NALSAR UNIVERSITY OF LAW

HYDERABAD

SESSION-IV

Airline Contracts

by

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PL.SWITCH OFF YOUR MOBILES

Introduction

- An airline is a company that provides air transport services for traveling passengers and freight. Airlines utilize aircraft to supply these services and may form partnerships or alliances with other airlines for codeshare agreements. Generally, airline companies are recognized with an air operating certificate or license issued by a governmental aviation body.
- Airlines vary in size, from small domestic airlines to full-service international airlines. Airline services can be categorized as being intercontinental, domestic, regional, or international, and may be operated as scheduled services or charters.
- **Airlines pay** according to aircraft weight and passenger count.

AIRLINE OPERATION RELATED ACTIVITIES

- DGCA clearances- Schedule Airline Personal Licenses, Airworthiness etc.
- Aircraft Maintenance Contracts
- Security Clearance from BCAS-, (Personal, Security approved Programme, Own security staff)
- Slot allotment
- Fueling
- Ticketing,
- Ground handling,
- Transportation
- Airport space, counters

TYPES OF AIRLINE OPERATIONS

- **Scheduled** air transport services Permit
- **Non scheduled** airlines Permits (NSOP)
    - For Chartered operations
    - For Occasional private use
- (Private aircraft operations)

LEASING OF AIRCRAFT

1. Introduction
2. Aircraft Leasing
3. Types of Leases
4. DGCA’s Policy
5. Legal Aspects of Leases
6. The Cape Town Convention
7. Issues
8. Drafting of Aircraft Lease Agreement

1. Introduction

- Owning an Aircraft is an expensive affair.
- It requires a huge investment in purchase of an aircraft.
- Long waiting periods in acquiring new aircrafts.
- It is an unattractive proposition to Airline Operators to buy aircrafts.

PRICE AND LEASE

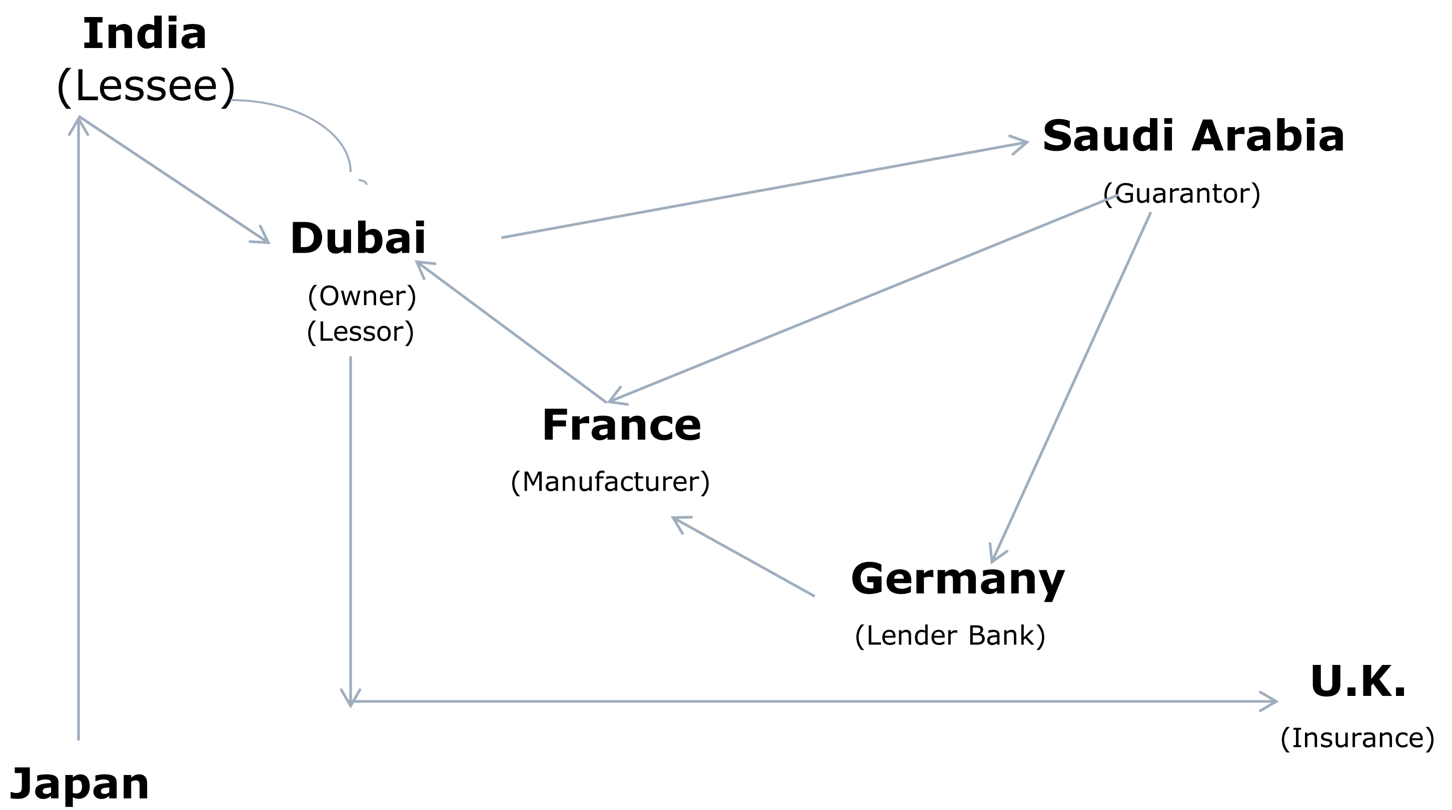
PRICE:	$ 165 Million	for a single New Airbus A-340 **or**
		for a Boeing 777 or
	$ 190 Million	for a New 737
	$ 160 Million	for an old 727 to be rebuilt as
	$ 185 Million	a freighter
LEASE:	$ 2 to 2.2	Million (9-10 Crores) a month with a wide body aircraft with Maintenance.
	$ 1 to 1.2	Million without Maintenance.

TRANSACTION STRUCTURE INVOLVING LEASING OF AIRCRAFT

EXAMPLE

1.	Financer	HSBC (Creditor)
2.	Vendor	France (Aircraft Manufacturer)
3.	Vendee (Lessor)	Dubai (Aircraft Purchaser)
4.	Operator (Lessee)	Indian (Lessee)

Aircraft Leasing and Financing Agreement



(Passengers) (If there is a default in payment or an accident what happens?)

2. AIRCRAFT LEASING

- **What is Aircraft Leasing?**

  Aircraft leasing is a contract whereby the owner of an asset (the lessor) grants to another party (the lessee) the exclusive rights to the use of the asset (aircraft) for an agreed period of time, in return for the periodic payment of rent.

- **Definition of Lease in simple: (5 P's)**

  - **P : Parties**
  - **P : Property (Movable)**
  - **P : Premium (Consideration/Rent)**
  - **P : Partial Demise (Temporary Transfer)**
  - **P : Period**

Advantages

1. Helps in increasing the fleet size.

2. It is fairly quick rate.

3. It reduces the cost of airline operators.

4. After maximum utilization of an aircraft it can be converted for cargo purpose.

3. TYPES OF LEASES

There are a plethora of leases depending on the :
accounting standards,
commercial and
tax laws of different countries.

Primarily there are three types of Leases:

1. Wet Lease
2. Dry Lease (Operating Lease and Finance Lease)
3. Damp Lease

Other types of Leases:

4. Finance Lease
5. Operating Lease
6. Sale and Leaseback

1. Wet Lease (or)

Aircraft, Crew, Maintenance and Insurance (ACMI)

- The Company leasing out the aircraft provides the crew, including pilots, engineers and flight attendants, besides maintenance and insurance, to the lessee i.e., the company / airline operator who takes the aircraft on lease.

- The salaries of the crew are paid by the lessor and not the lessee.

- However, the cost of fuel, parking, landing etc. are paid by the lessee.

- Irrespective whether the plane flies or not, the lessee has to pay for the minimum guaranteed block hours fixed by the lessor.

2. Dry Lease

- It does not include crew, maintenance or insurance.
- The average tenure of a dry lease is typically more than two years.
- Dry lease is of two types:

(i) **Operating Lease**: An aircraft is leased out for a short period of time compared to its total life. For instance, if the life of an aircraft is twenty (20) years, it would be leased out for a period of about 8 years. Upon the end of the lease period, the lessee returns the aircraft to the lessor and there is no option for purchase the aircraft.

(ii) **Finance Lease:** It is a long term lease and the lessee can purchase the aircraft on the completion of the lease period. The lease payments are in excess of 90% of the market value of the aircraft and the term of the lease is over 75% of the aircraft’s usable life.

3. Damp Lease

- Damp lease is wet lease sans the cabin crew, which means the lessor provides for maintenance and insurance of the aircraft it leases out but does not provide a crew to the lessee.

- However, in order to give initial guidance to the crew of the lessee, sometimes, the lessor provides a trainer on board for a limited period of time.

4. Finance Lease

- A Finance Lease is a contract.
- Almost all of the risks and rewards of ownership are borne by the lessee.
- Lease payments are made during the lease period.
- Payments are sufficient to cover the lessor’s costs and also a profit.
- It is analogous to a secured loan with the **exception** that the title continues to vest in the lessor.

- Long Term i.e. 12-25 years.
- Accompanied with restrictions of cancellation.
- Asset and associated debt shown on airlines’ Balance Sheet.
- Lessee is responsible for all repairs, maintenance and insurance costs and also bears the risk of obsolescence (going out of use).
- Lease period normally covers the economic life of the aircraft so that by the end of the lease, the residual value of the aircraft may be negligible.

5. Operating Lease

- The purpose of an Operating Lease is to facilitate usage of the asset rather than transfer of any ownership interest.

- The risks and rewards of ownership remain with the lessor.

- An operating lessor has to place the aircraft on a number of successive leases or sell the aircraft in due course to recover its capital outlay and make a profit, whereas a finance lessor looks to a single lease to do the same.

- Short Term i.e. 1-10 years.
- Varying degree of flexibility for cancellation by airlines.
- Lessor retains full title.
- No inclusion on Balance Sheet, treated as Operating Expense.
- Flexibility to introduce new routes or aircraft types.

NOTE:

An **Operating Lessor** must, therefore, have significant expertise in the management of the asset,

While a **Finance Lessor** is primarily concerned with effectiveness of the lease structure and has minimal interest in asset management.

6. Sale and Leaseback

- The owner of the asset (aircraft) sells the asset to a purchaser.
- The purchaser who then immediately leases it back to the seller.
- This enables the previous owner to continue using the asset, in addition to recovering the equity in the asset.
- An Airliner normally enters into a sale and leaseback of the aircraft to:
  - To improve capital flow;
  - Lessen the risk of variation in future aircraft value,
  - Fix the sale price in expectation of aircraft deliveries for fleet renewal,
  - Recover the present value of an aircraft which is liable to be retired in the near future; as a tax planning strategy; refinance aircraft owned by the airline at a reduced cost and / or streamline the ownership structure of the fleet.

4. DGCA's POLICY (REQUIREMENTS)

CRITERIA FOR LEASING OF AIRCRAFTS BY INDIAN OPERATORS

1. **Permission from the DGCA:** DGCA permission is mandatory before leasing an aircraft in India. An Indian operator can either take an aircraft on lease from a foreign operator or another Indian Operator.

2. **Aircraft on Lease from a Foreign Operator:** Where the Indian operator intends to take a foreign registered aircraft on lease, charter or any similar arrangement from a person holding Air Operator Certificate (AOC) issued by another State, the following information has to be provided by the Indian operator to the DGCA at least 45 days prior to the proposed date of operation with the leased aircraft:

a) Name and address of the Indian Operator and the lessor;

b) Aircraft details;

c) AOC details along with operations specifications, if any, of the lessor;

d) Name and contact information of the State of Registry;

e) A copy of the letter of intent;

f) Planned arrangements for operation and maintenance of aircraft during the lease period;

g) proposed date of import into India.

3. Aircraft Lease from an Indian Operator: In the event an Indian operator intends to borrow an aircraft on lease from an Indian operator (for domestic or international operations) the following information has to be provided to the DGCA at least 45 days prior to the proposed date of operation with the leased aircraft.

a) Name and address of the operator from whom the aircraft is intended to be leased;
b) AOC details along with operations specifications of the lessee and the lessor;
c) aircraft type, registration number and its main base;
d) maintenance agency with scope of approval;

e) a copy of the draft lease agreement and maintenance agreement;

f) any amendment proposed to be made in the Operations Manual or other relevant documents;

g) a document giving details of the respective responsibilities of compliance with regulatory requirements such as FDTL, arrangements for Flight Operations Quality Assurance, flight dispatch and responsibilities of the lessor and the lessee with regard to operation, maintenance and quality system of the aircraft.

Upon receipt of the above information, the DGCA finalizes the modalities for operation of the leased aircraft at a meeting with the Indian Operator.

Where the aircraft is taken on lease form a foreign operator, the representatives of the foreign operator an the regulatory authority are also allowed to participate in the meeting.

The DGCA can conclude an agreement under Article 83 bis with the State Registry an the State Operator for transfer of certain regulatory functions.

It has also the discretion to impose conditions while granting permission to the Indian operator for operations with the leased aircraft.

5. LEGAL ASPECTS OF LEASING

Indian Law

1.	**Indian Contract Act, 1872**	
	Chapter: IX Bailment	Sections 148-171
	Bailment of Pledges	Sections 172-181
2.	**Transfer of Property Act, 1882**	
	Leases	Sections 107
3.	**Sale of Goods Act, 1930**	

6. CAPE TOWN CONVENTION

1. The Cape Town Convention, 2001

   (Convention on International Interests in Mobile Equipment)

2. The Cape Town Protocol, 2001

   (Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment)

3. The Consolidated Text of the Cape Town Convention and Protocol

   (Consolidated Text of 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)

AIRCRAFT LEASE AGREEMENT

AIRCRAFT LEASE AGREEMENT

Dated as of December 5, 2003

BETWEEN

FRONTIER AIRLINES, INC.

as **LESSEE**

and

INTERNATIONAL LEASE FINANCE CORPORATION

as **LESSOR**

Information to be given regarding Aircraft

Aircraft Make and Model: New Airbus A319-111

Aircraft Manufacturer's Serial Number: 2198

Aircraft Registration Mark: Per Exhibit G

Make and Model of Engines: CFM56-5B5/P

Serial Numbers of Engines: Per Exhibit G

NEW AIRCRAFT NO. 1

DRAFTING OF AIRCRAFT LEASE (MODEL)

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ISSUES

- A variety of issues will present themselves to any Non-Indian Lessor or Financer of an Aircraft to an Indian Operator.

- The Leasing of the Aircraft
- The Making of Lease and Guarantee Payments
- The Security Package

are often magnified by the lack of clear authority and precedent in India.

TYPICAL ISSUES

A ”Typical” range of considerations for any inward Lessor or Financier is likely to include:

- The fact that a withholding **<u>Tax Exemption</u>** must be obtained from the **<u>Indian Ministry of Finance</u>** in relation to **<u>Lease Rental Payments</u>**.

- The fact that **<u>Exchange Control Approval from the RBI</u>** will be required in relation to certain **<u>Lease/Lease-related and Guarantee Payments.</u>**

- The fact that **<u>Indian Statutory Law does not make provision for Mortgages over Aircraft.</u>**

- The likelihood that **<u>Indian Stamp Duty will apply in relation to a variety of the transaction documents</u>**. The amount of Stamp Duty will vary from State to State and can be charged on copy documents that are brought into certain States.

LEASING OF AIRCRAFT

1. Ownership Interest: (DGCA-can record the lessor's proprietary interest as the owner of an aircraft but it doesn't act as a Title Registry).
2. Lease Interest: DGCA can record the Lease Agreement.
3. Cape Town Convention: (Convention on International Interests in Mobile Equipment signed at Cape Town on 16th Nov. 2001 – Known as The Cape Town Convention, 2001) India signed but not ratified. Once ratified the lessors and financers will be able to expect greater certainty in terms of recognition and registration of their interests (Ex. Protection of Airliner from Insolvency).
4. Enforcement and Repossession: In the absence of a consensual repossession of the aircraft following any lease termination, an aircraft can only be repossessed through the Courts – Indian Law does not recognize self-help remedies.

5. Lease and Guarantee Payments

Withholding Tax Exemption: Indian Lessees will get 40% Tax Exemption on Lease Rental Payments. These exemptions are issued by Tax Authorities. If no exemption, then they have to pay 40% tax.

Exchange Control Approval: A Lessor or a Financier will need to ensure that the lessee takes effective responsibility for the exchange control approvals that are likely to be required from the RBI in relation to the Lease Agreement and any payment Guarantee that is provided by an Indian Entity in the context of the transaction.

6. Security Documents: Security Package is taken to include security over the aircraft, the Lease Agreement and the Insurances / Reinsurances and also a Guarantee and Deregistration Power of Attorney.
7. Indian Law Aircraft Mortgage:
8. English Law Aircraft Mortgage: The Indian Courts will generally recognize the effectiveness of an English Law mortgage to crate a security interest in an aircraft in accordance with its terms and will generally recognize a judgment obtained against an owner in the English Courts, subject to Section 13 of CPC 1908.
9. **Lease Security Assignment**
10. **Insurance Security Assignment**
11. **Deregistration Power of Attorney**

END SLIDE