

10 Things You Need to Know About... Utilising a Cayman Islands SPV for Aviation Finance Transactions

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Special purpose vehicles (SPVs) are commonly employed in cross-border aviation finance transactions, and can be a particularly useful structuring tool for both owners and financiers. In their most basic form, they offer a way to hold an aircraft within a corporate structure, providing a degree of separation between the owner/operator and the aircraft. In more sophisticated financing and leasing transactions, however, it is common to see an “orphan” or “off-balance sheet” structure used, offering a number of additional benefits. Wherever an SPV structure is required, the stable political climate, flexible corporate regime and established and creditor friendly legal system offered by the Cayman Islands makes it an ideal choice of jurisdiction for establishing the SPV.

SPVs are widely used as structuring tools in aviation finance transactions

It is very common in the context of aviation finance transactions for an aircraft to be held through a corporate structure, with title to the aircraft being transferred to an SPV rather than to the ultimate beneficiary (whether an individual or a corporation) directly.

Broadly, one of two types of structures are commonly used for aircraft owning SPVs:

- “on-balance sheet” SPV structures; and
- “off-balance sheet” or “orphan” SPV structures.

In an “on-balance” sheet SPV structure, the ultimate beneficiary will establish a wholly owned SPV to acquire title to the aircraft, but will retain direct ownership and control of the SPV itself (and will typically also consolidate the SPV onto the parent’s balance sheet, hence an “on-balance sheet” structure). This means that they will be the parent/shareholder of the SPV and will normally also act as a (in the case of an individual) or provide directors to (in the case of a corporate owner) the SPV directly. On-balance sheet SPVs are often utilised within group structures for accounting, tax and/or administrative purposes. They can also be used for succession planning purposes, as well as to limit any personal liability arising in respect of the asset, where high net worth individuals are acquiring assets such as corporate jets.

“Orphan” or “off-balance sheet” SPVs are typically used for secured financing transactions, and may be established by either the owner or the financier depending on the requirements of the transaction. In these orphan structures, the shares in the SPV are held within an “orphan trust” structure by a corporate trustee (rather than directly by the beneficiary/operator) pursuant to a trust structure (either a charitable trust or a STAR trust). In addition, the directors will usually be independent of the ultimate beneficiary, and the SPV will instead utilise the services of professional independent directors. The SPV will be legally separate (or “orphaned”) from the beneficiary/operator and will be independent of the other transaction parties such as financiers. From an accounting perspective, the SPV will not typically form part of either the operator/beneficiary or the financier’s group as neither of these parties will have a direct ownership interest in the SPV, meaning the aircraft can be held off their respective balance sheets (hence being an “off-balance sheet SPV”).

SPVs allow an owner/operator to limit their liability in respect of an aircraft

Under Cayman Islands law, the SPV will be deemed to have separate legal personality and (absent fraud or wilful default) a shareholder cannot become liable for the acts of a company. There will therefore only be very limited circumstances in which a claimant could look through the SPV to bring a claim in respect of the asset directly against the parent/ultimate beneficiary.

By using an SPV structure in the context of an aircraft finance transaction, the parties can limit their personal liability in respect of the underlying asset. The operator/beneficial owner of the aircraft will not directly own the aircraft, but instead will transfer the aircraft to, or acquire the aircraft through, the SPV. It is therefore the SPV, and not the beneficiary, acting as counterparty to any agreements and other arrangements in respect of the aircraft, insulating the beneficiary/operator from any claims which may arise in connection with the ownership or operation of the aircraft, as any such claims will need to be brought against the SPV as legal owner of the aircraft.

SPVs are also particularly useful in group structures where they can also be employed to effectively segregate the aircraft from any other property held by the parent, reducing the risk of the asset being negatively impacted by any actions arising in connection with any of the parent's other property, or vice versa.

SPV structures give financiers a greater degree of certainty and control over the aircraft

The SPV will be established solely to hold title to a specific aircraft, and will therefore be untainted by any other activities undertaken by, or property held by, the owner that could negatively affect the aircraft or the value of any security provided by the SPV to the financiers in respect of the aircraft.

An SPV will typically be structured in such a way that, in the event of a default or breach which could impact the value of the aircraft or of any security provided in respect of the aircraft, the financier is able to take control of the SPV. This is usually achieved through a charge over the shares of the SPV, which will give the financier the right to transfer the shares in the SPV either to itself or its nominee upon the occurrence of an event of default which is continuing. In an enforcement scenario, this enables the financier to transfer the SPV as a going concern rather than having to arrest and sell the aircraft (which will often require a court order and can lead to practical issues, particularly given the mobile nature of aircraft).

In addition to any share security, the SPV typically also grants a security package that allows the financier to enforce certain rights against the aircraft and/or the SPV in order to protect its interest in the asset in the event of a default. The transaction documents would typically include covenants preventing the SPV from undertaking certain activities either in respect of itself or the asset without the consent of the financier, providing the financier with a further degree of control over the SPV.

Orphan SPV structures offer the benefit of Bankruptcy Remote Structuring

A key reason for establishing an off balance sheet SPV to hold an aircraft is to ensure that the structure is "bankruptcy remote". The primary purpose of a bankruptcy remote structure is to avoid any risk of the assets held by the SPV from becoming subject to bankruptcy proceedings in the event one of the transaction counterparties (for example, an airline lessee in respect of the aircraft) become subject to bankruptcy proceedings. Conversely, a bankruptcy remote structure would also protect the other transaction parties in the event that the SPV itself became subject to bankruptcy proceedings. In order to achieve this, the SPV will need to be structured in such a way that it is legally independent from both the originator/operator of the aircraft and the financier, and that none of the other transaction parties is able to exercise any direct control over the SPV. When properly structured, these are features that can be offered by a Cayman Islands orphan SPV structure.

In order to facilitate a bankruptcy remote structure, the transaction will need to be entered into on a "limited recourse" and "non-petition" basis. With a "limited recourse" SPV, the right of any transaction party to bring a claim against the SPV will be limited to the assets of the SPV. Broadly, this will be the underlying aircraft itself together with any earnings or proceeds of sale generated by the aircraft once all payments as required by the transaction documents have been made. Typically this will be achieved by including provisions in the transaction documents whereby the parties agree to contractually limit their recourse against the SPV (which is possible as a matter of Cayman Islands law and would be upheld by a Cayman Islands court). In addition to the limited recourse provisions, the transaction documents should also contain "non-petition" language, whereby the transaction parties agree not to petition for a liquidation or winding up of the SPV until following the termination of the financing transaction. This is to ensure that none of the parties contracting with the SPV can take any action to wind-up the SPV during the life of the transaction.

While the primary concern of a bankruptcy remote structure is to give financiers additional assurance that a bankruptcy event in respect of the owner/operator won't diminish the value or enforceability of their security, bankruptcy remote structures also give owners and operators some degree of comfort that the failure of a bank won't impact the aircraft, and that an event in respect of aircraft itself won't negatively impact the operator/owner.

The Cayman Islands offer an ideal political, legal and fiscal environment for establishing an aircraft owning SPV

The Cayman Islands are recognised as a leading international financial centre, combining a well-established, stable and trusted legal and political framework with a flexible yet robust corporate regime, creditor-friendly laws and a tax neutral environment. These are all important considerations for both owners/operators and financiers when determining where to establish their aircraft-owning SPV.

As a British Overseas Territory, the legal system is based on English common law, and the Privy Council forms the ultimate court of appeal. The laws of the Cayman Islands are passed by a democratically elected legislative assembly and the electoral system is based on the British parliamentary model.

The Cayman Islands are a tax neutral jurisdiction, and no income, capital gains or withholding tax is imposed by the Cayman Islands government on any Cayman Islands SPVs or arises within the Cayman Islands as a result of any transactions entered into with a Cayman Islands SPV. Furthermore, a Cayman Islands SPV can apply to the Cayman Islands government for a tax exemption certificate confirming the SPV will not be subject to any such taxes in the Cayman Islands for a period of 20 years from the date of the certificate.

Cayman Islands SPVs offer a high degree of flexibility

The Cayman Islands corporate regime offers a great deal of flexibility, without burdening the SPV and its directors with excessive regulation. A Cayman Islands exempted company, which is the most popular corporate vehicle used for SPV transactions, offers the following benefits:

- Cayman Islands SPVs are generally incorporated with limited liability and have separate legal personality.
- A Cayman Islands SPV can have a single director, which need not be a natural person (i.e. corporate directors are possible).
- There are no *prima facie* nationality or residency requirements for directors or shareholders of a Cayman Islands exempted company.
- There is no minimum level of authorised or issued share capital for an SPV. A Cayman Islands exempted company has a great deal of flexibility in issuing, redeeming and repurchasing shares. In particular, the company may issue shares at a premium to their par value, and can use any proceeds of the share premium account arising from such issue to pay dividends.
- There are no statutory restrictions under Cayman Islands law preventing a company from providing financial assistance for the purchase of its own shares, and consequently no need for any whitewash procedure.
- Cayman Islands companies have a separate legal personality.
- There is no requirement as a matter of Cayman Islands law for a Cayman Islands exempted company to appoint an auditor or file audited financial statements with the Registrar of Companies or any governmental body within the Cayman Islands.
- There are no exchange controls in the Cayman Islands.

A Cayman Islands SPV can facilitate registration of an aircraft on the Cayman Islands aircraft register

For an aircraft to be registered in the Cayman Islands it must be owned by a person meeting the eligibility requirements under the Air Navigation – Overseas Territories (Amendment Order) 2015 (the **ANOTO**).

This includes:

- The Crown in right of His Majesty's Government in the United Kingdom or in right of the Government of the Territory (Cayman Islands);
- United Kingdom nationals;
- Commonwealth citizens (which includes citizens of the Cayman Islands);
- Nationals of any European Economic Area State;
- Bodies incorporated in any part of the Commonwealth and which have their registered office or principal place of business in any part of the Commonwealth (which would include companies incorporated in the Cayman Islands); or
- Undertakings formed in accordance with the law of a European Economic Area State and which have their registered office, central administration or principal place of business within the European Economic Area.

If the current/proposed owner is not currently an eligible person, then a Cayman Islands exempted company can be incorporated as an SPV owner to take title to the aircraft and register the aircraft on the Cayman Islands aircraft register maintained by the Civil Aviation authority of the Cayman Islands.

Incorporating a Cayman Islands exempted company is a straightforward process. The Cayman Islands Registrar of Companies offers incorporation on an express basis, meaning that an SPV can be established within 1-2 business days.

The fees for incorporating and maintaining a Cayman Islands company are competitive and are calculated on a sliding scale based on the authorised share capital of the company.

The Cayman Islands have a pool of experienced independent SPV directors, share trustees and service providers with extensive knowledge of aviation finance structures

The Cayman Islands have an established financial services industry. There are several large corporate service providers, experienced offshore attorneys and Class A banking institutions with detailed industry knowledge and experience of complex transactions (including SPV financing, warehouse financing and ABS transactions) on hand to provide specialist services to aircraft finance SPVs.

In addition to providing independent SPV directors with extensive market-specific experience in the aviation finance space, corporate service providers are also able to offer services such as FATCA and CRS reporting, AML services and accounting, audit and financial reporting functions.

The Cayman Islands is a creditor friendly jurisdiction, making it ideal for establishing an SPV as part of a secured aircraft financing structure

As a creditor friendly jurisdiction, the Cayman Islands is attractive for financiers who are looking to establish an SPV as part of a secured asset financing structure. As a matter of Cayman Islands law, secured creditors will have the right to enforce their security in the event of a liquidation of the SPV in priority to unsecured creditors. Contractual subordination provisions are recognised, assuming they are effective under the governing law of the relevant agreement as a contractual matter, and non-petition provisions are statutorily recognised.

In addition, liquidators of Cayman Islands SPVs do not have the power to disclaim onerous contracts.

The Cayman Islands is a Cape Town contracting jurisdiction

Following the ratification by the UK government of the Convention on International Interests in Mobile Equipment and the associated protocol on matters specific to aircraft equipment (together the **Cape Town Convention**), and its subsequent extension to the Cayman Islands on 1 November 2015, the Cayman Islands are now recognised as a territorial unit of a contracting state for the purposes of the Cape Town Convention.

This means that where a Cayman Islands SPV owns an aircraft meeting the applicable size and power requirements to qualify as an “aircraft object” under the Cape Town Convention, any “international interest” (as such term is defined in the Cape Town Convention) created by the Cayman Islands SPV will be capable of registration on the international registry established pursuant to the Cape Town Convention (the **International Registry**) by virtue of the SPV being incorporated in a contracting state. As a result, creditors involved in financing an aircraft owned by a Cayman Islands SPV now have the additional comfort of knowing they can protect their security interests in that aircraft by making a filing in respect of any validly created and existing international interest with the International Registry.

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