

Aviation Finance & Leasing

Contributing editor
Mark Bisset



2016

GETTING THE
DEAL THROUGH

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Aviation Finance & Leasing 2016

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Published by
Law Business Research Ltd
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London, W11 1QQ, UK
Tel: +44 20 3708 4199
Fax: +44 20 7229 6910

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No photocopying without a CLA licence.
First published 2014
Third edition
ISSN 2055-7256

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Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112



CONTENTS

Global overview	5	Malta	84
Mark Bisset Clyde & Co LLP		Malcolm Falzon, Steven Decesare and Tara Cann-Navarro Camilleri Preziosi	
Aircraft operating leases – New York law or English law?	8	Mexico	91
Thomas A Zimmer and Neil Poland Vedder Price		Javier Alegre and Carlos Campillo Alegre, Calderón y Márquez Abogados	
Australia	11	Netherlands	96
Matthew Bode, Kate Craig and Samara Goode Colin Biggers & Paisley		Berend Crans and Thijs Elseman De Brauw Blackstone Westbroek NV	
Austria	16	New Zealand	102
Martin Geiger and Florian Huna Benn-Ibler Rechtsanwälte GmbH		Frank Porter and Rishalat Khan Buddle Findlay Lawyers	
Belgium	20	Nigeria	106
Giulia Mauri Pierstone Brussels		Lawrence Fubara Anga and Oluwasemilore Atewologun ÆLEX	
Bermuda	25	Oman	111
Jeremy Leese MJM Limited		Mansoor J Malik and Asad Qayyum Al Busaidy, Mansoor Jamal & Co	
Brazil	30	Panama	118
Renata Iezzi Basch & Rameh		Maria de Lourdes Marengo Patton, Moreno & Asvat	
Canada	36	Philippines	123
Donald G Gray and Jason MacIntyre Blake, Cassels & Graydon LLP		Aldous Benjamin C Camiso, Diana S Gervacio, Bhong Paulo A Macasaet and Maricar G Ramos SyCip Salazar Hernandez & Gatmaitan	
Cayman Islands	42	Portugal	128
Matthew Stocker Conyers Dill & Pearman		Luís Soares de Sousa Cuatrecasas, Gonçalves Pereira	
Dominican Republic	46	Russia	135
María Esther Fernandez A de Pou Russin Vecchi & Heredia Bonetti		Victoria Bortkevicha and Anna Nikulina Clifford Chance CIS Limited	
England & Wales	52	San Marino	140
Mark Bisset Clyde & Co LLP		Dennis Beccari and Francesca Podeschi Beccari Law Firm	
France	58	Sweden	144
Edward Campbell Stephenson Harwood AARPI		Fredrik Wilkens, Emma Stuart-Beck and Henrik Schön Advokatfirman Vinge	
Germany	64	Switzerland	149
Ulrich Stepler and Katja Helen Brecke Arnecke Sibeth		Frédéric Meyer, Raphaël Baeriswyl and Antoine Labaume Meyer Avocats	
India	70	Turkey	154
Ashwin Ramanathan, Zubin Mehta, Aditya Singh Chandel, Rustam Sethna and Mansi Shetty AZB & Partners		Serap Zuvin Serap Zuvin Law Offices	
Indonesia	75	United States	161
Wahyuni Bahar and Anggia Rukmasari Bahar & Partners		Thomas A Zimmer and Laura J Bond Vedder Price (CA) LLP	
Italy	79		
Laura Pierallini and Francesco Grasseti Studio Pierallini			

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Overview

1 To which major air law treaties is your state a party? Is your state a party to the New York Convention of 1958?

Australia was a signatory to the Rome Convention (1933); however, it denounced the convention in 2000, and it was replaced by the Damage by Aircraft Act 1999 (Cth).

Australia is a signatory to the Chicago Convention (1944) and ratified it in 1947.

Australia is a signatory to the Geneva Convention (1948) (signed on 9 June 1950), but has not ratified it.

Australia ratified the New York Convention of 1958 in 1975.

The Convention on International Interests in Mobile Equipment (Cape Town Convention) and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Aircraft Protocol) took effect in Australia on 1 September 2015.

2 What is the principal domestic legislation applicable to aviation finance and leasing?

The principal pieces of legislation are the Civil Aviation Act 1988 (Cth), the Air Navigation Act 1920 (Cth) and the Air Services Act 1995 (Cth) – which allowed for the former Civil Aviation Authority to be split into Airservices Australia and the Civil Aviation Safety Authority (CASA). The Personal Property Securities Act 2009 (Cth) (PPSA) is applicable to the registration of security interests over aircraft and engines.

3 Are there any restrictions on choice-of-law clauses in contracts to the transfer of interests in or creation of security over aircraft? If parties are not free to specify the applicable law, is the law of the place where the aircraft is located or where it is registered the relevant applicable law?

Australia has made a declaration under the Cape Town Convention and Aircraft Protocol providing that parties to an aircraft lease, security agreement or contract of sale are free to choose the law that is to govern their contractual rights and obligations, wholly or in part. Australian courts will generally recognise the parties choice of governing law and forum provided that such choice was made on a bona fide basis and not made in bad faith, illegally, against public policy or with the primary purpose of avoiding the laws of another jurisdiction. Usually parties will choose the governing laws of a state or territory in Australia where the aircraft or business is to be based (subject to stamp duty considerations).

Title transfer

4 How is title in an aircraft transferred?

In Australia, a bill of sale or a contract of sale is commonly used to transfer title to the aircraft; however, the aircraft is required to be registered on the Australian Civil Aircraft Register, which is maintained by CASA to formalise the transfer.

5 What are the formalities for creating an enforceable transfer document for an aircraft?

The bill of sale or contract of sale must be in writing, duly signed and delivered, and show consideration for the transfer of title in the aircraft or engine. There is no requirement for the document to be notarised, legalised or translated, although in some states it may be subject to stamp duty.

The former owner of the aircraft must complete a Form O27 Part 1 (Notice of Transfer of Ownership Former Owner) and provide the completed form to CASA within 14 days of the transfer of the aircraft. A copy of the completed form and the original certificate of registration needs to be provided to the new owner within 14 days.

To become the aircraft's new registration holder, the new owner of the aircraft needs to complete and provide a Form O27 Part 2 (application by new owner to become the registration holder) to CASA within 28 days after the date of transfer of the aircraft, otherwise the registration of the aircraft will be suspended. The CASA forms must be in English.

Registration of aircraft ownership and lease interests

6 Identify and describe the aircraft registry.

The relevant aircraft registry is the Australian Civil Aircraft Register which is both an owner and operator registry. The registry is open to the general public. Engines cannot be separately registered.

Section 4A(2) of the Civil Aviation Act provides that a provision of the Act or regulations may apply to an aircraft registered in a contracting state as if it were an Australian aircraft if an 83 bis agreement (Chicago Convention) has the effect of transferring a function of the contracting state to Australia.

Section 4A(3) provides that a provision of the Act or regulations does not apply to an Australian aircraft if an 83 bis agreement has the effect of transferring a function of Australia as the state of registry in respect of the aircraft to a contracting state.

7 Can an ownership or lease interest in, or lease agreement over, aircraft be registered with the aircraft registry? Are there limitations on who can be recorded as owner? Can an ownership interest be registered with any other registry? Can owners', operators' and lessees' interests in aircraft engines be registered?

The owner and the operator can be registered on the Australian Civil Aircraft Register but a lessee's interest cannot be registered. Registration holders and operators must be legal entities and an 'eligible person' within the CASA regulations. Proof of identity is required. See question 5 for the relevant CASA forms.

A partnership cannot be a registration holder or a registered operator (as it is not a legal entity or an 'eligible person'), nor can a trust. A trustee, however, can be noted as the registration holder on behalf of a trust provided a certified copy of the trust deed accompanies the application but not as a registered operator.

Registration is not possible for specific parts of an aircraft or engines on the Australian Civil Aircraft Register.

For leased aircraft, depending on contractual arrangements, the sole legal owner (ie, lessor) may become the registration holder. The registered operator must accept responsibility for the continuing airworthiness, maintenance and control of the aircraft.

It is not possible to register an ownership interest or a leasehold interest with any other registry in Australia other than the Australian Civil Aircraft Register, although it should be noted that the Cape Town Convention and Aircraft Protocol now allows for registration of ownership interests on the international register in Dublin.

It should also be noted that while an aircraft or engine lease, sublease or bailment may create a security interest in an aircraft or engine capable of

being registered on the Personal Property Securities Register (PPSR), such a security interest will be defeated by a security interest registered over the same aircraft object registered on the Dublin register. See question 17.

8 Summarise the process to register an ownership interest.

The owner must complete the relevant CASA forms. Timing in relation to registration and the delivery of the relevant forms is set out in question 5 above. A Form 029 – Registration Application is to be used by an owner of an aircraft when applying for initial registration. If the aircraft is already on the Australian Civil Aircraft Register and has an Australian ‘VH’ registration then a Form 027 – Transfer of Ownership must be used to transfer ownership.

Identification and the payment of relevant fees is required.

Title to an engine does not automatically vest in the owner of the host aircraft. An engine cannot be separately registered on the Australian Civil Aircraft Register.

9 What is the effect of registration of an ownership interest as to proof of title and third parties?

As the Australian Civil Aircraft Register is not a register of title, registration does not constitute proof of title. Ownership interests in an aircraft can only be confirmed through the parties relevant legal and commercial documentation (eg, bill of sale or contract of sale) outside of the CASA registration process, and where appropriate, through registration on the PPSR. Although the applicant legally declares to CASA that he or she is the owner of the aircraft, third parties cannot rely on the accuracy of the register or certificate of registration. A registered ownership interest with CASA will not be effective against third parties if the owner has no title or defective title and a party should therefore rely on the underlying title documentation which is usually a bill of sale or contract of sale.

10 Summarise the process to register a lease interest.

Lease interests cannot be registered on the Australian Civil Aircraft Register. However, as mentioned, certain leases of aircraft and engines (particularly where pooling arrangements provide for bailment of an indefinite duration) will require registration on the PPSR.

A failure to perfect a security interest may leave the aircraft or engines available to satisfy the obligations owed by the lessee to its creditors, or a purchaser of the aircraft or engines may take free of the lessor’s interest where the lessor has not perfected its interest.

11 What is the regime for certification of registered aviation interests in your jurisdiction?

The Australian Civil Aircraft Register comprises a hard copy of a register of Australian aircraft certificates for each registered aircraft and is supported by an online database.

The certificate of registration (issued by CASA) contains the following information:

- manufacturer;
- model;
- serial number;
- engine type;
- number of engines;
- date when aircraft first registered in Australia;
- year of manufacture;
- registration holder (and commencement date); and
- registered operator (and commencement date).

The certificate of registration does not state any mortgagee’s interest over the aircraft. Such security interests must be registered on the PPSR. CASA does not issue separate certificates of registration for engines.

12 Is an owner or mortgagee required to consent to any deregistration or export of the aircraft? Must the aviation authority give notice? Can the operator block any proposed deregistration or export by an owner or mortgagee?

CASA may cancel registration of an aircraft if appropriate and will give notice to the registration holder and registered operator.

A registration holder can submit a Form 1538 – Request for CASA to record Irrevocable De-Registration and Export Request Authorisation (IDERA) on Australian Civil Aircraft Register to CASA indicating that the ‘authorised party’ (ie, mortgagee) is the only party that has the right

to deregister and export a specified aircraft object. IDERAs are a voluntary measure providing greater security to creditors by preventing a debtor from flying an aircraft to a jurisdiction where the Cape Town Convention and Aircraft Protocol does not apply. The operator cannot block any proposed deregistration or export by an owner.

13 What are the principal characteristics of deregistration and export powers of attorney?

Deregistration of an aircraft with CASA (and its export) has been typically undertaken utilising a deregistration power of attorney provided at the start of the transaction. An irrevocable deregistration power of attorney will survive the insolvency of the creator of the power, although see question 14 below in relation to the relevance of these documents now that the Cape Town Convention and Aircraft Protocol and IDERA apply in Australia and are capable of being registered with CASA.

14 If the Cape Town Convention is in effect in the jurisdiction, describe any notable features of the irrevocable deregistration and export request authorisation (IDERA) process.

As the Cape Town Convention and Aircraft Protocol is now effective in Australia, CASA now accepts IDERAs. The registration holder must complete and provide the original IDERA (Form 1538), along with any related fees to CASA.

A Form 1538 does not have to be countersigned by CASA. Provided the IDERA satisfies all requirements and there is no other IDERA recorded against the aircraft, CASA will record the IDERA on the Australian Civil Aircraft Register.

Although most financiers are likely to still require a deregistration power of attorney, it is expected that all owners and mortgagees in relation to Australian aircraft will now lodge a Form 1538.

To deregister an aircraft under an IDERA, the authorised party must submit a Deregistration Form (Form 1542). If there is a CDCL (ie, a letter issued by the authorised party transferring its rights to a certified designee recorded (such as a financier)), then the CDCL form must be submitted by the certified designee. Once CASA has sent a confirmation of deregistration letter to the registration holder and registered operator, the aircraft is no longer a registered aircraft in Australia and does not possess a certificate of airworthiness and must not be flown. In the event of a default, the lender will be able to exercise the IDERA to secure deregistration and export of an aircraft. This ensures that an aircraft cannot legally be flown to another country to avoid recovery of the asset.

Security

15 What is the typical form of a security document over the aircraft and what must it contain?

A security document over an aircraft will usually be in the form of a specific security agreement over the aircraft or engine or a general security agreement over all of the assets of the grantor, creating a security interest in favour of the secured party (typically a financier). Generally, there is no specified form to these security agreements. These documents are not required to be registered on the Australian Civil Aircraft Register or the PPSR and are therefore not public documents. No maximum secured amounts or other economic details are required to be disclosed on the PPSR however the grantor (against whom the security interest is registered) may apply to the registrar of the PPSR for copies of the underlying documentation allegedly giving rise to the security interest if the validity of such security interest is disputed. The documents do not need to be in English (but typically are) however registration of security interests on the PPSR must be in English.

16 What are the documentary formalities for creation of an enforceable security over an aircraft? What are the documentary costs?

The security documents do not need to be notarised, legalised, translated or registered (although the security interests created by such documents needs to be registered on the PPSR). The amount of stamp duty payable will depend on the loan amount and method of calculation in each state and territory. The PPSR registration costs to record the security interests are minimal.

17 Must the security document be filed with the aviation authority or any other registry as a condition to its effective creation or perfection against the debtor and third parties? Summarise the process to register a mortgagee interest.

A security document does not need to be filed with CASA or the PPSR as a condition to its effective creation or perfection of a security interest against the debtor and third parties. However, a financing statement (which reflects the security interest created in respect of the 'collateral' (ie, aircraft and engines) will need to be registered online with the PPSR to perfect the security interest. There are complexities around timing requirements for registrations, which are dependent on the nature of the security interests created.

The Cape Town Convention and Aircraft Protocol established an online registry in Dublin for recording security and purchase interests in most aircraft, aircraft engines and helicopters. Section 256 of the PPSA provides that the International Interests in Mobile Equipment (Cape Town Convention) Act 2013 (Cth) prevails over the PPSA to the extent of any inconsistency (ie, the Dublin registry will have priority to the extent of any inconsistency with the PPSR).

The Cape Town Convention and Aircraft Protocol only applies to aircraft objects as follows:

- airframes that can transport at least eight persons (including crew) or goods in excess of 2,750 kilograms;
- helicopters that can transport at least five persons (including crew) or goods in excess of 450 kilograms; and
- aircraft engines that have at least 1750lb of thrust.

Accordingly, if an aircraft object does not fall within any of these definitions then it will continue to be governed by the PPSA.

As the PPSA has a broader application (eg, it captures certain proceeds of sale not necessary caught by the Cape Town Convention and Aircraft Protocol), it is expected that security interests in aircraft will, in practice, continue to be registered on the PPSR as well as on the International Registry of Mobile Assets in Dublin.

18 How is registration of a security interest certified?

When a secured party registers a security interest on the PPSR, a verification statement is sent to the secured party group's address for service by email and includes details such as secured party, grantor, collateral class and registration period. Neither PPSR search results nor the verification statement contain the ranking or priority of the security interest. However, the effect of registration upon the priority of security interests is demonstrated through the following default priority rules under the PPSA (although there are exceptions such as for a purchase money security interest (PMSI)), which includes a 'PPS Lease':

- a perfected security interest takes priority over an unperfected security interest;
- an earlier perfected security interest takes priority over a later perfected security interest; and
- an earlier unperfected security interest takes priority over a later unperfected security interest.

Aircraft (known as 'tangible property' under the PPSA), is a separate collateral class, and 'aircraft' is made up of four sub-classes: 'aircraft engine', 'airframe', 'helicopter' and 'small aircraft'. A registration in respect to aircraft will always require the identification of a sub-class and the inclusion of a serial number. Aircraft engines, airframes and helicopters must be described by the manufacturer's serial number, name and generic model designator. Security interests in aircraft and engines also need to be registered with the online international registry in Dublin established by the Cape Town Convention and Aircraft Protocol, which will have priority over security interests registered against the same aircraft object on the PPSR (see question 17).

19 What is the effect of registration as to third parties?

Generally, with the exception of a PMSI, registration does confer priority over subsequent security interests. There is no priority notice system in place as such, although see question 18 in relation to priority rules.

The PPSR provides a disclaimer as to the accuracy of the information, and parties need to rely on the underlying financing and security documentation (or lease or bailment arrangement in respect of a PPS Lease) of an aircraft or engine. The PPSR acts as a notice board for the underlying

security interest, and priorities can be amended contractually by way of deeds of priority or subordination.

20 How is security over aircraft and leases typically structured? What are the consequences of changes to the security or its beneficiaries?

A security trustee concept is recognised and may be used in granting security under Australian law in respect of aircraft and leases, and the nature of the security is a right in personam. A security agent trustee can hold security for a changing group of beneficiaries (ie, new lenders) without affecting the security provided. There is no need to make any amendments to the PPSR as the security agent trustee will remain the registered secured party. If the security interest in the aircraft is held directly (and not through a security trustee), then a novation of the lender will require a new security registration on the PPSR. Priority may not be apparent from a search of the PPSR.

21 What form does security over spare engines typically take and how does it operate?

An aircraft and its engines are treated as separate goods and require separate security registrations on the PPSR.

A security interest can be registered in respect of an engine even if it is not installed on the host aircraft at the time of creation and an encumbered engine does not cease to be encumbered merely because it is removed from a host aircraft or installed on another aircraft (although it may breach the underlying security).

A security interest over spare parts of an aircraft can be registered on the PPSR under the collateral class of 'other goods'. Consideration needs to be given to specific laws under the PPSA in respect of aircraft spare parts that are installed or affixed to an aircraft (or co-mingled) over which the secured party (of the spare parts) does not hold a security interest.

Enforcement measures

22 Outline the basic repossession procedures following lease termination. How may the lessee lawfully impede the owner's rights to exercise default remedies?

Self-help remedies are available in Australia provided such rights are exercised in accordance with the lease terms and undertaken in a lawful manner, however, where a lessee disputes the lessor's right to possession following a lease termination, a court order is usually obtained. The owner must notify and obtain the consent of the person on whose property it would need to enter to effect physical repossession of the aircraft. Consent from the relevant airport authority will typically be required.

Aircraft leases in Australia will usually allow a lessee a grace period within which to remedy a default.

There are no statutory time limits imposed on a lessor to repossess the aircraft. See question 23 in relation to the Cape Town Convention and Aircraft Protocol.

23 Outline the basic measures to enforce a security interest. How may the owner lawfully impede the mortgagee's right to enforce?

The Cape Town Convention and Aircraft Protocol provides that a creditor can enforce 'self-help' without reference to the court in an event of default, or an insolvency event. That is after a nominated waiting period (60 days), a creditor automatically gains the right to repossess the aircraft object. The courts have no powers to delay or prevent the enforcement of this remedy, however the courts still continue to have jurisdiction in relation to other aspects of the securities matter, such as the validity of the claim over a security interest.

The International Interests in Mobile Equipment (Cape Town Convention) Act 2013 (Cth) provides that Australian courts are restrained from exercising jurisdiction in relation to securities remedies that are subject to the Cape Town Convention, in favour of relevant 'self-help' provisions. In Australia a court order is usually obtained and a liquidator or receiver appointed. Voluntary administrations are common due to the personal liabilities that directors risk for trading while insolvent under the Corporations Act 2001 (Cth).

Voluntary administration will give rise to a stay on civil actions against a company during the administration (which will continue until an agreement is reached with creditors or a decision is made to liquidate the

Update and trends

Due to limited case law and testing, the PPSA (and its PPSR), and the Cape Town Convention and Aircraft Protocol are areas of current focus for aviation finance and leasing in Australia.

company). During this time creditors may only enforce security if they hold security over the whole or substantially the whole of the assets of the company, which is typical for an aircraft security where a special purpose vehicle holds title to the aircraft.

24 Priority liens and rights

Which liens and rights will have priority over aircraft ownership or an aircraft security interest? If an aircraft can be taken, seized or detained, is any form of compensation available to an owner or mortgagee?

A statutory lien against an aircraft in favour of Airservices Australia for unpaid service charges (for example, landing charges, route navigation charges, terminal navigation charges, etc) or arising due to moneys owing to the Australian Taxation Office will have priority.

Airservices Australia has powers to sell the aircraft where services charges remain unpaid but must recognise any mortgagee's debt incurred prior to the lien.

Governments at both state and commonwealth level have constitutional authority to requisition aircraft (both ownership and use) but are subject to paying just and fair compensation (other than for seizures following certain crimes or sanctions) although typically commercial agreements are negotiated with airlines and operators in times of emergency.

Taxes and payment restrictions

25 What taxes may apply to aviation-related lease payments, loan repayments and transfers of aircraft? How may tax liability be lawfully minimised?

A 10 per cent goods and services tax (GST) may apply to the sale, transfer, redelivery or importation of an aircraft depending on the circumstances. There is a GST exemption on the export of aircraft provided the purchaser of the aircraft exports it from Australia under its own power within 60 days of taking physical possession.

Taxes might apply where a non-resident lessor of aircraft is leasing to an Australian airline directly from offshore. Generally, royalty withholding tax (RWT) will be deducted from rental payments made to a non-resident lessor unless among other things, a double tax agreement (DTA) is in place between Australia and the country of residence of the non-resident lessor provides otherwise.

If Australia does not have a DTA with the relevant country, the RWT is 30 per cent of the gross royalty. If a DTA is in place, the rate of withholding is typically around 10 per cent.

Withholding tax (of 10 per cent) on interest payments may be payable where the interest on a loan is being paid to an offshore financier. It is typical for loan documentation to contain gross-up clauses and these are recognised under Australian law.

If the lessor has an Australian permanent establishment, the lessor might be subject to Australian income tax.

Stamp duty, in the form of a conveyance duty, may apply to the sale or transfer of an aircraft if the aircraft is being transferred, particularly with a lease and the lessee is located in certain states. Stamp duty, in the form of mortgage duty, may be applicable if the aircraft is located in New South Wales and security is taken in respect of the aircraft.

26 Are there any restrictions on international payments and exchange controls in effect in your jurisdiction?

Generally, there are no restrictions with transferring funds to and from Australia, subject to compliance with the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth). Foreign exchange controls are implemented from time to time against specific countries, entities and persons resulting from sanctions legislation.

27 Are there any limitations on the amount of default interest that can be charged on lease or loan payments?

If the default interest is excessive, it may at times be deemed by a court to be unenforceable as a penalty.

28 Are there any costs to bring the aircraft into the jurisdiction or take it out of the jurisdiction? Does the liability attach to the owner or mortgagee?

No import or export duty is payable with respect to an aircraft or engine; however, this may apply to spare parts. Customs legislation requires all imported spare parts for foreign owned aircraft (even where a customs duty exemption may apply) to be reported.

GST may be payable on the import of the aircraft or engine as set out in question 25. Liability for payment attaches to the importer.

Insurance and reinsurance

29 Captive insurance

Summarise any captive insurance regime in your jurisdiction as applicable to aviation.

There are no requirements that insurances be placed with local insurers in Australia.

30 Cut-through clauses

Are cut-through clauses under the insurance and reinsurance documentation legally effective?

While there is limited case law in this area, cut-through clauses are considered to be legally effective in Australia and there is argument that section 48 of the Insurance Contracts Act 1984 (Cth) will ensure that an absence of privity of contract between the reinsurer and the original insured should not be an impediment to enforceability.

31 Are assignments of reinsurance (by domestic or captive insurers) legally effective? Are assignments of reinsurance typically provided on aviation leasing and finance transactions?

Assignments of reinsurance are legally effective in Australia assuming there is a legally binding contract between the parties. An assignment of reinsurance will typically be provided where the insurers are located in jurisdictions where a cut-through clause may not be legally effective.

32 Can an owner, lessor or financier be liable for the operation of the aircraft or the activities of the operator?

If the owner of the aircraft is the employer of a negligent pilot then the owner will be vicariously liable for the negligence of his employee. The owner, lessor or financier will be liable only if its own negligence or contractual breach can be shown to be causative of loss and damage. However, previous strict liability on passive owners, lessors and financiers has been removed from Australian legislation, and now only apply to an operator of the aircraft as discussed at question 33.

33 Does the jurisdiction adopt a regime of strict liability for owners, lessors, financiers or others with no operational interest in the aircraft?

No. The Damage by Aircraft Act 1999 (Cth) imposes strict liability on the owner (unless the owner has no active role in the operation of the aircraft) and the operator of the aircraft (ie, the person who retains control of its navigation is taken to be the operator of the aircraft). State legislation may also apply and is not uniform in relation to damage by aircraft.

34 Third-party liability insurance

Are there minimum requirements for the amount of third-party liability cover that must be in place?

Australia's carriers' liability and insurance arrangements are outlined in the Civil Aviation (Carriers' Liability) Act 1959 (Cth)(CACL Act), which gives the force of law to a number of passenger liability regimes, including those arising under the Warsaw Convention, the Montreal Convention 1999, and a separate system of liability for domestic travel. The liability framework for domestic passenger travel is created under Part IV of the

CACL Act, and is complemented by state legislation to create a national uniform scheme.

Arrangements for compulsory passenger insurance are outlined in Part IVA of the CACL Act.

The acceptable contract of insurance requirement for coverage of the carrier against personal injury liability is A\$725,000 for domestic carriage and 260,000 SDRs (Special Drawing Rights within the meaning of the International Monetary Agreements Act 1947 (Cth)) for any Montreal Convention or other international carriage arrangements.

Liability arrangements for third-party (surface) victims are outlined in the Damage by Aircraft Act 1999 (Cth) and now increase the domestic passenger liability cap and mandatory insurance requirements from A\$500,000 to A\$725,000 per passenger as under the CACL Act.

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ISSN 2055-7256



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