About the Author

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He was educated by the Jesuits at Belvedere College, SJ, Dublin and at the Law School of Trinity College, Dublin University, from which he graduated with an MA degree. He received a European Commission scholarship to study Japanese language and business at Tokyo School of Japanese Language and Sophia University, SJ, as part of its Executive Training Programme in Japan. He also has an MA degree in Linguistics from Monash University, which he studied by distance learning, as well as an MBA degree in International Aviation from Concordia University, Montréal and a Diploma in Air Law from the International Air Transport Association (IATA) in Montréal, where he is an instructor in the IATA Training and Development Institute. He graduated *cum laude* with an LLM (Adv) in Air and Space Law from Leiden University in the Netherlands and obtained his doctorate there in 2011.

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He represents ACG on the Aviation Working Group (AWG), an industry association of major aircraft and aircraft engine manufacturers, lessors, and financiers, and is a member of the AWG team negotiating legal documentation standardization with IATA.

Before joining ACG in 2005, he was an aircraft leasing and finance lawyer with extensive experience, both in private practice and in house, in Ireland and England for McCann FitzGerald, in Japan for Linklaters and in the United States and The Netherlands for Tombo Aviation Inc. and other group companies of Mitsui & Co., Ltd.

He is a solicitor admitted in Ireland and England and Wales and is a member of the State Bar of California. He served as Chair of the International Law Section of the State Bar of California from 2006 to 2007.

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CHAPTER 1
Introduction

§1.01 CONTEXT

The aim of this work is to examine the aircraft operating lease from both a legal and practical point of view and, in particular, to contextualize it in light of both public and private international air law.

Personal property leasing can be traced back to ancient times: Lawrence and Minan[1] note that chartering of ships originated in the times of the Phoenicians and that the code of the Babylonian king Hammurabi[2] referred to the leasing of personal property.[3]

Although aircraft, not constituting or being attached to land, or real estate, do indeed constitute personalty, or personal property,[4] commercial aviation is very much a product of the twentieth century.

As a discrete field of jurisprudence, aircraft leasing is, therefore, comparatively young, having taken off, as it were, only on a major scale since the 1980s[5] – and yet already by 2007 over a quarter of the world's commercial aircraft fleet was leased.[6] Its importance is, therefore, growing very quickly with current estimates showing approximately 40% of such fleet being leased with the 50% mark looking increasingly achievable.

The duty of lawyers specializing in aircraft operating leasing is to record with certainty the commercial terms agreed between the leasing company (the lessor) and

1. Lawrence W.H. and Minan J.H., *The Law of Personal Property Leasing*, Thomson West, 2003, 1.01.
2. *Floruit circa* 1750 BC.
3. Code of Hammurabi: '236. If a man rent his boat to a sailor, and the sailor is careless, and the boat is wrecked or goes aground, the sailor shall give the owner of the boat another boat as compensation', as set out in http://avalon.law.yale.edu/ancient/hamframe.asp on 30 Aug. 2016.
4. Nolan J.R. and Nolan-Haley J.M., *Black's Law Dictionary*, West Publishing Co., 6th Edition, 1990.
5. Abeyratne R.I.R., *Aviation Trends in the New Millenium*, Ashgate, 2001, 1.
6. Morrell P.S., *Airline Finance*, Ashgate, 3rd Edition, 2007, 196.

the airline (the lessee) in the hope that good drafting will enable the parties to be clear about their respective rights and obligations under the contract and about their rights in the event of a breach of the terms thereof by the other party.

This desire was well summarized by Hamblen J of the English High Court in *Celestial Aviation Trading 71 Limited v. Paramount Airways Private Ltd.*[7] where he stated:

> The lessor, having a reversionary right to the asset, needs to know and agree with precision with the lessee: (a) the obligations of each party, (b) the events that will entitle the lessor to terminate the contract and recover its asset and (c) provisions which will show how, as a matter of business practicality, the contract will be terminated, the asset recovered and possession returned by the lessee to the lessor.

Typically, aircraft operating leases may run between 100 to 200 pages or so. As Wilson has noted, in the context of short- term aircraft engine operating leases:

> As much as a lessee may complain about the complexity of a lease, lessors have a point in justifying complex documentary requirements. Thorny legal issues exist, and lessors are entitled to ensure that sufficient legal protections are in place before transferring possession of their expensive assets.[8]

Nevertheless, the two parties do not enjoy complete freedom to contract on whatever terms they wish. For example, the lessor, in particular, may be subject to constraints imposed by its financier. Likewise, the lessee may be subject to regulatory constraints concerning aircraft registration or foreign remittances or other matters depending on its jurisdiction.

The European Civil Aviation Conference,[9] for example, has, while recognizing that leasing is a common practice in the airline industry and that a flexible approach to it can bring economic benefits to air carriers and consumers alike and help air carriers to meet market needs better, also recognized that:

> leases should not be used as a means to circumvent applicable laws, regulations or international agreements.[10]

and, accordingly, it went on to recommend, *inter alia*, that:

> [f]or the purpose of ensuring safety and liability standards and compliance with any applicable economic conditions, all leasing arrangements entered into by air carriers[11] should receive prior approval from the appropriate authorities.[12]

7. [2010] EWHC 185 (Comm) at para. 72.
8. Wilson F.S., *Mastering Engine Leasing: The Master Short-Term Engine Lease Agreement Will Serve as Models for Future Standardization in the Aviation Industry*, Air Finance Journal, 1 Sep. 2007.
9. ECAC Recommendation on Leasing of Aircraft, Recommendation ECAC/21-1, 2–3 Jul. 1997 in *Study on Aircraft Leasing*, Air Transport Committee, 156th Session of the Council, ICAO, 1999, at Appendix B.
10. *Ibid.*
11. This is somewhat ambiguous – it is unclear whether the reference is to all leasing arrangements entered into by air carriers as lessees or only those leasing arrangements entered into by air carriers as lessors, as contrasted with non-airline lessor. *See* Chapter 3 section §3.05[A][4] *infra.*
12. *Ibid.*

While concerned that a rigid approach to leasing would be counter-productive, Abeyratne[13] cautions against allowing overly flexible arrangements to the point where safety might be threatened, and calls for the two aspects of freedom of contract in leasing and safety to be addressed harmoniously so that 'a cautious balance of the elements of freedom and compulsion is maintained'.

With due respect to Abeyratne, this is somewhat confusing: it is hard to imagine (and indeed he does not explain) how safety could be compromised by virtue only of an airline operating an aircraft pursuant to a dry operating lease[14] rather than pursuant to a finance lease or pursuant to a secured loan or, for that matter, pursuant to outright ownership and it is submitted that safety is not really a valid concern in this context. It should be borne in mind that he was writing some sixteen years ago, when aircraft leasing was not as widespread or as familiar as it is now and his caution was not unusual among those rightly concerned with aircraft safety at that time. Maintenance and safety in the context of aircraft operating leases will be discussed at Chapter 3 sections §3.10 (Covenants) and §3.11 (Indemnities), *infra.*

The seasoned legal practitioner may be familiar with how various issues are typically resolved in the aircraft operating lease but may not always be familiar with the theoretical reasoning underlying such resolution. This is particularly so because many aircraft finance lawyers come to their field through more general financing law rather than through more general air law and thus may not be immediately familiar with applicable principles of public and private international air law. Likewise, when negotiating a lease, practitioners should bear in mind that ultimately if it comes to litigation, it will be adjudicated by a judge who may be unfamiliar with the commercial background: it is crucial, therefore, that the lease be properly drafted to reflect the intent of the parties and with an awareness of the regulatory and legal framework within which the judge must analyse the lease.

§1.02 'PRACTICAL' VERSUS 'LEGAL'

At this stage, it is appropriate to explain what is meant by 'practical' and 'legal' in the title of this work and why such contextualization is necessary or at least desirable. It is conceded that perhaps other terms could be used, but they seem as good as any others with some explanation.[15]

This work, limited as it is to the aircraft operating lease, has been influenced by the works of those who have gone before. In particular, this author draws attention to the work of, while in no way comparing himself to, Sir Roy Goode whose book, Commercial Law, is 'a synthesis of the theory underlying commercial relationships and

13. Abeyratne R.I.R., *Aviation Trends in the New Millenium*, Ashgate, 2001, 459.
14. *See* Chapter 3 section §3.05[A][4] *infra.*
15. Originally, this author had considered using 'theoretical' instead of 'legal' but was swayed in his final choice by the title of the DCL Thesis of Margo R.D., *Aviation Insurance in the United Kingdom: Law and Practice*, McGill University, 1979.

the practice which governs their operation'.[16] As Sir Roy points out, for such a synthesis:

> [t]he greatest difficulty… lies not in the sophisticated rule but in the fundamental concept. Rules may change, concepts are more permanent. Hence it is the theoretical framework of a subject which commands the closest attention, for it is that which endures when the detailed rule has passed into oblivion.[17]

[A] 'Practical'

By 'practical' is meant the approach of the legal practitioner in the field of aircraft operating leasing.[18] Such a practitioner may work in a commercial aircraft leasing company, as lessor, an airline, as lessee, or a private practice law firm representing either lessor or lessee. Practitioners in this field are, for the most part, highly qualified and experienced lawyers dealing in assets worth in the many millions of US dollars (USD). Certain practices are common among them, and the format of this work will broadly follow that of a typical aircraft operating lease deal for such practitioners, with such practices being discussed where they arise in Chapter 3.

Given the large sums of money involved, industry practice is highly developed, and all practitioners wish to ensure that such practice is, save where specifically negotiated otherwise, followed should matters end in litigation – the last thing they want is to find that a court has refused or is unable to enforce a provision of an aircraft operating lease on which they seek to rely due to a contrary judicial precedent, persuasive academic article, regulation, statute, or international treaty or other agreement or instrument.

In terms of the aircraft operating lease, each deal involves a high value asset, and tends to be a something of a tailor-made or bespoke agreement, based on a model lease produced by the lessor (occasionally, in the case of a powerful airline, by the lessee), with each lessor having its own preferred form. Thus, forms of lease vary even if overall their content is similar in effect to reflect then prevailing market practice.

To that extent, such leases, being fully negotiated by the parties, differ both from wet leases[19] and from short-term engine leases, where lessees typically have less bargaining power and the leases are correspondingly more one-sided, leading to

16. Street H., Foreword to First Edition, in Goode CBE QC Sir Roy, *Commercial Law*, 2nd Edition, Penguin Books, 1995, at xxiv.
17. Goode CBE QC Sir Roy, *Commercial Law*, 2nd Edition, Penguin Books, 1995, at xxvi.
18. Other forms of aircraft leasing and financing, such as finance lease, are discussed at Chapter 2 section §2.01, *infra*.
19. 'Wet leasing of an aircraft entails the transfer for use of an aircraft along with the cockpit crew, cabin crew, maintenance and hull insurance….A wet lease is generally concluded for a very short term….A wet lease is similar to an aircraft charter, except that the wet lessee must be an airline holding its own operating licenses and permits, and the aircraft must be operated under the lessee's flight designator codes and route authorities': Bunker D.H., *Aircraft Wet Leasing: The Perils and the Benefits*, Annals of Air and Space Law, Volume XXV, 2000, 67–82, at 67–68.

difficulty in enforcement in case of breach by the lessor.[20] This is because these are more typically entered into at short notice on an emergency basis where an airline finds itself needing an aircraft or engine at short notice due to a problem with another of its aircraft, or one of the engines on such aircraft.

Bunker[21] sets out in detail some of the problems which can be encountered with wet leasing, especially given the fact that generally the immediate need is so intense that there is less than ideal negotiation of the terms of the wet lease[22] or adequate due diligence: one of his primary cautions is to identify the wet lessor and to establish its bona fides.[23]

With short-term engine leasing, the International Air Transport Association (IATA),[24] in conjunction with the Aviation Working Group (AWG),[25] has prepared an agreed form Master Short-Term Engine Lease Agreement[26] which is freely available for use and adaptation by parties. It is only suitable for short-term leases of engines, but there has been some discussion of extending such standardization process further. Wilson[27] has commented:

> While some might say that it remains to be seen if document standardization comes to other aspects of aircraft finance, others think it inevitable and that the only question is, 'When'?
>
> it is the intent of this author that this work should flag the principal legal issues to be considered in developing a standard form aircraft operating lease and he will make certain recommendations in that regard.

[B] 'Legal'

By 'legal', on the other hand, is meant *not* a body of law that somehow exists only in theory and is not applied, as contrasted with practice, but rather that body of law, involving public and private international air law, statutes, regulations, and judicial precedent which indeed applies to any legal issues which may arise under an aircraft operating lease.[28] These will be examined as they arise in the context of an operating leasing transaction in the following pages. Such body of law may differ from the industry practice but, ultimately, while courts may take note of industry practice, in the

20. '… a judge's hands may be tied where, for example, a one-sided lease agreement fails to include any lessor default or adequate termination provisions in favour of the lessee', Bunker, *supra*, at 81.
21. Bunker D.H., *International Aircraft Financing, Volume 1: General Principles*, 2nd Edition, IATA, 2015, at 180–191.
22. *Ibid.*, at 241.
23. *Ibid.*, at 243.
24. *See* http://www.iata.org on 30 Aug. 2016.
25. *See* http://www.awg.aero on 30 Aug. 2016.
26. IATA Document No. 5016-00, *Master Short-Term Engine Lease Agreement*, 2002.
27. Wilson F.S., *Mastering Engine Leasing: The Master Short-Term Engine Lease Agreement Will Serve as Models for Future Standardization in the Aviation Industry*, Air Finance Journal, 1 Sep. 2007.
28. For more on the source of public and private international air law, *see* Diederiks-Verschoor I.H. Ph., *An Introduction to Air Law*, 7th Revised Edition, Kluwer Law International, 2001, at 3–4;

case of disputes as to the interpretation or enforcement of provisions of aircraft operating leases, the courts will, or should, apply the *lex lata*, the law as it is, and cannot easily ignore it simply because the outcome is inconvenient from the point of view of the aircraft operating lease industry.

It is certainly desirable, therefore, that such courts, and those practicing before it in the context of contentious litigation, should at least be familiar with the industry practice in respect of which they are asked to adjudicate. Likewise, it is incumbent on legal practitioners specializing in putting the transactions together to be aware of the legal framework within which those courts, who will adjudicate in case of dispute, operate.

To put it another way, the practical approach, guided by a desired certain commercial outcome, is deployed in putting the lease together, but the legal, or more theoretical, approach, applying the law to disputes arising thereunder, takes the lease apart in order to analyse it and to apply the law to it.

If it may be said that many aircraft finance lawyers are not as familiar with public and private international air law, it may fairly be said also that public and private international air law did not always, until relatively recently, take full account of the fact that ownership and operation of a given aircraft may be in different hands. This is not surprising, since the aircraft operating lease only really took off after the 1970s,[29] growing rapidly in the 1980s and 1990s.[30]

By contrast, most public and private international air law treaties have been in place before the mid-1970s, the Montreal Convention[31] of 1999 and the Cape Town Convention[32] of 2001 being the more recent developments in the field of private air law treaties and the amendment to the Chicago Convention[33] of 1944 by the addition of Article 83*bis*[34] being a more notable relatively recent development in the field of public air law treaties.

It is desirable, it is submitted, for those putting a lease together to know how it may be taken apart later, and it is equally desirable for those taking a lease apart later to know how and why it was put together the way it was.

Sir Roy Goode has written that:

> [t]he commercial lawyer of today needs to know not only his or her own law but of developments in what has come to be known as transnational commercial law, the corpus of law that grows from international conventions and other instruments

Bunker D.H., *International Aircraft Financing, Volume 1: General Principles*, 2nd Edition, IATA, 2015, at 457 et seq., and Dempsey P.S., *Public International Air Law*, McGill University, 2008, at 5–6.

29. Bunker D.H., *The Law of Aerospace Finance in Canada*, McGill, 1988.
30. *Study on Aircraft Leasing*, Air Transport Committee, 156th Session of the Council, ICAO, 1999.
31. Convention for the Unification of Certain Rules for International Carriage by Air, signed at Montreal on 28 May 1999.
32. Convention on International Interests in Mobile Equipment signed at Cape Town on 16 Nov. 2001.
33. The Convention on International Civil Aviation, signed at Chicago on 7 Dec. 1944.
34. *See* Chapter 3 section §3.15[H] *infra*.

> of harmonization and from conscious and unconscious parallelism in judicial thinking in different jurisdictions.[35]

This statement, it is submitted, is equally true if 'aircraft finance lawyer' is substituted for 'commercial lawyer' and 'public and private international air law' for 'transnational commercial law'.

§1.03 AIM AND METHODOLOGY

It is the aim of this work to provide an original contribution to legal science by examining, from a legal perspective, a typical lease transaction from the start of the deal through to execution of the documentation, discussing not only the typical issues that arise and their resolution, but the reasons underlying them. It is submitted that a comprehensive examination of the interrelationship between the law on the one hand and the practice of the typical provisions aircraft operating leases on the other hand has been a somewhat understudied area of aircraft finance law to date.

In terms of layout, this work is divided into four parts in addition to the various Annexes and Tables at the end:

(1) introduction, which as its name implies is introductory;
(2) overview, which is largely descriptive;
(3) the Aircraft Operating Lease, which is largely analytical and based on research, and constitutes by far the greater body of this work; and
(4) conclusion, which is largely prescriptive.

Finally, a Supplement is added after the end of this work which sets out a real example of a form of aircraft operating lease for a used aircraft, as used by a leading commercial aircraft leasing company.[36] This form will differ in detail from those used by other leasing companies but in overall terms of layout and content is representative of the current state of the market. This Supplement should be valuable in illustrating many of the points made in the body of the text itself and cross-references are made where appropriate.

In terms of methodology, there are two main ways of undertaking the analysis of this subject.

One is a systematic overview of public and private international air law, examining each international agreement in turn, and discussing where the provisions of each have an impact on aircraft operating leasing. Such a methodology may be seen in, for example, Pompongsuk.[37]

35. Goode CBE QC Sir Roy, *Commercial Law*, 2nd Edition, Penguin Books, 1995, at xx.
36. The company is Aviation Capital Group Corp. of Newport Beach California. As of the date of writing, this author is employed as Managing Director of its Irish based subsidiary, ACG Aircraft Leasing Ireland Limited.
37. Pompongsuk P., *International Aircraft Leasing: Impact on International Air Law Treaties*. LLM Thesis, McGill University, 1997.

The other is a systematic overview of the aircraft operating lease, examining each major section thereof in turn, and researching and discussing where the provisions thereof have been impacted, *inter alia*, by relevant provisions of substantive law. Such a methodology may be seen, for example, in Bunker.[38]

The methodology chosen in this work is the latter rather than the former for several reasons, among them, the following:

- Many provisions of substantive law (the theory, as discussed at section §1.02 *supra*) need to be considered, not only those set out in public and private international air law agreements, but also case law, statutes and regulations (which differ by jurisdiction), taking into account both common and civil law systems where appropriate.
- It is arguably more important to avoid problems in the interpretation of leases by addressing these issues at the time when the lease is being put together during the drafting and negotiation stage rather than *ex post facto* when it is being taken apart for analysis during litigation, by which stage it is too late to remedy any problems.
- This author was personally more familiar, at the outset of this research, with the situation of the legal practitioner who needs to understand better the theoretical framework in which he operates rather than *vice versa*.

This work differs from Bunker,[39] however, in having a more detailed discussion in relation to each section of the typical aircraft operating lease agreement under analysis. The reason for this is that Bunker is not confined to aircraft operating leasing but examines other forms of lease and indeed of aircraft financing. Further, although the major sources of air law are considered,[40] a detailed contextualization of the aircraft operating lease in that setting is outside the scope of that work.

This examination will be carried out in the context of reviewing the current literature in this area and making reference, where appropriate, to the results of extensive research into relevant learned articles and texts, case law, regulations, statutes, and international treaties, particularly those relating to public and private international air law.

In that regard, many different domestic legal systems may come into play: the governing law of the lease itself, the law of the jurisdiction of the lessor, the law of the jurisdiction of the lessee, the law of the State of registration of the aircraft pursuant to Article 17 of the Chicago Convention, and the *lex situs* of the aircraft all come to mind. To that extent, the examples given should be seen as precisely that: examples. The particular combinations of laws that may apply in a given case will often vary from deal to deal as each of the factors just cited changes.

Cross-border aircraft operating leasing is thus characterized by what Simon Hall describes as an 'absence of a uniform body of law',[41] with the rules of private

38. Bunker D.H., *International Aircraft Financing*, Volume 2, 2nd Edition, IATA, 2015.
39. *Supra*.
40. *Supra*, Volume 1, Chapter 6.
41. Clark T (editor), *Leasing Finance*, Euromoney, 1985, at 73.

international law governing, for the time being, 'what law applies, and, accordingly, what laws will govern the consequences of the contractual relations involved'.[42]

The governing law of the cross-border aircraft operating lease will, in the majority of cases, be English or New York law, since the English and New York courts have great experience in interpreting and enforcing operating lease provisions, thus reducing uncertainty of interpretation. This author has rarely seen in over twenty years of practice in the field a cross-border aircraft operating lease governed by the laws of any other common law jurisdiction and has never seen one governed by the laws of a civil law jurisdiction.[43]

This work will focus primarily, therefore, on English and, to an extent, New York law as the governing law of the lease, as well as to relevant principles and provisions of European Union law, but will refer to other systems of law elsewhere in the world where appropriate in addition to relevant principles of public and private international air law.

It is important to examine the structuring of the transaction and the letter of intent which precedes the negotiation of the lease first since these will set the parameters for the lease itself – for example, by determining who will be the parties to the lease and whether the lease will be directly from the lessor to the lessee or will consist of a head lease from the lessor to a special purpose company set up by the lessor for that purpose and a sublease from such special purpose company to the lessee. Even more complicated structures may be required depending on the particular jurisdiction and the requirements of the lessor's financiers.

Turning then to the lease itself, the major issues in aircraft operating leasing will be analysed from both a legal and practical point of view, with subjects divided according to the main typical sections of an aircraft operating lease. One reason for this is that, in practice, this is typically how, in this author's experience, leases are negotiated and legal, as well as commercial, technical and other issues are encountered – by a page by page turning through the draft lease, section by section, by counsel for both lessor and lessee together with other representatives of either party.

As will be seen in Chapter 3, the influence of the public and private air law treaties is to be found mainly in respect of safety and maintenance, licensing and certification, liability to third parties, as well as issues pertaining to registration and enforcement of remedies. Less evident, if evident at all in some cases, is a concern with the commercial aspects of the operating lease or the allocation of risk by the parties *inter se*.[44] Accordingly, as the provisions of the lease are gone through, this work shall,

42. *Ibid.*, at 75.
43. That is not to say, of course, that it does not or cannot happen. *See*, e.g., Fortier J.M., *Leasing of Aircraft in the Province of Quebec*, Annals of Air and Space Law, Volume XV, 1990, at 61–73, where the author discusses finance (but not operating) leasing in the Canadian civil law province of Québec, in particular, the exemption of aircraft on finance lease, or *crédit-bail*, as defined in Article 1603 of the then Civil Code of Lower Canada, from the provisions of Chapter First of the Lease of Things of such Civil Code, from the requirement that it be in good repair and that lessor grant a warranty against latent defects.
44. As will be discussed in Chapter 3 *infra*, only the Cape Town Convention and Aircraft Equipment Protocol thereto, of the international air law instruments, is directly concerned with contractual

depending on the section in question, dwell to a greater or lesser extent on applicable public and private international air law.

Professor Sir Roy Goode,[45] in his Official Commentary[46] to the Cape Town Convention, distinguishes private and public international air law. He echoes Abeyratne[47] in referring to States' balancing of each State's legal philosophy and the need to respect a high degree of autonomy for the parties.

Further, he points out that, although the Cape Town Convention is framed on a basis consistent with the preamble to the Chicago Convention that:

> international civil aviation may be developed in a safe and orderly manner and that the international air transport services may be established on the basis of equality of opportunity and operated soundly and economically,

the third preamble to the Aircraft Equipment Protocol to the Cape Town Convention is carefully worded, so as to 'avoid any implication that the Convention has to be construed by reference to the provisions of the Chicago Convention',[48] as follows:

> MINDFUL of the principles and objectives of the Convention on International Civil Aviation, signed at Chicago on 7 December 1944.

According to the Official Commentary,[49] the Cape Town Convention, together with the Aircraft Equipment Protocol thereto, provides 'an international legal regimen for security and related interests in aircraft', thus helping:

> to reduce legal uncertainty caused by differences in national laws and thereby opening up to developing countries access to finance at reasonable cost.

Sir Roy continues that, although both the Cape Town Convention and Chicago Convention have a similar set of principles and objects,[50] nevertheless, they address different subjects: the Chicago Convention is a public law convention establishing an international system centred on sovereignty to promote safe and secure flight operations whereas the Cape Town Convention is a private law convention designed to facilitate the financing and leasing of aircraft.[51] In his view, in any event, 'principles of

rights *inter partes*; for the most part, the others deal with the rights and obligations of third parties, such as passengers, those on the ground, tax authorities, air navigation and other service providers, etc.

45. Sir Roy was chairman of the Unidroit Study Group which initiated the Cape Town Convention as an ambitious private international law project.
46. Goode R., *Convention on International Interests in Mobile Equipment and Protocol Thereto on Matters Specific to Aircraft Equipment: Official Commentary*, Unidroit, 2002, at 175–180.
47. *See* section §1.01 *supra*.
48. *Ibid.*, at 176.
49. *Supra*, at back cover page.
50. The preamble to the Chicago Convention states that it was concluded 'in order that international civil aviation may be developed in a safe and orderly manner and that international air transport services may be established on the basis of equality of opportunity and operated soundly and economically.' The preambles to the Cape Town Convention and Aircraft Equipment Protocol refer to the need for clear rules to facilitate the financing of the acquisition and use of aircraft equipment.
51. *Ibid.*, at 180.

interpretation employed in dealing with one text are unlikely to apply in dealing with the other.'[52]

Even if that is so, in the context of aircraft leasing, the key word is to be found in the above-quoted third preamble to the Aircraft Equipment Protocol to the Cape Town Convention: allowing that Sir Roy is correct that the Cape Town Convention does not *have to be* construed by reference to the Chicago Convention, it is still necessary to be *mindful* of both applicable principles of public international air law and of private international air law.

Perhaps his distinction is somewhat artificial – by way of comparison, the Warsaw Convention does not refer to the Paris Convention,[53] the predecessor of the Chicago Convention,[54] at all; and the Montreal Convention 1999, in its fourth recital, simply 'reaffirms' the 'desirability' of an orderly development of international air transport operations 'in accordance with the principles and objectives of' the Chicago Convention. Indeed, the other public and private air law instruments referred to in this work do not refer to the Chicago Convention in this context at all.

With due respect to Sir Roy's role as chairman of the Unidroit Study Group which initiated the Cape Town Convention, it is not clear that the word 'mindful' in the context of the Cape Town Convention connotes as great a sense of separation from the Chicago Convention as Sir Roy implies it does.

Given that one of its aims is to 'ensure greater degree of certainty and enforceability of a lessor's contractual rights and obligations',[55] the Cape Town Convention will be discussed at length throughout this work.

The main premise of this author is that, under the operating lease, the lessor wishes to pass all operational risk to the airline lessee, retaining only the credit risk of the lessee and the risk of the residual value of the aircraft at the end of the lease term but that, while this may work *inter partes*, this does not bind third parties whose rights are founded not in contract but in law.

Too often, in this author's experience, lawyers in this field believe in absolute freedom of contract to allocate risk and too often find out, when it comes to litigation, that the courts refuse to enforce lease provisions in the way in which such lawyers had originally envisaged or even to enforce them at all. Practitioners should draft clearly, within the applicable legal and regulatory framework, so that courts can simply enforce the leases as drafted. Once that is done, for their part, courts should indeed simply enforce the leases as drafted.

In short, this work, then, aims to bring the lawyer through an aircraft operating lease in such a manner as to give him/her a thorough understanding not only of the practical manner in which leases are typically negotiated, drafted and executed[56] but of the theoretical legal reasons under applicable domestic and international law, whether

52. *Ibid.*, at 180.
53. The Convention relating to the Regulation of Aerial Navigation signed at Paris on 13 Oct. 1919.
54. *See* Article 80 of the Chicago Convention.
55. Djojonegoro A., *The Unidroit Proposal for a Uniform Air Law: A New Aircraft Mortgage Convention?*, Annals of Air and Space Law, Volume XXII, Part II, 1997, at 54.
56. As to which, *see also* Bunker D.H., *International Aircraft Financing, Volume 2: Specific Documents*, 2nd Edition, IATA, 2015, at 38–204.

by way of case law, statute or treaty, which underpin, or which should underpin, such practical manner.

More importantly, based on the research and analysis set out in this work, this author will consider if any patterns emerge in cases of divergence between the practical and the legal and will consider what implications such divergence may have in particular for the fields of public and private international air law.

CHAPTER 2

Overview

§2.01 AIRCRAFT OPERATING LEASING AND OTHER FORMS OF LEASING AND FINANCING

In the context of personal property, such as an aircraft, a lease may be defined as:

> a contract by which one owning such property grants to another the right to possess, use and enjoy it for a specified period of time in exchange for periodic payment of a stipulated price, referred to as rent.[1]

However, this definition, although it may work for most purposes, may not be entirely correct or comprehensive.[2]

There seems no good reason why such grant must be in exchange for a periodic payment (rent could be paid in advance in full, for example) of a stipulated price (the rent may be floating by reference to interest rate fluctuations, rather than fixed, or may otherwise be reviewable during the term) or at all (there could be a power by the hour arrangement whereby the airline is only obliged to store, maintain and use the aircraft, but is only obliged to pay rent, howsoever described, based on actual usage, with or without minimum usage requirements).[3]

The Cape Town Convention perhaps comes closer to a comprehensive definition by defining a lease agreement as:

> an agreement by which one person (the lessor) grants a right to possession or control of an object (with or without an option to purchase) to another person (the lessee) in return for a rental or other payment.[4]

1. Nolan J.R. and Nolan-Haley J.M., Black's Law Dictionary, West Publishing Co., 6th Edition, 1990 at 889.
2. For example, the lessor may not be the owner where it itself holds the leased property pursuant to a head lease.
3. Thus, the various attempts to define a lease in Abeyratne R.I.R., *Aviation Trends in the New Millenium*, Ashgate, 2001, 14 et seq., while good, likewise are not comprehensive.
4. Article 1(q).

The International Civil Aviation Organization (ICAO), the specialized agency of the United Nations dealing with international civil aviation, has, perhaps wisely, declined to define what constitutes a leased aircraft other than as one 'used under a contractual leasing arrangement' according to its Manual on the Regulation of International Air Transport.[5] Given the tailor-made nature of leases negotiated for specific situations, its Air Transport Committee has stated that a more precise definition has not proven possible.[6]

Aircraft leases are classified as being either operating or true leases on the one hand or finance or capital leases on the other hand.[7] This work will examine the aircraft operating lease.[8]

For accounting purposes, the International Accounting Standards Board (IASB)[9] adopted Standard 17 (IAS 17) which provides that:

> The classification of leases adopted in this Standard is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee.
>
> A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.

In the United States, the Financial Accounting Standards Board (FASB)[10] adopted Statement of Financial Accounting Standards 13 (FAS 13), which is more detailed than IAS 17.

Under paragraph 7 of FASB 13, a capital lease is one in which, *inter alia*:

(1) the lease transfers ownership of the property to the lessee by the end of the lease term;
(2) the lease contains a bargain purchase option;
(3) the lease term is equal to 75% or more of the estimated economic life of the leased property; or
(4) the present value of the lease payments, discounted at an appropriate discount rate, exceeds 90% of the fair market value of the asset.

An operating lease is simply defined as any lease which is not a capital lease.

5. Doc 9626.
6. *Study on Aircraft Leasing*, Air Transport Committee, 156th Session of the Council, ICAO, 1999, at 1.1.
7. *See* discussion in Vasigh B., Fleming K. and Humphreys B., *Foundations of Airline Finance – Methodology and Practice*, Routledge, 2015, at 495–530.
8. Specifically, the dry aircraft operating lease. For the distinction between dry and wet leases (which latter are more akin to charters of aircraft in certain respects and in any event beyond the scope of this work), *see* Chapter 3 section §3.05[A][4] and §3.05[B][5] *infra*. Also note Hamilton's statement that the United States Federal Aviation Administration has a basic presumption that, where an aircraft and crew are provided from the same source, the arrangement is a charter and not a lease, with wet leases being closely scrutinized: Hamilton J.S., *Practical Aviation Law*, 4th Edition, Blackwell, 2005, at 218.
9. http://www.ifrs.org on 30 Aug. 2016.
10. http://www.fasb.org on 30 Aug. 2016.

The IASB and the FASB harmonized their approach to lease accounting by requiring a lessee to recognize assets and liabilities for the rights and obligations created by leases, of whatever type.[11] Harmonization of IASB 17 and FAS 13 was achieved in January 2016 with the publication of IFRS 16 Leases,[12] taking effect from 1 January 2019,[13] which provides a new definition of a lease as follows:

> A lease is defined as a contract, or part of a contract, that conveys to the customer the right to use an asset for a period of time in exchange for consideration.

The Unidroit Convention on International Financial Leasing,[14] which has not been widely adopted,[15] sets out provisions dealing with 'financial leasing' which it defines as including, *inter alia*, the characteristic that:

> the rentals payable under the leasing agreement are calculated so as to take into account in particular the amortisation of the whole or a substantial part of the cost of the equipment.[16]

From a commercial and accounting point of view, the main difference between an operating and a finance lease is that, with the former, the lessor is expecting to receive the aircraft back while it still has a useful economic life and thus will be more concerned as to the physical condition of the aircraft since it must lease it out afterwards to a subsequent lessee. The aircraft remains accounted for as an asset on the books of the lessor, who is entitled to depreciation of the aircraft since the risks and rewards of ownership lie with it. Further, a benefit for the lessee in entering into an operating lease is the corollary that the operating lease does not appear on its books as a liability[17] since, with it:

> lease structures can be devised to meet accounting objectives of removing liabilities from a balance sheet – thereby, among other things, preserving the lessee's debt-to-equity ratio.[18]

With the finance lease, on the other hand, the aircraft is accounted for as an asset on the books of the lessee, with the depreciation rights which that entails, since the risks and rewards of ownership have been assumed by it. Barring a default on the part of the lessee, the lessor does not expect to retake possession of the asset.

11. http://www.ifrs.org/Current-Projects/IASB-Projects/Leases/Pages/Leases.aspx on 30 Aug. 2016.
12. *Ibid.*
13. http://www.ifrs.org/Current-Projects/IASB-Projects/Leases/archive/Pages/Project-update-October-2015.aspx on 30 Aug. 2016.
14. Signed at Ottawa on 28 May 1988.
15. It is only in force in ten States – http://www.unidroit.org/status-leasing-conv-1988 on 30 Aug. 2016.
16. Article 2(c).
17. This is, of course, only one benefit to the lessee of an operating lease. Even without such accounting treatment, the operating lease would still offer flexibility in terms of a finance lease in terms of committing the airline to an aircraft for only a portion of its economic life.
18. Bunker D.H., *Aircraft Financing in the Future*, Annals of Air and Space Law, Volume XXVII, 2002, 139–160, at 149.

In *Lithoprint (Scotland) Ltd. v. Summit Leasing Ltd. & Ors.*,[19] a case before Lord Milligan of the Scottish Court of Sessions, the dispute did not concern whether the lease in question was an operating lease or a finance lease. In it, the pursuers[20] asserted, and the defenders[21] did not dispute that, 'a finance lease typically transfers many of the risks and rewards of ownership to the lessee in return for payment of a rental, that most finance lessors fix the rental as if the transaction is a loan'[22] and 'that the rental is fixed with a view to a full return to the lessor of capital and interest'.

To that extent, the finance lessor can be considered as essentially akin to a secured lender, choosing to structure its security by way of ownership where the asset is subject to a finance lease in favour of what is thus essentially akin to a borrower rather than by allowing the borrower legal ownership while taking a mortgage over the aircraft.[23]

This argument was raised before Hamblen J of the English High Court in *Celestial Aviation Trading 71 Limited v. Paramount Airways Private Ltd.*[24] In that case, Hamblen J considered *Shiloh Spinners Ltd. v. Harding (HL)*,[25] which allowed the court to consider whether the insertion of a right of forfeiture essentially to secure the payment of money was a ground on which relief against forfeiture could be granted. In *Celestial*, Hamblen J held that the lease in question was an operating not a finance lease, that possessory rights for the lease term only were transferred not proprietary rights, and rejected the claimant's argument that relief against such forfeiture should be granted since, *inter alia*, the total of all lease rentals and supplemental reserves (as to which *see* Chapter 3 section §3.07 *infra*) to be paid to the defendant would exceed the cost of the aircraft. His reasoning included the fact that this was an operating lease and that, for leases of this type, the rent was set by reference to prevailing demand and supply for aircraft of the same type. He also rejected the claimant's method of calculation (specifically excluding supplemental rent since that is a fund to be used for major aircraft maintenance).[26]

Both the IASB and FASB are considering abolishing the distinction between operating and finance leases for accounting purposes. According to IASB:

> Classification as an operating lease results in the lessee not recording any assets or liabilities in the statement of financial position under either International Financial Reporting Standards or US standards.... This results in many investors having to adjust the financial statements....to estimate the effects of lessees' operating leases for the purpose of investment analysis. The proposals would result in a consistent approach to lease accounting for both lessees and lessors – a 'right-of-use' approach. This approach would result in all leases being included in the statement of financial position....[27]

19. [1998] ScotCS 36 (23 Oct. 1998).
20. Plaintiffs in Scottish courts.
21. Defendants in Scottish courts.
22. At page 2.
23. *See* the discussion 'Scope Problem: True Lease or Disguised Security Interest?' in Clark B., *The Law of Secured Transactions Under the Uniform Commercial Code*, Volume 1, Thomson Financial, 2000, at 1–45 et seq.
24. [2010] EWHC 185 (Comm.).
25. [1973] AC 691.
26. *Ibid.*, at 47.

Even if such convergence should take place for accounting purposes, it is submitted that this would not have any effect on the legal distinction between operating and finance leases, at least under English law. In *Celestial*,[28] Hamblen J referred to the distinction in accounting treatment[29] between operating leases and finance leases, but did not base his judgment on it. He based his judgment on the following:

> In the present case..., Paramount only has a right to possess the Aircraft for a proportion of its economic life. As such, Celestial retains a very real interest in the Aircraft themselves, including their proper maintenance, the extent of their use, their condition, and their rental and resale value. Possession of the Aircraft will revert to it at a time when the bulk of their economic life is still to run, and there are detailed terms addressing the return of the Aircraft and their required redelivery condition. Celestial therefore retains many of the risks and rewards of ownership. Moreover, rent was not calculated on the basis of recouping the cost of the Aircraft together with interest and profit.[30]

The Cape Town Convention, which will be examined in detail in Chapter 3 later,[31] particularly in the context of remedies, does not distinguish between operating and finance leases and thus a change in accounting treatment of operating leases would have no effect thereunder. This is not surprising since one of the main purposes of the Cape Town Convention is to establish 'clear rules to govern' asset-based financing and leasing alike: Article 1(i) thereof defines a creditor as being variously 'a charge under a security assignment, a conditional seller under a title reservation agreement and a lessor under a leasing agreement'.

Accordingly, this lack of distinction between operating and finance leases in the Cape Town Convention makes sense when one considers that it protects both the lessor under a lease (whether operating or finance) and the lender under a secured financing. If the lender chooses to lend under a finance lease, it will be protected as lessor under the Cape Town Convention. If it chooses to lend instead with the security of a mortgage over the aircraft, it will be protected as the holder of a charge thereover.

Further, Article 83*bis* of the Chicago Convention, also dealt with in detail in Chapter 3,[32] and dealing with leasing, likewise does not distinguish between operating and finance leases. Therefore, a change in the accounting treatment of operating leases would not have any effect under the Chicago Convention either.

The many other forms of aircraft financing available to an airline are beyond the scope of this work. They are discussed in detail in Bunker[33] but there is one thing worth pointing out here – operating leasing, as with finance leasing, secured finance and

27. http://www.ifrs.org/Current+Projects/IASB+Projects/Leases/ed10/Ed.htm on 30 Aug. 2016.
28. At 55.
29. Referring there to a Statement of the Institute of Chartered Accountants, SSAP 21.
30. At 54.
31. *See* Chapter 3 section §3.15[C] *infra*.
32. *See* Chapter 3 section §3.15[H] *infra*.
33. Bunker D.H., *International Aircraft Financing*, 2nd Edition, IATA, 2015.

outright purchase are all tools available to the airline to choose how it wishes to acquire and pay for the aircraft it uses. Although operating leasing may have once been seen as the preserve of carriers with a lower credit quality (who, lacking sufficient financial resources to place their own orders for new aircraft, were forced to rely on a small number of leasing companies), such has not been the case for at least the past decade.[34]

With the option of operating leasing, airlines can target certain aircraft for ownership as strategic long-term assets, but using additional aircraft more flexibly on operating lease, which they can allow to expire at the end of the lease term or extend, depending on their needs at that time. Further, whereas, upon a strict comparison, operating leasing may appear expensive compared with other sources of finance, this is not necessarily the case, especially when the cost of pricing in the lessor's assumption of the residual value risk is factored in.[35] In all cases other than operating leases, the airline assumes the residual value risk of the aircraft and this assumption should be priced into a comparison when deciding whether to buy or to lease.

§2.02 STRUCTURING THE LEASE

Having decided to proceed with an aircraft operating lease, the airline must next determine with the lessor how it should best be structured.[36]

In the simplest case, the lessor will own the aircraft and lease it to the lessee. However, many other permutations and combinations are possible and it is desirable for the team putting a lease together to obtain relevant legal advice pursuant to the jurisdictional questionnaire,[37] accounting advice, and technical advice[38] before fixing on the structure, which should be clear before committing to the letter of intent.[39]

For example, the owner and the lessor may not be the same. In such case, typically, the owner will lease the aircraft to the lessor under a head lease and the lessor will then lease the aircraft to the airline under a sublease.[40] The reasons for this may vary for reasons discussed below.

The lessor's financier (if it has one) may insist on having ownership of the aircraft placed in a special purpose vehicle (SPV) set up by the lessor but over which the financier has a pledge of shares[41] rather than allowing the lessor to retain ownership of the aircraft and accepting a mortgage of the aircraft. Reasons for so doing may be the greater ease of enforcement of a pledge of shares in the jurisdiction of incorporation of the SPV as compared with enforcement of a mortgage in the jurisdiction where the

34. Lobkowicz P. and Detrich B., *Operating Leasing: Who Wins Economically?* Airfinance Journal: A Guide to Operating Lease, June 1997.
35. *Ibid.*
36. *See* Bunker D.H., *International Aircraft Financing, Volume 2: Specific Documents*, 2nd Edition, IATA, 2015, at 37.
37. *See* section §2.04 *infra*.
38. For example as to the desirability of one aircraft nationality register over another.
39. *See* section §2.03 *infra*.
40. *See* Annex 1 *infra*.
41. *See* Annex 3 *infra*.

aircraft is registered or was located at the time of the creation of the mortgage or is located at the time of enforcement of the mortgage.[42]

Alternatively, there may be a withholding tax which, subject to any relevant tax treaty, the lessee would be obliged to withhold on payments to the owner's jurisdiction under the lease, and in respect of which the owner would oblige the lessee to gross up so as to ensure that, after making the necessary withholding, the lessor receives net the amount specified in the lease.[43] However, such a withholding tax may not apply with respect to another jurisdiction or it may apply at a lower rate. In such event, the owner will set up an SPV in a tax favourable jurisdiction and lease the aircraft to the SPV under a head lease. The SPV will then lease the aircraft to the airline under a sublease.

In the two examples above, the structure is the same (head lease and sublease) but the substantial party differs: in the first case, it is the lessor (the owner being simply an SPV); in the latter, it is the owner (the lessor being simply an SPV).

Another example of the same structure on paper is a head lease and sublease where the airline is owned by a parent company which does not hold an air operator's certificate or air transport license[44] but which, for whatever, reason, wants to be the immediate lessee of the aircraft. That parent will then sublease to its certificated and licensed airline subsidiary.

A different structure may occur where, for example, the owner wants to use an owner trust. This may be required due to restrictions on registration of aircraft on the nationality register of the airline's jurisdiction. For example, a non-US owner may wish to lease to a US airline with the aircraft being registered in the United States. It may enter into a trust agreement as beneficiary with a US owner trustee which will then lease the aircraft, not in its individual capacity, but solely in such capacity as owner trustee, to the airline.

In this case, and in the first two cases, the airline may well want a guarantee if the lessor is not leasing in its own capacity or is not the party in the transaction structure with substantial assets, and it should seek a letter of quiet enjoyment whereby any owner, head lessor or trust beneficiary undertakes not to interfere with the airline's quiet enjoyment and use of the aircraft so long as it is performing its obligations under the lease.

Indeed, owner trusts as lessor are not restricted to this instance: a non-US airline wishing to have an aircraft registered in the United States may also rely on an owner trust. In May 2010, the Federal Aviation Administration of the United States of America (FAA) expressed concern in a Notice of Proposed Rulemaking[45] over the situation where the beneficiary of the owner trust is the same entity as the entity that

42. Likewise, stamp duty in certain jurisdictions on mortgagers must be such as to make a mortgage uneconomical to pursue, in which case the lender will likely look to a solution involving its reliance instead on ownership in an SPV. In some cases, a lender will pursue a 'belt and braces' approach, wanting both ownership in an SPV over which it has a pledge of shares and also a mortgage by that SPV in its favour securing the amounts due to it.
43. This is the so-called hell or high water clause (as in, come hell or high water the lessee must ensure that the lessor receives the full amount of rent referred to in the lease). *See* Chapter 3 sections §3.07[A] and §3.08 *infra*.
44. *See* Chapter 3 section §3.05[B][5] and §3.05[B][6] *infra*.
45. 73 Fed. Reg. 10, 701 (proposed 28 Feb. 2008).

has operational control over the aircraft[46] – it did not express concern about where the parties are different (such as where the beneficiary of the owner trust is a lessor and the party with operational control of the aircraft is a lessee).

Although this issue remains under review, there has been no change so far in regulations or FAA practice and the issue, in any event, did not concern non-US lessors using owner trusts.[47]

The different possibilities involved due to aircraft registration are discussed in further detail at Chapter 3 section §3.10[B][3]*infra*.

The cost of a structure more complicated than that of a simple lease from the owner to the airline should be calculated in advance, and agreement reached as to how those costs are borne or shared, to determine their impact on the economics of the deal, before the parties are committed to proceeding with it. In this regard, the reason for the structure (to accommodate the lessor or the lessee) will play a role but, ultimately, the relative bargaining power of the parties will determine.

A useful source of reference in this regard is *Advanced Contract and Opinion Practices under the Cape Town Convention*[48] which assesses the implications of the Cape Town Convention[49] on a hypothetical but realistic transaction, from term sheet to closing.[50]

Having determined the structure of the lease, the parties are then in a position to enter into a letter of intent (which will be examined next) setting out the principal commercial terms of the desired leasing transaction. Alternatively, they may, if they so wish, reverse the order and agree the letter of intent first, leaving the precise structuring of the lease to be determined after the letter of intent is signed but before definitive lease documentation is agreed.

§2.03 THE LETTER OF INTENT

The lease is almost always preceded by a letter of intent[51] which sets out in summary form the principal terms. Legal issues here include the binding versus non-binding letter of credit and the issue of refundability of the deposit which is typically paid upon execution of the letter of intent so that the aircraft will be removed from the market pending negotiation and execution of the definitive lease.

With a non-binding letter of intent, or other letter of intent that does not include a deposit which is forfeitable in certain events, the lessor will have little motivation to remove the aircraft from the market.

46. Gerber D.N., *Aircraft Finance Issues: The Blue Sky Ruling; The New ASU and the 'Home Country Rule'; and Recent Developments at the FAA Registry*, a paper presented at the American Bar Association Air and Space Law Forum 2010 Annual Meeting in Seattle, Washington on 26 Oct. 2010.
47. *Ibid.*
48. Legal Advisory Panel of the Aviation Working Group, *Advanced Contract and Opinion Practices Under the Cape Town Convention*, Cape Town Paper Series, Volume 2, Unidroit, 2008.
49. Considered at Chapter 3 sections §3.01, §3.10, §3.15[C], et seq., *infra*.
50. *Ibid.*, at vii.
51. Also commonly referred to as a term sheet or memorandum of understanding.

The letter of intent is normally signed as soon as commercial agreement is reached in principle between the lessor and the airline with respect to the leasing of the aircraft. It will normally set out[52] the main commercial provisions, such as the parties, the aircraft, the target delivery date and lease term, the rent and other payment provisions (such as security deposit and maintenance reserves), any pre-approved subleasing by the lessee, key insurance requirements (such as stipulated loss value, minimum liability coverage and maximum deductible), and delivery and redelivery locations and (to a greater or lesser degree) conditions.

It is very desirable for a letter of intent to be reviewed by legal counsel to both parties (without slowing down the process unduly) since other matters, such as the governing law and jurisdiction provisions, the timeline for requisite corporate approvals subject to which the letter is signed, and other legal matters such as those identified above should be set out.

The more detailed the letter of intent, the less negotiation, in theory, there should be when it comes time to negotiate the lease itself and other definitive legal documentation, although this is not always the case. For example, if the lessor has legal, financing or other restrictions on where it can permit the lessee to operate the aircraft, it would be prudent to raise the issue at the letter of intent stage rather than leaving it until the definitive documentation, since such particular requirements could run contrary to the lessee's immediate or potential future plans for the aircraft.

A provision in the letter of intent that the transaction is subject to agreement of definitive legal documentation does not of itself make the letter of intent void for uncertainty or allow a contract party to evade its responsibilities by refusing to agree the definitive legal documentation following a change of heart about the transaction. Leggatt J, in the English High Court, has held in *Novus Aviation Limited v. Alubaf Arab International Bank BSC*[53] that it is:

> well established that, in the absence of very clear language to the contrary, a contractual discretion must be exercised in good faith for the purpose for which it was conferred, and must not be exercised arbitrarily, capriciously or unreasonably.[54]

Leggat J went on to make clear that this discretion included reviewing the documentation in a reasonable manner but did not include the right to review whether the counterparty still wanted to pursue the transaction at all. It is submitted that it is prudential to include an express provision in the letter that where the transaction is subject to agreement on definitive documentation, the parties will act reasonably and in good faith to agree in a timely manner such documentation on terms typical in the industry for such transactions save as expressly provided in the letter of intent.

Having agreed the letter of intent, the matter of drafting the lease is then turned to the legal counsel for the parties, with counsel to the lessor normally providing the first draft (after technical and commercial review by his or her colleagues) for review

52. *See* Bunker D.H., *International Aircraft Financing, Volume 2: Specific Documents*, 2nd Edition, IATA, 2015, at 16–37.
53. [2016] EWHC 1575 (Comm).
54. At 64.

by counsel to the lessee. This author has often noted that the lawyer's task at this point is to say in between 100 and 200 pages what the parties had already agreed to in fewer than twenty pages in the letter of intent – the additional pages being accounted for in no small measure by consideration of the legal considerations which are the subject matter of this work.

For cases where the Cape Town Convention applies,[55] the *Advanced Contract and Opinion Practices under the Cape Town Convention*[56] published by the Legal Advisory Panel of the AWG[57] recommends[58] that the letter of intent should be binding in order:

(1) to constitute an 'agreement for registration' if the intended nationality registration of the aircraft is to be the connecting factor under Article 3(3);[59] or
(2) to create an enforceable obligation to remove prospective registrations[60] if the Transaction does not close or the beneficiary of such registration ceases to have an interest.

That same publication also advises[61] that the letter of intent should make clear which international interests thereunder are to be registered pursuant to the Cape Town Convention but even if this is not done, it should be clear from the interests provided for in letter of intent and the provisions of the Cape Town Convention which interests are registrable thereunder and which are not.

Typically, with a binding letter of intent, the lessee will pay a deposit to the lessor in consideration of lessor's removal of the aircraft from the market.

In *JSD Corporation PTE Ltd v. Al Waha Capital PJSC and Second Waha Lease Limited*,[62] before Smith J in the English High Court, the plaintiff sought the return of a deposit paid by it under a letter of intent for the purchase by it of an aircraft where the sale did not proceed.

The letter of intent stated that the deposit was non-refundable except in case of total loss of the aircraft or a default by seller, either of which event would result in the deposit being returned to the buyer.

In its defence, the plaintiff argued that the defendant did not negotiate in good faith to finalize the documentation. Smith J was clear that there is no such obligation under English law. He held, however, that the defendant was in breach of the terms of

55. Considered *infra* at Chapter 3 sections §3.01, §3.10, §3.15[C] and elsewhere.
56. *Advanced Contract and Opinion Practices Under the Cape Town Convention*, Cape Town Paper Series 2, Volume 2, The Legal Advisory Panel of the Aviation Working Group, 2008.
57. An industry association of leading aircraft and aircraft engine manufacturers, lessor and financiers: *see* http://www.awg.aero.
58. At 11.
59. This provides for applicability of the Cape Town Convention where the aircraft is registered in the aircraft register of a contracting State or is to be so registered pursuant to an agreement for such registration in addition to Art. 3(1) which provides for applicability of the Cape Town Convention where the lessee is situated in a contracting State.
60. Prospective international interests may be registered under the Cape Town Convention pursuant to Article 6 but there should be a mechanism to remove them if the transaction does not close.
61. At 12.
62. [2009] EWHC 583 (Ch).

the letter of intent because, however inadvertently, it continued to advertise the aircraft for sale on Speednews, a trade publication, and thus failed, as agreed, to remove the aircraft from the market.

But for this clause, the plaintiff would not have succeeded – thus, it is imperative that lessors as well as sellers of aircraft ensure that, where a deposit is accepted in consideration for their removal of the aircraft from the market, all marketing efforts immediately cease and all advertisements lined up be cancelled.

Consistent with this approach, in *Tandrin Aviation Holdings Ltd v. Aero Toy Store LLC*,[63] the English Commercial Court upheld a seller's right to keep a deposit under a definitive sale agreement for the sale of an aircraft where a buyer failed to complete the purchase of an aircraft in a depressed market, holding on the facts that the amount of the deposit did not amount to a penalty and should be accepted in the circumstances as a true bargain between the parties as to a pre-estimate of seller's loss if buyer wrongly refused to complete the aircraft purchase. Similarly, in *Aercap Partners 1 Limited v. Avia Asset Management AB*,[64] the same court upheld a claim by an aircraft seller against a buyer where the buyer failed to pay the final instalment of a deposit. Gross LJ held that:

> it seems to me to follow that AerCap is entitled to base its loss of bargain claim on the difference between the contract… price and the market price once there was a market price.

Finally, if the obligation of either party to proceed is subject to its obtaining the approval of its board of directors, or to a satisfactory inspection of the aircraft by the lessee, or to any other condition or contingency, this should be made clear in the letter of intent, together with a clear deadline by which the conditions must be met, failing which the letter of intent should terminate and the deposit be returned to the lessee.

On the other hand, if the conditions are met, typically, the deposit paid under the letter of intent is applied towards the deposit payable under the lease once definitive lease documentation is signed.

§2.04 THE JURISDICTIONAL QUESTIONNAIRE

The jurisdictional questionnaire is a vital tool to help the lawyer assess the risk of leasing to an airline incorporated in a particular jurisdiction and allowing it to register the aircraft on that country's or another country's register.

Issues here include many of the items that will later be covered in the legal opinion to be given by the airline's lawyers to the leasing company but in general terms to help to identify jurisdictional risk and to determine any tax or legal issues which might affect the structuring of the deal.

For example, if the English courts are chosen as a forum for settlement of disputes under the lease, will the courts of the airline's jurisdiction enforce such judgment? If not, would they more readily enforce an arbitral award?

63. [2010] EWHC 40.
64. [2010] EWHC 2431, at 113.

Assignment: This section will set out the agreement between the parties whereby either may assign its rights and the lessor may, in addition, cause its obligations to be assumed under certain conditions by a third party.[87] The lessor needs to keep flexibility to sell the aircraft with the benefit of the lease attached whereas the lessee will want to ensure that it is not materially prejudiced by this, whether by virtue of a transfer to a leasing company with a much lower net worth or otherwise.[88]

Governing law: In the event of dispute which ends in litigation or other adversarial proceedings, the lease will set out what law has been agreed by the parties to govern the contract.[89]

Dispute resolution: If the parties cannot agree on the correct interpretation of the lease, or the facts in hand, the lease should make clear in what jurisdictions any claim may be brought. Enforceability of a judgment against the lessee in particular will always be primarily a concern of the lessor.[90]

Miscellaneous: These final clauses are sometimes called 'boiler plate' since they appear in most leases but their importance should not be overlooked.[91]

Execution: Finally, although this will normally only become an issue in the event of a dispute, the lease will need to be duly executed by both parties observing any formalities required and bearing in mind any stamp duty or other tax implications as to the place of execution.[92]

Thus, the typical aircraft lease can be seen simply as an agreement between two parties for one to deliver to the other possession of a specified aircraft for an ascertainable period in return for an ascertainable consideration, with certain obligations being placed on the parties during such period and in respect of the return of the property at the end, and with consequences for breach, and allocation of risk for damage by and to the aircraft being set out as between the parties.

Having such a rather high level overview of the layout of the typical aircraft operating lease, the heart of this work follows in Chapter 3 – a detailed examination of each of these parts of the lease with particular reference to the impact on each of them of the results of this author's research into relevant case law, statutes and regulations, and international treaties, especially in the context of public and private international air law, which in turn is followed by Chapter 4 – conclusions together with recommendations of this author in relation to issues that have come to light as a result of the research examined in Chapter 3.

87. Surely a lessee would never be allowed to rid itself of its obligations!
88. *See* Chapter 3 section §3.16 and section 14 of the Supplement *infra*.
89. *See* Chapter 3 section §3.17 and section 15 of the Supplement *infra*.
90. *See* Chapter 3 section §3.18 and section 15 of the Supplement *infra*.
91. *See* Chapter 3 section §3.19 and section 16 of the Supplement *infra*.
92. *See* Chapter 3 section §3.20 *infra*.

CHAPTER 3

The Aircraft Operating Lease

§3.01 PARTIES

The preliminary steps identified in Chapter 2 (Overview) *supra* will help to clarify who should be the parties to the lease – that is, whether a head lease/sublease structure, owner trust or other structure which may cause a change in the parties is required.

If so, whether or not there should be a guarantee of the obligations of either or both parties under the lease should be clear by this stage.

If the lessor is, for whatever reason, not the leasing company itself, but an intermediary vehicle of the leasing company or an owner trust under which the leasing company is the beneficiary,[1] the lessee should consider obtaining a guarantee of the lessor's obligations from the leasing company itself. Although the lessee is primarily the debtor under the lease and the lessor is primarily the creditor (and the parties are respectively seen as such under Article 1 of the Cape Town Convention), the lessee is a creditor in respect of refund of any security deposit and maintenance reserves it pays as well as for other contractual obligations and thus has a legitimate interest in the creditworthiness of the lessor.

If the lessee's credit is such that a guarantee of its obligations is required by the lessor, this should be demanded and reflected where appropriate in the drafting.

In particular, any representations and warranties given by a party in the lease should also be given by that party's guarantor, and any events of default relating to the creditworthiness of the lessee should be extended to such events in the context of the guarantor also since the lessor will in such instance be looking to the credit of the guarantor.

1. Since invariably in such case, the owner trustee will insist on undertaking obligations in the lease 'not in its individual capacity but solely as owner trustee'.

§3.02 RECITALS

Although not legally required, the recitals can be a useful introduction to the lease for the reader. *See also* Chapter 2 section §2.06[B] *supra*. They help put the lease in context but, under English law, are only used as an aid to construction in case of ambiguity.[2]

They can set out the context to the lease, which may be particularly useful, for example, where there is a complicated ownership structure, where the owner, the head lease from the owner as head lessor to the lessor as head lessee, and the intention of the lessor to lease the aircraft as sub-lessor to the airline as sub-lessee can be made clear.

Recitals are typically set out following the word 'Whereas' to indicate that they set out the background to the lease, and are then followed by such words as 'Now therefore, it is agreed between the parties as follows', and the actual agreement of the parties is set out.

Thus, the argument may be raised that the recitals do not form part of the contract itself.

It is typical, therefore, to include a provision whereby not only the recitals, but also any schedules, annexes and appendices to the lease are deemed to form part of the lease – this avoids any argument, for example, as to whether terms defined in the recitals and used elsewhere in the lease form part of the lease and as to whether any representation, warranties, or undertakings set out therein are representations, warranties or undertakings under the lease such that the remedies for breach thereof under the lease are not lost simply because they appeared in the recitals, that is, before the words 'Now therefore, it is agreed between the parties as follows'.

§3.03 DEFINITIONS

The definitions used are vital to the interpretation of the lease. They may be set out for ease of reference either at a particular place in the lease or as a separate schedule attached to the lease but it is desirable that they be set out in one place.[3]

One advantage of setting the definitions in a separate schedule is that technical staff for the lessor and the airline may request that technical provisions, particularly as to delivery and redelivery condition, also be set out in separate schedules. If the definitions are also set out in a separate schedule, they can simply extract the relevant schedules, including that for definitions, and refer to those alone. This is not a legal consideration, but is a practical one where cross-border aircraft dry operating leases typically run up from 100 to 200 pages in length.

One reason to use definitions is consistency, which will help in the correct construction of the contract.

For example, in the context of insurance, one may refer to agreed value[4] or to stipulated loss value but one should be consistent in one's choice of words to make sure that it is clear that the same concept is being referred to each time.

2. Clark T. (editor), *Leasing Finance*, Euromoney, 1985, at 52.
3. *See* section 1 of the Supplement *infra*.
4. *See* section §3.12[B][1] *infra*.

Likewise, one may refer either to security deposit or commitment fee[5] and one may refer either to maintenance reserves or supplemental rent[6] but one should be aware of the possible implications of one's choice of terminology (e.g., different treatment in the case of bankruptcy of the lessee)[7] and use the same words consistently when referring to the same concept.

Maintenance reserves may be defined by reference to the number of hours utilized by the aircraft. In this case, the draftsman should be clear whether flight hours or block hours are the relevant unit of reference and the relevant term defined clearly and used consistently to avoid confusion.

For example, a 'Flight Hour' means:

> each hour or part thereof elapsing from the moment at which the wheels of the Aircraft leave the ground on the take-off of the Aircraft until the wheels of the Aircraft touch the ground on the landing of the Aircraft following such take-off.[8]

whereas a 'Block Hour' means:

> [t]he number of hours incurred by an aircraft from the moment it first moves for a flight until it comes to rest at its intended blocks at its next point of landing… .[9]

If, therefore, only the term 'hours' were used, it would not be clear how to calculate the number of hours desired – hours in the air or hours in motion, whether on the ground or in the air.

Likewise, if 'Block Hours' were used where 'Flight Hours' was intended, or *vice versa*, or they were wrongly defined, the lessee could end up paying either too much or too little by way of maintenance reserves calculated based on hourly usage of the aircraft.

How terms are defined in leases will be looked at under the heading of the relevant part of the lease where they are most relevant. *See also* Chapter 2 section §2.06[A] *supra*.

§3.04 REPRESENTATIONS AND WARRANTIES

Each party will give each other representations and warranties, which may be repeated periodically, breach of which gives rise to remedies[10] for breach of contract.[11] Typical representations and warranties of a lessee include those set out at Annex 7.

5. *See* section §3.07[B] *infra*.
6. *See* section §3.07[C] *infra*.
7. *See* section §3.07[B] & §3.07[C] *infra*.
8. Bunker D.H., *International Aircraft Financing: Volume 2: Specific Documents*, 2nd Edition, IATA, 2015, at 52.
9. *Ibid*.
10. *See* section §3.15 *infra*.
11. *See* section 2 of the Supplement *infra*.

[A] Representations as to Present and Past Facts

Representations are made by each party to the other to induce the other to enter into the lease. They should be made with respect to present and past only. Representations as to the future are not possible and should be covered as covenants or events of default, which will be examined at sections §3.10 and §3.14 *infra* respectively.

[B] Repetition of Representations

It is not uncommon for a lessor to request that a lessee repeat its representations and warranties (with respect to facts and circumstances then existing) at delivery of the aircraft under the lease and possibly also periodically throughout the term of the lease – typically, throughout the lease term or at least on each rent payment date.

It is debatable as to whether there is much need to insist on this or much risk in acceding to such a demand since breach of a given repeated warranty will most likely be caught by one or other of the events of default anyway but the drafter should check rather than assume that such is indeed the case.

A stronger objection to automatic repetition of representation and warranties is that it may force a lessee into making a false representation and warranty. For example, the lease may provide that the representation and warranties will automatically be deemed to be repeated (with respect to facts and circumstances then existing) on each rent payment date. The lease may further provide a representation and warranty on the part of the lessee there are no withholding taxes payable on the rental payments and that such statement was correct when the lease was signed but subsequently the law is changed and a withholding tax is introduced. The lessor should be protected by the gross up clause in the taxation section (as to which *see* section §3.08 *infra*) requiring the lessee to pay a sufficient amount in rent such that, after making the requisite withholding, the lessor still receives the same net payment of rent as if there had been no withholding. With an automatic repetition of representations and warranties, however, on the next rent payment date after the change in law, the lessee will be deemed to have made a representation and warranty that is untrue, thus entitling the lessor to terminate the lease.

One instance where a lessor will have a strong need for repetition of representations and warranties will be if it decides to sell the aircraft to another party with the benefit of the lease attached. The purchaser will invariably want the lessee to repeat in its favour the representations and warranties set out in the lease before entering into a contractual relationship with the lessee. Lessees often refuse this on the basis that they are not so obliged under the lease – one possible compromise would be for the lessor to agree that the only repetition of representations and warranties in the lease by the lessee would be upon an assignment or novation of the lease to a purchaser of the aircraft and that even then, if the lessee could not truthfully repeat such representations and warranties with respect to facts and circumstances then existing, it could then qualify such representations and warranties accordingly.

[C] Representations of Law

A representation must be a statement of fact, not of opinion or (with some exceptions) of law.[12]

The fact that representations generally cannot be given as to law is sometimes relied upon be lessees who wish to limit their representations and warranties strictly to factual matters only and who wish to deal with representations as to law only in the legal opinion to be provided to the lessor by their lawyers as one of the conditions precedent to the lessor's obligations under the lease. This argument ignores two points.

The first is that representations as to foreign law, with which the lessor is not expected to be familiar itself, may be binding.[13] Most leases are cross-border leases where the lessor and lessee are based in different jurisdictions.

The other is that if a particular representation as to foreign law is incorrect, if it is only in the legal opinion, the lessor's only remedy is for damages against the lawyer giving the incorrect legal opinion whereas if it is in the lease, the lessor will have the full range of remedies as set out in the lease available to it, including the right not only to seek damages but to terminate the leasing of the aircraft and to recover possession of the aircraft.

If a representation misrepresented a relevant fact, under English common law, unless such representation were incorporated into the contract, no remedy for damages lay, although the party to whom such misrepresentation was made could seek to rescind the contract.[14]

[D] Warranties

A warranty does form part of the contract but is contrasted with a condition. Under the English Sale of Goods Act 1893, a condition was defined as a provision of a contract the 'breach of which may give rise to a right to treat the contract as repudiated'[15] whereas a warranty was a provision of a contract the 'breach of which may give rise to a claim for damages but not to a right to… treat the contract as repudiated'.[16] Such dichotomy between condition and warranty has since become 'a general but not a universal feature' of English contract law.[17]

To avoid the issues of whether a particular representation was made at all, whether it induced the lessor to enter into the contract, whether it forms part of the contract, whether, as part of the contract, it is, even if described as a warranty, a condition or a warranty for the purposes of English contract law, common drafting practice is to set out the relevant facts relied upon in the lease itself as both

12. Furmston M.P., *Cheshire & Fifoot's Law of Contract*, 10th Edition, Butterworths (1981), at 235–240.
13. *Ibid.* and Bunker D.H., *International Aircraft Financing, Volume 2: Specific Documents*, 2nd Edition, IATA, 2015, at 60–62.
14. Furmston, *supra*, at 235–240.
15. Section 11(1)(b).
16. *Ibid.*
17. Furmston, at 132.

representations and warranties together and to provide for the lessor's remedies for their breach in the lease itself, such remedies invariably including the right to terminate the leasing of the aircraft and to demand repossession thereof.

It should not be thought, however, that in aircraft operating leases, representations and warranties have thus fallen together for all purposes. In *Sabena Technics SA v. Singapore Airlines Limited,*[18] Colman J of the English High Court held on the facts that an incorrect statement with respect to the condition of the aircraft in question on the part of the lessor constituted a breach of warranty[19] even thought it did not constitute a misrepresentation under section 2(1) of the English Misrepresentation Act 1967[20] or negligent misrepresentation.[21]

[E] Conclusions

In the context of representations and warranties, on the basis of which the parties enter into the aircraft operating lease, thus far, no particularities relating to public or private international air law have been disclosed. As seen in section §3.04[D] *supra,* the governing law of the lease contract may have statutory provisions but these are of the sort which may be expected in the context of any contract, regardless of whether or not related to international aviation. The lease contract having been entered into on foot of those representations and warranties, the review turns next to conditions precedent which must be fulfilled before the respective obligations of the parties thereunder take effect.

§3.05 CONDITIONS PRECEDENT

Conditions precedent of a party are those conditions which must be satisfied before the obligations of that party under the lease become effective.[22] The major conditions will be examined in detail. Typical conditions precedent to be satisfied by a lessee in order for the obligations of the lessor under the lease to become effective include those set out at Annex 8.

It is important to define what is meant by conditions precedent, which in Roman law was treated not as part of the contract itself but an external fact on which the existence of the obligation depends.[23] It may be that the whole existence of a contract is suspended until the happening of a stated event, that is, until satisfaction of a condition precedent.[24] On the other hand, it may be that such a condition may operate:

18. [2003] EWHC 1318 (Comm).
19. At 94.
20. At 111.
21. At 114.
22. *See* section 3 of the Supplement *infra*.
23. Furmston M.P., *Cheshire & Fifoot's Law of Contract*, 10th Edition, Butterworths, 1981 at 129.
24. *Ibid.*

> not to negate the very existence of a contract but, to suspend, until it is satisfied, some right or duty or consequence which would otherwise spring from the contract.[25]

In the case of the aircraft operating lease, the latter is the more likely since it will typically provide that, if the lessor does not satisfy the conditions to be satisfied by it within the time specified, the lessee shall not be bound to accept delivery of the aircraft and, if the lessee does not satisfy the conditions to be satisfied by it within the time specified, the lessor shall not be bound to tender delivery of or to deliver the aircraft to the lessee. However, even in such event, the parties will want the lease agreement itself to survive since they will want such matters as representation and warranties, waivers of liability, and perhaps certain other matters to survive notwithstanding non-delivery of the aircraft. Commercially, the parties will wish to be clear as to the return or forfeiture of any deposits paid.

Further, the lessee generally will want to ensure that it is a condition precedent to its being obligated to take delivery of the aircraft under the lease that the aircraft meet the agreed delivery conditions.

[A] General Conditions Precedent

Certain conditions precedent (as set out below) should be satisfied by both parties, and generally the language required of each party will mirror that required of the other.

[1] Payments

For example, it is normally a condition precedent to the lessor's obligations under the lease that the lessor should have received in full payment of the security deposit and the rent in respect of the first rent period, usually one month payable in advance or as otherwise provided for in the lease.[26]

Although the lessor will not normally have payment obligations to the lessee, occasionally these do arise such as where a lessor agrees to make a payment to the lessee in lieu of a certain non-compliance with delivery condition or in order for certain work to be undertaken on the aircraft. Such obligations may, however, take the form of a credit against future rent.

[2] Constitutional Documents

Both parties should provide copies of their constitutional documents to the other, showing their legal capacity to enter into the aircraft operating lease. These will normally be outside the ability of the other party to interpret; hence, they should be read in conjunction with the legal opinions referred to in section §3.05[A][5] *infra*.

25. *Ibid.* at 130.
26. *See* Bunker D.H., *International Aircraft Financing, Volume 2: Specific Documents*, 2nd Edition, IATA, 2015, at 63.

[3] Corporate Approvals

Likewise, both parties should provide copies of their corporate approvals, whether board resolutions or otherwise, to the other, showing that all necessary internal corporate approvals have been obtained to enter into the aircraft operating lease. These will normally be outside the ability of the other party to interpret, at least in the case of cross-border leases; hence, they also should be read in conjunction with the legal opinions referred to in section §3.05[A][5] *infra*.

[4] Filings and Consents

Proof that any filings or external consents necessary for the lessor or the lessee to meet its obligations under the lease have been made or obtained as appropriate should be required by the other party.

For example, under Commission Regulation (EC) No. 859/2008, OPS 1.165(c)(1)(i) a European Union operator shall not dry lease-in[27] an aeroplane from an entity other than another such operator, unless approved by its authority. Any conditions which are part of this approval must be included in the lease agreement. *See also* section §3.05[B][5] *infra*.

Bilateral air transport agreements between countries may come into play.[28] According to the Air Transport Committee of ICAO, out of forty-one bilateral air service agreements found to contain provisions on leasing, three had clauses dealing with safety aspects requiring the aviation authority of the operator to be satisfied that airworthiness standards will be maintained.

Greater concern is shown therein for leases from one airline to another airline, with a desire to make clear that no additional traffic rights are granted being evident, and, importantly, in the context of the present work, a distinction being made in certain cases between leases from other airlines, on the one hand, and leases from non-airline lessors, on the other hand. For example, in certain cases, notification only rather than approval is required in the case of leases from non-airline lessors.[29]

Again, these should be read in conjunction with the legal opinions referred to in section §3.05[A][5] *infra*.

27. A dry lease is described as 'a lease of an aircraft where the aircraft is operated under the AOC of the lessee. It is normally a lease of an aircraft without crew, operated under the commercial control of the lessee and using the lessee's airline designator code and traffic rights' in ECAC Recommendation on Leasing of Aircraft, Recommendation ECAC/21-1 in *Study on Aircraft Leasing*, Air Transport Committee, 156th Session of the Council, ICAO, 1999, at Appendix B.
28. Article 6 of the Chicago Convention requires permission or authorization of a State for scheduled international service over or into its territory. Accordingly, the majority of international scheduled fights are regulated by ibilateral or multilateral air transport agreements. *See* Bunker D.H., *International Aircraft Financing, Volume 1: General Principles*, 2nd Edition, IATA, 2015, at 276.
29. *Study on Aircraft Leasing*, Air Transport Committee, 156th Session of the Council, ICAO, 1999, 4.3–4.14.

[5] Legal Opinions

The lessee should provide a legal opinion, from its qualified legal counsel[30] acceptable to the lessor, confirming the overall legal viability of the structure from a legal point of view. Where the governing law of the lease, the jurisdiction of registration of the aircraft, and the jurisdiction of incorporation and residence of the lessee differ, multiple legal opinions may be necessary, one from each relevant jurisdiction.

As the lessor will also owe certain obligations to the lessee, such as return of the security deposit, return of maintenance reserves and the covenant of quiet enjoyment during the lease term, a legal opinion or opinions from its qualified legal counsel acceptable to the lessee may also be appropriate.

See also Chapter 2 section §2.05 *supra* and Annex 6 *infra*.

[6] Process Agent Letter

Unless the lessee is domiciled in the jurisdiction (or otherwise subject to the jurisdiction of its courts) chosen as a venue for resolution of disputes (such as an English airline where the courts of England are chosen in the lease as having jurisdiction over any disputes that arise under the lease), a letter from an agent for the lessee agreeing to act as its agent for service of process within such jurisdiction should be obtained.

The lessee should likewise require a similar letter from the lessor.

Without such a letter, a party seeking to sue the other may be subject to cumbersome procedures to serve a party outside the relevant court's jurisdiction.

Even with such a letter, without substantial assets in such jurisdiction, the value of any favourable judgment will depend on the ability of the victorious plaintiff to enforce such judgment in a jurisdiction where the other party has indeed substantial assets.

[B] Airline-Specific Conditions Precedent

Certain documentary conditions precedent must be satisfied by the lessee before the lessor will agree to deliver the aircraft. These are necessary for various reasons: the lessor will want to ensure that the lessee has all necessary approvals and is competent to operate the aircraft. Even if the lessor does not ask for them, the lessee must have them in order to satisfy its legal requirements.

These documents include the certificate of insurance, certificate of registration, certificate of airworthiness, radio station license, air transport license, air operator's certificate, and Eurocontrol letter. There may be others, which should be determined by the lessor's local counsel, and which should have been identified pursuant to the jurisdictional questionnaire discussed at Chapter 2 section §2.04 *supra*.

30. This need not necessarily be from an independent law firm retained by the lessee but may, if the lessor agrees, be from in-house legal counsel in the employment of the lessee.

Article 19 of the Paris Convention, required that an aircraft covered by it be 'provided with', *inter alia*, certificate of registration, airworthiness, crew licenses and a license for any equipped radio[31] apparatus but did not expressly require that these be carried on board the aircraft – under Article 29 of the Chicago Convention, the aircraft must, *inter alia*, 'carry' such documents. Under Article 80 of the Chicago Convention, the Chicago Convention superseded the Paris Convention. Within the European Union, these documents together with the certificate of insurance, *inter alia*, must, be carried on each flight pursuant to OPS 1.125 of Commission Regulation (EC) No. 859/2008.

Each will be examined in further detail below.

[1] Certificate of Insurance and Broker's Letter of Undertaking

The lessor will want to know that the aircraft is adequately insured,[32] and that it, and any of its financiers, are covered adequately as to liability, as required by the lease (*see* section §3.12 *infra*) and will also want to receive a broker's letter of undertaking whereby, if the insurances should be cancelled, for example, due to non-payment of premium by the lessee, the broker will give a certain minimum notice first to the lessor to enable it to ensure continuation of coverage.

The certificate of insurance need not necessarily be kept on board the aircraft.[33]

In an English Court of Appeal case, *First Security Bank National Association (acting as owner trustee for the benefit of Leopard Leasing No 2 Ltd) v. Compagnie Nationale Air Gabon,*[34] May LJ upheld a refusal on discretionary grounds by Timothy Walker J in the English High Court to grant an injunction to lessor preventing lessee from flying the leased aircraft (which in this case had already been delivered) from France to Gabon where the proof of insurance was incomplete and not fully legible and the broker's opinion was missing. The judgment was without prejudice to the issue of damages.

[2] Certificate of Registration

The aircraft is required to carry its certificate of registration issued in compliance with Articles 17 and 18 of the Chicago Convention.[35]

31. Termed 'wireless' in the Paris Convention.
32. Typically, in accordance with the standard Lloyd's market endorsement for lessors and financiers AVN 67B or its replacement AVN 67C – http://www.awg.aero/projects/insuranceliability/ on 30 Aug. 2016. As the separation between aircraft owner and operator has developed, aircraft financiers had to become familiar with nuances of insurance in an effort to avoid last minute pressure to approve insurance provisions. AVN 67B was developed to standardize policy endorsements for finance and lease contracts in the London market which insurers elsewhere generally follow: Margo R.D. and Houghton A.T., *The Role of Insurance in Aviation Finance Transactions* in Butler G.F. and Keller M.R., executive editors, *Handbook of Airline Finance*, 1st Edition, Aviation Week: McGraw-Hill, 1999, at 279 et seq.
33. But *see* section §3.05[B] *supra* on Commission Regulation (EC) No. 859/2008.
34. Royal Courts of Justice, 10 May 1999.
35. *See* section §3.10[B][3] *infra*.

This may not always issue in time for delivery of the aircraft to the lessee and it is customary, where necessary, to allow a copy of such certificate to be forwarded to the lessor within a few days of delivery.

In practice, until now, a certified copy of the certificate of registration was simply collected pursuant to the conditions precedent around the time of delivery and forgotten about unless, pursuant to a sublease or some other development, a change in the State of registration was required during the lease term. This approach may change, certainly for aircraft registered in the United States, and for other countries which may follow its approach in introducing new regulations requiring re-registration of aircraft every three years pursuant to particular procedures which, if not followed, will lead to the aircraft being removed from its register.

Prior to such new regulations, registration was indefinite[36] – the purpose of the new regulations[37] is to clean up the register, burdened by thousands of outdated and inaccurate registrations.[38] Henceforth, certificates of registration issued by the United States Federal Aviation Administration will contain an expiry date dated three years later. One hundred and eighty days prior to such expiration, a reminder will be sent to owners, as befits an ownership-based system.[39]

The owner should beware that, if it fails to renew the registration of the aircraft, the registration of the aircraft will lapse, and the lessee will be unable to operate the aircraft – this would leave the owner/lessor open to a claim by the airline lessee for breach of its covenant of quiet enjoyment.[40]

Lessors should thus be careful to have systems in place to ensure renewal of such registration.

If similar requirements are brought in by jurisdictions with operator-based registries,[41] lessors should build in systems to ensure the lessee is required to show timely proof of such renewal.

[3] Certificate of Airworthiness

The aircraft is required to carry a certificate of airworthiness issued in compliance with under Article 31 of the Chicago Convention.[42] It is the responsibility of the aviation authority where the aircraft will be registered during the term to inspect the aircraft and to issue the certificate of airworthiness (except in the case of an Article 83*bis* delegation, as to which, *see* section §3.15[H] *infra*).

36. Gerber D.N., *Aircraft Finance Issues: The Blue Sky Ruling; The New ASU and the 'Home Country Rule'; and Recent Developments at the FAA Registry*, a paper presented at the American Bar Association Air and Space Law Forum 2010 Annual Meeting in Seattle, Washington on 26 Oct. 2010.
37. 14 C.F.R. section 47.40(a)(1).
38. *Ibid.*
39. *See* section §3.10[B][3] *infra*.
40. *See* section §3.10[A] *infra*.
41. *See* section §3.10[B][3] *infra*.
42. This supersedes.

[4] Radio Station License

The aircraft is required to carry a license for any radio apparatus with which it is equipped issued in compliance with under Article 30 of the Chicago Convention.

[5] Air Transport License

Council Regulation (EC) 1008/2008,[43] Article 3.1, provides that no undertaking established in the European Union shall be permitted to carry by air passengers, mail, and/or cargo for remuneration and/or hire unless it has been granted the appropriate operating licence, commonly known as an air transport license.

Article 4 sets out the conditions for granting such a license and it is worth setting them out here in full:

> *An undertaking shall be granted an operating licence by the competent licensing authority of a Member State provided that:*
>
> (a) its principal place of business is located in that Member State;
> (b) it holds a valid AOC issued by a national authority of the same Member State whose competent licensing authority is responsible for granting, refusing, revoking or suspending the operating licence of the Community air carrier;
> (c) it has one or more aircraft at its disposal through ownership or a dry lease agreement;
> (d) its main occupation is to operate air services in isolation or combined with any other commercial operation of aircraft or the repair and maintenance of aircraft;
> (e) its company structure allows the competent licensing authority to implement the provisions of this Chapter;
> (f) Member States and/or nationals of Member States own more than 50% of the undertaking and effectively control it, whether directly or indirectly through one or more intermediate undertakings, except as provided for in an agreement with a third country to which the Community is a party;
> (g) it meets the financial conditions specified in Article 5;
> (h) it complies with the insurance requirements specified in Article 11 and in Council Regulation (EC) No 785/2004; and
> (i) it complies with the provisions on good repute as specified in Article 7.

A practical issue here is that the airline must have one or more aircraft at its disposal. For a start up airline, the lessor can sign up a lease for the first aircraft, and, indeed may have to in order for the lessee to be able to obtain an air transport license, but it should require confirmation that such license has been obtained before it delivers the aircraft – the lessee in any event will need such license in order to put the aircraft into service.

43. Regulation (EC) No. 1008/2008 of the European Parliament and of the Council of 24 Sep. 2008 on common rules for the operation of air services in the Community.

Under Article 13.2, a dry or wet lease agreement[44] to which a European Union air carrier is a party shall be subject to 'prior approval in accordance with applicable Community or national law on aviation safety'.

Under Article 13.3, in the case of an aircraft registered in a third country, a wet lease agreement to a European Union air carrier is, unlike a dry lease, additionally subject to prior approval for the operation from the competent licensing authority which may, *inter alia*, require one of the following conditions to be fulfilled:[45]

(i) the Community air carrier justifies such leasing on the basis of exceptional needs, in which case an approval may be granted for a period of up to seven months that may be renewed once for a further period of up to seven months;
(ii) the Community air carrier demonstrates that the leasing is necessary to satisfy seasonal capacity needs, which cannot reasonably be satisfied through leasing aircraft registered within the Community, in which case the approval may be renewed; or
(iii) the Community air carrier demonstrates that the leasing is necessary to overcome operational difficulties and it is not possible or reasonable to lease aircraft registered within the Community, in which case the approval shall be of limited duration strictly.

The above requirements are not expressly extended to dry leases, but it is not clear whether or not similar requirements for dry leases could be invoked anyway pursuant to the more general language of Article 13.2, particularly where it is proposed to keep the aircraft on the register of a third country whether pursuant to Article 83*bis* of the Chicago Convention or otherwise.[46]

The license may be suspended or revoked pursuant to Article 9.

[6] Air Operator's Certificate

Commission Regulation (EC) No. 859/2008, Subpart C, OPS 1.175 et seq., deals with rules for the issuance of an air operator's certificate (commonly known as an 'AOC') to a European Union carrier and certifies that the operator has the professional ability and organization to ensure the safety of operations specified in the certificate.

Whereas the air transport license is concerned with the overall viability of the proposed enterprise, the air operator's certificate is concerned with safety. Indeed, as seen in section §3.05[B][5] *supra*, in the European Union it is a requirement[47] that an

44. A wet lease is described as 'a lease of an aircraft where the aircraft is operated under the AOC of the lessor. It is normally a lease of an aircraft without crew, operated under the commercial control of the lessee and using the lessee's airline designator code and traffic rights' in ECAC Recommendation on Leasing of Aircraft, Recommendation ECAC/21-1 in *Study on Aircraft Leasing*, Air Transport Committee, 156th Session of the Council, ICAO, 1999, at Appendix B.
45. Article 13.3(b).
46. *See* section §3.15[H] *infra*.
47. Article 4(b) of European Commission Regulation 1008/2008.

Indeed, each of the time of the essence, no waiver, entire agreement, and waiver of sovereign immunity provisions has been the subject of litigation, as has been demonstrated above.

§3.20 EXECUTION

Formalities as to execution, filings that must be made, and other formalities which have to be observed, are all matters that should not be forgotten at this final stage. Reference should be had to the jurisdictional questionnaire and to the legal opinion to ensure that formalities for lease execution are known and have been met.

There is one interesting English High court case involving the lease of a light aircraft. In that case, *Oxford Aviation Services Limited v. Godolphin Management Company Limited,*[719] Cooke J held that, on the facts, an agreement for hire or bailment existed on the basis of a draft unexecuted delivery for hire, where the parties had had a history of dealing with one another.

The jurisdictional questionnaire[720] obtained at the outset of a leasing transaction should, at the outset, and the legal opinion[721] at time of signing of the lease should clarify any issues regarding requirements for execution, witnesses, notarization and the like together with confirmation that no stamp duty will be imposed as a result of the place of execution of the lease or otherwise.

Disputes may exist as to the proper interpretation of any contract but no lawyer will want to tell his or her client that there is no contract to enforce at all for want simply of due execution.

719. [2004] EWHC 232 (QB).
720. *See* Chapter 2 section §2.04 *supra*.
721. *See* Chapter 2 section §2.05 *supra*.

CHAPTER 4
Conclusion

§4.01 OVERALL CONCLUSIONS

This part will attempt to synthesize the practical and theoretical lessons learned from the foregoing to show that the basic concept of the aircraft operating lease is intact but that, given the number of courts which may, rightly or wrongly, apply any number of legal provisions which override the provisions of the lease, one is dealing here more with art than with science. Certain recommendations will also be made.[1]

It is essential, in this author's view, that practitioners understand aircraft operating leases, and the issues associated therewith, not only in the context of practice but also in the context of relevant legislation and case law and, above all, in the overall context of public and private international air law.

Further, relevant provisions of public and private international law have been shown to be available to practitioners, and possibly of aid to their client's legal position, if only they are aware of them. In particular, the provisions of the Cape Town Convention on events of default and remedies come to mind.

Certain problems for practitioners in the field of the aircraft operating lease arising from certain provisions of, or *lacunae* in, public and private international air law have been identified examined and certain proposals are made in section §4.02 *infra* in respect thereof by way of remedy.

Before then, it is worthwhile here to review the principal parts of the aircraft operating lease in light of the research and analysis set out in Chapter 3 *supra*. Dividing the lease in the same manner as in Chapter 2 section §2.06 *supra*, the following broad conclusions can be drawn.

1. *See* section §4.02 *infra*.

[A] Pre-delivery

This covers the parties, recitals, definitions, representations and warranties, and conditions precedent.[2]

These generally reveal any do not any tension between the practice and law of aircraft leasing and are generally not the focus of the public or private air law and other instruments but are still influenced by and reflective of them. Perhaps this is not surprising, as, at this point, the aircraft has not yet been tendered for delivery to the airline, and thus legal disputes are less likely. Further, rights of third parties are not yet involved.

For example, the parties to the transaction will be determined by reference, *inter alia*, to applicable double tax treaties, and options regarding State of registration of the aircraft. Likewise, the conditions precedent listed, showing which licenses and approvals the lessee must have in place, will reflect the relevant legal provisions of the jurisdiction of the State of the lessee and, where different, the State of registration of the aircraft. These in turn are driven, at least in part, by the provisions of the public and private air law instruments to which such States are party.

[B] Post-delivery

This covers term and delivery, payments, taxes, manufacturer's warranties, covenants, indemnities, and insurances.[3]

Not surprisingly, this area sees more disputes, involving as it does, the condition and operation of the aircraft at and after delivery, and significant payment obligations.

Challenges to the provisions of leases dealing with conclusivity of the acceptance certificate seem inconsistent with challenges requiring precise conformity to delivery condition: it seems inconsistent that a court would, on the one hand, entitle a lessee to precise conformity to contracted delivery condition, while on the other hand allowing the lessee to disregard contractual agreements as to conclusivity of acceptance of delivery. Nevertheless, case law examined at Chapter 3 section §3.07 *supra* has shown how national legislation may provide for tests of reasonableness which override contractually agreed conclusivity. These challenges reveal a tension between law and practice, but not a particular relation to public and private international air law.

This is not so of the covenants, touching, as they do, on such critical issues as maintenance, liens, registration, and replacement of parts and engines, all of which are, to a greater or lesser extent, the subject of provisions of the public and private air law instruments.

Maintenance, being closely related to safety, is of concern to public international air law as well as national law. As discussed at Chapter 3 section §3.10[B] *supra*, the lease does not, and cannot, reduce the minimal requirements of such laws and will, if anything, set higher contractually required minima. Thus, the lease provisions reflect,

2. *See* Chapter 3 sections §3.01–§3.05 *supra*.
3. *See* Chapter 3 sections §3.06–§3.12 *supra*.

but are not in tension with, such laws, something which should give comfort to those concerned that the increase in aircraft leasing may be of concern from a safety perspective. Indeed, this should be considered a public benefit of leasing.

Liens are a great concern to lessor, since the lessor may stand to lose title to its aircraft for debts incurred by its lessee, and these risks are increasing most noticeably within the European Union as a result of the Eurocontrol and emissions liens. Proposals to give the lessor the tools to manage such increased risks are made in section §4.02 *infra*.

The role of the Chicago Convention and the variety of national laws passed as to registration are reflected in the discussion at Chapter 3 section §3.10[B] *supra*, as is the more active role of the Geneva Convention and the Cape Town Convention on the issue of title to replacement parts and engines, discussed also at Chapter 3 section §3.10[B] *supra*.

The insurance provisions, as the maintenance provisions, reflect the legally required minimum coverage, which they do not and cannot reduce, but if anything, the lease provisions increase such required coverage beyond the minima, which gives increased protection to third parties who suffer damage. This is a benefit of leasing in that the airline may not otherwise, and is not otherwise legally required, to have such increased insurance coverage. The indemnity provisions, which are closely linked to the insurance provisions, are very intimately bound up with the provisions of the Warsaw Convention, the Montreal Convention and other private air law instruments. These instruments, concerned as they are with protection of third parties, are not concerned with the contractual allocation of risk as between the private parties to an aircraft leasing contract. Nevertheless, they should be coherent and fair as regard the liability of the lessor, and certain observations and recommendations in this regard are made in section §4.02 *infra*.

[C] Post-lease Term

This covers redelivery, events of default, remedies, assignment, governing law, dispute resolution, miscellaneous, and execution.[4]

Disputes as to redelivery tend to be based on factual issues and national law rather than international law.[5] The Cape Town Convention deals with protection of contractually agreed remedies[6] in case of default.[7] The Cape Town Convention likewise deals with enforcement of duly registered assignments[8] and of dispute resolution provisions.[9]

4. *See* Chapter 3 sections §3.13–§3.20 *supra*.
5. *See* Chapter 3 section §3.13 *supra*.
6. *See* Chapter 3 section §3.15 *supra*.
7. *See* Chapter 3 section §3.14 *supra*.
8. *See* Chapter 3 section §3.16 *supra*.
9. *See* Chapter 3 section §3.18 *supra*.

The other public and private air law instruments are not, otherwise, as much in evidence in this part, which, given that the issues dealt with here do not affect third parties, is not surprising.

It is a fact that this work focuses more on areas of potential breach by lessees than by lessors. Although he freely admits to working for an aircraft leasing company, this emphasis reflects, not a bias towards lessor, but the simple fact that most undertaking in a lease are on the part of the lessee. The lessor's obligations are essentially limited to certain reimbursement obligations (maintenance reserves and security deposit) and its covenant of quiet enjoyment to the lessee. The lessee's obligations are many and varied, as is natural given that the lessee has operational possession and control of the aircraft during the lease term. Simply put, there is a lot more scope for breach on the part of the lessee under the operating lease than on the part of the lessor.

§4.02 RECOMMENDATIONS

This author believes that operating leasing of aircraft should be encouraged for reasons of public benefit for the reasons set forth in the following paragraphs.

The public international air law safety objectives of the Chicago Convention would be enhanced by encouraging airlines to meet maintenance and redelivery requirements of operating leases, which typically go beyond the SARP's made under the Chicago Convention as well as going beyond FAA or EASA or other local aviation authority requirements. The fact that the lessor's motives in having such high maintenance standards are primarily to preserve its equity in, and value of, its aircraft in no way cuts across the public benefit that flows therefrom.

Further, the public protection of the private international air law instruments would be enhanced by encouraging airlines to take out liability insurance for greater amounts, as typically required by leases, thus providing greater coverage than required under national law or private international air law[10] – and ultimately therefore providing greater protection for passengers and third parties.

Both the legally required minimum liability insurance requirements and the legally required minimum maintenance requirements are precisely that – *minima*. States have, therefore, an interest in encouraging airlines to observe their contractual obligations to meet a higher standard than the legally required *minima*. This is not only because enforcing higher contractually required minimum requirements on insurance and maintenance benefits the lessor in terms of increasing insurance covering of any potential liability on its part and because it is likely to maximize the residual value of the aircraft, although those benefits to the lessor are real. Rather, States should enforce such contractual requirements precisely because they provide increased protection to the public by way: (i) of increasing safety, by making an accident less likely to occur in the first place, in the case of contractually required maintenance obligations in excess of the legally required minimum, and (ii) if an accident should nevertheless occur, by

10. Bearing in mind that no minimum insurance requirements are set out in the Montreal Convention.

providing that more insurance coverage will be available for compensation to the public than is required by law.

In order to encourage, therefore, aircraft operating leasing, this author sets out below certain recommendations in respect of both public and private international air law as well as in connection with the practice of aircraft operating leasing.

[A] Article 83*bis* of the Chicago Convention

It is submitted that encouraging greater use of transfers of safety oversight under Article 83*bis* of the Chicago Convention is desirable from a lessor's point of view since the lessor's ability to register the aircraft in its name in a suitable jurisdiction will enable it to deregister[11] as required in the event of exercise by it of its remedies under the lease will encourage compliance by airlines with their lease obligations.

Even if this of itself does not ensure return of possession of the aircraft to the lessor, the ability on the part of the lessor to ensure deregistration means that, at least, it can prevent the lessee from operating the aircraft while not paying for it under the lease or otherwise breaching its lease obligations and thus greater use of Article 83*bis* would be of benefit to lessors.

States may not particularly care about a private debt due by an airline to a lessor, for example, for unpaid rent, or about a reduced residual value, as a result of failure to maintain as required by the lease, seeing these as private disputes between private parties. But States should care about promoting principles of public and private international law and in particular about safety.

One potential way in which greater use of Article 83*bis* could be achieved rather than by cumbersome bilateral negotiations[12] would be for an agreement to be developed whereby States that are party thereto may agree freely thereunder to allow Article 83*bis* delegations *inter se*, at least for aircraft dry leased from non-operators, thus addressing safety and regulatory concerns as to wet leases and as to dry leases from other airlines.

By analogy with the International Air Services Transit Agreement and the International Air Transit Agreement, whereby the Chicago Convention foresees certain arrangements subject to the consent of the States concerned, and such consent is, by the parties thereto, granted on a global basis, this author proposes that States which are satisfied with each others' safety standards could consider voluntarily entering into a multilateral agreement Article 83*bis* agreement whereby they would agree in advance that any aircraft[13] on the register of any one Member State could be the subject of a delegation of all or any of the responsibilities of such State of registration to the Member State of the operator.

11. And consequently deny then lessee the ability wrongly to prevent a deregistration.
12. *See* Annex 12 for the model agreement set out at *Guidance on the Implementation of article 83 bis* of the Convention on International Civil Aviation, ICAO, 2002, at 9–14.
13. The types could be restricted or not, as the States may choose.

The model ICAO agreement set out at Annex 12 *infra* could be adapted for such multilateral use. The main consideration would be for notification[14] of the delegation rather than the multilateral agreement itself to deal with the responsibilities transferred, the aircraft covered, and the lease terms thereof. Thus, a new multilateral agreement would not need to be entered into each time.

That said, no such multilateral agreement has been entered into as of the date hereof. The multilateral agreement entered into among the Russian Federation States[15] simply provided for application of the provisions of Article 83*bis* among the parties to such multilateral agreement prior to its coming into effect under the Chicago Convention.

With owned aircraft, an airline need only comply with the requirements of its national aviation authority. With a leased aircraft the subject of an Article 83*bis* transfer, in addition thereto, the requirements of such aviation authority of the operator will also have to be approved by the State of registration, and the lessor will further require under the lease compliance with FAA and/or EASA requirements as well as additional contractual requirements.

The fact that Article 83*bis* has not been widely availed of so far is no reason not to consider the benefits of its being more widely used.

[B] Cape Town Convention and IDERA

It is submitted that the public goals which can be achieved by greater reliance on Article 83*bis* transfers may equally,[16] and perhaps more realistically, be achieved by States becoming party to the Cape Town Convention and by giving effect to the provisions therein relating to IDERA.[17] However, in order for this to be effective, aviation authorities, and national courts need correctly to interpret the Cape Town Convention with respect thereto.

It is to be hoped that in due course it will be clear from judicial precedent or from other authoritative guidance that safety is not in any way at issue in allowing deregistration of an aircraft pursuant to an IDERA without providing proof first of the removal of the nationality and registration marks of the aviation authority to whom the deregistration request has been made.

Restrictions on enforceability of IDERA's set out therein should be properly limited to safety concerns, *proprement dit*. Requirements that the aircraft first be

14. Under Art. 83*bis*(b) of the Chicago Convention, notification of the delegation to bind another State party must be made to the ICAO Council and be made public or be directly notified to such other State party itself.
15. *See* Chapter 3 section §3.15[H] *supra*.
16. This author does not, however, share the unqualified preference of Fitzgerald for the Cape Town Convention over Art. 83*bis* of the Chicago Convention in this context. With the latter, the option is not towards flags of convenience but is always, if it occurs at all, to transfer safety oversight away from the State of registration (which may not be where the aircraft physically is) to the State of the operator (where the aircraft usually is). *See* Fitzgerald P.P., In *Defense of the Nationality of Aircraft*, Annals of Air and Space Law, Volume XXXVI, 2011.
17. In order to allow reliance on the IDERA, States must, of course, first become party to the Cape Town Convention.

repossessed and nationality marks removed should not be imported as additional requirements contrary to the clear wording of the Cape Town Convention. To do so would be to limit the value of the IDERA, to restrict the lessor from the legitimate exercise of its rights under the Cape Town Convention, and to push the lessor back on other solutions, such as greater reliance on Article 83*bis*.

The IDERA is not the only reason why wider adoption of the Cape Town Convention is desirable. Although it may not be a *panacea* as some its promoters may sometimes suggest, it does have real benefits in terms of providing for contractual certainty in allowing the parties to agree, for example, what constitutes a default, and in terms of allowing the parties a certain contractual freedom to agree remedies in the case of default.[18] Of course, where it applies, it is incumbent on the parties to an aircraft operating lease to take advantage of the Cape Town Convention by carefully reading it and by adapting the lease into which they enter to take account of its provisions, such as by expressly assenting in the leases to certain remedies provided for in the Cape Town Convention.

[C] Eurocontrol, Emissions, and Similar Liens

Although such liens seem unjust to this author, liens in respect of Eurocontrol liabilities and emissions breaches[19] seem to be a fact of life for lessors which will not go away. These liens are not simple rights of detention but extend beyond those to rights of sale of the lessor's aircraft for the unmet obligations of the airline.

A particularly worrying development is that discussed above in the case of Germany, where Germany seeks to impose not only a lien on the aircraft, but personal liability on the lessor as owner of the aircraft, for non-payment of travel tax by non-German airlines which have failed to appoint a German tax representative. This extension of liens in itself is objectionable in principle but imposing personal liability in addition represents a particularly unwelcome step by Germany.

Its justification for such a step is particularly difficult to understand in light of Germany's acceptance of a distinction between those having an operational role, such as airlines, and those not having an operational role, such as lessors, in the context of the Unlawful Interference Compensation Convention.[20] Surely, it cannot be argued that lessors have an operational role in the context of collection and payment by airlines of an air travel tax based on numbers of passengers carried by the airline as operator.

This author surmises that the real reason for the distinction is not a jurisprudential but a practical, opportunistic one. Governments may be willing to limit recourse for damage to third parties against lessors for the principled reason that they do not have

18. Contracting States can obtain further benefits from entering into the Cape Town Convention not only in relation to the IDERA but the other provisions of the Cape Town convention discussed throughout this work. Further, by making qualifying declaration thereunder, as discussed at Chapter 3 section §3.14[D] *supra*, they can obtain for their airlines a reduction to the minimum premium rates of finance provided for in the Sector Understanding on Export Credits for Civil Aircraft – Final Text, set out at Annex 11 *infra*.
19. *See* Chapter 3 section §3.10[B][2][b] and §3.10[B][2][c] *supra*.
20. *See* Chapter 3 section §3.11 *supra*.