

Insights

ENGINE LEASING, THE FUNDAMENTALS - SANCTIONS AND KEY CONCLUSIONS

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SUMMARY

In the previous articles in our series [Engine Leasing, the Fundamentals](#), BCLP's global aviation team has discussed the attraction of engine leasing and the key economic drivers. It has discussed the legal risks associated with engine leasing and the mitigating impact that the Cape Town Convention (CTC) has had on those risks. The team has also considered what additional steps and protections can be implemented in order to mitigate the risks associated with engine leasing and financing. In this, the final article of our series, the global aviation finance team provides an overview of the sanctions issues affecting engine financiers and lessors and draws together the key conclusions in our series "Engine Leasing and Financing, the Fundamentals".

As many industry participants will be aware, US economic sanctions are not limited to US persons or equipment that has significant US originated parts but can extend through "secondary sanctions" to non-US persons who are regarded by US Treasury Department to be acting in breach of sanctioned activities or doing business with Specially Designated Nationals (SDNs).

US sanctions can/will apply to US manufactured equipment, equipment with significant US content and to the use of US financial services – which would include transactions denominated in US dollars. You will immediately see the issue for both aircraft and aircraft engines.

In November of last year, Apollo Aviation LLC settled fines for inadvertent accidental breaches of Sudanese sanction regulations. Apollo had leased three spare aircraft engines to two different non-sanctioned entities and despite restrictions in the leases on sub-leasing and the inclusion of sanctions language and undertakings, the engines were sub-leased to a Ukrainian airline which installed them on aircraft wet leased^[1] to Sudan Airways (an SDN). On becoming aware of the issue Apollo self-reported the breach to OFAC. OFAC had imposed a US\$210,600 fine, but found that Apollo had not monitored the use of the engines and had not requested periodic certifications of compliance.

There have been other examples of leased aircraft/engines being sub-leased on via seemingly compliant airlines to SDNs (Mahan Air being a well-known example). The key take-away from these examples is that everyone in the chain of manufacturing, purchase, ownership, re-sale, leasing, sub-leasing, operating, servicing, maintenance and financing of aircraft and particularly of unattached engines (because of the way they are used) is potentially open to unintentionally falling foul of US sanctions – whether they are US persons or not.

Key Conclusions

Knowing your aircraft engine, its operating environment and maintenance status is as relevant as knowing the operator. Aircraft engines are highly moveable assets and warrant a granular and not just a high level understanding. It is imperative that financiers and lessors formulate risk assessment models (evaluating the level of capital outlay on purchase against achievable return in lease rates) to gain a consistent yield and return on investment based on expected residual value.

It is necessary for lessors, financiers and their service providers to be equipped with global technical know-how on maintenance status (with complete back-to birth records) to conserve residual values, and to evaluate the new technological wave in engine efficiencies as investment opportunities.

Aircraft engine financiers and lessors must educate themselves to navigate through the jurisdictional maze of aircraft engine title tracking, enforcement and repossession pathways. Aircraft engine financiers should conduct due diligence of applicable national laws in the multiple jurisdictions in which the asset may from time to time be based. Relevant jurisdictions may include jurisdictions where the aircraft engine is located when on-wing, on a shop visit or stored with an MRO or operator. Such due diligence should (i) consider what steps a financier or lessor must take with regard to protecting its priority and recovery interests, (ii) scrutinize any applicable CTC set of declarations and (iii) include obtaining relevant local legal opinions in key jurisdictions.

Provided that investors and financiers have undertaken thorough legal due diligence of the key jurisdictions where the aircraft engines will be operated, there are a number of tools that can be utilised in order to mitigate the risks associated with aircraft 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. In CTC jurisdictions engine financing and leasing can now present less risks than those jurisdictions where financiers and lessors are wholly reliant for recognition and enforcement on national laws for remedies on default and insolvency.

Over recent years the industry has seen a growth in investor interest in aircraft engines, stimulated not only by demand but by the increased understanding of the economic and legal risks associated with financing this asset class. As the implementation of the CTC progresses, and as industry knowledge of this asset continues to increase we anticipate that engine leasing will continue to be a

growth sector as investors as lenders and lessor owners seek to match capacity with the global demand for engines.

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MEET THE TEAM



Anton Chambers

Co-Author, London

anton.chambers@bclplaw.com

[+44 \(0\) 20 3400 4366](tel:+442034004366)

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