

## Buyer Due Diligence in Acquisitions of Leased Aircraft: Lease Document Review and Seller and Lessee Representations

May 20, 2021

---

### KEY POINTS

- Populating a template lease summary is an effective way to confirm significant commercial, legal and technical provisions in lease due diligence.
  - Comprehensive seller and lessee representations may be negotiated in the sale and lease-assignment agreements to round out the due diligence.
  - Real-world examples of unscheduled lessor payment obligations to the lessee and successive lease term extensions demonstrate the efficacy of this approach.
- 

### Introduction

This advisory discusses how a buyer of a portfolio of aircraft subject to existing leases may effectively use a template lease summary rounded out with seller and lessee representations to perform due diligence on the leases and mitigate risk. Due diligence on a portfolio of leased aircraft will include reading the lease documents, confirming the commercial terms match the seller's marketing materials, confirming that most provisions of the lease are within industry norms, confirming that the lease complies with minimum lease provisions set forth in the lessor's financing agreements (if applicable), and identifying and nonstandard provisions. Appropriate representations may then be sought from the seller in the aircraft sale agreement and the lessee in the lease novation or assignment.

The seller will provide a summary of the payment terms for each lease to enable the bidders to project the cash flows from and to the lessee for the balance of the lease term. These terms would include scheduled basic rent, maintenance reserve rates and balances or utilization payments, and any return compensation. The seller also should provide information for the bidders to use to assess the value of the aircraft based on its maintenance status, including time or cycles since new or the last major maintenance on the airframe, engine and other components, and the life remaining on engine life limited parts. This information also will allow the bidders to project when major maintenance events (for which the lessor may be required to make a cash contribution) will come due during the lease term.

The commercial matters discussed above are common to most operating leases. The lease documents also may have commercial terms that are specific to the particular transaction. For example, the lessor may have granted concessions or undertaken obligations to the lessee either to facilitate the transition of the aircraft to the lessee from a prior lessee, or induce the current lessee to agree to an extension of the lease term. A reading of the lease

---

documents will be required for the buyer to understand the effect of these provisions on the buyer's expected cash flows, return, and obligations as new lessor.

## **The Lease Summary's Role in Lease Due Diligence**

The winning bidder is provided access to a data room to conduct its due diligence on the lease documents. To do that in an orderly way, the reviewer should start with a lease-summary template. This is essentially a questionnaire about the provisions of the lease and related documents. Completion of a lease summary for each aircraft is typically a requirement of the aircraft financing agreements. But even for a leased aircraft purchased without debt financing, using a template is an effective way to conduct lease due diligence. A completed lease summary will provide far more information about the lease than the aircraft specification sheet or marketing materials that the portfolio seller provides to bidders. It will help confirm the expected commercial terms, confirm the lease otherwise contains customary provisions, and identify any circumstances that call for further diligence, for representations or covenants from the seller or lessee, or other risk mitigation.

The Lease Summary will typically include the following sections:

### **General Information**

- Identity of the parties.
- Listing of the lease and ancillary documents such as a delivery acceptance certificate, lessee parent guarantee, lessor parent guarantee, deregistration powers of attorney, insurance assignment, and any amendments, supplements or side letters.
- The lease term, including any renewal or early termination options held by the lessor or lessee.
- Purchase options, if any.
- Whether the lease is part of a head lease/sublease structure. If it is, then the seller and existing lessor are two different entities. For purposes of this Advisory, it will be assumed that there is a direct lease from the seller of the aircraft to the airline. Seller and existing lessor will be used interchangeably, as will buyer and new lessor.

### **Basic Rent and Other Payments**

- The amount of basic rent, and whether basic rent is fixed for the lease term or variable.
- The periodicity of basic rent (monthly, quarterly, semiannual, and whether payable in advance or arrear).
- A description of maintenance reserve payments or utilization payments, if any; the maintenance events to which they apply (e.g., six-year and 12-year airframe structural checks, engine performance restoration, replacement of engine life-limited parts (LLPs), APU overhaul, and landing gear overhaul); and whether such payments are adjustable for inflation or aircraft operating parameters.
- A description of the lessee's general indemnity obligations.
- A description of the lessee's obligations to indemnify against value-added tax (VAT), withholding tax and other taxes that may be assessed on the lease payments, on the import of the aircraft into the lessee's jurisdiction, on the ownership of the aircraft, including taxes for which the taxing authority may detain or otherwise impose a lien on the aircraft.
- The currency in which basic rent and other amounts are payable.
- Whether basic rent and other amounts are payable without any right of offset.
- Whether overdue payment obligations bear default interest.
- Whether there is a cash security deposit, security deposit letter of credit, lessee parent guarantee or other credit support.

## Operation and Possession

- Whether the lessee may sublease or reregister the aircraft is permitted, and if so under what conditions and into what countries.
- The lessee's covenant to discharge non-permitted liens on the aircraft.
- A description of the lessor's right to inspect the aircraft including its technical records.

## Maintenance and Redelivery

- The standard to which the lessee must maintain the aircraft: either the manufacturer's maintenance planning document or the airline's airworthiness-authority approved maintenance program.
- Whether the lessor has the right to preapprove the work scopes for major maintenance events.
- Whether the lessor must contribute to the cost of maintenance events for which lessee makes reserve payments, and under what conditions.
- Whether the lessor must reimburse the lessee for any part of the cost incurred by the lessee to take terminating action to comply with airworthiness directives, and under what conditions.
- Whether the lessee has the option to enter the engines (or other components) in a "power by the hour" agreement with the manufacturer or other vendor in lieu of paying reserves for the engines (or other components).
- A description of the condition in which the lessee is required to redeliver the aircraft at the end of the lease term, including hard-time minimums, whether the lessee must pay redelivery compensation based on the actual hard-time status of the aircraft at redelivery and whether such obligations may be modified or avoided by the existence of "power by the hour" agreements.
- The redelivery inspection procedures to which the lessor is entitled, including borescopes of the engines and the auxiliary power unit (APU).
- Whether the lessee is obligated to pay holdover rent if the aircraft fails to meet the redelivery conditions at the scheduled lease expiry date and in what amount.

## Risk of Loss and Insurance

- Confirm the lessee is obligated to pay "agreed value" or "stipulated loss value" if the aircraft suffers an event of loss, and what the amount of "agreed value" or "stipulated loss value" is, if it is fixed, and otherwise how it is determined.
- Confirm the lessee is obligated to replace an engine that suffers an event of loss.
- State the minimum amount of third-party liability insurance the lessee must carry. (The documents for a warehouse or asset-backed-security (ABS) financing will typically specify a minimum depending on the aircraft make and model.)
- Confirm insurance must comply with standard insurance provisions for leased aircraft such as AVN67B.

## Events of Default and Remedies

- Types of events of default (e.g., nonpayment, breach of covenants or representations, bankruptcy, cross-defaults to other transactions), and grace and cure periods.
- Types of remedies (e.g., repossession of aircraft, liquidated damages, recovery of costs and expenses arising from event of default).

## Miscellaneous

- Conditions to the lessor's right to assign its interest as lessor, either to another lessor or to a finance party as security, such as minimum net worth for a new lessor, payment of lessee's legal expenses incurred in the

transfer, payment of a transfer fee to the lessee, and indemnification by the existing or new lessor in favor of the lessee against any increase in the lessee's obligations under the lease arising from the transfer (such as with respect to withholding tax payable on the basic rent and other lease payments).

- Governing law and submission to jurisdiction.
- Requirement for the lessee to maintain an agent for service of process in any action arising out of the lease.
- Confidentiality and disclosures the lessor and lessee are nevertheless permitted to make.

## Representations and Warranties

### From the Seller

The buyer should ask that the seller make certain representations and warranties about each aircraft lease. Certain representations are standard. Others flow from lease-specific provisions, as further discussed below in "Special Situations." The seller will want to make the representations for the benefit of the buyer only, and not the lessee. For that reason, the representations should be contained in the aircraft sale agreement, to which seller and buyer (but not the lessee) are parties. Standard seller representations and warranties include:

- A true and complete listing of the Lease Documents (defined as all agreements that govern the leasing of the aircraft other than those that will be terminated before closing) is set forth in a schedule to the sale agreement.
- The lessee has not prepaid any amount payable under the Lease Documents.
- The lessee has not submitted any invoice or other demand for payment to the existing lessor (nor is the lessee currently entitled to any payment) for any amounts payable by the existing lessor under the Lease Documents except for amounts that the existing lessor has paid to the lessee in full.
- The lessee has not made any election or exercised any option set forth in the Lease Documents (or if it has, specify which elections or options).
- The Lease Documents have not been amended, modified, supplemented or waived except as provided in the schedule of Lease Documents.
- The seller will not amend the Lease Documents before closing.
- The seller has provided the buyer true and correct copies of the Lease Documents and will promptly following closing provide originals.

### From the Lessee

The buyer should ask that the lessee make the following standard representations in the novation or assignment of the lease from the existing lessor to the new lessor, to which (unlike the sale agreement) the lessee will be a party. If the operative document is an assignment of lease rather than a lease novation, the lessee may make its representations and warranties in a standalone consent. Some of the representations also will be made by the seller. Often the lessee will resist giving any but the most basic corporate representations. One reason is that a party can be sued for a breach of a representation. Unlike the seller, who wants to sell an aircraft, the lessee has no incentive to give additional representations, other than to maintain good relations with its lessors. Another reason may be that the point person at the lessee cannot readily determine (without consulting colleagues in other departments and checking records) that proposed representations are true as written. The lessee's representations should include:

- A true and complete listing of the Lease Documents (defined as all agreements that govern the leasing of the aircraft other than those that will be terminated before closing) is set forth in a schedule to the novation.
- The lessee has not prepaid any amount payable under the Lease Documents.

- The lessee has not submitted any invoice or other demand for payment to the existing lessor for any amounts payable by the existing lessor under the Lease Documents except for amounts that the existing lessor has paid to the lessee in full.
- The lessee has not made any election or exercised any option set forth in the Lease Documents (or if it has, specify which elections or options).
- The Lease Documents have not been amended, modified, supplemented or waived except as provided in the schedule of Lease Documents.

The existing lessor and lessee also should agree for the benefit of the new lessor on the amounts in the maintenance reserve subaccounts and the current and other most recent maintenance reserve rates if subject to adjustment for inflation or operating parameters, and memorialize that information in additional representations.

## Special Situations

Here we discuss two hypothetical situations that may be disclosed in due diligence on the lease documents, the risks these situations present and how to mitigate them.

### 1. The existing lessor agreed to pay for modifications to the aircraft to facilitate the transition of the aircraft to the fleet of the lessee.

In this example, an aircraft was initially delivered new under a lease with an eight-year term to a full-service international airline. The aircraft was delivered in a two-class configuration (business and economy). At the end of the term of the initial lease, the lessor placed the aircraft with a new lessee, a discount carrier that operates all aircraft in its fleet in an all-economy configuration. To facilitate that transition, the new lessee required that the cabin be reconfigured with 190 economy seats, the maximum takeoff weight of the aircraft be increased and an auxiliary center fuel tank be installed. Accordingly the lessor and lessee agreed in the lease documents to the following arrangement:

- The aircraft would immediately be placed on lease to this lessee.
- The lessee would perform these modifications during the first 18 months of the lease term.
- The lessee would receive a holiday for the payment of basic rent and hour- or cycle- controlled maintenance reserves (but not calendar-controlled reserves) for up to an aggregate of 90 days while the aircraft was out of service for the performance of the modifications.
- The lease term would be extended by the length of the rent holiday.
- The lessor would reimburse lessee for the cost incurred by the lessee to perform the modifications, subject to a dollar cap and to the lessor's receipt of satisfactory invoices and evidence of completion of the modifications.
- The lessee would use best efforts to sell the removed business seats to a parts dealer and remit the proceeds to the lessor.
- The parent company of the beneficiary of the owner trust that is the lessor would issue to the lessee a guarantee of the lessor's reimbursement obligation.

One year into the term of the lease to the discount carrier, the lessor puts the aircraft subject to the lease up for sale. The arrangement presents a number of issues for any prospective buyer of the aircraft:

- What is the effect of the reconfiguration on the future marketability of the aircraft? Is the new configuration as widely adopted among operators?
- Has the lessee already completed the reconfiguration? If the lessee has, has the lessor reimbursed the lessee as required by the lease? If not, is this an obligation that the existing lessor will retain following the buyer's purchase of the aircraft? If so, will the lessee agree to look only to the existing lessor for payment? If the new lessor will assume this liability to the lessee, can the amount of the liability be quantified so it can be

deducted from the aircraft purchase price? If not, will the existing lessor agree to reimburse the new lessor for its payment to the lessee? If so, is the new lessor satisfied with the creditworthiness of the entity that is the existing lessor, or will the new lessor require a guarantee of that reimbursement obligation from a creditworthy affiliate of the existing lessor?

- Has the rent-and-reserves holiday already been taken?
- Has the lessee sold the removed seats?

The answers to these fact questions may not lie in the lease documents presented to the buyer. Instead the answers may have to be provided in representations preferably made by both the existing lessor and the lessee in the sale agreement and lease novation or assignment evidencing the sale of the aircraft and transfer of the lease to the new lessor. It will be up to the buyer to propose appropriate representations.

**2. The existing lessor and lessee have extended the lease term several times, making other commercial changes each time.**

In this example, the existing lessor and lessee have extended the lease term three times:

- The first extension, by formal lease amendment, extended the term by two years at a reduced basic rent. The amendment also removed hard time minimum redelivery conditions for engine LLPs and other hard time components.
- The second extension, by side letter between the lessor's servicer and the lessee, further extended the term by 18 months. It also eliminated the requirement for the lessee to pay airframe maintenance reserves.
- The third extension, by exchange of email between an employee of the lease servicer and the fleet manager at the lessee, further extended the term by 12 months. The email exchange also provided for a further reduction in basic rent, elimination the redelivery C Check, the right of the lessor to provide a temporary replacement engine if a leased engine required a shop visit, and the right of the lessee to extend the redelivery date if the delivery of the aircraft intended to replace the current aircraft in the fleet of the lessee were delayed.

The point here is that the buyer must carefully piece together what may be successively more informal communications between representatives of the lessor and lessee to determine the currently effective remaining duration of the lease term, the currently effective basic rent and maintenance reserve payment obligations, and the currently effective redelivery conditions and other commercial terms. Note that the final email exchange allows the lessee to extend the term but does not say how many times, for how long, by what method or whether the extension requires prior notice. It would be important to get a representation from each of the seller and (if it is willing) the lessee in the lease novation as to what writings (amendments, side letters, even email exchanges) constitute the current leasing arrangement, that there are no other agreements (including verbal ones), and that the extension option has not been exercised by the lessee (including verbally). It also would be worth formalizing the lessee's extension rights in the lease novation that the existing lessor, lessee and new lessor will enter into.

---

## CONTACTS

For more information, please contact your Katten attorney or any of the following members of the firm's [Aviation](#) group:



**Timothy J. Lynes**  
+1.202.625.3686  
timothy.lynes@katten.com



**Stewart B. Herman**  
+1.212.940.8527  
stewart.herman@katten.com



**Brett J. Seifarth**  
+1.202.625.3615  
brett.seifarth@katten.com

# Katten

katten.com

CENTURY CITY | CHARLOTTE | CHICAGO | DALLAS | LONDON | LOS ANGELES | NEW YORK | ORANGE COUNTY | SHANGHAI | WASHINGTON, DC

Attorney advertising. Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

©2021 Katten Muchin Rosenman LLP. All rights reserved.

*Katten refers to Katten Muchin Rosenman LLP and the affiliated partnership as explained at [kattenlaw.com/disclaimer](http://kattenlaw.com/disclaimer).*

5/20/21