

October 15, 2024

Year 19

No. 05

Temporal engine swipes that are subject to a lien.

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Audio Message



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In aircraft financing, protecting creditors' rights is essential, particularly within the framework of non-possessory pledge agreements ("Pledge") governed by Mexican law. A Pledge grants creditors security interests in the airframe, and engines, and related rights, including the right to collect under the corresponding lease agreement, all of which can be enforced in the event of a default.

"Although engines are not typically considered accessories, there is a chance that a judge might interpret a replacement engine as one."

However, in the aviation leasing industry, the frequent practice of engine swapping or replacing engines raises significant legal and practical questions. Specifically, it is unclear whether these replacements fall under the original security interest or if additional legal measures are required to maintain the creditor's rights.

In the case of a permanent engine swap, it is clear that the replacement engine becomes part of the aircraft and is thus subject to the existing pledge. Nevertheless, it is advisable to execute a supplement or amendment to the original pledge to formally document the swap and include the new engine's details.

The situation becomes more complex when dealing with short-term operational engine swaps. Lease agreements typically allow for engine removal for purposes such as testing, repairs, maintenance, or overhaul, provided that the engine is promptly replaced with one of the same make and model. Strict conditions often apply, such as the requirement to reinstall the engine on the airframe within a set period, usually no longer than 365 days or upon default, whichever occurs first.

Additionally, lease agreements often permit lessees to temporarily install engines on another aircraft under their operation. However, lessees are usually required to provide written confirmation or establish in the transaction documents that no third party will acquire rights to the engine simply by virtue of its installation on a different airframe. Title to the engine must remain with the owner of the engine.

In line with standard leasing practices and principles of law, engine ownership remains with the owner of the engine even after removal from the aircraft. This raises an important question: Is the removed engine still subject to the Pledge? according to standard definitions of aircraft in pledge agreements, the aircraft includes the airframe and its parts, the engines and any replacement engines, **provided the title remains with the pledgor**. Therefore, since the removed engine's title remains with the pledgor, it is reasonable to conclude that the security interest continues to extend to that engine, unless such engine is replaced with one of the same make and model.

The second key issue is whether, in the event of a lessee default, which leads to a default by the pledgor (Lessor A), the pledgee has the right to repossess the aircraft owned by Lessor A, including an engine owned by a different lessor (Lessor B).

1.- "An aviation, Accessory (ACC) refers to parts and components that are added to enhance the performance or functionality of an aircraft. These accessories can include anything from navigation equipment to lighting systems, and they are crucial in ensuring aircraft safety and efficiency." What is ACC in Aviation? (Accessory) - Aviation Terms (termaviation.com)

2.- Examples of mechanical accessories are landing gear, wheels and brakes, and other components that help control the aircraft's movement on the ground and examples of electrical accessories include navigation and communication equipment, lighting systems, entertainment systems and alternator What is ACC in Aviation? (Accessory) - Aviation Terms (termaviation.com)

Under Article 2888 of the Mexican Federal Civil Code, the right granted by a pledge extends to **all accessories** of the pledged item and **any increases in the pledge**. This raises two questions, the first is whether a replacement engine is classified as an “accessory”^{1,2} and the second, is whether it could be considered as an “increase” in the pledge.

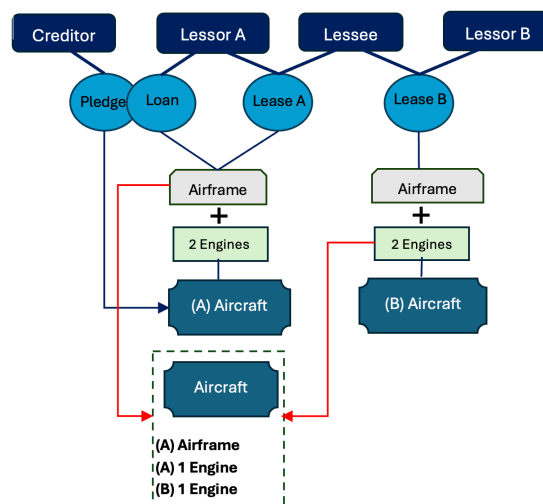
Although engines are not typically considered accessories, there is a chance that a judge might interpret a replacement engine as one. Similarly, a replacement engine could be subject to the right of accession, established under Article 886 of the Mexican Federal Civil Code, which states that ownership of goods extends to everything they produce or to anything naturally or artificially attached or incorporated into them, such as the case of replacement engines incorporated into an aircraft.

Therefore, if any of these two interpretations is maintained, the pledgee may have the right to repossess the aircraft along with both installed engines, regardless of whether one belongs to Lessor B.

“...it is crucial to anticipate potential disputes and reinforce contractual agreements.”

In this scenario, and as established above, Lessor B would not lose ownership of the engine because it was installed on a different aircraft. However, repossessing such engine creates a significant challenge for Lessor B, who may need to pursue an action to recover possession of their engine. In this line, Lessor B could argue ownership based on a bill of sale or contract of sale of the engine. More feasibly, Lessor B would have a claim against the lessee for the engine’s value in accordance with the lease agreement. This claim would be supported by the lessee’s acknowledgment in the corresponding transaction documents that engine would remain owned by owner, even if the engine is installed on an aircraft owned by another lessor.

The complexities of engine ownership, security interests, and leasing practices highlight the importance of clear documentation, and an understanding of the risks associated with temporary engine swaps. While engine swapping is a common practice in the industry, it is crucial to anticipate potential disputes and reinforce contractual agreements. This includes ensuring precise definitions of the aircraft, engines, and aircraft accessories in the relevant documents. Additionally, lessors may want to explore further protections, such as prohibiting the temporary swapping of any engine subject to a lien or reducing the time frame for returning engines from 365 days to mitigate risk for the parties. Furthermore, it is also important to establish the compensations and penalties in case of an engine lost due to the enforcement of a pledge.



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Vera has over 10 years of experience representing financiers and lessors in financing and leasing of their aircraft in Mexico. She negotiates the contractual rights and designs financing and corporate structures for aviation finance in Mexico and Latin America. She manages the registration and enforcement of Sierra LATAM clients' rights. Vera has successfully negotiated settlements for the repossession of assets through alternative methods of dispute resolution.

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