

COVID-19: TURBULENCE IN THE SKY - IS AIRCRAFT RE-POSSESSION THE ANSWER?



This article examines technical issues when lessors and financiers choose to repossess aircraft in Malaysia and considers how this process is complicated by the current Covid-19 pandemic.

Aircraft leasing is a popular choice for airlines to grow their fleet. Globally, of the 27,000 commercial jet aircraft valued at over \$696 billion (active and parked aircraft) operated by airlines, almost half of them are owned by operating lessors and leased to airlines.

Aircraft are capital-intensive assets. The list price of a new Airbus 380, for instance, is approximately US\$450 million. Many carriers are unable to invest such large sums of money to acquire a plane whilst established airlines may not want to put all their resources solely into purchasing one aircraft. This is where the aircraft leasing business steps in.

The amount of capital required to lease an aircraft is undoubtedly less than the expense needed to purchase an aircraft. Leasing is routinely used to build a fleet. Additionally, by leasing from lessors, airlines enjoy the luxury of operating newer and more fuel-efficient aircraft.

However, travel restrictions as a result of Covid-19 has devastated the airlines and lessees of these aircraft. Many airlines face imminent insolvency without government support.

If the airline is in default under the lease agreement and it is no longer commercially viable for the lessor to continue leasing the aircraft to the airline, the lessor may begin to formulate its strategy to repossess the aircraft. In this article, we discuss the process for repossessing a Malaysian registered aircraft and also consider the technical difficulties in doing so during this period.

General Overview of the Repossession Process

Generally, there is no legal requirement under Malaysian law for a lessor, who is also the owner of an aircraft, to seek judicial intervention in order to exercise its rights to acquire possession of the aircraft where the lessee has defaulted on the lease.

Prior to exporting the aircraft from Malaysia, a notice will need to be given by the lessor (as the owner of the aircraft) to the Civil Aviation Authority of Malaysia (“CAAM”) informing them that the aircraft is being exported. If there is a mortgage, lien or irrevocable deregistration or export request authorisation (“IDERA”) registered against the aircraft, these will need to be discharged before the aircraft can be deregistered and exported.

If judicial proceedings are required in order to repossess an aircraft, summary proceedings may be taken in Malaysia in a straightforward case. In summary proceedings, affidavit

evidence will be used to establish that the defendant (i.e. the lessee) does not have a defence in a claim and/or there are no triable issues or disputes of fact touching upon the plaintiff’s (i.e. lessor’s) claim. On the other hand, if the court finds that there is an issue or question in dispute which should be tried, the court may dismiss the application and direct that the lessee or defendant be given leave to defend the claim.

Separately, lessors need to be cautious that there are also certain circumstances where owners may be deprived of the right to repossess an aircraft. We have set out below some of the circumstances which may potentially hinder the right of the lessor to repossess an aircraft.

A. Civil Aviation Regulation 2016 (“CAR”)

Under Regulation 170 of the CAR, the Director General of the CAAM may detain an aircraft where an owner or operator of any aircraft defaults in payment of any fees or charges as prescribed under the Civil Aviation (Fees and Charges) Regulations 2016.

Upon detention, details such as the amount due, the date and time of detention, and date and time of the entry made will be recorded at the Aircraft Register and an aircraft lien shall be vested in the CAAM upon such entry. Accordingly, a notice of detention will be given to the owner, operator, lessee, hirer, charterer, pilot-in-command of the aircraft or the person who has security interest in the aircraft.

The Director General may retain possession of the aircraft until all outstanding amounts are paid. On the contrary, if the outstanding amount remains unpaid, the Director General may (a) sell the aircraft with the leave of the High Court (if the outstanding amounts remains due at the end of one month from the date of the aircraft lien) or (b) deregister the aircraft if the outstanding amount remains unpaid at the end of six months after the creation of the lien.

B. Income Tax Act 1967 (“ITA”)

Pursuant to Section 105(1) of the ITA, the Director General of Customs and Excise shall refuse clearance from any aerodrome or airport in Malaysia to an aircraft wholly or partly owned or chartered by a person who has not paid taxes for more than 3 months.

C. Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (“AMLATFA”)

An aircraft may also be seized by an investigating officer, upon obtaining approval from an investigating officer senior in rank to him, if he has reasonable grounds to suspect the aircraft to be the subject-matter of an offence under the AMLATFA or evidence relating to the commission of such offence or to be terrorist property.

D. Civil Law Act 1956 (“CLA”)

Section 5 of the CLA provides that, English law with respect to, inter alia, the law of carriers by air and mercantile law generally, shall be administered in the like manner as would be administered in England on the date the Civil Law Act came into force i.e. 7 April 1956 with respect to West Malaysia, and 1 April 1972 with respect to Sabah and Sarawak. Hence, by interpreting Section 22(1) of the Courts of Judicature Act 1964 with the aid of Section 20(2) of the UK Supreme Court Act 1981, an aircraft may be arrested under Malaysian law as a result of claims for pilotage, towage and salvage.

E. Convention on International Interests in Mobile Equipment (the “Cape Town Convention”)

Additionally, Malaysia has also made a declaration under Article 39(1)(a) of the Cape Town Convention which provides for the following non-consensual rights having priority without registration:

- (i) Liens in favour of airline employees for unpaid wages arising since the time of a declared default.
- (ii) Liens or other rights of an authority of Malaysia relating to taxes or other unpaid charges arising from or related to the use of the aircraft object and owed by the owner or operator and arising since the time of default.
- (iii) Liens in favour of repairers of an aircraft object in their possession to the extent of service or services performed on and value added to the object.

In short, such non-consensual rights and interests need not be registered with the International Registry in order for their priority status to be preserved. It is also immaterial whether such rights and interests arose before or after ratification of the Cape Town Convention and/or creation of the relevant international interests.

Malaysia further declares that nothing in the Cape Town Convention shall affect its right or that of any entity thereof, or any intergovernmental organisation in which Malaysia is a member, or other private provider of public services in Malaysia, to arrest or detain an aircraft object under its laws for payment of amounts owed to the Government of Malaysia, any such entity, organisation or provider directly relating to the service or services provided by it in respect of that or another aircraft object.

“Self-help” Remedy Under the Cape Town Convention

The Cape Town Convention was given effect in Malaysia pursuant to the International Interests in Mobile Equipment (Aircraft) Act 2006 (“IIME”)¹.

Under the IIME, the repossession of an aircraft may be carried out by way of “self-help” without a prior court order mandating or authorising such repossession.

The Cape Town Convention provides that where the self-help remedy is exercised in conformity with a provision of the security agreement, it must be exercised in a commercially reasonable manner except where such a provision is manifestly unreasonable². Additionally, the debtor’s consent is required in order for such self-help remedy to be exercised.³

The concept of “commercial reasonableness” is crucial for the protection of the debtor against unwarranted actions of the creditor bearing in mind that the latter will typically be in a stronger position as a result of the use of its standard terms and conditions in its security agreements.

One point to note, however, is that the Cape Town Convention does not define “commercial reasonableness” and it appears vague as to what principles and factors are relevant when considering whether the exercise of a self-help remedy complies with this requirement. It is thought that one way to enhance the debtor’s stance would be to set out the extent of the debtor’s consent in the security agreement. For example, a security agreement may provide that repossession of the aircraft should only be accomplished without breaching the peace or causing interference to its immediate operation.⁴

Difficulties in Repossessing an Aircraft During this Pandemic

Lessors and financiers would always want to ensure that they have the right to repossess their aircraft if it becomes necessary to do so. However, repossession may not always be the best option.

“Getting the plane back” is a common knee-jerk reaction but the process of repossessing an aircraft is expensive, time consuming and unpleasant. Lessors would need to incur significant costs to deploy personnel to the aircraft location to carry out inspections and arrange for the logistics of exporting the aircraft. At the present moment where travel bans and movement restrictions are enforced by many countries, it would be difficult to even get to the aircraft location. Worse still, if court intervention is required, this could significantly delay the repossession process and add to the costs of the lessor. It is also worth noting that the Malaysian courts are currently closed under the Movement Control Order imposed by the Malaysian Government and so it may not even be possible to obtain any court order to repossess the aircraft during this period.

¹ Malaysia deposited her instruments of accession to the Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (“Aircraft Protocol”) on 2 November 2005 and the Aircraft Protocol was incorporated under the International Interests in Mobile Equipment (Aircraft) Act 2006 which was which was effective from 31 August 2006.

² Art 8(3) of the Cape Town Convention

³ Art 8(1) of the Cape Town Convention

⁴ In some jurisdictions like the United States, this is one of the prerequisites of repossession. § 9-609 (b) (2) of the Uniform Commercial Code allows repossession without judicial process provided it can be accomplished without breach peace.

Even if the repossession process goes well and the lessor is able to get the aircraft back, if the aircraft is not in re-marketable condition and the maintenance reserves are insufficient, the lessor may need to spend money getting the aircraft back in shape. And even if all that is achieved, in the current climate where no airline is entering into new leases, the likelihood of being able to remarket a repossessed aircraft is so slim.

Lessors which take steps to repossess their aircraft would no doubt end any relationship that they have with the lessee. This may also start a chain reaction from other creditors of the lessee, causing the lessee to use its remaining resources to battle for its survival. Restructuring the lease, by deferring rental payments, on the other hand, would go a long way in helping troubled airlines to weather this storm and to ensure the continuity of the industry as a whole.

If you have any questions or require any further information regarding these or other related matters, please contact us.

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