



**SPECIALTIES OF AIRCRAFT LEASING: FROM THE UNITED KINGDOM AND  
THE UNITED STATES TO KAZAKHSTAN**

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## **Abstract**

My research work is generally concentrated on a detailed analysis of two cross-border aircraft operating lease contracts concluded between one of the major airlines of the Republic of Kazakhstan and Western lessors and governed by the laws of the United Kingdom and the United States. The purpose of my work is on the basis of this analysis to determine differences and similarities between them, extract the main aspects to be covered by every aircraft lease contract, as well as to demonstrate what problems might arise between different jurisdictions and particularly what risks and difficulties foreign lessors and Kazakhstani lessees might face with at entering into cross-border lease arrangements.

## List of abbreviations and acronyms

|          |   |
|----------|---|
| Art.     | article   |
| AVN48C   | the exclusion clause, excludes all cover for the hostile use of weapons of mass destruction   |
| AVN67B   | the Airline Finance/Lease Contract Endorsement  |
| AVV      | Aruba exempt company  |
| FARs     | Federal Aviation Regulations of Federal Aviation Administration                               |
| IATA     | International Air Transport Association   |
| ICAO     | International Civil Aviation Organisation   |
| JARs     | Joint Aviation Regulations  |
| LSW555.C | Hull war risks  |
| Para.    | paragraph   |
| p.       | page  |
| RK       | Republic of Kazakhstan  |
| SSAP 21  | Statement of Standard Accounting Practice – Accounting for Leases and Hire Purchase Contracts |
| UCC      | Uniform Commercial Code (United States)   |
| UNIDROIT | International Institute for the Unification of Private Law                                    |
| US       | United States   |
| UK       | United Kingdom  |

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## Introduction

Nowadays leasing in certain areas of industry is becoming more and more profitable for its participants – lessors and lessees, including banks and investors – which contributes significantly to the development of national economies and occupies a wider space on a market substituting for other types of transactions including purchase.

The above is especially true for aviation industry where rapid growth of leasing transactions started in 1980s in the US, the country which concentrates nearly half of the world's airline traffic<sup>1</sup>. Later the same trend was traced in Western Europe. Today, very few airlines own all their fleet as it would not be tax-efficient to do so. This is true for such big airlines as Air-France-KLM, British Airways, Qantas, etc<sup>2</sup>. Experience of those airlines has founded a well established practice to follow for the majority of start-up airlines in all parts of the world.

The factors which make leasing so attractive to aviation industry are determined by their simplicity and efficiency compared to purchasing and other types of financing in terms of taxation and possibility to upgrade the aircraft fleet since the aircraft manufacturing industry is developing very fast, constantly supplying the market with new, modernized aircraft.

In view of the high demand of leasing arrangements in aviation industry it is necessary to determine the reasons which have made lease so popular, to define its benefits for participants, to establish the main aspects of aircraft lease contracts.

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<sup>1</sup> Leaseurope and Arthur Andersen, *Leasing in Europe* (London: McGraw-Hill Book Company, 1992), p. 53-54.

<sup>2</sup> *Id.* p. 54.

The present research work is mainly concentrated on a detailed analysis of two cross-border aircraft operating lease contracts concluded between one of the major airlines of the Republic of Kazakhstan and Western lessors and governed by the laws of the United Kingdom and the United States. The purpose of my work is on the basis of this analysis to determine differences and similarities between them, extract the main aspects to be covered by every aircraft lease contract, as well as to demonstrate what problems might arise between different jurisdictions and particularly what difficulties foreign lessors and Kazakhstani lessees might face with at entering into such relations.

For the research purposes I used such primary sources as the relevant laws of the United Kingdom (Company Act, Finance Act, Air Navigation Order, etc.) and the United States (Uniform Commercial Code, Federal Aviation Act, etc.) as well as the legislation of the Republic of Kazakhstan, i.e. the Civil, Customs and Tax Codes, the legislation on leasing and pertaining to aviation. I also based the comparative part of my thesis on aircraft lease contracts concluded between Kazakhstani airline and international aircraft lease companies.

As for the secondary sources, my research is based on the books giving understanding of leasing in general and aircraft leasing in particular from both legal (R.M. Goode, Hire-Purchase Law and Practice, L. Del Duca, Secured Transactions Under the Uniform Commercial Code and International Commerce, etc.) and financial points of view (A. Littlejohns, Aircraft Financing, D. Soper, The Leasing Handbook, etc.). The books devoted to aircraft finance provide an understanding of the airline finance sphere and discuss its main aspects such as leasing markets, features of operating leasing, key contractual issues, and gives overview of the US, European and Asian perspective to aircraft financing.

I will start my research work from a brief overview of the reasons that have been the cause of rapid development of leasing in aviation industry. Further, I will define specialties of aircraft lease relationships, justify why operating lease is becoming more and more popular in aircraft financing and explain why cross-border leasing is the most attractive form of lease arrangements. In the *first chapter* I will also distinguish differences between operating lease, financial lease and hire-purchase agreements since they are quite often confused with one another, which sometimes may be explained by the legal understanding and approach to these institutions by different countries. Further I will discuss the specialties of lease regulations by the UK and the US legal systems.

Having determined the basic concepts of leasing being established by the UK and the US jurisdictions, I will shift to the *second chapter* which I devoted to the main issue of my thesis – comparative analysis of the key aspects of aircraft lease contracts governed by the UK and the US laws. By comparing I will define differences and similarities in regulation of the contractual provisions by those legal systems and demonstrate that aircraft leases are treated differently from lease of other equipment, first of all in terms of registration requirements in view of its importance for the state and national security.

By referring to the case law in the *third chapter* I will cover the main risks international lessors may face with at entering into cross-border leasing, i.e. enforceability of the contracts and repossession of aircraft in case of the lessee's default. I will also demonstrate a number of discrepancies Kazakhstani airlines face with due to a number of gaps in the national legislation raising certain confusions and difficulties in cross-border lease transactions for the participants. The *third chapter* is also devoted to specificities of regulation of lease arrangements by the legislation of Kazakhstan and factors restraining development of leasing in the Republic. One of such specificities is



that according to point 2 of Art. 117 of the Civil Code of the Republic of Kazakhstan of 27 December, 1994 aircraft are treated as immovable property.<sup>3</sup>

Understanding of the problems Kazakhstan faces with helps determining the ways in which the state shall move forward to achieve international standards in lease sphere. I will indicate the problems to be eliminated in the nearest future to enable Kazakhstani airlines full access to the international aircraft lease market.

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<sup>3</sup> *Гражданский кодекс РК от 27 декабря 1994 г., п.2 ст. 117: «К недвижимым вещам приравниваются также подлежащие государственной регистрации воздушные ... суда ...»* (translated by the author).

## **Chapter 1. Leasing with an emphasis to aircraft financing**

“The term ‘leasing’ can have a number of meanings. All are concerned, however, with the use of an asset of some sort by party who does not own that asset in the full sense.”<sup>4</sup>

In common law, especially under legislation of the United Kingdom, a lease of goods is a hire contract, the essential characteristic of which is that goods are bailed by one party to another party for use or in exchange for payment of rent.<sup>5</sup> Thus, summarizing the definitions the main essence of lease is that it transfers the right to possession and use of goods for a term in return for consideration.

In this chapter I will give a short overview to the period of development of leasing in aviation which started relatively many years ago and specify what types of leasing most commonly used in modern aviation as well as define the methods of regulation of leasing in the United Kingdom and the United States.

This chapter gives a general understanding of the world of lease arrangements from legal and financial point of view. I found it necessary to consider leasing from the former perspective due to the fact that taking a decision by an airline to opt for this or that type of leasing is mostly presupposed by its current and prospective financial capacities and interests with regard to the leased aircraft.

### **1.1. Historical background**

The first statutory reference to equipment leasing came in the Statute of Wales in 1284, where it was stated that “the legal action of covenant derived from land law was also

available for lease of moveable property.”<sup>6</sup> The leasing of assets with an option to purchase became popular in the UK from the 1860s, with the leasing of railway wagons by specialist finance houses. From 1970s leasing without a purchase option started to develop in the UK leasing industry. Very often leasing has been used for dishonest purposes, for instance, for hiding the actual situation as to who is the real owner and who is lessee to mislead creditors. In 1571 the Act on prohibition of such kind of deals was passed in England. Since then only true leasing was permitted and legal, meaning the one which cannot be re-characterised as a hire purchase or a security assignment.<sup>7</sup>

Considering leasing from the ‘up-to-date’ point of view, leasing is traditionally considered to be the American innovation which started in 1877 when American Company Bell Telephone Company instead of selling telephones to their users leased them.

Since the mid-1970s leasing has clearly established a major role in capital financing for British industry and commerce. In the UK aircraft industry leasing companies, by creating their own experience on residual values in second-hand markets, have managed to develop the operating lease as a critically important source of finance for new high-value equipment.<sup>8</sup>

In the US the wide use of leasing in aviation industry has started from the 1980s on. The leasing boom was predetermined by economical reasons, when in 1978 the

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<sup>4</sup> Derek R. Soper, Rbert M. Munro with Ewen Cameron, *The Leasing Handbook*, (London: McGraw-Hill Book Company Europe, 1993), p.1.

<sup>5</sup> UCC Art.2A-103(1)(j).

<sup>6</sup> Leaseurope and Arthur Andersen, *Leasing in Europe*, (London: McGraw-Hill Book Company, 1992), p. 53.

<sup>7</sup> *Id.* p. 55.

<sup>8</sup> Andrew Littlejohns, Stephen McGairl, Andrew Littlejohns, Stephen McGairl, Simon Hall, *Aircraft Financing*, (London: Euromoney Publication PLC, 3rd ed., 1998), p. 25.

Government took a decision to deregulate the airline industry by minimizing its interference into aviation business. It only reserved for itself the rights to regulate the most important issues, such as safety standards, registration of aircraft, etc. These measures allowed bringing new operators on the market from one side and increased competition from another. In order to remain competitive airlines needed to lower costs and constant upgrade their fleet which used to require a lot of investments. All these conditions as well as increased real cost of new aircraft caused the popularity of aircraft leasing during the 1980s. “In 1986, for example, approximately one-third of the fleets of the major US carriers were leased, compared with one-fifth in 1980. Between 1982 and 1984, in fact, one half of all aircraft acquisitions were the result of lease agreements.”<sup>9</sup>

Nowadays leasing is the most efficient way of acquiring aircraft not only for start-up airlines, but also for those who have been on the international aviation market for decades.

## **1.2. Forms of leasing relationships most commonly used in aviation industry**

### **1.2.1. Cross-border lease**

Cross-border aircraft leasing is an international lease arrangement whereas a lessee (usually an airline) leases an aircraft from a lessor domiciled in another country.

The UNIDROIT Convention on International Financial Leasing, signed in Ottawa on the 28<sup>th</sup> of May 1988 is an international legal document which was initiated specially

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<sup>9</sup> Global Competitiveness of US advanced technology manufacturing industries: large civil aircraft, Investigation No.332-332, Publication 2667, August 1993, Washington, DC 20436., (DIANE Publishing Company, 1995).

for regulation of aspects of cross-border lease arrangements. According to Art. 3 of the Convention

*“this Convention applies when the lessor and the lessee have their places of business in different States and:*

- a. those States and the State in which the supplier has its place of business are Contracting States; or*
- b. both the supply agreement and the leasing agreement are governed by the law of a Contracting State.”<sup>10</sup>*

There is an interesting aspect of the Convention is that in case of defects of the equipment when the lessee chooses the vendor, the equipment problems should be directed to the vendor, the party who is in the best position to negotiate a solution.

The main purpose for the parties to leasing arrangements to be involved in cross-border aircraft leasing is to get sufficient reduction of financing costs. For the majority of airlines it is particularly beneficial to opt for operating lease as it, depending on a jurisdiction, provides for an exempt from taxes. Moreover, *“rent payments made under operating leases are fully deductible to the airline as operating expenses.”<sup>11</sup>*

Other reasons in favor of cross-border lease are *“high tax rates in the lessor's jurisdiction, liberal depreciation rules and either very flexible or very formalistic rules governing tax ownership.”<sup>12</sup>*

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<sup>10</sup> UNIDROIT Convention on International Financial Leasing, Art. 3 (Ottawa, 28 May, 1988).

<sup>11</sup> Kenneth D. Basch, Government Amends Tax Treatment of Airline Finance Leases (August 16, 2006) <<http://www.internationallawoffice.com/Newsletters/detail.aspx?g=059ef0d1-fe26-db11-8a10-00065bfd3168>>.

<sup>12</sup> Equipment Leasing Depot (visited March 23, 2008) <[http://www.equipmentleasingdepot.com/cross\\_border\\_lease.html](http://www.equipmentleasingdepot.com/cross_border_lease.html)>.

Cross-border leasing has been widely used in some European countries, usually between European countries and the United States. Such scheme is explained by tax regimes between those countries and by the fact that some jurisdictions assign ownership and “*the attendant depreciation allowances to the entity that has legal title to an asset, while others (like the US) assign it to the entity that has the most indicia of tax ownership.*”<sup>13</sup> But there was a risk of such an arrangement that at long-term leases, for all or almost the whole usable life of a leased asset, the asset might have obtained two effective owners in both jurisdictions; this is often referred to as a double-dip lease. In other words, a double-dip lease is a cross-border lease in which the different rules of the lessor’s and lessee’s countries let both parties be treated as the owner of the leased equipment for tax purposes. Such situation allows both the lessor and lessee make depreciations on the lease equipment.

In view of the above mentioned laws of many countries take actions to eliminate such arrangements if it becomes obvious that a double dip is the major goal of the arrangements.

For example, to avoid double-dip lease arrangements, the United Kingdom sets the restrictive tax rules of export leasing (Section 42, Capital Allowances Act 1990) according to which “*export leases are not viable for rapidly depreciating plan.*”<sup>14</sup>

As an alternative, UK-based lease companies started leasing equipment to the lessee in another state from a third country (such as Switzerland or an off-shore centre) where a subsidiary leasing company has been established.

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<sup>13</sup> Cross-border Leasing (last modified October 9, 2007) <[http://en.wikipedia.org/wiki/Cross-border\\_leasing](http://en.wikipedia.org/wiki/Cross-border_leasing)>.

*“Capital allowances can then be claimed at realistic rates in the third country, with a broadly symmetrical flow of taxable income against deductible expenditures in each of the two countries where the finance companies are located.”*<sup>15</sup>

Almost the same situation took place in the United States. Initially there were the rules allowing applying *“domestic investment tax credits and accelerated depreciation allowance advantages for equipment which was meant to be used on the territory of the US.”*<sup>16</sup> But since there were not any explicit restrictions to apply the same regime to export transactions, the American lessors were able to apply domestic investment tax credits and lease the equipment abroad. However, in 1984 Congressman Pickle and Senator Dole initiated a reform of tax law, which became the law as the Tax Reform Act 1986. This Act, known also as the Pickle/Dole Bill, put restrictions on tax benefits for equipment used by tax-exempt companies and foreign companies that are not subject to federal income taxation. In other words, American lessors could not any more count on export tax benefits in cross-border leasing relations.

The solution to the problem was identical to the one in the United Kingdom, when some leading American banks and lease companies to get tax subsidies started establishing affiliated offshore companies for the purpose of cross-border lease arrangements. Such companies formed in foreign jurisdictions with which the US concludes tax treaties or information-sharing agreements (usually in Bermuda, US Virgin Islands or Aruba) are called foreign sales corporations (FSCs).<sup>17</sup>

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<sup>14</sup> Derek R. Soper, Robert M. Munro with Ewen Cameron, *The Leasing Handbook*, (London: McGraw-Hill Book Company Europe, 1993), p. 356.

<sup>15</sup> *Id.* p. 356.

<sup>16</sup> *Id.* p. 357.

<sup>17</sup> Andrew Littlejohns, Stephen McGairl, Andrew Littlejohns, Stephen McGairl, Simon Hall, *Aircraft Financing*, third edition, (London: Euromoney Publication PLC, 1998), p. 247.

### 1.2.2. Operating lease

It is essential to note that aircraft in aviation industry is considered as the main source bringing the airline profit; apart from this it is a valuable and expensive transportation mean, purchasing of which requires a lot of investments, which makes it quite complicated and irrational especially for a start-up airline. Therefore, as an alternative to purchasing, many airlines opt for operating lease which has during the 1980s and 1990s emerged as a major source of capital for the airline industry. The experts in the sphere of aircraft financing characterize operating lease in the beginning of its growth as

*“a capital substitute for second and third-tier carriers with poor access to traditional debt and equity markets. In reality operating lease is a combination of debt and equity for the airline and, thus, is a legitimate capital source in its own right. In recent years major airlines have begun to embrace operating leasing as a component of their capital structure, seeing it as a low-cost source of combined debt and equity and evaluating it on a blended cost basis.”*<sup>18</sup>

Abstracting from the financial characteristics and considering operating lease from practical point of view I may summarize that operating leasing may offer the most optimal and efficient access to certain urgently required equipment types. As the majority of lessors work in close cooperation with manufacturers they may provide a brand-new aircraft to the airline even faster than if the airline could obtain it from the manufacturer<sup>19</sup>.

According to the authors of ‘Aircraft Financing’, Andrew Littlejohns et al.,

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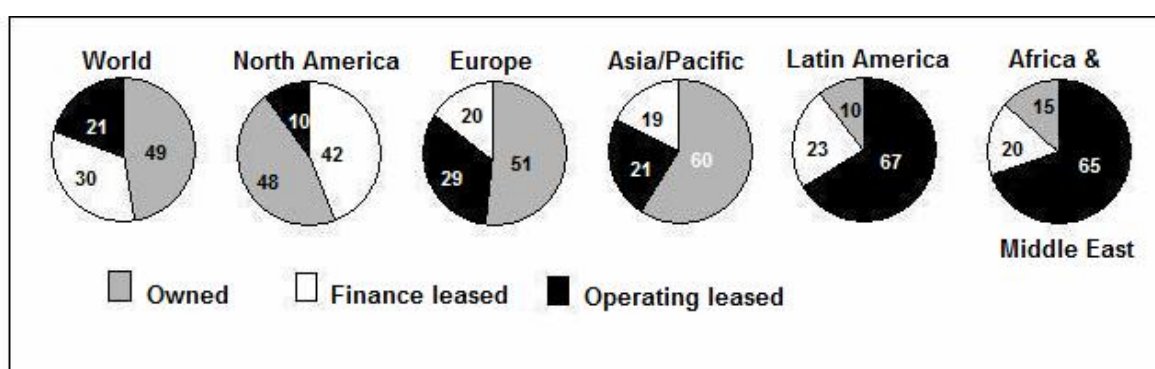
<sup>18</sup> Andrew Littlejohns, Stephen McGairl, Andrew Littlejohns, Stephen McGairl, Simon Hall , Aircraft Financing, third edition, (London: Euromoney Publication PLC, 1998), p. 22.

<sup>19</sup> *Id.* P. 25.



*“airlines have traditionally financed their aircraft either on-balance sheet with the use of non-aircraft related debt finance, via finance leases or on an operating lease basis. Today roughly half of the more modern jet aircraft (those built after 1985) are owned, with 30 % being finance leased and 21% being on operating leases.”<sup>20</sup> (See Exhibit 1.1).*

Operating lease term is generally much shorter than the economic life of the leased aircraft. With an operating lease the aircraft doesn't appear on the lessee's balance sheet.



**Exhibit 1.1**

**Source: GE Capital Aviation**

**Services<sup>21</sup>**

The above data indicates that spread of operating lease arrangements around the globe is unequal. This may be explained by the concentration of capital in the states located on a particular geographic area. Nonetheless, the current situation has been changing considerably in favor of operating lease. In fact, to date the vast majority of collateral in aircraft is operating lease arrangements. This may be explained by political and economical circumstances which have been considered earlier as well as by the high rate of predictable long-term growth. The former for both, lessors and lessees is

<sup>20</sup>Id. p. 8.

<sup>21</sup>Id. p.9

considered as the major reason explaining popularity and fast development of aircraft financing is so attractive.

Aircraft leasing differs from general equipment leasing in that the useful life of an aircraft is much longer than most pieces of industrial or commercial equipment.

*“In a typical equipment lease deal, cash flow from a particular lease on a particular piece of equipment only contributes to the deal for the life of the lease. In aircraft leasing, the equipment usually has an original useful life of 20+ years, but leases run for only 4-5 years.”<sup>22</sup>*

This means that the aircraft will have to be re-leased on expiration of the original leases.

### **1.2.3. Leveraged financial lease**

Another very important type of aircraft financing which in its various modifications is well known not only in the US, but also in the UK, Japan and Germany, is leveraged lease. In fact, almost all cross-border aircraft lease arrangements are in a form of leveraged lease. Quite often airlines prefer this type of lease particularly if they consider a long-term financing for a new aircraft. Such lease provides for the opportunity to purchase the aircraft by lessee at or near the end of the lease term, which reflects the essence of financial lease, also known as a capital lease, and takes place when one of the following conditions is met:

- at the end of the lease term the lessee has the option to purchase the aircraft at an agreed price;

- the lease payments are more than 90% of the market value of the aircraft;
- the term of the lease is over 75% of the aircraft's usable life.

In fact leveraged lease, which may be not only financial but also operating, is much more complicated than any operating or pure financial leases, but I will try to give it a comprehensive general overview.

Usually the following participants are taking part in the leveraged lease arrangement:

- a lessee – normally an airline;
- a lessor – an equity participant who partially funds the purchase of the aircraft;
- a lender – provides the rest of the required sum to purchase the aircraft (may be an insurance company or a commercial bank);
- an owner trustee – performs administrative functions.

*“The owner trustee, acting on behalf of the lessor, holds the title to the aircraft but confers beneficial ownership of the aircraft on the lessor. The lessor is thus entitled to all of the tax depreciation benefits of owning the aircraft.”<sup>23</sup>*

Sometimes it occurs that to get the loan with interest back the lender receives payments directly from the lessee and in case of the lessee's default the lender has a priority over the lessor as the loan to the lessor is secured by a mortgage on the aircraft.<sup>24</sup>

<sup>22</sup> Frank J. Fabozzi, *The Handbook of Financial Instruments*, (London: John Wiley & Sons, Inc., 2003), p. 441.

<sup>23</sup> Andrew Littlejohns, Stephen McGairl, Andrew Littlejohns, Stephen McGairl, Simon Hall, *Aircraft Financing*, third edition, (London: Euromoney Publication PLC, 1998), p. 109.

<sup>24</sup> Philip R. Wood, *Comparative Law of Security and Guarantees*, (London: Sweet & Maxwell, 1995), p. 201.

The benefit of the lessor mostly depends on the tax benefits and rental payments from the lessee in excess of the lessor's debt to the lender.

G. Gilmore states that such kind of lease, equipment trust lease as he calls it, was invented by railroad lawyers and has only been applicable for equipment which visibly produces income<sup>25</sup> (like railway cars or aircraft).

At analyzing aircraft lease contracts in the second chapter I will consider leveraged lease in more details as this type of arrangement is the one regulated by them.

#### **1.2.4. Wet, damp and dry lease**

The aircraft lease arrangements are traditionally divided to the following broad classifications:

Under wet lease the lessor has to provide an operational aircraft with crew, fuel, etc. This is a type of a short-term arrangement as the only asset the lessee owns is the traffic rights. In view of such an arrangement the lessor remains in full control of the aircraft and hence, bears all risks and responsibilities with regard to the aircraft.

Damp lease – an intermediate stage, whereby the lessee may provide only some of the additional services such as the flight deck crew (pilots, without cabin crew) or carry out some of the maintenance checks. As a rule the lessee provides the cabin crew. This can

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<sup>25</sup> Grant Gilmore, *Security Interests in Personal Property*, (Boston: Little, Brown & Co., 1965, republished in 1999), p. 79.

only be done if the cabin crew receives Safety and Emergency Procedures training by the lessor, in order to be acquainted with the differences of the aircraft.<sup>26</sup>

Dry lease – lease of the aircraft without insurances, crew, maintenance etc., whereby the lessor has title while the lessee has possession. This type of leasing is the one attributed to the cross-border aircraft operating lease contracts to be analyzed in the *second chapter*.

### **1.3 Distinction of operating lease from financial lease and hire-purchase agreements**

The specialty of an operating lease is that a lessor does not get a full coverage of his expenses with regards to a purchased aircraft from a single lessee. Instead it has to arrange several consecutive leases, after which he sells the aircraft to return his expenses and get income. As a result, an operating lessor “*receives all the benefits from achieving higher lease rates or a higher sales price and also suffers the cost of lessee defaults or lower lease rates.*”<sup>27</sup>

In contrast, the essence of a finance lease is that the lessor is not interested in re-leasing of the asset; instead his aim is to get repayment of his capital and income by arranging a long-term lease arrangement with a single lessee and provide him with an option to purchase the asset at or almost at the end of a lease term at a nominal or discounted price.

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<sup>26</sup>Aircraft Leasing Definition, as provided by GlobalPlaneSearch.com, (visited March 21, 2008) < <http://www.globalplanesearch.com/view/aircraft/aircraft-leasing-def.htm>>.

<sup>27</sup> Andrew Littlejohns, Stephen McGairl, Andrew Littlejohns, Stephen McGairl, Simon Hall , Aircraft Financing, third edition, (London: Euromoney Publication PLC, 1998), p. 58.

The authors of the Aircraft Financing, Andrew Littlejohns et al., distinguish operating lease from other types of lease on the basis of the following features:

- Term of lease is significantly shorter than the life of aircraft, ranging from three to seven years; in rare cases it may be shorter than six months or longer than twelve years.
- Operating lease rentals are set by market conditions rather than by reference to the purchase price of the aircraft or prevailing interest rates: 0.85 – 1.50% per month of the value of the aircraft.
- Rentals are payable monthly and in advance.
- Lessee has to pay a security deposit prior to delivery of aircraft, which is normally equal to two-three months' rental, in form of cash or a letter of credit from a first-class bank. Since the amount is relatively small compared to the value of the aircraft, maximum four per cent, the operating lease makes it attractive for even start-up airlines and airlines with low level of profit.
- Includes maintenance accruals or supplemental rents whereby lessee pays additional amount based on its monthly usage of aircraft in order to build up a dedicated fund for future major maintenance expenditures.
- Allows lessor to have relatively free access to aircraft for the purpose of technical inspections. Lessor has approval rights over the maintenance program and selection of maintenance providers.

- Detailization of redelivery conditions of aircraft. Lessor is interested in getting the aircraft back in as good condition, as it was before leasing. Lessee pays for major maintenance checks, maintenance and replacement.
- Strict insurance provisions. Lease agreement will lay down minimum insurance requirements (at least the replacement cost of the aircraft) and lessee is responsible for taking out adequate insurance to cover these amounts.
- Relatively stringent restrictions on the lessee's right to sub-lease the aircraft, which usually requires the lessor's prior approval.
- Does not normally include any financial covenants or ratios in respect of the lease (unlike in finance lease).<sup>28</sup>

Hire-purchase agreement in its turn also consists of periodic payments from the user to the owner of the asset. The main essence of the agreement is to transfer title to the asset by the owner upon fulfillment of the obligations by the hirer. But in order to be able to repossess the asset at any time in case of default of a hirer, i.e. on failure to pay installments, the agreement is treated as an agreement to let and hire, which contains a provision that when the last installment has been paid title to the asset shall be transferred to the hirer. Relations of the parties to such an agreement are predetermined by the fact that until all installments have been paid the lender remains the owner of the asset.

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<sup>28</sup> *Id.* p. 59.

The key difference between lease and hire-purchase agreements is that the aim under the hire purchase agreement is after series of periodic payments to obtain title to the assets, whereas the aim of lease agreements after a number of rental payments to get the asset back. Hence, the ownership feature is the one distinguishing hire-purchase from leasing.

If the difference between operating lease and hire-purchase is quite obvious, the distinction between hire-purchase and financial lease might be quite complicated. The complexity is generally predetermined by the wording of the contract and the true intention of the parties, but originally the main difference between both is that “[t]he lessee will ... keep the equipment through the period of its useful life and will pay in rent at least the equivalent of what the purchase price would be if the goods were offered for sale.”<sup>29</sup>

Hire-purchase belongs to the category of conditional sales, based on title retention or ownership, which, as G. Gilmore argues, for many years has been much stronger than the security interest<sup>30</sup>. Shortly after the situation changed when conditional sales in industrial equipment financing and consumer goods financing started to be treated as security devices. Such changes required performance of filing procedures to protect seller’s interest in the asset and in case of buyer’s default to claim the asset back through court proceedings<sup>31</sup>. But in view of the common law doctrine of equity it was not always possible to repossess the asset from the debtor’s possession provided he has paid for the asset a certain percent of its total cost.

<sup>29</sup> R.M. Goode, *Hire-Purchase Law and Practice*, (London: Butterworths, 2<sup>nd</sup> ed, 1970), p. 78-79.

<sup>30</sup> Grant Gilmore, *Security Interests in Personal Property*, (Boston: Little, Brown & Co., 1965, republished in 1999), p.67.

<sup>31</sup> *Id.* p. 67-68.



The law of the United States managed to draw a distinct line between lease and conditional sales:

*“Conditional sale - ...any contract for the sale [or bailment or leasing] of goods under which possession is delivered to the buyer and the property in the goods is to vest in the buyer at a subsequent time upon the payment of part or all of the price or upon the performance of any other condition or happening of any other contingency.”<sup>32</sup>*

Further this Act was consolidated to the UCC whereby conditional sales are regulated by the UCC Art. 9 which applies to security interests created by contract including pledge, assignment, conditional sale, etc.

According to legal doctrine, a lease contract shall be treated as hire-purchase contract if it is obvious under the terms of the lease that the purpose of the parties is to transfer the title to the object of lease to the lessee upon the expiry of the lease contract.<sup>33</sup> Additionally, if the lease term is equal to the anticipated economic (usable) life of the asset or where the asset has economical value only to the lessee, legal doctrine suggests that such lease contracts shall also be re-characterised as a hire-purchase.

Finally, all the discussed will have a result for the lessor and lessee not only in transfer of ownership issues but also in tax issues for both.

Due to these circumstances different jurisdictions set certain requirements and apply different tests to distinguish lease from hire-purchase. This issue will be considered

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<sup>32</sup> The Uniform Conditional Sales Act, Section 1.

<sup>33</sup> Lauri Peltola and Hans Wassgren, Leasing, (Finland: Waselius & Wist, 2003), p.15.

further on the basis of the legislative practice of the United Kingdom and the United States.

#### **1.4. Lease concept in the legal system of the United Kingdom**

There is an interesting fact, that there is no a precise definition of ‘leasing’ in the UK where the lease market is considered to be one of the most developed in the world and offers a wide range of leasing types which are not constrained by any statutory regulations.

According to the classification of lease contracts which might be found in the books devoted to the UK lease arrangements, one may find the following typical types of lease contracts:

- Hire-purchase agreements;
- Finance lease contracts;
- Operating lease contracts.

At the same time, it is important to underline that if the lease contract provides for the opportunity for the lessee to purchase the leased asset, such contract is not called and not treated for tax purposes as a lease contract. Provision of the purchase option in the lease agreement automatically turns the lease contract to purchase and sale contract and *“the ability to claim capital allowances may switch to the holder of the purchase option*

*rather than the lessor.*”<sup>34</sup> In fact, this is the main reason why lessors traditionally do not stipulate in the lease contract option to purchase the leased asset by the lessee. Hence, from the financial point of view I believe that the classification of lease contracts offered by a few specialists and given in the beginning of this sub-paragraph is not in line and sound with the UK tax legislation. In support of this position I cite one of the authors who suggesting the above classification from one side, states the following: *“the only tool that sets the boundaries of the leasing industry is the system of corporate taxation by determining the owner of the subject of the lease.”*<sup>35</sup> The authors of ‘Leasing in Europe’ further state that *“as a generic term leasing in the UK usually refers to finance and operating lease contracts rather than hire-purchase agreements.”*<sup>36</sup> I believe that the essence of such classification is not in terminological aspect, but in financial and tax aspects of the UK legislation.

At the same time from the legal point of view and having put aside tax and financial aspects of leasing, I believe that hire-purchase agreements might fit into the offered classification and stay close to financial leasing up to a moment of the lessee’s default which in case of hire-purchase, as we know, will raise a question of equity.

A financial lease contract is defined in SSAP 21 Accounting Standard as: *“a lease that transfers substantially all the risks and rewards of ownership of an asset to the lessee”*.<sup>37</sup> Such a transfer of risks occurs if the *“percent value of the minimum lease payments amounts to almost all (normally 90 per cent or more) of the fair value of the*

<sup>34</sup> Andrew Littlejohns, Stephen McGairl, Andrew Littlejohns, Stephen McGairl, Simon Hall , Aircraft Financing, third edition, (London: Euromoney Publication PLC, 1998), p. 155.

<sup>35</sup> Leaseurope and Arthur Andersen, Leasing in Europe, (London: McGraw-Hill Book Company, 1992), p. 25.

<sup>36</sup> *Id.* p.55.

<sup>37</sup> SSAP 21, Para.14 and 15 (1984).

*leased asset*”.<sup>38</sup> This is sometimes referred to as the 90 per cent test. Under a finance lease, the lessee does not have a purchase option on the leased asset. But at the end of the lease the lessee may continue the lease at a nominal rental or arrange, as agent for the lessor, for the equipment to be sold or scrapped.

The price at which the asset can be disposed of at the end of the lease might be determined by:

- a. the amount which lessee will have to pay to lessor in order to achieve full pay-out by the former (might be a purely nominal amount);
- b. any requirements of the tax laws relative to the granting of depreciation allowances and/or tax credits.<sup>39</sup>

Notwithstanding the above possibility to acquire title to the leased equipment after the end of a lease, finance lease is still regarded as “*means of financing the use of an asset without acquiring ownership*.”<sup>40</sup>

Operating lease contracts are also covered by SSAP 21. An operating lease contract is defined as “*any lease contract that is not a finance lease contract*.”<sup>41</sup> In operating lease the lessee does not have a purchase option on the leased asset. Often such type of lease arrangement in combination of maintenance services and fleet management is called contract hire.

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<sup>38</sup> *Id.* Para 15.

<sup>39</sup> Derek R. Soper, Robert M. Munro with Ewen Cameron, *The Leasing Handbook*, (London: McGraw-Hill Book Company Europe, 1993), p. 44.

<sup>40</sup> Leaseurope and Arthur Andersen, *Leasing in Europe*, (London: McGraw-Hill Book Company, 1992), p. 57.

<sup>41</sup> *Id.* p.56.

With regard to perfection of interest in the leased asset, the UK legislation does not treat leasing as security interest and does not require perfection.

### **1.5. Lease concept in the legal system of the United States**

The major source of law which gives us understanding of lease relationships with all its elements and distinctions is the Uniform Commercial Code (UCC), a comprehensive code addressing most aspects of commercial law. Mostly we are interested in Art. 2A of the UCC regulating true leases. Analysis of this article of the UCC has given me an impression that it only regulates mandatory norms and provides for adequate means of enforcing the rights and obligations of the parties; regulation of the rest issues in leasing, just like in the UK, is given to the parties.

As suggested by the author of ‘Secured Transactions Under the Uniform Commercial Code and International Commerce’, Louis F. Del Duca, regulation of security agreements, leases and conditional sales contracts by the US legal system appears to be quite complex due to its focusing on functioning and rejecting of formalism as a factor in characterizing transactions as security agreements, leases or conditional sales contracts. For example, the law defines conditional sales contracts as security agreements whereas the conditional buyer is the owner of the goods and the conditional seller has a security interest or charge on those goods.<sup>42</sup> In view of this circumstance, leasing might be often re-characterized in secured financing device. This fact underlines that the secured financing law of this jurisdiction takes into consideration not the form in which the parties convert the transaction, but the initial intention of the parties and a number of other attributes which are not indicated in any law but rather created by the

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<sup>42</sup> Louis F. Del Duca, *Secured Transactions Under the Uniform Commercial Code and International Commerce*, (Cincinnati, Ohio: Anderson Pub. Co., 2002), p. 229.

courts' practice. Additionally, the authors of Commercial Transactions Under the Uniform Commercial Law and other Laws suggest that as an extra factor to distinguish true lease from a security interest disguised as a lease (conditional sale) is the asset has to be returned with the value equal to the one before the asset has been leased.<sup>43</sup> The law, UCC Art. 2A-103(1)(j), in its turn only stipulates that true lease, which does not constitute a secured transaction, is regulated by Art.2A (on leasing) and a security interest disguised as a lease is to be governed by the Art. 9 (on secured transactions). According to Art. 9 the lessor will be required to file a financing statement or take other action to perfect his security interest in the goods against third parties. There is no such requirement with respect to true lease under UCC Art. 2A. In case of a security interest disguised as a lease, the remedies available to the lessor upon the lessee's default are expressly stated in part.5 of Art.9; with respect to leases under Art.2A there is no clear answer.<sup>44</sup>

The fundamental element in true lease is that ownership never passes to the other party, since it has neither the obligation nor the option to purchase the object of the agreement, but is required to return it at the end of the lease period. In contrast, when lease is intended as a security these possibilities are not excluded: "*... but a sale, including a sale on approval or a sale on return, or retention, or creation of a security interest is not a lease ...*".<sup>45</sup>

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<sup>43</sup> Donald B. King, Calvin A. Kuenzel, Bradford Stone, Commercial Transactions Under the Uniform Commercial Law and other Laws (New York: Mathew Bender, 1997), §21.02 Leases.

<sup>44</sup> Official Comment on Art.2A-101 of UCC.

<sup>45</sup> UCC Art.2A-103(1)(j).

The Article 2A mentions the “*option to purchase the property, which in itself does not make the lease one intended as security.*”<sup>46</sup> Although the fundamental element of true lease is that ownership never passes to the other party, since it has neither the obligation nor the option to purchase the object of the agreement, the mere presence of the option to buy does not exclude true lease.

Just as the inclusion of a purchase option in a lease does not, of itself, imply a secured installment sale, the exclusion of one does not automatically imply a true lease. Thus, in case the lessee has no option to purchase at all, it does not necessary mean, that this interest cannot be a security interest.

As has been mentioned, there has been a significant impact of courts in appliance of the functional test and establishing attributes that are typical of a true lease. One of such cases was *Benton v. Commissioner of Internal Revenue*<sup>47</sup> whereas the parties in 1945 entered into a lease of motor vehicleless and related equipment for the period of ten months, during which the lessee agreed too pay to the lessor USD 5,000 per month. At the end of the lease term, the lessee had the option to purchase the leased assets for a sum of USDD 10,000. The lessee claimed lease rental payments as tax-deductible businesss expense. However, the Internal Revenue Commissioner determined that the lease rental payment by the lessee to the lessor constituted capitall investment and was not deductible as rent. The Tax Court held that the lease rental payments by the lessee to the lessor weree towards acquisition of equity in the "leased" property, and hence, not deductible as rental expense. The Court of Appeals in its turn held that the nature of the contract should be considered from the parties' intention's point of view at the time of conclusion of the contract and not at the time of exercising of the purchase option.

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<sup>46</sup> *Id.*

The Court concluded that the monthly lease rentals and the purchase option price, at the time when the lease agreement was signed, was not an unreasonably low. Thus, the Court held that the conduct of the parties was consistent as a lease, and the lease rental payments did not constitute a capital investment.

Thus, the US courts practice has created a list of criteria attributed to a true lease:

- lessor is in the business of financing leases;
- goods are acquired solely in connection with the lease;
- lessor does not select, manufacture or supply the leased goods which are to be acquired or selected from a third party;
- lessee bears risk of loss;
- lease contains a 'hell or high water' clause – *“the clause virtually cuts off all defenses of the lessee to payment, once the lessee initially accepts the asset. The lessee must continue paying even if the lessor fails to provide essential performance. – the draconian nature of leasing contracts and Art.2A,”*<sup>48</sup>
- lease contains a non-cancellation, accelerated payment and late payment clauses;
- lessee pays all taxes;
- lessee procures and maintains insurance;
- lessee maintains the leased asset;
- lessee pays all licensing and registration fees;
- lease contains default provisions;
- lessee has to return goods at the end of the lease term;
- title remains with lessor;
- markings on the leased goods stating that equipment is the property of lessor;

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<sup>47</sup> Benton v. Commissioner of Internal Revenue, 1977 F.2d 745 (US Court of Appeals Fifth Circuit).



- lessee is prohibited from assigning the lease, subleasing the equipment, pledging or otherwise disposing of the lease or the leased property or is entitled to do some of these upon a prior consent of lessor;
- lessee has to keep equipment free and clear of all levies, liens, encumbrances.<sup>49</sup>

As can be seen from the above consideration of leasing by the UK and the US jurisdictions and methods applied to distinguish whether transactions create security interest or not are different and treatment of similar transactions (like conditional sales) also differs.

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<sup>48</sup> Charles A.Heckman, Unconscionability and Personal Property Leasing Law in Connecticut, Quinnipiac Law Review, 1998 p.206.

<sup>49</sup> E.Carolyn Hochstadter Dicker, John P. Campo, FF&E and the true lease question: Art.2A and accompanying amendments to UCC section 1-102 (37), American Bankruptcy Law Review, winter 1999.

## **Chapter 2. Comparative analysis of aircraft lease contracts governed by legal systems of the United Kingdom and the United States**

This part of my research paper contains a short summary of requirements to be fulfilled by the potential parties to start negotiating the provision of the contract and the detailed comparative analysis of the draft aircraft lease contracts between one of the leading Kazakhstani airlines and Western aircraft lease companies. The contracts are governed by the UK and US laws correspondingly (hereinafter referred to as UK and US contracts). The aim of this chapter is not only to distinguish differences between the UK and US aircraft lease contracts, but also to determine the main issues which necessary to cover at drafting aircraft lease contract and which in their turn make such type of contracts special and distinguishable.

### **2.1. Drafting a contract**

Like in every complex finance arrangements, and lease arrangements are within this category, one may define three major stages:

1. Preparation and justification of an arrangement;
2. Legalization;
3. Execution.

Lease arrangement begins from receiving by lessor a request from a prospective lessee to obtain an asset and lease it him.

As a rule, there is no a strict requirement to a request form, but nonetheless it has to contain such elements as specification of a lease object, its technical and economical characteristics, place of incorporation or seat of potential supplier, if any, etc.

Along with the request or shortly after its acceptance for consideration by lessor, a potential lessee provides all the documents which lessor might require, such as:

1. Certified copies of Charter and Act of incorporation, balance sheet for the previous financial year with the conclusion of an auditing inspection;
2. Economic justification and analysis of the efficacy of the arrangement (business plan);
3. Any guarantee to execute the potential contract (also includes a bank statement).

If required, lessor may request additional information.

After all the documents have been received by lessor, he starts to check them as well as to expertize lease project, its initial costs, duration of a lease contract, possible schemes of payments, their frequency, residual value, etc.

The main task of a lessor is to estimate abilities of lessee to pay rent, as well as market demand for a requested type of lease object in order to evaluate possibilities of its further re-lease or selling. Difficulties of correct estimation of paying capacity of lessee might arise from unstable financial situation in the state, necessity of estimation of not only the current but also future financial capacity of lessee, as the contract is deemed to be concluded for a certain number of years.

In case of international (cross-border) lease, the following problems might arise:

- currency rate fluctuations;
- customs regime of lessee;
- absence of agreement between states on elimination of double taxation;

- protection of ownership rights to foreign capital.

Additionally, well-qualified lawyers analyze the jurisdiction of the prospective lessee and give recommendations to the lessor in terms of reliability, protection of rights, etc. and on the basis of the obtained knowledge draft a contract.

The specificities of the common law legal family require drafting a very detailed lease contract *“concerned with the protection of the lessee whereas the terms expressed in the leasing agreement, being generally drafted by the lessor, are intended to govern the relationship between lessor and lessee in such a way as to protect the lessor’s right of ownership of the leased assets and to ensure that the lessor receives the rentals and is protected should the lessee default in carrying out the obligations under the leasing agreement.”*<sup>50</sup>

As was underlined by Jeremy Edwards, head of the Norton Rose Aviation Group, in his article ‘Key Factors When Negotiating Operating Leases’ *“the ‘three Rs’ - rent, reserves and redelivery condition – represent the real cost in any operating lease and will be the most important commercial considerations for any lessee.”*<sup>51</sup> He suggests that a lawyer at negotiating contractual provisions of operating lease has to make sure that the three ‘Rs’ are discussed with (and understood by) the technical representatives of the lessee *“to ensure that no hidden costs arise during the lease term.”*<sup>52</sup>

## **2.2. Specialties of aircraft lease contracts governed by the laws of the United Kingdom and the United States**

<sup>50</sup> Derek R. Soper, Robert M. Munro with Ewen Cameron, *The Leasing Handbook*, (London: McGraw-Hill Book Company Europe, 1993), p. 250.

<sup>51</sup> Jeremy Edwards, *Key Factors When Negotiating Operating Leases* (visited March 10, 2008) <<http://www.internationallawoffice.com/Newsletters/detail.aspx?g=4c57813f-7601-4916-a05f-07035be34e82>>.

<sup>52</sup> *Id.*

### 2.2.1. Cross-border operating leasing

Both the UK and US aircraft lease contracts regulate cross-border lease arrangements via sub-lessor located in the offshore country, in Aruba.

Both contracts stipulate that the Aircraft Lease Company (owner) leases aircraft to a so-called AVV (intermediate lessor) under the head lease who in its turn leases the aircraft back to the owner under the interim lease who then subleases it to the Kazakhstani airline (lessee).

*“The Aruba Exempt Company (AVV) is a new concept, introduced by Aruba in 1988. The purpose of the introduction of the AVV has been to increase the possibilities of the offshore companies in Aruba. The AVV is not intended for residents of Aruba. The most important feature of the AVV is its complete exemption from all taxes.”*<sup>53</sup>

Such scheme provides for exemption from taxes of the owner/lessor and creates a condition to register title to aircraft in the offshore territory.

### 2.2.2. Title

Every lease agreement contains a provision that title will always remain with the lessor. In addition, the US contract specifies that *“lessor and lessee intend this lease to be a ‘true lease.’*”<sup>54</sup>

At the same time, the main difference that has to be pointed out here is that the US contract provides for the opportunity to purchase the leased aircraft by the lessee: *“at*

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<sup>53</sup> Investment and Offshore (visited March 11, 2008) <[http://www.visitaruba.com/business/Invest\\_Offshore/avv.html](http://www.visitaruba.com/business/Invest_Offshore/avv.html)>.

<sup>54</sup> Aircraft Lease Agreement (US contract) Art.14.1.

*any time during the lease term, lessee may advise lessor that lessee is interested in purchasing the aircraft. If lessor is interested in selling the aircraft and lessee and lessor agree upon a price and other terms and conditions which are acceptable to lessor, lessor will sell the aircraft to lessee.”*<sup>55</sup>

The UK contract does not provide for a purchase possibility.

The above differences may be explained by the legal requirements of the both countries which have been discussed earlier.

### **2.2.3. Registration**

Despite of the fact that most of the jurisdictions treat aircraft as chattels (not like Kazakhstan<sup>56</sup>, Japan, Peru, etc.), and in view of a great importance of this type of vessel for a state and national defense, most of them require registration of title to the aircraft. Registration formalities provide for the possibility “*to capture aircraft for the state (and thereby to confer jurisdiction)*.”<sup>57</sup> An interesting fact is that a significant proportion of aircraft fleet around the world is registered under “*flags of convenience*”<sup>58</sup> in such jurisdictions as Aruba, Liberia, Panama, Cyprus, etc.

The Chicago Convention of 1944 on International Civil Aviation contains basic rules for international civil air transport, constitutes the ICAO and also regulates issues of the nationality of aircraft: “*aircraft have the nationality of the State in which they are*

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<sup>55</sup> *Id.* Art. 1.10.

<sup>56</sup> According to point 2 of Art. 117 of the Civil Code of the Republic of Kazakhstan of 27 December, 1994 aircraft are treated as immovable property (*Гражданский кодекс РК от 27 декабря 1994 г., п.2 ст. 117: «К недвижимым вещам приравниваются также подлежащие государственной регистрации воздушные ... суда ...»*).

<sup>57</sup> Philip R. Wood, *Comparative Law of Security and Guarantees*, (London: Sweet & Maxwell, 1995), p. 203.

<sup>58</sup> *Id.* p. 200.

registered”<sup>59</sup>; “an aircraft cannot be validly registered in more than one state”<sup>60</sup>; the contracting states have to supply to the ICAO information concerning registration and ownership of any aircraft registered in that state<sup>61</sup>, etc.

The US contract stipulates that the country of aircraft registration is Aruba (“*except that, in its sole discretion, lessor may agree at any time during the lease term to registration of the aircraft in the Republic of Kazakhstan*”<sup>62</sup>).

The UK contract also states that the “*state of registration shall mean Aruba.*”<sup>63</sup>

“*There are various reasons to register an aircraft in Aruba, such as legal, financing advantages and/ or VAT / import duties advantages for the investor/lessor in the residing country.*”<sup>64</sup>

“*Also, it’s important for the aircraft owner to register their aircraft where the laws and regulations protect ownership interests. If a worldwide leasing company wants to lease an airplane to a country with no experience, they come to Aruba ... in search of securing their assets overseas.*”<sup>65</sup>

Another important reason for the airline to obtain international aircraft registration is to get international acknowledgement meaning that the aircraft meet international

<sup>59</sup> Chicago Convention on International Civil Aviation Art. 17 (1944).

<sup>60</sup> *Id.* Art. 18.

<sup>61</sup> *Id.* Art. 21.

<sup>62</sup> Aircraft Lease Agreement (US contract) Art. 1.9.

<sup>63</sup> Aircraft Operating Lease Agreement (UK contract) Art. 1.

<sup>64</sup> Tax & Legal Services – Aviation Group (visited March 12, 2008) <<http://www.pwc.com/extweb/service.nsf/docid/197A4C810E253508852571E2006BD3E8>>.

<sup>65</sup> W. Stephen Dennis, Business in Perspective. The Aircraft Registry Group, Aviation & Business Journal, April 2004.

standards of safety. Registration of aircraft requires compliance with one of the three primary aircraft regulatory:

- USA, FAA FARs;
- EU, Joint Aviation Authority, JARs; or
- the British Civil Aviation Authority

Aruba, being an overseas territory and country of the European Union, follows the Joint Aviation Authority standards and its civil aviation regulations are based on the JARs with applicability of the U.S. FAA's regulations and conforms to the ICAO.<sup>66</sup>

In view of the above mentioned and due to the fact that Kazakhstan has not adopted safety and maintenance standards of the European Union, "foreign" registration of aircraft is also beneficial to its national carriers as it allows them to operate flights to the European Union by virtue of acceptance of international obligations imposed.

Under the covenants section, the US contract states that "*no authorization, approval or registration with, or the giving of notice to any U.S. Government Entity is required for the valid authorization, execution, delivery and performance by lessor of this lease*"<sup>67</sup>

due to the fact the lessor has chosen another country to perform registration and other formalities. Given the fact that jurisdictions of the third states are involved in the lease transaction (Aruba and Kazakhstan) international lessor has to protect its interests and

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<sup>66</sup> *Id.*

<sup>67</sup> Aircraft Lease Agreement (US contract) Art. 21.1.2.



ownership to aircraft in those states according to their national procedures by imposing filing and registration obligations on the lessee.<sup>68</sup>

The UK contract with regard to registration/filing/perfection requirements stipulates that *“it is not necessary or advisable under the laws of ... the state of registration [Aruba] and the state of incorporation [Kazakhstan] in order to ensure the validity, effectiveness and enforceability of this agreement ... or to establish, perfect or protect the property rights of lessor ... to be filed, registered or recorded ... and under all such laws the property rights of lessor ... have been fully established, perfected and protected, and under the laws of the ... state of registration the property rights of lessor ... .”*<sup>69</sup>

The method of protection of the lessor’s interests in aircraft in Kazakhstan consist of registration of the aircraft lease contracts in the Civil Aviation Committee of Kazakhstan and issue an official statement for the lessors that the Committee acknowledges:

- the registration of the aircraft in Aruba, including the ownership rights of lessor in the aircraft and lessor’s lease rights;
- that the registration of the aircraft in Aruba does not violate legislation in the Republic of Kazakhstan;
- that it has received a copy of the lease and no further filings or registrations are necessary in the Republic of Kazakhstan in order to evidence and perfect the ownership and lessor rights in the aircraft;

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<sup>68</sup> *Id.* Art. 14.4.

- consent to the export of the aircraft immediately on the termination of the lease term or at lessor's written request.

Peculiarity of the UK contract is that as a third party to the lease arrangement it includes bank – provider of finance for the acquisition of the aircraft by lessor and in whose favour or for whose benefit security over the aircraft is granted by lessor by way of loan or by way of non-recourse sale of lease receivables.<sup>70</sup> Under such scheme a bank provides a loan to a (head) lessor to enable him to obtain ownership to an aircraft who then on terms of operating lease assigns it to the airline via an interim lessor in Aruba (demise chartered<sup>71</sup>) with whom the (head) lessor/owner concludes a head lease agreement. The interim lessor assigns the benefit of sub-lease to the (head) lessor/owner, by way of security for his contractual obligations that he has towards the (head) lessor. *“The loan to the [(head) lessor/owner] is secured by a mortgage on the vessel, an assignment to the lender of the [agreement between head lessor and demise chartered], plus insurances, requisition compensation and a further assignment of the operating [sub-lease].”*<sup>72</sup>

Mortgage and security assignment mentioned in the above cited provision of the UK contract are referred to any obligation, assignment or pledge (aircraft) by the lessor in favor of the bank which were created with regard to the loan provided by the bank and not related to rights and obligations of the lessor and lessee under the lease contract. Such arrangement constitutes leveraged operating lease. The registration of aircraft

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<sup>69</sup> Aircraft Operating Lease Agreement (UK contract) Art. 13.4 (e).

<sup>70</sup> *Id.* Art. 1.1.

<sup>71</sup> Philip R. Wood, *Comparative Law of Security and Guarantees*, (London: Sweet & Maxwell, 1995), p. 201.

<sup>72</sup> *Id.* p. 201.

mortgage may be either in the title register of the aircraft (i.e. in Aruba) or in a special mortgage register for aircraft.

The US contract does not state that it has a similar leveraged lease arrangement, but does not exclude the possibility of appearing a lessor's lender in which case rights of the lessee to quiet, peaceful use and enjoyment of the aircraft will be protected by the quiet enjoyment letter issued by the lessor's lender to the lessee.

To give public notice of ownership the both contracts require the lessee to affix identification plates to the airframe (aircraft without engines) and engines containing the legend on the owner of the aircraft and its address and manufacturer's serial number;<sup>73</sup> additionally the UK contract stipulates that the plates shall contain notice that the "*lessor is subject to a first priority mortgage in favor of [bank].*"<sup>74</sup> This is an extra measure to protect the bank's interests in the mortgaged aircraft.

#### **2.2.4. The lessor's agreement to hire**

A standard statement that the lessor agrees to hire the leased assets to the lessee for a particular period of time upon the terms and conditions of the leasing agreement.

#### **2.2.5. The lessee's covenants**

In the US contract the lessee covenants to lessor that will comply with certain obligations during the lease term, i.e.:

- to make payments as stipulated by the lease contract;

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<sup>73</sup> Aircraft Lease Agreement (US contract) Art. 15 and Aircraft Operating Lease Agreement (UK contract) Art. 4.3.

<sup>74</sup> Aircraft Operating Lease Agreement (UK contract) Art. 4.3.

- neither lessee nor its properties or assets will be entitled to sovereign immunity under any laws of the Republic of Kazakhstan or any other jurisdiction affecting lessee and will continue to be subject to private commercial law and suit;
- prompt information by lessee about any suit or arbitration which might adversely affect lessee's financial condition;
- restriction on relinquishment of possession of aircraft without prior consent of lessor;
- no security interest created by lessee on or with respect to the aircraft;

The UK contract is much more detailed in terms of lessee's covenants and includes such requirements as:

- to continue to operate the same business;
- inform the lessor on the occurrence of any event of default, loss, theft, damage or destruction of aircraft;
- keep accurate, complete and current records of all flights made by the aircraft;
- To bear the cost of all taxes, expenses and outgoings relating to the leased assets, their operational use and their acquisition whether attributable to the lessor or to the lessee.

#### **2.2.6. Lessor's covenants**

Art.21.3 of the US contract states that *“so long as no event of default has occurred and is continuing hereunder, lessor covenants that none of owner, intermediate lessor, lessor nor any person lawfully claiming through any of them will interfere with lessee's quiet, peaceful use and enjoyment of the aircraft.”*

Even though the UK contract does not clearly state lessor's covenants, it nonetheless warrants that *“lessor undertakes that, provided lessee shall pay the rent ... and shall perform and comply with all of the other terms and conditions of this agreement, lessor will not interfere with the peaceful and quiet use and enjoyment of the aircraft by lessee provided that the exercise by lessor of its rights hereunder or in connection with this agreement will not constitute such an interference.”*<sup>75</sup>

### 2.2.7. Operating lease is a ‘net lease’

‘Net lease’ means that the lessee agrees to pay all expenses which are associated with ownership, such as repairs, insurance and taxes. When these three main costs are passed on the lessee, the arrangement is also called “triple net lease”. *“Because these costs are variable and almost never decrease, a net lease favors the lessor.”*<sup>76</sup>

Art. 5.11.1-2 of Aircraft Operating Lease Agreement (UK contract) state that *“this lease is a net lease and lessee’s obligation to pay fixed rent and make other payments in accordance with this lease will be absolute and unconditional under any and all circumstances of other events.”*<sup>77</sup>

The US contract contains similar provision: *“this lease is a net lease and lessee’s obligation to pay fixed rent and make other payments in accordance with this lease will be absolute and unconditional under any and all circumstances and regardless of other events.”*<sup>78</sup>

<sup>75</sup> Aircraft Operating Lease Agreement (UK contract) Art. 3.1.

<sup>76</sup> Nolo’s official web-site (visited March 15, 2008) < <http://www.nolo.com/definition.cfm/Term/33AC295C-C425-4D48-BEA04E9FDF69A28E/alpha/N/>>.

<sup>77</sup> Aircraft Operating Lease Agreement (UK contract) Art. 5.11.1-2.

<sup>78</sup> Aircraft Lease Agreement (US contract) Art. 5.11.

### 2.2.8. The lessor's right to terminate the lease

The only conditions allowing the lessor to terminate, repossess, and recover damages are the event of default in payment or breach of the terms of the lease or insolvency of the lessee.

In this part the US contract also refers to the Cape Town Convention<sup>79</sup> Remedies, *“if the Cape Town Convention has been or is ratified or made applicable in Aruba or the Republic of Kazakhstan”*.<sup>80</sup> Such remedies include steps required to deregister the aircraft, export the aircraft from the state of registration and, if applicable, discharge the international interest in respect of the aircraft, this lease and the other operative documents from the international registry of the Cape Town Convention.

### 2.2.9. Exclusion clause

Liability of lessor is excluded for a late delivery or non-delivery of the aircraft to the lessee. Such occurrences are attributed to force majeure events by the UK contract, specifying the reasons causing late or non-delivery of the aircraft: *“... whether or not such cause is beyond the control of lessor and whether or not occasioned by lessor's fault or negligence.”*<sup>81</sup> In such case the lessee only has a right to terminate the contract.

The US contract states that the lessor *“will not be liable for any loss or expense, or any loss of profit arising from any delay or failure in delivery to lessee unless such delay or failure arises as a direct consequence of the willful misconduct of owner [lessor] ... ,*

<sup>79</sup> "Cape Town Convention" means both the 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 which were adopted on November 16, 2001 at a diplomatic conference held in Cape Town, South Africa.

<sup>80</sup> Aircraft Lease Agreement (US contract) Art.26.5.

<sup>81</sup> Aircraft Operating Lease Agreement (UK contract) Art.1.1.

*and in no even lessor will be liable for any delay or failure which is caused by any breach or delay on the part of prior lessee.”*<sup>82</sup>

As we can see, according to the UK contract lessor does not bear any liability for the specified breach even if it was caused by lessor’s fault or negligence.

Historically, under the UK law lessor was entitled to exclude its liability in even a wider scope of situations including technical characteristics and damages to the aircraft leased. *“A considerable amount of legislation has restricted the ability of a lessor to exclude terms that would otherwise be implied in the agreement.”*<sup>83</sup> For example, the Unfair Contract Terms Act 1977 states the following:

- a. “The exclusion of the implied terms as to title, quiet possession and freedom from encumbrances is void as against a party to a contract who deals as consumer and is valid only against others if the exclusion satisfies the requirement of reasonableness.*
- b. Against parties who deal as consumer a term purporting to exclude any of the implied terms as to description of the leased assets, merchantable quality and fitness for purpose is void. Where the lessee does not deal as consumer, these implied terms may be validly excluded only if the exempting term satisfies the test of reasonableness, although liability for death and personal injury may in no circumstance be excluded.”*<sup>84</sup>

### **2.2.10. Indemnities**

There are two main issues in which the lessee shall indemnify the lessor:

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<sup>82</sup> Aircraft Lease Agreement (US contract) Art.3.4.

<sup>83</sup> Derek R. Soper, Robert M. Munro with Ewen Cameron, *The Leasing Handbook*, (London: McGraw-Hill Book Company Europe, 1993), p. 202.

<sup>84</sup> Unfair Contract Terms Act Section 2(1) (1977).

- an operational indemnity (against any and all claims, suits, judgments, costs, expenses, penalties, fines, etc.);
- a tax indemnity (against all taxes, fees, levies, imposts, duties, charges, deductions or withholdings of any nature).

Additionally, the US contract provides for exceptions to indemnity to a number of the listed taxes. It also provides for currency indemnity, meaning that in case of any claims *“in a currency other than Dollars ... lessee will ... fully indemnify lessor against the amount of the shortfall”*<sup>85</sup> due to difference in rate of exchange.

### 2.2.11. Insurance

Lessee is required to take out insurance in respect of the aircraft to avoid confusion between insurance policies of the lease contract and insurance generally offered to the lessee on commercial terms. Therefore, Jeremy Edwards, the specialist in the UK law, in his article *Key Factors When Negotiating Operating Leases* suggests that it is extremely important for a lessee

*“to carve out from the insurance obligations an acknowledgement from the lessor that the lessee intends to effect insurance policies which incorporate the airline finance/lease contract endorsement AVN67B”*<sup>86</sup> *into such insurance and that, to the*

<sup>85</sup> Aircraft Lease Agreement (US contract) Art. 5.12.

<sup>86</sup> The Airline Finance/Lease Contract Endorsement, Aviation Insurance clause issued by Aviation Insurance Clauses Group, a “stand-alone” endorsement that lists clearly the “Contract Parties” and the “Contracts”, and overrides any conflicting provisions in the underlying insurance policy, at least as regards the express provisions of the endorsement. Thus financiers do not need to review the underlying policy (Lmbc Aviation Technical Committee, Comments on the Explanatory Notes on AVN67C & AVN99, prepared by Freshfields Bruckhaus Deringer as Counsel to AWG (visited March 5, 2008) < [avindirect.com/wordings/LMBC-AVN67C-Comments-9-November-07.pdf](http://avindirect.com/wordings/LMBC-AVN67C-Comments-9-November-07.pdf) >).



*extent any provisions of AVN67B conflict, or are inconsistent with, the requirements of the operating lease, the conflicting or inconsistent provisions of AVN67B prevail.”*<sup>87</sup>

We can find the reference to the above-mentioned in the UK contract: *“In the event insurances ... is placed directly in the London insurance market, in the event of any conflict or inconsistency between this Article ... and the provisions of insurance clause AVN67B ... , the relevant provisions of AVN67B shall be acceptable to lessor for so long as, in the international insurance markets, insurance Clause AVN67B represents, at the relevant time, best aviation insurance industry practice.”*<sup>88</sup>

The US contract also refers to different aviation insurance clauses, such as LSW555.C<sup>89</sup> and AVN48C<sup>90</sup> (Art.18 of the US Aircraft Lease Agreement).

### **2.2.12. Subleasing**

It is important for the lessee to be able to sublease the aircraft to get an extra income in case of his inability to operate the aircraft. In most cases such provision benefits to both the lessor and lessee.<sup>91</sup> A lessee should ensure that its request to sublease cannot be ‘unreasonably withheld, delayed or conditioned.’

Thus, the US contract stipulates the following: *“no sublease without lessor consent. Lessee will not sublease or part with possession of the aircraft (except for maintenance and repair) at any time without the prior written consent of lessor (not to be*

<sup>87</sup> Jeremy Edwards, Key Feactors When Negotiating Operating Leases (visited March 4, 2008) <<http://www.internationallawoffice.com/Newsletters/detail.aspx?g=4c57813f-7601-4916-a05f-07035be34e82>>.

<sup>88</sup> Aircraft Operating Lease Agreement (U contract) Art. 11.2.

<sup>89</sup> Hull war risks.

<sup>90</sup> The exclusion clause, excludes all cover for the hostile use of weapons of mass destruction.

<sup>91</sup> Jeremy Edwards, Key Feactors When Negotiating Operating Leases (visited March 4, 2008) <<http://www.internationallawoffice.com/Newsletters/detail.aspx?g=4c57813f-7601-4916-a05f-07035be34e82>>.

*unreasonably withheld or delayed) and in accordance with such requirements as may from time to time be agreed in writing between lessor and lessee. No subleasing of an engine will be permitted.”<sup>92</sup> “Any approved sublease will be assigned to lessor as security. Lessee will deliver the original counterpart of the sublease to lessor and make any filings necessary to protect lessor's security interest.”<sup>93</sup>*

The UK contract says that “*lessee shall not sublet or otherwise part with possession of the aircraft or any part thereof unless previously approved by lessor in writing.*”<sup>94</sup>

Both contracts permit the lessee to enter into wet-lease agreements “*provided that lessee retains full operational and maintenance control of the aircraft.*”<sup>95</sup>

According to the US contract, wet-lease “*will not be considered a sublease of the aircraft and will be permitted without lessor's consent.*”<sup>96</sup> From the wording of the UK contract we may extract the identical meaning.

### **2.2.13. Engine pooling**

Since engines are extremely valuable parts of the aircraft, the lessor is interested in retaining title to the engines and that possession is not given to any third parties unless those arrangements have been approved by the lessor. Thus, both contracts forbid entering of lessee into interchange or pooling agreements in respect of an engine or part without the prior written consent of lessor. The consent usually requires conclusion of a separate agreement with engine manufacturers which in its turn will enable the lessee to

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<sup>92</sup> Aircraft Lease Agreement (US contract) Art. 11.1.

<sup>93</sup> *Id.* Art. 11.4.

<sup>94</sup> Aircraft Operating Lease Agreement (UK contract) Art. 12.1.

<sup>95</sup> *Id.* Art. 12.1.

<sup>96</sup> Aircraft Lease Agreement (US contract) Art. 11.5.

enter engine pooling agreements with other airlines having special agreements with the same manufacturer and provide spare engines to them. With this regards both contracts stipulate that if an engine is removed for repairs or provided to another airline, “*title to such engine will at all times remain vested in the lesser/owner*”<sup>97</sup> and the lessee has to make sure that the identification plates are not removed from the detached engine.

#### 2.2.14. Assignment/Transfers by lessor

The UK contract provides for the possibility of the lessor freely assign and alien its rights and interests upon written notice to lessee and upon prior written consent of lessee; “*such consent not to be unreasonably withheld or delayed.*”<sup>98</sup>

Contrary, the US contract provides for the possibility of lessor to “sell, assign or transfer its rights, interest and obligations as lessor hereunder or with respect to the aircraft to a third party”<sup>99</sup> “at any time and without lessee's consent.”<sup>100</sup>

With this regard the US contract only requires lessee’s cooperation, i.e. “*on request by lessor, new owner ... , lessee will execute ... documents ... to confirm lessee’s obligations under this lease and obtain lessee's acknowledgment that lessor is not in breach of the lease ...*”<sup>101</sup>

Additionally, the US contract says about Advance Consent under Cape Town Convention according to which lessee has to consent in advance “*to the transfer of the associated rights and related international interest in respect of any assignment by*

<sup>97</sup> *Id.* Art. 12.6.

<sup>98</sup> Aircraft Operating Lease Agreement (UK contract) Art. 12.2.

<sup>99</sup> Aircraft Lease Agreement (US contract) Art. 25.3.

<sup>100</sup> *Id.* Art. 25.3

<sup>101</sup> *Id.* Art. 25.5.

*lessor ... . For the avoidance of doubt, no additional consent by lessee will be required in connection with any such assignment of associated rights and the related international interests pursuant to the Cape Town Convention.”<sup>102</sup>*

### **2.2.15. Rental payments**

With regard to payments, the US contract distinguishes such kinds of rental payments as fixed rent, variable rent and additional rent.

Fixed rent is amount of money that lessee will pay lessor monthly in advance as rent for the aircraft (Art.5.3.1 of the US contract).

Variable rent is amount of money that lessee will pay to lessor based on lessee's use of the aircraft during the lease term, in the form of airframe portion of variable rent, engine performance restoration portion of variable rent, landing gear portion of variable rent, etc. The amount of each form of variable rent is based on such time frames as calendar month, engine flight hour and engine cycle (Art.13 of the US contract).

Additional rent for excess cycles is amount of money that lessee will pay to lessor if airframe or any engine operated more cycles than the maximum number of cycles (Art.1.8 of the US contract).

The UK contract also says about these definitions calling them rent, variable rent and supplemental rent.

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<sup>102</sup> *Id.* Art. 25.6.

### 2.2.16. Financial protections of a lessor

Financial protection might be in form of security deposit, advance rental payments and maintenance reserves which protect lessor in case of failure of lessee to perform its contractual obligations.

With regards to security deposit the US contract stipulates that *“if no event of default has occurred in the first three years of the lease term, lessor will refund the security deposit to lessee within five days after the expiration of the third lease term year, and the security deposit will be reduced to a certain amount of money.”*<sup>103</sup>

The UK contract additionally says about ‘commitment fee’ which is amount of money to be *“utilized for the payment of the first rent in respect of each aircraft.”*<sup>104</sup>

### 2.2.17. Previous operator's liens/encumbrances

This provision is especially important when the lease object is a used aircraft, to obtain protection from the previous operator’s interests in aircraft.

The UK contract stipulates: *“the aircraft will be delivered free of liens encumbrances and charges of Eurocontrol or other security interests other than security interests created by lessor which do not affect lessees right of quiet enjoyment.”*<sup>105</sup>

The US contract in its turn says about lessor’s lien which means *“any security interest created by lessor, intermediate lessor or owner [might be different from lessor].”*<sup>106</sup>

Moreover, the lessor’s liens are attributed to the category of permitted liens, which also

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<sup>103</sup> *Id.* Art. 5.1.2.

<sup>104</sup> Aircraft Operating Lease Agreement (UK contract) Art. 1.1.

<sup>105</sup> *Id.* Art. 3.1.

include “security interests arising in the ordinary course of lessee’s business for taxes either not yet assessed or, if assessed, not yet due or being contested in good faith ... ; materialmen’s, mechanics’, workmen’s, repairmen’s, employees’ liens or similar security interests arising by operation of law after the delivery date in the ordinary course of lessee’s business for amounts which are either not yet due or are being contested in good faith by appropriate proceedings ... so long as such proceedings do not involve any danger of sale, forfeiture or loss of the aircraft.”<sup>107</sup> The cited article only says about liens which might be created by the lessor, intermediate lessor or owner (if different) and which will not affect quiet and peaceful possession and use of aircraft by lessee. I assume that absence of the previous operator’s liens clause in the UK contract might be explained by the fact that it is considered as an implied term which no need to regulate by the contract.

### **2.2.18. Enforcement (rights of third parties)**

Practically an operating lease contract might refer to a number of persons who are not parties to the contract, for example, a bank financing the asset, its and lessor’s agents and employees, etc. In the UK legal practice it is in the lessee’s interests to restrict a number of persons who are potentially able to enforce the contract by referring to the Contracts (Right of Third Parties) Act 1999.

*“The Act reforms the rule of “privity of contract” under which a person can only enforce a contract if he is a party to it. The rule means that, even if a contract is made with the purpose of conferring a benefit on someone who is not a party to it, that person (a “third party”) has no right to sue for breach of contract. The Act sets out the*

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<sup>106</sup> Aircraft Lease Agreement (US contract) Art. 2.1.

<sup>107</sup> *Id.* Art. 2.1.

*circumstances in which a third party is to have a right to enforce a term of the contract (section 1), the situations in which such a term may be varied or rescinded (section 2) and the defenses available to the promissory when the third party seeks to enforce the term (section 3). It makes it clear that section 1 does not affect the promisee's rights, or any rights that the third party may have which are independent of the Act (sections 4 and 7(1)). The Act does not apply to certain contracts (whether wholly or partially) (section 6).”<sup>108</sup>*

Since the mentioned Act is purely the British product I discovered the reference to the third party rights only in the UK contract: *“Unless expressly provided to the contrary in this Agreement a person who is not a party to this Agreement has no right under the Contracts (Rights of Third Parties) Act 1999 (the “Third Parties Act”) to enforce or enjoy the benefit of any term of this Agreement... ”*<sup>109</sup>

### **2.2.19. Return of the aircraft**

The lessee is obliged to return the aircraft to the lessor at its own expense after the lessor will have the aircraft inspected.

On the basis of the given analysis I may underline that the main differences between the contracts are concentrated on the following aspects:

- inclusion of the purchase option and statement that the considered lease is a true lease in the US contract;

<sup>108</sup> Explanatory Notes to Contracts (Rights Of Third Parties) Act Chapter 31 (1999) (visited March 15, 2008) <[http://www.opsi.gov.uk/acts/acts1999/ukpga\\_19990031\\_en\\_1.htm](http://www.opsi.gov.uk/acts/acts1999/ukpga_19990031_en_1.htm)>.

<sup>109</sup> Aircraft Operating Lease Agreement (UK contract) Art. 1.3.

- in view of the complexity of lease arrangement under the UK contract compared to the one under the US contract, the latter provides for the protection of the lender's interests in the assets, and gives notice to the lessee and the third parties of priority of the lender's interests;
- requirement to obtain the lessee's consent to any lessor's assignment or transfer of rights in the UK contract;
- liability of the lessor under the US contract in case of late or non-delivery of aircraft to the lessee caused by the willful misconduct of the lessor, whereas the UK contract excludes any liability for late or non-delivery of the asset.

Summarizing the given analysis I have an opinion that in general the contractual provisions of both contracts look very much alike which might be explained by the party autonomy granted by the UK and US laws in regulation of lease arrangements. Such 'freedom' has significantly contributed to introduction of the 'model contract' containing international standards to be followed by the parties at drafting international lease contracts which nonetheless has to be adopted to mandatory requirements of national jurisdictions.



## Chapter 3. Problems of cross-border lease regulation by the legislation of the Republic of Kazakhstan

By analyzing the legislation of the Republic of Kazakhstan I will indicate the problems existing in the state, the gaps and contradictions of the national legal system which restrain development of lease market of the Republic. Further on, I will discuss risks that foreign lessors might bear and problems national lessees might experience at execution of cross-border lease contracts and enforcement of several of their contractual rights.

### 3.1. Regulation of lease arrangements by the legislation of the Republic of Kazakhstan<sup>110</sup>

1994 became a starting point for development of lease infrastructure in Kazakhstan and a number of lease companies have being founded since that time. This process was supported by the government of Kazakhstan which passed a lot of laws providing various privileges to participants of lease relations. One of such laws was the Law of the Republic of Kazakhstan No. 266 of December 1994 on Foreign Investments which provides for a significant state support, creation of favorable economic environment for development of lease on the domestic market.

Leasing is mainly regulated by Chapter 29 “Property rent” (*Имущественный найм*) of the Civil Code of December 1994 and Law of the Republic of Kazakhstan dated 5 July 2000 No. 78-II on Financial Leasing.

There are two definitions which we may find in the legislation – leasing and financial leasing. The definition to ‘*leasing*’ is given in para. 2 Chapter 29 of the Civil Code of

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<sup>110</sup> All translations of the legislative acts in this chapter are made by the author.

RK and is determined as a type of ‘property rent’ which requires participation of three parties: seller, lessor and lessee; and use the object of a lease for business purposes.

‘*Financial leasing*’ is regulated by the Law on Financial Leasing of RK and apart from the participation requirement of the three parties and use of the object for business purposes, it contains a number of other specifications and a minimal lease term of three years. The Law defines financial lease as “*a type of investment activity when lessor promises to transfer temporary possession and use of purchased object of lease agreement to lessee in return for a certain payment and on certain conditions for the term of not less than three years for business purposes.*”<sup>111</sup> Further the Law specifies the following attributes of financial lease any of which has to be present in the arrangement:

- Transfer of title of the object of lease stipulated in the lease agreement;
- Lease term exceeds 75% of economic life of the object of lease;
- Total lease payments for the entire lease period exceed 90% of the cost of the lease object.

According to Art. 3 of the Law on Financial Leasing of RK there are two forms of financial leasing: domestic and international (cross-border). In domestic lease relationships both lessor and lessee are the residents of the Republic of Kazakhstan. In

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<sup>111</sup> Закон РК «О финансовом лизинге» 5 июля 2000 №78-II, ст.3: «финансовый лизинг – вид инвестиционной деятельности, при которой лизингодатель обязуется передать приобретенный в собственность у продавца и обусловленный договором лизинга предмет лизинга лизингополучателю за определенную плату и на определенных условиях во временное владение и пользование на срок не менее трех лет для предпринимательских целей».

international leasing either lessor or lessee is non-resident of the Republic of Kazakhstan.

The Law on Financial Leasing of RK recognizes the following types of leasing:

- Sale and lease-back – when seller sells object of leasing to lessor under the condition of obtaining possession and use of it as a lessee;
- Secondary lease (a type of sale and lease-back) – when the object of leasing is leased to another lessee by the lessor/owner in case of termination or withdrawal from the original lease contract;
- Bank lease – when bank acts as a lessor;
- Full lease – when technical service of the object of leasing as well as its current maintenance is performed by lessor;
- Sub-lease (a type of full lease) – when lessee (sub-lessor) transfers to the third parties (sub-lessees) temporary possession and use of the object which has been received from lessor in accordance with lease agreement;
- Pure lease – when technical service and its current maintenance are performed by lessee.

In accordance with the definition given to financial leasing in the legislation of Kazakhstan (*supra*) lessor transfers possession and use with regard to the asset, but not

ownership which might be optional. At the same time the Tax Code of the Republic of Kazakhstan of 2001 considers financial lease as a purchase agreement (Art. 74: “*such transaction is considered as purchasing of goods by lessee. For this purpose lessee is an owner of goods and lease payments are payments for a loan provided by the lessor*”<sup>112</sup>). Such definition reminds me hire-purchase agreements rather than leasing. I believe that this inconsistency between the two laws has to be eliminated.

Despite of a wide variety of types of lease, Kazakhstani legislation primarily speaks about financial lease. Even the Civil Code of RK which provides for the possibility of obtaining object of lease without acquiring title to it defines such lease arrangement as an agreement according to which “*lessor agrees to obtain ownership to the goods specified by lessee and lease it to lessee in temporary possession and use for business purposes in exchange for rental payments.*”<sup>113</sup> Such definition – “lessor agrees to obtain ownership to the goods” – automatically cuts off opportunities of use other types of lease arrangements.

### 3.1.1. Aircraft leasing

There is no a separate law regulating aircraft financing in Kazakhstan. The Law of the Republic of Kazakhstan of 20 December 1995 No. 2697 on Use of Air Space and on Aviation of the Republic of Kazakhstan (Art. 32) slightly mentions aircraft leasing saying that Kazakhstani owner of the aircraft is entitled to lease it with or without crew to Kazakhstani or foreign operator. The lease term, purpose, rental payments,

<sup>112</sup> Налоговый кодекс РК от 12 июня 2001г. Ст. 74 “такая сделка рассматривается как покупка основных средств лизингополучателем. При этом лизингополучатель рассматривается как владелец основных средств, а лизинговые платежи - как платежи по кредиту, предоставленному лизингополучателю”.

<sup>113</sup> Гражданский кодекс РК от 27 декабря 1994г. Ст. 565: “По договору лизинга лизингодатель обязуется приобрести в собственность указанное лизингополучателем имущество у продавца и

possibility of transfer of ownership to lessee and other conditions have to be stipulated in the contract by the parties. The same rules are applied when Kazakhstani operator leases aircraft from a foreign lessor.<sup>114</sup> Further the Law (Art. 26) states that all transactions, including secured interests in aircraft, are to be registered (filed) in the unified state register of registered rights to immovable property and transactions with them.<sup>115</sup> This requirement is justified by the fact that jurisdiction of Kazakhstan treats aircraft as immovable property.<sup>116</sup> Additionally the Law prescribes obligatory registration of aircraft in the State Register of Civil Aircraft of the Republic of Kazakhstan. Due to the fact that according to the lease contracts previously analyzed (*see Chapter 2*), the aircraft leased by the Kazakhstani airline were registered in Aruba and it is not allowed to obtain the second registration in another state, the Civil Aviation Authorities of Kazakhstan, being a signatory to the Chicago Convention, only may or may not recognize ‘foreign nationality’ of aircraft leased by Kazakhstani air carrier and register (file) the lease arrangement. One of the criteria for recognition is acknowledgement of eligibility of the aircraft according to the national standards. Kazakhstan is currently brings its national, post-soviet, standards in accordance with ICAO standards, which it is obliged to follow being the Organization’s full member.

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*предоставить лизингополучателю это имущество во временное владение и пользование для предпринимательских целей за плату”.*

<sup>114</sup> Закон РК от 20 декабря 1995г. №2697 «Об использовании воздушного пространства и деятельности авиации Республики Казахстан Ст. 32: «Собственник воздушного судна Республики Казахстан вправе сдать в аренду судно с экипажем или без экипажа казахстанскому или иностранному эксплуатанту. Срок аренды, характер использования судна, размеры арендной платы, возможность последующего перехода судна в собственность арендатора и другие условия определяются договором между собственником воздушного судна (арендодателем) и арендатором.

*Аналогичный порядок применяется и в случаях аренды эксплуатантом Республики Казахстан иностранного воздушного судна».*

<sup>115</sup> *Id.* ст. 26 «Сведения о зарегистрированных правах (обременениях прав) на судно или строящееся судно подлежат внесению в единый государственный реестр зарегистрированных прав на недвижимое имущество и сделок с ним (правовой кадастр).»

<sup>116</sup> Гражданский кодекс РК от 27 декабря 1994 г., п.2 ст. 117: «К недвижимым вещам приравниваются также подлежащие государственной регистрации воздушные ... суда ...».

Such scheme allows the national air carrier to obtain the state certificate of airworthiness and operate flights.

### 3.1.2. Customs Code amendment

According to the Customs Code of the Republic of Kazakhstan of 5 April 2003, there are two customs regimes for goods including transportation means at importing them in the customs territory of Kazakhstan:

- *Customs clearance of goods intended for free use on the territory of Kazakhstan.*

The goods under this regime have to remain and be consumed on the territory of Kazakhstan at all time.<sup>117</sup> It requires payment of all necessary customs duties and fulfillment of the other requirements prescribed in the Customs Code and other legislative acts of Kazakhstan.<sup>118</sup>

- *Temporary import of goods and transportation means on the territory of Kazakhstan.* This regime allows use of the goods and foreign transportation means on the territory of Kazakhstan with total or partial exemption from payment of customs duties, taxes, etc. and with a commitment to remove the goods or transportation means from the territory of Kazakhstan within the established time limits.<sup>119</sup>

<sup>117</sup> Таможенный кодекс РК от 5 апреля 2003г. Ст. 119 «Выпуск товаров для свободного обращения – таможенный режим, предназначенный для постоянного использования и потребления товаров, ввозимых на таможенную территорию Республики Казахстан».

<sup>118</sup> Id. Ст. 120 «Выпуск товаров для свободного обращения осуществляется при условии:

1) уплаты таможенных пошлин и налогов;

...

3) выполнения других требований, предусмотренных настоящим Кодексом и иными законодательными актами Республики Казахстан ... ».

<sup>119</sup> Id. Ст. 188 «Временный ввоз товаров и транспортных средств - таможенный режим, при котором иностранные товары и транспортные средства используются на таможенной территории Республики Казахстан с полным или частичным освобождением от уплаты ввозных таможенных пошлин и налогов ... с последующим вывозом товаров и транспортных средств за пределы таможенной территории Республики Казахстан».

The Customs Code refers to the Regulation of the Government of the Republic of Kazakhstan of 21 August of 2001 No. 1092 on Establishing of the List of Lease Objects With Applicable Customs Regime of Temporary Import of Goods and Transportation Means<sup>120</sup> which includes civil aircraft.<sup>121</sup> The inclusion on the List provides for the opportunity to be totally exempted from payment of any customs duties, taxes, etc. for Kazakhstani air carriers leasing aircraft from abroad. But until July 26, 2007 there used to be a very important issue revealing a gap in the legislation, i.e. the Customs Code stipulated that the terms of temporary import of transportation means shall not exceed three years.<sup>122</sup>

The lease term under the UK and US lease contracts analyzed in the previous chapter is five years. This fact changes the whole picture completely and requires the airline to proceed for '*Customs clearance of goods intended for free use on the territory of Kazakhstan*' regime which requires payment of all taxes and customs duties. But due to the fact that this regime requires use of the transportation mean on the territory of Kazakhstan at all time and in view of the fact that the aircraft is a mobile transportation mean intended to operate not only domestic but also international flights it would require customs clearance of the aircraft every time it crosses the border of Kazakhstan which might happen several times a day and night.

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*Id.* Ст.189 «Товары и транспортные средства помещаются под таможенный режим временного ввоза товаров и транспортных средств при условии ... представления обязательства о вывозе товаров и транспортных средств за пределы Республики Казахстан в установленные сроки ... ».

<sup>120</sup> Постановление Правительства РК от 21 августа 2001 года № 1092 Об утверждении перечня предметов лизинга, к которым применяется таможенный режим временного ввоза товаров и транспортных средств

<sup>121</sup> «... самолеты гражданские: производства стран СНГ, находящиеся в эксплуатации не более 15 лет с даты выпуска; производства стран, не являющихся государствами – участниками СНГ, находящиеся в эксплуатации не более 10 лет с даты выпуска».

<sup>122</sup> Таможенный кодекс РК от 5 апреля 2003г. Ст. 192 «Срок временного ввоза товаров ... не может превышать три года с даты помещения товаров под таможенный режим временного ввоза ... ».

To avoid such complications and with no any better solution the airline has been practicing customs clearance prescribed for temporary import of transportation means regime and enjoying all the benefits listed above.

In view of this discrepancy, in the beginning of 2007 the Customs Committee of the Republic of Kazakhstan filed a law suit to the district court of the first instance in Astana<sup>123</sup> to oblige the airline to change the regime of customs clearance and pay a fine for violation of the legislation.

By the court decision the defendant was obliged to compel to the plaintiff's requests. The airline appealed to the city court backing up its position by stressing the gap in the legislation, referring to the international aircraft lease practice and total impracticability of appliance of any other customs regimes. The judge found the airline's justification sound and strong enough to overrule the decision of the lower court which resulted in the Customs Committee's legislative initiative to amend the Customs Code accordingly. As of July 26, 2007 the Art. 192 of the Customs Code was amended: the terms of temporary import of transport means shall not exceed three years *with the exceptions provided by this article. Upon a written request of the declarant terms of temporary import of goods might be extended by the Customs Authority.*<sup>124</sup>

### 3.2. Lessor's risks in cross-border leasing

<sup>123</sup> Customs Committee of RK v Air Astana, February 20, 2007 (unpublished material on file with Air Astana).

<sup>124</sup> *Id.* Ст. 192 «Срок временного ввоза товаров ... не может превышать три года с даты помещения товаров под таможенный режим временного ввоза, за исключением случаев, предусмотренных настоящей статьей. По письменному заявлению декларанта сроки временного ввоза товаров могут быть продлены таможенным органом ... ».



Due to a large number of jurisdictions regulating lease arrangements of high-value equipment differently, it is of a crucial importance for the lessor to protect its rights to the aircraft. And registration of title to aircraft might be one of the methods of protection. But unfortunately, in the vast majority of the states, including the US<sup>125</sup>, aircraft registration is not evidence of ownership; in the UK registration of title is *prima facie* evidence of title, but is not conclusive and varies from strong to very weak evidence,<sup>126</sup> which courts will have to consider and weigh.

In recent years, aircraft manufacturers and major leasing companies have found Eastern European and Asian countries, including Russia and Kazakhstan, to be perspective new markets with promising development of aviation business. However, legislation in such jurisdictions may not always be satisfactory with regard to the sellers' or financiers' security interest. Therefore, opting for other developed countries with favorable regime as places of registration might protect the lessor's/owner's rights. For example, aircraft mortgages or any other security interests created on the leased aircraft under the laws of foreign jurisdictions might not be recognized in the country of registration and cannot therefore be enforced there; also it is a plus if arbitral award or court judgment may be enforced in the place of registration even if the lease agreement itself is governed by another law.<sup>127</sup> But despite of these facts, the repossession issue still remains to be one of the most complicated.

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<sup>125</sup> Federal Aviation Act Sec. 47.11, 47.33 (1958).

<sup>126</sup> Philip R. Wood, *Comparative Law of Security and Guarantees*, (London: Sweet & Maxwell, 1995), p. 215.

<sup>127</sup> W. Stephen Dennis, *Business in Perspective. The Aircraft Registry Group*, *Aviation & Business Journal*, April 2004.

### 3.2.1. Varig case

There is a number of interesting cases with regard to repossession of aircraft which reveal complications that the lessors might face with due to differences in treatment in various jurisdictions. One of them is Brazilian air carrier Varig case.<sup>128</sup> In June 2005, Varig's aircraft lessors ordered the lessee to stop flight operations in view of the airline's default declared by the lessors and threatened to repossess the aircraft. To protect its rights, on June 17, 2005, Varig filed application in the Commercial Bankruptcy and Reorganization Court in Rio de Janeiro for the commencement of 'judicial reorganization' proceedings pursuant to the New Bankruptcy and Restructuring Law of Brazil (NBRL), Law No. 11.101 of June 9, 2005. On June 22, 2005 the Rio de Janeiro Court granted Varig's request, which permitted Varig to remain in possession and control of its businesses and properties, thus, protecting it from enforcing of the creditors' claims. As an extra measure, upon Varig's request the court granted interim relief, equivalent to a temporary restraining order, prohibiting aircraft lessors from repossession of aircraft and interference with the airline's flight operations.

On June 17, 2005 Varig also filed a suit seeking ancillary protection from the US Bankruptcy Court, since it had aircraft flying to the US, bank accounts in the US, etc. The US court issued a preliminary injunction in support of the Brazilian judicial reorganization proceeding. Since those measures were temporary, in early 2006 eleven lessors to Varig filed repossession cases in Rio de Janeiro civil courts. In some cases Brazilian courts ordered Varig to pay overdue rent, but in most cases Rio courts did not even order payment of debts; one of the aircraft was seized at the airport in New York by its lessor, the US Bank. In addition, two US court rulings allowed lessors to

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<sup>128</sup> Cenneth D. Basch, New Law Impact on Repossession of Aircraft Leases, June 14, 2006, <<http://www.internationallawoffice.com/Newsletters/detail.aspx?g=0f26d188-09fa-da11-8a10-00065bfd3168>>;

repossess nineteen of Varig's aircraft. In a number of other cases the US court declined lessors' request to issue a repossession order against Varig.

By referring to this case, my main purpose has been to demonstrate that the repossession issue is indeed very complicated when different jurisdictions are to be taken into account, as well as the lessee's flight operations to the state of the lessor's incorporation, enforceability of foreign judgments in the lessee's jurisdiction, etc.

### **3.2.2. Repossession and other problems of the legal system of Kazakhstan**

There are also considerable problems in the sphere of repossession of the object of lease in Kazakhstan. Art. 48 of the Tax Code of the Republic of Kazakhstan stipulates that in case a tax payer fails to pay taxes on time, he might be subject to an official restraining order limiting his rights of disposition of his property, including objects obtained in financial lease or as a collateral. In other words, lessor does not have possibility to repossess the leased object even in case of a lessee's default in payment of rent. From the other side, in case of a lessor's breach of the tax legislation (or bankruptcy), lessee cannot purchase the leased object even if it is stipulated by the lease agreement.

I believe that the laws of the Republic of Kazakhstan should be changed in favor of prohibiting use of leased assets to satisfy claims of the parties' creditors. This is an international standard established by the UNIDROIT Convention on International Financial Leasing: *"The lessor's real rights in the equipment shall be valid against the*

*lessee's trustee in bankruptcy and creditors, including creditors who have obtained an attachment or execution.*”<sup>129</sup>

Other risks that might emerge at cross-border lease arrangements are derived from the fact that Kazakhstan might not be a party to any multilateral or bilateral treaty with the contracting state (this is the case with the United States) for the mutual enforcement of court judgments. Consequently, should a judgment be obtained from a court in another jurisdiction, it is unlikely to be enforced in Kazakhstan. In the opposite situation, when courts of Kazakhstan will apply laws of foreign jurisdiction, there is a level of uncertainty of how those laws will be interpreted given the fact that the international contract might include terminology and concepts unknown to the Kazakhstan legal system.

All these and many other factors affect conditions of the contract and even might result in increase of costs for the Kazakhstani party to compensate for the lessor's potential risks.

### **3.3. Necessary steps required for Kazakhstan to meet international standards in aircraft financing sphere**

The above analysis of the lease market in the Republic of Kazakhstan justifies the reasons of inability of the local market to provide guarantees to investors/lessors with regard to such highly valuable assets as aircraft. To be precise, there may be determined two types of restraining factors – economical and legislative. If the latter type is predetermined by such substantial factors as historical development, political power, availability of natural and human resources, etc., it is also governed, regulated and hence, may be either supported or restrained by the former type, the legislative. With this regard I would like to draw one's attention to the international aspect of this

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<sup>129</sup> UNIDROIT Convention on International Financial Leasing Art. 7.1.a (Ottawa, May 20, 1988).

problem, prompt resolving of which might open for Kazakhstan further opportunities for development and growth.

James T. Hitch III, Managing Partner of Baker& McKenzie – CIS Ltd. in his speech about conditions for developing modern, effective and competitive air transportation sector in Kazakhstan addressed to the necessity of Kazakhstani airlines in additional Western aircraft.<sup>130</sup> Citing the words of the Chairman of the Committee on Civil Aviation Mr. Kubayev M.M. Kazakhstan is aimed at creating an aviation system close to the European model. “To achieve this result the government introduces plans on increasing aviation safety by meeting the ICAO standards and lowering the age of aircraft operating by Kazakhstani airlines and changing aircraft fleet by Western aircraft.”<sup>131</sup> Earlier it has already been stated that the most convenient way of obtaining new equipment of a high value is operating lease. But in view of the discussed problems, the lease terms offered to Kazakhstani airlines by foreign lessors are very steep compared to those offered to other airlines in countries with “*more developed legal and economy system.*”<sup>132</sup> In order to resolve this problem Kazakhstani airlines in cooperation with the leading lawyers of Kazakhstan opt for adoption of the Cape Town Convention on International Interests in Mobile Equipment, and the related Aircraft Protocol by Kazakhstan, which were developed by committees of the International Institute on Unification of Private Law (UNIDROIT) and the Legal Committee of the International Civil Aviation Organization (ICAO) in 2001.

<sup>130</sup> Developing the Transport Potential of Kazakhstan in the System of Integration Processes (visited March 22, 2008) < [http://www.fic.kz/view\\_news.asp?id=24&lng=en](http://www.fic.kz/view_news.asp?id=24&lng=en)>.

<sup>131</sup> Report of the Chairman of the Civil Aviation Committee, Mr. Kubayev M. (visited March 19, 2008) <<http://www.mtk.gov.kz/ru/podr.asp?str=2&Idpodr=159>>.

<sup>132</sup> Developing the Transport Potential of Kazakhstan in the System of Integration Processes (visited March 22, 2008) < [http://www.fic.kz/view\\_news.asp?id=24&lng=en](http://www.fic.kz/view_news.asp?id=24&lng=en)>.

*“The Convention and the associated protocols were designed to address the problem of refusal by national courts to recognize the validity, priority or enforceability of secured party, seller or lessor interests in mobile equipment created under the law of other states.”*<sup>133</sup>

The aim of the convention is reducing the risks of lending on high-value mobile assets such as aircraft, so as to increase investment and commercial activity in the aviation industry. It also aims to provide an international legal regime for leases (Art.1(q)), conditional sale agreements (Art.1(11)) and security interests (Art.1(ii)). Additionally the Convention:

- creates a priority system for international security interests;
- provides an international registration in order to perfect international security interests and provide notice of the security interest to third parties;
- establishes a variety of remedies available upon insolvency or default.

Ratification of the Convention will make relations between the parties easier in terms of reliability; it will also help bring the national legislation in conformance with international obligations imposed by the Convention.

Another important international Convention which has to be signed and ratified by Kazakhstan is UNIDROIT Convention on International Financial Leasing (Ottawa, 28 May, 1988) which will provide the investors necessary guarantees at concluding lease agreements with Kazakhstani parties. The Convention applies to cross-border financial leases of equipment when the lessor and the lessee have their places of business in two

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<sup>133</sup> Louis F. Del Duca, Secured Transactions Under the Uniform Commercial Code and International Commerce, (Cincinnati, Ohio: Anderson Pub. Co., 2002), p. 228.

different countries. The Convention sets a ‘ceiling’ on the rights of lessor for recovering damages in case the lessee did not perform the contractual obligation.

*“The Convention prohibits the lessor from enforcing an acceleration clause for payment of future lease payments when the lessor has terminated the financial lease agreement” ... For the purpose of the creditors' right to the lessee's assets, the Convention applies the law of the country where the equipment is located or, in the case of equipment normally moved between countries, the law of the country where the lessee has its principal place of business.”<sup>134</sup>*

Transposing of the Convention and bringing the Kazakhstani legislation in correspondence with the Convention will allow the legislation of Kazakhstan to govern international financial lease agreements.

These measures along with harmonization of the national legislation will attract a much bigger amount of foreign companies who in view of stability of Kazakhstani legal system will be able to offer goods and services at competitive prices. Additionally it will allow foreign lessors to recognize registration of aircraft in Kazakhstan and make the process of enforcement of certain rights, like repossession, easier.

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<sup>134</sup> UNIDROIT Convention on International Financial Leasing (visited March 28, 2008) <<http://www.spb-mb.ru/index.php?page=394>>.

## Conclusion

Leasing all over the world is considered as not only important instrument of introduction of new technologies, upgrading of assets, but also as an effective and efficient mean of stimulation of business development, attraction of investments and development of the economy of a state.

Despite a significantly recent emergence of lease arrangements in aviation industry to date they are able to offer a wide range of different types of leasing more suitable for a particular lessor and lessee, including possibility of participating of the third parties. The factors which make leasing so attractive to aviation industry are determined by their simplicity and efficiency compared to purchasing for example, in terms of taxation, possibility to upgrade of the aircraft fleet since the aircraft construction industry is developing very fast, constantly supplying the market with new, modernized aircraft.

The analysis of the variety of lease arrangements in the aviation sphere has given the assurance that the most common type of aircraft acquisition is leasing, operating and leveraged financial, which compete with purchase agreements. Preferential tax treatment became the main reason for the fast spread of operating leasing in aviation.

In the research paper I have discussed different approaches to understanding and regulation of lease arrangements in the United Kingdom, United States and Kazakhstan. With this regards I have considered the differences between operating lease, financial lease and hire-purchase agreements which might be confused with lease arrangements. To distinguish the differences among them the UK applies criterion of ownership and tax characteristics and sometimes in the literature one may find the definition of 'lease'



as a 'tax lease'. The US in its turn applies functional test on the basis of which it distinguishes true lease from lease intended as security and unlike the UK law, attributes conditional sales to secured transactions. Kazakhstani legislation in my opinion mixes financial leasing and conditional sales by stating that title does not transfer to the lessee and purchase is only an option from one side and for tax purposes treating financial lease as purchase agreement when lessee is considered to be an owner of the leased asset from another.

On the basis of the detailed analysis of the aircraft lease contracts concluded between the Kazakhstani airline and the UK and US lessors I have also managed to underline specificities of lease contracts and come to the conclusion that there are not many essential differences between the two contracts. This fact might be explained by liberal legislation of the UK and US which only set a minimum of mandatory norms to be complied with and leaves the rest provisions to be stipulated by the parties. These factors contributed to compilation of a set of contractual provisions regulating the most important aspects of aircraft leasing, such as registration, inclusion (or not) purchase option, rights and obligations of the parties to, first of all, protect lessor's international interests in aircraft.

Another issue that has been raised by the analysis of the contracts is to reveal the most common problems surrounding cross-border lease arrangements, where the crucial one is the repossession problem in case of lessee's default. The case law has demonstrated that this issue remains to be the most sensitive one since there might be mandatory domestic provisions restraining lessor from seizure of the leased asset despite of the governing law of the contract and the law applicable to aircraft registration which are intended to protect lessor in such cases.

The analysis of the Kazakhstani legislation and understanding of the main trends of development of the international aircraft leasing has given the understanding that within ten years since introduction of leasing in the state it has managed to create the base for promoting financial lease transactions to acquire such assets as agricultural equipment and machinery, equipment for railway transport and construction industry. But there is still not enough experience and legal protection with regard to stimulation of financing of high-value assets like aircraft.

By tracing the process of interrelation of the above legal regimes of aircraft lease with the national legislation of the Republic of Kazakhstan, I have indicated a number of difficulties experienced by foreign lessors as well as local lessees. Along with revealing numerous gaps and contradictions in the national legislation I have raised a problem of the binding effect and enforceability of the obligations of lessee under the lease which might be subject to any limitations arising from legal norms regulating insolvency, bankruptcy, liquidation, reorganization and similar laws affecting rights of creditors and debtors. Adoption and ratification of the UNIDROIT Convention on International Financial Leasing and the Cape Town Convention by Kazakhstan will benefit to both, the Kazakhstani lessees and international lessors, by reducing costs for the lessees and giving assurance in stability of Kazakhstani legislation being in line with the international standards by the lessors.

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