

COELUM

COELUM Pronunciation: 'che-løm, 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.

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Ownership Rights on Aircraft Maintenance Reserves. | Kendra Medina.

The general definition of a reserve is an account maintained to provide funds for anticipated expenditures. Within the context of preservation of an asset, reserves are monies that need to be kept to maintain the relevant asset in suitable condition for its intended use and for purposes of maintaining its value. For instance, real estate property require certain repair services throughout the year for its intended use (plumbing, heating and electric systems, interior and exterior painting, etc.). Each of these services may or may not be scheduled and may or may not affect the value of the property. If not scheduled, then they can be performed whenever necessary (i.e. exterior painting can improve the appearance without affecting the value, but can certainly make the property more appealing whenever the property is intended to be sold). Other maintenance needs to be scheduled (i.e. repairs to the heating system are critical each year during winter season) and are relevant to maintain the asset's value because if they not properly and continuously completed, it can deteriorate the value of the property (i.e. a deteriorated plumbing system may cause very costly structural damages). Every rational asset owner must anticipate these necessary expenditures and either reserve the necessary funds himself or cause the user of the asset to provide for such funds, to the extent that the use of the asset causes the wear and tear that needs to be repaired in order to maintain the value of the relevant asset or maintain the asset in suitable condition for its intended use.

Within the context of aircraft leasing, the concept of aircraft maintenance reserves is similar, although it has its own particularities. The purpose of this article is to explore the nature of aircraft maintenance reserves within the context of aircraft leasing and the property rights over such reserves.

Aircraft maintenance reserves are amounts that need to be reserved to cover the cost for the maintenance required for an aircraft to be kept in suitable condition for its intended use (airworthy condition) and to maintain its value (marketable condition). The most common mistake within the industry is to interpret that these amounts need to be "reserved" by the aircraft lessee, instead of the aircraft lessor. It is in the best interest of aircraft lessor to maintain their equipment in a marketable and above all, airworthy condition, so as to avoid any potential liabilities. Airworthiness of an aircraft is maintained by complying with the minimum safety requirements to conduct flights under normally conceivable conditions as usually determined by the country with jurisdiction over the aircraft.

“The rent collected by an aircraft lessor from the operator is made up of two main components: the market fixed rent for leasing a determined type of aircraft and the variable component determined by the amount of use of the aircraft in hours and cycles.”

Depending on the type of equipment, scheduled maintenance services or “checks” must be performed on the airframe, according to the number of flight hours accumulated, and according to the number of cycles with respect other equipment and aircraft components, such as engines, landing gear, auxiliary power units, etc. Hence, the rent collected by an aircraft lessor from the operator is made up of two main components: the market fixed rent for leasing a specific type of aircraft and the variable component determined by the use of the aircraft in hours and cycles. The fixed component is set forth and agreed between the parties as rent payment, usually paid in advance on a monthly basis (regardless of whether the aircraft was flown or not) and maintenance reserves which are paid either in advance and if applicable, then adjusted at the end of the relevant period, or in paid arrears, once the operator of the aircraft has delivered a utilization report on the hours and cycles completed within a certain period, usually monthly, in order to determine the variable component to be paid to lessor.

In accordance with basic principles of law under both common law and civil law systems, ownership right over an asset is actually the sum of several rights: the right to use the asset (*ius utendi*), the right to earn income from the asset (*ius fruendi*) and the right to dispose of the asset (*ius abutendi*). Under an aircraft lease agreement, where the aircraft lessor is the owner of the aircraft, the lessor delivers the possession of the aircraft to the lessee, agreeing to transfer the *ius utendi* of the aircraft to the lessee in exchange for the payment a rent (*ius fruendi*), keeping the right to dispose of the aircraft (*ius abutendi*) limited to lessee’s right of quiet enjoyment.

“Maintenance reserves are supplemental rent to guarantee maintenance expenditures. They are not deposits.”

There is no question as to whether the rent to be paid by lessee to the aircraft lessor is the property of lessor. However, different interpretations have been given to the payment of maintenance reserves. Mostly because the nature of such payments is not considered to be income to be earned by the aircraft owner/lessor and then reserved for the maintenance of the aircraft, but is to guarantee the lessee’s payment obligations with respect the maintenance of the aircraft. However, maintenance “reserves” are supplemental rent, not deposits to guarantee maintenance expenditures. The difference is very subtle but the consequences of not interpreting correctly the nature of the maintenance reserves can be very relevant, especially within a bankruptcy context.¹

It is true that maintenance of the aircraft is the responsibility of the lessee, as operator of the aircraft. If the aircraft lease agreement is silent as to the timing and form of payment for maintenance, checks, repairs and overhauls necessary to be made on the airframe, engines and other components, then lessee’s obligation is limited to return the aircraft to the lessor/owner in the agreed redelivery condition, at the end of the lease term. If the redelivery conditions are not met, then the aircraft lessor/owner is entitled to the remedies set forth in the lease agreement. This is not standard, but it is an example of an extreme situation

1.- See “Maintenance Reserves and Bankruptcy under Mexican Law” by the author, COELUM, April 2010 Edition.

where maintenance reserves are not required to be paid by lessee to lessor, nor is maintenance required to be guaranteed by lessee in any form and therefore, there are no payments to be made by lessee to the aircraft lessor/owner that can be considered to be maintenance reserves.

A middle point (usually supported by those who argue that maintenance reserves are not property of aircraft lessors) is to agree under the aircraft lease agreement that maintenance reserves are a form of guaranty of lessee's payment obligations with respect the maintenance of the aircraft and therefore can be substituted by a bank letter of credit or a bank account in escrow. This approach is not either wrong or right, but from an aircraft lessor/owner perspective, although the aircraft lessor/owner is entitled to certain remedies, in the short term, the risk is transferred to the aircraft lessor/owner and if sufficient funds are not maintained in the escrow account, important shortfalls may be required to be paid by the aircraft lessor/owner in order to put the aircraft in an airworthy and/or marketable condition. Bank letters of credit are less risky in this regard, but from an administrative efficiency stand point are not convenient. Unless utilization ratios are accurately pre-established, the lessee must keep updating the bank letter of credit for each utilization period, regardless the inherent risk involved.

The most generally accepted approach towards aircraft maintenance reserves is the supplemental rent concept. Different from other kinds of assets, such as real estate property, where the landlord cannot be sure of the amounts that need to reserved on a monthly basis to pay for external painting, plumbing or heating system repair services, once the tenant has vacant the property, and therefore, only a lump sum is required at the beginning of the lease term as a form of guarantee for such obligation, the periodic use of an aircraft can be measured and, accurate and itemized utilization ratios can be retrieved from the operator on a periodic basis. Therefore, instead of requiring from the lessee a guaranty for its payment obligations with respect the maintenance of the aircraft, supplemental rent is paid in advance and, if applicable, further adjusted at the end of the relevant period, in accordance with the applicable utilization reports provided by the lessee.

At the end of the day, maintenance is responsibility of the user of the asset. It is up to the owner/lessor to request payment for such maintenance obligation in a form of guarantee (deposit) or advanced supplemental rent payments, but within an aircraft leasing context, once aircraft maintenance reserves are specifically addressed in the lease agreement, specific rates are set forth for each hour and cycle for each component, and the obligation to pay for each item on an hourly and/or cycle basis is agreed to be delivered to lessor, they become income to be earned by the aircraft lessor for the use of the aircraft (*ius fruendi*) and therefore, such payments are property of the aircraft lessor/owner.

The Fascination of Flight . | Svein Azcué.

*“When once you have tasted flight, you will forever walk the earth with your eyes turned skyward, for there you have been, and there you will always long to return” **Leonardo da Vinci.***

One hundred and seven years have passed since the Wright brother’s first successful flight in 1903 and since then, mankind has evolved from horseback and steam powered locomotives, to pre-cooled turbofan jet engines and outer-space rocket ships. As technology progresses at a staggering pace mankind’s imagination continues to be limitless and fueled by the dream of flight. What was once a “Dream of Generations” has now evolved into commercial aviation.

As we meet year’s end, we cannot help stopping to recall the many events that have marked this past year - 2010, and the many bumps, accomplishments and failures that the aeronautical industry has survived; along with the criticisms, reports, recommendations, information and analysis performed within the articles of COELUM. So, here is a recap on 2010’s most eventful facts with a vision of what may come in the future for civil aviation:

The beginning of 2010 held turbulent times for the aeronautical industry, as airlines and airports faced escalating costs, revenue growth constraints and increasingly dissatisfied customers as a result of the global economic recession that took place in 2009. There was the impact of the H1N1 influenza pandemic and jet fuel price increases. Airlines throughout the world had decreased passenger traffic and were struggling to recover from the global financial crisis.

The low-cost carriers surpassed the traditional network carriers and increased their profit and also began to enter long-haul markets. In Mexico, the “low-cost” airlines Interjet, Volaris and Viva Aerobus started operations from Mexico City International Airport (AICM) which saturated the capital’s airport even more. As the low-cost carriers price and route war continued, the Mexican flag carriers, Mexicana and Aeromexico, found themselves at a financial disadvantage which, when added to the decrease in passenger traffic and higher ticket prices, kept these two Mexican airlines in a financial debacle. There was government pressure for a merger between the two airlines, based on the idea that the passenger demand would not be enough for two major flag carriers to subsist in Mexico. The merger never took place and Mexicana finally filed for bankruptcy along with its subsidiaries.

Flag carriers throughout the world are still working through these turbulent times and there is now an urgent demand for a new aviation model, framework and politics in order to change the current business model in the aviation industry in preparation for the increasing markets and passenger and cargo rising demands.

“The beginning of 2010 held turbulent times for the aeronautical industry, as airlines and airports faced escalating costs, revenue growth constraints and increasingly dissatisfied customers...”

International Flag carriers keep looking to reduce their operating costs and close the gap between themselves and their more cost-effective rivals, the low-cost carriers. As a result, many airlines have agreed or been forced into mergers in 2010, looking to collaborate against the fierce competition and avoid bankruptcy. Some of the biggest mergers this year include Continental Airlines with United Airlines, Delta Air with Northwest Airlines (becoming the world's largest carrier by passenger traffic)¹ and AirTran Airways with Southwest Airlines. In Mexico the possibility of a merger between Aeromexico and Mexicana has been discarded and as the merger between the low-cost airlines Interjet and Volaris have not yet taken place and it is still to be discussed as both airlines continue to operate independently and no formal proposal has been announced nor accepted. A number of different airlines ceased operations this year and filed for bankruptcy. These are: Japan Airlines, Arrow Air (American cargo airline) and Mexicana de Aviacion.

As airlines showed little improvement or recovery from last year's crisis, the need for new aviation models, network and business plans has become even more evident this year, as the customer satisfaction decreased and the passenger experience was affected by intrusive security checks, long queues, baggage check-in and travel time through connecting flights. Hybrid models are developing as network airlines and low cost carriers borrow from each other's best practices. (i.e. mix lease/own aircraft, single aircraft types, second airport routes, simplified fare structure, etc²) Airlines have started to implement self-service possibilities such as the check-in kiosk, giving the passenger the choice and control of their trip as well as reducing costs, while offering a more user friendly travel experience. Mexico is late on these new aviation policies and was actually re-classified from a Category I to a Category II by the FAA³, due to low security standards in Mexico. This change was as a result of a negative assessment of the Mexican Aviation Authority (DGAC) under the International Aviation Safety Assessment (IASA) Program. Because of this, Mexican carriers cannot open any new international routes to the US.⁴

The expectation for lower fares and ticket prices to increase consumer demand was abruptly ended during the summer holiday season, where airline tickets reached a sky high record price level during the peak summer travel season, impacting passenger traffic and limiting tourism. Therefore a much broader damage was done to passengers, airports, airlines and the tourism sector, making it harder for airlines to recover.

Regarding environmental issues, global warming escalated in political agendas this year, resulting in delays or cancelations of a number of airport expansion projects in the United States, UK and Asia. Topics such as oil spilling prevention and de-icing operations forced more attention to be paid to environmental issues and now legal standards and rulings need to be observed by airlines in the search for more fuel-efficient, eco-friendly aircraft and the possibilities of using bio-fuel. The Boeing 787 aircraft was launched on 2010, considered the most fuel-efficient

1.- http://en.wikipedia.org/wiki/Delta_Air_Lines-Northwest_Airlines_merger visited November 24th, 2010.

2.- Vincent Charles, *Aviation 2010*, IBM Global Business Value. 2007

3.- Federal Aviation Administration of the United States of America.

4.- For further reading: *FAA and the IASA Program: Indirect Enforcement of the International Standards on Passenger Air Transport Safety*.

airliner and the world's first major airliner to use composite materials for most of its construction. On the same environmental note, in April 2010, aviation was struck by the eruption of Iceland's "Eyjafjallajökull" volcano, causing the closing of the European airspace for more than 10 days and millions of dollars worth of damages.

“Hybrid models are developing as network airlines and low cost carriers borrow from each other's best practices.”

Currently the world of aviation keeps recovering from the wounds left from last year's crisis and adjustments are being made to aeronautical policies and aviation business plans. Collaboration across airlines and airports need to improve and as new emerging technologies help better the passenger experience thus making airlines more efficient and environmental friendly. In Mexico, one of the oldest airlines in the world, Mexicana de Aviacion is going through a bankruptcy proceeding along with its subsidiaries Click and Link with the hope of soon flying again. Mexico is still classified as a category II by the FAA as the aeronautical authorities bureaucrats work to regain the previous category I, while the new aviation policies and laws are still to be written and observed.

And so within the world's fascination of flight, airlines come and go, aircraft keep flying higher, farther, and faster, carrying their pilots to as-yet-unseen parts of the world and universe, thanks to a seemingly endless supply of inspiration by men who have broken their bonds with earth and plunged into a blue sky full of endless possibilities. For years to come, man will keep on turning to the sky and wonder why something heavier than air, can fly.

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Extract of Mexican Aviation News

[Airbus flights before Boeing.](#)

The European aircraft manufacturer, Airbus, declared that the company sold 42 aircraft in October; this raised its orders to more than 400 aircraft in this year, nevertheless this numbers are below of Boeing sales. Airbus overcome Boeing in aircraft delivering in this year, but its behind in aircraft orders for the next years. Between January 1st. and November 2nd. Boeing received 553 orders and 73 cancellations for a total of 480 net Orders, unlike Airbus that received 421 aircraft orders and 52 cancellations for a total of 369 net orders. El Economista. 08/November/10.

[México and Spain reinforce Aviation cooperation.](#)

Airports and Auxiliary Services (ASA) signed a contract with the Spanish Agency of Air Security (AESA) for the design and execution of projects in matters of production of biofuels for aviation. This initiative includes industrial modules, an economic study, areas of raw material, production and consume of biokerosene, and in the aeronautic matter, issues of certification, and engine testing. This agreement is derived from the Framework Agreement of Cooperation in Civil Aviation between México and Spain. El Economista. 08/November/10.

[Mexicana gets protection in US.](#)

Javier Christlieb, Manager of Mexicana de Aviación, said that an American judge granted to the Company a legal recognition of the insolvency procedure. This measure will allow to the airline restart its operations in United States whenever they want. The resolution allows to the airline to keep their “slots” and all the physical spaces in American airports. Nevertheless, this resolution also forces to pay 9.5 million of dollars to pay debts to 15 airports and 6 American Government agencies. Thus, a preliminary order in which 9 airports were going to terminate their contracts with Mexicana, is now lapsed. El Norte. 10/November/10.

[Click and Link will be dissolved.](#)

Mexicana the Aviacion will be ready to reinstate operations by the end of December, only if its creditors approve the PC Capital proposal, said Humberto Treviño, undersecretary of Transportations. As for Link and Click, Mexicana’s subsidiaries, they will get dissolved. Javier Christlieb, administrator of the company, explained that the proposal from PC Capital gives viability and it is much more sustainable for the airline, in the short, medium, and long term period. El Financiero. 11/November/10.

[Aeromexico flights even higher because of Mexicana’s shutdown.](#)

Mexicana suspending operations last August 28th was extremely beneficial for both Aeromexico and Interjet. Aeromexico is actually the 1st place with 46.5% of the market and Interjet on second with 21.2%, according to the DGAC. These airlines immediately took control of Mexicana’s exclusive routs and got an enormous amount of benefits. Truth to be told, with or without Mexicana, people keep flying; there is a captive market for airlines. CNN Expansión. 12/November/10.

[Airlines Operations Affected by Insecurity.](#)

The troubles that México is facing towards insecurity, has given a terrible impression causing a negative effect in the amount of passengers coming from Europe and Latin America. As for Lufthansa, the loss has been about 15% less passengers to Mexican cultural destinies. As for Continental, they declared that foreigners are scared to visit México because of the insecurity that the country is facing, they have asked that flights do not arrive very late at night so that can arrive safely before noon to their hotel, which puts Mexico in a tough situation. El Financiero. 16/November/10.

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[Mexicana; against the clock.](#)

The time for Mexicana to reinstate operations is almost over, and it all seems to point to the Pilot and Flight Attendants Unions, that will finally give their acceptance for PC Capital to be designated as new owner of the airline. Both Unions agree that the important thing is to restart operations as soon as possible, counting the risks taken if operations do not initiate by the end of December. The best offer as for now is the one made by TG Group, which guarantees the continuity of the 85% workers. Milenio. 17/November/10.

[Mexicana has a debt of 888 million dollars, according to the Ifecom.](#)

Griselda Nieblas Aldana, General Director of IFECOM, said the Mexican airline Mexicana de Aviación, has a total debt with its respective suppliers of approximately 888 million dollars. At the end of her semiannual report, she said before the Supreme Court of Justice (SCJN), that in this month, IFECOM prepares the final list of creditors of the enterprise, to know the extent of the rights and obligations of the firm. El Universal. 26/November/10.

[The SCT authorized the construction of an airport in the mountain community of Creel.](#)

The deputy of SCT, Eduardo Esperón Gonzalez, said that the general direction announced the construction of an airport in the mountain community of Creel, township of Bocoyna. The construction will end in two years, what will become a socioeconomic trigger for this region of the state. He announced the airfield would be 500 meters from Creel, in the settlement of Pino Gordo, township of Bocoyna, where 100 passenger airplanes will be able to land like the Boeing 707; it will become a touristic attraction and place for other economic activities thanks to this construction. El Financiero. 29/November/10.

[The Mexican air sector continues without reaching passenger levels.](#)

The Mexican air sector continues without reaching passenger levels that it did during 2009. Only in October 1,958,800 people were transported in national airlines, 0.8% less than in 2009, according to data from the General Aeronautical Civil Direction (DGAC). After the departure of Mexicana de Aviación, Click and Link, alternate airlines covered destinations within the country, nonetheless, an increase of prices up to 40% was registered according to the president of Asociación Mexicana de Agencias de Viaje, Jorge Hernández. El Economista. 29/November/10.

[IP demands to stop the rescue of Mexicana.](#)

The business sector of the touristic industry makes a call to the authorities to stop trying to rescue a lost airline, and instead start to support Airlines that are still flying. The conciliator of the Bankruptcy proceeding of Mexicana de Aviación, Gerardo Badin, is negotiating with creditors, including Bancomext. Asa (Aeropuertos y Servicios Auxiliares), Seneam (Servicios a la Navegación en el Espacio Aéreo Mexicano) e IMSS, to achieve the restructuring of the airline, this has raised many reactions against the government which is believed to be preparing a disguised rescue. El Universal. 30/November/10.

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