

Insights

ENGINE LEASING AND FINANCING, THE FUNDAMENTALS - MORE LEGAL MITIGATIONS

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SUMMARY

In our previous article [Engine Leasing, the Fundamentals – Legal Risks and the Cape Town Convention](#), BCLP’s global aviation team discussed the legal risks associated with engine leasing and the mitigating impact that the Cape Town Convention (CTC) has had on those risks. In this, the third of our four part series focussing on engine leasing and financing, the aviation finance team consider what additional steps and protections can be implemented in order to mitigate the risks associated with engine leasing and financing more generally.

Mitigating Factors

EXPORT POWERS OF ATTORNEY

As an additional precaution to facilitate enforcement and repossession action against a defaulting engine debtor, local advice should be sought from counsel as to the need to obtain from the aircraft engine debtor, a separate or specifically prepared aircraft engine “export” power of attorney to allow for the removal and export of an engine on enforcement (for clarification, such power of attorney being independent of or in addition to any customary aircraft deregistration power of attorney). This export power of attorney generally permits the beneficiary to take such actions as may be necessary on the operator’s behalf to export the aircraft engine from the relevant jurisdiction.

This may afford greater protection than merely relying on an IDERA or non-CTC airframe deregistration and export power of attorney from the aircraft operator. The function of an irrevocable de-registration and export request authorisation (“**IDERA**”) is to permit the beneficiary of an IDERA to de-register and export an aircraft from a CTC jurisdiction with the assistance of the relevant aircraft registry and other authorities. It is not clear in many CTC States how holding an airframe IDERA with reference to separately owned /secured and registered aircraft engines installed can practically assist their export when there is no separate aircraft engine register from which to be de-registered for export. Local law advice differs from jurisdiction to jurisdiction as to the value of an IDERA in practice for aircraft engine export.

Title tracking

The CTC overrides any applicable national law which would otherwise apply a doctrine of accession. It ensures that neither the installation of an aircraft engine nor its removal from the aircraft affect the ownership of or other interest in that aircraft engine. Thus the CTC adopts the principle of title tracking rather than title transfer. Under the CTC regime “aircraft engines” are now given a clear independent interest which will not change merely by installation on or removal from an airframe

Nevertheless title tracking is still supported by aircraft engine owners entering into recognition of rights agreements (“RORAs”), which are discussed in more detail in the following section.

Recognition of rights agreements

As we have noted in earlier paragraphs, in some jurisdictions there are issues around aircraft engines (legally) forming part of the aircraft to which they are attached (e.g. in The Netherlands - which is not a CTC State)). This is an issue for an aircraft engine lessor as it may result in competing claims from both the owner of such Aircraft and any financier of such Aircraft.

To address this problem the owner of an aircraft will usually agree to enter into a RORA with the aircraft engine lessor (and sometimes the engine financiers), which recognises the rights of the aircraft engine owner/financiers in the aircraft engine. The form of such RORAs are varied, as they can be incorporated as provisions in a lease or provided under separate agreements (and in some circumstances, oblige owners of applicable aircraft and aircraft engines to accede to such agreements before being entitled to benefit from any RORA arrangements). RORA arrangements would customary provide that the aircraft owner/financier will co-operate with the aircraft engine owner/financiers should such aircraft engine owner/financier seek to repossess the aircraft engine (and, likewise, the aircraft engine owner/financier often agrees to co-operate with the aircraft owner/financier, in the case of a repossession of the aircraft on which such engine is installed).

Traditionally, an aircraft/engine lease agreement would provide that the benefit of RORA rights and entitlements had to be mutual with any other applicable aircraft owner/financier before the aircraft engine could be attached to such other airframe. In more recent times, operators who have ever expanding fleets and who have to manage aircraft engines swapping on and off wing have either resisted providing RORAs or only agreed to them being provided within a certain timeframe of an engine being fitted to an aircraft. The latter causes issues, as it requires monitoring by the lessor and, in practice, it ends up taking some time for the RORA to be provided as the operator is not that motivated once it has its engine on wing where it needs it.

To balance practicalities, RORA language (allowing engine installation swapping but not title transfer) is now frequently incorporated in aircraft/engine leases to protect the interest of aircraft engine owners/financiers, whether or not they are CTC covered, to accommodate the contingency of a separately financed (spare) engine being on wing at the time of enforcement. This practice

increasingly replaces the burdensome and untimely practicalities of procuring separate RORAs when an engine on-wing replacement first occurs.

Other ownership/lessor right protections

Separate aircraft engine registries are not common, although some aircraft registries permit an aircraft engine owner to be noted on the aircraft's certificate of registration. Lessees resist the latter as it is simply not practical in the context of an asset operating as a spare, which is leased for the purpose of being taken off one aircraft and put on another at short notice and on a regular basis.

What then are the additional common protections which engine lessors and financiers rely on?

(a) Engine nameplate

The nameplate on the firewall module of an aircraft engine noting the name of the owner (and financier) is important for providing constructive notice to third parties in order to prevent issues around ownership and fraudulent sales. Ensuring a nameplate is installed promptly should be a priority, as well as checking the nameplate is still installed upon any annual inspection of the aircraft engine.

(b) Local filings

In some jurisdictions it is possible to register the rights of an engine lessor/owner with the courts of such jurisdiction by filing the engine lease agreement. This is particularly important where the operator's jurisdiction is not a CTC state. Local law advice is key here.

(c) Transaction structures

In the case of spare aircraft engines for a US carrier, eligible for Section 1110 bankruptcy shield/protection, a financing can be structured on an all-or-nothing basis – meaning that the airline cannot “cherry pick” among aircraft engines which serve as loan collateral – they would need to confirm all of the debt secured on the aircraft engine pool or release the entire aircraft engine pool in a default situation. This provides significant additional structural leverage for the secured lender.

Conclusion

Provided that investors and financiers have undertaken a thorough legal due diligence of the key jurisdictions where the engines will be operated, there are a number of tools that can be utilised in order to mitigate the risks associated with engine leasing and financing. Such tools may include obtaining export powers of attorneys, requiring recognition of rights agreements, installing engine nameplates and ensuring all available local filings are completed. As has been discussed in our previous article “Engine Leasing, the Fundamentals – Legal Risks and the Cape Town Convention” such steps are in addition to those protections afforded by the Cape Town Convention/Aircraft Protocol.

In the next and final instalment of “Engine Leasing and Financing, the Fundamentals” BCLP’s global aviation finance team will provide an overview of the sanctions issues that engine financiers and lessors should be aware of and draw together the key points highlighted in our series of articles on engine leasing and financing.

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MEET THE TEAM



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