

## Innovative Negotiations Result in Historic Aviation Transaction

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Katten Aviation partner Stewart Herman, along with aircraft finance group colleagues in London and the United States, acted as counsel to The Transportation Group (TTG), the mandated sole arranger in a transaction which consisted of (i) the purchase from Ethiopian Airlines of three Boeing 767-300ER passenger aircraft in Ethiopian's fleet and the immediate leaseback of the aircraft to the airline, (ii) the scheduled induction of the aircraft during the lease term for a full freighter conversion to be financed by the lessor and its lender, and (iii) the continued leasing of the aircraft after the conversion for the remainder of the lease term as freighters.

After putting out a Request for Proposals, in April 2021 Ethiopian Airlines awarded the mandate for this transaction to TTG, the only bidder to agree not only to allow, but also to arrange financing for, the freighter conversion during the lease term. TTG then had to go out into the market and source the equity and debt financing for both parts of the transaction.

To do this, TTG and Katten had to devise a new structure — and draft a lease and other transaction documents — to ensure that freighter conversion, to be performed during the lease term rather than before, would be completed if the airline did not perform.

They also had to get the airline and freighter conversion agency to agree to the structure. This was complicated by the facts that the conversion facility was new (and the first in Africa), the airline provided labor and the physical facility for the conversions, and the conversion of these aircraft was meant to be a demonstration project to show the capabilities of the new shop.

Compounding the challenges was the ongoing threat that the United States and other countries could at any time impose sanctions against Ethiopia over its then-worsening internal political situation.

A final complication was the Russia-Ukraine conflict. TTG initially awarded the equity investment to a leasing company that then unexpectedly failed to obtain the approval of its credit committee. The committee met to approve the transaction on February 24, 2022, the day Russia invaded Ukraine, resulting in the committee's turning down the transaction, a rare occurrence for that equity investor. TTG then had to source a replacement equity investor.

In order to deal with the risk of that the freighter conversion of the on-lease aircraft would not be completed, Stewart negotiated a first-ever "step-in" agreement with the freighter conversion agency, a joint venture of Israel Aerospace Industries (IAI) and Mitsui. In that agreement, he negotiated to allow the lessor to "step in" to the position of the airline as customer if the airline did not perform. This meant that the lessor would have the right on notice to the conversion agency to pay the balance of the conversion price, have the conversion completed, and take delivery of the converted

aircraft. This package of rights borrowed from the model of predelivery payment (PDP) financing for new aircraft as well as concepts from project finance.

Stewart also negotiated a unique set of covenants to deal with the potential for sanctions.

The transaction closed with Titan Aircraft Investments I, Ltd, a fund managed by Titan Aviation and backed by Bain Capital, as the equity investor. Titan tapped its P2F conversion-loan facility, meant to fund conversions for its freighter airline affiliate, to fund the debt portion of the financing.

## **Postscript**

Stewart's innovation in this historic transaction, with these aircraft the first scheduled to be converted at the new B767 freighter conversion facility opened by IAI and Mitsui in Addis Ababa (the first freighter conversion facility in Africa), resulted in his being awarded the 2022 Freighter Finance Deal of the Year on January 16, 2023 at the Airline Economics Dublin 2023 industry conference.