

THE INTERNATIONAL **AVIATION**  
**FINANCE & LEASING**  
REVIEW 2023 / 24



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# The International Aviation Finance & Leasing Review 2023/24

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# FOREWORD

## Airline profitability outlook strengthens despite challenging global economic environment

# IATA



### BIO

Marie joined IATA in 2022 as Chief Economist. In January 2023 Marie added responsibility for IATA's Environment and Sustainability activities to her role.

Marie joined IATA from Lombard Odier where she was Head of Global Trends and Sustainability. Her 30-year professional life includes roles for both investment banks and private banks, including HSBC in London, Merrill Lynch in Paris, and Indosuez in Geneva. Outside of the financial sector Marie worked for IKEA, and she also founded and managed her own company in the equine industry. Marie holds an MBA from the University of Gothenburg in Sweden, and a PhD in International Economics from the Graduate Institute in Geneva, Switzerland. She speaks Swedish, English, and French fluently.

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# Airline profitability outlook strengthens despite challenging global economic environment



There is much talk about looming recessions. It is likely based mostly on sentiment, because of the sharp slowdown we are experiencing in the global economy, rather than on any numerical analysis. In fact, global GDP growth is in line with the historical average since the 1970s. This year, the growth rate is likely to be in the vicinity of 3% in 2023, down from 3.4% in 2022, and from 6.3% in 2021.

What makes a global recession unlikely today is the highly unusual phenomenon of excessively tight labor markets. In April 2023, the US unemployment rate stood at 3.4%, which is historically low compared to the average rate of 5.7% from 1948 to 2023. In the OECD countries, the average unemployment rate was 4.8% in March 2023, the third month at this record low since 2001. In the European Union, the unemployment rate was 6.0% in March 2023, also a historic low, and that of the Euro area fell to 6.5% in the same month. While we would expect unemployment rates to rise again in the latter part of this year, it is difficult to anticipate a recession at the current junction given that record numbers of workers are earning a regular income.

The fact that more people are earning an income is more important than the loss in purchasing power they are suffering from the higher rates of inflation. Despite some significant monetary policy tightening, inflation remains somewhat stubborn, impacting the real interest rates and affecting debt holders. The price of money is going up (although it is still low), and this will impact all debt holders.



Climate change and the transition to a sustainable economy is already taxing growth and lifting the need for both public and private investments.

Global debt levels remain high at 338% of GDP in 2022, though this is down by 12 percentage points from 2021. Most of the declines came from advanced economies, while the debt-to-GDP ratio for emerging markets rose by 2 percentage points. Over the past few years, the number of vulnerable economies has risen. As the cost of servicing this debt has risen, governments worldwide will have limited space for fiscal stimulus and may resort to raising taxes.

Climate change and the transition to a sustainable economy is already taxing growth and lifting the need for both public and private investments. Achieving this amidst diminishing multilateral collaboration and the return of war to Europe presents additional challenges.

All these headwinds come at a time when the airline industry is just regaining profitability. At the depth of the COVID crisis, airline losses equalled USD 76 per passenger. In 2023, airline industry net profits are expected to reach \$9.8 billion (1.2% net profit margin) which is more than double the previous forecast of \$4.7 billion (December 2022). The return to net profitability, even with a 1.2% net profit margin, is a major achievement.

In addition, Airline industry operating profits are expected to reach \$22.4 billion in 2023, much improved over the December forecast of a \$3.2 billion operating profit. It is also more than double the \$10.1 billion operating profit estimated for 2022.

Economic uncertainties have not dampened the desire to travel, even as ticket prices absorbed elevated fuel costs. After deep COVID-19 losses, even a net profit margin of 1.2% is something to celebrate! But with airlines just making \$2.25 per passenger on average, repairing damaged balance sheets and providing investors with sustainable returns on their capital will continue to be a challenge for many airlines.

# AUSTRIA

## Key developments & the latest trends in Austria – from a legal perspective

# BENN-IBLER



### BIO

Dr. Martin R. Geiger, LL.M. completed postgraduate studies at the University of Amsterdam after studying law at the University of Salzburg. He was admitted to the Austrian Bar in 2002. Before being a founding partner of Benn-Ibler in 2010 he was a partner in an international law firm.

Martin Geiger is inter alia a specialist in aviation law, including sales and financing transactions as well as regulatory issues, litigation and arbitration. His legal know-how and long standing practical experience in the aviation sector is valued by national and international aircraft carriers and operators, banks, financial institutions as well as technical and service enterprises of the aviation industry.



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**BENN-IBLER**

# BENN-IBLER



## BIO

Mag. Irena Gogl-Hassanin, LL.M. is a partner and an attorney at law at Benn-Ibler and has been a member of the Austrian Bar since 2009. She is also a lecturer in Aviation Finance for students of the Aviation Management master programme at the University "Joanneum" in Graz, Austria.

After graduating the University of Vienna, she completed post graduate studies in International Banking & Finance at University College London. Before joining Benn-Ibler, she gained vast finance and corporate law experience in renowned international business law firms in Vienna, Warsaw and London, specialising in, amongst others, aviation law and finance.



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**BENN-IBLER**

# Key developments & the latest trends in Austria

## – from a legal perspective

**BENN-IBLER**

### Business Aviation in Austria

Despite the recent challenges of the COVID-19 pandemic, Austria has been able to maintain a very active and prospering business aviation industry. Due to its strategic location within Europe and its history as neutral country between Eastern and Western European countries and the usually favourable reception of “Austrian registered aircraft” at airports in countries all around the globe, Austria has maintained its position amongst the top 4 business aviation destinations within Europe.

Professional operators, reliable maintenance facilities, favourable air traffic rights, a functioning and efficient judicial system and an aircraft registry open to owners of all nationalities have attracted many business jet owners to make Austria their home base.

### The Austrian Aircraft Registry

A major reason for the local market’s attractiveness for business jet owners is the operator-based Austrian Aircraft Registry. Only the operator of an Aircraft is registered in the Aircraft Registry, meaning that ownership rights and security

interests cannot be registered and are not published. The benefit of this operator-friendly approach is the flexibility the system provides, as any owner can register its aircraft in Austria, provided he appoints an Austrian operator to operate his aircraft. Aircraft can also be registered in Austria upon request of the operator,

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Despite the recent challenges of the COVID-19 pandemic, Austria has been able to maintain a very active and prospering business aviation industry.

if (i) the operator is based in a member state of the European Union or in a country accorded equal status by international agreement, (ii) the aircraft is not registered elsewhere and (iii) the operator in case of an intra-community transaction provides a confirmation of the tax authority in the sense of Art 27 of the Austrian VAT Act.

Austria has not ratified the Cape Town Convention on International Interests in Mobile Equipment and the related Aircraft Protocol (“**Cape Town Convention**”) and there is no political intention in the near future to change that. This does not, however, mean that an international interest pursuant to the Cape Town Convention cannot be registered on an Aircraft registered in Austria. If such entry is made on an Austrian registered aircraft, it will be disregarded by Austrian authorities and courts, but will become relevant when the Aircraft is sold and deregistered in Austria to be moved to a state where the Cape Town Convention is applicable.

The particular situation of the Austrian registry framework has benefits as regards the most possible flexibility on the ownership structure of the aircraft but has certain restrictive effect on the way aircraft financing transactions need to be structured if the aircraft is to be registered in Austria.

### The “Dead Pledge” Principle

You will not find many loan financed aircraft registered in Austria. Under Austrian law, the acquisition of aircraft is typically structured in the form of a financing lease, where the financing party becomes the legal owner of the aircraft and leases it to the lessee, who can then acquire ownership rights to the aircraft at the end of the lease period. Alternatively, a hire purchase agreement is concluded between the financing party as the seller and the financed party as the purchaser. In such structure, the financing party remains the legal owner of the aircraft until the final payment under the hire purchase agreement is made. This does not mean that financing the acquisition of an aircraft by means of a loan is not possible. Due to the particulars of Austrian property law, it is just not as common as leasing.

The main reason for most commonly financing aircraft by a lease or hire purchase agreement is related to questions of the provision of collateral.

A loan financing of an aircraft will typically be secured by providing a pledge over the Aircraft as collateral. Under the Austrian property law “dead pledge” principle, a pledge over movable objects can only be validly created by physically handing over the object to the pledgee. This systematic is not uncommon in jurisdictions based on the old Roman law, and has the main objective of protecting the pledgee by requiring a certain degree of publicity to display that the object is pledged and not freely available to the pledgor. This requirement, however, is somewhat restrictive to the owner of the aircraft, who can then not operate or use the aircraft himself. In aviation, this requirement would contravene the purpose of owning an aircraft.

If the financing party is the lessor and therefore the owner of the aircraft, there is no need to pledge the aircraft as collateral, and therefore no “dead pledge” principle applies. A lease structure therefore allows the financing party to be secured by the asset itself, whereas the aircraft can be used by the party in need of financing.

Whereas an ownership right to a movable property, such as an aircraft, is also established by physically handing over the aircraft – signing a bill of sale or registering the aircraft in the Austrian registry is not sufficient – the owner’s title to the aircraft does not extinguish if, after acquisition of the title thereto, it is physically handed over to the lessee under a lease agreement.

### Third party operators as intermediary

The “dead pledge” principle poses less problems if a third party operator – meaning a person different from the borrower – shall operate and therefore physically possess the aircraft. In such case a pledge can be created in favour of the lender by a so called “instruction to possess” from the borrower to the operator. The borrower, in such instruction, informs that operator that the aircraft is being pledged to the lender and instructs the operator to possess the aircraft for the benefit of the lender as pledgee for as long as the pledge is in place. An instruction to possess which is acknowledged by the possessor, is considered sufficient publicity for maintaining a pledge of movable asset.

### Tripartite Arrangements

Now, it is rather the norm that owners of business jets (or persons wanting to own a business jet) do not operate the aircraft themselves. In order to operate an aircraft, an Aircraft Operator Certificate is required, which again requires special know-how and needs to be applied for with the Aviation Authority (in Austria this is Austro Control).

Here, the professional operating company comes into place. The operator – the entity which is also registered in the Austrian Aircraft Registry – is the person factually in possession of the aircraft, flying the aircraft (i.e. selling charters) and responsible for keeping the Aircraft in an airworthy condition.

It is also the person in charge of making changes to the Aircraft Registry, whereas the owner alone will not be successful with requesting any changes to the registry.

The operator is appointed by the lessee or the borrower and approved by the lessor or the lender, the operating agreement concluded between the lessee (borrower) and the operator.

To protect the lessor as the owner of the aircraft, Austrian aircraft lease financing documentation typically also includes a so called tripartite agreement, which is signed by the lessee, the lessor and the operator, by which the operator acknowledges the lessor as the owner of the aircraft, agrees to respect the lessor’s ownership and also provides a deregistration power of authority for the benefit of the lessor. This protects the lessor in that he can act without the operator should the lessee come into default under the lease agreement and the lease agreement is terminated by the lessor.

“

Now, it is rather the norm that owners of business jets (or persons wanting to own a business jet) do not operate the aircraft themselves.



In loan financing structures, where the aircraft is pledged to the lender, a tripartite agreement is used to facilitate the enforcement of the pledge in case the borrower defaults under the loan agreement. The Operator here, too, acknowledges the lender's rights as pledgee and provides a deregistration power of authority in favour of the pledgee.

### The power of the Austrian Operator

A deregistration power of authority, however, does not protect the lessor or the lender, if the operator does not cooperate in physically handing over the aircraft, too. The Austrian Aircraft Registry, as flexible as they are with the registration, do not involve themselves in civil disputes and will typically not support an owner or pledgee to obtain physical possession of the aircraft. In such case, the physical handover will need to be enforced through the civil courts – and that might take time.

The reasons why an operator might not be willing to hand over the aircraft are various, mostly relating to management fees or operating costs payable under the operating agreement.

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A deregistration power of authority, however, does not protect the lessor or the lender, if the operator does not cooperate in physically handing over the aircraft, too.

Whereas the relationship between the lessee (borrower) and the operator under the operating agreement and any outstanding fees which the operator might face vis-à-vis the lessee (borrower) needs to be settled between these two parties and do not serve any beneficial purpose for the lessor (lender), expenses made on the aircraft, such as necessary maintenance works or payment of insurance premiums, can justify a retention right of the operator vis-à-vis the lessor, if such rights of retention have not explicitly been waived between the parties (in the tripartite agreement).

Furthermore, any registration of an international interest in the International Registry, might become another obstacle for the lessor, if the lessor intends to sell the aircraft outside of Austria (which is quite common as the market in Austria for used business jets is not big enough). The same applies to the lender who wishes to enforce his pledge.

Aircraft need to be in operation to maintain their value, maintenance checks need to be performed on a regular basis and insurances kept up to date. Lessor (lender) and lessee (borrower) in such constellations typically do not have the expertise and knowledge to perform these tasks. This makes them more dependent on the operators, which makes it even more important for lessors (or lenders) to have the financing documentation drawn up with the best possible legal protection available.



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# CAYMAN

## Aviation in the Cayman Islands: The Sky's the Limit

# WALKERS



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### BIO

Sarah Humpleby is a partner in the Finance and Corporate Group at Walkers in the Cayman Islands. She specialises in all aspects of asset finance with a particular focus on aviation.

Sarah has extensive experience in aircraft and ship financing transactions for a full range of clients across the industry, including major operating lessors, aircraft/ship owners, financiers, airlines and operators. She works closely with leading on-shore law firms advising on a variety of transactions including securitisations and ABS transactions, establishment of joint venture vehicles, PDP and delivery financing and leasing for both private and commercial aircraft, commercial vessel and yacht acquisitions and financings, export credit supported financing, sale and leaseback transactions, loyalty programme financings, EETCs and distressed matters including repossessions, restructurings and transitional aircraft registrations.



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 **Walkers**

## BIO

Hannah Hawkins joined Walkers' Cayman Islands office in 2022 where she is an Associate in the Finance and Corporate group. Hannah specialises in asset finance with a particular focus on aviation.

Hannah has extensive experience in a broad range of aircraft leasing and financing transactions and has worked closely with lessors, lessees, operators, original equipment manufacturers and financial institutions, as well as counsel for these institutions, across the sector.

# Aviation in the Cayman Islands: The Sky's the Limit



The Cayman Islands is well known for more than just white sandy beaches. This article provides an overview of why the Cayman Islands is the offshore jurisdiction of choice for so many and gives a flavour of the ways in which incorporating it into a transaction can be effective.

## Innovation in the industry

IATA's mid-year assessment of the aviation industry has noted the positive trajectory of the rebound of air travel and airline profitability despite ongoing pockets of economic uncertainty. Having faced significant headwinds over the last several years, the aviation industry has proved itself to be both resilient and innovative in its endurance. There has been a clear expansion in the range of transactions and structures in which Cayman Islands entities are deployed and that flexibility is attractive to participants at all levels from investors to operators.

## 6 answers to 'Why Cayman?'

The Cayman Islands' strength in financial services is borne out of its ability to provide institutionally focussed services to a global network of clients and this has seen it mature

into one of the largest international financial centres in the world. The global financial industry can rely on the Cayman Islands' well developed and predictable company and partnership laws and put its trust in effective, cost-efficient and tax-neutral transaction structuring. We will focus on the key advantages here.



The business in which a Cayman Islands entity can be involved is generally unrestricted provided it falls within what is permitted by law

**1. Sophisticated Legal System and Political Stability:** The Cayman Islands is a self-governing British Overseas Territory with an independent legal and judicial system grounded in English common law with well-developed local legislation. This predictability and stability is attractive when combined with a widely known and accepted corporate governance framework.

**2. Tax Neutrality:** The Cayman Islands has no direct taxation and a structure involving a Cayman Islands entity has the advantage of minimising potential tax leakage. It is free from any form of income, capital gains or corporation tax and no Cayman Islands' withholding tax is imposed on an entity's cash flows. Certain Cayman Islands entities with exempted status may also apply for a government undertaking confirming that such entity will not be subject to any taxation in the Cayman Islands for a period of 20 to 50 years (depending on the type of entity). The tax transparency of Cayman Islands exempted companies and partnerships can enable efficient raising of capital.

**3. Flexibility:** The business in which a Cayman Islands entity can be involved is generally unrestricted provided it falls within what is permitted by law. Combined with the ability to incorporate a new entity within as little as 24 hours, the flexibility allows parties to move quickly and efficiently. The Cayman Islands remains a relatively inexpensive jurisdiction in comparison to its competitors with government fees being assessed on a scale linked to the authorised share capital of the SPV. There are no exchange control restrictions allowing money and securities in any currency to be freely transferred to and from the Cayman Islands.

**4. Creditor Friendly:** The Cayman Islands' insolvency regime is recognised as creditor friendly. Contractual rights including subordination, netting and set-off are recognised by express statutory provisions. The effective use of bankruptcy remoteness structures is a key aspect of asset and structured financing in the Cayman Islands and recognised as robust by rating agencies and financiers.

**5. Regulation:** There is a well-established regulatory framework encompassing international standards around anti-money laundering and counter terrorism, data protection, economic substance and the Common Reporting Standard (to name a few). Regulatory and financial transparency are core values embodied by the Cayman Islands Monetary Authority which is an independent regulator charged with consistent application of regulatory requirements for financial institutions.

6. International Connectivity: It is well known that Ireland is a key global hub for the aviation industry not least due to its enviable treaty network. There is a well-established route for Cayman Islands entities to be established as Irish tax resident and that can be a powerful structuring tool in a variety of transactions.<sup>1</sup>

### What's in a name?

One of the most commonly chosen entities for structured and asset finance deals is the exempted company incorporated with limited liability (an 'SPV'). Exempted Companies have their registered offices in the Cayman Islands and carry on business outside of the Cayman Islands. SPVs are distinct from segregated portfolio companies ('SPCs') and limited liability companies ('LLCs') in the jurisdiction. At an investor level, an exempted limited partnership is likely to be the entity of choice and the Cayman Islands is the premier jurisdiction for investment funds with an estimated 80% of all new offshore funds domiciled in the country. The biggest challenge to incorporation or formation of a new entity may well be settling on the naming convention!

### Off-balance sheet financing

In an aviation context, an SPV is typically incorporated to act as a borrower and owner/lessor of an aircraft and its shares will be held on trust by a professional trust company such as Walkers Professional Services. This effectively separates the legal and beneficial ownership of the SPV and creates the 'orphan' structure taking the SPV off the balance sheet of the relevant parties and isolating the underlying assets from the corporate credit(s) in the deal. The trust will generally be a charitable or purpose trust maintained for the life of the deal.

The other key feature for an orphan SPV deal is that all documentation is entered into on a limited recourse and non-petition ('LRNP') basis. This ring-fences the assets and preserves bankruptcy remoteness by limiting the chance of claims against the SPV.

### Transactional diversity

Aviation itself is a multi-billion dollar industry, from commercial passengers to freighters, private aircraft, the vast network of regulators and technical service providers, the manufacturers and the infrastructure required to support it all. It is no surprise then that there are so many ways to transact. We have already touched on some of the kinds of transactions we see but below is a (non-exhaustive) list of where the Cayman Islands can feature in deals.

**Funds and investment** – as we have mentioned, the Cayman Islands is the jurisdiction of choice for the formation of investment

funds. In recent years we have seen new investors with capital to deploy becoming new entrants into the aviation sector.

**Alternative lending, joint ventures, new leasing platforms** – once the investment is identified, those funds need to be put to use and we

have seen Cayman incorporated entities being used in the establishment of alternative lending platforms, joint ventures with established industry players and the founding of new leasing platforms. The flexibility of Cayman entities is particularly attractive to alternative lenders who can deploy capital quickly and fulfil a need where traditional lenders have retreated.

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In an aviation context, an SPV is typically incorporated to act as a borrower and owner/lessor of an aircraft and its shares will be held on trust by a professional trust company such as Walkers Professional Services.

1) <https://www.walkersglobal.com/index.php/publications/100-article/2758-aviation-structuring-in-a-time-of-recovery>

**Debt financing** – traditional debt financing for new and used aircraft also favours the use of bankruptcy remote SPVs. From pre-delivery payment financing, to delivery financing at the point of delivery from the manufacturers (including export credit guarantee and insurance backed products), to warehouse financing of portfolios, all lend themselves to an SPV borrower. As production lines continue to ramp up, we also expect to see carbon-neutral and de-carbonisation projects increasingly highlighted across the industry. Improvement in fuel efficiency, innovations in aircraft technology and a growing focus on what ESG means for aviation financing will be put into practice in debt documentation and elsewhere as pre-delivery payments fall due and new aircraft are delivered.

**Capital markets** – Cayman incorporated Irish tax resident issuers is a tried and tested structure in aircraft asset backed securitisations ('ABS'). Where we also see the use of Cayman entities in capital markets and rated deals are in connection with note of bond issuances (secured or

unsecured) and in non-US enhanced equipment trust certificate ('EETC') transactions. At the time of writing access to the ABS market is heavily restricted due to, among other things, interest rate volatility and the disconnect between lease rates and cost of funds. Those who need to find access to financing or refinancing have had to look elsewhere and there has been a surge in term loan

transactions to fill that gap and those deals are commonly structured with an SPV borrower.

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Traditional debt financing for new and used aircraft also favours the use of bankruptcy remote SPVs.

**Loyalty financing**<sup>2</sup> – the highly structured transactions entered into by several major US airlines following the deep impact of the global pandemic is an excellent example of the innovative approach the industry takes to self-preservation. The valuation of frequent flier programmes has long been a closely guarded secret but the first-of-its-kind United Mileage Plus financing changed that. The bankruptcy remoteness protections afforded to the financiers and investors by using Cayman Islands SPVs were integral to the highly structured nature of these transactions.

**Listing services** – many of the transactions already described are likely to have a requirement for notes to be listed. The Cayman Islands Stock Exchange ('CSX') was the first offshore stock exchange to be granted approved organisation status by the London Stock Exchange. In addition, the UK HMRC also recognises the CSX under section 1005 of the Income Tax Act (ITA) 2007 regards the CSX as a 'recognised stock exchange'. The CSX is a specialised exchange which prides itself on being user-friendly and offering an efficient and competitively priced listing service.

**Aircraft registration** – a summary of the involvement of the Cayman Islands in aviation is not complete without a word on the Cayman Islands Civil Aviation Authority ('CAACI'). The aircraft registry maintained by the CAACI is an internationally respected registry with strategic values and a desire to strengthen the reputation of the jurisdiction as a safe, effective and innovative registry of choice.<sup>3</sup> It is predominantly a private aircraft register but can also handle commercial aircraft (including those of the national flag carrier, Cayman Airways). It has an Article 83bis Agreement in accordance with the International Civil Aviation Organisation ('ICAO') with the Kingdom of Saudi Arabia and in more recent times, a transitional register for commercial aircraft. The transitional registration programme developed significantly throughout 2020 with an increase in demand from the commercial aviation community for reliable registry services resulting from the effects of the global pandemic.<sup>4</sup> It should also be noted that the Cayman Islands benefits from the Convention on International Interest in Mobile Equipment (the '**Cape Town Convention**') following the United Kingdom's ratification. It affords entities structuring their asset financing transactions with a Cayman Islands SPV the added protection, certainty and uniformity that the Cape Town Convention and its Protocols afford.

2) <https://www.walkersglobal.com/index.php/publications/100-article/2362-liquidity-boosted-by-loyalty-creative-collateral>

3) <https://www.caacayman.com/about-us/caaci-vision-2025-strategic-plan/>

4) <https://www.walkersglobal.com/index.php/publications/100-article/2759-how-to-guides-transitional-aircraft-registration-with-the-civil-aviation-authority-of-the-cayman-islands>

### Management and professional services

Regardless of the type of transaction, a Cayman Islands SPV still requires directors. Cayman Islands fiduciary service providers such as Walkers Professional Services can be engaged to provide administration and management services for SPVs and other kinds of Cayman entities including the provision of directors and officers, and importantly ensuring provision is made to assist the SPV meets its regulatory obligations. Ongoing monitoring and testing can be implemented to maintain required compliance procedures and ensure that the relevant entities remain in good standing with the appropriate authorities including the Registrar of Companies CIMA and the Department for International Tax Cooperation.

### Looking to the future

The additional macro-economic headwinds in early 2023 against a backdrop of multiple black swan events in recent years have not dampened optimism. For those who have been around long enough, there is faith in the industry cycle; firm demand for air travel which will continue and the good times will return. What we have learned is that the fundamentals remain strong in respect of both the industry itself, and the reasons why the Cayman Islands is an effective jurisdiction to support it. When the unexpected occurs, there is courage in innovation and Cayman has the tools to reinforce that progress.

### Walkers

The Cayman Islands is a leading offshore financial centre and Walkers (Cayman) LLP and Walkers Fiduciary Services ('Walkers') are right at its heart. With the expertise to get any asset and structured finance transaction off the ground, Walkers can truly make your transaction fly. For further information or advice, please reach out to the authors or your usual Walkers contact.

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Regardless of the type of transaction, a Cayman Islands SPV still requires directors.



# Commercial problem solvers

Here at Walkers, our award winning Global Asset Finance Group is all about collaborating with our clients and helping them to seize opportunities and conquer the challenges they face. Our experience providing legal and fiduciary services for the most innovative, complex and high profile aviation transactions globally, means clients trust us to guide them on the most commercially sound strategies and solutions needed to establish and service their aviation investments.



To tell us about your challenges and hear more about our work visit [walkersglobal.com](https://walkersglobal.com)

# CYPRUS

## THE ACCESSION OF CYPRUS TO THE CAPE TOWN CONVENTION

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#### BIO

Elvina Montanios was born in Nicosia, Cyprus. She read Law at Bristol University, England, and was awarded an LL.B. Honours Degree in 1998. She then obtained an LL.M. in Maritime Law at King's College, University of London. Elvina was called to the English Bar by the Honourable Society of the Middle Temple in 2000 after completing the Bar Vocational Course at the Inns of Court School of Law in London.

She joined M&M in 2000 as a trainee advocate and she was admitted to the Cyprus Bar in 2001. In 2012, she became a partner in the firm.

Elvina primarily specialises in asset finance with an emphasis on aircraft and shipping. She advises a wide range of clients in the aviation sector including aircraft leasing companies, financing institutions, and operators of commercial aircraft, helicopters and corporate/private jets in connection with operating lease and financing lease transactions on a domestic, cross-border and international basis. She has been involved in aircraft sales and purchases as well as the registration and deregistration of aircraft under the applicable Cypriot legislation. She also represents clients from across a number of sectors in the shipping industry including ship owners, ship managers, banks, equity funds and other financial institutions and covers a broad range of shipping finance matters including drafting, negotiation and implementation of such Cyprus law security documents as ship mortgages, account charges and share pledges.

She also has considerable experience in matters of corporate & commercial law, including corporate restructurings, joint ventures, transfers and acquisitions.

Elvina is a member of the Shipping & Aviation Law Committee of the Cyprus Bar Association.

# THE ACCESSION OF CYPRUS TO THE CAPE TOWN CONVENTION



## 1. Introduction

Friday 16 November 2001, a “day to be remembered in the annals of transnational commercial lawmaking” (as Ray Goode very rightly said) when the **Convention on International Interests in Mobile Equipment** (the “**Convention**”) and the **Protocol on Matters Specific to Aircraft Equipment** (the “**Protocol**” and together the “**CTC**”) are concluded in Cape Town.

Twenty-one years later, the Council of Ministers of the Republic of Cyprus gives the green light and on 25 November 2022, the House of Representatives ratifies the Convention and the Protocol, a significant act for the Cyprus aviation industry.

On 20 July 2023, the instruments of accession of Cyprus to the CTC are finally deposited with Unidroit paving the way to their entry into force on 1 November 2023.

## 2. Overview of the main CTC Provisions

In brief, the CTC provide for the recognition of certain rights and interests in specific aviation assets, a system for perfection and priority of such interests by way of electronic registration and a standardised set of rights and remedies on a debtor default.



An international interest will be created by most key agreements typically seen in aircraft financings in Cyprus i.e. mortgages and lease agreements.

### 2.1. What kind of aircraft assets are covered by the CTC?

The CTC cover *Aircraft Objects* which are defined as airframes, helicopters and aircraft

engines that meet certain specified size requirements.

It is interesting to note the inclusion of aircraft engines as an object for which rights may be registered separately, which has not previously been possible.

### 2.2. What rights are covered by the CTC and when does the CTC apply?

The Convention will apply to a transaction if (a) an *international interest* is created over an *aircraft object* and (b) if one of two connecting factors exists.

#### What is an international interest

An *international interest* under the CTC refers to interests in *aircraft objects* of a (a) lessor under a leasing agreement (b) chargor under a security agreement, (c) conditional seller under a *title reservation agreement* (i.e. conditional sale or hire purchase agreement).

It is therefore evident that an *international interest* will be created by most key agreements typically seen in aircraft financings in Cyprus i.e. mortgages and lease agreements.

#### Which are the connecting factors

There will be a connecting factor when, on execution of the relevant agreement creating or providing for the international interest, (a) the *debtor* (defined as the chargor under a security agreement, a conditional buyer under a title reservation agreement, a lessee under a leasing agreement or a person whose interest in an object is burdened by a *registrable non-consensual right or interest*) is situated in a Contracting State (hereinafter “**CS**”) or (b) the airframe or helicopter is registered in a CS in which CTC is in force. The fact that the *creditor* (namely the chargee under a security agreement, a conditional seller under a title reservation agreement or a lessor under a leasing agreement) may be situated in a non-contracting state does not affect the applicability of the CTC.

In accordance with Article 4 of the Convention, a *debtor* is situated for these purposes in the CS where (a) it is incorporated, or where it has (b) its registered office or statutory seat, or (c) centre of administration or (d) place of business.



### 2.3. What is the International Registry and what is its purpose

One of the most significant features of the CTC is the establishment of the *International Registry*, a centralised electronic register and database which provides for the electronic registration, and the protection of, inter alia, *international interests* which are recognised by all ratifying states, with priority being determined on a “first-to-file” basis.

In addition to *international interests*, the CTC enable the registration of *prospective international interests* (i.e. interests intended to be created or provided for in an aircraft object in the future), *registrable non-consensual rights or interests* (referred to in 3.4 below), *assignments of international interests* (i.e. contracts which, whether by way of security or otherwise, confer on the assignee associated rights with or without a transfer of the related international interest) and *prospective assignments of international interests* as well as contracts of sale of an airframe pertaining to an aircraft or a helicopter registered in an aircraft register of a CS.

Although the International Registry is a notification system only and registration of an *international interest* is no guarantee of its validity, it creates a framework for the international recognition of the above interests with the said interests being recognised and enforceable across all CS since accession to the Convention obliges them to recognise the effectiveness of registrations made through the International Registry.

The registration of ownership, security, and other rights in aircraft items that fall under the scope of the CTC and the ensuing priority received over later registered interests and unregistered interests represents a significant departure from the approach adopted previously in Cyprus. According to the Civil Aviation Laws No. 213(I)/2002 the registration of the lessor’s interest in the Registry and notation of a chargee’s interest does not accord any priority in line with the date of registration. Priority is mainly decided in accordance with the general principles of common law and equity that are applicable in Cyprus.

#### Priority rules

Subject to the exceptions mentioned below, once an *international interest* has been registered with the International Registry, it has priority over a subsequently registered *international interest* and over an unregistered interest, provided the conditions have been met for the creation of an international interest.

The principal exception to the Convention registration priority system and the general rule of ‘first to register wins’ as regards Cyprus relates to the fact that the Cypriot government has opted-in Article 39 whereby certain preferred national law rights have priority over registered interests, even though they are not registered. It is also possible for the priority rule to be varied by agreement among the transaction parties (as in the case where a party to an interest agrees to subordinate its interest to an interest registered later in time).

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The principal exception to the general rule of “first to register wins” relates to the opting-in of Article 39 whereby certain preferred national law rights have priority over the registered interests

#### Search engine

In addition to the higher priority status and greater legal protection afforded to the *creditor* (in the event of default or insolvency of the debtor), the International Registry provides a publicly accessible platform and an efficient means for aircraft financiers, lessors and other interested parties to conduct searches in order to obtain information about registered interests in specific aircraft object, to ascertain whether an asset is encumbered by any existing interests and check the status of their interest.

This is a great advantage to a potential purchaser or financier of an aircraft registered in Cyprus as there is no single register in Cyprus where he could verify that the aircraft is free of encumbrances. An electronic search could be carried out in Register of Charges kept at the Companies' Registry against a Cypriot chargor (which, however, is not the usual scenario). Furthermore, a search could be conducted at the Cypriot Aircraft Register to check whether any mortgage or other rights over the aircraft were entered in the said Register. Nonetheless (in view of the nature of the notation system thereof), not many mortgagees register their interest in the Aircraft Register.

#### 2.4. Remedies

It has been correctly stated that any international law treaty is as good as its remedies and there is no doubt that the CTC has succeeded in this field. It has brought tremendous innovation in the remedies available and the method for exercise of the same and the extent of remedies available

is extremely practical and well thought of. Moreover, a time-bound approach as well as the distinction drawn between rules governing the remedies of chargees, who need better protection, and those applicable to conditional sellers or lessors, who have superior rights, gives the provisions their real strength.

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It has been correctly stated that any international law treaty is as good as its remedies and there is no doubt that the CTC has succeeded in this field.

Default remedies for chargees are elaborated

under Article 8 of the Convention which provides three remedies to a chargee under a security agreement that are consistent with those typically available under traditional financing documents. These are (a) taking possession or control of the aircraft object charged, (b) selling or granting a lease of such object and (c) collecting or receiving any income or profits arising from the

management or use of any such object.

Article 10 of the Convention provides for two default remedies of conditional sellers or lessors (which are not as detailed as that of a chargee), namely (a) the termination of the relevant agreement and (b) possession or control of the object to which the agreement relates.

The Aircraft Protocol modifies the Convention to meet the particular requirements of aircraft financing and leasing by allowing a creditor to remove the aircraft from the debtor's control and place it in the control of the creditor. Article IX offers *creditors* two additional remedies namely to procure (a) the de-registration and (b) export and physical transfer of the aircraft from the territory in which it is situated.

In connection with the exercise of remedies relating to the de-registration and/ or export, Article IX(5) of the Protocol enables the creditor to obtain the cooperation of the applicable aviation registry and other administrative authorities of the place of registration of the aircraft and, in the case of export, the place where the aircraft is located. The registry authority must honour a request for de-registration and export if the request is properly submitted by the authorised party under a recorded IDERA (for which please see below in 3.10).

It should be noted, however, that these remedies are only available to the extent agreed by the debtor (which agreement can be given any time) and provided the prior written consent of the holder of any registered interest ranking in priority to that of the creditor is obtained.

### 3. What declarations has the Cyprus Government made?

A principal objective of the CTC is to balance the need for an internationally recognised and effective regime with the autonomy of the CS, the protection of national interests and preservation of their legal traditions. As such, both the Convention and the Protocol contain a number of optional provisions (set out in the form of declarations) which CS can decide whether or not to adopt.

The declarations that have been made by Cyprus are listed below:



### 3.1. Declaration under Article 39.1(a)

Under Article 39(1)(a), the CTC allows CS to identify, generally or specifically, which categories of *non-consensual rights or interests* (hereinafter the “NCRIs”), which under local law have priority over the equivalent to an *international interest*, will be given priority over a *registered international interest* without registration of such NCRI under the International Registry priority system of the Convention.

Cyprus has declared that all categories of NCRIs under Cypriot law which have priority over a *registered international interest*, whether in or outside insolvency proceedings and whether registered before or after Cyprus accession of the CTC will also continue to have priority in the future.

NCRIs are defined as those rights or interests created under national law (not contractually or consensually) to secure the performance of an obligation. The said right or interest must have a meaning under local law that is equivalent to a registered *international interest*.

The Cyprus authorities will, therefore, need to determine, in accordance with Cypriot law, which are the interests or rights created under Cyprus law to secure the performance of an obligation which are equivalent to an interest of a chargee under a security agreement or the lessor under a lease agreement or a conditional seller under a title reservation agreement.

By way of guidance, the Aviation Working Group recommended two possible specific categories of non-registrable NCRIs namely (a) liens in favour of workers for unpaid wages arising since the time of a declared default under a contract to finance or lease the relevant object and (b) liens in favour of repairers of an aircraft object in their possession to the extent of service performed on and value added to that object.

In Cyprus, there is no general lien for repairs but the rest of the aircraft liens (except the contractual lien which does not meet the CTC requirements) that are recognised in Cyprus, namely possessory liens, seller’s lien or salvage liens could, potentially, qualify as non-registrable NCRIs.

### 3.2. Declaration under Article 39.1(b)

Under Article 39(1)(b), Cyprus declared that nothing in the Convention shall affect its rights or that of any state entity, any intergovernmental organisation or other private provider of public services to arrest or detain an object in accordance with the laws of the Republic of Cyprus for payment of amounts

owed to it or to any such state entity, organisation or provider directly relating to the services provided by it in respect of that object or another object.

By making the said declaration, Cyprus preserved its local law rights of arrest for nonpayment of charges for public

services related to an aircraft object without registering these rights in any registry. These include detention powers for non-payment of airport charges due to the aerodrome operator or international air navigation charges including those due to Eurocontrol, or dues under the Cypriot law implementing the EU-ETS Directive.

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By making a declaration under Article 39(1)(b), Cyprus preserved its local rights of arrest for non-payment of charges for public services related to an aircraft object without in any registry.

### 3.3. Declaration under Article 39(4)

Pursuant to Article 39(4), the Republic of Cyprus declared that all the categories of NCRIs covered by the declaration lodged pursuant Article 39(1)(a) of the Convention shall have priority over a security interest registered prior to the date of its deposit of its instrument of accession.

Priority is therefore to be given under the terms of Article 39(1)(a) over an international interest registered even prior the 20th July 2023.

### 3.4. Declaration under Article 40

Article 40 concerns *registrable NCRIs* (i.e. those NCRIs registrable pursuant to a declaration deposited thereunder) recognising a Contracting State's right to declare which categories of its NCRIs shall be capable of being registered as a *registered interest*, i.e. a treaty-based right effective and recognised in all other Contracting States.

In this declaration, Cyprus has specified that the following categories of NCRIs shall be registrable under the Convention as regards aircraft objects as if they were an international interest and shall be regulated accordingly:

(b) liens or other rights of the Cypriot Government relating to taxes or other unpaid charges of any type whatsoever (which is not covered by the declaration under Article 39(1)(a) of the Convention);

(c) liens or other rights of the Government of the Republic of Cyprus relating to taxes or other unpaid charges arising from or related to the use of an aircraft object and owed by the owner or operator of that aircraft object, and arising prior to the time of a declared default by that owner or operator under a contract to finance or lease that aircraft object;

(d) notifications of bankruptcy orders when the bankruptcy estate includes objects covered by the Convention in order to protect the rights of the bankruptcy estate and

(e) any other non-consensual right or interest which is not covered by the declaration under Article 39(1)(a).

The significance of this declaration is that it brings the NCRIs listed above within the Convention for priority purposes as if they were an international interest. They are, therefore, subject to the first in time registry priority rules to which all CS adhere and will have effect in actions and priority disputes in all CS. This is different than Article 39, which declares NCRIs that do not need registration, are not subject to the first in time priority rules and do not have effect in other CS.

### 3.5. Declaration under Article 53

Under Article 53, Cyprus has declared that the District Courts of the Republic of Cyprus will have primary jurisdiction over any CTC matter.

It is important to note, however, that this declaration was initially considered before the Admiralty Court was established. The said court has exclusive jurisdiction to decide at first instance any type of "admiralty case". This term has been defined to include claims concerning aircraft (in addition to vessels). Hence the declaration may need to be revised to take into account the creation of the new Admiralty Court.

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The significance of the declaration under Article 40 is that it brings the NCRIs set out therein within the Convention for priority purposes as if they were an international interest.

(a) rights of a person obtaining a court order permitting attachment of an aircraft object in partial or full satisfaction of a legal judgment;



### 3.6. Declaration under 54(2)

Article 54(2), one of the mandatory declarations for the CS under the CTC, requires a CS to decide about the availability and exercise of non-judicial remedies.

Cyprus has declared that all remedies available to a creditor under the CTC, which are not expressed under the relevant provision thereof to require application to the court, may be exercised without leave of the court.

In practice, this is extremely beneficial for financiers and lessors in Cyprus as they are able to exercise the remedies available to them without the permission of the court especially in view of the long delays faced in the judicial system of Cyprus.

It is evident that Cyprus prefers a creditor-protective approach by choosing to have a declaration that allows private enforcement. This is, of course, in line with the general approach taken by common law jurisdictions which are in favour of the availability of self-help remedies, unlike in CS with a basis or roots in civil law where non-judicial remedies are generally viewed with scepticism.

### 3.7. Declaration under Article XXX (1)

From a practical point of view and in terms of efficiency, one of the most important declarations is the one made by the Cyprus government under Article XXX(1) of the Protocol regarding the issue and use of the Irrevocable Deregistration and Export Request Authorisations (hereinafter "IDERA") and the applicability of the provisions of Article XIII of the Protocol thereon (hereinafter the "IDERA Route").

The self-remedy provided by the IDERA Route is a powerful tool for *creditors*. It enables them to take possession or control of the aircraft or aviation equipment and allows them to swiftly seek deregistration and export of the aircraft without either the need for judicial intervention or the registry authority having discretion in this regard. Both factors considerably expedite the process of enforcing their security interests and is particularly advantageous in situations where immediate action is necessary to protect the asset from potential harm or misuse.

The IDERA Route obliges registry authorities in CS to honour a request for de-registration and export submitted under a recorded IDERA if certain prerequisites are met including the recordation of the IDERA by the applicable authority, the discharge of all registered interests having priority over the interest of the IDERA holder and the giving of notice of the proposed de-registration and export to all interested persons specified the CTC.

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It is evident that Cyprus prefers a creditor-protective approach by choosing to have a declaration that allows private enforcement.

### 4. Final remarks

Article 169 of the Cypriot Constitution, provides that *"treaties, conventions... approved by law made by the House of Representatives... shall have ... superior force to any municipal law"*.

There is no doubt that having the CTC prevail over domestic laws in the event of conflict, will be to the benefit of financiers or lessors who are interested in financing or leasing aircraft to be registered in the Cyprus Aircraft Register. The CTC has indeed heralded a sea-change in the aircraft industry worldwide and its importance cannot be underestimated. Accession to the CTC will undoubtedly result in Cyprus being a favourable jurisdiction for aircraft leasing and financing.



# IRELAND

## KEY DEVELOPMENTS & THE LATEST TRENDS IN IRELAND – FROM A LEGAL PERSPECTIVE

# A&L GOODBODY



### BIO

Maria Mc Elhinney is a partner with the Aviation & Transport Finance group. Maria has extensive experience in a wide variety of international financing and corporate transactions, particularly involving aviation assets. Maria has advised many of the world's leading financial institutions, aircraft leasing organisations and private investors on transactions involving the financing, acquisition and securitisation of aviation assets.



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**A&L Goodbody**

# A&L GOODBODY



## BIO

Keith Mulhern is a partner in the Aviation & Transport Finance practice of A&L Goodbody. He has provided exceptional advice on a broad range of complex, innovative and award-winning transactions for important clients over several years. Keith graduated with a Master of Laws degree from the University of Cambridge and is known for having excellent legal and technical skills, a practical and commercial approach to transactions and a calm demeanour. He has acted for a wide range of aviation clients including leasing companies, airlines, banks, manufacturers, funds and credit support providers. He has extensive experience acting on a variety of aviation financing and leasing products and structures including operating leases, finance leases, sale and leasebacks, JOLCO structures, debt finance (bilateral, syndicated and warehouse facilities), capital markets issuances (secured ABS and unsecured perpetual bonds), pre-delivery payment financing, Islamic financing, joint ventures/side cars, export credit agency supported financing and AFIC/Balthazar supported financing.

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**A&L Goodbody**

# KEY DEVELOPMENTS & THE LATEST TRENDS IN IRELAND – FROM A LEGAL PERSPECTIVE

A&L Goodbody

## Introduction

As the global hub for aircraft leasing, Ireland enjoys a wide perspective on the trends and developments in the industry. During 2022, the aviation sector began its recovery from the unprecedented market collapse during the COVID-19 pandemic with air travel numbers increasing. This increase was driven largely by a strong rebound in international travel, attributable to pent-up demand for leisure travel following removal of COVID-19 restrictions combined with accumulated consumer savings following extended global lockdowns. Global passenger numbers rebounded in 2022 by more than 55% according to IATA

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The Irish aircraft lessor community continues to play a vital role in the recovery of the global aviation sector.

and the expectation in 2023 is for another year of strong growth boosted by the lifting of travel restrictions in China. However, the global aviation industry was called on once again in 2022 to demonstrate its remarkable resilience as new significant challenges emerged. Despite these additional setbacks including the ongoing

war in Ukraine which has affected the global economy and resulted in rising interest rates, inflation and fuel prices, the industry has regrouped and pushed towards a recovery.

The Irish aircraft lessor community continues to play a vital role in the recovery of the global aviation sector. In this article, we examine some of the key developments and latest trends in the aviation finance and leasing sector in Ireland, and how aircraft lessors will continue to navigate a post-pandemic industry.

## Market volatility and inflation

Following on from the challenges faced by the aviation sector in the period between 2020 and 2022, the industry is expected to return to profit this year. The latest forecast from IATA predicts a global profit of US\$4.6bn on revenues

of US\$779bn in 2023. This will be a significant achievement for the industry demonstrating its resilience following the impact of the pandemic. However, recovery continues to be fragmented. Recovery has been linked to the pace at which travel restrictions were eased with the Asia-Pacific market being slower to recover during 2022. There are also significant macro factors at play for airlines including inflationary pressures, the heightened interest rate environment and the rising price of oil.

One year on from the invasion by Russia of Ukraine the economy as a whole has been shaken and this has been seen particularly within the aviation sector in Ireland.

## Sanctions

Initially this was in the form of sanctions imposed by the EU prohibiting the leasing of assets into Russia and all insurance policies were cancelled. Those sanctions had a significant impact on the Irish aircraft lessor community with aircraft on lease to Russian airlines. Approximately 500 Irish owned aircraft operated by Russian airlines have been unlawfully appropriated by Russia. Over 200 of these aircraft have since been unlawfully re-registered in Russia following the decision by Bermuda and Ireland to suspend certificates of airworthiness for Bermudan and Irish registered aircraft currently in Russia. As a result of lessors' inability to recover their assets from Russia, a number of the affected lessors have initiated legal actions against their insurers. Payout has not occurred on the grounds that recovery of the aircraft may still be possible. This litigation action is expected to take years to resolve. For a number of Irish lessors this has had a long-lasting impact on their balance sheets resulting in asset write-downs together with increased costs as lessors continue their efforts to counteract such losses.

## Rising costs

Increased costs has also affected aviation lessors from a financing perspective with interest rates rising swiftly which have caused issues for the industry and the expectation is that these will continue. Rising rates have pushed up borrowing costs, purchasing costs and maintenance costs. The market is adapting and seeing an upward movement of lease rates but it will take some time for these to catch up with rising interest rates.

New aircraft deliveries have gained pace but airframe and engine manufacturer delays continue with deliveries in 2022 remaining well below pre COVID-19 levels. Global supply chain challenges are further hindering aircraft production rates with engines and other parts being short on supply. Many Irish lessors are predicting a shortage of aircraft in the short-term and these challenges are likely to increase demand for leased aircraft. Due to the shortage, lessors should have strong bargaining power when it comes to negotiating lease rates both for lease extensions and new leases.

Recent trends have seen an increase in trading activity in the secondary market with an uptick in asset values as a result of the rising inflationary environment. However asset sales are being constrained by a lack of capital driven by the effective closure of the ABS as a means of financing aircraft as well as rising interest rates affecting the cost of funding.

## Sources of finance

With a muted aviation ABS market in 2022 only a few closed, amounting to less than US\$1bn of volume, among them Carlyle Aviation and Airborne Capital. High interest rates and market volatility makes it a market for the brave although given the popularity of the ABS product many will be preparing behind the scenes and will be ready for its return.

Investment grade lessors have looked to the unsecured bond market notwithstanding the high interest rates and volatility. Aircraft lessors issued US\$3.373bn in unsecured capital markets debt in the first quarter of 2023 which exceeds the amount of any quarter in 2022, but remains relatively low in comparison to other years. These type of bond offers however are limited to only a number of Irish lessors with the majority looking for other means to avail of financing.

Export credit agencies and the Aircraft Non-Payment Insurance products offered by AFIC and Balthazar may step-up to provide financing to bridge the gap left by the traditional aviation banks and the closure of the ABS market. It is likely that we will see an increase in export credit lending to assist with financing requirements in the short to medium term.

Many lessors have also turned to the new entrant alternative lenders such as Volofin, Ashland Place, Pk Finance or Av Airfinance to meet financing requirements for their commitments.

These lenders are able to react quickly and be nimble which is appreciated by the industry. There has been a growing trend in new alternative lenders coming to the aviation space with LR AirFinance and AIP Capital being recent entrants. Alternative lenders are quickly building up a loyal customer base and their strategy has been welcomed by many lessors.

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New aircraft deliveries have gained pace but airframe and engine manufacturer delays continue with deliveries in 2022 remaining well below pre COVID-19 levels.

Traditional aviation bank lenders scaled up commitments during 2022 on the back of the recovery in the industry. The value of strong relationships will be realised as many will revert to existing financiers and agree refinancing and extensions where possible. For some the current cost of financing means that they will seek to delay financing as long as possible however other commentators would argue that if you need financing in the short to medium term then now is the best time as the market is unlikely to improve quickly. Those with strong trusted relationships with their lenders are engaging early to agree refinancing terms as soon as possible. However this reliance on the aviation banks may only be available for the top tier credits and those with pre-existing banking relationships.

From an airlines perspective, the sale-leaseback structure will be attractive for funding deliveries in the current volatile market. Using sale-leasebacks shores up liquidity for airlines and is a useful tool for hedging residual risk. Sale-leasebacks are also attractive options for new entrants to the leasing market as an alternative strategy to building scale alongside portfolio purchases.

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From an airlines perspective, the sale-leaseback structure will be attractive for funding deliveries in the current volatile market.

### Fragmentation and consolidation

Recent years have seen something of a correction to the previous trend of fragmentation through new entrants into the aircraft leasing market. This fragmentation often took the form of new investment from sources like private equity firms partnering

with experienced aircraft lessors or lessor-based talent in launching new aircraft leasing platforms, joint ventures or investment sidecars. There has recently been a number of high profile examples of consolidation among aircraft lessor led by those at the top of the market.

2021 saw a monumental market event in this sector with the US\$30bn merger of AerCap and GECAS, at the time the two largest aircraft lessors in the world. AerCap emerged from that transaction with a staggering portfolio of approximately 1,900 and a further 423 aircraft on order. The transaction signalled the beginning of a trend toward merger and acquisition activity in the sector and bidders with capital to deploy have seen opportunities in that environment. Many are seeking to achieve growth and scale which has a number of key advantages to an aircraft lessor in terms of strengthening its leverage when negotiating key transactions such as orders with manufacturers, financing terms or more generally their suppliers including maintenance providers. It can also facilitate the opening of new sources of funding for larger deals evidenced by the access of a number of larger and investment grade lessors to the unsecured bond markets. Access to diverse sources of funding can be a key differentiator in a leasing business strategy in a market that has seen significant volatility in the cost of debt through the pace of interest rate hikes in 2022. Others see these types of acquisitions as an opportunity to acquire key talent, attractive portfolios or order books which would not otherwise be available to it.

In December 2022, the US\$6.7bn acquisition by SMBC Aviation Capital of Goshawk brought SMBC's portfolio to 700 owned and managed aircraft with approximately 220 more on order. The transaction was initially financed using a US\$1.83bn term loan together with a US\$710m revolving credit facility which was later increased by US\$815m as a result of strong demand. Carlyle Aviation Partners, following its earlier purchase of FLY Leasing, completed the purchase of AMCK's aircraft portfolio of 125 aircraft valued at US\$4bn and a further 20 on order through its Maverick Aviation Partnership with funding through a US\$2.5bn bridge loan. Other examples include the acquisition by Chorus Aviation of Falko Regional Aircraft in May 2021 and more recently the acquisition by Aergo Capital of Seraph Aviation Management in November 2022 under which it assumed the management of 88 aviation assets spread across 38 lessees with a combined asset value of US\$2.5bn.

The trend towards consolidation is predicted to continue with reports at the beginning of 2023 that Standard Chartered is exploring options to sell both its aviation finance and leasing businesses. The proposed sale of a portfolio of 53 aircraft by ALAFCO to Macquarie Airfinance for approximately US\$2.2bn has also been reported since 2022.

In contrast, there are a number of examples of new investment and platforms launching in the current market. The GECAS/AerCap transaction indirectly paved the way for the founding of High Ridge Aviation and LR AirFinance by a number of high profile ex-GECAS officers led by Greg Conlon (the former GECAS CEO) partnering with PIMCO to offer a mix of traditional operating/finance leasing and debt solutions to customers, with a recognised focus on managing (rather than owning) assets on behalf of institutional investors with access to diverse sources of funding. Another example is the Kingdom of Saudi Arabia's high profile investment in aviation through its Public Investment Fund – with a planned commitment of US\$100bn to aviation through the launch of a new airline and the founding of new leasing platform, AviLease with Ted O'Byrne as CEO.

Investment into the aircraft leasing industry is driven by performance of the industry itself and by the performance of aircraft as an asset class relative to other assets classes. The aviation industry may be under pressure from a number of factors, but it remains a solid investment and competitive with other assets classes in uncertain times and the availability of highly experienced and talented senior aviation executives in Ireland continues to help new entrants hit the ground running with new platforms.

### Green aviation

Green aviation and environmental, social and governance (ESG) factors are coming increasingly back into focus. Analysts predict the airline industry will return to profit in 2023 after a period of crisis following the pandemic. These considerations are no longer in the background for credit committees. The industry has committed to "net zero" carbon emissions by 2050 - a radical step in the context of current technological capabilities - which challenges the major aircraft manufacturers to deliver fundamental technological change in the coming decades.

Some interesting interim approaches are being taken to help decarbonise air travel while wider efforts to design and develop new technologies and upscale the development of sustainable aviation fuel and its commercial viability remain in the early phases. The decline in the availability of finance from traditional sources like commercial banks, coupled with rapid interest rate hikes in 2022, volatility in fuel prices and the backlog of fixed rate leases, necessitate more innovative methods of securing debt. This combination of market conditions has the potential to lead to further sustainability-linked financing the aviation sector. Different sectors are seeing financial institutions offer green financing products in light of regulatory and public pressure to consider ESG issues in their investments.

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Investment into the aircraft leasing industry is driven by performance of the industry itself and by the performance of aircraft as an asset class relative to other assets classes.

Green Bonds and Green Loans require that funds are used for projects with a positive environmental impact whereas sustainability-linked financing allow the borrower much greater flexibility as to how loan proceeds are used; the borrower's overall corporate performance is assessed against ESG targets. The extent to which the borrower meets its sustainability targets determines the loan's pricing, an attractive opportunity for aircraft lessors and airlines focused on carbon reduction while also providing financiers an opportunity to meet their own ESG objectives. This type of product has been seen more frequently in airline financing transaction and 2022 saw the first sustainability-linked aircraft-secured loan provided to an airline by Air-France-KLM and SocGen. In addition, Rockton, a Swedish regional-focused boutique aircraft asset manager launched the industry's first sustainable aviation fund.

Carbon credit programmes are also being developed as another strategy to facilitate carbon reduction. SMBC Aviation Capital is leading the way on the lessor side of the market, having invested in

a project in Burkina Faso to provide energy efficient cookstoves to 28,000 families and forward purchased carbon credits from a range of cookstove projects in Africa, Asia and Central America. In March 2023, Southwest Airlines agreed to purchase over 400,000 carbon credits from SMBC to support its operations and meet CORSIA requirements.

Under the programme,

carbon credits can be acquired from SMBC by airlines with as part of a lease contract or independently.

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The industry continues to attract new investment while demand for scale, talent and attractive portfolios is driving consolidation at the other end of the market.

## Conclusion

The industry continues to attract new investment while demand for scale, talent and attractive portfolios is driving consolidation at the other end of the market. New structures and new business modelling are likely to follow as financiers, airlines and lessors adjust to the challenges faced in inflationary pressures, market volatility, geopolitical developments and the increasing focus on decarbonisation. Innovation, experience and agility are key to navigating this market and the industry is well placed to respond having demonstrated incredible resilience in recent years. One guarantee is that Ireland will remain a reliable and trusted jurisdiction that will continue to support the industry in its future success.

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Maria McElhinney, Keith Mulhern, Marie O'Brien, Séamus Ó Cróinín.



# IRELAND

Global leader in aircraft leasing housing approximately 70% of the top 20 leasing firms.

## KPMG IN IRELAND



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Joe is a tax partner and is the Head of Aviation Finance in KPMG who advises a broad range of clients on both domestic and international tax matters. He has extensive experience in tax structuring, international tax planning, complex financing transactions and cross-border acquisitions. He has regularly led multi-country teams in delivering tax advice to his clients on large scale projects. Joe has experience in advising companies in the aviation financing, leasing, insurance and banking sectors. Joe has spoken at numerous international conferences on tax issues impacting the aviation and insurance sectors.



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# KPMG IN IRELAND



## BIO

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# Ireland is the global leader in aircraft leasing housing approximately 70% of the top 20 leasing firms.



Ireland is a major centre for aircraft leasing, with approximately 50 percent of the world's leased commercial aircraft managed in Ireland and 70% of the top 20 leasing firms operating in the country. This article delves into why Ireland is preferred for leasing and the opportunities that lie ahead.

## Ireland's success in leasing

Though Ireland's success in leasing can be attributed to several factors, the major ones are:

- favourable tax policies focussed on leasing
- access to EU capital markets
- a strong services industry focussed on the leasing sector
- a skilled workforce and English-speaking country
- a business-friendly regulatory environment
- a strong infrastructure supporting the aviation industry
- geographic proximity to either side of the world.

1. **Favourable Tax Policies** – There are two key policies that underpin Ireland's growth in the aviation sector:

- a. **Double tax treaties:** Ireland has a wide network of double tax treaties with countries worldwide. As of May 2023, Ireland has signed double tax treaties with over 76 countries (74 of which are in effect), including many of the world's largest economies. These treaties generally follow the model tax convention developed by the Organisation for Economic Co-operation and Development ("OECD") and provide for reduced tax rates or exemptions for

residents of the treaty partner countries. The treaties also include provisions for the exchange of information between tax authorities to prevent tax evasion.

- b. **Low tax rate:** In particular, from 1 January 2003, the Irish government reduced its general level of corporate tax from 32% to just 12.5%, which has helped to attract a large number of leasing companies to the country. This tax rate is significantly lower than in many other countries, making Ireland an attractive destination for airlines looking to minimise their tax burden. However, the benefit of a lower tax rate extends to a range of industries beyond aircraft leasing firms, thus encouraging many to set-up offices in Ireland. Now, with a range of industries to cater to, a natural opportunity exists for financial firms to fund such ventures within Ireland, leading to a well-developed financial industry giving access to global capital.

It's a combination of these two ingredients, double tax treaties and lower tax rates, that is encouraging Sale and Leaseback ("SLB") transactions in Ireland. SLB is a financial transaction in which an airline or other aircraft operator sells one or more of its aircraft to a third-party leasing company, and then immediately leases the same aircraft back from the leasing company, thus allowing it to free up capital while retaining the use of the aircraft for its operation. Ireland promotes tax-efficient planning of SLB transactions by encouraging airlines companies to:

- Form an Irish leasing company of substance: By setting up an Irish leasing company of substance in Ireland, airlines can benefit from the lower tax rates in these countries, helping them reduce the overall tax burden of the transaction. However, these entities are required to have employees and business offerings in Ireland.
- Structure a lease as an operating lease: Operating leases are generally considered more tax-efficient than finance leases, as the lease payments are treated as operating expenses for tax purposes.

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Ireland has signed double tax treaties with over 76 countries (74 of which are in effect), including many of the world's largest economies

- Optimise your tax structuring: Ireland offers tax incentives for leasing companies, such as accelerated depreciation. By working with a leasing company that qualifies for these incentives, the airline can benefit from lower lease payments and improved tax planning.

**2. Access to EU Capital Markets** – On the demand side, airline companies are looking to benefit from a favourable tax regime in Ireland. However, on the supply side, leasing companies are able to access capital from European Union (EU) capital markets to fund such transactions. Being a member of the European single market, Ireland can leverage the free movement of goods, services, capital, and people within the EU, facilitating cross-border investment and business activity.

Moreover, many financial institutions such as international banks and investment firms have set-up their base in Ireland for European operations due to Ireland's favourable business and tax policies making it easier for lessors to access services from such institutions. Membership of the EU also grants Ireland a certain degree of political stability, thus giving leasing companies a sense of protection and security on the assets they hold.

**3. A strong services industry focussed on the leasing sector** – Apart from core leasing, there are a basket of services that Ireland offers to support the aircraft leasing sector, a few of them being accounting, tax advisory, and technology. These additional services give leasing companies the optionality to conduct business in Ireland from an end-to end perspective as well as scale up quickly. E.g., a growing leasing firm could conveniently migrate from the use of Excel to an Enterprise Performance Management ("EPM") tool to better manage their finance or contract management function as there are multiple firms within Ireland offering such services. Right from setting up an entity, managing the affairs of business, to winding up - all such services are available to the leasing sector.

**4. A skilled workforce and English-speaking country** – A vital factor supporting any nation to thrive in a specific industry is the availability of a skilled workforce pertaining to that industry. Ireland has a well-developed education system, which has helped to produce a large pool of educated workers with expertise in general finance, law, and transfer pricing. Further, many Irish universities offer specialised courses in aviation finance, aircraft leasing and related subjects, helping Ireland develop a workforce well-equipped for the industry. These courses are often bundled with a series of guest speakers so that students get a first-hand perspectives from industry leaders.

In addition, Ireland is an English-speaking country making it an attractive location for foreign companies looking to set up operations in a country where they can communicate easily with the local workforce and customers. It's also an incentive for talent to move to Ireland as they don't need to learn a new language for communication.

Coupling this advantage with friendly immigration laws incentivise candidates to relocate.. Many companies sponsor visas under the 'critical skill permit' route, allowing candidates to get a two year work visa for Ireland.

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Apart from core leasing, there are a basket of services that Ireland offers to support the aircraft leasing sector, a few of them being accounting, tax advisory, and technology implementation.

5. **A business-friendly regulatory environment** – Ireland’s well developed regulatory environment offers the following advantages:

- a. **Easy Company Formation:** It is relatively straightforward to set up a company in Ireland, with most of the processes being done online. The Irish government also provides support to start-ups and small businesses.
- b. **Flexible Employment Laws:** Ireland’s flexible employment laws are designed to promote job creation and support businesses. This includes a range of employment incentives such as tax credits for hiring new employees and reduced social insurance contributions for certain categories of workers.
- c. **Support for Innovation and Programmes:**

Ireland has a strong culture of innovation and supports research and development through tax incentives, grants, and other programmes. For example, the Irish government offers a tax credit for companies engaged in R&D activities. In addition, the government promotes entrepreneurship and supports business growth through programs such as Enterprise Ireland and the Industrial Development Agency (“IDA”) Ireland.

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There are various institutes set-up in Ireland to support the aviation industry not only through a commercial lens but also through a sustainability one.

6. **Infrastructure supporting the aviation industry** –

Ireland has a set-up multiple authorities and institutes to support the sector for various purposes. The main authority from a regulatory purpose is the The Irish Aviation Authority (“IAA”). The IAA, with a strong reputation for professionalism and responsiveness, is the national aviation authority responsible for the regulation of Irish aviation. Additionally, the government has established the Irish Aviation Research Institute (“IARI”), the Shannon Aviation Cluster, the International Aviation Services Centre (“IASC”), and Aircraft leasing Ireland (“ALI”). ALI represents the aircraft leasing industry in Ireland and is dedicated to the continued development and success of Ireland’s aircraft leasing industry.

All these institutes are set up to support the aviation industry not only through a commercial lens but also through a sustainability one, especially in areas of sustainable aviation fuels, zero-carbon propulsion systems, and noise mapping. Additionally, there are generous donations from leading Irish Universities to support such innovation allowing both the industry and students to benefit.

7. **Geographic proximity to either side of the world** –

Being strategically located and with modern airport infrastructure connecting Ireland to most global cities, Ireland has been a preferred choice by all three business regions – Americas, EMEA and APAC. The country has several modern, state-of-the-art airports that are well-connected to the rest of the world making it possible to reach major cities like New York and London with direct flights. Amongst the airports in Ireland, the Dublin Airport is one of the busiest airports in Europe, and it serves as a major hub for transatlantic flights. Additionally, Shannon Airport and Cork Airport are also important hubs for the aviation industry as a few leasing companies and aviation services providers located in these regions. Further, the Irish government continues to invest heavily in the development of the country’s transport infrastructure, encouraging international companies to begin operations in the country.

## Opportunities Ahead

It's clear that Ireland remains a global hotspot for aviation finance, with its favourable tax policies, EU market access, skilled workforce, professional services and infrastructure combining to make it a global leader in the aircraft leasing sector. However, with growth in passenger demand continuing unabated and new technologies emerging combined with an increased global focus on sustainability that challenges all industries, the pace of change for the aviation industry is moving faster than it has in a long time. So what new opportunities lie ahead for Irish-based aircraft leasing?

### 1. Leasing next gen aircraft and Future of Flight vehicles:

The demand for commercial aircraft is expected to continue to grow, particularly in emerging markets. As a result, there will be a need for more aircraft leasing companies to provide airlines with access to modern, fuel-efficient aircraft. Ireland's expertise in aircraft leasing and its favourable tax regime make it an attractive location for companies looking to establish a presence in the industry. Further, with momentum picking up globally on Urban Air Mobility, conventional leasing firms have begun investing in the future of flight vehicles such as eVTOLs (electric vertical take-off and landing), STOLs (short take-off and landing), and drones. Though the leasing business model is yet to mature, Ireland is poised to lead this space as well.

**2. De-carbonization of the aviation industry:** The aviation industry is facing increased pressure to reduce its carbon footprint to become more sustainable. Hence, airline companies need to think of pragmatic ways to constantly upgrade their old fleet with modern, fuel efficient ones. Opting for aircrafts on lease rather than buying them give airline companies the flexibility to continuously upgrade their fleet.

Ireland too has a strong commitment towards sustainability and to support airline companies in this transition. Therefore, Irish leasing companies would also be required to upgrade their fleet to cater to the increasing demand for modern aircraft.

### 3. Implementation of financial systems for better deal

**evaluation:** With the aviation industry recovering at a pace faster than anticipated, there is a need to implement smarter ways to evaluate deals. Conventionally, Excel was the preferred tool to build financial models to evaluate deals, however, as the number of deals in the market continue to rise, Excel may prove to be a cumbersome tool to compare deals. We believe migrating from Excel to a financial system is the way forward, this would enable leasing firms to compare the effect of each deal on their financial statements to take better business decisions.

## Going forward

Ireland remains a global leader in aircraft leasing, with its favourable policies and economic and political stability attracting over two-thirds of top global firms to date. This growth has continued even during an unprecedented period of hardship over the last few years for the industry globally.

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The demand for commercial aircraft is expected to continue to grow, particularly in emerging markets.

Although aviation's post-pandemic recovery is well on the way, with momentum increasing on technology and sustainability development, it's important that all stakeholders continue to evolve, even while in an already strong position.

There is ample opportunity for Ireland to maintain its position as an aviation leader, building on its strong reputation for technological development and innovation to help build the industry of tomorrow, essential in meeting the needs of growing consumer demand, pressure to decarbonise and taking advantage of new technology opportunities.

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# Japan

## Key Developments & the Latest Trends in Japan from a Legal Perspective

### MORI HAMADA & MATSUMOTO



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MORI HAMADA & MATSUMOTO

# Key Developments & the Latest Trends in Japan from a Legal Perspective

MORI HAMADA & MATSUMOTO

## Introduction

Although the Japanese aviation industry, including airlines and the aviation finance industry, was significantly harmed by the COVID-19 pandemic, fortunately no airline in Japan has gone bankrupt due to the pandemic, and the industry is now recovering thanks to the rapid recovery of passenger demand as well as the general global trend of recovery. The recovery trend in Japan is expected to continue, but there are some challenges such as the rising price of oil. From the legal perspective, there have not been any remarkable updates or developments in aviation finance and leasing in recent years.

## Legal Framework for Aviation Finance & Leasing

Aviation Finance & Leasing Regulatory Framework In Japan, there is no single, comprehensive piece of legislation regulating aviation finance and leasing.

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Under the Civil Aeronautics Act, MLIT registers an aircraft in the Aircraft Register (Koukuuki Tourokugenbo) by application of an owner of the aircraft (Article 3, Article 5)

The following two laws (including the orders and regulations thereunder) are relevant to aviation finance and leasing on top of Japanese Civil Code and the Commercial Code. Please note that citations to relevant articles and provisions of the laws below refer to the law in each respective section

title unless noted otherwise.

### A) The Civil Aeronautics Act (*Koukuu Hou*)

The Civil Aeronautics Act governs civil aeronautics activities in Japan based on the Convention on International Civil Aviation (the Chicago Convention) and its Annexes. For treaties related to aviation finance and leasing, in addition to the Chicago Convention, Japan has ratified the Convention for the Unification of Certain Rules for International Carriage by Air (the Montreal Convention). On the other hand, Japan has not ratified the Convention on Damage Caused by Foreign Aircraft

to Third Parties on the Surface (the Rome Convention), the Convention on the International Recognition of Rights in Aircraft (the Geneva Convention), and the Convention on International Interest in Mobile Equipment (the Cape Town Convention) and the Protocol to the Convention on International Interest in Mobile Equipment on Matters Specific to Aircraft Equipment.

Under the Civil Aeronautics Act, the Ministry of Land, Infrastructure, Transport and Tourism (“MLIT”) is the principal regulator of aviation matters. In addition, the act defines “aircraft” as any aeroplane, rotorcraft, glider and airship that can be used for air navigation with a person on board and any other apparatus used for air navigation as may be specified by a cabinet order related to the act.

Aircraft in the context of aviation finance and leasing would fall under “aeroplane” (*hikouki*) in the definition above.

Under the Civil Aeronautics Act, MLIT registers an aircraft in the Aircraft Register (*Koukuuki Tourokugenbo*) by application of an owner of the aircraft (Article 3, Article 5). This Aircraft Register is a registry of owners of aircraft. As it currently stands, there is no registration system for engines of aircraft, lease interests in aircraft and lease agreements over aircraft in Japan, and lessees of leased aircraft cannot be registered in the Aircraft Register. By completing registration in the Aircraft Register, the registered aircraft acquires a Japanese nationality. In principle, any aircraft which does not have this registration cannot be operated in Japan with exceptions for foreign-registered aircraft (Chapter 8). Under this law, any registration in the Aircraft Register cannot be made regarding any aircraft owned by (i) any person who does not have a Japanese nationality, (ii) any foreign state or public entity or its equivalent in any foreign state, (iii) any juridical person or body established in accordance with the laws and regulations of any foreign state, or (iv) any juridical person of which the

representative is any one of those listed in the preceding three items or of which one-third or more of the officers are those persons or one-third or more of voting rights are held by those persons (Article 4, Paragraph 1). In the context of aviation finance and leasing, in order for a foreign owner to lease aircraft that are or will be registered in the Aircraft Register to a Japanese airline, in practice, the owner nominates an SPC that does not fall under any of the requirements above to own the registered aircraft.

Under the laws of Japan, any transfers of aircraft ownership take effect upon execution of an agreement between the seller and the purchaser, and no formalities are required, but the new owner of the registered aircraft is required to apply for a transfer of registration within a period not exceeding 15 days (Article 7-2). However, the act stipulates that no acquisition or loss or change of ownership of any registered aircraft (more precisely, limited to aeroplanes and rotorcraft) may be duly asserted against a third party unless the aircraft has been registered. That is, registration in the Aircraft Register also functions as a means of perfect ownership. However, it should be noted that if the registration is false and there is a true owner who is not registered in the Aircraft Register, the buyer cannot acquire ownership of the aircraft. In this sense, the Aircraft Register acts as a crucial piece of evidence to prove ownership, but it does not per se protect a person who relies on a false registration.

#### B) The Aircraft Mortgage Act (*Koukuuki Teitou Hou*)

The Aircraft Mortgage Act clearly stipulates that aircraft can be the subject matter of a mortgage (*teitouken*; Article 3) though the act explicitly provides that the registered aircraft cannot be the subject matter of a pledge (*shichiken*; Article 23). The types of mortgages when it comes to aircraft include revolving mortgages (*neteitouken*), which secure unspecified claims of a certain scope, up to the limit of a maximum amount on top of ordinary mortgages as well as ones stipulated in the Civil Code. The Aircraft Mortgage Act does not stipulate a mortgage over engines or other spare parts of aircraft, but those parts may be subject to

security assignments (*jototanpo*; note that pledges are practically not used for those parts since the Civil Code stipulates that a pledgee may not allow a pledgor to possess the thing pledged on behalf of the pledgee (Article 345 of the Civil Code)).

Although creation of aircraft mortgages takes effect without any registration, a registration of an aircraft mortgage in the Aircraft Register in which ownership of the aircraft is registered is necessary for its perfection against any third party (Article 5 of the Aircraft Mortgage Act). To register an aircraft mortgage, the mortgagee and the mortgagor must jointly apply for registration and submit a document verifying the existence of the mortgage, such as the mortgage agreement, and other necessary documents. The aircraft mortgage registration tax is JPY 0.003 multiplied by the loan amount or the maximum secured amount. Since the amount of tax tends to be high, it is customary to make a provisional registration (*karitouroku*) for the mortgage and pay only JPY 2,000 as a registration tax per aircraft.

In addition, for the priority of aircraft mortgages, the Aircraft Mortgage Act stipulates that an aircraft mortgage has the same priority as a first-rank lien (*sakidoritokken*; Article 11). First-rank liens include liens for leases of immovables, lodging at hotels and transportation (Article 330, Paragraph 1, item 1 of the Civil Code).

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Under the laws of Japan, any transfers of aircraft ownership take effect upon execution of an agreement between the seller and the purchaser.

## Repossession and Enforcement of Security

### A) Repossession Procedures

Under the laws of Japan, in principle, self-help is illegal. Thus, even if a lessee does not voluntarily return leased aircraft to a lessor after the termination of a lease agreement, if the lessor repossesses the aircraft from the lessor by itself, the repossession can be judged as

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Under the laws of Japan, in principle, self-help is illegal.

a tort (Article 709 of the Civil Code). Thus, in the case above, the lessor needs to file a petition for compulsory execution and, if necessary, an execution of provisional seizure of the aircraft to a competent district court in order to retrieve the aircraft from the lessee. More specifically, under the Civil Aeronautics Act, the compulsory

execution and the execution of provisional seizure of a registered aircraft are governed by rules issued by the Supreme Court (Article 8–4, Paragraph 2 of the Civil Aeronautics Act), and the Civil Execution Rules (*Minji Shikkou Kisoku*) and the Civil Provisional Remedies Rules (*Minji Hozen Kisoku*) apply to the compulsory execution and execution of provisional seizure of the registered aircraft (Article 84 of the Civil Execution Rules and Article 34 of the Civil Provisional Remedies Rules).

If the court decides to commence the procedures for compulsory execution, it must order a public auction of the aircraft, obtain the documents which are necessary to fly the aircraft, including verification of the aircraft's nationality, and prohibit the aircraft's departure (Article 84 of the Civil Execution Rules and Article 114 of the Civil Execution Act). In addition, the execution of a provisional seizure is carried out by (i) making an entry of the provisional seizure in the register, or

(ii) obtaining the documentation necessary to fly the aircraft, including the verification of the aircraft's nationality (Article 34 of the Civil Provisional Remedies Rules and Article 48 of the Civil Provisional Remedies Act). Since aircraft without any registration certification cannot be used for aviation under the laws of Japan, aircraft subject to the court's orders will be detained through the procedures for compulsory execution and execution of provisional seizure. On top of that, if it is likely that a compulsory execution will become significantly unfeasible unless the aircraft is in detention, the lessor may file a petition with the district court with jurisdiction over the aircraft's home base (*teichijyo*) before commencing the compulsory execution procedures to request that the court order for the delivery of the registration certification. Furthermore, if there are pressing circumstances, the lessor may file the petition with the district court with jurisdiction over where the aircraft is located (Article 84 of the Civil Execution Rules and Article 115 of the Civil Execution Act). Even if the certification of registration is delivered, the possession of the aircraft is not deemed delivered to the lessor or the court. The lessor may file a petition to appoint a custodian to maintain the aircraft until the compulsory execution starts (Article 84 of the Civil Execution Rules and Article 116 of the Civil Execution Act).

For the compulsory execution, it shall be carried out based on “title of obligation” (Saimumeigi), which includes, among others, (i) a final and binding judgment, (ii) a judgment of a foreign court for which an execution judgment has become final and binding and (iii) an arbitral award for which an execution order has become final and binding (Article 22 of the Civil Execution Act). For (ii), in order to obtain an execution order from a court, it must satisfy the following requirements (Article 118 of the Code of Civil Procedure):

- (a) the jurisdiction of the foreign court is recognised pursuant to laws and regulations, conventions, or treaties;
- (b) the defeated defendant has been served (excluding service by publication or any other service similar thereto) with the requisite summons or order for the commencement of litigation, or has appeared without being so served;
- (c) the content of the judgment and the litigation proceedings are not contrary to public policy in Japan; and
- (d) there is a guarantee of reciprocity in the country of the foreign court.

In terms of (iii) above, Japan has ratified the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention). The Arbitration Act stipulates that an arbitral award (irrespective of whether or not the place of arbitration is in Japan) shall have the same effect as a final and binding judgment; provided, however, that a civil execution based on said arbitral award requires an execution order (*Shikkoukettei*; Article 45, Paragraph 1 of the Arbitration Act). However, this provision is not applied in some exceptional cases such as if the petition filed in the arbitration procedure is concerned with a dispute that may not be subject to an arbitration agreement pursuant to provisions of the laws and regulations of Japan or the content of the arbitral award is contrary to public policy in Japan.

## B) Procedures for Enforcement of Security

As mentioned above, under the laws of Japan, in principle, self-help is not permitted. Thus, even if an owner of an aircraft declines to cooperate with a mortgagee to conduct a voluntary sale other than a disposal agreed under a security agreement between the mortgagee and the owner, the mortgagee needs to file a petition for compulsory execution to a competent court. The compulsory execution is the same as the one for repossession mentioned above (Article 175 of the Civil Execution Rules).

### Choice of Law

The Act on General Rules for Application of Laws stipulates that (i) a real right to movables or immovables and any other right requiring registration are governed by the law of the place where the subject property of the right is situated and (ii) acquisition or loss of the right is governed by the law of the place where the subject property of the right is situated at the time when the facts constituting the cause of the acquisition or loss were completed regardless of (i) (Article 13 of the Act on General Rules for Application of Laws). Although it is not expressly provided for in the act, the law of the registration is usually considered as the governing law of real rights regarding aircraft.

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Japan has ratified the Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

## Taxation

If a business provider transfers or lends any property or provides services to a third party for consideration within Japan, a consumption tax will be levied on the transaction (the current rate is 10%). However, if the transaction is considered an export under the Consumption Tax Law and the business provider has an export permit, the transaction may be exempt from

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When an aircraft is registered in the Aviation Register, a registration tax is imposed.

consumption tax. In the case of an aircraft that delivers passengers or cargo outside Japan, the transfer of the aircraft may be exempted if certain requirements under the Consumption Tax Law are satisfied.

Furthermore, the Stamp Tax Law requires that stamps be affixed to certain documents, including an agreement to sell and

purchase an aircraft. The amount of the stamp depends on the purchase price. For example, if the price is more than JPY 100,000,000 but not more than JPY 500,000,000, the stamp amount is JPY 100,000; and if the price is more than JPY 5,000,000,000, the stamp amount is JPY 600,000.

In addition to the above, annual property tax is imposed on the owner of an aircraft. On top of that, withholding tax may be imposed on rent paid by a Japanese lessee to a foreign lessor.

Furthermore, as mentioned above, when an aircraft is registered in the Aviation Register, a registration tax is imposed.

## Exchange Control

Under the Foreign Exchange and Foreign Trade Act, except in the event of certain exceptional cases such as payment to a person subject to economic sanctions, payments in relation to aviation financing and leasing are not subject to any approval requirements. However, it should be noted that a post-closing report on certain payments or receipt of payment is required if the payment amount is equal to or greater than JPY 30,000,000.

# MEXICO

Key developments & the latest trends in Mexico – from a legal perspective  
International Air Finance and leasing review

## ABOGADOS SIERRA



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Attorney at Law. Mr. Miguel Ruelas Rosas of Mexican nationality obtained his law degree at Instituto Tecnológico Autónomo de México (ITAM). Miguel has participated in the legal structuring and counseling of cross-border transactions, financing and leasing of aircraft and mobile assets in Mexico. Mr. Ruelas Rosas is on a full-time secondment to the Aviation Working Group, assisting the secretariat on all AWG projects.

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LANGUAGES: Spanish and English.

PRACTICE AREAS: Aviation Law, Aircraft Contract Law, Corporate Law.

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L A T A M

# Key developments & the latest trends in Mexico – from a legal perspective

## International Air Finance and leasing review



### Overview

The aviation industry has been swept by unprecedented turbulence worldwide. The covid-19 pandemic, the Russia-Ukraine conflict and the temporary, yet years-lasting, disequilibrium in the supply and demand in the aircraft market shocked the industry and beyond. The legal realm has had to rapidly adapt and find solutions to a shocked past couple of years. As the pandemic ends, and the market continues in its recovery path, one thing can be certain: the resilience of the aviation industry and its finance and leasing market.

The Mexican aviation industry was no exception to the world turbulence, and domestic problems particular to the domestic aviation industry contributed to the complexities in Mexico's key recent developments and trends. Arguably,



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the biggest issue Mexico faced are the reckless policy decisions made by the current Federal administration that have impacted the Mexican Aviation market as a whole. First, with regards to the decision to scrap the construction—on a political basis—of the much needed New Mexico City mega airport; second, the

inability to adequately manage and assist Mexican airlines during the pandemic; thirdly, the lack of policies and regulations that resulted in the downgrade of Mexico's FAA assessment. Below we will assess these developments from a factual and legal standpoint. Finally, we will note how despite these challenges, the Mexican Aviation market trends are positive favourable and ever-growing.

### Latest developments

#### The Mexico City Airport Dilemma

It's no secret that the Mexico City Airport ("AICM") has been saturated for years. Given this saturation which has been evident for several years, there was an urgent

need to find a viable alternative for the connectivity and infrastructure in Mexico City. Therefore, the previous administration began construction of the New Mexico City International Airport ("NAICM"), a project that represented the largest infrastructure project in Latin America and the second largest airport in the world.<sup>1</sup> However, the new administration formally announced the cancellation of the NAICM.

Instead, to fix the saturation of the current Mexico City Airport, the government would allow and encourage simultaneous operations of three different airports, these being, the AICM, the Felipe Angeles International Airport ("AIFA"), and the Toluca International Airport ("TLC"). This was done with a backdrop where there was already existing infrastructure associated with the Metropolitan Airport System, which includes the AICM and TLC. Having 30% of the original NAICM project completed the Federal Administration decided that the construction of the AIFA airport rather than continue with the construction of the NAICM was the way forward. This political assessment provided the Secretary of National Defence with the construction of the project and costed the Mexican taxpayers, and investors around 13 billion dollars in cancellation liability, lost infrastructure, and the cost of the new AIFA airport from scratch.<sup>2</sup>

#### The Mexican Airline situation

The next developments in this series of events in the Mexican aviation market was the global stress that the pandemic had on aviation travel. This resulted in financial difficulties that the Aviation Finance market suffered globally, the situation was particularly difficult for two out of the four main carriers in the Mexican market.

Mexico's third-largest airline which had a fleet of approximately 85 aircraft ceased operations in December 2020, and eventually declared bankruptcy a year and a half after.

1) <http://www.aeropuerto.gob.mx>

2) [https://comunicacionsocial.diputados.gob.mx/index.php/notilegis/gastos-por-el-aeropuerto-de-texcoco-y-construccion-de-la-terminal-aerea-de-santa-lucia-rebasan-los-500-mil-mdp-hector-saul-tellez#:~:text=Refir%C3%B3%20que%20la%20cancelaci%C3%B3n%20del,Comunicaciones%20y%20Transportes%20\(SCT\).](https://comunicacionsocial.diputados.gob.mx/index.php/notilegis/gastos-por-el-aeropuerto-de-texcoco-y-construccion-de-la-terminal-aerea-de-santa-lucia-rebasan-los-500-mil-mdp-hector-saul-tellez#:~:text=Refir%C3%B3%20que%20la%20cancelaci%C3%B3n%20del,Comunicaciones%20y%20Transportes%20(SCT).)

The loss of the third-largest airline caused connectivity in Mexico to become extremely reduced. What followed was the repossession of the leased aircraft with the substantive majority of aircraft being repossessed in a timely manner prior to bankruptcy. The successful repossession of aircraft is testament to the strong and reliable legal system that Mexico provides by assuring creditors property and repossession rights. Compliance with the Cape Town Convention’s declaration in accordance with the Mexican declarations allows expedited remedies assuring creditors that their rights and property are protected and respected. The legal framework for Aviation Finance in Mexico is not only reliable but has also been stress-tested in multiple occasions.

The death of one of the four major Mexican airlines covering the market was not an isolated incident. Aeromexico, the largest airline in Mexico, had to seek restructuring under Chapter 11 proceedings in June 2020. Aeromexico was able to exit their restructuring process and was able to secure \$5 billion for a 5-year fleet expansion plan in March 2022, with the case officially closing in December 2022.<sup>3</sup> The property, secured transactions, and restructuring regulations in Mexico have granted lessors and financiers the security and trust to recognise their rights in these procedures.

### The FAA Category conundrum

Nonetheless, the last piece of the trifecta for a perfect storm of the Mexican aviation industry was the downgrade by the Federal Aviation Administration (FAA) from Category 1 to Category 2. The FAA conducted an excruciating audit on the Mexican Civil Aviation Authority between October 2020 and February 2021. The result of such audit was devastating, as the U.S. Department of Transportation determined that Mexico had several infractions identified by the International Aviation Safety Assessment process regarding Annexes 17 and 18 of the Convention on International Civil Aviation. Therefore, Mexico’s safety rating according to the FAA was downgraded from category 1 to category 2.<sup>4</sup>

The aviation industry moved swiftly in ensuring open conversations with the government so that they treat this downgrade as a priority, however the government’s response was practically non-existent. This meant that the industry stakeholders had to deal with the consequences of the downgrade by themselves. Among these consequences, are (i) the prohibition for Mexican airlines to add or initiate new services, aircraft, or routes to the US, (ii) maintenance and repair facilities are only authorised to provide services to Mexican registered aircraft (unless they have a separate FAA certification), and (iii) increased scrutiny on Mexican operators’ flights to the US.

It has been two years since the downgrade, and as a result, US airlines have gained at least 10% of market share due to increased number of flights and routes to Mexico,<sup>5</sup> as Mexican airlines cannot operate more or new flights to meet the demand. Since the downgrade, and in an effort to regain its Category 1, Mexico has been working endlessly in the training of air traffic controllers and aeronautical personnel, as this was one of the reasons for the downgrading which is caused mainly by the lack of budget by the government. To this day, Mexico has yet to recover its Category 1.

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### Trends and future

Despite the terrible trifecta discussed above, the Mexican aviation industry is growing significantly, and is already exceeding, as of the date of this article, pre-covid traffic, and aircraft order numbers. The Mexican aviation industry currently has the largest commercial fleet it has had since 2018, with Aeromexico having just over 40% of the fleet, followed by Volaris and Viva Aerobus.<sup>6</sup>

3) <https://simpleflying.com/united-states-bankruptcy-court-closes-aeromexico-chapter-11-case/>  
 4) <https://www.faa.gov/newsroom/federal-aviation-administration-announces-results-mexicos-safety-assessment?newsid=26142>  
 5) <https://a21.com.mx/index.php/normatividad/2022/05/25/degradacion-de-mexico-categoria-2-que-ha-pasado-en-un-ano#:~:text=MediaKit%202022-,Degradaci%C3%B3n%20de%20M%C3%A9xico%20a%20Categor%C3%ADa%20%2C%20%C2%BFqu%C3%A9,ha%20pasado%20en%20un%20a%C3%B1o%3F&text=Hoy%20se%20cumple%20un%20a%C3%B1o,en%20la%20seguridad%20a%C3%A9rea%20nacional.>  
 6) <https://airinsight.com/looking-at-mexico-civil-aviation-1q-results-in-2023/>

Further, domestic passenger has increased by 23% compared to pre-pandemic levels. Nonetheless, it is important to note, that Aeromar, a domestic carrier ceased operations in February 2023, which was a blow for Mexican aviation industry, but also highlighted the effective repossession mechanisms that are in place for lessors and financiers. Further emphasising Mexican courts' willingness to honour contracts and the international remedies of the creditors.

Creditors in Mexico can be assured that their leasing and property rights are and have remained secured and will continue to do so, even beyond national carriers and Mexican-registered aircraft. The Mexican Civil Aviation Authorities and the Judges have truly honoured the Cape Town Convention obligations and the Mexican law in enforcing remedies in light of the detention of Russian-operated aircraft in Mexican territory. This was highlighted with the repossession of Russian aircraft in Mexico as a result of the imposed sanctions and cancellation of registration mark. This, in unison effort with International

authorities and other governments. The turbulent landscape that Mexico has confronted in the past few years provides certainty for creditors and financiers that their rights will be respected, and efficiently enforced.

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With Mexico potentially regaining its category 1, it is expected that the Mexican aviation industry will see further growth and airlines will strengthen their operations even more.

Finally, at the end of May 2023, the FAA finished its audit on the AFAC to determine eligibility for category 1. The FAA has 40 days to officialise its response. It is expected for Mexico to regain Category 1. Many benefits will come from this, such as:

- Mexico would be permitted again to operate into the US and/or codeshare with US operators, and
- Mexico would be able to re-launch new commercial services into the US or codeshare with US airlines and seek new codeshare agreements.

With Mexico potentially regaining its category 1, it is expected that the Mexican aviation industry will see further growth and airlines will strengthen their operations even more, thereby positioning the market to increase its aircraft demands in Mexico. With these reinstated benefits, Mexican carriers would be able to move back in, and take back approximately US\$242 million that could have been allocated in new flights and routes.<sup>7</sup>

There is no doubt the past years have been full of challenges and complications, but they have also been filled with successful experiences and precedents for main industry players, strengthening the confidence in the Mexican market. Successful restructuring and asset repossessions in Mexico have provided confidence in the market. With a proven legal success record in the country, current Mexican aviation market continues to grow.

The space that the bankruptcy of several airlines has had in Mexico, confirms a gap in aircraft and seat offer in the market. This is quickly and securely being filled. The region is well-positioned for healthy recovery beyond near-term market disruptions. According to Boeing's 2022 Commercial Market Outlook (CMO), the Latin American and Caribbean region will need 2,240 new airplanes by 2041, Mexico being the second largest market in the region.<sup>8</sup> Seat and passenger growth has seen a 31.8% growth versus 2022 levels and a 14% growth versus 2019 levels prior to the COVID-19 pandemic.<sup>9</sup>

Mexico is and continues to be a resilient market, and Aircraft Finance will continue to grow strongly.

7) <https://simpleflying.com/mexico-faa-category-1-end-2022/>

8) <https://boeing.mediaroom.com/news-releases-statements?item=131153>

9) <https://simpleflying.com/aeromexico-14-percent-passenger-traffic-increase-april-2023/#:~:text=Between%20January%20and%20April%2C%20Aeromexico,points%20increase%20versus%20last%20year>

## WHO ARE WE

Sierra LATAM is the premier law firm offering comprehensive legal services to the aviation industry in Latin America.

our commitment is to provide the highest quality legal services and solutions, with our customary level of sophistication and excellence that have characterized us for thirty years.



## OUR MISSION

We aim to establish ourselves as the go-to law firm for aviation across the Latin American Region

We recognize the importance of seamless collaboration and effective communication across the aviation industry in Latin America. To facilitate this, we have established a regional integrated services network throughout the region to ensure that the same level of advice, guidance and solutions is provided in jurisdictions throughout Latin America.

In our Latin American expansion, we continue to holistically represent and tailor creative and efficient solutions on:

- (i) aviation finance and leasing transactions;
- (ii) international carrier regulatory aspects, and
- (iii) litigation practice



With offices in Mexico, Miami, and Cancun, we are an international legal firm strategically positioned to serve clients throughout their business in all Latin America. Our presence in these key locations allows us to provide local expertise and solutions with a global and aviation-specific perspective.

# Philippines

## International Aviation Finance & Leasing Review 2023/24

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### BIO

Kerwin Tan heads TH Counsel's aviation practice group in Manila. He holds law academic qualifications in both Manila and New South Wales, Australia.

Currently, he manages Tan Hassani and Counsels Law Offices and mainly focuses on corporate and commercial transactions and tax law. As one of the few handful of aviation law practitioners in Manila, he advises on aircraft financing, leases, and acquisitions. His breadth of experience in this field is wide – covering everything from small turboprops and helicopters, to business jets and commercial aircrafts.

He also acts as counsel to several licensed air operators and flying schools in the Philippines, appears before the civil aviation authority, and assists with the application to operate scheduled and non-scheduled air transport services. He also acted as Philippine counsel to one of the biggest aircraft OEM in the world and was instrumental in setting up its MRO venture in the Philippines.

# TAN HASSANI & COUNSELS



## BIO

Fay Rutor is one of the senior associates at TH Counsels' corporate and special projects group. She also assists with the aviation practice group in Manila. Prior to joining TH Counsels, she also had experience in advising on one of the major airport projects in the Philippines.

With a background in dispute resolution, Fay's experience comes into significance by ensuring that aircraft owners and lessors have adequate protection in the aircraft finance and lease transaction documents. She works hand in hand with the lawyers in the aviation practice group to provide a more holistic approach with a view to closing finance and lease deals.

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## BIO

Eugene Kaw is a special counsel to TH Counsel's special projects and aviation practice group in Manila where he has assisted and advised in numerous aircraft finance and lease transactions throughout the years.

He was a former Philippine government official having served for 9 years in various senior management capacities in the legislative and executive branch, the most recent of which was as Assistant Secretary in the Department of Tourism of the Republic of the Philippines. He is back in the private sector where he advocates for the aviation industry and also acts as a management consultant for a leisure, entertainment, food, and property development conglomerate. He is also a Faculty Member and Lecturer of Law at several top ranked Philippine law schools.

As special counsel, his specialisation covers privacy laws and compliance, public policy and legislation, and government affairs and regulations.

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Air travel contributes significantly to the Philippines' economic growth as it bridges not only the islands within it but also links the archipelago to the rest of the world. The industry has accelerated trade and tourism and has opened gainful opportunities not only for businessmen but the national government as well.

In 2020, the COVID-19 pandemic and the concomitant government restrictions on the movement of people worldwide caused an unprecedented financial blow to the industry. Notably, aircraft fleets were grounded and a number of airlines were reported to have ceased operations. Nevertheless, with the easing of these restrictions, the demand for air travel is once again gaining strength.

However, while most government restrictions have been lifted, air operators who are still recovering from the effects of the pandemic, must still deal with rising fuel costs and

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other operational expenses. Thus, to adequately respond to the demands of air travel, air operators in the Philippines have to effectively manage operational costs which include acquisition of aircrafts. Fortunately, aviation financing and leasing have been widely recognised in the Philippines and have provided a cost-

effective means for air operators to acquire their tools-of-the-trade, so to speak.

## Aviation finance structures in the Philippines

### • Simple Lease

The first and most common finance structure may be denominated as a “Simple Lease” whereby a usual lease agreement is executed between the aircraft owner-lessor and the Philippine lessee who will also be the operator of

the aircraft in the Philippines. We note, though, that while the simplicity of the first structure reduces the necessary transaction documents, there is a risk that the aircraft owner-lessor, which is usually an entity registered in another jurisdiction, may be said to be “*doing business without a license*” in the Philippines.

“*Doing business without a license*” is a legal concept in the Philippines which provides that a foreign company “doing business” in the Philippines “without a license” cannot sue in the Philippines, but may be sued therein. Effectively, this will deprive aircraft owner-lessor access to Philippine courts in case of disputes but the Philippine lessee may pursue its legal actions against the owner-lessor even through the Philippine courts.

Nevertheless, should the parties find that a Simple Lease is suitable for their arrangement and, more importantly, their financial situation, they may adopt said structure but it is advised that the legal definitions of “doing business” and “without a license” will be taken into account in the overall structuring of the finance lease. With proper guidance, a Simple Lease transaction can even fall under one of the legally-recognised exceptions to the “*doing business*” rule.

### • Combination of a Head Lease and a Sublease Agreement

This structure consists of a two-tiered approach: (a) a “*Head Lease*” between the aircraft owner-lessor as Head Lessor and an offshore company owned or controlled by the Philippine lessee acting as Head Lessee; and (b) a “*Sublease Agreement*” between the offshore company as Sublessor and the operator of the aircraft in the Philippines as Sublessee.

Under this structure, the aircraft owner will not be transacting directly with the Philippine operator, thereby removing the arrangement from the concept of “*doing business without a license*.”

• **One Lessor per Aircraft**

Under the third structure, an aircraft owner has a separate entity acting as lessor for each and every aircraft as opposed to the set-up where all aircrafts owned by the aircraft owner are consolidated under one entity. Each separate company can directly lease to the Philippine lessee who will also be the operator of the aircraft in the Philippines. This structure is more common in operating leases rather than finance leases.

In this case, the aircraft owner will not fall within the coverage of the “*doing business*” rule but the separate entities may be covered by the “*doing business*” rule unless these entities will fall under an exception to such rule. Again, with proper guidance, this third structure can still be feasible within the exception.

While the second and third structures may involve less risk from a business and legal standpoint, it must be noted that their implementation will require additional steps, requirements, and costs.

**Governing Law of Aircraft Financing Lease in the Philippines**

In the Philippines, aircraft transactions are generally governed by the Philippine Constitution, Civil Code of the Philippines (Civil Code), Republic Act No. 9497 otherwise known as the “The Civil Aviation Authority Act of 2008” (CAAP Law), and Republic Act No. 8556 otherwise known as the “The Financing Company Act of 1998.”

While the above-mentioned legislations are the principal domestic laws, the Civil Code allows parties to agree on which system of laws will govern their transaction. It is by reason of this rule that aircraft finance leases are usually governed by the laws of the lessor’s jurisdiction (e.g., USA and UK laws). The parties’ choice of law will be generally recognised by Philippine courts as long as said law is not contrary to law, morals, or public policy. Nevertheless, Philippine laws, particularly the CAAP Law, may still be directly applied with respect to issues which may include, among others, the nationality of the lessee based in the

Philippines and its compliances with government agencies concerning the leasing and operation of an aircraft.

**Registration and Transfer of Title of Aircrafts**

The Civil Aviation Authority of the Philippines or the CAAP is the agency responsible for the registration of aircrafts in the Philippines as well as the annotation or recording of any interest over the aircraft or the engines, as the case may be.

Under the Philippine Civil Aviation Regulations (PCAR), airline operators must register the aircrafts with the CAAP before operating the same. However, there are nationality qualifications before an aircraft may be registered in the CAAP registry. An aircraft is eligible for registration if it is owned by or leased to a citizen or citizens of the Philippines or corporations or associations organised under the laws of the Philippines at least 60% of whose capital is owned by Filipino citizens, or a government entity of the Republic of the Philippines and is not registered under the laws of any foreign country. The aircraft is registered under the name of the Philippine lessee-operator. Simply stated, the CAAP registry is an “operator-registry” and does not register it under the owner-lessor’s name. The foreign owner may, nevertheless, still protect its interest by recording the same with the CAAP as will be discussed in the next section.

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Foreign-owned or registered aircraft may be eligible for registration if it will be utilised by members of aero clubs organised for recreation, sport or the development of flying skills as a prerequisite to any aeronautical activities of such clubs within the Philippine airspace, and if authorised by the CAAP. However, said aircraft may engage only in domestic air travel and may be operated in and to the Philippines only upon issuance of a Validation of Air Operator Certificate in the name of the operator.

### Security interests in an aircraft

While the PCAR requires that the aircrafts must be operated by lessees with Philippine nationality and duly registered as such, owner-lessors may still protect their interests in their aircrafts by registering their security interest with the CAAP. The following information will then be annotated on the aircraft's Certificate of Registration: (a) the name of the owner-lessor; and (b) the de-registration power of attorney (DPOA) issued by the lessee in favour of the lessor. This will serve as notification to third parties that the lessee is not the owner of the aircraft.

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Foreign-owned or registered aircraft may be eligible for registration if it will be utilised by members of aero clubs organised for recreation.

The same can be done for an owner-lessors' security for engines. If the engine is owned separately from the aircraft, the lease agreement over the engine can be annotated on the aircraft's Certificate of Registration. This gives notice to third parties that the engine is owned separately. Further, the engine itself can be registered

with the CAAP. It can have its own separate Certificate of Registration where the engine lease can also be annotated.

While mortgaging the aircraft may be an option to secure the owner-lessor's interests as mortgagee, it signifies that the lessee is actually the owner of the aircraft since Philippine laws requires that the mortgagor be the owner of the property being mortgaged. Hence, the owner-lessor will be constrained to transfer the aircraft's ownership to the lessee at the start of transaction. By reason of such, this type of security is not recommended.

### Relevance of the DPOA

The Cape Town Convention on International Interests in Mobile Equipment (Cape Town Convention) allows the owner-lessor to request for an Irrevocable De-Registration and Export Request Authorisation (IDERA) over an eligible aircraft. The IDERA grants the "authorised party" exclusive power to de-register and export the aircraft.

Since the Philippines is not a party to the Cape Town Convention, the DPOA is prepared in lieu of the IDERA is made a condition precedent to the lease to ensure that in case of termination of the lease, by any reason whatsoever, the owner-lessor may file the necessary applications for de-registration and export of the aircraft.

### Possession of Aircraft in Pending Disputes

The ideal situation is that in case of dispute, the lessee will voluntarily relinquish possession of the aircraft and the lessor can use the DPOA to file the necessary applications for de-registration and export of the aircraft. If not, the lessor may have to go through the courts to pursue its claim and forcibly take possession of the aircraft. Generally, these cases will be prosecuted out of the Philippines (e.g., courts in the State of New York in the City of New York or Courts of England) while the aircraft remains in the Philippines. It is understandable that the lessors will want to recover possession of the aircraft during the pendency of the case to avoid any damage or further use by the lessee who has breached its contractual obligations. This may be done through "replevin" which may be initiated as an action by itself or as a provisional remedy to a pending action before Philippine courts.

For this purpose, the lessor/owner of the aircraft may file: (a) an original action for replevin if the case is initiated outside the Philippines; (b) an action for recognition of judgment with application for replevin if the case is filed and has been decided outside of the Philippines; or (c) a civil case of breach of contract before Philippine courts with application for replevin.

In applying for replevin, the lessor will certainly incur costs that may include filing fees, bonds, and even logistics expenses for the recovery of the aircraft. It is, therefore, prudent to include in the lease contract clear provisions that will allow the lessor to reimburse legal fees and costs from the lessee.

### **Current status of aviation financing in the Philippines**

Philippine-based lessees continue to require aircraft financing considering the strong recovery of the demand for air travel vis-à-vis operational costs (e.g., market value of aircraft and fuel costs). Notably, the industry is gaining prominence in the Asia Pacific. While the constant fluctuation of the US Dollar to Philippine Peso rate poses a great challenge, aircraft financing will remain to be a viable option in view of the technical expertise of international lessors to maintain and operate an aircraft which other financial institutions might not have.

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## HIGHLY EXPERIENCED AVIATION LAWYERS IN THE PHILIPPINES



For more than a decade now, the lawyers at Tan Hassani and Counsels have handled multiple aircraft finance and lease transactions – from small turboprops and helicopters to business jets and commercial airlines. Each transaction was structured by the team to ensure utmost protection to the aircraft owner, taking into consideration special nuances present in Philippine laws. They also counsel air operators and FBOs.

Tan Hassani and Counsels continue to be one of the few aviation law practitioners in the Philippines but arguably with one of the most varied and broadest experience in the aviation industry as a whole.



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