

Aircraft Lease Financing: Who's the Owner?

Amundsen Davis Financial Services Alert

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Aviation lending is a world unto its own, populated by lawyers and lenders alike that focus on this niche area. Other than just understanding the difference between FAR Part 91 and Part 135, or what the Cape Town Convention was, or how to obtain and perfect a security interest in a jet engine, lenders sometimes must be able to walk the line between regulations promulgated by the FAA and proper commercial financing. One example of this is the question on whether the lessee of an aircraft can register it with the FAA despite the fact that the lessee is not the owner. As with many things in the law, it depends.

For taxation, depreciation, and other reasons that are not germane to the topic of this article, lessees of aircraft sometimes desire to be considered the “owner” for aircraft registration purposes. This could be problematic for lenders because the owner of an aircraft for registration purposes is not necessarily the actual owner of the aircraft. Which entity should sign the security agreement with the lender? Which entity has the right to grant a security interest in the aircraft?

Decades ago, the FAA issued an opinion stating that lessees of aircraft could register it with the FAA, even though they were not the actual owner, if certain conditions were met. The basic requirement was that the lease must have a purchase option for the lessee that essentially made the lease a disguised sale (also known as a “synthetic lease”). In addition, the purchase option must have been 10% or less of the value of the aircraft (meaning that at least 90% of the value of the aircraft was paid through lease payments); or, the purchase option is more than 10% of the purchase price, but the lease contains a requirement that if the lessee does not exercise the option, they must pay for the residual value of the aircraft in an amount equal to or greater than the amount of the purchase option; or, payout is more than 10% and there is no mandatory full payout if the option is not exercised, but the option price is less than the lessee’s reasonable cost of performing under the lease. In these cases, the lease must require that the lessee be the party responsible for the maintenance, insurance, taxes, operations, and risk of loss; and, the lease must not give the lessee the unilateral right to terminate without economic penalty.

Despite the fact that a lessee can be the “owner” for the purposes of registering the aircraft with the FAA, the lessor is the actual owner. The fact that both the lessor and lessee are considered owners, albeit in different contexts, can be confusing and lenders must insure that the proper party grants them a security

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interest. If the lessee signs the security agreement, the lender will find itself without a security interest in the aircraft despite the fact that the lessee has the legal ability to register the aircraft as an owner, according to the FAA.

Lenders must be diligent in not only knowing their customer, but also in knowing the law. An unsecured multi-million dollar loan that was not approved by the lender needs to be avoided. Any questions about the proper entity to execute a security agreement should be directed to lender's legal counsel.

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