

Aircraft Finance

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Aircraft finance is one of project finance segments developed in a special industry because of the features of aircraft, which are very complex, dangerous and expensive assets.

The common types of aircraft financing are a backed or secured loan, finance and operating leases that are often mixed to give a financier effective protection. All these types are used in Ukraine, though an operating lease is the most attractive.

Aircraft backed loans used in Ukraine to buy business jets and helicopters are usually structured as simple mortgages (asset-based) or as finance leases. Private investors or airlines typically put in about 15% of the cost of an aircraft with banks financing 85%. In the case of a Boeing direct purchase from the manufacturer by a Ukrainian airline, the Export-Import Bank of the United States may work alone. In the event that the aircraft is purchased by a foreign leasing company with subsequent leasing of the aircraft to Ukrainian airlines, the leasing companies usu-

ally work with leading banks (Wells Fargo, DVD Bank, Erste Group Bank AG, etc.), which come to club or syndicate deals. Financing may be attracted if the aircraft or leasing company needs short-term (revolving, warehouse, bridge loans) or longer term financing. In the case of purchase of new aircraft, buyers are typically expected to make pre-delivery payments that can come to between 10% and 20% of the aircraft's total value. This money is usually provided by most banks in return for long-term financing.

Countries that have aircraft or component manufacturers, by making it easier for foreign buyers to finance imports, offer their support through Export Credit Agencies that either lend to foreign importers directly or reduce the risk of them defaulting by guaranteeing loans made by the banks. This is particularly important in emerging markets, to which Ukraine belongs, where finance can be less readily available. Support depends on where the aircraft, components to it or flight simulators are manufactured, rather than where the buyer is based.

The most significant export credit agencies for aircraft financing sector are UK Export Finance, France's Coface, Germany's Hermes, ATR France's Coface and Italy's SACE, Export-Import Bank of the United States, Export Development Canada and Brazil's Banco Nacional de Desenvolvimento Econômico e Social (BNDES).

At the end of 2016 the Law of Ukraine *On Ensuring the Large-Scale Expansion of Export of Goods (works, services) of Ukrainian Origin by Insurance, Guarantee and Cheapening of Export Lending* was adopted. The Law defines the principles of state support for export activities through insurance, reinsurance, guarantee, partial compensation of the interest rate on export credits in order to create conditions for large-scale expansion of the export of goods (works, services) of Ukrainian origin to foreign markets, ensuring protection of Ukrainian exporters from risks of non-payment and financial losses and increasing the competitiveness of Ukrainian producers on world markets. Besides, the Law provided to set up an Export-Credit Agency (ECA) in the form of a joint stock company, where at least 50% plus one share is owned by the Cabinet of Ministers of Ukraine (CMU). The Law stated that the initial statutory capital of the ECA should be at least UHR 200 million to be formed at the expense of the state budget. At the beginning of 2018 Regulation No. 65 was adopted by the CMU. It ap-

proved a chapter on the ECA, which regulates a lot of issues in great detail, including those already provided in the Law. These two aspects — small statutory fund and excessive regulation — will significantly weaken the ECA's ability to work effectively. The ECA was registered at the end of 2018 and its statutory fund was formed. The German Advisory Group believes that at least 3 years are necessary for an ECA to start its work, so one may not expect it to support Ukrainian producers of aviation equipment in the near future. There will definitely be no such support in 2019 as the Law on the State Budget law set the sum of USD 2.5 million for all of the ECA's activities in 2019.

The work of any ECA is not possible outside of the Arrangement on Officially Supported Export Credits (the Arrangement) and understanding of its appropriate sectors. It is supposed by this Law of Ukraine (Article 11) that the provision of state financial support for export activities will be based on the provisions of the Arrangement and the obligations of Ukraine as a member of the World Trade Organization under the WTO Agreement on Subsidies and Countervailing Measures, particularly the requirements of the Subsidies Agreement and compensatory measures. Ukraine has started to study appropriate procedures under the treaties named above. In fact, its delegation has already participated in the work of one of the OECD committees, the Working Party on Export Credits and Credit Guarantees (also known as the Export Credit Group). Besides, Ukraine participates in the work of the Berne Union Prague Club Committee through UkrEximBank.

The Aircraft Sector Understanding is a "gentlemen's agreement" that applies to officially supported export credits relating to civil aircraft. It specifies the maximum amount of support, maximum repayment term, principal repayment mode, interest and minimum premiums that are calculated depending on the risk classification of buyers or borrowers, which are based on their senior unsecured credit rating. The Aircraft Sector Understanding also details minimum commitment and arrangement fees, and recognises that pure cover premiums may be charged as an up-front amount or financed as an annual spread over the outstanding principal. In response to the coming into force of the Cape Town *Convention On International Interests In Mobile Equipment* (CTC) and Aircraft Protocol to it, to which Ukraine is a party, the Aircraft Sector Understanding allows

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Jurvneshtservice was formed in 1987 and since then has been advising leading Ukrainian and foreign corporations on legal issues of the contemporary Ukrainian market. Jurvneshtservice's attorneys have cultivated the culture, commercial pragmatism and technical and interpersonal skills required to deliver world-class services tailored for the preferences of world-class clients. Over the years of practice the firm's attorneys have received numerous awards and written a great number of publications.

Jurvneshtservice cooperates with such leading law publishers as Kluwer Law International, which issued the Anna and Gennadii Tsirats monograph *Civil Procedure in Ukraine* (2012) and *Intellectual Property Law in Ukraine* (2011). Gennadii Tsirat is an expert in cross-border litigation and has published monographs *International Civil Process: Modern Condition and Perspectives*

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As the leading expert on franchising in Ukraine, Anna Tsirat has published the *Guide on Drafting of Franchise Agreements* (2010) as well as *Franchise and Franchising Agreement* (2002). Her studies in aircraft finance are reflected in the monograph *International Private Air Law* (2018). Anna Tsirat is the author of numerous chapters on Ukraine that are updated annually. These include *The Official Guide to Aircraft Registration and Tax*, *PWSP World Aircraft Repossession Index*, *Aircraft Financing*, *Aircraft Liens and Detention Rights*, *International Agency and Distribution Law*, *Getting the Deal Through: Air Transport*, *Getting the Deal Through: Franchise in 28 Jurisdictions worldwide*, *Getting the Deal Through: License in 28 jurisdictions worldwide*,

The Aviation Law Review, *International Joint Ventures*, *International Secured Transactions*, *International Franchising*, etc.

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a discount from the "base premium" if the operator/borrower/buyer/lessor is based in a Contracting State which has made specific declarations and which is on an agreed list. The required declarations include the relevant State agreeing that it will apply regime A in case of an airline's bankruptcy that is treated as a "hard insolvency regime". It stipulates that the creditor may receive back a leased aircraft no later than within 60 days after any event connected with a local airline's bankruptcy.

Though Ukraine has issued a declaration on application of regime A of the CTC and applies de facto the de-registration and export procedures under the Aircraft Protocol, that application may not be treated as a strict one for different reasons.

The Aircraft Protocol provides for such a creditor defence measure as usage of IDERA, an instrument that allows the de-registering and exporting of an Aircraft in case of an airline's default under a lease agreement. IDERA is registered at the State Aviation Administration (the "SAS"). After its registration, its holder may require that the Aircraft be de-registered, on the one hand, and SAS may deregister the Aircraft only under allowance of the IDERA holder. Under the CTC a holder of IDERA is a creditor to a person in whose name a local aircraft register is held. Aircraft registers are usually hold either in the name of an owner or name of an operator. As the Ukraine Civil Aircraft Registry is held in the name of owners, only they can issue IDERAs. Irrespective of that practice

shows that SAS files IDERAs are issued either by aircraft owners or local operators, i.e. airlines that leased aircraft. Thus, the holders of IDERAs are either lessors that leased an aircraft to a local airline or creditors to the owner of the aircraft that was purchased using external financing. In case of the default of a borrower, which could be either a local airline (failure by a local airline to pay in time lease or maintenance or insurance payments) or aircraft owner (failure to recover its debt to creditors that loaned aircraft purchase), the IDERA holder usually decides to repossess the aircraft that assumes its deregistration and export from Ukraine. Performance of this decision is complicated by undeveloped Ukrainian legislation and reluctance of Ukraine's State Aviation Administration to improve it.

The current Rules of Civil Aircraft Registration (Rules) state that an aircraft may be de-registered from the Ukraine Civil Aircraft Registry only in case of return to SAS of the original of the certificate of aircraft registration (AOC). Under the Chicago Convention, the original AOC shall be held on board the aircraft. In practice it could be there or at the local airline's office. As soon as the IDERA holder does not operate the aircraft it has no access to the original AOC. Due to that and in case of non-cooperation of the local airline, the IDERA holder should negotiate with the State Aviation Administration to de-register the aircraft. SAS and Rules requiring return of the AOC original contradict CTC requirements and official recommendations as to its implementation.

Though IDERA is destined for de-registration and export, it is never filed at any Ukrainian customs body. It is known that under the Tax and Customs Codes of Ukraine, airlines do have an incentive in allowance not to pay VAT at the temporary import of an aircraft to the territory of Ukraine. As commercial aircraft are very expensive, all Ukrainian airlines use this tax exemption and all aircraft are imported with the obligation of local airlines to export them at a certain moment fixed by the customs authorities. In case of a local airline's default under a lease agreement and necessity for a creditor, a lessor, to export the aircraft, it needs to use another local airline's assistance in aircraft export, namely performance of certain formalities at Ukrainian customs, but not IDERA. Besides, the foreign creditor should use another local airline's assistance to ferry flight performance as the Rules or any other regulation in the aviation sector do not provide allowance for a foreign crew or operator to ferry the flight of such an aircraft from Ukraine.

All these obstacles are reasons for the non-inclusion of Ukraine in the OECD-CTC discount list to purchase aircraft equipment. They add negativity to the image of Ukraine in the eyes of foreign investors as indicators of low investment attractiveness. That is why local producers of aviation equipment, even including the Antonov Plant, may not use the low loan rates of foreign banks to expand the manufacture of their products.