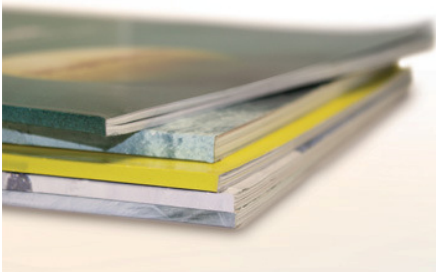


Aircraft Financing – What You Should Know

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Legal and administrative service providers in the Cayman Islands can offer aircraft owners and financiers much more in the way of financing, leasing, securitisation and ownership structures not limited to Cayman registered aircraft. A common component to these structures is the use of a Cayman Islands special purpose vehicle (“SPV”), through which funding and leasing arrangements may allow for certain tax, accounting and regulatory relief.

SPV Formation

In a typical structure using a bankruptcy remote SPV, the company is incorporated as an exempted company, the shares of which are issued to a Cayman Islands trustee (usually a licensed trust company) for the benefit of a charitable or purpose trust. The aim is to ensure that the SPV’s shares are vested in a third party so that it is not regarded as a subsidiary of the originator or financier.

A charitable trust is the type of structure used most regularly to facilitate a particular commercial arrangement. Any potential profit upon an eventual sale of the aircraft must be considered, as this could become payable to the charity upon termination of the trust arrangements at maturity of the transaction. It is usual for the SPV to receive a small profit (e.g. US\$1,000), which is helpful for commercial benefit issues of the SPV and also ultimately paid to the charity. Because recourse to the SPV is usually limited, the small profit can usually be justified by the minimal risk involved.

The SPV will also appoint an administrator to provide directors and officers and day to day administration of the SPV. Independent directors are essential to ensure the “*off balance sheet*” effect and to avoid the risk that the directors may not be able to discharge their fiduciary duties to act in the best interests of the SPV.

The SPV enters into contractual arrangements with

the original owner of the aircraft (“Originator”) to effect a “*true sale*” of the aircraft from the Originator. The SPV can obtain the monies to purchase the aircraft from the Originator by issuing asset-backed commercial paper in the form of debt notes to chosen investors.

The goal of any contractual arrangement which is set up in these circumstances is to:

- a) achieve an off-balance sheet structure which does not affect the accounting position of the financier, the airline, the trustee, or the Originator;
- b) achieve bankruptcy remoteness from the Originator – particularly where there is a connection with the United States bankruptcy courts, which have a power to consolidate groups of companies in certain circumstances;
- c) the SPV is not part of the assets available to creditors of the trustee or Originator if either were to become insolvent; and
- d) achieve limited recourse – the recourse of the financiers will be limited to the aircraft and any other supporting security provided by the SPV over its ancillary assets. In order to provide the best possible security to the financiers, the aircraft can be ring-fenced by comprehensive security over the aircraft so that in the event of insolvency of the SPV

the aircraft will not form part of the insolvent estate of the SPV.

Legal Framework

In a common scenario, an airline will contract an aircraft manufacturer to purchase the aircraft. Prior to delivery, the airline will assign the purchase agreement to the SPV, pursuant to which the SPV will purchase the aircraft and register it on delivery in the registry of choice to be agreed by the financier. By use of this structure, any incidental borrowing costs are reduced with the issuance of notes and the airline does not need to be concerned with incorporating the aircraft (and related debt) into its balance sheet.

Once it owns the aircraft, the SPV will enter into a lease arrangement with the airline. The lease documentation will provide for payment of lease rentals and covenants in favour of the lessor in default of which the SPV shall have available a number of remedies, including repossession.

There will be security documents which secure the obligations of the SPV which might include an aircraft mortgage, a debenture, a security assignment (usually assigning insurances and rights of the owner under the lease arrangement etc). There is often also an equitable mortgage over the shares of the SPV granted by the trustee which enables financiers, as mortgagees, to assume control of the SPV in the event of default in a financing or leasing arrangement.

An aircraft mortgage will enable a financier, as mortgagee, to assume control of the aircraft and by taking the necessary steps on enforcement to ultimately transfer registered ownership of the aircraft into its own name.

There will also often be a deregistration power of attorney which enables the financier, in an event of default, to deregister the aircraft from its existing registry and take ownership.

Cape Town Convention

It should be noted that, although the United Kingdom has not yet ratified the Cape Town Convention on International Interests in Mobile Equipment, and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (the "Convention"), the Cayman Islands has enacted domestic legislation to recognise the Convention.

As a result of this legislation, a structure which involves a Cayman Islands entity owning an aircraft

leased to an operator in a Convention State will provide financiers with the additional comfort of having Convention-type remedies against the SPV. Financiers can now rely on the certainty of the International Registry and of International enforcement.

Conclusion

As a creditor friendly jurisdiction with the expertise of the service providers, the sophistication of the financing and leasing structures available in the Cayman Islands lends itself to transactions capable of being structured to meet the requirements of leading aircraft lending institutions free of unnecessary risks, as well as meeting the unique requirements of airlines in their home jurisdictions.

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