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Securitising future passenger and cargo revenues

For the past 30 years, airlines around the world have been raising funds in the international capital markets by securitising their future passenger and cargo receivables on specified routes.

The first deals in Asia were executed by Philippine Airlines and Asiana Airlines 20 years ago. Since then, ticket and cargo receivables securitisation has become a regular financing tool for many Asian airlines.

While these structures have stood the test of time, since the COVID-19 crisis took hold earlier this year, there has been a renewed focus on the structure as it has allowed some airlines to raise significant funds by selling future revenues notwithstanding the relative uncertainty of sales in the short term.

It also provided an avenue for governments, developmental agencies and policy banks to consider providing strategic support to airlines by participating in these securitisations in a number of ways.

For example, the Korean government provided support to three cargo securitisations by Korean Air (of its key routes to the US, Japan and Hong Kong) during the COVID-19 crisis.

The benefits to an airline of securitising these future revenues includes:

- **Raising cash today from revenues to be generated in the future.** The airline can raise significant upfront capital by selling revenues which will be generated in the future. This cash injection can be used for any purpose and provides important liquidity to the airline;
- **Lowering funding costs.** Funding costs can be significantly lower than the airline's other funding sources as the structure can allow the debt securities to be rated up to three notches higher than the rating of the airline;
- **Diversifying funding sources.** A securitisation programme allows the airline to diversify its funding sources by tapping domestic and international debt capital markets investors rather than its traditional relationship banks.

As airlines continue to look for effective ways to manage their liquidity position and find ways to engage with governments and stakeholders regarding tangible methods of receiving support, the securitisation of future flows on key routes ought to feature firmly in conversations.

This is particularly the case in Asia as airlines continue to be buoyed by a resurgence in demand in their key passenger and cargo routes.

Based on our (the author and PwC network) understanding of the commercial, legal, tax and structuring nuances, and by navigating around the risks, airlines who are able to tap the future flow securitisation market may well open up an important source of funding in the ensuing months and into the future.

What is a "securitisation"?

When we "securitise" an asset, we are turning the cashflow from the asset into a debt security which can be sold to investors. We can do this by setting up a special purpose company or a trust to purchase the cashflow arising from the sale of passenger tickets or cargo shipments from the airline in a legal "true sale". That means that the cashflow will be fully owned by the special purpose company or trust and cannot be claimed by a liquidator of the airline in the future. As these cashflows are the key source of income for the airline, the buyers of the debt securities are in a senior position vis-à-vis other creditors of the airline (such as lessors).

In a typical transaction, a special purpose company will issue debt securities to capital markets investors. Those debt securities are fully backed by the cashflows that the special purpose company has bought from the airline. Therefore, as long as passenger or cargo receivables are being generated by the airline on the relevant routes, the cashflow arising from those receivables will belong to the special purpose company and will be used to service payments on the bonds or notes that it has issued to investors.

By selling the receivables and diverting the cashflow to the special purpose company or a trustee, the debt securities can receive a rating uplift (generally around 2-3 rating "notches" higher than the rating of the airline or the relevant sovereign rating). This significantly reduces funding costs for the airline and is a key driver for these structures. In some deals, we have seen sovereign/quasi-sovereign entities provide credit enhancement to these transactions through a credit facility or guarantee which allows the airline to further reduce funding costs.

Which receivables can be securitised?

Cargo and passenger ticket receivables are commonly securitised. Airlines may have cashflows arising from other assets (such as frequent flyer programmes) which can also be securitised. In most cases, the cargo and passenger receivables are generated by agents on behalf of the airline. Direct cargo and ticket sales may be included in the deal depending on the volume and ability to segregate them from other cashflow of the airline.

The key point to note is that the actual sale does not involve a sale of “individual” receivables on a piecemeal basis. Instead, all the future arising receivables on a particular route will be sold to the special purpose company or trust. The receivables are reassigned back to the airline once the debt securities have been fully repaid.

As an example, if an airline is based in Country A and has a profitable cargo route to Country B, it would sell all of its future arising cargo revenues arising on the route operating between the two countries. Following the sale, all revenues arising on that route will be collected in Country B directly from IATA (or the relevant merchant processor bank for certain credit card companies) and held in a trust account for the benefit of the special purpose company and the investors in the debt securities.

The reason that these receivables can be securitised is because they are an amount “owed” to the airline by a third party. Typically, the amounts are owed by IATA (through its CASS/BSP airline settlement systems) or by a merchant processor bank on behalf of credit card companies. The airline assigns its “right” to receive the payments from IATA or the relevant merchant processor on the relevant route to the special purpose company or trust. In order to do this, IATA or the merchant processor will agree to remit all payments to a newly established trust account held for the benefit of the special purpose company and the investors.

Such an agreement with IATA or the merchant processor is crucial to the structure as it provides comfort to investors that for so long as the airline is generating receivables on the relevant route, IATA or the merchant processor will settle the payments directly to the trust account.

The structure

The structure of the transaction will depend on the laws (including tax laws) of the jurisdiction of incorporation of the airline, the location of the relevant branch (which generates the receivables) and the governing law of the receivables.

The simplest structure is generally for the airline to deposit all of its rights to the receivables into a specially created trust. The trust or a trustee would be the owner of the receivables and would issue two trust certificates back to the airline to represent a 100% interest in the assets of the trust, i.e. the receivables.

The airline would retain one trust certificate for the life of the transaction and would sell the other trust certificate to the special purpose company (the “Investor Certificate”).

The special purpose company would then issue asset-backed debt securities to investors which are secured by the Investor Certificate. This means the investors are secured by an interest in a trust which owns the receivables.

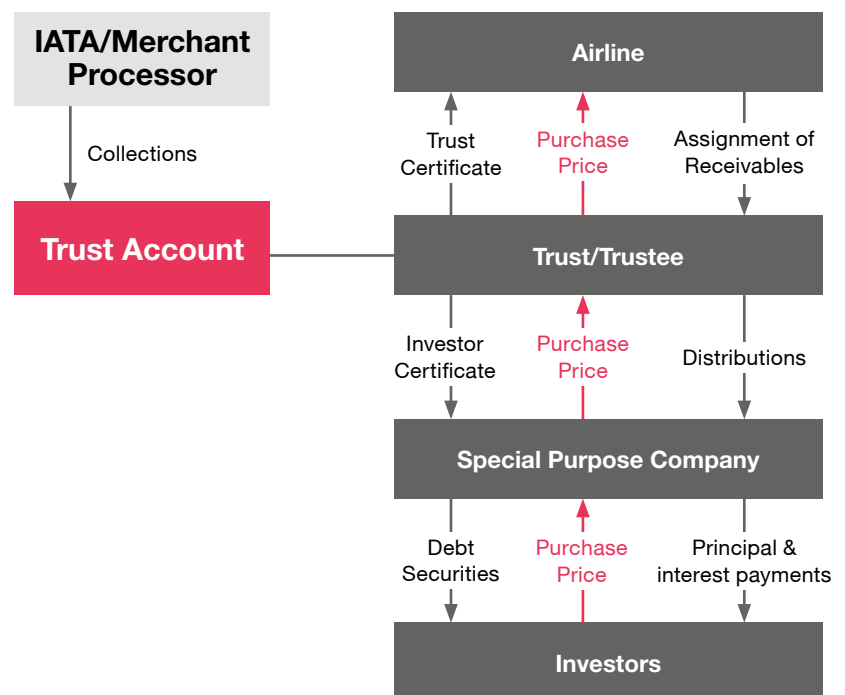
From collections received on the receivables each month, the trustee accumulates sufficient funds to make distributions on the Investor Certificate

on the next payment date (which are equal to the interest and principal payments due on the debt securities). Once sufficient cash has been accumulated, all extra collections received on each day during that month will be distributed to the airline. In this way, the airline need only observe a short delay each month before it receives the surplus cash on the receivables.

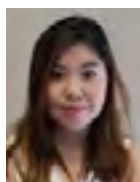
It is fairly common, particularly for airlines with a lower credit rating, to obtain additional credit support from a sovereign/quasi-sovereign bank. This is usually in the form of an irrevocable credit facility (which performs like a guarantee).

This could enable the airline to raise funds even at the sovereign rating with such governmental support.

More importantly, if a government wants to provide credit support to an airline or provide a strategic credit enhancement to encourage particular routes, for example, it can do so by providing a credit facility to the special purpose company. Then, if there is a shortfall of cash to make payments on the debt securities, the special purpose company will be able to drawdown on the credit facility to maintain the liquidity in the securitisation structure.



Establishing the PRC's next international aviation hub: an overview of recent policy developments in Hainan



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In June 2020, the Central Committee of the Chinese Communist Party and the PRC Government announced a Hainan Free Trade Port (FTP) Master Plan comprised of various policies to facilitate Hainan's development as a major transport and logistics hub and free trade port by 2050.

Relaxation of obtaining foreign debt quota for offshore aircraft financing

The Master Plan relaxes certain requirements for obtaining foreign debt quota and registering the same for offshore aircraft financing. Currently, PRC-incorporated lessors registered in a free trade zone (FTZ) would need to obtain prior foreign debt quota from the National Development and Reform Commission (NDRC). Subject to local implementation and interpretation, such restrictions would be removed for aircraft lessors incorporated in Hainan FTP. Offshore financiers would also benefit from a streamlined process to register foreign debt with the State Administration of Foreign Exchange (SAFE) i.e. they would be able to proceed with registration at banks in Hainan FTP instead of with local governmental authorities as applicable for FTZs.

Tax reforms and concession schemes

The Master Plan optimises Hainan FTP's tax environment to attract both domestic and foreign direct aviation investment as well as aviation professionals into Hainan FTP. Aircraft lessors operating in FTZs may be drawn by the competitive rate for corporate income tax and individual income tax (set at a maximum rate of 15%) under the Master Plan. Like other FTZs, the Master Plan also offers zero-tariff treatment for import of aircraft into Hainan which would benefit domestic lessees and lessors

in the PRC. The Master Plan allows accelerated tax depreciation on qualifying capital expenditure incurred by enterprises operating in Hainan FTP. The Master Plan further reforms tax regulations and revitalises the Hainan FTP business environment by exempting corporate income tax on income generated from incremental outbound investment made by enterprises engaging in tourism, modern services, modern services (spanning logistics industries, consumer services, education and public services), and the high-tech industry set up in Hainan FTP before 2025.

These proposals appear initially to be positively received by foreign investors. In August 2020, twelve foreign enterprises, including TUI AG – the largest global tourism company and operator of five airlines in Europe – entered into cooperation agreements with Hainan FTP. Media reports suggest that TUI AG intends to form a joint venture and establish its Asia-Pacific headquarters in Hainan FTP. While such tax reforms may require further policy guidance, these measures may transform Hainan FTP into a tax-friendly platform for foreign and domestic stakeholders in the aviation sector.

Bonded logistics and aviation hub

In August 2020, a bonded logistics centre has been officially approved to be set up under the supervision of China Customs (a Type B centre under local regulations) in Hainan FTP. As duty-free goods may be stored, processed or manufactured in bonded logistics centres, they play an important role in the storage and trade of commodities in cross-border e-commerce and international trade. Setting up a Hainan FTP bonded logistics centre at Sanya Phoenix Airport may now be perceived as a

move of strategic importance as it can act as a confluence of goods, cargo, and supply chain logistics between the PRC and the world.

The Master Plan also proposes initiatives to liberalise air traffic rights to and from Hainan. These include expanding so-called "fifth freedoms" of the air (i.e. the right of an airline to pick up, drop off, and carry passengers or cargo between two countries, neither of which is its home domicile country, on a route which originates in its home country) and to pilot the opening up of "seventh freedoms" (i.e. the right of an airline to operate services between two countries, neither of which is its home country, on a route which does not touch its home country). These initiatives are unprecedented in the region, particularly the seventh freedom proposals. As a consequence, foreign air carriers could seize the opportunity to create bases in Hainan FTP to be used as springboards for their PRC operations. The establishment of bonded logistics centres and liberalisation of the Hainan aviation market for overseas airlines would facilitate collaboration between foreign and Hainan-based domestic airlines and logistics companies.

Conclusion

The Master Plan removes certain restrictions in obtaining offshore aviation financing, reforms the taxation policy and seeks to develop Hainan FTP into a major logistics hub. It also intends to offer an industry-friendly environment for increased flows of aviation industry human and investment capital to and through Hainan. Although we expect further policy announcements and guidance to refine operational aspects of the Master Plan, Hainan FTP is poised to play an important role in the development of aviation and logistics in the PRC.



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It goes without saying airlines have been forced to make drastic changes to their networks and operations owing to the COVID-19 pandemic. Airline survival and economic recovery will both be instrumental in shaping business performance in 2020 and beyond. One of the more dramatic impacts on airline operations post-COVID-19 has been the emergence of cargo as a key source of revenue and cashflow for carriers while passenger markets have been near completely or totally shut down. The market has observed many solutions to this pivot toward cargo, including increased freighter utilisation and flying passenger aircraft with only cargo in the bellyhold, to flying cargo on the seats in the cabin and the most invasive change: removing seats and monuments in the cabin to increase cargo capacity on the main deck as well as lower deck. This has been the case with both widebody aircraft, and increasingly narrowbody passenger aircraft, too, in the first half of 2020. Will this continue to be a trend in the cargo market? We examine the case for the A321-200 passenger airplane to be used as a main-deck freighter without cutting a large cargo door.

It is all about payload

“Load more and pay less”, or trying all means to squeeze every usable cubic inch of space in order to increase profit, is the rule logistics industry players follow for business success, and narrowbody freighters are no exception. Airbus and Boeing converted A320 and 737 freighters are all targeting flight ranges between 3500km and 4200km and providing full-load capacity to serve regional and standard express-density cargo.



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	737-300SF(AEI)	7374300SF(AEI)	737-800SF(AEI)	A320-200P2F	A321-200P2F
Engine	CFM56-3B2	CFM56-3C-22	CFM56-7B27	CFM56-5B4/P	CFM56-5B3/P
Max. Structural Payload	19t	21t	23t	21.9t	27.9t

Subject to European Union Aviation Safety Agency (EASA) loading instructions regarding acceptable weight in the cabin, A321 passenger aircraft can carry a 22-tonne payload after the removal of all its cabin seats. The conversion normally takes 6-8 engineering hours to empty the cabin. In other words, an A321 passenger aircraft can become a freighter overnight without fundamental changes to the aircraft's structural design.

As the aircraft structurally remains in the passenger aircraft specification, it retains its longer range as compared to the 737-800SF and A320-200P2F and can even reach 4800km which is usually covered only by 757Fs among narrowbody freighters.

How about volumetric capacity?

In order to retain cabin flexibility and allow for an easy change back to passenger operations, the PSU (passenger services unit, which includes the overhead compartments with the oxygen masks, call buttons, passenger lights and bins) must remain unchanged. Subject to aviation regulations, cabin packages on seats would not be allowed to be stacked higher than the top of the seat, and these requirements significantly effect usable cargo volume on the main deck. In practice the standard two-cabin passenger seat layout A321 has only 80 available cubic meters for cargo carriage, including 29 cubic meters in the cargo hold.



However, if all cabin seats are removed, an A321 passenger aircraft will have 160 cubic meters in total available. If the PSUs are removed, volumetric capacity will easily reach 200 cubic meters and allow cargo to be stacked up to the cabin ceiling. This is ideal for transporting PPE such as face masks, as those package dimensions are around 68*68*40 cm and weigh 7 kg, to easily maximise the use of every corner of the cabin.

The sweet spot

Passenger aircraft acquisition costs are less than converted freighters, and the A321 is no exception. The cost savings primarily stem from the passenger-to-freighter (P2F) conversion expenses of around USD8.5-10.8 million per airplane. This expense does not include the costs for airframe overhaul or engine performance restoration, which normally involves the inspection, rebalancing or replacement of specified parts in the core gas flow path e.g. high-pressure compressor (HPC), combustor, and high-pressure turbine (HPT). These are all significant cashflows out and create additional financial burdens on aircraft owners.

The time saved and revenues gained

by not converting to P2F aircraft is another point which needs to be strongly considered. Modification capacity is always a bottleneck to the industry, as well as the conversion learning curve and downtime needed on what is a relatively new P2F programme. The first three A320s modified at the Singapore EFW facility took more than twelve months to complete the whole process. Until

For aircraft owners, especially those of A321s not more than 15 years' old, it is important to retain the flexibility to switch between freighter configuration back to passenger use in just one overnight shift. When demand shifts between passenger and cargo markets, airlines can adjust capacity rapidly, and help these high-value assets to secure their liquidity.

Conclusion

Indeed, there are certain restrictions when passenger aircraft are operated as freighters, such as the maximum loading weight per square meter, an inability to build and break down pallets, and no ULDs could be used on the aircraft. All these could lead to an overall reduction in aircraft utilisation.

However, more and more ecommerce cargo will be carried by air, and their small, light bulk in low-density packaging are a natural fit to be easily stored manually in a passenger cabin. Although loading may take 2-3 hours more than using ULDs on a full-freighter aircraft, in view of saving the large cost of modification and keeping the aircraft's flexibility, passenger A320 family and 737 aircraft have unique cost advantages to penetrate the freighter market.



Sustainable investment opportunities in Chinese airports



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Due to the environmental impact and long asset life cycles of civil aviation activities, there is an inevitable trend in the aviation sector to invest in sustainable initiatives and innovations around the design and operational strategies of airports to stay on top of the game. In recent years, Chinese airports have begun to adopt more energy-saving and environmentally



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friendly measures, and their success in projects such as the award-winning Beijing Daxing International Airport and World Bank-backed Jiangxi Shangrao Sanqingshan Airport have set new heights in China's green aviation market.

On top of the traditional focus on improving the fuel efficiency of aircraft, green terminal designs and waste

minimisation through recycling, industry research reports and successful international experience¹ have identified promising initiatives which can be applied in both the design and construction of brand new, high-tech airports as well as upgrades and retrofitting of existing airports.

These initiatives can be broadly divided into two categories (i) sustainable energy solutions and policies and (ii) infrastructure and system upgrades.

Apart from bringing environmental, social and corporate governance (ESG) benefits, various stakeholders may also be able to manage their operational risks and derive financial savings through these initiatives in the long run.

¹ Clean energy and infrastructure: Pathway to airport sustainability report, Clean Energy Finance Corporation and AECOM, <https://www.cefc.com.au/media/402343/cefc-pathway-to-airport-sustainability.pdf>;
ICAO Seminar on Green Airports
<https://www.icao.int/Meetings/GREENAIRPORTS2019/Pages/Presentations.aspx>;
HKIA Carbon Reduction Award Scheme 2018 Best Practice Sharing,
https://www.hongkongairport.com/iwov-resources/file/sustainability/environment/carbon-management/HKIA-Carbon-Reduction-Award-Scheme-2018_Best-Practice-Sharing.pdf;
China - Jiangxi Shangrao Sanqingshan Airport Project Implementation Completion and Results Report, The World Bank,
<https://documents.worldbank.org/en/publication/documents-reports/documentdetail/862511562940874794/china-jiangxi-shangrao-sanqingshan-airport-project>;
Beijing Daxing International Airport, Airport Technology,
<https://www.airport-technology.com/projects/beijing-daxing-international-airport-china/>



Sustainable energy solutions and policies

Effective energy solutions and policies are at the heart of emissions saving practices.

The use of renewable energy, no matter through generating energy from waste, employment of on-site solar panels, wind turbines or geothermal generators and battery storage systems, or even purchase of renewable energy from offsite utility providers are effective ways to cut emissions.

For instance, the Daxing Airport has integrated a mixture of solar, rain collection and geothermal systems to minimise its reliance on non-renewable energy sources.

Electrification (i.e. substituting combustible fuels with electricity as power sources) of onsite vehicle transportation and ground support equipment could also create significant reductions in carbon emissions.

These sustainable energy solutions can also be coupled with other infrastructure and systems to achieve greater environmental impact.

Infrastructure and system upgrades

Airports around the world have adopted various strategies to improve the overall energy efficiencies of their critical infrastructure and systems, including their heat, ventilation and air-conditioning infrastructure and logistical and aircraft supporting systems.

Examples include centralisation of utility plants and ground source heat pumps for cooling and heating to benefit from economies of scale, enhancing their baggage handling systems by lowering the carry-load and streamlining the baggage logistics process, and upgrading their airfield light systems using LEDs and smart fixtures to control light intensity.

The development and deployment of building analytics technologies to detect, diagnose and monitor performances of various controls and heat and air conditioning systems of the terminals enables timely maintenance and repair, and can also help to improve energy efficiency and improve the life cycles of the assets in the long run.

Aside from improving their own systems and policies, the designs and operations of airports could influence aircraft operators in making emission-cutting decisions. For example, airports can facilitate the airlines' upgrade to more energy efficient aircraft by ensuring that their infrastructure are able to service future aircraft needs. Parked aircraft require power for onboard lighting, electronic and air conditioning while waiting for passengers at its gates - installation of fixed electrical ground power and pre-conditioned air systems could therefore remove the need for the aircraft to start their engines or

auxiliary power units while they are parked, hence reducing the use of aviation fuel. By ensuring that the fuel delivery infrastructure is compatible with biofuels or other sustainable alternatives, airports can also facilitate and encourage airlines to switch to greener options.

Airport operators may also cooperate with transport authorities to ensure the availability of sustainable surface access to the airports, such as providing green public transport options, which is crucial for reducing carbon footprint from the public's journeys to and from the airports.

Despite the transformations in the investment and financing landscape caused by COVID-19, we are seeing significant investment opportunities for the Chinese government, which plays a major role in the civil airport industry, and other stakeholders in the industry to transform and upgrade their airport assets to comply with ESG standards and achieve cost efficiency in the long run.

Not only would the adoption of sustainable initiatives help attract capital investment during this difficult time, the adoption of innovative ESG practices also presents opportunities for the governmental stakeholders to engender and bolster investment in greener growth when the aviation industry recovers from the pandemic and demonstrate market leadership in overcoming sustainability challenges.²

² <https://edition.cnn.com/travel/article/china-new-airports/index.html>;
<https://www.icao.int/Meetings/greenairports/Pages/default.aspx>;
<http://www.greenfinance.org.cn/displaynews.php?id=1797>;
<https://www.worldbank.org/en/results/2019/10/29/supporting-green-airport-development-in-china>;
http://www.transformcn.com/Topics_En/2018-01/23/content_142602.htm;
<https://www.icao.int/Meetings/GREENAIRPORTS2019/Pages/Presentations.aspx>;
<https://www.icao.int/Meetings/GREENAIRPORTS2019/Green%20Airports%20Presentations/Marina%20Bylinsky%20session%203.pdf>;
<https://chinadialogue.net/en/cities/11563-what-does-beijing-s-new-mega-airport-mean-for-emissions/>;
http://english.scio.gov.cn/videos/2019-07/02/content_74943283.htm;
https://www.hongkongairport.com/iwov-resources/html/sustainability/HKIA_Environmental_E-newsletter_Issue%2001_2020.html;
<https://blogs.worldbank.org/eastasiapacific/edge-award-winning-green-airport-chinas-shangrao-city-brings-opportunity-reduces>;
<https://www.ecomena.org/airports-green-initiatives/>



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Cases relating to the Cape Town Convention (Convention) and the Protocol to the Cape Town Convention on matters specific to Aircraft Equipment (Aircraft Protocol) (Convention and the Aircraft Protocol, together, the “CTC”) have been relatively few and far between.

As such many practitioners have been monitoring the Virgin Australian administration (which remains a daily news item at the time of finalising this article for publication) given Australia’s accession to the CTC and adoption of the “Alternative A” insolvency remedy meant that the Virgin Australia group’s administration would give rise to remedies being exercised under the Aircraft Protocol (whether it be the administrator seeking directions or secured parties seeking to repossess Aircraft).

The recent Australian Federal Court judgment in *Wells Fargo Trust Company, National Association (trustee) v VB Leaseco Pty Ltd (administrators appointed) [2020] FCA 126* (Wells Fargo case) is one of few cases where Alternative A under Art XI of the Aircraft Protocol has been analysed on the practicalities of the content of the obligations for the insolvency administrator, especially in the context of how provisions of the treaty should be given effect.

While the decision (which has been appealed and will be heard on 22 September 2020) covered matters of Australian insolvency law along with the CTC remedies, this article looks primarily at one of the main CTC questions of greatest interest to aircraft lessors, financing and investors: namely, what does “give possession” mean under Alternative A provisions of the CTC, noting that

many important CTC jurisdictions including the USA, China, India, Indonesia, Ireland, Singapore and Brazil have also adopted Alternative A insolvency provisions in their versions of the CTC.

In this case, the court held that “give possession” requires the relevant aircraft object (in this case, certain aircraft engines) to be returned in accordance with the requirements of the lease. This included the obligation to return the engines at a specific redelivery location (in this case, in Florida) and with a complete set of records, in accordance with the provisions of the lease.

Background

The Wells Fargo case involved certain engines leased by Wells Fargo (as owner trustee of the engines held on trust for the benefit of Willis Lease Finance Corporation) to the Virgin Australia group. Under the terms of the engine lease agreements, upon expiry of the lease, the lessee was required to return the engines in a specific redelivery location in Florida along with certain records.

As readers are likely aware, the Virgin Australia group was put into administration on 20 April 2020. Administration is an interim insolvency proceeding under Australian law which puts control of the company in the hands of insolvency practitioners (the “administrators”). This is intended to give some breathing space to the administrators of the company to consider and make recommendations as to the future of the company. As such, administrators are required to take certain acts and make their recommendations about what to do with the company within certain timelines.

It was common ground between the parties that:

- Wells Fargo held an international interest;
- an insolvency event had occurred under the CTC; and
- Wells Fargo was entitled to exercise CTC remedies, including under Article XI(2) and Alternative A of the Aircraft Protocol as adopted by Australia (providing that the insolvency administrator or debtor is required to give possession of the aircraft object to the creditor within the waiting period of 60 days or otherwise cure all defaults other than the insolvency default).

“Giving possession” or “giving the opportunity to take possession”

The administrators contended that they had satisfied the lessee’s obligations under Article XI and Alternative A by making the engines available “as is” and “where is” (that is, in whatever condition and whatever location the engines happened to be at the relevant time), and referred to both Australian domestic insolvency laws as well as section 1110 of the US Bankruptcy Code, both of which only requires the insolvency practitioner to allow assets to be taken away wherever they may be on an “as is, where is” basis. They, therefore, argued that the words “give possession” should be taken to be read as if the lessee should only be required to give the lessor the opportunity to take possession.

The court rejected the administrator's arguments. The court took a purposive approach to its interpretation of Article XI, and after examining the text and the purpose of the Article XI and the insolvency remedies available under the Aircraft Protocol, concluded that that phrase "give possession" required the lessee to comply with the return obligations stipulated in the lease agreement.

In rejecting the administrator's argument, the court took the following approach to interpreting the CTC, which may be informative in other jurisdictions since the court attempted to construe the CTC consistently with international norms and public international law principles:

- When interpreting treaties, the rules governing the interpretation of treaties should be applied, and in this context, the proper construction of the CTC and Aircraft should therefore be with reference to the text of the CTC itself, and in accordance with public international law requirements pursuant to Australia's treaty obligations.
- As Australia was also a party to the Vienna Convention on the Law of Treaties, the interpretation provisions of the Vienna Convention also apply (which requires that treaties are to be interpreted in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose).
- The CTC itself provides that when construing the provisions of the CTC, regard is to be had to "its purposes as set forth in the preamble, to its international character and the need to promote uniformity and predictability in its application".
- Australia adopted the text of the CTC as a whole and where there is any inconsistency with Australian law, the CTC prevails to the extent of any inconsistency, and therefore Australian domestic law must give way to the extent of any inconsistency.

Taking the above into account, the court concluded that the CTC itself provided the answer for the meaning of "give possession". Applying the ordinary natural meaning and purposive approach to the interpretation of "give possession", the court found that it meant "to deliver, hand over", and, by extension, doing so "in accordance with the requirements of the lease agreements". Likewise, if the administrator was able to cure all defaults (other than the insolvency default) then the administrator was entitled to "retain possession", also, by extension, such possession as that which was granted under the lease agreements. Moreover, the phrase "given the opportunity to take possession", also used in Alternative A in the context of the administrator having an obligation to preserve aircraft objects, was specifically contrasted to the words "give possession".

Essentially, the administrator was obliged to return possession in the redelivery location agreed under the lease agreements, and preserve and maintain the aircraft as agreed under the lease agreements until the time the lessor was given an opportunity at the redelivery location to take possession of the aircraft. Alternatively, the administrators could retain possession under the lease agreements by curing all defaults (except the insolvency default) and otherwise performing their obligations under the lease agreements. The relevant provisions of Alternative A therefore necessarily needed the court to read obligations under Alternative A of the CTC in the context of what was agreed under the lease agreements.

The court also considered the issue of remedies under the CTC needing to be exercised in a commercially reasonable manner, and that a remedy would be deemed to be exercised in a commercially reasonable manner where it is exercised in conformity with a provision of the agreement except where it is manifestly unreasonable.

The court found that as the lease agreements provided the manner in which the engines should be returned, the requirement that exercise of the insolvency remedy under Article XI to be done in a commercially reasonable manner would be met if possession was given in conformity with the lease return requirements.

The court also considered that reading "give possession" in the way put forward by the administrators would not be in accordance with the purpose of the convention, which includes predictability and enforceability.

Predictability would be achieved by requiring aircraft objects to be redelivered in accordance with the relevant agreement (that, it was known from the outset what the redelivery location return obligations were under the lease agreements), whereas it would not be achieved if the lessor or secured party had to go to wherever the aircraft or engine happened to be located at, and take them "as is, where is".

The wider implications of the obligation to redeliver the aircraft in accordance with the lease agreements and otherwise than on an "as is, where is" basis (apart from the redelivery location issue that was at dispute in this case) would need to be examined closely as it has considerable ramifications for airlines and administrators which may not have been previously factored into their decision making, particularly in the present case where the administrators had already made decisions in respect of the sale of the airline based on the assumption that they could satisfy their Cape Town obligations under Alternative A by returning relevant aircraft objects "as is, where is".

Aircraft lessors, financiers and investors will also take away an important reminder, especially in the current economic downturn, that not only is it important to check whether CTC applies in a particular jurisdiction, but the content of the declarations made, and how they interact with the drafting of the leasing and financing documents which in themselves should be prepared in a robust and granular manner, independent of the protections of the CTC, given the close interaction of the CTC, local law and the agreed contractual position under the relevant leasing and financing documents.

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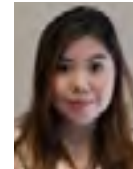
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