

Aviation Finance & Leasing

Contributing editor
Mark Bisset



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GETTING THE
DEAL THROUGH

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Aviation Finance & Leasing 2016

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Bermuda

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Overview

1 To which major air law treaties is your state a party? Is your state a party to the New York Convention of 1958?

Bermuda is not a signatory (or a party by extension from the United Kingdom) to the Rome Convention, the Geneva Convention, the Chicago Convention or the Cape Town Convention.

In relation to the Chicago Convention, however, certain provisions of that Convention with which the United Kingdom is obliged to ensure that its overseas territories (including Bermuda) comply are reflected in the Air Navigation (Overseas Territories) Order, 2013 and Overseas Territories Aviation Requirements, applicable in Bermuda.

In relation to the Cape Town Convention, following ratification of the Convention by the United Kingdom in November 2015, Bermuda intends to pass the enabling legislation in the near future to have the Convention on International Interests in Mobile Equipment and the associated Protocol to the Convention on International Interests in Mobile Equipment on matters specific to aircraft equipment come into force in the jurisdiction. Bermuda is, by Order-in-Council from the United Kingdom, a party to the New York Convention.

2 What is the principal domestic legislation applicable to aviation finance and leasing?

The principal domestic legislation is the following:

- the Air Navigation (Overseas Territories) Order 2013, as amended (Order); and
- the Mortgaging of Aircraft and Aircraft Engines Act 1999 (Act).

3 Are there any restrictions on choice-of-law clauses in contracts to the transfer of interests in or creation of security over aircraft? If parties are not free to specify the applicable law, is the law of the place where the aircraft is located or where it is registered the relevant applicable law?

Except for public policy considerations, there are no restrictions under Bermuda law on the parties' freedom to choose the governing law of such arrangements.

Title transfer

4 How is title in an aircraft transferred?

While there are no particular Bermudian requirements, title is usually transferred by means of a bill of sale.

5 What are the formalities for creating an enforceable transfer document for an aircraft?

Except for general enforceability considerations, there are no specific formalities. It should be noted that a document executed in, brought in original form to or produced before the courts of Bermuda may be subject to Bermudian stamp duty.

Registration of aircraft ownership and lease interests

6 Identify and describe the aircraft registry.

The Bermuda Register is a Category I register under the United States Federal Aviation Administration's Flight Standard Service International Aviation Assessment Programme. That categorisation evidences

Bermuda's compliance with international standards in providing safety oversight of its air carriers that operate in the United States.

The Register is maintained by the Bermuda Department of Civil Aviation (BDCA). Registration may be effected by a qualifying owner or charterer by demise of an aircraft (see question 7). While most of the aircraft on the Bermuda Register are corporate or privately owned jets, it is increasingly common to see its use for the registration of commercial aircraft.

Arrangements to register aircraft in the public transport category on the Bermuda Register most often require arrangements between the BDCA and the appropriate foreign civil aviation authority. The BDCA is responsible for the registration and issuance of permissions and validations for aircraft and flight crew on the Bermuda Register. The agreement with the foreign civil aviation authority provides for the delegation of regulatory oversight of the air operator in that foreign jurisdiction, setting out the safety regulatory oversight responsibilities of both countries in relation to Bermuda-registered aircraft.

Bermuda was the first country to register a safety regulatory oversight agreement with the International Civil Aviation Organisation (ICAO). The ICAO is a specialised agency of the United Nations that sets international standards for the safety, security, efficiency and regularity of air transport and serves as the medium for cooperation in all fields of civil aviation among its 185 contracting states.

The BDCA has an 83-bis arrangement in place with Russia, which has been in effect since 1999. International lessors and financiers regularly require Russian operated aircraft in which they have an interest to be registered in Bermuda. Additional agreements are in place with Austria, Azerbaijan and Uzbekistan.

7 Can an ownership or lease interest in, or lease agreement over, aircraft be registered with the aircraft registry? Are there limitations on who can be recorded as owner? Can an ownership interest be registered with any other registry? Can owners', operators' and lessees' interests in aircraft engines be registered?

Under the Order, the following persons are qualified to hold a legal or beneficial interest by way of ownership or by charter by demise in an aircraft registered in Bermuda (or a share therein):

- the Crown in right of Her Majesty's Government in the United Kingdom or in right of the Government of Bermuda;
- United Kingdom nationals;
- Commonwealth citizens;
- nationals of any European Economic Area state;
- bodies incorporated in some part of the Commonwealth and that have their registered office as principal place of business in any part of the Commonwealth; or
- undertakings formed in accordance with the law of a European Economic Area state and that have their registered office, central administration or principal place of business within the European Economic Area.

A recent shift in government policy, which used to permit only Bermuda exempted companies to register an aircraft in Bermuda, has seen the extension to those categories of persons set out in the Order, as referenced above, of the ability to do so as well.

The BDCA has a discretion to cancel a registration on a charge of ownership, or if any unqualified person otherwise becomes entitled to a legal or beneficial interest by way of ownership of the aircraft or of a share therein, in which latter case the registration will become void and the Certificate of Registration must be returned to the BDCA.

With respect to interests in aircraft engines, it is possible to register a mortgage on the Bermuda Register of Aircraft Engine Mortgages pursuant to the Act. Mortgages can be registered against Bermuda-registered aircraft engines that are either owned by, or otherwise in the possession of, a Bermuda incorporated company (see question 17).

8 Summarise the process to register an ownership interest.

Persons wishing to register an aircraft must first prove eligibility to hold a legal or beneficial interest by way of ownership or charter by demise in an aircraft registered in Bermuda (or a share therein) as described above.

The BDCA requires all applicants to submit a preliminary online application for pre-approval, which will include, among other things, the following particulars:

- company name under which the aircraft is to be registered;
- make, model and serial number of the aircraft, its intended base and its principal geographic areas of operation;
- maintenance, operations and crewing arrangements;
- intended use of the aircraft (ie, in private or public transport); and
- name and contact information of the person who will be responsible for technical presentation of the aircraft to the BDCA during the registration process.

Aircraft registered in Bermuda must be operated in accordance with the Order and aircraft operated for valuable consideration on a per flight basis in carriage of passengers or cargo is generally deemed under the Order to be flying for the purpose of public transport.

Provided that the preliminary application is approved, the BDCA will issue an approval in principle, which lists the items that must be submitted to the BDCA in support of the formal application. The BDCA will inspect the aircraft prior to its registration and the issuance of a Certificate of Airworthiness, which is renewable annually following further inspection. The BDCA will also issue a Noise Certificate together with any other operational permissions as may be appropriate.

Simultaneously with the application to the BDCA, application is made for a Class Six Radio (Aeronautical Mobile Services) Licence. The radio licence is issued once the aircraft has been registered by the BDCA. A copy must be carried on board the aircraft together with all the registration and technical documents referenced above.

9 What is the effect of registration of an ownership interest as to proof of title and third parties?

While registration and the issue of a Certificate of Registration indicates that the BDCA considers the relevant application to be qualified for registration, and may, therefore, be considered prima facie evidence of ownership or the holding of an applicable charter by demise interest in the aircraft, registration is not proof of legal ownership and the Certificate of Registration will state so on its face.

10 Summarise the process to register a lease interest.

See question 7, in the context of charterers by demise. In general terms, the BDCA will not concern itself with the terms of the lease itself.

11 What is the regime for certification of registered aviation interests in your jurisdiction?

The Certificate of Registration is issued by the BDCA and set out therein are the following particulars:

- the number of the Certificate of Registration;
- the nationality mark and the registration mark given to the aircraft;
- the name of the constructor of the aircraft and its designation; and
- the serial number of the aircraft and the name and address of every person who is entitled as owner to a legal interest in the aircraft or in the case of an aircraft that is subject to a charter by demise, the name and address of the charterer by demise.

12 Is an owner or mortgagee required to consent to any deregistration or export of the aircraft? Must the aviation authority give notice? Can the operator block any proposed deregistration or export by an owner or mortgagee?

Where the aircraft is subject to a mortgage registered on the Bermuda Register of Aircraft Mortgages or the Register of Aircraft Engine Mortgages, the aircraft will not be deregistered without the consent of all parties registered as mortgagees.

Although not a legal requirement, as a matter of practice, where there is a charter by demise over the aircraft, the BDCA will agree, if requested, not to deregister the aircraft without the consent of the registered owner.

The BDCA will, if requested, provide the lessor or owner of the aircraft with a 'comfort letter' whereby the BDCA acknowledges the ownership and leasing structure of the aircraft and confirms that it will not remove the aircraft from the Aircraft Register without receiving written authorisation from the lessor or owner. The BDCA will place a notation on the Aircraft Register of the undertaking so provided and of the ownership or leasing structure.

13 What are the principal characteristics of deregistration and export powers of attorney?

Under Bermuda law, a deregistration power of attorney, when granted to secure an obligation owed, typically, to the finance parties, will be irrevocable until that obligation is discharged and will survive the insolvency of the grantor. The power of attorney may be granted to more than one attorney-in-fact on a joint or several basis, or both.

Further, under Bermuda law, a power of attorney is required to be executed as a deed. However, a deregistration power of attorney need not be governed by Bermuda law. It will frequently have the same governing law as the other transaction documents, for example, English law or New York law.

It is possible to send the deregistration power of attorney to the BDCA and obtain an acknowledgement from them with respect to it.

With regard to the deregistration process itself, there is no specific form of deregistration request and deregistration will, therefore, typically consist of the owner of the aircraft making a written application to the BDCA requesting cancellation of the Certificate of Registration. In support of the application, the owner must enclose a resolution of the board of directors of the registrant company authorising the cancellation. The original Certificate of Registration and other documents issued at the time of registration must be returned to the BDCA for cancellation, as the aircraft cannot be deregistered until the BDCA receives the original of such signed certificate.

Except for any aircraft that is subject to an undischarged mortgage, the BDCA will deregister the aircraft in accordance with the registrant's instructions, and will issue a letter of deregistration, which confirms the deletion of the aircraft from the Bermuda Register. The aeronautical regulatory authority of the next intended state of registration will be informed of the deletion by the BDCA.

In addition, the other principal requirements for deregistration of an aircraft are:

- that any balance on the account for the aircraft is paid in full; and
- where a Certificate of Airworthiness for Export is required, the relevant party will need to make a request to the BDCA for such certificate and make arrangements for one of the BDCA surveyors or its agents to inspect the aircraft.

14 If the Cape Town Convention is in effect in the jurisdiction, describe any notable features of the irrevocable deregistration and export request authorisation (IDERA) process.

The Air Navigation (Overseas Territories) Order, 2013, as amended, provides for the Cape Town Convention IDERA regime to be recognised and take effect in Bermuda once the Cape Town Convention is in force in Bermuda.

While the Cape Town Convention is not yet in force in the jurisdiction, registration of a registrable international interest or interests may be possible where an aircraft owned by a Bermuda entity has a connection to a jurisdiction that is a signatory.

Security

15 What is the typical form of a security document over the aircraft and what must it contain?

Security usually takes the form of a mortgage. There is no statutory format with which the mortgage must comply. The mortgage itself need not be governed by Bermuda law. The original mortgage deed need not be provided to the BDCA.

The following are also common in aviation finance structures:

- assignments of any charter agreements, insurances, warranties or aircraft leases relating to the aircraft. In addition, the borrower will usually deliver a deregistration power of attorney to the lender, the terms of which prohibit the borrower from deregistering the aircraft without the lender's consent;
- charges over the shares of the company owning an aircraft; and
- leasing or charter by demise arrangements, where the owner gives control and possession of the aircraft to the charterer. The charterer then becomes responsible for all responsibilities and liabilities associated with its operation.

16 What are the documentary formalities for creation of an enforceable security over an aircraft? What are the documentary costs?

There are no specific documentary formalities under Bermuda law. No stamp duty or other documentary costs should be payable.

17 Must the security document be filed with the aviation authority or any other registry as a condition to its effective creation or perfection against the debtor and third parties? Summarise the process to register a mortgage interest.

With respect to a mortgage over an aircraft registered on the Bermuda Aircraft Register, it is possible to register such mortgage on the Bermuda Register of Aircraft Mortgages and the Register of Aircraft Engine Mortgages pursuant to the Act. Mortgages can be registered against Bermuda-registered aircraft and aircraft engines that are either owned by, or otherwise in the possession of, a Bermuda-incorporated company. Such mortgages give the lender priority over unsecured creditors of the aircraft's owner, permit the lender to take possession of the aircraft in the event of a default by the borrower and permit the lender to sell the aircraft to realise monies to pay the lender's debt.

There are two specialised registers, one for the registration of aircraft mortgages and the other for the registration of aircraft engine mortgages. The Minister responsible for aviation is empowered to make regulations in respect of the administration of the two registers, as well as in respect of fees and charges in relation to the services provided under the Act, and in respect of making provision for the rights and liabilities of the mortgagors and mortgagees.

The procedure to effect registration of a mortgage is simple and straightforward, requiring an application by the mortgagee. The mortgagee must provide the BDCA with a short registration form summarising the principal points of the mortgage (ie, date, aircraft description, mortgagor contact details and confirmation of sum secured). An original of the registration form (although, in certain circumstances the BDCA may proceed on the basis of a pdf copy), signed by either the mortgagee or his or her agent or legal counsel must be submitted to the BDCA, together with a copy of the mortgage certified by the applicant to be a true and correct copy. The mortgage registration fee should also be submitted upon registration, which fee is calculated on an ad valorem basis depending on the sum secured, as follows:

- where the amount secured by the mortgage does not exceed BM\$5 million, the fee is BM\$200;
- where the amount secured by the mortgage does not exceed BM\$20 million, the fee is BM\$400; and
- where the amount secured by the mortgage does exceed BM\$20 million, the fee is BM\$800.

If the aircraft mortgage grants a charge over assets that go beyond the scope of an aircraft or aircraft engine, and the registrant is a Bermuda-incorporated company, the document should be registered with the Registrar of Companies under the Companies Act 1981 to protect the priority over those assets. Charges over shares and other ancillary security documents are also generally filed with the Registrar of Companies to protect priority if the registrant is a Bermuda-incorporated company. Similarly,

in leasing transactions, leasing documents are filed with the BDCA and are also generally registered with the Registrar of Companies under the Companies Act 1981 if the registrant is a Bermuda-incorporated company.

18 How is registration of a security interest certified?

The BDCA will issue a certificate of registration, which is generally available on, or soon after, the date of registration. The certificate states the date and time of registration, whether it is the first or a subsequently registered mortgage with respect to the relevant aircraft, the principal details of the mortgage and acknowledges receipt of the relevant registration fee.

19 What is the effect of registration as to third parties?

A registered mortgage is given statutory priority over subsequently registered mortgages and unregistered mortgages. The priority of the registered mortgage will not be affected by the bankruptcy of the mortgagor, and the security interest will rank in preference to any right, claim or interest of other creditors. It should be noted, however, that possessory liens for work done on the aircraft (whether before or after the mortgage was created), over persons lawfully entitled to possession of the aircraft or with a right to detain the aircraft, will have priority over a registered mortgage. In addition, a previously registered mortgage or a mortgage created prior to the coming into force of the Act would have priority over a subsequently registered mortgage.

Registration of the mortgage cannot take effect until the aircraft is registered, but a lender can apply to file a priority notice with the BDCA in advance of the execution and delivery of an aircraft mortgage or aircraft engine mortgage. This provides notice of the lender's intention to file a mortgage. If a mortgage is entered into the Aircraft Register or Aircraft Engine Register within 14 days of the priority notice being filed, the mortgage is deemed to have priority from the time the notice was registered. Lodging of a priority notice will prevent any other security interests over the aircraft being registered in advance of registration of the mortgage that is the subject of the priority notice.

The priority notice is a simple form, along the same lines as the mortgage registration form, and must be accompanied by the applicable nominal priority registration fee (BM\$80).

All registered mortgagees must provide their consent to removal of the aircraft in question from the Aircraft Register before such removal can take place, and a registered mortgage will continue to exist despite removal of the aircraft from the Aircraft Register.

Although registration of a mortgage does not constitute evidence of its validity, it does constitute express notice of all facts appearing on the Mortgage Register.

20 How is security over aircraft and leases typically structured? What are the consequences of changes to the security or its beneficiaries?

To protect the security held in an aircraft the following documents and options are available, depending on the structure of the transaction and the nature of the Bermuda-owning or leasing registrant (Registrant):

- a mortgage over the aircraft and its engines, filed appropriately;
- a charge granted over the shares of an owning Registrant with the charge being filed with the Registrar of Companies, if the Registrant is a Bermuda incorporated company;
- an irrevocable proxy from the Registrant's parent authorising a security trustee or the like to vote the shares of the Registrant. Most standard form Bermuda-exempted company by-laws do not make accommodation for irrevocable proxies and would need to be amended in this regard if the Registrant is a Bermuda incorporated company;
- executed, but undated, resignation letters from the directors and officers of an owning Registrant and an irrevocable direction to complete the resignation letters, so that a security trustee would have the ability to step in upon a default pursuant to the terms of the charge over shares and direct an owning Registrant without interference from the pre-existing company directors and officers;
- advance written approval from the BMA (if the Registrant is a Bermuda incorporated company) for a transfer of shares to the security trustee, lender or a designee or transferee (Secured Party) pursuant to the terms of a charge over shares, though if the Secured Party is a licensed bank or other licensed lending institution in an 'Approved Jurisdiction' (which includes, for example, Canada, the United States of America and all countries in the European Union), no further governmental permissions are required;

Update and trends

The most significant Bermuda development, as noted in this chapter, is the impending extension of the Cape Town Convention to Bermuda by the implementation of local legislation in this regard, which should see the jurisdiction enhance its position in the forefront of offshore financial centres involved in financing structures for commercial aircraft. The declarations that will be adopted for Bermuda, including those relating to insolvency, are expected to be in line with those recommended under the OECD Aircraft Sector Understanding for the purposes of qualifying for the Cape Town Discount. We anticipate that this move will be welcomed by lenders, ECAs, lessors, airlines and other parties participating in the aircraft industry.

One further development has been the expansion of the categories of qualifying registrants with respect to the Bermuda Aircraft Register, as described in question 7. By opening up the ability to register aircraft in this way, it is anticipated that it will lead to a significant increase in the number of aircraft registered in the jurisdiction.

- an undated share transfer form from the shareholder of an owning Registrant and an undertaking by such Registrant to transfer its shares upon the instruction of a security trustee or, in the alternative, amendment to the owning Registrant's by-laws (if the Registrant is a Bermuda incorporated company) to remove the standard discretion of the board to refuse to register a share transfer other than a transfer contemplated by the charge over shares;
- amendments to an owning Registrant's by-laws (if the Registrant is a Bermuda incorporated company) to add additional notice provisions for shareholder or board meetings where the purpose would be to achieve certain objects such as the winding up of the owning Registrant or the sale of the owning Registrant's assets;
- amendments to an owning Registrant's memorandum of association (if the Registrant is a Bermuda incorporated company) to the effect that the only business that it could conduct would be to acquire and operate the aircraft, namely, assisting in making the Registrant bankrupt remote by removing risks of additional business ventures;
- a deregistration power of attorney from the Registrant and a letter of assurance from the BDCA recognising additional security interests held in the aircraft; and
- a letter of quiet enjoyment from the Registrant to the ultimate operator.

The main security documents will usually not be governed by Bermuda law but by, for example, English or New York law, except that a charge over the shares of a Bermuda company (if the Registrant is a Bermuda incorporated company) is often governed by local law.

The secured party is often a security trustee or collateral agent for the financing parties from time to time.

21 What form does security over spare engines typically take and how does it operate?

The statutory definition of 'aircraft engine' in the Act includes all parts, equipment and data, and manuals and records relating to them. A registered mortgage may cover any store or spare parts for the aircraft, but does not include a mortgage created as a floating charge or a mortgage of spare parts on their own. It is possible to register a mortgage over an aircraft engine on the Bermuda Register of Aircraft Engine Mortgages pursuant to the Act (see question 17).

Enforcement measures

22 Outline the basic repossession procedures following lease termination. How may the lessee lawfully impede the owner's rights to exercise default remedies?

Subject to enforceability considerations under the governing law, the *lex situs* and any other relevant laws (other than Bermuda law), will typically be recognised by the Bermuda courts and enforce contractual arrangements such as lease termination provisions created under foreign laws. The Bermuda courts would also generally recognise self-help remedies by which the counterparties may take possession of the aircraft, for example, by dealing directly with the BDCA pursuant to a deregistration power of attorney to effect a deregistration.

23 Outline the basic measures to enforce a security interest. How may the owner lawfully impede the mortgagee's right to enforce?

Similarly, the Bermuda courts would typically recognise self-help remedies in the context of an enforcement of security interests over the aircraft (and often over the shares of the aircraft-owning vehicle). Bermuda law will generally also respect the secured parties' security interests in the event of the insolvency of the relevant company (if the Registrant is a Bermuda incorporated company).

24 Which liens and rights will have priority over aircraft ownership or an aircraft security interest? If an aircraft can be taken, seized or detained, is any form of compensation available to an owner or mortgagee?

See question 19. Generally, issues of compensation for detentions, requisitioning, etc, are typically also dealt with contractually in the transaction or insurance documentation.

Taxes and payment restrictions

25 What taxes may apply to aviation-related lease payments, loan repayments and transfers of aircraft? How may tax liability be lawfully minimised?

Bermuda currently has no form of income, corporate or capital gains tax and no estate duty, inheritance tax or gift tax.

Additionally, if the Registrant is a Bermuda incorporated company, Bermuda-exempted companies (as well as exempted limited partnerships and exempted trusts) are entitled to obtain a tax assurance exempting such entity from the effects of any changes to the Bermuda tax regime until 31 March 2035 (with such date likely to be pushed back further closer thereto).

26 Are there any restrictions on international payments and exchange controls in effect in your jurisdiction?

Bermuda has exchange controls, which apply to residents in respect of the Bermudian dollar pursuant to the Exchange Control Act 1972 and the Exchange Control Regulations 1973. Exempted companies are considered to be non-resident for exchange control purposes, so there are no controls on their freedom to make transfers and carry out transactions in all other currencies.

27 Are there any limitations on the amount of default interest that can be charged on lease or loan payments?

Arrangements that provide for a penal rate of interest may be unenforceable under English common law principles, which are of persuasive, if not binding, authority before the courts of Bermuda.

28 Are there any costs to bring the aircraft into the jurisdiction or take it out of the jurisdiction? Does the liability attach to the owner or mortgagee?

Aircraft registered on the Bermuda Aircraft Register are almost invariably located and operated outside of Bermuda.

Were an aircraft to be imported into Bermuda, it would be subject to Bermudian import duty.

Insurance and reinsurance

29 Summarise any captive insurance regime in your jurisdiction as applicable to aviation.

Bermuda is the largest jurisdiction for captive insurance, with captive insurance companies regulated by the Bermuda Monetary Authority. In relation to aircraft insurance, apart from where the relevant aircraft is 'ordinarily based' in Bermuda, Bermuda insurance legislation does not apply and it is typically the case that insurance is placed in the principal aviation insurance centres of London and New York.

30 Are cut-through clauses under the insurance and reinsurance documentation legally effective?

There are no Bermuda statutory provisions in relation to such clauses. The position under Bermuda law will reflect English common law principles, which are of persuasive, if not binding, effect before the courts of Bermuda.

31 Are assignments of reinsurance (by domestic or captive insurers) legally effective? Are assignments of reinsurance typically provided on aviation leasing and finance transactions?

Subject to the usual enforceability qualifications, such arrangements are effective under Bermuda law and are common in aircraft finance transactions.

32 Can an owner, lessor or financier be liable for the operation of the aircraft or the activities of the operator?

With respect to an owner, section 76 (4) of the UK Civil Aviation Act, 1982 is extended to Bermuda to the effect that loss or damage caused by an aircraft in flight or by a person in, or an article, animal or person falling from, such an aircraft, is transferred to the person to whom the owner has demised, let or hired out the aircraft if the demise, let or hire is for a period of more than 14 days and no crew member is employed by the owner.

In general terms, a lessor or financier would not otherwise be liable solely by operation of Bermuda law.

33 Does the jurisdiction adopt a regime of strict liability for owners, lessors, financiers or others with no operational interest in the aircraft?

Except as noted in question 32, the owner of the aircraft would be subject to strict liability by virtue of section 40(2) of the UK Civil Aviation Act, 1949, extended to Bermuda.

34 Are there minimum requirements for the amount of third-party liability cover that must be in place?

There are no specific Bermuda law requirements.



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