nature of the Bermuda owning or leasing registrant (the "Registrant"):

- (i) a mortgage over the aircraft and its engines, filed appropriately;
- (ii) a charge (i.e. pledge) granted over the shares of an owning Registrant with the charge being filed with the Bermuda Registrar of Companies;
- (iii) an irrevocable proxy from the Registrant's parent authorising a security trustee or the like to vote the shares of the Registrant. Most standard form Bermuda exempted company bye-laws do not make accommodation for irrevocable proxies and would need to be amended in this regard;

- (iv) executed but undated resignation letters from the directors and officers of an owning Registrant and an irrevocable direction to complete the resignation letters so that a security trustee would have the ability to step-in upon a default pursuant to the terms of the charge over shares and direct an owning Registrant without interference from the pre existing company directors and officers;
- (v) advance written approval from the Bermuda Monetary Authority for a transfer of shares to the security trustee, lender or a designee or transferee (the "Secured Party") pursuant to the terms of a charge over shares, though if the Secured Party is a licensed bank or other licensed lending institution in an Approved Jurisdiction (which includes, for example, Canada, the United States of America and all countries in the European Union), no further governmental permissions are required;
- (vi) an undated share transfer form from the shareholder of an owning Registrant and an undertaking by such Registrant to transfer its shares upon the instruction of a security trustee or, in the alternative, amendment to the owning Registrant's bye-laws to remove the standard discretion of the board to refuse to register a share transfer other than a transfer contemplated by the charge over shares;
- (vii) amendments to an owning Registrant's bye-laws to add additional notice provisions for shareholder or board meetings where the purpose would be to achieve certain objects such as the winding up of the owning Registrant or the sale of the owning Registrant's assets;
- (viii) amendments to an owning Registrant's memorandum of association to the effect that the only business which it could conduct would be to acquire and operate the aircraft i.e. assisting in making the Registrant bankruptcy remote by removing risks of additional business ventures;

- (ix) a deregistration power of attorney from the Registrant and a Letter of Assurance from the BDCA recognising additional security interests held in the aircraft; and
- (x) a letter of quiet enjoyment from the Registrant to the ultimate operator.

## 2.6 Cape Town Convention

Once widely in force, the Cape Town Convention on International Interests in Mobile Equipment (the “Cape Town Convention”) and the related Aircraft Equipment Protocol (the “Protocol”) will facilitate the cross-border financing and leasing of, amongst other aviation assets, aircraft engines. There will be an ability to register international interests in such assets. Until such time, owners and financiers alike will look to traditional methods of control over the use of their asset. They will use a full range of backstops, both legal and practical, to ensure their valuable security is available in an expected and acceptable location at the time enforcement and repossession is being contemplated.

While the United Kingdom (and hence Bermuda) is as yet not a signatory to the Protocol, registration of a registrable international interest or interests may be possible where an aircraft owned by a Bermuda SPV Structure has a certain connection to a jurisdiction which is a signatory. In these circumstances, Conyers Dill & Pearman Limited is able to arrange for a third party registration service in regards to the relevant equipment.

## 2.7 Bermuda and the Aviation Working Group

Bermuda is the jurisdiction of choice for the incorporation of the Aviation Working Group (“AWG”), 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](http://www.awg.aero).

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