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English Blue Sky Case Study

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OVERVIEW

English law is among the principal schemes of law nominated by parties to administer aircraft leasing and financing transactions, as it is a robust, nonetheless adaptable, system under which creditors have clear privileges and solutions. However, the Blue Sky trial has underlined the complication of the divergence of laws position in many aviation contracts and the English High Court's judgement has confirmed that a distinctive method is mandatory to meet the commercial outlooks of industry members and to preserve English law's modest position**.**

This case report will address the following:

- Summarize the case
- The problem described in the case
- Symposium on the consequences of the court decision
- An analysis of the applicability of the Geneva Convention to this case
- An analysis of the applicability of the Cape Town Convention to this case
- Current on-going similar issue within the aviation industry

Keywords

Aircraft mortgages – Cape Town Convention – Geneva Convention – Lex situs – Lex registry – Renvoi

Lawsuit Summary

The Blue Sky v. Mahan Air case involves an international dispute over the validity of the English mortgages of six Boeing 747 airplanes. In summary terms, the dispute arises out of transactions entered into 2006 against the background of sanctions imposed by the United States which prevent the sale or lease of United States aircraft and aircraft containing significant components manufactured in the United States to Iranian individuals or companies (Casemine, 2017).

The owners of these aircrafts were English Special Purpose Vehicle, and they leased the assets to a company in Armenia. But two airplanes were chartered by Mahan Air, a private Iranian airline. On December 2006, two out of the three package 1 aircrafts were mortgaged to PK AirFinance US Inc., a financier in United States. When the debtor defaulted, the financier initiated proceedings in England to repossess the two aircrafts, and Mahan Air subsequently challenged the validity of the mortgages. The first plane had English nationality was in the Netherlands, while the second plane had Armenian nationality was in Iran.

The English High Court determined that under Dutch laws the mortgage of the first plane was ruled invalid and they did not use *lex registri(i)* to revert back to English law when the secured interest was valid. As for the second plane, there was no substantial evidence for the asset's location, so this mortgage was valid under English property laws. As a result, the mortgages were unenforceable which caused $ 43.1 million U.S. loss of PK AirFinance US Inc.

Further research conducted on the Blue Sky lawsuit

Facts:

Parties:

- Balli Group plc (UK co.) and the Alaghbands
    - Controlled 3 English Special Purpose Vehicles –Blue Sky One, Blue Sky Two, Blue Sky Three
- Blue Airways LLC (Armenian co.) – wound up

- Mahan Air –Iranian private airline
- PK Airfinance US Inc.

Aircraft

- Blue Sky SPVs each acquired 1 B747 "Package 1" aircraft – and leased them to Blue Airways, who chartered them to Mahan.
- PK provided finance for 3 additional "Package 2" aircraft – mortgage granted by Blue Sky Two and Blue Sky Three over Package 1 aircraft as additional collateral

US sanctions against Iran

- 2008 TDO issued by BIS against Balli, Mahan, Alaghbands and Blue Airways

Aircraft de-registered from Armenian register

- Mahan purported to transfer title to aircraft to themselves under Option Agreement

The Problem

Following the case, there is an issue as to whether an English law mortgage is valid of an aircraft in certain situations. Only when an aircraft is located in England at the time of determinative day or where the location of an aircraft is unknown, the mortgage is enforceable under English law without additional requirements.

In other situations, the parties need to address more complicated laws to confirm that an English law mortgage is effective. In general, there are two representative situations as follows:

- When the aircraft had English nationality is not in England at determinative day, an English mortgage must be valid under the law of the jurisdiction where the aircraft is located in order to be effective.
- When an aircraft had un-English nationality is not in England at determinative day, the parties need to confirm the mortgage is valid under the law of the jurisdiction where the aircraft is registered to ensure the mortgage is effective.

If the parties of aircraft transactions need to ensure these situations under an English law mortgage, there will be more cost and higher risk. It is because there was no convention to confirm which national laws should be chosen that this problem existed.

The Decision – Court Decision

In Blue Sky v Mahan Air, it was vital for the court to study if the English choice of law rule as to the 'purpose of title to movables' signifies only to the domestic law of the applicable country, or if it also involves that a country's private international law and its choice of law rules (*renvoi*).

The dispute occurred in the context of a claim by a mortgagee for delivery up of two aircraft. The mortgages were administered by English law, and at the time the mortgages were signed, one aircraft was in England while the aircraft was claimed to be in Iran. The court settled that, in the case of title to tangible movables, the reference to the lex situs (*law of the place where an object is situated at the time of the event said to confer title)* is to the native (domestic) law

of the place where the aircraft is situated, and not the entire law of that country, including its choice of law rules. Consequently, the principle of renvoi does not apply in such cases.

The judgement delivered a thorough and comprehensive investigation of the relevant case law and the theoretical explanation on the use of the principle of renvoi. After critical review of the criticism of the principle, on both moral and applied grounds, the court decided that it is disagreeable to approve a rule which would leave the applicability of the renvoi principle to a case by case analysis, supported on the connection of the rule behind the private international law of another country: this would yield an ambiguous legal system. The case is a strong denial of the principle in the event of determination of title to movables.

Geneva Convention: International Recognition of Rights in Aircraft

Geneva convention, formally known as the convention on the International Recognition of Rights in Aircraft, was established on June 19, 1948 and went into effect on September 17, 1953 (Guzhva, Raghavan, & D'Agostino, 2018). According to Guzhva, Raghavan, and D'Agostino (2018) "It was the first attempt to address differences regarding aircraft security interests" (p. 111). Its aim was to facilitate financing and recognition of property basis and conditions for aircraft sales (Guzhva, Raghavan, & D'Agostino). Following rights were recognized; "rights of property in aircraft, rights to acquire aircraft by purchase coupled with possession of the aircraft, rights to possession of aircraft under leases of 6 months or more, and mortgages and similar rights in aircraft which are contractually created a security for payment of an indebtedness" (Guzhva, Raghavan, & D'Agostino, 2018, p. 111). The agreement left the effects of the aforementioned rights to be determined and governed by the laws of the state where the aircraft is registered at the time but not necessary where it is physically located (Guzhva, Raghavan, & D'Agostino). This treaty was primarily concerned with the *who* that possesses the control over an aircraft's domestic and international operations (Guzhva, Raghavan, & D'Agostino). It is noteworthy that the treaty is only effective when both the

registry country and the country where the vehicle is located at the time of incident (Guzhva, Raghavan, & D'Agostino). It also allows the participating nations to select other participating and nonparticipating nations with which they refuse to recognize the treaty (Guzhva, Raghavan, & D'Agostino). The applicability of the so-called Geneva Convention is heavily depended on the involved nations' affiliation with the agreement, as well as their individual predilections. Nations involved in this dispute were Armenia, Iran, Netherlands, United Kingdom, and the United States of America (Casemine, 2017). Only Netherlands and US had ratified the treaty; Iran and UK had signed but yet to ratify and Armenia never signed (International Civil Aviation Organization, 2019). Therefore, regardless of the treaty's relevancy to the issue under investigation, it may not be considered because the nation in which the aircrafts were registered in (i.e., Armenia & UK) are not participating members of the treaty. Therefore, the treaty had no authority.

Cape Town Convention: Convention on International Interests in Mobile Equipment

Convention on International Interests in Mobile Equipment, commonly known as *the Cape Town Convention*, on the other hand, was intended to address different type of issues with more technologically advanced methods (Guzhva, Raghavan, & D'Agostino, 2018). It is a web-based international registry system for *aircraft objects* which are defined as airframe capable of transporting eight or more personnel, equipped with an engine with minimum thrust of 1750 lbs or 550 rated takeoff shaft horsepower, and helicopters which is capable of carrying five or more personnel (Guzhva, Raghavan, & D'Agostino). Once an aircraft object is recorded, the registered owner has the right to exercise his/her interest in any place where the treaty is recognized (Guzhva, Raghavan, & D'Agostino). Out of the four nations involved in this legal action, only the United Kingdom had signed the treaty at the time of the incident (International Civil Aviation Organization, 2019). However, UK's participation to the agreement was ratified on the July 27th, 2015, which means that it was not effective during this court case

(International Civil Aviation Organization). Netherlands ratified the treaty on July 20th, 2010 (International Civil Aviation Organization). Despite the ineffectiveness of this treaty, the aircraft objects involved would have met the treaty's definition of an aircraft object (Guzhva, Raghavan, & D'Agostino). Yet, the treaty also specified conditions to be satisfied to qualify as an applicable aircraft object (Guzhva, Raghavan, & D'Agostino). The ability of the aircrafts under investigation to satisfy the determined conditions is beyond the scope of this analysis, therefore, we assumed that those conditions were met. Under its doctrine, parties involved in the business transaction of aircraft objects are allowed to choose an applicable set of laws (e.g., English law or New York law) which will be given priority over the local regulations (Guzhva, Raghavan, & D'Agostino). Therefore, the English law, the contracting law, could have been applied to this lawsuit, *if* the aircrafts were registered in one of the participating countries. In reality, the MSN 24383, which was registered in Armenia on 21 DEC 2006, Mahan deregistered this aircraft from Armenian aviation registry on 16 OCT 2008 and registered on the Iranian registry. Location of this very aircraft was confirmed at Mehrabad airport on the 17 DEC 2006, Kerman airport on the 27 DEC 2006, and Tehran airport on the 03 JAN 2010.

Conclusion

The Blue Sky lawsuit emphasized the commercial inconvenience of the lex situs rule (excluding renvoi) in the context of aircraft financing transactions and its current function has crucial penalties for the UK aviation financing business and for English law as one of the ideal governing laws for such dealings. The verdict has been extensively panned as affecting ethics of law to air- craft mortgages and other property acts which are solely unsuitable. This highlighted the demand for an international security system, such as the Convention which is aimed to cut the legal and commercial risks linked with cross-border aircraft financing.

In contradiction of this setting, and apart from common economic settlements which may be acquired, there is a persuasive and vital case for UK approval of the Convention.

Current on-going issues

In the recent Kingfisher and SpiceJet cases before the High Court in India, the deregistration mechanism, IDERA (De-Registration and Export Request Authorization) and the related provisions in the CTC and Aircraft Protocol were put to the test.

Kingfisher case

India had ratified the CTC in 2008. As a late fallout from the financial crisis, in 2012 Kingfisher Airlines ceased operations, with more than 1 billion USD owing. Two of the creditors and lessors of Kingfisher (namely DVB Bank [‘DVB'] and the International Lease Finance Corporation [the ‘IFLC’]) lodged requests with the Indian Directorate General of Civil Aviation (the ‘DGCA') and applications to the Indian courts to de-register and repossess their aircraft (Weber, 2015).

DVB, an acquisition financier for two A320-232 aircraft, sought to deregister and repossess its aircraft and successfully repossessed one of them, as it was outside of India, but faced difficulty in the deregistration process. Kingfisher objected to the deregistration of the aircraft, claiming that it had ownership rights. This led DVB to sue the DGCA and Kingfisher. Kingfisher argued that it had a purchase option and an acquired equity interest in the aircraft through payment of rent to the lessor under the lease agreement (Weber).

The court ultimately directed the DGCA to deregister the aircraft. The court, however, did not go into the merits of Kingfisher's claims that the deregistration of the aircraft conflicted with the airline's right to exercise its purchase option. Like DVB, the ILFC faced similar hurdles in regaining possession of its six leased aircraft. It took the company six months to secure the successful removal of one of its A321 aircraft.

In this case, the CTC could not protect the petitioners because India had failed to adopt implementing legislation and adjust existing regulations, and therefore the pre-CTC local laws applied. Also, the acquisition and delivery of the aircraft had predated the ratification of the

CTC by India. Meanwhile, commentators noted that India's behavior in the Kingfisher case had undermined the Cape Town Convention (Weber).

SpiceJet cases

In December 2014, SpiceJet, an Indian air carrier, had defaulted on payment of lease rent for three B737 aircraft. The foreign lessors promptly issued repossession notices to the airline. SpiceJet did not comply. The petitioners submitted the respective IDERAs to the DGCA with a request to de-register the aircraft and permit their export and physical transfer to Singapore. The DGCA instructed SpiceJet to surrender the Certificate of Registration (COR) and deactivate the 'Mode S' transponder code of the aircraft. When the Airline failed to comply, the DGCA did not issue a deregistration order. Consequently, the lessors applied to the High Court in Delhi (Weber, 2015).

SpiceJet argued inter alia that the repossession of aircraft would impact public interest (labor, and passengers' rights), that the court had no authority to issue an order to DGCA for de-registration of the aircraft and that the issue of termination of the lease agreements first required determination by a competent court. Further, it argued that the DGCA on receiving the request for deregistration had the discretion, not an obligation, to issue a deregistration order; where, as was the case here, liens on the aircraft were subsisting for wages of employees, taxes and dues owed by the airline to various statutory authorities, the DGCA could not order the de-registration (Weber).

The High Court considered whether the petitioners are entitled to seek deregistration and export of the aircraft under the IDERA and, if so, what consequential relief ought to be granted. The court, after reviewing the commitments of India under the CTC and Protocol:

- confirmed the obligation of the DGCA to deregister the aircraft upon the lessors' application;

- determined that termination of the lease agreements is not required for the exercise of the default remedies under the CTC;
- rejected the argument that de-registration and re-possession of the aircraft would impinge upon the public interest; and finally,
- held that DGCA should forthwith de-register the aircraft.

Meanwhile, upon a subsequent SpiceJet application, the court ordered that the DGCA give SpiceJet the opportunity to reach settlements. The settlements were agreed, and the plaintiffs did not need to petition for execution of the court's order of deregistration against the DGCA (Weber).

The SpiceJet case, while lessening some of the uncertainty surrounding the Kingfisher case, clarified the obligations of national registry authorities pursuant to an IDERA, at least in India (Weber). However, it is clear that in certain other countries the same problems may occur where national registry authorities may be reluctant to deregister aircraft of national carriers upon petition of foreign lessors or creditors in the absence of a court order.

As part of the fallout of the SpiceJet cases, in February 2015 the Ministry of Civil Aviation of India amended Rule 30 of the Aircraft Rules 1937, by insertion of a new sub-paragraph. While Rule 30 could formerly be read to give the DGCA a large degree of discretion, instead of an obligation, to cancel the registration upon receipt of deregistration request accompanied by an IDERA, that discretion has now been removed.

Even before the SpiceJet cases, other States parties to the CTC had similarly clarified their national rules on deregistration to accommodate IDERA. In July 2014, the Turkish Civil Aviation Authority revised a Directive on Implementation and Enforcement of the IDERA to provide greater clarity on its recordation and enforcement.

The amendment was made in order to improve the local regulations so as to implement the provisions of the Convention and the Protocol.

Furthermore, in November 2014, the AWG issued guidance material on the subject, namely a 'Model Implementing IDERA Regulation', which contains a model for a national IDERA Regulation and explanatory comments. Moreover, it published a useful 'Summary of Requirements regarding De-registration and Export'.

Aircraft Repossession Under Cape Town Convention in the UAE

Although the UAE is a party to the Cape Town Convention and a court application is required in respect of the remedies contained in the Cape Town Convention, it is fair to say that it is extremely rare to make an application for repossession of aircraft in the UAE (Coppingger, Zreiqat, & Saoudi, 2016). Although it is a common procedure in the UAE courts for a creditor to issue an ex parte application and to request the court to attach the assets of the defaulting debtors in contractual disputes, an application for an order for repossession of an aircraft has remained relatively untested (Coppingger, Zreiqat, & Saoudi).

The UAE Law of Civil Procedures (Federal Law No 11 of 1992) ('Civil Procedures Law') allows a creditor, or an owner of an asset or a plaintiff with a valid claim against a defendant to attach an asset in possession of the other party (Coppingger, Zreiqat, & Saoudi). Therefore, in the event of a dispute over the right to possession of the aircraft, in theory the lessor may pursue attachment of the aircraft by court proceedings in the UAE, and in any Emirate of the UAE where the aircraft is situated afterwards to physically retrieve the aircraft (Coppingger, Zreiqat, & Saoudi). The lessor will have to file the substantive action before the competent court within eight days as of the date of filing the attachment proceedings, and will then have to litigate the matter until a final and conclusive judgment is issued to the effect of returning possession of the aircraft to the lessor (Coppingger, Zreiqat, & Saoudi). Such proceedings against the aircraft are called retrieval proceedings, and from the lessor's perspective are usually based on proving that it is the rightful owner claiming ownership of the aircraft from another party who is in actual possession (Coppingger, Zreiqat, & Saoudi).

The basic procedure for an attachment application is to draw up an application and file it in the appropriate UAE court (Coppingger, Zreiqat, & Saoudi). This is an ex parte application to a duty judge who makes a prompt decision on the merits of the proposed attachment (Coppingger, Zreiqat, & Saoudi). The grant of an attachment order is based solely on the documents provided as evidence. There is no scope for affidavits or witnesses (Coppingger, Zreiqat, & Saoudi). If the attachment application is successful, an attachment order is granted by the judge and sent by the court bailiff for attachment of the aircraft (Coppingger, Zreiqat, & Saoudi). Within eight days of any successful attachment application, a substantive action needs to be filed in support of the attachment proceedings. Failing this, the attachment order will be considered void. If the substantive action is successful, and all the appeal stages have been exhausted, the lessor can then proceed with the execution of the judgment through the relevant court execution department (Coppingger, Zreiqat, & Saoudi). In summary, it may be said that the retrieval proceedings based on the Civil Procedures Law is time consuming and it may take years before an executable judgment is rendered and subsequently enforced through the execution department (Coppingger, Zreiqat, & Saoudi).

The Geneva Convention: Convention on the International Recognition of Rights in Aircraft. Signed at Geneva on 19 June 1948 (International Civil Aviation Organization, 2019).

Entry into force: The Convention entered into force on 17 September 1953

Status: 90 Parties

Algeria
Angola
Argentina
Australia
Azerbaijan
Bahrain
Bangladesh
Belgium
Bolivia (Plurinational State of)
Bosnia and Herzegovina
Brazil
Cameroon
Central African Republic Chad
Chile
China
Colombia
Congo
Côte d'Ivoire
Croatia
Cuba
Czech Republic
Denmark
Dominican Republic Ecuador
Egypt
El Salvador
Estonia
Ethiopia
Gabon
Gambia
Germany
Ghana
Greece
Grenada
Guatemala
Guinea
Haiti
Hungary
Iceland
Iran (Islamic Republic of)
Iraq
Ireland
Italy
Kenya
Kuwait
Kyrgyzstan
Lao People's Democratic Republic Lebanon
Libya
Luxembourg
Madagascar
Maldives
Mali
Mauritania
Mauritius
Mexico

France
Monaco
Morocco
Netherlands
Niger
Nigeria
Norway
Oman
Pakistan
Panama
Paraguay
Peru
Philippines
Portugal
Qatar
Romania
Rwanda
Senegal
Serbia
Seychelles
Slovenia
South Africa
Sri Lanka
Suriname
Sweden
Switzerland
Tajikistan
Thailand
The former Yugoslav Republic of Macedonia
Togo
Tunisia
Turkmenistan
Uganda
United Kingdom
United States
Uruguay
Uzbekistan
Venezuela (Bolivarian Republic of)
Viet Nam
Zimbabwe

The Cape Town Convention: Protocol to the Convention on International Interests in Mobile Equipment on matters specific to Aircraft Equipment (UNIDROIT, 2017).

Adoption:	Place: Cape Town
	Date: 16-11-2001
Entry into force:	01.03.2006
Contracting States:	75
Regional economic integration organizations:	1

Countries:

- Afghanistan
- Albania
- Argentina
- Australia
- Bahrain
- Bangladesh
- Belarus
- Bhutan
- Brazil
- Burkina Faso
- Burundi
- Cabo Verde
- Cameroon
- Canada
  - Alberta
  - British Columbia
  - Britannique
  - Manitoba
  - New Brunswick
  - Newfoundland and Labrador
  - Northwest Territories
  - Nova Scotiaz
  - Nunavut Ontario
  - Prince Edward Island
  - Quebec
- Chile
- China
- Colombia
- Congo
- Costa Rica
- Côte d'Ivoire
- Cuba
- Democratic Republic of the Congo
- Denmark
- Egypt
- Ethiopia
- Fiji
- France
- Gabon
- Germany
- Ghana
- India
- Indonesia
- Ireland

Italy
Jamaica
Jordan
Kazakhstan
Kenya
Kuwait
Latvia
Lesotho
Luxembourg
Madagascar
Malawi
Malaysia
Malta
Mexico
Mongolia
Mozambique
Myanmar
Namibia
Netherlands, Kingdom of the
    Royaume des 2
    Caribbean part
    Curaçao
    Sint Maarten
New Zealand
Nigeria
Norway
Oman
Pakistan
Panama
Paraguay
Romania
Russian Federation
Rwanda
San Marino
Saudi Arabia
Senegal
Sierra Leone
Singapore
South Africa
Spain
Sudan
Sweden
Switzerland
Tajikistan
Togo
Tonga
Turkey
Ukraine
United Arab Emirates
United Kingdom
    Bermuda
    Cayman Islands
    Gibraltar
    Island of Guernsey
    Isle of Man
United Republic of Tanzania
United States of America
Uzbekistan
Viet Nam

Regional economic integration organizations

European Union

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