



## **LEASE OF AIRCRAFT**

\*Note: The following responses were prepared for the Questionnaire of the L2B Group, an international network of aviation law firms, of which De Sola, Pate & Brown is the Venezuelan member.

### **Introduction**

Venezuela has no general legislation with respect to the concept of a financial lease, that is a transaction in which the vendor of usually a chattel, or a separate financial entity, finances the purchase of the good in question while remaining the titular owner but with the possession and use of the good passed to the purchaser under the concept of a lease thereof; the lessee/purchaser's right to purchase is assured by the granting at the beginning of the relationship of an option to purchase at usually a minor balloon price, given that the "lease" transaction is financially structured as if it were an installment sale and not a true operating lease. However, the Venezuelan banking law does authorize certain types of domestic financial institutions to engage in financial lease transactions, as regulated by this law. Notwithstanding, at the insistence of many foreign vendors/financiers there have been numerous attempts to use the financial lease concept, usually by requiring the lessee/purchaser to create an offshore entity that in essence enters into the financial lease with the vendor/financier and that in turn grants an operating lease to the lessee/purchaser in Venezuela, with the assignment of all of the sublessor's rights back to the financial lessor. By virtue, however, of not normatively recognizing the concept of a financial lease entered into by commercial parties (other than domestic banking institutions), that is principally designed from the vendor/financier's perspective as a security mechanism by in principle permitting the relatively prompt repossession of the aircraft in the event of default, parties who attempt to enter into agreements based on this concept run at least two significant risks.

First, it is conceivable that a Venezuelan court looking at all of the components of the transaction could conclude that rather than the effective transaction as to Venezuela being an operating lease in fact the whole transaction is merely an installment sale; moreover, as Venezuela has express legislation regarding the types of security interests that may be created in this situation, none of which are satisfied by this form of financial lease (unless carried out through a qualified domestic bank), therefore the operating lease is not recognized as a true lease and, in consequence, the position of the vendor/financier reverts to that of a mere unsecured creditor.

The other risk that the parties run is in the tax area. Part of the fiction that Venezuelan lessees/purchasers have benefited from under the financial lease mechanism is that they have been able to deduct the full amount of the "lease" payments as expenses, whereas if the transaction were to be described as an

installment purchase, then only the interest and financial cost amounts could be deducted. In contrast, only in the case of a true operating lease could the full lease payments be deducted. Even though the government has apparently been willing to overlook certain areas of tax compliance in order to encourage the importation of aircraft into the country, nevertheless the fact is that these practices are tax irregularities and could adversely affect both the vendor/financier and the lessee/purchaser. Indeed, in the case of permitted financial leasing through domestic banking entities, the tax law expressly treats the transaction for tax purposes as an installment purchase and not as an operating lease.

#### 1. Form of Lease:

(i) Will the State of Registration recognize the concept of a lease over the aircraft? Venezuela recognizes the concept of a true operating lease, but not that of a financial lease (unless carried out through a qualified banking institution). A provision of Venezuelan law (Art. 1579 of the Civil Code) provides that if a lease is combined with an obligation on the part of the lessor to deliver title to the leased good at any time, then the transaction is deemed to be a sale. Accordingly, if an operating lease were to be combined with a purchase option the lessor risks losing the benefit of ownership.

(ii) Are there any special provisions that must be included (or which it is advisable to include) in the operating lease if it is to be registered in the Aircraft Registry? There are no special provisions that must be included in the agreement in order to facilitate registration. The agreement must comply with the requirements for a contract by stating the identification of the parties, the essential terms and conditions of the transaction, and so forth. Evidently, the agreement should stipulate that the lessor is the owner (or head lessor, as the case may be) of the aircraft, that the aircraft is being let for whatever purpose, and that the lessor has the right to the return of the aircraft at the end of the lease or upon default (and following the legal procedures; see below).

(iii) Are there any special formalities relating to signing the operating lease (notarized, legalized, apostilled)? As a general proposition in Venezuela, all documents that are to be presented to public authorities must be notarized, if signed in the country, or notarized and either legalized by the corresponding Venezuelan consulate or apostilled by the corresponding authorities of the jurisdiction where the documents were executed.

(iv) May the lease be in the English language? The lease may be in the English language. However, any document that is to be presented to public authorities in Venezuela must be translated to Spanish by a licensed public translator. The contract may stipulate, though, that the English version is to prevail.

(v) May the lease be governed by New York law or English law? Is any jurisdiction more helpful when it comes to enforcement (e.g. because of reciprocal rights)? Given that a straight forward operating lease does not involve special security mechanisms nor other than general principles of Venezuelan law, it may be governed by foreign law, e.g. that of New York or of England. However, the application of such a foreign law contract will be circumscribed by Venezuelan procedural norms as well as by concepts of public policy. Therefore, for example, as Venezuela does not recognize the concept of "self-help" remedies, in the event a dispute that would give rise to the repossession of the aircraft it is necessary to so request through the Venezuelan courts. Moreover, if the aircraft is in commercial service, it is conceivable that any recovery of the aircraft could be delayed by the application of the "public use" doctrine, that is if the executive branch determines

that to remove the plane from service could harm the interests of the flying public.

## 2. Registration

(i) Please advise where the lease should be registered (e.g. aviation authorities and other registers). The operating lease will only need to be registered in the air registry of the Ministry of Infrastructure. The registration will indicate the ownership of the aircraft in the lessor, or if there is a head lessor, in said head lessor.

(ii) What documents will be required for registration? In the case of a straight forward operating lease the only documents that are required for registration are the operating lease agreement and proof of ownership of the aircraft (bill of sale to the lessor). The air registry will also require other documentation regarding the deregistration of the aircraft in the country of origin and the new registration in Venezuela, but these relate more to the operation of the aircraft in the country rather than to the registration of the lease per se. In the case of a head lease/sublease transaction, it will be necessary to also file the head lease.

(iii) Are originals or certified copies required and should translations or summaries be prepared? Will any of these documents need to be certified, notarized, consularized or will faxed copies suffice? For Venezuelan purposes, all documents presented to the air registry must be in the form of certified and legalized copies, and they must be translated to Spanish by a licensed translator.

(iv) Will lessor's interest be noted on the registry and what is the effect of such notation? If registered, will the lease be given priority to all other rights (including other leases) over the aircraft? If not, what other rights will take priority? By virtue of registering the operating lease, the lessor's ownership or rights will be noted on the registry. This creates the presumption that the lessor has the exclusive right to repossess the aircraft at the termination of the lease or in case of default. The lessor's property rights will take priority over the interests of any third party, with the sole exception of the possible application of the public use doctrine, as indicated above.

(v) What fees are required in connection with the registration of the lease? The fee for registering the lease is 10 Tax Units (the value of a tax unit is to be adjusted yearly based on the rate of inflation; for 2001 the tax unit is Bs13,200 or approximately US\$18 at what is expected to be the average exchange rate for said year).

(vi) How long will registration take and can the registration of the new ownership of the aircraft and the lease take place simultaneously? Provided that all of the documentation is in proper order, registration should not take more than one to two weeks. In the event that there was a change of ownership of the aircraft in anticipation of the transaction with a Venezuelan party, this should be completed prior to filing with the air registry and all of the documentation should reflect the structure as it will operate in Venezuela.

(vii) Does the registration require renewal? If yes, what is the cost of renewal and the effect of failing to renew? The lease registration would only have to be renewed in the event that it were to be modified. Assuming that it is essentially the same lease, the cost would likely be only a minimal stamp tax. However, the registry might adopt the position that it was a new lease document and so apply the full fee for registration.

(viii) Are any other steps beside the registration of the lease in the aircraft registry necessary to perfect the interest of the owner in the aircraft? Not in the case of any

operating lease.

(ix) Are there any other categories of creditors (e.g. aircraft charges, air navigation charges) whose interest in the aircraft would rank ahead of the lessor? In the case of an operating lease the lessor has no priority right to be paid lease payments over the claims of other creditors. Accordingly, to the extent that the lessor allows lease payments to accumulate this indebtedness is non-privileged. In this context, the priority rights of governmental entities to taxes due, the claims of employees and the several other types of claims given priority by law will take precedence over the debt for unpaid lease amounts. Of course, the protection for the lessor is to ask for the return of the aircraft.

(x) Will the fact that the owner is registered as such in the aircraft registry impose any liability on it with respect to the aircraft in relation to the operation, maintenance or insurance or impose on it any liability to third parties as a result of any loss or damage caused by the aircraft? The mere fact of appearing as the owner in the air registry does not in itself impose any liability. However, evidently in the event of harm caused by the aircraft it is possible that the owner could be joined as a co-defendant in any resulting suit. Of course, the owner should be amply protected by insurance and save harmless provisions in the contract.

### 3. Consents and Taxes

(i) Should the lessor apply in advance for an export license to re-export the aircraft upon the lease terminating either upon expiry or due to a default? How long does it take to obtain an export license in advance? As a general proposition, it is the lessee, not the lessor, who must request the deregistration/export license. The lessee could authorize the lessor to undertake this, but in Venezuela there is no way to assure that the lessee could not subsequently challenge this authorization or power of attorney in a Venezuelan court in the event of a dispute. As a general rule, obtaining a deregistration/export license is a fairly rapid administrative procedure, provided that all obligations of the lessee/operator are up to date (airport fees, radio fees, etc.) and further provided that there is no dispute between the lessor and the lessee. In any event, it is not possible to apply for or to obtain a deregistration/export license more than a short period prior to the anticipated date on which the aircraft is to leave Venezuela, so this is not something that could be obtained long in advance and kept in reserve.

(ii) How long does it take generally to obtain an export license and what are the costs involved? Provided that the lessee/operator is up to date with all of its obligations to the ministry and other agencies involved in the operation of the aircraft, the deregistration/export permit should be issued in only a couple of weeks at most. On the other hand, this assumes that there is no dispute between the lessee and the lessor, the lessee is willing to give up possession and use of the aircraft, and there is no reason for the application of the public use doctrine. There are no fees involved in deregistration.

(iii) Are any governmental consents required for the lease of the aircraft by lessor to lessee? The lessee is subject to a number of governmental approvals with respect to the importation and use of the aircraft. However, other than the general authorization to operate the type of aircraft involved and the inspection thereof as to airworthiness, there are no approvals required as to the lessor. As to the lessee, however, the Ministry of Infrastructure must authorize the importation and the proposed use of the specific plane, as well as ascertain its proper operation.

(iv) Would the leasing of the aircraft be liable to stamp duty, sales tax, VAT, import duty or any other tax? Stamp taxes would be payable upon the registration of the

operating lease and in conjunction with certain other procedures. Venezuela has no sales tax, but it does have a VAT, which would be charged in relation to the lease payments; the VAT is presently 14.5%. In the case of an operating lease, in particular, normally the lessee would request an exemption of the payment of customs duties, which would also imply an exemption from the payment of the VAT upon the importation. By law, such an exemption is supposed to be granted in cases of the temporary importation of goods and may be granted for up to six months, renewable once for a further six months. However, as a matter of practice the tax authorities have been willing to continue to exempt aircraft lessees from the payment of the import duty and VAT on aircraft, although this may be about to change. Hence, at least initially, the only import cost that would be payable would be the 1% port fee. In addition, the lessor will be subject to income tax in Venezuela on the revenue generated by the lease. Under the Venezuelan income tax law in the case of non-domiciled lessors the lessee is to withhold the amount of 5% from each lease payment and to pay said sum to the tax authority on each occasion. In principle, this is the only income tax obligation that the lessor would have, although the lessor is still to file an income tax declaration. In certain cases, the income tax withholding could be modified by a double tax treaty, of which Venezuela has in recent years subscribed various.

(v) Would any payments made to lessor or any assignee of lessor be liable to VAT or withholding tax? Assuming that the lessor, or its assignee, are non-domiciled parties, the lessee would be responsible for calculating the VAT on each lease payment and then paying those monies to the tax authority. Likewise, the lessee would be responsible for effecting the withholding corresponding to income tax from each lease payment made to the lessor or its assignee.

(vi) If any such taxes are payable, is there any jurisdiction to which such payments could be made to avoid their imposition? We are not aware of any tax treaties to which Venezuela is a party that have totally exonerated such taxes. Certain treaties may reduce the amount of the income tax withholding, but none of the treaties exempt such taxes as customs duties or the VAT.

(vii) Would the gross up provisions of the lease be enforceable? As a general proposition, a Venezuelan party can contractually commit to pay the tax obligations of the other contracting party and that stipulation in a contract is enforceable. However, vis a vis the tax authority the responsibility to pay taxes due is still of the party that receives the benefit, so in the event of default by the party contractually obligated to pay, the other party only has a claim for damages against the defaulting party but otherwise has no defense against a claim by the tax authority.

(viii) Is there a limit to the amount of interest chargeable under the lease or the compounding thereof (i.e. interest added to the principal amount monthly and interest accruing on the new principal amount)? In principle, the government may establish ceilings on interest and related charges, and in practice does so for certain types of operations. However, with respect to commercial credit transactions any limitations are not deemed to be unduly restrictive. On the other hand, it is prohibited by law in Venezuela to charge interest on unpaid interest. Therefore, it is necessary to take care in crafting contractual provisions to clearly provide for the capitalization of unpaid interest, after which current interest could be charged on said newly capitalized amount.

(ix) Should lessee obtain exchange control or other governmental consents to make lease payments in US\$ under the lease? At the present time Venezuela does not have in effect any form of exchange controls, for which reason it is not possible to obtain any such consents. On the other hand, it should be noted that Venezuela did have in effect during two periods in the last 18 years exchange control regimes that

made it difficult to obtain foreign exchange on a timely basis with which to satisfy foreign obligations, and the future imposition of exchange controls cannot be discarded. Accordingly, it would always behoove foreign lessors to attempt to structure an offshore source of payment or to otherwise seek a form of insurance or guarantee against exchange control disruption.

(x) If the lease was assigned and the assignment was to be enforced, would the payment of lease rentals to lender be liable to VAT or withholding tax? The assignee would step into the same position as the original lessor and would be liable to all of the same taxes.

#### 4. Matters affecting the lessor

(i) Is lessor liable for any of the operational debts incurred by lessee regardless of whether these have been passed on by contractual provisions in the lease or otherwise? Although it could depend on the specific language of the contract, in principle the lessor should not be liable for any debts incurred by the lessee. At the same time, if deregistration is being held up due to the non-payment of airport or radio fees, it might behoove the lessor to pay these and to then bring a claim for reimbursement against the lessee.

(ii) Is lessor's financial interest in the aircraft sufficient to entitle claimants to pursue liability claims against lessor? If a third party in Venezuela had a claim against the lessor and had standing to sue the lessor in a Venezuelan court, the third party could seek to attach the lease payments or eventually the aircraft.

(iii) Is lessor deemed to be doing business in the State of Registration by virtue of having entered into the lease? As a general proposition, no. However, it would be advisable to structure the transaction so as to keep the lessor as removed from the Venezuelan jurisdiction as possible, e.g. arranging for delivery and return abroad and so forth.

(iv) Please confirm that lessee will not be deemed to be the owner of the aircraft due to the purchase option, i.e. the lease will not be considered a disguised security. As noted in the introduction and in 1(i), this is precisely the problem in Venezuela absent specific legislation recognizing and regulating the concept of financial lease (except when carried out by qualified domestic banks). By virtue of the purchase option, as well as possibly the pricing structure of the transaction, it would be conceivable that the Venezuelan courts could determine that the transaction was in effect an installment sale and not a lease, thus recognizing ownership in the lessee and annulling the security interest of the lease. Under these circumstances the vendor/lessor could find itself in the position of a mere unsecured creditor.

(v) Will insurances on the aircraft placed by the lessee be required to be placed with insurers in the State of Registration? If so, can reinsurance be placed outside the State of Registration? It is required for operators of aircraft to contract insurance with a domestic insurer. However, the standard practice is to then acquire reinsurance outside of the country for the amount required.

#### 5. Enforcement

(i) If lessee defaults please advise steps and ease of lessor repossessing the aircraft, deregistering and exporting it, i.e. can this be done without the need for judicial proceedings? Is the permission of any party (including any official body) required? Would it generally assist if the lease was signed in the presence of a notary public or as a notarial deed? In Venezuela no self-help remedies or actions

are legally possible. Hence, if the lessee refuses to give up possession of the aircraft in the case of a default the lessor has no choice other than to go to court to enforce the provisions on repossession. Once this stage has been completed the lessor should have no difficulty in having the court order the enforcement of any deregistration and exportation provisions in the lease agreement. The only exception would be in the possible, but quite unlikely event of the application of the public use doctrine, which could delay the effective repossession of the aircraft, although not the right of the lessor to receive compensation. Deregistration and the granting of an export license (which may be a ferry flight permit) is the responsibility of the air registry and other aviation authorities of the Ministry of Infrastructure. It would not make any difference under these circumstances if the lease was signed before a notary or as a notarial deed.

(ii) Will export duty be payable following repossession or other termination of the lease? Venezuela does not impose any form of export duty, so the only costs in this respect would be port and handling charges, if any.

(iii) Can lessor deregister the aircraft without lessee's consent? Only with a court order.

(iv) If the consent of lessee is required to deregister the aircraft would an irrevocable deregistration power of attorney given by lessee to lessor at commencement of the lease be upheld in the jurisdiction of the State of Registration? Does the jurisdiction of the State of Registration accept the concept of an irrevocable power of attorney? If no, could the power of attorney be governed by English law and would that be enforceable in the State of Registration? In principle, Venezuela recognizes the concept of an irrevocable power of attorney, provided that it is coupled with an interest, as would be the case in this context. However, as a practical matter it would be possible for the grantor to revoke the power of attorney. Nevertheless, if the lessee has a contractual obligation upon the termination of the lease for whatever reason to take the measures necessary to deregister the aircraft and refuses to do so, or has revoked a power of attorney given to the lessor to do so on its behalf, then the courts will obligate the lessee to specifically perform the contractual deregistration obligation (i.e. the court will merely so instruct the air registry). Given that the concept of an irrevocable power of attorney would, in principle, be upheld by the Venezuelan courts, it would not assist the lessor in this case to have a foreign law power of attorney; indeed, this could complicate the matter of enforcement.

(v) Alternatively would a signed and undated deregistration certificate be effective? In the event of a dispute under the contract between the parties the lessee could void such a certificate by notification to the air registry. Of course, if there is no dispute then such a certificate could be used.

(vi) Is lessee entitled to claim sovereign or other immunity from suit? If yes, can it be waived? Sovereign or other immunity from suit would only apply to certain entities of the central government as specified in the constitution. As a general proposition in those few cases they could not waive their right to immunity unless this were to be expressly authorized by the National Assembly.

(vii) Can lessee deregister or sublease aircraft without lessor's consent notwithstanding any contrary provision of the lease? No.

(viii) Would the courts of the State of Registration uphold a New York [or English - see question

1(v)] choice of law clause in the lease? As long as the lessee was not one of the entities of the central government specified in the constitution as subject only to

Venezuelan law and jurisdiction. Otherwise, there would be no objection to the application of foreign law.

(ix) Would the courts of the State of Registration recognize a final judgment of a New York [or English - see question 1(v)] court? As a general proposition, yes, provided only that there were no allegations that basic principles of due process had been violated or that the decision was contrary to Venezuelan public policy, etc. However, in this context it would be highly unlikely that such a foreign judgment would not be recognized and enforced.

(x) Would the courts of the State of Registration award, recognize or enforce a judgment expressed in a foreign currency? Yes. The principle in Venezuela is that any debt can be paid in the local currency, but if the debt is denominated in a foreign currency the obligor must pay both the amount required to satisfy the debt as well as to effect payment in the currency stipulated in the contract, barring the existence of exchange controls.

(xi) Is a clause granting an indemnity on foreign exchange losses enforceable? Yes. In principle this would be a valid contractual stipulation.

(xii) Have any laws approximating those of Chapter XI of the United States of America or Administration in the United Kingdom affecting the ability of lessor to repossess the aircraft upon a default of lessee caused by insolvency or otherwise been enacted in the jurisdiction of the State of Registration? Venezuela does have norms regulating the process of insolvency and bankruptcy, both voluntary and involuntary. Once a lessee falls under the administration of a bankruptcy court the rights of the lessor to repossess the aircraft could be delayed but they should not be substantively affected.

(xiii) If the answer to (xii) is yes, in what circumstances can a liquidator or administrator set aside the lease or impose the rights of any other creditors in priority to it or prevent or delay the ability of the owner to repossess the aircraft on the termination of the lease? In the case of an operating lease, the administrator could determine that it was in the best interest of the bankrupt entity and the mass of creditors to continue to operate the aircraft even when the owner would prefer to exercise its rights of repossession. However, the administrator can only do this by agreeing to pay a fair rent for the use of the aircraft, as well as fulfilling all of the other conditions of the lease contract on maintenance, insurance, etc. Once the administrator makes this election the lessor is to be paid the current lease amount on a timely basis, even though unpaid rentals that had accumulated prior to the state of bankruptcy may be payable only from the general assets of the bankrupt entity on a *pari passu* basis. How long this situation could persist would depend on the circumstances and any subsequent court decisions.

## 6. Deregistration

(i) Would the deregistration power of attorney survive the liquidation of the lessee? If it terminates will this cause practical problems in deregistering the aircraft? The deregistration power of attorney would be unlikely to survive the liquidation of the lessee. However, the court should order the deregistration of the aircraft.

(ii) Who should apply for deregistration and is there any time period within which such application should be made? What documents are required? The lessee should be the party applying for deregistration. This should be done at least a couple of weeks in advance of the anticipated date of exportation. The documentation required is the application form, and certificates of good standing with respect to airport and radio charges. If the lessee is a public service airline, it will also have

had to provide an explanation as to how it will cover the routes with an alternative aircraft, etc.

(iii) If lessee objects, how long will deregistration take? Given that a court action would be required in order to obtain deregistration, it would depend on the nature of the dispute. In any event, it would be unlikely that a serious dispute would be resolved in less than six months and, of course, it could take considerably longer. However, in the interim it should be possible for the lessor to request the court to have the aircraft delivered to a custodian, although it may be necessary for the lessor to post a bond. In this context it may be noted that arbitration may offer a more expeditious alternative to resorting to the courts.

(iv) What are the costs and practical difficulties involved in deregistration? If everything is basically in order and there is no dispute with the lessee, the deregistration process should be routine and not costly. However, if the contrary is the situation then the costs and difficulties could be considerable.

## 7. Assignment of the lease

(i) Does the law of the State of Registration recognize the legal concept of assignment? Yes.

(ii) The lessor may assign the lease payments under the lease to lender. Should the notice of the assignment served on the lessee and the lessee's acknowledgement follow any special form or be specially served, filed or registered? In principle, obtaining a written acknowledgment of the assignment from an authorized signatory of the lessee is sufficient. Notice of the assignment can also be filed with the air registry for additional public record.

## 8. Other

(i) Please advise any other matter which a prudent lessor or lender should be aware of in this transaction. It is essential to undertake a thorough due diligence check and then to continuously monitor the customer and the situation in the country. It is most advisable to attempt to structure the transaction with as much collateral outside of the jurisdiction of Venezuela as possible.

## 9. Conventions

(i) Please advise whether the State of Registration has ratified:

- (a) Chicago Convention of 1944 on international civil aviation
  - (b) Geneva Convention of 1948 on the international recognition of rights in aircraft
  - (c) Rome Convention of 1933 for the unification of certain rules related to the precautionary arrest of aircraft
- Venezuela has ratified only the Chicago Convention