LEASE AND LEASING OF AIRCRAFT IN ITALY AND QUEBEC: DEFAULT OF THE LESSEE

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a constant guide throughout my entire life. Only by doing this, I hope, I will be able to prove my acknowledgement for their immeasurable love.

ABSTRACT

Although the contracts of lease and leasing have been used for many years by airline companies, increase in traffic volume predicted for the following years will certainly determine a greater need for aircrafts and consequently a greater demand for use of these kind of contracts.

Not only do they offer economic benefits but they are also very important instruments in the hands of an airline for fleet planning.

Operating and financial lessors have a wide market for their costly "toys", but, as the market and profits expand, so does the need for lessors to be at any time able to keep total control of them. In fact, one of the biggest fears for a lessor is to loose his property because he is not able to repossess it after a default of the lessee.

This thesis first briefly overviews the contract of lease and leasing and how the latter, being a contract of common law origin, has been included in the legal systems of two civil law countries like Italy and Quebec. Subsequently, the main clauses of a contract of aircraft lease or leasing are analysed not only to see the duties that a lessee entering into such a contract has, but also to see if these clauses follow the provisions which govern the contract, in general, and the contract of lease and leasing, in particular, in Italy and Quebec.

Chapter II deals with the remedies that, in case of the lessee's default, a lessor has, in Italy and Quebec, in order to repossess his aircraft; whether these remedies can

guarantee speedy repossession and whether the remedy of the "self-help repossession", which is a typical common law legal instrument, can be applied in Italy and Quebec.

Finally there is a short analysis of the "Convention on International Interests in Mobile Equipment" which is being drafted by Unidroit and its possible help in solving the problem of quick repossession in the case of a default by the lessee.

RÉSUMÉ

Les contrats de louage et de crédit-bail ont été utilisés par les compagnies aériennes depuis longtemps. Au-delà des avantages fiscaux, ils offrent beaucoup d'avantages économiques et la possibilité de mieux gérer la flotte d'aéronefs selon les exigences du marché.

Puisque il s'agit de contrats qui se réfèrent à des objets très chers tels que les aéronefs, ils ont une structure très complexe avec un nombre incroyable de clauses que le locataire ou le crédit-preneur doivent respecter afin de garder l'aéronef en bon état. Les difficultés créées par la complexité de ces contrats sont plus grandes au Quebec et en Italie, pour ce qui concerne le crédit-bail, parce que tous les deux sont des pays de droit civil qui ont dû intégrer dans leurs systèmes juridiques un tel contrat, qui est né dans un système de common law.

C'est pour çette raison que cette thèse analyse d'abord les dispositions italiennes et québécoises sur le louage et le crédit-bail. Ensuite les clauses les plus complexes d'un contrat typique de louage ou de crédit-bail d'aéronef seront examinées, en voyant en même temps si cettes stipulations sont conformes aux règles des systèmes juridiques québécois et italien.

Puisqu' il arrive parfois que le locataire ou le crédit-preneur ne respectent pas les stipulations du contrat et que dans ce cas ci il est bien possible que le locateur ou le crédit-bailleur veuillent reprendre possession immédiatement de l'aéronef, on verra, dans la deuxième partie de la thèse, quels sont les moyens, judiciaires et extra-

judiciaires, à la disposition du locateur ou du crédit-bailleur qui veut reprendre possession de l'aéronef. On verra aussi si l'instrument du "self-help repossession", bien connu dans les pays de common law, peut être utilisé dans des pays de droit civil tels que l'Italie et le Québec.

Enfin nous analyserons brièvement la "Convention on International Interests in Mobile Equipment" qu'Unidroit est en train de préparer, et nous soulignerons son utilité dans le domaine du crédit-bail et de la reprise de possession d'aéronefs

INTRODUCTION

The contracts of lease and leasing

The contracts of lease and leasing have been closely linked for years. Leasing, being a contract of Anglosaxon and common law origin, at first created problems of interpretation in civil law jurisdictions like Quebec and Italy. Courts, especially in Italy, and commentators very often focused their attention on the similarities of the two contracts which led to the "characterization" of leasing as a type of lease. Today the interventions of the legislator in Quebec, and of the Supreme Court in Italy, have defined the contract of leasing in such a way that it can no longer be considered just a different kind of lease. The distinction will be particularly important when it comes to analyzing their application in the aviation world.

The contract of lease is the contract by which a party (the lessor) undertakes to provide the other party (the lessee) with the enjoyment of a movable, or possibly immovable property for a certain time and in return for a specified rent.
An almost identical definition of the contract of lease is given by art. 1571 of the Italian Civil Code and art.1851 of the Quebec Civil Code. Both codes deal with the legal regime of movable and immovable property. The lease of an aircraft, certainly the most "movable" of movables subject to a contract of lease, is also governed in Italy by articles 1571 to 1606 of the Italian Civil Code and in Quebec by articles 1851 to 1891. However in Italy, when it comes to the lease of an aircraft, the rules contained in the Italian Navigation Code have to be taken into consideration too. Art. 939 of the

Navigation Code states that the lease of an aircraft is subject to the rules of articles 376 to 383 concerning the lease of ships. The rules of the Italian Navigation Code, however, do not differ from those of the Italian Civil Code except for the fact that they take into consideration the particular nature of the aircraft. In case of conflict the rules of the Navigation Code will prevail.

As to leasing the Quebec Civil Code also sets out its legal regime in articles 1842 to 1850. Contrary to what happened in the Civil Code of Lower Canada in which only art. 1603 was concerned with leasing, the new code "fait dorénavant du crédit-bail un contrat nommé et non plus une exception au contrat de louage"[1].
Article 1842 defines leasing as a contract by which a person (the lessor) puts at the disposal of another person (the lessee) a movable property, which the first has acquired from a third person in accordance with the instructions of the lessee, for a fixed term and in return for payment.

In Italy the situation is certainly more complex due to the fact that the contract of leasing is not a nominate contract[2]. It is not unknown to the Italian legislator, but what is lacking is a complete regime of the contract. What we have now are only rules

[1] See **A. Grenon** , "Le crédit-bail et la vente à tempérament dans le code civil du Québec" (1994) 25 Revue général de droit 217 at 224. The author explains that in the Code Civil du Bas-Canada the only article on the leasing was art. 1603. Whenever a leasing contract did not follow the rules set out in that article, the dispositions on the lease contract were to be applied. The Author adds that now the function of the leasing as a mean of financing is clear.
[2] In this sense **De Nova**, *Il Contratto di Leasing*, 3rd ed. (Milano: Giuffrè Editore, 1995) at 9. According to the Author a contract can be considered codified only if a specific and complete legal regime has been implemented. In his opinion this is not the case of the leasing contract in Italy. Contra see **Clarizia**, "La tipizzazzione legislativa del contratto di locazione finanziaria" (1993) Rivista Italiana del Leasing 251 at 257. According to the Author the leasing contract can be considered a codified contract because the legislator, even with different laws enacted at different times, has regulated all the characteristics and the different structural and functional aspects of leasing.

relating to certain aspects or certain kinds of leasing[3], or financial lease ("locazione finanziaria") as it is more often referred to[4].

This is why a complete analysis of the legal regime of leasing in Italy has to take into consideration the decisions of the Italian Courts, with emphasis on the decisions of the Supreme Court, usage and the rules on nominate contracts.

The freedom to sign a leasing contract has never been questioned by the Italian courts: according to art. 1322 par. 2 of the Italian Civil Code the parties are free to sign any kind of contract, even an innominate one, as long as that contract "pursues interests worthy of protection"[5].

But this is not the only aspect of leasing analyzed by the Italian Courts. Due to the lack of an organic regime, courts of first instance and courts of appeal, at first, and the Italian Supreme Court, eventually, have been called upon, over the years to clarify the legal regime applicable to the contract of leasing[6].

This task has not been easy and the difficulties the Courts have had to face are reflected in the different opinions given by the Italian Supreme Court over the years.

In a first phase, from 1972 to 1989, characterized by decision n. 8766, the Supreme Court underlined the financing purpose of the leasing contract and its differences with the installment sale and the lease contract. Moreover for the first time a distinction

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[3] For an example see art. 17 para.2 of the law n.183 of 2nd May 1976 which defines the operations of leasing as "[those] operations of lease of movables or immovables, bought or having been built by the lessor, but chosen by the lessee who also assumes all the risks and who can become the owner of the property at the end of the lease by paying a previously defined price". However , not only the definition still links the leasing contract to the lease contract, but also, since the law n.183 sets out the discipline of the "leasing agevolato" for industrial machinery, the definition itself only applies to these kinds of transactions.

[4] The word leasing should be preferable to "locazione finanziaria". The first one would highlight the fact that it is a non typical contract of common law origin and not a type of lease.

[5] Among the others see Tribunale di Monza, 19 October 1984

[6] The fact that a contract is not a nominate contract does not necessarily mean that it is not disciplined. In fact through the interpretation of the contract it can be underlined its similarities to one or more nominate contract whose legal regime will be, partially or totally, applicable to the innominate contract.

was made between the operating lease ("locazione operativa") and the financial lease ("locazione finanziaria").

In a second phase the Supreme Court, in its decisions n. 5569-5574 of 13th December 1989, distinguished two types of leasing: a "traditional" type, also called "leasing di godimento", and a "new" type, called "leasing traslativo". The first one was a means of financing and was characterized by the fact that the economic life of the leased goods was equal to the length of the contract; the second one, on the contrary, was in essence a form of exchange and was characterized by the fact that the residual value of the leased goods was superior, at the end of the contract, to the price established for the purchase option.

Although in a decision of May 1991 the Supreme Court went back to its previous position and reaffirmed the unique financing purpose of the leasing contract, by decision n. 65 it has (finally ?) confirmed the distinction between the two types of leasing which had been accepted in 1989. Recently the 3rd Section of the Supreme Court has affirmed that " in order to establish if a leasing contract is to be considered a "leasing di godimento" or a "leasing traslativo" one must look at the will of the parties at the moment of the signing of the contract itself"[7].

Different kinds of aircraft leasing

The one thing that can be said about an aircraft is that it is a very expensive item. The price of a brand new Boeing 777-300 varies from $ 149 million US to $ 171 million

[7] Italian Supreme Court, 3rd Section, *Macias vs. Soc Roamaleasing* , 17 December 1997

US. As the prices of planes went up so did the need for airlines to find alternative ways of payment to acquire the equipment needed for their business. This explains the rapid growth of lease and leasing in the aviation world.

The numerous advantages offered by these kinds of transactions coupled with the international nature of the aviation industry has led to a world wide use of lease and, especially, of leasing. Moreover, because of tax benefits that can be obtained, lease and leasing transactions have been well analyzed by tax and accounting experts. This has led to a multiplication of the kinds of leasing, each of them similar to the other but different in one or two elements in order to have a certain result which can be better tax reduction or a more profitable depreciation.

It is thus important to take a rapid look at this sea of names in order to be able to define precisely the transaction we are going to discuss in the thesis.

The basic distinction is between an operating lease and a financial lease.

A financial lease (also called capital lease) is a full payout lease pursuant to which the lessee acquires the use of an aircraft for a substantial part of its useful life; the lessor purchases the aircraft from the manufacturer according to the indications of the lessee; rent payments are structured so that the lessor recovers the cost of the aircraft plus return on investment; the lessor remains the owner of the aircraft but the contract substantially transfers the risks of loss to the lessee.

An operating lease is a lease of short to medium term duration (generally not more than ten years) where the lessee acquires the use of an asset for a term equal only to a fraction of the airplane's useful life ; at the end of the lease the aircraft is returned to the lessor who can lease it again.

As said earlier many factors have contributed to the development of many forms of leasing. The following are the most "well-known" :

a) Cross-border leasing : a lease or leasing where the lessor and the lessee are based in different countries with different legal systems.
b) Wet lease : a lease where the lessor provides the crew to operate the aircraft. In the case where the lessor provides the flying crew and the lessee provides the cabin crew, it is called a damp lease.
c) Dry lease : a lease where the lessor provides only the aircraft.
d) Double-dip lease : a leasing that uses significant tax benefits from two different sources normally situated in two different countries.
e) Sale-leaseback : a leasing where the purchaser of the equipment leases it back to the seller.

We have previously underlined how expensive an aircraft can be. One of the lessor's biggest concerns is that his asset could be in some way damaged and that he may not repossess it. This is why a contract of lease or leasing will always be carefully drafted for as far as the duties of the lessee are concerned. At the first sign of non-compliance of the lessee with the terms of the agreement (which in the long run could lead to damage to the aircraft), the lessor will always want to be able to resiliate or terminate the contract and repossess the aircraft.

In chapter I I will analyze the provisions of an aircraft lease or leasing contract which set out the obligations of the lessee and whose non-compliance could give rise to the resiliation of the contract by the lessor.

In Chapter II I will then attempt to analyze the necessary legal steps that a lessor should follow, in Italy and Quebec, in order to regain possession of his plane.

Many scholars have studied the aircraft lease and leasing transactions, as will be seen later. The issue of the repossession of the aircraft has also been discussed by many authors. But the analysis has often focused on the contracts as structured in a common law system. My intention is to study how the leasing contract, born in common law countries, has been accepted in civil law countries like Italy and Quebec. I felt it necessary to examine also the contract of lease both because of its extensive use in the aircraft industry and because it has been used, particularly in Italy, to explain the contract of leasing. Finally I thought it was important to see if the Italian and Quebec legal systems allow adequate protection to the lessor if he wants to repossess the aircraft. Many articles have been written with regard to the solution adopted by common law countries. Can that solution be applied in Italy and Quebec ? Is it necessary ? When it comes to remedies, do Italy and Quebec have to take common law countries as their example ?

CHAPTER I

DEFAULT

INTRODUCTION

Contracts of aircraft lease or leasing have such a complex structure that it is not unusual to compare them according to their "thickness" instead of their number of pages. They can be made up of a "jungle" of clauses drafted in a very detailed way in order to preserve each party's rights.

Because non-compliance with any of the dispositions included in a contract of lease or leasing can put the lessee into default, paragraph 1 of this chapter is dedicated to the instances of default and briefly overviews the most relevant clauses of an aircraft lease or leasing. Subsequently, paragraphs 2,3 and 4, analyze the clauses concerning maintenance, insurance and transfer of possession, which are the most relevant given the influence compliance with them can have on the safety and conditions of the aircraft and on the protection of the lessor's interests.

1.1 Instances of Default

In a contract of lease, operational or financial, a detailed analysis of the clauses of default is of major importance both for the lessor and the lessee. Because of the high value of the asset involved in these kinds of transactions, the lessor will want to be able to resiliate the contract and repossess the aircraft in case of any a default of the

lessee. From the lessee's perspective a detailed overview of his duties will allow him to mitigate clauses which could be drafted in such a detailed and onerous way that he could go inadvertently into default for some relatively benign action or omission[8]. Typical instances of default in an aircraft lease contract will include the following:

a) Rent

This is the most important default. The payment of specified amounts at specified dates in return for the enjoyment of the use of a certain equipment is what constitutes the basis of a lease contract. A distinction between scheduled payments and non-scheduled payments should be drawn because it would be unreasonable, in the second kind of payment, for a default remedy to be triggered without first putting the lessee in default.

In case of scheduled payments it is a matter of negotiation as whether or not days of grace are to be given or the failure to make such payments will automatically constitute an instance of default. The lessee will always try to obtain a period of grace on the basis that failure to fulfill these obligations exactly on time can occur for administrative or technical reasons. A lessor , on the other hand , will always argue that modern techniques of fund transfer do not generate any kind of bona fide delay[9]. However, such periods will be accepted by the lessor for those defaults which do not have serious consequences and are easy to remedy[10]. In the industry the cure period for

[8] See **Rod Margo**, "Aircraft Leasing : The Airline's Objectives" (1996) XXI number 4/5 Air and Space Law pag.173.
[9] See **Donald Bunker**, *The Law of Aerospace Finance in Canada* , McGill University , Montreal , Quebec , 1988, at 291-292.
[10] See **Mark Coker**, " **Addressing the main provisions of a lease transaction**" **Airfinance Annual (1992/93) 124.**

failures to make basic rent payments is five to ten business days after the day payment was due[11].

b) Insurance

The breach of an insurance covenant may be considered, under the terms of the agreement, an instance of default given the high value of a modern aircraft. Typically the lessee will be required to maintain insurance on the aircraft under both an operating and a financial lease. However, the lessor under an operating lease will want the insurance to cover not only his liability, as the owner, but also the value of the asset, including the residual value in case of loss[12].

In a cross-border lease some domestic law may require that the insurance be placed with an insurance company of the country of registration. In these cases the lessor may require that reinsurance be placed with reinsurers who agree to "cut-through" provisions, permitting the lessor, as an additional insured, to claim directly under the insurance[13].

Given of the importance of the insurance clauses in an aircraft lease, these will be discussed later in a separate section of this chapter.

c) Maintenance

The drafting of maintenance clauses of an aircraft leasing are of vital importance for

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[11] See Michael S. Speas, "Aircraft leveraged lease terms and conditions" Airfinance Annual (1993/94) 18.

[12] See J. Pritchard., W. Piels and T. Zimmer, "Special legal aspects of a cross-border operating lease" Airfinance Annual (1993/94) 99-100.

[13] See D. Bunker, supra note 9 at 304.

both the lessor and the lessee. Although the lessee is the user of the aircraft and, therefore, the first concerned with its state and condition, the lessor will require a scrupulous drafting of and compliance with the maintenance provisions. In a financial lease the lessor will always want his equipment to be properly maintained in order to preserve its residual value since it is his security for the transaction.

In an operating lease, because of the extreme importance of the residual value of the aircraft at the end of the lease, the lessor will be even more concerned about the maintenance clauses.

In case of failure by a lessee to perform the required maintenance, lessors are more generous when it comes to give a cure period. Normally the cure period for this kind of default is around 180 days after written notice to the lessee[14].

Given the importance of the maintenance clauses, a detailed analysis will be made in the following section of this chapter.

d) Transfer of Possession

These clauses are always carefully negotiated in an aircraft leasing. The lessor will be concerned about his aircraft being placed in other hands during the term of the lease. The lessee will want to enjoy the freedom when it comes to its fleet organization. Transfer of possession can be achieved through subleasing, pooling agreements, and pooling of engines.

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[14] See M. Speas, supra note 11 at 18.

(i) Subleasing

An airline entering operational or financial aircraft leasing, is nowadays more likely to request a high degree of flexibility to sublease the aircraft as market conditions and demand may change. The lessor's main concern, when it comes to sublease, is that the aircraft will be maintained, insured and operated according to the original lease and that his rights and ability to repossess the aircraft are not adversely affected by the sublease[15].

The Italian Navigation Code ("Codice della Navigazione") at article 378 allows subleasing but only if the lessor approves it[16]. Equally the Quebec civil code, at art.1870, requires the consent of the lessor to be given to the lessee in order for the subleasing to be possible. Moreover the same article require the lessee to give notice to the lessor of his intention and the name and address of the intended sublessee.

The clauses of an aircraft leasing do not differ from these provisions although recently it has become common to include a very detailed clause which lists the conditions which are to be met in order to sublease the aircraft thus enabling the lessee to obtain a sort of "prior consent" by the lessor which will speed up the whole process of subleasing.

A more detailed analysis of "subleasing clauses" will be found in the last section of this chapter.

[15] See Air Finance Journal (January 1991) 36.

[16] This is in line with the dispositions of the Italian Civil Code which at the art.1874 says that in case of a mobile property the subleasing must be authorized by the lessor or allowed by practice.

(ii) Pooling of Aircrafts

Normally the lessor will limit the lessee's freedom to enter pooling agreements with other airlines in order to protect his asset. He will do so by listing, by name or category, the airlines with whom the lessee may or may not enter pooling agreements. The decision will be usually made on the basis of the maintenance standards of the pooling partners[17].

(iii) Pooling of engines

The lessee will always want to keep the right to switch the engines from the leased aircraft to other aircrafts of its fleet which use the same kind of engine. This could create a problem to the lessor if he wants to repossess the aircraft because of competing liens which could exit on the other engines. Furthermore, practical difficulties of repossessing engines which have been transferred to aircrafts not owned by the lessor may be encountered. Moreover, in some jurisdictions, like The Netherlands, the placing of a leased engine on another airframe belonging to someone else, including the lessee, will automatically transfer the title of such an engine to the owner of the airframe. That is why many lessors will insist on a reciprocal agreement with the owners or lienholders of the aircraft and engines leased to such lessee in order to waive any claims on the lessor's engine[18].

[17] See R.Margo, supra note 8 at 171.
[18] See M.C.Mulitz , "Aircraft opertaing leases, current issues" (ALI-ABA Course of Study, March 16, 1995).

e) Cross-default

This clause allows the lessor to terminate the agreement when an instance of default has occurred in another transaction involving the lessee. It is clear that the attempt to include such a provision in a contract of lease or leasing can lead to lengthy discussions. The lessee will always fear that an overly restrictive clause will cause him to be in default when an event, caused by some factor beyond his reasonable control, has occurred[19]. On the other hand, the lessor will benefit from a cross-default clause because "provided [he] has notice of the other default, he is able to take action to protect his own position before other creditors have seized the lessee's assets or before insolvency procedures [...]. The lessor will thereby get the benefit of the most stringent events of default negotiated by other creditors"[20].

In order to mitigate the potentially heavy burden of this clause the lessee will try to limit its application to other agreements with the same lessor and only over a certain aggregate amount of debts or a percentage of its net assets[21]. Furthermore, the clauses should apply only if the default has not been rectified within a specified period of grace.

f) General Insolvency

This is a common instance of default. A default occurs when "steps are taken for the liquidation or the reorganization of the lessee in bankruptcy or insolvency

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[19] See R. Margo , supra note 8 at 172-173.
[20] M. Coker, supra note 10 at 124.
[21] See D. Bunker, supra note 9 at 293-294 and M. Coker, supra note 10 at 124.

proceedings"[22]. Sometimes this clause incorporates a default provision which applies in case "an execution, attachment or distress [is] levied against any of the assets of the debtor"[23]. These clauses should not create any problem because they are directly related to the financial situation of the lessee whose ability to perform his primary contractual obligation, the rent payments, is of absolute importance for the lessor.

Many more problems could arise in the drafting of a clause of default related to material adverse changes in the lessee's financial condition. The lessor is likely to use this clause to protect himself against unforeseen circumstances and not as a substitute for specified events. The lessee will always want to restrict the instance of default to a material adverse change in his ability to perform his obligations under the lease[24].

g) Other clauses

Other clauses of default may be included in the lease relating to: (i) The disposition by the debtor of a substantial part of his assets or of his business; (ii) the loss of or a major change of routes; (iii) the loss of a certificate of airworthiness or the loss of an operating license[25].

The importance of these clauses has been stressed by the adoption by the Council of the European Union of the "third package" of air transport liberalization regulations[26].

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[22] See D. Bunker, supra 294.
[23] Ibid. at 294.
[24] See M. Coker, supra note10 at 124. The author adds that the event of default could be triggered by reference to the accounts of the lessee , either the account produced at the outset of the lease or the latest set of accounts.
[25] See D. Bunker, supra note 9 at 293.
[26] The third package , entered into force on 1 January 1993 , consists of three Regulations :

One of the most important innovations introduced by the third package is the concept of Community Air Carriers ('CACs') . If a carrier qualifies as a CAC under the provisions of the EU Licensing Regulation, he has cabotage rights inside the entire European Union. The loss of an operating license by a community carrier, which would inevitably lead to a loss of some routes, could be incorporated as a major event of default under the lease.

Moreover, in order to obtain an operating license, an airline has to meet certain financial requirements outlined in Articles 5 and 6 of the Licensing Regulation, and the license can be revoked, under Art. 12 , in the event that insolvency or similar proceedings are launched against an airline and the competent authority in a Member State is convinced that there is no realistic prospect of achieving a satisfactory financial reconstruction within a reasonable time[27]. In spite of its ambiguous language, this provision may very well help the lessors to terminate the agreement at the first sign of major financial problems encountered by the lessee.

It should also be noted that art. 5.3 of the aforementioned Regulation requires the airline to inform the licensing Member State authority of any major operational change[28]. If the authority thinks that the change(s) could put an unaffordable burden

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1) the Licensing Regulation (Regulation No. 2407/92 of 23 July 1992; OJ No. L. 240/1) , dealing with the requirements for the issuance and revocation of operating licences to air carriers established in the Community;
2) the Access Regulation (Regulation No. 2408/92 of 23 July 1992 ; OJ No. L 240/8) , which gives access to intra-Community routes to Community Air Carriers ;
3) the Fares Regulation (Regulation No. 2409/93 of 23 July 1992 ; OJ No. L 240/15) which abolish government intervention as to determination of fares on intra-Community routes.

For more details on The European Third package see **R. Ricketts and J. Balfour**, "Aircraft Use , Registration, and Leasing in the EC" (1990) XVIII Air and Space Law 25 **at 25-28** and **B. J. H. Crans**, "The Third EC Aviation Package : its impact on the Leasing Industry" (1993) XVIII Air and Space Law 103 **at 103-108.**

[27] See **B. J. Crans, supra** note 27 at 105.

[28] Art. 5.3 lists the following changes :

a) operation of a new scheduled or non-scheduled service to a continent or world region not previously served ;
b) changes in the type or number of aircraft used ;
c) a substantial change in the scale of the airline's activities ;

on the carrier's financial situation it could ask the latter to submit a revised business plan. Although the language is again not very clear, it is possible to assume that, by referring to Art. 5.5, a license could be revoked or suspended in the case where the competent authority thinks that the revised plan would not allow the airline to meet its existing and forseeable obligations. A covenant, obliging the lessee to inform the lessor: (i) of any notice given to the Licensing Authorities; (ii) of any request received from the Licensing Authorities; (iii) of any information submitted to the Licensing Authorities; should be included in a lease agreement. By doing so the lessor will then be independently able to assess the lessee's financial position in the event of a major change proposed by the lessee, to closely monitor the position of the lessee as a licensed operator and, if the clause of default is broad enough, to terminate the agreement whenever he fears that the lessee's operating license may be suspended or revoked[29].

1.2 Maintenance

Before we discuss the main maintenance provisions in a contract of aircraft leasing or lease we should consider what the law in this field is. From the Italian perspective, as far as an operating lease is concerned, we must consider the provisions of art. 1576 second paragraph of the Italian Civil Code which states that in case of the lease of

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d) any intended merger or acquisitions ;
e) any change in (direct or indirect) ownership of any single shareholding representing 10% or more of the carrier' total sharecapital ;

[29] In this sense B. J. Crans , supra note 27 at 105-106.

movable property the expenses for ordinary maintenance are borne by the lessee, unless otherwise stipulated ("Se si tratta di cose mobili, le spese di conservazione sono, salvo patto contrario, a carico del conduttore."). The article clearly leaves the parties freedom to make any agreement about maintenance. The Italian Supreme Court has held that "[t]he dispositions of art. 1576 par. 2 and art. 1576 of the Italian Civil Code [...] are not of public order and can be negotiated by the parties"[30].

For aircraft leasing it must be remembered that leasing is not a codified contract in Italy. During the last 25 years the Italian Supreme Court has focused its attention on the qualification of the contract and on the problem of its resiliation and its effect on payments already made. Thus we have to look at the practice. Under the terms of the agreements for aircrafts, the lessee assumes all maintenance expenses, both ordinary and extraordinary.

For the leasing contract in Quebec we have to look at art. 1846 second paragraph of the Civil Code which states that "(the lessee) likewise assumes all maintenance and repair expenses". If we turn our attention to the operating lease, it is art. 1864 that we have to look at. According to this provision, " [t]he lessor is bound, during the term of the lease, to make all necessary repairs, others than lesser maintenance repair, which are assumed by the lessee unless they result from normal aging of the property or superior force". Although this provision may seem to leave little room to the parties of a lease contract, it seems that, keeping in mind the principle of freedom of contract ("liberté contractuelle"), the parties may draft a clause by which the lessee assumes one or more obligations specified by the lessor[31]

It is clear then that the most important source to look at is the practice.

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[30] Italian Supreme Court, 3rd section, 2nd November 1992, n. 11856, Soc. Bastogi vs. Ruffini.

[31] In this sense see **Pierre-Gabriel Jobin**, *Le Louage* (Les Editions Yvon Blais Inc., 1996) at 451.

The drafting of maintenance clauses of an aircraft lease or leasing agreement are of vital importance for both the lessor and the lessee. Although the lessee is the user of the aircraft and, therefore, the first concerned with its state and condition, the lessor will require a scrupulous drafting of and compliance with the maintenance provisions for various reasons. In a financial lease the lessor will want his equipment to be properly maintained in order to preserve its residual value, if he is the one entitled to it, or to protect his security in the transaction. But even if the financial lease contract does not provide for the return of the aircraft to the lessor at the end of the contract, the financial lessor will still be concerned with the maintenance of the plane in case, due to a default of the lessee, he has to terminate the lease, repossess and sell the aircraft in order to recover his investment[32].

In an operating lease, because of the extreme importance of the residual value of the aircraft at the end of the lease for the lessor, he will be even more concerned about maintenance clauses. The maintenance status of an aircraft has a direct correlation with its value, due to the expense of such maintenance and the objectively calculable "life" of the aircraft[33]. Indeed " a great component of valuation of an aircraft is its maintenance record"[34]. Due to the medium to short length of an operating lease (beside the possibility of an early termination of the contract and a repossession of the aircraft), the lessor will need his asset to be, at any time, in a condition which will allow him to release it immediately[35].

Apart from the maintenance covenants of a lease or leasing contract, aircrafts are required by the aviation authority to be maintained properly in order to keep the

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[32] See **D. Bunker, supra** note 9 at 304 and **M. Coker, supra** note 10 at 122.
[33] See **J.P.Howitt**, "Selected issues with respect to operating lease" , (1997) Westlaw 425 at 426.
[34] **R.A.Greenspon**, "Documentation of Aircraft Operating Lease" , (May 1990) International Business Lawyer at 230.
[35] See **J. P. Howitt, supra** note 34 at 457.

airworthiness certificate issued by that authority[36]. Certainly the selection of the national registry in which the aircraft will be registered will affect the standards by which the maintenance of the aircraft will be judged. Thus if the lease allows the lessee to register the aircraft in the national register of his own country, as it happens in most cases, the lessor may want to include provisions which require the lessee to meet maintenance requirements (such as keeping the maintenance record in the English language) which are imposed by the aviation authority of the lessor's home jurisdiction, in addition to whatever is required by the authority of the country where the aircraft is registered[37].

If compliance with the minimum legal requirements is sufficient in the case of a financial lease, this is totally inadequate for an operating lessor given the various reasons already mentioned. This is why an operating lease contains more detailed provisions relating to aircraft maintenance. Typical general maintenance requirements will include the following :

a) Maintenance of the aircraft, all parts and engines in good repair, condition and appearance. The equipment should be in the same condition as when delivered with the exception of the ordinary wear and tear.

b) Replacement of worn out, obsolete parts, etc. The operating lease usually distinguishes between "on condition", "condition monitored", "hard life" and "calendar life" components. "On condition" components are continuously

[36] The Annex 8 to the Convention on International Civil Aviation signed at Chicago ,December 7 , 1944 (hereinafter referred as " The Chicago Convention") sets out the International Standards and the Recommended Practices , with respect to aircraft airworthiness, which must be adopted by each State party. The aircraft airworthiness issue in Canada is regulated by section 210 to 221 inclusive of the Air Regulations and it is administered by the Department of Transport. In Italy the airworthiness certificates are issued by the Italian Aeronautical register ("Registro Areonautico Italiano") and they are subject to

monitored by visual inspection, measurement and testing. They do not require a teardown inspection or an overhaul and are replaced when they fail. "Condition monitored" components are those which are monitored on a continuous basis and are replaced in accordance with statistical data relating to their failure rates and according to their condition. "Hard life" components are those which are given a definite operating life based on hours/cycle flown. "Calendar life" components are those which must be replaced on a particular date subsequent to their installation[38].

c) Prohibition of discrimination against the equipment in the performance of the maintenance[39].

d) Corrosion control procedures.

e) Timely correction of all defects.

f) Accurate and up-to-date keeping of all the log-books and engine records.

g) Compliance with the airworthiness directives issued by the relevant regulatory authority or with the service bulletins issued by the manufacturer during the term of the lease. While airworthiness directives are mandatory orders of the competent aviation authority, service bulletins are classified as mandatory, recommended or optional by the manufacturer according to the degree of importance he wants to give them[40]. The burden of complying with airworthiness directives and mandatory service bulletins is on the lessee in the case of a financial lease. In an

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the provisions of art. 126 to 154 Section I Part VI (" Sezione I Capo VI") of the Royal Decree of January 11 1925 n. 56 ("Regio Decreto 11 gennaio 1925 n. 56 ").

[37] See **J. Pritchard, W. Piels and T. Zimmer, supra** note 13 at 99.

[38] See **R. Margo, supra** note 8 at 170.

[39] If the lessee has aircrafts leased from different lessors in his fleet, each lessor will want that the same standard of maintenance is assured to all the aircraft of the fleet so that no special treatment is reserved to aircrafts belonging to others lessors or to the lessee itself.

[40] Some airworthiness directives or service bullettins may just require a repetitive inspection while in others a certain repetitive inspection may be enough for a certain time after which the installment of a certain component or a certain kit may be required. See **R. Margo, supra** note 8 at 170.

operating lease sharing of costs for any modifications is a matter of negotiation between the lessor and the lessee.

Especially in the case of a short-term operating lease, due to the increase of the residual value at the end of the lease obtained by the lessor , the lessee will ask for the cost of such modifications to be equally shared with the lessor. The latter will, on the other hand, argue that the lease is a net lease and "these required modifications are costs and risks of operation which the lessee should properly bear"[41]. The current practice calls for the lessee to comply with airworthiness certificates and mandatory service bulletins while in some leases there is an agreement that a recommended service bulletin be followed by the lessee but that the cost of such an operation be shared by both parties[42].

In addition to these general provisions aircraft lease and leasing contracts include some specific maintenance provisions which are usually strongly negotiated. It is important to take a short look at these provisions to see how extraordinarily complex maintenance clauses can be in aircraft leasing. The most important provisions are the following :

a) Approval of the maintenance program

[41] **J. P. Howitt , supra** note 34 at 465.

[42] In this sense see **R. Margo, supra** note 8 at 170-171, **D. Bunker, supra** note 9 at 308 and **J. P. Howitt, supra** note 34 at 465. Howitt explains that in case of cost/sharing agreements "the lessor will reimburse the lessee for the cost (often subject to a threshold) of mandatory modifications pro rata based on an assumed useful life of the modifications, and the term of the lease remaining , or if the cost of the modifications is above a certain threshold , the lessee can either pay for the modifications or terminate the lease (unless the lessor agrees to reimburse the lessee for such modifications)".

Although most maintenance programs are based on the manufacturer's maintenance planning document and therefore are similar for all types of aircraft, each operator is free to establish his own program subject to the regulatory authority approval. The approval of the maintenance program is directed at ensuring that regular maintenance is scheduled in order to protect the lessor's residual value and the "remarketability" of the equipment. A maintenance program distinguishes between :

(i) Daily service

This check is accomplished every day the aircraft is in operation. It includes sumping of each fuel tank, fuel, oil, potable water and lavatory servicing as well as a check of tire pressure, tire wear and engine oil and hydraulic quantities. For international flights a communication, navigation, fire warning and oxygen level check is included.

(ii) "A" check

In addition to daily service checks, exterior and interior of the aircraft, flight recorder, emergency equipment, brake wear, landing gear, etc. are checked during this control. The logbook is audited and cleaned[43].

(iii) "B" check

This consists of all items in an "A" check plus an engine run for leak check, checking of spark igniters, emergency lights and items of this nature. The landing gear strut pistons and the landing gear inspection windows are cleaned.

(iv) "C" check

In addition to all "B" check items this operation includes routine lubrification, fluid and air servicing and detailed inspection of the aircraft. Some components are replaced and an extensive cabin and engine maintenance is made.

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[43] The word "cleaned" is used because the log book is materially changed with a new one but, juridically, it is still the same log book which appears as it was cleaned from all the that was written in after each flight.

(v) D" check

This check, also called "heavy check", is required for aircrafts with high flying time and is composed of different checks (nose landing and main landing gear overhaul, structural checks and corrosion prevention, structural checks and flight control changes) which are performed after a certain amount of flight hours, variable from airline to airline and from aircraft type to aircraft type[44].

Sometimes the approval of a maintenance program is replaced by the inclusion of an objective standard for the quality of the maintenance service, which often takes the form of permitting any program which would be approved by the aviation authorities of the United States, the United Kingdom, France or Germany.

Some aircraft lessors may require that certain specified maintenance checks (such as airframe structural maintenance) be performed by certain approved firms.

Very often, especially in the case of small airlines, the lack of maintenance facilities obliges the operator to enter a maintenance agreement with another airline to perform its heavy checks. In this case lessors may require an assignment of such an agreement as security for the obligation of the lessee to maintain the aircraft and in order to be able to enforce the agreement or the main contract of lease or leasing in case of default by the lessee[45].

These agreements may also be signed with maintenance companies and may cover all maintenance duties. In this case the major problem which could arise is a dispute between the lessor and the maintenance contractor in relation to the maintenance contractor's or repairer's privilege, which entitles one party to retain possession of a movable property if it has improved it. However, it is difficult to distinguish between a

[44] For a more detailed analysis of the different checks please refer to **D. Bunker, supra** note 9 at 306-307.

[45] **Ibid.** at 304-305.

mere repair and an improvement. The Italian Supreme Court has recently held[46] that "included in the meaning of improvement are works which, by transformation or moving parts to a different position, increase the value, enjoyment, productivity and profitability of the immovables, without they being different from the property in which they are incorporated". Although very rare, an improvement could be possible in an aircraft leasing. A change in landing gear could be a case in question. Moreover, total compliance to the maintenance program suggested by the manufacturer can lead to an increase in the economic life of the aircraft. Thus, as said before the line between maintenance and improvement is really thin and this makes the drafting of a maintenance clause a very important part of the entire operation.

When it comes to privileges on airplanes, the rules of the Italian Navigation Code and the Italian Civil Code need to be analyzed. According to art. 2750 of the Italian Civil Code " [t]he privileges on [...] aircrafts are governed by the Italian Navigation Code". The aeronautical and maritime privileges are special kinds of privileges because they are only granted on certain categories of movables, such as aircrafts, and only for certain rights. Art. 1022 of the Italian Navigation Code states that "[t]he privileges established in this chapter are preferred to all other general or special privileges"; the following article establishes a privilege on the aircraft in the case of rights for "airport fees; other fees of the same nature; all expenses for custody [...] of the aircraft after its arrival at the last landing place" and on "the rights which derive from contracts entered into by the captain, by virtue of his legal power,[...] for the maintenance needs of the aircraft and the continuation of the trip". If the maintenance contractor has possession of the aircraft at the time of the lessee's default, it could be difficult for the lessor to

[46] Italian Supreme Court, 3rd Section, decision n. 4871 of 14th may 1998, Anselmi c. Sgrosso.

repossess the plane if there are charges overdue because the maintenance agency may refuse to surrender it[47].

It has been suggested that a solution could be found in a clause, inserted in the lease or leasing agreement and specifically brought to the attention of the maintenance contractor in advance, which would exclude all privileges, "other than repairers' or other like privileges arising in the ordinary course of business, with respect to obligations which are not overdue or which do not arise by virtue of any default or omission on the part of the lessee"[48]. The privilege is then possible but becomes "unauthorized" once the repairers' charges are overdue or unpaid. In my opinion it is hard to see how the maintenance contractor may waive his privilege simply by being informed of this provision in a contract to which he is not party. Moreover, as said above, the areonautical privileges in Italy are directly established by the law and it is very doubtful that the parties can cancel those privileges created to protect the creditor. Finally, because of the importance of the technical records for the residual value of the aircraft and for registration purposes, the lease should stipulate that the records belong to the lessor no matter who created them. This clause will allow the lessor to recover the records easily[49].

b) Maintenance accruals or reserve and maintenance contributions

Some leases, especially operating leases, require the lessee to pay additional charges based on the actual use of the aircraft (airframe, engines, landing gear and auxiliary

[47] The Court of Appeal of Trieste held that " the maintenance agency has a legitimate right of not surrendering the engine of a ship, detached to be repaired, as a guarantee for its credit". (Court of Appeal of Trieste, 24th May 1953). One can see how this decision may be applicable to aircrafts.
[48] See Euromoney supplement (May 16 1991) 25.
[49] Ibid. at 25.

power unit). The purpose of these charges, usually known as maintenance accruals or maintenance reserve, is : (i) To compensate the lessor for the cost of actual use of the aircraft; (ii) to ensure that the aircraft's major maintenance will be performed; (iii) to compensate the lessor for the extensive heavy maintenance that is to be made on the aircraft at the end of the lease in case the lessee is in no position to meet the conditions of return[50].

The charges are calculated on a monthly basis and in an amount equivalent to the number of hours of operation and cycles (take-offs and landings). Generally the lessor reserves for himself the right to increase the charges, in the case of an increase in maintenance costs, or decrease, in the case of an aircraft used on short hauls and therefore with few hours of flight per cycle.

The main problem with these sums is their ownership together with the ownership of the accrued interest. The lessee will insist on the fact that these reserves do not represent an additional rent while the lessor will stress the contrary. In practice lessors will agree on the refundability of these sums in cases where, upon return, the aircraft is in a better condition than at delivery. Sometimes maintenance accruals are replaced by the so-called "upsy-downsy" maintenance status adjustment payment on return. Basically this clause calls on the lessor to pay the lessee for any improvement in the maintenance status of the aircraft on return, compared with delivery, and the lessee will pay for any deficiency. This appears to be in contrast with the provision of the Italian Civil Code. According to art. 1592 if the lessor has agreed on the

[50] A scrupulous drafting of the conditions of return is nowadays a must in any contract of aircraft leasing because every lessor will want back the aircraft back in an immediate releasable condition. Basically lessors will require that 30-40 percent of the time between two heavy checks on the airframe is left or that the last "C" check has been completed not more than three to four months earlier. For more

improvements, the lessee has the right to a compensation which amounts to the equivalent of the lesser amount of the improvement and the value of the goods at the end of the lease. In any case, since this is not a rule of public order, the parties are free to negotiate a different rule.

In return for the payment of maintenance accruals, lessors often agree to make contributory payments for certain types of maintenance. Usually the contribution is limited to the "heavy checks" for the airframe and to certain types of off-the-wing scheduled overhaul for the engines[51].

1.3 Insurance

The reasons for scrupulous drafting of the insurance clause in a contract of aircraft lease or leasing are similar to those analyzed for the maintenance provisions. Whether we consider the operating lessor's or the financial lessor's point of view, the aircraft is a valuable asset which must be protected particularly if we think that in civil law countries like Italy and Quebec, under a lease or a leasing, the title remains with the lessor. In addition to these considerations we must keep in mind that an aircraft accident can lead to costly claims against the airline but also against the owner of the aircraft. This is why an insurance policy which is not drafted in a way to cover the lessor from any possible loss or claim arising from the use of the aircraft could indeed place a heavy burden on the shoulders of lessors and financiers. And this is why in the

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details on the return provisions of aircraft leasing see **D. Bunker , supra** note 2 at 308 and **J. Howitt , supra** note 34 at 470-471.

[51] For a detailed analysis of the maintenance accruals and contribution see **J. Howitt , supra** note 34 at 460-464

case of non-compliance by the lessee with the provisions of an insurance clause, the lessor will want to resiliate the contract and repossess the aircraft.

The Italian Civil Code does not contain any provision which obliges the lessee, in a lease contract, to insure the leased goods. In my opinion the question of whose duty it is to insure the goods is a question of negotiation between the parties. In the leasing contract in Italy, however, according to usage, the lessee is the one who has to carry insurance for the goods. In the Quebec Civil Code we should look at art. 1846 which, in a leasing contract, states that "the lessee assumes all risks of loss of the property [...] from the time he takes possession of it".

The contract of aircraft insurance in Italy is regulated by the provisions of the Italian Navigation Code, arts. 514 -547 and 996-1021, with the exception of art. 515, first paragraph, 527 and 538. According to art. 1885 of the Italian Civil Code the provisions of the latter, arts.1882-1918, are also applicable to aircraft insurance if they are not excluded by the provisions of the Italian Navigation Code. The passenger insurance and the insurance against damages to third parties on the ground, which are only "aeronautical insurances", are governed by arts. 996-1000 (passenger insurance) and arts. 1010-1016 of the Italian Navigation Code (insurance of damages to third parties on the ground insurance)

Analysis of the insurance contract is beyond the scope of this thesis but the latter provisions must be highlighted because they establish a duty for an operator to insure the passenger against "flight damages" ("infortuni di volo") for five million and two hundred thousand lira (art. 941) and to keep in force a liability insurance for damages to third parties on the ground for a sum indicated in art. 967 and calculated on the basis of the weight of the aircraft.

Similar rules exist in Canada. Section 203.(1)(a) of the Air Carrier Regulations requires "liability insurance covering risks of injury to or death of passengers in an amount that is not less than the amount determined by multiplying $300.000 by the number of passenger seats onboard the aircraft engaged in the commercial air service" and Section 203.(1)(b) requires insurance for liability arising from injury to third persons and damage to property on the ground. In this case the required insurance varies from $1.000.000 to more than $2.000.000 according to the weight of the aircraft.

These minimum requirements certainly do not cover the lessor's needs. In fact he does not always need to be protected against third party liability claims but he always needs protection for the aircraft itself. An insurance clause of an aircraft lease is aimed at ensuring that the lessor or the financier, in a leasing contract, is always protected in these two major areas.

A) The aircraft

A lessor will always ask the lessee to subscribe to three different insurance policies, which cover almost all the risks the user of the aircraft will have to face :

1) The "Hull all risks" policy, which protects the insured against any physical loss or damage to the aircraft. This policy was formerly issued on a "incurred value" basis: the insurer, in case of total loss, had the possibility to choose to replace the aircraft with another one of the same type or to pay a sum of money equal to the market value of the aircraft but not superior to the insured value. Nowadays the

policies are issued rather on an "agreed value' basis: in case of a total loss , the insurer will pay the value agreed with the insured at the beginning of the insurance. There are some exclusions from the coverage of the "hull all risks" policy, the most important of which being "war and allied perils" exclusion .

2) The "Hull war risks" policy, which basically takes over where the "Hull all risks" ends. The scope of this policy can in fact be defined by looking at the so-called "War, Hijacking, and other Perils Exclusion Clause (AVN48B)" in an "Hull all risks" policy. This clause defines "War and allied Perils" as : (a) war, invasion, civil war, rebellion, insurrection martial law, etc.; (b) any act of one or more persons for political or terrorist purposes; (c) any act of sabotage; (d) confiscation, nationalisation, seizure, requisition under the order of any Government; (e) hijacking or any unlawful seizure of the aircraft or crew in flight by one person or several persons on board.

   Because very often the "Hull all risks" and the "War all risks" policies are not issued by the same underwriters and because it is sometimes hard to determine precisely which policy applies, in the past the issue of whether a loss was covered by one policy or the other has created many problems and delays in compensation. This is why lessors will always want the inclusion of the 50/50 clause which provides for 50% payment by each of the "all risks" and "war risks" policies in the package of the lessee's insurance; in case of dispute over which policy applies, this way the lessor will be able to fully recover the loss or damage suffered without wasting precious time in establishing which policy applies.

It is important to highlight the fact that seizures, confiscation, etc. by the Government of the State of registry are not covered by this policy.

3) The "Repossession" or "Political risk" insurance

This insurance provides coverage against confiscation, deprivation, inability to repossess and refusal to deregister the aircraft. This policy is aimed at protecting against seizure, confiscation, etc. by the Government of the State of registry which, as stated above, are not covered by the "war all risks" policy. It may be noted that the insurers are liable only in the case of loss or damage resulting from the action of the Government effective for a period not shorter than the waiting period specified in the policy (loss or damage during this period can be covered under a "hull all risks" policy).

It is interesting to note how two standard exclusions of this policy are strictly related to a lease contract :

a) Material default by the insured. This exclusion applies to any loss arising from material default of the lessee in the performance of his obligations under the lease agreement.

b) Rights of repossession in the event of non-renewal or non-extension of the policy. This excludes any loss arising out of any provision in the lease agreement that allows the lessor to exercise a right of repossession in circumstances where underwriters decline to renew or to extend this policy.

Recently another exclusion has been added to the policy which reads :

"Excluding any loss arising out of any provision in the lease agreement that permits, or purports to permit, the insured to exercise its rights of repossession due to any failure of the lessee to pay or reimburse the insured the cost of insurance premiums

due under this policy or any other insurance policy on which the insured is an additional insured".

As we have seen there is no indication, either in the Italian or the Quebec Civil Code, of who, the lessee or the lessor, has the obligation to subscribe insurance for the leased property. It is, then, a matter of negotiation between the parties. On the contrary, in a leasing contract it is the lessee who has to insure the aircraft.

If the duty to insure the aircraft is placed on the lessee, the insurance clause in a lease or leasing agreement of aircraft will, first of all, require the lessee to maintain these insurance policies throughout the duration of the lease.

The lessor will want to be named as an additional insured and it is common practice to include in the insurance policy a so-called "loss-payee" clause which will normally specify that all payments on a total loss will be made directly to the lessor or that all payments above a certain limit agreed upon will also be paid to the lessor while payments below this limit can be made to the lessee.

In the case where, according to the terms of the contract, it is the lessor who has to maintain the proper insurance, an insurance clause will focus on the duty of the lessee not to do or omit to do any act which could invalidate, suspend, revoke or adversely affect the insurance.

Most airline policies contain express warranties according to which the insured shall take all reasonable precautions to ensure that, among others, the aircraft is not used for illegal purposes, that it has a current and valid Certificate of Airworthiness and that is not used outside the territorial limits specified in the policy. Failure to comply with these provisions could cause cancellation of the policy. A breach of other provisions in

the policy, like failure to comply with notification requirements or inaccuracies in the application declaration, could lead to the same results.

In order to be protected under these circumstances lessors or financiers will require the lessee to include a "breach of warranty" clause. This kind of coverage is often provided in accordance with the standard market AVN28 endorsement. The clause holds the lessor liable for premiums not paid by the insured, obliges him to notify the insurers of any increased hazard he becomes aware of, and to provide "proof of loss" if the insured fails to do so. It must be emphasized that in Canada it has been held that "this clause does not constitute an independent contract between the underwriter and the creditor and the clause relates only to acts or omissions which occur after the policy has been issued"[52].

B) Third party liability

In this area a lessor has to be assured that the limits of liability coverage are broad enough, according to the size of the aircraft and the regions of operation, to be protected against any involvement in law suits following an accident. The insurance clause in the lease agreement will oblige the lessee to include the lessor as an additional insured under the liability insurance.

Because of the risk that a lack of insurance can place on the lessor's assets, a failure to comply with the insurance requirements of a lease/leasing transaction will constitute default of the lessee. Moreover, lessors need to know if and when the lessee has gone

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[52] **D. Bunker , supra note 9 at 218.**

into default. This is why there is usually specific requirement in the policies that notice of cancellation be given to the additional insured at least 30 days before the policy becomes ineffective as regards the latter. Notice will also be required in the case of a material change in the policy and the conditions affecting the interest of the lessor.

In the case where the insurance is placed, by law or regulation or under a request of the lessee, with an insurer that has limited financial resources or is owned by the government of the country of registration, the lessor and financier will insist on a specified level of reinsurance arranged with a specified market-place. In such a reinsurance contract, the lessor will also ask for the inclusion of a "cut-through" clause which will require the reinsurer to make the payment directly to the loss payee nominated in the primary insurance. This clause could create some problems in Italy considering that art. 1929 of the Italian Civil Code states that the contract of reinsurance does not create any legal relation between the insured and the reinsurer. The contract of reinsurance is simply taken out by the insurance company to protect itself against the risk of not being able to pay too high a compensation. In other words, through a reinsurance contract the insurance company is trying to protect itself against the risks of its own activity. The contract is then between the insurer and the reinsurer and the lessor is only a third party.

1.4 Transfer of possession

Transfer of possession can be achieved through subleasing, pooling of aircrafts, assignment of contract.

(i) Subleasing

Subleasing in a lease transaction is permitted under the Italian and Quebec law although it is subject to certain conditions.

The Italian Navigation Code, art. 378, allows subleasing but only if the lessor gives his consent[53].

Equally the Quebec Civil Code, art. 1870, requires the consent of the lessor to be given to the lessee in order for the subleasing to be possible. In addition to this requirement the same article requires the lessee to give notice to the lessor of the name and address of the potential sub-lessee. According to art. 1871 the lessor cannot refuse to give his consent without a serious reason and if he refuses he has to inform the lessee of his reasons within fifteen days after receiving notice, otherwise, he is deemed by law to have consented. This is further protection of the lessee which is not present in the Italian law.

But we have to ask ourselves if the provisions of arts. 1870 and 1871 of the Civil Code of Quebec can be considered rules of public order. It is important to distinguish between the two articles. In the first case the rule is aimed at protecting the lessor considering the fact that the lease is a contract *intuitu personae* and that the lessor has important interests at stake, as noted above. But the lessor in a lease transaction is certainly the stronger party and consequently the party less likely to need additional

[53] This is in line with the dispositions of the Italian Civil Code which at art. 1874 says that in case of a mobile good the subleasing must be authorized by the lessor or allowed by the usage.

protection against freedom of contract. The lessor is then free to waive his right to approve the sublease[54].

What about the requirement for the lessor to have a serious reason in case of refusal to approve the sublease under art. 1871? There is no doubt for the lease of dwellings: art. 1893 makes it clear that the rule is mandatory. For the other kinds of lease, although freedom of contract and the absence of a provision similar to the one contained in art. 1893 for the lease of dwellings have been used as arguments for the opposite view, I agree with the part of the doctrine[55] which sees the requirement of a serious reason as a rule of public order.

If we look at the usage in the lease of aircrafts we see that a proviso requiring the approval of the lessor is always included in the agreement. However, for the aforementioned reasons of speed in the whole process of sublease, it has become fairly common to include sublease rights in an aircraft lease transaction. In other words the lease will list the conditions that the lessee must fulfill in order to be able to sublease the aircraft.

These conditions will include :

a) Approval of the sublessee. The lessor will require the right to approve of the sublessee. In many leases there is a schedule of "approved airlines " which has been agreed upon in advance. In this case the sublease clause will merely require the sublessee to be chosen among the "approved airlines". The lessor will require the right to remove, on reasonable grounds, airlines from this schedule.

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[54] In this sense **P. G. Jobin** , *Le Louage*, 2e edition, Yvon Blais , 1996, pp. 69-70.

[55] See **P. G. Jobin** , "Les règles impératives dans le louage commmercial", in Faculté de droit , Université McGill, *Conférences commémoratives Meredith*, 1989 : *Problèmes contemporaines en droit immobilier*, Cowansville (Quebec) (Yvon Blais 1990) 177 at 184-186. Contra *Berard-Schetagne* c. *Lauzon*, J.E. 94-1830 (C. S.); *Family Life Assurances Co.* c. *Creeco* , J.E. 82-846 (C.S.).

b) Insurance. If the insurance is to be taken out and maintained by the sublessee the lessor will require the right to review and approve the insurance policy. He might also request to be named as an additional insured .

c) Maintenance. If the sublessee is chosen among the "approved airlines", when choosing the airlines, the lessor will have already considered that these airlines are capable of maintaining and operating the aircraft satisfactorily. In any case he will ask to reserve the right to approve any change in the maintenance program. If the sublessee is not among the approved airlines then a review of the maintenance record and program will probably be required.

d) Additional requirements. It is possible that the chosen sublessee operates in areas where a prudent lessor would require certain additional requirements, such as a political risk insurance or a letter of undertakings from the competent authority in order to allow deregistration and export in accordance with the terms of the lease. Because of the rapid changes in the world's political scenario, it is impossible to determine in advance the airlines "at risk".

e) Procedure. The sublease clause is likely to set out in detail the procedure for the sublease. The lessee should give details as regards the sublessee, the new state of registration and any change in maintenance programs and a draft sublease. The lessor should give his consent, if necessary subordinate to the fulfilling of certain additional requirements, within a certain period, no more than fifteen days in Quebec according to art. 1871 of the Civil Code.

f) Wet lease. The sublease clause may distinguish between a dry lease and a wet lease. The conditions in the former, when the airplane is still operated and maintained by the lessee, will be less onerous[56].

Can such a sublease clause, drafted as described, be considered a sort of prior consent of the lessor? In other words, can the consent of the lessor be given in advance even though it is subject to the fulfillment of the conditions listed in the sublease clause? In my opinion the answer is no. The sublease clause can only be regarded as an indication, for the lessee, of the main concerns of the lessor, which could eventually lead, in case of non-compliance, to a refusal of consent to sublease by the lessor himself. The lessee will in any case be required to inform the lessor of his intention to sublease and will have to ask for the lessor's consent. The inclusion of a sublease clause, and the compliance with its substance when drafting a sublease contract, will only guarantee the lessee the approval of the lessor.

Finally, it is important to see whether these clauses comply with the law .We have to consider then if the rule of the serious reason for refusing to consent to the sublease should apply to the conditions specified in the lease or in its schedule. I think that the application would be indirect. The lessor's refusal could be justified by referring to the conditions which have not been met in the sublease draft but it will still be left to the judge to decide whether they are serious or not. In other words, the fact that a condition has been put in a sublease clause is not a guarantee of reasonableness. From a theoretical point of view all the conditions previously analyzed are, in my opinion, reasonable : the approval of the sublessee is determined by the need for the lessor that

[56] For a detailed analyses of the conditions in a subleasing clause see J. D. Mcguinness, "Subleasing and the need for flexibility" AirFinance Annual (January 16 1991) 36.

his valuable asset be operated by a trustworthy company; the insurance and maintenance conditions reflect the lessor's need to protect his asset; the condition of restricting the list of potential sub-lessees to those who operate on certain routes is certainly dictated by the fear that the aircraft would be in danger if operating in areas where an armed conflict has broken out. From a practical point of view, in case of a dispute between the lessor and the lessee, it would be still left to the judge to decide whether a particular clause is reasonable or not. The Italian Supreme Court has held that " [T]he serious reasons which justify the opposition of the sublessor to the sublease [...] must concern the person of the sublessee, his reliability and his economic position or the whole projected operation, excluding the reasons which are related [...] to the needs and the situation of the lessor".[57]

In Italy there is no procedure specified in the Civil or Navigation Code about subleasing. A practice of including in a lease a clause which subordinates the sublease to a certain procedure and to the conditions analyzed above would be justifiable, in my opinion, by considering, first, the principle of freedom of contract and secondly the fact that the lease is a contract *intuitu personae*; accordingly the lessor has the right to review every aspect of the transaction which could adversely affect his asset.

From the Quebec law point of view, bearing in mind that art. 1871 fixes a mandatory, maximum limit of fifteen days, to inform the lessee of his reasons for refusing to give consent to the sublease, I think nothing prevents the parties to include such a clause in the lease for the same reasons as those seen for the Italian law. In my opinion, this is a limit set to protect the interest of the lessee to a speedy process and the interest of the lessor to a detailed check of the sublease, and thereby could be lowered with the consent of the lessor.

[57] Italian Supreme Court, 7th May 1991, decision n. 2386, Crugnale vs. Pileri.

When we turn our attention to a leasing transaction we note that in the Quebec Civil Code (art. 1842 ff.) there are no provisions relating to sublease. Part of the doctrine is of the opinion that the recent codification of the contract of leasing has definitely excluded the possibility that leasing be a type of lease[58]. This means that the articles which have been analyzed in the context of an operational lease cannot be applied to leasing . This is why I think we have to look at the usage when it comes to the sublease clause in a contract of leasing. The sublease transaction will only be possible if explicitly included in the leasing contract and if the lessor will give consent to it.
In Italy the hypothesis of sublease has been accepted both by the doctrine[59] and by some courts[60]. Of course, according to usage, it will still be necessary to obtain the consent of the main lessor[61]. A legal problem which could arise from a sublease contract in a leasing contract is to keep it distinct from an assignment of lease. The Court of Milan has held that " if the rent due to the main lessor by the sublessee, is that which was due to the sublessor, we are in presence of a sub-lease [...]"[62]

As we have seen, one of the major fears of the lessor is not to be able to repossess the aircraft in case of a default of the sublessee. The Italian and Quebec Civil Codes have adopted different solutions to this problem, both also trying to protect the main interest of the lessor in the revenue from his asset.

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[58] See in this sense **P. G. Jobin , supra** note 32 at 55-56.
[59] See **Dario Purcaro**, *La locazione finanziaria*, (Padova: CEDAM, 1998) at 293 and **R. Clarizia**, *La locazione finanziaria*, (Torino 1996) at 270.
[60] Court of Milan, 30 March 1987.
[61] In this sense **D. Purcaro**, supra note 58 at 294.
[62] Court of Milan, 6th February 1987.

The Italian Civil Code, art. 1595 first paragraph, allows the lessor to directly act against the sublessee to oblige him to perform his obligations under the sublease contract. This solution would then allow him to keep in force the contracts of lease and sublease and at the same time protect the aircraft in case of a default of the sublessee. In addition to this, art. 1595 third paragraph provides that the nullity or the resiliation of the lease contract has an effect on the sublessee as well. Although this may not seem to be much of a protection if the lessor wants to repossess his aircraft, we must consider that very often the sublease reproduces the provisions of the main lease; accordingly a default under the sublease could be considered as a default under the main lease as well, leading to resiliation of the latter and repossession of the aircraft.

The Quebec Civil Code, art. 1875, holds that "where the non-performance of an obligation by a sublessee causes serious damage to the lessor or to the other lessees or occupants, the lessor may apply for the resiliation of the sublease". In this case the protection of the lessor is direct. A breach of contract of sublease leading to serious damage allows the lessor to resiliate the contract of sublease, although he is third party to the sublease transaction.

(ii) Pooling

This term refers to (1) exchange of large and small items of equipment between different aircrafts in one airline's fleet and (2) exchange of equipment between different airlines.

Normally pooling of small items will be permitted even if subject to certain rules[63]. Pooling of complete engines could be a problem. The change of an engine can cause a considerable difference in the aircraft value. The lessor or the financier will have to agree with the airline if the governing principle will be title preservation (where the detached engine will remain in the hands of the lessor no matter on which aircraft it is installed) or title exchange (where the lessor will acquire title to the replacement engine at least while it is on his airframe). The parties are free to determine whether these agreements are convenient or not. But what if the engines are owned by third parties? In this case, unless the third party has acquiesced to the agreement, he is definitely not bound by the agreement, especially the title exchange agreement.

The provisions of the Italian and Quebec Civil Codes on accession do not apply in this case . Art. 939 of the Italian Civil Code says that in the case where two things belonging to two different owners being united to form one thing, are separable without serious damage, each owner keeps his title and can ask for separation. Art. 971 of the Quebec Civil Code holds that " [w]here movables belonging to several owners have been intermingled or united in such a way as to be no longer separable without deterioration or without excessive labour and cost.....". In our case, the separation of an engine is neither excessively expensive nor potentially dangerous to the engine or the aircraft.

However, in practical terms, if the airline should default it could be very difficult "to disentangle the ownership of each engine in the fleet"[64] and get quick repossession.

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[63] See **A. Littlejohns** , "Legal issues in aircraft finance" 1993 2nd edition Aircraft financing (Euromoney books) at 292-293.

[64] **Ibid.** at 293.

CHAPTER II

REPOSSESSION OF THE AIRCRAFT

Introduction

As we have seen in the previous chapter, the lessor will always ask for a detailed drafting of the clauses of default. A lessor is, of course, concerned with the conditions and value of his asset and with his chances to repossess it promptly in case of an early termination of the contract. But resiliation and repossession is not the only remedy available to the lessor. He can also ask for specific performance by the lessee or damages. In addition, the contract of leasing may raise the problem of the return of the payments already made if resiliation occurs.

In the Italian Civil Code art. 1453 governs the remedies of resolution of the contract, specific performance and damages for breach of contract by the lessee. The lessor is entitled to ask for the specific performance of the obligations. In this case, according to art. 2931 of the Italian Civil Code, the procedure specified in art. 612 ff. of the Italian Code of Civil Procedure is to be followed. If the lessor decides to avail himself of this remedy he may, for example, obtain from the court a judgment in payment for the rent payment or he could apply, both in Italy and Quebec, for an injunction of the court to obtain the specific performance of certain maintenance checks. If the lessor decides to ask for the specific performance he may nevertheless, according to art. 1453

par. 2 , ask, instead, for resiliation of the contract in the course of the judicial proceedings.

In Quebec the right to enforce performance is given to the lessor by art. 1601 and art. 1863 of the Quebec Civil Code.

In any case, whether the lessor decides to ask for resiliation or for specific performance, he is also entitled to damages according to art. 1453 of the Italian Civil Code and art. 1863, 1590 and 1458 second paragraph of the Quebec Civil Code. In Quebec art. 1604 second and third paragraphs also give the right to the lessor to a proportional reduction of his obligations, in the case where he is not entitled to resolution because the default of the lessee is of minor importance. However in practical terms it is difficult to see how this rule could apply in the case of an aircraft lease where, according to usage, all the obligations (to maintain, insure and so on) are on the lessee. Normally the lessor will only have to guarantee to deliver the property in a good state and provide the lessee with a peaceable enjoyment of the property throughout the term of the lease.

Resiliation of a contract of leasing raises another problem : what happens to payments already made by the lessee. The Quebec Civil Code gives us the answer in art. 1849: the lessor has to return the prestations he has received from the lessee but, if the lessee has derived benefit from the contract, he can deduct a reasonable sum to take account of such benefit. For the contract of lease the general rule contained in art. 1606 will apply: resiliation will relieve the parties of their obligations for the future only.

In Italy the situation is more complicated due to the uncodified nature of the contract of leasing. Since 1972 the Italian Supreme Court ("Corte di Cassazione") has been

trying to qualify the contract of leasing in order to allow the application of art. 1526 of the Italian Civil Code which obliges the seller, in the case of a conditional sale, to return previous payments but gives him the right for compensation for the use of the goods and a right to damages[63]. In the decision n. 65 of 7th January 1993 the United Sections of the Italian Supreme Court confirmed the distinction between a so-called "traditional leasing" (or "leasing di godimento") and the so-called "new or non-traditional leasing" (or "leasing traslativo") and affirmed the application of art. 1526 only to the new leasing.

Finally, in the case of the resiliation of a contract the lessor may avail himself of a penal clause, a clause by which the parties assess the anticipated damages by stipulating that the debtor must suffer a penalty if he fails to perform his obligations, without the creditor having to prove the injury he has suffered. Both the Italian Civil Code, art. 1382, and Quebec Civil Code, art. 1622, consider this clause. In our case it could be stipulated that the payments made at the time of the breach, will remain with the lessor as liquidated damages. However art. 1623 of the Quebec Civil Code and art. 1384 of the Italian Civil Code provide for a reduction of the stipulated penalty if the creditor has benefited from partial performance of the obligation or if the clause is abusive.

[63]The analysis of the contract of leasing by the Italian Supreme Court has gone through different phases. The Italian Supreme Court has distinguished between a "traditional leasing" with a financing cause and a "new or non-traditional leasing" with an exchange cause. In the first case each payment is intended to compensate the lessor for the value of the good which deteriorates during the execution of the contract and has a value ,at the end of the contract, of almost nothing. In the second case the payment includes not only the value for the use of the good but also a part of the price of it. At this case it could be applicable the discipline of the conditional sale and so art.1526 is applicable. For a complete analyses of the Italian Supreme Court jurisprudence on leasing see **G. De Nova, supra** note 2 at 21-33.

It is clear that in the case of a default of the lessee, whether he wants to resiliate the contract or avail himself of the remedies, the lessor has to be aware of the legal issues that may arise. But the scope of this dissertation is to concentrate on what steps are to be taken, what pitfalls are to be avoided and what instruments can help the lessor if he intends to repossess his aircraft.

Lessors must in any case keep in mind that the judicial or extra-judicial repossession is only a part of the requirements needed to get their aircraft back in case of an early termination of the lease. In order to regain possession of the plane physically a lessor has also to deregister it and reregister it in his own name, obtain in some cases an export license of airworthiness, obtain visas for the crew who have to fly the aircraft to its new destination, and so on.

In particular the deregistration procedures can be tricky and lengthy in the case where the lessee decides not to collaborate. In countries with operator-based registration it may be difficult to de-register an aircraft registered without the consent of the operator. In this case a solution could be found in a power of attorney given to the lessor by the lessee in advance, at the time of the contract. Of course the contract should specify that such a power would be in force only in the event of default of the lessee and an early termination of the lease. In this way the lessor may act as the lessee's representative and take all steps necessary to obtain deregistration[64].

It is also possible that deregistration is made difficult by local authorities because the lessee is a government-owned carrier or flag carrier. In this case a prior written

[64] See J. Howitt, supra note at 486-487 and J. Pritchard, W. Piels and T. Zimmer, supra note at 100.

commitment by the competent authorities or by the local government that it will deregister the aircraft upon termination of the lease, could help the lessor.

It is important to underline that in Italy de-registration can be achieved only after a number of formalities and on the expiry of a minimum of a 60-day period in which the holders of privileges, having priority under the law, have the opportunity to object to de-registration[65].

On the contrary in Quebec law repossession, even under a mere leasing, is not subject to the conditions and the procedure of realization of a security on property.

Keeping in mind these administrative requirements we now turn our attention to the legal issues to be taken into consideration by the lessor in order to repossess the aircraft. We will first analyze the first step in the sequence of remedies, resiliation of the contract; then we will examine judicial repossession and self-help repossession. The last part of this chapter will present a brief overview of the international instruments which could affect or facilitate the repossession of the aircraft.

2.1 Resiliation

In the case of a default of the lessee the lessor may want to repossess his aircraft. He may do so by self-help repossession or by judicial repossession. In any case the first step to the lawful return of the aircraft in his hands is resiliation of the contract.

[65] See S. Beltramo, "Legal aspects" , Airfinance Annual (1996-1997) 179. As previously seen art. 1023 of the Italian Navigation Code lists the credits for which the law establishes a privilege on the aircraft.

Resiliation of a contract can be achieved, in Italy and Quebec, judicially or extra-judicially.

In Italy resolution of the contract without judicial proceedings is possible in three different hypotheses:

1) Express resolutory clause . According to art. 1456 the contracting parties can include in a contract a clause which states that the contract will be resolved when a specific duty is not performed according to the agreement. The clause does not operate automatically but it is necessary that the party who intends to use it declares it be so. It is important to note that the Italian Supreme Court has ruled that in presence of an express resolutory clause the breach of contract does not need to be of major importance[66]. Nevertheless in the case where the contract states that the clause is effective regarding any obligation included in the contract, without specifying any of them, the clause is held to be a clause de style ("clausola di stile") and the judge can then proceed to an estimation of the importance of the breach[67] but only when the party in default challenges the fact that an event of default has really occurred;
2) Notice to perform. This hypothesis is governed by art. 1456. In the case where an express resolutory clause has been stipulated a party can obtain resolution without judicial proceedings by sending the other party a notice to perform within a specified period (which can be no less than fifteen days according to art. 1456 para.2). If the debtor does not perform the obligation within the specified time, the

[66] See Italian Supreme Court, 21 march 1970, n.756
[67] See Italian Supreme Court, 1 march 1974, n. 578

contract is resiliated. In our case a lessor might ask the lessee to perform a certain maintenance check or enter into a specified insurance policy.

3) Time essential to one party. According to art. 1457 a contract is resiliated *ipso iure* if an obligation is performed after a certain time considered essential for the creditor, meaning that the same performance would have no meaning for that party after that time. In my opinion this case is not likely to be applied in an aircraft lease. Even if we hypothesize of a situation when the lessee has failed to perform a specified check at the time specified in the contract it is hardly arguable that a late performance is meaningless for the lessor. The same goes for rental payments, insurance coverage, etc.

In Quebec, according to art. 1605, resiliation of a contract without judicial proceedings is possible where "a debtor is in default by operation of the law or where he has failed to perform his obligation within the time allowed in the writing putting him in default".

We have to look at art. 1597 to know the cases where a debtor is in default by operation of the law. The article enumerates 6 different hypotheses:

1) where the performance of the obligation would have been useful only within a certain time which he allowed to expire (in our case it is possible that the lessee has not renewed an agreement with an airport authority to use one or more slot and has thus practically showed his intention not to fly a particular route anymore);
2) where he fails to perform the obligation immediately despite urgency to do so (i.e. renewal of an insurance contract);

3) where he violates an obligation not to do. For an example in our field we can imagine a lessee who has sublet the aircraft to an airline not approved by the lessor;

4) where the specific performance of the obligation has become impossible through the debtor's fault;

5) where his intention not to perform the obligation has been made clear to the creditor (i.e. the lessee may not want to comply with a service bulletin);

6) Where, in the case of an obligation of successive performance, he has repeatedly refused or neglected to perform it (i.e. the lessee has failed to make a maintenance check several times).

The other case of extra-judicial resiliation of a contract specified in art. 1605 is to be interpreted by keeping in mind art. 1594 para. 1 and para. 2 and art. 1595. By an express clause the parties can waive their right to a default notice. If they do not waive such a right a default notice is necessary and, according to art. 1595 para. 2, it has to "[...] allow the the debtor sufficient time for performance, having regard to the nature of the obligation and the circumstances [...]". If the default notice requirement is met, then resiliation of the contract for any important breach is possible (if the breach is not important the creditor has only the right to damages or to a reduction of his obligations according to art. 1604). However the ambit of art. 1605 is unclear: in some cases extra-judicial resiliation would conflict with specific rules in a given contract. Art. 1883 of the Quebec Civil Code is a perfect example of this conflict. In a recent decision[68] the Quebec Court of Appeal has held that , in the case of lease

[68] *Place Fleur de Lys c. Tag's Kiosque Inc*, [1995] R.J.Q. 1659 (Que. C.A.)

contract, resiliation by operation of law is impossible because it conflicts with the right of the lessee, under art. 1883, when sued for resiliation for non-payment of the rent, to avoid resiliation at any time before judgment by paying the rent due, interest thereon and legal costs.

The Italian Civil Code lists the judicial resiliation of a contract in art. 1453 among the other possible remedies available to a contracting party. According to the aforementioned article the first condition a judge looks for is the breach of contract by the defendant. The breach of contract is a violation of the terms of the agreement or the law irrespective of any damage the other contractor might have suffered[69]. At first sight it might seem that any breach, even that which is not caused by the defendant's negligence, could constitute a valid base for resiliation of the contract. However, the Italian courts have constantly interpreted this article as requiring at least negligence of the defendant in order to blame him for breach of contract[70].

Art. 1455 adds to these requirements the need for the breach to be one of major importance, bearing in mind the interests of the other party. It is important to note that the Italian Supreme Court has ruled that in the case of a lease, late payment of one of the rental payments cannot be automatically considered a breach of major importance. It will be necessary to verify whether late payment is important enough to justify resiliation of the contract with respect of its framework[71].

To obtain possession of the aircraft the lessor can also file an action in restitution. This is a particular action given to an owner who wants to repossess his property or goods

[69] See R. Sacco e G. De Nova , *Il Contratto* , Tomo secondo (UTET: 1993) at 595
[70] See Italian Supreme Court, 15 Septembre 1970, n. 1441 or Tribunale di Napoli , 20 July 1974
[71] See Italian Supreme Court, 19 May 1969, n. 1741

when the contract, which gave another party the right to possess that property, is terminated. This is different from the action in revendication by which the owner asks the court to recognize his right of ownership or right to hold the goods and to allow him to repossess his property. The difference between the two actions is important because in an action in revendication the owner has to prove his right while in an action in restitution the owner only has to prove the consignment of the goods in execution of a contract, the termination of that contract (in our case by judicial or extra-judicial resiliation) and therefore the lack of legal basis for the possessor (in our case the lessee) to maintain the possession of the property (in our case the aircraft).

The conditions for the resiliation of a contract in Quebec are not different from those we have analyzed in the Italian law. Arts. 1590 and 1604 provide for the resiliation of the contract in the case of an important breach. Art. 1590 par. 2 adds that the failure to perform by the debtor has to be without justification on his part. Here a distinction between obligations of means and obligations of result is to be drawn : in the case of an obligation of means the creditor has to show negligence while in the case of an obligation of result the creditor must only prove that he did not receive the expected result, and the debtor can avoid the resolution only by establishing force majeure. Similar to art.1455 of the Italian Civil Code, art. 1604 para. 2 of the Quebec Civil Code excludes the possibility that a breach of minor importance could lead to resiliation of a contract. This indirectly stresses the need for the breach to be of major importance. Nevertheless, the same article adds that if the default is of minor importance but occurs repeatedly, the creditor is entitled to the resiliation of the contract.

Also in Quebec the owner of a property, according to art. 953 of the Quebec Civil Code, is entitled to an action in revendication against the possessor or the person detaining it without right. This is the action which will be used by a lessor in the case of a financial leasing. In the case of an operating lease the article we have to look at is art. 1889 : " [...]; the lessor of a movable may ,[after the expiry of the lease], obtain the handing over of the property.".

Once the contract has been resiliated the lessor will be able to start procedure to repossess the aircraft. As was said before, there are two ways of repossessing an aircraft : the first involves intervention of the court and is therefore subject to precise procedural rules. We will focus on this kind of repossession in the next section. The second is the so-called self-help repossession. By this expression we mean the right of the creditor to exercise a certain remedy without taking any judicial proceedings. The right can be given to the creditor by the law or by agreement.

2.2 Judicial Repossession

Achieving the final result of having the contract resiliated by a judicial decision may take a long time. As we have seen in the case of default of the lessee the lessor will be concerned with the condition of his aircraft. A breach of the contract by the lessee is a breach in the reciprocal confidence of the two parties in the exact compliance with the terms of the agreement. It is then understandable that the lessor is no longer willing to let the lessee use his valuable asset during judicial proceedings. If the breach is a failure to maintain the aircraft according to the agreement the lessor may be afraid to

let the aircraft fly at risk without the proper maintenance. If the breach is a failure to insure the aircraft, the lessor might not be willing to bear the economic risks that an uninsured aircraft may represent.

Seizure before judgment is then a necessary step to be taken in order to prevent the, now "untrustworthy", lessee from using the aircraft.

In Italy seizure of the aircraft is governed by the rules of the Italian Code of Civil Procedure and by articles 686 to 1079 of the Italian Navigation Code.

The Italian Code of Civil Procedure distinguishes two kinds of seizure: judicial seizure ("sequestro giudiziario") and conservatory seizure ("sequestro conservativo"). The latter is meant to protect a secured creditor against any act which could diminish his security. Although it might be used by a creditor in a leveraged lease, the analysis of such a device is outside the scope of this thesis.

What can surely be used by a lessor is the judicial seizure. The procedure for this seizure, both before or during the law suit, is set out in the recently added articles 669 bis to 669 quaterdecies. These articles apply to all the so-called conservatory measures ("procedimenti cautelari"). Arts. 670, 675, 676 and 677 of the Italian Code of Civil Procedure and the aforementioned articles of the Italian Navigation Code apply in addition to these rules. The analysis of the entire procedure leading to judicial seizure of the aircraft is not within the scope of this thesis; it is however necessary to examine the rules of judicial seizure which could be of relevance in our case.

Art. 670 of the Italian Code of Civil Procedure governs seizure before judgement. It lists the goods that can be seized and the conditions to be met to obtain seizure. The

judge may authorize, among others, seizure of movable property if its title or possession is under judicial scrutiny and its temporary custody or management must be provided. Authorization always contains an order to the commander of the aircraft not to let the aircraft take-off and in case the aircraft is in flight, not to leave the airport of arrival.

When an authorization to seize is issued, then the aircraft, according to art. 675 of the Italian Code of Civil Procedure, is to be seized within thirty days of issue of the authorization. It will lapse if the process of seizure has not started within this period of time.

In Quebec seizure before judgment is governed by art. 733 to 740 of the Code of Civil Procedure.

According to art. 734 the plaintiff may, among other goods, seize before judgment " the movable property which he has the right to revendicate". Once again we will not analyze the entire procedure but it is sufficient to say that seizure, according to art. 735, is effected in virtue of a writ which, according to art. 736, orders the officer charged with it "to seize [...] only the movable property specially described therein". Finally art. 737 states that the seizing officer may make the plaintiff-lessor the guardian of the seized property.

In case repossession is granted by the court it has been suggested[72] that it is helpful that the court order contains:

a) a direction to the sheriff or the officer to assist the lessor in effecting repossession of the aircraft;

b) a break and enter conclusion authorizing the sheriff to enter in any premises;

c) a conclusion allowing the sheriff or the bailiff to call for police or other assistance as he may consider necessary to allow the repossession to proceed in a peaceful and orderly manner;

d) authorization for the sheriff to obtain an indemnity from the party instructing the seizure and instructing the sheriff to proceed without a bond.

It is possible for the lessor to make the court application without giving notice to the lessee but this would only be advisable in extreme circumstances. Proceeding on an ex-parte basis requires a representative of the lessor to depose that notice to the lessee may jeopardize repossession in that jurisdiction because the aircraft may be transferred to a jurisdiction where repossession would be difficult. Full disclosure of all relevant facts would have to be made in court, with the consequence that if the lessee should manage to prove that less than full disclosure was made at the time of the ex-parte application, the court may well revoke the order and make it extremely difficult for the lessor to find further relief from the court[73].

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[72] See M. K. Feldman and J. E. Harris, "Cross-border aircraft leasing in Canada" Studies in Leasing Law and Tax 1995 : A special supplement to World Leasing Yearbook and Airfinance Annual (Euromoney Pubblications) at 52

[73] Ibid. at 52

Once the lessor has proceeded to obtain resiliation of the contract, then the seizure is held to be valid and the court orders that the aircraft be given back to the lessor (if, at the time of the seizure before judgement, it was left with the lessee).

2.1 Self-help Repossession

Self-help repossession is a typical legal device of common law countries. In the U.S., for example, art. 2A section 525 of the Uniform Commercial Code governs repossession rights of a lessor in the case of a lease or a leasing. The lessor has the right to repossess the leased goods in the case of default of the lessee even if the goods are in the hands of a third party. The default is the only requirement for repossession and the lessor is not required to give any prior notice to the lessee. The lessor can proceed to self-help repossession but he has to do so without a breach of peace. The Uniform Commercial Code however does not define a breach of peace : the gray area between the physical violence (which, without any doubt, represents a breach of peace) and a lessor peaceably persuading the lessee to give up the goods (which is certainly a valid hypothesis of legal self-help repossession) is difficult to define.

Is this remedy applicable in civil law jurisdictions such as Italy and Quebec?

In Italy no provision of the Italian Civil Code on lease gives the lessor the right to self-help repossession. On the other hand, the Italian Criminal Code art. 392 punishes by a fine "whoever, for the purpose of exercising an alleged right, where it is possible to

have recourse to the courts, arbitrarily asserts his rights by using violence against property". The article defines violence against property as occurring "whenever a property is damaged or changed, or its intended use is altered". In addition to this, art. 393 punishes by imprisonment "whoever, for the purpose specified in the preceding article, and where it is possible to have recourse to the courts, arbitrarily asserts his rights by using violence or threat towards persons".

What happens if self-help repossession is made without violence against property and towards persons? Although the situation might be unlikely to happen in real life, if we analyze it from a theoretical point of view I think such an action by the lessor should not be condemned by the court. But, as I have said, it is highly improbable that one can enter an aircraft (maybe with a copy of the keys, as it could be done for a car), start it and fly it back to the lessor. Given the value of such a property, and consequently the necessary security measures taken, repossession without breach of peace is hard to imagine.

In Quebec we should take a look at the articles which govern the taking in payment by a hypothecary creditor. The situation described in art. 2778 ff. of the Quebec Civil Code may recall the case analyzed in this thesis: in the case of a default of the debtor, or in the case of payment not being made, which has not been remedied in the time allotted, the hypothecary creditor has the right to take the property in payment. According to art. 2783, he becomes the owner of the property from the time of registration of the prior notice which he is obliged to give to the debtor if he wants to exercise the remedy of taking in payment. If the debtor is unwilling to give up the property, the creditor must necessarily apply to the court for a judgment. Any clause

attempting to avoid these proceedings would be void as held by art. 1801 of the Quebec Civil Code.

However, art. 2783 shows the gap between the taking in payment by a creditor and the self-help repossession by a lessor in case of a default of the lessee. Whether we consider an operating lease or a financial lease, the lessor remains the owner of the aircraft so he cannot become the owner of it by the action of taking in payment. He is in fact repossessing his own property. Then the possibility of an indirect application of these rules to our problem must be excluded. The lessor cannot be assimilated to a hypothecary creditor.

Similarly the rules for repossession included in the Quebec Civil Code (art. 1957 to 1970) specifically apply only to the lease of a dwelling. The specialty of this subject does not permit to make an indirect application by analogy to aircrafts. The articles refer only to the lease of dwellings and could not be applied to lease, let alone leasing, of aircrafts.

The only chance for a lessor to proceed to a self-help repossession could be thinkable if the procedure were set out in the contract. As Prof. Grenon correctly stated "l'exercice de recours par le crédit-bailleur en cas de défaut n'est régi par aucune règle législative propre [...] En conséquence, les contrats de crédit-bail seront plus forcément détaillés: ils comporteront[...] des clauses réservant au crédit-bailleur, en cas de défaut de la part du crédit-preneur, le droit de reprendre le bien,.... "[74].

[74] **Alain Grenon, "Le crédit-bail et la vente à tempérament dans le Code Civil du Québec" 1994 Revue générale de droit 217 at 230**

Although the analysis of Prof. Grenon only relates to leasing, it is possible to extend these considerations to the case of an operating lease. No procedure for repossession is set out in the Quebec Civil Code in the case of the lease of a movable property. The parties are thus free to establish their own rules in the contract.

The only possible limit is represented, in the case of a contract of adhesion, by art. 1437 of the Quebec Civil Code according to which "an abusive clause in [...] contract of adhesion is null". Paragraph 2 of the same article describes an abusive clause as one "which is excessively and unreasonably detrimental to [...] the adhering party and is therefore not in good faith".

Although in reality aircraft lease and leasing contracts are heavily negotiated, and therefore do not fall into the category of contracts of adhesion, it is possible to imagine a situation where a commuter airline has to enter into a contract with a big leasing company which decides to use a standard-form contract. In this case a repossession clause drafted in such a way as to be detrimental for the lessee could be challenged by reference to art. 1437.

2.4 The International framework

The analysis of the Italian and Quebec legislations would not be complete without a look at the international conventions which have had an impact on the subject of this thesis.

Four conventions have a direct or indirect link with the contract of leasing or with the problem of repossession of the aircraft :

1) The "Convention pour l'unification de certaines règles relatives à la saisie conservatoire des aéronefs", signed in Rome on May 29, 1933[75];
2) The "Convention on the international recognition of rights in aircraft", signed at Geneva on June 19, 1948[76] ;
3) The "European Community Civil Jurisdiction and Judgments Convention", signed in Brussels on September 27, 1968[77] ;
4) The "Unidroit Convention on International Financial Leasing", signed in Ottawa on May 28, 1988[78];

2.4.1 The Leasing Convention

I think it is important to start from the last one which is the most comprehensive although it is not meant to govern aircraft leasing specifically but the contract of financial leasing in general.

A complete discussion of the whole International agreement is beyond the scope of this thesis. It is necessary to concentrate our attention on the part related to the subject of this work.

The Leasing Convention recognizes in its preamble the importance of "removing certain legal impediments", "the need to make international financial leasing more available" and "the desirability of formulating certain uniform rules relating primarily to the civil and commercial law aspects of international financial leasing".

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[75] Hereinafter Rome Convention
[76] Herinafter Geneva Convention
[77] Herinafter Brussels Convention
[78] Herinafter Leasing Convention

The scope of the Convention is limited by art. 1.4 to "all equipment save that which is to be used primarily for the lessee's personal, family or household purposes" and by art. 3 to the international leasing transaction. The International leasing transaction is defined by art. 1 which is a compromise between civil law and common law countries : in fact the Leasing Convention applies "whether or not the lessee has or subsequently acquires the option to buy the equipment or to hold it on lease for a further period, and whether or not for a nominal price or rental".

A close look must be given to art. 8(b) which states : " The Lessor shall not, in its capacity of lessor, be liable to third parties for death, personal injury or damage to property caused by the equipment." The provision is of major importance in the aviation field where, as seen in the previous chapter, liability claims in case of an accident represent a great danger for owners and operators of aircrafts

However the following paragraph, art. 8(c), adds that " [t]he above provisions of this paragraph shall not govern any liability of the lessor in any other capacity, for example as owner". We have previously seen that the contract of leasing, in the Italian and Quebec legislations, provides for the retaining of the title in the hands of the lessor during the term of the contract or, in the appropriate case, until the lessee has availed himself of the option to buy the equipment. Art. 8(c) thus renders the insurance clause of a leasing agreement to which the Italian or Quebec laws apply, very important. A lessor will always want to be sure that he is completely protected in case of a liability claim.

Article 9 which briefly lists the duties of the lessee to "take proper care of the equipment, use it in a reasonable manner and keep it in the condition in which it was delivered, subject to fair wear and tear and to any modification of the equipment agreed by the parties".

Certainly the article which interests us the most for this thesis is article 13 which considers the lessor's rights and remedies in the event of default by the lessee. According to paragraph 2 of the aforementioned article , "where the lessee's default is substantial, then subject to paragraph 5 the lessor [...] may terminate the leasing agreement and after such termination :

a) recover possession of the equipment ; [...]"

Paragraph 5 of the same article simply adds that "the lessor shall not be entitled to exercise its right of acceleration or its right of termination under paragraph 2 unless it has by notice given the lessee a reasonable opportunity of remedying the default in so far as the same may be remedied".

The Leasing Convention is the only one, among those conventions taken into consideration at the beginning of this paragraph, to which Italy and Canada are both parties.

2.4.2 The Rome Convention

Particularly important is the "Convention pour l'unification de certaines règles relatives à la saisie conservatoire des aéronef", signed in Rome on May 29 1933, ratified by Italy by law n. 933 of May 28, 1936 and having come into force on January 13, 1937.

The Rome Convention focuses on the precautionary arrest[79] ("saisie conservatoire" in the original French text) by including in this expression "tout acte, quel que soit son nom, par lequel un aéronef est arrêté, dans un intérêt privé, par l'entremise des agents

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[79] Art. 2 paragraph 1 of the Rome Convention

de la justice ou de l'administration publique, au profit soit d'un créancier ou d'un titulaire d'un droit réel grevant l'aéronef, sans que le saisissant puisse invoquer un jugement exécutoire, obtenu préalablement dans la procédure ordinaire, ou d'un titre d'exécution équivalent."

According to art. 3 the following are exempt from precautionary arrest :

"a) les aéronefs affectés exclusivement à un service d'Etat, poste comprise, commerce excepté;

b) les aéronefs mis effectivement en service sur une ligne régulière de transports publics et les aéronefs de réserve indispensables;

c) tout autre aéronef affecté à des transport de personnes ou des biens contre rémunération, lorsqu'il est prêt à partir pour un tel transport, excepté dans les cas où il s'agit d'une dette contractée pour le voyage qu'il va faire ou d'une créance née au cours du voyage."

These two articles certainly constitute an additional obstacle for the lessor who wishes to repossess his aircraft in one of the countries which have ratified this Convention. However, the next paragraph of article 3, according to which the rules of this article do not apply to precautionary measures exercised by the owner dispossessed of the aircraft by an unlawful act, may give the lessor leverage to circumvent the provisions of the Rome Convention by using the Brussels Convention.

2.4.3 The Geneva Convention

The "Convention on the International recognition of rights in aircraft" signed in

Geneva on June 19 1948[80] is to be mentioned because its article 1 paragraph 1 contains the express recognition by the Contracting States of "the rights to possession of aircraft under leases of six months or more". The Convention does not say anything about the case of a default of the lessee and the rights to a speedy repossession by the lessor.

2.4.4 The Brussels Convention

The last convention we have to analyze is certainly the least directly related to aircraft leasing but is the one which could be useful for an aircraft lessor who wishes to repossess his asset in the shortest time possible. The European Community Civil Jurisdiction and Judgments Convention, signed in Brussels on 27 September, 1968, provides rules for the recognition and the enforcement in a Contracting State of judgments rendered in other Contracting States.

The importance of this Convention is easily understood if we consider the extreme mobility of an asset like an aircraft. At the end of a judicial procedure of repossession started in a certain country, the aircraft may be located in another country which would force the lessor to start new proceedings. This Convention provides for the recognition of judgments rendered in a Contracting State without the need of other proceedings. However, having obtained a judgment of first instance in a Contracting State does not necessarily mean that enforcement can be easily achieved in another Contracting State[81]. Lessors may in fact face a denial of enforcement on the grounds set forth in

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[80] The Geneva Convention has been ratified by Italy with the law n. 545 of 1st May 1952 and has come into force for Italy on 3rd June 1952

[81] B. Crans, "Enforcement of 'Authentic' Lease Instruments in Europe" 1997 Vol. XXII n.2 Air & Space Law 76 at 77-78

articles 27 and 28. Among the other reasons, recognition can be denied if it is contrary to 'public policy' in the State applied to; if the defaulting defendant was not served with the summons correctly and in time for him to arrange his defense; if judgment is incompatible with a judgment rendered in a dispute between the same parties in the State where the application has been made; or if the mandatory jurisdiction rules of Articles 7-16 of the Convention have been breached.

Moreover, according to art. 38 of the Brussels Convention the Court seized with the recognition of a judgment may stay its decision if judgment is under appeal in the country of origin or if appeal is still possible. But in Italy the law n. 353/1990 provides for the provisional enforceability of a judgment of first instance. If judgment is appealed then the court of appeal may suspend the enforceability, in the presence of serious reasons. Because the Brussels Convention, in art. 38, says that the Court whose decision is appealed may stay its decision if the judgment is appealed in the country of origin, then, in my opinion, a Court seized with an application on the ground of the Brussels Convention could permit enforceability of an Italian judgment of first instance, even though it has been appealed and especially if the suspension of enforceability has been denied by an Italian Court of Appeal.

The fact that enforceability of a judgment of first instance may be achieved in a Contracting State of the Brussels Convention is of little help to a lessor who is anyway obliged to follow ordinary procedure before being able to take any precautionary measures, if himself and the lessee are both citizens of States Parties to the Rome Convention.

On the other hand, because the Convention also provides for the recognition and enforcement of 'authentic instruments'[82], it has been suggested[83] that a speedy repossession of the aircraft could still be achieved. Inclusion in an authentic lease agreement of the following clauses:

1) the lessor shall have the right to terminate the lease upon the occurrence of an instance of default;
2) termination of the lease implies the obligation for the lessee to return the aircraft to the lessor and the right of the lessor to repossess the aircraft wherever such aircraft may be located ;
3) the lessor is authorized to deregister the aircraft;
4) the books and records of the lessor shall be conclusive as to the question of what the amount due by the lessee is,

should make enforceability of the right to repossession quite simple by following the procedure described in art. 39. By using an 'authentic' lease agreement the limits of the Rome Convention could be ignored : the authentic French text of the Rome Convention refers to "un titre d'exécution équivalent" as a legal basis to take precautionary measures; thus it could be possible to argue that "any action taken on the basis of an authentic instrument is based on a right of seizure equivalent to an immediately enforceable judgment"[84].

In Italy, in my opinion, this interpretation could not be followed. A notarial deed in Italy is immediately "executable" only if it proves a claim and not a contract. In order to make a right to repossession included in an authentic lease agreement enforceable, a

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[82] Authentic instruments are a typical feature of civil law countries and find no equivalent in common law systems. In Italy they refer to notarial deeds and acts written by a public officer.
[83] See B. Crans, supra note 82 at 78-79
[84] Ibid. at 79

lessor must initiate proceedings to obtain a "decreto ingiuntivo" (which is approximately equivalent to the common law "summary judgment) which will order the lessee to give the aircraft back to the lessor. The procedure of injunction is definitely shorter than the ordinary procedure but :

1) if the lessee objects the "decreto ingiuntivo", then a proceeding similar to the ordinary, and just as long procedure, is started ;
2) in any case, considering that the injunctive procedure is a special procedure which does not include any hearing of the lessee, in my opinion the "decreto ingiuntivo" cannot be considered " un titre d'exécution équivalent" to the ordinary procedure as required by art. 3 of the Rome Convention to take precautionary measures. The intent of the Rome Convention is in fact, as I understand it, to protect operators of aircrafts as much as possible from having their "working tools" seized without having the chance to defend themselves. Such a protection would be lost if a summary proceeding like the one briefly exposed above were accepted as a way for the lessor to obtain possession of his aircraft.

The procedure to obtain a "decreto ingiuntivo", on the contrary, could be useful if the lease agreement contained a clause which declared failure to return the aircraft to the lessor at the termination of the lease an illegal act according to the dictates of the Rome Convention. In this way, by applying the provisions of art. 3.2 of the Rome Convention, the restrictions of the latter could be set aside.

One can see how difficult it may be for a lessor to gain possession of his aircraft in the case of an early termination of the contract. The Rome Convention especially represents a serious obstacle to a lessor. Although it could be argued that its application is limited, I think the time has come for denunciation of the Rome Convention or for the substitution of an international instrument that better reflects the

needs of the aviation industry. The Rome Convention, just like the Warsaw Convention which limits the liability of the aircraft operators, is an example of an instrument conceived to protect an infant industry, as the aviation was in the early years of the century. Nowadays aviation is a solid industry which has to be subjected to the rules of the market and certainly does not need protection anymore. A new Convention could also better take into consideration the development of the use of contracts of lease and leasing in the aviation world and could better protect the interest of lessees and lessors.

The description of the international framework related to the lease and leasing of aircraft would not have been complete without the analysis of the most recent international development in this field: the Unidroit draft Convention on International Interests in Mobile Equipment. This draft Convention is important not only because of the prestige of the organization that is trying to develop it, but also because, in my opinion, it perfectly targets the obstacles that slow down the process of repossession of the aircraft and tries to overcome them.

2.4.5 The Unidroit draft Convention on International Interests in Mobile Equipment

The Canadian government proposed in June 1988 that Unidroit should address the matter of an international interest in mobile equipment. But it was only in March 1993 that a study group held its first session about it. The study group is currently at

work on a draft Convention on International Interest in Mobile Equipment[85] which will be amended and supplemented by a protocol[86], as the same relates to airframes, aircrafts, engines and, possibly, helicopters .

The Convention aims at creating a wholly new international interest in mobile equipment. However " taking its inspiration from Article 9 of the Uniform Commercial Code and the Canadian Personal Property Security Acts, the international interest embraces not only the classic security interest granted under a security agreement but also those functional equivalents, the interest retained by a seller under a title reservation agreement and that retained by a lessor under a leasing agreement". In the first steps of the study group on the Convention the idea that "[a]n aspect of the project should be to [...]exclude from the scope of the Convention or rules transactions such as[...] equipment leases that are not treated as security agreements under the law of the State in which they are used"[87] was put forward. However, it was admitted that "a possible deficiency in the Questionnaire was its failure to address directly the issue as to whether leases of equipment should be brought within the scope of at least the registration and priority structures of the Convention (or rules)". However, several respondents having identified themselves as lessors, and at least two having identified themselves as lessees, appear to have answered the Questionnaire on the assumption that a Convention (or rules) would apply to leasing contracts"[88].

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[85] Hereinafter referred as "The Convention"
[86] Hereinafter referred as "Aircraft Equipment Protocol"
[87] **See Analyses of the replies to the questionnaire of an international regulation of aspects of security interests in mobile equipment (prepared by the Unidroit secretariat) , UNIDROIT 1991 Study LXXII - Doc. 3 at 9-10**
[88] **See Restricted exploratory working group to examine the feasibility of drawing up uniform rules on certain international regulation of aspects of security interests in mobile equipment, UNIDROIT 1992 Study LXXII - Doc.4 at 5.**

The issue of including the lease contracts in the scope of the Convention was brought up in May 1995 in a memorandum prepared jointly by Airbus Industrie and the Boeing Company on behalf of an aviation working group. According to this memorandum "all lease contracts, regardless of duration or other terms and conditions, shall be included as title reservation agreements and thus covered by the proposed convention. No distinction between leases and other types of title reservations should be made"[89]. Any attempt to draw a distinction between types of leases, "on any ground other than the duration", would result "in intractable problems" and in an increase in financing costs[90]. On the other hand " excluding short term leases, by reference to duration, is not desirable in the context of aircraft finance.[...]Thus a short term lease exclusion would either (i) require a complex and inefficient dual system for regulating priority and enforcement rights in leases or (ii) provide for a disincentive to enter into short term leases."[91] The Memorandum prepared by the two giant aircraft manufacturers also suggests the inclusion of the sub-lease contract in the scope of the Convention.

On this matter it is interesting to note the position of the Italian Banking Association, in whose opinion "the simple assimilation of the lease concept to title reservation agreements put forward by the proposed Convention (Art. 1(2)(c)) seems to emphasize the view that leasing transactions - as well as retention of title under a conditional sale - must be intended to serve the function of security. In Italy the opposite idea has prevailed, that is, that the lease is to be regarded - in its traditional form - as a

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[89] See Study group for the preparation of uniform rules on international interests in mobile equipment : sub-committee for the preparation of a first draft, UNIDROIT 1995 Study LXXII - Doc. 16 at 13 (herinafter UNIDROIT 1995 Study LXXII – Doc.16). The memorandum in a note precise that agreements referred in the aviation world as "wet leases" or "charters" should be excluded from the scope of the Convention because these are neither bailments nor financing ,in the broadest sense of these terms.

[90] The reference is clearly made to the U.S. Uniform Commercial Code where an unclear distinction between "true-operating leases" and "financial/security leases" has created many interpretative problems to courts.

[91] See UNIDROIT 1995 Study LXXII-Doc. 16 at 13.

financing transaction. In the light of this no analogy with retention of title is admissible. Therefore the proposed Convention should be limited to regulating the lease by way of security"[92]. The Study group for the preparation of the first draft of the Convention agreed with this approach[93] and decided that "it would be necessary to have three categories of interest, security interest, title reservation and leasing, on the basis that an effort would be made to devise rules that were, as far as possible, the same for all three categories but which, in some respects, would be bound to differ as between one category and another"[94].

The Unidroit working group found several difficulties in defining the scope of the future Convention. In May 1992 the opinion of the working group was that "the proposed Convention should be confined to mobile equipment, that is equipment held by the debtor for business use (as opposed to consumer goods) which was of a kind normally moving from one State to another in the ordinary course of business"[95]. Later on the sub-committee for the preparation of the first draft of the Convention ," in order to overcome the difficulties inherent in defining "mobile" equipment, [...]agreed that a list of movable tangibles falling within the scope of the proposed Convention should be drawn up. No decision was taken as to whether this list should be exclusive or non-exclusive..."[96]. In the previously cited memorandum, Airbus and Boeing urged the

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[92] See Study group for the preparation of uniform rules on international interests in mobile equipment : sub- committee for the preparation of the first draft, UNIDROIT 1995 Study LXXII- Doc.15 Appendix III

[93] The European federation of Equipment Leasing Company Associations had previously made clear that " it did not regard leasing as a form of reservation of title because there was no dispositive intent on the part of the lessor, the leased asset was the lessor's property and leasing did not involve the reservation of title". See Study group for the preparation of uniform rules on international interests in mobile equipment, UNIDROIT 1996 Study LXII - Doc. 27 at 6 (herinafter UNIDROIT 1996 Study LXII - Doc. 27).

[94] See UNIDROIT 1996 Study LXII - Doc. 27 at 6.

[95] See UNIDROIT 1992, Study LXXII - Doc. 5 at 3

[96] See UNIDROIT 1995, Study LXII - Doc. 15 at 4

drafting group "to consider (a) limiting the proposed Convention to enumerated types of specifically identifiable high value mobile equipment (i.e. , aircrafts, aircraft engines, ships, oil rigs, satellites and rolling stock)"[97]. In a following meeting held in Rome in early April 1996, the Study group for the preparation of uniform rules on international interest in mobile equipment found a solution to the troublesome definition of "mobile equipment" in "the nature of the equipment to be covered, that is high-value equipment lending itself to unique identification". The group decided to "concentrate on an exhaustive list of specific assets that would not be mobile equipment generally"[98]. Art. 2 of the revised draft Convention dated July 1997 lists the following assets as those applying to the Convention:

1) airframes ;
2) aircraft engines ;
3) helicopters ;
4) [registered ships][99] ;
5) oil rigs
6) containers ;
7) railway rolling stock ;
8) space property ;
9) objects of any other category each item of which is uniquely identifiable and habitually moves from one state to another in the ordinary course of business.

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[97] See UNIDROIT 1995 , Study LXII - Doc. 16 at 3
[98] See UNIDROIT 1996, Study LXII - Doc. 27 at 6
[99] The square brackets shows are used because the inclusion of the registered ships in the scope of the Draft Convention is still under discussion.

The issue of default is regulated by art. 11 of the revised draft Convention which states:

"1.- The Parties may provide in their agreement for any kind of default, or any event other than default, as giving rise to rights and remedies specified in Articles 8 to 10 or 14.

2. - In the absence of such an agreement, "default" for the purposes of Articles 8 to 10 and 14 means material default.".

Upon the occurrence of any default or other event agreed upon by the parties, an equipment lessor under a leasing or subleasing agreement, whose rights are set forth in a document satisfying certain criteria[100], may use a set of basic remedies unless, and to the extent that, such rules relating to such basic remedies are not excluded by the equipment lessor and equipment user in their transaction documents. The basic remedies available to a lessor are, in addition to the right of the lessor to terminate the agreement, the rights to (1) take possession of the aircraft equipment and (2) de-register (from the relevant national register) and export the aircraft equipment. The inclusion of the rights to sell or grant a lease of the aircraft equipment, collect or receive income arising from the management of the aircraft equipment, and apply any funds received pursuant to the remedies listed above against the amounts secured (which are granted to a chargee) were thought by some to be superfluous and are currently under discussion. These remedies will apply mandatorily to countries which have ratified the Convention and the Aircraft Equipment Protocol. The jurisdiction to resolve the dispute arising under the Convention will belong to the courts in the

[100] The relevant agreement must be in writing, relate to aircraft equipment in respect of which the equipment lessor has power to enter into the agreement, identify the aircraft equipment. See **Aircraft Protocol Group 1997 - Doc. 8 Appendix 1 at 5**

jurisdiction of the equipment user, the country of national registration and the location of the aircraft equipment.

The Convention will contain the following rules which will apply if, and only if, (a) the relevant contracting State has not entered a reservation in respect of the same at the time of ratification of the Convention and of the Aircraft Equipment Protocol, and (b) the transaction parties have not excluded applicability of such rules in their transaction documents :

(a) Self-help rule : the basic remedies available upon the occurrence of default will be exercisable without the necessity of judicial proceedings, assistance or intervention.

(b) Expedited Relief Rule : An Equipment Lessor who adduces *prima facie* evidence that a default has occurred will be entitled to expedited judicial and related relief. The forms of that relief are broad, including (1) immobilisation of the aircraft equipment, (2) preservation of aircraft equipment or its value, (3) possession, custody or management of aircraft equipment, (4) de-registration and export of aircraft equipment, (5) sale or lease of aircraft equipment, and (6) application of proceeds or income relating to the aircraft equipment. This general provision will require such relief to be available on a "speedy" basis. Contracting States will be given the opportunity to supplement this provision with a binding definition of "speedy relief" which will establish a timetable not exceeding thirty days from the date such relief is sought.

Once again the drafters have to consider the differences between legal systems especially between the countries which recognize the self-help remedies and those which do not. As strongly urged by Airbus and Boeing, the Convention aims at a speedy relief either by by-passing the judicial phase or by making the latter as short and fast as possible.

As I said at the beginning of this chapter the most difficult task the law has to face is to pace with the technological changes as much as possible. Achieving this, particularly in the field which is under discussion in this thesis, would not only lead to more orderly juridical relationships among the subjects, but also to an economic improvement of the airline industry and, indirectly, of the overall economy.

In a study document prepared under the auspices of INSEAD and the New York University Salomon Center , Prof. Saunders and Prof. Walter have demonstrated the beneficial impact of the adoption of the aircraft equipment protocol[101] from the point of view of economics.

Without going into economic details it is interesting to note that the study shows the benefits of the approval of a convention like the one Unidroit is drafting. The potential gains would not only benefit the end-users of the aircraft equipment, namely airlines, their employees, shareholders and customers, but also "national economies, through improved transportation infrastructures, size and structure of the external debt and increased commercial activity, and manufacturers, their shareholders, employees and suppliers"[102].

[101] See Aircraft Protocol Group 1997, APG Doc. 8
[102] Ibid. at 1

There is no doubt that the fear of not being able to easily repossess the asset by a lessor, or the chances to repossess it only after lengthy and costly proceedings, contributes to raise the cost of any transaction of an airline. The higher the risk the higher the price a lessee is forced to pay to convince a lessor or a financier to accept the risk. Clearly an improvement in the financial market efficiency, which is what the Unidroit Convention hopes to accomplish, will bring about a reduction in the financial cost (in our case in the cost of a leasing transaction). A worldwide, more stable set of rules for the enforcement of leasing transactions will also lower the cost for an airline that comes " in the form of delays, legal fees, resale prices of aircraft under distress conditions, as well as gains attributable to improved efficiency in fleet planning and equipment allocation"[103].

The reduction in cost will indirectly benefit the customers, through a reduction in ticket prices, and the reduction of the market risks will enhance the availability of funds, which will cause a rise in the level of investment in commercial aircrafts. And this in turn will determine a rise in employment, in the airline manufacturing industry, and an overall economic growth.

[103] **Ibid.** at 39

CONCLUSION

One of the most difficult problems the law has to face is certainly remaining in contact with reality as far as possible. This is particularly true for fields, like aviation, where fast technological improvements, and the predictable increase in costs of aircrafts, have led to rapid changes in the way the acquisition of these "costly toys" is made and in the legal rules to be followed in these acquisitions. The development of the contract of leasing and the more and more frequent applications of the lease contract to aircrafts are proof of these changes.

Although civil law countries, like Italy and Quebec, due to the need of a legislative intervention have more difficulties to recognize a new type of contract, in this process of adaptation of the law to reality, this analysis shows how in both countries the process is, at least from a substantial point of view, completed or on its way to completion. In Italy, where there is still a lack of a legal set of rules on leasing, the ratification of the Unidroit Convention on International Financial Leasing has led to the recognition of certain important rights to lessors and lessees.

However, granting certain rights represents only half the mission of the law, the other half is enforcing those rights whenever they are violated. Unfortunately this is a point where Italy and Quebec have not succeeded in matters of aircraft leasing. A lessor wishing to repossess his asset after a default of the lessee has to go through lengthy litigation proceedings. This, in turn, means he has to bear not only some legal costs but also the costs of not being able to use this source of income. This deficiency of the two legal systems has indirect but powerful effects on the economy considering that

very few lessors are willing to invest in a country if they feel their interests are not adequately protected.

This is, however, not only a problem of Italy and Quebec. The need of a worldwide restructuring of the whole legislative infrastructure governing secured transactions and leasing is demonstrated by the recent initiatives of the World Bank and the European Bank for Reconstruction and Development.

In fact an international solution in the form of a convention could be a possible solution. In an international field like aviation particularly, a solution reached by confronting the problems of each country's legislation could be a start. Italy, for example, has greatly benefited from the need to adapt its legislation to conform to the requirements set out in the EU treaty. The need to respect an international agreement may be a strong incentive to remove any obstacle which, otherwise, would be ignored or even forgotten.

Certainly the most important initiative in this sense is the one taken by Unidroit, not only because of the prestige of the organization and its past successes in the creation of international sets of rules, but also because its attempt focuses on "the legal problems arising out of the everyday movement of high-value mobile equipment across international frontiers"[88].

As we have repeatedly said during this analysis, the aircraft equipment is the only source of income for a lessor and it cannot produce any income if it is sitting on the ground waiting for a court decision.

[88] M. J. Stanford, "Completion of a first draft of Unidroit's planned Convention on International Interest in Mobile Equipment", (1996) n. 2 Unidroit Law Review at 274

It is therefore desirable that the Unidroit Convention be completed and put into force as soon as possible. It would not only represent a safe harbor for legal systems, like those of Italy and Quebec, which have proved to be limping on this matter, but it would provide the aviation world with the necessary instruments to support the predicted boom of the coming years.

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