

The Cayman Islands aircraft registry is known to be the registry of choice for many private aircraft owners. The majority of aircraft registered in the private category in the jurisdictions include all of the most commonly seen aircraft manufacturers including Dassault Falcon, Gulfstream, Bombardier, Embraer, Airbus and Boeing aircraft. There are now over 150 private aircraft registered in the Cayman Islands, the majority of these registered to multinational companies or high-net-worth individuals.



Aircraft financing

- what you should know

by **Caroline McCann**

Legal and administrative service providers in the Cayman Islands such as Appleby are able to 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 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 Cay-

man 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 the SPV is an "orphan" and not regarded as a subsidiary of the originator or financier. In a charitable trust the beneficiary of the trust is a charity. With a purpose trust, the object of the trust is the commercial purpose of holding the shares in the SPV and there is often a charitable beneficiary as well. Although the main duty of the trustee of a charitable trust is to maximise the benefits for the charity, this is the type of structure used most regularly



to facilitate a particular commercial arrangement. A purpose trust with charitable beneficiaries can also be used but this alternative is complicated by the need to have a separate enforcer.

If a charitable trust is determined to be the beneficiary of the trust, any potential profit upon an eventual sale of the aircraft must be considered as such profit 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 for entry into the transaction such as US\$1,000 (helpful for commercial benefit issues of the SPV) and this is also ultimately paid to the charity. Because recourse to the SPV is normally limited, the small profit can usually be justified by the minimal risk involved.

These SPVs can be incorporated in as little as a day if necessary and no licences or regulatory approval is required. Given the speed at which these transactions develop this is an attractive solution for transaction parties.

The SPV will also appoint an administrator to provide directors and officers to the SPV and day to day administration of the SPV. The issue of who pays the administrator's bills in its capacity as administrator and trustee in relation to the SPV comes down to the onshore tax analysis. Either the originator or financier can make these payments annually without bringing the SPV onto its balance sheet or these payments can

flow through with the cash flow of the transaction or the payments can be made upfront for the life of the deal as part of the acceptance fee.

Appleby, through its various service companies and subsidiaries, can simplify this process by providing the trustee, administrator and independent directors.

Independent directors are essential to ensure the "off-balance-sheet" effect of the SPV, to avoid the risk that the

directors of the SPV may not be able to discharge their fiduciary duties to act in the best interests of the SPV and any resulting consolidation of the SPV with the financier, originator or trustee or the collapse of the structure.

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 to the SPV to transfer ownership to the SPV. 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:

1. achieve an off-balance sheet structure which does not affect the accounting position of the financier, the airline, the trustee, or the originator;
2. achieve bankruptcy remoteness from the originator – particularly where there is a connection with the jurisdiction of the United States bankruptcy courts, which have a power to consolidate groups of companies in certain circumstances, it is essential that the aircraft be insulated from the risk of insolvency of the originator;
3. the SPV is not part of the assets available to creditors of the trustee or originator if either were to become insolvent; and
4. 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 taken by the financiers 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

Depending on the nature of the contractual arrangements to be put in place, the SPV will enter into the transaction documents which are typically UK or US law governed.

In a common scenario, an airline will contract with the aircraft manufacturer to purchase the aircraft. Prior to delivery of the aircraft the airline will assign that 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 then 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 the insurances and the rights of the owner under the lease

agreement and any related lease documents etc). There is often also an equitable mortgage over the shares of the SPV granted by the trustee. This final document enables financiers, as mortgagees, to assume control of the SPV in the event of default in a financing or leasing arrangement which can be a

straightforward and quick solution.

An aircraft mortgage, which can be governed by UK, US or Cayman Islands law, 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.

A share mortgage and aircraft mortgage have been found to be most beneficial when used together in the suite of security documents as this provides the financier with additional protection over not only the aircraft as an asset but the SPV itself.

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 Cayman Islands has enacted domestic legisla-

tion to recognise the Convention. As a result of this legislation, a structure which involves a Cayman Islands entity owning an aircraft which is leased to an operator in a Convention state will provide financiers with the additional comfort of having Convention-type remedies against the Cayman SPV. The law now enhances the existing status of the Cayman Islands and addresses the concerns of financiers objecting to any entity in the structure not recognising the Convention by providing them with access to the benefits of the Convention. 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 present in the Cayman Islands, the sophistication of the financing and leasing structures available in the Cayman Islands lends itself to transactions capable of being structured in such a way to meet the requirements of the leading aircraft lending institutions free of unnecessary risks as well as meeting the unique requirements of airlines in their home jurisdictions.

BIO: AT A GLANCE

Caroline is a member of the Banking and Asset Finance and Structured Finance Teams within the Corporate and Commercial Practice Group. Her practice areas include banking and asset finance, corporate finance, syndicated loans, project finance, property finance and general aspects of banking and finance law. Caroline specialises in aircraft and vessel financing, leasing and registration, Islamic financing structures, project finance, corporate acquisition and joint ventures.



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