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Aviation Finance & Leasing

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Contributing editor**Mark Bisset**

Clyde & Co LLP

Lexology Getting The Deal Through is delighted to publish the seventh edition of *Aviation Finance & Leasing*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Singapore, South Korea, Switzerland and Turkey.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Mark Bisset of Clyde & Co LLP, for his continued assistance with this volume.



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OVERVIEW

Conventions

1 | To which major air law treaties is your state a party?

Japan has ratified the Chicago Convention (1944), the New York Convention (1958) and the Montreal Convention (1999), but has not ratified the Rome Convention (1933), the Geneva Convention (1948) or the Cape Town Convention (2001).

Domestic legislation

2 | What is the principal domestic legislation applicable to aviation finance and leasing?

The Civil Aeronautics Act (Act No. 231 of 1952) (together with the orders and regulations thereunder) generally regulates matters related to civil aviation activities (including the registration system for aircraft), implementing the Chicago Convention. The Aircraft Mortgage Act (Act No. 66 of 1953) provides for security interests in aircraft and the registrations thereof. The Aircraft Registration Cabinet Order (Cabinet Order No. 296 of 1953) (together with the regulations thereunder) provides the rules for the registration of aircraft and aircraft mortgages. Apart from the registration of aircraft and aircraft mortgages, the foregoing legislation does not particularly regulate aviation finance and leasing, to which general civil and commercial laws (including the Civil Code (Act No. 89 of 1896) and the Commercial Code (Act No. 48 of 1899)) are applicable. Unless otherwise mentioned, 'aircraft' means aircraft registered (or to be registered) in Japan with the aircraft registry maintained by the Ministry of Land, Infrastructure, Transport and Tourism of Japan (the Aeronautics Authority) subject to the legislation set out above.

Governing law

3 | Are there any restrictions on choice-of-law clauses in contracts to the transfer of interests in or creation of security over aircraft? If parties are not free to specify the applicable law, is the law of the place where the aircraft is located or where it is registered the relevant applicable law?

Article 13 of the Act on General Rules for Application of Laws (Act No. 78 of 2006) provides that property rights over movable or immovable assets and any other registrable rights shall be governed by the law of the jurisdiction where the assets subject to those rights are located and that acquisition or loss of those rights shall be governed by the law of the jurisdiction where the relevant assets are located at the time such acquisition or loss is factually complete. It is not clear whether article 13 directly applies to matters related to aircraft. The prevailing view is that a transfer of title to or creation of a mortgage on aircraft would be governed by the law of the state of registration, but there is a possibility that a Japanese court would look to the law of the jurisdiction where

the aircraft location is considered as being more relevant than its registration. Therefore, a transfer of title to, or creation of a mortgage on (and the rights and remedies of the mortgagee thereunder), an aircraft registered and located in Japan would be governed by Japanese law. If an aircraft is registered (or, in certain cases, located) outside Japan, the laws of the relevant jurisdiction (ie, the laws of the jurisdiction in which that aircraft is registered and/or located) would govern the title transfer and creation of the mortgage.

TITLE TRANSFER

Transfer of aircraft

4 | How is title in an aircraft transferred?

Title to an aircraft is transferred by the seller's disposition, which is usually evidenced by a bill of sale. Registration of an ownership interest in an aircraft has the effect of perfecting the transfer of the same as against third parties (such as competing transferees and bankruptcy trustees). Accordingly, a transferee of an aircraft cannot assert its ownership if another person receives a competing transfer and completes its registration first. On the other hand, although registration requires a number of supporting documents, which would enhance the trustworthiness of the aircraft registry, its accuracy is not officially guaranteed. Accordingly, as a general rule, a person who purchased an aircraft from a seller who is not the real owner does not acquire an effective ownership interest in the aircraft even if such seller was shown as the registered owner in the aircraft registry.

Transfer document requirements

5 | What are the formalities for creating an enforceable transfer document for an aircraft?

There are no specific formality requirements for a transfer document, but it must be issued by the owner and must specify the purchaser, the aircraft to be transferred, the transfer date and the seller's agreement to transfer title to the aircraft to the purchaser. For the purpose of registration with the aircraft registry, a Japanese translation also needs to accompany a transfer document written in any language other than Japanese. In addition, if a transfer document is issued by a foreign entity or person, it should be publicly notarised. A transfer document executed in Japan is subject to stamp duty in an amount tied to the purchase price shown thereon. If the purchase price is not shown thereon, the amount of the required stamp duty is ¥200.

REGISTRATION OF AIRCRAFT OWNERSHIP AND LEASE INTERESTS

Aircraft registry

6 | Identify and describe the aircraft registry.

The aircraft registry in Japan is maintained by the Aeronautics Authority. The aircraft registry is an owner registry, and the interests of operators or lessees in aircraft cannot be registered. The aircraft registry is open to the public and anyone may access it and obtain an official certificate of entry for a nominal administrative charge.

Japan has not yet entered into 83-bis arrangements with other jurisdictions. The aircraft registry is for the registration of aircraft and there is no engine-specific registration system in Japan.

Registrability of ownership of aircraft and lease interests

7 | Can an ownership or lease interest in, or lease agreement over, aircraft be registered with the aircraft registry? Are there limitations on who can be recorded as owner? Can an ownership interest be registered with any other registry? Can owners', operators' and lessees' interests in aircraft engines be registered?

An aircraft with foreign nationality cannot be registered in Japan. Any person described below will not be eligible for ownership registration (ownership requirements):

- an individual without Japanese nationality;
- a foreign state or a foreign governmental entity or its equivalent;
- a juridical person or other association established under the laws of a foreign jurisdiction; or
- a juridical person whose representative falls under any of the above or one-third or more of whose directors or voting shares fall under, or are held by, any person(s) falling under any of the above.

Owing to these ownership requirements, a foreign owner of an aircraft (such as an operating lessor established outside Japan) cannot register its ownership with the aircraft registry. To enable a foreign owner to lease an aircraft registered in Japan to a Japanese operator, there is an established practice of nominating a special-purpose vehicle that satisfies the ownership requirements to hold title to such aircraft.

Neither lease interests in, nor lease agreements for, aircraft can be registered with the aircraft registry. As there is no registration system for interests in aircraft engines in Japan, the interests of owners, operators and lessees in aircraft engines cannot be registered with the aircraft registry.

Registration of ownership interests

8 | Summarise the process to register an ownership interest.

An application for registration with the aircraft registry of an ownership interest in an aircraft must be made by the new owner of the aircraft (or its attorney) and is required to describe the following particulars:

- the type and model of the aircraft;
- the manufacturer of the aircraft;
- the manufacturer's serial number of the aircraft;
- the home base of the aircraft;
- the registration mark of the aircraft (if already given);
- the name and address of the applicant;
- the name and address of the attorney of the applicant (if the application is made by an attorney);
- the grounds for registration and the date thereof;
- the purpose of registration; the date of the application; and

- the amount of the applicable registration tax and the tonnage of the aircraft.

The supporting documents that need to be submitted to the Aeronautics Authority (in the case of initial registration in Japan by a corporate owner of an imported aircraft) are as follows:

- a power of attorney issued by the applicant (if the application is made by an attorney);
- an original and a copy of the certificate of airworthiness for export, issued by the exporter's country;
- notarised bills of sale issued by the seller or manufacturer, or both;
- a certificate of non-registration issued by the exporter's country;
- a seal certificate of the representative of the new owner (issued within the last three months);
- a commercial registration certificate of the new owner (issued within the last three months);
- evidence of the home base of the aircraft (such as an original permission letter issued by an airport operator);
- evidence of the aircraft's weight;
- an official payment slip of the registration tax (if the registration tax exceeds ¥30,000); and
- documents evidencing that the new owner satisfies the ownership requirements. (The Aeronautics Authority might require further documents for registration.)

The registration tax will be in the amount of ¥30,000 per tonne. According to the Aeronautics Authority, it usually takes one week (or two weeks depending on the season) from the application date to obtain an official transcript of entry of ownership of the aircraft. Unless otherwise specifically agreed, title to an engine installed in a host aircraft automatically accompanies a transfer of the ownership interest in the host aircraft and vests in the new owner of that aircraft if the aircraft and the engine are owned by the same person.

Title and third parties

9 | What is the effect of registration of an ownership interest as to proof of title and third parties?

Registration is not a requirement for the effectiveness of the transfer of an ownership interest in an aircraft; therefore, the transfer can be effective without registration of the ownership interest (provided that a new owner of a Japanese-registered aircraft is required to apply for the transfer of the registration for the aircraft within 15 days of the transfer, and failure to do so could trigger a non-penal fine of up to ¥300,000). However, registration of an ownership interest in an aircraft has the effect of perfecting the transfer of the same as against third parties (such as competing transferees and bankruptcy trustees). Accordingly, a transferee of an aircraft cannot assert its ownership if another person receives a competing transfer and completes its registration first. On the other hand, although registration requires a number of supporting documents, which would enhance the trustworthiness of the aircraft registry, its accuracy is not officially guaranteed. Accordingly, as a general rule, a person who purchased an aircraft from a seller who is not the real owner does not acquire an effective ownership interest in the aircraft even if such seller was shown as the registered owner in the aircraft registry.

Registration of lease interests

10 | Summarise the process to register a lease interest.

No registration system for lease interests exists in Japan.

Certificate of registration

11 | What is the regime for certification of registered aviation interests in your jurisdiction?

When an aircraft is initially registered in Japan, the Aeronautics Authority issues to the applicant a certificate of registration, which must be kept on board the aircraft. The certificate of registration shows the following:

- the nationality mark and registration mark;
- the manufacturer and manufacturer's designation (ie, the type and model) of the aircraft;
- the aircraft serial number;
- the name of the owner; and
- the address of the owner.

However, the certificate does not show the owner's, operator's or any mortgagees' interests in the aircraft. No separate engine certificate of registration will be issued.

Deregistration and export

12 | Is an owner or mortgagee required to consent to any deregistration or export of the aircraft? Must the aviation authority give notice? Can the operator block any proposed deregistration or export by an owner or mortgagee?

An aircraft can be deregistered by the owner submitting an application for deregistration with the supporting documents to the Aeronautics Authority. When applying for such deregistration, the owner needs to submit a consent letter from any party having registered interests in the aircraft (such as a registered mortgagee) to the Aeronautics Authority unless the deregistration is mandatorily required owing to a total loss of the aircraft or non-satisfaction of the ownership requirements. Therefore, a registered mortgagee may block the proposed deregistration, but a lessee cannot do the same, as leasehold interests cannot be registered. In addition, if the aircraft needs to be deregistered because of non-satisfaction of the ownership requirements, the Aeronautics Authority will notify the mortgagee of the aircraft to give them an opportunity to enforce the mortgage. The mortgagee will be given three months to commence the enforcement procedures, during which time the Aeronautics Authority will suspend the deregistration.

The export of an aircraft from Japan is to be made by obtaining an export permit from the Director General of Customs. An application for such permit must be accompanied by supporting documents, including the relevant invoice and the permits, approvals and certificates required under export and other laws and regulations. No consent of the mortgagee or the operator is required for the export. In the event that the aircraft is to be exported to certain restricted countries, export permission from the Ministry of Economy, Trade and Industry may be required under the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949).

Powers of attorney

13 | What are the principal characteristics of deregistration and export powers of attorney?

A deregistration power of attorney in Japan is to be granted by the owner of the aircraft and addressed to the Aeronautics Authority (but cannot be registered with the Aeronautics Authority). Once it is effectively issued, it will authorise the attorney or attorneys named therein to act in accordance with the terms thereof. However, under the current practice of the Aeronautics Authority, a deregistration power of attorney dated within three months prior to the application for deregistration would be required for such deregistration, and an application for the deregistration would need to be accompanied by the commercial

registration certificate and the seal certificate of the owner, each issued within three months of the application for deregistration.

A deregistration power of attorney may be revoked regardless of a statement to the effect that it is irrevocable if a justifiable reason is shown.

The matters related to export are handled by customs and not by the Aeronautics Authority. The authorisation for the deregistration and the export may be included in one power of attorney.

Cape Town Convention and IDERA

14 | If the Cape Town Convention is in effect in the jurisdiction, describe any notable features of the irrevocable deregistration and export request authorisation (IDERA) process.

Japan has not ratified the Cape Town Convention.

SECURITY

Security document (mortgage) form and content

15 | What is the typical form of a security document over the aircraft and what must it contain?

The typical form of a security over the aircraft is an aircraft mortgage. There are two types of aircraft mortgages: ordinary mortgages, which secure specified obligations, and revolving mortgages, which secure unspecified obligations falling under a certain agreed scope up to the agreed maximum secured amount. An ordinary mortgage secures the principal of the secured obligation together with interest and default interest accrued thereon during the two years prior to the commencement of its court sale, whereas a revolving mortgage secures the principal of the secured obligation together with interest and default interest accrued thereon up to the pre-agreed maximum secured amount. With respect to a revolving mortgage, crystallisation of the secured obligations is necessary before it can be enforced.

An aircraft mortgage may be created by an agreement between the mortgagor and the mortgagee. To create an effective aircraft mortgage, the mortgage agreement needs to specify the aircraft subject to the mortgage and (in the case of an ordinary mortgage) the secured obligations or (in the case of a revolving mortgage) the scope of the secured obligations. There is no language requirement for a Japanese mortgage, and there is no specified form for it. However, for the purpose of registering a mortgage, certain economic conditions of the secured obligations need to be specified.

A mortgage can be registered in two ways. A full registration of an aircraft mortgage effectively perfects the mortgage as against third parties. A provisional registration will also be available and will confer priority over subsequently registered security interests, but will need to be converted into (typically by both the mortgagor and the mortgagee) a full registration before the mortgage can be enforced. Owing to the nominal amount of registration tax enforced to provisionally register an aircraft mortgage, it is common to keep the registration of an aircraft mortgage provisional until an actual credit risk involving the mortgagor occurs. To provisionally register an aircraft mortgage, in practice a mortgage option agreement is prepared for registration purposes in which an aircraft mortgage is created upon the mortgagee's exercise of an option.

An aircraft registered in Japan cannot be the subject of a pledge (article 23 of the Aircraft Mortgage Act). Although it is possible to create a security interest in an aircraft by way of collateral assignment or provisional registration of a transfer of ownership interest, such alternative security interests are not common in Japan owing to the relatively high registration taxes and the ownership requirements for the transferees.

Security documentary requirements and costs

16 | What are the documentary formalities for creation of an enforceable security over an aircraft? What are the documentary costs?

A mortgage does not need to be notarised, legalised or stamped to be enforceable. When registering a mortgage under a foreign language mortgage agreement, its Japanese translation needs to be filed with the Aeronautics Authority. Likewise, in order to commence court proceedings in connection with a mortgage agreement, its Japanese translation must be submitted to the court. To create an effective aircraft mortgage, the mortgage agreement needs to specify the aircraft subject to the mortgage and (in the case of an ordinary mortgage) the secured obligations or (in the case of a revolving mortgage) the scope of the secured obligations. There are no documentary costs, such as stamp duties, imposed on aircraft mortgages. The registration tax will be in the amount of 0.3 per cent of the amount of the secured obligations (or, in the case of a revolving mortgage, the maximum secured amount) while the registration tax for provisional registration of an aircraft mortgage is ¥2,000 per aircraft.

Security registration requirements

17 | Must the security document be filed with the aviation authority or any other registry as a condition to its effective creation or perfection against the debtor and third parties? Summarise the process to register a mortgagee interest.

Registration of a mortgage is not a condition to its effective creation, but is required for its perfection as against third parties.

An application for registration of an ordinary mortgage with the aircraft registry must be made jointly by both the mortgagee and the mortgagor, and the application form needs to describe the amount to be secured, the interest rate (if relevant), any conditions to the secured obligations, and any special agreement on the scope of the coverage of the mortgage (if any part or engine of an aircraft is excluded from the coverage of the mortgage over the aircraft). In the case of a revolving mortgage, the application form needs to describe the scope of the secured obligations and the agreed maximum secured amount, any special agreement on the scope of the coverage of the mortgage (if any part or engine of an aircraft is excluded from the coverage of the mortgage over the aircraft) and any date of crystallisation, if agreed. If the obligor of the secured obligation is different from the mortgagor, the application also needs to describe the name and address of the obligor.

The supporting documents that need to be submitted to the Aeronautics Authority (in the case of registration by a corporate mortgagee and a corporate mortgagor) are as follows:

- powers of attorney issued by the mortgagor and the mortgagee (if the application is made by an attorney);
- seal certificates of the representatives of the mortgagor and the mortgagee (issued within the last three months) (or their equivalent for a foreign corporation);
- commercial registration certificates of the mortgagor and the mortgagee (issued within the last three months) (or their equivalent for a foreign corporation);
- an original and a copy of the mortgage agreement; and
- an official payment slip of the registration tax (if the registration tax exceeds ¥30,000). (The Aeronautics Authority might require further documents for the registration.)

The registration tax will be in the amount of 0.3 per cent of the amount of the secured obligations (or, in the case of a revolving mortgage, the maximum secured amount). On the other hand, the registration tax for provisional registration is ¥2,000 per aircraft, which is the main reason

that provisional registrations are often used when registering an aircraft mortgage. According to the Aeronautics Authority, it usually takes one week (or two weeks depending on the season) from the application date to obtain an official transcript of entry of the mortgage.

Registration of security

18 | How is registration of a security interest certified?

When the procedure for registration or provisional registration of a mortgage is completed, the entry will be made in the aircraft registry. An official transcript of entry of such updated aircraft registry will be available approximately one week (or two weeks depending on the season) after the application date.

Effect of registration of a security interest

19 | What is the effect of registration as to third parties?

A full registration of an aircraft mortgage will perfect the creation of the aircraft mortgage as against third parties (such as competing transferees, mortgagees and bankruptcy trustees) and confer priority over subsequently registered security interests. A provisional registration also confers priority over subsequently registered security interests but needs to be converted into a full registration before the aircraft mortgage can be enforced.

Security structure and alteration

20 | How is security over aircraft and leases typically structured? What are the consequences of changes to the security or its beneficiaries?

While Japanese law recognises the concept of a trust, the security trustee structure is not typically used to grant security over aircraft in favour of a group of lenders (especially for domestic transactions). It is a general principle under Japanese law that the creditor of a secured obligation and the security holder need to be the same. However, the Trust Act (Act No. 108 of 2006) introduced a security trust scheme, under which a trustee holds the security interest on behalf of lenders. In order to engage in the security trustee business in Japan, certain licences under the Trust Business Act (Act No. 154 of 2004) or the Act on Provision, etc of Trust Business by Financial Institutions (Act No. 43 of 1943) are required. In addition, another point to be noted is that there remains uncertainty in the enforcement procedure for a security held by a security trustee. If an aircraft mortgage is held by a security trustee, no change in the registration with the aircraft registry or assignment of the aircraft mortgage is necessary with respect to loan transfers.

It is common in Japan (especially for domestic transactions) for the owner of an aircraft to create an aircraft mortgage on the aircraft in favour of the respective lenders. In this case, a loan transfer would trigger assignment of the mortgage. The registration of the assigned mortgage needs to be updated to perfect such assignment.

Security over spare engines

21 | What form does security over spare engines typically take and how does it operate?

Effect of aircraft mortgage on engines installed thereon

Movable assets (including aircraft engines and spare parts) constituting an integral part of an aircraft are subject to an aircraft mortgage created over that aircraft unless the mortgage agreement otherwise provides (and is registered with the aircraft registry) or the mortgagor's addition of such movable assets constitutes a fraudulent act against creditors and as such is rescinded. If an engine is not installed on the aircraft at the time of creation of an aircraft mortgage, such engine would not be

covered by such aircraft mortgage, but once it is installed on the mortgaged aircraft, the engine will be subject to the then-existing mortgage if that engine is owned by the owner or mortgagor of the aircraft and unless otherwise agreed in the mortgage agreement or the installation of that engine is rescinded. On the other hand, it is not clear, because of the lack of judicial precedents, if an engine installed on a mortgaged aircraft qualifies as being subject to the aircraft mortgage even after it is removed from the mortgaged aircraft, or even if in the affirmative, how the mortgage can be foreclosed upon with respect to such removed engine.

Security over spare engines not installed on a host aircraft

Spare engines could be subject to a pledge but, as a pledgee may not allow the pledgor to possess the pledged property under article 345 of the Civil Code, pledges are not typically used for creating security interests in spare engines not installed on a host aircraft. Alternatively, a collateral assignment of a spare engine can be made by its owner in favour of a creditor. In creating a collateral assignment over a spare engine, the owner will transfer title to the engine to its creditor only for the purpose of securing its obligations. A collateral assignment can be perfected as against third parties by transferring the possession of the engine to the creditor, but such delivery can be made fictionally with the owner continuing to possess the engine and can also be made by way of registration under the Act on Special Provisions, etc of the Civil Code Concerning the Perfection Requirements for the Assignment of Movables and Claims (Act No. 104 of 1998). A holder of a collateral assignment can enforce its rights by selling the spare engine to a third party or by retaining the spare engine, but the holder is required to pay to the owner the difference between the sale proceeds or the fair value of the spare engine and the secured obligations. The spare engine could cease to be subject to the collateral assignment if a bona fide purchaser purchases the engine without knowledge of the existence of the collateral assignment on such engine without fault.

Security over spare engines installed on a host aircraft

It is theoretically possible to create a collateral assignment over a spare engine installed on a host aircraft. If the aircraft and the spare engine are owned by the same person (such as an airline) and the aircraft is subject to an aircraft mortgage, the fact that the spare engine is not subject to the aircraft mortgage should be recorded on the aircraft registry. In addition, such spare engine could cease to be subject to the collateral assignment if a bona fide purchaser purchases the aircraft (including the engines installed thereon) or the spare engine only without knowledge of the existence of the collateral assignment on that spare engine without fault.

ENFORCEMENT MEASURES

Repossession following lease termination

22 | Outline the basic repossession procedures following lease termination. How may the lessee lawfully impede the owner's rights to exercise default remedies?

Japan is a jurisdiction where no self-help remedy per se is permissible. If the lessee refuses to redeliver the aircraft to the lessor even following lease termination, the lessor must commence a court procedure against the lessee to repossess the aircraft from the lessee.

To prevent the lessee from transferring its possession of the aircraft to a third party to frustrate the repossession thereof, the lessor may petition the competent court for a provisional remedy or injunction called a provisional disposition, which prohibits the lessee from transferring its possession of the aircraft to a third party. Although the required court fee is nominal, the court may require that the lessor post

a deposit to cover the damage that may be incurred by the lessee. The court has discretionary power in determining if a deposit is required and the amount thereof. The lessee could impede the owner's rights to exercise default remedies by arguing that the lease termination is not effective and that it still has the right to possess the aircraft.

Enforcement of security

23 | Outline the basic measures to enforce a security interest. How may the owner lawfully impede the mortgagee's right to enforce?

Self-help is not permitted in Japan. If the owner and, if different, the operator are cooperative with the mortgagee, the mortgagee can sell the aircraft to a third party or retain it by itself and apply the sale proceeds (or the fair value) of the aircraft to the secured obligations if permitted in the mortgage agreement. Otherwise, the mortgagee needs to commence a court procedure to foreclose upon the mortgage by way of a public sale supervised by a court (a court sale). To commence a court sale procedure, the mortgagee must file an application for foreclosure of security interests with supporting documents (including an official transcript of entry of the aircraft registry). Once the court sale procedure commences, the court will order the court enforcement officer to deprive the certificate of registration, the certificate of airworthiness and other documents to be kept on board the aircraft to detain the aircraft and enable the court sale. Even before the application for the foreclosure, the mortgagee may petition the competent court to order the detention if it is probable that a court sale would be difficult without having detained the aircraft at that time. Unless an objection is made to the commencement order for a court sale, a court sale procedure may commence and the aircraft can be detained by way of an ex parte application.

In Japan, bankruptcy proceedings under the Bankruptcy Act (Act No. 75 of 2004), special liquidation proceedings under the Companies Act (Act No. 86 of 2005), civil rehabilitation proceedings under the Civil Rehabilitation Act (Act No. 225 of 1999) and corporate reorganisation proceedings under the Corporate Reorganisation Act (Act No. 154 of 2002) are the main insolvency proceedings. When being applied to a corporate entity, the former two proceedings aim to liquidate the entity and the latter two aim to rehabilitate or reorganise the entity. A mortgagee with a perfected aircraft mortgage may enforce its rights under the mortgage even after the commencement of bankruptcy, special liquidation or civil rehabilitation proceedings in respect of the mortgagor outside these proceedings. However, once corporate reorganisation proceedings in respect of the mortgagor commence, a mortgagee cannot foreclose upon the mortgage and will receive distributions in accordance with the reorganisation plan approved by the creditors' meeting and the court.

The owner could impede the mortgagee's enforcement rights by not cooperating with the mortgagee, which would make it difficult to foreclose upon the mortgage by a private sale even if foreclosure is permitted under the mortgage agreement. In that case, the mortgagee will need to commence a court sale procedure.

Priority liens and rights

24 | Which liens and rights will have priority over aircraft ownership or an aircraft security interest? If an aircraft can be taken, seized or detained, is any form of compensation available to an owner or mortgagee?

Registered aircraft mortgages have priority in aircraft in accordance with the order of the registrations. A seller or repairer of an aircraft may have a statutory lien over the aircraft, but the priority of a statutory lien is below that of a registered mortgage on the same. On the other hand, a tax claim may have priority over a registered mortgage on an aircraft

with respect to taxes that had been due prior to the date of registration of the mortgage. Therefore, it should be noted that, if an aircraft mortgage is created and perfected by an owner that is delinquent on taxes, such mortgage could be subordinate to the tax claims against the owner. Another lien having (de facto) priority over a registered mortgage is a possessory lien. A possessory lien under the Civil Code is the right to retain possession of property until the possessor receives full payment of the obligation having arisen with respect to such property. The Commercial Code also provides for another type of possessory lien, which arises on property owned by the debtor to secure an obligation arising through commercial transactions between merchants (including corporations) notwithstanding whether the obligation has arisen with respect to the property. Airport charges or repairer's fees can be secured by these possessory liens arising on aircraft. A possessory lien has de facto priority in the subject property because the holder of a possessory lien may detain the property until the secured obligations owed to it are paid in full, even if a court sale is commenced and completed.

An aircraft will not be confiscated or requisitioned for use by the Japanese government except in certain unusual circumstances such as where the aircraft is used to engage in criminal acts. However, it could be possible for an unsecured creditor of the owner of the aircraft to attach the aircraft to collect its claims pursuant to the general enforcement proceedings, save where it is unlikely that there will be any excess above the secured creditor's claims with respect to that aircraft (provided that registered mortgagees have priority over such unsecured creditors if the aircraft mortgage has been registered before the attachment).

Enforcement of foreign judgments and arbitral awards

25 | How are judgments of foreign courts enforced? Is your jurisdiction party to the 1958 New York Convention?

A judgment rendered by a foreign court (including courts in England and New York) that is final and conclusive may be enforced by a Japanese court by obtaining an execution judgment for a judgment of a foreign court therefor if certain conditions are met. The required conditions are:

- the foreign court's jurisdiction over the relevant matter is recognised by an applicable law, order or treaty;
- the respondent either has been served by summons and not by public notice or has appeared in the action in the foreign jurisdiction without receiving service thereof;
- the judgment and the proceedings of the foreign court are not contrary to the public order or good moral doctrine in Japan; and
- judgments of Japanese courts receive reciprocal treatment in the courts of the foreign jurisdiction concerned (in which respect, there are precedents that admitted such reciprocal treatment between Japan and England and New York, respectively).

Japan has ratified the New York Convention (1958).

TAXES AND PAYMENT RESTRICTIONS

Taxes

26 | What taxes may apply to aviation-related lease payments, loan repayments and transfers of aircraft? How may tax liability be lawfully minimised?

Withholding tax

Interest payments under a loan agreement or rent payments under a lease agreement by a Japanese party to a non-Japanese party may be subject to Japanese withholding tax. If the recipient of these payments acts through a permanent establishment in Japan that holds an effective exemption certificate from the tax authority or is qualified to receive such payments without withholding tax under a double taxation treaty

between Japan and the jurisdiction where that recipient resides, the payer is not required to withhold this tax from the payments.

Consumption tax

A sale of an aircraft and its lease (excluding a certain type of finance lease) may be subject to Japanese consumption tax (which is a tax similar to value added tax and currently is imposed at the rate of 10 per cent of the purchase price or each rent) if such sale or lease is 'conducted in Japan'. Whether such sale or lease of an aircraft is conducted in Japan will be determined by the location of the aircraft registry. Even if a sale of an aircraft is deemed to be conducted in Japan, certain exports or leases of aircraft from Japan are exempt from Japanese consumption taxes.

Fixed asset tax

Aircraft as depreciable assets may be subject to Japanese property tax (or fixed asset tax). Japanese fixed asset tax is a local tax levied by the local government where an aircraft's home base is located. The annual amount of that tax is about 1.4 per cent (which could differ depending on the relevant local government) of the taxable base (or the quoted value) of the aircraft, which could be reduced in certain cases, including aircraft operated for international flights.

Stamp duty

Certain documents (including loan agreements, aircraft purchase and sale agreements, assignments of contracts (such as assignments of insurance) and guarantees) are subject to Japanese stamp duty if they are executed in Japan. On the other hand, documents executed outside Japan are not subject to Japanese stamp duty even if a party (or parties) to such documents is a Japanese entity. The tax authority in Japan currently treats an agreement or document as being executed outside Japan when the last party to the agreement or document executes and releases the same outside of Japan.

Exchange control

27 | Are there any restrictions on international payments and exchange controls in effect in your jurisdiction?

The Foreign Exchange and Foreign Trade Act provides that certain payments or transfers of money (in an amount exceeding ¥30 million) between Japan and foreign countries may be subject to routine ex post facto reporting to the Minister of Finance through the Bank of Japan. Save where the relevant payments violate international or domestic sanctions, regular commercial payments in aviation financing or lease transactions will not be subject to any approval or notification requirements.

Default interest

28 | Are there any limitations on the amount of default interest that can be charged on lease or loan payments?

The Interest Rate Restriction Act (Act No. 100 of 1954) restricts the rate of interest on loans. The Act Regulating the Receipt of Contributions, the Receipt of Deposits, and Interest Rates (Act No. 195 of 1954) prohibits receiving interest at a rate in excess of 20 per cent per annum, a breach of which may trigger criminal penalties. Default interest is considered to be a part of the rate of interest regulated under these acts, and receipt by a commercial lender of default interest at a rate in excess of 20 per cent could be both null and void and trigger criminal penalties. No limitation is set on the amount or rate of default interest under a lease agreement (unless it is against the public order and good morals doctrine).

Customs, import and export

- 29 | Are there any costs to bring the aircraft into the jurisdiction or take it out of the jurisdiction? Does the liability attach to the owner or mortgagee?

No fees, charges or the like are required to apply for an import or export permit in respect of a commercial aircraft from the Director General of Customs, provided that the import of an aircraft into Japan is subject to import consumption taxes imposed on the entity that imports the aircraft into Japan. If the importer or exporter retains a customs agent, fees for the customs agent would be required.

INSURANCE AND REINSURANCE

Captive insurance

- 30 | Summarise any captive insurance regime in your jurisdiction as applicable to aviation.

There is no requirement that insurance be placed in Japan nor is there a typical captive insurance regime. However, it is typical for Japanese operators to place insurance in the local market. All the Japanese insurance companies that provide aviation insurance have formed the Japan Aviation Insurance Pool (JAIP). When a member of the JAIP underwrites aviation insurance, the aviation insurance will be put in an insurance pool provided by the JAIP and will be allocated to the members of the JAIP according to a certain ratio, and then a reinsurance will be placed to cover that insurance. The JAIP sets out the standards for insurance premiums applicable to JAIP members.

Cut-through clauses

- 31 | Are cut-through clauses under the insurance and reinsurance documentation legally effective?

In the case of a cut-through clause governed by foreign law (such as English law), a court in Japan would look to that governing law to decide its effectiveness. In the case of a cut-through clause governed by Japanese law, such clause is considered to be a 'contract for the benefit of third parties', and once the beneficiary (such as the insured or additional insured under the primary insurance policy) expresses its intention to the reinsurer to enjoy the benefit under the cut-through clause, such clause effectively binds the reinsurer.

Reinsurance

- 32 | Are assignments of reinsurance (by domestic or captive insurers) legally effective? Are assignments of reinsurance typically provided on aviation leasing and finance transactions?

Assignments of reinsurance by domestic insurers can be made legally and effectively. To perfect such assignment as against third parties, notice of assignment to the reinsurer or acknowledgement of assignment from the reinsurer must be made by a document with a dated stamp such as a notarised document or a content-certified mail. It is generally the case that the Japanese insurance market is considered an internationally reputable insurance market and an assignment of reinsurances is not considered typical.

Liability

- 33 | Can an owner, lessor or financier be liable for the operation of the aircraft or the activities of the operator?

As a matter of general principle, for a person to be legally liable for any loss caused in connection with the operation of an aircraft or the

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activities of an operator, that person needs to be held to have (individually or jointly) caused such loss wilfully or negligently. Unless an owner, lessor or financier is acting wilfully or negligently or is in a position to exercise any effective control over the operation of the aircraft or the activities of the operator, such person would not be liable for such operation or activities as a matter of law.

Strict liability

- 34 | Does the jurisdiction adopt a regime of strict liability for owners, lessors, financiers or others with no operational interest in the aircraft?

In Japan, there is no general rule of strict liability for owners, lessors or financiers of aircraft. Unless they have (individually or jointly) caused any loss related to the aircraft wilfully or negligently, they would not be liable as a matter of Japanese law.

Third-party liability insurance

- 35 | Are there minimum requirements for the amount of third-party liability cover that must be in place?

The Aeronautics Authority has the authority in consideration of the public interest to order that insurance contracts are entered into to cover the liability an operator may incur owing to aircraft accidents, but there is no specific minimum requirement for the amount of third-party liability coverage that must be in place. Further, Japan has ratified the Montreal Convention (1999), article 50 of which provides that the member states shall require carriers to maintain adequate insurance covering their liability thereunder.

UPDATE AND TRENDS

Key developments of the past year

- 36 | What were the key cases, decisions, judgments and policy and legislative developments of the past year?

With effect from the taxable years commencing on or after 1 April 2020, the rules relating to the restriction on deductibility of interest expenses from taxable income (the Earnings Stripping Rules) have been changed

as a result of the tax reform enacted in 2019 to match with Action 4 of the Base Erosion and Profit Shifting (BEPS) Final Report from OECD. After that reform, in addition to the change in calculation of the deductible interest expenses and the requirements for exemption, not only the interest amounts paid to the related party but also the interest amounts paid to the third parties not subject to Japanese taxation have become subject to the Earnings Stripping Rule, which has affected the practice of cross-border loans to Japan.

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