

COVID-19 Update: A Planning Guide for Aircraft Lessors

March 23, 2020

With the advent of the COVID-19 pandemic, our industry is forced to confront many challenges, including broad government mandates of indefinite duration restricting the movements of vast amounts of the global population. This is a threat that is difficult to assess, but clearly presents a daunting worst-case scenario for the survival of the airline sector. The repercussions of the pandemic affect strong airlines as well as the weak, and effectively operate to suspend air transportation as a viable commercial activity for the time being. Restrictions on civil activity worldwide take away the ability of lessors to redeploy aircraft from faltering carriers to healthier ones. Indeed, the very notion of repossession as a solution to lease defaults is called into question as air- transportation lockdowns prevent an aircraft even from being ferried from a defaulting lessee's home base, or if courthouse personnel are not available to issue a repossession order. Perhaps the likeliest strategy is for the industry to hit the "pause" button for a few months until the air transportation renormalizes, or at least looks like it's getting there.

Nevertheless there are some things an aircraft lessor should consider doing at this time:

- **Have the conversation with the lessee.** Many lessees have reached out to their lessors to ask for a rent holiday, a rent deferral, a moratorium on enforcement, early redelivery, or conversion of the rent from a fixed amount per month to a "power by the hour" plan by which the lessee pays, in lieu of fixed rent, a utilization charge for each flight hour that it actually operates the aircraft. Lessors are usually looked to as a source of concessions – sometimes consensual, sometimes not – when an airline wants to conserve cash. Giving the airline a break on payments for a time may make sense. However, the airline should make up for it later on when the period of crisis is over. So as part of an agreement to defer rent, the lessor may have the lessee issue an unsecured promissory note to the lessor to pay the deferred rent over time with interest, or the lessor and lessee may agree to extend the term of the lease at the contract-rent rate by at least the period of any rent holiday. Care should be taken to ensure that any such agreement is agreed to or otherwise permitted by lessor's aircraft-finance parties.
 - **Make sure the lease security documents are ready to use.** The existing original deregistration power of attorney should be pulled out and consider repositioning it with local counsel in the airline's jurisdiction along with any supporting documents that counsel advises need to be filed to deregister and export the aircraft. If the lease security deposit consists of a letter of credit, find the original and all subsequent extensions and other amendments. A pro forma drawing package should be prepared and submitted as a PDF to the issuing bank or confirming bank, if the letter of credit has been confirmed for review. Many banks will undertake this review before the letter of credit is drawn on, and will advise of any flaws. It may avoid unnecessary delays and allow for a smooth execution on the letter of credit.
 - **Be aware of the installation of the engines and the level of utilization of the aircraft.** If an engine is not installed on the airframe, determine if it is at an MRO facility, in storage or installed on another airframe. If that other airframe is owned by or financed by a party other than the lessor, determine if a recognition-of-rights agreement exists that would facilitate the return of installed engines to their owners. Confirm by
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regularly checking the commercial websites that the aircraft continues to operate in scheduled service. Although a lease will not require that an aircraft be operated regularly, the grounding of an aircraft can lead to deferred maintenance and stripping of parts.

- **Be aware of potential liens on the aircraft by airport and navigational authorities.** As airlines move to conserve cash, they may fall behind on payments to airport and navigational authorities. Liens on aircraft for unpaid charges may stay with the aircraft and put it at risk of detention now or even after it exits the airline's fleet. If an airline eventually elects to permanently cease operations, it will be imperative to terminate the leasing of an aircraft before an airport or navigation authority puts a lien on it, in order to reduce the claim against the aircraft from the entire fleetwide balance of charges to the charges on the specific aircraft.

Therefore it does not hurt to prepare a termination notice for possible eventual use. Moreover, as part of the conversation with the lessee in regard to any lease concessions, ask the airline for evidence that it is current on paying the periodic (typically monthly) invoices from its airport and navigational authorities. The lessor will likely have received permission when the lease was entered into to contact the authority directly in order to ascertain whether the airline is current, and the lessor should consider making such a request at least to the authority or authorities having jurisdiction over the aircraft's base of operations.

- **Be aware of potential mechanics' liens on the aircraft, engines or other components.** The lessor should understand whether the aircraft, an engine or other component is at an MRO facility or about to be sent to one. An MRO facility's unpaid bill may result in a lien (by statute or by the terms of the MRO contract) on the applicable equipment undergoing repair or maintenance, which may result in the facility's detaining the equipment or filing a lien on a public register, which would impair the ability of the lessor to sell or finance the equipment.
- **Be aware of when a lease event of default will occur.** Most leases call for rent to be paid monthly. Although many lessors invoice their lessees for rent, invoicing is not typically required under the lease. The rent is payable on either the first day of the calendar month, or the same day in the month as the delivery date, subject to business-day conventions (which can be tricky if they refer to non-banking days in various jurisdictions). Generally the failure to pay rent matures into a lease event of default when a certain number of business days have elapsed from the payment due date. Maintenance reserves are subject to similar provisions, but normally are payable on a date late in the month, after the lessee reports the prior month's utilization, and the lessor computes the maintenance reserves payable for that month's utilization.

The current world situation also presents room for other types of lease events of default. For example, even before a lessee actually files for bankruptcy or insolvency protection (universally a specified lease event of default without any notice, grace or cure period), events may occur that nevertheless constitute a lease event of default. Whatever they are will be as specified in the lease, e.g., cessation of the lessee's airline operations; the taking by the lessee's board of directors of action approving the seeking of insolvency protection; or the inability of the lessee to pay its debts as they come due. Even before an event specified in the lease occurs, it may be possible under the governing law of the lease to find the lease to be in default by asking the lessee for adequate assurance that it will be able to pay rent going forward. If the lessee cannot do so, an event of default may be deemed to have occurred.

- **Step up inspection of the aircraft including its technical records.** When airlines ground aircraft and have to conserve cash, there is a temptation for airline maintenance personnel to transfer serviceable parts from one aircraft to other aircraft to replace unserviceable parts. To deter this non-permitted activity, lessors should diligently exercise their inspection rights (usually enhanced in the case of a lease event of default) against the aircraft physically and especially receive regular electronic updates of the aircraft technical records. Another reason to do so is that if there is ever an accident involving the aircraft that is traced to faulty maintenance, victims or their insurers may attempt to pin liability on lessors for failing adequately to police the maintenance activities of the lessee, particularly one in distress. Finally, if the lessor ever does have to repossess, it will be imperative to have records as up to date as possible. They will be hard to obtain in the case of a non-consensual repossession of the aircraft.

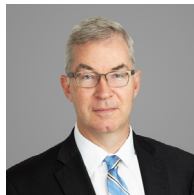
- **Be aware of what lessee rights are suspended when a lease event of default occurs.** For example, typically insurance proceeds under a threshold specified in the lease (e.g., US\$500,000) payable for damage to the aircraft are payable by the insurers directly to the lessee, who then has the obligation to repair the damage. The lease may specify, however, that if a lease event of default is continuing, such proceeds are instead payable to the lessor (so it can ensure that the proceeds are paid to the servicer, if that is what the lessor wants to do). Other rights that the lease may provide terminate when a lease event of default is continuing, including the right of the lessee to put the engines in a pooling arrangement and the right to dry sublease the aircraft.
- **Review provisions of credit documents.** The credit and security documents by which a leased aircraft is financed may provide that a lease event of default automatically constitutes a loan event of default. Even if no lease event of default has yet occurred, other loan events of default may be triggered such as the occurrence of a material adverse change to the business or prospects of the lessee. In many aircraft leveraged leases, the equity investor will have negotiated cure rights, lease-default remarketing rights, the right to proceed against the lessee without lender consent after a standstill period, or the right to prevent the lender from foreclosing the equity without simultaneously repossessing the aircraft. Many of these rights will have deadlines for the equity investor to act and need to be carefully reviewed so any right can be exercised promptly.

CONTACTS

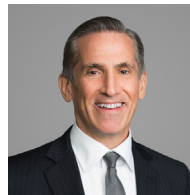
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