CLIFFORD CHANCE

Briefing note January 2012

The Eurozone Crisis and Aircraft Leases

The Eurozone crisis continues to dominate the global economic landscape and the possibility of a Eurozone member departing from the currency union has been touched on publicly by European leaders. While Euro-denominated aircraft leases are not common, they are written; this briefing looks at a set of questions in the context of how such lease documentation might (or might not) deal with such an eventuality, albeit an unlikely one.

***Question*: I have a Euro denominated lease of a commercial passenger aircraft to a private airline incorporated in a Eurozone country and I am worried the country may leave the Eurozone (the "Departing State"). If the Departing State were to leave and establish its own currency, would the lessee still be obliged to pay in Euro?**

Answer: One of the challenges with analysing such a set of circumstances is that the manner and legal basis upon which a country exited from European Monetary Union (EMU) would impact substantially on the analysis. There are a number of ways in which it is possible to foresee such an event occurring, ranging from a European Union (EU) approved withdrawal from the EU and the Eurozone or an approved withdrawal from the Eurozone but not the EU (although there is no mechanism in the Lisbon Treaty for the latter), to unilateral withdrawal by the Departing State from one or both on a non-consensual basis, in each case with the likelihood of the imposition of exchange controls. Accordingly, a complicated set of possible legal considerations arises, in particular based on whether or not the departure of the Departing State is agreed by EU member states and facilitated by supporting EU legislation (and if so on what terms) and whether, as is likely, exchange controls are imposed (again, if so on what terms). Indeed there could be wider controls imposed on the movement of funds or assets. In particular, the scope of such controls on movable assets such as aircraft will need to be assessed (*see also below on enforcement issues*). Also, the conflicts of law position would further complicate matters as would the approach adopted in any monetary legislation to redenomination which may be effected in various different ways.

For the sake of simplicity therefore, assume that the Departing State passes a law establishing monetary sovereignty re-denominating all debts owed by and to its nationals from Euros into a new currency; without EU consensus and over-arching EU legislation. For these purposes we will not consider any exchange control implications. We also assume that "all debts" would include rental and other payments (including indemnities) under chattel leases, whether the lease is an operating lease or a finance lease, although we note that

Key issues

When analysing aircraft leases for potential effects of a Eurozone member's departure, consider:

- **Jurisdiction**
- **Governing law**
- **Currency of payment provisions**
- **Place of payment**
- **Events of default and other documentary provisions**

Additional considerations:

- **Enforcement against the aircraft – registration and location issues**
- **Other collateral – including security deposit letters of credit and cash accounts**
- **Borrower loan obligations and potential lease-loan mismatches**
- **ECA supported aircraft financings**

in other contexts, operating leases are often intended to fall outside definitions of "financial indebtedness" or "borrowings", whereas finance leases fall within such terms. It should also be noted that other arrangements dealing with title transfer, possession and use, such as conditional sales, instalment sales and hire-purchase agreements, should be examined.

If you have a Euro denominated lease with an English governing law provision, submission to the exclusive jurisdiction of the English courts and a payment obligation in the single currency of the Eurozone with payment outside the Departing State – and assuming that no consensual protocol is established by the Eurozone states or the EU members to permit a Eurozone exit, then the English courts should hold that payments are to be made in Euro and if they are not made in Euro there will be a resulting event of default under the lease. However, where any of these factors are missing, then the analysis becomes more complicated.

As noted, there are four main areas in lease agreements that are relevant to determining the currency in which the debt is to be paid: (a) the submission to jurisdiction provision; (b) the governing law of the agreement; (c) the way in which the obligations to pay in a particular currency are drafted; and (d) the place stipulated in the contract for payment.

Each area is discussed in greater detail below:

(a) Jurisdiction – If the jurisdiction submission provision permits the courts of the Departing State to have jurisdiction then, whatever the governing law, the Departing State's courts would, in all likelihood, give effect to the Departing State's redenomination legislation. So it would be likely to mean that the lessee would be able to pay in the new currency and not in Euros. On the assumption that the Departing State would remain in the EU, the Brussels I Regulation would oblige English courts to recognise and enforce a judgment of the Departing State's courts, unless to do so would be "manifestly contrary" to English public policy.

(b) Governing law – If the governing law is that of the Departing State, the English courts would give effect to the Departing State's redenomination legislation pursuant to the Rome I Regulation. The English courts would decline to do so only if necessary to give effect to overriding English mandatory laws or if giving effect to the Departing State's redenomination legislation would be manifestly incompatible with English public policy. This would be the case only in unusual circumstances. If, however, the Departing State passed its redenomination legislation in breach of an EU Treaty, it is possible that the English courts would consider enforcement of that redenomination legislation to be contrary to English public policy. If, on the other hand, the governing law is English law, the Departing State's legislation would not affect the lessee's obligations under the lease agreement, subject to what is said in paragraphs (a), (c) and (d).

(c) Currency of payment – If the lease agreement is subject to English law and to the exclusive jurisdiction of the English courts, the main question is whether the clear contractual intention was for the currency of payment to be (i) the single European currency, in which case the lease would remain payable in Euros or (ii) the currency of the Departing State from time to time. This should be determined by the specific currency definition in the lease agreement and where it is not definitive, by reference to any other relevant circumstances, including the place of payment and any evidence as to the parties' intentions.

(d) Place of payment – The place of payment could be relevant for two main reasons. First, if there is no currency definition in the lease agreement but the place of payment is within the Departing State, that creates a rebuttable presumption that the parties to the agreement intended the currency of payment to be the currency for the time-being of the Departing State. If an agreement requires payment in the currency from time to time of the Departing State and the Departing State changes its currency from the Euro to a new currency, the payment obligation under the agreement will similarly be converted into an obligation to pay in the Departing State's new currency (converted at the rate set out in the Departing State's legislation) (this is referred to as the lex monetae principle). The presumption that the parties intend the currency and place of payment to be aligned is, however, rather weak, and the courts will look at all the circumstances in order to ascertain whether the parties intended the currency to be that of the Eurozone or that of the Departing State. Secondly, the Departing State's redenomination legislation could render payment in Euros illegal regardless of the requirements of the agreement. If so, for agreements concluded on or after 17 December 2009, the English courts have a discretion under article 9(3) of the Rome I Regulation to give effect to that legislation if, the place of payment is the Departing State and,

as would probably be the case, that legislation represents an "overriding mandatory provision" of the Departing State's laws. For agreements concluded before that date (and arguably all contracts, whenever concluded) the supervening illegality in the place of payment would render the obligation to pay in Euros in the Departing State unenforceable as a matter of English law.

***Question*: I have obtained a judgment from an English court. Can I enforce it against the lessee's assets located in the Departing State?**

Answer: Obtaining an English court judgment against the lessee is one thing. Enforcing against assets in a Departing State is something else. In many cases, it is likely that the lessee would only have substantial operations and assets in the Departing State. In the ordinary course, a creditor would enforce against those assets by asking the courts in the Departing State to enforce the English judgment. In the case of a Eurozone exit, the Departing State's courts would almost certainly be required to give effect to the Departing State's redenomination legislation and would, therefore, be unlikely to recognise, or enforce, an English judgment for Euro denominated debt against the lessee. As a consequence, enforcement against assets located in the Departing State would be difficult.

In the specific case of aircraft, the aircraft might be located outside the Departing State at the time of enforcement, therefore, it is possible that the lessor would be seeking recognition of the English judgment in the courts of a third state.

However, not least because the aircraft is likely to be registered in the civil aviation register of the lessee, as operator, dealings with the Departing State's courts and other authorities will still be relevant, regardless of whether or not the aircraft is located in the Departing State at the time of enforcement. Whether the aircraft is held to be "property of the lessee" by the Departing State's courts or whether the courts recognise the lessor's ownership rights will be a crucial factor. Further, in practical terms, there may be an issue as to whether the aviation and customs authorities (separate from the courts) would co-operate to de-register and export the aircraft and to permit repossession in the light of any exchange controls or sanctions against transfers of assets.

The characterisation of the relevant lease as an operating lease or a finance lease might be a significant factor in the enforcement analysis.

***Question*: I have a Euro denominated lease of a commercial passenger aircraft to a private airline incorporated in a Departing State. Would the Departing State's exit from the Eurozone trigger an event of default under my lease agreement?**

Answer: Typical lease agreements do not envisage a Eurozone exit as a specific event of default, and it is unlikely that any legacy lease documentation would do so, but you should check. However, depending on the circumstances, some of the more common events of default might be relevant, for example:

Non-payment: If the lessee's payment obligations are denominated in Euro but the lessee tries to make payment in a new domestic currency, this would likely constitute a payment event of default. Indeed, the lessee may be in financial difficulties occasioned by the withdrawal and redenomination (see the discussion on material adverse change below) and not be able to make any payment regardless of currency. This might also mean that any insolvency event of default would apply.

Material adverse change: Eurozone exit would impact a lessee's Euro denominated revenues from domestic sources. If a lessee is heavily dependent on domestic revenues to service the lease, and depending on the facts and the wording of the clause in question, it might be that a Eurozone exit itself would trigger any material adverse change (MAC) event of default, particularly if the MAC is expressed by reference to the lessee's ability to perform its obligations under the lease agreement.

Unlawfulness: If the Departing State were to withdraw from EMU, it is highly likely that the Departing State would impose exchange controls and that the lessee would only be allowed to enter into an obligation to (re)pay Euros if it first obtained exchange control consent (likely to be administered through the Central Bank or the Ministry of Finance). If such consent were not granted, it could be argued that any illegality event of default in the lease documentation would be triggered. However, this would require careful consideration of exactly what the Departing State's law provided.

There may also be repeating representations which are breached, for example relating to non-conflict with law or regulation; or the Departing State passing legislation making payment under the lease agreement unlawful; or the Departing State refusing to recognise the

express choice of law in the lease agreement.

***Question:* If my lease agreement contains a currency indemnity, might that help?**

Answer: A currency indemnity is often included to cover potential currency losses of the lenders in relation to a judgment of a court which is given in a currency other than the contractual currency. Such an indemnity may be relevant where judgment is given in the new domestic currency but the payment provisions remain denominated in Euro. However, there are some doubts as to the effectiveness of such indemnities generally.

***Question:* I have a Euro denominated lease of a commercial passenger aircraft which is guaranteed by a guarantor in the Departing State. Would the Departing State's exit from the Eurozone impact the guarantee obligations?**

Answer: The effect on the guarantee would be a matter for the governing law of the guarantee and the points referred to in answer to the previous questions would also be relevant here. Most important would be whether the intention was that the guarantor's Euro payment obligations were to be in Euro or in the national currency from time to time of the guarantor's (or lessee's) jurisdiction of incorporation.

See separately below in relation to ECA supported aircraft financings.

***Question:* What if my lessee is the Departing State itself?**

Answer: For a sovereign debtor, in addition to looking at English governing law and submission to the jurisdiction of the English courts, it would also be important to consider whether there is a waiver of immunity provision because typically there is immunity under domestic law from attachment of assets of a sovereign. Therefore, no enforcement measures can, in general, be taken against such a state's assets unless there is a waiver of such immunity. Even if there is a waiver of immunity, it might remain difficult in practice to enforce a judgment against the Departing State in the Departing State.

In relation to airlines specifically, we note that, although many airlines are private companies, they may be legacy state entities, the state may retain a significant shareholding or there may be significant regulation of the aviation industry, as a "public service". Therefore, state interference in claims against the lessee may be a particular concern.

***Question:* Could there be cross defaults or defaults under related credit support and derivatives documentation?**

Answer: Yes. Even if obligations under a lease agreement remain denominated in Euro and no events of default would be triggered by a Departing State leaving the Eurozone or re-denominating its currency and imposing exchange controls, the lessee could be party to other agreements which may be defaulted by these events.

Question: My lease transaction involves an owner/borrower SPV which owns the aircraft and leases it to the lessee in the Departing State and which has entered into a Euro-denominated loan with the leasing company or the financiers. What is the impact of redenomination of the Euro-denominated lease on the borrower's loan obligations?

Answer: In most aircraft lease financings, an SPV will be established to own the aircraft and lease it to the ultimate operator, being in our assumed scenario an airline in the Departing State. The SPV will typically be funded by a loan or other financing provided by an operating lessor or syndicate of financiers, on a limited recourse basis. The loan and lease payments are often matched, for example, in a full pay-out lease. If we assume that the owner/borrower SPV is not incorporated in the Departing State, then any redenomination legislation and exchange controls should not apply to the SPV or to its loan obligations. However, assuming that repayment of the loan is dependent on the SPV receiving lease payments from the lessee, there will be a currency (and potentially timing) mismatch between the lease payments and the loan payments. This may in turn impact on the solvency of the SPV, subject to the scope of the limited recourse arrangements. The financiers and/or leasing company will need to review termination and acceleration/prepayment triggers under the loan, e.g. for lease payment defaults and lease illegality. The currency of the secured debt under a mortgage or other security over the aircraft may also need to be considered.

If an operating lessor or any financier is providing equity support to the SPV, then such party should assess whether they are liable for any deficiency between the SPV's loan obligations and amounts received under the lease, due to a currency mismatch or the lessee's absolute failure to pay.

***Question:* I am the lender in a Euro-denominated lease financing to an airline which is supported by an export credit agency ("ECA") established in a Departing State. What is the impact of the state's Eurozone exit on the ECA support?**

Answer: Broadly, this will depend on the governing law and jurisdiction of the ECA support agreement (whether in the form of a guarantee or insurance policy), as well as the currency and place of payment. Generally, such agreements are subject to the law of the ECA's home state and the jurisdiction of its home courts. The ECA may also be an agency or division of the Departing State, therefore sovereign debtor issues will be relevant.

The specific terms of the support agreement and any standard terms of the ECA which apply to such support will need to be reviewed. For example, whether there is an express currency of payment provision in the support agreement itself or if the support agreement follows the relevant loan or lease so that the ECA's obligations are expressed to be payable in the currency of the underlying debt. The specific transaction terms will also influence the options available to the lenders, e.g. whether they can accelerate the financing on the basis of a loss or a change in the ECA cover and whether they can enforce any transaction security.

***Question*: For new deals, what should I be putting in my lease documents?**

Answer: You need to ensure that you have chosen a satisfactory governing law clause and submission to jurisdiction. A definition of the currency in which payment is due which makes it clear that the obligation is in Euros and not the currency from time to time of the obligor's jurisdiction of incorporation is important, both for lease agreements and for guarantees, and the place of payment should be outside the jurisdiction of the Eurozone member you are concerned about. Whether you want to include extra credit protection, for example an express default provision for redenomination, would depend on the circumstances of the transaction.

***Question:* Are there any other steps I should take?**

Answer: The essential thing will be to establish where you have leases which are potentially affected and then to locate all relevant documentation (including any credit support, guarantees, security, hedges, insurance etc.) and analyse how robustly they deal with the issues discussed above, since, "forewarned is forearmed" and you would be placed in a position to act rapidly if circumstances demand.

Actual payments: In particular, it should be noted that the actual place of payment of rentals and other payments under the lease could affect the analysis, regardless of any provision in the lease documentation specifying place of payment. In other words, you should check where payments under your leases are being made as an operational issue and not rely solely on a review of the documentation.

Other collateral: In typical aircraft lease financings, the lessor and/or financiers will have the benefit of other collateral in addition to ownership of or security over the aircraft itself, including a charge over the rental account and any maintenance reserves account, and a lease security deposit in the form of cash in a charged account or a letter of credit ("L/C") issued by an acceptable bank. You should check the location of such accounts and the identity and location of the account bank (including branches) and consider whether the relevant redenomination legislation and exchange controls apply to such accounts, on the basis that they are "assets of the lessee", even if they are secured to the lessor or a third party. In certain leases, the lease deposit and maintenance reserves are paid directly to an account in the name of the lessor.

Security Deposit L/Cs: If the issuing bank is located in the Departing State, then you will need to consider the impact of redenomination legislation and exchange controls on its obligations under the (Euro denominated) L/C, by reviewing the governing law and jurisdiction clauses, currency and place of payment, as described above. The ability of the L/C bank to meet its obligations will also need to be assessed.

Payments to the lessee: Your lease may be drafted to include payments from the lessor to the lessee, for example, in relation to maintenance contributions or rental rebates. It will be important to assess the impact of any redenomination legislation on payments owed to nationals of the Departing State, i.e. whether a payment obligation on the lessor would remain Euro denominated

when the lessee's lease obligations are redenominated.

***Question:* If my lease satisfies the conditions as to governing law, submission to jurisdiction, currency and place of payment so that (absent any overarching EU legislation) it is likely that an English court would give a Euro denominated judgment on its terms, notwithstanding a currency redenomination by a Departing State, is that an end to my concerns?**

Answer: No. Future overriding EU legislation could impact the analysis. As explained above, enforcement against assets located either within the Departing State or outside England could be a concern. Additionally, receipt of payments, even if the lessee was apparently able and willing to pay, could be blocked or delayed by the exchange controls which would be likely to be implemented alongside any currency redenomination. As mentioned above, the timeliness of lessee payments could affect the wider transaction, such as the timing of loan obligations of a separate borrower entity.

Of course the fundamental difficulty with achieving repayment would relate to whether, given the economic circumstances, the lessee actually has sufficient resources to pay in whatever currency and indeed whether it is insolvent. Therefore you may have done your best to preserve your position, but achieving actual repayment in volatile and uncertain times would still be an achievement.

The wider context

The above simply gives a flavour of some of the issues generated by the Eurozone crisis, there are likely to be many more questions and concerns regarding its impact on aircraft lease financing documentation. As with any hypothetical situation it is difficult to foresee how a Eurozone exit might be implemented from a legal perspective and there would be many political, economic and practical barriers to such an event. There is no existing mechanism for a Eurozone member to depart from EMU under the Lisbon Treaty and therefore a Departing State would either be exiting on a non-consensual basis or on a consensual basis with the support of other Eurozone member states pursuant to a treaty or other legal framework which does not currently exist. The manner of implementing any exit route would have substantial implications in relation to the analysis as to the legal consequences on contractual arrangements, especially in the context of any conflict of laws analysis. The accompanying economic difficulties would give rise to testing and untested eventualities. Nevertheless, as Dwight D. Eisenhower once remarked, "Plans are worthless, but planning is everything".

Related Briefings

- The Eurozone Crisis and Derivatives
- The Eurozone Crisis and Loan Agreements
- The Eurozone Crisis and Eurobond Documentation
- The Eurozone Crisis and High Yield Bond Documentation
- Exchange Controls - Back on the Agenda
- The Return of Capital Controls?

Authors

William Glaister
Partner

T: +44 20 7006 4775
E: william.glaister
@cliffordchance.com

Kate Gibbons
Partner

T: +44 20 7006 2544
E: kate.gibbons
@cliffordchance.com

Edmund Boyo
Partner

T: +49 697199 3324
E: edmund.boyo
@cliffordchance.com

Yann Beckers
Counsel

T: +33 14405 5478
E: yann.beckers
@cliffordchance.com

Marisa Chan
Senior Professional Support Lawyer

T: +44 20 7006 4135
E: marisa.chan
@cliffordchance.com

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

© Clifford Chance LLP 2011

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Kyiv ■ London ■ Luxembourg Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh* ■ Rome ■ São Paulo ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Clifford Chance has a co-operation agreement with Al-Jadaan & Partners Law Firm in Riyadh.