Aviation finance and security interests in Malta: a new impetus

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A NEW IMPETUS IN THE AVIATION SECTOR
Malta’s standing as a leading maritime nation needs little introduction. It has the largest ship registry in Europe by tonnage and the seventh largest globally, as well as copious experience in shipping activities and related services, such as ship finance and mortgages.

Over the last few years, the Government of Malta has sought to emulate this success in the aviation sector through the development of legal and administrative infrastructure modelled on the common law system and international conventions. These developments include:

- Adoption of the Cape Town Convention on International Interests in Mobile Equipment and the Aircraft Protocol (CTC).
- The creation of a dynamic aircraft and mortgage register.
- The introduction of comprehensive laws on trust.

Collectively these developments have established greater certainty to financiers as to the modes of security available, with the ultimate aim of attracting international investors to promote the continued growth of the aviation sector.

A landmark development has been the enactment of the Aircraft Registration Act (ARA) in 2010. The ARA effectively rewrites Maltese law relating to aircraft registration and security over aircraft. It was drafted with a view to establishing a robust legal framework to aid the creation of a successful aviation register in Malta and effectively consolidates the laws on registration and security over aircraft into a single piece of legislation. The ARA provides, amongst other things:

- Modern ownership structures for business and private jets (such as fractional ownership and ownership through trust structures).
- Facilitation of aircraft leasing.
- The introduction of a comprehensive security regime coupled with amendments to the Civil Code (Chapter 16 of the Laws of Malta).
- Most importantly, ratification of the CTC.

AIRCRAFT MORTGAGES AND OTHER CHARGES OVER AIRCRAFT

Mortgage characteristics
In terms of Maltese law, aircraft constitute a particular class of movables, forming separate and distinct assets within the estate of their owner. An aircraft may constitute security for a debt either by agreement or by operation of law. A mortgage over an aircraft is one of the more common forms of security agreements employed to secure actions and claims to which an aircraft is subject. Under Maltese Law a mortgage is recognised as a voluntary encumbrance created over an aircraft by means of a unilateral instrument, signed and registered by the mortgagor and will rank according to the time and date of registration. A mortgage does not affect an absolute transfer of property, although the mortgagee does obtain a form of proprietary interest in the aircraft.

Registration of mortgages. All mortgages and transactions in relation to mortgages over an aircraft are registerable in terms of the ARA. The execution and registration of a mortgage is further extended in favour of a security trustee appointed or acting under a trust for the benefit of persons to whom the debt or other obligation is due. The security trustee is recognised as the mortgagee and can exercise all the rights related to that mortgage as are accorded to mortgages by Maltese law. A mortgage cannot however, be created where the mortgage instrument prohibits further mortgages, unless the prior written consent of all the mortgagees is given.

Securing priority. An aircraft frequently constitutes security for a debt through a mortgage or a special privilege. While a mortgage arises by agreement, special privileges arise by operation of law. The registration of a mortgage is the means of securing priority for the mortgagee over other debts such as subsequent mortgages and certain, but not all, privileged debts. Therefore, once registered, a mortgage will rank in accordance with the ranking allocated to other registered and privileged debts, if any. Special privileges accorded priority ranking over a registered mortgage include:

- Judicial costs in connection with the sale of an aircraft and the distribution of proceeds pursuant to the enforcement of a mortgage or other executive title.
- Fees and other charges due to the Directorate (on behalf of the Director General who is the person responsible for Civil Aviation in Malta).
- Wages due to crew in respect of their employment of the aircraft.
- Any debt due to the holder of a possessorry lien for the repair or preservation of the aircraft to the extent of the service performed and the value added to the aircraft to the extent that the services performed and the value added to the aircraft. The lien holder cannot however be compelled to release the aircraft until the sums due to him are paid.
- Other expenses incurred for the repair or preservation of the aircraft to the extent of the services performed and the value added to the aircraft.
- Wages and expenses for salvage in respect of the aircraft.
- Any other previously registered mortgages.

In the event of bankruptcy and/or insolvency, the mortgagee or owner of the aircraft, registered mortgages are not affected by the bankruptcy and/or insolvency, provided the mortgages were registered prior to the bankruptcy or insolvency.

Where there is more than one mortgage registered over the same aircraft, mortgagees will enjoy priority according to the date of registration of their mortgage in the National Aircraft Register. On
the registration of a mortgage the rights of the mortgagee cannot be affected by the creation of any separate privilege or change (except in the case of special privileges set out in the ARA) on any part, appurtenance or accessory of an aircraft, which may attach by virtue of any provision of Maltese law. From registration the mortgage is deemed to create an executory title that attaches to the aircraft until it is discharged, provided the obligation secured by the debt:

- Is a sum that is certain, liquidated and due. The sum secured must be expressly stated in the instrument creating the security.
- Does not consist in the performance of an act.

Consequently, the mortgagee can unilaterally seek the automatic enforcement of the mortgage in the case of default by the mortgagor.

Deregistration. Until a mortgage is discharged it will attach to the aircraft. Cancellation requires the presentation of a declaration by the mortgagee on the correct statutory form, asserting that the mortgage has been discharged. Where the aircraft is sold at auction by court order or by private sale the mortgagee can no longer exercise the rights arising from the registered mortgage as the aircraft is deemed to be sold free and unencumbered, but the interests of all the mortgagees in the aircraft nevertheless pass on to the proceeds of the sale. There may also be instances where the purchaser of an aircraft is not a qualified person under Maltese law to own a Maltese registered aircraft. In this case the registration of the aircraft cannot be cancelled or deemed void unless all mortgagees consent to the deregistration of the aircraft.

The law governing the validity of the mortgage
Despite the absence of any significant Maltese case law on the matter, the formal validity of the mortgage deed is governed by Maltese law, as the law of the place of the registered aircraft. Conversely the law governing the substantive rights of the parties (that are collateral to the mortgage deed) is likely to be governed by the proper law of the contract, but even this matter has not been decided definitively by the Maltese courts. Reference has however been made to generally accepted principles of English private international law which the Maltese Courts have applied.

Rights and duties of the mortgagee
The occurrence of an event of default of any term or condition under the mortgage entitles the mortgagee to take possession of the aircraft or its relevant share without judicial intervention. Maltese law provides a number of remedies in this respect that are immediately enforceable by the mortgagee after due notification to the mortgagor:

- The right to take possession of the aircraft.
- Power to sell the aircraft or its share. The registered mortgagee is considered an executory title, enforceable in the same way as a court judgment. This right is exercisable without the necessity of the leave of court, except where there is more than one registered mortgage over the aircraft. In this case a subsequent mortgagee must obtain court authorisation and the concurrence of every prior mortgagee for the remedies to take effect.
- Right to lease the aircraft and to receive any income that may be generated from the management of the aircraft (see below, Recognition of foreign mortgages).

The mortgagee is not considered to be the owner of the aircraft or of any share in it by virtue of the mortgage. Any surplus proceeds resulting from sale must be deposited in court or held under trust for the benefit of other creditors. Therefore, the creditor selling the aircraft must act in a commercially reasonable manner and is bound by fiduciary duties towards the debtor and other creditors when effecting the sale. The mortgagor remains the owner of the aircraft and only ceases to be so far as may be necessary for making the aircraft available for security for the mortgaged debt. The mortgagee in possession can also apply for extensions, pay fees, receive certificates and generally act in the name of the owner to the extent required to maintain the status and validity of the registration of an aircraft.

Recognition of foreign mortgages
In accordance with the provisions of the ARA a foreign mortgage will be recognised as a mortgage with all the rights and status granted to a mortgage registered under the National Aircraft Register, provided certain requirements are complied with, namely:

- The foreign mortgage has been validly recorded in the registry of aircraft or other register of the country under whose laws the aircraft is documented.
- The above registry is a public registry.
- The foreign mortgage appears on a search of the registry.
- The foreign mortgage is granted a preferential and generally equivalent status as a mortgage under the ARA in accordance with the laws of the country where the mortgage is registered.

Where the requirements above are not met, a foreign mortgage will only be recognised and enforced under Maltese law if it is registered in the International Registry in terms of the CTC. In this instance the creditor holding an international interest has the right to:

- Take possession or control of the aircraft (with or without court intervention).
- Sell or lease the aircraft where this was agreed to writing under the agreement creating the security or interest.

AIRCRAFT LIENS

Possessory liens
The concept of liens as understood in common law systems does not exist in Malta, with only minor reference made to liens in the ARA. Under Maltese law aircraft repairers, aircraft manufacturers or other creditors can retain possession of an aircraft entrusted in their care for the execution of works, until the creditor is paid the debts due to it for any building, repair or activity. Maltese law does not provide for the creation of any other form of aircraft lien. The ARA maintains that the debt due to the holder of a possessory lien is granted privileged status. Under the ARA, which implemented the CTC, the debt due to the holder of a possessory lien in terms of the ARA is declared to be one of the priority non-consensual rights or interests for the purposes of the CTC. The priorities established in terms of the CTC in so far as registered international interests are concerned, do not affect the priority of the privilege granted by Maltese law in favour of the debt due to the possessory lienholder.

Extinguishment of possessory liens
The possessory lien is extinguished by the voluntary release of the aircraft from the custody of the creditor, if the aircraft is released pursuant to a court order or following a judicial sale of the aircraft. The lienholder has no general right to sell an aircraft in its possession, except with the authority of the court. In the latter case, the creditor enjoys a privilege over the proceeds of sale of the aircraft and ranks before mortgages but after special privileges. The lienholder is only obliged to release the aircraft if he is paid the sums due, or if adequate security is deposited in the First Hall of the Civil Court of Malta in satisfaction of the claim.

Recognition of foreign liens
Unlike the position of foreign mortgages, the recognition of foreign liens or other foreign privileged rights on an aircraft are not explicitly provided for under the ARA. To the extent that a foreign lien is registered in the International Registry, the security interest may be recognised under the ARA and enforceable in terms of Maltese law. In general, it is the law of the place in which the aircraft was when the right was created (lex situs), that determines whether a valid and enforceable security right over the aircraft has been created. While there is no hard and fast rule in this respect, in the case where a Maltese Court enjoys jurisdiction, it may recognise foreign liens and allow their enforcement in Malta. With regard to
ranking, ranking is usually treated as a matter of procedure and consequently falls under the domain of the Maltese Courts, which will apply Maltese law to determine the way in which debts rank.

JUDICIAL ENFORCEMENT OF SECURITY INTERESTS

Obtaining possession through judicial intervention

Since the amendments to the ARA, Maltese law now allows creditors holding a mortgage or an international interest to take possession of an aircraft without the necessity of judicial intervention. However, judicial intervention is offered as an additional form of redress for creditors who prefer the additional certainty and inherent authority associated with a court decision ordering the judicial sale of the aircraft in satisfaction of the creditors’ claims. Creditors can resort to the warrant of arrest of aircraft which was introduced in 2010 concurrently with the introduction of the ARA.

Characteristics of a warrant of arrest

The effective application of a precautionary warrant of arrest will result in the detention of an aircraft which is in Malta. The remedy can be issued to secure a debt or claim, whether in personam or in rem that could otherwise be frustrated by the departure of the aircraft. For the purpose of the law on arrest warrants under the Code Of Organisation And Civil Procedure (Chapter 12, Laws of Malta) the term “aircraft” is defined as including all data, manuals, technical records, parts, the airframe and other accessories and appurtenances that are onboard belonging to the aircraft, as well as any engines owned by the owner of the aircraft whether attached or not to the aircraft, provided they are in Malta.

The warrant of arrest must be sued out by means of an application in the appropriate form and involves seizing the aircraft from the debtor and transferring it into the custody of the Authority for Transport. The warrant provides that the Authority for Transport must not release the aircraft or allow the debtor to otherwise divest himself in whole or in part of the aircraft or any rights in the aircraft. The warrant is lawfully when notice is served on the executive officer of the Authority for Transport in whose possession or under whose power or control the aircraft is placed.

For the purposes of Maltese law, an aircraft is deemed to be in the power or control of the Authority for Transport as soon as the aircraft enters Maltese airspace. Following the arrest of an aircraft in any airport or aerodrome or over Maltese airspace, a court can order the sale of an arrested aircraft, pending litigation, if it appears to the court that the debtor is insolvent or otherwise unlikely to be able to continue trading or maintaining the aircraft.

De minimis rule

Unless the warrant of arrest is in respect of a mortgage duly registered in the National Aircraft Register or a registered International Interest, the warrant of arrest can only be demanded and obtained before the courts of Malta and Gozo as security for a debt or other claim provided the sums due are above the statutory minimum. The statutory minimum differs for private and public aircraft. Any claim in respect of:

- An aircraft used in the public transport of goods and persons must be for a minimum amount of EUR1 million.
- Private aircraft must be for a minimum amount of EUR7,000.

Where, in spite of the issue and execution of a precautionary warrant of arrest, the aircraft is removed from the jurisdiction of Malta, the owner, lessee or other person in possession or control of the aircraft is deemed to be in breach of the warrant of arrest. Such person(s) will be held jointly and severally liable to a penalty of EUR120,000, payable to the party granted the warrant. This penalty is in addition to any other possible sanctions that may be applied under Maltese law for contempt of court.

CONCLUDING REMARKS

Although rooted in continental civil law, the Maltese judicial system is heavily influenced by the common law, particularly in the field of commercial law. The introduction of the ARA has resulted in Maltese law offering a particularly protective framework for the interests of the mortgagee and holders of other security interests, illustrating a progressively common law approach in recent years. In addition, the rules and procedures concerning judicial and private sale of assets in Malta are swift and flexible, allowing Malta to offer an attractive forum for the purposes of security and other financial arrangements.

Malta’s adoption of the CTC has proved to be the keystone in this progressive movement to facilitate all aspects of aviation business conducted in Malta:

- By recognising security interests registered in the International Register.
- Through expeditious and predictable default and insolvency related remedies.
- The provision of an additional and faster means of enforcing security interests without the need for judicial intervention.

Collectively, these legislative introductions have increased certainty for payment of debts following default, broadening the appeal of Malta as a centre for aviation finance. The emergence of Malta as a hub for international financial and trading services has further enhanced interest in Malta, particularly in the field of asset-based financing and as a jurisdiction for the setting up of special purpose vehicles by lenders in financed lease structures.

ONLINE RESOURCES

Website: www.justiceservices.gov.mt

Description: This is one of the services offered by the Parliamentary Secretariat for Justice within the Office of the Prime Minister. The website brings together a collection of all the Laws of Malta, including the Constitution, the Statute Law Revision Act 1980 and subsidiary legislation and judgments given by the Courts of Justice of Malta from 1944 onwards.
Practical Law Contributor profiles

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