

COELUM



COELUM Pronunciation: 'che-läm, is Latin for air space or sky. The Romans began questioning the rights they had in the space above the land they owned and to how high above did that right extended to. Ad coelum et ad inferos, they discussed, meaning that their right of property would extend as high up to the heavens and down to hell.

newsletter |

monthly digital publication by

ABOGADOS SIERRA Y VAZQUEZ

www.asyv.com

september 15, 2009

year 04 | No. 05

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The Always Winding Way: The Aviation Registry. |

Misael Arellano.

In this issue the author will follow up on some deficiencies of the Mexican Aviation Registry (the Registry) which we discussed in the first half of 2008 with a scrutiny of legal aspects, operating problems and the procedure of aircraft de-registration.¹

“The Mexican aviation industry is going through enormous changes and causing an upsurge of requirements from the Registry...”

Much hard work has been undertaken by several users and carriers, especially those represented by our firm with several legally founded and proven claims that have been filed before the Registry. As a result the General Directorate of Civil Aviation (DGAC) and the Ministry of Communications and Transport (SCT) have been trying to achieve an improvement in the performance and quality of services rendered by the Registry. The Registry however maintains its poor staffing levels, even when its services have become day by day, more insufficient.

The Mexican aviation industry is going through enormous changes and causing an upsurge of requirements from the Registry, with the current increase in defaults, re-structures and repositions due to the world recession, all of which have a direct effect on the aviation transactions. Furthermore the position taken by the Registry and DGAC is almost incredible when faced by the current problems, most of them caused by such required re-structures or aircraft de-registrations. It is just not understandable that the aviation authorities do not work to gain the trust of the owners, financiers and lessors of aircraft placed with Mexican carriers, looking to obtain lower costs and more friendly requirements and clauses in aircraft agreements with Mexican airlines.

Dealing with the Registry to re-structure or repossess an aircraft.

As we know, the matter of re-structures and aircraft repositions are very delicate issues which require the registration of several documents that at times are urgent to execute in a very heated negotiation provoked by the situation incurred by the aircraft possessors; the last problem that the parties want to face are those involved with the aviation authority specifically with the Registry.

In these cases, the very first step is to know the actual aircraft status with the Registry, in order to modify all applicable agreements for a lease restructuring or to cancel all required documents for a de-registration proceeding. For such purposes, Article 41 of the Regulation of the Aviation Registry (Regulation) states that the authorization for certificate requests filed before the Registry about the documentation recorded for a specific aircraft must be provided within the following three days after the filing and payment of duties caused by the request. In actual fact the real period for the authorization of these requests could be more than one month in the best of cases because of the poor performance of the Registry and the backlog of other unsolved procedures that should not interfere with other requests duly filed by different users.

This deficient performance of the Registry on the issue of certificates affects in several ways the aircraft de-registration request because without such document issued by the Registry, users can not be sure that they have executed or granted all required termination or consent agreements for each document duly recorded before the Registry. The process and turnaround times for an aircraft de-registration request is clearly stated on the Forth Title of the Regulation: “About

1.- COELUM's editions in March, May and July, 2009.

rectification, de-registration and cancellation of records".

Article 32 of the Regulation states that an aircraft de-registration request filed by the aircraft operator or the aircraft owner must be authorized within five working days after its filing provided that all recorded documents have been duly cancelled. It creates much more work, if the user has to wait more than a month for a certificate of recorded documentation, because the Registry usually takes two or three weeks to analyze the required documentation for the aircraft de-registration and after such analysis then issues a prevention document that suspends and restarts the aircraft de-registration process only because of its delay on the issuance of such certificate.

The practice to provide a prevention document is commonly used by the Registry just to avoid the applicable legal terms or justify its deficient performance. More than a modification to the regulations, a real solution for this poor performance of the Registry would be an increase in the number of staff and to attend to their training. It is unacceptable that up to the end of 2008, the Registry staff had no more than 15 people and just three or four had a professional Law degree.

The Aircraft De-registration Notification.

Why are the standard procedures to notify the authorities of an aircraft de-registration not applicable to the Mexican aviation authority? For the registration of used aircraft in Mexico, the aviation authority requires only a facsimile transmission of the notice of de-registration sent by the aviation authority of the previous State of registration; however when an aircraft is registered in Mexico, in order to obtain the new registration of the aircraft, some aviation authorities as the Federal Aviation Administration (FAA) require a very formal and classified document of de-registration notice signed by four of the highest authorities of the DGAC (General Director, Legal Director, Director of

Transport and Director of the Aviation Registry) which must be delivered by certified post in a closed envelope that can not be handled or reviewed by the user any time.

The important matter about this over-formal aircraft de-registration notification is that such procedure is not stated, regulated or even mentioned in any law, regulation or procedure; and all these special requirements were stated because the FAA was receiving some falsified de-registration notifications about aircraft registered in Mexico.

Due to the lack of proper procedures and the poor communication between DGAC's departments, this aircraft de-registration notification issued directly by DGAC to any other state may take 7-10 days after the aircraft de-registration has occurred. This procedure implies that to be able to register the aircraft in other country, users must wait 20-30 days after the beginning of aircraft de-registration process.

What is required for an improvement of the Registry's performance?

Mexican aviation industry says that is obvious, necessary and urgent that the aviation authorities make immediate improvements in the current poor performance of the Registry so that it can become an institution capable of providing high quality services, and attain the same level of efficiency as any other aviation registry in the world.

Facilities, electronic systems for the storage, analysis and consultation of the information recorded by users, increase and training of the personnel working in the Registry could be the beginning of the Registry's performance improvement.

Until now, and after more than a year since our previous analysis of the most problematic deficiencies, and with the ongoing growth of the industry, the performance of the Registry gets worse every day. Unfortunately it does not appear that the Mexican aviation authority will fix these problems any time soon.

Renegotiation: How Aircraft Lessors Can Make the Best Out of the Worst? | Kendra Medina.

Worldwide chess champion Garry Kasparov once said: “sometimes you are better off having a good position than having more pieces than your opponent”. This is often true in most aspects of life and aircraft leasing is not the exception. Sometimes it is worth giving up a little bit of rent or other economic benefits derived from the lease of an aircraft in exchange of having an advantageous position with respect to the lessee. It is true that in a lease contract the main purpose for the lessor is to receive rent payment on schedule and in full, and therefore most of the attention when negotiating these type of contracts are focused on the financial aspects. However, there are other terms and conditions that if correctly addressed when negotiating an aircraft lease agreement, can place either party in a better position in the long term or in specific circumstances.

“Sometimes it is worth giving up a little bit of rent or other economic benefits derived from the lease of an aircraft in exchange of having an advantageous position with respect to the lessee.”

The 2008 financial debacle and the 2009 epidemiological alert due to the spread of swine flu all over the world has caused many airlines to have serious financial breakdowns. This produced one of the worse scenarios for any aircraft lessor. Rent payment in full and on a timely basis has stopped and, even worse, rent and maintenance reserves were not received at all. Some lessors were lucky enough to have cooperative lessees that returned the aircraft on a timely basis after aircraft lessor's

termination of the contract, along with all records and documentation in place and in appropriate redelivery condition. Also, they were lucky to find new operators interested in such aircraft and to be able to place them once again in the market. However, even though the financial condition of the airline, which may be bad, but is not as bad as bankruptcy and because the crisis is expected to be of a temporality nature, terminating a business relationship may not always be the first and best option from a lessor's stand point.

In this article we will explore some of the most important aspects that may be renegotiated, from both a legal and an economic perspective, with particular emphasis on lease contracts for aircraft to be operated in Mexico by Mexican airlines. There are certainly more aspects than the ones addressed in this article that could be more appealing or important to renegotiate, depending on the particular case, the governing law or jurisdiction of the contract, the state or registration of the aircraft, etc., but for purposes of an article of this length, we will limit our suggestions to: Redelivery Conditions, Registration Obligations, Guarantees, Penalties, Cross-Default and Cape Town Convention Provisions.

1. Redelivery Conditions.

The redelivery condition of a leased aircraft is a key aspect of an aircraft leasing negotiation. Provided a fairly equal leverage position, redelivery conditions are usually negotiated on a parallel basis. When returned to the lessor, the aircraft, engines and other components shall be in the same condition as when delivered to the lessee.

These terms are fair enough and provide certainty for both parties on lessee's redelivery obligations at the end of the term of the lease agreement.

“...aspects that may be renegotiated, from both a legal and an economic perspective, with particular emphasis on lease contracts for aircraft to be operated in Mexico by Mexican airlines.”

In a renegotiation environment, the lessee may be willing to accept less certainty with respect to its future redelivery obligations in exchange for a decrease in the amount of current rent obligations. This way the lessor gives the lessee what it currently needs to comply with its payment obligations by providing certain flexibility with respect to lessee's present cash flow and lessee can worry on how to comply with redelivery conditions later, even years from now, by the time the lease term expires or otherwise terminates. What seems to be a sacrifice for lessor now, may represent significant savings later if the lessor can get the aircraft redelivered from lessee already in accordance with the airworthiness or other requirements under the new state of registration, pursuant to the requirements of the air authority with jurisdiction over the new operator, with applicable airworthiness directives already completed, or even agree to have the lessee assume ferry flights or fuel costs, that otherwise lessor would have had paid for.

2. Registration Obligations.

Renegotiation of the terms and conditions which are applicable to registration or de-registration of the aircraft may not necessarily mean economic savings for the lessor in the future, nor represent an economical advantage

for lessee in the present time, but in light of the complex financial situation which lessee may be going through, lessor's leverage can push lessee to accept additional rights or remedies related thereto. For instance, the lessor can be in a position to request from the lessee its consent to one or more persons designated by the lessor to act as Lessee's professional user or professional user entity for dealings with the International Registry in relation to the aircraft, in order to be able to complete this kind of registration. In addition the lessee could provide the lessor with powers of attorney and other documented approvals necessary to remove the aircraft from the operating certificates of the lessee and also among other acts, to conduct the de-registration of the aircraft on behalf of the lessee, to demonstrate termination of the lease or to execute on behalf of the lessee any termination agreements as required for de-registration purposes.

3. Guaranty.

Security deposits guarantying payment of rent and maintenance reserves are essential for any aircraft lessor and should not be negotiable. These guarantees will have been in the possession of lessor since the commencement of the lease term and are one of the most valuable resources that the lessor has in the event of default of lessee's payment obligations. However, depending on each particular case, some flexibility may be permitted, such as allowing lessee to temporarily substitute the cash security deposits delivered to lessor with letters of credit¹, so long as the lessor can have access to an increased coverage of the security deposit and additional guarantees (*in rem guaranty over lessee's property, personal guaranty from third parties or promissory notes*). This way, although from a cash flow point of view the lessee's situation improves, and the

1.- Issued on an irrevocable and unconditional basis, by an internationally recognized banks, acceptable to the lessor.

lessor's situation seems to be negatively affected, the lessor in fact in the short term, during the crisis, gets backing from a financial institution and in the long term, gets additional guaranty. Likewise, the lessor can take advantage of its leverage in this kind of situations to change the use of the term "security deposit" for "commitment fee", not only to get the benefits from a financial stand point by registering the security deposit as an income in its accounting records, but in order to prevent any claw-back of the security deposit in case lessee is declared to be insolvent.

4. Penalties.

Lessor's leverage in the renegotiation process described herein can also improve lessor's ability to impose additional penalties to lessee in certain circumstances. For example, as is now practice in Mexico, the Air Authority can indefinitely leave uncompleted the registration of certain interests on the aircraft, regardless of whether or not the relevant documentation is submitted in proper form, but just due to the heavy workload or negligence of the Air Authority. In this situation, any follow-up by the lessee with the Air Authority is very helpful and it would undoubtedly be much more effective if an economic penalty is imposed on lessee for each day any registration or de-registration is not completed after the agreed date, as well as for late redelivery of the aircraft.

5. Cross-Default Provisions.

It is very useful for the lessor to insist on having cross-default (and also set-off) provisions not only with respect lessee's payment obligations under all of the aircraft lease

agreements it may have entered into with the lessee, but also, to have these mechanisms embodied in all of its contracts with the same lessee or the lessee's affiliates, such as engine and any other component leases, or services. Furthermore, if due to a financial patch the lessor and the lessee have entered into additional agreements for repayment of any amounts owed by the lessee with respect to rent, maintenance reserves or other concepts, it should also be taken into consideration to cross-default such agreements with the rest of the contracts.

"...lessees may be happy to give away their position in exchange of certain economic concessions..."

6. Cape Town Convention² Provisions.

Finally, any renegotiation of an aircraft lease agreement to which the Convention does not apply, would definitively need to address the inclusion of provisions with respect the applicability of the Convention to such agreement. Furthermore, it shall include provisions addressing the event of any conflict or discrepancy between the provisions of such lease agreement and the Convention in order for the Convention to prevail over the lease agreement. This should be carefully drafted, provided there are several provisions in the Convention that leave certain aspects to be agreed between the lessee and the lessor. For instance, Article XI, alternative B of the Protocol to the Convention, in accordance with the declaration made by Mexico when it ratified the Convention, leaves to the agreement of the parties the term the lessee has (as debtor

2.- Cape Town Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment (the "Convention").

under an insolvency proceeding) to determine whether or not it will comply with its obligations under the lease, and if not, the separation of the aircraft from the insolvency estate would be ordered by a court. Otherwise, the 20-day term provided by Mexican Law would apply.³ In this case, the lessor may be in a position to request from lessee an agreement to a shorter term, more favourable to the lessor.

Likewise, specific rights and remedies of the creditor under the Convention should be agreed by the lessee to be included in the lease agreement, such as those provided under Articles 8, 10 and 13 of the Convention (which among other things, provide for creditor's right to apply for a court order for the possession and control of the aircraft, or the collection or receipt of any income or profits arising from the management or use of the aircraft, in the event of default. Also, it is recommended that the lessee agree that Article 13(2) of the Convention (which provides for the possibility of the relevant court to impose the terms it considers necessary protect debtor's interests if creditor fails to perform any of its obligations or fails to establish a claim) will not apply if the lessor chooses to exercise its rights under Article 13(1) of the Convention (which provides for the lessor's right to obtain speedy relief from a court to preserve the aircraft and its value, to the possession, control, custody, immobilization, lease or management of the aircraft and the income therefrom).

CONCLUSION.

Current conditions of the aircraft leasing market and the dramatic financial turnarounds that have taken place lately have forced us to

revise the perspective from which current and new aircraft lease contractual relationships may be approached. Lessors may find out that it is worth giving up a little bit of rent or other economic benefits in exchange for a better of legal position than their lessees and there may be situations where the lessees may be happy to give away in exchange of certain economic concessions, such as rent reduction or deferral of payments.

In any case, it is very important to have in mind that every renegotiated provision should be documented as a consideration in exchange for concessions on behalf of the lessor due to a difficult financial situation through which lessee is going through, in order to avoid any risk of having leonine contracts as a result. Hence, adequate local legal advice is very important to this type of renegotiations, as well as for drafting alternative aircraft lease agreements that a lessor may want to have in hand when at the first negotiating stage, in case the other party is interested in exchanging certain benefits for a rent reduction.

³- Article 92 of the Mexican Law of Insolvency Proceedings.

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Extract of Mexican Aviation News

Merger plans discarded.

A representative of both Aeromexico and Banamex, advised that a possible merger plan between Aeromexico and Mexicana has been discarded. He stated that there are no negotiations currently taking place and that the CFC (Antitrust Commission) has already declared their opinion on these matters. Even though the air transport sector looks grim, Banamex will not leave the market because the shareholders have already injected 500 million pesos into the company. *El Financiero*. 10/August/2009.

Flight Attendance Union: Internal Conflict.

On August 8th the Secretary General of the Flight Attendance Union, Lizette Clavel was dismissed, in her place Raul Salazar was elected. This has caused Lizette Clavel to argue the illegality of the procedure that dismissed her. The air transport sector is worried, since the most radical groups are getting more power inside the Union. Another important related issue is the end of union agreements between Aeromar and Mexicana with the new union leadership. *Reforma*. 10/August/2009.

England lends \$563 million to Airbus.

Great Britain will lend \$563 million to Airbus to help finance its new A350 XWB. The lending will be in the form of refundable aid and will serve to finance projects in Great Britain, principally as for manufacture of wings, a strong point for this aeronautical industry. This fuel efficient plane, can carry between 270 and 350 passengers. Airbus indicates that they have already received a total of 493 requests from 31 companies for this new aircraft. *Reforma*. 14/August/2009.

Toluca Airport helping airlines.

Due to the decrease in aeronautical activity in the country, Toluca's Intl. Airport has decided to sacrifice its gains and offer discount up to 25% on airport services, with the objective that the airlines keep their base operations in Toluca's terminals. The airport administration decided to help the carrier by reducing their revenue so as to reach an equilibrium point where there are no earnings, but there are no losses either. *Milenio*. 17/August/2009.

Fare reductions benefit air traffic worldwide.

World passenger traffic stabilized this past June, thanks to fare reductions more people travel. The airlines lowered their fares on several routes because of the reduction in the number of travelers, due to the global economic crisis. *El Economista*. 19/August/2009.

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Extract of Mexican Aviation News

Aviacsa will invest the necessary to fly again.

Aviacsa will inject the necessary resources to restart operations. It is just waiting to be declared insolvent, to start the restructuring of its debts. The procedure has been started and accepted, and in 30 working days the final judgment will be ready. This will allow the restart of operations, so the injection of capital will come shortly. Milenio. 24/August/2009.

Aviacsa might lose protection.

Aviacsa could face a new problem with its creditors if the request for the insolvency proceeding gets rejected. This could happen if the IFECOM decides that because the company owns 23 aircraft, it could sell some to pay its debts. The company is in the process of requesting insolvency proceedings and in the next few days is waiting for the resolution of IFECOM's visit. If the IFECOM comes up with any means that will allow the airline to find a way of paying its debts, the insolvency proceeding will be suspended immediately. Excélsior. 25/August/2009.

Bureaucracy delays credits for airlines.

Four months have passed since Bancomext announced credits for airlines, with the objective of helping them survive the negative impact caused by the Swine flu pandemic but to date no Company has been able to access these resources. Although several companies are still in the process of requesting relief, another group which have already been granted credits but none of them has received any money. Chief Director of Interjet declared that the request procedure is very complicated because there are so many governmental authorities involved, and that the whole process is delayed by bureaucracy. Milenio. 26/August/2009.

Air traffic begins to recover.

The world's airlines transported 11.3% less of cargo and a 2.9% less passengers than last year. While this data is very volatile, but it confirms that a recovery has begun in the demand of air transport. Take into considerations however that the recovery from this recession will be weaker and slower than other crisis recoveries. El Economista. 27/August/2009.

Contributors



MISAEEL ARELLANO

Attorney at Law: Admitted to practice law in 2006. Mr. Misael Arellano, of Mexican nationality obtained his law degree at Instituto Tecnológico y de Estudios Superiores de Monterrey, Mexico City and attended studies in Social Sciences Program 2003 by Universidad Antonio de Nebrija, Madrid, Spain. LANGUAGES: Spanish and English. PRACTICE AREAS: Aviation Law, Industry Affairs with Aviation Authorities, Real Estate and Corporate Law. e-mail: marellano@asyv.com



KENDRA MEDINA CHAVEZ

Attorney at Law: Admitted to practice law in 2000. Ms. Kendra Medina, of Mexican nationality obtained her law degree at Instituto Tecnológico Autónomo de México (ITAM), Mexico City and completed a post-graduate Diploma in Telecommunications Law at ITAM and a Masters Degree of E-Law at the University of Melbourne, in Australia. She has attended post-graduate studies in Airline Contract Law and, Aircraft Acquisition and Financing, by the International Air Transport Association (IATA) in Montreal, Canada. Ms. Medina has contributed as member of the editorial board for the magazine of the Science and Technology Law Section of the American Bar Association. LANGUAGES: Spanish and English. PRACTICE AREAS: Aviation Law, Aircraft Contract Law and Corporate Law. e-mail: kmedina@asyv.com

ABOGADOS SIERRA Y VAZQUEZ

Prol. Reforma No. 1190 25th Floor

Santa Fe México D.F. 05349

t. (52.55) 52.92.78.14

f. (52.55) 52.92.78.06

www.asyv.com / www.asyv.aero

mail@asyv.com

members of **advoc** www.advoc.com

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