

Aircraft Repossession Under Cape Town Convention in the UAE

- Partner
- Dubai International Financial Centre

Yazan Al Saoudi - Insurance / Shipping, Aviation & Logistics
y.saoudi@tamimi.com

October 2016

Aircraft Leasing -Premier Finance Structure

Aircraft leasing is the most popular transaction structure in the aviation industry and it is important at the outset of any transaction to establish the rights and remedies available to aircraft lessors in the event of default. On an economic level, if there is certainty for aircraft lessors or creditors in being able to recover aircraft in the event of continued default on the part of a lessee operator, then there is a corresponding ability to predict and plan for the provision of finance. Lessors are able to reduce their costs to account for risk and are able to make greater amounts of financing available to airlines on more attractive terms. Lessees or operators benefit too as these reduced costs will be reflected in fleet leasing rates. Ultimately if a country is a sophisticated jurisdiction with rights and remedies clearly defined, and the country is a party to the relevant international treaties, the airline is in a better position to attract the provision of finance and has the ability to grow its aircraft fleet size. Also, the airline may qualify for other forms of finance. For instance, countries with a significant manufacturing base for aircraft may provide Export Credit Agency (ECA) backed financing, whereby a quasi-governmental or private nominated institution (the ECA) acts as an intermediary between state governments and exporters to provide finance to the airline to purchase aircraft.

Brief History and Reasons for the Cape Town Convention 2001

Because aircraft are constantly flying between borders and landing in different jurisdictions, there has always been a requirement for an international system to codify the rights which the lessor and operator may have in the aircraft, and the Geneva Convention on the International Recognition of Rights in Aircraft 1948 ('Geneva Convention') went some way to developing an international system providing for the international recognition of rights in aircraft and for protecting property interests, defining orders of priority, and protection of consensual liens and mortgages. However, the Geneva Convention had a number of flaws which mainly centered on the fact that in many instances lessors were unable to repossess their aircraft after a consistent failure on the part of the lessee to pay lease rent because the laws of the relevant country in which the aircraft was based were inadequate, and relying on procedures regarding the exercise of rights for repossession of aircraft to domestic law of a state produced great uncertainty. As a general consensus, there was a need for a uniform system regarding protection of international interests in aircraft. As a result The Convention on International Interests in Mobile Equipment (2001) ('Cape Town Convention') and its Protocol to the Convention in Mobile Equipment on Matters Specific to Aircraft Equipment (2001) ('Aircraft Protocol') was concluded at a diplomatic conference organised and promoted by two sponsoring organisations, UNIDROIT, the UN Agency dealing with Private Law Conventions, and the International Civil Aviation Organisation (ICAO).

Brief Overview of Cape Town Convention 2001

The Cape Town Convention supersedes the Geneva Convention with regards to aircraft and aircraft objects, and supersedes the Rome Convention for the Unification of Certain Rules Relating to the Precautionary Attachment of Aircraft 1933. The Cape Town Convention is designed as a multi-equipment treaty with protocols for aircraft equipment, railway rolling stock and space assets, but the only protocol to be adopted so far is the Aircraft Protocol and it applies to airframes, aircraft engines and helicopters: airframes which can carry at least eight persons or goods in excess of 2750 kg; all aircraft engines which have at least 1750 lbs of thrust (if jet powered) or 550 HP (if turbine powered); and helicopters carrying 5 or more passengers. At the time of writing, the Cape Town Convention has been ratified by 64 contracting states, including the UAE, as well as the European Union.

The main aim of the Cape Town Convention is to reduce the cost of raising finance for large high value mobile assets (such as aircraft) which regularly cross borders, and the main mechanism is to provide for the creation of 'international interests' such as a mortgage or an aircraft finance lease which is capable of being recognised in all contracting states, and to provide for international remedies available to creditors should an airline or operator default on repayments relating to an international interest. Additionally the Cape Town Convention creates an electronic international register for the registration of 'international interests'.

The Cape Town Convention provides standard remedies in the event of default by a debtor including the ability to:

- take possession or control of an object;
- sell or grant a lease of an object;
- collect or receive income or profits arising from the management or use of an object; and
- vest an object in satisfaction or redemption.

There are also remedies available for conditional sellers or lessors and interim relief pending final determination of a claim.

In addition the Aircraft Protocol provides remedies including :

- the ability to require the removal of an aircraft from the national civil aircraft register; and
- the ability to export the aircraft.

Chapter III, Articles 8 to 15 of the Cape Town Convention provide a lessor or financier with a set of remedies in the event of a debtor's default, and these remedies include taking possession of the equipment. The Aircraft Protocol Article IX (1) expands those remedies to include deregistration, export and physical transfer of the aircraft from the territory in which it is situated, together with a subsequent re-registration of the aircraft. Article 13 of the Cape Town Convention (as modified by Article IX of the Aircraft Protocol) provides the mechanism to make an application to court, and the lessor's entitlement to request court relief stems from the contractual agreement within the aviation finance lease documentation agreed between the lessor and lessee so that the provisions of the Cape Town Convention and Aircraft Protocol and its remedies will apply, and are agreed in accordance with Article IX of the Aircraft Protocol.

Cape Town Convention in the UAE

The Cape Town Convention was ratified by the UAE and came into effect in the UAE on 1 August 2009. The benefits to the UAE have been that leasing and finance structures drafted in relation to the UAE have habitually incorporated the rights and remedies available under the Convention, and in turn lessors and financiers have been able to reduce risk and to reflect that in the cost of credit supply.

However, when ratifying the Cape Town Convention, the UAE made a number of Declarations under the convention, one of which is that where Cape Town Convention remedies are available to the lessor without

the need for an application to court (so called self- help remedies); such remedy may only by be exercised by application to court. Thus in the UAE a court application will always be required in a contentious situation where a lessee is in default and is refusing to return the aircraft.

Other points to note specific to the Cape Town Convention in the UAE are that if interests are registered on the international register and create international interests (as defined in the Cape Town Convention) over the aircraft and engines, no other filing, registration, submission or governmental approval is necessary to perfect or protect the rights of the lessor and lessee to the aircraft, and such international interests will be effective against third parties in the UAE. Accordingly the lessor under an aviation finance lease will have the rights and remedies available to a holder of a registered international interest under the Cape Town Convention. The Gulf Civil Aviation Authority (GCAA) recognises the concept of the Irrevocable De-registration and Export Power of Attorney (or IDERA) which allows the person (usually the lessor) in whose favour the document is issued to exercise those rights and remedies contemplated by the Cape Town Convention, as adopted and implemented in the UAE.

The GCAA maintains a national aircraft register in accordance with Article 28(2) of UAE Law regarding Civil Aviation Law (Federal Law no 20 of 1991) (the 'Aviation Law'), and an aircraft is to be registered according to defined conditions and procedures. According to Article 5(2) of the Aviation Law, no aircraft registered on the aircraft register may be legally disposed of in any way without the prior written consent of the GCAA. Upon the cancellation or termination of an aviation finance lease and subject to the filing of the IDERA with the international register there will be a right, subject to an application to court, (i) to repossess the aircraft, (ii) to de-register the aircraft from the aircraft register and international register and (iii) to export the aircraft from Dubai and the UAE, all without requiring any further consents, approvals or licenses from the GCAA.

Retrieval Proceedings in the UAE-General Procedure

Although the UAE is a party to the Cape Town Convention and a court application is required in respect of the remedies contained in the Cape Town Convention, it is fair to say that it is extremely rare to make an application for repossession of aircraft in the UAE. Although it is a common procedure in the UAE courts for a creditor to issue an ex parte application and to request the court to attach the assets of the defaulting debtors in contractual disputes, an application for an order for repossession of an aircraft has remained relatively untested.

The UAE Law of Civil Procedures (Federal Law No 11 of 1992) ('Civil Procedures Law') allows a creditor, or an owner of an asset or a plaintiff with a valid claim against a defendant to attach an asset in possession of the other party. Therefore in the event of a dispute over the right to possession of the aircraft, in theory the lessor may pursue attachment of the aircraft by court proceedings in the UAE, and in any Emirate of the UAE where the aircraft is situated afterwards to physically retrieve the aircraft. The lessor will have to file the substantive action before the competent court within eight days as of the date of filing the attachment proceedings, and will then have to litigate the matter until a final and conclusive judgment is issued to the effect of returning possession of the aircraft to the lessor. Such proceedings against the aircraft are called retrieval proceedings, and from the lessor's perspective are usually based on proving that it is the rightful owner claiming ownership of the aircraft from another party who is in actual possession.

The basic procedure for an attachment application is to draw up an application and file it in the appropriate UAE court. This is an ex-parte application to a duty judge who makes a prompt decision on the merits of the proposed attachment. The grant of an attachment order is based solely on the documents provided as evidence. There is no scope for affidavits or witnesses. If the attachment application is successful, an attachment order is granted by the judge and sent by the court bailiff for attachment of the aircraft. Within eight days of any successful attachment application, a substantive action needs to be filed in support of the attachment proceedings. Failing this, the attachment order will be considered void. If the substantive action is successful, and all the appeal stages have been exhausted, the lessor can then

proceed with the execution of the judgment through the relevant court execution department. In summary, it may be said that the retrieval proceedings based on the Civil Procedures Law is time consuming and it may take years before an executable judgment is rendered and subsequently enforced through the execution department.

Recent Case Grounding Repossession and Delivery Up in Sharjah Court

In a recent client case a lessee operator of an aircraft had failed to pay substantial monies owing to the lessor, composed primarily of unpaid aircraft rental arrears and maintenance reserves, and this default had been ongoing for a considerable period of time. The aircraft was not registered in the UAE, but was registered in a foreign jurisdiction, but the lessee operator of the aircraft had a place of business and assets in the UAE. The aircraft was due to land in Sharjah on a certain date known to the lessors, primarily to undertake repair works and was due to enter a workshop for maintenance with a Maintenance Repair and Overhaul (MRO) provider.

Given the sustained and continuing default on the part of lessee, instructions were issued to attempt to ground and repossess the aircraft and secure deregistration and onward release of the aircraft to the lessor in accordance with the terms of the lease agreement between the parties, in addition to attaching the assets of the lessee towards securing the unpaid rent and maintenance charges.

A draft application to the Sharjah Court was prepared on an ex parte basis. The application was firstly for the grounding and repossession of the aircraft, and secondly for the attachment of the UAE assets of the lessee. The application was premised on the provisions of the Cape Town Convention in addition to the provisional attachment provisions available under the Civil Procedures Law. In the first part of the application (grounding/repossession), the relevant provisions under the lease agreement which incorporated available remedies under the Convention were highlighted and exhibited. The several default notices issued by the lessor were explained and the court was taken through the remedies set out under Article 13 of the Cape Town Convention for delivery up, repossession, procurement of de-registration of the aircraft from its home jurisdiction, and the procurement of export of the aircraft once the order was perfected.

The second part of the application included a request to the Sharjah Court to issue a provisional attachment order against the UAE assets of the aircraft operator for the outstanding amounts in default in the payment of the applicable rent and maintenance arrears and exhibited and explained the several notices and demands issued in relation to the relevant aircraft.

An order was granted by the Sharjah court and served on all relevant parties including the debtor, Sharjah Airport, the Sharjah Civil Aviation Department, the GCAA, the MRO provider, the banks and properties identified in the attachment application and the order was also served in relation to all identifiable assets subject to the application. The aircraft was secured and moved to a facility within Sharjah Airport pending finalisation of the deregistration of the aircraft from its home civil aircraft register and re-registration in a new national civil aircraft register arranged by the lessor of the aircraft.

In this instance the order was successfully granted and the eventual outcome has been that the aircraft has been flown from the UAE and re-registered on another country's civil aviation authority aircraft register and the aircraft has been repossessed by the lessor.

Nevertheless, a number of factors combined to enable success: the lessee operator's default in nonpayment of rental payments and maintenance reserves was abundantly clear and prolonged; the ex-parte application to the judge made full and frank disclosure and demonstrated the continuing default; the appended lease documentation was properly drafted so as to incorporate Cape Town Convention remedies; the Sharjah court was fully appraised and had competence in dealing with Cape Town Convention remedies; the lessor was in a position to offer a bond or guarantee if required (albeit this was not required); the application for de-registration of the aircraft from its home civil aircraft register and jurisdiction was made at the same time as the Sharjah court application; the assets for the attachment

section of the application were properly researched and identified; the lessor client had made provision for the safe retention of the aircraft with a local MRO and had made provision for onward ferry flights and ultimate re-registration on another country's register; the defaulting lessee to a certain extent did not contest the substance of the application and, again to a certain extent, entered into negotiation with the lessor.

Conclusion and Policy

Policy-wise, UAE courts are not in the habit of regularly granting orders for repossession of aircraft, and UAE courts will deal with applications on a case by case basis. In this instance an order was successfully secured, and in practical terms made sure that the aircraft was re-possessed, de-registered from its own jurisdiction, re-registered in another jurisdiction and returned to the lessor.

However, there are very few recalcitrant lessees in the UAE region and it is important to note that the overwhelming intention of the Cape Town Convention is to provide certainty in protecting international interests, and to enable the reduction in cost of raising finance for large high value assets such as aircraft, and in turn to promote an environment where airline businesses can grow and increase fleet size. Gulf Carriers have demonstrated that growth in abundance and have utilised the aircraft finance market to achieve this, and such success is a superb example of the commercial benefits which may be obtained by signatory States to the Convention.

Correspondingly, on the rare occasion in which a lessor must enforce its remedies under the Convention, it is of comfort to note that the UAE jurisdiction will grant the necessary court order if the case is properly argued and the Cape Town

Convention remedy is appropriate in the circumstances.